A Study on the Foreign Direct Investment in Thailand

By

KUNSABFUENG Wanna

THESIS

Submitted to
School of Public Policy and Management, KDI
in partial fulfillment of the requirements
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MASTER OF PUBLIC POLICY

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ABSTRACT

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Foreign direct investment (FDI) is one of the driving forces binding countries into closer economic interdependence. FDI flows have grown rapidly in recent years associated with the deeper liberalization of national and international investment regimes.

Foreign direct investment—the acts of private businesses investing capital in a foreign country in order to produce goods or services—has contributed to a dense tissue of cross-country economic relations that, called “global economic interdependence”. Flows of foreign investment have increased dramatically in recent years. Between 1985 and 1997, they grew from around US$60 billion to US$400 billion, substantially faster than growth of international trade.

Chapter I is discussing about the theoretical background together with a “new” investment theory. Many different kinds of theoretical approaches which explain the foreign direct investment including MacDougall (1960), Ohlin (1967),

Nurkse (1972), Hymer's (1960), Cave (1971), Vernon's (1966) and Dunning's electric (1982). Dunning's electric (1982) could be regarded as the most comprehensive theory explaining FDI phenomenon.

Chapter II is explaining the enabling environment for increased foreign direct investment flows and trends in Thailand towards foreign direct investment. The facilitation of FDI flows is linked to two types of policy measures, those to be undertaken by source or home countries and those by host countries. There are three kinds of business organizations in Thailand: sole proprietorships, partnership, and limited companies. This chapter also mentioned about the Factory Act, the Patent Act, the Copyright Act and the Trademark Act.

Chapter III is explaining an overview of FDI in Thailand's development. Foreign direct investment has played a key role in the industrial transformation of the Thai economy. FDI inflows concentrated in industry in the 1980s and helped develop and diversify the industrial structure, including into textiles, automobiles and more recently electronics. Foreign firms played a major role in the export boom in electrical and chemical products and also, in textiles. The potential impact of MNE activities on the Thai balance of payments goes beyond their contribution to exports.

Chapter IV is concerning the government policies and tax incentives. The Board of Investment is the single most important body to foreign investors of Thailand. It has its origins in the Board of Investment for Industry, which was established in 1960 under the Investment Promotion for Industry law with the objective of stimulating industrial investment, both domestic and foreign, and encouraging industrial expansion in Thailand. There are few restrictions placed on foreign companies. The more significant ones are that a foreign-owned firm generally cannot own land unless it has received promoted status from the BOI, and that certain occupations and activities are set out in the Alien Business Law are prohibited to foreigners and foreign firms.

Chapter V is explaining Thailand investment promotional zones and the criteria for granting tax and duty privileges. There are three investment Zones: Zone 1, Zone 2 and Zone 3, based on economic factors depending on the level of income and the availability of infrastructure in each province.

Chapter VI is regarding the policies towards foreign investments in special sectors.

Thailand has recently embarked on a tariff reduction program in compliance with its commitment under AFTA. AFTA is another example of the government's liberalization policy. Thailand is taking part in three schemes: Brand-to-Brand Complementation (BBC), the ASEAN Industrial Joint Venture Program (AIJVs), and the Common Effective Preferential Tariff (CEPT) scheme.

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INTRODUCTION

Until the summer 1997, Thailand was one of the world's fastest growing economies and, since the 1960s; it has been one of the most successful developing countries. Impressively high real growth rates of 8-9 percent were maintained for almost 30 years. Before the crisis, the economy had reached a size almost four times as large as in 1970. In spite of occasionally high world interest rates, oil shocks, cyclical declines in demand for Thai exports and terms of trade shocks, Thailand had not, until 1997, experienced a single year of negative growth in the past three decades.

Exports have been the main engine of economic growth, particularly since the mid-1980s. Historically one of the world's leading rice exports, Thailand has become a major exporter of manufactured goods, rising from only one third of total exports in 1980 to over 80 percent by 1997. This shift in exports is mirrored in the structural transformation of the Thai economy, away from agriculture and into industry. While agriculture's contribution to GDP was three times that of manufacturing in 1960, by the early 1990s it was less than half as important as manufacturing.

Foreign direct investment (FDI) has played a key role in this process. Electronic Products, particularly computer parts and integrated circuits, make up almost one third of the country's total exports. These sectors are dominated by foreign multinational enterprise

(MNEs). Through inward investment, Thailand has become the ninth largest exporter of computers during the 1990s, with computer exports growing fourfold in the past five years. Thailand is also a major producer of automobiles, mostly by Japanese companies. As a result of extensive foreign investment in these sectors, Thailand is now a major destination for FDI inflows in the developing world, ranking eighth in terms of inflows in the 1990s, or twenty-second worldwide.

Much of this investment has come since the mid-1980s. Until then, Thailand received far less FDI than its smaller neighbor, Malaysia. Although the Government generally welcomed foreign investors interested in Greenfield sites, attracting FDI was not a priority, and in the early stages of its development the Thai economy was dominated by local capital. Foreign investors tended to focus on those sectors where the Government promoted import substitution and, as a result, much of this production was intended for the local market.

The situation changed in the second half of the 1980s. As with Malaysia, Thailand benefited from a massive relocation of production away from Japan, Chinese Taipei and other economies in the region as a result of currency appreciation in these economies at the time, as well as the loss of preferential access to major export markets and rising costs of production at home. Although Thailand was clearly in the right place at the right time, it also had in place the right policy environment to encourage and to accommodate these massive inflows. This environment included sound macroeconomic stabilization policies and a growing emphasis on outward looking policies.

Recent trends since the crisis indicate a continued strong interest on the part of foreign investors in the Thai economy. Information from the Bank of Thailand, based on actual FDI inflows across all sectors, shows that inflows doubled in bath terms in 1997 and grew by another 64 percent in 1998. Growth rates in dollar terms are more modest because of the sharp depreciation of the bath, FDI inflows in 1998 of around $4.7 billion exceeded inflows in 1997 by almost $1 billion. Inflows declined in the second half of the year.

Furthermore, direct investment has held up in the face of a sharp decline in domestic investment and net outflows of other forms of international capital. In 1997, for example, international bank lending to Thailand represented a capital outflow of $22 billion, compared with FDI in Thailand of $3.8 billion. Similarly, while applications to the Board of Investment (BOI) for investment projects were evenly divided between foreign and domestic investors in 1996, in the first seven months of 1998, applications by foreign investors were 162, compared with only 15 for domestic investors. These trends indicate the resiliency of FDI for both balance of payments financing and investment in the local economy.

Some large, capital-intensive projects have been postponed and foreign investors Oriented towards the domestic market are suffering from the sharp drop in demand, but new opportunities for investment have opened up elsewhere in the economy. Some foreign investors have raised their stakes in their affiliates, while others have taken advantage of liberalization in sectors such as banking.

CHAPTER I

OUTWARD FDI: A THEORETICAL REVIEW

FDI: THEORECTICAL BACKGROUND

Foreign direct investment is regarded as one of the most important factors for the development process of developing countries. Initially, it is regarded important in providing additional capital to these countries where capital resources are scare and labor plentiful. Such in inflow of foreign capital brings about an increase in labor productivity and helps increase real wages. The theoretical approach explaining MacDougall (1960) suggested this kind of phenomenon. The basic idea of this theory is similar to a few other economists who try to explain why foreign direct investment is taking place, using the theory of capital movement, resulting from the difference in inter-country interest rates. Among those pioneer economists are, for example, Ohlin (1967) and Nurkse (1972). These theories are based on competitive market assumptions. On the other hand, new theories of international investment try of explain the phenomenon in the context of the theory of the firm, mostly in terms of oligopolistic advantage of overseas investors or firms from investing countries. Hymer's (1960) "specific advantage hypothesis" can be regarded as a starting point. In this theory, Hymer believes that the primary objective for firms to have overseas investment is to control foreign operations due to imperfect market power in the home market. This imperfect market power arises because of the firm's ownership-specific advantages such as better of superior technology, better enterpreneurship, etc.

Caves (1971) also explain FDI in a similar way. Using his industrial economics approach, he argues that FDI occurs mainly in industries characterized by certain market structures in both home and host countries. He divides FDI into horizontal and vertical. Horizontal FDI usually occurs in industries where product differentiation and oligopolistic power exist while vertical FDI occurs mainly because the firm wants to secure its raw materials or intermediate products for its own operation in the home market.

Vernon's (1966) product life cycle is also popularly used to explain such phenomenon. Vernon's theory is basically a technology oriented, and a dynamic model of FDI. Vernon believes that technological development usually starts in developed countries where there are large domestic markets and high-income elasticity. When a firm or a country starts developing its own technology, it will use such technology in the production process and later export the products to other countries. As the technology becomes standardized, the originator of technology will become less and less profitable. Thus, it forces the country that develops the technology to shift its resources into the development of new technologies.

In his work, Vernon explains that every product has its lifetime. In the initial phase, products are innovated in advanced or developed countries where innovating firms have possessed scientific and technical skills. The firm that introduces the product will have a comparative advantage over other firms because of its technology superiority. So the firm will start producing the product in its home market.

In the second phase, there is a rapid growth of the output. This is called a “growth” period. In this phase there is a certain degree of product differentiation. This means that many other firms can copy and produce the same kind of product but with some degree of differentiation. As competition increases, the rate of profits of the originator declines. At this stage, the firm that introduces this product would begin to shift its production to some other countries in order to avoid competition. Thus, it motivates the firm to go internationally. Also at the same time firms in other countries would have accessed to this production technique and begin to produce the same product. Thus, in this stage, there will be an internationalization of the product.

