

THE SIGNIFICANCE OF FORESTRY TO THE STATE REVENUES OF SABAH

by

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## ABSTRACT

The objective of this thesis is to review the development experience of the economy of Sabah (formerly North Borneo) which is a state within the federation of Malaysia. Over the past three decades, the financing for the development in Sabah has essentially been funded by revenues derived from forest resources.

Further analysis reveals evidence of the need for an immediate reduction in the level of timber production and harvesting of forest resources in Sabah to slow down the current rapid depletion that is occurring.

Given that reductions in Sabah's revenues from the forest sector will arise either from over exploitation or from enforced mandatory quotas, this state will have to initiate varied policies and adjustment strategies within the overall plan for the Malaysian federation.

To maintain a desired growth rate in terms of development for Sabah, it would appear that revenue flows must be maintained for the foreseeable future until a more mature private sector emerges. One approach would be for a more equitable transfer of revenues from the federal government to the state government of Sabah.

## CHAPTER ONE

### INTRODUCTION

One of the many subjects that were discussed during the Earth Summit in Rio de Janeiro in June 1992 was conservation of the world's forests. Malaysia, which accounts for almost half of the world's total exports of tropical timber, has become deeply concerned over the deforestation of the nation's forest resource.

Under the Malaysian Constitution, lands and forests are under the jurisdiction of state governments. Thus, the management and conservation of the natural forests in each state are the responsibility of the state forestry department. Sabah's production of timber currently contributes about one fourth of the nation's total production and revenue from royalties on log production contributes about half of its total revenue. Thus, while conservation may be best for everybody else in the world, the revenue implications it has for Sabah cannot be overlooked.

The objective of this thesis is to review the development experience of the economy of Sabah which, over the past three decades, has essentially been funded by the revenue derived from the forest resources. Recent research

identifies the need for an immediate reduction in the level of timber production as its forest resources are depleting rapidly. Hence, Sabah's revenues will be substantially reduced, thereby jeopardising its development efforts.

This thesis will be divided into five chapters. Chapter One provides an introduction. From the outset it should be noted that the data used in this thesis in \$ signs are Malaysian ringgit.

Chapter Two contains the overview of the constitutional considerations on the division of powers and responsibilities as well as the financial arrangements between state and federal governments. Following that, a general description of Sabah's economic background, its population, distribution of employment, infrastructure, and a macroeconomic overview is provided.

Chapter Three focuses on the forest resources of Sabah. Such aspects as the allocation of lands and exploration licences, the wood processing industry, problems related to the timber industry, and also the state's efforts to develop its timber industry will be discussed.

This will then be followed in Chapter Four by a review of the state's sources of revenues for past years. This will be done by sub-dividing the chapter into sections on forest revenues, other sources of revenue, and federal grants. It will be shown that the forest revenues have been

the single largest contributor to the state's revenues and thus to the state's annual expenditure. There is also a consideration of revenues accruing to the state from offshore oil production.

In Chapter Five, some concluding observations will be made.

## CHAPTER TWO

### BACKGROUND TO THE OVERALL ECONOMY OF SABAH

#### General Background

Malaysia is located within the tropical zone of South East Asia. Peninsular Malaysia extends 740 km from Perlis in the north to the state of Johore in the south. It consists of the states of Perlis, Kedah, Penang, Perak, Selangor, Negeri Sembilan, Malacca, Johore, Pahang, Terengganu, Kelantan and the Federal Territory of Kuala Lumpur. (See Figure 2.1(a) and 2.1(b))

Sabah and Sarawak stretch some 1,140 km from Tanjung Datu (Sarawak) in the west to Hog Point (Sabah) in the east. Sabah is situated in the north-eastern part of the island of Borneo. It is bounded by Brunei and Sarawak to the west and by Indonesia Kalimantan to the south. With a coast line 1,440 km in length, it is the second largest state in Malaysia with a total land area of 73,711 sq km. In addition, there are 38 islands in a fringing reef totalling about 320 sq km.

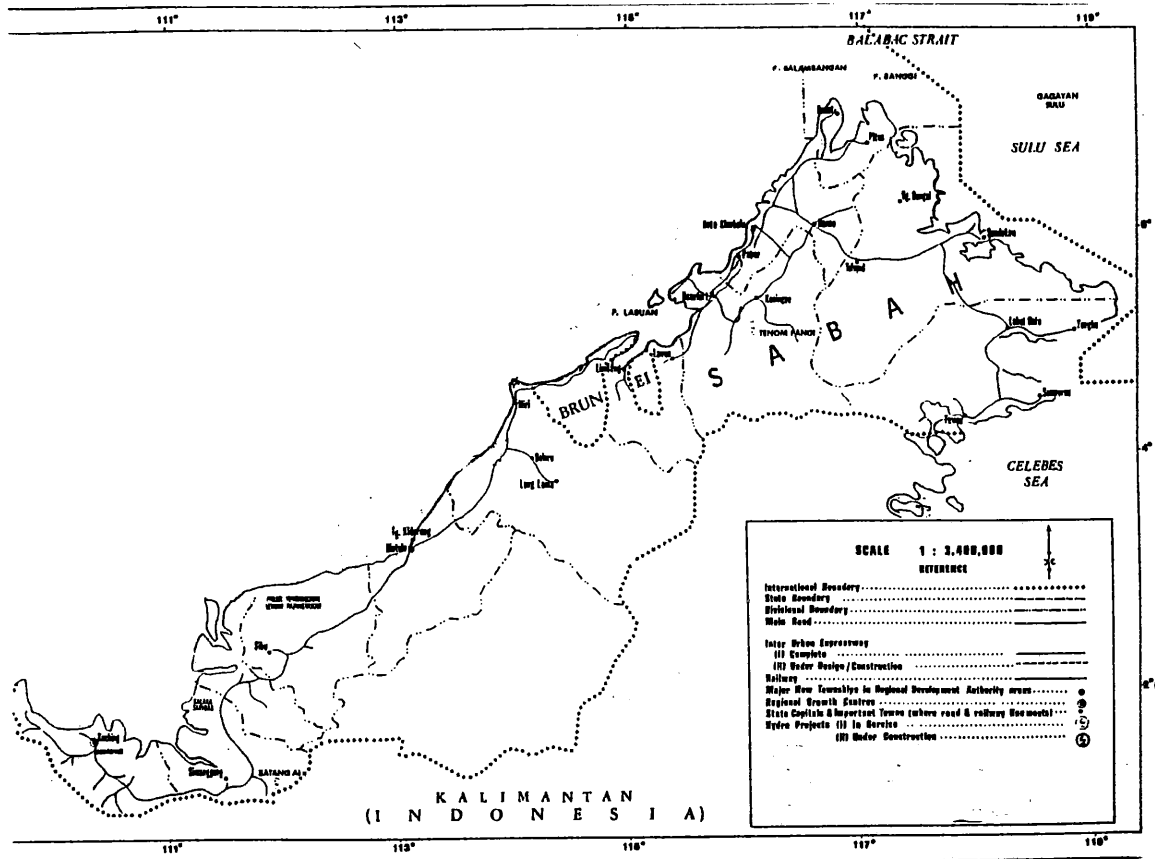
The capital city of Sabah is Kota Kinabalu and there are 6 major towns as well: Sandakan, Tawau, Lahad Datu, Kudat, Semporna, and Kunak.

As one of the 13 states in Malaysia, goals and



FIGURE 2.1 (b)

## MAP OF MALAYSIA: SABAH AND SARAWAK



Source: Government of Malaysia, Sixth Malaysia Plan 1990-1995, Kuala-Lumpur, 1989.



directions regarding Sabah's future have already been broadly established at the federal level. Thus Sabah's economic goals are bounded by national aspirations and subsequent planning in the state must be consistent with the overall direction taken by the federal government. Specifically, all the Malaysia Plans<sup>1</sup> set broad directions within which Sabah is expected to develop.

In 1987, the state government launched the "Sabah Action Blueprint" to serve as a framework for the state government to bring about a diversified, value-added economy to the state. More specifically, actions and programmes were introduced to improve the present crop production, to introduce new crops, to step up the domestic processing of the primary products, to develop a skilled workforce, and to ensure stable political and social conditions to encourage both the local and foreign investment.

### **The Division of Powers and Responsibilities - State and Federal**

By virtue of the 1963 Constitutional Amendment of the Malaysia Act, three new states (Sabah, Sarawak, and Singapore) were admitted to the new Federation. The Amendment converted the Federation of Malaya into the Federation of Malaysia.<sup>2</sup>

However, the Amendment also emphasized the different

constitutional status and rights enjoyed by the new states. This led to criticism since it violated the principle of equality enshrined in the 1957 Constitution (Federation of Malaya), that all states should enjoy the same status and rights in relation to the central government.

Under the 1957 Constitution, legislative powers were divided according to the Federal List, the State List, and the Concurrent List. The 1963 Amendment also provides Sabah and Sarawak with special provisions in addition to the existing State and Concurrent Lists.

The Federal List includes important functions, such as education, medicine and health, transport and communication, finance (including taxation), and external affairs. The State List includes land, agriculture and forestry, matters pertaining to the Islamic law, and ports and harbours.

With a highly centralized decision-making structure, this gives rise to a danger that a state's interests will be ignored. This is particularly true with respect to development priorities, the needs of the population, fiscal policies and budgetary considerations.

Though matters such as health and medicine are constitutionally under the federal government, it was not until 1974 that Sabah's health department was handed over to the federal government. The same is also true in the case of transport and communications (including roads). The

state government was financially responsible for the construction of roads and bridges until 1986, when the federal government started to pick up some of the bills. As of 1990, only 12 percent of road construction was financed by the federal government through the Fifth Malaysia Plan.

### **Financial Arrangements under the Constitution**

The centre-state financial relations for Sabah and Sarawak were also different from those for the original 11 states. Part III of the Tenth Schedule establishes the sources of revenues allocated to the 11 states, Sabah, and Sarawak. (See Exhibit 2.1)

From the list, it is obvious that sources of state revenue in Malaysia are rather limited; and come mostly from a state's own resources, especially land (mines and forests). This is very important as these revenues will determine the state's capability to finance its own development projects.

The allocation of natural resources is not evenly distributed among the thirteen states in Malaysia, with some large states like Sabah, Sarawak, and Pahang being able to generate a substantial amount of revenues from lands and forests. The smaller states like Perlis, Penang, and Malacca have to depend on allocations from the federal government for their development purposes.

**EXHIBIT 2.1****PART 111 OF TENTH SCHEDULE: SOURCES OF REVENUE ASSIGNED TO STATES**

1. Revenue from toddy shops
2. Revenue from lands, mines and forests
3. Revenue from licences other than those connected with mechanically propelled vehicles, electrical installation and registration of business
4. Entertainment duty
5. Fees in courts other than Supreme Courts
6. Fees and receipts in respect of specific services rendered by departments of State Governments
7. Revenue of town boards, town council, rural boards, local council and similar local authorities other than:
  - (a) municipalities established under any Municipal Ordinance
  - (b) those town boards, town councils, rural boards and similar local authorities which have power under written law to retain their revenues and control the spending thereof
8. Receipts in respect of water supplies, including water rates
9. Rents on State property
10. Interest on State balances
11. Receipts from land sales of State property
12. Fines and forfeitures in courts other than Supreme Court
13. Zakat, Fitrah, and Baitul-Mal and similar Islamic religious revenue
14. Treasure above

In addition to the sources of revenues assigned in Part III of the Tenth Schedule, Sabah and Sarawak also enjoy extra financial provisions as specified in Part IV and V of the Tenth Schedule. This provision allows Sabah to receive revenues from import and export duties on petroleum products and also export duties on timber and other forest products. It also empowers it to levy a state sales tax although this has never been levied.

