

## Introduction

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# Introduction

When Malaysian Prime Minister Dr. Mahathir Mohamad introduced a new economic policy entitled “Look East,” in which Malaysia intended to shift toward Japan’s industrialization policies, particularly its in-house production methods, people laughed, saying “It is useless to learn from Japan. Malaysia is Malaysia. We have our own way.” Ten years later, however, the Malaysian economy was growing very rapidly, and nobody was laughing. To the surprise of no one, Mahathir’s successful Look East Policy remains in effect today.

In its history, the Latin American region has twice faced excellent opportunities to industrialize its economy. The first occasion was the transition from colonialism to nationalism, in which an oligarchical system developed and dominated, based on the exportation of primary products. The second occurred after the Great Depression when statism dominated through populist rule, and import-substitution industrialization policies were emphasized.

Prolonged import-substitution policies ended up with external debt crises in the 1980s. During that period, the per capita income of Latin America deteriorated. Now under the free market philosophy, a third opportunity to catch up with modern industrial societies is being tried. This liberalization or economic opening up is accelerating, and a free trade area may even become a reality during the 1990s. At first glance, it appears these new development attempts will be successful under laissez-faire regimes, and many believe that the North American Free Trade Agreement (NAFTA) and other free trade arrangements in the region will bring about instant prosperity.

However, market forces alone are not likely to lead to the social and economic welfare gains that are expected. Nothing of consequence has changed in Latin America since the end of the 1970s, particularly the industrial infrastructure and an institutional frame of mind. Because of the external debt burden, public as well as private investment for infrastructural maintenance was ignored and, as a result, infe-

rior conditions were not improved. Moreover, the income gap widened.

Latin America is in need of a new economic and social approach to permit the nations that comprise the region to increase their productive wealth through industrialization. This approach must neither be a repetition of the past failures, nor rely too much on the comparative advantage of natural resources, an advantage of last resort that has helped Latin America ease past previous economic crises.

If Latin America really wants to transform its structure, it needs a different model, one which is based on the East Asian model. This model is, at a minimum, worth trying, because East Asian methods, particularly those concerning factory production and institutional linkage, have produced some universal truths in the search for increased quality and productivity.

Latin America, however, is not Asia. There are many different economic, social, cultural, religious, and metaphysical factors that must be considered. It is not prudent to stamp the East Asian model directly on Latin America. Some necessary modifications will be required in the search for an appropriate, eclectic Latin American model, one having an East Asian flavor. It is important, therefore, to step aside, take a minute to reflect without prejudices, and listen to the voice of Asia.

So far this decade, extraordinarily deep structural changes have been taking place under Latin American regimes that support and believe in trade liberalization. The industrial structure is being transformed across borders through the price mechanism according to the comparative advantage of different industries. To ensure a smooth economic transition and to increase product competitiveness, many steps are needed to catch up with modern technological society. Two issues are crucial to push toward quality and competitiveness: in-house measures and the functional linkage of factories and industries. In-house measures that apply to both large or small firms include improvements in the choice of raw materials, machinery and equipment, process technology, molds and dies, as well as gains in product design, quality control, and management.

Organizational aspects that can be addressed include the strengthening of intra-firm and inter-industry divisions of labor, particularly the functional linkages between parts-and-component producers and assemblers. What we are talking about here is the subcontracting system or, in other words, the formation of supply chains. Small- and medium-scale enterprises (SMEs) play a vital role as suppliers of parts and components (they are usually referred to as "supporting industries") to larger down-stream industries. Small- and medium-scale industries, functioning alone, are not able to enjoy the advantages of economies of scale, but may do so if they are integrated with larger enterprises (external verticalization).

*The Voice of East Asia* examines what is happening on the shop floor at both the intra-factory, and intra- and inter-industry levels in East Asia. Government policies are analyzed as well. These policies are then examined as to their applicability to Latin America. The findings of two industrial studies on small-scale enterprises (SEs) in Brazil and Mexico, which were carried out in 1992, are also presented.

*The Voice of East Asia* consists of four chapters. The first explains East Asian economic development, with particular emphasis on trade and investment policies.

The globalization of business activities, a recent eye-catching phenomena in the East Asian region, is analyzed, as is how an international division of labor can be established through the market mechanism, especially through dynamic comparative advantage.

Chapter 2 deals with in-house production measures, and how the subcontracting system has been used to increase quality and productivity throughout East Asia, particularly in Japan, the Republic of Korea, and Taiwan. These methods (Far Eastern method) emphasize cooperation and coordination of all workers, including managers, and are based on the horizontal flow of information among all participants.

Subcontracting is a standard business practice employed to reduce costs and to share future returns with subcontractors and assemblers (the prime firms). Since SMEs play a vital role in the subcontracting system as supporting industries, Japan's experience in the development of SMEs is introduced as a case study. It is now known that SMEs are more flexible, dynamic, and even more profitable than was originally believed. This fact demonstrates that nurturing SMEs is an important step in the process of economic development and modernization, an essential step for all developing countries.

Chapter 3 focuses on Latin America. Brazil and Mexico were examined because their economic policies contrast, providing valuable insights. Mexico is now ready to fully open up its economy, while Brazil is suffering through hyperinflation and growing uncertainty. The industrialization policies of both countries are reviewed briefly. While a major policy shift began in Mexico in the mid-1980s, Brazil has only just now began to make changes. Both countries consider the improvement of product productivity and quality a top priority.

In the Chapter 4, the focus is on the SEs of Brazil and Mexico. Industrial censuses of both countries show that SEs are declining, in terms of employment and sales, while large-scale enterprises (LEs) are registering gains. This has been the trend for the last thirty years. These gains are attributable to the import-substitution policies, instituted by both countries, which were biased toward LEs. Even though economic liberalization policies will help balance this gap, some government assistance is needed because SEs usually lack adequate access to modern business amenities such as financial institutions and new technology. Many SEs, in addition, have little collateral.

To obtain more information on Latin American SEs, two industrial surveys were conducted, one in Mexico, the other in Brazil. Each survey was conducted through personal interview questionnaires. In February/March 1992, 129 small business establishments were contacted and surveyed in Mexico City and its vicinity, while in July/August 1992, 196 establishments were surveyed in São Paulo and its vicinity. The findings cover in-house production methods involving quality and productivity, subcontracting, cost structure, profit ratio, wages and labor, government financing, and technological education.

Based on an analysis of what was discovered, suggestions and recommendations for Latin American economic policy are cited in the final chapter. Of note is the formation of supply chains, particularly the existing subcontracting exchange service

in Brazil and Mexico (the *bolsas de subcontratación* system). This is in many ways the first step to a new economic future in Latin America.