

**Free Trade Agreement and Protection of Industrial
Sectors:
*Two Cases in Southeast Asia***

by

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CERTIFICATION

I certify that this is my own work and has not been submitted in any form for another degree or diploma at any university or other institute of tertiary education. This Master's thesis contains ideas and information derived from published and unpublished work of different authors which have been acknowledged in the text and list of references.

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ABSTRACT

The slow progress of multilateral trade liberalization under auspices of the WTO led to the revival of interest in bilateral and regional free trade arrangements elsewhere. This new mechanism of trade liberalization forced Southeast Asian countries (mostly developing countries) to alter their trade policy strategies to draw alongside the globalist (developed countries especially United States and EU). This phenomenon invited debates on various issues related to free trade between developed and developing countries.

By utilizing bilateral free trade agreement between Thailand and Malaysia with Japan as case studies, this thesis embarks on a comparative analysis of the two countries' responses, in particular responses made by government officials and societal actors (industrial players and business groups) on the negotiation process of each agreement in perspective of protection of strategic key industrial sectors. With past industrial policies which were implemented to foster domestic industries in their hand, both countries negotiated in opening up their domestic market which largely influenced the industries' competitiveness.

The study of JTEPA and JMEPA shows that relationship exists between the objectives and nature of past industrial policies (state-led/private-led development model) and responses made by government officials and societal actors on free trade. Malaysia's case revealed that high governments' involvement in business, with less emphasis on the roles of private, led to intensive efforts made by government's officials' in retaining past protective industrial policies and minimal opposition efforts made by the said societal actors. Whilst, minimal governments' involvement and high emphasis on private sectors resulted in more liberal response from Thai officials and rigorous opposition efforts made by its societal actors in keeping for their interests.

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LIST OF ABBREVIATIONS AND SYMBOLS

ACFTA	ASEAN-China Free Trade Area
ADC	Automotive Development Committee
AFTA	ASEAN Free Trade Area
AJCEP	ASEAN-Japan Comprehensive Economic Partnership
AKFTA	ASEAN-Korea Free Trade Area
AP	Approval Permit
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
ASEAN+3	ASEAN plus Japan, China and Korea
BOI	Board of Investment
CBU	Completely Built Up
CEO	Chief Executive Officer
CEP	Comprehensive Economic Partnership
CKD	Completely Knocked Down
CLMV	Cambodia, Laos, Myanmar, Vietnam
CRC	Cold Rolled Coils
DRI	Direct Reduced Iron
DTN	Department of Trade Negotiations

EOI	Export Oriented Industrialization
EU	European Union
E&E	Electrical and Electronic
EIA	Economic Integration Agreement
EON	Edaran Otomobil Nasional (National Automobile Distributors)
EPA	Economic Partnership Agreement
EU	European Union
FA	Framework Agreement
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTAA	Free Trade Agreement of Americas
FTI	Federation of Thai Industries
FTZ	Free Trade Zone
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
HICOM	Heavy Industries Cooperation of Malaysia
HRC	Hot Rolled Coils
ICT	Information and Communication Technology
IMP	Industrial Master Plan

IPR	Intellectual Property Rights
ISI	Import Substitution Industrialization
ISIT	Industrial Standard Institute of Thailand
ISIT	Iron and Steel Institute of Thailand
JAMA	Japan Automobile Manufacturers Association
JAPIA	Japan Auto Parts Industries Association
JMEPA	Japan-Malaysia Economic Partnership Agreement
JSEPA	Japan-Singapore Economic Partnership Agreement
JSG	Joint Study Group
JTEPA	Japan-Thailand Economic Partnership Agreement
LDP	Liberal Democratic Party
LMW	Licensed Manufacturing Warehouse
MAA	Malaysian Automotive Association
MAFF	Ministry of Agriculture, Forestry and Fisheries, Japan
MASAAM	Motorcycle & Scooter Assemblers Association
METI	Ministry of Economy, Trade and Industry, Japan
MIDA	Malaysian Industrial Development Authorities
MITI	Ministry of International Trade and Industry, Malaysia
MNC	Multi National Corporation
MOFA	Ministry of Foreign Affairs, Japan

MOI	Ministry of Industry, Thailand
MPV	Multi Purpose Vehicle
MVAC	Motor Vehicles Assemblers Committee
NAFTA	North America Free Trade Area
NEDB	National economic Development Board
NEDSB	National Economic and Social Development Board
NEP	New Economic Policy
NGO	Non-Governmental Organization
OEM	Original Equipment Manufacturers
PEKEMA	Persatuan Pengimport dan Peniaga Kenderaan Melayu Malaysia (Malaysian Malay Vehicle Importers and Business Association)
PERODUA	Perusahaan Otomobil Kedua
PERNAS	National Corporation of Malaysia
PIO	Pioneer Industrial Ordinance
PROTON	Perusahaan Otomobil Nasional
PTA	Preferential Trade Agreement
RTA	Regional Trade Arrangement
SEDC	State Economic Development Corporation
SJEPA	Singapore-Japan Economic Partnership Agreement
TAPMA	Thai auto Parts Manufacturers Association
TCC	Thai Chamber of Commerce

TRT	Thai Rak Thai
U.S	United States
USSFTA	United States-Singapore Free Trade Agreement
WG	Working Group
WTO	World Trade Organization

CHAPTER 1: INTRODUCTION

1.1 Background

Free Trade Agreements (FTAs) are widely discussed by policy makers, politicians, economists as well as the public at large. Nowadays, it becomes a trend for countries to rush in their negotiating and concluding for FTAs irrespective of their status. This clearly shows the importance of an FTA as a crucial element in trade policy. Traditionally, an FTA can be described as an agreement between two countries or a regional grouping aiming at the elimination or reduction of tariffs or non-tariff barriers between them or this can simply be described as ‘market opening’ among participating countries. However, from this traditional definition, FTAs have developed to a broader concept of deeper agreements (“new age” FTAs) which go beyond tariff elimination/reduction to include creation of regulations in new areas such as investment in services, competition policy, economic cooperation, government procurement, intellectual property rights (IPR) and the movement of natural persons.

All FTAs are preferential in nature as only signatory parties or members benefit from the consequence of the agreement. Therefore, some view that the FTAs incur *de facto* discrimination against trade partners who are non-members and thus will distort trade while others view that FTAs promote liberalization which creates trade. It is a never ending debate whether an FTA is a building block or a stumbling block to the multilateral trading system of the World Trade Organization (WTO). The WTO does recognize FTAs in Article 24 of General Agreements on Tariffs and Trade (GATT) and Article 5 of the General Agreement on Trade in Services (GATS). FTAs are exempted from the fundamental principle of most-favored nation (MFN) rules as pursued by the WTO under Article 1 of GATT.¹ “This exception is allowed as long as the FTAs meet three criteria; trade barriers are to be abolished for substantially all trades, trade barriers must not be raised higher than they were before integration and regional integration must be completed within a reasonable length of time” (Urata, 2002).

¹ MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

According to WTO, “the surge in RTAs has continued unabated since the early 1990s”.² Until July 2009, 249 agreements were in force. The breakdown of these agreements before and after inauguration of the WTO is shown in Table 1. Of these RTAs, the FTAs account for 60 per cent with 149 FTAs were notified and in forced.

Table 1: Regional trade agreements notified to the GATT/WTO and in force by type of Agreement

Agreement	GATT (1948-1994)	WTO (1995–July 2009)	Total
Free Trade Agreement (FTA)	21	128	149
Economic Integration Agreement (EIA)	7	61	68
Preferential Trade Agreements (PTA)	9	4	13
Custom Union	9	10	19
Total	46	203	249

Source: Compilation from WTO RTAs database - The Regional Trade Agreements Information System (RTA-IS). <http://rtais.wto.org/UI/PublicAllRTAList.aspx>

The breakdown of the Seattle WTO Ministerial Conference in 1999 and slow pace in trade liberalization negotiations under the Doha Round with the

² The WTO website on Regional trade agreements (RTA) http://www.wto.org/english/tratop_e/region_e/region_e.htm. RTA includes PTA, FTA, custom union and EIA.

collapse of the Cancun Ministerial Conference in September 2003 revealed the problems faced by the WTO in pursuing multilateral trade negotiations. These further promoted bilateral or regional FTAs as an alternative to multilateralism. Consequently, bilateral and regional FTAs are foreseen as more expeditious and advantageous compared to the WTO multilateral negotiations as they make possible for contracting parties to promptly and flexibly negotiate, thus forming new economic rules by taking into account their actual economic conditions. Taken into effect in respect also to the rules of various areas of which are not yet covered or difficult to reach agreement on under the WTO multilateral negotiations such as investment in services and IPR.

In East Asia, the earliest FTA began with the formation of regional free trade area of Southeast Asian nations or ASEAN Free Trade Area (AFTA) in 1992 to counter the power of other trading blocs in other regions such as the European Union (EU) in Europe, and the North America Free Trade Area (NAFTA) in America. AFTA would be fully implemented between its regional members with 0% import duty by 2010 for ASEAN 6 (Singapore, Thailand, Malaysia, Indonesia, Philippines and Brunei) and 2015 for Cambodia, Laos,

Myanmar and Vietnam (CLMV). Among the Southeast Asian countries, Singapore had led in bilateral trade agreements with its first bilateral FTA with New Zealand in 2000. However, its bilateral FTA with Japan - the Singapore - Japan Economic Partnership Agreement (SJEPA), in 2002 is considered as the most notable FTA in the region as it involved the 'new age' concept of FTA, which was named as an Economic Partnership Agreement or EPA. This EPA was also remarked as a trigger point for other ASEAN members to start shifting their trade strategies from multilateralism to bilateralism. Thailand, for instance, followed suit by signing its first comprehensive bilateral FTA with Australia in 2003. This development further made other ASEAN members to consider bilateral FTAs as part of their new trade policies.

Besides AFTA, ASEAN on its own and its member countries individually signed bilateral FTAs with Japan. To date, ASEAN collectively and its five major countries individually, had engaged in various bilateral FTAs with partners within or outside the East Asian region as shown in Table 2.

Table 2: Southeast Asia's FTAs

Country	Implemented/signed	Under negotiation
ASEAN	ASEAN-China (2003) ASEAN-Korea (2006) ASEAN-Japan (2008) ASEAN-Australia-New Zealand (2009) ASEAN-India (2009)	ASEAN-EU (2008)
Singapore	Singapore-New Zealand (2001) Singapore-Japan (2002) Singapore-Europe (2003) Singapore-Australia (2003) Singapore-US (2004) Singapore-Jordan (2005) Singapore-India (2005) Singapore-Trans-Pacific (2006)* Singapore-Korea (2006) Singapore-Panama (2006) <i>Singapore-GCC (2008)**</i> Singapore-Peru (2009) Singapore-China (2009)	Singapore-Mexico (2000) Singapore-Pakistan (2005) Singapore-Canada (2007) Singapore-Ukraine (2007) Singapore-Chile (2007)
Thailand	Thailand-New Zealand (2004) Thailand-Australia (2005) Thailand-Japan (2007)	Thailand-Bahrain FA (2002) Thailand-India FA (2003) Thailand-Peru FA (2003) Thailand-US (2006)
Malaysia	Malaysia-Japan (2006) Malaysia-Pakistan (2008)	Malaysia-India (2008) Malaysia-US (2006) Malaysia-Australia (2005) Malaysia-Chile (2006) Malaysia-New Zealand (2005)
Philippines	Philippines-Japan (2008)	Philippines-US Philippines-Pakistan Philippines-China

Country	Implemented/signed	Under negotiation
Indonesia	Indonesia-Japan (2008)	Indonesia-New Zealand Indonesia-Australia Indonesia-India

Source: Compilation by author from various government websites.

* *Singapore-Trans-Pacific – Singapore, Brunei, Chile and New-Zealand*

***Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates*

ASEAN has formed AFTA in creating its own regionally integrated market where there is a free flow of goods in the region which in turn would promote and enhance intra-ASEAN trade. At that time, ASEAN concerned that the formation of other regional free trade areas would create disadvantage to ASEAN countries. Products from ASEAN would be uncompetitive as they would not enjoy any preferential treatment compared with signatory countries of the respective region. Despite fostering AFTA, ASEAN also did recognize the importance of its other economic partners. With intensification in efforts for East Asian regionalism especially under regional economic cooperation and integration through ASEAN+3, ASEAN started to look for possibilities of having FTAs with China, Japan and Korea.

By setting aside concern about potential economic damages posted by China, on 4 November 2002, ASEAN signed the Framework Agreement of ASEAN-China Comprehensive Economic Cooperation as an important foundation for East Asian regionalism. This Framework Agreement, which came into force on 1 July 2003, was an umbrella agreement which provided general provisions on the establishment of an ASEAN-China Free Trade Area (ACFTA) within 10 years, with special and differential treatments and flexibility for the newer ASEAN members. ACFTA, like AFTA, was relatively a 'simple agreement' with limited coverage in areas for liberalization. Consequently, following Japan's initiatives and its concern about the importance of securing investment from its major foreign investors and trading partners, ASEAN collectively signed the Framework of ASEAN-Japan Comprehensive Economic Partnership (AJCEP) on 8 October 2003. Compared to ACFTA, AJCEP was a comprehensive agreement which covered a wider scope by including services, investment, economic cooperation and dispute settlement mechanism. In addition to AJCEP, ASEAN signed the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and Korea (AKFTA) on 13 December 2005. With the AKFTA, ASEAN accomplished its efforts for economic integration with the three major countries of Northeast Asia.

Despite attempts made by ASEAN in negotiating and concluding bilateral FTAs, its individual member country at the same time pursued FTAs with partners outside the ASEAN region. As an alternative way for quicker trade liberalization to sustain its economic prosperity and also to compensate for the financial crisis-affected AFTA market, Singapore, sooner than other ASEAN members, shifted its emphasis from multilateral trade expansion within ASEAN to a series of bilateral FTAs with non-ASEAN countries by negotiating and signing various FTAs with many major powers of most advanced economies like Japan, the United States, and Australia. Being compelled to follow Singapore, Thailand also started to consider advantages held by bilateral FTAs to its economy, and changed its stance by negotiating and concluding FTAs with extra-regional partners. Thailand signed its first FTA with Australia in April 2004.

The move in the pioneer FTA agreement between Singapore and Japan became a contentious issue for ASEAN. Few members especially Malaysia who still preferred for the multilateral and regional trade liberalization pursued by the WTO and AFTA, criticized Singapore as they believed that FTA's ratification with non-ASEAN members was an indication of relative loss of interests in the

home region which would further harm AFTA and impede ASEAN cooperation. For Malaysia, any bilateral FTAs should not be initiated, negotiated or concluded without the ASEAN consensus. However, this resistance had only short life and was altered along with intensified FTA proliferations elsewhere. Malaysia, for instance, dropped its vehement opposition of these cross-regional FTAs for fear of ‘missing out’ or being ‘left out the boat’ and changed its stance towards FTAs to its new trade strategies by signing its first bilateral FTA with Japan on 13 December 2005. The same fear of isolation also forced other ASEAN members like the Philippines and Indonesia to follow suit and started to consider bilateral FTAs as a new tool in their trade policy where the Philippines and Indonesia respectively signed their first FTAs, both with Japan on 9 September 2006 and 20 August 2007.

Notwithstanding efforts made in fostering trade through their engagement in FTAs, many Southeast Asia countries are facing difficulties in balancing its foreign trade policy with their domestic policy. The protection of specific industries has made tough for them in negotiating for FTAs. Many of these countries are forced to make structural adjustment into their domestic policy to reap the benefits of FTAs.

In generating their domestic economic growth, many Southeast Asian countries opted to develop their own strategic sectors as the key industries. Therefore, various industrial policies were formulated and adopted by respective governments. According to Kelly (1988: 15), “industrial policy is broadly defined as the deliberative attempt by the government to influence the composition of nation’s industrial output where it encompasses all government actions to foster activity in specific sectors”. Further, these industrial policies that aspired to promote the selected key industries are likely contradicted with trade policy that pursues trade liberalization. This situation further placed difficulties for government officials in deciding the best for their nation as any decision made would have positive and negative implications to their own domestic industries. In relation to this, societal actors who gained benefits from particular industrial policies i.e in the form of protection are also likely to oppose any decision made by the government to remove protective measures which shielded them from import competition.

1.2 Objectives of the Research

It is noted that the success of major Southeast Asian countries (except Singapore) in achieving fast economic growth was mainly based on the transformation of their main 'economic generator' from the agricultural sector to the industrial sector. Various industrial policies have been formulated by the respective government in fostering their industrial sectors to improve their economic power. Therefore, in doing so, many of these countries adopted different approaches when dealing with trade liberalization promoted by FTAs. For example, Malaysia with direct governments' involvement in certain strategic industries, assumed for the protective approach. Whilst, Thailand with no direct governments' involvement or investment in specific strategic industries, assumed for the liberal approach towards trade liberalization under FTAs with less protection granted to the industries.

To further nurture the industrial sectors, Southeast Asian countries did realize the need to retain access to the international market. In doing so, most of them engaged in FTAs in order to gain preferential treatment for market access of their exported goods. As the numbers of FTAs accelerated and the fear of lose

jolted, these countries responded to the new phenomenon by gradually negotiating and signing FTAs. These FTA involvements, however, came with many consequences. In reaping the benefits of the 'give and take' situation, many of these Southeast Asian countries are requested to open-up their own domestic markets for imported goods which in turn created predicament for domestic industries especially those that were uncompetitive or still struggling at nascent stage.

Thus far, the rapid increase of FTAs in Southeast Asia has drawn attention from many scholars to examine its causes and effects. A few studies have also been conducted to observe the motivation and influential factors of the FTA initiation. However, not much observation has been done on the factors which could influence the negotiation process of the FTAs, especially at the country specific level of the Southeast Asian region. Therefore, this dissertation is conducted with the objective to know the kind of industrial policies adopted by Southeast Asia countries and to further explore how the factors in relation to trends toward fostering or developing specific industrial sectors influence the negotiation process of an FTA.

1.3 Significance of the Research

The Southeast Asian countries have few similarities. In terms of industrial development, many of these countries such as Thailand, Malaysia, Indonesia and the Philippines implemented both import substitution and export promotion policies. However, in implementing the policies, different approaches have been adopted by the respective government depending on their degree of protection and liberalization of domestic industries. These differences could clearly be seen in the governments' moves towards the automotive industry which could be regarded as a vital sector to their national economic development strategies. In this sense, Malaysia as compared to the other Southeast Asia countries, notably Thailand, had a distinct approach in automotive development policies. Abdulsomad (1999: 275) stated that "diversity emerged after the 1980s when Malaysia with a state-led approach, adopted its new automobile industrial development policy with the commencement of the 'national car' project which transformed Malaysia from vehicle importers and assemblers into a full-pledged car manufacturers while Thailand with a private-led approach, remained as vehicle assemblers".

This movement required Malaysia to undertake the fullest efforts to protect its automotive industry to ensure the fruitfulness of the industry. In contrast with Malaysia, Thailand, which left the development of the automotive industry in the hand of private sectors and has no direct involvement in the industry, made less effort to protect the industry and preferably choose liberalization to enhance the industry's competitiveness. This different approach, i.e. protectionist or liberalist, has further transmitted in their FTA negotiations' stance. The Philippines and Indonesia, despite having no national cars, also had a tendency to protect its local assemblers in fostering the automotive industries.

In gaining the economic and political advantages of FTAs, many of Southeast Asian countries hurriedly joined the FTA bandwagon without vigilance and readiness. These created troubles during the negotiation process of the FTAs and raised concerns of many interest groups especially those directly affected by the FTAs. The mandate for successfully negotiated and concluded FTAs placed the government negotiating team in difficulties as to come up to a 'win-win' situation, they needed to accept certain requests from FTA partners to open up their market in targeted sectors which still shielded with protection measures. By

accepting the requests, the government would deposit risk to their domestic market. This in turn would negatively affect domestic industrial players and create frustration among them towards government's policies on FTAs. The societal groups which represented the industries would react towards any commitments made by the government. Those enjoyed fruits from government policies of protective measures would oppose such policies' removal whilst those who would get benefit from its lifting support the move.

As various bilateral FTAs are currently implemented and negotiated by Southeast Asian countries, it is crucial to analyze how influential factors in relation to the protective trends of industrial policy influence the negotiation process of an FTA. This research is inclined to study the influence of two major factors towards the FTA process in relation to the trends to foster or develop a specific industrial sector. On part of government officials, it is very crucial for them as policy-makers to fully aware of their own domestic industrial policy before negotiating for any FTAs to minimize the negative effects of those FTAs and to ensure that any FTA engagement is in line with their domestic industrial policy which will benefit domestic industries in return. For societal actors, involvement of those related to specific targeted industrial sectors will

influence the FTA process where these groups will pressure the government to make wise decision in negotiating for FTAs. The findings of this research may provide useful guidance for policy makers in their future prescriptions for potential bilateral or regional FTAs.

To accomplish this research, I will examine the relationship between industrial policies and trade policies in two Southeast Asian countries, Thailand and Malaysia by giving focus on the protective trends of past industrial policies along the negotiation process of bilateral FTAs.

1.4 Limitation of the Research

The study of protection in industrial sectors especially in FTA's negotiations is a complex issue and widely confidential in nature. Therefore, I found that it was relatively hard for me to gather primary data from government's documents. In addition to this, a fieldwork (including interviews) only confined to Malaysia in collecting primary data. A similar fieldwork was not carried out in Thailand due to time and financial constraint. Therefore, this study heavily relied on secondary sources gained from books, journals, newspapers and internet. This

limitation created difficulties for this researcher in accomplishing in-depth and meaningful research. The lack of reference materials on previous studies and researcher's experience in the research area also limit the sources for gathering valuable information and ability to produce a high standard outcome for this research.

