Future of Industrial Policies

Part 1: Malaysia's failure and Thailand's success

EE 482: Public Policy and Industrialization
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Faculty of Economics, Thammasat University

Malaysia's failure and Thailand's success

- Until 1982, Malaysian auto industrialization focused on kit assembly.
- The already small market was shared by more than a dozen assemblers.
- The resulting market fragmentation made it difficult for components producers to achieve economies of scales, thus, the locally produced parts and components were expensive.
- "This hindered the further localization. In 1979, the average local content achieved was merely 8 per cent" (Fuangkajonsak 2006).
- Policy became radically more state-directed under Prime Minister Mahathir bin Mohamed.
- In 1981, he established the **government-owned Heavy Industries Corporation of Malaysia (HICOM)** which aimed to establish a **Japanese-like fully integrated automobile industry**, i.e. to build the **whole supply chain**.
- **A 'national car project' – Proton** – was launched as joint venture with **Mitsubishi (HICOM held 70% of the shares).**

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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Figure 10: National car Proton Saga (left) vs Mitsubishi Lancer (right)

Source: Wikipedia public domain photos.

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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- Unfortunately, the first fruit of this effort (the Saga, Figure 10) appeared in **1985 – the year the 2nd unbundling started to destroy the economic foundations of single-nation automobile production.**
- **Tariffs and taxes** meant that the Saga was **20-30% cheaper** than similar models domestically (Fujita 1999); its **market share rose to 73%** (Uzir Mahidin and Kanageswary, 2004).
- Exports started in 1989, mostly to Britain under the GSP scheme which allowed in up to 14,000 units duty free; these were sold below the Malaysian domestic price (Wad and Chandra 2011 p.166).
- Proton upgraded from assembling imported key components and parts to manufacturing them locally. Localization efforts, however, did not go smoothly.
- Saga continued to **rely on Mitsubishi for technology and design**. Despite its local and export success, Proton's sale volumes remained small by industry standards (under 100,000 units per year for all models).

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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- A second big push came in the 1990s as Proton introduced new models and produced them with varying engine sizes;. Malaysian production more than doubled from 1990 to 1997.
- Proton's plans, however, were even more ambitious. It announced a new project, **'Proton City'**, which would become an **integrated automobile manufacturing city** with a production capacity rising to 250,000 units in 2003.
- During this Proton expansion, **a second national car company** was set up (Perodua a joint venture with Daihatsu that produced a modified Daihatsu Mira called the Kancil).
- For many governments, **the 1997 Crisis** was the moment they realized that **the ISI dream was over**.
- Building a supply chain, like Japan and Korea had done, **was not optimal** and **indeed not possible after the 2nd unbundling**.
- **Quite simply, offshoring had killed import substitution**.

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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- The Malaysian government, however, persisted in pursuing its 1980-era strategy as far as possible. **Perodua was sold to its Japanese partner**, but Proton was re-nationalised in 2000 and the new, highly advanced plant was completed (Tanjung Malim, with a production capacity of 500,000 vehicles per year).
- Proton introduced the first Malaysian-designed car – the Waja (Impian in Britain) – with the help of **technology it acquired when it bought the British car company Lotus**.
- Proton moved up the value chain to **manufacturing its own engine in 2002**. **Given the high costs of parts production, Proton's domestic market share continues to fall into 2010**.
- Much of its **production capacity is idle**. The government is looking for a foreign partner for Proton.
- After four decades of import substitution, Malaysian auto sector employment was about 50,000 – 70% of whom are working for Proton or Perodua, and about 80% are unskilled labourers (Wad and Chandra 2011).

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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- Thailand's 1960s auto-industrialization plan also aimed for **the whole supply chain, starting with CKD assembly**.
- The **Thai Board of Investment** provided incentives that attracted automakers from the US, Japan, and Europe (Fujita 1999). Thailand raised **local content requirements** and effective rates of protection progressively.
- Japanese part suppliers established production in Thailand at the request of Japanese assemblers, thus recreating the close corporate ties that had long existed in Japan.
- **Japanese assemblers also developed their own Thai supplier networks** by helping local part firms raise their quality via technical assistance (Techakanont 2008).
- The economic slowdown and the progressive raising of the local content led GM, Ford, and Fiat to withdraw in the early 1980s just before Thailand's GDP growth took off.
- The booming domestic vehicle sales from **1987 came just as Japanese auto companies embraced the 2nd unbundling**.
- Unlike Malaysia, **Thailand abandoned the old wave to ride the new wave**.