Finally, the production technology becomes mature and fully standardized. This is called the “standardization” phase. This is a time when any firm can produce the product. The technology becomes so well known that the economic rent or the quasi-monopoly power of the innovator is completely eroded. At this phase, scientific and technical problems as well as management problems have been solved. Now the developing countries have a comparative advantage, since only a routine line of management is required, and production can be based on their low wage, unskilled and semi-skilled workers. Consequently, the product will be exported back to the developed countries or the countries that first produced the product, hence enforcing the originator to develop newer technologies.

Dunning's electric (1982) could be regarded as the most comprehensive theory explaining FDI phenomenon. The theory explained that a firm would engage in FDI if three conditions, namely, the ownership-specific advantage, the internationalization-incentive advantage, and the location-specific advantage were simultaneously satisfied.

In the first place the firms must possess net ownership-specific advantages over other firms in the particular markets. These ownership-specific advantages can take several forms, mostly of intangible assets e.g. size and established position, proprietary technology, product or process diversification, monopoly power, better resources capacity and usage, and also ability to take advantage of division of labor and specialization, etc. Second is that the firm must use these ownership specific advantages itself rather than to sell or lease them to some other firms. In other words, the firm must use them internally through an extension of its own activities rather than externalize them through licensing and similar contracts with other firms. Finally, having got the above two advantages, the firm will find itself more profitable to utilize these advantages in conjunction with at least some resources in other countries outside its home country otherwise foreign involvement would be replaced either by exports or licensing.

Although Dunning's eclectic theory is criticized as not really a theory of FDI, since it is derived mostly from all other theories of FDI. It still has a strong explanatory power over other theories and hence remains a popular approach in explaining the features of FDI.

A "NEW" INVESTMENT THEORY

The nature of direct investment implies that firms engaging in it will typically earn what might be considered supernormal profits. As the "new" trade theory dealing with imperfect competition has suggested, the existence of such rents creates an additional class of arguments for intervention. The basic theme is that a nation can use trade policy to garner a large share of the industry's worldwide rents. However, this new class of arguments has met with a cool reception. The theoretical case for any particular policy prescription is highly sensitive to modeling assumptions. Those with practical bent note that conditions in few, if any, real-world industries remotely resemble those required to make the case for national-welfare-enhancing policies along these lines; moreover, the policy process is unlikely to be endowed with the pinpoint accuracy required to ensure national welfare gains rather than losses. Most believe that this new literature, like the older one based on infant industries and other market distortions, yields little guidance for policymaking; adherence to free trade is still seen as the best practical advice.

As with policies toward trade, national policies aimed at investment tend in practice to reduce global efficiency via sub optimal allocation of resources in production and via associated rent-seeking activities. The investment policies are less likely to reduce the country's own aggregate welfare than are those aimed directly at trade flows. International cooperation to avoid a "prisoner's dilemma" situation may therefore be more important than in the case of trade.

For a country small enough to have no appreciable effect on world prices, the cost of tariff protection is borne almost entirely by the country itself. Even for large countries, the net effect of protection on national welfare is typically negative. But when a tariff creates an incentive for import-substituting direct investment and investment policies are then used to extract some part of the rents generated by foreign-controlled production for the local market, the country may in fact gain. However, the foreign investor will also gain at least relative to the situation of protection but no investment.

Corresponding losses, although potentially larger in the aggregate, will be spread among other nations but may be small for any one of them. An important implication is that the "problem" of investment policies is at least in part of problem of incomplete liberalization of trade that creates a location advantage. Without tariffs, quotas, and other important barriers, there would be less rent to extract and thus less scope for performance requirements.

CHAPTER II

THE ENABLING ENVIRONMENT FOR INCREASED FOREIGN DIRECT INVESTMENT FLOWS AND TRENDS IN THAILAND TOWARDS FOREIGN DIRECT INVESTMENT

ELEMENTS OF A FAVORABLE INVESTMENT CLIMATE

The facilitation of FDI flows is linked to two types of policy measures, those to be undertaken by source or home countries and those by host countries. International financial institutions increasingly are playing a catalytic role in influencing such policies with varying degrees of success. Source country policies and institutions affecting FDI can be divided into three areas. The first area is the domestic policy framework, which includes foreign exchange controls, fiscal and monetary policies, the trade regime and the regulatory framework. The second area relates to the official instruments and programs adopted for, and the institutions in charge of promoting and regulating FDI in developing countries. These include investment treaties, promotion services, investment guarantees and financial support services. The third area consists of the regulations regarding the conduct of the source country multinationals in developing countries.

POLICY FRAMEWORK IN THE SOURCE COUNTRY

Global savings are a prerequisite to international capital flows. By maintaining sound macroeconomic policies, which promote savings and investment and contain inflationary pressures, capital exporting countries create conditions conducive to the increase of investment outside their respective territories, including investment in developing countries. In addition, sound fiscal and monetary policies prevent real interest rates from becoming so high as to divert investment flows away from FDI into higher interest bearing debt instruments.

The more specific policies that could be undertaken by source countries to encourage investment flows include the maintenance of open trade and payment systems, particularly the removal of barriers to the import of products from developing countries. Export oriented industries are becoming more attractive to both investors and host countries. But the corollary to export-oriented FDI is the existence of open trade arrangements with developed countries, which provide the markets for these goods. Hence the importance of the GATT as a mechanism for ensuring the reduction of tariff and non-tariff barriers to imports from developing countries. The successful conclusion of the Uruguay Round trade negotiations is a critically important objective in this respect.

Another important area where source countries can encourage FDI is in their taxation systems. Tax policy affects FDI flows through a number of channels. First, the tax treatment of income generated abroad has a direct effect on the net return on FDI. Second, the tax treatment of income generated at home affects the net profitability of domestic investment compared to the net profitability of foreign investment. In addition, the relative net cost of external funds for a transnational corporation operating in different countries may also be affected by tax policies.

Thailand is in the third wave of Asian countries after Japan and the “four tigers” to embark on rapid and widespread industrialization. Once known as the Kingdom of Siam, Thailand is the only country in the Southeast Asian region never to have been colonized by the West, rooted in Buddhist heritage and a democratic system within a constitutional monarchy, the country has enjoyed a relatively stable political and social climate compared to other countries at a similar stage of economic development. The country’s relatively large population, rapid economic growth, and position next to the emerging economies of Indochina, combine to make it highly attractive as both a market and a location for production and distribution. Thailand has had one of the fastest growth rates of the Asian tigers.

Thailand’s economic development policies have been relatively conservative with an emphasis on a competitive free-market philosophy. The industrialization process was largely characterized by an import substitution policy in the 1960s, an export promotion policy in the 1970s, a foreign direct investment promotion policy in the 1980s, and a trade liberalization policy in the 1990s. Various Thai governments to influence the pace of industrialization have most frequently used differential tariff rates on imports. Other measures include import quotas, credit assistance for exports and imports, local content requirements, and tax rebates for export goods production.

Thailand 's economic policy formulation has been guided by a series of five-year National Economic and Social Development Plans, first implemented in 1961. The goal of the Seventh Plan (1992-1996) was for the country to achieve improvements in economic liberalization, investment in basic and social infrastructure, industrial development at the provincial level, and in environmental protection and energy conservation programs.

The Thai economy has experienced exceptional rates of GDP annual growth in recent decades with growth peaking at over 10% from 1988-1990. Since 1991, the average annual rate of GDP growth has been about 8%. Before the financial crisis of 1997, the International Monetary Fund (IMF) predicted that the economy would continue to grow with an average annual rate of 7.6% from 1995-2002, making Thailand the eighth fastest-growing economy in the world. Thailand's National Economic and Social Development Board (NESDB) has projected that by the year 2000, the GDP will be U.S.$289 billion, making Thailand the largest economy in Southeast Asia. In July 1997, Thailand's economic prospects were thrown into doubt by the sudden collapse of its currency. The Thai bath plunged by about 20% in just a few days, forcing the government to drop its fixed rate for a floating one, but still retaining exchange controls. This crisis was precipitated by a large deficit in the balance-of-payments and by the recognition that many Thai banks held debts of questionable quality. In response, the

International Monetary Fund put together a support package with strict terms. By November 1997, the Thai bath was down 33% in value relative to the U.S. dollar from a year previously, and stock market values were down by nearly 50%.

Thailand has successfully attracted significant foreign direct investment (FDI) to build plants wherein consumer electronics and other labor-intensive goods are assembled for export to developed economies. Besides so long as the bath was pegged to the $US, Thailand was viewed as even more attractive for FDI and foreign portfolio investment in its securities market. Until recently, Thailand ran a trade surplus as a sign of successful industrialization policies. But in recent years, even the trade surplus has evaporated; as stimulated domestic demand has been pulling in more merchandise imports than the country exports. This has rendered a current account deficit on Thailand's balance of payment 8.3% in 1995, 7.9% last year and estimated at 7.5% this year even before the devaluation.

As in most countries, there are three kinds of business organizations in Thailand: sole proprietorships, partnership, and limited companies. The most popular form of business organization among foreign investors is the private limited company. Private limited companies require a minimum of seven promoters and must file a memorandum of association, convene a statutory meeting, register the company, and obtain a company income tax identity card. They must also follow accounting procedures specified in the Civil and Commercial Code, the

Revenue Code and the Accounts Act. A balance sheet must be prepared once a year and filed with the Department of Revenue and Commercial Registration. In addition, companies are required to withhold income tax from the salary of all regular employees.

The Ministry of Industry administers The Factory Act, which governs factory construction and operation, as well as safety and pollution-control requirements. In some cases, factories do not require licenses, in other instances the requirement is simply to notify officials in advance of start-up, and in some cases licenses are required prior to commencing operations. Licenses are valid for five years, and are renewable. Thailand recognizes three kinds of intellectual property rights: patents, trademarks, and copyrights. The Patent Act protects both inventions and product designs and pharmaceuticals. The Copyright Act protects literary, artistic works, and performance rights, by making it unlawful to reproduce or publish such works without the owner's permission. The Trademark Act governs registration of trademarks.

