Thai Journal of Development Administration Vol.36, No.3, July-September 1996

Export and Foreign Direct Investment in Thailand

*Pranee Chitakornkijsil**

1. The Seventh National Economic and Social Development Plan (1992-1996)

In the draft of the Seventh Plan, the government appears to attach importance to continued industrial sector growth, which is expected to be not less than 9.3% per annum and should account for 29% of GDP by the last year of the plan.The target industries are still export oriented; and, because the majority of the population is still reliant on agriculture, the food processing industry is still prominent.

In addition, in conformity with the projects to develop the eastern and southern seaboards, the government's goal is to promote heavy industries, such as petrochemicals and shipyards. Also interesting is the government's intention to push industrial development in specific areas. Regional industrialization policies have not been notably successful. It is now intended to create new economic zones, e.g. on the eastern and southern seaboards, where the government will provide basic services in order to attract private investment.

The target areas and industrial groups are:

- Eastern Region. Mab Ta Put has been set up as the location for heavy industry, such as petrochemicals, and will become one of the country's most modern industrial cities. Laem Chabang, becoming one of the country's most modern industrial cities, and a location for the processing industry, is the country's most modern port. Environmental problems there will need to be carefully controlled.

- Northeastern Region. Engineering and light export industries supporting the Central Region will be located here. Industries will be centered in Nakhon Ratchasima, Khon Kaen and Ubon Ratchathani.

- Northern Region. Export industries will be promoted and developed. Chiang Mai will be developed into a complete export center for the upper northern part of the region.

---

* Associate Professor, Graduate School of Business Administration, National Institute of Development Administration

The lower part, centered on Pitsanulok, will concentrate on agricultural machinery.

- Southern Region. Shipyards, ship repair and industries involving petrochemicals, crude oil and natural gas will be promoted and developed. Krabi, Songkhla, Surat Thani and Nakhon Si Thammarat will be the region's centers.

In addition to attempting to widen the country's industrial base, the government also attaches importance to an increase in the competiveness of the export industry in world markets. It therefore aims for Thailand's economic system to become more internationalized and implements liberalization policies, while maintaining economic stability. The overall industrial development goal in the next decade is for Thailand to become an export oriented industrial nation as well as the trade and financial center of the region.

2. The Investment Promotion Situation, Institutions and Incentives

Promulgation of the 1954 Industrial Promotion Act marked acceptance of the idea that the private sector should be the key mechanism in the country's industrial development. Some important investment promotion measures in this Act were:

- Tax privileges and rights. Exemption from or reduction of import duty on machinery.
- Protection measures. Measures to prevent competition from both domestic and foreign producers.
- Export promotion. Exemption from or reduction of export duties.

In practice, this failed in part. Few industries were promoted and the country's industrial base remained small in both size and variety.

Investment promotion in the industrial sector began with the government's promulgation of the 1960 Investment Promotion Act, introducing measures to exempt income tax on profits and offering guarantees to investors.

3. The Investment Promotion Zone

Target Activities

Exemption for 4 years, extendable yearly up to a maximum of 8 years, for projects which satisfy one or more of the following criteria:

1. Save or earn net foreign exchange of at least US$ 1 million a year,
2. Are agro-based activities, or encourage the use of domestic agricultural products, or use of domestic supplies for at least 50% of the total value of raw material usage,
3. Employ at least 200 persons full-time,

4. Are considered by the Board to have special importance,

5. Locate their factories in industrial estates.

Under Section 35 of the Investment Promotion Act B.E.2520, the following special privileges concerning corporate income tax are provided:

1. Reduction of corporate income tax by 50% for 5 years after the exemption period,

2. The following, to be granted on a case by case basis:

a.) double deduction from taxable income of water, electricity and transport costs for 10 years from the date of first earning income,

b.) deduction from net profits of 25% of the cost of installation or construction of the project's infrastructure facilities.

Promotion in the investment promotion zone

- Reduction of commercial tax on sales of goods produced, to not more than 90%, for a period of not more than five years.

- Possible entitlement to 50% reduction of juristic person income tax for a period of five years from the last day of the tax exemption period from the date income began to be earned.

- In calculation of juristic person income tax, permission to deduct transportation fees and water costs at twice the amount spent in operation of the business.

- Permission to deduct up to 25% of cost of constructing or installing conveniences from net profits of any year or years within a period of 10 years from date income began to be earned.