It must also be mentioned that the establishment of the National Land Council which empowered the central government to acquire state land for national development and national interest projects only affect the 11 states in Peninsular Malaysia and not Sabah and Sarawak. The same also applies with respect to the National Forest Council, which was established to advise state governments on forest management. Thus, in dealing with issues such as the management and conservation of forests in Sabah, the Council does not have any influence at all.

### **Brief History of Sabah**

Prior to the nineteenth century, Sabah consisted of scattered chieftaincies and autonomous communities owing a general allegiance to the Sultans of Brunei. In 1704, the land east of Marudu Bay was ceded to the Sultans of Sulu in return for Sulu help in a succession dispute, an agreement

which up until the present provides the basis for the Philippines' claim to Sabah.

By 1847, there was an early British trading settlement on Labuan Island under the governorship of James Brooke - who later became the King of Sarawak - following the ratification of a treaty with the Sultan of Brunei in 1846. About twenty years later, William Clarke Cowie obtained permission from the Sultan of Sulu, to establish a trading post in Sandakan Harbour on east coast of North Borneo. The new settlement, Elopura, stimulated commercial activity along the east coast. Sandakan Harbour became the centre for the export of jungle produce such as rattan and wild rubber.

In 1881, Cowie's British North Borneo Company was granted a Royal Charter by the Queen. The Company extended its influence over coastal areas along the western and eastern shores and to this was added the Padas-Klias Peninsula, opposite the island of Labuan.

Sabah was under the administration of the Company until the Japanese conquest in 1941. After the Japanese occupation, the Company surrendered its rights to the British government and Sabah became a British Crown Colony. Sabah was able to achieve its independence from Britain by agreeing to Tunku Abdul Rahman's Malaysian proposal and becoming a part of the Federation of Malaysia in 1963.

## Population

In 1980, Sabah had a population of 1,032,348 which was comprised of 83.5 percent indigenous people (Kadazan, Bajau, Dusun, and Murut), 16.2 percent Chinese, 0.5 percent Indians and 0.3 percent others.

During the Fourth Malaysia Plan period (1980-1985), the population of the region increased rapidly to almost 1.25 million people, due mainly to two factors. Firstly, there was a high natural growth rate population, some 3.9 percent, which was the highest in Malaysia and well above the 2.6 percent national average. Secondly, there was an influx of international migrants mainly from Indonesia and the Philippines.<sup>3</sup>

The population of Sabah can be broadly divided into two groups: urban and rural communities. In 1985, out of the 1.25 million population, about 26.7 percent were urban. Despite its small size, this group is the one with the interest in commercial and educational development activities and which participates in the manufacturing and service sectors. The urban community also has greater access to social facilities, in particular educational and medical services.

The rural community is involved in a more traditional lifestyle. There is a high incidence of poverty within this group, with many households in 1989 earning less than the

poverty line of \$533 per month.<sup>4</sup> Their sources of income are fishing, farming, and shifting cultivation. These industries experience low productivity due to inefficient size of land holdings, traditional agriculture, low commodity prices, and lack of access to resources due to the absence of basic infrastructure such as road networks.

Forestry, the backbone of Sabah's economy, has generated significant income and has a greater potential for improving trade. With its linkages, it has also contributed to the rapid development of the urban areas, in terms of housing development, employment opportunities, and the intensified build up of infrastructure.

Despite the increased revenues from forest resources, from 1984 to 1987, the level of poverty in the state increased from 33.1 percent to 35.3 percent. However, this was solely due to an increase in the incidence of poverty among the Bumiputera. This, in turn, was blamed mainly on the slower economic performance of the manufacturing and construction sectors; which accordingly limited their employment creation capacity and the income-earning opportunities of rural labour.<sup>5</sup>

The number of poor households also increased significantly by about 17 percent from 76,000 households in 1984 to 89,000 households in 1987. In comparison with either Sarawak or the states in Peninsular Malaysia, Sabah's



performance is quite depressing since most of the states (except for Negeri Sembilan and Federal Territory) had recorded a reduction in the incidence of poverty.

During the first four years of the Fifth Malaysia Plan, Sabah's population grew from 1.22 million in 1985 to 1.42 million in 1989 of which 85.1 percent were made up of the indigenous people, 14 percent Chinese, and 0.9 percent Indians and others. This represents an increase of 16 percent from the 1985 level and was caused mainly by the high fertility rate of the indigenous people which varied between 3.8 and 4.2 percent during the four year period. Sabah's population only accounted for 8.2 percent of the total population for Malaysia in 1989.

Sabah is also characterized by its relatively young population. In 1989, about 71 percent of the population was younger than 30 years old and of this 63 percent were below 20 years of age. This group represented 59 percent of the total work force in Sabah for 1988. At the same time, this group also formed almost 90 percent of the total unemployment in the state.<sup>6</sup>

### **Distribution of Employment**

Sabah is a state that relies heavily on the primary sector. In 1980, 59 percent of the total workforce was employed in agriculture, forestry, and fishing but by

1988, this percentage had fallen to 45.5 percent. (See Table 2.1)

**TABLE 2.1**

**PERCENTAGE DISTRIBUTION OF EMPLOYED PERSONS BY INDUSTRY**

Industrial Group	1980	1985	1988
Total	100.00	100.00	100.00
Agriculture, Forestry, Hunting, & Fishing	59.04	46.40	45.40
Mining & Quarrying	0.34	0.80	0.60
Manufacturing	5.05	4.90	6.70
Construction	3.29	7.20	4.70
Electricity, Gas, & Water	0.14	0.80	0.70
Wholesale & Retail Trade, Hotels, & Resta.	8.07	15.20	14.70
Transport, Storage, & Communication	3.30	4.20	4.40
Finance, Insurance, R.Estate, & Bus.Services	0.97	2.60	2.70
Community, Social & Personal Services	19.52	17.90	20.00

Source: Government of Sabah, Annual Bulletin of Statistics, various issues

Although mining and quarrying contributed about two-fifths of the state's GDP, these industries accounted for less than one percent of total employment. This is not surprising as both industries are capital-intensive. The service sector accounted for one-third of the total employment in 1980, increasing to approximately 42 percent

in 1988.

In 1988, among the employed people, only 2 percent received a college or university education while 21.9 percent had no formal education. Those with a high school education formed the remaining 74.6 percent.

### **Health**

At the time of independence, health services in the state were very poor as there were only 40 doctors available whereas there were 46 health care centres (hospitals, dispensaries and health centres). In 1989, however, the number of registered doctors increased to 312. There was also a tremendous increase in the number of people who were admitted to hospitals and received other medical services. However, the ratio of doctors to population in the state is still very low relative to that in the Peninsular Malaysia. For example, in 1988 it was 1: 4308 in Sabah as contrasted to 1: 2858 in the Peninsular Malaysia.

For the year of 1989, the state's infant mortality rate was 17.6 per 1,000 live births; a much higher than the national average of 13.5. The state's crude birth rate of 36.8 per 1,000 of mid-year population is also higher than that of the national average of 30.1. A very high crude birth rate tends to indicate frequent occurrence of births to teenage mothers and at high maternal ages, as well as

short birth-spacing.<sup>7</sup>

Before independence, the principal causes of death were malaria, pneumonia, tuberculosis, and dysentery. By 1985, circulatory diseases had emerged as the leading cause of death - contributing to 18.4 percent of deaths in government hospitals. However, infectious and parasitic diseases do still appear among the ten principal causes of death.

The disease pattern in Sabah is in a transitional stage, typical of that of a developing state with infectious and parasitic diseases still significant but with cardiovascular diseases and neoplasms beginning to have an impact.<sup>8</sup>

One of the major problems faced by the state's health department is that the efforts made to reduce the incidence of communicable diseases is being complicated by the presence of immigrants. For instance, in 1987, 71 percent of the total cases for diphtheria occurred among the immigrants.

Attempts to control the communicable diseases were hampered by the fact that immigrants are often reluctant to come forward for immunization and to make use of the health facilities because they lacked the proper legal immigration documents. Some are also mobile and often difficult to trace.<sup>9</sup>

**Education**

The national education policy increased the accessibility of education which resulted in a massive enrolment explosion and a subsequent expansion of the education system of the state. The abolishment (which was done by stages beginning in 1966) of school fees for both the primary and secondary schools also enabled more children from poorer communities to receive an education.

By 1975, the enrolment in both primary and secondary schools was almost double that of 1963. Along with this increase, the number of schools and teachers also expanded significantly.

By 1989, enrolment in vocational schools had reached 1,788 students. Originally these schools were established to enable the less academically inclined students acquire vocational skills suitable for industry and other sectors of the economy. This resulted in vocational schools being compared unfavourably with other educational institutions.

The fact that during the first four years of the Fifth Malaysia Plan, the growth rate in the number of students attending the primary and secondary schools was higher than the rate of the population growth signified that a growing proportion of the population was receiving formal education.

At present, there are several major problems faced by the Department of Education in the state. With the ever

growing student population in the schools, there is a constant battle to provide sufficient physical facilities, such as classrooms, teachers' quarters and hostels. Due to the shortage of these facilities, many schools in the state, especially those in urban areas, are operating on double-session. In some cases, classrooms are over-packed with students.<sup>10</sup>

Another problem is the need for a more stable teaching staff especially in the secondary schools. Currently, most of the secondary school teachers are from the Peninsula and they work in Sabah on a short term basis usually for two to five years, before returning home. These teachers are normally recruited immediately after the completion of their basic teacher-training course and therefore are inexperienced. By the time they have gained some experience and adjusted themselves to the local customs, it is time for them to return home, thus setting in motion another cycle of inexperienced teachers in the schools.<sup>11</sup>

### **Infrastructure**

In 1980, only 34.8 percent of population had piped water. However, by 1985 the number had increased to 51.5 percent, indicating an increase of almost 48 percent which is higher than the increase in the national average of 18.4 percent. Despite the higher growth rate, Sabah's

performance is still far below the national average.

In 1980, only 36.7 percent of the population was provided with electricity, and this number increased to 48.0 percent by 1985. These figures were below the national average with the national averages in 1980 and 1985 being 49.9 and 71.3 percent respectively. The main reason for the poor performance in both cases was Sabah's scattered population, which made it more difficult and more expensive to service.

In terms of transport and communication, Sabah is served by railway, ground, sea, and air services. The existing railway line, which is restricted to the West Coast only, was completed in 1959. The rail connection is from Tanjung Aru on the outskirts of Kota-Kinabalu to Tenom via Beaufort. It is used mainly for freight but passenger service is also available.

At the time of independence, there were only 1,863 kilometres of roads, of which 22.5 percent were sealed. This meant that most of the major towns were largely isolated. The government has been consistently allocated a large amount of money for the construction of road networks in the state. Throughout the first five Malaysian Plans, expenditure in transport ranged from 31 to 38 percent of the total development fund.

As a result, total road kilometres (sealed, gravelled

and earth) in Sabah increased from 1,863 km. in 1963 to 6,967 kms. in 1989. Even though the distance had significantly increased, the total distance of sealed road is still low accounting for only 31 percent of the total road network.

For the past ten years, the development of air services and associated ground facilities in Sabah has been significant. Kota-Kinabalu International Airport's runway has been improved and it is one of the most modern in the region. It should also be mentioned that this airport is the second busiest and largest in Malaysia. Under the Fourth Malaysia Plan, the government, through the Civil Aviation Department, spent more than \$150 million on the airport improvement project. All the other major towns in Sabah such as Sandakan, Tawau, and Lahad Datu have airports.

Sabah has 7 main sea ports which are accessible to world shipping. These are Kota-Kinabalu, Sandakan, Tawau, Lahad Datu, Kudat, Semporna, and Kunak. All the ports are under the jurisdiction and control of Sabah Ports Authority.

