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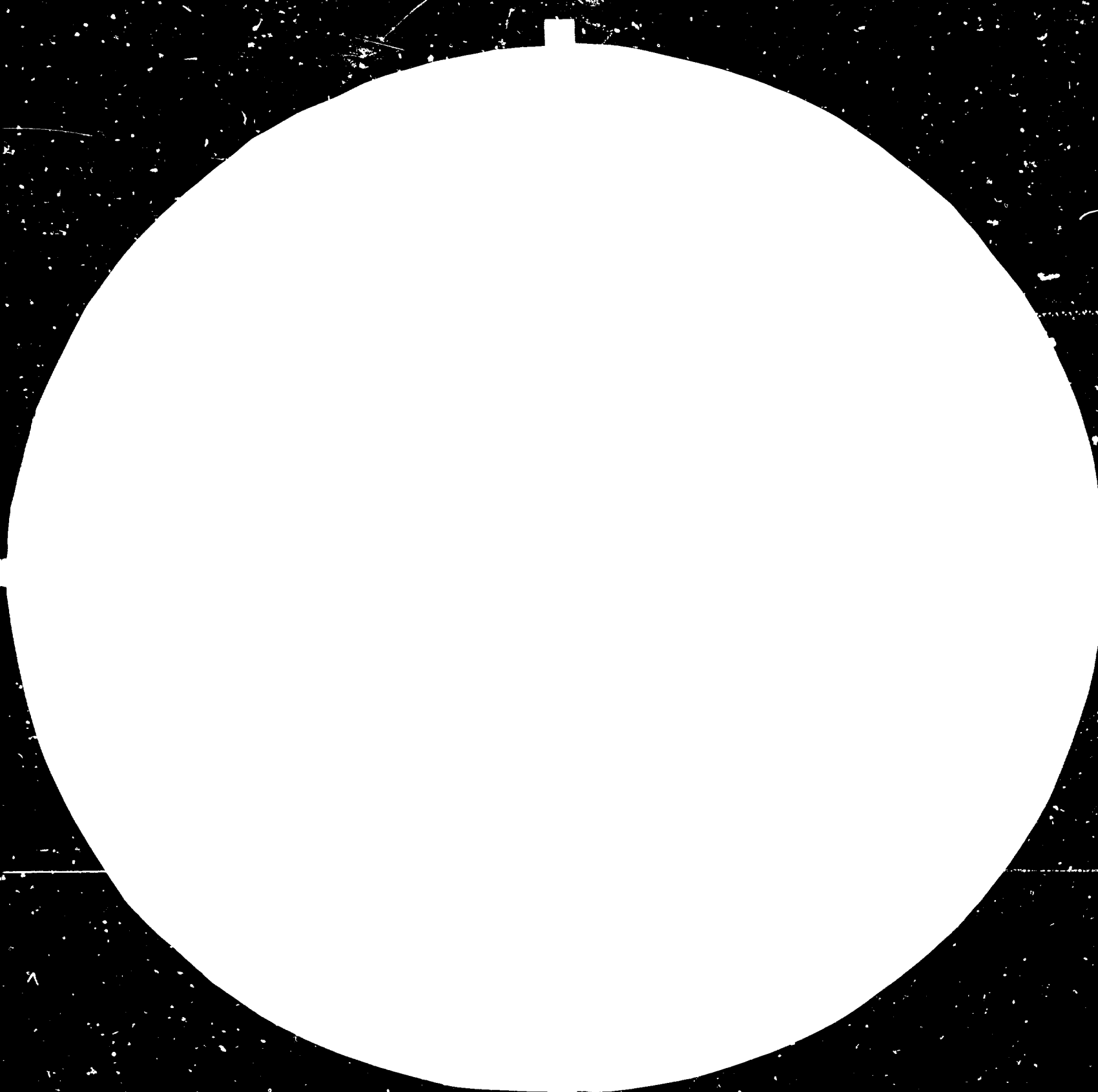
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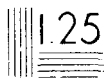
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SHORT REPORT ON
THE AUTOMOTIVE INDUSTRY IN THAILAND: IS A STRATEGY POSSIBLE?

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Seminar on Industrial Restructuring in Thailand

THE AUTOMOTIVE INDUSTRY IN THAILAND: IS A STRATEGY POSSIBLE?