4. Foreign Direct Investment in Thailand

4.1 Investment Climate

During 1987-1988, neighboring countries could not understand why industrial countries such as Japan and Taiwan were investing in Thailand in such large measure. Some neighbors, believing their basic investment strategies, infrastructures, utilities and promotional privileges to be better than those offered by Thailand, puzzled over the lack of interest shown in their countries by these same investors.

Among the factors that brought foreign investors to Thailand, rather than to other ASEAN countries, were:

1. The stability of the Thai economy when compared to that of others in the group. Confidence in Thailand was justified by the fact that during the economic recession

following the second oil crisis in the early 1980s, Thailand's economic expansion rate, while tending to decline, was nonetheless higher than others, This may be ascribed to the fact that Thailand's economic structure is balanced and distributed among three important sectors: agriculture, industry and services. A setback in one sector was likely to be countered by the performance of others not similarly affected. The economies of the neighboring countries of Malaysia, Indonesia and Singapore depended mainly on oil trading, so that when the price of oil went down, so did their economic performance. Conversely when oil prices increased, their economies reacted accordingly. Although its dependence on imported oil was to Thailand's disadvantage, the flexibility of its economy helped maintain its economic growth at a level not much lower than those of its neighbors. As has been said, the country's economy has three strong sectoral bases, agriculture, industry and services, which have helped see Thailand through many difficulties.

2. Thailand is large, with a population of over 50 million, second only to Indonesia and the Philippines in this region. This large population at least ensures the existence of a large domestic market. Moreover, the size of the population means that Thailand does not lack labor, as do smaller countries such as Singapore, Malaysia and Brunei. Skilled and unskilled wage rates are also lower. For these reasons, a large number of labor-intensive industries have moved to Thailand.

3. Thailand's domestic and foreign policies have remained stable. Although governments have changed quite often in the past, since Gen. Prem Tinsulanonda took over as Prime Minister political stability has increased. Attempts at coups d'etat have failed, and although the most recent one was successful, the coup leaders established an interim Cabinet to ensure a new constitution and a rapid return to democracy.

Most important, however, is that despite frequent changes in government, policy remains the same, especially in the promotion of private investment and the government's support of the private sector. It has been said that Thailand's important development mechanism is in no small measure the strength of its bureaucracy and the existence within the system of many technocrats. The bureaucracy has helped push forward the continuation of projects, despite government changes.

Another important factor is the reduction in the level of border conflicts with the neighboring countries of Laos and Cambodia. After North Vietnam took over the South and invaded Cambodia, many western countries believed that Thailand would be the next country to fall victim to Communism. The domino theory has not proved always true. Thailand remains free and the fear of foreign invaders has dissipated.

4. Next is the decline in Communism worldwide, and the effect of that decline on Indochina. Thailand was able to solve its problem of Communist insurgency many years ago, long before the global decline.

Economic problems were the main reason behind this change. Communist countries began to realize that to apply socialist theory rendered countries poor and their production methods obsolete and inefficient. Even the leader of the Communist world, the Soviet Union, failed to overcome this problem and could no longer help the smaller Communist countries of Indochina. Two significant changes have resulted. These countries have had to change their economic structures by supporting private sector involvement in the production process. In addition, they have also now tried to attract foreign private investment.

The change in Indochina has affected Thailand. Geographically, Thailand borders both Laos and Cambodia and has had a long historical relationship with them. Three decades of continuing development have made Thailand more advanced and more economically progressive than its Indochinese neighbors. When these countries finally open their doors, it will be a good opportunity for Thailand to become the economic center of the region. Other countries wanting to do business with Indochina can use Thailand as a base. Thailand is fully prepared, ready and waiting for this opportunity.

5. Thailand is a flexible country, both in its economy and social culture. Thais are not normally violent and prefer to avoid conflict, such as that which has occured in Malaysia between Malays and Chinese or in the Philippines between Muslims and Christians, and where coups have been staged quite often. The peaceful nature of the Thai society is perhaps due to the fact that it is of a Buddhist nature, which prefers compromise to violence.

Being a Buddhist country may be one factor which has drawn Japanese and Taiwanese. At least there is a common religious base. Another issue which at one time worried foreign investors was labor unrest. Fortunately, this has not been a problem in Thailand for quite some time.

6. A decision by foreign investors to invest in a given industry will depend to some extent on the level of industrial development in the country under consideration and thus on the level of support they can expect from complementary local industries. An example in Thailand is the automotive industry which is long established and which is supported by a wealth of firms making parts and accessories. This has caused Japanese investors to choose Thailand as a foreign production base where automobiles and motor cycles are produced for export to other countries.

