Chapter VI

Industrial Policies and Trade Liberalization
- The Automotive Industry in Thailand and Malaysia -

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1. Introduction

One of the major pillars of the APEC's activities is trade and investment liberalization and facilitation. Although the APEC's liberalization program basically operates on a voluntary basis, the multilateral framework of the World Trade Organization (WTO), and regional arrangements such as the North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN) Free Trade Agreement (AFTA) act as the major driving forces behind pressuring developing countries to liberalize their trade regimes.

Many developing countries regard automotive industry as an economically strategic sector "in the light of its contribution to national production, employment and technology, reinforced through the magnitude of upstream and downstream activities."[1] These factors, combined with the large amounts of investment and large-scale production typically required of capital intensive industry, largely explain the government's extensive intervention in the sector prevalent in many countries. After initially importing completely built-up (CBU) cars, many countries have attempted import substitution; they set up a local industry as a joint venture with

[1] Audet and VanGrasstek (1997), p.18.

foreign companies to assemble imported completely knocked-down (CKD) parts, and they protect the industry from competing imports by using tariff barriers or quotas.

Since the 1960s, import-substituting industrialization supported by the infant industry argument has come under increasingly harsh criticism.[2] Especially in recent years, the global move towards liberalization is gradually freeing up the flow of capital and products even in this heavily protected sector, and emerging markets are slowly being integrated into the global network of automotive industry. At the same time, however, many developing countries are still concerned about protection of domestic industries which are not ready to compete with global players, and they are exerting countervailing force against liberalization. In this sense, the current move towards liberalization can be understood as a test of success or failure of past industrial policies in developing competitive domestic industry.

Within the APEC region, ASEAN has been regarded as one of the growth centers for the world's auto industry. Among the ASEAN members, Thailand and Malaysia have the largest and most developed automotive sectors. While both countries followed variations of the import substitution strategy to develop the industry, they used remarkably contrasting approaches, particularly with regard to the role assigned to foreign multinationals and the nature and extent of government protection over time. This paper examines how the policies adopted by the governments of the two countries have shaped the development patterns and structure of the industry, and the paper shows how the policies and the resulting industrial structure in turn have affected their approaches and capabilities to cope with the new challenges of liberalization and globalization of automotive industry.

The rest of the paper will be organized as follows. Section 2 reviews and compares policies adopted by Thailand and Malaysia to develop automotive industry. Section 3 examines the current situation of the automotive industry in the two countries, and

[2] The infant industry argument claims that protection of newly established local industries is necessary to enable large-scale production and cost reduction, until the industry becomes capable of competing with imported products. The main criticism against the infant industry argument is that protected industries never become competitive, resulting in persistent protection and creation of the basis for rent-seeking. For a detailed account of the debate, see Gillis et al (1992).

discusses how the two countries are coping with the new challenges of ongoing liberalization schemes and the recent currency crisis. The section also attempts to give insight into the future prospects of automotive industry in the respective country. Section 4 offers the conclusion of the paper, including the implications of liberalization on automotive industry in the two countries, and the possible role APEC can play in the liberalization process.

2. Industrial Policies and Development of the Automotive Industry in Thailand and Malaysia: An Overview

Although in the early years, both Thailand and Malaysia adopted variations of the import substitution strategy to build automotive industry, the two countries have exhibited remarkable differences in subsequent development paths. In order to shed light on differences between industrial policies adopted in the two countries, this section gives a historical account of the development of automotive industry in Thailand and Malaysia.

2-1. Thailand

In Thailand, the private sector has been generally recognized as the leading force in the process of industrialization, while the government's facilitating role also deserves credit.[3] Unlike some other ASEAN countries, the Thai state did not exhibit highly centralized political leadership or links to specific businesses.[4] In the case of automotive industry, the Thai government basically encouraged foreign multinational corporations (MNCs) to establish their production bases by providing various privileges and protection, and the government simultaneously adopted policies to develop local parts suppliers.

[3] Ikemoto (1994), p.172.

[4] Doner (1991) points out these features of Thailand's domestic political conditions. In his study of automobile industrialization in four of the ASEAN countries, he argues that the state-business relationship is the most important factor in determining how much the local automotive industries expand their bargaining power against foreign investors.

The emergence of automotive industry in Thailand dates back to the early 1960s. With the enactment of the Industrial Investment Promotion Act of 1960 and its revision in 1962, the Board of Investment (BOI) provided incentives[5] for automotive assembly plants to locate in the country. This policy revision proved to be successful in attracting foreign investors from the US, Japan, and Europe to set up joint ventures with Thai businesses. During the 1960s, several joint ventures were established to set up assembly plants for commercial and passenger vehicles, including Thai Motor Industry Co., Ltd. (a joint venture between Anglo-Thai Motor and Ford (UK)), Karnasuta General Assembly (Fiat) Co., Ltd., and a joint venture between Siam Motors and Nissan Co., Ltd.

By the end of the 1960s, however, it had been recognized that the lack of controls on new entrants and linkages had resulted in a proliferation of inefficient import-dependent assembly operations, which led to an increase in trade deficits and inability of the industry to achieve the economies of scale. Through consultations both within the bureaucracy and with businesses, the government came up with a new policy aimed at progressive localization of auto production. In 1971, the Automobile Development Committee, which had been established under the Ministry of Industry, announced a policy requiring progressive increases in localization ratios to 25 percent for passenger cars, 20 percent for commercial cars with windshields, and 15 percent for commercial cars without windshields by 1975. In response, Japanese auto parts subcontractors started to invest in Thailand, and Thai firms also became actively involved in parts production. However, at this stage, the effect of the localization policy was undermined by competition between locally assembled cars and imported CBU automobiles, and it was also diminished by the lack of economies of scale due to the existence of too many assembly plants.

In 1978, the government announced an import ban on CBU passenger cars, and it raised import tariffs on CKD kits from 50 percent to 80 percent. The local contents

[5] The privileges included: (1) 50% reduction of import duty on completely knocked down (CKD) for 5 years; (2) exemption of corporate income tax for 5 years; (3) permission to remit foreign exchange out of the country; and (4) permission to bring in foreign experts and technicians.

requirement for passenger vehicles was also raised from 25 percent in 1978 to 50 percent during the five years up to 1983.[6] However, due to slow growth of production and sales resulting from the economic recession in the early 1980s, and in response to the demands from the businesses, the Ministry of Industry temporarily froze the local contents requirement for passenger vehicles at 45 percent in 1982. In order to promote large-scale production, the government prohibited the establishment of new plants and the introduction of new models or series, while allowing the assemblers to expand the size of the existing plants.

The automotive industry in Thailand encountered difficulties during the period from the late 1970s to the mid-1980s. By the mid-1970s, the first oil crisis slowed down economic growth, while domestic political instability and the Vietnam War aggravated the political and economic risks for foreign investors. For these reasons, General Motors (GM) and Ford pulled out of Thailand completely in the late 1970s, and Fiat also withdrew because it could not meet the local contents requirement.[7] The slow economic growth continued into the early 1980s, which, along with the government strengthening local contents requirements every year, put Japanese manufacturers in a difficult position. However, they maintained their operations through the turbulent years, which eventually enabled them to capture the dominant position in Thailand's car market.

