Article

Industrial Catch up and Look East Policy[1]

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1. Introduction

The Look East Policy was introduced by ex-premier, Dr. Mahathir in 1982. In this short paper, it is attempted to examine the back ground or reasons why the Look East Policy was settled and implemented at that time. It also refers to its possible contribution to the Malaysian economy.

In the early 1980s, Malaysia entered the era of the second stage of the import substituting industrialization after the first stage of the import substituting industrialization in the 1960s and first stage of the export oriented industrialization in the 1970s. Malaysia employed almost the same industrialization policies introduced in the more advanced countries in Asia. Following the success models of the more advanced countries, almost the same industrialization policies were implemented not only in Asia but also in the other regions.

However, just introducing the same policies does not necessarily guarantee that the late comers will enjoy the same industrial success. Especially in the second stage of the import substituting industrialization and thereafter, Malaysia needed a number of disciplined managers, engineers and skilled workers for the further development. Malaysia was looking for the industrial models to follow and tried to learn how to produce necessary human resources from Japan and Korea.

It is quite difficult to evaluate exactly how much the Look East Policy contributed to the industrial growth. In this paper, we will refer to the possible contribution of the Look East Policy both at micro and macro levels. The concept of the organizational capabilities and the total factor productivity (TFP) will be used for this purpose.

It seems that the Look East Policy promoted to attract the foreign direct investment (FDI) inflows from Japan. Even before the rapid appreciation of Japanese yen, which started in 1985, we could find the large amount of FDI in the steel and transportation equipment sectors in the early 1980s. The Look East Policy could have some the contribution to the inflow of FDI from Japan and South Korea.

2. Historical Background

In the late 1970s, *Japan as Number One: Lessons for America* was published by Dr. Ezra F. Vogel. In this book, he described the differences between the Japanese and American large companies, saying that the former was doing much better than the later. Even though he is a sociologist, his views showed us some evidences why Japanese companies became competitive in the world market.

Some American economists had already tried to understand the reasons for the economic miracles of Japanese economy in general and Japanese companies in particular. Dr. James. C. Abegglen, a famous economist pointed out the three major features of Japanese companies in his series of books[3]. They were, life time employment, in-house union and seniority system. Together with other features such as groupism and loyalty to the company, so called Japanese management system was established after the

1 This paper was written based on the presentation in the international seminar, "30 Years Celebration of the Look East Policy: Sustainability and Achievement", 23rd June 2012, organized by University of Malaya.

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3 See, for instance, Abegglen (1958).

World War II. It was built under the some specific economic and social situation in the 1950s and 1960s, therefore it would not be simply applicable to the other countries with different historical, social and economic backgrounds. Notwithstanding, the emerging Japanese management system showed the new management system, which was unique and quite different from the Western style management, could be created outside the Western world.

The Japanese management system and positive involvement by the government contributed to accelerate the economic growth, especially the manufacturing sector until the 1970s in Japan. In the early 1980s, the production amounts of steel and automobiles in Japan surpassed those of USA. These impressive changes saw the shifting economic power from USA or West to Japan or East.

3. Industrialization Policies in Asia

In Asia, most of the countries began to emulate the industrialization policies introduced by more advanced countries. The Asian NIEs (Korea, Taiwan, Hong Kong and Singapore) followed Japan. The ASEAN 4 (Malaysia, Thailand, Indonesia and the Philippines) employed the policies implemented by Asian NIEs. This is the catching up processes observed in this region. The major industrialization policies and their features will be briefly explained in this section.

The first round of the industrial policy employed in Asian developing countries was the import substitution. Under this policy, the government protected the domestic market by the tariffs and quarters. Both local and foreign manufactures supplied their products to the protected domestic market. Due to the limited capital and skilled workers, mainly the light industries such as textiles, clothes and sundries were predominant in this stage.