The wharf facilities are excellent and meet international standards, and at the same time being constantly increased and improved. Congestion in Sabah ports is virtually non-existent.

Despite the fact that Sabah is strategically located to serve the South East Asia and broader regions in Asia, it is



off the primary trade routes. Cargo vessels and airlines travelling from west to east call mainly in Kuala Lumpur and Singapore rather than Sabah. The cost of transferring goods from Sabah to Port Klang (Kuala-Lumpur) has been estimated to be almost the same as from Sabah to U.S ports although the shipping distance to U.S ports is ten times that to Port Klang.<sup>12</sup> Thus, Sabah is at a disadvantage in being isolated from major marketing, trading and financial centres. Access to external markets is limited and the small size of the domestic population restricts overall demand.

#### **Macroeconomic Overview**

Sabah's economy consists of a number of sectors. (See Table 2.2) Agriculture, forestry, livestock and fishing contributed about 35.1 percent of Sabah's Gross Domestic Product (GDP) of \$3,631 billion in 1985, while mining (including petroleum) and quarrying contributed about 21 percent over the same period.

Manufacturing accounted for about 4.0 percent to the state's GDP and other sectors such as transport, storage, hotels, retail trade and restaurants, etc. accounted for about 16 percent. (See Table 2.2)

During the Fourth Malaysia Plan (1980-1985), Sabah's economy grew at a high rate of 7.2 percent per annum, which

TABLE 2.2

GROSS DOMESTIC PRODUCTS BY KIND OF ECONOMIC ACTIVITY IN  
PRODUCERS' VALUES, AT CONSTANT PRICES (1978=100)

Sectors	1980	1985	1989
Agriculture, Forestry, Livestock, & Fishing	1,275	1,821	2,307
Mining & Quarrying	774	1,014	1,364
Manufacturing	144	229	406
Construction	204	271	228
Electric., Gas & Water	27	49	59
Transport, Storage, & Communication	191	285	363
Wholesale and Retail Trade, Hotels, & Resta.	384	544	620
Finance, Insurance, Real Estate, & Bus. services	81	138	205
Government services	254	388	453
Other Services	297	87	113
Total	3,631	4,826	6,118
GDP at purchaser value	3,584	3,946	4,307
per capita GDP	3,066	3,572	4,130
Ratio to M'sian average	0.95	0.95	1.06

Source: Government of Sabah, Annual Bulletin of Statistics, various issues.

Note :

- (a) Population is in '000
- (b) All figures are in millions except for per capita items

is considered relatively better than some other developing countries despite the widespread global economic recession following the second oil crisis.<sup>13</sup> This figure, however, was somewhat exaggerated by the dominance of mining, that is petroleum, in the state's GDP. Higher oil prices obviously constitute an advantage to Sabah as petroleum is a major

contributor to its external trade.

During this period, the per capita GDP grew at 3.1 percent annually. In absolute terms, Sabah's per capita GDP had a value of \$3,066 in 1980 and \$3,572 in 1985. This was 95 percent of the national average in each of the two years. All sectors, except the transport, storage and communication, government services sector and other services sector, recorded annual growth rates above their national averages.

During the Fifth Malaysia Plan, Sabah's economy was expected to grow at 5.6 percent per annum but given the high population growth rate of 3.4 percent, its per capita GDP was only projected to expand at 2.1 percent per annum. Projected per capita GDP for 1990 was \$3,957, 0.94 of the national average.<sup>14</sup> In 1989, Sabah's per capita GDP was \$4,130 which was 106 percent of the national average. This was far greater than the forecast in the Fifth Malaysia Plan.

From 1985 to 1989, agriculture and livestock production became more and more significant to the state's GDP. This was primarily due to the substantial land potential which enabled the state to generate new employment and income opportunities through land settlement and other agricultural schemes. In contrast, the forestry and logging sector, which is traditionally the major contributor to the state's

GDP declined.

The mining sector continued to be the second largest contributor to the state's GDP. Its share fluctuated between 18.4 and 22.3 percent during the 1985-1989 period. This is attributed to the further exploitation of petroleum and copper deposits.

The manufacturing sector marked a small increase in its share of the total GDP. It grew from 5.6 percent in 1985 to 6.6 percent in 1989.

The construction sector deteriorated during the first four years of the Fifth Malaysia Plan. In 1985, it contributed 5.6 percent of the state's GDP with a value of \$270.9 million but its contribution fell to 3.7 percent in 1989.

The services sector (excluding electricity, gas and water) contributed 30 percent of Sabah's GDP in 1985. However as the economy grew, the contribution of this sector declined slightly such that by 1989, its share was only 27.4 percent. Among the services sector, only the transportation and government services sectors showed a greater increase than the national average.

The effect of international migration (immigrants) continued to be felt during this period. The labour force grew to slightly less than half a million people by 1989, expanding faster than the projected creation of new jobs.

The unemployment rate rose to 11.4 percent, the highest in the nation.

**ENDNOTES**

1. The eleven original states of the Federation of Malaya were Perlis, Kedah, Penang, Perak, Selangor, Negeri Sembilan, Malacca, Johore, Pahang, Terengganu, and Kelantan. In 1965, Singapore left the Federation of Malaysia to become independent.
2. The Malaysia Plans were started in 1965. Each Plan is for a five year period and contains some specific goals and objectives that the Federal Government will try to achieve during the Plan period. At present, Malaysia is on its Sixth Malaysia Plan.
3. Government of Malaysia, Fifth Malaysia Plan 1986-1990, National Printing Department, Kuala-Lumpur, 1986, pp. 131-2.
4. The Poverty Line Income (PLI) used here is the one defined by the Federal Government. The State Government, however, has its own definition of PLI of \$375 per month. Government of Malaysia, Sixth Malaysia Plan 1990-1995, National Printing Department, Kuala-Lumpur, 1989, p. 25.
5. Government of Malaysia, Mid-Term Review of the Fifth Malaysia Plan 1986-1990, National Printing Department, Kuala-Lumpur, 1989, p. 47.
6. Department of Statistics (Sabah Branch), Sabah Annual bulletin of Statistics, Kota-Kinabalu, various issues.
7. Mechiel K.C. Chan, "Development in Health Services in Sabah 1963-1988", Sabah 25 Years Later 1963-1988, Institute for Development Studies, Kota-Kinabalu, 1989, p. 252.
8. Ibid, p. 257.
9. Ibid, p. 258.
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11. Ibid, p. 312.
12. Government of Sabah, Sabah Action Blueprint: Managing

the Transition to a Diversified Value-Added Economy,  
Government Printers, Kota-Kinabalu, 1989, p. 11.

13. Government of Malaysia, Mid-Term Review of the Fourth Malaysia Plan, National Printing Department, Kuala-Lumpur, 1983, p. 35
14. Government of Malaysia, Fifth Malaysia Plan 1985-1990, National Printing Department, Kuala-Lumpur, 1985, p. 60.

## CHAPTER THREE

## FOREST RESOURCE OF SABAH

**Sabah Timber Resources**

Sabah is well endowed with resources, primarily land, forest, marine, and agricultural. Of its total land mass of 7.371 million hectares, 4.439 million hectares is estimated to be covered by forest.

TABLE 3.1

## AREA UNDER FOREST AND OTHER LAND, 1989

Total Land Area (in hectares)		7,371,100
Forest Reserves	3,348,640	
Other State Forest	1,091,909	
Total Forest		4,440,549
Other Land		2,930,551

Source: Government of Sabah, Annual Bulletin of Statistics, 1989.

In accordance with the National Forest Policy, 3,348,641 hectares of these forests constitute the forest reserves. The state forest reserves, on the other hand, are divided into seven classifications made by the state forest department and each serves a particular function of its own.

**Class I - Protection:** Forest conserved for the



maintenance of the stability of essential climatic, watershed, and other environmental factors. These areas cannot be logged.

**Class II - Commercial:** Forest which can be logged, to supply timber and other products. Most often these are lowland and hill dipterocarp forest, including forest up to about 800m above sea level.

**Class III - Domestic:** Forest for supplying timber and other forest products for local consumption only.

**Class IV - Amenity:** Forest providing recreational and attractive sites, especially on road sides in Sabah. Exotic species are often planted to enhance the amenity value of these areas.

**Class V - Mangrove:** Forest for the supply of mangrove timber and other produce. *Rhizophora* species are the most commonly harvested of the mangrove trees, with products ranging from firewood to fishing stakes. The commercial harvesting of all mangrove wood products is controlled by the forest department.

**Class VI - Virgin Jungle:** Forest conserved intact for research purposes. This forest cannot be logged, but several cases of illegal felling have occurred in Sepilok Virgin Jungle Reserve.

**Class VII - Wildlife:** Forest conserved primarily for the protection of wild animal species. At present, there

are only two such reserves in Sabah, both in the Dent peninsula on the east coast.<sup>1</sup>

These classifications with pertinent areas are shown in Table 3.2. Out of the 2.931 million hectares of state land, 8.43 percent is reserved as National Parks. The remainder of the state lands could ultimately be deforested for agricultural activities. These lands are not subjected to any silvicultural practices.

The 4.440 million hectares of forest lands are

**TABLE 3.2**

**CLASSIFICATION OF FOREST RESERVES, 1989 (IN HECTARES)**

CLASS	NAME	AREA
I	Protection Forest Reserves	99,977
II	Commercial Forest Reserves	2,674,575
III	Domestic Forest Reserves	7,355
IV	Amenity Forest Reserves	20,767
V	Mangrove Forest Reserves	316,457
VI	Virgin Jungle Reserves	88,306
VII	Wildlife Reserves	141,303
Total Forest Reserves		3,348,641

Source: Government of Sabah, Annual Bulletin of Statistics, 1989.

made up of several types of forests that can be categorized as shown in Table 3.3. Also shown is the depletion of each

type of forest lands since 1975. Over the fourteen year period, it is the undisturbed high forest that has been depleted most rapidly; constituting about 37.8 percent of the total land of Sabah in 1975 and comprising only 7.87 percent of the total in 1989. This is not surprising as the undisturbed high forests contain the lowland and highland dipterocarp, which provide logs and lumber to the state.

The other forest, which is composed of the immature and disturbed and regenerating forests, have shown a substantial

**TABLE 3.3**

**STATUS OF SABAH'S FOREST LANDS IN 1975 AND 1987  
(IN HECTARES)**

Type	Area in 1975	Area in 1989
Mangrove	365,500	316,457
Transitional Beach and Fresh Water Swamps	203,256	193,840
Undisturbed High Forest	2,800,236	580,300
Montane Forest	771,874	725,244
Other Forest	1,399,024	2,624,699
Total Area in hectares	5,539,890	4,456,963

Source : Government of Sabah, Annual Bulletin of Statistics, 1975 and 1989.

increase to almost double their 1975 percentage. The rise in the percentage of disturbed forests is explained by the

decline in the area of undisturbed forests.

The total area of forest reserves also decreased over this period by as much as 20 percent of its 1975 level. In 1989, forest reserves only made up about 60 percent of the total land mass of the state.

In a study done in 1976 (The Land Capability Study), it was shown that some forest lands are suited for agriculture and that some state lands are only suited for forestry. The state forest department is now attempting to release the former and reserve the latter as the opportunity arises.<sup>2</sup> State lands, which are usually used for agricultural development purposes are not subject to any management policies and do not come under the responsibility of the forest department.

#### **Allocation of Land for Exploration**

The expansion of the logging industry has been aided by the utilization of powerful machinery. All logging operations are carried out by contractors, either operating on long-term concession agreements or on short-term licences. Logging is confined not only to the commercial forest reserves but also to the state forest land, which ultimately will be brought under agriculture.

