

# Reforming automobile excise taxes in the ASEAN region for pro-growth and pro-environment outcomes

*Rob Preece*

## Abstract

The commencement of the ASEAN Economic Community (AEC) from 31 December 2015 could be a critical point in time for the future shape of the automotive industry in the region. ASEAN seeks to establish a 'single market' which is an opportunity for the industry to build and sell vehicles in a market of over 600 million consumers at a time when the environment is increasingly shaping government policies and consumer interest, including in the automotive sector. Can these objectives meet and see ASEAN become a major global hub for automobile production, potentially in new energy efficient and lower emission products? Significant progress towards the critical 'single market' needed to underpin growth in the automotive sector has been made in terms of cutting import tariffs on intra-regional trade, however this progress could be undermined by the emergence of various non-tariff measures appearing across the region. This paper focuses on excise taxation and the recent restructuring of some national excise systems before the commencement of the AEC and the extent to which these excise tariff measures may be acting as non-tariff barriers to the formation of a single market. In response, this paper explores the possible options in the area of developing and adopting a coordinated excise tax policy for ASEAN based on principled excise policy and reflecting changes in relation to the environment. The coordination discussed is indeed not dissimilar to the successful development of the ASEAN Harmonised Tariff Nomenclature (AHTN), and explores the concept of a possible 'ASEAN common excise tariff', or similar which, if allowed to progress, may assist in eventually removing excise taxation policies that could undermine the key principles of the AEC.

## 1. AEC 2015: What level of integration is proposed (and what will be seen)?

In 2003, the leaders of the 10 member countries of ASEAN agreed to the formation of an Economic Community – the ASEAN Economic Community – as part of its larger 'ASEAN Vision 2020' plan.<sup>1</sup> A 'road map' for implementation of the Economic Community was then set out in 2007 in a document titled the 'ASEAN Economic Community Blueprint' in which deeper regional integration was to be achieved by:

- the creation of a single market and single production base
- a highly competitive economic region
- a region which is equitable in terms of economic development
- a region which is fully integrated into the global economy.

A range of ‘sub-level’ objectives sit under these core objectives, many of which will be discussed in this paper, such as the free flow of goods, services, skilled labour, investment and capital and, through the Blueprint, for which the region has agreed a range of ‘action items’ to support the implementation of this deeper regional integration.

In terms of a move towards the ‘single market and production base’, there may be a different interpretation of the concept than is seen in other economic communities. Given that the AEC will operate with each of the 10 member countries retaining full border controls, the ‘free flow of goods’ which is outlined as a measure of the single market and production base, will not refer to the intra-regional borderless movement of goods but rather refer to the reduction of the customs tariffs on ASEAN-origin goods moving across those borders.

Therefore, ‘free flow’ in the AEC will not be ‘free circulation’ as, say, in the European Union (EU) where goods of EU origin, or goods from outside of the EU having cleared Customs, may move freely from one member country to another. Instead, under the AEC, ‘free flow of goods’ means, essentially, the removal of customs import tariffs under the Common Effective Preferential Tariff (CEPT) mechanism of the ASEAN Free Trade Agreement (AFTA),<sup>2</sup> by 2015, with some flexibility for Cambodia, Laos PDR, Myanmar and Vietnam until 2018. Similarly, the ASEAN Trade in Goods Agreement (ATIGA) also serves to ensure that tariff barriers eliminated under the CEPT are not replaced with non-tariff measures.<sup>3</sup>

The term ‘free flow of goods’ may also mean the proposed improvements to customs procedures at national borders, and a reduction in the time taken for goods to leave and enter member countries. The AEC Blueprint calls for better trade facilitation initiatives such as the simplification and transparency of relevant import/export procedures, as well as calling for improved customs integration between member states of ASEAN.<sup>4</sup>

Harmonised classification of goods traded with ASEAN has also been largely addressed through the development and implementation of an ASEAN Harmonised Tariff Nomenclature (AHTN) from 2003<sup>5</sup> and will have a positive effect on certain aspects of trade facilitation and ease of import/export transactions in the region. However, it should be noted that no ‘common external tariff’ has been developed, and is unlikely to be developed until the region is ready to remove customs border control on intra-regional trade, an area not really discussed as yet.

At this point, clarity may be useful in the context of what level of economic integration will be occurring from 31 December 2015. Holden (2003) has summarised the literature into the key stages of economic integration as being a:

- Free trade agreement (FTA) or preferential trade in which members reduce tariffs to zero for intra-regional trade and reduce non-tariff barriers
- Customs Union which is an FTA with a common external tariff, free flow of goods across borders but maintenance of national economic policies
- Common Market which is a Customs Union with free flows of services, investment, labour and capital, with some harmonisation of economic policies
- Economic Union which is a Common Market with common economic policies and common political and economic institutions.

Using Holden (2003) as a guide, it would appear that despite the terminology of ‘Economic Community’, ‘single market’ and ‘free flows of goods and services’, ASEAN is realistically developing an ‘enhanced free trade area’ or is at the first level of regional economic integration. Understanding this position on regional economic integration now helps inform key questions in relation to the study in that for ASEAN as an enhanced free trade area:

- How can excise taxation policy be coordinated to support tariff reduction so that the automobile industry sees ASEAN as a single market?
- How can excise taxation policy be coordinated to support tariff reduction so that the automobile industry sees ASEAN as a single value chain in the production of automobiles?
- What are the key objectives of automobile excise taxation and how do these relate to the coordination of excise reforms in the region?

The AEC Blueprint also envisages greater integration with the rest of the world and, as an entity, ASEAN has successfully negotiated and implemented FTAs with the following countries:<sup>6</sup>

- Australia and New Zealand
- China
- India
- Japan
- Republic of Korea.

This objective of greater global integration is designed to help boost the income of the region by opening up new market opportunities for ASEAN-based businesses, taking full advantage of the efficiencies gained from more efficient supply chains and reduced costs to be more competitive in these new markets.

However, as the 31 December 2015 start date for the AEC drew nearer, it was increasingly apparent that full implementation of the Blueprint would not be achieved and indeed, at the time of writing, the ASEAN leaders ‘signed off’ on a new way forward: a document known as the *ASEAN Economic Community Blueprint 2025* to finalise economic integration.<sup>7</sup>

In terms of the focus of this paper on automobile excise taxation, the main question will be how to coordinate excise taxation amongst the member countries so that the elements required for a strong ASEAN-based automobile industry can be put in place as a platform for the region to be exporting product through these FTAs and beyond. This point is expressly contained in the new AEC Blueprint as part of the need to coordinate certain taxation policies as:

Explore the possibility of collaboration in excise taxation and information sharing among ASEAN Member States on common excisable products.<sup>8</sup>

Indeed, automobiles are subject to an excise tax in all 10 ASEAN member countries and thus very much are a ‘common excisable product’ (Preece 2014).

A strong ASEAN-based automobile industry will need ASEAN to be seen as a single ‘domestic market’ of over 600 million consumers, and as an ‘integrated regional value chain’ allowing for economically efficient production and distribution. Only with the ability to make competitively priced automobiles and sell into a domestic market of this size can the base be formed to compete in the global automobile market to the full potential.

## **2. Snapshot of the ASEAN automobile industry in the lead up to the AEC**

As the AEC approaches, the ASEAN Automobile Federation (AAF) (2015) states that the current status of the automobile industry across the region includes total automobile production of 3.98 million units in 2014 (down by 10 per cent from 2013). Production is dominated by Thailand (1.88 million) and Indonesia (1.3 million) which together is around 82 per cent of total regional output. Production also occurs in Malaysia (0.59 million), Vietnam (0.12 million) and the Philippines (88,000).

In terms of sales, some 3.19 million automobiles were sold within ASEAN during 2014 (again, down around 10 per cent from 2013 sales). Thailand and Indonesia also have the largest markets: Indonesia at 1.21 million sales and Thailand at 0.88 million. Malaysia then follows with 0.67 million units sold, with the rest of ASEAN (Brunei, Cambodia, Laos PDR, Myanmar, Philippines, Singapore, and Vietnam) making up the remaining 0.43 million sales.