I. Industrial Pathology

In those developing countries (DC) where an automotive industry (AI) has been established, its evolution can be charted with the clinical precision of a disease. With no local technology, private domestic capital unwilling to enter heavy industry and internal markets severely constricted by the very conditions of underdevelopment, the first phase witnessed the arrival of numerous transnational corporations (TNC) who set up assembly plants behind tariffs which imposed much heavier duties on the import of completely built-up vehicles (CBU) than of semi or completely knocked down ones (SKD or CKD). The fact that AI is characterized by oligopolistic competition on the global scale was enough to ensure that several TNC (rather than just one) would go to each DC and that their rivalry would take the form of multiple-model production: these two conditions in the framework of limited domestic demand guaranteed small-scale, high cost (compared to CBU) output. They were reinforced by an additional feature of TNC behaviour - the desire to secure market presence at minimal cost and risk. Thus the 'capital' contribution was almost invariably through second-hand equipment shifted from plants in the TNC home country and valued by the firm itself. This equipment was generally best suited to assembly of models already outdated in the country of origin. Its presence as 'equity capital' created an ambiguous situation regarding total payments to the TNC - it could claim both for its provision of hardware (the machinery) and software (management) as well as risk capital (the machinery again).

The first phase objectives of DC had, without exception, been creation of a 'core sector' which could diffuse industrial technology to other sectors, the promotion of industrial employment, and a reduction in foreign exchange

outlays; without exception, those objectives were not realised. The subsequent history of the sector has revolved around successive attempts to achieve, albeit partially, the aims fixed at the outset. The favoured instruments of policy have been: local content (LC) rules, designed to transform the local industry from assembly to production (in the sense that key parts are made domestically) and thereby generate greater upstream linkages in the economy; export subsidies, to encourage larger-scale domestic production of vehicles and reduce the foreign exchange drain (it was quickly discovered that the cost of SKD packages was not much below that of CBU vehicles while the former also incurred foreign exchange payment noted above); balanced trade rules, requiring each TNC to compensate for its imports by earning equivalent foreign exchange through export; domestic market quotas, tying local sales (market share) to net foreign exchange earnings of each firm, thereby seeking simultaneously to improve the foreign balance and reduce the number of local suppliers; direct restrictions on the number of local firms; and diverse measures to entice TNC to use DC as bases for component production, the output being destined for the home base or other links of the corporate chain.

The policies have been elaborated in most DC in the order just given. Over time, therefore, the preoccupation has moved more and more towards stanching the outflow of foreign exchange connected with AI. Except for Brazil and the Republic of Korea, the schedules proposed for constant rises in LC have had to be frozen or abandoned altogether - and even in these two countries the dependency of domestic production on foreign design persists while recent developments indicate that governments are prepared to relax LC to some extent if the TNC concerned will increase exports. At no stage has policy formulation been the exclusive preserve of the governments: on the contrary, both the substance and actual practice of the

policies has conformed quite closely to the strategic requirements of the TNC and the driving forces of oligopolistic struggle among them.

In the early phase those firms were content to 'register' as the sources of auto production, if and when local demand became appreciable. The rise in LC was satisfied by purchasing or producing fairly simple parts, none of which required substantial capital investment and whose deletion from the KD kits was in any case not matched by a corresponding reduction in their price. The preoccupation of DC with the trade balance in AI likewise had its positive aspects for TNC: on the one hand, it coincided with their experimentation with DC as cheap production sites for models which were still sold in OECD locations (the VW Beetle is the classic example) and on the other was not a risky activity due to the substantial subsidies (explicit and implicit) granted to exporters. Most recently the accent has been on cutting back the number of producers and models manufactured within each DC and on offshore sourcing (OS) of key components. This phase too is hardly out of step with changes in TNC strategies and the state of oligopolistic competition: at the moment, all leading TNC (GM and Ford from US, Toyota and Nissan from Japan, VW, Peugeot/Citroen/Talbot and Renault from Europe) are deeply enmeshed in strategic positioning on the global scale i.e. choosing product mixes, collaboration partners and production locations for particular components and vehicles. This rationalization of operations carries with it a willingness to withdraw from some markets and reinforce presence in others. At the same time the 'second set' of TNC (chiefly the Japanese firms Toyo Kogyo, Mitsubishi and Honda, but also to a lesser extent Fiat) must internationalize yet their more limited resources oblige them to do so via careful selection of regions and countries which (save for Honda's ventures in US and UK) means DC.

The policies elaborated in DC have been based on certain implicit assumptions:

- (i) that LC can be increased in steps which, whatever their effect on domestic production costs may be, correspond to established technical stages which are stable over time
- (ii) that the markets of DC represent a powerful pull for TNC producers and consequently they will struggle to get in and stay in
- (iii) that the far lower wage rates prevailing in DC were a strong force attracting TNC to localise their production of many components in DC and use the countries as export platforms
- (iv) that TNC would be unwilling to collaborate with each other in DC markets
- (v) that it was sufficient to deal with vehicle producing TNC without devoting much attention either to TNC component firms or to the interconnections between the two kinds of TNC
- (vi) that, in sum, it was the countries which held the important assets in the context of a stable oligopoly.