4.2 FDI by Country

Japan, The United States, the EEC and Asian NIEs are the major sources of FDI funds to Thailand. The Japanese share of the total increased during the 1980s and since has clearly become the largest source, overtaking the United States in 1986. The Japanese share remained high, at over 50%, in 1988 and 1989. The relative role of the US's direct investment has been declining since 1985, to a mere 11% share in 1988.

The EEC and Asian NIEs were unstable sources in terms of net FDI inflows, with an average of 9% and 24% shares, respectively, during 1986-1988. Among Asian NIEs, Taiwan and South Korea have played an increasing role since 1986.

Similar trends were also seen among promotion FDI, of which the Japanese share was about half in terms of registered capital and about one-third in terms of number of projects during 1987 and 1988. Other important sources were Taiwan, the United States, Hong Kong, the United Kingdom, South Korea, and Singapore.

This pattern is not surprising, since Japan has become the world's largest direct investor over the past few years, although most of the Japanese FDI was made in North America and Europe during the period 1985-88, with only 10-15% in Asia. The whole of ASEAN's share steadily declined throughout the 1980s. Thailand's share of Japanese FDI amounted to less than 1%, but it has been increasing since 1985 to become over 1% in 1988.

4.3 FDI by Sector

FDI in Thailand has been diversified. The manufacturing sector's share was just less than one third of total net direct investment inflows during 1980-86. This sector increased significantly in 1987 and 1988 and amounted to 52.5% and 57.9%, respectively. Construction, trade and services also attracted sizable FDI during the 1980s, and financial institutions have received more attention recently. The trade sector's share of FDI appeared to increase steadily during 1980-86, but declined in 1987 and started climbing again. FDI in agriculture and services was fluctuating during 1980-88, and the share of mining and construction has been declining.

Within the manufacturing sector, electrical appliances, chemicals, and food were the leading industries, accounting for a large share of FDI. In 1987 and 1988, there was a noticeable rise in the share of the so-called engineering/machinery industries, especially electrical/electronic products, metal and non-metallic products, and machinery and transport equipment. This is different from earlier FDI to Thailand, when the predominance of light consumer goods industries is observed.

Recent changes in the structure of FDI and a rising share in the manufacturing sector in 1987 and 1988 were mainly due to FDI from Japan and the Asian NIEs. Japanese FDI, which had swung from one major sector to another during 1980-86, became concentrated on the manufacturing sector in 1987 and 1988. The FDI structure of Asian NIEs also shifted more towards manufacturing, but the funds were taken mainly from the financial sector which was predominant during 1980-86. In 1987 and 1988, particular industries which attracted a substantial amount of FDI from Japan were electrical appliances, metal-based, non-metallic and chemical industries, while those obtaining a large proportion of FDI from the Asian NIEs were chemicals, electrical appliances, textiles, and food.

As far as American FDI is concerned, the sectors gaining the largest share during the 1980s were manufacturing, services and trade. Manufacturing's share fluctuated by around 30-40% during the 1980s, while the share of trade increased and that of services declined. Within manufacturing, American FDI concentrated on processed food, electrical appliances, and chemicals. However, the share of chemicals declined after 1985 to a mere 1% in 1988.

The FDI share of the US in mining and quarrying, which dominated the early 1980s, has also declined in recent years.

As for European FDI, the sectors attracting the largest share during the 1980s, particularly in the last few years (1986-1988), were manufacturing, financial institutions and trade. Manufacturing's share increased from less than 20% in the early 1980s, to an average of over 50% during 1986-1988, while the shares of financial institutions and trade were about 24% and 18%, respectively, in 1988. Within manufacturing, industries which consistently attracted a significant amount of FDI during the 1980s were processed food and chemicals, textiles in 1987 amd 1988, and metal based and non-metallic products in 1986 and 1987. The share of European FDI in construction, and mining and quarrying, declined over the 1980s, while the share in services fluctuated around 12-22%, and agriculture never topped 2%.

5. Trade Policy Procedure, and Regulation of Exports and Imports in Thailand (Documents, Problems, Bonded Warehouse Systems)

According to international trade agreements and regulations, investment promotion measures which offer tax benefits to manufacturers can be regarded as support given to industry. Thailand's important trade partners have persistently cited this to justify the enforcement of tax countermeasures against Thai products. Protectionist measures of this sort have been enforced by the US against certain goods from Thailand.