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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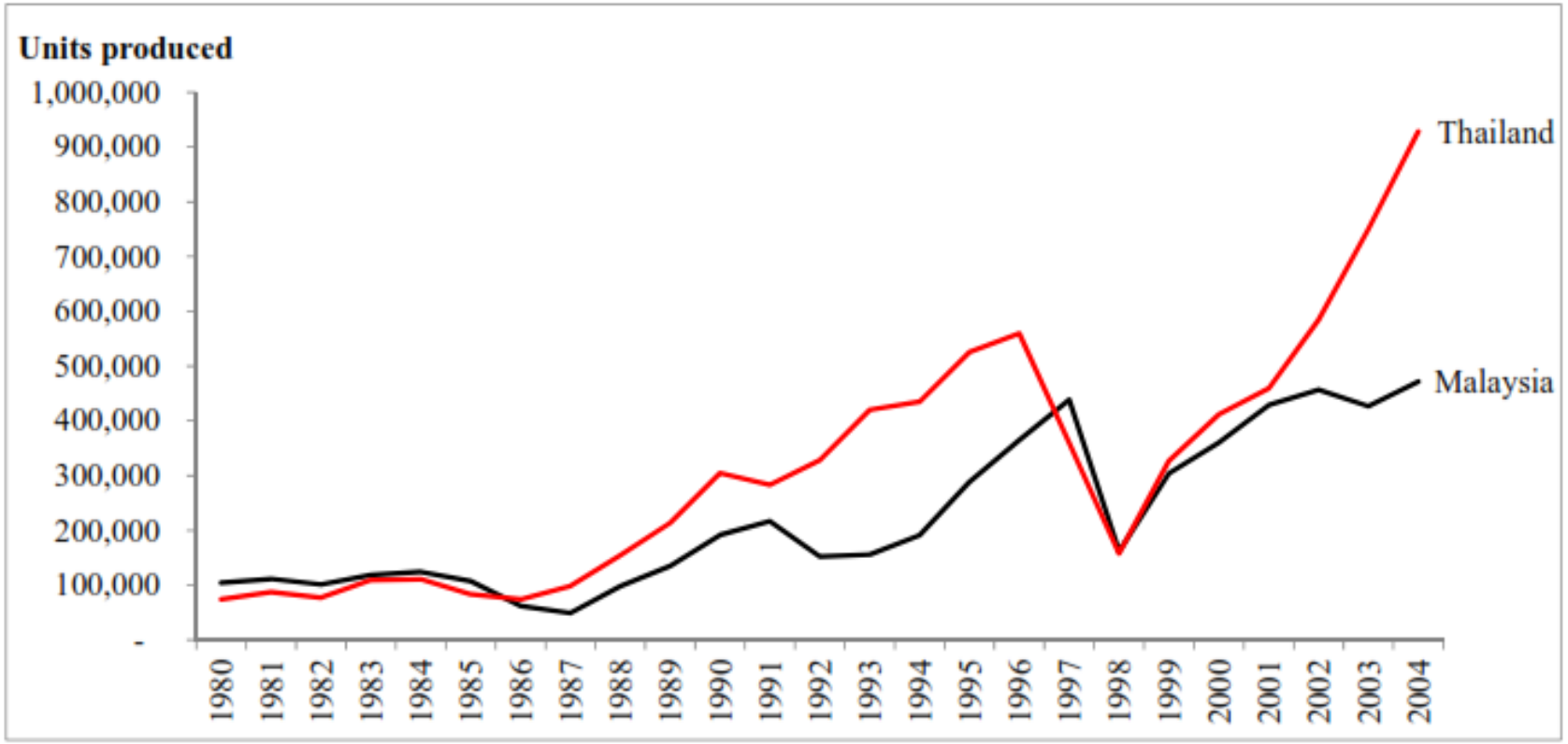
Figure 12: Vehicles produced, Malaysia and Thailand, 1980-2004



Source: Fuangkajonsak (2006 Table 1).

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.