ASEAN's automobile industry is dominated by Japanese multinational automobile manufacturing companies. In 2013, Japanese original equipment manufacturers (OEMs) combined to account for around 86 per cent of total ASEAN production of automobiles, and some 87 per cent of automobile sales across ASEAN (*JAMA News* 2014). Within these 3.87 million automobiles produced in 2013, some 1.27 million were exported from ASEAN which makes the automobile industry one of the more important manufacturing sectors in the region. It is therefore important to note at this point that Japanese OEMs have also identified full implementation of the AEC 2015 as an area of concern, particularly the non-tariff barriers to trade along with customs and related trade procedures which work to limit the potential for future growth that could normally be expected under closer economic integration (*JAMA News* 2014).

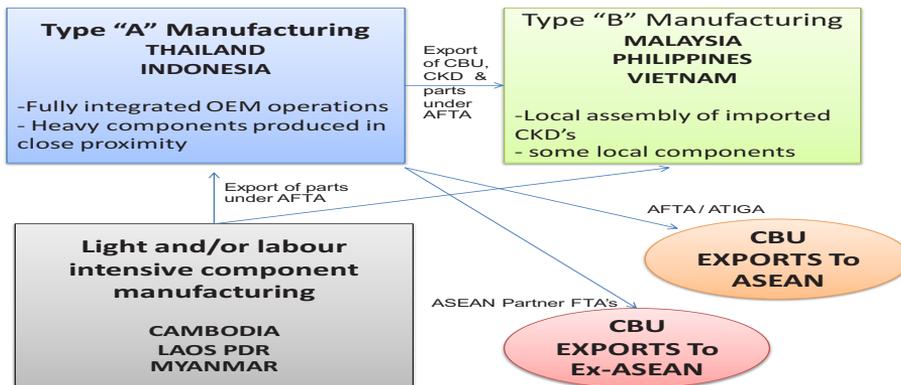
### **3. How might the AEC impact upon the ASEAN-based automotive industry?**

The automotive industry is one of 12 'priority integration sectors' under the AEC (ASEAN 2011, p. xiii). This has earmarked the automotive industry for focus on several key integration issues such as mutual recognition of 'approvals' and harmonisation of technical regulations – both significant to the automotive industry.

Notwithstanding this, several researchers including Wad (2009, pp. 172-93) and the Economic Research Institute for ASEAN and East Asia (ERIA) (2014, pp. 4-15) have attempted to look beyond the commencement of the AEC to estimate the impact of the level of economic integration proposed (and likely) as per the discussions above. Whilst it is recognised that at this stage only predictions of the effect can be made, it is important to hear what these types of industry experts believe will be the result of the implementation of the AEC in its current form. These researchers consider that any restructure could adopt the following components, which the author has also outlined in Figure 1:

- Concentration of fully integrated or traditional automobile assembly of Completely Built Up (CBU) units into Thailand and Indonesia, supported by heavy component manufacture such as power train plants, etc., which will stay in close proximity to the final assembly places
- Some growth in the assembly in large or emerging markets of primarily imported Completely Knocked Down (CKD) units such as in Malaysia, Philippines and Vietnam, and some very small scale assembly of Semi Knocked Down (SKD) and CKD in new markets like Cambodia, Laos PDR and Myanmar
- Light components and/or labour-intensive component parts production move to lower wage cost Cambodia, Myanmar and Laos PDR with associated 'hollowing out' of auto component parts industries in higher wage cost Thailand, Indonesia and Malaysia
- Export growth of CBUs and CKDs from Thailand and Indonesia with components from across ASEAN, going to both the ASEAN market and markets outside of ASEAN, and that
- Singapore and Brunei will continue to be 'fully import' CBU markets.

Figure 1: Possible shape of automobile industry in ASEAN post AEC implementation



Source: Author.

#### 4. Can deeper regional integration strengthen ASEAN's automotive industry? A case study from NAFTA

The premise is that the region desires greater economic growth using the AEC and its deeper level of integration to help achieve this. To begin looking at the relationship, this paper now looks at a region of similar economic integration and which has an automobile sector important to its combined economies. In this regard, the North American Free Trade Agreement (NAFTA), comprising the United States (US) of America, Canada and Mexico is an ideal case study. Commencing in 1994, NAFTA provides a number of insights into the benefits of closer economic relations and identifies that it has been positive for the automotive industries of all three countries.

Whilst the benefits to the three members of NAFTA differ somewhat, overall regional integration has been successful for the market of 485 million consumers with intra-regional trade growing from around USD290 billion in the year prior to the commencement of NAFTA to over USD1.1 trillion after the first two decades (Sergie 2014). Trade outside the region has also grown, and on an annual basis, exports from the US have grown 6.3 per cent, from Canada 4.7 per cent, and from Mexico, a significant 10.5 per cent.

In relation to the automotive industry within the NAFTA area, it appears there were immediate positive impacts for all three countries. According to the Heritage Foundation (1997), the first three years of NAFTA can be summarised with the following milestones:

- The total trade on motor vehicles and parts between the US and Mexico doubled to USD25 billion between 1991 and 1995
- US exports of motor vehicles and parts to Mexico increased 11 per cent between 1993 and 1996
- US exports of motor vehicles overall increased in excess of 500 per cent between 1993 and 1996
- Mexican exports of motor vehicles and parts to the US increased by 100 per cent
- The Canadian parts industry was able to take advantage of the tiering of the industry and make necessary restructuring to stay viable

- Canadian OEMs were able to reconsolidate after the early 1990 cyclical downturn into a position of strength that may not have been possible without NAFTA
- US imports of Mexican-assembled motor vehicles contain more than 50 per cent US-made parts (and is a percentage which is continuing to rise each year).

The actual quantitative assessment as to the extent of that success for the automobile industry over the 20 years of NAFTA is very much subject to ongoing debate. Whilst the ‘headline’ numbers are positive, there were certain areas within NAFTA which have different experiences, for example, a US-based worker, or a US town where employment positions have been re-allocated to plants in Mexico, have been impacted negatively by NAFTA. However, at the industry level and based on the numbers, NAFTA is viewed as a success:

‘... in the past 20 years of NAFTA exports of Mexican cars have grown 480 per cent since 1993, and imports of North American cars to Mexico have increased 280 per cent – a dynamic win-win’.<sup>9</sup>

On a qualitative basis, the quantitative assessment is also supported by industry:

‘The automotive industry’s supply chain has successfully intertwined across our North American borders, allowing for synergies and economies of scale. Without NAFTA, Mexico’s positive contributions to the automotive industry, one of the world’s most critical business sectors, never would have reached fruition.

‘Thanks to NAFTA, we are experiencing job creation, profits and sales across our borders in the auto industry and beyond. It is this mutually beneficial trade agreement that served as a catalyst for making North America a stronger, more powerful group of nations and a dominant player in the automotive industry.’<sup>10</sup>

Similar comments come from government sources, such as:

Since 1993, light vehicle production capacity has increased in all NAFTA countries, including an increase of 714,000 units in the United States and 437,000 units in Mexico. U.S. automotive parts production has increased 81 per cent since 1992, to \$181 billion in 2001 (International Trade Administration 2001).

Perhaps one measure of success is the level of Foreign Direct Investment (FDI)<sup>11</sup> or what investors are prepared to put into the industry and into industry in the NAFTA region. In terms of the North American automobile industry, and looking at FDI as a measure of attractiveness as a destination for investment, the first three years of NAFTA saw an additional USD39 billion in US plant and equipment and a further USD3 billion in Mexico. Since then FDI has grown steadily in Mexico as it realises its potential, but significantly its growth in FDI has come without decreases in the other two member countries – rather, NAFTA has seen real growth in FDI across the Northern American area.

Canada’s benefits have not been touted in the same glowing terms as those of the US and particularly Mexico but, as discussed above, the implementation of NAFTA has seemingly allowed a ‘rebuilding’ and ‘repositioning’ of the sector to provide the strength to remain viable. This also seems to be true in the US. Some of the FDI increases for Mexico are noted to have come from the US-based auto makers and this seemingly is due to re-structuring of the industry into a series of ‘productive and financially efficient networks’, which in itself was a ‘critical factor for United States auto makers being able to once again regain their competitive edge’ (Carrillo, Lung & Van Tulder 2004, p. 146).