After 1987, the industry started to expand rapidly, led by rapid growth of the Thai economy and increased purchasing power of the middle class coupled with the surge of foreign direct investment (FDI) inflows by Japanese firms after the Plaza Accord in 1985.

The early 1990s saw a drastic change in the policy towards liberalization of the auto industry. The government initiated the policy change under newly appointed Prime Minister Anand Panyarachun. Officially, the policy shift was intended to strengthen international competitiveness of the industry by increasing competition among local producers who had enjoyed protection for a long period, and also to serve the benefits of consumers by lowering

[6] Pickup trucks were also subject to gradual increases in local contents requirement in a similar manner.
[7] Panichapat and Kanasawat (1997).

car prices.[8] In 1991, the government lifted the ban on import of CBU passenger cars with a displacement volume of 2,300cc or less,[9] and the total import tax (duty plus surcharge) burden on passenger cars[10] and the import duty rate on CKD kits were substantially reduced. In 1992, further tariff reductions were implemented on six important components and materials. In 1993, the government announced approval for establishing new passenger vehicle assembly plants.

As the price gaps between imported and domestically produced cars narrowed, imported passenger cars from the US and Europe flooded into the market. In addition, low-priced Korean cars penetrated into the market, further escalating the competitive pressure for Japanese multinationals. The share of Japanese manufacturers in the total passenger car sales decreased from 79.0 percent in 1990 to 68.7 percent in 1995.[11] The Japanese firms, in response, tried to cut down production costs and launched a series of low-priced Asian passenger cars.[12]

In 1993, the Thai government started to promote export orientation for the automotive industry, which was an important turning point in Thailand's automotive industrial policy that had always targeted at the domestic market. In line with 'The Automobile Industry Export Promotion Project' announced by the Ministry of Industry, the BOI granted incentives for assembling automobiles for export, which include exemption from import duty for auto parts and exemption from corporate income tax for eight years from establishment.

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[8] For a detailed account of the formation of liberalization policy, see Ikemoto (1994). He argues that, through negotiations between the government and the assemblers, CBU car imports that would directly compete with those assembled in Thailand continued to be largely restricted, while import of cars with specifications complementary to those assembled locally was allowed. He, thus, concludes that liberalization did not increase competition for local producers although it led to lower prices and increased demand.

[9] The ban on imports of passenger cars with a displacement volume larger than 2,300cc had already been lifted in 1985.

[10] Initially, the total import duty burden was reduced from 300 percent to 100 percent for passenger cars with engine displacement over 2,300 cc and from 180 percent to 60 percent for those with up to 2,300cc. Later, the cut-off level was raised to 2,400cc after active lobbing by Volvo, which had been put in a disadvantaged position in its competition with Mercedes Benz (Panichapat and Kanasawat, 1997).

[11] Calculated by the author based on data provided in FOURIN (June, 1997, p.114).

[12] The major examples are Honda's 'City' and Toyota's 'Soluna.'

The outlook seemed bright in the mid-1990s, when Thailand was expected to become the regional center of automotive production and sales in ASEAN for MNCs. Domestic car sales totaled nearly 600,000 in 1996 and were forecast to increase to between 850,000 and 915,000 in 2000,[13] and the bright outlook for Thailand's automotive market attracted new investment. Ford and Mazda formed a joint venture to produce pickup trucks, and they planned to export about half of the production.[14] In 1996, GM decided to invest US$750 million in pickup truck production, and they planned to export 80 percent of the output. Along with the above-mentioned incentives, GM succeeded in eliciting special privileges from the Thai government, including exempting all assemblers from the local content requirement beginning in July 1998, a year and half ahead of the January 2000 date specified by the WTO. In addition, the major investors in Thailand announced plans to expand production capacities towards the end of the decade, which would increase the total annual production capacity in the country to 1,099,000 units by 2000.[15]

However, with the recent currency turmoil, the emerging consensus of Thailand as the future center of ASEAN's automotive industry is now being reconsidered. Section 3.3 will discuss this in detail.

2-2. Malaysia

In Malaysia, the development of automotive industry, particularly since the 1980s, needs to be studied in the context of the state-led heavy industrialization project in the complex ethnic situation.[16] Although Malaysia made early attempts during the 1960s and 1970s to build automobile production for import substitution, competition among numerous assembly firms producing different models made it impossible for them to reap the benefits of the economies

[13] FOURIN, June 1997, p.1.
[14] Takayasu et al (1996), p.14.
[15] ibid., p.13.
[16] For further discussion of the role of domestic circumstances (i.e., political leadership and national goals) and global factors (i.e., strategy of MNCs) shaping the development of Malaysia's automotive industry, see Machado (1992).

of scale. In 1979 the Mandatory Deletion Program (MDP) was enacted. Under the MDP, foreign assemblers were forbidden from including certain components in their imported CKD package. Following recommendations of parts manufacturers under the committee organized by the government and business associations, the government made the list of car parts to be produced locally. However, dependence on imported parts persisted as locally produced parts remained costly because of the lack of economies of scale.

In the early 1980s, the government launched a project to develop heavy industries under the leadership of Prime Minister Mahathir bin Mohamad. To establish this project, the government set up the Heavy Industries Corporation of Malaysia Berhad (HICOM), a corporation completely financed by the state. Here, it is important to note two other national development objectives which played complementary roles in the heavy industrialization project. Under the first development objective called the 'Look East Policy', the prime minister encouraged learning from Japan's work ethics. The other objective is raising the position of *bumiputra*, or native Malays, a group which had been regarded as economically backward in the Malaysian society, to achieve racial harmony in the country after serious ethnic tension between the Malays and the Chinese in 1969. More specifically, the government through HICOM tried to encourage Malays to participate in heavy industry regarding capital, employment, and management.

Under the heavy industrialization project, the automobile industry became one of the targeted sectors for the Malaysian state. In 1983, Perusahaan Otomobil Nasional Berhad (Proton), a national car company, was established as a joint venture between HICOM, Mitsubishi Motor Corporation (MMC) and Mitsubishi Corporation (MC).[17] The project aimed at rationalizing and localizing the automotive industry, as well as improving the economic position of *bumiputra* in the Malaysian society. In 1985 the company started to produce Malaysia's national car 'Saga', a slightly modified Mitsubishi 'Lancer.' From the start, the

[17] At the time of establishment, the shares of capital participation by HICOM, MMC and MC were 70%, 15% and 15% respectively.

government granted a wide range of privileges exclusively to Proton including the following:

- exemption of import tariffs for auto parts for CKD assembly, while other firms were subject to import duties of 15 percent, which was raised to 25 percent in 1983 and 40 percent in 1984[18];
- reduction of excise duty (including commodities and sales tax) by 50 percent; and
- introduction of low-interest loans available to civil servants when purchasing 'Saga'.

