

## RETHINKING THE AUTOMOBILE INDUSTRIAL POLICY AND FOREIGN DIRECT INVESTMENT IN NIGERIA

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### ABSTRACT

*Presently, among the top ten most populous countries in the world, Nigeria and Bangladesh are the two countries without vibrant automobile industry. Given the Nigerian potential market, strategic position in West Africa and sustained economic growth over the last seven years, Nigerian Government has started to use this opportunity as a launch pad to resuscitate the country's automobile industry. The new policy designed - Automobile Industrial Policy aimed to attract both the foreign direct investment and local investment to develop and promote this all important automobile sector in Nigeria. The manufacturing sector is considered as one of the key drivers of economic growth, so government had decided to take the opportunity of its large domestic market, labour intensive characteristics, strong industrial linkages, existing installed base and export capability to other ECOWAS countries. This study therefore, looks at the effect of FDI, the current and future challenges that must be overcome for Nigerian automobile industry to survive and contribute meaningfully to the economic growth of Nigeria. In order to review this policy and the one before it, the study analyses the current capabilities, opportunities and challenges faced in the past and recommendations were made based on international best practices as done in other similar climes like Malaysia and Thailand.*

Key words: Nigeria, Automobile Industrial Policy, Foreign Direct Investment, Economic Growth, ECOWAS, Industrial Linkages

### Introduction

Nigeria has begun to return to the growth path with vigour as the government has taken bold step to draft new blueprint for automotive industry. For a country of more than 170million (est.) people with ever increasing number of the middle class not boast of a single automobile company is economically wise. Once upon a time Nigeria was bubbling with a vibrant local automobile industry consisting of about ten assembly plants spread across her territory. According Akiagwe 2010, through joint partnership with the Federal Government of Nigeria, companies from France, Britain, Germany and America got licenses of operations. Hence, Automobile Nigeria Limited (PAN) Kaduna in 1975, Volkswagen of Nigeria Limited (VWON) Lagos 1978, Anambra Motor Manufacturing Limited (ANAMMCO) Enugu (1980); Steyr Nigeria Limited Bauchi, National Truck manufacturers (NTM) Kano, Fiat Production, LeyLand Nigeria Limited (LNL) Ibadan, between 1970 and 1980. Aside heavy investment witnessed in the oil sector in the 70's, automobile came second. The current minister of trade and investment Mr. Olusegun Aganga stated that "automobile industry is an engine of growth and stimulus to other economic activities like creating of employment opportunities, growth of other satellite industries and enhancement of technology transfer of skill acquisition". The establishment of the six automobile industries in the country, the economy activities was stimulated and improved considerably because petroleum products are transferred from point of production to fuel filling stations with no trouble. Agricultural produce are easily transported from the far northern part of the country to the Southern region of the country vis-a-vis. People traveled with ease and less travel time from one location to another. Suddenly, these feasts were upturned and the situation was allowed to lapse into irrelevance for many years as successive governments through various fiscal and austerity policies gradually shifted attention of those operating in the sector from production to importation of Fully Built Vehicles (FBU). Currently, Nigerian roads are full with imported second-hand cars usually called *Tokunbo*, because the country is a profitable market for all kinds of cars and spare parts. This situation compelled the government to resuscitate the comprehensive automotive development plan for the industry. This study would take a critical look at the new policy thrusts and the current situation in term of infrastructural development, purchasing power, sustainable foreign direct investment(FDI), knowledge transfer and incentives which must be well taken care of for a successful and vibrant automobile industry.

### Literature review

#### Foreign Direct Investment and Capital accumulation deepening

This study looked at the broad concept of FDI and the motivation for foreign direct investment and its different channels of contribution to economic growth of the host. Characteristically, one reasons of FDI as building a production plant at abroad. In addition to common views, Foreign Direct Investment (FDI) entails of a much broader class of foreign trade. OECD came up with a broad meaning of what FDI is ("OECD Benchmark definition of FDI", 1999, p. 7): "FDI reflects the objective of obtaining a lasting interest by a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the

investor (direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.”

From the import of this definition it can be deduced that establishing a business enterprise and *creation of a manufacturing corporation* abroad is known as foreign direct investment. FDI can also be seen in form of acquiring a sufficiently high equity share in a foreign company with the intent of building up a long term business relationship. There are three basic transmission channels for FDI.