In the context of NAFTA, and the success for the Mexican automobile industry, it is worthwhile reviewing a particular ‘challenge’ for the Mexican Government which was protecting the automobile sector from imports at the time NAFTA was being negotiated – the issue of ‘protectionism’ which may well be

one faced by some governments in ASEAN and which will be discussed further below. Mexico had a wide range of ‘protectionist’ policies supporting the local automobile industry at the commencement of NAFTA but these were gradually phased out and rather than a collapse of the industry, today in Mexico the situation according to Scotia Bank (2014) is highly positive:

- some USD10.6 billion in FDI in the last three years (80 per cent of FDI from the North American automobile industry)
- annual growth of 6 per cent in automobile and automobile parts production
- Japanese and European automobile makers now responsible for 60 per cent of Mexico’s automobile production
- reaching the top 10 automobile producing countries in 2006.

Thus there are important lessons for ASEAN in terms of the link between removal of tariff and non-tariff barriers to intra-regional trade and real growth in the automobile sector, with the Mexican auto sector highlighting the potential for growth in a functional ‘single market and production base’.

## 5. Reforming automobile excise – the latest principles

Automobile excise taxes have traditionally been based on vehicle ownership being seen as a ‘luxury’ and having excise taxation designed to contribute to the progressivity of a country’s tax system, however, this view is now slowly changing in recognition of levels of vehicle ownership and the need to correct a range of negative externalities. The OECD notes this shift in the taxation of motor vehicles in its latest consumption tax trends review:

... ownership of car levels has led to less progressivity [arising from the taxation of automobiles]. The new objectives of automobile taxation relate to consumer or business behaviour with more recent trends being environmental – reference to CO<sub>2</sub> emissions, fuel efficiency, other emissions, town planning, and transport policies ... (OECD 2014, pp. 143-7).

In designing any tax policy some concepts remain constant in that taxes should be neutral, or that tax rates, tax bases and tax structures should not impact markedly on investment, production or consumption decisions. Taxation should not be designed by policymakers to discriminate – either negatively or positively – so as to favour any one industry or one taxpayer over another nor should it be used to distort business and investment decisions.

However, in certain circumstances, including the taxation of automobiles, there can be a justification to levy a ‘special’ tax like an excise duty to correct various negative externalities associated with the consumption of selected products. In terms of automobiles, Cnossen (2005, p. 598), Preece (2015, pp. 16-17), and Weisbrod, Vary and Treyz (2003, p. 3) state that such externalities can include:

- Cost of operating public roads which is seen as an ‘economic charge’ on road users and would extend to addressing revenues required for road building as well as ongoing operations such as traffic lights, road signage, rescue and recovery, etc.
- Costs of maintaining roads from damage caused during normal road usage
- Emissions of CO<sub>2</sub> contributing to negative environmental impacts such as immediate air quality in urban areas and the broader impacts associated with climate change
- Traffic congestion from the growing number of automobiles on the road and the increased number of trips being made by those vehicles particularly at certain peak periods. This is particularly the case where road infrastructure is unable to support the volume of vehicles. There are also connections

with other environmental costs as emissions are double those from idling vehicles as from moving vehicles. There is also an economic cost from increased times taken for workers and businesses to move people and goods via road in terms of ‘travel cost’, ‘additional business operating costs’ and ‘lost productivity’.

Aside from revenue and externality correcting considerations, there is often a further level of excise tax policy considerations in those countries which have an existing or emerging automobile industry. In this case, it is usual for the automobile industry to contribute substantially to that country’s GDP and as such be of significant economic benefit for which excise (and other tax policies) can often be shaped to support the ongoing viability of the industry.<sup>12</sup>

The automobile sector covers an entire supply chain adding value from ‘upstream’ industries such as mining and metals, rubber, plastics, glass, etc., to ‘downstream’ industries such as distribution including to retail, service and repairs, marketing, finance, insurance, rentals and fuel products, and is not limited to component production and vehicle assembly. Value is added at each point of the automobile supply chain, employing many people across the economy.

Just as important to the economy is the development of new technologies and other intellectual property (IP). The value that this creates can be significant and ensures the long term position of the automobile sector and can create potentially large export income opportunities for the country. In addition, some of the next technology or IP created in the industry can be utilised in other industries (for example, CO<sub>2</sub> emission reductions), further expanding the value of this sector.

In this context, and as highlighted by the OECD (2014), there is a clear trend towards shifting automobile excise taxes to address environmental concerns and encourage (or support) the development of reduced emission technology in new automobiles. Across the rest of Asia, excises or special consumption taxes exist in major automobile producing countries like China, South Korea, India and Japan – and indeed policies in these countries are starting to shift towards addressing various environmental and fuel use issues (Van Calster, Vandenberghe & Reins 2015). Automobile excise taxes also appear widely across Africa, and environmental levies and surcharges have appeared in the automobile excise tax system of South Africa.

Excise taxes on automobiles are not widely used across either the Middle East or the EU. However, in the EU there is taxation of automobiles which occurs through ‘road use’ taxes, and in many cases will recognise energy use and environmental policies. Looking at a current example from the EU of an automobile tax, the United Kingdom’s ‘Vehicle Excise Duty’ (VED)<sup>13</sup> system classifies vehicles primarily by their CO<sub>2</sub> emissions, then applies a rate depending on whether the vehicle uses petrol/diesel or ‘alternate fuels’. However, it should be noted that VED is actually an annual road tax despite being levied on the vehicle owner and despite the tax being called an ‘excise’.

## 6. What is happening with automobile excise reform in ASEAN?

The lead-up period to the AEC has seen several reforms to the excise taxation of automobiles, some of which will actually come into effect from 2016 in line with the AEC starting timeframe. The most significant of these reforms is Thailand’s restructuring of its classification criteria to reflect CO<sub>2</sub> emissions – aligning with some of the international thinking on more closely linking the taxation of motor vehicles with the key externality of emissions. However, there have also been notable amendments to automobile excise taxes in Indonesia, Malaysia and Vietnam, as well as a new policy announcement made in the Philippines details of which were to be released at the end of 2015.

The following country reforms highlight some trends – particularly a move to incentivise products with ‘environmentally friendly’ features such as smaller engine displacements, higher fuel efficiency and lower CO<sub>2</sub> emissions. However, these reforms are also designed to ensure promotion of local automobile

assembly often by shaping the classification criteria to support a certain product category, and in some instances the shaping of such criteria, or indeed the design of such excise taxes in general, which can create a barrier to the import of like products in a particular category of automobile. This will no doubt arise as the AEC establishes itself and risks the creation of the ‘single market and production base’ that is critical in an industry such as the automotive which relies on economies of scale and the ability to source best priced componentry for assembly and distribution to a large market.

In terms of individual country reforms during the lead up to the start of the AEC, we see:

## Thailand

In terms of reform, the most notable is that of Thailand which will see two significant amendments. First, it will transform its excise tax classification of automobiles to be based on CO<sub>2</sub> emissions, as well as incorporating a general excise tax-wide reform that will see the current *ad valorem*-based excise rates applied to each category of motor vehicle moved from the manufacturer’s ‘ex-factory’ valuation to the manufacturer’s ‘suggested retail price’ (JAMA 2015). The actual classification changes appear in Figure 2 and came into effect on 1 January 2016, and apply to vehicles with an engine displacement of up to 3000cc or 3250cc for Passenger Pick-up vehicles (Preece 2015).

Figure 2: Thailand: New automobile excise structure from 1 January 2016

Vehicle type	Category (CO <sub>2</sub> emissions)
<b>Passenger cars not more than 10 seats</b>	≤ 100 g/km
	101 - 150 g/km
	151 - 200 g/km
	> 200 g/km
	> 3,000 cc
<b>Space-cap Pick-up</b>	<b>Cab type: Rate differs for Double, Space, or Single</b>
	≤ 200 g/km
	> 200 g/km
<b>Passenger Pick-up Vehicle (PPV)</b>	≤ 200 g/km
	> 200 g/km
<b>Space-cap Pick-up &amp; PPV</b>	> 3,250 cc
<b>Eco cars</b>	< 100 g/km
	101 – 120 g/km
<b>Electric vehicle/fuel cell/hybrid</b>	≤ 3,000 cc
	> 3,000 cc
<b>OEM Natural Gas Vehicle (NGV)</b>	≤ 3,000 cc
	> 3,000 cc

Source: Excise Department, Ministry of Finance, Thailand.