Only the commercial and wildlife forests reserves, which comprise 84 percent of the total forest in Sabah, are

opened for exploitation. There is also logging in Class V of forest reserves, that is to extract mangrove. It was also reported that very little logging has been authorized in Class 1 of forest reserves.<sup>3</sup>

As specified earlier in Table 3.1, logging areas are made available in three ways:

(a) **Concessions**

In 1986, there were 10 of this type. The number increased to 14 by 1989. Concessions are issued by the forest department under Section 15 (I) of the Forest Enactment, 1986. These are long term agreements which usually range between 21 and 25 years. The size also varies from 20,000 to 80,000 hectares. The Sabah Foundation holds a licence agreement of this type of over 0.86 million hectares of forest reserves for a period of 100 years, from 1970 to 2069. Timber production from this area contributed 35.3 percent of the state's total production for 1989.

(b) **Special Licences**

These are usually issued for a period of 5 years but could be renewed for period of 1- 5 years. In practice, all these licences are renewed. The area under these licences is variable and no limit has been fixed. The number

of licences issued has increased from 60 in 1986 to 76 in 1989. The timber production from these licences was 28 percent of the state's total production in 1989.

(c) **Annual Licences**

As implied by the name, these are issued for a period of one year, ending at the end of each year, renewable until all commercial trees in the licenced area are exploited and removed. The size of areas varies, but it is generally small and within the forest reserves. Annual licences are also issued to use state lands for agricultural purposes. In this case, the size of the approved area is in accordance with the area approved for development. These licences are also issued for cutting and removal of mangroves. Timber production from these licences made up almost 37 percent of the state's total in 1989.

The Sabah Forest Development Study (1972) reported, "With the rapid expansion of special licences and Form 1 licences in recent years it is safe to say that by 1980 close to 50 percent of forest allocations aside from those of the Sabah Foundation were politically determined." This system of allocation has continued up to a point where there

are now very few uncommitted unlogged areas in commercial forests or on state land. The Forest Development Study recommended public competition for logging areas, planning of the forest exploitation and management, and the restoration of control to the forest department.

### **The State's Timber Industry**

The first shipment of logs from the state, which was then known as North Borneo, was made as early as in 1885 by a small group of Australians who had established an abortive sugar estate near Sandakan.

Following that, the timber industry started to develop and grew gradually. From very small beginnings in 1885, timber exports in 1910 had grown to 6,201 cu. metres. Within the next thirty years, these reached more than one million cu. metres.

The reconstruction and development programmes following the end of the Second World War further stimulated the timber industry as almost all of the major towns in Sabah were heavily damaged. Local demand for sawn timber increased significantly and it was not until 1950 that sufficient local sawn timber was available to make good this damage.

Timber activities in Sabah up to 1954 continued to be regulated under the conditions of the 1936 Forest Ordinance,

which basically consigned the forest department to revenue collection and acting as an agent for the British Borneo Timber Company (BBTC), which had a monopoly over timber extraction. With the termination of that concession and the revision of the Forest Ordinance in 1954, the Conservator of Forestry was given wider powers to protect and manage the forests of the Colony.

The four companies which took over the concessions formerly held exclusively by BBTC were each given a 21-year agreement. In addition annual licences were issued to smaller operators. By 1953 there were 45 such licences and the number has since increased to 66.

This excessive expansion threatened profitability and markets and jeopardised the development of a stable timber industry in the colony. In the face of lobbying by existing licensees, the government introduced measures in 1955 to restrict the growth and export of annual licensees.

Timber processing expanded rapidly after the war to meet the demand for sawn timber for housing construction. In 1952, in an effort to encourage further timber industrialization, a clause was included in the licence agreements that 25 percent rising to 33 percent of the volume of timber extracted should be milled in the Colony. This, however, ended in failure with the concessionaires arguing that saw-milling was unprofitable. The clause was



dropped in 1956.

Between 1950 and 1955 the production of logs rose from 0.23 million cu. metres to 0.78 million cu. metres, with log exports in 1955 valuing \$21.6 million compared at \$6.5 million in 1950. In 1960, timber exports further increased to \$90.7 million with a volume of 1.42 million cu. metres.

Fundamental changes also occurred in the timber export market in the ten years after the war. Hong Kong, the main original export destination, was superseded by Australia in 1948 and 1949, followed by the U.K in 1951, 1952, and 1953. Thereafter the U.K market diminished rapidly and almost completely with the closing of the Suez Canal in 1956. The market was soon filled by Japan, which took 36 percent of North Borneo log exports in 1956. Log production increased consistently since the late 1950s (see Table 3.4) with Japan taking 64.7 percent of the value of the colony's logs by 1960; a pattern which still prevails today.

Timber production continued to increase rapidly over the following years. In 1963, timber production increased by almost 61 percent of its 1960 level. The timber processing industry up to 1960 had been expanding rapidly too, with sawn timber rising from 10,268.8 cu. metres in 1950 to 30,302.4 cu. metres in 1960. By 1963, however, most of the sawmills owned by the major concessionaires had closed, with sawn timber production confined to meeting

TABLE 3.4

## LOG PRODUCTION IN SABAH 1950-1989 (IN CUBIC METRES)

Year	Production	Year	Production
1950	226,692.4	1970	6,559,782.0
1951	262,780.9	1971	6,952,187.7
1952	277,484.3	1972	8,525,737.1
1953	368,288.0	1973	11,102,942.1
1954	537,326.5	1974	9,921,002.5
1955	782,123.6	1975	9,118,361.7
1956	762,513.0	1976	12,636,293.0
1957	960,562.2	1977	11,916,087.0
1958	1,154,560.4	1978	13,289,035.3
1959	1,562,567.5	1979	10,786,970.0
1960	2,150,240.2	1980	9,062,946.0
1961	2,250,340.4	1981	11,730,102.0
1962	2,794,488.0	1982	11,739,262.4
1963	3,455,963.0	1983	11,991,409.6
1964	3,584,720.5	1988	10,504,737.6
1965	4,162,189.5	1985	10,757,424.7
1966	5,553,962.0	1986	9,811,078.0
1967	5,708,027.0	1987	12,174,344.0
1968	3,745,043.1	1988	10,980,563.0
1969	6,200,232.0	1989	9,494,113.0

Source: Government of Sabah, Forestry Department Annual Reports, various issues

domestic requirements. Sawn timber exports fell to 6,417.5 cu. metres only.

In 1963, there was a major policy shift with regard to forest exploitation requiring that profits made on timber extraction on land suitable for agriculture would have to be ploughed back into land development.<sup>4</sup>

The timber industry of Sabah is traditionally oriented towards the export of round logs, with an insignificant portion being processed locally. This is for several reasons: there is a high demand for logs by the secondary and tertiary industries of the importing countries. The present size of the state's timber processing industry can only absorb about 5-10 percent of log production, and investments in the log export trade entail lower capital output, lesser risks, better profit margin and faster turnover.<sup>5</sup>

However, this practice gradually changed throughout the 1970s with more round logs being converted locally into lumber, veneer, plywood and more recently blockboard. The implementation of the export quota system in 1977 resulted in the mushrooming of timber processing mills throughout the state.<sup>6</sup>

Timber production hit its first double-digit million cu. metres in 1973. It fell back to nine million cu. metres for the next two years. After 1975, timber production continued to be at more than ten million cu. metres annually (except for 1974, 1975, 1980, and 1986).

It is estimated that, given the present rate of production, the natural forest cannot maintain this extraction rate any longer. In the very near future, it is expected that timber production will decline as the area of

the forest becomes gradually reduced. Looking at the table again, this reduction had actually started in 1979.

According to the World Bank report, taking the average logging rate for the period 1976 to 1989 of 11.3 million cu. metres per year and at an average yield of 75 cu. metres of timber per hectare, the entire commercial and state lands forests would be depleted by 1995.<sup>7</sup>

### **Wood Processing**

The present policy of the forestry department is to generate greater value-added from the forest resources by phasing out log exports gradually and pursuing development of the wood processing industries. In view of the need to exploit timber resources more fully and to reduce export instability, the state government has been trying to promote downstream processing activities.

In response to this strong support from the government, the timber industry of Sabah has started to invest in the production and export of high value-added products such as moulding. The heavy reliance on log exports could be seen from the fact that most timber exports are dominated by log exports. For example, in 1987, Sabah exported 2,882 million Ringgit worth of timber. Out of this, 96 percent was exported in the form of logs and sawn timber.

For the past few years, not only has the export value

of timber increased it has also been widened. At present, the range of forest products includes sawn timber, plywood, veneer, blockboard, wastewood, core veneer wastewood, printing and writing paper and moulded products.

The incentives offered by the state government such as the preferential royalty rate for logs processed locally, has contributed to a dramatic increase in the sawmilling industry as reflected by the increase in export value of sawn timber which jumped from \$348.9 million in 1983 to \$520 million in 1988. The export value of plywood has also risen drastically from \$15.4 million in 1983 to \$105.9 million in 1988. These impressive increases however must be measured against the cost of export royalties forgone by the state government.

In 1988, for every cubic metre of log that was processed locally instead of exported, the state lost between \$45 and \$75. Based on the volume of sawn timber exported in 1988 (1,033,232 cu. metres), the state incurred an opportunity cost of between \$92 and \$154 million through not exporting this volume of logs (on the assumption that the conversion ratio from logs to sawn timber is 2 to 1).<sup>8</sup> While the state can ill-afford to forgo such large amounts of revenue, it is nevertheless prepared to consider this as an investment to build up a strong and efficient wood processing industry in the state.

These concerted government efforts are showing positive returns as there are impressive increases in volume and value of sawn timber and plywood exports in recent years. Many sawmills and veneer mills are also being reactivated. In 1989, there were some 146 sawmills, 7 veneer mills, 5 ply mills, 1 blockboard mill, 1 woodchip mill, 7 wood preservation plants, and 1 pulp and paper mill in Sabah.

Despite the incentive of a preferential royalty rate for locally processed logs provided by the government, there is little transition activity from primary products (i.e. sawn timber and plywood) to secondary higher value-added products. The fact that currently Sabah needs to import over 80 percent of timber furniture from Peninsular Malaysia illustrates this point.

#### **Expected Timber Production**

The balance of the forests (both state land and Class 11 commercial forest reserves) as of 1988 was 1,159,727 hectares. All of these areas have already been licenced. The special licences will be completely logged by 1993.

Most of the annual licences would have been logged by that time except those on state lands which are being converted to agricultural plantations. By this time, the timber producing area will be the Sabah Foundation Concession comprising 1,041,400 hectares. In other words,

over the next decade, most of the timber production will be expected to come from an area of about 685,036 hectares of unworked forests.<sup>9</sup>

It is projected that for the years beyond 1994, timber production for the natural forest will not be sufficient to meet the requirement of the timber processing industry. The government is hoping that this deficit will be supplemented by timber production from the forest plantations.<sup>10</sup>

### **The State's Forestry Policy**

By the time that Peninsular Malaysia, Sabah, and Sarawak joined together to form Malaysia, forestry had become an important foreign exchange earning activity. Each state in the federation had its own forestry enactment and rules, with a considerable degree of uniformity, but with some differences in format and substance. Nevertheless, in spirit their aims of conservation and exploitation were similar.<sup>11</sup>

The state government of Sabah has long been aware of the vital role of the forest sector to the state's economy. As forestry falls under the state's responsibility, it is the state government which had been entrusted with the responsibility of planning, formulating, and implementing policies and legislation for proper and sustainable management and conservation of the forests. In Sabah,

despite the existence of some good policies and legislation on paper, the actual practice has been the opposite.