Since the domestic market was protected, the competition was not very hard and there was almost no incentive for manufactures to improve the productivity or efficiency. Once the domestic market was saturated by the locally produced products by the above-mentioned industries, the growth rate of the manufacturing sector as a whole began to decrease because of the dominant positions of these industries.

The other type of the industrialization policy was called export oriented. The manufacturers exported their products to the world market. In general, labor intensive industries such as textiles had comparative advantages and could export their products. Some industries which had experienced import substitution would step up to be export oriented. Other industries which did not experience import substituting stage could emerge as export oriented industries if multinational corporations (MNCs) set up their subsidiaries in the developing countries. Export oriented industries could enjoy economy of scale and reduce the production costs. Since the market was open to the world, the growth rates of the export oriented industries could be much higher than those of the import substituting industries. However, it was not easy to find and penetrate into the new foreign markets for the local companies in the developing countries. Also, the competition in the world market was very tough and companies in the developing counties must have overcome some obstacles by obtaining export know how and/or developing distribution networks in the foreign markets. In this regard, some government supports would be needed. In Japan, sogo-shosha, a trading company with wide range of business activities, played very important roles and Korea also made use of the same type of companies.

In the Asian region, we could find many export processing zones (EPZs) or free trade zones (FTZs). In the 1960s, both Taiwan and India introduced EPZs, followed by Korea and Malaysia in the 1970s. In China, they were called special economic zones and the first one was established in Shenzhen in 1980. The main roles and purposes of these zones are almost the same. The companies locating inside the zones can enjoy duty free imports and exports. The products which are sold in the domestic markets will be imposed duties. They facilitate the export oriented industrialization by providing special benefits to the companies locating in the zones. They have contributed to attract FDI from developed countries. MNCs set up their subsidiaries and make use of the cheap labor in the host countries. Most of the materials for production would be imported from their home countries and final products would be exported to the foreign markets. These subsidiaries could enjoy incentives, such as tax holidays provided by the host governments, too.

Both import substituting and export oriented industrialization have the first and second stages. Normally, in the first stages, labor intensive or light industries were predominant. In the second stages, heavy and capital or technology intensive industries, such as steel, shipbuilding and automobile will be the major industries.

4. Industrializing Processes in Malaysia[4]

The industrialization policies introduced in Malaysia was almost the same as those found in Korea up to the mid 1980s with time lags. Malaysia employed the first stage of import substitution in the 1960s, similar to the other developing countries in Asia. At that time, rubber processing was the largest industry in the manufacturing sector, then came food and wood industries. By the end of the 1960s, major import substituting industries faced the decreasing growth rates because of the saturation of the domestic market.

In the early 1970s, the government decided to establish FTZs in Malaysia and the first FTZ was built in Penang. By 1975, eight FTZs were developed in the states of Penang, Selangor and Malacca. A lot of MNCs from Japan, USA and Europe invested in the field of electrical and electronics (E&E), especially semiconductors and some in textiles. Large MNCs such as Intel, Motorola and Panasonic in the E&E industry and Toray in the textile industry contributed to the high growth rates of the manufacturing sector and the manufactured exports, respectively. The exports share of the manufactured products in the total exports reached over 20% in 1975, making this sector the second largest exporter next to rubber.

Malaysia stepped up to the second stage of import substitution in the early 1980s, when the Look East Policy was introduced. The industrial bases including supporting industries were not readily prepared to launch the heavy industrialization. Malaysia also faced the shortage of the capital, entrepreneurs and engineers in the private sector. Owing to these obstacles, the government had to play important roles in this stage. The heavy industry corporation of Malaysia (HICOM) was established to set up joint ventures with Japanese companies in the automobile, steel and motorcycle industries and so forth.

