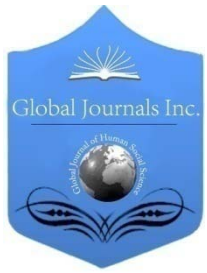
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Malaysia NAP: More Shadows than Lights

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Introduction- After World War II, and in particular during the 1960s and the 1970s, many developing countries began their industrial revolution path. In particular, most of them followed a path of government-led industrial development, with central planning at the heart of the industrial policy. Such a model is not new in economic history and it is typical of many 'second-comers' in the industrialization process. The most famous one is the case of Prussia/Germany: with the Zollverein (1833-34) and after the unification in 1870, it was the government which stimulated the development of a powerful heavy industrial system, following what was preached at the time by Friedrich List. In particular, the key point of List preaching was that second-comers countries need to protect their industrialization process (characterized by infant industries) from foreign competition. According to List, once the protected industries reach an adequate competitive level, protection should be removed and the national companies should face competition in the market, in order to stimulate further technological development. Many second-comers countries embraced this model; however, in most cases they failed to follow the second part of List's recommendations: opening to the market in a second stage.

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Malaysia NAP: More Shadows than Lights

Carmelo Ferlito

I. Introduction

After World War II, and in particular during the 1960s and the 1970s, many developing countries began their industrial revolution path. In particular, most of them followed a path of government-led industrial development, with central planning at the heart of the industrial policy. Such a model is not new in economic history and it is typical of many 'second-comers' in the industrialization process. The most famous one is the case of Prussia/Germany: with the Zollverein (1833-34) and after the unification in 1870, it was the government which stimulated the development of a powerful heavy industrial system, following what was preached at the time by Friedrich List[1]. In particular, the key point of List preaching was that second-comers countries need to protect their industrialization process (characterized by infant industries) from foreign competition. According to List, once the protected industries reach an adequate competitive level, protection should be removed and the national companies should face competition in the market, in order to stimulate further technological development. Many second-comers countries embraced this model[2]; however, in most cases they failed to follow the second part of List's recommendations: opening to the market in a second stage.

Malaysia is for sure among the countries which used a massive political protection in order to develop national industries, in particular the automotive industry. Malaysian case is quite unique: instead of limiting the action in attracting foreign producers, government, under the leadership of Dr Mahathir, established a national brand through specific automotive policies: NCP and NAP. However, as we shall see, the results of such policies are contradictory.

In section II. we will briefly draw a historical sketch about the evolution of the Malaysian automotive policy. In section III. the NAP 2014 will be presented. Section IV. is devoted to explain, from a free market perspective, why tariffs and protection can be dangerous for a national economy. Finally, section V. will explain how NAP failure was predictable; if the modest result of Proton development is widely recognized, many studies failed to point out the right reason behind such failure: government central planning. Therefore, the future role for government intervention in industrial development will be analysed. Section VI. will try to show a possible way out for the government role and the Malaysian car industry.

II. NCP and NAP: A Brief Historical Sketch

Malaysia is one of the developing countries which, in the past decades, developed a defensive policy in order to give birth to a local automotive industry. It was in particular during the 1960s and the 1970s that many developing countries established automotive assembly industries in the realm of the so-called import-substituting industrialization (ISI) programmes[3]; with such programmes, they aimed to attract foreign direct investment and to protect the emergence of local industries[4]. Automotive was and is one of the favourite industries in which such protective schemes were implemented and the legacy of such protective policies still affects the industry[5]. In fact, before the mid-1960s Malaysia policy was characterized by a certain free market orientation and a regular plan to support local industries was implemented only after pressures from the World Bank in 1963[6].

As other countries, Malaysia developed such policy through LCRs (local content regulations) and tariff protection. But, as noted in Natsuda and Thoburn (2014, p. 1353), the case for protectionist policies was not limited to economic motivations. On the contrary, «a key background was the policy designed to give ethnic Malaysia and other 'indigenous' people (collectively known as *bumiputera*) affirmative action preferences in relation to Malaysian ethnic Chinese and Indians and in relation to foreigners».

Even if the political party known as UMNO (United Malays National Organization) has ruled Malaysia since independence in 1957, a key political moment in Malaysia history was represented by the race riots in 1969, risen after ethnic Chinese parties experienced an exploit[7], winning more seats than expected[8]. In particular, the political situation brought

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[1] See List [1841] (1909).
[2] See in particular Gerschrenkon (1962).
[3] For a detailed description of Malaysian ISI policies see Rasiah (2011), pp. 150-156. See also Danaraj (2011), p. 399.
[4] Natsuda, Segawa and Thoburn (2013), p. 113.
[5] Segawa, Natsuda and Thoburn (2014), p. 423.
[6] Rasiah (2011), p. 152.
[7] Natsuda and Thoburn (2014), p. 1355.
[8] Lim (2011), p. 12.

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out the trade-off between the politically powerful Malays majority and the economic power in Chinese hands[9]. It is after these riots that the New Economic Policy started to be implemented, aiming to reduce economical inter-ethnical disparities and in particular aiming to grow the economic position of *bumiputra*[10]. Main sight of the NEP was to achieve national unity eradicating poverty and increasing employment[11], and government had immediately clear that to do so meant to support the Malay population.

> The New Economic Policy initiated in 1970 following the riots was designed explicitly to redress the economic balance in favour of *bumiputra*; in the 1980s it became the driving force of the country's national car policy under its aggressively nationalist and longest-serving fourth Prime Minister, Dr Mahathir Mohamed (1981-2003)[12].

Regarding the specific situation of the automotive industry, the New Economic Policy came after a series of protection schemes was already introduced in order to develop a national car industry: the import licence scheme (1966) and the Manufacturing License (1967)[13]. Thanks to such protection, from 1970 to the early 1980s, the total production of vehicles grew from 28,000 to 100,000 units[14].