One important issue (Preece 2015, pp. 28-9) arising in relation to the use of CO<sub>2</sub> emissions as a criterion for taxation is that of emission certification or emission confirmation given this becomes central to the product's final classification. Given that emissions of a vehicle will depend on the type of testing conducted, it will be essential to include the emissions measurement process as part of any excise tariff law. In this regard, Thailand has combined existing CO<sub>2</sub> testing procedures operated under consumer and environmental law with excise law and an 'Eco Sticker' which includes CO<sub>2</sub> emissions expressed as grams per kilometre, as well as fuel economy expressed as litres per 100 kilometres and fuel/emission standards met, will also serve as the basis to confirm excise tax classification from 2016.<sup>14</sup>

In terms of a move towards a suggested retail price from the manufacturer's selling price ex-factory, this has been touted as a response to the need for increased transparency as retail prices are accessible to all parties for verification, whereas there have been issues confirming import values and manufacturers' selling prices.<sup>15</sup> This move to use a suggested retail price will apply to all goods subject to excise taxation in Thailand and will require a range of supporting regulations, particularly in those cases where an importer or manufacturer has little certainty about what the likely retail interest will be.

The challenge for Thailand in these two reforms will be to ensure that these respective regulations for determining CO<sub>2</sub> emission levels (through the Eco Sticker process) and assessment of the suggested retail price do not unduly impact on importers but rather apply to domestic assemblers.

### Indonesia

Indonesia made reforms in both 2013 and 2014 to its 'Luxury Sales Tax' in relation to automobiles, the 2013 regulations supporting significant government policy objectives around attracting investment in a 'Low Cost Green Car' (LCGC) category which would strengthen the local automobile sector. The 2014 reform made through the Finance Minister's Regulation 64/PMK 11/2014 primarily placed a significant tax burden on passenger vehicles with larger engines, by increasing the tax rate on such products by 67 per cent. The new Luxury Sales Tax rates for passenger vehicles are now as follows:<sup>16</sup>

Passenger Car (Multi-Purpose Vehicle Two-Wheel Drive) less than 10 passengers (spark ignition and compression engine)

Engine capacity:

- < 1,500 cc      10%
- 1,500–2,500 cc    20%
- 2,500–3,000 cc    40%
- > 3,000 cc      125%

The effect of the reform is to create a substantial rate differential for vehicles above and below engine displacements of 3,000 cc, and places significant competitive pressures on importers or domestic producers with products in that size market. The excise rate increase for larger engine vehicles also reinforces measures taken with the reforms to the Luxury Sales Tax in 2013 which were introduced to support or further promote the LCGC program and its objectives for a product category in which the Indonesian auto sector could take leadership.<sup>17</sup>

Under Finance Minister Regulations 41 and 33 of 2013, the taxable value applicable in calculating the Luxury Sales Tax can be reduced by either:

- 75 per cent: Use of advanced engine technology, dual petrol/gas engines (converter kit CNG/LGV), bio-fuel engines, hybrid engines, CNG/LGV dedicated engines with fuel consumption of 20-28 lt/km
- 50 per cent: Use of advanced engine technology, dual petrol/gas engines, biofuel engines, hybrid engines, CNG/LGV dedicated engines with fuel consumption of > 28 lt/km

- 0 per cent: Motor vehicles manufactured under the LCGC and LCEP programs (other than sedans and station wagons) with:
  - › Spark ignition up to 1,200 cc; or
  - › Compression ignition up to 1,500 cc; and
  - › Fuel consumption of at least 20 km/ltr.

Whilst a clear targeting of environmental harm and fuel efficiency is part of this reform, it is unlikely that imported products will ever have access to the discounted taxable values as one criterion to access the discounts is an 80 per cent local content condition.<sup>18</sup> Whilst this would be a measure directly targeting support for the local automobile sector, it is in effect a non-tariff measure for which the AEC Blueprint, AFTA and ATIGA agreements seek to have removed in intra-regional trade.

## Malaysia

Malaysia's National Automobile Policy (NAP) was released in 2014 and included a reform to the existing 'local added value' adjustments (discounts) to the value to be used for excise calculation as permitted under the Industrial Adjustment Fund (IAF). To encourage Malaysia to become a 'hub' for the energy efficient vehicle (EEV) certain 'multipliers' were added in addition to the local value content discounts.

These multipliers of between 1.1 and 1.6 (as awarded by the government based on levels of 'base localisation') reduce the taxable value exponentially by the awarded factor. An automotive analyst's briefing highlights this dual policy incentive effect<sup>19</sup> and suggests that where a 1.6 multiplier has been awarded (or 65 per cent 'base localisation'), the effective rate of excise is reduced to almost 0 per cent.<sup>20</sup>

Again, the excise policy reform is reflective of positive environmental and fuel efficiency outcomes, however, it is equally providing incentives through the excise system for investment into the Malaysian automotive industry, particularly through the creation of a specialised category, the EEV. As with Indonesia, the move to provide this type of support to the local auto sector has led to what can also be described as a non-tariff measure given that fully imported products will be unable to access the excise tax benefits that will be available to locally built vehicles meeting a minimum local content requirement.

## Vietnam

Decree 108/2015/ND-CP of November 2015 creates new classification criteria as well as adjusting rates and the taxable value for both domestically assembled and imported vehicles. In terms of new classification criteria, for passenger motor vehicles up to nine seats, classification for excise will be based on the following engine displacements:

- < 1,000 cc
- 1,000 up to 1,500 cc
- Over 1,500 up to 2,000 cc
- Over 2,000 up to 3,000 cc
- Over 3,000 cc.

The new smaller engine classifications of < 1,000 cc and 1,000–1,500 cc have been determined 'priority' categories<sup>21</sup> and given effective excise tax rate cuts whilst the larger engine categories receive small rate increases that will take effect on 1 July 2016.

The revised classification criteria also introduce a new category for '*passenger cars with cargo carrying*' commonly known as 'pick-up trucks' which will receive a rate that is 60 per cent of the rate applying as if it were a passenger car (that is, determined by engine displacement) which is an effective rate increase for any pick-up truck with an engine size over 1,000 cc. Existing rate discounts for vehicles running on bio-fuels or hybrids continue to apply at the existing discounts.

The other area of reform in the Draft is the amendment of the valuation for excise tax calculation for imports from a (CIF + Customs Duty) value to an 'importer's on-selling price' that must be 'greater than 105% of the CIF + Customs Duty value' which effectively increases the excise valuation for these products. For domestic assemblers, the new excise value will be the 'wholesale price' which itself must be with 7 per cent of the average wholesale price for that product. If either imported or locally assembled vehicles fall outside these valuation parameters, a valuation process prescribed in an as yet unwritten Regulation will be used.

### The Philippines

The Philippines has recently announced a new automotive industry policy through Presidential Executive Order 182 aptly titled the Comprehensive Automobile Resurgence Strategy or 'CARS' program. The intention is outlined in the Order itself that states:

... the 'CARS Program' is hereby adopted and implemented in order to attract new investments, stimulate demand and effectively implement industry regulations that will revitalize the Philippine automotive industry, and develop the country as a regional automotive manufacturing hub ...

The program will allocate a maximum of 27 million Peso to an Automotive Development Fund through the annual national budget each year for six years starting in 2016. Included in the eligibility criteria will be a need to meet the standards for fuel efficiency and emissions, as well as having a minimum production threshold. Excise tax incentives will also be introduced, however, as with all fiscal details of the CARS program, observers and industry participants are awaiting the release of the supporting Implementing Rules and Regulations (IRRs) due for release at the end of 2015 (Magkilat 2015) however, at the time of writing, these IRRs had not been released.

## 7. The AEC and 'pro-growth' for the automotive industry

The AEC 2015 represents a significant opportunity for the ASEAN member countries to coordinate across a range of policy areas with the intention of building a leading automobile production region which is highly competitive globally. This paper focuses on excise taxation as a possible area of better policy coordination. Currently, ASEAN as a region is producing less than 4 per cent of the world's passenger motor vehicles and less than 2 per cent of commercial vehicles,<sup>22</sup> therefore significant potential exists to grow this figure and for the region and its people to share in the wealth such growth would create.