It is expected that the next decade will see an international trade war. Enforcement of protectionism, citing support for the export of industrial goods, will be more severe. It will be necessary for the government to resort to a policy of across-the-board duties and taxes, instead of offering privileges to specific manufacturers or industrial sectors. The benefits of this policy will thus extend to all manufacturers in general, including those who do not receive privileges. It is also believed that the implementation of a liberal trade policy will help increase efficiency and provide leeway from the effects of protectionism.

Thus, the role of BOI in the future will change. Tax privileges will be reduced, and only the exemption on juristic person income tax will remain as an incentive to attract foreign investors or for industry to move to provincial areas. BOI will instead focus on service, providing investment information, investment coordination and technical assistance.

BOI policy objectives in the next decade will be to promote:

- Industrial development in the provinces.
- Research and development in production.
- The subcontracting system.
- Set-up of regional offices of multinational companies.
- Maintenance of the natural environment.

Industrial development in the future will go along with technological development, with the aim of encouraging R&D, developing human resources and adopting foreign technology. Thai industrial development in the next decade as framed by the government will move Thailand towards the direction of a new, more broadly based industrial country. However, the success of industrial development will not solely depend on the targets and policies set by the government; but the strength of political, economic and social institutions will also be an important factor.

Trading Problems of Thailand

In order to sustain economic growth, Thailand will have to adhere to the export promotion regime. Under the EP regime, a proper exchange rate along with cost reduction procedures have been used to push Thai exports to a higher volume. In addition the marketing effort has to be mobilized to keep markets open to Thai goods. There are still many problems facing Thai exports and they must be resolved before the adverse effects maim the prospect.

In the following analysis, we shall adopt the sectoral approach to these problems. That is, agriculture, manufacture and service trade are disaggregated. This simplistic approach should elucidate the situation succinctly. In the agriculture trade, fundamental problems center around the global structure of agriculture production and trade. In their analysis, Anderson and Tyers (1987) found that subsidies have been given to farmers in the EC, the US and Japan. While the paper rightly stressed the EC role in shrinking export opportunities of developing countries, Thailand's trade in grain (i.e. rice) has suffered from the US Farm Act (1985) more than from the CAP itself. The terms of trade lost due to the US Farm Act are quite enormous and continue to raise some concern for US price fixing. Therefore Thailand believes that agricultural subsidy programmes by the industrialized countries should be rolled back and eventually eliminated. Thai sugar trade falls in the same situation, because of the CAP programme which encourages high cost production of beet sugar. The dismantling of subsidy on sugar can be a boon to other developing countries us well.

Thailand-EC trade has, over many years, contracted. The absolute volume of trade has grown in value terms but its percentage share in each side's trade has declined markedly. It is correct to state that intra-EC trade has grown, and indeed intra-EC trade is about 54% of all EC trade. Thailand-EC trade in agriculture involves one commodity, tapioca pellets.

Thai exports of manufactures to other markets (i.e. EC and Japan) do not perform better than exports to the US. In the EC markets, the FOB prices of Thai manufactures can compete with many other countries' exports. Yet a close look reveals that some African countries have an edge over Thai export prices when one calculates tariff. Lome Convention countries pay no import duty while many Thai exports face an over 24% tariff level. It is very difficult to expect Thai prices to be competitive in that situation.

In the Japanese market, Thai products, up to 1985, performed poorly. Since the revaluation of the yen, Thai products have found their way to Japan. But it is quite premature to presume that the Japanese market is receptive to Thai manufactures. Being a high per capita income society, the Japanese purchase high-end products and therefore Thai manufactures cannot compete with other countries' products. To worsen the matter, Japan is prone to resort to value quotas, which could check rapid export penetration by Thailand.

Apart from the trade in goods, it is correct to state here that Thailand has not paid much attention to the services account. From the point of view of services balance (expressed in balance of payments) Thailand has deficits in several classifications. These include shipping, insurance and income from investments. Surplus has been noted in tourism and worker's remittances.

Among all categories which have been mentioned, it is difficult to expect shipping, insurance and finance to improve on their performance in the near future. The state of these industries is quite apparent. The sharp decline of crude oil prices in the OPEC countries has curtailed many construction projects in the Middle Eastern countries. The scope of increasing remittance from migrant workers appears to be limited. That leaves Thailand with income from tourism, which in certain years is ranked very high among exchange earners.