The protection policy became more aggressive during the 1980s, when the regulation on the so-called local contents were introduced, together with a stronger intervention in order to enhance *bumiputra* participation in heavy industries[15]. It is in the 1980s, in fact, that the Fourth Malaysia Plan (1981-1985) focused on the process of heavy industrialization[16]. The establishment of Proton was decided with the First Industrial Master Plan (1986-1995)[17]. With regard to car industry protection, foreign producers were required to manufacture specific components locally, rather than importing them; at the same time protection via tariff and investment incentives was raised in order to protect local component producers[18]. In 1982, in example, tariffs on CBU PVs were 90 to 200 per cent[19].

Table 1 : Tariffs on CBU PVs (%)

	Before 1997, Oct	1997 Oct	2004 Jan	2005 Jan	2005 Oct	2006 Mar	2010 Jun
Non-Asean/ Less than 1,800cc	140	140	80	50	30	30	30
Non-Asean / 1,800cc – 1,999cc	170	170	100	50	30	30	30
Non-Asean / 2,000cc – 2,499cc	170	200	120	50	30	30	30
Non-Asean / 2,500cc – 2,999cc	200	250	160	50	30	30	30
Non-Asean / Over 3,000cc	200	300	200	50	30	30	30
Asean / Less than 1,800cc	-	-	70	20	15	5	0
Asean / 1,800cc – 1,999cc	-	-	90	20	15	5	0
Asean / 2,000cc – 2,499cc	-	-	110	20	15	5	0
Asean / 2,500cc – 2,999cc	-	-	150	20	15	5	0
Asean / Over 3,000cc	-	-	190	20	15	5	0

Source: Segawa, Natsuda and Thoburn (2014), p. 426.

Through such policy, the local content in the automotive industry increased from 8% in 1979 to 18% in 1982 and 30% in 1986[20]. Finally, in 1991 the Malaysian government introduced the *local Material Content Policy*, aiming to reach 60% of local content for PVs of less than 1850cc and 45% for PVs of 1851-2850cc by 1996[21].

However, what distinguishes Malaysia among the developing countries is the attempt not simply to grow as manufacturing hub for foreign producers; rather, under Mahathir direction, during the 1980s, Malaysia implemented a big effort to develop a national car manufacturer through the so-called National Car Project (NCP), introduced in 1982[22]. Prime Minister 'dream' was to see Malaysian driving cars they had built themselves[23]; in a way, Mahathir was right in arguing that local manufacturing is a necessary step for a country which wishes to develop; being able to import foreign product or assembly them would not be enough[24].

> In late October 1982, Mahathir Mohamad, the fourth Prime Minister of Malaysia, announced that Proton would be established to produce the first national car, which would be named the Saga. This National Car Project aimed to accelerate Malaysia's heavy industrialization and the development of supporting industries. The project was also expected to strengthen the economic position of the *bumiputeras* and secure their participation in supporting industries[25].

[9] Lim (2011), p. 12.
[10] Natsuda, Segawa and Thoburn (2013), p. 114.
[11] Lim (2011), p. 12.
[12] Natsuda and Thoburn (2014), p. 1355.
[13] Natsuda and Thoburn (2014), p. 1355.
[14] Natsuda, Segawa and Thoburn (2013), p. 120.
[15] Natsuda, Segawa and Thoburn (2013), p. 120.
[16] Lim (2011), p. 19.
[17] Danaraj (2011), p. 400.
[18] Natsuda and Thoburn (2014), p. 1356.
[19] Segawa, Natsuda and Thoburn (2014), p. 425.
[20] Natsuda and Thoburn (2014), p. 1356.
[21] Natsuda and Thoburn (2014), p. 1356.
[22] Natsuda, Segawa and Thoburn (2013), p. 120.
[23] Mahathir (2011), p. 510.
[24] Mahathir (2011), p. 512.
[25] Segawa, Natsuda and Thoburn (2014), p. 424.

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Therefore, the sight of the project was twofold: creating a car producer and, at the same time, «enhancing *bumiputera* participation in heavy industries»[26]. Proton was born in 1983 and Malaysian government invested RM 480 million to establish the first factory[27]; however, the company was not able to reach a profit until 1989[28]. Perodua, the second Malaysian car producer, launched its first manufacturing plant in 1994[29]; while the first remains a national flagship, with capital majority in local hands, the policy for Perodua was less aggressive and nowadays the control is still in Japanese hands[30]. Thanks to such protection, Proton and Perodua dominate the Malaysian automotive market.

The creation of Proton via NCP became one of the strongest areas of government intervention in Malaysia. In fact, the national automotive industry was, and is, not only protected by tariffs and the system of local content, but also heavily subsidised: only between 1986 and 1994, the Ministry of International Trade and Industry of Malaysia spent RM 22 million to support the *bumiputera* participation in companies producing high-technology components[31]. *Bumiputera* protection was implemented in particular through the Vendor Development Program: under this scheme, Proton had to buy several components from small and medium enterprises[32] in which more than 70% of equity was held by *bumiputera* and in which more than 55% of total employees were *bumiputera*[33].

In the following years, Proton and the NCP suffered several problems due to:

- difficult relationships with the technological partner, Mitsubishi, which ended in a divorce;
- the acquisition of Lotus with the consequent financial troubles;
- the free-trade agreements signed in the WTO and South East Asia cooperation realms.

In fact, starting in the 2000s, the automotive industry changed. The concentration process made the big players more important. Therefore many developing countries focused in attracting such big players into their territory and in becoming regional hubs for their production and export[34]. But Malaysia preferred since the beginning the ambitious project to develop its own national brand[35].The most evident sign of the troubles suffered by Proton is the fact that in 2005 it was overcome by Perodua in terms of number of cars sold[36]. Even the privatization attempted in the 1990s did not succeed and government had to purchase back 27.2% of the company from DRB-HICOM though Petronas in 2000[37].

Regarding, instead, the obligations imposed by the WTO, Malaysia tried to gain time, moving forward the terms for removing tariffs[38], and, above all, replacing a policy of direct intervention with new and more hidden means of protection.