1.5 Organization of the Thesis

This thesis is organized and structured into five chapters. Chapter one provides a brief introduction on area of my study and also the development of FTAs at various levels, East Asia, ASEAN and individual Southeast Asian countries. Chapter two looks at past relevant literature on FTAs in general and FTAs involving Southeast Asia and Japan in order to gather broad-spectrum ideas on the scope of the study. This chapter also provides analytical frameworks of this research. The following Chapter three and Chapter four are each allocated for empirical analysis on the Japan-Thailand Economic Partnership Agreement and the Japan-Malaysia Economic Partnership Agreement. Finally, Chapter five will conclude the thesis by providing discussions on the findings of this research.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

The proliferation of bilateral FTAs intensified around the late 1990s. This FTA phenomenon became the subject of intense debate for many scholars. As a consequence, there has been an emerging number of literature in various aspects (economic and political economy aspects) of FTAs. As my focus is on political economy, literature review is carried out on previous studies of FTAs from the political economy's perspective. Following this, I will summarize the past studies according to FTA studies in general, studies of Southeast Asia's FTAs and studies of Japan-centered FTAs.

2.2 General FTA studies

Urata (2002) examined the conditions of the mounting inclination towards regionalism in the 1990s. He observed that there were few characteristics of the growth in FTAs. According to Urata, the FTAs were getting bigger with an expansion in terms of their membership; the agreements also became deeper as they incorporated new elements such as common rules and cooperation between

FTA's members in various areas like labor mobility, competition policy and intellectual property. In addition, there also an increase in agreements between countries that was not necessarily in geographically close such as between Singapore and Chile; and countries which previously reluctant to join the FTA's bandwagon such as Japan and South Korea were now willing to do so by negotiating and signing FTA with various partners. By using the surge in FTAs as a focal point, Urata elucidated why FTAs were favored by many countries rather than multilateral trade liberalization under the WTO. From his observation Urata found that "a complex mix of external and internal factors, as well as economic, political and security-related factors was behind the expansion, intensification and diversification of RTAs" (Urata, 2002: 6). He held that the external and internal factors were the main reasons behind the proliferation of FTAs. Many countries were motivated to choose FTAs due to the external factors which include an access to overseas market and securing the existing one together with and internal factor which sought for domestic regulatory reform through external pressure brought by FTAs. Furthermore, the nature of bilateral FTAs which required less time to be concluded and involved fewer participants as compared to multilateral trade under the WTO were also contributed to the intensification of FTA's

proliferations. Urata also discussed the different type and characteristics of FTAs, the economic effects of FTAs including the static effects (trade creation, trade diversion and terms of trade) and dynamic effects (market expansion and competition enhancement) and their significance for the global and Japanese economies. He held that all the economic effects (excluding trade diversion effects) provided for positive developments to all FTA's members. He further asserted that "if FTAs could expand market, enhance competition and promote growth by members, the benefit would not be limited to that country party to the FTA, but to nonmembers also" (Urata, 2002: 28). In assessing the significance of FTA to Japan, he concluded that if Japan does not vigorously take part in FTAs, and if persisting for agriculture's protection in future FTAs, there was a risk that it would not be regard as a worthwhile FTA partner by other countries and would bear the cost of being expelled from future FTAs.

In relation to the rise in bilateral FTAs in East Asia and the Asia Pacific, Dent (2005) studied the characters and the main causes of these FTAs and possibility in advancing for regional cooperation and integration. He found that there were four reasons for the FTA's proliferations; the shift in countries trade

policy paradigm, from mercantilism to liberalism; trade institutions faltering of the WTO, ASEAN, APEC on moving forward with their respective trade liberalization agendas; the responses to the global FTA trend where they eager to catch up with their individual rivals from other regions to secure market access; and the strategic diplomatic responses to the 1997-1998 Asian financial crises where East Asian countries opted for the bilateral trade agreements as a means to cement the international economic relations in the regions. Dent further asserted that “the above politico-diplomatic and political economic motives for initiating FTA projects have been generally more important than pure economic motives for the Asia-Pacific states” (Dent, 2005: 294-295). In observing the nature of these FTAs and its contribution to regional economic integration, Dent argued that the different and rival FTA models and modalities between the U.S ‘asymmetric neo-liberal’ model and the Japanese ‘developmental-industrial’ model complicated any efforts in forging for an Asia-Pacific FTA. Furthermore, significant barriers such as the agri-trade protectionism and economic disparities in the region impeded the realization for this regional FTA.

In addition to this, Ravenhill (2003) in his study on the new bilateralism in the Asia Pacific investigated why Western Pacific countries apparently changed their approach to trade liberalization from non-discriminatory basis (multilateralism) to discriminatory basis (bilateralism) and what were the likely effects of the proposed bilateral agreements. His study revealed that there were three reasons for the new interest in bilateralism in the Western Pacific countries; “an increasing awareness of the weakness of existing regional institutions and initiatives; perceptions of positive demonstration effects from regional agreements in other parts of the world; and changing of domestic economic interests” (Ravenhill, 2003; 300). Ravenhill argued that the consequent of the Asian financial crisis together with different members’ perception on the progress of market liberalization of the APEC and ASEAN as well as the WTO, encouraged many Asia Pacific countries to divert their interests from multilateralism to bilateralism. He also asserted that the new interests in bilateralism was also augmented as pro-liberalization forces believed that these new bilateral agreements could be as a means of supporting the movement towards freer trade and would further be a foundation for a global free trade. In addition, bilateral FTAs “could act as a steppingstone by gradually exposing the protected sectors to

the international competitions” (Ravenhill, 2003; 302). Ravenhill also argued that there were five likely effects of the FTAs; economic effects of the participant economies; economic effects of non-participants; effects on domestic political economies of the participants; effects on the existing regional organization; and effects on the international trade. In terms of the effects on domestic political economies, Ravenhill stated that unlike multilateral trade liberalization which required for reciprocity and tends to maximize pressure on participant countries to open up domestic market, bilateral FTAs did otherwise by offering less external pressure to its participants to engage in the reciprocal liberalization. In addition, the bilateral FTAs provide avenue to participant countries for selective liberalization. However, he affirmed that the results of the new bilateralisms were likely to be paltry with the participant economies especially developing countries only captured small gain from the agreement. This new bilateral FTAs also tend to force governments to remove protection on certain sectors by adopting approach of “liberalization without political pain” (Ravenhill, 2003: 299).

Ravenhill (2006) also conducted a study on the political economy of the new Asia-Pacific bilateralism. Based on FTAs involving East Asian countries

with 12 having been implemented, 15 currently under negotiation and 10 under study, Ravenhill found that many of these agreements have been asymmetrical and driven by political factors which in turn made exclusion for several sectors. He further argued that although this exclusion provided governments with political benefits, at the same time it created a new structure of protectionism that might harm consumers, created trade diversion and encouraged further lobbying by protected industries. As a result, this new bilateralism which provided a means to achieve liberalization without political pain encouraged protectionist interests and had the possibilities to undermine pro-liberalization alliances.

2.3 Research on FTAs in South East Asia

In assessing how FTAs in Southeast Asia were essentially a means to secure FDI at the expense of the working class, Arnold (2006) in his study of Free Trade Agreements and South East Asia, held that free trade and FTAs were often portrayed to the people especially in the developing countries as a prescription for economic prosperity, promising that the domestic industry would develop in parallel with export market expansion. Therefore, if these developing countries wished to gain benefits from FTAs, they were required to make a structural

reform at home by liberalizing their domestic markets and get rid of all rigid trade obstacles in order to draw the FDI. Arnold further stated that “structural reform is essentially locked into FTAs and making liberalization difficult to reverse once begun” (Arnold, 2006: 205). By using the Mexico’s experience with the NAFTA and the ongoing negotiated FTA between the U.S and Thailand, he argued that these FTAs would give negative effects on workers especially from labor-intensive industries. He held that the negative effects of FTAs still apparent despite positive arguments (win-win arrangements) made by the participating countries as many developing countries still could not sustain for unprecedented global markets competition, FDI and ever-cheaper production. Arnold concluded that “free trade, increased market integration, and FTAs were more compatible with the authoritarian labor control, increase poverty, job displacement, and weakening of the development process than with sustainable development” (Arnold, 2006: 214).

Daquila and Huy (2003) analyzed Singapore’s FTAs and asserted that while Singapore has always supported the encouragement of free trade at regional and multilateral levels, various factors had contributed to its bilateral trade policy.

First, the progress of the ASEAN regional integration was sluggish, beneath Singapore's anticipation for its own advantage and for the opulence of ASEAN. Therefore to address this issue, Singapore seeks accomplishment of its aims through bilateral conduits to complement its regional and multilateral trade liberalization initiatives. Second, ASEAN has been taken time in constructing free-trade linkages with the developed countries such as the United States, Japan, and the EU. Third, Singapore has also pushed to refine its trade policy by giving emphasize to bilateral trade to ensure that its companies would not seriously be disadvantage due to the advancement in trade liberalization and growth activities in the Western block with the formation of trading blocks such as NAFTA, the enlargement of the EU and the expected formation of a Free Trade Area of Americas (FTAA). Fourth, Singapore's FTAs are hoped to serve both economic and strategic interests, and fifth, Singapore's FTAs were supposed to advance market liberalization and integration and accelerate the worldwide free trade within the WTO framework. By using Singapore's bilateral FTAs with Australia and New Zealand, Japan and the U.S, Daquila and Huy demonstrated and asserted that those FTAs provided equal benefits to all signatories despite various critics posted to them. Furthermore, FTA with the U.S went beyond economic realities

as “for Singapore, the USSFTA would signify for a continued American engagement in Southeast Asia that could help Singapore to balance regional power politics for its own national interests and survival” (Daquila and Huy, 2003; 920).

In examining Malaysia’s FTA policy, Suzuki (2003) found that there were two important facets in Malaysia’s policy towards FTAs; “economic impacts of FTAs on its domestic industries and diplomatic aspects of FTAs that were closely related to its ASEAN diplomacy” (Suzuki, 2003: 286). Suzuki argued that it was not easy for Malaysia to pursue FTAs without reforms of its own protective industrial policy especially on the automotive sector. Due to its protective stance, Malaysia has delayed liberalization on the automotive products under AFTA. The study also concluded that Malaysia preferred to have the ASEAN-based FTAs rather than bilateral FTAs that received no ASEAN consensus due to its concern about ASEAN’s unity and its effort in building and maintaining the ASEAN economic integration. Malaysia also foreseen that the ASEAN-based FTAs could provide more flexibility for its commitment as they helped to a certain extent shielded the impact of such FTAs on the domestic industries. Malaysia changed

its position towards bilateral FTAs with its potential FTA with Japan only after both ASEAN and Japan agreed on approach for bilateral FTAs among ASEAN members along with the realization of the regional ASEAN-Japan Comprehensive Economic Partnership Agreement.

In case of Thailand's FTA policy, Nagai (2003) studied on the continuity and change between the Chuan and Thaksin governments. The study found that the initiative for bilateral FTAs under the Thaksin government had come mainly from Prime Minister himself. Nagai also held that there were three main factors that motivated Thailand to seek for bilateral FTAs. Firstly, slow pace of liberalization under auspices of the ASEAN and the WTO especially in the agricultural sector. Secondly, Thailand tried to circumvent the FTA syndrome which created the fear of being isolated and excluded from the world by not participating. Thirdly, the change of the Thai government to Thaksin led to the formation of a new economic strategy through the implementation of the 'dual track' policy - FTA policy and domestic policy where the FTA policy promotes FDI and exports while the domestic policy strengthens the domestic economy.

In accessing why countries particularly Thailand were so eager to establish bilateral and minilateral FTAs and the impact of these FTAs, Kiyota (2006) made an attempt by focusing his study on the political and economic aspects of Thai FTAs. His study found that Thailand changed the focus of its FTA's partners from developing countries to developed countries when Thai's supremacy was taken by Thaksin in early 2001. This change was linked to both internal and external factors. The internal forces were the sluggish of the Thai economy after the Asian financial crisis and the altering support from domestic business circles whilst the external factors include "the formation of an AFTA, implementation of the new WTO rules and policies, and competition with Singapore and China to attract new FDI" (Kiyota, 2006: 207). In analyzing the economic aspects of bilateral trade agreements, Kiyota used the CGE model to examine the impact of Thai FTAs on the Asia-Pacific economies. Based on this model of analysis, Kiyota established that "the positive impact of Thai FTAs was not always guaranteed unless the AFTA is successfully implemented" (Kiyota, 2006: 227). He also assured that the combination of the AFTA with bilateral FTAs would be more favorable to the Thai economy than the geographically scattered minilateral FTAs. Kiyota asserted that Thailand's bilateral FTAs should not be considered as a main goal of Thailand's trade policy, but as a step towards multilateral trade agreements pursued by the WTO.

Mutebi (2004) in his study on Thailand in 2003: Riding High Again examined the Thai political and economic highlights in 2003. In his study, Mutebi found that the political and economic landscape in 2003 was dominated by Prime Minister Thaksin Shinawatra. He affirmed that the Thaksinomics contributed to Thailand economic prosperity in 2003. In relation to trade policy, in particular the bilateral and multilateral trades, he insisted that Thaksin's policy was concentrated on securing bilateral FTAs and escalating regional groupings under ASEAN. Thailand, which was previously aloof itself from FTAs, vigorously pursued them in 2001, after Singapore signed its bilateral FTA with the United States. Mutebi held that "the Thai government seems to follow Singapore's move and share its idea that FTAs particularly those with the U.S. would help provide a counterweight to China, the rapidly growing regional economic powerhouse" (Mutebi, 2004: 85). Mutebi further concluded that "the combination of a fast-growing economy and strong-arm politics throughout 2003 created a level of stability in Thai politics".³

From Malaysia's perspective, Okamoto (2006) studied changes of Malaysia's stance towards FTAs from reluctant bilateralist to new trade policy

³ *ibid.*, pg. 86.

strategies. According to Okamoto, there were two factors contributed to the change in Malaysia's stances toward bilateral FTAs. First, the economic costs of not participating or excluding from the FTAs became so large that the Malaysian government needed to react promptly and not to disregard them anymore. Second, FTAs concluded and negotiated between other ASEAN countries, particularly Singapore and Thailand, bothered Malaysia and made it found ways to make certain that its exporters were competitive and not being deprived through the proliferations of the recent and coming FTAs. Even though Malaysia started to consider for bilateral FTAs, Okamoto held that there would be various political obstacles in promoting these FTAs as resistance would emerge from the automobile and services sectors. He further concluded that "although the promotion of bilateral cooperation created some gains for Malaysia, it might not become a major mode of trade governance" (Okamoto, 2006: 232). Due to the emerging resistances, Okamoto affirmed that a deeper agreement which was common among recent FTAs would be difficult to pursue for Malaysia compared to other ASEAN countries. Furthermore, Malaysia still preferred ASEAN-based framework rather than bilateral ones.

2.4 Studies of Japan-Centered FTAs

Pempel and Urata (2006) examined Japan's new move towards bilateral FTAs and concluded that there were three major reasons on why FTAs had gained greater appeal in Japan; FTAs have become a major policy pursued by many other countries as the economic advantages to the participating countries and the detriments to those not participating became apparent, FTAs to assist in advancing domestic structural reforms in the economy, and lastly FTAs to counter the China's FTA strategy towards ASEAN and other East Asian countries. Both authors however held that it would not be easy for Japan to pursue bilateral FTAs due to its domestic political economy as "entrenched powers have strongly resisted rapid economic adjustment" (Pempel and Urata, 2006: 92).

By using Japan's FTAs with Mexico and the Philippines, Corning (2007) studied this two FTAs in the context of parallel negotiations in the Doha Round. From his observation he affirmed that both agreements gave advantage to Japan in terms of market access of its auto and steel sectors and at the same time, Japan managed to secure protection on its agricultural sector by providing only minimal access to the Mexican and Pilipino agri-products. Corning found that Japan's

approach to selective liberalization in bilateral FTAs was largely consistent with its approach to multilateral liberalization in the Doha Round. He held that Japan in all means tried to the fullest to protect its agricultural sector and limit any liberalization cost of this sector at both bilateral and multilateral levels. In addition to this, he affirmed that “the real obstacle to progress in the Doha Round has not been a diversion of time and resources created by FTA’s negotiations or an eroding belief in the value of multilateralism but the unwillingness of Japan and other industrialized countries to commit to genuine liberalization of agricultural trade at either the bilateral or multilateral level” (Corning, 2007: 51). He further ascertained that the prospect for increased Japanese flexibility in the multilateral agricultural negotiations lies in accelerated modification of the agricultural policy rather than lessened weight on the quest of FTAs.

In this vein, Mulgan (2008) analyzed Japan’s FTA politics and the problem of agricultural trade liberalization and asserted that Japan’s eagerness to negotiate on FTAs was not corresponding to its readiness for agricultural trade liberalization. According to Mulgan, various means were employed by Japan to limit the coverage of agricultural compromise in any FTAs. She argued that compared to

liberalization mechanism pursued by the WTO, FTAs were supposedly became a more useful tool in liberalizing the Japanese agricultural trade “because FTAs reshape the domestic politics of Japanese trade in ways that are conducive to further market opening” (Mulgan, 2008: 164). Mulgan also observed that market liberalization sought by FTAs “altering the domestic politics of trade policymaking on the demand side as well as some aspects of the supply side”.⁴ On the demand side, business groups which benefited from greater market access, voiced for a strong demand to lift protections on agricultural sector while on the supply side, the significance of FTAs for broader state interests are accepted by politician-leader. Mulgan further stated that public choice theory would envisage that the vibrant alteration from both side would then lead to a declining trend in agriculture protection through the realization of a pro-FTA policy. However, Mulgan anticipated that various obstacles might emerge along the policy making process which could obstruct “the altered demand and supply-side dynamics from necessarily delivering free trade outcomes”.⁵

⁴ *ibid.*, pg. 166.

⁵ *ibid.*, pg.164.

Burgschweiger (2009) in her paper regarding *Deeper Integration from Another Perspective: Trade Liberalization Imbalances within Japanese Comprehensive Economic Partnership Agreements* concluded that “although PTAs are persisted as a complement to multilateral trade negotiations aimed at the ultimate goal of free trade, but with their discriminative nature, PTAs had some potential of promoting protectionism in certain sectors or at least sub-sectors” (Burgschweiger, 2009: 13). The EPAs enabled the Japanese government to promote political rhetoric of assisting developing countries as well as to gain market access and preferential treatment serving Japanese exporters without being reciprocally forced to open up its own sensitive sectors.

By focusing on similar issue of agricultural trade protection, Yoshimatsu (2006) further made good efforts to examine how domestic politics influenced the new Japan trade policy towards FTAs. Within the framework of bureaucrats’ and politicians’ preferences towards FTAs, he illustrated how economic and political linkages in East Asia had pressed Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Liberal Democratic Party (LDP) to move from their stance of rejection to provisional acceptance of FTAs. As FTAs emerged as a primary

national policy and increased commitments gained from other ministries along with the growing number of FTAs in East Asia, MAFF was discomforted and felt the necessities to react and assume for more positive position in the inter-ministry competition in outlining the Japan's FTA policy. With the increasing trends in current and future agricultural exports to East Asia, MAFF held upon export development as a primary means to rationalize the importance of FTAs to Japanese farmers. This change in MAFF's stance together with the Japanese agricultural groups has forced *norin zoku* (agricultural tribes) in the LDP to discover a fresh approach to support FTAs by addressing concerns of the growing shadow of China in East Asia and the need to counterbalance China's influence.

In addition to this, Yoshimatsu (2005) examined how domestic societal actors have impinged on the evolution of Japan's trade policy toward FTAs by focusing on the role of Nippon Keidanren, the most influential business federation in Japan. It is affirmed that Keidanren has played three important roles in developing Japan's trade policy towards FTAs: as a pressure group endeavored to directly shape the preferences of political actors in the executive and legislative sectors through direct lobbying; as an information's provider to politicians to assist

them in making desirable and appropriate policy choice; and as an interest coordinator within private sectors, both in and outside Japan. Based on case studies of Japan's FTAs with Singapore, Mexico and South Korea, Yoshimatsu further analyzed policy preferences and commitments of Keidanren to the policymaking process and found that there were varying motivations for Keidanren's support of these projects such as to defend its members' commercial interests in the case of Mexico and to promote domestic industrial adjustment and regional economic integration in case of Singapore and South Korea.

2.5 Assessment of Past Literature

FTAs encouraged for quicker trade liberalization which provides wider trade opportunities and advantages to signatory parties, therefore many countries rushing to engage in FTAs to foster their trade. As a result, FTAs have thrives everywhere as no one wants to be left behind the others. While the government conducted feasibility studies of potential FTAs, then initiated, negotiated or concluded FTAs, concerns arose whether the new FTA-centered trade policies are consistent or in contrast with the domestic economic and industrial policies in strengthening the domestic economy.

Based on the survey of past literature of general FTA studies, I found that most of the scholars focused on the causes or reasons of FTA's initiation/involvement. The possible effects of FTAs are also discussed including the tendency of governments to protect certain sectors by making exclusion from the agreements. At the Southeast Asian level, scholars also concentrated on reasons why the Southeast Asian countries like Singapore, Thailand and Malaysia shifted towards FTAs as their new trade policies and strategies. Besides these studies, some studies examined the use of FTAs in securing FDI and consequences of these FTAs to the Southeast Asia countries.