1. Greenfield Investments this happens when foreign firms directly employ new production technologies in the host country. These technologies are put into use for the intermediate production of capital goods; they can increase significantly the aggregate physical capital stock in several ways: They can increase the physical amount of capital goods, as well as the quality and variety of capital goods available in the host country thereby adding to number of choices available to the domestic market.

2. Indirect Transmission is the shift of management expertise and production know-how to a foreign firm abroad to facilitate the production of new kinds of capital goods and thereby foster technological progress and economic growth. However, the effect of the impact on economic growth on the host country through foreign ownership participation depends on the amount of knowledge transfer from the foreign investor.

3. Second-round effects this is a situation where the existence of foreign firms or corporation in developing countries makes it easier for domestic firms to adopt new technologies and raise total production (technology diffusion and knowledge spillover effects).

#### **Motivation for FDI**

The general equilibrium model of FDI proved that where FDI and trade are complementary which means access to cheap production inputs, for instance low wage labour, is seen as the main driver for FDI when the vertical motive prevails. Production is not aimed to serve the foreign market but rather located abroad to serve the home market. The utilization of the lower production costs abroad comes with increased intra-firm trade from the foreign production entity to the headquarters plant at home.

In the work of Hoffman (2013), she noted that motive for foreign firm to invest abroad is an attempt to striving to augment the innovative capabilities of the entire corporation by accessing overseas knowledge. A foreigner buys a domestic company or establish a completely new company with the aim to either acquire the target firm’s knowledge and its technology assets (ranging from intangible process and market know-how to patents, brand names, trademarks etc.) or to tap the foreign (often regional) pool of knowledge. Kogut and Chang (1991) and Yamawaki (1994) concluded that for Japanese firms that enter the US and the European market through various channels of FDI was based on technology sourcing and advanced technical know-how. Evidence from empirical analysis shows that the technology sourcing abroad and monitoring motive for FDI is important for multinational companies from both developed and developing countries while target locations are mainly technologically leading countries. According to (UNCTAD 2005) technology sourcing is the main driver, the dominant mode of FDI.

Brems’s opined that the motivation for FDI is to increase the quantity of the physical capital stock at an early stage of development of the FDI-receiving country. However, Brems’s and in accord with the endogenous FDI models of the 1990s; it will also deliver positive long-run effects of FDI on economic growth through a permanent stream of technological change.

#### **FDI and Economic Growth: The linkage**

In the empirical work using pooled industry dataset, Blomstrom (1986) argues that Mexico manufacturing industry 1970 and 1975 the performance of industries vary with the presence of foreign subsidiaries and foreign presence is related with structural efficiency and foreign entry is related with structural changes in the modern part of the industries but not in traditional industries; the most important source for enhancing efficiency is competitive pressure

Blomstrom et al. (1994) conducted a study on 78 developing countries(Cross-section dataset, 1960–1985) found that inflow of FDI has significant positive effect on income growth rates but only for higher income developing countries; not for poor countries; thus, FDI having growth effects depends on having already a high level of development.

In the conclusion made by Chowdhury and Mavrotas (2006) from time-series data 1969–2000; direction of causality between FDI and growth analyzed using Toda-Yamamoto test for causality on Chile, Malaysia and Thailand. The causality between GDP and FDI is country-specific; GDP growth causes FDI in the case of Chile and not vice versa; for both Malaysia and Thailand bi-directional causality between the two variables is detected

Karimi and Yusop (2009) using time series data Malaysia, 1970–2005, the study did not show evidence for the long-run relationship between FDI and GDP adopting Toda-Yamamoto test for causality and ARDL. In the same vein, Alfaro (2003) conducted study on 47 countries between 1980–1999; his conclusion was that FDI exerts an ambiguous effect on growth in the overall dataset but different effects for sectors; negative effect in the primary sector; positive for manufacturing; ambiguous for service sector.

Also Carkovic and Levine (2005) work on 72 country panel; 1960–1995. Their assertion was that no robust causal link between FDI and economic growth; controlling for joint determinations of growth and foreign capital inflow (endogeneity), country specific factors as initial income, educational attainment, economic development, trade openness and financial development GMM.

### Policy appraisal: Nigeria Automobile Industry Plan

Karl Benz built the first modern automobile using petrol engine 1885 in Mannheim, Germany. Among old but subsisting viral industry of the world which impact on both economy and culture, give jobs to thousands of people, produce substantial of foreign exchange earnings to many countries.

The well being of people is enhanced by the access opportunity provided by automobiles as they allow people to live, work and play in ways that were unimaginable many centuries ago. The industry does not only give freedom but enables people to have access to markets, doctors, to jobs and far distance places for business or tourism. Almost all the car trip ends with either an economic transaction or some other benefits to our quality of life.