> Although all the tariffs on CBU and CKD vehicles were reduced, the government introduced a new excise duty system to compensate for the revenue losses from the reduction of tariffs in 2004. Furthermore, in March 2006, the Malaysian government introduced the National Automotive Policy (NAP), which linked refunds of the excise duty to the level of local content ratio, enabling the Malaysian government to protect local national car producers that, in general, used locally made components of lower cost and quality than imported ones[39].

The replacement of the NCP with the NAP became necessary with the aim to restructure a suffering industry. Government looked at the possibility to facilitate integration of Proton into the global automotive GVC (2006) and started to emphasize the possibility to develop an environment-friendly strategy (2009)[40]. However, Malaysian government did not miss the occasion to introduce hidden forms of protection through the Industrial Linkage Programme (ILP) and the Industrial Adjustment Fund (IAF)[41], still linked with the LC system[42]. Favourable treatment was introduced for national car assembly, together with other non-tariff barriers like import quotas[43]. In this way, Malaysia was able to avoid to violate WTO rules and in the same time to implement a system of advantages for the national automotive industry. Moreover, the AP system (1966) and the ML system (1967), which are not in line with WTO prescriptions, were never abolished[44]. At the same time, NAP 2006 and NAP 2009 found new ways to support and promote local vendors, a policy that WTO is strongly asking to withdraw[45]. Malaysian government, however, intends to continue its support to Proton and the *bumiputera* support policy remains a central and hot topic of the political agenda also regarding automotive and, in general, industrial development policies.

[26] Natsuda and Thoburn (2014), p. 1356.
[27] Natsuda, Segawa and Thoburn (2013), p. 120.
[28] Natsuda, Segawa and Thoburn (2013), p. 120.
[29] Mahathir (2011), p. 521.
[30] Segawa, Natsuda and Thoburn (2014), p. 424.
[31] Natsuda and Thoburn (2014), p. 1356 and Natsuda, Segawa and Thoburn (2013), p. 120.
[32] It means with shareholders' funds below RM 2.5 million. Segawa, Natsuda and Thoburn (2014), p. 429.
[33] Segawa, Natsuda and Thoburn (2014), p. 429.
[34] Natsuda, Segawa and Thoburn (2013), p. 113.
[35] Natsuda, Segawa and Thoburn (2013), p. 114.
[36] Natsuda, Segawa and Thoburn (2013), p. 114.
[37] K.S. and Tan (2011), p. 353.
[38] LC requirements and the mandatory deletion programme were abolished in January 2004. Natsuda, Segawa and Thoburn (2013), p. 124.
[39] Natsuda and Thoburn (2014), p. 1360.
[40] Natsuda, Segawa and Thoburn (2013), p. 125.
[41] Natsuda and Thoburn (2014), p. 1360.
[42] Natsuda, Segawa and Thoburn (2013), p. 126.
[43] Natsuda, Segawa and Thoburn (2013), p. 122 and 125.
[44] Natsuda and Thoburn (2014), p. 1360.
[45] Segawa, Natsuda and Thoburn (2014), p. 432.

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> Politics has also been an important part of the affirmative action story. On the one hand, the *bumiputera* policy has aimed to achieve sustainable social stability by addressing Malay grievances. On the other hand, the continuation of the policy has been deeply involved in the maintenance of the ruling Barisan Nasional's political power in the country and the legitimacy of its leading party, the United Malays National Organisation (UMNO) as a Malay party. The cessation of the Malay preferential policies will not happen without strong political determination on the part of the government […]. It is difficult to imagine that the BN government – returned to power in the May 2013 election – will abolish the *bumiputera* policy in the foreseeable future […]. In this sense Proton has become an albatross around the necks of Dr Mahathir's successors, who have had to deal with Proton's weaknesses while at the same time retaining their legitimacy within UMNO. Furthermore, MITI insists that Malay special rights are guaranteed in the Constitution, and that the WTO and other organisations do not understand the backwardness of the Malays and their need for preferential policies[46].

However, even with such a massive protection and with heavy government investments, we can say that the Malaysian car industry is not bringing out the expected result. If it is true that Proton and Perodua were producing 57.2% of the Malaysian car output in 2010, in 2012 Malaysia was still a net importer of vehicles[47]. Countries like Thailand, instead, focused in becoming a hub for international producer such as Toyota and results are satisfactory; Malaysian policy aiming to develop a national car brand didn't produce the same good results: Thailand attracted, in the period 2005-2010, 20 times more FDI than Malaysia[48].

Bad performances reflected in general on the industry. Due to the protection of the LC requirements, local suppliers of parts, mainly serving Proton, still do not meet international standards[49]. In particular, Malay preferential policies have in a way impeded further steps toward higher value-added activities[50].

In general, automotive protection failed to stimulate (or even blocked) technological development and failed to meet market demand. As we shall see later, such as a result was to be expected.

III. NAP 2014: A Summary

NAP 2014 does not appear as a radical revolution compared with what was implemented under NAP 2006 and its 2009 review. The most important news appear to be the focus on «green initiatives, development of technology and human capital […] and enhancement of the automotive industry ecosystem»[51]. With NAP 2014 government focus is shifting from the development and defence of the local car manufacturing toward the possibility for Malaysia to become «regional hub in Energy Efficient Vehicle (EEV)»[52].

With NAP 2014, then, government plans to spend more in technological and environmental-oriented policies. However, it seems that the way to support such initiatives is not new: MLs for EEV category and customized incentives[53]. Moreover, it is the government in itself that assumes the burden to provide relevant infrastructure[54]. All the future action is planned to be sustained with favourable loans and tax support.

The most interesting part, however, is the support for developing human capital, in order to enhance local technological growth. Still, it will be the government taking care of the training programs necessary to enhance technicians quality.