The need for greater coordination lies in the core of the AEC 2015 which is to create a single market for automobiles produced in the region so that the five automobile producing member countries today are selling not just domestically but to a potential consumer base in excess of 600 million people. From such a strong ASEAN single market, the OEM based in the region are able to generate the efficiencies of scale required to build automobiles which can then begin to compete globally.

Strong regional sales will result in the necessary investments of capital by the OEMs, spreading opportunities across the region as value chains are developed, vehicles assembled and sales made. Some predictions (Frost & Sullivan 2012), have put total automobile sales in the ASEAN region at 4.7 million units (3.1 million passenger and 1.6 million commercial vehicles) by 2018, meaning it would become the world's 6th largest automobile market, provided the benefits of the AEC can be properly realised.

The potential may also expand into future technology development, with the Thai Board of Investment (BoI) aspiring to have new 'green automobile' technologies designed and produced in the region, which could make ASEAN a global centre of 'green car' production. However, the BoI notes that the success of ASEAN as a global production hub will depend upon the proper implementation of the AEC stating:

... Although the AEC will make ASEAN a hub of auto production, there are challenges to overcome and a need to minimize any barriers that will impact industrial growth (BoI, Thailand 2013).

What does the Thai BoI mean by ‘barriers that will impact industrial growth’ in auto production? Whilst trade barriers between ASEAN have been largely reduced (over 99 per cent of tariff lines are now at ‘zero’ for the ASEAN 6, and 98.6 per cent of tariff lines at 0-5 per cent on ASEAN CLMV),<sup>23</sup> there is a growing level of concern that the region is implementing a number of non-tariff measures to continue a level of protection over certain sensitive industries (Austria 2013, pp. 31-4). These are described by Austria (2013, p. 34) as currently including, at the border, additional taxes and charges, import bans, import subsidies, non-automatic licensing, import procedures and technical barriers, whilst beyond the border, investment measures, state aid and trade facilitation measures, and as is the focus of this paper, the design of excise taxes.

Non-tariff measures (NTMs) are a particular concern in the automotive sector across ASEAN. Austria (2013, pp. 62-6) has reviewed the ASEAN Non-Tariff Measure Database<sup>24</sup> finding for HS codes 8703 (motor cars and other motor vehicles) and 8708 (parts for 8703) that between 70 to 100 per cent of trade in these HS codes in the region are subject to NTMs. This is having two main (negative) effects. First, it is risking the establishment of a ‘single market’, a key objective of the AEC 2015, and denying the industry the opportunity to maximise ‘domestic’ sales. Second, it is impacting the competitiveness of the industry as the regional value chain is having costs added to it each time parts and components move across borders for assembly. These costs resulting from NTMs add notably to the price of finished products, and again, detract from another key objective of the AEC: to create a single production base.

In terms of excise taxation, the structure (items, rates and rate differentials) of an excise tax system can operate as a non-tariff measure, impacting the commercial viability of importing or manufacturing those products which will face exponentially larger excise liabilities than those applying to competing products. The following is a summary of the common ways in which an excise tax can be designed and can effectively operate as an NTM, with each of these designs being seen across ASEAN.

### **Use of excise rate differentials**

*The use of excise rate differentials on what are essentially ‘like goods’.* A product category is ‘split’ into sub-categories based on a single criterion, in the case of automobiles it is usually engine displacement, with each sub-category being assigned a different excise rate. Usually, as engine sizes increase so will the assigned excise duty rate. Whilst this may be reasonable in excise taxation where sub-categories have different levels of externalities associated with consumption, it becomes questionable when one sub-category is assigned an exponentially higher rate so that just a small increase in engine size results in a substantially higher excise tax burden, particularly if local producers are specialising in certain engine sizes.

### **Excise valuation ‘discounts’ on meeting certain criteria that support domestic production**

*The use of a discounted excise valuation to calculate excise where there is local value add.* Automobiles can be exported as CBUs, or exported as kits which are either SKD or CKD for which there will need to be a value add conducted in the country of import thus providing some economic benefit to that country. To encourage the maximum local value add, the excise system can be designed to provide a discount in excise for SKDs, and higher discounts for CKDs over imported CBUs.

The use of discounted excise valuations can also be used if, say, a criterion is met such as a minimum local content in the automobile. Usually, this is as a result of a government policy to support the local

automobile sector, both component production and vehicle assembly. Increasingly, this is used with other criteria relating to a government initiative to develop a new product which is perhaps environmentally friendly, energy efficient, low cost, or several of these.

*The use of discounted excise valuation 'multipliers' based on local content and other criteria.* As above, and usually arising from a government policy to support the local automobile sector (and other initiatives to develop new products related to, for example, the environment and emissions, energy efficiency, affordability from consumers, or several of these), the discount for use of local content or for local value add is increased exponentially, encouraging importers and manufacturers to use more local components and do more local assembly.

### **Use of government incentives to direct products to lower taxed classifications**

*Reduced production costs to access lower excise rate categories.* These can be used in excise systems where excise rate differentials exist based on a particular selling price. Where a government exempts certain taxes and charges, or subsidises certain costs, these feed into the taxable value and can place the product in a lower excise category than an importer or manufacturer not given access to the same exemptions or subsidies.

## **8. The pathway to removing excise-based non-tariff measures**

If it can be accepted that on the grounds of seeking 'pro-growth' and 'pro-environment' outcomes from the AEC for auto manufacturers, the next question to address is how does ASEAN agree on a coordinated regional policy for excise taxation which, if implemented, will steer policymakers away from designing excise tax based NTMs to support local industries? Significantly, ASEAN is not the only free trade area to consider the issue of excise tax policy coordination across its membership and options for the ASEAN region could be informed by the approaches adopted in these other trading blocs.

Looking at other 'free trade areas' it is apparent that the process of achieving excise tax coordination across a region is not easy. In the experience of three such economic communities, the issue of aligning priority areas and policy objectives of all member states is difficult, according to Cnossen (2010) in relation to the Southern African Development Community (SADC) and, similarly, Petersen (2010) in relation to the East African Community (EAC). Whilst both these communities have attained levels of economic integration deeper than ASEAN hopes to achieve by the end of 2015, excise coordination is still somewhat illusive. Even the EU which has attained the deepest form of integration, struggled with coordination of excise tax policies and achieved a degree of coordination that contains many compromises and often provides significant flexibility to accommodate the differences between the 27 members (Cnossen 2010).

Another significant factor is the legal basis of the formation and operation of the free trade area itself and the ability for a central body to make and enforce rules on member countries. This will be a challenge for ASEAN as it lacks a set of regional institutions capable of both making and enforcing regional policy and practices, instead it moves forward on concepts and issues via consensus (Cuyvers, de Lombaerde & Verherstraeten 2005; Hill & Menon 2010; Rillo & Wignaraja 2015). Rather, ASEAN through its Charter operates a Secretariat which is more a 'coordinating' body in Jakarta which works to coordinate regional members and facilitate the building of consensus, as required, between those members (ASEAN 2008). In this context, it is difficult to pursue a 'legislative' approach such as in the EU where laws made by the European Parliament and Directives issued by the European Commission are legally binding on member countries.

Therefore, it is perhaps more relevant to discuss the approach by the Southern African Customs Union (SACU) which comprises Botswana, Lesotho, Namibia, South Africa and Swaziland. Again, the formation of a customs union represents a deeper level of economic integration than is being implemented through the AEC with both a free trade agreement between members and a common external tariff setting import tariff rates for imports from outside the SACU. However, like ASEAN, the SACU maintains full border controls between members with a number of facilitation measures such as ‘one stop clearances’ being introduced (Stern & Ramkoloman 2013). Here, the approach to excise coordination in the SACU stems from the original agreement which established the Union known as the *2002 Southern African Customs Union Agreement* which, at Article 22, states:

**Legislation relating to Customs and Excise Duties:**

Except as otherwise provided in this Agreement – Member States shall apply similar legislation with regard to customs and excise duties.

Article 22 is merely a statement of intent and guidance for excise policymakers in each member country, and the critical aspects of excise tax coordination become the national laws of each member state – regulations, guidelines and procedures and how these operate.