These privileges enabled Proton to keep the price of Saga more than 20 percent lower than cars with similar specifications produced by other manufacturers.[19]

Proton suffered from the economic downturn from 1985 to 1987 because of the falling prices of primary commodities and because of the rise in the cost of imported inputs due to the appreciation of yen following the Plaza Accord in 1985. However, since the end of 1987, Proton started to expand its production and share of automobile sales in the market again because of two main reasons. One reason was the surge in domestic demand for automobiles following the economic recovery and stabilization of employment. Total car sales in Malaysia increased from around 54,000 in 1987 to 69,000 in 1988, and to 123,000 in 1989.[20] The other reason was the reform of Proton's management and production systems carried out by the president and personnel sent from MMC in Japan. This symbolized a drastic change from the firm's previous strategy which had emphasized management by the Malays. Proton steadily expanded its business and production capacities, recording its first profits in 1990.

While automobile production up to the mid-1980s had been mainly targeted at the domestic market, Proton started to export Saga, initially to Bangladesh in 1985. In 1989, the firm started exporting to the UK, where the import duty was exempted up to the Generalized System of Preferences (GSP) limit of 14,000 units per year. Although Proton has diversified export destinations since then, the UK has always been the main absorber of its

18 Daiwa Institute of Research (1996), p.4.
19 ibid.

exports.

In 1989, considering the improvement in Proton's performance, the government lifted its regulation on the models of cars produced, which had aimed to encourage concentration of production.

As for localization of auto parts, the MDP has been in effect since 1979, but with limited success. Torii (1991, pp.284-5) reported that many of the key components, such as those related to engines and transmissions, were not included in the MDP list as of 1988. In 1992, the government introduced an additional requirement of meeting the specified localization ratio. The ratio was originally set at 30 percent for passenger cars with a displacement volume of 1,850cc or less and 20 percent for passenger cars of over 1,850cc and commercial vehicles weighing 2.5 tons or less.[21] As shown in **Table 1**, the localization requirement for both categories was scheduled to increase gradually every year.

Table 1 Localization Requirement in Malaysia

	Passenger cars (Displacement volume)			Commercial vehicles (Vehicle weight)	
	1,850cc or less	1,850 to 2,850cc	over 2,850cc	2.5 tons or less	over 2.5 tons
1992	30%	20%	no specified localization ratio (only mandatory deleted items)	20%	no specified localization ratio (only mandatory deleted items)
1993	40%	30%		30%	
1994	50%	35%		35%	
1995	55%	40%		40%	
1996	60%	45%		45%	

Source: FOURIN (June, 1997)

As seen in the Proton Components Scheme started in 1988 and followed by the Vendor Development Program in 1993, Proton made efforts to develop domestic parts manufacturers. Under the program, Proton provided markets and technical assistance, while the government and financial institutions offered financial assistance, to targeted components

[20] Nikkan Jidosha Shimbunsha (1992/1993).

[21] National cars fall under the category of passenger cars with a displacement volume of 1,850cc or less.

manufacturers mostly run by *bumiputra*. In 1992, the government imposed a 13 percent tax on imported parts used by Proton, which had been exempted from import tariffs on CKD parts, for the purpose of promoting the development of the domestic parts industry.

In 1990, following Dr. Mahathir's proposal, the second national car project was announced. The second national car manufacturer, Perusahaan Otomobil Kedua Sdn. Bhd. (Perodua), was established as a joint venture between Malaysian firms and Daihatsu[22] in 1993, and Perodua started production of Kancil, a passenger car with a displacement volume of 660cc and modeled after the Daihatsu 'Mira.' Although the initial localization ratio was around 40 to 50 percent, with the rest of the parts imported mostly from Japan, Perodua enjoyed exemption from import duties on CKD parts, as in Proton's initial phase. For this reason, as shown in **Table 2**, the price ranges for Perodua's models are lower than those of other manufacturers. Kancil did not face local competition because it was priced even lower than Proton's models,[23] and its sales increased steadily. In 1996, Perodua started production of a commercial car, the 'Rusa', and Perodua began to export Kancil to the UK in 1997.

Table 2 Car Prices in Malaysia (as of May 1996)

Manufacturer	Model	Displacement Volume (Unit: cc)	Price Range (Unit: Thousand Ringgit)
Perodua *	Kancil	659	25.0 - 32.7
	Rusa	1296	34.3 - 39.4
Proton *	Tiara	1124	34.9 -36.8
	Saturia	1298 / 1597	35.0 - 47.2
	Saga	1298	38.1 - 39.4
	Wira	1298 / 1800	46.0 - 73.0
	Perdana	1997	86.4 - 92.4
Toyota	Corolla	1332 / 1587	72.3 - 89.4
	Camrey	2164	111.7 - 121.4

[22] The firm was established as a joint venture with equity participation as follows: UMW Corp. (38%), MED-Bumikar-Mara (20%), Daihatsu (20%), PNB Equity Resource Corp. (10%), Mitsui Corporation (7%), and Daihatsu (Malaysia) (5%).
[23] FOURIN, January, 1998, p.32.

Honda	Civic	1493 / 1590	85.5 - 95.7
	Accord	1997 / 2156	108.7 - 141.9

Note: * indicates Malaysia's national car firms.
Source: Daiwa Institute of Research (1996)

Proton undertook various initiatives to expand its business in the mid-1990s. First, it promoted product diversification by introducing new models such as 'Wira' and 'Saturia,' both of which were produced with varying ranges of displacement volume. Second, Proton established an alliance with Citroen to produce a new model, 'Tiara.' The main reasons behind its affiliation with a French firm instead of Japanese were the rising cost of imported parts resulting from rapid appreciation of yen and dissatisfaction with the slow progress in technology transfer from MMC to Proton.[24] Third, Proton established subsidiaries or related companies to assemble and distribute vehicles in the Philippines and Vietnam. Fourth, Proton made plans to expand production capacity of the existing plant in Shah Alam, from an annual capacity of 150,000 units in 1995 to 180,000 in 1996 and 230,000 units in 1998. In addition, it announced plans to build 'Proton City' at Tanjung Malim. It was designed as an integrated automobile manufacturing city with a new plant with production capacity of 150,000 units in 2000, to be increased to 250,000 units in 2003.

In short, Malaysia's automotive industry has been built around national car firms which depended on governmental support for capturing a large share of the domestic market. Progress in liberalization and the recent currency crisis have revealed the constraints of such policies, which will be discussed in Section 3.

2-3. Industrial Policies of the Two Countries Compared

The development of automotive industry in both countries has been a cumbersome process. Both countries encountered the problem of small domestic markets, which makes it difficult to benefit from the economies of scale, and they experienced the difficulties of developing

[24] Daiwa Institute of Research (1996), p.8.

competitive local manufacturers and parts suppliers through technology transfer from foreign multinationals. While automotive industry in both countries started out with import substitution through protective measures, their fundamental strategies and subsequent policy developments show differences, which can be summarized into the following points.

First, whereas Thailand has attracted MNCs to lead the automotive industry, Malaysia has focused exclusively on the 'national car' program. In Thailand, foreign auto manufacturers formed joint ventures with Thai firms, providing technology, equipment and facilities, as well as management, production and marketing know-how. The government attempted to develop local parts suppliers by gradually strengthening the local contents requirement for foreign assemblers. On the other hand, Malaysia has concentrated its efforts on establishing a national car firm to produce its own national brand, and has avoided dependence on FDI by adopting policies which explicitly favor the national car. It is important to understand that Malaysia's policies have been strongly influenced by the goals of national development symbolized by heavy industrialization and advancement of the position of *bumiputera* in the society.

