

CHAPTER 1: INTRODUCTION

1.1. Background

ASEAN Free Trade Area (AFTA) is a collective effort by the Association of South East Asian Nations (ASEAN) member countries to reduce or eliminate tariffs on intra-ASEAN trade in the goods sector. The targeted tariff in the year 2003 was between 0% and 5% for the six original ASEAN members. Automotive parts are one of the key sectors in the goods sector which is affected by the AFTA implementation. However, Malaysia applied and was granted an extension of time until the year 2005 instead of 2003, in phasing out the current tariff duties on automotive products into CEPT (Common Effective Preferential Tariff) Inclusion List.

The Malaysian government hopes the extension of time provided for enforcement of the AFTA requirement for the automotive sector together with a rebounding economy and increasing demand for automobiles, particularly passenger cars, will help the domestic auto industry increase its economies of scale and market share as well as profitability. The delay in the AFTA enforcement is deliberate to help increase local content in the Malaysian-made cars such that automotive industry linkages are strengthened and automotive parts manufacturers are more profitable. The postponement will also provide chances for gradual implementation of more creative cost cutting measures especially in labour requirements, production costs and precision engineering in the automotive industry. Furthermore, more time will be available for automotive industry players to address future capital funding requirements, strategize and confirm what market niche they would be in the face of the impending liberalization due to the World Trade Organization (WTO).

Nevertheless, on 31 December 2003, the newly elected Malaysian Prime Minister, Dato' Seri Abdullah Ahmad Badawi simultaneously announced the

reduction in import duty and the extension of the imposition of excise duty on motor vehicles (as stipulated under Excise Duty Order 2004). The new tax legislation on motor vehicles was effective from 1 January 2004, a year ahead of the schedule, and took many by surprise.

The reduction of import duty is seen as a step towards achieving AFTA objectives. However, it is set off against the imposition of excise duty on all cars regardless of whether they are imported models or locally manufactured. The Malaysian government argues that the imposition of excise duty on imported cars is vital for offsetting losses projected in government revenues due to reduction or elimination of import duty due to the AFTA requirement.

Thirty percent (30%) of Malaysian government's total revenue is contributed by the import duty on the automobile industry. Reduction or elimination of import duty on motor vehicles due to AFTA would affect the Malaysian governments' tax revenue. Thus, in order to offset the tax revenue loss from the reduction or elimination of import duty on motor vehicles, the imposition of excise duty is seen as a shrewd move towards maintaining the Malaysia government's tax revenue.

In addition, the imposition of excise duty is to protect the national automobile industry; specifically Proton and Perodua. In the Industrial Master Plan (IMP), a plan towards achieving Vision 2020, the Malaysian government identified the automobile industry as a priority industry acting as a catalyst for the development of the engineering and other supporting industries in the country. This notion was based on the universal recognition that the automobile industry was one that required a high degree of technological research and development, labour skills, precision machineries and extensive linkages with other supporting industries.

The Malaysian government has so far protected the national carmakers (Proton and Perodua) from foreign competition mainly because the level of technological usage as well as research and development (and hence the level of competitiveness) at both Proton and Perodua which are still below par of the

more established foreign manufacturers. Moreover, the Malaysian government argues that Proton and Perodua is the only indigenous car companies operating in ASEAN while other car manufacturers, such as Honda and Toyota in Thailand, though operating in the ASEAN region, are not indigenously owned brands of an ASEAN country. This leads to the idea of protection of national interests and patriotism among Malaysians.

1.2. Research Problem

The latest tax legislation announced by the Malaysian Prime Minister has undoubtedly affected the governments' revenue in respect of import duty and excise duty from the automotive sector. Moreover, the changes in total import and excise duties on motor vehicles should be analysed in determining the net effect of total duties imposed indirectly on both manufacturers and consumers.

The past market trend of vehicle sales in Malaysia need to be scrutinized in determining the national car brands overall position in the Malaysian market. An analysis of the relationship between demography, ownership and method of financing of vehicles in Malaysia may be able to indicate whether new vehicles in Malaysia are reasonably priced.

Finally, it is essential to determine the perception and awareness of Malaysians on the tax legislation as well as the implication of AFTA towards the automotive industry particularly.

1.3. Research Objective

After analysing the research problems indicated above, this study is carried out with the following objectives:

- i. To examine the tax revenue contribution to the Malaysian Government from excise duty and import duty from the automotive sector;
- ii. To analyse the changes in import duty and excise duty for motor vehicles as announced by the government on 31 December 2003 applicable to ASEAN countries (CEPT);
- iii. To analyse the market trend of the automotive industry specifically passenger cars in Malaysia between the years 1999 and 2003;
- iv. To analyse and draw relationship between demography, ownership and method of financing of vehicles in Malaysia;
- v. To determine Malaysians' perception of motor vehicle prices due to AFTA; and
- vi. To determine Malaysia peoples awareness of tax legislation as well as the implication of AFTA towards the automotive industry.

1.4. Scope of the Study

The study will look into the indirect tax revenue contributed by the motor vehicle sector, particularly from excise duty and import duty, as well as the automobile industry in Malaysia, particularly the national car manufacturers (Proton and Perodua). It will also analyse the impact of the new tax legislation on motor vehicles as announced by the Prime Minister on 31 December 2003.

1.5. Organisation of the Study

Chapter 1 demonstrates the background of the study that leads to the research problem and objectives. The scope of study is defined. Chapter 2 provides the literature review available from the previous studies on the subject. The description of ASEAN Free Trade Area (AFTA) and the automotive industry in ASEAN and Malaysia is provided in Chapter 3.

Chapter 4 lays out the research methodology and techniques, including the research limitations. Analysis of the research is carried out in four separate chapters. Chapter 5 studies the Malaysian Government's Revenue in general and specifically examines the indirect taxes contribution to the government's revenue. A detailed discussion on import duty and excise duty is then followed by an analysis of the total revenue contributed by the motor vehicle sectors.

Chapter 6 analyses the changes in import duty and excise duty for motor vehicles as announced by the government on 31 December 2003 applicable to ASEAN countries (CEPT). Chapter 7 continues by analysing the market trends of the automotive industry specifically passenger cars in Malaysia between the years 1999 and 2003.

Chapter 8 examines the results of a survey conducted in order to draw a relationship between demography, ownership and method of financing of vehicles in Malaysia; to determine Malaysians' perception on motor vehicle prices due to AFTA; and to determine Malaysians' awareness of tax legislation as well as the implication of AFTA towards the automotive industry.

Chapter 9 concludes the research findings from the previous chapters with several recommendations for further research in the future.