ASEAN Research Digest

SPECIAL EDITION

Research Partner: FROST & SULLIVAN

IN THIS ISSUE

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The ASEAN Research Digest is a quarterly publication aimed at communicating research findings related to ASEAN integration, cooperation and development that are relevant to business and industry in anticipation of the formation of the ASEAN Economic Community in 2015.

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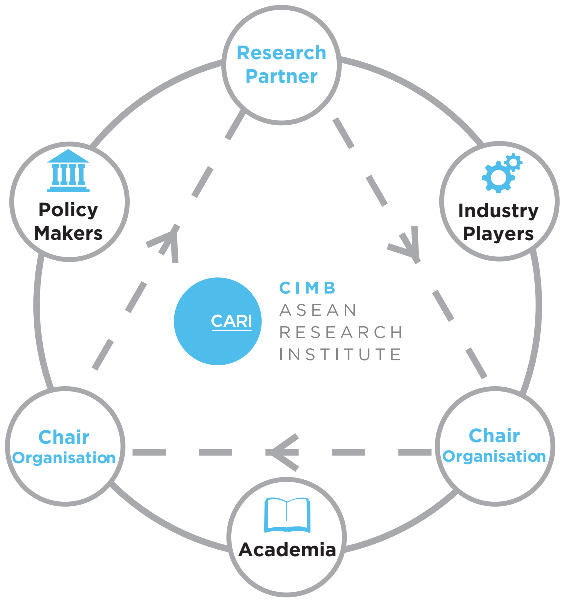
OVERVIEW

Research objectives:
The CIMB ASEAN Research Institute (CARI) in collaboration with the ASEAN Business Club (ABC) launched the Lifting-The-Barriers Initiative (LTBI) in 2013 as an integrated year long research platform involving core research as well as stakeholder engagement.

The objective was to adopt a vertical approach by means of identifying bottlenecks and barriers hindering free trade of prioritised sectors in the context of the ASEAN Economic Community (AEC).

The LTB Initiative targets six identified sectors which have pressing relevance to the business landscape in ASEAN and will play a major role in the successful formation of the AEC. The six sectors were Retail, Legal & Tax, Food & Beverages, Financial Services & Capital Markets, Minerals, Oil & Gas and Automotive & Manufacturing.

RESEARCH STRUCTURE



Two leading **ASEAN corporations** were selected to champion each sector, providing the direction and experiential insight into their industry. The input from these champions, or chair organisations, were key to understanding the issues faced by industry stakeholders and to develop the recommendations as part of the discourse.

CARI's Research Working Committee and its Strategic Advisors also worked closely with each of the six nominated Research Partners in producing these reports.

The Research Partners were either top management consulting firms or academic institutions who provided the technical knowledge and quantitative analysis required.

METHODOLOGY

The Lifting-The-Barriers Inititive (LTBI) is divided into four phases.

PHASE I

PRELIMINARY RESEARCH

Core research and compilation of qualitative and quantitative input from targeted sectors.

PHASE II

ABC FORUM

PHASE III

LTB REPORTS

The final outcome, a set of white papers, for ASEAN policy makers and community to effect real changes in the region.

PHASE IV

FINDINGS SOCIALISATION

The findings from the LTB reports will be prioritised and presented to various stakeholders including policymakers.

NTBs HINDERING ASEAN AUTOMOTIVE INTEGRATION

By: Frost & Sullivan | **Published by:** CARI, September 2014
Co-Chair 1: Alex Newbigging, Group Managing Director, Jardine Cycle & Carriage Ltd | **Co-Chair 2:** Yeap Swee Chuan, President & CEO, AAPICO

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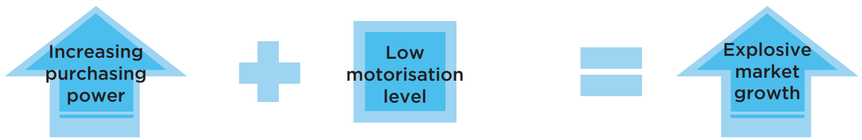
BACKGROUND

Research objective:
To explore the issues faced by the automotive and manufacturing sector in ASEAN, and analyse barriers to regional integration.

1. DEMAND SIDE

- ASEAN ranks as the world's 5th largest automotive market and is expected to retain that position in the coming years.
  - Sales in 2013 were 3.5 million units.
  - Sales in 2020 are expected to reach 4.5 million units.
- Demand in the region is increasing due to the increased affluence of the region's large population of over 600 million people.
- Increasing purchasing power coupled with low motorisation across ASEAN could fuel explosive and unparalleled market growth.