In general, as a guideline to the management of the state's forest, the planning of forestry department activities and their implementation is based on the state forest policy, which is as follows:

1. To preserve permanently for the benefit of the present and future inhabitants of the state sufficient forest land.
2. To manage the forest estate with the objective of obtaining the highest revenue compatible with sustained yield.
3. To provide the technically trained staff necessary for forest management and revenue collection and for research.
4. To support and cooperate in all appropriate schemes of regional forest research.
5. To accept in principle that security of tenure and long term planning is necessary for the successful management of the forest estate.
6. To foster by education and propaganda, a real



understanding amongst the people of Sabah of the value of the forests to them and their descendants.<sup>12</sup>

To achieve the above objectives, the forestry department with enactment of a bill in the state legislature, has established a goal to reserve at least fifty percent of the total land mass of the state as permanent forest cover, and to sustain commercial harvesting of timber at not less than five million cu. metres per annum.

In 1984, the federal parliament passed the National Forestry Act, which was designed to standardise the development and conservation of forests on a national level. The Act, however, has not yet been enforced due to the lack of effective enforcement machinery. It also lacks support from the state governments involved, who regard the Act as undermining their autonomy. It does, however, represent an attempt by the federal government to adopt an integrated approach to forest resource management.<sup>13</sup>

### **Problems Associated with the Timber Industry**

There are several problems which to some degree have contributed to the rapid depletion of the forest that can be identified with Sabah's timber industry. Some of these problems are:

(a) Excessive cutting

Over the past decades, the average annual log production had been estimated to be about 11 million cu. metres. This is far greater than the 5 million cu. metres suggested under the sustained yield management programme.<sup>14</sup>

(b) Inadequate planning in the allocation of forest resources

When the forest reserves were drawn up in the past, they were done without reliable data on land use. As a result there has been on occasion a conflict of interest between forestry and agriculture.<sup>15</sup>

(c) Land tenure

The growing of Dipterocarp tree crops is a long term business involving periods of over sixty years. Land tenure is essential because without the security of tenure, no working plans for these forests can be successfully implemented.<sup>16</sup>

(d) Forest regeneration

The commercial forests are presently being regenerated naturally by seedlings and advanced growth left in after logging. Today, due to heavy

mechanization in logging, a sizeable portion of the commercial forests has been heavily damaged with a degree of exposure which creates a favourable condition for the prolific growth of non-commercial pioneer species.<sup>17</sup>

(e) Incomplete and wasteful utilisation of forest trees

Unlike many other tropical countries, the natural forests in Sabah contain a very high proportion of merchantable tree species. Of the trees above 20 centimetres diameter at breast height, about 80 percent are dipterocarp species, 14 percent other merchantable species, and only 6 percent non-merchantable species. However, previous and current logging practices have been quite wasteful, with as much as 50 percent of the merchantable volume left behind as butt ends, "defective" logs, low-grade logs, or currently non-merchantable species. The Food and Agriculture Organisation (FAO) had indicated that there is an available and usable volume, equivalent to the annual extracted timber from the forest in Sabah, still left standing as standing trees in the natural forests.<sup>18</sup> A United Nation Development Programme (UNDP) report has also indicated categorically that the total usable logging waste and mill residue amount to some 3.4

million cubic metres.<sup>19</sup>

### **Measures Taken by the Government to Improve the Forest Sector**

Much has been written about the wood resources of Sabah, such as their rapid exploitation, the foremost position of the state as a supplier of tropical hardwood logs to the world economy, and the revenue generated by this trade both from timber royalties collected by the state and from earnings of loggers and exporters. Several estimates have been made in recent years of the future of Sabah's unexploited natural forest. All these studies have predicted an immediate decline in total annual production of logs from the high of more than 11 million cu. metres to a much lower level of 5 to 6 million cu. metres.

In December 1976, the chief minister announced an export log quota scheme that was to reduce the volume of log exports by 50 percent over a five-year period. Its objectives were two-fold: first to minimize the effects of log price fluctuations on the economy, and secondly, to reverse the growth of the log export industry and replace it with home-based timber processing.<sup>20</sup>

The scheme came into effect on 1st July 1977, but log exports did not start to fall for three years. During this three year period, log exports averaged to more than 12

million cu. metres volume annually, which was substantially beyond the quota. In fact more than 95 percent of total log production was exported during that period. In 1978, log exports reached a peak of 13.127 million cu. metres, which was about 98.8 percent of log production volume for that year. Although log exports did decrease, starting in 1980, the 1982 volume of log exports was about 82 percent of the 1976 level.

In 1986, the state government once again imposed an export quota on round logs of six million cu. metres along with a reduction in the royalty rate for processed timber, as a policy to encourage local processing of logs into sawn timber, plywood, veneer, and other finished products.

However, an examination of Table 3.4 once again, reveals that log production and thus exports did not even come close to the quota. Notwithstanding, exports of sawn timber, plywood, and veneer increased quite significantly. This could be attributed partly to the fact that the state government also offered a financial incentive, which took the form of reducing the royalties imposed on logs processed locally.

The state government had also earmarked half a million hectares of land for a tree plantation programme, of which, 70,000 hectares had been planted by 1991 with fast growing species. It is expected that the remaining area of 430,000

hectares will be fully planted by the end of the Seventh Malaysia Plan (the year 2000).

Recently, the federal government had to interfere in the state's forest practices by warning the state government to reduce its logging operation, or face a ban on log exports.<sup>21</sup>

## ENDNOTES

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## CHAPTER FOUR

### FINANCIAL AND REVENUE FACTORS RELATED TO FOREST RESOURCES IN SABAH

#### The Period Prior to Independence

The following table, Table 4.1, shows the sources of revenue for Sabah (formerly North Borneo) from 1947 to 1963. From the table it can be seen that customs duties - import and export duties - were the main source of government revenues. Of the two, import duties (on tobacco, petroleum, cigarettes, luxury and semi luxury goods, textiles, and liquors) were most important, providing around 60 percent of total customs duties. Export duties were largely obtained from rubber, copra, hemp, and timber. (See Table 4.1)

The other major source of revenue was from assets of Sabah, i.e. lands, forests, fees, and interests. Although customs were the most important source of revenues to Sabah, the percentage contribution of customs duties to Sabah's revenue decreased significantly over that period. For instance, in 1947 it provided about two-thirds of the state's revenue, but in 1963 it fell to only about one-third of the total revenues.

Part of the reason for this was growth in the timber

TABLE 4.1

## NORTH BORNEO ORDINARY REVENUE BY SOURCE 1947 - 1963.

	1947	1950	1955	1960	1963
Customs	4.6	11.2	16.5	27.7	32.6
Lands	0.7	0.6	0.8	1.5	1.6
Forests	0.1	0.5	2.0	6.2	14.1
Licences & Fees	0.5	2.0	6.9	8.4	16.9
Posts & Telegraph	0.4	0.6	1.2	1.2	4.4
Others	0.5	1.8	2.1	12.2	28.2
Total	6.8	16.7	29.5	59.0	97.9

Source: Peter Gudgeon, A Commemorative History of Sabah 1881-1981, Kota-Kinabalu, 1981.

Note: Figures are in million.

industry following the termination of the British Borneo Timber monopoly. With the ending of the monopoly, the government was able to secure for the first time a fairly free hand in levying revenue from the state's principal economic assets.

Income tax was also a significant component of the state's revenue. In 1960 alone, it contributed \$6.3 million to the state's total revenue, of which two-thirds came from the company tax and the rest from the personal tax.<sup>1</sup>

### **The Post Independence Period**

With the end of the Colonial administration, the state of Sabah began a new era under the new Federation of Malaysia. As discussed in the previous chapter, the state had won the right to retain a fair degree of financial and administrative autonomy within the federation.

Of prime importance was the maintenance of control over the land and forest resources. However, along with the transfer of financial responsibility to the federal government for certain basic services (such as Education, Civil Aviation, Health, and Posts and Telegraphs), the state also handed over some major sources of revenue, including custom duties and income tax.

In the period immediately prior to independence, the state government with the assistance and cooperation of the federal government, had started to draw up a six-year development plan, "The Sabah State Development Plan 1965-1970". This plan was in fact later incorporated in the First Malaysia Plan 1966-1970.

In the State Plan, \$436.32 million was allocated for the state's development expenditure, of which 47.2 percent would be from federal sources. This plan represented an ambitious start for the development efforts of the new state government. The sizeable federal contribution also reaffirmed its commitment, expressed in the 1963 Agreement,

to hasten the development of Sabah and bring it up to the level of the other states in the federation.

Although no major changes in policy and objectives were apparent between the two plans, there were some significant differences in the sectoral allocations of expenditure and the relative proportions to be financed by the federal and state governments.

In the original plan, \$377.02 million was to be provided for development purposes. Of this, 83.6 percent was to be provided by the federal government and the rest by the state government. The mid-term review of the First Malaysia Plan, however, showed that, of the revised allocation of \$538.4 million (compared to \$377.02 in the original plan), 43.6 percent was from federal funds compared to 83.6 percent in the original plan.

The reasons given for this major shift in financing responsibility included the slow release of the federal funds.<sup>2</sup> However, the actual expenditure under the Plan was only \$413.5 million, 76.8 percent of the revised allocation amount. The federal government's share of the actual expenditure was just 21.8 percent of the total.

Since 1964, income derived from forests has been the most important source of revenue to the state. Revenues from forests in 1964 constituted more than one-fifth of total revenues. This percentage increased drastically

during the First Malaysia Plan. Thus, by 1970, forest revenue contributed no less than 45 percent of the state total revenue. Income derived from forests, through the royalties charged per cubic metre of timber felled, was seen by the government as the main source of income to the state and thus would enable the state to allocate more money for its development expenditure.

### **Royalties and Other Taxes on Timber Exports**

Revenues on forest resources are collected mostly in the form of royalties on the volume of timber felled. Forest royalty is fixed and collected by the state forest department. For royalty purposes logs are classified into several classes.

The classes as at July 1992 are summarised below:

Class	Species
A	Belian, Merbau
B	Mengilan / Agathis
C	White Seraya
D	Melapi, Red Seraya, Selangan Batu
E	Yellow Seraya, Nyatoh, Sepetir, Perupok, etc
F	Kapur, Keruing
G	Kembang
H	Kayu Pengiran, Mersawa

- I Jelutong, Teluto, Mengaris, Darah Darah, etc
- J Bangkal, Berangan, Kedondong, Medang, etc

As at June 1979, the export royalty on Sabah's timber was based on the free-on-board (fob) prices. For example for class A, which were the hardwood species, the royalty rate was just a flat rate of 25 percent of the fob prices. For the remaining classes, the rate charged was a progressive rate based on the fob prices. As long as the fob prices fell below \$8.00, the lower rate applied.

Prior to June 1992, the forest department had quoted a fixed amount of timber royalty for round logs (per cubic metre), revised quarterly, based on species rather than classes. Thus, the royalty varied across species within classes. For example, in Class E the royalty varied from \$50 to \$178 per cubic metre.

Since July 1992, the forest department has standardized the royalty within classes. For July-Sept. 1992, the royalty charged varies from \$50 to \$350 per cubic metre.

In the case of sawn timber, species are split into four groups. The royalty is standardized within groups but varies across groups. As at March 1992, royalties range between \$50 and \$150 per cubic metre for rough sawn timber, and proportionately less for semi-finished sawn timber.

As part of the state government's incentives to promote

down stream processing industries in the state, royalties on processed products such as rotary and sliced veneer, railway sleepers and plywood are significantly lower than on unprocessed timber. For example, for the items indicated above, the royalty varies between \$20 and \$70 per cubic metre. For processed products such as blockboard, furniture, fibreboard etc, there is no royalty imposed.