Moreover, government plans to spend RM 75 million to further support the growth of *bumiputera* presence in the automotive industry[55]. What looks really impressive is the claim that the «NAP 2014 will include measures to create globally competitive Bumiputera entrepreneurs»[56].

The last sentence confirms us in the belief that nothing is radically changing with NAP 2014. We can see a shift in the focus from the manufacturing side to the environment and technological perspectives. However, everything strongly remains linked with the big and visible hand of government action. No opening to the market is appearing. Market expectations are supposed to be known by the central planner: government assumes, in example, that a Malaysian hub for EEV is what the Asian automotive market actually needs and asks for. Government is assuming that specialized technicians are what the labour market actually wants. The pretence of knowledge is high. Even, government is aiming to create competitive entrepreneurs. But is government mission to create entrepreneurs? And can actually and practically a centrally planned action develop entrepreneurship in a country? The next two sections will deal with the effects of a government-led development and the impossibility for it to bring out satisfactory results.

IV. What did go Wrong? Economic Arguments Against Government Industrial Protection

The usual motivation behind the choice to protect the birth and development of a new industry in every country is quite straightforward: the new industry is strategic for the country development; the new industry could bring out new employment; being not yet adequately developed, it would need protection against external competition. Protection is thus presented as the necessary step in order to protect an industry who could develop the country and create new jobs. And in such a

[46] Segawa, Natsuda and Thoburn (2014), pp. 436-437.
[47] Natsuda and Thoburn (2014), p. 1362.
[48] Natsuda and Thoburn (2014), p. 1364.
[49] Natsuda and Thoburn (2014), p. 1364.
[50] Segawa, Natsuda and Thoburn (2014), p. 425.
[51] MITI (2014), point 4.
[52] MITI (2014), point 5.ii.
[53] MITI (2014), point 24.
[54] MITI (2014), point 27.iv.
[55] MITI (2014), point 49.ii.
[56] MITI (2014), point 48.

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context, setting up «a motor industry is often seen as a crucial stage in industrialisation»[57].

Let us have a deeper look into such straightforward argument with a practical example. Suppose[58] that the average cost to import a foreign vehicle on the Malaysian market is 100. If an emergent industry requires tariffs, it means that, at the present status of the industry technology in that country, it would not be possible to produce vehicles at a competitive price. In our example, if Malaysian automotive industry requires to be protected, it means that, given its technology and productivity, it is not able to produce cars spending less than 100. Therefore, in order to allow automotive industry to come into existence, Government will be forced to make imported vehicles more expensive. Suppose that production cost for Malaysian cars is 120. In order to make Malaysian cars attractive, government should impose a duty able to: cover the Malaysian production cost, allow a profit for the producer and cut off the feeling that foreign cars are better and therefore it is worth to pay more money for them. A duty of 30 on foreign cars would not be enough in order to cover the three points. Most likely an adequate duty should be 80[59]. At the given technology and productivity of Malaysian automotive industry, situation can be summarized as follows:

1. In case of free market (free of duties):
   a. Malaysians could have foreign cars at 100.
   b. Malaysian automotive industry would not arise unless a better technology and productivity would emerge.
   c. Improvement of technology and productivity would be stimulated, in order to force the country to compete with foreign products.
2. In case of import duties:
   a. Malaysian could have foreign cars at 180.
   b. Malaysian could have local cars at 140 (production cost plus profit).
   c. Technology and productivity would have no incentive to be improved, given the fact that local cars are more convenient in price. Indeed, as argued in Natsuda and Thoburn (2014, pp. 1358-1359), «Proton suffered from weak product development and marketing capacity»[60].

[57] Segawa, Natsuda and Thoburn (2014), p. 422.

[58] The example is modelled on Hazlitt [1946] (2012), pp. 58-59.

[59] The estimation in our example is not exaggerate. In fact, as reported in in Natsuda, Segawa and Thoburn (2013, p. 121), the «effective rate of protection (that is, protection on value-added) for the Malaysian transport and equipment sector as a whole was 252% in 1987, a very high figure, which probably had been reduced to about 140% for the least protected vehicles by 2011».

[60] See also Natsuda, Segawa and Thoburn (2013), p. 114.

The simple example easily demonstrates how tariffs create, at a first glance, two direct bad effects: 1. stop incentives for technological development and 2. increase price of products. Point 1. is easy to understand and does not need to be stressed. However, it would be interesting to reflect on the consequences of point 2. Even if, with tariffs, local cars would be cheaper than the imported ones, they are still more expensive than foreign vehicles in case of free market. What it is not always observed is that, *de facto*, introducing tariffs means to shift on people money the cost of industrial development. In fact, after tariffs, citizens would be forced to finance the cost of bringing the new industry into existence (40% in our example).

Bad consequences are then spread on other industries. In fact, people will have to pay now 140 for what was paid before just 100. Indeed, we can say that citizens are financing the emergent industry. But this means also that if before people could spend 100 for cars and 40 for other products, now they would have to spend 140 only for vehicles, being forced to cut their expenditures in other industries. Imposed tariffs therefore force people to cut their consumption: real incomes shrink not only because of the highest prices of cars, but also because the minor expenses devoted to other industries will force such industries to eventually cut their labour force.

Everybody seems to be happy in watching a new industry arise and new jobs created. This fact is pretty evident. But such evidence hides the bad consequences of tariffs: increased prices, less money available for different consumptions (diminished real wages), unemployment spreading in other industries because of the shift in relative prices.

Therefore, the relationship between industrial protection and employment is a fallacious one, as fallacious seemed, in the past, all the policies aiming to support employment[61]. Stimulating emergent industries means to modify the structure of relative prices, and as a result, many entrepreneurs will modify their production strategies. This change in production strategies will result in a change in the composition of the demand for capital goods of those entrepreneurs, and will also reduce the aggregate amount of money devoted to buying lower-order goods in the market. Therefore many entrepreneurs will stop buying goods from their usual suppliers. As a result, these suppliers will lose part of their markets and many will be forced to lay off workers or event to cease business[62].