Similar to the SACU, the SADC and the EAC have agreements on excise tax coordination. Whilst the SACU has a general requirement in the agreement which creates their economic community, the SADC and EAC have more definitive agreements based on treaties which create their economic communities providing for ‘areas of cooperation’ and a mechanism for member countries to develop protocols – in this case around excise tax coordination (SADC 1992; EAC 1999).

The SADC comprises the five SACU members plus Angola, the Democratic Republic of the Congo, Malawi, Mauritius, Mozambique, the Seychelles, Tanzania and Zimbabwe, and has agreed to a *Memorandum of Understanding in Cooperation in Taxation Related Matters* which includes a ‘commitment’ to harmonise taxation policy and administration as it relates to excisable goods. However, despite the success in reaching such an agreement, the Memorandum of Understanding, which was signed in 2002, has in effect seen little progress in the actual level of excise coordination in reviews conducted in both 2006 and 2010 (Cnossen 2010).

Likewise, the EAC which comprises Burundi, Kenya, Rwanda, Tanzania and Uganda has identified harmonisation of excise duties as an important trade issue for further negotiation after the economic community was officially formed in July 2000. Excise rate harmonisation remains as only one of two unresolved issues being discussed (the other being the import duty rates that will be levied in the external customs tariff) at Head of State level, with both issues long preventing the region moving forward to a full customs union (EAC 2004). Some 15 years later, both issues are still under consideration and delaying the region attaining the full benefits of deeper economic integration (Petersen 2010) and (PwC 2014).

## **9. Where to start coordination of excise tax policies in ASEAN?**

To look at the question of regional coordination of excise tax policies, economists working in the excise field, such as Cnossen (2010, 2013) and Laffer (2014), agree on the need to first establish a number of principles on which the region can build agreement. Central to such principles are the concepts that a market should be allowed to achieve an ‘efficient allocation of resources, and that tax policies should not interfere with this premise’ by creating distortions in a market which impact on decisions such as investment, manufacturing location, and consumption.

Building on this basic principle of non-distortion is the need to recognise the role of excise taxation. Cnossen (2005, 2013) explains that tax policymakers need to work with a ‘clear one-on-one relationship between the goals and instruments of taxation’ and that in the case of excise taxation, these goals include ‘internalising the external costs associated with the use or consumption of those goods or to enhance the progressivity of the tax system’. Importantly for this study, Cnossen adds that the goal of excise does not include protection of local industry and that this a goal or a function of a customs import tariff.

In this context it would appear that coordination of excise tax policy is not so much about the need for all members of an economic community to agree on a range of goods and services that will be subject to excise duties and apply a single rate to each of those goods and services but rather it is about agreeing on:

- a principle that excise policy development will avoid the use of tax design to discriminate against categories of goods and services and instead promote the operation of the single market and production base of the AEC
- the criteria on which to subject goods and services to excise
- standard definitions for product categories, product types, and services
- the most appropriate tax base for those good and services
- circumstances when exemption or rate differentials could be applied.

The nature and style of agreement will be a separate issue, and needs to be tailored to the ASEAN way of consensus rather than direction. Under the ASEAN Charter, legal instruments can be agreed and brought into force with the agreement of all 10 member countries, and indeed a range of instruments sit below the Declaration bringing the AEC into force, including a number of Memoranda of Understanding, Protocols, and ASEAN Agreements (ASEAN 2015). At this point in time, some 40 legal instruments have been agreed to in support of the AEC.

Whilst agreement on principles is critical, any regional agreement on coordination of excise tax policies should also contain substance in relation to ‘technical’ standards that should apply, particularly in the areas of product definitions and tax bases. Both Cnossen (2013) and Preece (2015) in relation to ASEAN, and Petersen (2010) in relation to the EAC refer to the need to standardise categories of goods and services and products within these categories as well as the legal definitions to classify such products.

As an example, Preece (2014) found that each of the major automobile producing countries within ASEAN – Thailand, Indonesia and Malaysia – have introduced excise concessions for what may be termed ‘eco’ or ‘green’ cars which are built to provide consumers with a less environmentally harmful product which, in turn, has a positive effect on a country’s CO<sub>2</sub> emissions from the transport sector. To support this type of product all three countries have introduced an excise tax concession with a view to both recognise the reduction in harm from that vehicle’s use and to assist in product pricing to attract consumers. However, without agreed guiding standards, each country has developed criteria for an ‘eco’ car that qualifies for a local excise tax concessional rate but which then effectively excludes from the same concession any ‘eco’ cars produced and imported from the other two countries. Figure 3 outlines the three sets of current criteria for ‘eco’ cars found in the three main auto producing ASEAN member countries.

Figure 3: What is an 'eco car' in ASEAN?

Criteria	Thailand (Phase 2)	Indonesia	Malaysia
Maximum engine size (in cubic centimetres)	1,300 (petrol) 1,400 (diesel)	1,200 (petrol) 1,500 (diesel)	< 2,500 all engines
Emissions	< 120 grams/kilometre	< 120 grams/kilometre	To be advised
Fuel efficiency	> 4.3 litres/100 kilometres	20 kilometres/litre	Depends on vehicle weight – ranges from 4.5 litres for vehicles < 0.8 tonnes to 12 litres per 100 kilometres for vehicles exceeding 2.5 tonnes
Retail price	N/A	< IDR 100 million	N/A
Fuel type	N/A	RON 93 gasoline CN 51 diesel	All fuels
Other	Meets UN Regulations for safety standards Regulations 94 and 95 Minimum production of 100,000 units by 4th year Minimum investment of THB 5 billion Pre-approved licence from Board of Investment	80% local content	Includes hybrid models

Source: Author.

For a vehicle manufacturer in, for example, Thailand, it becomes difficult to meet the minimum investment and production levels if it is unable to export a Thai version of an 'eco' car to the other major markets of Indonesia and Malaysia, as it simply cannot be competitive against locally produced eco cars. Industry observers seem to agree somewhat and state that several other manufacturers in the area are also concerned about the ability to sell Thai-manufactured 'eco cars' overseas and, therefore, meet the minimum production level requirements to access the discounted excise rates (IHS 2015). If correct, this could possibly be a significant loss of investment to ASEAN and a reason to revisit the objectives of the AEC, and in this case, pursue agreement on a coordinated regional excise tax approach.

### The concept of a 'Common Excise Tariff'

A 'Common Excise Tariff' has been produced by the SACU which, notably, has also been able to develop a Common External Tariff covering imports from outside the community and so both tariffs can sit together in national tariff laws. The authority for developing both comes from Article 22 of the 2002 Southern African Customs Union Agreement which states:

#### Legislation Relating to Customs and Excise Duties

Except as otherwise provided in this Agreement Member States shall apply similar legislation with regard to customs and excise duties (SACU 2002).

The result is that the excise tariffs and supporting rules are identical in all five member countries, which is true coordination. For information, an extract relating to automobile excise is reproduced in Figure 4:<sup>25</sup>

Figure 4: Extract of SACU Common Excise Tariff (from Lesotho Customs and Excise Tariff Act)