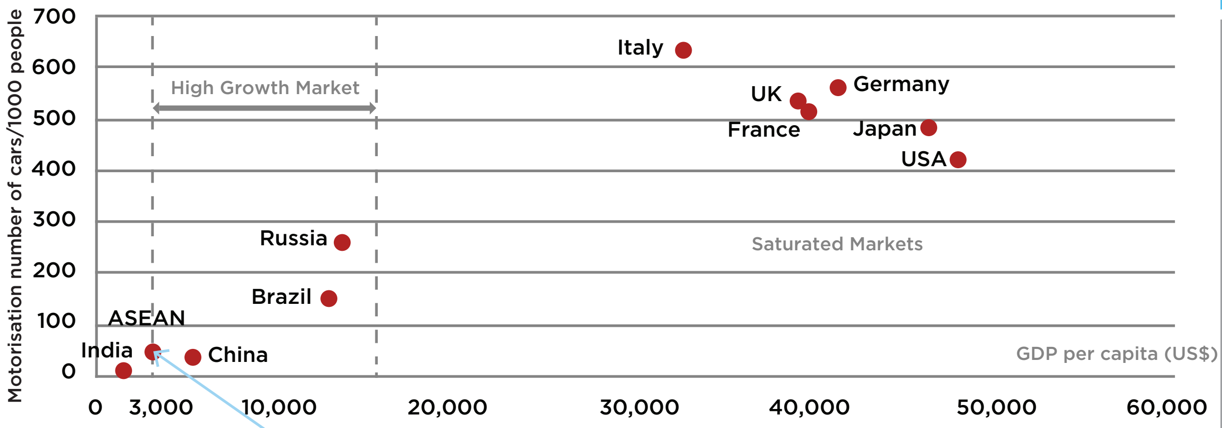


Global top 10 automotive markets – 2013 vs. 2020 (million units)

RANK	COUNTRY	SALES 2013
1	China	21.9
2	USA	15.6
3	Japan	5.3
4	Brazil	3.6
5	ASEAN	3.5
6	Germany	3.2
7	India	2.9
8	Russia	2.8
9	UK	2.5
10	France	2.2

RANK	COUNTRY	SALES 2020
1	China	34.5
2	USA	17.4
3	Japan	7.7
4	Brazil	4.9
5	ASEAN	4.5
6	Germany	4.3
7	India	3.6
8	Russia	3.4
9	UK	2.8
10	France	2.6

Motorisation vs. GDP per capita in key global markets

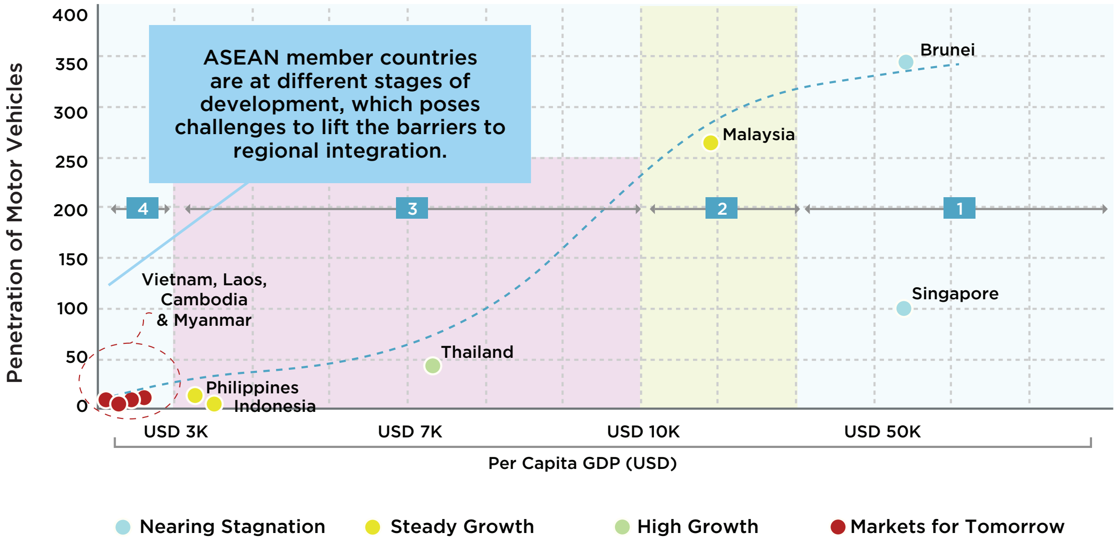


As ASEAN crosses the US$3,000 GDP per capita mark, vehicle ownership is poised to grow twice as fast as per capita income.

- Apart from natural market growth, government policy in ASEAN countries is also a driver of demand in the region.
- The regional and global economic integration policies of ASEAN countries are the most recent policies that shape the automotive landscape of ASEAN.