This means that the change in the structure of relative prices, set in motion by support for national industries, triggers a disinvestment process that, weakening the consumption goods sector, generates unemployment.

[61] Ferlito (2013), chapter 3.

[62] See Ferlito (2013), p. 99 and Sanz Bas (2011), p. 298.

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Moreover, it has to be argued that, introducing to people products at a price higher than the market one, central national industrial protection enhances an inflationary dynamics. Short term injections of money (industrial support) may well help to maintain jobs at a higher level than would be possible otherwise; nonetheless, in the long term, the employment level resulting from these policies is destined to fall.

While it is true that an increase in monetary incomes may increase employment, the basic mistake is to believe that implementing industrial government support may automatically generate employment. If spending is spread across the various sectors in a manner other than that in which employment is spread in the same sectors, then it cannot be assumed that an increase in spending has a positive effect on employment.

The main outcome of inflationary forces and planning is to create a distortion in the system of resource allocation. A readjustment process is only possible where the free interaction of individuals allows the creation of information (discovery process) needed to catch mistakes and take a different path.

When government support comes to an end, probably because inflation has reached an unsustainable level, demand will be forced to return in the direction expressed by the temporal preferences in existence prior to central intervention; inasmuch, employment created artificially in all probability will not be permanent. The new unemployment level may even be higher than the pre-stimulus situation, if monetary injections (subsidies and tariffs) have not only increased employment but have also stimulated the creation of new economic initiatives in the sectors so stimulated.

There are other aspects to be mentioned as negative for the national economy. First of all, the cost for industrial protection. With the aim of developing 'national interest' governments are able to make the people to digest the burden for the protectionist policies. In fact, as we already have seen, the prospective of higher employment and national income (GDP) is the political argument to support every national industry, hiding the fact that the people will be burdened with higher prices products.

> Discussions on matters of economic growth have become a favourite pastime of our age. Among newspaper readers and television viewers all over the world, even among some economists, the notion that in this great age of ours it has become possible to sum up in one single figure the result of the economic activity of groups of individuals in countries, regions, or industries, appears to be accepted as a self-evident truth. Such figures are then used as a measure for comparisons over time and, with gusto, between countries. In many circles a low rate of growth of the gross national product has come to be regarded as a symptom of a social malaise[63].

In the above passage, Lachmann anticipated the present day critics toward GDP as a reliable instrument for measuring economic performances in a country and among countries[64]. However, the central point is «how it would have to be reached», while the «pattern of action required for the 'path' that leads towards it, is in general neglected»[65]. What Lachmann (1973, p. 39) says can be interpreted in this way: neglecting how employment and GDP are generated means to hide the social cost created by implemented policies. Which is their cost? Who will pay for that?

Such critics reveals a contradictory aspect of government plan for national industries defence: the micro foundations hidden behind the supposed macroeconomic development. Malaysian government heavily subsidised Proton, spending billions of RM. What people fail to realize is that the burden of those subsidies is directly shifted on *rakyat* shoulders. This happens in a double way: first through taxation. Money for subsidies has to come from somewhere and a higher taxation is the price that people pay (often praising at the same time the nationalistic economic policies because of their ideological appeal). Second, government can finance its development projects through further debt. This means a heavier fiscal burden for future generations[66]. It is enough to mention that Malaysian government spent RM 700 million for supporting the automotive industry in 2011 and RM 5 billion in 2012. In the first ten months of 2013 the amount reached RM 3 billion[67]. Who is paying for this? It seems people fails to see that the burden of such heavy investment is on their shoulder (if paid through taxes) or on the shoulder of future generations (if investments are financed by debt).

In such a situation[68], the government, issuing additional debt, increases the demand for loanable funds, making the interest rate to rise. This fact brings out two consequences: on one hand, the supply of loanable funds rises; on the other hand, we see a reduction in the demand for investment from private sector. But less investment means more consumption. This means that «with a reduced rate of investment, the economy grows at a slower rate, impinging negatively on the consumable output available in the future. To this extent, the debt burden is shifted forward»[69], to the future generations.

A larger deficit means lower taxes today on all taxpayers, shifting «some of the burden of current government spending onto future voters who are inadequately represented in today's borrowing decisions». This means that, in such a way, a higher level of government spending becomes politically

[63] Lachmann (1973), p. 36.

[64] Ferlito (2015), p. 18.
[65] Lachmann (1973), p. 39.
[66] Ferlito (2012b), pp. 111-113.
[67] MITI (2014), point 8.
[68] See Garrison (2001, p. 85).
[69] Garrison (2001), p. 87.

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palatable[70]. Furthermore, as we can learn from the European crisis, borrowing can become an endless business, in particular if the debt is bought by Central Bank, that, monetizing it, creates distortions[71].

Commenting the enormous American deficit, Garrison comes back on this topic, stressing that, at that level of borrowing, the effect of deficit will be:

- higher interest rates (if the government borrows domestically);
- increased inflation (if the Federal Reserve monetizes the debt);
- weakened export markets (if the government sells debt abroad);
- tax hikes […]; or
- all the above in some combination[72].

It doesn't matter where the resources for financing deficit come from. The situation is always negative. First of all, the government can borrow domestically[73]. In this case, Garrison (2001, p. 113) argues that, if individuals lend money to the government, then their saving is not available for private investment. Thus, demand for loanale funds that comes from government wins the competition against the firms.

The second possible situation is that the government borrows from the central bank. This is the classical example for money creation. The typical result is that the «increased borrowing and spending put upward pressure on prices and wages», generating an inflationary process; the following adjustment brings out «inequities, perversities, and inefficiencies»[74].

The last possibility is that government borrows in world capital markets, from foreign savers and foreign central banks. This situation brings out a negative effect in real economy: deficit in international trade. In fact, ordinarily two countries exchange goods for goods. But, in this case foreign investors trade goods for Treasury bills, so the national industries are seriously damaged by such a politics[75].