Accompanying the economic growth has been a structural shift from agriculture to manufacturing. Textile products, computers and components, and electrical appliances have been the three leading manufacturing exports. Export of integrated circuits is becoming increasingly important.

In 1994, Thailand's exports totaled over U.S.$40 billion. Thailand's major trading partners are industrialized countries, including the United States, Japan, and Germany. However, Thailand increasingly takes part in interregional trade, largely through Singapore and Hong Kong, with total direct investment from Asian NICs recently outweighing that of Japan. Leading imported products are machinery (nonelectric and electric), other consumer goods and chemicals.

MNCs, such as Shell, British-American Tobacco, Singer, and Unilever, were present in Thailand even before World War II. A significant increase in foreign investment in the country began in 1957 with the industrialization of the country during the Field Marshall Sarit Thanarat regime. In order to promote and render assistance to private investors, the government established the Board of Investment (BOI) in 1958. It also formed the National Economic and Social Development Board to regularly produce five-year development plans to guide investment.

Because of the country's import substitution policy during the 1960s and 1970s, direct foreign investment concentrated on production for the protected domestic market. A shift in government emphasis from import substitution toward an export orientation and changes in the BOI's promotional criteria in 1983, to complement the new government policy, has led to a higher inflow of export-oriented foreign investment. The surge of investment can also be attributable to the Plaza Accord Agreement in 1985, which resulted in a favorable realignment of exchange rates for Thailand. Between 1980 and 1988, direct foreign investment more than tripled.

The net inflows of foreign direct investment in Thailand at the end of 1996 were 57,472 million baht. Since 1996, the inflows have shifted more to the production of labor-intensive products for export to Northeast Asia, the United States, and Europe. Leading sectors of foreign investment, in terms of value, have occurred in industries such as food**,** textiles, metals, electrical appliances, and construction. In Thailand, FDI is moving away from low-value-added textiles and food production to concentrate in manufacturing areas like electrical appliances, machinery and electronics. In the case of Thailand, most of the consumer electronics production is exported. An increased share of FDI also went to a car production, of which the largest share is directed to booming domestic markets in Southeast Asia, which are expected to grow by 11 percent yearly.

Manufacturing represents the largest sector for inward investment in Thailand but less than all other sectors taken together. Over one quarter of manufacturing investment is in the electrical equipment sector. Outside of manufacturing, foreign firms have invested most in distribution and trade in order to tap into the growing discretionary spending of Thai consumers. Direct investment in the property sector, particularly hotels, has always been volatile, rising tenfold and then falling back by an equal amount in the past five years. At its peak in 1995, investment in the property sector represented 42 percent of total inflows, partly reflecting the construction boom at the time. Volatility of FDI in petroleum products results partly from the lumpiness of such investments.

The electronics industry has the highest FDI penetration ratio, with foreign investments constituting about 95 percent of total investment. Foreign investors are also particularly active in the automotive and metalworking industries where they account for roughly 80 percent of total BOI-promoted projects. In agri-industries, in contrast, wholly Thai-owned projects are on a par with foreign projects.

FDI Inflows into Thailand, 1980-98 (million baht: percent)

	1996	1997	1998	**1980-98**	
Industry	17,942	58,337	81,034	**324,935**	**42.95%**
Food, beverages, tobacco	1,143	6,971	2,775	**23,329**	**3.10%**
Textiles, leather, clothing	1,247	1,493	3,944	**16,451**	**2.20%**
Metal and non metallic products	2,851	6,610	12,801	**41,003**	**5.40%**
Electrical equipment	6,095	18,446	9,884	**90,902**	**12.00%**
Machinery and transport equipment	2,749	12,873	26,428	**55,976**	**7.40%**
Chemicals	4,631	6,054	8,342	**44,537**	**5.90%**
Petroleum products, coal	-6,332	452	12,737	**10,442**	**1.40%**
Construction materials	88	-395	-75	**1,139**	**0.20%**
Other manufacturing	5,470	5,833	4,208	**41,158**	**5.40%**
Financial institutions	1,823	3,725	26,586	**61,482**	**8.10%**
Trade	13,798	33,947	37,711	**158,534**	**20.90%**
Construction	1,782	5,786	6,466	**56,309**	**7.40%**
Mining, quarrying, petroleum	490	653	2,332	**25,001**	**3.30%**
Agriculture	51	37	19	**3,506**	**0.50%**
Real Estate	19,054	3,467	8,629	**87,843**	**11.60%**
Services and other	2,532	11,737	30,268	**72,272**	**9.50%**
Total	57,472	117,689	160,058	**756,895**	

Source:Bank of Thailand

The significant increases in inflows in 1997-98 were not confined to any specific sectors. The fastest growth in 1998 occurred in the financial sector, as the crisis created opportunities for foreign investors to acquire or increase their stakes in Thai financial companies. Growth has also been dramatic in the past two years in industry and distribution. Among the major sectors, only property investments recorded a significant decline, as the crisis hit property values. Among manufacturing sectors, metals, machinery and transport equipment have all increased significantly since 1997.

The private sector in Thailand possesses three distinct characteristics. First, it is dominated by a well-integrated local Chinese-Thai business, unusually free from ethnic and religious divisions. Second, the private sector plays a large and active role in policy making. Third, it has not been eclipsed by the recent surge of MNC foreign direct investment. To the contrary, Thai capital accounts for a significant share of assets in the key industrial sectors, for example, 45% in the automobile and textile industries.

Some Thai companies are aggressively expanding internationally. The first wave of Thai multinationals began in the agricultural sector. Today, Thai firms are doing everything from building dams and highways in Indochina to operating manufacturing plants in the United States.

Most of these top companies are very active in the international arena. For example, Charoen Pokphand Feedmill, the sixth largest public local company, is part of the C.P. Group conglomerate that is the largest foreign investor in China. This privately held concern typifies many Thai family-based concerns and conducts many different activities, including agribusiness, aquaculture, international trading, marketing and distribution, real estate and land development, petrochemicals, automotive and industrial products, telecommunications, and the production of petroleum. The ninth largest public company, Italian-Thai Development, a property concern, is investing $40 million in central Laos. The eighth largest public company, Saha-Union group, operates a modern textile plant in the United States. C.P. Group and Shinawatra were recently ranked in an Asia week survey as the first and eighth Asian companies with the greatest potential for growth.

Most of Thailand’s globalization drivers favor the participation of foreign MNCs. In addition, Thailand has become increasingly attractive as a gateway and hub for the emerging economies of the Indochina region.

Sources of FDI

Firms from the United States took an early lead in investing in Thailand, encouraged in part by the US-Thai Treaty of Amity of 1966, which accorded national treatment to US investors. Much of this investment involved fully foreign-owned affiliates in areas such as petroleum and chemicals. The US role in Thailand was gradually eclipsed by that of Japan, beginning slowly in the early 1970s and then decisively in the late 1980s. Early Japanese investments were designed either to avoid tariffs by establishing assembly operations, particularly for consumer goods, or as export platforms back to Japan and to third countries. Japanese investors were followed in the 1990s by firms from Singapore, Chinese Taipei and Hong Kong, China. The NIEs were by far the largest investors in Thailand between 1990 and 1996, though Japan has regained its position since 1997. Thailand has benefited from a diversification of sources of FDI over time, much as it has across sectors.

In terms of cumulative FDI inflows, Japanese and US firms account for almost one half of the total, with NIEs representing another 29 percent and the top five European investors only 12 percent. In 1998, Japanese and US firms maintained their shares of total inflows, while the cumulative stock of investments by Singapore firms grew by almost 40 percent, suggesting that firms from Singapore are capitalizing on their relatively stronger financial position during the crisis to expand within the region. One such purchase involved the acquisition of a Thai bank.

Japanese investments, mostly involving joint ventures, are concentrated in chemicals, electrical machinery and transport equipment. Japanese investors also dominate the automobile industry with about 90 percent of projects involving foreign equity, although US firms were beginning to make inroads in this sector before the crisis. Japanese firms also account for 65 percent of foreign investments in the electronic industry and 59 percent in the metal working industry. While in the past Japanese investors were mainly large multinationals, many new Japanese entrants are small and medium-sized firms supplying parts and components to large Japanese joint venture manufacturers already based in Thailand. Unlike in the 1960s and 1970s, when Japanese investment concentrated in assembly of consumer goods, newer Japanese investment has diversified into intermediate goods and export industries.

Investors from Hong Kong and Singapore tend to focus on non-industrial sectors, particularly finance. One French company is quite active in oil exploration. British firms invest primarily in chemical and petroleum products while French companies are active in the area of construction materials, such as cement and plaster, and services and utilities such as electricity. Direct investment from Chinese Taipei has been concentrated in manufacturing, notably electronic appliances, textiles and chemicals, followed by the trade and property sectors.