In Korea and Taiwan, after the second stage of import substitution, some heavy or technology intensive industries became export oriented to climb up the second stage of the export oriented industrialization in the 1980s. In Malaysia, so far the heavy industries are still domestic market oriented and less competitive in the world market. Those heavy industries in Malaysia could not enjoy scale merit and failed to reduce the production costs. It made it impossible to export their products to the world market. Furthermore, the changing strategies of MNCs had some impacts on the exports from developing countries. They allocated their subsidiaries all over the world and most of the big markets were already occupied by them. It became harder for the companies in the developing countries to enter the foreign markets after the mid 1980s.

5. Catching up Processes by Malaysia

In Asia, Japan has been keeping the top position in economy and it became a member of OECD in 1964. Korea and Taiwan could learn how to industrialize or what kind of policies they should pursue from

4 For more details, please refer to Jomo (2007).

Japan. It is quite natural for the developing countries to follow the way which more advanced countries showed before.

Dr. Gershenkron[5] pointed out that more developed countries are showing the less developed countries the picture of the latter's future. In other word, late comers, namely less developed countries have some advantages toward more developed countries. It is called the advantage of backwardness.

Dr. Akamatsu[6] showed the flying geese model. In Asia, Japan got ahead of the Asian NIEs then came ASEAN 4. It looks like the way the wild geese flying in flocks. Currently, China, Vietnam and India are joining this catching up process.

The flying geese model also showed the direction of FDI in this region. The more developed countries invested into the less developed countries to make use of the different development stages and the factor endowments in each country. For instance, labor cost would be more expensive in the developed countries and labor intensive industries prefer to relocate their factories where they can find cheap labor. Japanese textile industry began to invest in other neighboring countries in the 1970s, when the wage rates soared very rapidly in Japan.

Dr. Kojima[7] examined this kind of FDI by Japanese companies and called it Japanese style FDI or trade promoting FDI. He pointed out that those industries loosing comparative advantages chose to invest where the comparative advantages of the same industries could be found. The Japanese FDI into the labor intensive industries in the developing countries would promote the production and exports from the host developing countries by providing the necessary industry specific capital and production know how to the host country. FDI from developed countries sometimes accelerated the catching up processes.

Malaysia could learn the industrial development processes of Japan and Asian NIEs, mainly Korea and Taiwan to catch up as a late comer. In the early 1980s when the Look East Policy was embarked, Japan had already stepped into the second stage of export oriented industrialization and had been exporting steel, automobiles and ships. Korea had just shifted into the second stage of the export oriented and steel and shipbuilding became more competitive in the world market. Since Malaysia had been chasing these countries, it was natural for Malaysia to follow the same way they had already paved.

6. Necessary Resources to be More Industrialized Country

Under the Look East Policy, it was attempted to emulate the economic success models of the East for the development of Malaysia. Dr. Mahathir was especially impressed by the Japanese management system which included the discipline, loyalty to the companies, groupism, long term perspectives of the management and so forth[8].

In the first stage of the import substitution, namely the import substitution in the light industries, the technologies used for production was not the most advanced ones. The production processes were not complicated and the investments for the machinery were not very large amounts. It was not difficult for the local manufactures to enter into these industries.

Except for the cases of Korea and Taiwan, the first stages of export oriented industrialization were led mostly by MNCs. MNCs established large factories and employed a lot of unskilled workers, most of

5 Gershenkron (1962).

6 Akamatsu (1961).

7 Kojima (1973).

8 Mahathir (1985).

whom were young females. Even in the case of the so called high technology sectors such as semiconductors, MNCs introduced only the labor intensive production processes in the host developing countries. The technology transfer was limited and these factories were controlled by the managers from home countries. Almost all these export oriented subsidiaries were wholly owned by the parent companies in the developed countries and they were under the strong control of the headquarters.