Second, the Thai government has been relatively less interventionist compared to the Malaysian government. Although the Thai state offered extensive protection for the industry and regulated new entry to encourage scale economies, the policies were never firm-specific, and they created some competitive pressure for firms located in the country. However, this has another interpretation: the Thai state often lacked consistent policy objectives for developing the automotive industry, or failed to maintain autonomy from private business interests. The government's policies have been generally flexible in accommodating demands of the private sector, as seen in the temporary freeze of the localization ratio during economic downturn, but this is also a reflection of the weak bargaining power of the state against businesses. The growth of Thailand's automotive industry is attributed largely to the active roles of the private sector and the favorable environment such as expansion of domestic demand and the surge of FDI inflows, rather than to the government's policies.

On the other hand, the Malaysian government played a much more active role in developing the automotive industry within a wider framework of the national goals of heavy industrialization and advancement of *bumiputra*'s position in the society. In other words, the national car project was assigned a political role, and this gave a reason for the government's interventionist role and persistent protection. Since the early 1980s, the state has adopted industrial policies which explicitly favor the national car firms. Such policies enabled the national car firms to set the prices at the level substantially lower than the price levels of imported cars, and to capture a dominant share of the domestic market.

Third, partly in relation to the previous point, the progress of liberalization in the 1990s has been much faster in Thailand than in Malaysia. Up until the 1990s, automotive industry in both countries remained largely protected. In the 1990s, Thailand's liberalization program made substantial progress. The Thai government eliminated the ban on imports of CBU passenger cars, and it drastically reduced tariff rates. These measures increased competition with imported cars and parts, and attracted new investment by US auto manufacturers. In the mid-1990s, an emerging consensus predicted that Thailand would be the regional center of global automotive production network for MNCs.

In contrast, Malaysia's national car firms are still granted extensive privileges. Even after Proton established a dominant position in the market, the government has not made attempts to reduce protection as implied by the infant industry argument. The establishment of Perodua did not substantially increase competitive pressure on Proton because the specifications of models produced and the targeted markets were different. In effect, Malaysia's strategy has focused exclusively on realizing economies of scale, and it has failed to improve the competitiveness of national car firms by promoting competition with foreign manufacturers on equal footing.

3. Current Situation and New Challenges for the Automotive

Industry in Thailand and Malaysia

3-1. Current Situation of the Automotive Industry in the Two Countries

Considering the contrasting strategies adopted by the two countries, it is natural to expect differences in the structure and performance of the automotive industry in Thailand and Malaysia.

Figure 1 shows the growth of automobile sales in the two countries. The growth of total sales followed similar patterns in the two countries up to the late 1980s, reflecting the regional economic downturn during the mid-1980s. However, Thailand has clearly outperformed Malaysia in the 1990s. The growth of sales in Thailand has been remarkable in the 1990s, and this is largely attributable to the inflow of new investment and expansion of existing production capacities, increase in car imports, and the fall in car prices following liberalization. Despite a drop in sales from 1990 to 1991, car sales in Thailand in 1995 totaled 571,580 units, which is more than twice the sales in 1991, 268,540 units.[25]

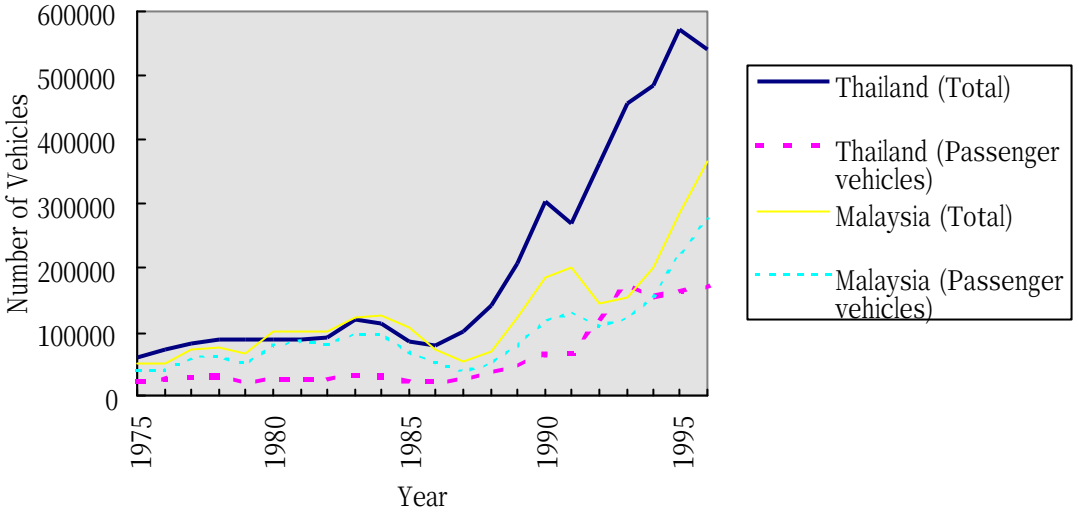
From the same figure, it is also clear that the share of passenger vehicles to total car sales has been much higher in Malaysia than in Thailand. The ratio of passenger car sales to the total car sales in 1995 was 28.6 percent in Thailand and 83.1 percent in Malaysia,[26] which may be explained by the difference in the level of economic development.[27] Referring to the level of motorization, which is measured by the number of vehicles registered per 1,000 persons, Nagata (1998) points out that Malaysia has already reached the mature dissemination phase and is even moving towards multi-car ownership phase, while Thailand has not even reached Malaysia's motorization level in 1980.

[25] Nikkan Jidosha Shimbunsha (1998).

[26] The figures are calculated by the author based on data provided by Nikkan Jidosha Shimbunsha (1998).

[27] Thailand's GDP per capita in 1995 was US$ 2,740, while that of Malaysia was US$ 3,890 (World Bank 1997).

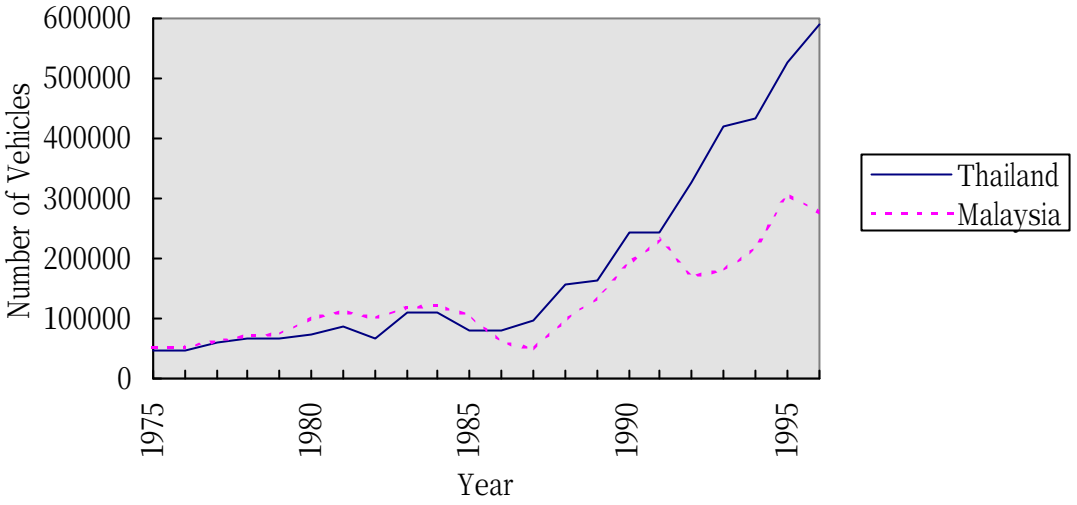
Figure 1 Automobile Sales in Thailand and Malaysia