Schedule 1 / Part 2B			
Tariff Item	Tariff Subheading	Article Description	Rate of Excise Duty
<b>126.03</b>	<b>87.03</b>	<b>Motor cars and other motor vehicles principally designed for the transport of persons (excluding those of heading 87.02), including station wagons and racing cars:</b>	
126.03.01	8703.10	Vehicles specially designed for travelling on snow; golf cars and similar vehicles	(See Note 2 to this Part)
<b>126.03</b>	<b>8703.2</b>	<b>Other vehicles, with spark-ignition internal combustion reciprocating piston engine:</b>	
<b>126.03</b>	<b>8703.21</b>	<b>Of a cylinder capacity not exceeding 1 000 cm<sup>3</sup>:</b>	
126.03.03	8703.21.23	Vehicles of the open body tubular frame type, with an engine capacity not exceeding 250 cm <sup>3</sup> and a vehicle mass not exceeding 250 kg	(See Note 2 to this Part)
126.03.05	8703.21.60	Vehicles with motorcycle-type handlebars and hand-operated controls	(See Note 2 to this Part)
126.03.07	8703.21.70	Six or eight-wheeled vehicles, chain-driven and hand operated through an integral gearbox and differential unit	(See Note 2 to this Part)
126.03.09	8703.21.90	Other	(See Note 2 to this Part)
<b>126.03</b>	<b>8703.22</b>	<b>Of a cylinder capacity exceeding 1 000 cm<sup>3</sup> but not exceeding 1 500 cm<sup>3</sup>:</b>	
126.03.11	8703.22.90	Other	(See Note 2 to this Part)
<b>126.03</b>	<b>8703.23</b>	<b>Of a cylinder capacity exceeding 1 500 cm<sup>3</sup> but not exceeding 3 000 cm<sup>3</sup>:</b>	
126.03.13	8703.23.90	Other	(See Note 2 to this Part)
<b>126.03</b>	<b>8703.24</b>	<b>Of a cylinder capacity exceeding 3 000 cm<sup>3</sup>:</b>	
126.03.15	8703.24.90	Other	(See Note 2 to this Part)
Notes:			
2. For the purposes of items 126.02 to 126.05 the rate of excise duty on:			
(a) vehicles manufactured in the Republic shall be -			
(i) $((0,00003 \times A) - 0,75)\%$ with a maximum of 25%; and			
(ii) "A" means the recommended retail price, exclusive of value-added tax, less 20%.			
(b) Vehicles imported into the Republic shall be -			
(i) $((0,00003 \times B) - 0,75)\%$ with a maximum of 25%; and			
(ii) "B" means the value for the ad valorem excise duty on imported goods as prescribed in section 65(8)(a) of the Act.			
(c) The result of the calculations $0,00003 \times A$ and $0,00003 \times B$ shall be rounded-off to the third decimal comma.			

Source: Lesotho Revenue Authority.

To note in Figure 4 is the linking with the excise tariff Item with the HS code which in turn becomes the Tariff Item Sub-heading and provides the product's description in classification – and is the case in all five member countries. Also noted are the attempts to ensure parity in compliance with GATT Article III between domestically produced goods and like imports.

Full excise coordination is critical in the SACU. All excise (and customs) duties collected by the five revenue authorities are paid into an SACU's 'revenue pool' from which 15 per cent is deducted for a 'Development Fund' and the remainder distributed to the five member countries through an agreed formula (revenue sharing) based on the members' GDP.<sup>26</sup> Non-alignment or non-coordination of excise taxes would distort the markets and reduce revenues as all excisable goods would be cleared into home consumption in the countries with the lowest excise duty rates.

## 10. What might ASEAN excise tax policy coordination look like?

This is a question that the AEC Blueprint 2025 needs to explore further. From the discussion above, it is apparent that certain contextual areas also need to be considered as they will determine what form and level excise coordination within the AEC can take. In this regard, the following points could guide future discussion on how excise coordination can be attempted:

- ASEAN is run by consensus between members rather than by a central authority with law making and law enforcing powers over member countries and as such, the nature and form of excise tax coordination need to be agreeable to all 10 countries.
- The AEC will seek to establish a single market and production base but will retain all border controls between member countries, and excise taxation will be payable in the country of consumption and collected by the local tax or customs border agency.
- Agreement on excise tax coordination will not be binding or enforceable through legislation or directives, and so must clearly show real benefit to all 10 members of ASEAN and likely take the form of a Memorandum of Understanding or Protocol, similar to such agreements in place today.
- Excise tax harmonisation will not be an option given the current levels of economic disparity still in existence across the region, and coordination will best take the form of an agreement which covers:
  - › principles as guidance in excise tax policy development
  - › consistency in defining product categories, products and classification
  - › consistency in the application and defining of appropriate tax bases.
- Build on the success of existing intra-regional trade coordination via the ASEAN Harmonised Tariff Nomenclature (AHTN) with a similar ASEAN Common Excise Working Tariff (ACEWT) for use in future regional excise tax policy development.
- Recognise the potential for ASEAN to significantly grow its 'regional automotive industry' to be a leading industry sector for the region which is exporting to the global market and bringing with it the FDI and associated economic benefits to lift the wealth levels of all member countries.

The design of a product, such as an ACEWT, not only needs to account for the unique environment which is ASEAN, and the characteristics of the AEC, but also needs to consider the objectives for automobile excise taxation in a region aspiring to develop a strong automotive industry competing in the global auto market. These types of considerations need to include:

- facilitating the establishment of a 'single market' by ensuring that:
  - › excise taxation is not used as a non-tariff measure to make intra-regional trade less commercially viable

- › better alignment of product categories, products, and classification criteria allows for greater facilitation as a product carries similar classification in all member countries
- › assessment of excise duty liabilities are transparent and readily able to be calculated.
- establishing a ‘single production’ base with cost effective supply chains seeing parts, components and assembled vehicles moving efficiently from source to assembly lines to market
- recognising the global trend towards fuel efficiency and reduced emissions, so that ASEAN-built vehicles are meeting the specifications of consumers in export markets
- recognising local experience and expertise in certain areas and taking global leadership in product design with development and marketing of ‘regional product champions’ for export to global markets
- understanding that the industry often needs a significant lead-in time when developing new models and that whilst this occurs, locally produced current models need to stay commercially viable in the ASEAN market.

Whilst the ASEAN context sets the nature of the agreement on automobile excise tax coordination, the outline of local automotive sector directions will assist in setting the technical content of the agreement, that is, they become part of the development of any proposed ACEWT.

Recognising the contextual and technical needs above, can ASEAN consider the benefits of building or developing a document for use by regional excise policymakers which captures a range of measures to assist in regional excise tax coordination? Such measures would recognise that:

- automobiles are subject to excise tax in all ASEAN member countries
- ASEAN has been able to harmonise the WCO HS nomenclature for the region
- ASEAN has considerable expertise in certain product areas such as the ‘pick-up vehicle’
- a new focus is being sought to reduce CO<sub>2</sub> emissions through greater fuel efficiency, smaller vehicles and new technologies
- ASEAN does not have regional set standards for member countries in terms of fuel consumption and vehicle emissions.

Against this background, Figure 5 is an attempt to capture both the latest thinking in automobile excise taxation, including that within ASEAN and the need for consensus and sovereignty across the ASEAN membership.

Figure 5: Proposed Draft ASEAN Common Excise Working Tariff design

<b>'ASEAN COMMON EXCISE WORKING TARIFF'</b>					
<b>Schedule 1: Automobiles</b>					
<b>Definitions</b>					
<i>Ad valorem</i> rate means a rate expressed in percentage terms of a value set in national excise tariff law.					
<b>Bus</b> means a vehicle designed for the carriage of 10 or more persons including the driver and includes 'mini vans' seating 10 or more persons including the driver.					
<b>Commercial Motor Vehicles</b> means motor vehicles principally designed for the carriage of goods, or persons (10 or more) including the driver, or for special purposes.					
<b>CO<sub>2</sub> emissions</b> means the level of CO <sub>2</sub> emissions of a motor vehicle measured in grams per kilometre in a testing methodology approved under UN Regulations.					
<b>Fuel efficiency</b> means the fuel consumption of a motor vehicle measured in litres per 100 kilometres in a testing methodology approved under the UN Regulations.					
<b>Hybrid</b> means a motor vehicle with at least two different energy sources and two different energy storage systems on board the vehicle for the purpose of propulsion.					
<b>Passenger cars</b> means a road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver).					
<b>Passenger Pick-up vehicles</b> are pick-up vehicles designed with an extended or dual cab for the carriage of no more than nine persons (including the driver).					
<b>Pick-up vehicle</b> means any vehicle which contains both a passenger compartment designed for the carriage of less than four persons and open cargo bed for the carriage of goods.					
<b>Special purpose vehicles</b> means a commercial motor vehicle with specific purposes such as fire-fighting, ambulances, spraying, concrete mixing, mounted cranes, etc.					
<b>Sports utility vehicles</b> means a passenger vehicle that is designed as an off-road vehicle with four-wheel-drive capability (or two-wheel where other specifications of this definition are met), high ground clearance and a wagon body type, seating up to nine persons (including the driver).					
<b>Truck</b> means a vehicle with a power unit and either a permanently fixed or detachable cargo carrying capability with two or more axles.					
<b>Truck tractor</b> means a non-cargo carrying vehicle designed to tow trailers and other devices.					
<b>Van</b> means any vehicle with a closed cargo bay designed for the carriage of goods with no more than two axles.					