A study done by Pringle, shows that between 1979 and 1981, the amount of royalties that the state government had to forgo in order to promote the down stream processing industry in the state, was in excess of \$300 million. Many of the sawmills in operation were badly designed and processed sawn wood so poorly that they actually lowered the value of the raw material on the export market. However, they may have been able to show profits because of the subsidized log costs. Pringle concluded there is a need for the state government to reassess royalty rates in order to ensure supplies to the better and permanent sawmills.<sup>3</sup>

Apart from the royalties, the state government also collects revenues from timber premia and timber extraction charges (other than the settlement scheme), logging vehicle fees, sawn timber export cessions, and timber scaling, grading, inspection and marking fees. The revenues collected from these sources, however, only constitute about 2 percent of the total revenues collected from forest

resources.

### **Forest Revenues and State Government Expenditure**

It can be seen from Table 4.2 that the state expenditure has also increased consistently over time. The large budgetary surpluses of more than 70 million (from 1967 and 1968) had permitted the state government to accept a greater share of the financing burden than had been drafted in the First Malaysia Plan.<sup>4</sup> (See Table 4.2)

However, a deteriorating trade position in 1975 and a sudden fall in timber exports from \$240 million in 1974 to \$184 million in 1975 was to worsen the state's financial position. This trend, however, was to be reversed in the first four years of the Second Malaysia Plan (1976-1979), in line with the rise in timber exports.

The impressive increase in forest revenue in 1976 to more than double its 1975 amount, and a further increase in 1977 and 1978, resulted in a drastic improvement in the state's financial position. The state's savings started to accumulate and with forest revenue reading more than a billion dollars in 1979, Consolidated Revenue Account (CRA) balance increased to over \$1.2 billion in 1979. Government spending continued to increase during the Third Malaysia Plan, 1980-1985. This was attributable in part to the creation of government statutory/link agencies in the



TABLE 4.2

**CONTRIBUTION OF FOREST REVENUE TO TOTAL STATE REVENUE AND SAVINGS ACCUMULATED (IN MILLION)**

Year	Total Revenue	Total Expend.	Forest Revenue	Forest Rev. to Tot.Rev	Forest Rev. Surplus	CRA Bal
1971	183.3	185.4	95.5	52.1%	(2.1)	280.4
1972	168.4	234.8	78.0	46.3%	(66.3)	214.2
1973	299.2	213.4	183.8	61.5%	85.8	300.0
1974	380.3	345.6	240.0	63.1%	34.7	334.7
1975	265.8	414.6	151.6	57.1%	(148.8)	185.9
1976	557.5	342.1	326.5	58.6%	215.4	401.3
1977	716.3	556.7	496.9	69.4%	159.7	561.0
1978	777.3	637.5	510.3	65.7%	139.8	700.7
1979	1,439.7	926.0	1,110.0	77.1%	513.7	1,214.5
1980	1,538.3	1,383.5	1,053.5	68.5%	154.9	1,369.3
1981	1,026.1	1,738.2	731.7	71.3%	(712.1)	657.3
1982	1,481.7	1,340.5	984.1	66.4%	141.3	798.5
1983	1,315.6	1,645.7	804.9	61.2%	(330.2)	468.4
1984	1,336.2	1,437.2	701.1	52.5%	(101.0)	367.3
1985	1,156.4	1,037.2	504.1	43.6%	119.2	486.6
1986	1,099.4	1,018.0	552.7	50.3%	81.5	568.0
1987	1,411.5	1,061.7	985.1	69.8%	349.8	917.8
1988	2,037.9	1,715.1	1,037.6	50.9%	322.8	1,240.6
1989	1,743.9	1,740.7	825.5	47.3%	3.3	1,243.9
1990	1,575.8	2,001.3	785.3	49.8%	(425.5)	818.4

Source: Government of Sabah, State Financial Statements, various issues.

Note : CRA is Consolidated Revenue Account

manufacturing sector, some of which were: Sabah Cement Industries, Sabah Flour and Feed Mills, Sabah Forest Industries, and Sabah Gas Industries.

In order to set up these various companies, the state government in 1981 spent over half its budget. After 1981,

contributions to the statutory fund were the single largest government expenditure item followed by expenditures by the chief minister's department and treasury.

Although forest revenues continued to be the dominant contributor to the state revenue, it is obvious from Table 4.2 that its share has been slightly, though erratically decreasing for the last twelve years. It can be expected, however, that in the foreseeable future, timber revenue will continue to be the main source of income for the government.

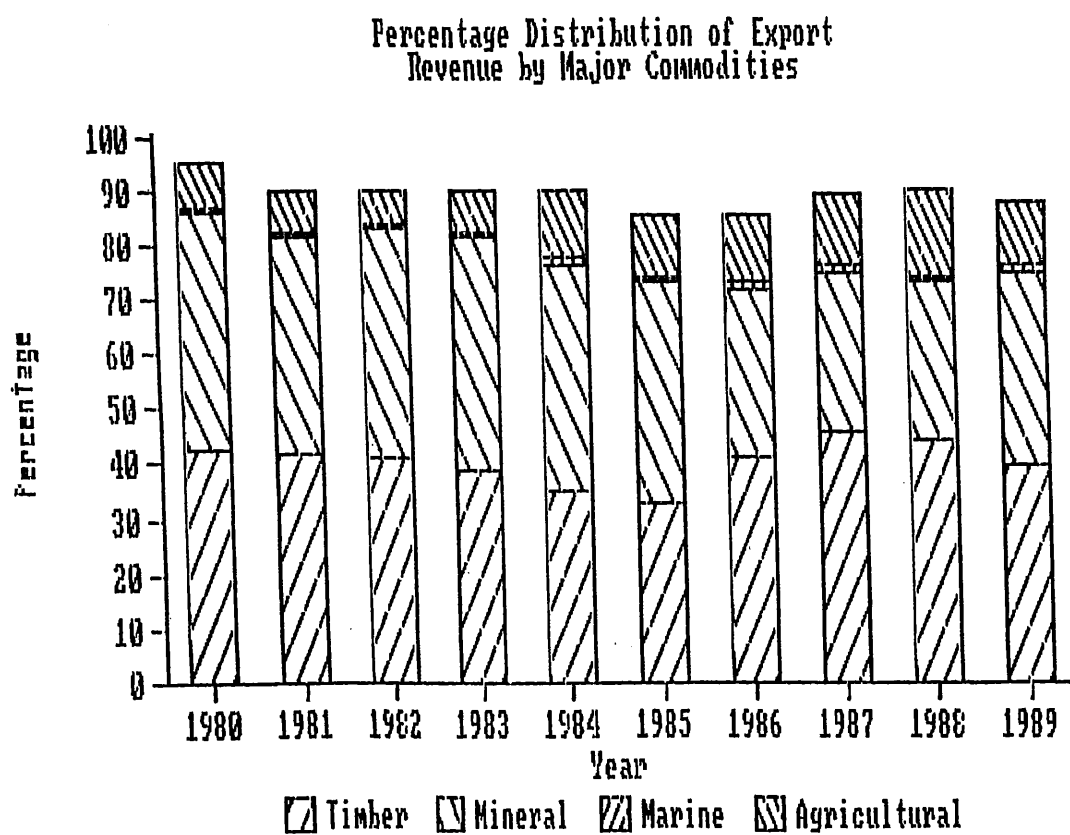
#### **Other Sources of Funding**

Besides forest revenues, another four sources that have potential as major sources of income to the state are: customs, lands, royalties, and interest and dividends. (See Figure 4.1)

#### **Customs**

In Figure 4.1 customs refer only to the custom duty revenue derived from the import duty and excise duty on petroleum products. In 1980, this source only contributed 2.4 percent of the state's revenue though by 1989, it increased to 6.4 percent. Although the rate of growth during the nine year period is high, the proportion of customs revenue to the state's revenue was still below one-tenth of the total revenue.

FIGURE 4.1



Source: Government of Sabah, Annual Bulletin of Statistics, various issues.

### **Oil Royalties**

Oil royalties, on the other hand, showed a negative growth rate over the nine year period. Three companies are involved in petroleum exploration and production in Sabah: Sabah Shell Petroleum Company, Exxon Production Malaysia, and BP-Carigali. All work closely with the National Petroleum Limited (PETRONAS). With the passing of the *Petroleum Act 1974*, PETRONAS acquired the entire ownership in and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia.<sup>5</sup>

In June 1974, the state government signed a production sharing agreement with the oil companies and PETRONAS in exchange for a cash payment in the form of a yearly sum amounting to the equivalent of 5 percent of the value of the petroleum won and saved from areas in the state and sold by PETRONAS or its agents or contractors.<sup>6</sup>

As provided under the Constitution, oil and gas (offshore and onshore) in Malaysia are under the responsibility of the federal government through PETRONAS. It was in exchange for this right, that the state government (the neighbouring state for offshore oil) became entitled to its cash payment of 5 percent of the total production.

In Malaysia, there are several instruments used to extract a share of the surplus flowing from petroleum

projects: sliding scale production sharing, royalty, income tax, tax on profit, excess profits tax and carried interest.<sup>7</sup>

As mentioned earlier, the state government of Sabah is only entitled to the 5 percent royalty annually, which is paid directly to the state government by the oil companies. On the other hand, the state government is not involved in the exploration or development costs of the oil projects. Thus, the cost risks are borne entirely by the investor.

There are several weaknesses of this royalty system.<sup>8</sup> The use of royalties can distort the oil companies' production and investment decisions. For example, it may lead the oil companies to abandon prematurely oil fields. As the royalty rate is a flat rate, in the case of lower oil prices or higher exploitation costs, the flat rate royalty will take an increasing share of gross profits. This will certainly increase the marginal cost of production.

However, there are some advantages associated with the use of royalties. They are simple and easy to understand. The administration, monitoring and auditing costs are usually low.

Two years ago, the issue of the 5 percent oil and gas royalties was strongly debated by the local politicians. Some members of the ruling party in Sabah talked to the press openly about their unhappiness with the present

arrangement. They requested 'informally' (since no meeting had taken place between them and the Prime Minister) that the oil royalties be increased to more than 20 percent of the total production. The continuing discussion of the issue among local politicians resulted in a very tense relationship between the state and federal governments. Finally, the Prime Minister issued a statement clarifying the matter by saying that the 5 percent royalty of oil and gas was agreed under the inter-government meeting in 1974 and thus shall no longer be discussed publicly.<sup>9</sup>

#### **Land and Interest and Dividends**

Two minor sources of income for Sabah are land, and interest and dividends. These two sources fluctuated quite volatily from 1980 to 1989. This was especially true in the case of land. In 1980, revenue from this source contributed 1.7 percent of the state's revenue, but reached 6.4 percent in 1984. This was caused mainly by an increase of \$0.77 million in Lands and Survey Revenue and also by an increase in the premiums from land sales from \$27 million in 1983 to \$64 million in 1984.

Land revenues, however, fell back to 2.9 percent of the total state revenue in 1986, where they remained for the next three years until rising again to 6.4 percent in 1979. There is no definitive reason for these ups and downs,

however, they could be attributed to the poor collection management of the state government itself.

Interest and dividends are proceeds from dividends on public corporations, interest on loans of various bodies such as the statutory bodies and local authorities and interest payments on the state's cash balances and short term deposits. It is the last category that has been the dominant in this group.

In the early 1980s, this source contributed about one tenth of the total state's revenue. However, for the past five years, there has been a downward trend in this particular source so that by 1988, it contributed only about 4 percent of the total state's revenue.

### **Exports Revenues**

External trade is very important to Sabah's economy. In 1989 alone, the percentage of export to GDP was about 80 percent, which clearly indicates the state's heavy dependency on its export sector. The composition of exports is mainly concentrated on crude materials (sawlogs) and mineral fuels, which together constituted about two-thirds of the state's exports in 1989 (\$7.642 billion).

Sabah's export revenue (1980 - 1989) by major commodities group is illustrated in Figure 4.2. It can be seen that a large part of the export revenue comes from

natural resources particularly timber.