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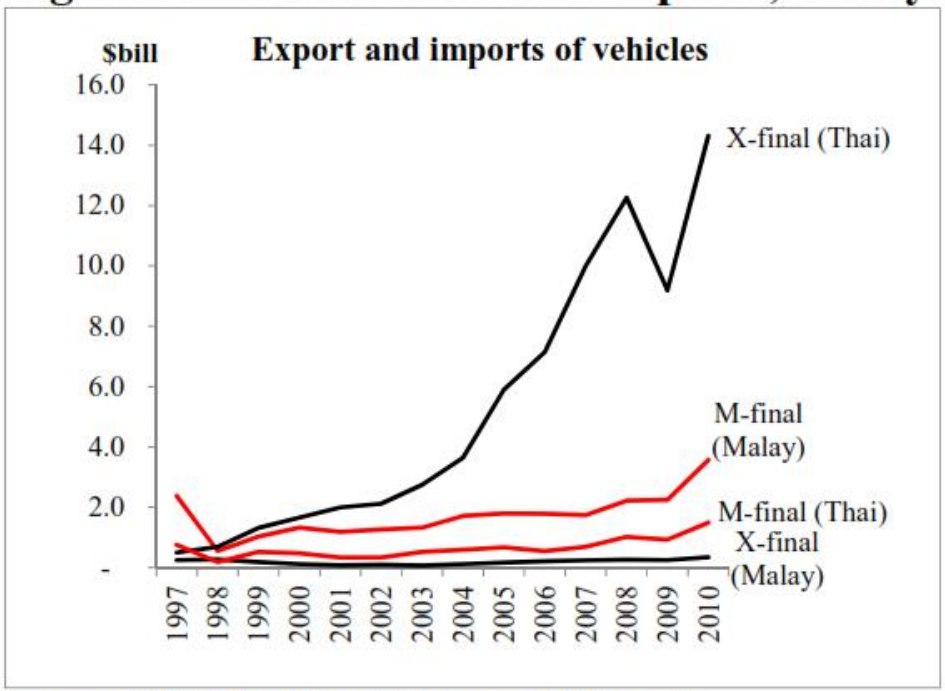
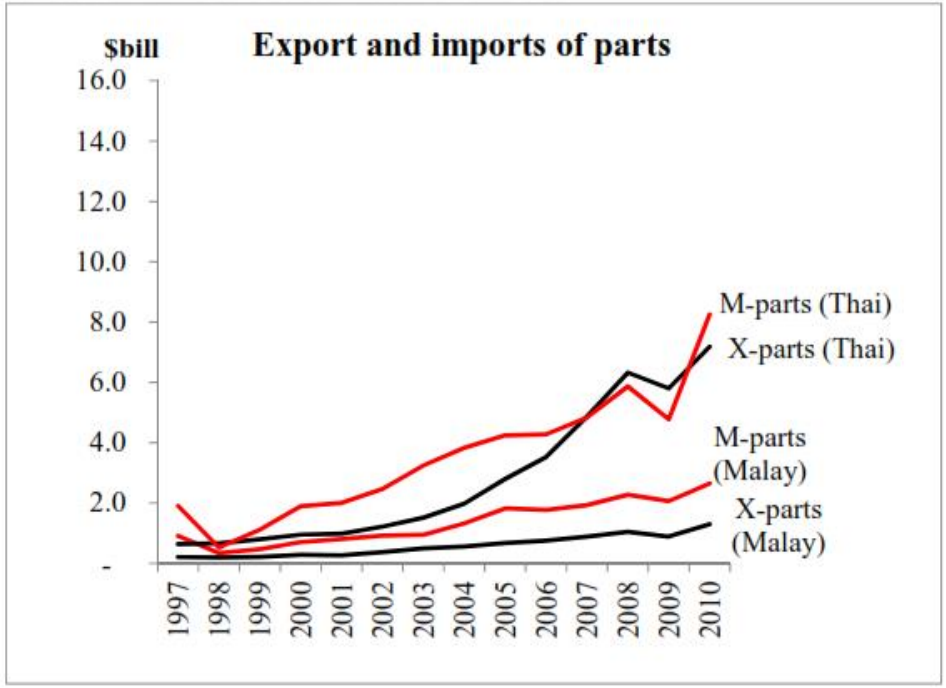
Figure 13: Trade in autos and parts, Malaysia and Thailand 1997-2010





Source: WITS online database, SITC v.3.

Source: Baldwin, R. (2011). Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters. NBER Working Paper No. 17716.