Events of recent years have placed major interrogation signs behind each and every one of these statements. The reason is the global crisis, its impacts on DC and the particular forms of crisis management adopted by the TNC in this sector. For the sake of brevity the dominant features of recent and actual trends can be summarized as follows:

- (i) the severe external debt problems affecting a large and growing number of DC have led to the imposition of economic policies which cut back economic growth in general but bite especially hard on the industrial sector; both demand for and production of autos has fallen sharply in most DC in the past two or three years.
- (ii) among the OECD countries new norms concerning products, production processes and corporate organization are rapidly being put into place. The essence of them on the product side is to reduce the

number of models sold in the region, strongly upgrade the quality and price, and introduce a notably higher content of electronic and of non-steel materials. Regarding production processes, the decisive change has been the massive reduction in employment of unskilled and semi-skilled labour accompanied by a move towards flexible manufacturing systems which permit the simultaneous achievement of low cost output with a high degree of adaptability of the product mix. Corporate organization has been marked by a mushrooming of collaborative arrangements (including some equity sales) among almost all TNC and the rationalization of production networks on the international scale. The future competitive position of each firm will depend on its ability to compete in these three dimensions.

- (iii) far greater selectivity is now being applied by TNC to their choice of DC in which to operate, what and how to produce in each selected country, how to organize investment in the country (joint ventures with public enterprises becoming more popular), the financial and other conditions to be obtained from the government, and the nature of linkages with local industry.
- (iv) Overall the strategic options facing DC are becoming starker at the same time as their bargaining strength vis-à-vis TNC weakens. The main directions (only some of which are available to most DC, and which are not necessarily mutually exclusive) comprise full local production of a few models, partial LC with continued import of major parts, concentration on production for export (via intra-firm trade) of major parts, production for export of simpler original parts, production for export of replacement parts, and the abandonment of the sector to imports.
- (v) the attempts at casting some strategies in terms of regional co-operation are faring very badly. It is the affiliates of TNC which co-ordinate if they wish, not countries.

II. The Situation in Thailand

In several senses AI represents a test case for Thailand, and for RESCOM in particular. It poses fundamental questions regarding whether a sector subject to substantial incorporation of new technology in the leading countries can be focus of technological learning and diffusion and a foreign exchange earner in the second half of the 1980s. It forces the government to develop strategies for bargaining with TNC at a period not only when the country's negotiating assets are not particularly powerful but also when the TNC themselves are mostly too preoccupied elsewhere to pay much attention to fresh initiatives. It obliges the government to reexamine the public/private income transfers which, overtly and covertly, are the consequence of the existing structure of the industry. It compels a serious assessment of the meaning of ASEAN industrial co-operation.

The present state of AI in Thailand shows the following characteristics:

- it is still more assembly than production; although LC is allegedly around the 45 per cent mark no major parts are produced within the country;
- more than 100 models are made locally with output per model at derisory levels;
- for at least the past 18 months there has been debate over whether the existing CBU ban should be maintained and the future timetable for LC;
- even existing LC is of dubious value: the import content of production costs in parts manufactured locally is high (around 60%) and there is little sign that the government is contemplating investments in other sectors which would permit that import content to be reduced;

- most parts producers make many other items which are not sold to AI: the economic pressures of the past couple of years have already driven these firms to diversify output and markets, particularly through export sales.
- domestic market is dominated by Japanese firms (accounting for roughly 80 per cent of all sales); the product split is approximately 70 per cent commercial vehicles with the rest passenger cars
- the sector is languishing in a state where it is not contributing to any substantial technological advance (though on the job learning may still be increasing somewhat) or to much diffusion, where other types of internal industrial integration are severely limited, where employment is falling gradually (the drop has been cushioned mainly by the diversification noted above), and where foreign exchange outlays are substantial.
- in short, it presents a major strategic challenge.

Till now, Thailand has not had any well-defined industrial strategy. Relatively few basic industries have been established; the participation of public enterprises in industry is extremely low compared to most other DC of the region (whatever their economic orientation); the administration seems to have only limited involvement with the elaboration and implementation of important control and monitoring systems affecting industrial structure and performance; little experience seems to exist regarding the collection of information on and assessment of TNC corporate strategies, corporate behaviour, technological development affecting industry in Thailand, or investigation of international markets; and the promotion of industry has had more to do with fixing the terms which would ensure private profitability rather than building an industrial fabric based on careful selection of activities to be undertaken at home and those for which foreign inputs would be required. These circumstances affect the whole of industry yet apply with particular force to AI due to the nature

of global changes in that sector. To develop a strategy for AI will thus require the government to depart drastically from its past practices.