Source: Nikkan Jidosha Shimbunsha (various years)

Figure 2 compares the growth of automobile production in Thailand and Malaysia. While the growth patterns of the two countries up to the year 1991 have been more or less similar, we observe a marked difference thereafter. Whereas automobile production in Thailand increased by 80.9 percent from 1991 to 1995, the growth rate in Malaysia was merely 6.0 percent, with a 26.2 percent decline from 1991 to 1992. Again, the rapid growth of production in Thailand after 1991 can be explained by the fact that liberalization progress encouraged new investments and expansion of the previous investments by MNCs.

Figure 2 Automobile Production in Thailand and Malaysia



Source: Nikkan Jidosha Shimbunsha (various years)

(Figure 3 - Excel)

(Figure 4 - Excel)

(Figure 5 and 6 - Excel)

Table 3 Export of Vehicles

(Unit: Thousand US dollars)

	1990	1991	1992	1993	1994	1995
Thailand	221,818	298,019	332,215	632,782	858,967	725,721
Malaysia	76,259	83,832	131,152	157,884	123,711	168,643

Source: United Nations (various years)

Table 4 Car Prices in UK

Manufacturer (Country)	Model	Displacement Volume	Price in UK (in sterling pounds)
Proton (Malaysia)	Persona	1,300cc 1,500cc 1,800cc	8,888-9,199 10,399-10,699 12,599-13,599
Hyundai (Korea)	Accent	1,300cc 1,500cc	7,599-8,799 10,599
Kia (Korea)	Pride Mentor	1,300cc 1,600cc	6,219-7,479 9,469-11,309

Source: Autocar, Feb. 18, 1998

Table 5 Import of Vehicles

(Unit: number of vehicles)

		1991	1992	1993	1994	1995
Thailand	Passenger	66,679	107,797	159,288	111,022	142,594
	Commercial	38,020	38,382	41,672	51,874	68,158
Malaysia	Passenger	58,131	36,893	29,130	42,113	62,355
	Commercial	72,985	21,987	30,034	38,190	55,576

Source: Nikkan Jidosha Shimbunsha (1998)

Table 6 Import Value of Automotive Parts and Components

(Unit: thousand US dollars)

	1989	1990	1991	1992	1993	1994	1995
Thailand	1,138,790	1,567,661	1,110,160	1,036,454	1,545,208	1,977,738	3,047,459
Malaysia	103,337	125,216	139,604	138,298	172,382	230,336	300,950

Source: United Nations (various years)

The share of vehicle sales by manufacturers can be found in **Figure 3**. In Thailand, Japanese car manufacturers dominate the market, particularly for commercial vehicles. It should be noted that the data show the situation after liberalization led to a decline in the share

of Japanese manufacturers for passenger vehicles with the entry of US, European, and Korean manufacturers, as described in Section 2. In Malaysia, the two national car firms, Proton and Perodua, account for as much as 80 percent of the total passenger vehicle sales in 1996. As for commercial vehicles, which actually occupy only a small proportion of the whole vehicles market in Malaysia as seen previously in Figure 1, Japanese manufacturers account for more than 80 percent of total sales. However, it should be pointed out that Perodua recorded 8 percent of the market share in the first year it started to produce a commercial vehicle, the 'Rusa'.

Table 3 shows the growth of automotive exports for both countries. Exports from Thailand have expanded rapidly since the government started providing export incentives in 1993, whereas the export growth in Malaysia has been rather modest. **Figure 4** shows the destination of Thailand's automobile exports. The majority of passenger car exports go to Singapore which has the highest tariff rates on passenger car imports among ASEAN countries.[28] This suggests that Thailand's passenger cars are highly competitive in terms of price. As for commercial vehicles, the figure suggests that auto manufacturers are making attempts to cultivate newly emerging markets, perhaps in search for market 'niches.' As for Malaysia, **Figure 5** shows that, although Proton's exports have increased gradually, production has expanded even faster in the 1990s. In 1996, export accounted for merely 11 percent of the total production. Figure 6 shows that almost half of Proton's total exports go to the UK, which offers tariff exemption privileges up to the GSP limit. Furthermore, as **Table 4** indicates, the prices of Proton's models in the UK tend to be higher than models made by competing Korean manufacturers,[29] which largely explains why Malaysian car makers (i.e., Proton and Perodua) have only achieved a mere 0.53 percent share of the UK's

[28] In Singapore, passenger car imports are subject to a 150 percent registration surcharge in addition to a 41 percent import tariff (Nikkan Jidosha Shimbunsha, 1998). Singapore has set tax rates on passenger vehicles at a high level to curb the growth of vehicle ownership and to control traffic congestion in the city center (Japan Economic Research Institute, 1992).

[29] Proton's 'Saga' exported to the UK was costly due to modifications necessary to satisfy British safety regulations. It was one of the most expensive economy cars on the British market, though it was priced below the retail price in the Malaysian market (Lim and Fong, 1991, p.152).

import market of passenger cars.[30]

Table 5 shows automobile imports in the 1990s for the two countries. In Thailand, particularly the number of passenger cars imported has increased rapidly since liberalization in 1991, and this resulted in intensified competition for domestic producers. The increase in imports has been modest in Malaysia, which still protects domestic producers with tariffs and non-tariff barriers.

Table 6 shows the import value of automotive parts and components. In Thailand, the rapid expansion of production in the 1990s largely depended on parts and components imported from abroad. Malaysia's import of parts and components does not seem to have grown so much, which partly reflects the slower increase in production compared to Thailand.

Regarding the development of local suppliers, localization programs are said to have contributed to the increased local contents ratio in both countries. In Thailand, the localization ratio for Honda's 'City' is reported to be 65 percent, and the ratio for Toyota's 'Corolla' is said to be 60 percent.[31] Car manufacturers are making efforts to increase the localization ratio above the official requirement of 54 percent in order to reduce production costs.[32] The average localization ratio for Proton's 1996 'Wira' model is 80 percent, and the ratio for Perodua's model was 60 percent in 1996.[33] However, it should be pointed out that both countries calculate the localization ratio based on percentage points assigned for categories of parts, instead of their costs. Thus, the localization ratio in terms of costs may be lower than the official figures. In fact, it is reported that the localization ratio of Proton and Perodua in terms of costs had been decreasing because they depended on imports from Japan for key parts and materials.[34] This observation is consistent with the increased import value of parts and components for both countries, which is shown in Table 6.