Share of FDI in Thailand by principal investors (period averages)

	70-79	80-84	85-89	90-96	97-98
Japan	30%	25%	42%	26%	34%
United States	35%	26%	23%	15%	19%
NIEs	5%	19%	19%	35%	27%
Other	29%	29%	16%	24%	20%

Source:Bank of Thailand

Cumulative FDI flows by country, 1980-98 (billion baht)

	1970-95	96	97	98	70-98	

Japan	131.3	13.3	44.1	61	249.6	30.90%
United States	70.3	10.9	23	34.3	138.5	17.10%
Hong Kong, China	68.5	5.4	15.7	17.8	107.4	13.30%
Singapore	36.5	7	8.3	26	77.7	9.60%
Chinese Taipei	27.2	3.5	6.1	4.4	41.2	5.10%
UK	15.7	1.4	3.7	7	27.9	3.40%
Netherlands	8.7	-1.0	4.4	12.7	24.8	3.10%
France	9.8	0.8	0	7.5	18	2.20%
Germany	8.4	1.1	2.1	3.2	14.9	1.80%
Switzerland	7.7	1.3	3.4	2.3	14.7	1.80%
Australia	4	0.9	3.8	1.9	10.5	1.30%
Korea	2.7	0.6	0.9	3.7	8	1.00%
Others	47.5	12.4	2.2	11.6	73.7	9.10%
Total	439.6	57.5	117.7	193.3	808.1	

Source:Bank of Thailand

Thailand is a global source for customers seeking cheap labor or material inputs. The country is rich in natural resources-tin, rubber, natural gas, tungsten, and timber being a few examples. The country is a major source for agricultural products.

Thailand also has an abundant supply of low-skilled labor with high participation rates in the work force-86% for males and 67% for females in 1995. At the same time, the country is the most developed in Southeast Asia, making for a relatively reliable work environment. In consequence, foreign companies use Thailand as a production base in labor-intensive and light industries such as textiles, consumer electronics, and auto parts to serve their region networks.

Thailand's comparative advantage of labor cost is slowly eroding. The threats have come from the opening of China and Vietnam's markets with their even cheaper labor sources. The Thai government is relatively stable and business friendly as newly industrializing countries go, although it does maintain careful watch on and regulates the activities of foreign MNCs in

Thailand. Most foreign MNCs consider the Thai economy to be highly attractive with its relatively peaceful political atmosphere and the highly liberal foreign trade and investment policies pursued by various governments. For example, in the insurance industry foreign companies are now allowed 25% ownership, with a target of 49% allowable by 2000, and foreign branch establishment by 2005. In banking and finance, the Thai government aims to compete directly with Singapore to become “The Asian financial center”. The government has initiated the country’s Financial Master Plan to ensure the stable progress of the capital and money markets. The Finance Ministry has adopted a scheme to increase the country’s savings, minimize exposure to currency fluctuations, and to undertake swaps to hedge against foreign-exchange loss. In addition, the Ministry has introduced electronic data interchange to speed up custom and exchange procedures.

To attract investment in the provincial areas and tighten control around Bangkok, the Board of Investment adjusted its criteria in 1993, offering greater incentives for businesses to relocate to underdeveloped rural provinces. Maximum foreign equity allowances in promoted projects stood at 49% in 1997 for primary production, mining and service sectors, and manufacturing due mainly for domestic distribution. Majority share holding is allowed in manufacturing projects whose production is at least 50% export. If 80% of the products are exported, 100% ownership is allowed. In newly privatized industries such as public utilities, environmental projects, and infrastructure, ownership is considered on a case-by-case basic by the ministry concerned. Thailand has been aggressive in pursuing economic cooperation with its neighbors. In the south, an economic triangle has been formed between northern Sumatra in Indonesia, the five southern provinces of Thailand, and the four northern states of Malaysia. In the north, the Indochina's Economic Quadrangle has been formed between Thailand, Laos, Myanmar, and the south Chinese province of Yunnan. Additional economic cooperation with Vietnam and Laos is under study. The success of this cooperation will certainly enhance regional investment, trade and tourism.

Thailand is a member of ASEAN, APEC, and the World Trade Organization. As part of the Asian Free Trade Association (AFTA) agreement, free movement of goods among ASEAN countries is promised by December 2008. Of the fifteen products that will undergo fast-track tariff rate harmonization, Thailand will implement the scheme for many additional products.

In technical areas, Thailand is slowly moving toward international standards. The country subscribes to ISO 9000, and has had the Thai Industrial Standards Institute manage compliance since 1991.

Largest Foreign Multinational Companies in Thailand

Rank	Company	Nationality	Industry	1995 Revenues
				U.S.$millions
1	Toyota Motor Thailand	Japan	automobile	1,372
2	Shell Company of Thailand	U.K.	oil	1,148
3	ESSO Standard	U.S.	oil	1,068
4	Tri Petch Isuzu	Japan	automobile	990
5	Seagate Technology (Thailand)	U.S.	computer	850
6	MMC Sittipol	Japan	automobile	840
7	Thai Honda Manufacturing	Japan	automobile	576
8	Siam Nissan Automobile	Japan	automobile	539
9	Caltex Oil (Thailand)	U.S.	oil	528
10	Honda Car Manufacturing	Japan	automobile	367
11	Thai-Hino Motor Sales	Japan	automobile	319
12	Lever Brothers (Thailand)	U.K.	consumer products	287
13	Thai Suzuki Motor	Japan	motorcycles	246
14	Fujitsu (Thailand)	Japan	computer	241
15	Siam National	Japan	consumer products	201
16	Mitsui & Co.(Thailand)	Japan	electronics	198
17	Minebea Electronics (Thailand)	Japan	electronics	196
18	Cal-Comp Electronics (Thailand)	Taiwan	computer peripherals	190
19	Volvo Thailand	Sweden	automobile	185
20	Singha Thailand	U.S.	appliances	176

Source:Financial Day 2000

Largest Companies Listed on the Bangkok Stock Exchange

Rank	Company	Main Business	1995 Revenues
			in U.S.$millions
1	Siam Cement	building	4,173
2	Thai Airways International	transportation	3,069
3	Bangkok Petroleum	energy	1,240
4	Siam Makro	commerce	1,231
5	petrochemical Industry	petrochemical	997
6	Charoen Pokphand Feedmill	agribusiness	954
7	Shinawatra	communication	784
8	Bangkok Produce Merchandise	agribusiness	758

9	Italian-Thai Development	property	731
10	United Communications	communication	626
11	Robinson Department Store	commerce	588
12	Saha Union	textiles	545
13	Siam City Cement	building	542
14	Advanced Information Service	communication	495
15	TPI Polene	chemicals	491
16	Siam Suk	foods	479
17	Alphatec Electronics	electronics	476
18	Thai Central Chemical	chemicals	408
19	International Cosmetics	commerce	386
20	Land&House	property	378

Source:Stock Exchange of Thailand

CHAPTER III

AN OVERVIEW OF FDI IN THAILAND’S DEVELOPMENT

Linkages with global and regional production networks obtained through FDI have been crucial to the change in Thailand’s industrial structure, shifting the economy away from agriculture towards manufacturing and, within manufacturing, away from textiles into electronic goods. This move away from the most labor-intensive activities should not disguise the fact that value-added in Thailand, even in more technological-intensive sectors, originates in relatively labor-intensive operations.

Foreign firms are major contributors to industrial employment and played an important role in the expansion of manufacturing employment by one million in the 1980s. The expansion of largely export-oriented FDI led to a surge in investment as a result of the export boon. The large inflow of FDI beginning in the mid-1980s was matched by an unprecedented high rate of Thai domestic investment, suggesting that foreign and domestic investment were largely complementary during this period. This boom was made possible because large local firms such as Siam Cement or CP Group were favored as partners in joint ventures with foreign investors. Moreover, smaller Thai firms engaging in trade, services or manufacturing were able to take advantage of the greater integration of the Thai economy with the outside world to expand the scope of their activities and to move into exports. Local investment was also stimulated by the capital market, which developed institutions to mobilize new sources of capital

While FDI may not have crowded out domestic capital, the rapid expansion of employment in certain export sectors may have served to deprive other firms of skilled labor at affordable wage rates. Over time, the supply of human capital will expand in the economy to meet the need, but in the short term, there may have been some crowding out of firms, which did not export.

FDI AND EXPORT PERFORMANCE

Foreign direct investment has played a key role in the industrial transformation of the Thai economy. FDI inflows concentrated in industry in the 1980s and helped develop and diversify the industrial structure, including into textiles, automobiles and more recently electronics. Foreign firms played a major role in the export boom in electrical and chemical products and also, in textiles. The development of manufactured exports began with the textile industry, which was dominated by foreign firms, as they relocated from Japan, Chinese, Taipei and Hong Kong, China beginning in the 1970s. Following the yen appreciation in the mid-1980s, existing Japanese textile joint ventures in Thailand increased their capacity.

In electronics, FDI contributed much later to Thailand's export performance because it was at first primarily domestic market-oriented. Electrical and electronic products now represent almost one third of total Thai exports, and those come primarily from foreign-owned firms. In 1997, the 125 most prominent BOI-promoted electronics companies, which are mostly 100 percent foreign-owned or Thai-foreign joint ventures, accounted for 90 percent of total exports of electronic and electronically products.

Foreign affiliates in Thailand have become more export-oriented over time, in response to both export promotion policies and to favorable exchange rates after 1985. The average export propensity of foreign firms rose from 10 percent in 1971 to 33 percent in 1984 and to more than 50 percent in 1988. Between 1985 and 1990, export-oriented firms accounted for 60 to 80 percent of total BOI-promoted FDI projects. Over 80 percent of Thailand's total exports are now in manufacturing, including electrical appliances, machinery, transport equipment parts, and chemicals, mostly produced by foreign investors or joint ventures.

MNEs AND THE THAI BLANCE OF PAYMENTS

The potential impact of MNE activities on the Thai balance of payments goes beyond their contribution to exports. Foreign affiliates also import goods and services, as well as bringing in capital and repatriating interest, income and royalties. FDI is frequently accompanied by an increase in imports of capital goods as the project comes on line, but many affiliates also import a large share of their inputs from abroad. This is particularly the case for export-oriented investment where investors must find competitively priced and high quality inputs in order to be able to compete effectively in global markets.