Events are moving rapidly in Asia regarding AI. The Japanese TNC, which dominate sales throughout the region, are taking up strategic positions in response to various pressures including: competition among them both in the Japanese market and elsewhere; restrictions on export sales in major OECD locations, encouraging a search for surrogate export bases; opportunities to establish in potentially big markets hitherto closed; the need to confirm Japanese command over Asia just as the US TNC maintain their grip in Latin America; and the constant necessity to secure raw material supplies - since the Japanese firms are part of giant conglomerates which straddle numerous sectors (by no means confined to manufacturing industry), there are chances to conclude deals in which auto production is a quid pro quo for long term raw material contracts. In these strategic choices, however, there two factors which the Japanese firms do not seem to regard as advantageous viz. cheaper labour abroad and the possibility of local parts production. To consider these elements in isolation abstracts from the system productivity of the Japanese producers: for competitive reasons it is essential that foreign output approximate as closely as possible the quality and cost standards set in Japan, and this means either that major-parts should be supplied from home base or that Japanese component firms be encouraged to set up in other Asian countries (in which case LC may be met on paper but in practice will not imply much local participation).

In the past three years the strategic positioning has been:

- Republic of Korea: Mitsubishi has taken a 10 per cent stake in the publicly owned Hyundai, concluding also a technical assistance contract in the context of a doubling of capacity aimed at launching exports of the second generation Pony Model.

- Taiwan: Toyota has concluded a joint venture involving public and private domestic capital aimed at production of 300,000 units of Toyota model by the end of the decade, with one-half scheduled for export to OECD
- India: Suzuki (in which GM has a 34 per cent equity stake) has signed a joint venture with publicly owned Maruti for production of 100,000 vehicles per annum by the end of the decade. The extent of domestic parts production is as yet unclear, but the 26 per cent equity stake held by Suzuki gives it, under Indian company law, the veto power over choice of component suppliers. Various other arrangements between Japanese and Indian enterprises are under discussion covering other parts of the vehicle market.
- Malaysia: in early 1983 Mitsubishi took a 30 per cent equity stake in a new joint venture with the publicly owned Hicom aimed at building a so-called 'national car'. LC is not in fact scheduled to rise that much and there is talk that parts produced elsewhere in ASEAN would qualify as LC. However, the key aspect of the venture is the construction of body building plant with an initial annual capacity of 80,000 units and due to come onstream in the next two to three years. Tariff increases to support this project are envisioned.
- Philippines: the government has recently (August 1983) announced measures to reduce the number of participants in the Progressive Car Manufacturing Programme (PCMP) from 5 to 2. In response the local affiliates of Toyota and GM seem likely to link up, while the other combination may come from the affiliates of Ford, Mitsubishi and Nissan.
- Singapore: the government is concentrating entirely on parts production, with Japanese, US and European component producers all involved in negotiations.

These comments, intended only to be illustrative of recent moves, serve to demonstrate that within ASEAN itself as well as elsewhere in Asia major choices have already been made. The standard format is the joint venture with a publicly owned firm (often in the steel business) where Japanese have minority equity participation but firm grip on technical procedures and

management: in several, but not all, cases a significant proportion of output is destined for export. Mitsubishi has been particularly active in strengthening its position while Toyota may be in the first phase of expanding its activities (these are two TNC in the forefront of production within Thailand). Of the other Japanese TNC the interesting absentees are Honda (whose foreign strategy seems to be directed at the OECD) and the third largest Japanese producer, Toyo Kogyo (in which Ford holds a 25 per cent equity share) - it has so far apparently not made any major moves to strengthen its production bases nor has Ford done so. Among the European TNC the only one with real preteansions at the moment is VW, and its activities seem to be focused on China and Japan itself (the arrangement with Nissan for production of the Santana model).

Hence in relation to its own past limited experience in development and implementation of an industrial strategy, to the major alterations occurring in the global AI, and to developments in other Asian countries, Thailand is in a particularly weak position in the auto sector. Future actions cannot be reduced to marginal juggling of policy instruments but must focus on the role of AI in an overall industrial strategy in the next few years. Realistic assessments of what can be done and how require an examination of developments not only within Thailand but also in other countries of the region, with heavy emphasis on the likely behaviour of major TNC (both vehicle and component producers). The path to be followed cannot be simplified to a choice between export-oriented or import-substituting production (it is too often forgotten that an export-oriented policy does not necessarily yield positive net export earnings): rather, it is a question of selecting certain kinds of external contacts to achieve specified objectives of domestic production. If RESCOM is to help in that decision-making process, it will need an aggressive approach which actively seeks information on external developments and tries to utilise it in line with Thailand's own resources.