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30 The figure is for 1996 and is calculated from the data given by SMMT (1997).

31 The figures are based on Takayasu et al (1996, p.13), and include parts procured from other ASEAN countries under the Brand-to-Brand Complementation (BBC) scheme, to be explained in Section 3.2.

32 Takayasu et al (1996), p.13.

33 FOURIN, Dec., 1997, p.5

34 Takayasu et al (1996), p.23.

3-2. Coping with Trade and Investment Liberalization

Liberalization of trade and investment has become a global trend even in the automotive industry, and it is pressuring developing countries to cope with the liberalization goals without sacrificing their own development objectives. The following reviews the progress of the liberalization schemes that would affect the automotive industry in Thailand and Malaysia, and discusses how the automotive industry in the two countries are trying to cope with the liberalization goals.

3-2-1. The Progress of Liberalization Schemes

AFTA

ASEAN countries need to comply with AFTA's regional tariff reduction goals. The Common Effective Preferential Tariff (CEPT) scheme stipulates that tariffs for imports within the region need to be reduced to 5 percent or less by 2003.[35] Automobiles and automotive parts are currently placed on the Temporary Exclusion List of sensitive items, and these are to be transferred to the Inclusion List in five installments beginning January 1, 1996. However, items still remaining in the Exclusion List in 2000 may be designated as final exclusion items.[36]

Along with the effort to bring down tariff rates, attempts have been made to promote intra-ASEAN trade of automotive parts. Under the Brand-to-Brand Complementation (BBC) scheme initiated in 1988, auto manufacturers procuring at least 50 percent of parts from within ASEAN were entitled to a 50 percent reduction in tariffs for parts imported from ASEAN members, and they were allowed to include these in the local contents ratio calculation. A number of MNCs have developed their own networks of regional division of labor by making use of the scheme.[37] The ASEAN Industrial Cooperation (AICO) scheme,

[35] For detailed discussion of tariff reduction schedules under AFTA, see Chirathivat (1996).

[36] It is pointed out that efficacy of the AFTA Council, which is responsible for determining the final exclusion items, is limited by the strong voice of the member governments (Fuji Research Institute, 1998, p.14).

[37] For example, Toyota produces diesel engines and electronic and body parts in Thailand, transmissions

which came into effect in 1996, has a broader application to all manufacturing sectors. It reduces intra-ASEAN import tariffs on all manufacturing products, parts, and materials to between 0 and 5 percent, provided that the ASEAN Secretariat has authorized the firm to be eligible based on government approval of each country concerned.[38] Reflecting the reluctance of some of the ASEAN members concerned about protecting domestic industry, so far, none of the applications submitted by foreign investors had been approved.[39] Recently, Volvo succeeded in obtaining official approval from the governments of Malaysia and Thailand, and it is likely to become the first firm eligible for the scheme.[40]

APEC

Under APEC, tariff reduction and elimination of non-tariff barriers are to be achieved by 2020 for developing countries. At the Vancouver Ministerial Meeting in November 1997, automotive goods were specified as one of the fifteen areas for early voluntary sector liberalization, which was agreed upon in order to maintain the momentum toward the liberalization goal. It is reported that GM intends to proactively engage in the APEC forum to benefit from trade and investment opportunities in the region,[41] and other MNCs may also follow suit.

However, considering the fact that the liberalization scheme works on a voluntary basis, at this stage, it is difficult to foresee the APEC process creating a concrete impact on the liberalization of the ASEAN automotive sector.

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in the Philippines, steering gears, radiators and shock absorbers in Malaysia, and engines for commercial vehicles in Indonesia. Steering gears produced in Malaysia are exported to subsidiaries in the rest of the region (Fujita and Hill, 1997, p.317).

[38] In order to be eligible, firms must satisfy a number of criteria including procurement of at least 50 percent of parts from within ASEAN and local capital participation of at least 30 percent.

[39] Yoneya (1997, p.11) reports that Toyota, Honda, Denso, and others encountered difficulties in obtaining approval from Malaysia and Indonesia after their applications were approved by the Thai government.

[40] Nihon Keizai Shimbun, Feb. 7, 1998

[41] General Motors Corporation (1997), p.71.

WTO

Under the WTO, the trade-related investment measures (TRIMs) agreement specifies that by the year 2000 developing countries should eliminate investment measures that are not consistent with the principles of national treatment and prohibition of quantitative restrictions. Such measures include: (1) local contents rules; (2) trade-balancing rules; (3) domestic sales requirements; and (4) foreign exchange restrictions. Accordingly, this will force Thailand and Malaysia to abandon their local contents requirements, which have been raised to high levels as described in Section 2. Thailand's reaction had been generally positive before the currency crisis. The Thai government agreed to eliminate the requirements by July 1998, a year and half ahead of the deadline set by the WTO, in exchange for GM's decision to invest in Thailand instead of the Philippines. The firm planned to procure 52 percent of parts and raw materials locally.[42] Eliminating the local contents requirement may pose a serious challenge to the local parts and components industries in both Thailand and Malaysia.

3-2-2. Expected Impact of Liberalization on the Automotive Industry

As seen in the previous section, the most important features of liberalization in the automotive industry are tariff reduction and elimination of local contents requirements.

Drastic tariff reductions in the automotive sector through various liberalization schemes represent opportunities as well as challenges for the member countries. On one hand, liberalization widens the market, and thus automotive manufacturers gain better chances of benefiting from the economies of scale in production of both automobiles and automotive parts. For new entrants to the market, particularly MNCs, removal of protective policies opens up new trade and investment opportunities by enabling them to build competitive production networks in the region. On the other hand, for local car manufacturers, tariff reductions mean competition with imported products on an equal footing, and new investment by MNCs may further enhance competitive pressure. As price and non-price aspects of

[42] Takayasu et al (1996), p.14.

competitiveness become crucial,[43] firms will eventually be compelled to meet global standards of cost efficiency and productivity.

One problem with ASEAN's automotive industry is that most of the members have been trying to develop their own automotive industry and assist the growth of local suppliers despite the small size of their domestic markets. Furthermore, the market characteristics of automotive products in ASEAN members are perhaps more competitive than complementary. In such a setting, liberalization will likely lead to intensified competition between Japanese, US, European and Korean manufacturers and national car firms in Malaysia and Indonesia. It may eventually lead a few very competitive firms dominating the market.

Table 7 Tariff Rates in Thailand and Malaysia as of January 1998

		Thailand	Malaysia
CBU	Passenger vehicles	80%	CBU import requires import license (granted mainly to *bumiputra*-affiliate dealers.) Import tariffs range from 140% to 300% depending on displacement volume
	Commercial vehicles	Trucks:30% Pickup trucks, panel vans: 60% Commuters: 40% Ambulances etc.: 10%	4WDs,MPVs: between 60% and 200% depending on displacement volume Vans: between 42% and 140% depending on displacement volume
CKD	Passenger and Commercial Vehicles	Passenger cars: 20% Trucks: 10% Pickup trucks, panel vans: 20%	<National cars (Proton, Perodua)> Information not disclosed <Other manufacturers> Tariff rates designated within the following range. - passenger vehicles: 42% to 80% - 4WDs and MPVs: 10% to 40% - vans: 5% to 40%.