The final and most important result of a protection policy is on the structure of production. In fact, through government intervention, the productive structure is not defined by economic actors preferences, tastes and expectations. On the contrary, it is defined by government priorities and, in the best case, by what government assumes to be the good for the country. However, good intentions not necessarily meet reality. How can government implement and industrial plan which could actually meet market/consumer expectations? How can do this in the global market realm? Government, of course, lacks the necessary information content for a successful action and this is why its industrial effort is often frustrated. This problem will be analysed in detail in the next paragraph.

V. Automotive Government Protection: A Failure to be Expected

As we have seen, government protection worked as a break for technological development[76]. Not only, government action also failed to supply what desired by consumers in the market[77]. As we shall argue soon, the result is not surprising and it had to be expected. Before starting such analysis, however, it is necessary to stress that NCP and NAP not simply failed to create a competitive Malaysian car brand, but they, together with the NEP in general, also missed their second target: to implement the *bumiputera* entrepreneurial action in the realm of Malaysian industrial development. Such a failure is recognized, first and for all, by former Prime Minister Mahathir, who was a stronger supporter of the NEP. In recent interviews[78], Dr M admitted that he tried, for 22 years, to change Malays mentality, but the result was a failure. Mahathir's conclusion is that Malays are lazy and the NEP furtherly increased such laziness. Dr M's delusion regarding the failure of the NEP towards *bumiputera* is clearly stated in his latest book.

> The Government provides them [the Malays] all kinds of support to help them acquire knowledge and skills. Unfortunately, they have developed a dependency on this support and demand that it be made permanent. What is the good of becoming an independent nation if internally as individuals and as a community we are always dependent on others?
>
> […]
>
> I have discussed the New Economic Policy at length in these pages and how it has contributed much towards overcoming the gross economic disparities and social disadvantages between the races in Malaysia. But affirmative action cannot go on forever. I had hoped that much of the disparity would disappear through education, which is why we endured criticism of discrimination in the award of scholarships. But it is now nearly 40 years since the NEP was first implemented and we still have not achieved our target of making the Malays own 30 per cent of the country's corporate wealth. The Government's provision of enhanced access to university education to Malays has seen a similar wasting of opportunities. To ask the non-Bumiputera to stand aside and wait while so many of the Bumiputera are happy to play around and not study is unfair.
>
> […]
>
> Perhaps many Malay men like things that way, to be economically dependent upon and supported by their wives while they laze around in coffee shops or indulge in motorcycle stunts. […] then they should not deny the right of others. Their attitude makes me worry about the Malay future[79].

«Where, I wonder, have we gone wrong?»[80] is the laconic conclusion of Dr M, who adds: «What more

[70] White & Garrison (1999), p. 8.
[71] White & Garrison (1999), p. 8.
[72] Garrison (2003), pp. 3-4.
[73] Garrison (2001), pp. 113-114.
[74] Garrison (2001), p. 114.
[75] Garrison (2001), p. 115.
[76] Natsuda, Segawa and Thoburn (2013), p. 114 and 126.
[77] Natsuda and Thoburn (2014), p. 1359 and Natsuda, Segawa and Thoburn (2013), p. 126 and 128.
[78] See Rahim (2014) and Shi-lan (2014).
[79] Mahathir (2011), pp. 756-757.
[80] Mahathir (2011), p. 756.

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do they [the Malays] expect to be done for them?»[81]. We stressed this aspect in order to remark how the automotive protection can be judged as a failure not only from the economic perspective but also from the racial point of view.

Coming back to the economic perspective, we hinted that such a failure had to be expected. Why? In order to explain this it is necessary to explain why every kind of central planning is destined to be a failure[82]. We shall demonstrate that, even without considering the *a posteriori* negative effects that State intervention may introduce into the system, every degree of planning is theoretically untenable *a priori*.

The central question to be posed is whether rational economic calculation is possible in a centrally planned economic system (or in a specific industry). Such a question brings out another point: can the plan of a single man or institution (central planner) replace the free interaction of individuals in a complex society? We can start our analysis defining socialism as «any system of institutional aggression on the free exercise of human action or entrepreneurship»[83]. Human action is the core of economic analysis. In particular, human action deals with the ends-means framework chosen by individuals. Every economic agent is moved by expectations and preferences. Expectations and preferences generate desired ends. The content of information at disposal of each actor allows him to choose the supposed suitable means in order to reach the desired ends, consistently with expectations. The attempt to coordinate ends with means, in turn, generate action plans. Of course, plans are always consistent with the content of information at disposal of each individual at a certain moment in time. However, the setting in motion of plansput individuals in relationship with each other. Knowledge and information, therefore, change through the interaction happening in the market. Thanks to such information transmission, errors can be discovered, expectations and preferences change, plans need to be revised in the attempt to make them more mutually consistent. It is important, thus, to observe the existence of *limited* information and to look at the market as the place in which such limited information can become less limited, moving the actors to a higher consistency between their relative plans.

Consumers, entrepreneur-producers and resource owners are the players in the market; the latter, in turn, is where their interacting decisions, during any period of time, take place. Every player has his own content of (limited) knowledge, tastes and expectations. Depending on their knowledge, tastes and expectations, the players set up their action decisions, or plans. Since, in order to carry out their plans, individuals need to interact, it is only through interaction and in time that content of information will be modified and eventually a revision of decisions can happen.

> During the given period of time, exposure to the decisions of others communicates some of the information these decision-makers originally lacked. If they find that their plans cannot be carried out, this teaches them that their anticipations concerning the decisions of others were overly optimistic. Or they may learn that their undue pessimism has caused them to pass up attractive market opportunities. This newly acquired information concerning the plans of others can be expected to generate, for the succeeding period of time, a revised set of decisions[84].