Being adherent to trade liberalization under auspices of the WTO, Japan's involvement with FTAs attracted many scholars to examine its Japan-centered FTAs. Many studies observed motivations which made Japan shift its focus from multilateralism under the WTO to bilateralism through FTAs. Alongside, a few scholars also assess the agriculture's protection trend in Japan's FTAs. Corning (2007) and Mulgan (2008) found that protection of the agricultural sector became an obstacle for Japan in negotiating the FTAs. Yoshimatsu (2005, 2006) went deeper by conducting studies on influence of state and non-state actors in

reshaping Japan's trade policy towards FTAs. In his studies, Yoshimatsu analyzed how these influential factors - state and non-state actors influenced the FTA process. Their concerns with effects of agricultural liberalization through FTAs have made MAFF and agricultural tribes in the LDP oppose Japan's FTAs moves at the earlier stage and conditionally accepted the FTAs after realizing the positive effects brought by those FTAs.

By assessing these past literatures, it can be concluded that many scholars - Urata, 2002; Dent, 2005; Ravenhill, 2003 & 2006; Daquila & Huy, 2003; Kiyota, 2006; Okamoto, 2006; Pempel & Urata, 2006 - focused on external and internal factors in understanding motivations for countries engaging in FTAs. Although these studies are able to show the underlying factors of countries' involvement, those factors were only be highlighted on the surface. In-depth observation has not been carried out on internal factors in particular at the country-specific domestic level. This observation is important as it would provide clearer insights that might be linked to domestic politics of FTAs. Though few scholars such as Mulgan (2008) and Yoshimatsu (2005, 2006) had made a valuable attempt to examine the domestic politics of FTAs with the backdrop of agricultural trade

protection, these studies did not go deeper to find the relationship between past policies and recent trend of trade policy preferences of Japan.

Nevertheless, Japan's case showed the protection trend of specific industries, in particular, the agricultural sector which can be regarded as a sensitive sector in the FTA process. It clearly demonstrated the way on how bureaucrats, politicians and non-state actors reacted in protecting the agricultural sector along the FTA process. As most developing countries in Southeast Asia have their own targeted industries to be developed, this trend also might be applicable to these countries. The government of these countries also might adhere to protect specific sectors to make certain of its development. With past industrial policies in their hand, question arose on how these governments protected its specific strategic sectors and how its officials' preferences in fostering these sectors influence the FTA process. In addition to this, question also arose on how non-state actors/societal actors react to the FTA, what role have they played and whether their action influence the process of the FTA.

Based on past studies on Southeast Asia's FTAs, I found that thus far, no studies are conducted to observe the protection aspect of industrial policies in FTA's negotiations. Therefore, this research will make a bold attempt to fill the gap found in the previous literature.

2.6 Research Questions

Southeast Asian countries had gradually adopted FTAs as their new trade policy strategies. Many of these countries started to alter their trade policies after moves made by Singapore in initiating and concluding FTAs with various partners outside the region. Compelled by Singapore's move, these countries then made efforts to initiate and negotiate for FTAs. However compared to Singapore which already fully liberalized its market, these other Southeast Asian countries faced difficulties to conclude the FTAs as they have industries to be considered. Some of the targeted key industries are highly supported by the government through various protective measures and incentives to make them competitive. Therefore, in ensuring growth at home and tapping enlargement overseas, many of these countries made the fullest efforts to retain domestic industrial policies. Based on this situation, this thesis will make an attempt to provide answers to the

following research questions:

- (1) What kind of industrial policies were implemented by Southeast Asian countries?
- (2) How have past policy trends to protect specific industrial sectors influence the negotiation process of an FTA.

With respect to research question (2) above, I would like to provide the tentative hypothesis as follow:

- (1) Government official's preferences to continuously foster specific strategic sectors is the major factor that have negatively influence the negotiating process of an FTA; and
- (2) Domestic societal groups which benefited or affected by past industrial policy also conducted lobbying to pressure the government in protecting their interests.

2.7 Research Methodology

Both primary and secondary sources were used in gathering valuable data and information for this research. For the primary sources, I relied on the

qualitative method of data collection. Interviews with relevant government officials who are responsible for policy-making and who are directly involved in this FTA was conducted in order to gather first-hand information. In addition to this, primary data was also collected from government reports, statistics and other official documents which provided useful information on the background of these FTAs, related policies as well as current perspective of the issue. For the secondary sources, information was collected from books, book chapters, newspapers, journals articles as well as reliable online references.

In the framework of this dissertation, a comparative analysis of Thailand and Malaysia's EPA with Japan was undertaken. Why did I choose these two countries in Southeast Asia and Japan as case studies for this research? Firstly, both countries had commenced for industrialization process almost at the same time i.e in the early 1960s. Secondly, under this process Thailand and Malaysia chose similar industries (automotive and steel) as their key strategic sectors to be developed. Finally, both countries officially commenced their FTA's negotiations with Japan almost at the same time which was in early 2004 but the negotiations were concluded at different time with Thailand required longer period of

discussion. The varied period of negotiations may shed some lights into difference of issues involved in the FTA process by taking into consideration that both of them negotiated for an FTA with similar partner i.e Japan.

CHAPTER 3: JAPAN-THAILAND ECONOMIC PARTNERSHIP AGREEMENT (JTEPA)

3.1 Introduction

Thailand has a long established bilateral economic relationship with Japan. The bilateral trade between these two countries expanded significantly during the past few decades. For Thailand, Japan has been the largest trading partner where Japan became Thailand's top destination of exports and main source of imports especially for electrical and automotive products. Thailand also received a huge amount of FDI from Japan, which contributed to the economic growth of Thailand. The wellbeing of Thais' economy now depends crucially on the exports of manufactured goods made by Japanese affiliated plants in various sectors including automobiles and parts, electronics, machinery, rubber products, chemicals, and plastics. Because of Japanese FDI, Thailand now counts among the top ten exporters of automobiles in the world. It is notable that the economic relationship between Thailand and Japan developed rapidly following the 1985 Plaza Accord where we can see a massive investment, flowed from Japan into Southeast Asian countries. Though the relationship was impeded by the Asian financial crisis in 1997, the amount of trade and direct investment surged through the early 2000s.

Given the significant bilateral economic ties with Japan and the successful FTA concluded between Japan and Singapore, Thailand was inspired and eager to have a similar FTA with Japan to reap the benefits of free trade. Thailand foreseen that the FTA would further expand economic interaction with Japan as under such an agreement, unnecessary barriers to trade would be removed to facilitate free flows of goods, investment, services and persons between both countries. Moreover, the Thai FTA's policy further advanced under Prime Minister Thaksin's administration which adopted a "dual track policy that strongly promotes the enhancement of international competitiveness, the expansion of domestic demands, and the vitalization of the grassroots economy" (MOFA, 2006).

However, as Thailand's economic growth is founded by import-substitution and export oriented industrialization associated with government protections, Thailand faced difficulties to simultaneously implement trade policy and industrial policy as market liberalization will only be achieved at the expense of domestic market. Therefore, it is interesting to examine how Thailand negotiated for free market with the domestic industries backed in mind.

In doing so, the first part of this chapter will explain Thailand's industrialization process and industrial policies, in particular, policies on key industrial sectors, namely the automotive and steel sectors. The second part of the chapter will then examine the JTEPA, in particular the negotiation process of JTEPA with the objective to observe how past policy trends to continuously foster Thai's automotive and steel sector influence the negotiation process by looking at the actions or responses of government officials and societal actors along the negotiation process.

3.2 Overview of Thailand's Industrial Policy

The Thai economy was one of the most robust in Asia. Thailand had enjoyed rapid economic growth especially from 1960s to mid-1990s before tremendously suffered from the Asian financial crisis in 1997-98. Currently, after the turmoil, Thailand's economic growth is accelerating similarly with other ASEAN countries. The World Bank Report on East Asian Miracle did recognize Thailand's economic achievement. The driving force behind Thailand's remarkable economic growth for the last few decades was industrialization. As a common model for economic development in East Asia, the Thai economic

structure which previously concentrated on the agriculture-based economy has been transformed into an industrial-based economy.

According to Peamsilpakulchorn (2006: 76), “Thai industrialization went through two broad phases; import substitution industrialization (ISI)⁶ and export-oriented industrialization (EOI)⁷”. The ISI was first promoted by the authoritarian government in the 1950s by adopting the state-led model. This economic strategy was implemented with an aim to replace/substitute the imported goods with domestically produced products. During this time concentration was given to consumer goods such as processed food and textiles. To attract foreign investment, the Thai government enacted the Industrial Promotion Act 1954, the Promotion of Industrial Investment Act 1959, and established the Board of Investment (BOI) in 1959 to facilitate the industrialization process in Thailand. The BOI was created as the sole agent for the promotion of industrial development, empowered to select, protect and

⁶ The ISI is the inward-looking economic strategy where developing countries made attempts to replace the imported products (from industrialized countries) with products produce at home.

⁷ The EOI is the outward-looking economic strategy where the industrialization is encouraged by expanding exports.

promote targeted industries (Suehiro, 2003: 132). However, “the ISI was not successfully implemented as not much industrial progress been made during the 1950s, due in part to the absence of a consistent framework of industrial policy” (Linnemann, Dijeck & Verbruggen 1987: 297). During this period, “the Thai government enacted the Industrial Promotion Act 1954 which provided tariff protection and tax incentives for import-substitution industries and later in the second half of 1950s, gradual relaxation of the existing restrictive control system was implemented under purview of the BOI”.⁸

Only in 1960s, the Thai government started to seriously implement the ISI. According to Hansanti, Islam & Sheehan (2008: 48), “official reforms of the trade patterns in Thailand took place in the early 1960s, alongside the establishment of the National Economic Development Board (NEDB), which acted as the government’s economic planning agency to develop strategies to transform Thai economy into a global economy”.⁹ In 1961, the NEDB implemented the First

⁸ *ibid.*

⁹ The NEDB is currently called as the National Economic and Social Development Board (NESDB).

National Economic Development Plan (1961-1966) which aimed to encourage industrialization and economic growth in the private sector. This Plan was then followed by the Second National Economic Development Plan (1967-1971). “The First and Second National Economic Plans set out a clear import-substitution strategy, based on the private sector” (Linnemann, Dijeck & Verbruggen 1987: 297). It was argued by Daquilla (2005) that, in order to reduce its reliance on imported consumer goods, the ISI was used as the main objective of Thailand’s policy makers during the period from 1960-1971. In implementing the ISI regime, the Thai government formulated various policies which were implemented by various agencies including the imposition of higher tariffs on imported goods (Ministry of Finance), the imposition of quota restrictions (Ministry of Commerce) as well as the introduction of investment incentives (BOI) such as an exemption from import duties on capital goods, raw materials and intermediate inputs and also an exemption from corporate tax (Daquilla, 2005: 77-78). These investment incentives were provided to both foreign and domestic investors in selected key sectors.

Although the ISI policy was successful in setting Thailand on the path of industrialization, its ability to constrain for durable development became less certain by the 1970s due to several reasons such as deteriorating profitability, the exhaustion of domestic demand, excess capacities, saturated market, etc. The ISI also “encountered problems due to the small-scale domestic market and a growing trade deficit owing to increased imports of capital and intermediate goods” (Higashi, 1996: 1). In addition, ISI in Thailand left many problems to be resolved and it was widely known that this “ISI was not targeted accordingly to systematic economic criteria, but was pursued in a chaotic, inefficient manner and for too long by the BOI” (Siripachai, 1994a: 5). Furthermore, protectionism granted to the domestic industry under ISI regime was not well accepted by technocrats which favor for EOI.

Due to several weaknesses of the ISI, the World Bank mission to Thailand, in 1970 recommended to the Thai government “to move towards a less protected and more competitive industrial structure by among other, made a vigorous promotion of export oriented manufacturing” (Siripachai, 1994b: 14). Thus, starting from 1972, the Thai government started to move from ISI to EOI by

adopting the Third National Development Plan (1972-1977) which emphasized a change in its industrial policy towards the promotion of manufactured exports, the deepening of the import-substitution process for intermediate goods and raw materials, the promotion of small-scale and labor-intensive industries, and the dispersion of industries into rural areas (Daquilla, 2005: 77-78). During this time after 1970s, Linnemann, Dijeck & Verbruggen (1987: 298) viewed that “Thailand pursued a dualistic industrialization and trade strategy”. Import-substitution industries were further encouraged through increased tariff protection resulting from the tariff revision in 1970 and 1974. At the same time, manufactured exports were promoted through additional incentives under the Investment Promotion Act which was revised in 1972. Industries which were included in the list of ‘promoted export-oriented industries’ under the BOI enjoyed various privileges such as full exemption from import duties and business taxes on intermediate goods and machinery, exemption from export duties, tax advantages, and a rediscount facility at subsidized interest rates. “Those not promoted by the BOI were also entitled for a refund of import duties and all other taxes incurred in the production of exportable goods”.¹⁰ The emphasis on the EOI was propounded in

¹⁰ *ibid.*

the subsequent Thai's National Economic Development Plans with the import-substitution policy remained intact.

The implementation of EOI was further deepened after the economic downturn and external oil shocks in 1980s, indicating problems in policy for manufacturing sectors. During this time, the importance of trade liberalization, transfer of technology by FDI, and the role of exports in spurring economic growth were recognized as important components in the country's development. Therefore, in gaining the advantage, Thailand started to give full commitment to the EOI policies in pursuit of economic reform by mid-1980s. This effort contributed to the robust economic growth (1985-1997) and deeper integration of the Thai economy in the international economy.

3.2.1 Policy on the Automotive Industry

The automotive industry was regarded as one of Thailand's key sectors for economic development under the ISI strategy. The industry is viewed by many developing countries as a major engine of economic growth in achieving their aim of industrialization, often due to business/economic linkages created by this particular

industry. “The automobile industry became a major target for industrialization as it has a wide range of related sectors with immense effects on job creation and the development of sophisticated industrial structures” (Yoshimatsu, 2002: 121).

The Thai automotive industry started to commence its operation in 1960s with limited production of auto parts by private-led companies with strong protection by the state. The industry developed with an objective of substituting imports of completed built-up units (CBUs). To accelerate the substitution of imports and to create employment, the Thai government promoted the establishment plants to assemble automobiles and manufacture auto components/parts by granting various tax incentives. By 1969, there were six assemblers in the industry; (1) Siam Motor & Nissan, (2) Toyota Motor Thailand, (3) MMC Sittapol (Mitsubishi), (4) Isuzu Motor Thailand, (5) Thailand Hino Industry, and (6) Thonburi Automotive Assembly (Benz) (Abdulsomad, 1999: 275). In 1971, as the automobile industry generated negative trade balance which was in sharp contrast to the intentions of government promotional policy, the government announced a new rationalization plan for the development of the Thai automobile industry. In conjunction with this plan, “the Automotive Development

Committee (ADC) was set up by the MOI, and the BOI stopped granting promotional privileges to new assembly plants” (Abdulsomad, 1999: 281).

Under the ISI regime, the Thai government adopted various protection measures in alleviating competition to ensure the survival and development of the domestic automotive industry. “In early 1975, local content requirements were introduced at 25 per cent for passenger cars, 20 per cent for commercial vehicles with windshields and 15 per cent for commercial vehicles without windshields” (Abdulsomad, 1999: 275). “In 1978, the Thai government banned imports of CBU passenger cars and raised import duties on CKD kits to 80 per cent. The government also required assemblers to increase the ratio of local content for passenger cars from 25 per cent to 50 per cent within 5 years” (Doner, 1991 as cited in Yoshimatsu, 2002). “In 1978, the government also introduced the “mandatory deletion” of specific parts from imported CKD kits such as brake drums and exhaust system, which had been locally produced for some time” (Abdulsomad, 1999: 275).

As a result of the protective import policies (such as import ban on CBU vehicles), domestic demand for local passenger cars increased drastically in the 1980s. However, this demand was not satisfied by the availability of supply by local producers due to their limited capacity. The unavailable stock together with the restriction imposed on imported cars, created consumer's tension and dissatisfaction which led to the automotive policy reform by the government. "In 1991, with the establishment of the Anand Panyarachun government, Thailand started to introduce liberalization policy which transformed the automotive sector into an internationally competitive industry" (Abdulsomad, 1999: 82). In this year, the Ministry of Commerce announced an abolishment of passenger-car-import restriction where the ban on imports of CBU was lifted in April 1991. "The Cabinet also launched a new structure for passenger-car tariffs, including a commercial tax to reduce tax burden for imported and domestically assembled cars where import tariffs on CBU and CKD were substantially reduced in July 1991. Further, the government approved the establishment of new assembly plants for passenger cars in 1994" (Higashi, 1996: 7). Consequently, after these relaxations, the car price decreased and domestic consumers were largely benefited as they could enjoy cheaper cars.

After almost 30 years adopting industrial development strategy based on ISI which more dependable on protection policy, the Thai government made a significant reform by intensifying its liberalize policy beginning from year 2000. According to Ministry of Industry's Report, "effective on 1st January 2000, local-content requirement policies that had been applied on automotive assembling since 1972 was abolished and new automotive companies enjoyed free entry into the automotive industry" with no limitation on number of firms allowed (MOI, 2002: 10). Effective on the same date "a revised-automotive-tariff was enforced to complement with the policy's elimination of local content requirements".¹¹

The industrial policies implemented by the Thai government on the automotive sector, especially at the earlier stage of its development had undoubtedly fostered the industry. These policies helped Thailand to achieve its goal of the ISI in substituting imports by developing its local assemblers and auto parts manufacturers. These government policies also succeed in creating conducive business environment which encouraged investment from private (local

¹¹ *ibid.*

and foreign investments). With the private-led development model, the Thai auto industry was developed in a speediest manner as compared to other Southeast Asian countries. In addition, the gradual liberalization of the auto policies based on market situation/condition further benefited both, the consumers and the producers.

3.2.2 Policy on the Steel Industry

The steel industry is regarded as an important industry in most of developing countries which became vital for economic growth of their national economy. Although Thailand adopted ISI in 1960s, the steel industry was not properly developed compared to its neighboring countries. There was no state-owned firm that involved in this industry. As Thailand's development strategy is based on the private-led economic development model, the development of the industry was left in the hand of private firms which operated with low capital investment mainly concentrated in downstream activities. According to Higashi (1996: 12), "until the 1970s, the development of the industry was limited to downstream processes such as pipe manufacturing, steel

bar production and, wire rod manufacturing”. Moreover, Nakagawa (2007: 160) argues that, although Thailand’s steel industry began to develop along with the ISI strategies set out in the 1960s, any effective policies were not carried out by the Thai government until mid 1980s.

However, the Thai government started to give attention to the steel sector after the increase of domestic demand became apparent, especially from the construction sector resulting from massive foreign investment after the Plaza Accord in 1985 (Nakagawa, 2007: 160). “In 1988, due to the high linkage between the steel industry and many other industries, the BOI began to promote investment of an integrated steel project in response to the future increasing demand for flat steel products” (Higashi, 1996: 12). At this time, “the MOI adopted protection measures through restriction on number of steel producers”.¹² As the integrated steel project required capital intensive, the ministry had “limited this steel project to only one producer at first, in order to support the huge investment on such project”.¹³ In relation to this, the BOI granted the right to Sahaviriya Group to launch Thailand’s first integrated steel project in 1989.

¹² *ibid.*

¹³ *ibid.* No similar project would be allowed for the next 10 years to protect huge and massive investment of selected firm of the integrated steel mills.

In the early 1990s, the steel industry grew steadily in parallel with the increasing demand from utilized industries such as the automotive and electrical appliance industries and the rapid economic growth of Thailand. Therefore, “in the Seventh National Economic Plan (1992-1996), the iron and steel industry was recognized as one of the six targeted industries to be selected for priority development where under this plan, the upstream iron industry was promoted by the government” (Higashi, 1996: 14). To meet the increased demand, the government lifted the previous restriction on number of producers allowed to produce flat rolled steel.¹⁴ With this liberalization, the industry then was no longer monopolized by only one producer. “In case of cold rolled steel projects, the government would permit cold-rolled production from January 1998 as long as producers sell their products to the local market” (Low, 1995 cited in Higashi, 1996: 14). To further promote the iron and steel industry, “new projects were permitted an 8-year corporate income tax exemption regardless of location” (Kwan Tse, 1996: 1).

¹⁴ Previously, only Sahaviriya Group was allowed to produce flat rolled steel for 10 years period.

However, the increased trend in domestic consumption did not last long as in mid 1990s, Thailand's domestic demand dropped sharply due to the decline in the construction boom which reached its peak in 1995, and the destructive impact of 1997 currency collapse (Nakagawa 2007: 160). This situation further created overcapacity of steel production in the local market. During this time, an excess capacity of steel production also occurred worldwide. To protect domestic steel makers, the BOI, in August 1996, "imposed additional surcharges on imports of structural sections, low carbon wire rod, and stainless cold-rolled products which were set at 16 per cent, 10 per cent and 9 per cent, respectively" (Kwan Tse, 1996: 2). To further protect the domestic steel industry, "the Industrial Standard Institute of Thailand (ISIT), under the MOI, announced three compulsory standards that pertained to hot-rolled coil, plate, and sheet and began implementing the new rules in August 2001 to stop imports of substandard hot-rolled products" (Wu, 2001: 26.3).

As worldwide excess capacity of steel heightened in 2002, Thailand also imposed restrictive measures in the form of non-tariff barriers to safeguard the domestic industry from available cheap imports. "In May 2003, the Thai

Government, through the Ministry of Commerce, decided to impose antidumping duties that ranged from 5.98 per cent to 136.5 per cent on hot-rolled steel imported from Japan and 13 other countries, which included Algeria, Argentina, India, Indonesia, Kazakhstan, the Republic of Korea, Romania, Russia, Slovakia, South Africa, Taiwan, Ukraine, and Venezuela. A 36.25 per cent tariff was imposed on imports from Japan” (Wu, 2003: 26.3). “In December 2003, Thailand started to gradually liberalize its steel industry. The government announced that import taxes would be gradually reduced to 5 per cent on certain steel items”.¹⁵

The import tax reduction was carried as shown in Table 3.