[43] Examples of non-price aspects of competitiveness include quality and design of vehicles, quality of pre- and after-sales services, and the development of niche vehicles customized to meet the needs and tastes of particular categories of consumers (Feketekuty, 1997, p.226).

Source: Nagata (1998)

Table 7 shows the current import tariff system and non-tariff barriers for automotive products in the two countries. In Thailand, the tariff rates for imported CKD kits are kept at relatively low levels and the system itself is simple and uniform. It should be noted, however, that following the recent currency crisis the rate for CBU passenger vehicles was raised to 80 percent in November 1997, from the previous levels of 68 percent for passenger vehicles with a displacement volume of 2,400cc or above and 42 percent for those below 2,400cc. As for Malaysia, the tariff system still remains highly complicated and even prohibitive. The country still prohibits CBU passenger vehicle imports except for *bumiputra* firms which are granted an import license. Though not officially disclosed, Perodua's import tariffs for CKD are exempted, and tariffs are set at 13 percent for Proton,[44] which are substantially lower than the tariff rates designated for non-national car firms.

Consequently, tariff reduction under AFTA and APEC is likely to be a serious challenge, particularly, for Malaysia's national car firms which have been heavily protected by tariff and non-tariff barriers.

The elimination of the local contents requirement will enable firms to source parts and components from the most competitive suppliers within or outside ASEAN. At the same time, this may be a serious threat to domestic suppliers which have depended on governmental support. As described in Section 2, both Thailand and Malaysia have raised localization ratios to encourage the use of locally produced parts and components. Particularly, Malaysia's policies have tended to encourage development of *bumiputra* suppliers. Previously, the localization requirement was one of the barriers for new entrants considering investment in Thailand,[45] and its elimination will likely be seen as an opportunity for MNCs. On the other hand, liberalization is expected to put less competitive local suppliers in a difficult position.

[44] Daiwa Institute of Research (1996), p.7.

3-3. Managing the Impact of the Currency Crisis

Before turning to the future prospects for the automotive industry, we need to study the impact of the Asian currency crisis which started in Thailand in July 1997 and spread to the East and Southeast Asian region. Although at this stage it may be too early to elicit any decisive conclusions about its impact, the following summarizes how the crisis will likely influence the future of automotive industry in Thailand and Malaysia.

3-3-1. How Has the Crisis Affected the Automotive Industry?

In spite of the differences in the specific nature of the crisis and the extent of seriousness across countries, the currency turmoil seems to have affected the automotive industry in the Thailand and Malaysia in the following aspects.

First, because of the severe economic downturn, domestic as well as regional demand for both passenger cars and commercial vehicles dropped sharply. Compared to other commodities, the fall in market demand for durables was particularly serious, and the automotive sector has been disproportionately affected by the fall in demand, as it had catered largely to the domestic market rather than to export markets.

Second, tight monetary policy adopted by the governments to counter the economic crisis, as well as the troubles of the financial institutions, has made it difficult for firms and individuals to obtain loans from banks. The credit crunch is driving automotive firms, particularly small- and medium-scale local parts suppliers, into the crisis of survival. In addition, the squeeze of consumer loans and high interest rates further reduced the domestic demand for cars.

Third, with the drastic devaluation of the local currency, a large number of automotive manufacturers have incurred serious foreign exchange losses, while imported parts, components and technology became substantially more expensive. Although Thailand and

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[45] Takayasu et al (1996), p.14.

Malaysia are said to have achieved certain levels of local contents ratio, many of the key parts and components are still imported. This pushes up the total production cost and it puts pressure on firms to increase car prices.

3-3-2. Thailand

In Thailand, the automotive sector has been seriously affected by the economic slowdown, squeeze on loans for consumers, and increase in value-added tax and excise taxes. Following the crisis, the government raised import duties on CBU vehicles from previous levels of 42.0 or 68.5 percent to 80 percent. Car sales totaled 363,156 units in 1997, a 38.4 percent drop from 589,156 in 1996,[46] and the forecast for 1998 ranges from 200,000 to 270,000.[47] The prospect for recovery, though still very uncertain, is expected to take at least a few years.

The crisis has given a serious blow to new investors in Thailand. GM has reduced its investment amount from US$ 750 million to US$ 500 million, and the firm cut down the planned annual output from 100,000 units to 40,000 units.

Japanese car manufacturers, many of which have been operating in the country for more than three decades, are basically trying to survive the difficult years by resorting to two main strategies. One strategy is to rationalize their operations in Thailand. Most of the major Japanese investors continue production on a reduced scale by operating only a limited number of production lines, producing only on certain days of the week, or even closing down some existing plants.[48] Some of the firms made plans to conduct training for Thai employees in Japan while the work shifts are being reduced, and some firms plan to offer financial assistance to its local first-tier suppliers. At the same time, as assemblers are compelled to cut back the number of suppliers due to falling demand, third-tier suppliers, most of which are

[46] Nation, January 20, 1998.
[47] Bangkok Post, Feb. 4, 1998; Nation, January 20, 1998; Toyama (1998).
[48] For details of specific measures taken by individual manufacturers, see FOURIN, Feb., 1998.

Thai firms, are likely to be severely damaged.[49]

The other strategy is to boost exports from Thailand in order to overcome the depressed domestic markets. As discussed in Section 3.1, the former destinations of Thailand's automobile exports included regional neighbors which have also been affected by the crisis, and thus firms are trying hard to search for new markets. Japanese investors have announced plans to increase exports of cars and parts from Thailand to countries including Australia, New Zealand, and South Africa. MMC Sittipol, with the longest history of production for export among Thailand's car manufacturers, exported more than 40,000 units of pickup trucks in 1997, which is more than three times the record of 1996, and the firm announced plans to increase exports to 80,000 units in 2000. Ford plans to export most of its output when production starts in 1998. However, taking into account new investments and capacity expansions, it is doubtful that Thailand's excess production capacity can be absorbed by exports when car manufacturers in other Asian countries are also desperately searching for export markets.[50]

3-3-3. Malaysia

Following the currency crisis, demand for cars dropped drastically due to the economic slowdown, squeeze on auto loans, and high interest rates.[51] Car sales in January 1998 recorded 12,182 units, a 63.5 percent drop compared to 33,421 units sold in the same month in 1997.[52] According to the car retailers association, car sales in 1998 are forecast to be

[49] Poapongsakorn and Fuller (1998, p.29) argue that indigenous third-tier suppliers are likely to be in a particularly vulnerable position due to poor technological capability. They also point out that Japanese manufacturers tend to favor their own suppliers during difficult times because of the investments they have already made in the suppliers for improving the quality and delivery and for reducing production costs, referred to as investment in 'relation-specific intangible assets.'

[50] Toyama (1998) adds that rapid growth of the car market cannot be expected in industrialized countries including Australia, and that the emerging markets of China and India already suffer from over-capacity.

[51] Local banks are cutting the number of loans by half and raising interest rates on car loans from 7 percent to 10 percent (Business Week, Mar. 9, 1998).