In the year 2005, fifty leading automobile corporations produced over sixty- six million vehicles which include cars, vans, trucks and buses. Equivalent of this huge output is the global turnover of €1.9 trillion which represents sixth largest economy in the world according to OICA 2013. Therefore for a country like Nigeria to miss out in this huge business with her teeming population of over 170million representing 7<sup>th</sup> most populous nation in the world is a great disservice to her balance of trade. Currently, over 38 million people are within the middle class bracket and more than 23% of her population is not employed: the later can help the supply side while the former can sustain the demand side of automobile industry.

The latest report from International Organization of Motor Vehicle Manufacturers (OICA) 2013 shows that the top 10 countries with highest population produced over 59% of total vehicles output in the world. This indicates that country domestic population is a major criterion for automobile market. The paper would expect a country like Nigeria whose economy dominates other West Africa market to take advantage to produce automobile.

Table 1: World Total Vehicle Output 2012

S/N	Country	Cars	Commercial Vehicles	Total
1	Argentina	506,539	284,468	791,007
2	Australia	185,427	30,499	215,926
3	Austria	146,566	19,862	166,428
4	Belgium	465,504	38,000	503,504
5	Brazil	2,722,979	989,401	3,712,380
6	Canada	965,191	1,414,615	2,379,806
7	China	18,085,213	4,031,612	22,116,825
8	Czech Rep.	1,128,473	4,458	1,132,931
9	Egypt	25,650	13,400	39,050
10	Finland	20,500	103	20,603
11	France	1,458,000	282,000	1,740,000
12	Germany	5,439,904	278,318	5,718,222
13	Hungary	220,000	2,400	222,400
14	India	3,138,988	741,950	3,880,938

15	Indonesia	924,753	281,615	1,206,368
16	Iran	630,639	113,041	743,680
17	Italy	388,465	269,742	658,207
18	Japan	8,189,323	1,440,858	9,630,181
19	Malaysia	543,892	57,515	601,407
20	Mexico	1,771,987	1,280,408	3,052,395
21	Netherlands	0	29,183	29,183
22	Poland	475,000	108,258	583,258
23	Portugal	109,698	44,303	154,001
24	Romania	410,959	38	410,997
25	Russia	1,919,636	255,675	2,175,311
26	Serbia	10,100	805	10,905
27	Slovakia	975,000	0	975,000
28	Slovenia	89,395	4,339	93,734
29	South Africa	265,257	280,656	545,913
30	South Korea	4,122,604	398,825	4,521,429
31	Spain	1,719,700	443,638	2,163,338
32	Sweden	161,080	N.A.	161,080
33	Taiwan	291,037	47,683	338,720
34	Thailand	1,071,076	1,385,981	2,457,057
35	Turkey	633,604	491,930	1,125,534
36	Ukraine	45,758	4,691	50,449
37	UK	1,509,762	88,110	1,597,872
38	USA	4,368,835	6,697,597	11,066,432
39	Uzbekistan	133,740	21,020	154,760
40	Others	476,422	128,699	605,121
	<b>Total</b>	<b>65,462,496</b>	<b>21,891,507</b>	<b>87,354,003</b>

Source: Organization of Motor Vehicle Manufacturers (OICA) 2013

A country like South Africa with less than half of Nigeria population generating 12% of export and 7% of her GDP from automobile manufacturing is a typical example of a country that has a robust automobile policy. Lately, the world have witnessed that the industrialization of South East Asian countries greatly depends on the development of their automotive industry with help of FDI and enabling environment nurtured by political will.

Table 2. Import of Vehicles into Nigeria (UNCTAD)

Year	2007	2008	2009	2010	2011	2012
	(US\$M)	(US\$M)	(US\$M)	(US\$M)	(US\$M)	(US\$M)
Motor Vehicles for transport of goods, special purpose	427	930	847	1,466	731	1,125
Motor Vehicles for the transport of persons	1,096	2,344	1,746	2,705	2,024	2,326
Total	1,523	3,274	2,593	4,171	2,755	3,451

Source: National Automotive Council (NAC), 2014

In 2012 alone, the annual expenditure of Nigeria on automobile is over N550 billion (US\$3.5 billion) see the table 2 above being second user hard earned foreign after Boilers machinery and appliances.