Table 3: Reduction of Import Duty on Steel Products

Steel Products	Previous Import Duty	New Import Duty
hot-rolled steel products	10%	<ul style="list-style-type: none"> • Reduced to 7.5% (from 16 Dec 2003-31 Dec 2004) • Reduced to 5% (beginning Jan 2005)
cold-rolled steel sheet in coils and cold drawn bar	12%	<ul style="list-style-type: none"> • Reduced to 9.5% (from 16 Dec 2003-31 Dec 2004) • Reduced to 7% for year 2005 • Reduced to 6% for year 2006 • Reduced to 5% beginning Jan 2007

Source: Southeast Asia Iron and Steel Institute, 2004.

¹⁵ *ibid.* As cited by Wu, 2003 in Southeast Asia Iron and Steel Institute, 2004b, Thailand reduced import taxes on certain products, SEAISI Newsletter, accessed August 3, 2004, at URL http://www.seaisi.org/news_detail.asp?id=1490&y=2004&m=1.

The protective industrial policies successfully developed the Thai steel industry even though concentration to this sector was given later than the auto sector. The Thai government had wisely and promptly formulated industrial policies based on market's demand and supply of the steel products. The government's protection (through protective industrial policies) and gradual reduction of this protection helped the industry to develop steadily as their survival was guaranteed by the government.

3.2.3 Nature of Thailand's Past Industrial Policy

As mentioned in the previous section, industrialization brought Thailand into one of prosperous developing countries in Asia. Despite this remarkable success, Thailand also faced a bumpy road along its industrialization process. In its earlier attempt for industrialization, the Thai government widely involved in the process by setting-up various state enterprises producing industrial products. However, this initiative failed as the operation of most of these public enterprises was inefficient due to poor management and widespread corruption (Ingram, 1971 cited in Yang, 1994: 192). Furthermore, involvement of state also discouraged

private enterprises to invest as they refused to compete with state-owned enterprises.

This situation forced the government to revisit the industrialization strategy. According to Yang (1994: 192), in late 1950, the government sharply reversed its industrialization policy by reducing its direct involvement in the manufacturing sector and switched instead to play a supporting role to private enterprises through the granting of investment incentives and the provision of public infrastructure, and limiting public control of the private sector. This strategy further allowed private sectors to expand (Hewison, 2002: 232). The private-led strategy with less government's intervention and vast involvement of private sector provided for a conducive environment for business to grow. This created strong business groups which dominated the Thai industry. The strong foundation of the private sector undoubtedly contributed to the development of the Thai economy until today. This private-led model adopted by the Thai government along its industrialization process has evidently placed Thailand as one of the rapid developing countries in Asia. This strong private sector's background together with past industrial policies which favored private sectors

further provided an interesting ground to observe more on their response towards JTEPA which request local industries to sacrifice for market liberalization.

3.3 Overview of Japan-Thailand Economic Partnership Agreement (JTEPA)

3.3.1 Overview of JTEPA

The possibility of having bilateral FTA between Japan-Thailand was early proposed by Prime Minister Thaksin to Japanese Prime Minister, Junichiro Koizumi during his official visit to Japan in November 2001. Further to this, “during their bilateral meeting at the margin of Boao Forum for Asia in Hainan Island, China, on 12 April 2002, the two Prime Ministers decided to begin consultations for an agreement of Japan-Thailand Economic Partnership (JTEP) in a Working Group, which was subsequently set up under the Japan-Thailand Economic Partnership Consultations meeting held on 12 July 2002” (MOFA, 2003a: 2). Subsequent to this, “two preparatory meetings were held in May 2002 in Bangkok and in July in Tokyo between representatives of the two governments, who decided to use the Japan-Singapore Economic Partnership Agreement

(JSEPA) as a reference to pursue the JTEP”.¹⁶ A Working Group (WG) was formed to explore the JTEP and to create informal texts for reference in the coming negotiations on JTEP. Based on the outcome of the WG, the Task Force then addressed various issue of JTEP in three meetings held from July to November 2003.

The formal negotiation for JTEPA began in February 2004. These negotiations took 10 Rounds to be completed and involved various contentious issues along its process. Despite all the difficulties faced by the Thai government, the JTEPA was successfully signed by government leaders in Tokyo on April 3, 2007. The joint statement by the two leaders, Prime Minister Shinzo Abe and Prime Minister Surayud Chulanont appropriately declared that JTEPA was concluded with the aim to “take onto a higher plane our partnership for the mutual benefit of our peoples and lay a solid foundation for an East Asian community” (MOFA, 2007). This statement is in line with Thailand’s main objective for JTEPA which among others are; (1) the JTEPA must help to promote more investment between the two countries; (2) JTEPA to ensure the free flow of people and (3) JTEPA is to enhance further cooperation in all possible areas.

¹⁶ *ibid.*

3.3.2 Outcome of JTEPA

The JTEPA came into force on November 1, 2007. “The agreement covers various areas such as trade in goods, rules of origin, trade in services, investment, movement of natural persons, cooperation in 9 areas and 7 joint projects”.¹⁷ Under trade in goods, “tariffs on 99.51 per cent of goods imported from Japan in 2006, amounting to 99.49 per cent of the total value of imported Japanese goods, have been reduced or eliminated, or received a special quota quantity from Japan. At the same time, tariffs on 92.95 per cent of Thai exports to Japan were reduced or eliminated or granted special quotas, comprising 98.06 per cent of all tariff lines for Thai exports to Japan in 2006”.¹⁸ Thailand has committed to allow Japan and the Japanese citizens to hold up to 50 per cent equity in automotive production firms (with Thais holding the remaining equity), and the company established is not required to seek permission to operate the business.

¹⁷ Information on “Japan-Thailand Economic Partnership Agreement (JTEPA)” from Department of Trade Negotiation (DTN), Thailand. http://www.thaifta.com/english/index_eng.html

¹⁸ *ibid.*

The JTEPA also identified seven initial project areas for cooperation between the Thai Minister of Commerce and the Japanese Ministry of Economy, Trade and Industry namely; (1) “Kitchen of the World” Project; (2) Japan-Thailand "Steel Industry Cooperation Programme”; (3) "Automotive Human Resources Development Institute" Project; (4) “Energy Conservation Project”; (5) “Value-creation Economy” Project; (6) “Public - private Partnership” and (7) Cooperative Project in the Textile and Garment Industry.¹⁹

In terms of industrial products specifically for the automotive industry, “tariffs on most imports of Japanese vehicle parts would be eliminated by 2011. For sensitive items, tariff would be eliminated by 2013. Tariffs on automobile imports of passenger cars with engines larger than 3,000 cc would drop from their current level of 80 per cent to 60 per cent by 2009” (BOI, 2006: 1). For the steel industry, “tariffs on hot-rolled steel not produced in Thailand would be eliminated immediately once JTEPA enters into force”.²⁰ Details of the outcome of the agreement for the steel, auto and auto parts sectors are shown in Table 4.

¹⁹ Information on “Japan-Thailand Economic Partnership Agreement (JTEPA)” from Department of Trade Negotiation (DTN), Thailand. http://www.thaifta.com/english/index_eng.html

²⁰ *ibid.*

Table 4: Outcome of JTEPA on Industrial Goods

Products	Tariff Before JTEPA	Tariff After JTEPA
Steel and steel goods	1% - 20%	<ul style="list-style-type: none"> • Tariff on hot-rolled steel that no produce locally will be eliminate immediately. • Quota: steel for using in auto industry received 280,000 ton in 1st year without tariff. Quota then will be calculated every year by advising from Japan-Thailand steel dialogue. Tariff will be completely removed in year 11. • Out of quota steel for auto industry – tariff will be kept for 10 years. • Other hot-rolled steel – tariff will be kept for 10 years and remove in next year.
Auto parts for OEM	15% - 30%	<ul style="list-style-type: none"> • If tariff > 20% - reduce to 20%, keep for 5 years then remove in next year.

Products	Tariff Before JTEPA	Tariff After JTEPA
		<ul style="list-style-type: none"> • If tariff < 20% - tariff will be kept for 5 years and then remove in next year. • For auto parts and engine – tariff will be kept for 7 years then remove in next year.
Automobile engines > 3,000cc	80%	<ul style="list-style-type: none"> • Tariff will be reduced 5% each year until become 60% in 4 years then tariff will be re-negotiated.
Automobile engines < 3,000cc	80%	<ul style="list-style-type: none"> • Renegotiate in year 6th.

Source: MOFA, Thailand. Japan-Thailand Economic Partnership Agreement, 2nd Publication 2006 as cited in Bhangsba (2008).

3.3.3 Negotiation Process of JTEPA

The negotiation of JTEPA faced several difficulties. It took almost three years to be negotiated before it can be concluded in November 2007. Although Thailand formally began its negotiation at the same time (February 2004) with its neighbor country, Malaysia who also negotiated for an EPA with Japan, Thailand was late in concluding the deal. This was due to difficulties faced by the Thai government along the negotiation process. In negotiating on the JTEPA, the

government already set its main interest. As one of major exporters of agricultural products, Thailand tried to find new market and secured the existing market for its agriculture exports. Therefore, Thailand negotiated the JTEPA with the aim to open-up Japan highly protected agricultural sectors such as rice, sugar and chicken, which were considered as sensitive sectors for Japan. In contrast, Japan had interested in getting market access to industrial sectors, especially the automotive and steel sectors which were regarded as Thai's key industries.

The first phase of the negotiation is stalled due to Thai's request for Japan to scrap import tariffs on rice, chicken, sugar and starch. Prime Minister Koizumi rejected the request to scrap rice tariffs. Koizumi contended that, "what is impossible is impossible, even if a lot of time is spent on it".²¹ The resistance from the Japanese government could be predicted earlier as Japan was consistently protected its agricultural sector in various fora including in its bilateral FTA policy and multilateral trade negotiation under the WTO. To overcome the impasse and to accelerate the JTEPA, Thaksin decided to withdraw rice from the negotiation table and proceed with other commodities of agriculture

²¹ The Japan Times, 13 October 2004.

and industrial products. The second phase of negotiation only took place after the working group of trade liberalization on goods resumed talks on Nov. 8-10, 2004 in Bangkok.

In the second phase of the JTEPA's negotiation, Thailand faced a new wave of difficulties in negotiating on its industrial goods as there was intense opposition exerted along the negotiation process. The obstacles in the negotiation process were then followed by dozen of critiques and actions taken by the NGOs, politicians and academicians towards the transparency of the negotiated agreement, credibility of current government and possible consequences of the agreement. However, since Thailand adopted a single undertaking concept²² in negotiating for the agreement, it managed to conclude for an agreement which could be regarded as having "win-win situation" elements at the end of the negotiation process of JTEPA.

3.4 Domestic Politics of JTEPA

The Japanese quest for trade liberalization of Thai's automotive and steel

²² A concept where agreement can only be reached if everything is agreed across the sectors.

sectors raised concern among various groups. In Thailand, “the interface between international and domestic forces came into full play and turns the FTA policy into a highly controversial issue garnering widespread interests and provoking intense political debates” (Peamsilpakulchorn, 2006: 65). For FTA’s opponents, trade liberalization sought by Japan would give negative impacts on the domestic market. Many of them wished for Thailand’s negotiators to wisely negotiate for the JTEPA in order to safeguard their interests. While for FTA’s supporters, FTA with Japan would create an opportunity in gaining market access to Japan. Between these groups, stood state actors/government officials who were involved in trade policy formulation and who were tasked and given mandate to negotiate for a high-quality FTA with Japan.

According to Peamsilpakulchorn (2006: 66), “the enthusiasms and intensities of the politics surrounding FTA policy provide an interesting framework to question the dynamic and conflicting forces in Thailand’s current trade policy”. Furthermore, “in a democratic society, how a government responds to international imperatives through properly engineered foreign economic policy, which could satisfy the majority of its constituency, could have definitive effects

on government viability” (Peamsilpakulchorn, 2006: 66). In addition to this, the interest of all stakeholders has also to be considered in achieving a meaningful FTA policy. Therefore, it is interesting to study domestic politics that rest behind the JTEPA in order to observe the stakeholders’ interests, particularly economic interests, both from private and state/government perspectives. This observation is in need as in this study I will try to examine how past policy trends to foster specific industrial sectors influence the negotiation process over an FTA. By evaluating the societal actors and government official’s responses towards JTEPA, it could give insights into how domestic societal actors in relation to domestic industrial policy interact with international forces brought by FTAs and how government officials could pursue FTAs with those societal actor’s pressures (support/oppose) and with their own preferences held, as “concerns for negative consequences of deeper economic liberalization and unfair global economic governance would have political repercussions not only on the global scene but also on the domestic front”.²³ For societal actors’ (in particular business groups’) responses, Ricardo-Viner model laid a basic foundation in associating their

²³ *ibid.*

respond towards liberalization pursued by FTAs.²⁴ According to the model, “the political cleavage would be aligned along the boundary between the export-oriented or competitive sector (free traders) and import-oriented or uncompetitive sectors (protectionists)” (Peamsilpakulchorn, 2006: 68). Here we can say that export-oriented sectors will support JTEPA while import-competing sectors will make the fullest efforts to oppose it.

In assessing domestic politics surrounding the JTEPA, this paper will further examine responses and preferences of the societal actors’ and government officials towards JTEPA (in relation with past industrial policy) by focusing on the negotiation process of the JTEPA. To have better understanding on relationship between responses and preferences based on past industrial policy with the negotiation process, this paper will examine how the societal actors’ response and government official’s preferences influence the negotiation process of JTEPA. Will the responses and preferences make the negotiation process smooth or unsmooth. In order to fulfill this objective, I will divide this section into

²⁴ The Ricardo-Viner model argues that, in reality, factors are not mobile and once they are employed in a certain industry, they are specific to that industry, so that when an industry is decline, they cannot, in the short run, move to a more profitable industry (factor immobility).

two parts. In the first part, I will focus on government officials' influence on the negotiation process of JTEPA, and the second part will focus on societal actors' influence.

3.4.1 Government Officials' Preference in the Negotiation Process

In understanding politics behind JTEPA, it is important to examine the involvement and influence of government officials especially policy makers and negotiators towards the negotiation process of JTEPA. Although officials are mandated to negotiate for a meaningful and benefited deal with Japan, they also need to consider various issues along the negotiation process before achieving the goal. Negotiators play an important role to bring the negotiations to a successful conclusion. However, Thailand's negotiators which were led by Chief Negotiator, Mr. Pisan Manawapat, Deputy Permanent Secretary, Ministry of Foreign Affairs, were guided by high ranking officials namely Prime Minister and Ministers, in negotiating for the FTA agreement. Therefore, they do not have authority or final say for all issues negotiated with the Japanese side. This was shown by the statement made by Mr. Pisan for the press release of the Chief-Delegate and Working-Level Retreat on the JTEPA on 25 and 28 October 2004. Mr. Pisan

reaffirmed that “the Thai side would adhere to the leaders’ guidance thereby withdrawing rice from its request list, and expressed hope that the Japanese side do likewise”.²⁵ Moreover, in JTEPA’s case, it is interesting to note the policy preferences of Thailand’s Prime Minister, Thaksin who held the final say for any decision made along the negotiations process. Upon his appointment as Thai Prime Minister, Thaksin, a successful businessman turned to be a politician, declared to govern Thailand using CEO-style which was similar in running a company with a preference for a quick result-oriented. Thaksin and his party, Thai Rak Thai (TRT), also fostered a “dual-track development strategy that aimed to strengthen domestic activities at the grass-roots level as well as promote linkages between the domestic economy and the world economy” (Hewison, 2004: 511). His business background together with his policy preference charted his decision on JTEPA.

²⁵ JTEP Office, MOFA, Thailand. “Unofficial translation of Press Release JTEPA”, October 28,2004 http://www.mfa.go.th/jtepa/en/archives/news_127.html

Although Thailand applied the top-down system in decision making with authority that was in the hand of Prime Minister and his deputy, negotiators which represented by various ministries also played a significant role during the negotiation process of JTEPA. In the negotiation arena, in order to ensure the effectiveness of the negotiators' role, it was very crucial for negotiators to have a clear mandate from all stakeholders to make certain that a meaningful and benefited agreement could be reached after negotiations were concluded. In Thai case, it could be seen that there was no concrete mandate given to the negotiators in negotiating for their national interest, instead some observers believed that Thailand was rushing in negotiating and concluding FTAs with its partners. "FTAs were rushed, driven by fuzzy foreign-policy goals, and had very little sense of an economic strategy. Careful preparation was conspicuously lacking. There was little thinking about the links between FTAs and the national economic framework in terms of domestic policies, supporting institutions and priorities for reform. Rather FTAs were tacked on with little aforethought" (Sally, 2005: 4).

In the JTEPA's negotiation, it was obvious that two different directions were given to Thai negotiators along the negotiation process. In the early stage,

there was an intention for them to protect their key industrial sectors (automobile and steel industry). However towards the end of the negotiation, they were given diverse directions to open-up the Thai market for Japanese imports. This was due to different approaches taken by officials in continuously fostering the automotive and steel industries. Some officers preferred government to continue granting protection to the industries and for them this protection would shield the local industries from stiff competition with imported goods and would further help them to faster the growth of those industries. Whereas for other officials especially the high ranking officers/politicians, they foresee that the growth of the industries could only be realized by removing protection and allow for a fair competition with imported goods. For them, stiff competition from imports would force the industries to be competitive and change their strategy by making efforts to expand their market internationally.

Officials from Ministry of Industry (MOI) preferred to protect the domestic industry to ensure its survival from competition brought by imported industrial goods. Before negotiating on JTEPA, during the Task Force meeting, Thailand stressed that few industries are considered sensitive for liberalization.

The said industries were iron and steel items, automotive and automotive parts and petrochemical products. According to officer from Department of Trade Negotiations (DTN), Thailand, “the steel industry was protected by many groups especially MOI and Iron and Steel Institute of Thailand (ISIT)” (Bhangsbha, 2008: 50). One of government senior official also “urged local steel manufacturers, users and foreign carmakers to hold out against the Japanese government’s demand that Thailand open its steel and auto industries to competition”.²⁶ The “newly appointed Commerce Minister Thanong Bidaya also expressed that he would pursue bilateral free trade negotiations, especially with Japan, but only if Thailand is treated fairly”.²⁷ This statement showed how an attempt to protect the local industries was made by officials’ based on their preferences to continuously foster the domestic industry in Thailand by continuously protecting the industries. To further ensure that no injuries would be faced by the steel industry, Deputy Prime Minister, Somkid Jatusripitak asked for the establishment of a “bilateral commission to study steel-related issues and to examine steel quality standards

²⁶ The Nation, “Opposition to steel and auto sectors in FTA”. March 22, 2005.

²⁷ Bangkok Post, “Thanong vows fair treatment in trade talks”. March 17, 2005.

and product requirements of the domestic auto industry”.²⁸ Should “Thai mills are unable to produce steel as required by carmakers, then the product can only be included in negotiations under the JTEPA”.²⁹ However, due to limited sources, all of these attempts and statements were unable to show us on how and to what extent do these officers try to protect domestic industries from trade liberalization sought under JTEPA.

Despite endeavor to continuously protect sensitive industries during the negotiation process, the divergence of stance also existed among government officials of Thailand. With an aim to transform Thailand to become the ‘Detroit of Asia’, Thailand’s Prime Minister, Thaksin Shinawatra had his own agenda to make structural adjustment at home through liberalization under JTEPA. For him, the growth of the domestic industry internationally could only be quickly achieved with stiff competition brought by liberalization mechanisms. During his speech at the United Nations on 18 February 2003 on the benefits of FTA to Thailand, he stated that the government had to make Thailand’s private sectors

²⁸ Bangkok Post, “Somkid calls for commission to study steel-related issues”. 02 April 2005.

²⁹ *ibid.*

stronger and ready to move internationally. In doing so the government need not wait for the private sectors, instead private sectors had to follow the government by accepting liberalization under FTA as FTA bring many chances by opening market for Thai manufacturers and consumers (Bhangsbha, 2008). Along the negotiation process of JTEPA, Thaksin also did condemn Thai's private sector for seeking protection from government and he insisted Thai's auto sector to understand the essential of liberalization in the Thai market.³⁰

The investment plan proposed by Japan's automobile players was seen to indirectly influence Thai officials' stance. After it was reported that Toyota was planning to invest \$467 million to establish a third auto plant in Thailand, Mr. Thanong, Thai's Commerce Minister, welcomed the idea by stating that "the move would benefit the local auto parts sector and would further the country's goal to become a regional auto production hub".³¹ Impressed by the idea, Thanong then came out with a controversial stance where during the press

³⁰ The Nation, "Thai-Japanese FTA: Thaksin blasts pact opponents". 07 May 2005.

³¹ Bangkok Post, "Thailand could ease steel barriers, Move to spur Japan-Thai free trade talks. 31 March 2005.

statement he stated that “hot-rolled steel could be excluded from Thailand's sensitive list in negotiations for the proposed JTEPA”.³² The move, which would give advantage to local carmakers (which largely depends on hot-rolled steel in their production) at the expense of Thai steel producers, was seen as a compromise to Japan. However for Thanong, the opening-up of Thai's steel market would boost the production base of the automobile industry. He also believed that importing steel would also encourage car manufacturers to expand operations in Thailand to take advantage of lower costs. In addition to the investment plan, Thanong's stance was also influenced by efforts made by the Japanese negotiators and business groups. “Japanese negotiators have taken the unusual step of bypassing Thai trade officials and making their pitches directly to Commerce Minister Thanong”.³³ The leaders of Japan Keidanren then followed the step by meeting with Thanong to further lobby or express the need for Thailand to liberalize its automotive and steel markets.