Heavy reliance on imported inputs is a constant for FDI in Thailand. It was estimated in the 1980s that, for foreign investment projects, which received promotional privileges from the BOI, 90 percent of all machinery and equipment was imported and over 50 percent of raw materials. According to UNCTAD data, the ratio of imports of parts to exports of finished goods is 60 percent for electronic products in Thailand (the highest ratio in the region). On average the important content of exports is estimated at 43 percent in Thailand.

In terms of net exports, therefore sectors dominated by FDI do not rank as highly as they do if one only looks at the export side. Computers and parts exports, for example, are roughly on a par with exports of agricultural and fishery products, but in terms of their contribution to net exports, the latter group figure much more prominently because of the high level of imports of components in the computer industry. The same could be said of other sectors dominated by MNEs.

In the wake of the crisis, the importance of FDI as a potential source of net capital inflows has been emphasized. It has clearly demonstrated its benefit in this regard, compared to other forms of capital flows. At the same time, however it is useful to stress that in the long term FDI should be judged by its impact on the capacity of the Thai economy to respond to the opportunities offered by global economic integration. One measure of this is the impact of FDI on the export performance of the economy as a whole rather than in specific sectors dominated by foreign MNEs. In this respect, FDI in sectors supplying goods and services to local firms at competitive prices may have a significant impact on Thai exports even if the affiliates themselves do not export.

Unfortunately, this effect is difficult to establish empirically. For one reason, capital inflows as a result of FDI may cause an appreciation of the real exchange rate, which might reduce exports in other sectors. Attempts to measure the effect of FDI on aggregate Thai exports have tended to mix results. In one study, the relationship between exports and cumulated FDI inflows appears to be quite strong for the period 1986-91 but becomes much weaker during 1992-96. Another finds only a weak causal effect of FDI on Thai exports in the manufacturing industry, although there is a clear impact of FDI in specific sectors. The same study reveals that FDI appears to lag growth in exports, suggesting that foreign investors respond to the export opportunities offered by currency realignments, etc. often after a lag and that this response to be the case in the mid-1980s, with the beginning of the export boom preceding the FDI surge.

CHAPTER IV

GOVERNMENT POLICIES AND TAX INCENTIVES

Foreign investment policies in Thailand have traditionally reflected the broader development strategies in place at the time. Early foreign MNEs were enticed by high tariff barriers to locate assembly production in Thailand to supply the domestic market. The second wave of FDI came in the late 1980s in order to take advantage of favorable unit labor costs and exchange rates, as well as export promotion policies, to establish export platforms for markets elsewhere. Although import substitution and export promotion policies have tended to converge over time, foreign investment in Thailand still tends to be divided sharply between local market oriented and export-oriented production.

This dichotomy is reflected in policies towards FDI in Thailand. Firms wishing to export most of their output have traditionally faced few restrictions. They can locate anywhere and hold all of the shares in the affiliate, as well as the land on which the factory is built. They also receive tax holidays and exemptions on duties for imported inputs. In contrast, firms wishing to sell mostly in the local market are either prohibited or restricted in a number of ways depending on the sector, they often have to settle for minority ownership and can only lease land for a fixed period. In some cases, they require an authorization through a lengthy and not always transparent process. In the automobile sector, foreign investors have also faced cumbersome local content requirements.

Unlike policy initiatives in other areas, this dualistic policy towards foreign investors was changing only slowly before the crisis. There have been proposals to amend the Alien Business Law in the past, but as with earlier efforts to amend the ABL, this one is meeting opposition in Parliament. The reforms proposed as a result of the crisis represent a significant step towards a more open and unified approach to FDI policy. Nevertheless, the fact that reforms have been enacted during an economic crisis and that some, such as in banking or concerning majority foreign ownership of joint ventures, appear to be temporary might suggest to potential investors that they are not based on fundamental reappraisal of development strategies and hence will not survive the return of economic growth.

The ongoing financial crisis in Thailand and the structural problems which it has brought to light present an opportune moment to reassess whether existing policies towards FDI in Thailand, as part of more general growth strategies, have best served the interests of economic development. Export promotion policies based on foreign investment had proved highly successful at generating massive exports in sectors in which Thai firms had no experience. But at the same time, the years before the crisis were characterized by growing concerns over shortages of skilled labor and rising wages not matched by productivity. As a result, Thai low-technology exports were declining in the face of stiff competition from China, Bangladesh and Vietnam, and this shortfall was not being offset by sustained growth in medium-to high-technology exports.

Experience in both OECD and non-OECD countries suggest that too great an emphasis on export promotion does not always yield the expected benefits. Not only has the resulting export growth often proved unsustainable, but also such exports are also often highly dependent on imported components because of the need for high quality inputs in order to compete effectively in export markets. This dependency reduces both the potential benefit to the balance of payments and the responsiveness of the economy to exchange rate changes. In addition, because highly export-oriented firms are less likely to source locally, such investment limits potential technology transfers between foreign affiliates and local suppliers.

In contrast, local market oriented firms are more likely to source locally and hence offer greater potential scope for technology transfers. Furthermore, because they often offer goods and services of higher quality and lower prices, they make it easier for Thai firms which make use of these goods and services to compete in world markets, thus assisting in the development of indigenous exporting capabilities. Recent reforms in FDI policies in Thailand have reduced this strong bias in favor of export-oriented investment projects and could open the way for more FDI by firms wishing to supply the Thai market. If these reforms prove to be durable, the Thai economy may be poised in the medium term for a period of more sustainable growth, with local firms contributing more to export growth.

THE BOARD OF INVESTMENT (BOI)

The Board of Investment is the single most important body to foreign investors of Thailand. It has its origins in the Board of Investment for Industry, which was established in 1960 under the Investment Promotion for Industry law with the objective of stimulating industrial investment, both domestic and foreign, and encouraging industrial expansion in Thailand.

The Office of the Board of Investment (OBOI) is the functioning arm of the Board and is given the following powers and duties by the Investment Promotion Act:

1. to perform such functions as may be resolved or assigned to it by the Board:
2. to publicize potential investment opportunities and induce investments in those activities which are important and beneficial to economic and social development, and security of the country.
3. to establish an Investment Services Center to assist prospective investors in obtaining permissions and services related to investment; this center is now colloquially referred to as the "One-Stop Shop":
4. to appraise projects requesting promotion and to supervise, control and value

promoted investment projects;

5. to conduct studies and research in identifying investment opportunities, to prepare feasibility reports and to formulate an investment promotion program;
6. to study and compile data relating to investment in Thailand.
7. to perform other duties in the furtherance of the objectives of the Investment Promotion Act.

The Board's major discretionary power is the granting of Promotional Investment Privileges, also known as Promotional Status. This includes a package of incentives and tax concessions. These are available for both new industrial projects and the expansion of existing operations, provided they fall within certain guidelines, that is they provide a high value-added component, have a high export potential, provide a new use or outlet for domestic resources, involve the development of domestic resources, involve the processing of domestic agricultural resources, contribute a new technology, and represent labor intensive processes, etc. The Board is not involved in the capitalization or financing of foreign investment but often helps foreign investors to locate reputable local partners. It should be noted that the BOI is not a screening mechanism for foreign investment or technology transfer and there are no such agencies in Thailand. However, prospective investors are welcome to make use of the BOI's information and facilitation services even if they are not seeking promotional privileges.

The Office of the BOI deals with investment projects according to the following sectors activities:

1. Agriculture and agricultural products
2. Mining, ceramics and basic metal industries
3. Light industries
4. Metal-working, machinery, and transport equipment
5. Electronics, and electrical industries
6. Chemical industries, paper, plastic products
7. Services and infrastructure services.

The seven divisions deal with all aspects of a promoted project so that investors only need to deal with one division for most of their business with the BOI.

In June 1992, the BOI was appointed to be the secretariat of the Joint Public-Private Sector Consultative Committee (JPPCC). As such, the BOI will play a more active role in mobilizing the private sector to work together with the Government. In addition to promoting government dialogue with both the local and foreign business sectors, the JPPCC has had an impact on streaming export and investment promotion procedures.

The “One Stop Service Center” assists investors in obtaining the official permits and documents required for carrying out business. The Center also helps prospective investors and promoted firms to obtain visas, work permits and permanent residence. In addition, the Center also assists in gaining access to utilities needed for an investment.

RESTRICTIONS ON FOREIGN INVESTMENT

There are few restrictions placed on foreign companies. The more significant ones are that a foreign-owned firm generally cannot own land unless it has received promoted status from the BOI, and that certain occupations and activities are set out in the Alien Business Law are prohibited to foreigners and foreign firms. Aside from a few designated activities in which alien activity is limited, the Thai government permits foreign majority equity and control of non-promoted firms undertaking any industrial or service activity. Generally, only normal business permits and licenses are required although some restrictions are placed on the location of certain types of industries. In these matters, equal treatment is accorded to foreign and Thai applicants.

ALIEN BUSINESS LAW

Foreigners in Thailand derive their legal rights primarily from the domestic laws of Thailand. In general, foreigners enjoy the same basic rights as Thai nationals.

Restrictions on foreign ownership in commercial banks, insurance companies, commercial fishing, aviation businesses, commercial transportation, commodity export, mining and other enterprises exist under various laws. In addition, Thai participation will frequently be required in those activities seeking permission from the BOI.