Over the ten-year period covered by Figure 4.2, timber products export revenue declined in the first six years (1980-1985). Its shares to the total export revenue fell from 42.4 percent in 1980 to 32.7 percent in 1985. Although, in current value it only fell by small amount (\$1.89 billion in 1980 to \$1.81 billion in 1985), it was significant as total export revenue increased by almost 25 percent over that period. In the late 1980s timber products revenues regained strength, rising as high as 45.5 percent in 1987, though it decreased to 39.8 percent in 1989.

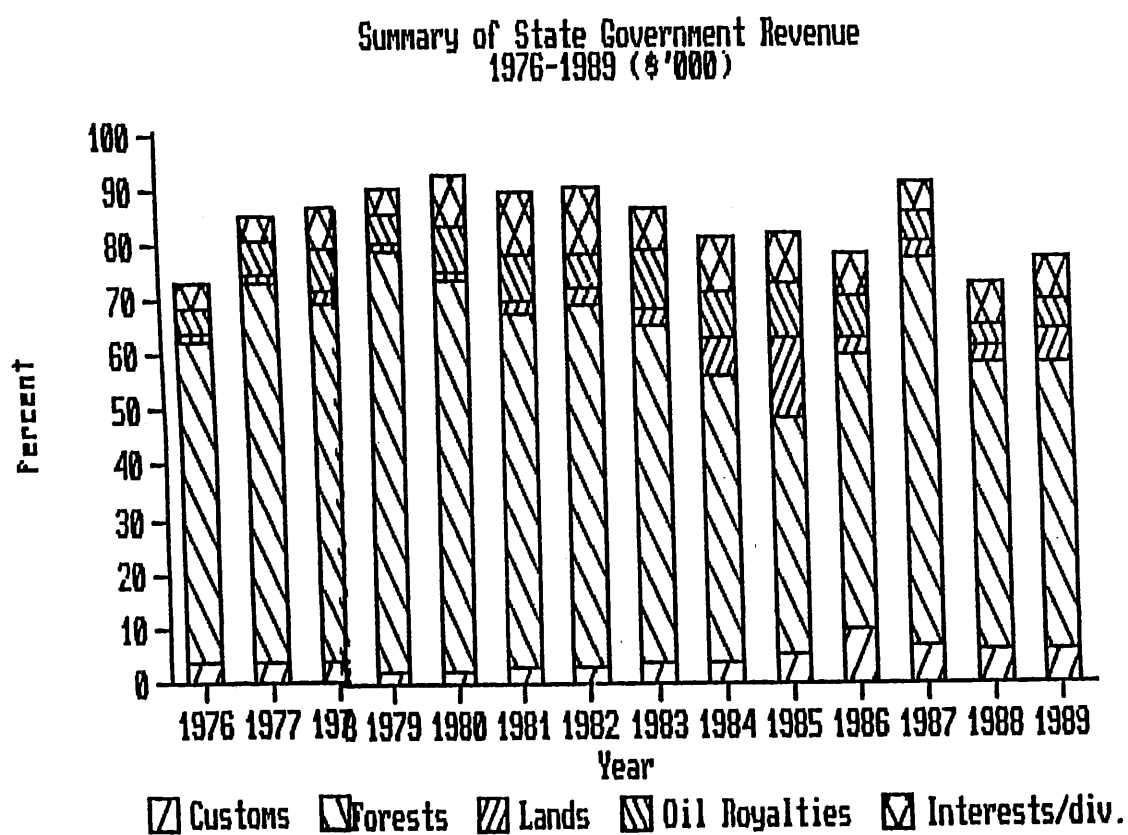
Timber products can be further broken down into several categories: sawlogs, sawn timber, plywood plain, and veneer sheets. The volume and value of each of these categories are provided in Tables 4.3, 4.4, and 4.5.

It can be seen that for all processed wood products both the export volume and values have consistently increased in recent years. Moreover, with a readily available demand for these products from countries such as Japan, the United States, Belgium, Hong Kong, and Taiwan, it can be expected that export revenues from these groups will increase steadily in the future.

Revenues from mineral, on the other hand, have shown more volatility. These accounted for more than two-fifths of the export revenue in the early 1980s. The high



FIGURE 4.2



Source: Government of Sabah, Annual Bulletin of Statistics, various issues.

TABLE 4.3

## LOGS EXPORTS 1959-1989 (IN CUBIC METRES)

Year	Volume	Value (\$)
1959	1,386,107	57,393,045
1960	1,770,675	86,173,972
1961	2,254,432	100,668,047
1962	2,465,624	120,600,000
1963	2,974,901	148,667,480
1964	3,348,493	146,519,272
1965	3,796,955	183,594,779
1966	4,856,083	258,771,457
1967	5,321,575	316,299,081
1968	5,796,595	334,052,017
1969	6,187,654	374,422,613
1970	6,150,139	395,806,800
1971	6,558,354	419,001,221
1972	7,708,433	409,332,150
1973	10,143,866	799,710,189
1974	9,733,071	870,581,425
1975	8,991,012	567,781,150
1976	12,061,346	1,193,484,908
1977	12,337,264	1,241,472,714
1978	13,127,110	1,326,265,148
1979	10,332,238	2,179,194,409
1980	8,510,441	1,845,249,873
1981	9,361,200	1,726,659,524
1982	9,949,666	2,119,229,484
1983	9,495,489	1,704,226,102
1984	7,339,578	1,482,469,519
1985	8,442,266	1,411,383,708
1986	8,792,353	1,578,777,175
1987	10,265,206	2,370,389,200
1988	8,238,007	2,156,734,364
1989	6,134,321	1,685,097,478

Source: Government of Sabah, Forestry Department Annual Reports, various issues.

TABLE 4.4

## SAWN TIMBER PRODUCTION AND EXPORT (IN CUBIC METRES)

Year	Production		Export
	Volume	Volume	Value
1959	n.a	30,063	3,670,662
1960	75,643	30,380	4,575,210
1961	62,073	16,735	2,123,532
1962	53,951	12,285	1,504,781
1963	46,942	6,414	940,038
1964	55,684	5,326	742,225
1965	63,801	7,127	836,715
1966	63,597	3,164	354,526
1967	57,061	3,464	528,351
1968	69,868	4,013	596,166
1969	68,905	10,016	935,541
1970	74,177	11,897	1,031,437
1971	92,671	6,442	445,282
1972	93,438	8,352	670,951
1973	126,825	12,577	2,331,077
1974	139,040	4,277	857,157
1975	135,466	9,442	808,762
1976	135,273	16,430	4,376,009
1977	177,320	35,693	11,974,594
1978	149,117	32,807	7,957,227
1979	220,903	77,075	25,029,472
1980	541,546	258,424	86,260,555
1981	675,736	427,329	143,405,871
1982	897,214	641,398	224,676,207
1983	1,107,068	1,038,213	366,405,403
1984	893,735	840,635	306,075,487
1985	1,003,411	983,418	371,860,952
1986	978,039	924,907	373,860,772
1987	965,876	909,694	415,797,077
1988	n.a	1,032,000	519,785,232
1989	n.a	1,401,000	886,033,544

Source: Government of Sabah, Forestry Department Annual Reports, various issues.

TABLE 4.5

## PLYWOOD AND VENEER SHEETS EXPORTS BY YEAR

Year <sup>b</sup>	Plywood		Veneer	
	Volume	Value	Volume	Value
1959	NIL	NIL	NIL	NIL
1960	NIL	NIL	886,414	478,954
1961	NIL	NIL	131,674	64,541
1962	NIL	NIL	1,189,833	635,327
1963	NIL	NIL	2,732,112	1,269,158
1964	NIL	NIL	3,594,020	1,467,422
1965	NIL	NIL	3,879,546	1,537,782
1966	160,837	227,414	3,529,486	1,520,131
1967	736,371	936,219	2,334,444	819,486
1968	1,021,502	1,419,161	3,453,501	1,089,415
1969	971,983	998,470	4,369,501	1,395,063
1970	1,589,280	1,813,980	4,805,797	2,552,847
1971	1,831,358	2,145,296	6,148,263	3,146,510
1972	3,289,837	3,916,815	7,881,737	2,701,574
1973	3,555,162	6,025,096	7,366,104	3,620,287
1974	2,232,465	5,811,025	10,077,636	8,493,926
1975	4,658,984	8,196,984	5,496,873	2,987,041
1976	4,063,105	10,718,150	3,992,745	3,812,141
1977	3,223,361	10,786,942	3,080,560	3,725,123
1978	1,485,933	6,186,079	1,653,822	1,378,302
1979	3,057,342	12,322,044	8,472,271	9,079,119
1980	4,191,565	17,991,402	9,266,096	10,288,304
1981	4,068,960	19,147,046	15,510,978	17,738,517
1982	3,300,136	14,791,200	19,923,470	18,143,613
1983	3,436,043	14,301,724	8,408,859	9,079,119
1984	2,738,643	9,912,019	43,638,195	44,064,190
1985*	24,800	17,185,864	127,200	53,789,581
1986	37,400	33,212,586	117,200	38,484,545
1987	99,300	71,564,547	134,300	56,592,693
1988	128,400	105,787,744	136,600	74,367,211
1989	142,900	114,362,368	177,800	99,121,054

Source: Government of Sabah, Forestry Department Annual Reports, various issues.

Note: \*Prior to 1985, volumes are in square metres. From 1985 onwards, volumes are in cubic metres.

level of export revenue was explained by the fact that oil constituted more than 90 percent of minerals exports and the early 1980's was the period when the oil crisis hit the world economy for the second time. Despite the instability of these exports prices, export revenues increased by more than 70 percent from 1980 to 1989.

Marine and agricultural products have been insignificant in terms of their contributions to the export revenue. Their share, however, has increased over the ten year period. In 1980, they contributed less than one tenth of the total but reached to 16.7 percent in 1988.

#### **Grants and Transfer Payments**

In addition to providing grants and transfer payments to the state, the constitution also makes provisions for safeguarding the financial position of the state.

There are three types of grants received: General Grants, Specific Purpose Grants, and Grants to Local Government. These headings can be broken down into further sub-headings.

- General Grants:**
- Capitation Grants
  - Increased Revenue Grants
  - Special Grants

- Specific Purpose Grants:**
- Roads Grants
  - Grants for Economic  
Development
  - Service charges
  - Assistance for Low Cost  
Housing
  - Finance of Federal Depart.

**Grants to Local Government:** - Launching Grant

For the fiscal year of 1980, Sabah received \$57.4 million from the federal government in the form of grants and transfer payments as specified under the Constitution. Of the total amount, 64.4 percent came under the general grants, while the special grants represented 48.4 percent of the transfers received. The remainder was made up of the Specific Purpose Grant, namely the Roads Grant (34 percent) and Launching Grant (1.4 percent).

From 1980 to 1985, the amount of transfers received increased by 53.5 percent and reached \$88.1 million (excluding oil royalties). This change was largely caused by an increase in the Roads Grant from \$19.5 million to \$37.7 million and by some additional economic development grants.

In 1985, the revenue growth grant showed a marked

increase of 140 percent from its 1980 level of \$9.2 million. However, no payment has been made under this grant since 1986 as the federal government's revenues have been falling.

Although this grant had been quite significant, the loss was offset by the tremendous increase in the other grants, especially roads grants.

In 1988, Sabah obtained more than \$141 million from the federal government. With an objective of improving the means of communication in the state, Sabah was able to secure \$75 million for its road projects from the federal government. This marked an increase of almost twice the 1985 amount.

Despite the huge increase in federal grants to Sabah, such grants nevertheless constituted only a small percentage of the total state revenue. For example, in 1980, federal grants only contributed 3.7 percent of the total state revenue and 6.9 percent in 1988.