In the event of liberalizing trade in services, it would be difficult for Thailand to exchange on a quid pro quo basis with other GATT nations. Primarily, the trade in services in Thailand concentrates on factor services, while the trade in services by other industrial countries tends to concentrate on non-factor services. There is also a perception among government officials that trade in services cannot be liberalized due to legal and security issues. Particularly telecommunications and financial services are thought to be related to legal issues in Thailand. Officials are prepared to discuss services which are not bound by any legislation. Without the benefit of foresight, it is likely that trade in services for Thailand will continue to show deficits unless industries can invest in service exports rapidly.

It is appropriate also to view the present preferential treatment (i.e. GSP)for Thailand. Trade conducted under S&D conditions has grown steadily over the years. However, trade through GSP for Thailand remains small compared to various other countries in ASEAN. Some 67% of Singapore trade was under GSP, while trade under GSP for Thailand is in the 20% range. There are over 2,000 GSP catagories which Thai exporters can fill, but some 400 items of the GSP have been exported by Thailand. This indicates that there are many alternatives available to Thai exporters. Trade through GSP at present cannot help Thai export earnings.

6. Export Promotion Policies and Institutions

Investment Promotion Act: Export Promotion

- Exemption from import duty and commercial tax on raw materials and necessary supplies.
- Similar exemption on goods imported for export purposes.
- Exemption from export duty and commercial tax.
- Permission to deduct from assessed income 5% of annual increased income arising from exports, excluding insurance and freight.

As investment in export production in this period has expanded rapidly, the inadequacy of the Thai infrastructure and basic utilities has been felt. The government, unable to provide for all of these needs, now encourages private investment in some projects, including a utility service center for the petrochemical industry, containerized packing and testing for export, mass transit systems for Bangkok, satellite communications services and other services.

The transfer of technology to Thailand has been slow, and industrial expansion during the current plan has had to rely on foreign technology. To overcome this, the government announced, in March 1989, promotion privileges for R&D, including for instance exemption on import duty and juristic person income tax. Thailand's industrial promotion measures have been instrumental to development in a proper direction.

The export promotion measures implemented by the government during this period have been:

- Tax privileges for exporters, available through BOI, as referred to earlier under Investment Promotion.

- Refund of customs duty in accordance with Article 19 of the Customs Department regulations. This measure enables the Customs Department to refund to exporters duty and tax paid on imported raw materials used in production for export purposes, refundable when the goods are exported.

- Duty and tax compensation for export goods to help exporters reduce their liability on imported raw material.

- Packing credit by which the Bank of Thailand can help to finance exports. Loan guarantees and export insurance are available to protect exporters.

- The Export Service Center has been set up by the Ministry of Commerce to assist the private sector by providing information on goods and performs a public relations function to encourage foreign investors to invest in Thailand.

- Establishment of an industrial estate to support export by offering privileges and providing facilities for export producers.

The government export promotion measures have resulted in a major expansion of Thailand's exporting industry. At the same time, however, the expansion, helped by tax and other privileges available through BOI, has caused a distortion in the Thai industrial structure. The result is that few capital goods are available from Thai manufacturers and must still be imported. This will have an effect on the future direction of the country's industrial development.

REFERENCES

Dhira Phantumvanit, *Thailand Natural Resources Profile,* Bangkok: Sangdad Publications, 1993.

David Dapice, Frank Flatters, *Thailand: Prospects and Profile in the Global Economy,* Chonburi: Ambassador City Jomtien, 1994.

Juanjai Ajanant, Suthiphand Chirathivat, and Chalermpoj Iamkamala, *ASEAN Trade Policy Option for Thailand,* Bangkok: Industrial Management Co., Ltd., 1990.

Norbert Wagner, *European Investment in ASEAN,* Singapore: Kin Keong Printing Co. Pte., Ltd., 1989.

South East Asia Monitor, *Thailand 1992 Annual Report on Government Economy, Finance & Industry with Forecasts to 1993,* Bangkok: Business Monitor International Ltd., 1994.

The Industrial Finance Corporation of Thailand, *Industrial Development in Thailand,* Bangkok: The Industrial Finance Corporation of Thailand, 1993.

The Thailand Development Research Institute, *The Outlook for the Thai Economy,* Chonburi: Ambassador City Jomtien, 1994.

The Thailand Development Research Institute, *Thailand Economic Information,* Bangkok: The Thailand Development Research Institute, 1994.

Twatchai Yongkittikul, Paitoon Wiboonchutikula, *Thailand's Transformation into a Newly Industrialized Country,* Bangkok: The Thailand Development Research Institute, 1994.