Main policies shaping ASEAN automotive landscape	Effect
The ASEAN Economic Community (AEC)	Likely to have a gradual but significant impact, but faces substantial challenges.
Free Trade Agreements (FTAs)	• Noodle bowl effect: trade complexities due to different rules of origin restrain FTA usage. • Only 26% usage rate in 8 APAC countries, according to recent HSBC survey.

Position of ASEAN countries on growth curve



2. SUPPLY SIDE

- ASEAN is also a significant base for automotive manufacturing.
  - The region is the world's 6th largest manufacturer of vehicles and could soon overtake Korea as the 5th largest base.
- Thailand is ASEAN's main manufacturing and exports hub with about 50% of manufactures exported.
- Other ASEAN countries mainly target domestic demand and have negligible exports.
  - Exports are further inhibited by a lack of alignment with global standards, supply chains and markets.

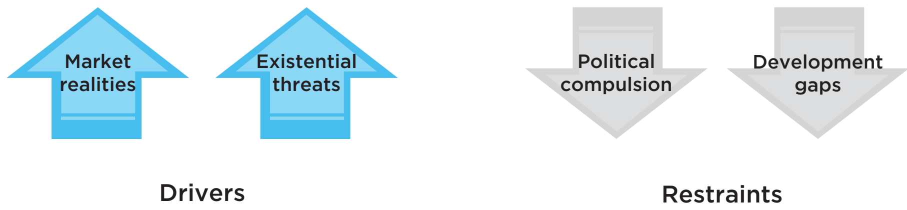
Top global vehicle production bases - 2013 (million units)

RANK	COUNTRY	SALES 2013
1	CHINA	22.1
2	USA	11.0
3	JAPAN	9.6
4	GERMANY	5.7
5	CHINA	4.5
6	ASEAN	4.4
7	JAPAN	3.9
8	GERMANY	3.7

AEC Objectives for the Automotive Sector

1. Abolition of regional tariffs
2. Harmonisation of automotive technical regulations
3. Mutual recognition of certification
4. Streamlining of customs procedure and distribution
5. Fostering of supporting industries and human resources
6. Promotion of safety and environmental protection

- By realising these objectives, AEC aims to enhance the region's competitiveness, create a level playing field without compromising on economic performance, bridge the development gaps and enhance ASEAN's role as a global supplier and market.
- Market realities and existential threat perceptions are the biggest drivers of sector integration while political compulsions and development divide are the key restraints.



- Three key measures of integration have been identified to reach the integration objectives of the automotive sector of ASEAN:

  1. Increasing intra-ASEAN trade and investment
     - Tariff elimination
     - Decreasing non-tariff measures
     - Custom co-operation
     - Effective implementation of ASEAN Industrial Co-operation Scheme (AICO) and The Common Effective Preferential Tariff (CEPT)
     - Improvement of rules of origin
     - Standards and conformance
     - Future investment
     - Improvement of logistics services
  2. Increasing technological capabilities
     - Enhance ASEAN car manufacturing capabilities
  3. Improving human resources capability
     - Training and skill certification system

IMPACT OF THE AEC ON THE AUTOMOTIVE INDUSTRY

- Even though the impact of the AEC on the automotive industry will most likely be significant over time, quick and radical transformation of the sector is highly unlikely.
- It is mainly due to the nature of the automotive industry itself, in which changes to local automotive sectors in ASEAN countries risk getting hold up by policy makers:
  - Heavy capital investment made over decades,
  - Strong linkages to other industries and supply eco-system,
  - Significant employment impact.
- The impact of the AEC can be assessed throughout the automotive value chain - from parts and component manufacturers and contract assemblers to original equipment manufactures (OEMs) and their channel partners:
  - Large global suppliers are expected to make inroads into the OE market as new entrant OEMs expand further.
  - New entrants are expected to gain the most as the level playing field will make it easier for them to expand their presence.
  - Dominance of big Japanese OEMs will be under threat.
  - Hard for local OEMs such as Proton to maintain their market positions.
  - Local suppliers, starved for demand and new technologies, are likely to focus more on the aftermarket.
  - Market consolidation and new strategic partnerships are expected.
- The likely impact of the AEC on the automotive landscape would be an interplay between seven key variables:

Impact of The AEC	
Drive Towards Lower Costs	**Market size** ▸ Lower cost due to scale economies **Market growth** ▸ Sustained demand growth due to low motorisation level and increasing affluence **Tax incentives** ▸ Government support to lower cost and enhance feasibility of investment **Manpower costs** ▸ Lower labour cost drives overall production costs
Policy Thrust	**Automotive policy** ▸ Government intent and sector focus will help attract more investment and fuel demand **Policy implementation** ▸ Government commitment and transparency to attract investors **External stimuli** ▸ Politico-economic influence of key auto markets such as China, Korea, and Japan.