³² Bangkok Post, “Thailand could ease steel barriers, Move to spur Japan-Thai free trade talks. 31 March 2005.

³³ Bangkok Post, “Support for auto hub linked to ease tariffs”. 11 April 2005.

Statement made by Thanong directly influenced the negotiation process of the JTEPA. This statement undermined the negotiating position of Thai's negotiating team. The negotiators especially from MOI who tried to protect the steel industry and the team who wished to utilize steel as a 'key bargaining chip' in their strategy to force Japan to open-up its domestic agricultural market was now puzzled by a contrast indication given by Thanong. Previously in 2004, in order to protect the steel industry, Ministry of Commerce "imposed anti-dumping duties on imported hot-rolled steel from a number of countries including Japan".³⁴ Even though the protection measures still took place and Japan was closed to agree for Thailand to continue its protection on key industrial goods including hot-rolled steel in exchange for Japan to maintain protection on agricultural goods, now, the negotiating team was directed to open-up the steel market for imports from Japan.

Thanong's policy shift made the negotiators' ability to further bargain for a meaningful deal was dwindled and Japanese negotiators now are more

³⁴ Bangkok Post. "Thai stance 'undermined' by Thanong's compromise on steel". April 01, 2005.

advantageous in the ‘negotiating game’. The Japanese negotiators scraped the final day of talks for the 7th Round and searched for a direct meeting with Mr. Somkid, the Finance Minister and Head of Committee on FTA Strategy and Negotiations, to request for more industrial concessions on liberalization and to discuss Tokyo's trade stance directly bypassing the Thai negotiating team.

Notwithstanding the contradictory signal which created chaos for the Thais along the negotiation process, lobbying efforts made by Japanese business groups and officials also worsened the situation. It was reported that the Heads of Japan Automobile Manufacturers Association (JAMA), Japan Auto Parts Industries Association (JAPIA) and senior officials of the Ministry of Economy, Trade and Industry (METI) met Thaksin “to pledge full support and gave assurance for Thailand's ambitions to become the ‘Detroit of Asia’ with the condition that Thailand would be ready to liberalize steel and car tariffs under the JTEPA”.³⁵ Further, these groups also warned that Japanese carmakers (members of JAMA and JAPIA) “might pull out of Bt41 billion worth of planned

³⁵ Bangkok Post, “Support for auto hub linked to eased tariffs”. April 11, 2005.

investments if Thailand fails to cut tariffs on steel and vehicles under the agreement”.³⁶ It is reported that JAMA-member assemblers and JAPIA parts-suppliers provided about 122,000 jobs in Thailand during the negotiations took place. This lobbying strategy adopted by Japanese side indirectly influenced Thaksin in making decision and providing direction for the negotiating team.

The JTEPA’s case showed that government officials’ preferences have a significant influence on the negotiation process. Preferences to continuously foster specific industrial sectors however were differently interpreted in terms of its approach. This further led to a divergence stance made by the officials’ along the negotiation process of the JTEPA which made the process unsmooth and chaotic. The JTEPA exemplified how cohesion among government officials’ and coordination between authorities were needed in policy making process in order to avoid confusion and problem along the negotiation process. Furthermore, it is imperative for the government officials to have a solid mandate as they are the ones who are responsible to keep for the national interests.

³⁶ The Nation, “JAPAN FTA: Cut steel tariffs or else, carmakers warn”. April 11, 2005.

3.4.2 Societal Actor's Influence on the Negotiation Process

In order to conceptualize linkages between trade liberalization brought by JTEPA and political responses from social groups, it is important to reiterate here that since Japan's main aim was to acquire market access to the Thai industrial sector, particularly the auto and steel sectors, most political responses would come from economic/business actors who would be directly affected by trade liberalization of the auto and steel industries. Therefore, in examining this response, this study will only concentrate on influences made by economic actors or business groups towards FTAs negotiation and will not look for other influences brought by other groups such as the NGOs like FTA Watch, academicians, and the public in general.

“Although businesses tend to be supportive of the government's overall attempt to liberalize the economy, they also strongly opposed the FTA if it directly threatens their interests” (Peamsilpakulchorn, 2006: 83). “Strong business resistance from import-competing sectors was evident with the JTEPA where political alignment opposing the deal was found among local steel producers,

local auto parts producers, and non-Japanese carmakers”.³⁷ These business actors which represented domestic industrial players used various channels to express their concerns on the agreement. In the beginning of the JTEPA’s negotiation, there were no resistance efforts made by these business groups as negotiation was focused on ‘normal track’ and agricultural goods. The opposition efforts from local auto parts producers started to instigate from 5th Round of negotiation, when negotiators negotiate for ‘sensitive track’, in particular, the market opening of auto and auto parts industries. These efforts were also supported by non-Japanese carmakers. The opposition efforts were then followed by local steel producers. All of them pressured government to exclude automobile and steel industries from the negotiation table.

“Domestic steel producers protested that opening the domestic market to Japanese producers would be inequitable considering the fact that the Japanese steel industry had been developed far stronger than the Thai industry, with heavy subsidies from the Japanese government”.³⁸ These producers sought the

³⁷ *ibid.*

³⁸ Bangkok Post, “Local Manufacturers Cry Foul over Change in Stance on Steel”, April 04, 2005.

government to grant protection continuously as they needed more time to develop their manufacturing and to improve their competitiveness to the world market standard. Moreover, they claimed that “removing protection of hot-rolled steel under the agreement would create unfair treatment between local steel manufacturers and automotive makers”.³⁹ In relation to this, a joint press conference were held by the Thai Chamber of Commerce (TCC) and Federation of Thai Industries (FTI) to “criticize the government for considering ending tariffs on Japanese hot-rolled steel imports and insisted that protection was needed in order to avoid the Thai industry would be controlled by Japan and the whole country suffering from an increased trade deficit caused by a flood of Japanese imports”.⁴⁰

Furthermore, FTI also urged the government to exclude steel from JTEPA’s negotiation as they feared that local steel manufacturers would be at “serious disadvantage” if steel be included in the JTEPA’s concession.⁴¹ In order

³⁹ Bangkok Post, “Local Manufacturers Cry Foul over Change in Stance on Steel”, April 04, 2005.

⁴⁰ The Nation, “Furore over Steel ‘Cave-in’”, April 05, 2005.

⁴¹ Business Day, “FTI Wants Thai-Japan FTA to Exclude Steel”, April 06, 2005.

to protect domestic high-quality steel industry which was still at nascent stage, the FTI's steel club proposed to the government to impose import quotas/quota restriction on types of steel that cannot be produced locally as the free flow of Japanese steel would wipe out this industry.

Apart from the steel industry, opposition to market opening and request for government protection also came from domestic car component manufacturers. The prospect of cutting tariffs on completely built-up (CBU) vehicles and car components raised strong concern among this industry. "Thai auto parts manufacturers expressed strong opposition to a plan to reduce tariffs on imported Japanese automobiles with engines larger than 3,000cc under the proposed JTEPA".⁴² To pressure the government to protect the local auto-parts industry, the Thai Auto Parts Manufacturers Association (TAPMA) organized a press conference to warn the government that "the local car-parts industry would be wiped out by a flood of Japanese parts and Thailand would suffer a parts trade deficit and billion losses in import tax revenues if FTA is signed".⁴³

⁴² Bangkok Post. "Parts makers up in arms against FTA". May 02 May, 2005.

⁴³ The Nation, "AUTO INDUSTRY: Parts makers air Japan FTA fears", May 02, 2005.

To further pressurize the government, TAPMA had “petitioned Prime Minister and related ministers to exclude auto parts from the FTA framework”.⁴⁴ TAPMA expressed its concern that any removal or reduction of import tariffs on CBU cars and parts would give great impact to local industries as cheap imports would lead to a decreased demand for locally made products. In relation to this, local customers would also tend to shift their preference “to consume imported large-engine vehicles instead of locally assembled cars with smaller engines”.⁴⁵ To avoid severe injuries to the domestic auto parts industry, TAPMA also urged the government “to extend timeframes for any tariff reductions by 10-15 years to provide local producers with time to adjust themselves to greater competition in the future”.⁴⁶

The similar concern was also shared by the FTI and Board of Trade, two of the country’s largest business associations. Both groups organized a joint press conference, urging “the Thaksin government to overhaul its proposed free-trade

⁴⁴ Bangkok Post, “Parts makers up in arms against FTA”, May 02, 2005.

⁴⁵ *ibid.*

⁴⁶ *ibid.*

pact with Japan or scrap the proposed deal altogether, feeling that the deal is unbalanced and wreak havoc on crucial domestic industries”.⁴⁷ Both business groups asserted that “an FTA with Japan would result in massive damage to the automotive, auto parts and steel industries in Thailand, while the Kingdom stands to gain little by having access to Japan’s agricultural market”.⁴⁸ This action was made amid news that “it became likely that the negotiation would not grant benefits to possible Thai products as much as hoped for” (Peamsilpakulchorn, 2006: 21). FTI and Board of Trade also echoed the move made by TAPMA by expressing their concern on behalf of the industry through press conference held. Both groups pushed the government to protect the industry by gradually reduced the tariffs in order to give breathing space to the industry to fairly compete with Japanese imports.

Protection for the auto industry was not only seeks by domestic auto parts producers per se, instead the American and European automakers also aligned

⁴⁷ The Nation. “FTA WITH JAPAN: Fix trade pact or forget it, say industry chiefs”. May 06, 2005.

⁴⁸ *ibid.*

themselves with those groups to pressurize the Thai government to ensure that their investment in Thailand is well safeguarded. The top executives of eight non-Japanese car companies (General Motors (Thailand) Ltd; Land Rover (Thailand); DaimlerChrysler (Thailand) Ltd; BMW (Thailand) Ltd; Volvo Car (Thailand) Ltd; Ford Operations (Thailand) Ltd; Jaguar Cars (Thailand) and Thai Yarnyon Co Ltd, (Volkswagen and Audi importers) sent a letter to Deputy Prime Minister, Somkid, other ministers and Thai chief negotiators to urge the government to maintain tariffs on vehicles with engine over 3,000cc. They feared that the lifting of the particular tariffs would “create Japanese monopoly, restricting consumers choice and with the potential for monopolistic price-setting in the future”.⁴⁹ They also warned that “the product strategies and longer-term automotive industry investment plans of the European and American manufacturers would likely be abandoned and the choice of Thailand as a regional production hub would be reviewed in search of a more favorable environment where there continues to be a viable domestic market”.⁵⁰

⁴⁹ The Nation, “Thailand pressured to exclude autos from FTA talks with Japan: EU and U.S threaten to leave if tariffs dropped on luxury cars”, April 8, 2005.

⁵⁰ *ibid.*

The lobbying efforts made by local industrial players and business groups directly had influence on the negotiation process of JTEPA. The efforts led Thai policy makers to revisit concession negotiated by both Thai and Japanese side. For instance, due to massive protest from domestic steel producers after controversial stance made by Commerce Minister and aggressive move from the Japanese side to seek for new concessions, Thai negotiators warned that they would put back agricultural issues on the negotiation table if the Japanese side continue to pressure the Thai side to liberalize the steel sector. The lobbying efforts made by these groups further forced Prime Minister Thaksin to interfere by seeking cooperation from Prime Minister Koizumi to solve the deadlock of JTEPA's negotiation. For example, it was reported that in order to rescue the JTEPA's deal and to ensure that the deal could be concluded within the deadline, Prime Minister Thaksin had wrote to Koizumi and made two suggestions to accelerate the negotiation process. Thaksin proposed "either both countries could take sensitive issues off the negotiation table by signing for a limited deal that was high in symbolism but low on free trade, or alternatively if Japan offered concession on agriculture, Thailand would consider faster removal of its steel and auto tariffs."⁵¹

⁵¹ Financial Times, "Japan-Thailand talks on free trade deal stall", May 23, 2005.

Strong societal actors' oppositions were apparent in the JTEPA's case. The lobbying efforts made by the industrial players and business groups indeed gave a significant influence on the negotiation process of the JTEPA. The strong coalition among these groups contributed to an organized opposition efforts with a strong voice in expressing their concerns on the ongoing JTEPA's negotiation. This coalition also managed to force the Thai government to reconsider their business views and concerns and to one extent made the government to incorporate their proposal into the agreement.

3.5 Conclusion

Thailand had implemented various industrial policies in developing its automotive and steel industries under both, the ISI and EOI. The policies implemented under the ISI include import restrictions such as import ban, import quota, import tariffs, local content requirement and so forth. Policies implemented under the EOI include import tax exemptions on raw materials, intermediate goods and machinery used to produce exported goods, export duties exemption, Free Trade Zones (FTZ) and so forth. These policies undoubtedly turned the industries into prosperous sectors.

Although Thailand currently fully pursued for the EOI which gave greater emphasize on export promotion activities, protective industrial policies adopted under the ISI such as import tariffs and import quota still intact and being implemented. The protective policies applied to the auto and steel sectors became a contentious issue in the JTEPA's negotiation as Japan requested and insisted Thailand to reduce or completely abolish those policies. The request was accepted in a mix manner by the Thais officials as diverse preferences exist among them towards the JTEPA. Lack of cohesion among government officials and coordination between the authorities in policy making process led to a contrast mandate given to the negotiators in negotiating for the JTEPA. This further made the negotiation chaotic and unsmooth. However, towards the end, policy preference of high ranking officials' to liberalize domestic market toppled any preference for continuous protection and gave more influence on the negotiation process.

This policy preference of high ranking officials and their attempt for market liberalization also garnered negative reaction from certain business groups especially those from the import-competing industries - the auto parts and steel

industries as well as from non-Japanese automakers. Strong coalition and organized efforts made by these groups in expressing their business concerns significantly influenced the negotiation process. Their actions also gave a strong signal to the government on how a vigilant action and decision should be made to safeguard the national interests. This action further forced the government to revisit its negotiated concession and stance to accommodate the request and at the same time hold its quest for trade agenda.

Past industrial policies and its nature also have a strong linkage with responses made by both, government officials and societal actors towards the negotiation process of the JTEPA. As an authority which was responsible for industrial development, the MOI had formulated various policies to support the development of the industry. Therefore, as the JTEPA would distort the industry's development if the protective policies be lifted, the MOI's officials responded by resisting to reduce or eliminate those policies to continue to protect the industries. On the other hand, previous liberalization efforts made by the Thai government by gradual reducing of the protective policies inspired the high ranking officials' to continuously liberalize the market to make it competitive.

In addition, nature of past industrial policies which was based on private-led with less government's involvement also linked to responses made by the officials' and societal actors'. Minimal government's involvement in the industry with no interests to be kept made the officials' less obliged to retain the protective industrial policies. In contrary, high private involvements in the industries created for a strong business foundation with strong and organized coalition among themselves in expressing their opposition towards the JTEPA.

CHAPTER 4: JAPAN-MALAYSIA ECONOMIC PARTNERSHIP AGREEMENT

(JMEPA)

4.1 Introduction

Malaysia is one of the developing countries in Southeast Asia which experienced a vigorous economic growth in the early 1990s before severely affected by the Asian financial crisis 1997-98 and quickly recovered after the crisis. The economic prosperity was supplemented among other with its economic linkage with Japan. Both countries had established close ties in terms of bilateral trade and investment since the past few decades. The relationship between these two countries was further enhanced with the adaptation of the “Look East” policy⁵² by the Malaysian government. This policy which could be regarded as an attempt to emulate Japan’s modernization becomes a key foundation for Malaysia in formulating its economic strategies for the development of the country. Bilateral trade and investments had also expanded remarkably after the

⁵² The “Look East” policy was launched by former Prime Minister, Mahathir Mohammad in 1982. This policy used Japan and South Korea as a role model for an enormous economic development for Malaysia. For details discussion, see Fumitaka Furuoka. (2007) “Malaysia-Japan Relations under the Mahathir Administration: Case Studies of the “Look East” Policy and Japanese Investment in Malaysia”. *Asian Survey* , Vol. 47, Issue 3, pp. 505–519

implementation of this policy where Japan became one of the most important trading partners for Malaysia and vice versa. “In 2002, Japan was the 3rd largest export destination for Malaysia (US\$10.4 billion, accounting for 11.2% of total exports) and the largest source of import (US\$14.2 billion, accounting for 17.8% of total imports). For Japan, Malaysia ranked the 10th largest trade partner for export (1.38 trillion Japanese Yen, 2.6%) and 10th largest trade partner for import (1.40 trillion Japanese Yen, 3.3%)” (MOFA, 2003: 4). During this period, “86.6 percent of export from Malaysia to Japan consisted of industrial goods, while the remaining 13.4 percent being agriculture, forestry and fishery items. Almost all the exports from Japan to Malaysia were industrial goods”.⁵³ In 2002, Japan became the 2nd largest foreign direct investor in Malaysia with the investment mainly concentrated in manufacturing sectors. Currently (as of April 2010), Japan remains as the 3rd largest export destination for Malaysia (10.2% of total Malaysia’s export) after Singapore and China.⁵⁴ In terms of FDI, currently (as of March 2010), Japan was recorded as the 3rd largest investors in Malaysia (with investment amounted to US\$131 million) after Singapore and China, dropped

⁵³ *ibid.*

⁵⁴ According to MITI’s statistic, Japan became 3rd largest export destination for Malaysia from 2005 to current (except for 2009, Japan became 4th largest export destination after China).

from its previous position as the top investor in 2009 (investment of US\$2,058 million).⁵⁵

In developing the economy, Malaysia has adopted several industrialization strategies which attached with various protective policies to safeguard the domestic economy. Despite the obligation for trade liberalization under the auspices of the WTO and the bilateral and regional trade arrangements, Malaysia also committed itself to liberalize the domestic market. However in doing so, Malaysia still preserved protections for its industrial sectors which were regarded as the engine of growth of its economic development. As the proliferations of bilateral and regional free trade agreements were intensified in East Asian region since the early 2000 and Malaysia had joined this FTA bandwagon, it would be interesting to observe how the Malaysian government negotiated for a free trade with the backdrop of various protections granted to the industrial sectors.

⁵⁵ Information from Malaysian Industrial Development Authority (MIDA). Projects Approved by Major Countries.
http://www.mida.gov.my/en_v2/index.php?page=projects-approved-by-major-country

This chapter will then focus on the first FTA for Malaysia which was signed with Japan on 23 May 2006. This chapter will be organized as follow. In the first part of the chapter, I will give an overview of industrialization process in Malaysia and industrial policies adopted during this time. Further, in order to know what kind of industrial policies adopted by Malaysia, focus will be given on policies implemented on two key sectors in Malaysia, namely, the automotive and steel sectors which became the central discussions in the JMEPA's negotiations. In the second part of this chapter, I will concentrate on JMEPA by providing an overview of the JMEPA including its outcomes and negotiation process. Given the importance of the protective industrial policies as a backdrop, the third part of this chapter will then discuss on how past policy trends to foster specific industrial sectors namely the automotive and steel influenced the negotiation process of JMEPA by analyzing government officials' preferences and societal actors' responses towards JMEPA. The final part of the chapter will provide the findings and conclusion for the chapter.

4.2 Overview of Malaysia's Industrial Policy

Malaysia was regarded as one of the robust economies in South East Asia.

The driving force behind the remarkable economic growth for the last few decades was the industrialization. Since its independence in August 1957, the Malaysian economy had undergone several structural changes in its industrialization strategies. The Malaysian industrialization went through two stages; the ISI and the EOI. For many developing countries, including Malaysia, the ISI was considered as an appropriate strategy to be opted to jump-start their economy. According to Alavi (1996: 34), “the ISI strategies had been adopted in developing countries mainly for two major reasons; (1) to cope with external trade imbalances and (2) to promote industrialization”. For Malaysia, the adaptation of the ISI strategies/regime somehow has contributed to its economic growth at the early stage of its economic development.

Malaysian industrial strategies went through four developmental stages under the ISI and EOI. The ISI was categorized into two phases with the first stage concentrated on consumer goods and the later concentrated on intermediate and capital goods of heavy industries, both with the aim to replace imports. Details of the adopted developmental stages and industrial policies were shown in Table 5.

Table 5: Stages of Industrial Strategies in Malaysia (1957-1990s)

Phase	Industrial Strategy	Industrial Policy	Government Emphasis
Phase 1	ISI strategy (1957-1970)	<ul style="list-style-type: none"> • Pioneer Industrial Ordinance, 1958 	<ul style="list-style-type: none"> - Simple consumer goods - Domestic market oriented
Phase 2	EOI strategy (1970-1980)	<ul style="list-style-type: none"> • Investment Incentives Act, 1968 • Industrial Coordination Act, 1975 	<ul style="list-style-type: none"> - Export orientation - labor intensive - Free Trade Zones (FTZ) - Electronic and textile for exports
Phase 3	ISI strategy (1980-1985)	<ul style="list-style-type: none"> • Heavy Industries policy 	<ul style="list-style-type: none"> - Consumer durables, intermediate and capital goods - Domestic market oriented
Phase 4	EOI strategy (1980s-1990s)	<ul style="list-style-type: none"> • Industrial Master Plan 1986 • Promotion of Investment Act 1986 	<ul style="list-style-type: none"> - Resource-based industries - Capital intensive - Encourage of exports

Source: “Industrialization in Malaysia: import substitution and infant industry”. Alavi (1996: 32)

During the first phase of the ISI strategy, the government endorsed the Pioneer Industrial Ordinance (PIO) in 1958 to promote the establishment of new industries to subordinate imports. In 1966, the Federal Industrial Development

Authority (currently was changed to the Malaysian Industrial Development Authority/MIDA) was established to support policies outlined by the PIO. Under this strategy, tariff and non-tariff protections became major policy tools to promote the development of local industries especially to support the growth of newborn industries. Protections granted to the industries had helped them to fulfill the domestic demand. “The existing structure of protection fostered the growth of the manufacturing sector, especially pioneer industries” (Djeck, Linneman & Verbruggen, 1987: 364). However, as the market was relatively small, industrial expansion took place at the earlier stage of the ISI strategy and the growth was stifled when the limit of domestic market was reached. In addition to this, “linkage effects with the rest of the economy were also weak and limited” (Alavi 1996: 35).

