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Fixing our ailing heavy industries

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CONSISTENT with the "Look East" strategy adopted under the leadership of Prime Minister Datuk Seri Dr Mahathir Mohamad, there was a major push for heavy industries by Malaysia in the early 1980s.

The Government's main objectives, inter alia, were to develop a capital goods sector and establish greater linkages with the domestic economy, especially with Bumiputera enterprises. The key projects that had been implemented over the past 20 years were the national car, motorcycle engines, iron and steel billets, petroleum refining and petro-chemicals, cement and, pulp and paper mills.

While the heavy industries of Malaysia are at a crossroads, they have indeed brought tremendous positive economic implications for the nation. Besides providing over one hundred thousand jobs to the locals, thousands of small and medium enterprises have been developed through the "umbrella" approach to vendor development over the years.

Although the progress of the heavy industries has been at a snail's pace, the fact that it continues improving over the years is worthy of note. The acquisition of Lotus Group by Proton in 1996 resulted in the invention of the CamPro engines in 2002.

Despite the expectation that heavy industries would take long gestation and payback periods, the performances of most projects in Malaysia are privately acknowledged to be disappointing.

Not surprisingly, facing stiff competition on the world markets, these projects require Government tariff and non-tariff protection, without which they would not likely be viable. This is worrisome as the world-trading regime is increasingly open and liberalised, which means Government interventionist policies would have to be gradually lifted.

While it was initially hoped that their strategic foreign partners would transfer technical know-how to the locals over time, the fact that most heavy industries continue depending substantially on imported materials and components, particularly from Japan, suggests that the heavy industries have been less successful in engineering positive spill-over from their foreign partners.

As a result, Malaysia today remains exposed to the vulnerability of volatile exchange rates between the ringgit and Japanese yen.

The scandal-ridden Perwaja Steel in Malaysia has been the biggest heavy industrial failure for the nation.

Probably caused by mismanagement and financial irregularities, it has not only failed to make profit since its establishment in 1982, but also incurred about RM10 billion in losses and liabilities.

Understandably, the Perwaja saga has raised doubts among Malaysians at large about the feasibility of developing heavy industries in Malaysia. This is within reason, as many have also had to pay for the inefficiency of the local heavy industries.

Despite all these, the debate should not have been on whether or not to develop such industries, but rather been on which heavy industries to develop and how.

Some of the Government-dominated heavy industries have been experiencing improvements in both financial performance and productivity growth over the years, and this has reinforced the belief that heavy industries are indeed viable in Malaysia.

As the performances of these projects have been quite varied, it is

imperative that the Government strategically and tactically repositions and restructures the whole industry now.

It is vitally important to divide these projects into two categories, namely Type One and Type Two.

The former are projects which have not performed well since their establishment but have the potential to turn around in the fore-seeable future, while Type Two are projects which have been consistently showing improvement over the years.

Those that are not in either one of these two categories ought to be liquidated in due course.

For Type One projects, it is suggested that the Government either scale them down or get foreign companies to take up a controlling stake in them. Although this might be seen as a blow to the national pride, it is better than forgoing all the positive spill-over effects.

For Type Two projects, it would be a shot in the arm if the Government could either strategically pool their resources together or help them acquire foreign technological know-how.

Alternatively, for those in Type Two that are considered less strategic to the nation, the Government may consider allowing foreign companies to take up a controlling stake in the projects as well.

The Government ought to also look for other kinds of heavy industries that could synergistically spur the national heavy industrialisation programme.

Ironically, the semiconductor industry, which contributed about 30 per cent of the total manufactured exports in Malaysia over the past 20 years, has been treated seriously by the Government only since the mid-90s.

Considering its fast-growing exports from RM2.3 billion in 1980 to RM11.7 billion in 1990, and RM71.1 billion in 2000, the Government should have realised much earlier that semiconductor could be potentially developed as a key heavy industry in Malaysia.

And in order to develop an integrated semiconductor industry, the production should not be concentrated only on assembly and testing (downstream integration), but also research and development (R&D) and wafer fabrication (upstream integration).

As seen in other world-leading semiconductor countries in the region, namely South Korea, Taiwan and Singapore, Government intervention has indeed been crucial in the early development stage of the industry.

To date, the Malaysian Government has spent nearly RM1 billion on Mysem, the national semiconductor project undertaken by the Malaysian Institute for Microelectronic Systems (Mimos), but it has yet to show any remarkable commercial success.

While the Fab 2 of Mysem has just started producing microprocessor chips indigenous to Malaysia, namely Pesona, since the end of last year, it is unlikely that it can be successfully competing head-on with other producers on the world markets without any Government policy instruments.

In view of rapid changes in the global scene, another area that needs to be urgently looked at is the development approach presently adopted in Malaysia.

While Malaysia's approach is best described to be following South Korea's Large Firm International Model under the "Look East" strategy adopted since the early 80s, maybe it is time to also consider following Taiwan's SME-Public Research Institute (PRI) Model in developing heavy industries.

As seen in the 1997 Asian financial crisis, Taiwan's heavy industries were hit the least in the region. Under this model, the entry of public sector enterprises (PSEs) to heavy industries would be rather sporadic and Government would no longer create private conglomerates to internalise

markets and drive heavy industrialisation programmes.

Government support would be strictly but intensively provided for PSEs to upgrade their R&D and enhance the technological capability of SMEs.

With the organisational input of trade associations and Government financial assistance, all heavy industries would be initiated via strategic partnering such as collaborative R&D ventures and alliances between SMEs and PSEs.

Obviously, the increasingly open world trading regime would prise open the Malaysian market sooner or later. This does not mean that Malaysians would have to bow out of its less competitive heavy industries.

As seen in other latecomers, particularly the newly industrialising economies, their Governments had also adopted interventionist policy approach in the early development stage of their heavy industries.

In the case of Malaysia, what matters is that the Government should create a sense of urgency among the PSEs involved to speed up the development process of the heavy industries.