In the second stage of import substitution and for the further development of the manufacturing sector, the necessary resources for the management and production would not be the same as the previous two stages. The investment amounts would be huge to purchase facilities and machinery and they needed a lot of engineers and skilled workers. The companies should be well organized and managed. Thus the entry barrier was very high for the local companies. In Malaysia, private companies were reluctant to take the risks of investing in the heavy industries with long gestation period. Hence, the Malaysian government established HICOM, a public company, to facilitate for the development of the heavy industries. HICOM was encouraged to set up joint ventures with foreign companies, mostly with Japanese companies. The technologies for production were transferred from foreign partners. Many engineers came to Malaysia for the training of the local engineers and skilled workers. Since the production processes were complicated, it took long time for training and transferring the technologies.

Managing the large companies and factories was outstandingly a hard task for the managers. They should learn how to manage and have some experiences to be good managers. The engineers and skilled workers also played very important roles. They should have the latest knowledge on production and learn how to maintain the daily production and related activities. In general, to be successful or competitive in the manufacturing sector, both tangible and intangible assets were important. The former includes the machinery and so on and the latter includes management know how, technology and skills. In the heavy and technology intensive industries, intangible assets tend to be more important.

Organizing and managing large factory in the heavy industry was almost the first experience to Malaysian managers when Malaysia launched the heavy industrialization. It was also true for Malaysian engineers and skilled workers. They needed model cases they should follow. Having joint ventures with Japanese companies gave them the opportunities to learn and make use of the Japanese management and production systems. Scientific knowledge was, of course, very important, however, other organizational or cultural issues had some influences, too. As it was mentioned in section 2, the Japanese management system was in limelight in 1970s and 1980s, under the Look East Policy it was expected to learn the essence of the industrial success in Japan. More attention was paid to the team work or groupism, positive involvement of the workers and work ethics.

Under the Look East Policy, many engineers and workers were sent to Japan to learn Japanese production system. It was a good opportunity for them to learn cultural issues, as well. Many Malaysian students were also sent to Japanese universities to study both natural and social sciences to be the human capital necessary for the further development of the nation.

7. Economic Rationalities

Here we would like to discuss the possible contribution of the Look East Policy both at micro and macro levels. Due to the limited data, we can not measure exactly how much the Look East Policy contributed to enhance the organizational capability and total factor productivity (TFP). Nonetheless, it seems possible to show the way how the Look East Policy contributed to them.

It became more common in the business field that enhancing organizational capability was the edge of competitiveness. Organization is not mere an aggregate of the people. Companies are the typical organization which struggle to survive in the business world. They have to have core competences and enhance capabilities continuously. The human resource is the key issue for the company and the organizational capability can be understood as the synergy of the human resources involving. In this sense, cooperation among the all the members, namely, managers, engineers and workers will be inevitable. If all the members are quite independent and looking for their own benefits and neglect those of the organization, it can not maximize the capability as an organization.

The Japanese management system described in section 2 had many factors which would stimulate to strengthen the organizational capability. The groupism or team work would be one of the important factors to maximize the capability of the organization. If all the employees of the company have the confidence that we are the important members of the company and devoted themselves for the company, the organizational capability will be enlarged. Individualistic behavior or just following the orders from their superiors will not create something new or something useful for the company.

It would help to strengthen the organizational capability to learn Japanese management system and even the cultural issues. Thus those who studied or trained in Japan under the Look East Policy would transfer some factors necessary for this purpose.

At the macro level, growth accounting model will be used to measure the factors contributed to the economic growth. In this model, the factors will be divided into three categories. They are capital, labor and the others or residuals. TFP is measured as the residuals after calculating the contribution of capital and labor to the economic growth. In other word, it is something contributing to the growth but not attributable to the increasing capital and/or labor. TFP might include new technology, advanced management system, skills and so forth. These elements are important for the further development of the manufacturing sector.

The Look East Policy could contribute to increase the TFP at macro level by introducing Japanese management system or new technology through the Malaysians educated and trained in Japan.