The Foreign Business Act of 1999, which became effective on March 4, 2000, repeals and replaces the 1972 National Executive Council Announcement 281, better known as the Alien Business Law. The Act serves to define an “alien,” and identifies the scope of foreign participation in business in Thailand. An “alien” is defined as

- A natural person who is not of Thai nationality
- A juristic entity that is not registered in Thailand
- A juristic entity incorporated in Thailand with foreign shareholding accounting for one-half or more of the total number or value of shares
- A limited partnership or ordinary registered partnership whose managing partner or manager is a foreigner

INVESTMENT INCENTIVES

The Investment Promotion Act, BE 2520 (1977), as Amended by the Investment Promotion Act (No 2), BE 2534 (1991)

The Board of Investment has a discretionary power to grant Promotional status which includes a package of incentives and tax concessions to a business. The Investment Services Center, Office of the Board of Investment, should be contacted for permission to enter Thailand for the purpose of studying investment opportunities or performing any other acts related to investments in Thailand. The Center will assist in obtaining necessary permits and licenses.

Special permission may be obtained to bring in foreign technicians and experts over and above the normal immigration quotas to work for a promoted firm. Permission must be sought, by filing a request with the Investment Services Center of the Office of the Board of Investment on a standard Office form, which is available, for approval of the positions to be held and the duties to be filled. The request must contain details of the positions and indicate a time limit within which the duties are to be performed. After approval of the positions, duties and numbers of experts has been obtained, each expert must fill out a form detailing his personal history and evidence of technical competency. Forms for this purpose are available from the Investment Services Center of the Board of Investment. This form, together with the bio-data and other pertinent documents relative to the spouse and dependants of expert, must be presented for the Board's consideration for permission. Once approved by the Board, the expert must obtain a Non-Immigrant Visa for entry into Thailand. If it is necessary to extend the period of the expert's stay, a written request fro such extension must be submitted to the Board of Investment.

Special permission may be obtained to own land for carrying out promoted activities. Generally, no alien or company of which more than 49 percent of the number of shareholders is an alien or of which aliens hold more than 49 percent of the shares is allowed to own land.

However, a promoted person who registers as a company may be allowed to own land for caring out promoted activities at the amount the Board deems appropriate. In order to seek approval the promoted person must file an application in the official standard form with the Office of the Board of Investment, which will present the application to the Board of Investment for consideration. The application must be accompanies by the following documents:

1. A map showing the land location, surrounding area, and the instructions to or access to the site if inspection is required
2. The Land Map shown on the opposite side of the Title of Deed with complete set of numbered boundary posts, either duplicated or copied
3. A construction plan, which indicates the type of construction and specific location. The calculation of construction areas of each item and total area required for construction must be clearly shown, and a full explanation must be given of the purpose for the remaining areas not under construction. If the application is approved, the Office of the Board of Investment will notify the Land Office in the area in which the land is located and request their cooperation in granting permission for the promoted company to assume ownership of the land approved. The promoted company will then proceed directly with the local land officer.

As part of its policy to decentralize industry the government has promoted the development of designated areas as industrial estates. These are under the authority of the Industrial Estates Authority of Thailand (IEAT), which was set up under the IEAT Act (1979). Facilities provided in these estates include telephone, telex, and post and telegraph systems, roads, electricity, water supply and drainage systems, central sewage and garbage treatment and disposal systems, fire protection system, trade center, banks, medical centers, and residential quarters for workers. Security services, a goods receiving and dispatching service and a bonded warehouse service are also provided.

A number of tax incentives are available under the Investment Promotion Act. These include the following.

1. An exemption or 50 percent reduction of import duties and business taxes on imported machinery is available for approved machinery. In order to apply for this relief the promoted person has to compile basic lists of machinery in accordance with the standard forms prescribed by the Office of the Board of Investment. When completed, these forms are submitted to the Board, which will decide on the items

and the number of items to be granted tax and duty relief.

2. A reduction of import duties and business taxes of up to 90 percent on imported raw materials and components is also available

3. A promoted enterprise may be exempted from corporate income tax on net profits for three to eight fiscal years. This exemption may be extended to income derived from the sale of by-products and semi-finished products. If losses are incurred in the exemption period, they may be carried forward for five years from the end of the exemption period.

4. Exemption of up to five years on withholding tax on goodwill, royalties or fees remitted abroad is available.

5. Dividends derived from promoted enterprises during the income tax holiday are also excluded from taxable income of the shareholder.

CHAPTER V

THAILAND INVESTMENT PROMOTIONAL ZONES

There are three investment Zones based on economic factors depending on the level of income and the availability of infrastructure in each province.

Zone 1: 6 Central provinces with high income and good infrastructure consisting of Bangkok, Samut Prakan, Samut Sakhon, Pathum Thani, Nonthaburi and Nakhon Pathom

Zone 2: 12 provinces consisting of Samut Songkhram, Ratchaburi, Kanchanaburi, Suphanburi, Ang Thong, Ayutthaya, Saraburi, Nakhon Nayok, Chachoengsao, Chon Buri, Rayong and Phuket.

Zone 3: The remaining 58 provinces with low income and less developed infrastructure.

All areas in the Zone 3 provinces are designated as Investment Promotion Zones.

CRITERIA FOR GRANTING TAX AND DUTY PRIVILEGES

Zone 1- Approved projects located in Bangkok, Nakhon Pathom, Nonthaburi, Pathum Thani, Samut Prakan and Samut Sakhon shall be granted:

- 50 percent reduction of import duty on machinery that is subject to import duty of not less than 10 percent
- Corporate income tax exemption for 3 years for projects located within industrial estates or promoted industrial zones, provided that such a project with capital

investment of 10 million bath or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year

- Exemption of import duty on raw or essential materials used in the manufacturing of export products for 1 year

Zone 2- Approved protects located in Kanchanaburi, Chachoengsao, Chon Buri, Nakhon Nayok, Ayutthaya, Phuket, Rayong, Ratchaburi, Samut Songkhram, Saraburi, Suphanburi and Ang Thong shall be granted:

- 50 percent reduction of import duty on machinery that is subject to import duty of not less than 10 percent
- Corporate income tax exemption for 3 years, increased to 5 years for projects located within industrial estates or promoted industrial zones, provided that such a project with capital investment of 10 million bath or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year.
- Exemption of import duty on raw or essential materials used in the manufacturing

of export products for 1 year

Zone 3- Approved projects located in the remaining 58 provinces shall be granted:

- Exemption of import duty on machinery
- Corporate income tax exemption for 8 years provided that a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year.
- Exemption of import duty exemption on raw or essential materials used in the manufacturing of export products for 5 years
- A project located in one of the following 40 provinces: Krabi, Kamphaeng Phet, Khon Kaen, Chanthaburi, Chai Nat, Chiyaphum, Chumphon, Chiang Rai, Chiang Mai, Trang, Trat, Tak, Nakhon Ratchasima, Nakhon Si Thammarat, Nakhon Sawan, Prachuab Khiri Khan, Prachin Buri, Phangnga, Phattalung, Pichit, Phitsanulok, Phetchaburi, Phetchabun, Mukdahan, Mae Hong Son, Ranong, Lop Buri, Lamphang, Lamphun, Loei, Songkhla, Sa Kaew, Sing Buri, Sukhothai, Surat Thani, Nong Khai, Udon Thani, Uttaradit, Uthai Thani and Ubon Ratchathani shall be granted tax and duty privileges as follows

A project located within industrial estates or promoted industrial zones is entitled to the following privileges:

- 50 percent reduction of corporate income tax for 5 years after the exemption period
- Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activity.

For a project located outside industrial estates or promoted industrial zones, a deduction can be made from net profit of 25 percent of the proejct's infrastructure installation or construction cost for 10 years from the date of first sales, and net profit for one or more years of any year can be chosen for such deduction. The deduction is additional to normal depreciation.

A project located I one of the following 18 provinces consisting of Kalasin, Nakhon Phanom, Narathiwat, Nan, Buri Ram, Pattani, Phayao, Phrae, Maha Sarakham, Yasothon, Yala, Roi Et, Si Sa Ket, Sakhon Nakhon, Sathun, Surin, Nong Bualamphu, and Amnat Charoen shall be granted tax and duty privileges and other privileges as follows:

- 50 percent reduction of corporate income tax for 5 years after the exemption period
- Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activities
- Deduction can be made from net profit of 25 percent of the project's infrastructure

installation or construction cost for 10 years from the date of first sales, and net profit for one or more years of any year can be chosen for such deduction. The deduction is additional to normal depreciation.

CRITERIA FOR FACTORY RELOCATION

To encourage industrial decentralization, the Board will grant promotion status to existing activities in the Central area, whether being promoted or not, if they relocate to the other regions. The following criteria are used:

- The operation must relocate from Zone 1 to Zone 2 or from Zone 1 or Zone 2 to Zone 3
- The operation must relocate to industrial estates or promoted industrial zones
- The type of activity must be one that is included in the List of Activities Eligible for Promotion and the size of the Investment must be in accordance with that specified by the Board
- The existing operation must be closed down and the operation at the relocated location must start within 2 years from the date of receiving the promotion certificate
- The relocated project is granted tax and non-tax privileges as follows:

-- A project relocated to industrial estates or promoted industrial zones in Zone 2, will be granted corporate income tax exemption for a period of 5 years, provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from the start-up date of its new plant, otherwise the corporate income tax exemption will be reduced by 1 yea

-- A project relocated to industrial estates or promoted industrial zones in 40 provinces in Zone 3 will be granted the following:

1.1 Corporate income tax exemption for a period of 8 years, provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year

1.2 50 percent reduction of corporate income tax for 5 years after the exemption period

1.3 Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activity.

--A project relocated to industrial estates or promoted industrial zones in 18 provinces in Zone 3 will be granted the following:

1.1 Corporate income tax exemption for a period of 8 years, provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from the start-up date of its new plant, otherwise the corporate income tax exemption will be reduced by 1 year

1.2 50 percent reduction of corporate income tax for 5 years after the exemption period

1.3 Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activity

1.4 Deduction form net profit of 25 percent of the project's infrastructure installation or construction cost for 10 years from the date of first sales, and net profit for one or more years of any year can be chosen for such deduction. The deduction is additional to normal depreciation.