#### **Development Grants under the Malaysia Plan**

Under the Sixth Malaysia Plan, the federal government had allocated \$2.307 billion for development purposes in the state. This amount makes up about 6.45 percent of the total federal allocation of \$35.757 billion (excluding the interstate projects). Although the Sixth Malaysia Plan allocation was about \$50 million more than the revised

allocation of the Fifth Malaysia Plan, the state incurred a cut of 1.8 percent if one looks at the percentage change in federal allocations between Fifth and Sixth Malaysia Plans.

In terms of per capita development allocations, which are only \$1,683, Sabah has also been given the lowest amount among the federal government's so-called "lesser developed" states of Perlis (\$2,808), Kedah (\$2,085), Sarawak (\$2,014), and Kelantan (\$1,791).

The negative percentage change is not only the most severe among the five lesser developed states (all except Sarawak had a 0.6 percent gain) but also in the whole country. Ironically high-income states like the Federal Territory and Selangor secured percentage gains, whereas three of the seven medium-income states also have gains.

Out of the sum allocated to Sabah under the Sixth Malaysia Plan, \$390.4 million has been allocated for roads and bridges. This allocation is less than half of the \$786.8 million given to Sabah's neighbouring state, Sarawak, and only about 7 percent of the \$5.6 billion allocated to the Peninsula. Per capita allocation for development of roads and bridges in Sabah is therefore \$284.7 compared to \$493.8 in Sarawak and \$398.9 in Peninsular Malaysia.

Several political leaders in Sabah had expressed their unhappiness regarding the amount allocated to Sabah for its roads and bridges development. They argued that except for



Sarawak, Sabah's land area is bigger than any Peninsular state; in fact it is about 56 percent of the entire Peninsular Malaysia land area. Due to geographical factors, Sabah's population is scattered over a wide area with most of the population in the rural area. It also more costly to build roads and bridges in Sabah because of the mountainous terrain and because the places where such infrastructure is required are often located far from the sources of building material.<sup>10</sup>

#### **Revenues and Their Relationship to the State's Development**

Revenue provides the means to achieve certain ends. With abundant revenues there is greater likelihood that there are funds to utilise for development. The ability to secure revenues is crucial in developing countries such as Malaysia where the type, pace and quality of development are essential for the government in power and the standard of living of the inhabitants.

Revenues are vital because they provide the funds for implementing policies, programmes and activities in the economic, social, political and cultural fields. The levels and continuity of revenues will determine the pace of development in these fields. Government has realised the importance of these programmes and activities; they are willing to spend a huge amount of money to meet the demands

and aspirations of the people.

The total development expenditure for 1980-1989 is given in Table 4.6. It can be seen that development expenditure financed by the state represented an average of 25 percent of the total state's expenditure during 1980-1989. This was made possible through the income derived from the forest revenues.

Out of this development expenditure, about 20 percent was spent on roads and bridges. This is not too surprising because of the poor condition of roads in the state. In 1989, only 34 percent of roads were paved, the lowest figure of any state in the country. This is largely because Sabah is very large in size and its topography makes the cost of road construction very expensive.

It should also be mentioned that although transport and communications (including roads) are under the responsibility of the federal government, it was not until 1986 that the federal government started to assume some of the bills for road construction in the state. In 1990, out of the 8,658 km. of roads in the state, 12 percent was financed by the federal government under the Fifth Malaysia Plan, with \$440 million being spent. This represents about 9 percent of the total expenditure by the federal government on roads and bridges.

About another one-fifth of the total development

**TABLE 4.6****STATE GOVERNMENT'S DEVELOPMENT EXPENDITURE 1980-1989**

Year	Amount Spent (\$)	% to Tot. Expend.
1980	396,635,000	20.7
1981	798,727,000	46.0
1982	555,460,000	41.4
1983	328,983,000	20.0
1984	299,889,000	20.9
1985	239,231,000	23.1
1986	206,510,000	20.3
1987	212,710,000	20.0
1988	306,325,000	17.9
1989	409,202,000	23.5

Source : Government of Sabah, State Financial Statements, various issues.

expenditure was spent on the water supplies in the state. This huge spending is counter-balanced by the fact that 100 percent of the urban population has access to piped water. This percentage is above the national average of 93 percent.

In 1990, however, only 52 percent of rural population was covered by water supply. Although this is quite a remarkable increase from 38 percent in 1985, the percentage is still way below the national average of 66 percent and was the third lowest in Malaysia. Again, this was mainly due to the scattered nature and remoteness of the villages.

Housing and town development is another item that has consistently represented a large share of the state's expenditure. Public housing in Sabah was introduced after

the formation of Malaysia. When the state obtained its independence, the immediate concern of the new Sabah government was economic development. Social and other development was to come later. The state government, through its statutory body the Sabah State Housing Committee (SSHC), got itself involved in the planning, programming and implementation of public low cost housing for the low income groups in Sabah.

Although most of the funds are from the state government, SSHC was also able to get some loans from the federal government. It is only recently (mid 1980s), that the private sector got involved in low-cost housing construction in the state, mainly because of a policy introduced by the state government which required all private housing developers to build at least 30 percent low-cost houses in each of their housing projects.

Given the fact that the state government will have to reduce its timber production, it will have to find ways to compensate for the associated reduction in forest revenues. On the other hand, the state government can also reduce its spending, which means it must reduce either its development expenditure or operating expenditure.

A decision to reduce expenditure will obviously have a serious impact on Sabah's economy and development. At present, the state government plays three major roles in the

economy: planning, operating projects, and enforcing regulations. However, evidence in both developed and developing countries shows that economic power is positively correlated with decreasing public sector presence in the economy.

The private sector, on the other hand, is heavily dependent on state government's contracts, especially in construction, manufacturing and services. These businesses, especially the larger ones, have come to expect government to provide the sole market.<sup>11</sup>

The private sector also sometimes lacks a pioneering spirit, particularly in manufacturing. Hence, the private sector tends to rely heavily on government incentives, such as tax relief, large loans and reduced rates, and other forms of subsidy.<sup>12</sup>

The overall spending pattern of the state government and the expenditure intensity in each sector are two important determinants governing the development of Sabah. Given the need for better infra-structural facilities in the state, the government had increased the level of expenditure for development purposes from \$206 million in 1986 to \$1 billion in 1990.<sup>13</sup>

For the Sixth Malaysia Plan (1990-1995), the state government approved a sum of \$2,866.9 million for development. Of this amount, 73 percent will be allocated

for continuation projects, while the remainder will be for new projects.

To maintain a continuous stream of development, Sabah must have a secure stream of revenues to finance these projects. As such the sources and the volume of revenues must be adequate and sustaining. In order to have that, there must be proper revenue management and in the case of the state, a proper natural resources management, namely the forest resources.

The same applies to export revenues. With proper export revenues and total revenue management, more funds become available for the private sector as it is the private sector which will benefit from these export revenues in the form of incomes and profits.

From the previous discussion on the sources of income to the state government, it is obvious that both the export revenues and state government revenues are dependent on a very limited type of resource, in particular the forest resource. This is especially true of the state government revenues. However, one must also remember that these resources are depletable resources although they could be renewable. But continuing over-exploitation will only further reduce available forest resources and will consequently result in lower revenues.

The effect of fluctuations in forest revenues can also

be seen in the volatile movements in the state government revenues. An obvious example here is the drastic drop in the state government revenue from \$2.03 billion in 1988 to \$1.18 billion in 1989. The main cause for this sudden reduction was the decrease in the forest revenue as a result of bad timber prices brought about by world wide recession. It is imperative, then, that the government planners realize that it would be precarious on the part of the state government to depend on a few items only for its revenue given the potential depletion of its natural resources.

Awang and Chai (1988) in their report to the state forest department, had estimated that the commercial forest reserves of about 2.27 million hectares, if felled at the present rate, will be completely exhausted by the year 2012.

The revenue from petroleum can also be expected to be very small as Sabah is only getting 5 percent of the total revenues from petroleum under the 1976 agreement. Therefore, although export revenue from petroleum has exceeded more than 2 billion ringgit for the past years, Sabah is only getting slightly more than 150 million ringgit. The revenue from petroleum is expected to decrease due to low prices in the petroleum market.

As far as the revenue from copper (minerals export revenue) is concerned, the revenue from it could be very much reduced when the mine is approaching the end of its

operational life. At present, there are already signs that revenue is falling.

Perhaps the only stable source of revenue from natural resource is land rents. But, looking back at Figure 4.1, it is obvious that this form of revenue only accounted for a very small fraction of total revenue. Therefore, the prospects of land rent and premiums becoming a major contributor to the state government revenue will be small given the nature and the limiting factor of the source itself.



**ENDNOTES**

1. Income tax is grouped under the Licences and Fees in Table 4.1.
2. Government of Sabah, State of Sabah: The Second Malaysia Plan, Government Printers, Kota-Kinabalu, 1970, p. 35.
3. Stanley L. Pringle, Development of Sawmilling, Kiln Drying, and Preservation Research in Sabah, A Technical Report to the Government of Malaysia, UNDP/FAO, Sandakan, 1982, p. 7.
4. Government of Sabah, State of Sabah: The Second Malaysia Plan 1970-1975, p. 34.
5. Government of Malaysia, Laws of Malaysia Act 144: Petroleum Development Act 1974, Kuala-Lumpur, 1974, p. 7.
6. Peter Gudgeon, A Commemorative History of Sabah 1881-1981, Kota-Kinabalu, 1981, p. 299.
7. Wade Locke, Economic Issues Related to Taxation of Offshore Oil Projects: Hibernia as a Case Study, Institute of Social and Economic Research, Memorial University of Newfoundland, 1992, p. 18.
8. Alexander Kemp, Petroleum Rent Collection Around the World, The Institute for Research on Public Policy, Halifax, 1987, pp. 91-2.
9. Borneo Mail, July 13, 1990, Kota-Kinabalu, p. 1.
10. ———, August 3, 1991, p. 3.
11. State Government of Sabah, Sabah Action Blueprint: Managing the Transition to Value-Added Economy, Kota-Kinabalu, 1987, p. 12.
12. Ibid, p.12.
13. State Treasury Department (Sabah), Estimates of Revenue and Expenditure, Kota-Kinabalu, 1990, p. 9.

## CHAPTER FIVE

### CONCLUSION

Natural resources, and in particular the forest, have been the mainstay of Sabah's economy, not only as a revenue source for the state government but as a source of employment for the people of Sabah. Sabah still does not have an alternative source of revenue comparable to its natural forests.

However, it is also evident that an immediate drastic reduction in timber extraction is necessary in order to sustain the natural forests. The state government's policy to discourage log exports by raising royalty rates and eventually the banning of round logs is aimed at the conservation of the state's natural forests. The creation of man-made forests was a partial solution to the problem, but the real solution lies in the judicious management of the remaining areas of the natural forests that the state still has.

A reduction in the volume of logs exported will certainly have a serious impact on the state's revenues as royalties from log exports contribute a large portion of the state's total revenues. Deficits and surpluses have occurred during the past few years, but with this strong indication of an upcoming decline in the state's revenue

collection, substantial deficits cannot continue for long without compromising the role of the state government in promoting economic development.

A different prognosis would prevail if the state government had greater access to revenues from off-shore oil. During the Fifth Malaysia Plan, the Federal Government generated about \$26 billion in revenue from petroleum and almost a third of it came from Sabah.

Notwithstanding, much has been accomplished in terms of economic development since Sabah became independent. The people of Sabah are much better off socio-economically than they were before independence. Incomes have increased and better educational opportunities are now available to them. There are also better roads, more hospitals and schools. But if one compares these achievements with those in Peninsular Malaysia, one finds that a great deal still has to be done to attain a measure of equality with the mainland states and to avert the possibility increased dependence on the national government.

Substantial reductions in State's revenues from the forest will clearly set back Sabah's attempts to achieve equality in economic development with mainland states and will increase its dependence on hand-outs from the national government.

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