Data from the Nigerian Automotive Manufactures Association (NAMA), the Nigerian Bureau of Statistics (NBS), and the United Nations Conference on Trade and Development (UNCTAD), as illustrated in table 2 indicates that Nigerian economy bought 400,000 vehicles (100,000 new and 300,000 used). However, from NAC feasibility study it was discovered that \$185million would be generated if those vehicles were assembled locally rather than been imported. If the policy is fully implemented not less than 280,000 people will be engaged directly and indirectly, while 490,000 other employment would also be created in the raw materials supply industries. With this in mind, the Federal Government of Nigeria came up with the Automotive Industry Development Plan, 2013-2024 with the intention to annex the potentials and opportunities in the automobile industry to improve the welfare of people.

### Automobile Industry Development Plan, 2013-2024: Potential and Opportunity

This section would look at prospects and benefits that Nigerian economy would get if FDI is attracted and as well mobilized and enable the local investors to take the advantage of the policy. Currently, Innoson Vehicle Motor Manufacturing (IVM) in Anambra State is a shining example of local investor which has started manufacturing Light Commercial Vehicles (LCV), Buses and Sport Utility Vehicles (SUVs). Since the policy has become an act of parliament, all the privatized Assembly plants including Volkswagen of Nigeria, now VON Nigeria; NTM, Kano; Steyr Nigeria, Bauchi; Leyland, Ibadan (now Leyland Busan); Anammco, Enugu and Peugeot Automobile of Nigeria (now PAN Nigeria Ltd) are all ready to begin operations in full force. To confirm the viability of the policy Nissan one of the leading automobile manufacturers came out with first car (Nissan Patrol Jeep) early 2014 and some others have also begun Greenfield investment. Nevertheless, this policy must not lose sight of daunting issues that inherent in the industry which is why policy of this nature should be updated and improved upon for optimal performance for sustainability.

### Component of the Automotive Development Plan

The Nigeria Industrial Revolution Plan (NIRP) is a 5 year programme developed by the Federal Ministry of Industry, Trade, and Investments to reduce Nigeria economy and revenue dependence on oil through industrialization and to increase manufacturing's contribution to GDP from 4% today, to 6% by 2015, and ultimately 10% by 2017. Among the focal points in NIRP is automobile sector because it holds the key to rapid industrialization as it creates strong industrial linkages and more importantly diversification of the economy because of its export potential into Economic Community of West African States (ECOWAS) and Central African Countries most of which are land locked which make Nigeria the best option to fulfill their automobile needs. Some the elements of automobile policy include:

**Industrial infrastructure**, the intent of this is to develop localization advantages for the industry by creating supplier parks and clusters so that firms within this area can share, resources, information, knowledge and technical expertise and even security. This would save a lot for the government by avoiding duplication of cost on infrastructure and the likes.

According to Holwag et al (2005) Industrial clusters are groups of specialising and producing firms of a particular component or parts of a vehicle, ideally they must be located within a confined industrial area setting or free trade zone but could have customers far beyond the national industrial boundary. In the work of Isbashoiu (2007) citing Marshall (1920) opined that three conditions for setting an industrial cluster are: (1) existence of a pool of adequate labor, (2) the existence of specialized suppliers and (3) the possibility of external spill-overs (the rapid transfer of know-how and ideas inside the cluster). Furthermore, Isbashoiu (2007) expanded this concept using the export-oriented industries and its linkages to other industries. This is in line with pattern of automobile industry in Thailand where automobile industry belt is created to achieve cost effectiveness for the firms and industry at large.

Table 3: Type of cluster

Type of cluster	Features
Potential cluster	Some good opportunities and some key elements are already in place
Latent cluster	Cluster with a high number of firms but with a low level of interaction due to the lack of trust, low cooperation and high transaction costs
Working cluster	A well developed industrial district

Source: Burange L.G. and Shruti Y. 2008

**Saleable skills development**, manpower requirements for the success of this industry is not over looked. Both highly skilled and semi-skilled labour development strategies should considered. The synergy between some ivory towers, polytechnic and specialized vocational institutions would be formed to sustain human resources needs of this industry. Abubakar Tafawa Balewa University and Elizade University already have plans to offer the automobile engineering programmes. In addition, National Automotive Council (NAC), with the National Board for Technical Education (NBTE)- regulatory body for polytechnic and monotechnic institutions in Nigeria have been empowered and encouraged by the government to train more middle level technicians a.