-- Activities that are included on the List of Activities Eligible for Promotion, but which are not eligible for corporate income tax exemption, will not be granted such exemption when operations are relocated.

- The corporate income tax exemption shall be granted from the day the first revenue is received from the relocated activities.

- Applications for relocation must be submitted to the Office of the Board of Investment.

REQUIREMENT TO REPORT OPERATING RESULTS

To ensure the effectiveness of the tax and duty privileges, to ensure that the use of the privileges granted is correct and in line with the policies for promotion, and to encourage the good governance of promoted projects, all promoted projects must report their annual operating results to the Board for review prior to the Board granting tax and duty privileges for that year.

The Board shall follow the above general criteria in considering and approving investment promotion and granting tax and duty privileges, except in the following cases:

- When different tax and duty privileges have been specified to particular activities on the List of Activities Eligible for Promotion
- When the Board considers that special reasons apply to certain activities
- To allow projects located in Laem Chabang Industrial Estate or in industrial estates or promote industrial zones in Rayong Province to be granted privileges under the previous criteria as well as privileges of an Investment Promotion Zone, granted in accordance with Section 35, industrial estates or promoted industrial zones in Rayong Province, which have applied for investment promotion privileges prior to

the effective date of this Announcement, and Laem Chabang Industrial Estate shall be designated as an Investment Promotion Zone until 30th December 2004

- A project located in an industrial estate or promoted industrial zone in Zone 2 and Zone 3 (whose promotion application is submitted prior to the effective date of this Announcement) shall be granted the tax and duty privileges under the original criteria under the previous Board of Investment Announcement No. 1/2536 as follows:

1.1 A project whose operation is located in an industrial estate or promoted industrial zone in Zone 2, except in Laem Chabang Industrial Estate or in an industrial estate or promoted Industrial zone in Rayong Province shall be granted the following privileges:

1.1.1 50 percent reduction of import duty on machinery that is subject to import duty of not less than 10 percent

1.1.2 Corporate income tax exemption for 7 years provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year

1.1.3 Exemption of import duty on raw or essential materials used in the manufacturing of export products for 1 years

1.2 A project whose operation is located in an industrial estate or promoted industrial zone in Zone 3, Laem Chabang Industrial Estate or in an industrial estate or promoted industrial zone in Rayong Province shall be granted the following privileges:

1.1 Import duty exemption on machinery

1.2 Corporate income tax exemption for 8 years, provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year

1.3 Exemption of import duty on raw or essential materials used in the manufacturing of export products for 5 years

1.4 75% import duty reduction on raw or essential materials used in manufacturing for domestic sales for 5 years, with year-by-year approval. Such raw or essential materials shall not be those that are produced or originated in the Kingdom with similar quality and sufficient supply. This does not apply to projects located in Laem Chabang Industrial Estate

1.5 50 percent reduction of corporate income tax for 5 years after the exemption period

1.6 Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activity

1.7 Deduction from net profit of 25 percent of the project's infrastructure installation or construction cost for 10 years from the date of first sales. This amount can be deducted from net profits for one or more years, and any year can be chosen for this deduction. The deduction is additional to normal depreciation.

1.3 A project relocated into an industrial estate or promoted industrial zone (whose promotion application is submitted prior to the effective date of this Announcement) shall be granted the tax and duty privileges under the previous criteria under the Board of Investment Announcement No. 1/2536 as follows:

1.1 A project relocated into an industrial estate or promoted industrial zone in Zone 2, except in Laem Chabang Industrial Estate or in an industrial estate or promoted industrial zone in Rayong Province shall be granted corporate income tax exemption for 7 years provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from its start-up date, otherwise the corporate income tax exemption will be reduced by 1 year:

A project relocated into an industrial estate or promoted industrial zone in Zone 3, Laem Chabang Industrial Estate or an industrial estate or promoted industrial zone in Rayong shall be granted

1.1 Corporate income tax exemption for 8 years provided that such a project with capital investment of 10 million baht or more (excluding cost of land and working capital) obtains ISO 9000 or similar international standard certification within 2 years from the start-up date of its new plant, otherwise the corporate income tax exemption will be reduced by 1 year

1.2 50 percent reduction of corporate income for 5 years after the exemption period

1.3 Double deduction from taxable income of transportation, electricity and water costs for 10 years from the date of first revenue derived from promoted activity

1.4 Deduction from net profit of 25 percent of the project's infrastructure installation or construction cost for 10 years from the date of first stales, and net profit for one or more years of any year can be chosen for such deduction. The deduction is additional to normal depreciation.

Some estates are divided into two sections-a General Industrial Estate and an Export Processing Zone. Those industries permitted to set up plants in the Export Processing Zone will be able to import necessary raw materials and equipment and export their products duty-free. Normally those firms allowed to set up in such a zone will be high-value-added, export-oriented firms which are labor-intensive and use local raw materials or raw materials from neighboring countries.

Incentives available for those locating in industrial estates include permission to bring in foreign skilled workers and experts and to own land in the estate. The BOI has declared Industrial Estates and Export Procession Zones as Investment Promotion Zones and therefore industries locating there may also be eligible for BOI incentives (reductions of 50 percent of corporate income tax for five years from the expiration of tax holidays or from the date income is earned, allowance of a deduction from the taxable corporate income of up to 25 percent of the investment costs of installing infrastructure facilities for 10 years from the date of income earning and allowance to double the cost of transportation, electricity and water supply for deduction from taxable corporate income).

Recently, a number of private sector industrial estates have been completed or planned. These estates must meet strict standards with regard to factory facilities and utilities.

INCENTIVS FOR EXPORT ENTERPRISES

One of the main elements of industrial policy in Thailand is the promotion of export-oriented industries. To encourage industries in this sector the Investment Promotion Act provides the following incentives for promoted projects substantially producing for export.

1. Exemption of import duties on imported raw materials and components.
2. Exemption of import duties on re-exported items
3. Exemption of export duties on products exported
4. Allowance to deduct from the taxable corporate income the amount equivalent to 5 percent of an increase in income derived from export over the previous years, excluding costs of insurance and transportation.

Restrictions and Trade-related Investment Measures

- The Alien Business Law of 1972 allows foreign participation in certain enterprises provided that Thai ownership is more than 50%.

- Thailand is presently revising the Alien Business Law to further liberalize trade and industry.
- Currently, any firm that exports all or at least 80% of its production may be completely foreign owned although full ownership may be negotiated on a case-by-case basis at lower export levels.
- For projects in agriculture, fishery, mining and services, foreign investors may hold majority or all shares if capital investment is over one million baht. However, Thai nationals must acquire at least 51% control within 5 years of operation. In manufacturing projects for the domestic market, maximum foreign participation is 49%. For export enterprises that sell 50% of total sales is exported, majority foreign ownership is allowed.

CHAPTER VI

POLICIES TOWARDS FOREIGN INVESTMENTS IN SPECIAL SECTORS

Thailand plans to transform its economy into a strong regional financial center by the Year 2000. The government has recently allowed more foreign banks to set up branches in the country. It is also set to liberalize the telecommunications, retail, constructions and transport services. After a period of heavy protectionism in the late 1980s when relatively high tariff rates were adopted, Thailand has recently embarked on a tariff reduction program in compliance with its commitment under AFTA. Beginning 1995, Thailand has cut tariffs on 8 013 goods and an additional 3 908 tariff items have been reduced, affecting 11 product categories. Imported raw materials and essential production inputs are subject to relatively low tariff rates. Tariffs on fast-tract products will be cut from 25% to zero to 5% by 2000. Normal-track tariffs are subject to 30% taxation. In the case of the 3 908 items, which now attract taxes of up to 100%, tariffs will be cut to 30% or less. The Thai Government uses import licensing, largely to protect infant industries. While the coverage of import licensing has decreased since the late 1970s, the number of products currently under licensing is greater than in the early 1980s. Around 100 product categories are affected by import licensing. About one-fourth of these are composed of agricultural commodities such as rich and sugar. Industrial products covered by import licensing include certain textile products, machinery items, and motor vehicles, motorcycles, paper products, chemicals, porcelain items, and building stones.

- There are local content rules on dairy products, tea and motor vehicles as a way of aiding local producers.

- The government also regulates imports to meet certain technical regulations and standards for health and safety reasons.

SELECTED SECTOR INVESTMENT OPPORTUNITIES

Thailand's automotive industry has performed spectacularly since 1988, tripling production from 145,000 units to almost a half a million units in 1993. Production is projected to reach 1 million units by 2000. The kingdom is currently Southeast Asia's largest and most dynamic auto market and the world's second largest pickup market.

Thailand is well positioned to join the small global group of automotive "tigers", whose performance places them a notch below the automotive giants (Japan, North America and Europe), but well ahead of other developing countries.

Thailand initiated its diversification drive in 1991 by allowing competition from imports for the first time in 20 years. In 1992 alone Thailand imported 22,000 vehicles or 20 percent of the passenger car segment. Under pressure from imports, domestic producers cut prices by up to 25 percent, with the result being more people can afford cars, government revenues are up and Thailand's industry is now more productive.

A second tool for diversification in promotion of new vehicle assembly operations. The Board of Investment has reopened promotion privileges to automotive assembly projects for export, aiming to make Thailand a regional automotive production center. This is encouraging North American, Korean, and European firms to enter a market that has been near-exclusively owned by Japanese manufacturers.