[52] New Straits Times, Feb. 21, 1998

around 160,000, a drop of 60 percent compared to the previous year.[53]

Faced with the worst time in its history, Proton has announced a number of measures to deal with the crisis. One measure raises the local contents ratio in order to cut costs of imported parts which became more expensive due to the depreciation of ringgit. However, it may not be so easy because the firm has had to rely on imports for many key parts and technology despite the government's localization policy. This reliance on imports is largely due to the lack of technological capability of local suppliers, which cannot be raised in the short run. Another strategy to cope with the crisis is to boost exports. However, as discussed in Section 3.1, it is not likely to be promising considering the lack of competitiveness and difficulties faced in expanding the market share in the UK. Although Proton is trying to use political ties in the Third World to export cars to new destinations such as Africa,[54] competition should be intense because car manufacturers in other Asian countries are also searching for export market to overcome depressed home markets.

Compared to the above measures, drastic restructuring, including scaling down of operations by firing workers, seems more difficult for Proton because of political sensitivity.[55] The company has decided to postpone, but not cancel, the large-scale project to construct Proton City in Tanjung Malim.

In relative terms, Perodua seems to be faring better than Proton. Its sales fell by only 13.2 percent to 3,294 units in January 1998 compared to 3,793 units in the same month in 1997, and Perodua substantially increased its market share to 33.7 percent in Malaysia's passenger car segment.[56] With models priced lower than Proton's, Perodua may still have some room for increasing its sales in domestic and international markets.

However, one still needs to consider that the domestic market is limited in a country with a population of 20 million, and in the long run, a car manufacturer can hardly compete in

[53] Nikkan Kogyo Shimbun, January 24, 1998.
[54] Straits Times, Mar. 4, 1998.
[55] ibid.
[56] New Straits Times, Feb. 21, 1998

the international market only in terms of low price. The currency crisis has further reinforced the urgent need for Malaysia's national car firms to improve their competitiveness, and Malaysia will have to face this challenge as the country eventually removes trade barriers.

3-4. Future Prospects

Before the currency crisis, Thailand was clearly taking the lead in the liberalization process of the automotive industry. Besides being the largest car market in the ASEAN region, relatively liberalized and simplified tariff structure and incentives to attract foreign investors placed the country in the best position to take advantage of the opportunity to become the regional hub of the globalized automotive industry. However, it has to be pointed out that the bright picture was mainly based on the active involvement of foreign investors. The liberalization progress is gradually exposing the fundamental constraints of Thailand's automotive industry that has depended largely on favorable economic conditions and external environment for its performance. For example, as seen in GM's request to eliminate the local contents requirements ahead of the WTO schedule, foreign investors are keen on sourcing parts and components from the most competitive suppliers, which may not necessarily be the local ones. If the country intends to avoid becoming merely a regional platform for auto assembly, the limited success of the policies to develop competitive domestic parts industry may become a serious obstacle.

For Malaysia, liberalization creates an enormous challenge for the national car firms, which continue to be protected by high tariff rates and non-tariff barriers. Although Proton has captured a large share in the domestic market, it is doubtful that it can successfully compete with the US, European, or other Asian car manufacturers without protective measures, considering the difficulties its products encounter to make inroads into the export market.

The currency crisis hit Southeast Asia at a bad time. It happened when many of the auto firms in Thailand and Malaysia were expanding production capacity through upgrades of existing facilities or taking on new investment projects. Virtually all of them, including MNCs

which are just starting new undertakings, need to find a way to survive the difficult years by restructuring and adjusting their operations in accordance with the completely changed outlook for the regional economy. They also need to compete with foreign car firms in export markets in terms of price, quality and other aspects of competitiveness. The crisis will likely give substantially greater damaging impact on the less competitive firms which have depended on protection, particularly national car firms and weak local suppliers, than on the world's top MNCs which have survived through competition in other markets. This would widen the gap between more competitive firms and less competitive ones in the ASEAN region, which would further reinforce the expected outcome of eventual liberalization.

4. Conclusion

This paper has examined the development of automotive industry in Thailand and Malaysia in a comparative perspective. It has been observed that the difference in approaches and capabilities of the two countries to cope with the challenges of liberalization can be explained largely by the differences in policies and the resulting development patterns of automotive industry.

In the early years, both countries followed the import substitution strategy to protect the infant industry and to ensure large production volume typical of capital intensive industry. However, the policies of the two countries have evolved differently, particularly in terms of the nature and extent of government intervention.

In Thailand, the private sector has basically taken the lead, and the government played its role mainly in offering protection and restrictions on entry during the early years and specifying the local contents requirement. The policies were never firm-specific, leaving room for competition at least among firms operating in Thailand. In addition, the government moved quickly towards liberalization and export orientation. This policy change, and more importantly, the favorable environment of expanding domestic demand, globalization of automotive industry, surge of FDI inflows opened up new opportunities for the Thai

automotive sector by taking advantage of liberalization progress.

On the other hand, Malaysia's automotive industry was assigned a political role of advancing the position of *bumiputra*, and the government guided it much more strongly. As a result, the national car firms could expand without facing with competition, and they captured an overwhelming share of the domestic market by relying on government protection. In effect, Malaysia's policies have focused exclusively on economies of scale, which are limited in a country with a population of merely 20 million. Malaysia's policies failed to discipline the national car firms because the firms were not exposed to competitive pressure. The failure of previous policies to strengthen the national car firms' competitive edge is expected to make the task of competing with other manufacturers within the region, particularly MNCs, extremely difficult.

With the recent currency crisis, automotive firms in both Thailand and Malaysia have had to face the constraints of their previous strategies, and they are trying to survive the difficult period by rationalizing their operations and searching for export markets. Coping with these challenges is expected to be more difficult for less competitive firms, particularly heavily protected national car firms and local suppliers, than for well-established top MNCs.

Similar to Thailand and Malaysia, many developing countries have attempted to build their own full-fledged automotive industry through various means, mainly because of its strategic nature. However, this often resulted in a large number of protected firms operating at inefficiently small scale, which meant a huge economic loss. The governments of developing countries should recognize that globalization and liberalization have become an irreversible trend, and they need to start preparing for intense competition in the future by gradually opening up their markets and exposing local automotive industry to external competition. This would enable firms to learn to compete on global standards, and it would probably encourage them to specialize in certain niche products or market segment in which they can compete the best.

Within ASEAN, nationalistic attitudes by some member governments act against smooth implementation of the AICO scheme to promote regional cooperation and tariff reduction under the CEPT scheme. The elimination of local contents requirements as

specified by WTO is not likely to be easy for Thailand and Malaysia, particularly considering the recent economic slowdown. However, MNCs still keep their eyes on the Asian automotive market, and they will likely demand further market liberalization in the region. In this regard, APEC, despite the voluntary and non-binding nature of its liberalization program, has the potential to play a role different from that of AFTA or WTO: to become a forum for dialogue between concerned parties including the member governments, local car manufacturers, and MNCs operating in the region or considering new investment. The most important contribution APEC can make in terms of trade liberalization in the automotive sector is perhaps mediating and reconciling possible conflicts of interests between the concerned parties.

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