KEY FINDINGS

NON-TARIFF BARRIERS

- The main barrier of the automotive sector manifests in non-tariff barriers (NTBs) to trade including, import quotas, anti-dumping actions, technical-, administrative-, health-, and safety regulations.
- These NTBs ended up having protectionist effects, especially non-harmonised technical standards, reduced mutual recognition of certification, and cumbersome customs procedures that do not sync with each other.
- NTBs are supposed to be eliminated in 2015 in the ASEAN-6 and by 2018 in the CLMV countries, but the process has been slow due to difficulties in identifying and compiling such measures at country level.
- Restrictions posed by NTBs vary between ASEAN member states:

Levels of NTB

Low → **High**

Cambodia | Thailand … **Myanmar | Indonesia | Philippines**

Main Barriers
1. Non-harmonised standards
2. Limited mutual recognition of certification
3. Cumbersome customs procedures
4. Skilled labour shortage

KEY FINDINGS

1. Non-harmonised standards

- Harmonisation of standards and mutual recognition of certification are the bedrock of Technical Barriers to Trade (TBTs).
  - Different product standards, varying by market and non-adherence to any international standards have an adverse impact on export competitiveness for locally manufactured automotive products
  - Furthermore they pose issues to environmental protection and road safety.
- The efforts towards harmonisation cover four key areas :
  - Environment and Fuel
  - Certification
  - United Nations Economic Commission for Europe (UNECE) Regulation Adoption
  - ASEAN MRA (Mutual Recognition of Agreements)
- Under the AEC, 19 priority UNECE standards are to be implemented by 2015.
  - However, the progress has been non-uniform and the pace of adoption has varied considerably between ASEAN Member States (AMS).
- The development gap in ASEAN remains a serious hurdle.
  - While Malaysia and Thailand are signatories to the World Forum for Harmonisation of Vehicle Regulations, other ASEAN countries are only observers.

2. Limited mutual recognition of certification

- A significant step was taken towards trade facilitation when the first pilot project on Self-Certification was launched in 2010.
  - The aim of the project is to enable certified exporters make out invoice declarations on the origin of their goods, shifting responsibility from the government to the industry.
  - An ASEAN-wide consensus on self-certification is expected to facilitate intra-ASEAN trade, promote regional production networks, increase usage of ASEAN Trade in Goods Agreement (ATIGA) and reduce cost of doing business.
- The first project was joined by Thailand, Malaysia, Singapore and Brunei
- Indonesia and the Philippines championed a second pilot project in 2013, joined by Laos.
- The industry hopes for a merger of the two programs, but is unlikely due to the non-acceptance of exporters and traders and third-country invoicing by the second pilot project.
- Other than the Operation Certification Procedure (OCP) of the two projects, limited participation of automotive players and the ambivalence of Cambodia, Myanmar and Vietnam, pose significant challenges in the quest for complete and uniform implementation.

3. Cumbersome customs procedures

- As ASEAN is not a customs union, the streamlining of customs procedures is imperative for ASEAN to root out corruption, stem delays and lower the transaction costs.
- The Trade Facilitation Framework was developed to integrate customs procedures, establish the ASEAN Single Window (ASW) program, enhance preferential tariff certification procedures, harmonise standards, and conformance procedures.
- Significant process has been made in developing the ASEAN Harmonised Tariff Nomenclatures (AHTN), ASEAN Customs Valuation Guide, and ASEAN Post-Clearance Audit Manual.
- Progress has however been slow with regards to the ASW Program as not all member countries have been able to establish and operationalise their respective National Single Windows (NSWs).
- Implementation challenges are many and vary among countries.

Implementation Changes	
Thailand Indonesia	Coordination issues, resource crunch, legal inadequacies
Philippines	Data standardisation, simplification of business processes

4. Skilled labour shortage

- The issue of labour mobility is especially important for businesses that have invested in manufacturing or assembly.
- As labour prices rise in key automotive hubs – Thailand and Indonesia – businesses are seeking flexibility in sourcing cheaper labours from other ASEAN countries.
- There is a great emphasis on market access of professionals and Mutual Recognition of Agreements (MRAs) have come to be the main way forward.
- Furthermore, many MRAs have still not been ratified by all countries and those that have, are facing some implementation challenges.
- Finally, MRAs will not address the issue of market access completely as employment is a sensitive issue in most markets and there are strong political and nationalistic pressures to ensure high percentage of jobs available for the locals.

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