Market process is then built up by «this series of systematic changes in the interconnected network of market decisions». Therefore, and this is the central point, it is not possible to conceive a market process in the realm of perfect knowledge. The process arises precisely because of the initial ignorance of market participants and the natural uncertainty of human action. And the process can only happen during the flow of real time. With no market ignorance and no review of plans, there is no process at all. Since from one period of market ignorance to the next one, ignorance has been somewhat reduced, market participants realize that not only should they implement more attractive opportunities but also that such attractiveness needs to be judged in comparison with the opportunities offered by competitors. When the incentive to offer more attractive opportunities stops, the competitive process stops, too[85].

To conceive economic action in this way means that all subjects, in a way, perform entrepreneurial actions. Having defined the objectives, the means for achieving them must be chosen in a process that unfolds over time. The attainment of certain objectives naturally involves costs, arising from the subjective perception of renouncing the attainment of other goals. The expectation is that the subjective benefit obtained on attaining the objective is higher than cost/sacrifice. The concept of entrepreneurial profit lies in this difference. This does not mean that losses may not be incurred or entrepreneurial errors be made. That is, over time, entrepreneurs may realise that errors were made in the choice of means and purposes and that these entrepreneurial activities must therefore be reviewed. This is possible precisely because, through the free exercise of human action, discovering errors increases the heritage of information. The nature of economic calculation lies in this comparison between entrepreneurial gains and losses. In a market regime, such assessments are possible because subjective assessments, in terms of income and sacrifice, are transformed into objective values through the price mechanism. It precisely mirrors the subjective meeting

[81] Mahathir (2011), p. 757.
[82] On this see in particular Ferlito (2013), chapter 4, Huerta de Soto [1992] (2010), Mises [1920] (1990) and Hayek (1935).
[83] Huerta de Soto [1992] (2010), p. 3.
[84] Kirzner (1973), p. 10.
[85] See Ferlito (2014a).

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of subjective assessments that, in meeting, generate objectively weighted and quantifiable assessments.

Such definition of human action and entrepreneurship is flanked by a corresponding idea of socialism, as we noticed before. If the socialist perspective would be technically possible, it would be possible, in its realm, to experience a rational calculation as the one happening for the individual planning; rational calculation means the possibility to compare costs and revenues expressed in objective prices. This means that it would be possible for a central planner to gather all the data needed to produce a perfect rational economic calculation. In this way, the central authority, after collecting the necessary information from the minds of individuals, provides all the new information to the players, in terms of prices, the goods to produce, how many, etc...

Two main objections can be raised. Firstly, the type of information that each subject possesses, of an exclusive character, is by nature tacit and cannot be articulated. This means that it is «logically impossible for this information to be transmitted to the governing body»[86]. In fact, the problem is not merely quantitative; it does not simply involves an enormous amount of data but also the dispersion of such information among individuals, as well as of its being impossible to transmit it to any planning organ. This argument, which we could define as static, can be flanked by a dynamic argument, which can be summarised as follows: the information available to individuals is not given once and for all; rather, it is continuously modified, so that – in a dynamic process taking place in real time – expectations and plans change with it.

It is clear, then, that in a socialist system, the mediator role played by the price system is absent. Since there are no subjective evaluations, because everything is determined by the central authorities, prices cannot exist. As we noticed before, prices are the objective synthesis of subjective evaluations exchanged in the market. Without the market, such a synthesis function cannot happen and prices cannot arise. Calculation is impossible.

As a result, we realised how the nature of the problem does not consist in one or another system of equations to be solved but, rather, in understanding how human action and related knowledge actually take part in the market process. Even if a central planning body had a certain amount of information at disposal, judged good enough to determine a plan, the fundamental problem is that, once the plan is notified to the individuals, during its implementation the information resumes its dynamic process of change, thereby making the data used to define the plan already 'old'. Yet this does not mean say that no plans exist in economic action. Quite the opposite. Plans are continually implemented by individuals in an effort to attain their objectives. And we must not conclude that the knowledge available to individuals is perfect, given and unchangeable. On the contrary, it is constantly changing. However, in the process of interaction between individuals, the dynamic process of acquiring information can take place over time and allow plans to change accordingly, in the ceaseless search for mutual coordination, thanks to the information transmission operated by prices. In a more or less planned system, however, it is assumed that data remain unchanged for a period of time that is long enough to allow the plan to be implemented; this assumption, by evidently distorting reality, contains the core for the failure of every planning experiment[87].

Such argument, however, seems not to be understood nor by politicians neither by economists. The fact is witnessed by the massive government intervention developed in the East and in the West after World War II.

> For more than half a century, the belief that deliberate regulation of all social affairs must necessarily be more successful than the apparent haphazard interplay of independent individuals has continuously gained ground until to-day there is hardly a political group anywhere in the world which does not want central direction of most human activities in the service of one aim or another[88].

Economists are especially guilty for being not able to understand the objections to central planning, resting «on the impossibility within a socialist system of generating the practical information in the form of market prices, that is necessary for the intellectual division of knowledge which a modern society requires and which only arises from the creative capacity of human action or entrepreneurship»[89].

> The main reason why we cannot hope to achieve efficiency, through centralised management, in the use of resources not even remotely comparable to what is made possible by the market is that the economic order of all large societies is based on the use of special circumstantial knowledge spread among thousands or millions of individuals[90].

Central planning, therefore, by preventing the exercise of entrepreneurial functions, even if only limited to the main capital assets and natural resources, does not allow the creation and transmission of the practical information needed to form of a price system, a necessary aspect for every rational economic calculation. It is clear that the problem cannot be circumvented by an arbitrary system of prices defined by a central authority based on premises more or less extraneous to reality. Every socialist economic decision takes place in total and utter ignorance of economic processes and without the basis for rational economic calculation.

[86] Huerta de Soto [1992] (2010), p. 54.

[87] On this see also Phaneuf and Ferlito (2014).
[88] Hayek (1935), p. 1.
[89] Huerta de Soto [1992] (2010), pp. 104-105.
[90] Hayek (1976), p. 6.