Due to several weaknesses of the ISI, the Malaysian government, starting from 1970 changed the industrialization strategy by adopting the EOI to promote exports which was foreseen could created spillover effects to other industries as well as generated more jobs and reduced unemployment. “Under the first phase of the EOI, two industrial policies were formulated by the Malaysian government,

Investment Incentive Act, 1968 and Industrial Coordination Act, 1975. The Investment Incentive Act was invented to encourage more foreign investors into export-oriented activities” (Alavi, 1996: 37). However, like the previous ISI strategy, “this first EOI strategy also failed as concentration only given into industries/activities which were located in Free Trade Zones (FTZs) which were dominant by electrical and textile industries”.⁵⁶ This strategy has divided the local industries into two different worlds. Under the FTZs, the industries were granted free imports of raw materials for producing goods mainly for exports and limited sales in the domestic market. While for industries outside the FTZs, they were subject to a higher production cost as the government imposed import duties on the imported raw materials. Therefore, the EOI failed to develop economic linkages between those two as dual contrasting policies and strategies were adopted at the same time. The EOI also had undermined the ISI policies which were formulated to assist local industries to be domestically and internationally competitive.

⁵⁶ *ibid.*, pg. 43.

The failure of the first phase of EOI strategy was then replaced with the introduction of the second phase of the ISI strategy in the early 1980s. Inspired by the successful story of Japan's and South Korea's heavy industrialization, the Malaysian government under Mahathir's administration invented the heavy industry policies. The Government thought that the development of heavy industries would foster higher economic growth through strong "backward and forward linkages between industries" (Alavi, 1996: 43). Under this strategy, the government was deeply involved in developing Malaysian heavy industries through joint-venture with several foreign companies in few strategic industries such as the automotive and steel sectors. During this second phase of the ISI strategy, tariff protections was once again became the primary tool for the government in developing the heavy industries.

Besides tariff protections, several other incentives were also provided to the industries to accelerate the growth. According to Alavi (1996: 43), "the re-emphasis of the ISI strategy had not only increased the import duties on priority items, but they had been given further protections through price control, import restriction, duty exemption and other investment incentives under the pioneer status".

Nevertheless, “the development of Malaysian heavy industries promoted under the ISI seemed to be unsatisfactory and problematic” (Machado, 1989).⁵⁷ Due to the weak performance and slow growth of the state-owned industries, the government then shifted to the second phase of the EOI strategy to accelerate the economic growth by inviting more foreign investments. The Promoted Investment Act, 1986 was introduced for this purpose. Under this Act, full foreign ownership was allowed for foreign companies with the condition that they must be export-oriented companies and their exports had to reach certain required level as ratio to domestic sale. In 1986, Malaysia also visualized its First Industrial Master Plan (IMP) which charted the way or plan for the industries (especially manufacturing sector) to be developed from 1986 to 1995. This First IMP then followed by the Second IMP, 1996-2005. The 2nd IMP “deepened the development of the manufacturing sector which led to increased value-added activities, enhanced productivity, greater industry linkages as well as growth of

⁵⁷ Machado stated that PROTON and Perwaja were plagued with serious problems and recorded large losses in their early years. He further stated that Mahathir attributed the troubles of both industries primarily to the shrinkage of the domestic markets for autos and steel owing to the mid-1980s recession, the mounting costs of debt service following yen appreciation, and to management inadequacies.

manufacturing-related services”.⁵⁸ Besides the IMPs, the industrial policies were also pursued along with the periodical 5 years economic plans i.e the Malaysia Plan (MP) which was began in 1966.⁵⁹

Apart from the above explanation on industrialization and industrial policies, it is worthwhile to discuss on Bumiputera policy which is broadly adopted and applied to most of the industrial policies along the industrialization process.⁶⁰ This policy emerged due to an ethnic clash that erupted after the parliamentary election in May 1969. This event forced the Malaysian government to regulate policies aimed at eliminating economic disparities and forming national unity in Malaysia. In conjunction with this incident, the government crafted New Economic Policy (NEP) with the objectives to reduce poverty and to re-distribute economic wealth among races by giving attention to indigenous

⁵⁸ The Star. “Prime Minister Datuk Seri Abdullah Ahmad Badawi’s speech at the official launch of the Third Industrial Master Plan 2006-2020”. 18 August 2006. <http://thestar.com.my/news/story.asp?file=/2006/8/18/nation/20060818164726&sec=nation>

⁵⁹ The 1st MP (1966-1970), 2nd MP (1971-75), 3rd MP (1976-80), 4th MP (1981-85), 5th MP (1986-90), 6th MP (1990-95), 7th MP (1996-2000), 8th MP (2001-2005) and currently Malaysia is implementing its 9th MP (2006-2010).

⁶⁰ Bumiputera means ‘son of the soil’ in particular indigenous Malay ethnic.

Bumiputera, particularly the Malay ethnic. The objectives were carried out under the Second Malaysia Plan (1971-75) and other subsequent Plans.

The Second Plan clearly stated that “economic policies and development would be considered in their relationship to social development in general and the over-riding needs for national unity in particular” (The 2MP, pg. 2). Under the second prong⁶¹ of the NEP, the government tried to close the economic gap between races through a process of which “involves the modernization of rural life, a rapid and balanced growth of urban activities and the creation of a Malay commercial and industrial community in all categories and at all levels of operation, so that Malays and other indigenous people would become full partners in all aspects of the economic life of the nation”.⁶² Due to this social responsibility, the government broadly intervened into business through the formation of business organization such as the National Corporation (PERNAS), Urban Development Authority (UDA), and etc., inevitably to represent the

⁶¹ The NEP outlined two prongs. The *first prong* is to reduce and eventually eradicate poverty, by rising income levels and increasing employment opportunities for all Malaysians, irrespective of race. The second prong aims at accelerating the process of restructuring Malaysian society to correct economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function (The Second MP, p1).

⁶² *ibid.*, pg. 1.

Bumiputera. According to Taylor (2007: 91), “a major objective of the government’s participation in the corporate sector of the economy was to increase the ownership and control of the corporate wealth for the Malay community”⁶³.

In line with this aspiration, the government also creatively formulated industrial policies which favored for Bumiputera’s participation such as under the Industrial Coordination Act, 1975, a 30 per cent Bumiputera equity was required before license granted to a new manufacturing company.⁶⁴ In addition to this, the 30 per cent Bumiputera equity was also applied to companies seeking to be public listed into Bursa Malaysia (formerly known as KLSE). The heavy industry policy also became a means for the government to advance the Bumiputera. According to Jomo (1994: 269), “state-sponsorship for heavy industry was seen as a way to strengthen the economic position of the indigenous Bumiputera to better achieve the ethnic redistribution targets set by the NEP”.

⁶³ The NEP targeted the 30 per cent Bumiputera equity ownership in corporate sector in 20 years period ended by 1990. This policy was further continued with the fact that the targeted percentage was unachieved in the given period.

⁶⁴ Requirement for 30 per cent Bumiputera equity was relaxed and 100% foreign equity holding is allowed for all investments in new projects effective from 17 June 2003. http://www.mida.gov.my/en_v2/index.php?page=government-policies

4.2.1 Policy on the Automotive Industry

The automotive industry was regarded as the most important industry or the key industry in Malaysia which became central for the economic development strategies. The industry had spilled over effects to other industries. “The industry brings together an immense variety of components and parts⁶⁵, many of which are manufactured by independent supplier firms in other industries such as textile, glass, plastics, electronic, rubber, steel and other metals” (Abdulsomad, 1999: 274). Due to this nature and joint-venture, the industry was expected to bring more employment as well as technological transfer to Malaysia.

The Malaysian automotive industry started in the 1960s under the ISI strategy to substitute imports of CBUs.⁶⁶ The government policies towards the industry could be linked to two different development stages. The first stage was encouraging local assembly and content (1967-1982) while the second phase (1983 to present) started after the government launched the national car project (Abdulsomad, 1999 and Jomo, 2007). Before the implementation of the ISI

⁶⁵ An automobile is a complex product, consisting of about 3,000 parts and components.

⁶⁶ Malaysia was previously highly depending on imports of passenger cars (CBU) to satisfy its local demand. This import dependence was further forced the government to develop its national car project in 1980s with the establishment of PROTON.

strategy, Malaysia relied heavily on imports of CBU cars from the Europe. During the ISI regime, with the aim to substitute imports and develop local automotive industry, “the government policies had moved towards protective promotion of local automobile assembly using CKD kits” (Jomo, 2007: 127).

In 1963, a policy to promote an integrated automobile industry was developed. To accelerate the substitution of imports and to create employment, the Malaysian government had encouraged for the establishment of assembly plants to assemble automobiles and manufacture the components/parts of automobile. In the late 1967, the Motor Vehicle Assembler Committee (MVAC), an inter-departmental agency set up under MITI to oversee the automobile industry, granted approval to six assembly plants to start operation in Malaysia namely; (1) Kelang Pembena Kereta Sdn. Bhd. (Fiat and Mitsubishi); (2) Swedish Motor Assemblers Sdn. Bhd. (Volvo); (3) Oriental Assemblers Sdn. Bhd. (Honda and Peugeot); (4) Cycle & Carriage Bintang Bhd. (Mercedes Benz); (5) Assembly Services Sdn. Bhd. (Toyota and Daihatsu); and (6) Associated Industries Malaysia Sdn. Bhd. (Ford, Chrysler and Land Rover) (Abdulsomad,1999; Jomo, 2007). In 1977, another five assemblers were approved to form a total of 11 assemblers in

the industry by 1980.⁶⁷ To strengthen and foster Malaysian industrial base, the government had introduced a local content requirement policy for assemblers. According to Jomo (2007, 168), “the government targeted expansion of local content to 40 per cent by weight over a ten-year period beginning 1971”. Subsequently, “the local content requirement has been increased from 10 per cent in 1971 to 35 per cent in 1982 (expansion by approximately 3 per cent per year)” (Abdulsomad, 1999: 277). However, the industries were found not satisfied the local content requirement. By end of 1970s, the industries’ actual average local content was only 8 per cent which was far in reaching the targeted local content for the automotive industry. “This local content were only limited to certain auto parts such as tyres, batteries, paints, filters, seat-belts, and glass items” (Jomo, 2007: 168). During this time, “automobile industry contributed little to the national economy because the industry relied excessively on CKD assembly which generating little or no value-added profit for Malaysia” (Yoshimatsu, 2000: 186).

⁶⁷ *ibid.*

Due to the slow pace for localization of automotive industry, necessity to enhance local industrial based and also due to the need to balance the socio-economic between ethnic groups, the government decided to intervene and directly involved in the industry.⁶⁸ This involvement had been marked as a start for a second phase of development in the government policies on the automotive industry. In 1984, the Malaysian government launched its first 'national car' project, Perusahaan Otomobil Nasional (PROTON), which was a joint-venture project between governments' wholly-owned Heavy Industries Corporation of Malaysia (HICOM) and Japan's MNCs. Later in 1992, the Malaysian government launched the second 'national-car' project, Perusahaan Otomobil Kedua (PERODUA) to produce passenger cars with smaller engines capacity for domestic sales. Being regarded as a national-car, PROTON and PERODUA were highly supported and protected by the government. "It enjoyed various kind of preferential treatment from the state, including reduction and exemption from import duties and sales tax, low interest rate loans and technical, financial and

⁶⁸ Due to race riots on 16 May 1969, Malaysian government has given priority to close the economic disparity between Bumiputera (the indigenous Malays) and other races in Malaysia. The NEP is launched in 1971 aiming for poverty eradication and socio-economic restructuring by the way of increasing Bumiputera's participation in economic function. The agenda was further applied to other government policy including heavy industries policy under Mahathir's administration.

other assistance via a special vendor development programme for developing Bumiputera parts and component manufacturers” (Jomo, 2007: 168).

Apart from national carmakers, the local parts suppliers were also well supported and protected by the government. In line with the local content requirement, “the government had introduced a Mandatory Deletion Programme in 1980 to prohibit local car producers, or franchisors from importing all automobile parts and components listed as ‘mandatory deleted components’ for use in local automobile assembly” (Rosli, 2006: 96).⁶⁹ Under this programme/scheme, all assemblers and car makers were forced to procure the listed parts and component from local suppliers in order to develop the auto parts industry and also to enhance localization of automobile industry. This programme, however was discontinued with effect from, 1 January 2004.⁷⁰

To further foster the automotive industry, the government had come out with a revised local content policy in 1991. Under this policy, manufacturers of

⁶⁹ According to Yoshimatsu (2000: 187), there are 25-30 important parts which were listed as the compulsory items that must be procured locally.

⁷⁰ Information from MITI’s documents (unpublished).

passenger vehicles less than 1,850cc are required to increase local content up to 60 per cent by 1996 where for vehicles with engine capacity in range between 1,851cc to 2,850cc were required to increase local content up to 45 per cent in 1996. Table 6 showed details of the revised local content requirement.

Table 6: Local Content Requirement for Passenger Cars, 1992-1996

Auto-type/category	Local content requirement (%)				
	1992	1993	1994	1995	1996
Passenger vehicles up to 1850cc	30	40	50	55	60
Passenger vehicles 1,851 to 2,850cc	20	30	35	40	45

Source: MACPMA and MIDA as cited in Rosli (2006)

In compliance with AFTA’s commitment, the Malaysian government then abolished the local content requirement starting from 1 January 2002. In addition to local content requirement, “Malaysia also imposed high tariffs on imported CBUs and CKDs in order to promote auto-assemblers to source out parts locally” (Rosli, 2006: 95). In 1998, the government had increased import duties on CBU and CKD for cars 2,000cc and above from original 42 per cent to a new rate

ranging from 60 – 80 per cent according to the engine capacity.⁷¹ This protection, however, did not last long. Due to its compliance with the AFTA agreement, in 2005, Malaysia had reduced the import duties for CKD and CBU of all categories of vehicles from ASEAN countries to 20 per cent and vehicles imported from non-ASEAN were subjected to import duties of 10 to 50 per cent.⁷² At the same time, a high excise duties (60 - 100 per cent) were imposed on all vehicles in order to give equal treatment to both local as well as imported vehicles.⁷³ In addition to this, national car makers were also granted a 50 per cent rebate on excise tax which gave weight to Proton and Perodua against its competitors.

Apart from tariffs, other non-tariff barriers such as import licensing through Approval Permit (AP) system was also enforced by the government on imports of CKD and CBU.⁷⁴ Under this system, imports were only permitted up to

⁷¹ *ibid.*

⁷² Imports from non-ASEAN: CKD for Passenger Car/MPV/4WD/Van (10% import duty), CKD for Bus and Lorry (zero duty), CKD for Motorcycle (0-10% duty), CBU for Passenger Car/MPV/4WD/Van (50%), CBU for Bus (30%), CBU for Lorry (35-50%), CBU for Motorcycle (40%).

⁷³ MITI's document (unpublished).

⁷⁴ The AP system was introduced in 1970 with the objective of promoting and providing

10 per cent of total local production of passenger cars, and importers needed to apply to MITI to get approval for number of cars that could be imported. Certain criteria and requirements needed to be fulfilled and evaluated by the AP committee before any approval granted. For CBU, “APs on passenger cars were divided into two categories; the non-franchise APs (open APs) for new/used passenger car and MPV and the franchise APs for specific makes and models of passenger car and MPV”.⁷⁵ For new franchise company, the AP would only be given if the company fulfilled certain criteria/requirement includes “models were not been assembled/ marketed in Malaysia and 70 per cent company’s equity was held by Bumiputera”.⁷⁶

Protection granted by the government to the automotive sector through protective industrial policies gave advantages to the state-owned companies relative to the other private companies. Due to huge investment onto the sector, the

opportunities for Bumiputera entrepreneurs in the automotive sector.

⁷⁵ Policy On Approved Permit (AP) For Motor Vehicle, 7th January 2005
http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.article.Article_ec961044-7f000010-16251625-732bbf7b

⁷⁶ MITI’s Administrative Guideline (unpublished).

Malaysian government creatively crafted policies which gave weight to the state-owned companies. Many of those policies also associated the Bumiputera's policy agenda which resulted for uncompetitive industry. High government's involvement in the auto industry further discouraged private investment which in turn negatively affected the developmental progress on the auto industry.

4.2.2 Policy on the Steel Industry

The steel industry in Malaysia could be categorized into two main segments, namely the long products and the flat products. "Long products included billets, steel bars, sections and wire products which were used mainly in construction and civil engineering such as wire mesh, nails, bolts and nuts, wire rods and barbed wire. On the other hand, flat products include hot rolled coils (HRC), cold rolled coils (CRC), coated steel coils, electro galvanised iron (EGI) which were used as intermediate raw materials for downstream applications of manufacturing process such as automotive parts and component, electrical and electronics appliances, water pipes and roofing sheets".⁷⁷ Therefore, it could be said that steel industry served as a backbone to other industries.

⁷⁷ MITI. "Policy Review on Iron and Steel Industry" (unpublished).

The Malaysian steel industry started in the early 1960s along with the implementation of the ISI strategy. In the earlier stage of the ISI, there were three companies in operation to manufacture galvanized iron sheet primarily for roofing purposes.⁷⁸ The industry then expanded with the establishment of Direct Reduced Iron (DRI) plant, billets and steel bars in the 1970s and 1980s. Given the importance of steel industry and economic linkages created by this particular industry, the government regarded this industry as a key industry for development. With the adaptation of policy on heavy industries in the 1980s, Malaysia started to give higher priority to the steel industry, along with the automotive industry. In 1982, to rationalize the steel industry and to reduce dependence on imports, the government started to fully involve in the industry through the establishment of Perwaja Terengganu Sdn. Bhd., a joint-venture company with Nippon Steel Corporation (NSC). Similar with other state-led projects i.e Proton, Perwaja was also granted a high protection by the government. Perwaja had enjoyed various tax incentives including tax holidays under Pioneer status as well as tax exemptions on a few imported raw materials.

⁷⁸ MITI. "Historical Development of Malaysia Iron and Steel Industry" in Policy Review on Iron and Steel Industry. The established manufacturers are Federal Iron Works, Selangor (1960), Southern Iron and Steel Works, Penang (1965) and Ann Joo Steel Sdn Bhd, Penang (1961).

In the 1990s, the Malaysian steel industry is further expanded into manufacturing of flat products such as HRC and CRC with the establishment of Megasteel Sdn. Bhd., the first integrated steel mill in Malaysia to produce flat steel products and the only producer of hot-rolled products in the country. “The introduction of Megasteel signifies the government’s intention to ensure a ready supply for the development of the manufacturing and construction sectors and thus, removing its vulnerability to imports”.⁷⁹ Unfortunately, the Asian financial crises in 1997-98 distorted the development of steel sector. Therefore, in addressing the impact of the crisis and in order to protect the industry, the Malaysian government had imposed “import tariff of 0-25 per cent on a wide range of flat products (HRC, CRC and EGI) in April 1999”.⁸⁰

In 2002, due to the surplus in the global steel market resulted from overcapacity in production by major steel producers and also introduction of safeguard measures by the United States on steel products, the government had introduced several protective policies in order to protect local steel industry from

⁷⁹ MBAM’s Report. 19 June 2007.

⁸⁰ MITI. “Historical Development of Malaysia Iron and Steel Industry”.

available cheap imports. “Effective on 15 March 2002, the government had increased import duties between 30-50 per cent on HRC, hot-rolled coils pickled and oiled, CRC, electro galvanized, steel rods, galvanized steel coils and steel pipes”.⁸¹ “The hike was significant as previously, HRC were subjected to a maximum of only 25 per cent tariff, CRC to a maximum of 10 per cent and steel pipes to duties of around 20 per cent or less”.⁸² Imports of these iron & steel products were also subjected to Approval Permit (AP) issued by MITI.⁸³ In addition, the government continues to maintain import duties for long products at 10 to 30 per cent and the requirement of AP for imports was also maintained for this products. The government also introduced the determination of a quarterly HRC base price which was monitored and fixed quarterly by MITI to ensure domestic selling price was competitive and in line with the international price.⁸⁴ In relation to this, in the same year i.e 2002, import duty exemptions were granted to seven sectors namely the automotive and components, electrical and electronics, shipbuilding and ship repairing, petroleum and gas, steel furniture, exporting

⁸¹ MITI. “Historical Development of Malaysia Iron and Steel Industry”.

⁸² MBAM’s Report. 19 June 2007.

⁸³ MITI’s Document. “Guidelines for Import Duty Exemption and Approved Permit (AP) on Iron and Steel Products Effective 15 March 2002”.

⁸⁴ MITI’s Document. “ Policy Review of Iron and Steel Industry”.

companies and companies located in FTZ/LMW.⁸⁵ “Exemptions had also been given to industries that were unable to source their products locally but they must submitted applications to the government for licenses that exempted them from the tariff”.⁸⁶

Similar to the automotive industry, high government’s involvement in the steel industry also resulted for an increase in number of protective industrial policies. Market monopoly by certain company further dominated the scene as the government had crafted policies in favor of this company in order to ensure for its development and survival after huge capital investment poured by them in the industry. Even though the protective policies managed to foster the steel industry, at the same time it discouraged private investments that have potential to further develop and enhance the industry’s competitiveness.