**Standards** the quality of inspection and monitoring is as good as the product itself. A motor vehicle has over 5000 components which must be of international certification standard (ISO). The policy has incorporated the local Standard Organization of Nigeria (SON) and in collaboration with Nigeria Automotive Council, they have developed over 106 vehicle safety standard. International Original Equipment Manufacturers (OEMs) has bought into this policy to facilitate and guarantee overall product quality Nigeria's auto industry.

**Investment promotion**, aside juicy incentives in the policy to encourage foreign direct investment government has also made the policy in a way to protect the investment through act of parliament. Fiscal measures are also in place to check underground market that could undermine the policy these include smuggling control measures with the use state of the art technology and high tariff on Fully Built Units (FBU) to discourage importation.

**Market development** In an effort to depress imports of automobiles especially (FBU) and to promote localization of automobiles, high taxes are applied on imported automobiles through Tariff Based System (TBS). Sometimes, imports of automobiles are made when the demands are greater than total produced vehicles (Rohail, 2010).

In order to create a profitable domestic market for locally made cars, government as a matter of policy through NAC will collaborate with OEMs to set up domestic dealership networks, captive finance operations, and integrate into the existing banking system in Nigeria. The growth of the industry is mainly due to high disposable incomes of the middle class in many part of the world. The automobile industry depends on economic uplift, availability of auto financing at satisfactory terms and sustainable consistent industry friendly policies. However, in Nigeria where large percentage of the population are not having enough to buy new cars, government has taken steps to create financing scheme driven by private banks to boost the purchasing power of Nigerians. Also, automobile manufacturers would be encouraged to produce more of low cost vehicles which would be affordable for many Nigerian thereby discouraging Nigerian from patronizing used cars from abroad.

### Recommendations

Unlike previous experience whereby poor policy framework, lack of political will coupled with warped fiscal policies which led to the collapse of the laudable efforts and growth of the automobile manufacturing industry, this paper would make some recommendations if applied, the past experience may not likely repeat itself again. Learning from the Pakistan automobile pitfalls, Muhammad et al (2014) identified the following area of to care of.

**Consumers' sovereignty** The Automobile manufacturers should not be allowed to oppress the Nigerian customers by taken advantage of the nation's dire needs for the sector. There should not be any justification for the price of locally produced vehicles to be higher than imported ones as this act would encourage smuggling and eventually weaken policy. Automobile companies should accord their customer due respect by paying deserved attention to consumers needs and complaints. Nigerian consumer should be able to have a fair deal as well as international quality at affordable price. Nevertheless, Consumer Protection Agency and Standard Organization of Nigeria must be identified with consumer.

**Competitive structure** the structure of market in which firms operate has a great influence on the behaviour of the firm. If government encourages laissez faire market system whereby every company would be able to determine their price and mode of operations without the state interference would stimulate innovation, and create choices for the consumer. Excessive government protection would not make the industry competitive thereby compromising the welfare of local consumer.

**Protection rate** one of the differences between Thailand and Malaysia is the way government intervene in the auto industry. In the former complete ownership and control by foreigners is allowed while the later does not allow that to happen except in recent times when the regional trade agreement and the desire to improve on performance is changing the structure of the industry. According to the report from ASEAN automotive federation 2014, Thailand produced 2,457,057 vehicles while Malaysia has 601,407. This indicates that there some performance drivers in the industry which affect the two country industry differently. Much of these are attributed to trade liberalization and market driven economy system. Nigeria must learn lesson from this by adopting a system that would drive optimal performance in the system. Long term trade barriers are just like slow poisoning to the industry that kills the production and innovation capabilities of the forms.

**Consistency in policy framework** the regulatory bodies should be cautious of dishing out frequent policy framework as this affect the confidence and growth of foreign direct investment in the sector. A case worth of mention is Pakistan where regulatory body made more than 30 policy changes from 1994 to 2000 Muhammad et al, (2014). The vitality and inconsistencies can limit the growth of the industry the government of Pakistan realized this, so it adopted uniform policy framework for the industry which has resulted to appreciable growth since 2000. It would be in the interest of government to learn from the mistake of others by streamlining and be consistent in making policy framework,

### Conclusion

On the basis of above descriptive analysis and literature review, the paper concludes that the automobile industry is a major foreign exchange booster for a country. With practicable policy and political will on the part of the government; foreign direct investment even local investment can be attracted and sustained. However, to manage the success for a long time some government and regulator must realize that steadiness of policies, market competitive structure, good consumer protection strategy, reasonable tariff and incentive structure should be put in place. The paper would monitor the sector as it unfolds in order to give further appraisal of the automobile sector in Nigeria.

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