8. Contribution to FDI form Japan

In the second stage of the import substitution, the government positively involved to promote the heavy industrialization. The public company, HICOM was established in 1980 and set up joint ventures with Japanese companies. Table 1 shows the Japanese FDI by industry (1981-1985). In 1982, the FDI in the iron/nonferrous metals soared

Table 1 Japanese FDI in Malaysia's Manufacturing Sector (US$ thousands)

Year	1981	1982	1983	1984	1985
Industry					
Food	1,830	218	2,630	-	678
Textiles	2,272	13,199	16,362	-	555
Wood	503	488	1,279	4,383	-
Chemicals	799	8,456	1,646	1,296	3,420
Iron/Nonferrous metals	2,757	26,824	6,422	72,163	9,514
Machinery	442	87	689	699	1,822
Electrical	6,072	8,049	8,253	19,949	2,268
Transport	1,803	765	73,381	5,499	3,587
Others	1,623	1,188	628	10,082	10,943
Total	18,103	59,276	111,293	114,071	32,790

Sources: Ministry of Finance (Japan), *Zaisei Kin-yu Toukei Geppou* (Monthly Statistical Report on Public Finance), Ministry of Finance, Tokyo, various issues.

because of the establishment of the joint venture of HICOM and Japanese steel company. The foundation of national car producer, Proton, a joint venture of HCOM and Mitsubishi brought a large FDI from

Japan in the transport, together with other HICOM projects with three Japanese motorcycle companies, Suzuki, Honda and Yamaha in 1983. Again, the additional investment to joint ventures of HICOM with Japanese companies pushed up the FDI in iron/nonferrous metals in 1984.

Japanese companies were the leading companies in these industries and it was natural for Malaysian side to set up joint ventures with Japanese companies. However, the Look East Policy and friendly attitude to Japan should have some influence on the decision making of the Japanese companies.

After 1985, with the rapid appreciation of Japanese yen, the global strategies for Japanese companies changed drastically. Japanese FDI to Malaysia soared after 1987 with the amount of 147, 796 thousand US$. The years 1988 and 1989 saw the huge increase of FDI from Japan with 346, 202 and 470, 586 thousand US$, respectively. The E&E industry was the major industry which attracted huge amount of Japanese FDI. Many Japanese E&E MNCs built up the export bases in Malaysia. Their subcontractors followed these Japanese MNCs to continue the business with them in Malaysia.

The main reason for the increasing FDI from Japan after 1985 would be attributed to the appreciation of yen. On the other hand, as it was pointed out, friendly attitude to Japan would have the positive effects to their decision making where to invest in Southeast Asia. The neighboring countries of Malaysia, especially Thailand and Indonesia tried to attract more FDI from Japan. The competition among these countries had been very tough. The Look East Policy might have helped Malaysia to attract more FDI from Japan.

9. Concluding Remarks

The Look East Policy is quite unique comparing with other economic policies. In general, the targets and the term of the policies should be fixed. In the case of the Look East Policy, numerical targets were not settled and lasting 30 years. There will be two reasons for the long continuity of the policy, one is that it takes long time to develop the human resources and absorb social and cultural issues, the other is that it is beneficial for both sides to continue good economic relationship.

Because of its uniqueness, it is not easy to evaluate the effects of the policy. In this paper it was attempted to investigate the possible contribution of it by using the concept of the organizational capability and total factor productivity.

Some economists were critical to the Look East Policy and afraid of the economic penetration by Japanese companies when it was introduced[9]. We could observe the over-presence of the Japanese companies in Southeast Asia until the early 1990s. It will be necessary to evaluate rationally both the positive and negative effects of the Look East Policy to the FDI and other business activities of Japanese companies.

The East Asian Miracle published by World Bank revealed some features related to the economic success in Asian countries. Out of several common features of these countries, human resource development was crucial. The Look East Policy is basically the policy to develop human resources. The education and training provided in Japan for people from Malaysia should have the positive effect for this purpose.

For many years, Asian countries have been looking the West. The economic success of Japan after the World War II was the evidence that the Eastern world can be the economic models to the developing countries.

9 See, for instance, Jomo (1985).

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