⁸⁵ Effective from 1 August 2009, import duty exemption for these seven selected sectors was abolished, since it is no longer relevant, as the policy review on tariff reduction structure has taken into consideration the requirement for these sectors.

⁸⁶ MBAM’s Report.

4.2.3 Nature of Malaysia's Past Industrial Policy

Industrialization undoubtedly propelled Malaysian economy. Along the industrialization process, two approaches were taken by the government in implementing industrial policies. In the earlier stage, the Malaysian government introduced various incentives to stimulate private investments in selected sectors in order to substitute imports and develop those sectors. This approach could be regarded as a private-led development model. During this time, private sectors were encouraged to establish firms producing products which are listed under promoted industries such as the automotive and steel products. As to acquire for technological transfer, a joint-venture firms were also allowed to operate on accelerating the development of the industries. At this juncture, the government hoped that incentives and protections given to private firms would further develop and stimulated for a competitive local automotive and steel industries.

At the same time, there was no government's direct involvement in the business. However, after it came clear that this approach was rather unsuccessful due to several reasons, among other, failed of an attempt for the localization of industries and unattained intention on reduction of economic imbalance between

ethnic groups, the Malaysian government later intervened into the industry by involving itself in business operations.⁸⁷ According to Taylor (2007: 91), “since the development of sizeable Malay commercial and industrial community would took time, the government embarked on establishing and operating Malay enterprises, both wholly government-owned and public-private joint-ventures through the establishment of statutory corporation such as PERNAS and the State Economic Development Corporation (SEDC) and other business ventures under the government’ umbrella”. This intervention was further strengthened with the implementation of policy on heavy industries where the government actively involved in the automotive and steel operations through its state-owned enterprises. The Malaysian government then provided high protection to these enterprises and industries as a whole through policies, under which, provided for various kind of incentives and privileges. In analyzing the Malaysian industrial policy, Gustafsson (2007: 52) stated that “Malaysia had used and continued to use selective protection instruments in a pro-active way”. Nevertheless, this government-led approach which accompanied by higher government’s protections

⁸⁷ Due to social responsibility after ethnic clash, Malaysian government implemented various economic policies under the NEP and national economic plan (Malaysia Plan) to eradicate poverty and lessen the economic gap between its indigenous Malay and Chinese. Among them was the 30 per cent Bumiputera equity participation in business.

fall short as until now the state-owned enterprises remained less competitive or marginal and failed to meet national aspiration. The broad government's involvements in business together with protections given to the industries provide a good foundation for me to examine the response made by the Malaysian officials' and business actors' towards the JMEPA.

4.3 Japan-Malaysia Economic Partnership Agreement (JMEPA)

4.3.1 Overview of JMEPA

Initiative to create for an economic partnership between Malaysia and Japan was put forward by Prime Minister Mahathir to Japan's Prime Minister Koizumi during their meeting on 12 December 2002. Preparatory work to establish the Japan-Malaysia Economic Partnership (JMEP) commenced in February 2003 with the formation of Working Groups (WGs) followed by the establishment of Joint Study Group (JSG) which involved government officials', representatives of trade and industry and academicians to deeply discuss and expedite the realization of the JMEPA.

According to the JSG's Report 2003, "based on the outcomes of the WGs, the JSG addressed a wide range of issues of the JMEP including (a) issues on liberalization and facilitation of trade in goods and services and investment, business environment enhancement as well as issues on cooperation in various areas, with a view to examine ways to enhance mutually beneficial economic partnership between Japan and Malaysia, by taking into account the necessity of flexibility for sensitivity; and (b) analysis on the economic impact of the JMEP" (MOFA, 2003b: 3). "The JSG also discussed an across-the-board range of issues to be included in the possible scope of negotiations. As a result of the discussions, both sides achieved greater understanding of each other's position on a variety of issues, including the sensitive sectors in each country".⁸⁸

Subsequent to the JSG's report, the Prime Ministers of Malaysia and Japan agreed on 11 December 2003, to commence formal negotiations. The JMEP involved 9 Rounds of negotiations (of which the last 3 negotiations were the High Level meetings), within two years from 13 January 2004 to 22 Mei 2005.⁸⁹ "The

⁸⁸ *ibid.*

⁸⁹ MITI's document on JMEPA (unpublished).

agreement in principle was reached on 25 May 2005 between the Prime Minister of Malaysia and the Prime Minister of Japan on the key elements of the JMEPA”.⁹⁰ The JMEPA was officially signed on 13 December 2005. “The JMEPA marked a new era for the Japan-Malaysia strategic partnership, by forging close economic relations through cooperation, liberalization and facilitation in trade and investment between the two countries”.⁹¹

4.3.2 Outcome of the JMEPA

The Agreement which came into force on 13 July 2006 covered the FTA component which included “trade in industrial and agricultural goods, trade in services, investment, rules of origin, customs procedures, standards and conformance, intellectual property, competition policy, enhancement of business environment, safeguard measures and dispute settlement as well as cooperation in areas such as agriculture, forestry and commodities, education, human resource development, information and communication technology (ICT), small and

⁹⁰ Information on Japan-Malaysia Economic Partnership Agreement (JMEPA) from http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section_5451c5df-c0a8156f-2af82af8-a1ebb9df&rootid=com.tms.cms.section.Section_8ab48a0a-7f000010-72f772f7-4dc62890

⁹¹ Joint Press Statement of JMEPA, 13 December 2005.

medium enterprises, science and technology, tourism and environment”.⁹² For the industrial goods, both countries would employed a phasing-out period for tariffs reduction and elimination which was based on products/items categorization such as early-harvest, normal-track, sensitive and highly-sensitive products. Generally, tariffs on essentially all goods (including the automotive and steel products) would be reduced or eliminated within 10 years from the date of the entry into force of the JMEPA. Details of the tariff reduction are shown in Table 7.

Table 7: Tariff Reduction in Auto, Auto Components and Parts and Steel in Malaysia under JMEPA

Products/Items	Tariff Reduction
Completely Knocked Down (CKD)	<ul style="list-style-type: none"> Import duties will be immediately eliminated on the date of entry into force of the JMEPA
Auto components and parts	<ul style="list-style-type: none"> Import duties will be 5-30% in 2007, 0-5% in 2008 and 2009, and eliminated in 2010.
Completely Built Up (CBU) (i) For passenger cars exceeding 3,000cc. (ii) For passenger cars exceeding 2,000cc,	<ul style="list-style-type: none"> Import duties will be 20% in 2007, 0-5% in 2008 and 2009, and eliminated in 2010. Import duties will be gradually eliminated by 2010.

⁹² Information on JMEPA retrieved from http://www.miti.gov.my/cms/content.jsp?id=com.tms.cms.section.Section_5451c5df-c0a8156f-2af82af8-a1ebb9df

Products/Items	Tariff Reduction
<p>Multi-Purpose Vehicles (MPVs) exceeding 3,000cc, trucks exceeding 20 tonnes and buses.</p> <p>(iii) For all others CBU other than (i) and (ii).</p>	<ul style="list-style-type: none"> • Import duties will be gradually eliminated by 2015.
<p>Iron and steel</p>	<ul style="list-style-type: none"> • Import duties on essentially all iron and steel products will be eliminated within 10 years. • Import duties exemption will be granted for Japanese products which are directly used in the manufacturing activities⁹³ subject to the following conditions: <ul style="list-style-type: none"> (i) The products are not produced locally; (ii) The products whose specification, grade or quantity are not available locally; or (iii) The products whose specification, grade or quantity does not meet a user's requirement.

Source: Ministry of International Trade and Industry (MITI), Malaysia.

⁹³ The specific sectors to be granted import duty exemption include automotive and components, electrical and electronics, shipbuilding and ship-repairing, petroleum and gas, steel furniture, canning, re-rolling activities and galvanized iron for construction and home appliances.

4.3.3 Negotiation Process of JMEPA

As previously mentioned, formal negotiations of the JMEPA started in December 2003 which involved 9 Rounds of negotiations between negotiators as well as ministers from both countries. These negotiations took less than two years to be completed, from 13 January 2004 to 22 Mei 2005. Before starting to explore and negotiate for an FTA with Japan, the Malaysian side first sought for the Cabinet approval/decision for the proposed bilateral FTA. On 5 June 2002, the Malaysian Cabinet decided that the country would enter into negotiations with Japan towards concluding Malaysia-Japan FTA. Based on this mandate, various preparatory works were done including a thorough study of cost and benefits of the possible FTA. A Steering Committee was established to examine Malaysia's interests and concerns in pursuing an FTA with Japan.

The study conducted by this Committee indicated that “in the long term, controlled and phased market liberalization for the Japanese products, services and investments could contributed towards enhancing the competitiveness of the Malaysian industries. However, in the short to medium term, Japan could gain more from the liberalization elements of the FTA as its industries were more

developed than those in Malaysia”.⁹⁴ The study also stressed that “Malaysia would also benefit through strengthening technical cooperation and capacity building to address areas such as technical standards, Human Resource Development (HRD), Research and Development (R&D) and technical assistance programmes”.⁹⁵ The study further recommended that “Malaysia to adopt the Closer Economic Partnership (CEP) approach toward strengthening Malaysia-Japan cooperation whereby to secure Japan’s commitments in areas related to facilitation, technical cooperation and capacity building”.⁹⁶ These signified that the intensified global competition makes it imperative for Malaysia to explore all avenues to enhance its competitive position and the CEP with Japan would contribute towards meeting this objective.

The first meeting to discuss the JMEPA was held on 13 January 2003 in Putrajaya, Malaysia. The meeting agreed on the framework of the negotiations for the JMEPA which comprise of the basic principles, structure and scope of

⁹⁴ MITI. Report on “Proposal for Malaysia-Japan Free Trade Agreement/Closer Economic Partnership” (unpublished).

⁹⁵ *ibid.*

⁹⁶ *ibid.*

negotiations. Key elements of the framework include:⁹⁷

- There should be comprehensive and substantial liberalization of trade, consistent with the WTO; and
- Negotiations would take into account flexibility for sensitive sectors; scope of negotiation does not include government procurement, however compromise was achieved by making the scope on trade and investment related issues non-exhaustive.

The approved framework provided the basic principles, scopes, structures and guidelines of the negotiation process towards realizing the early conclusion of the economic partnership agreement (EPA) between Malaysia and Japan. Although the JMEPA was not required for a long time to be concluded, there still a lot of contentious issues cropped up along the one year negotiation process. As the Japanese main interest was to open-up the Malaysian industrial market, Japan tried the best to urge the Malaysian side to liberalize the domestic market especially for the automotive and steel sectors which were regarded as key

⁹⁷ Government document (unpublished). “Updates to MITI’s Secretary General on Malaysia-Japan Economic Partnership Agreement”. January 2004.

industries for Malaysia. This attempt unease Malaysia as these two sectors still received numerous protections from the government. For Japan, there remained an impression that an EPA with Malaysia was seen to be easier to conclude than that with other ASEAN countries, particularly with Thailand that they had ongoing discussions.⁹⁸ Moreover, despite a high protection provided to industrial sectors, agricultural sector were not protected by the government except certain products that were mainly serve for self-sufficient purposes such as rice. Therefore, for Japanese side, negotiations with Malaysian might be easier compared to Thailand.⁹⁹

In negotiating for the JMEPA, both countries adopted a single undertaking concept where agreement could only be reached if everything was agreed across the sectors. That was to say that an agreement would not solely consist of tariff cuts and tariff reductions on certain products but must also addressed services, investment, economic cooperation and so forth. In this manner, “since countries had to negotiate simultaneously on both sectors that

⁹⁸ Japan faced difficulties in negotiating for agriculture sector with Thailand as Thailand keen to have more market access for its competitive agriculture products while Japan highly protected its agriculture sector.

⁹⁹ Thailand was a major rice exporter from ASEAN countries.

were highly competitive and those that were much weaker, they could made deals and concessions that involved unrelated products and multiple sectors” (Higashi, 2008: 17). This concept gave advantage to both sides as they could reach for an agreement which had elements of a win-win situation.

4.4 Government Official’s Preference in the Negotiation Process

Government officials especially the negotiators and policy makers¹⁰⁰ had their respective significant roles in negotiating and preparing for the FTA’s agreement. In case of the JMEPA, both negotiators and policy makers worked closely to keep national interests along the negotiation process of the JMEPA. In addition to this, ministers also played an important role along the negotiation process.

With the backdrop of developing and enhancing competitiveness of the key industries especially the automotive and steel industries, the Japanese quest for market liberalization for industrial goods was received in a mixed manner. On one hand, Malaysia was constricted with the national economic agenda to develop

¹⁰⁰ Policy makers were those directly responsible for industrial policy’s formulation.

local industries by continuously maintained government protections, and on the other hand, Malaysia perceived that local industries' competitiveness could be achieved through market liberalization by way of competition. In the JMEPA, various officials from various departments and ministries were involved in the negotiation process. However in the light of the industrial sectors especially the automotive and steel sectors, the officials mainly came from MITI and its agencies including Malaysia Industrial Development Authority (MIDA). As an authority which was tasked to develop local industries and promote the international trade, MITI now had the dual role to play. At the earlier stage of the JMEPA, the officials tried their best to ensure that local industries would be protected and not severely injured, even if the government had to liberalize the market. Before the negotiation started, one of MITI senior officers warned that Japanese METI might be taking a strong position that any FTA's possibility would inextricably linked to Malaysia's policies on the automotive sector as in Tokyo Mini-Ministerial meeting, Japan had raised the issue of alleged 'discriminatory treatment' to foreign producers in respect of the excise duties

imposed by Malaysia. Therefore, he suggested that “adequate preparations though were vital to ensure that any outcome was mutually beneficial”.¹⁰¹

During the JMEPA’s negotiation, “a high amount of considerations was given to the current industrial policies to avoid or minimize the effects to local industries, and MITI in fact wrote and mentioned to the Cabinet in the MITI’s Cabinet Paper on the need to protect local industries”.¹⁰² The Malaysian negotiators also explained to the Japanese negotiators on why the government needed to continue retaining the current industrial policies which was imperative for the development of the local industries especially the automotive and steel sectors. For Malaysia, these two sectors had utilized huge government’s investments and there was vital for the government to continuously develop the sectors. MITI’s Minister, Rafidah Aziz, admitted that the Malaysian government provided a lot of protections to PROTON since the establishment of this national carmaker and the government with all the possible would assist the company and

¹⁰¹ Report from Minister Counselor (Economy), MITI Tokyo, 22 April 2003.

¹⁰² Interview conducted with Dato’Abdul Ghafar Musa, Senior Director Entrepreneur Development Division which was previously became the MITI’s Lead negotiators for JMEPA. Putrajaya, Malaysia. 10 March 2010.

provide protection within limit allowed by the WTO.¹⁰³ Furthermore, she stressed that in a tariffs determination, in order to protect PROTON, she always instructed her officers to prepare price impact stimulation before any changes made to tariff in order to ensure that there was a difference between the price of PROTON's car and the final prize that would be imposed to imported cars.¹⁰⁴

In conjunction to this, “the Malaysian negotiators at the same time tried to the fullest to defend the protective policies which were vastly questioned by the Japanese side”.¹⁰⁵ In the early stage of the negotiations, the Japanese government requested the Malaysian government to submit various legal grounds (guideline, law and standard of permission) and detailed information such as on remissions for national car makers, excise duties and import duties for CKD and Approval Permit (AP) which was required for the importation of CBU's car. They also requested the Malaysian side to explain the import restriction measures (including AP) on each type of steel products and submit the legal ground of the import

¹⁰³ Utusan Malaysia. “Kerajaan beri perlindungan syarikat kereta nasional” (*Government Granted Protection to National Car Companies*). 13 March 2005.

¹⁰⁴ *ibid.*

¹⁰⁵ Interview with Dato' Abdul Ghafar Musa.

duties exemptions on steel products which were consumed by specific seven sectors of industries.¹⁰⁶

Further to the request, Japan continuously urged Malaysia to dismantle all imports barriers for the Japanese automotive and steel products. Japan wanted Malaysia to abolish/reduce tariffs and non-tariff barriers for those two sectors including the need for Malaysia to abolish the AP system for the automotive and steel sectors or at least make sure that the procedures were not trade restrictive. In response to the Japanese demand and with protection of local industries in mind, the Malaysian negotiators continuously defended the policies by stating that Malaysia's position on the automotive policies remained unchanged as policy review on the automotive industry was in progress.¹⁰⁷ Malaysia also expressed its stance that the AP system was not a trade restrictive measure but instead was being used for the purpose of data collection and to monitor the importation of the automobile and the iron and steel products. Furthermore, for policy makers, it was

¹⁰⁶ MITI's Document (unpublished). The 7 qualified sectors and products for import duties exemption are: automotive and components; electrical and electronics; shipbuilding and ship repairing; petroleum and gas; steel furniture; exporting companies and manufacturers located in Free Trade Zones (FTZs)/Licensed Manufacturing Warehouse (LMW).

¹⁰⁷ Malaysia had come out with the National Automotive Policy (NAP) on 22 March 2006.

impossible for the Malaysian government to rapidly open up the local automotive and steel market as the industries still at very early stage compared to Japan and it required few decades for Malaysia to reach maturity in both industries. Therefore, elimination/reduction of tariff for Malaysian iron and steel products required a longer time period and the elimination/reduction need to be done on gradual basis to ensure the survival of the industries.

The continued pressures made by the Japanese negotiators for Malaysia to reconsider its industrial protective measures and the eagerness of the Malaysian negotiators to maintain its stance on several protective policies on the automotive and steel sectors, created difficulties on the negotiation process of the JMEPA. “In EPA negotiations with Malaysia, Malaysia’s National Car Policy was an obstacle to negotiations over removing a tariff on imported Japanese automobiles” (Higashi, 2008: 12). Therefore, according to Mr. Ghafar, “when there were difficulties in making a decision, the negotiators then would break-off the negotiation to get information before it was resumed”.¹⁰⁸

¹⁰⁸ Interview conducted on 23 March 2010.

To overcome the difficulties faced by the negotiating team and to accelerate the negotiations, MITI's Minister, Rafidah Aziz intervened in the process. A Ministerial-level meeting was held between Rafidah and Japanese Economy, Trade and Industry Minister, Shoichi Nakagawa on 22 May 2005 in Kuala Lumpur to dismantle deadlock on several contentious issues faced between both negotiating teams. At their joint-press conference, Rafidah told that "both of them had tied the loose strings in the JMEPA".¹⁰⁹ The news reported that the JMEPA was finalized, with differences over issues involving the automotive and steel sectors being resolved. However, it was reported that both ministers declined to elaborate on the consensus reached instead said that it was a "win-win situation". Previously both Ministers had met during Rafidah's trade mission to Japan on April 2005 and it was reported that Nakagawa had told Rafidah on the need to swiftly resolved issues that impeded the negotiation of the JMEPA. He suggested that both of them needed to ask and instruct their respective officers to find a way out for issues that could be resolved while for those that could not be resolved among them, it would be discussed at the ministerial level.¹¹⁰

¹⁰⁹ The Star. "Tokyo and KL finalise deal". 23 May 2005.

¹¹⁰ Berita Harian. "Malaysia-Jepun hampir setuju selesai isu JMEPA" (*Malaysia-Japan almost agree to settle JMEPA's issues*) . 23 April 2005.

Subsequent to this, Rafidah “realized that instructions from the minister to bureaucrats would be necessary for negotiations to proceed. Following the meeting, “the Minister instructed bureaucrats and negotiations proceeded rapidly thereafter” (Higashi, 2008: 15). Rafidah was also reported as said that “I actually did not believe that what Japan requested was something that we could not give. We want Japan to invest more in our automotive sector”.¹¹¹

Therefore, at the later stage of the negotiation, after Minister’s instructions, both negotiators tried to find ways on how to have a “win-win outcome” for both countries. In line with Malaysia’s efforts to further enhance competitiveness of the automotive industry and its request on cooperation in automotive, Japan agreed to provide support in the form of cooperation and capacity building for Malaysia. The cooperation included the expert collaboration programme, the automotive skill training programme, the business development programme and the export promotion cooperation. In exchange for these cooperations, Malaysia agreed to commit for market access improvement for the

¹¹¹ Berita Harian. “TK, Tokyo harus elak isu jejas FTA” (*TK, Tokyo should avoid issues affecting FTA*). 27 April 2005.

Japanese goods. However, given the need to protect the national carmakers, Malaysia pledged to gradually eliminate tariffs on finished vehicles below 2000 cc by 2015 as these vehicles would directly compete with cars manufactured by the Malaysian national carmakers, PROTON and PEROUA.¹¹² Further, this mutual understanding between both sides accelerated the negotiation process of the JMEPA.

Strong government officials' preference to continuously foster the automotive and steel sectors by means of continuous protection was obvious in the JMEPA case. The preference was consistently carried out along the negotiation process of the JMEPA. This constant preference yielded for a solid mandate (continuous protection) which further negatively influenced the negotiation process by making it difficult and unsmooth. As compared to Thailand, the solid stance was easier to be made by the Malaysian government as the authority for the development of the industries and the promotion of trade

¹¹² Information cited from Kyodo News. [just-auto.com editorial team](http://www.just-auto.com/news/japanese-and-malaysian-governments-agree-major-elements-of-free-trade-pact_id73814.aspx). JAPAN: Japanese and Malaysian governments agree major elements of free trade pact. 25 May 2005. Retrieved from http://www.just-auto.com/news/japanese-and-malaysian-governments-agree-major-elements-of-free-trade-pact_id73814.aspx

were given to a single ministry i.e MITI. This position facilitated the coordination between industrial policy and trade policy in the decision making process of the JMEPA which in turn gave weight to the past protective industrial policies which aimed for continued protection of the local automotive and steel industries.