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After decades of socialist experiments, we can easily conclude that the

> most important theoretical knowledge gained from a basic analysis of the effects of price controls is this: the effect of intervention is the very opposite of what it was meant to achieve. If government is to avoid the undesirable consequences, it cannot stop with just market interference. Step by step it must continue until it finally seizes control over production from the entrepreneurs and capitalists[91].

How is it possible for politicians and, in particular, for economists to have indulged for so long on such a big mistake? Hayek ([1974] 2008, p. 30) associates the persistent errors of economists with «their propensity to imitate as closely as possible the procedures of the brilliantly successful physical sciences». Economists, with the pretext of being 'scientists, imitate the methods of the natural sciences but in doing so apply an inappropriate method to the study of human sciences, giving birth to utterly unscientific theories, since the method is not imposed by the object studied in accordance with to the Aristotelian tradition but by the ideological preconceptions of the scholars themselves.

In complex phenomena, fundamental data are often not measurable. If our analysis were to refer only to measurable entities, we would be obliged to restrict the field of investigation to a great extent. It is consequently the case today in our science that those who believe they have a truly scientific approach because they do nothing other than correlate and correlate series and series of data in the search for functional relationships, actually produce theories which are extremely limited and most unlikely to say anything useful about reality.

Consequently, ignorance of true economic science and the presumption that science can only be based on measurable quantities has culminated in producing massive damage in the real world. The presumption of providing exact requirements in time and space, of being able to determine the level of employment exactly starting from planned fixing of aggregate demand, has created a «very extensive misallocation of resources which is likely to make later large-scale unemployment inevitable»[92].

Unluckily, economic theory is merely a pretext and used to determine even more social control, with the excuse of thinking higher interests or a notorious common good. Yet the

> welfare of a people, like the happiness of a man, depends on a great many things that can be provided in an infinite variety of combinations. It cannot be adequately expressed as a single end, but only as a hierarchy of ends, a comprehensive scale of values in which every need of every person is given its place. To direct all our activities according to a single plan presupposes that every one of our needs is given its rank in an order of values which must be complete enough to make it possible to decide between all the different courses between which the planner has to choose. It presupposes, in short, the existence of a complete ethical code in which all the different human values are allotted their due place[93].

Yet the problem is that such a comprehensive code of ethics able to organise society in hierarchical terms in accordance with a precise scale of purposes and values, cannot exist and be defined. In particular, cannot be defined by way of imposition. The State as an organisation cannot allow itself to identify such a code of ethics.

As we have seen so far, serious analysis of planning cannot but lead to the conclusion that, in order to be implemented, it has to be conducted through more or less accentuated forms of dictatorship. The freedom that planners promise is nothing more than freedom from the responsibility of deciding for oneself, freedom from action and from decisions with all the weight of personal responsibility that it entails. The desire for presumed equality and an easy life can destroy the longing for liberty, because true freedom always implies responsibility.

A society can only grow, on the contrary, through free individual action. Economists should be servants of that principle and not slaves of artificial systems of ideas, which often become the justification for erroneous policies, 'scientists' whose only goal is to restrict freedom by ever increasing degrees. The main point for a social scientist is to acknowledge that planning cannot be implemented, unless the intended goal is collective suffering.

> The recognition of the insuperable limits to his knowledge ought indeed to teach the student of society a lesson of humility which should guard him against becoming an accomplice in men's fatal striving to control society – a striving which makes him not only a tyrant over his fellows, but which may well make him the destroyer of a civilization which no brain has designed but which has grown from the free efforts of millions of individuals[94].

VI. Suggestions and Conclusions

So far we have seen how Malaysian government succeeded in creating a national car brand, thanks to heavy protectionist and supportive policies. However, results are below expectations. It is true that Proton and Perodua dominate the local market in terms of production, but Malaysia remains a net importer of vehicles. Moreover, the great financial effort to support the national automotive industry stopped the local technological development because of the lack of competition. In the same time, it increased the public debt and forced consumers in purchasing cars at a higher price than the market level. Finally, together with NEP, NCP and NAP missed the sight to create a strong group of *bumiputera* entrepreneurs.

The core of our thesis is not only that industrial protection policies damage the economic system, but also that such a failure is to be expected, because of the

[91] Mises [1929] (1996), p. 105.
[92] Hayek [1974] (2008), p. 44.
[93] Hayek [1944] (2006), p. 60.
[94] Hayek [1974] (2008), pp. 55-56.

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technical impossibility of rational economic calculation under every kind of central plan. Which direction should be taken, then? Someone argues that it would be good enough to link Proton (and eventually other national companies) with a big and important international partner[95]. To reason in this way means to miss completely the point. We agree with Dr Mahathir when he stresses that developing countries remain colonies if they need to import technology and they are not able to develop a national system of innovation[96]. And his attempt, under this perspective, is remarkable. However, the action focus should be shift from a direct intervention toward an educational one. How to enhance innovation processes development?

We believe we should look at the educational system. At the very first, it could seem that a strong scientific education, like the one developed in the Asian context, should be a good engine for an innovative mind set development. We do not agree with such perspective. Engineering, in the way in which it is often taught, does not stimulate creativity and innovation. On the contrary, it simply transfers technical notions to be applied to practical issue. This is the worst approach to creativity, because it teaches simply how to apply given technics to limited problems.

It is a humanistic approach, instead, which can shape a different mentality. Philosophy, literature, poetry, history: these are the disciplines who can help young eager minds to question about everything, not to simply accept given solutions. Everybody can potentially apply a given solution to a specific problem. Innovators, on the contrary, are not happy with given solutions. What is needed is developing curiosity and questioning attitude.

This could be a first step, for developing nations like Malaysia, to try to shift from 'importing technology' to 'generate innovation': curiosity and questioning attitude, forged by an educational system which stimulates debates and minds interaction. Such an educational system is centred on philosophy and history rather than engineering.

Such a solution will not answer to our original question. But maybe it could help to shape the future in a different way[97].

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