<b>Schedule 2: Excise Tariff Items</b>					
<b>Item</b>	<b>Heading</b>	<b>Sub item</b>	<b>Sub item description</b>	<b>AHTN Ref</b>	<b>Excise Rate</b>
1	<b>Motor cars and other motor vehicles principally designed for the transport of persons, including station wagons and racing cars</b>		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO <sub>2</sub> emissions		Set by national government
		1.1	<b>Passenger Motor Vehicles</b>	8703.21, 8703.22, 8703.23, 8703.31, 8703.32, & 8703.33	Set by national government

		1.2	<i>Passenger Motor Vehicles meeting ASEAN standard CO<sub>2</sub> emissions and fuel criteria</i>	8703.21, 8703.22, 8703.31, & 8703.32	Set by national government
		1.3	<i>Hybrid vehicle as defined</i>	87032, 87033, & 87039	Set by national government
		1.4	<i>Other (reserved)</i>	8703.90	
2	<b>Motor vehicles principally designed for the carriage of persons (10 or more) including the driver</b>		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO <sub>2</sub> emissions		
		2.1	<i>Buses and mini-vans of 10 or more seats</i>	8702.10	Set by national government
		2.2	<i>Other (reserved)</i>	8702.90	
3	<b>Motor vehicles principally designed for the carriage of goods, or special purposes</b>		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO <sub>2</sub> emissions		
		3.1	<i>Dumpers for off-highway use</i>	8704.10	Set by national government
		3.2	<i>Trucks</i>		Set by national government
		3.2.1	Gross weight not exceeding 5 tonnes	8704.21, & 8704.31	
		3.2.2	Gross weight exceeding 5 tonnes but not exceeding 20 tonnes	8704.22, & 8704.32	
		3.2.3	Gross weight exceeding 20 tonnes	8704.23, & 8704.33	
		3.3	Special purpose vehicle other than those principally designed for the transport of persons or goods (for example, breakdown lorries, crane lorries, fire fighting vehicles, concrete mixer lorries, road sweeper lorries, spraying lorries, mobile workshops, mobile radiological units)	8705	Set by national government
		3.4	<i>Pick-up truck</i>	87042, & 87043	Set by national government
		3.5	<i>Van</i>	87042, & 87043	Set by national government

Source: Author.

Figure 5 also provides for the aspiration of some to develop ASEAN as an ‘eco car’ development and manufacturing hub. The critical aspect for agreement will be the classification criteria under each tariff item. The issues raised in this paper suggest that current differing automobile excise tax policy priorities and the desire by some member countries to support certain types of domestic production mean the

region could be starting a long way apart. Equally, this paper considers that to not move towards such agreement will risk the benefits that should materialise from the implementation of the AEC and that for an industry such as automobile manufacturing the options for investment are such that ASEAN may not see the future growth it could have otherwise reasonably expected for this industry.

The emerging demand for more fuel efficient and lower emitting vehicles is an opportunity for the region to seek investment in the production of such vehicles, however, the first step is to ensure that those potential investors can sell enough product locally to realise the returns they need. Thus, ASEAN and its AEC are entering a critical time for the automotive industry and the issue of regional excise policy coordination needs urgent attention. If there is the will, there are mechanisms to resolve the issues raised in this paper.

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## Notes

- 1 The ASEAN Vision 2020 can be accessed through the ASEAN Secretariat website at [www.asean.org/news/item/asean-vision-2020](http://www.asean.org/news/item/asean-vision-2020).
- 2 See Article 4 of the CEPT scheme.
- 3 See Article 2 and Article 6 of ATIGA.
- 4 See paragraphs 15-18 of the AEC Blueprint.
- 5 Protocol Governing the Implementation of the ASEAN Harmonised Tariff Nomenclature, viewed 12 March 2015, [www.asean.org/archive/16954.pdf](http://www.asean.org/archive/16954.pdf).
- 6 See [www.asean.org/communities/asean-economic-community/category/free-trade-agreements-with-dialogue-partners](http://www.asean.org/communities/asean-economic-community/category/free-trade-agreements-with-dialogue-partners).
- 7 See [www.asean.org/communities/asean-economic-community](http://www.asean.org/communities/asean-economic-community), viewed 12 December 2015.
- 8 Paragraph V, Section B5 ASEAN Economic Community Blueprint 2025, p. 18.
- 9 Interview with Antonio Manderla, Chair, Panel for the Trilateral Commission's North American Regional Meeting on NAFTA and CEO of Tier 1 supply company.
- 10 See Note 9.
- 11 Foreign direct investment (FDI) is defined by the OECD as an investment involving a long-term relationship and reflecting a lasting interest and control by an entity resident in one economy (foreign direct investor or parent enterprise) in an enterprise resident in another economy (FDI enterprise or affiliate enterprise or foreign affiliate). FDI has three components: equity capital, reinvested earnings and intra-company loan.
- 12 See, for example, the automobile industries of Thailand 12 per cent (Board of Investment), Malaysia 3.2 per cent (EXIM Bank), China and India 7 per cent and globally approximately 3 per cent.
- 13 UK Driver and Vehicle Licensing Agency 'Vehicle Excise Duty' 2014, [www.gov.uk/government/uploads/system/uploads/](http://www.gov.uk/government/uploads/system/uploads/)

attachment\_data/file/299797/V149\_\_2014-15.pdf.

- 14 See [www.car.go.th](http://www.car.go.th) and [www.unep.org/transport/gfei/autotool/approaches/information/labeling.asp#Thailandencourageconsumers](http://www.unep.org/transport/gfei/autotool/approaches/information/labeling.asp#Thailandencourageconsumers) to buy more efficient vehicles.
- 15 Interview of Somchai Pulsawat, Director General, Thai Excise Department in *The Nation*, 27 August 2014, [www.nationmultimedia.com/webmobile/national/Excise-tax-to-be-levied-on-retail-prices-not-low-e-30241872.html](http://www.nationmultimedia.com/webmobile/national/Excise-tax-to-be-levied-on-retail-prices-not-low-e-30241872.html), and remarks by Dr Nathan Junprateepchai of the Thai Excise Department at the Director-General Meeting of ASEAN Member Countries on Automobile Taxation on 20 November 2014, [www.jama-english.jp/asia/news/2015/vol58/article1.html](http://www.jama-english.jp/asia/news/2015/vol58/article1.html).
- 16 Full title: Regulation 64/PMK 11/2014 'Luxury Sales Tax on Motor Vehicle Types' coming into effect 17 April 2014.
- 17 See Regulation 41 of 2013, <http://sipuu.setkab.go.id/PUUdoc/173799/PP0412013.pdf> and Regulation No. 33/M-IND/PER/7/2013 of 2013.
- 18 See Note 17.
- 19 AmResearch 2014.
- 20 See Note 19.
- 21 See pp. 28-9 of Draft Decree *11140/BTC-CST* of 13 August 2015.
- 22 European Automobile Manufacturer's Association 2013, p. 39 (adjusted for Australia and Taiwan).
- 23 ASEAN 6 includes Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, and ASEAM CLMV includes Cambodia, Laos PDR, Myanmar, and Vietnam.
- 24 See [www.asean.org/communities/asean-economic-community/item/non-tariff-measures-database](http://www.asean.org/communities/asean-economic-community/item/non-tariff-measures-database).
- 25 See Lesotho Revenue Authority, [www.lra.org.ls/tariffs.php](http://www.lra.org.ls/tariffs.php).
- 26 See SACU, [www.sacu.int/tradef.php?id=419](http://www.sacu.int/tradef.php?id=419).

## Rob Preece



Rob Preece is a senior lecturer in excise studies with the Centre for Customs and Excise Studies (CCES), Charles Sturt University and is currently based in Bangkok, Thailand. He is the Convener of CCES's postgraduate Diploma in Excise Studies program and undertakes various research and training programs in the area of excise taxation. Rob is also an Adjunct Associate Professor at the University of Canberra. He undertakes capacity building, vocational training, policy development, and research on behalf of governments, private sector and academic partners. Rob holds a Master of International Customs Law and Administration, and has 28 years' experience in the areas of excise and customs law, including 15 years with the Australian Customs Service.