4.5 Societal Actor's Influence on the Negotiation Process

Societal actors play an important role in assisting government in policies' formulation including trade policy on FTA. The societal actors especially business group/association had vast experiences and better knowledge on their own business or industry and what was best for them. As the JMEPA in particular and FTA in general, promoted for market liberalization, business groups that represented the import-competing industries would normally oppose those agreement as it would injured their business. However, in the JMEPA's case, there was no significant role played by business groups in opposing the deal as compared to the Thai case. This could be explained through the policy formulation process undertaken by the Malaysian government. In Malaysia, before any policy was formulated, consultation with private sectors was held to gather input and also to know their concern on proposed policies. In view of

industrial and international trade policies where MITI acted as the main coordinator, private sectors were invited to participate in the MITI Annual Dialogues. During the Dialogue, business associations presented their concerns on industry or trade issues which created problem to their business and made recommendation to government to resolve the issues. According to Jomo (2007: 118), “the institutionalization of consultative dialogues reflects the government’s commitment to be responsive to the views and the needs of the private sector”. This close ‘public-private’ relationship resulted to orderly manage of opposition efforts (if any), made by local industrial player or business groups towards the JMEPA.

In support, the Trade Policy Review of the WTO also stated that “the practice of Malaysia’s trade and broader economic policy involved an increasing degree of transparency and consultation. Important policy initiatives were preceded by extensive consultations with affected sectors and other stakeholders”.¹¹³ The WTO’s Report further stated that “representatives from the business sector, academia, and NGOs including several interest groups were

¹¹³WTO Trade Policy Review. WT/TPR/S/156. www.wto.org/english/tratop_e/tpr_e/s156-2_e.doc

members of the various task forces, and committees chaired by the MITI Minister. MITI also incorporates the views and inputs received into the policy formulation process”.¹¹⁴ Therefore, the inclusions of all interested parties in policy formulation led to accountability and acceptability of the said policy by general public.

In the case of the JMEPA, societal actors especially industrial players, businesses and industries associations and other interested parties were invited and fully involved before and along the negotiation process of JMEPA”.¹¹⁵ MITI conducted meetings with various industrial players including business groups before making any decision for the JMEPA’s negotiations. For example, on 10 July 2003, MITI conducted a meeting on FTAs (including the JMEPA) to discuss issues¹¹⁶ which had impact on the automotive industries. Prior to this, a survey on ‘feedback on the proposed JMEPA’ was sent to all related business groups such as Malaysian Automotive Association (MAA), PROTON Vendors Association,

¹¹⁴WTO Trade Policy Review. WT/TPR/S/156. www.wto.org/english/tratop_e/tpr_e/s156-2_e.doc

¹¹⁵ Dato’ Abdul Ghafar Musa. Interview conducted on 10 March 2010.

¹¹⁶ Issues that were put into consideration are tariff reduction, non-tariff barriers and sensitive products (identification of products to be protected/excluded from FTA).

Motorcycle & Scooter Assemblers Association of Malaysia (MASAAM), PERODUA Vendors Club and *Persatuan Pengimport dan Peniaga Kenderaan Melayu Malaysia* (PEKEMA) to collect their views on the JMEPA. In addition to this, “main business/industries associations were also asked to standby outside the negotiation room to be ready for any input should it be immediately needed by the negotiators”.¹¹⁷ For Malaysia, any stance made along the negotiation process was not the governments’ alone decision but rather its incorporated views of local industrial players and business groups. Therefore, according to Mr. Ghafar, “there was no reason for the industries to oppose the JMEPA as what consisted in the agreement was already consulted and agreeable by them”.

Besides the consultations organized by the government, the industrial players including main industries association/business group also conducted briefing to the government officials to explain and update the government on their business situation and supports needed by them to move forward. Based on inputs given by the industries, the policy makers then negotiated and formulated policies

¹¹⁷ Dato’ Abdul Ghafar Musa. Interview conducted on 10 March 2010.

which had both elements; protection elements as well as elements to enhance the industries competitiveness under the JMEPA.

Therefore, it could be summed that the wide involvement of industrial players and business groups in Malaysia's trade policy formulation process had effectively minimized dissatisfaction and opposition towards the JMEPA. Due to this, there were not much lobbying efforts made by the industries/business groups to put pressure on the government to continue to protect the local industries. According to Minister Rafidah, "the Malaysian private sectors now understand the need to cooperate through joint-venture and efforts to make Malaysia as a manufacturing hub for Japanese companies".¹¹⁸

Echoed itself with the Minister's statement, MAA stated that "Malaysian industry players must look at the opportunities that would arise and try to benefit from any FTA".¹¹⁹ It was further stated that "the majority of local auto industry players were currently tied with Japanese manufacturers and were already

¹¹⁸ Berita Harian. "Malaysia, Jepun atasi kebuntuan perkongsian" (*Malaysia, Japan resolved cooperation's dead end*) . 23 May 2005.

¹¹⁹ The Star Online. Star-Motoring. "Cheaper cars?". 3 July 2005.
http://star-motoring.com/news/story.asp?file=/2005/7/3/ms_features/1

enjoying sourcing of components under the CEPT rates from ASEAN which means that there was little impact on the total Malaysian auto industries”.¹²⁰ On the other hand, according to the MAA, there was likely being “more opportunities for more Japanese investment in making components in Malaysia”.¹²¹

Despite close relations between the private sectors and the government during the policy formulation on the JMEPA, there were still little opposition and dissatisfaction existed on the JMEPA. The Malaysian auto parts vendors expressed their concerned that further incentives for the Japanese manufacturers would hurt the domestic market and urged the government to limit the incentives for CBU vehicles of more than 3,000cc. Furthermore, the groups stated that the entry of more CBU vehicles would not give advantage to the Malaysian auto parts makers as it would not generate more business.¹²² This concern was echoed by the National Automobile Distributor (EON). EON’s Managing Director expressed that “there should be a national agenda in the FTAs to enable local players,

¹²⁰ The Star Online. Star-Motoring. “Cheaper cars?”. 3 July 2005.
http://star-motoring.com/news/story.asp?file=/2005/7/3/ms_features/1

¹²¹ *ibid.*

¹²² The Star. “Motor players to gain from Malaysia-Japan FTA”. 28 May 2005.

especially the vendors (parts and component suppliers) in the motor industry to grow. According to him, whatever the final details of the FTAs were, they must not stifle the growth of PROTON”.¹²³

Concern was also made by PROTON Adviser, Tun Dr. Mahathir Mohamad.¹²⁴ He was reported as saying that the influx of imported cars without control would give big impact to local automotive industries especially PROTON’s markets, which for him would be shrinking.¹²⁵ The MITI’s Minister later responded by stated that MITI never abandoned the national automotive industry by approving imports of foreign cars without limit¹²⁶ and in fact MITI was always gave a lot of considerations to the national automotive industry aligned with the policy fixed by the government.¹²⁷ In relation to this, the Prime

¹²³ The Star Online. Star-Motoring. “Cheaper cars?” 3 July 2005.

¹²⁴ This critique however was coincided with AP’s issue where he alleged that MITI, in particular Rafidah had abused and approved for a big number of APs for imported cars which undermined Proton.

¹²⁵ Utusan Malaysia. “Kedudukan kereta nasional dicabar” (*National car’s position was challenged*). 26 May 2005.

¹²⁶ Imports of foreign CBU cars required AP which would be based on 10 percent from total production of local passengers and commercial cars.

¹²⁷ Utusan Malaysia. “Kementerian tidak abai industry automotif negara – Rafidah” (*Ministry not neglect national automotive industry- Rafidah*). 29 May 2005.

Minister, Datuk Seri Abdullah Ahmad Badawi also stated that “national car makers had to start competing with other manufacturers and not expect the government to protect them indefinitely”.¹²⁸ The dissatisfactions from business groups and Proton’s adviser however rose after the negotiation was concluded and the agreement was agreed in principle.

Although import-competing industries normally opposed for trade liberalization, the JMEPA’s case proved that this thought is not necessarily right as the same industries would also support the FTA if correct approach and clear benefit perceived by them. In the JMEPA it was also clear that though the market was monopolized by few companies (such as PROTON, PERODUA and PERWAJA), insignificant opposition efforts from industrial players and business groups prevailed as government’s interests coexisted within the industries. Due to this, the industries’ concerns were transmitted through the governments’ response towards the JMEPA (resisted to dismantle the protective policies). In addition, the proper approach undertook by the Malaysian government by involving the

¹²⁸ New Straits Times. “Protection of Proton not indefinite”. 2 June 2005. The Prime Minister also reported as stood by MITI’s Minister explanation on AP policy that the system was keeping Proton alive, and doing away with it would be “disastrous” to Proton.

industries in policy making process further alleviated any negative reaction or opposition from these groups towards the JMEPA.

4.6 Conclusion

Malaysia had implemented various industrial policies in developing its industries. As the government had largely developed the industries through state initiatives or state involvements, various protective measures which accompanied with the industrial policies were adapted to further foster the industries. Among protective policies implemented by the government includes import ban, import tariffs, local content requirement, tax exemptions, mandatory deletion programme, and AP requirements. The introduction of the heavy industry policy further enhanced government's protections on the automotive and steel industries by means of the protective industrial policies. The government's interest and the Bumiputera policy agenda which was largely attached and implemented along with the industrial policies made imperative for the government to continuously retain the current industrial policies along the negotiation process of the JMEPA.

With backdrop of the domestic industrial development agenda, government officials tried to their fullest to retain the protective industrial policies on the automotive and steel industries in negotiating for trade agreement on industrial goods under the JMEPA. Compared to Thailand, this policy preference of the officials was consistent along the negotiation process of the JMEPA. In addition, the solid stance of the Malaysian government was able to be formed as coordination between industrial policy and trade policy was done by a single authority i.e MITI which lessen any possibilities for a diverge stance among the authorities. The persistence preference of the officials and the concrete stance made on the JMEPA further made the negotiation process rocky.

Despite government officials' influence on the negotiation process of the JMEPA, there was no significant role played by the industrial players and business groups in lobbying the government to retain current industrial policies along the negotiation process of the JMEPA. The close 'public-private' relationship between the government and the industries in the policy formulation process of the JMEPA also contributed to the minimal opposition efforts made by the industrial players and business groups. The agreed trade policy had took into

considerations all inputs provided by the industrial players through a continuous consultation held with them. Therefore, there were no opposition or resistance made by this societal actors along the negotiation process of the JMEPA as they were fully aware of the proposed agreement which already incorporated their interests.

Past industrial policies and its nature also linked to the government officials' and societal actors' responses towards the JMEPA. Number of protective industrial policies on auto and steel sectors increased after the involvement of the Malaysian government in those particular sectors. These policies which most were formulated and implemented by MITI has made the officials persisted to retain them in the JMEPA's negotiation in order to continuously protect and develop the auto and steel industries which were considered unready for stiff competition. In addition, MITI officials also insisted to maintain the policies as social agenda (Bumiputera policy) was attached onto most of those policies. If the policies be removed it would gave negative impact to the national social economic objectives which were to eliminate economic disparities and to form national unity among Malaysian ethnics. The vested

government's interests in the industries also made it imperative for the officials to continuously protect those sectors as huge investment and sources were endowed to both sectors. On the other hand, the nature of past policies (protective policies which favored state-owned companies) discouraged private investments. This situation further gave disadvantage to the industries and created for a weak business foundation with no voice to express their concern.

CHAPTER 5: CONCLUSION

This thesis tried to highlight responses made by two Southeast Asian governments - Thailand and Malaysia, and their industries towards FTA's negotiations in relation to past industrial policies adopted by both governments. My previous two empirical chapters started with a brief description on industrial policies adopted by Thailand and Malaysia in order to answer my first research question on what kind of industrial policies are adopted by Southeast Asian countries. Following this, a brief account of JTEPA and JMEPA were provided, and analyses on government officials' preference and societal actors' response in relation to automotive and steel sectors were carried out to observe on how past policy trend to foster both sectors influenced the negotiation process of JTEPA and JMEPA. As this research come to an end, I will first summarize findings for each case based on my research questions and hypothesis and finally I will conclude this chapter with suggestions on areas for future research.

5.1 Industrial policies Adopted by Thailand and Malaysia

From this research, I found that Thailand and Malaysia had undergone a

similar industrialization process since 1960s, both under ISI and EOI. With this process, both countries established an administrative agencies agency to deal with industrial development such as BOI in Thailand and MIDA in Malaysia. At the same time, various industrial policies which applied according to industrial sectors were adopted such as Pioneer Industrial Ordinance, Investment Incentives Act, Industrial Coordination Act and Industrial Promotion Act. Policy on heavy industries was also espoused in Malaysia in concurrence with state's involvement. The implementation of industrial policies was outlined in respective national economic development plans as well as industrial master plans of both countries. Further to this, specific policies on the automotive and steel sectors adopted by Thailand and Malaysia are shown in Table 8.

Table 8: Industrial Policies in Automobile and Steel Sectors

Sector	Country	
	Thailand	Malaysia
Automotive	<ul style="list-style-type: none"> ✧ Promotional incentives (e.g tax incentives) to new assembly plants ✧ Restriction on new plants ✧ Import ban on CBU ✧ Import tariffs on CBU 	<ul style="list-style-type: none"> ✧ Promotional incentives (e.g tax incentives) to new assembly plants. ✧ Local content requirement ✧ 'Mandatory Deletion' programme ✧ Import ban on CBU

Sector	Country	
	Thailand	Malaysia
	<ul style="list-style-type: none"> and CKD ✧ Local content requirement ✧ ‘Mandatory Deletion’ programme 	<ul style="list-style-type: none"> ✧ Import tariffs on CBU and CKD ✧ Approval Permit (AP) system. ✧ Heavy industry policy.
Steel	<ul style="list-style-type: none"> ✧ Promotional incentives Restriction on number of steel operators ✧ Tax exemptions ✧ Import tariffs on imported steels ✧ Additional import surcharges ✧ Compulsory standard 	<ul style="list-style-type: none"> ✧ Promotional incentives ✧ Tax incentives and privileges ✧ Import tariffs ✧ AP system ✧ Import duty exemption on seven key sectors including automotive. ✧ Heavy industry policy

Source: Compilation by author from various sources.

These industrial policies were created and enforced aiming to protect and foster domestic industries, in particular, automotive and steel sectors. Although some of these protective policies were later lifted, several policies still remained intact for both countries. Importantly, this research found that even though many of the policies seem similar in both Thailand and Malaysia in terms of their name, differences existed in terms of the way the policies were implemented. For instance, due to its social-economic objectives, Malaysia attached the Bumiputera

policy along with its industrial policies (e.g heavy industry policy required for Bumiputera managerial skills in the state-owned companies). The exercise of the Bumiputera policy along with the industrial policies differentiated Malaysia from Thailand. Further, an approach to implementing the policies also differed. This can be explained through the nature of those policies implemented by both governments. The implementation of industrial policies based on the private-led model in Thailand, provided opportunity for the private sector to dominate the industry, which in turn created strong and competitive local automotive and steel industries. By contrast, Malaysia's approach which was based on the government-led model with extensive state involvement in the automotive and steel sectors, inevitably felled short as until now state-owned enterprises remained less competitive or marginal and failed to meet national aspiration. Abbott (2004: 65) argued that "different pattern of industrialization reflect distinct political pattern where Malaysia's internationalist strategy had relied on the capabilities of an autonomous, interventionist state, while stronger business influence in Thailand had bolstered indigenous capability building".

Therefore, it is valuable to note that the different way and approach in implementing the industrial policies would yield for different consequences. Thailand which implemented industrial policies mainly based on economic objective and private sector's emphasis resulted for competitive local industries. Whilst Malaysia which implemented policies based on economic and social objectives and government-led emphasis left for a marginal and uncompetitive industries which continuously relied on government's protection for their endurance. The objectives and nature of past industrial policies further established the different setting of the government and local industries' foundation which then acted differently in both FTA cases (JTEPA and JMEPA).

5.2 Government Official's Preference in the Negotiation Process of an FTA

Government officials played an important role in any FTAs negotiations where they were obliged to keep for their national interest. Therefore, preferences of these officials together with the mandate to continuously foster strategic industrial sectors crafted their manner towards the negotiation process of an FTA. The summary of my research finding on influence of government officials' preference in the negotiation process of the JTEPA and JMEPA is shown in following Table 9.

Table 9: Government Officials' Preference towards JTEPA and JMEPA

Country/FTA	Influence on Negotiation process	Government Officials Preference
Thailand (JTEPA)	Unsmooth & Chaotic	Oppose & Support
Malaysia (JMEPA)	Unsmooth	Oppose

My analysis on government officials' preference revealed that this factor has direct influences in the negotiation process of both FTAs by making the process unsmooth and chaotic. Preferences to retain past industrial policies in order to continuously foster domestic industries forced the officials to oppose the JTEPA and JMEPA. In contrast, the higher-ranking officials, in Thailand, were found supporting the agreement similarly with the aim to foster the domestic industries rather through stiff competition brought by FTAs. Nevertheless, policy preferences of high-ranking officials dominated the scene and highly influenced the negotiation process. This preference was associated with previous liberalization efforts made by Thailand which started in 1991 and further enhanced in 2000. The endeavor to make Thailand as a regional hub or 'Detroit of Asia' for automotive production also drove preference of high-ranking officials to support the JTEPA.

For Malaysia, the unyielding preference to retain past industrial policies in the name of industrial protection was further linked to Malaysian national economic agenda which was based on socio-economic restructuring after a racial clash in May 1969. The Bumiputera policy which emerged after this incident and is largely attached to the industrial policies has made imperative for the Malaysian officials to prefer to retain past industrial policies to ensure that the national economic and social objectives could be achieved. This social economic agenda (Bumiputera policy) differentiated Malaysia from Thailand and explained why Malaysia was keen to maintain past policies as it had two goals to be achieved (economic equality and prosperity and social unity). Further, the government officials perceived that economic prosperity would only be achieved if economic disparities between races can be ceased.

In addition, a solid stance to continue to protect the automotive and steel sectors in the JMEPA's negotiation was easier to be made by the Malaysian officials as compared to the Thais officials (in JTEPA) as cohesion and coordination in policy making process existed among the officials. These conditions were found lacking in Thailand which resulted in divergence stances made by its officials towards the JTEPA.

Furthermore, it was observed that the nature of past industrial policies (whether based on private-led or government-led development) was also linked to responses made by government officials towards JTEPA and JMEPA. In case of Thailand, as the business development was left in the hand of private sectors and minimal government involvement, the government officials, especially high-ranking officials, were less keen to maintain current protective industrial policies along the negotiation process of JTEPA. However, dissimilarity materialized in Malaysia's case. With the extensive involvement of the state in the economic development due to social agenda as explained before, the government officials made the fullest efforts to retain protective industrial policies in order to foster the strategic sectors and at the same time to fulfill their social agenda for economic equality and social unity.

5.3 Societal Actor's Influence on the Negotiation Process of an FTA

Societal actors in particular from import-competing industries normally would negatively respond to any FTA deal. However, in this research, I found that different responses emerged in both cases. The result of my analysis is shown in Table 10.

Table 10: Societal Actors' Response towards JTEPA and JMEPA

Country/FTA	Societal Actors (Industrial players & Business groups/ associations)	Influence on Negotiation process
Thailand (JTEPA)	Strongly oppose	Unsmooth
Malaysia (JMEPA)	Not oppose	Smooth

In case of JTEPA, strong oppositions were voiced out by industrial players and business groups/associations against the deal. Extensive lobbying efforts were made by these societal actors to pressure the government to protect their interests by retaining past industrial policies. These efforts instituted significant influence on the negotiation process of the JTEPA. Strong coalition among the industrial players and business groups made possible for them to organize the opposition efforts to express their concerns. This business pressure also, though unsuccessful to retain current protective policies, managed to urge the government to reconsider the proposed option in keeping their interests.¹²⁹

¹²⁹ The proposed option was to gradually reduce import duties as well as to impose import quotas on certain steel imports.

Similar opposition efforts were not found in the JMEPA's case. My analysis on Malaysia revealed that there is no significant role played by societal groups in opposing the JMEPA's deal due to the government's interest in the business and the effectiveness of public-private consultation between government and societal actors held before and along the negotiation process of the JMEPA. Furthermore, there was no reason for industrial players and business groups to oppose the JMEPA as their needs and concerns were attended by the government and well reflected in the agreement.

Another point to be highlighted is the nature of past industrial policies linked to responses made by societal actors towards both FTAs. Strong foundation of private sectors in Thailand led to strong business institutions (business group/association) that were influential in pressurizing the government. Whilst in Malaysia, high government's involvement in business led to insubstantial private sectors foundation which closely relied on government for their movement.

5.4 Suggestion for Future Research

In wrapping my thesis, some ideas and possibilities triggered in my mind

that I think worth to be explored for future research. In the findings, I explained linkages between trade policies and industrial policies of the Malaysian government which was pursued based on its socio-economic agenda at home. Due to economic imbalance between ethnic groups, the Malaysian government formulated economic policies aimed to reduce and eliminate the disparities by concentrating on fostering the certain ethnic groups which were reflected in various policies. This relationship between the state and its society worth to be observed as characteristics of societies might also influence government external policies in other countries.

Beside that, in conducting my research, I only focused on the defensive side of FTAs. Responses were observed from the bird eye view of the import-competing industries (the automotive and steel sectors) which relatively opposed for trade liberalization brought by FTAs. Different result might emerge if observation is done from the offensive side of FTAs i.e responses from export-oriented industries such as the textile and agricultural sectors. Hence, another area of interest for future research is to look at how the export-oriented industries and those benefited from market liberalization, respond to market opportunities offered by FTAs.

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