Thailand effectively implemented local content requirements in the 1980s and 1990s to achieve basic component assembly and delivery capabilities. In its quest to enhance its global competitiveness, Thailand is now making industrial deepening a priority as it courts new investments in components and supporting industries. Established automakers are expanding their investments and setting up supply lines within the country; this is considered a strong indication of the profitability of such operations.

Industrial deepening will transform the automotive assembly industries into pillars of the economy, which will integrate raw steel into metal bending into finished body panels. Ventures, which promise additional value-added work in Thailand, are favored.

Thailand's auto industry means to get globally competitive by pursuing market diversification Dan industrial deepening to achieve competitive targets in 2000 and taking their share of Asia's fastest growing automotive market.

The automotive industry provides a primary example of the Thai government's efforts at trade liberalization. While Thailand remains a well-protected car market, the government continues to pursue liberalization efforts first initiated in 1988. In October of that year Thailand signed the ASEAN BBC (Brand-to-Brand Complementation) agreement. Since 1991, Thailand has undertaken unilateral measures to liberalize the automotive industry in an attempt to make itself the regional center for automotive assembly and components. The government significantly reduced high import duties on fully assembled cars in 1991. It also announced in 1994 that a tariff rebate of more than 90% on imported completely knocked down car kits that would be reexported as assembled vehicles. The Board of Investment has expanded its promotional incentives for assembly plants to be located in provincial regions. These incentives include a seven-year tax exemption on income earned from exports, reduced duties on imported machinery, and government subsidies for construction, transport and power. As a result of these liberalizing measures, Thailand is relatively less protected than its neighbors. Auto manufacturers can also expect further relaxation in the local content requirements as the Thai government implements WTO agreements.

AFTA is another example of the government's liberalization policy. Thailand is taking part in three schemes: Brand-to-Brand Complementation (BBC), the ASEAN Industrial Joint Venture Program (AIJVs), and the Common Effective Preferential Tariff (CEPT) scheme. Through BBC, assemblers in participating countries are able to import components from other members and obtain local content points and a 50% reduction in the normal import duty. In Thailand, Toyota, Honda, Mitsubishi, Nissan, and Volvo are trading parts under the scheme.

Thailand is increasingly becoming both a battleground, as MNCs fight over its domestic market, and a staging area, as MNCs use its location, its cheap labor, and resources as a springboard to regional and global markets. Thailand is becoming an important market for both local and foreign businesses. Thai businesses are major players in the garment, textile, agricultural, gem, and jewelry industries. In the hotel business, MNCs such as Quality Inn and Best Western have made their presence known. Thai hoteliers have also been aggressive in acquiring foreign properties, for example the Dusit Group with its purchase of Germany's Kempinski group in 1995 and with its expansion in Texas. In information technology, the National Electronic and Computer Technology Center (NECTEC) are studying how to reposition Thailand as a center for software R&D for global leaders in the industry. Thailand is also becoming an important part of globally interdependent business systems, and global competitive battles. Foreign MNCs, Japanese have used Thailand as a production and export platform to compete internationally and to bypass some trade protection measures of its trading partners. For example, in the consumer electronics industry, Japanese manufacturers exported to the United States through their Thai subsidiaries to bypass the Voluntary Export Restraint Quotas affecting U.S. and Japan trade.

MNCs from Europe, Japan and the United States have all pursued different strategies in the Thai market. The companies also view Thailand as important for their regional strategies, driving an export focus for production. In all industries, competition is increasingly intense and the strategies pursued by these companies partially reflect the growing global pattern of competition.

The six MNCs that are successful in Thailand are Nestle, Unilever, Toyota, Matsushita, IBM, and Procter and Gamble. Except for IBM, which now ranks third in the personal computer market, all are leaders in their core products. Nestle is the largest branded food company in Thailand. It enjoys a 30% market share for milk products and an 80% market share in the instant coffee market. Unilever is dominant in seven of the twelve markets in which it competes, including laundry detergents, ice cream, and hair care products. Procter and Gamble dominates disposable diapers, and holds near-leadership positions in feminine hygiene, skin care, and hair care products. Toyota and Matsushita respectively lead in automobile and consumer electronic products.

Thailand is large enough to be an attractive market in its own right and now has the added attraction of being a conduit to Indochina. All six companies entered the country with export strategies and subsequently engaged in direct investment strategies by setting up wholly owned subsidiaries or forming joint ventures with local partners. The direct investments of Unilever and P&G occurred through wholly owned subsidiaries, while those of Nestle, Toyota, and Matsushita took the form of joint ventures with local companies. However, Nestle subsequently acquired shares from its partners in the joint venture and currently wholly owns Nestle Thailand.

Of the six companies, Unilever is the oldest and P&G the youngest in Thailand. Unilever first established its wholly owned subsidiary, Siam Industries Ltd. In 1932, to produce and market soaps. P&G Thailand was established in 1987, when the parent company acquired Richardson-Vicks worldwide in 1985, and took over that company’s operation in Thailand. IBM, Matsushita, Toyota and Nestle’s initial investments were made respectively in 1952,1961,1962, and 1967. Matsushita created a joint venture with a local company to assemble imported parts and components to supply domestic market demand.

The success of Toyota and other Japanese MNCs in the auto industry can be attributed to their early entrance to set up production facilities in Thailand. Their distribution and service networks are well established, affording them a high degree of consumer loyalty. Pushed by the increasing value of the yen, and pulled by growth in local demand as well as by the Thai government's liberalized policies and incentives, Japanese producers have increasingly relocated auto parts factories to Thailand, and have embarked on expansion plans to increase production capacity there.

Auto companies often pursue an alliance strategy when entering Thailand. For example, the Auto Alliance Co., Thailand of Ford, Mazda, and local partners producers pick-up trucks. Fiat and Italsiam combined to make the Fiat 178 world car, while Isuzu, Nissan, and Toyota partnered to produce and exchange parts in order to meet the current 54% local content requirement for cars assembled in Thailand.

Partnering with local companies or the government is particularly important in regulated industries such as telecommunications. For example, AT&T of the United States has partnered with Shinawatra, OTC International of Australia with Samart Group, and Cable and Wireless of the United Kingdom with Sophonpanich Group.

The low cost of local production has encouraged many MNCs to produce in

Thailand either for the local market, for export or both. All of these six MNCs use Thailand as a production base to supply the local market and to export. All are conducting factory expansion projects to increase their production capabilities. Toyota has the highest degree of regional integration for value-added activities. A relatively developed backward linkage in Thai auto industry has allowed Toyota to successfully pursue the strategy of vertical integration. Toyota makes extensive use of the BBC scheme set up in ASEAN. Toyota produces diesel engines, stamped parts, and electrical equipment in Thailand and ships these around the region in partial exchange for other components and parts.

The Thai production base is part of Toyota's regional strategy. Jigs and dies were exported to Japan, Taiwan, Malaysia, and Indonesia even before it implemented the BBC scheme. In 1992, the first completely built-up unit was exported to Laos. While the current activities are concentrated on sourcing and manufacturing, Toyota plans to use Thailand for the design and development of new car models.

Nestle pursues a policy of creating products from local ingredients and has invested significantly in developing the indigenous industry to assure the quantity and quality of its product ingredients. P&G views Thailand as the future production hub for its key product brands such as Pampers disposable diapers, Whisper sanitary napkins, hair care products such as Rejoice, Ivory, Head & Shoulders, and Pentene, and Oil of Olay facial skin care products. In

1996, the company opened a second U.S.$60 million plant. This has helped not only to reduce Thailand's reliance on imports of its brand name products, but has made the country an important distribution center for P&G products for Australia, the Philippines, Singapore, Malaysia, Indonesia, and Taiwan. Citing overall investor-friendly economic policies as one reason for its future expansion, P&G announced plans to increase its investment in Thai production facilities to U.S.$140 by the year 2000. In an example of localization, P&G distributes its products through nine Sales District Offices (SDO) that are jointly managed with a local, Thai owner. Each SDO is technically independent and operates within a clearly defined radius, but because they have a common interest in promoting their products, information and ideas are often shared.

P&G has planned to participate in the AIJV. It has proposed to invest five billion bath over a five-year period in four countries-for the production of detergent and soap in the Philippines; sanitary napkins, skin care moisturizers, shampoo, hair conditioners, and diapers in Thailand; soaps and fatty acids in Malaysia; and cosmetics in Singapore. So far, Singapore and the Philippines have given approval to P&G to proceed. In contrast, the Thai government has decided not to participate for fear that P&G expansion would crowd out local consumer goods manufacturers.

For both Matsushita and IBM, manufacturing activities are for labor-intensive products or components with relatively low levels of technological sophistication, such as low-capacity disk drives.

With the increasing convergence of consumer needs and tastes in Thailand to those of Western nationals, MNCs are eagerly jumping at opportunities to build their share of this market. All companies are able to use their global brand names in the Thai market. On the other hand, they share a need for local adaptation-translation information on product packages and enclosed documents into the Thai language.

MNCs view Thailand less and less as a separate market. To the contrary, a regional view prevails and therefore operations in Thailand are becoming increasingly linked with those in other countries. In addition, MNCs are making significant efforts to upgrade management processes and skills. Unilever, for example, attempts to exploit regional benefits while protecting individual subsidiary's local advantages by coordinating various product decisions through "Product Champion Groups". Such groups consist of managers representing various functions from each country in the region, and are led by a senior manager from one of those countries. To assure global strategic consistency, the Product Champion Groups are integrated in corporate networks.

Nestle, IBM, and Toyota have engaged in some reorganization to better coordinate their regional activities. In its marketing division, Nestle established Business Groups and

Business Units to enhance responsiveness and flexibility in sales and marketing. For example, combing the Milk 1 and Milk 2 groups in the previous structure formed the Milk Department. The department now has eight marketing managers handling twelve milk products under four brands. The company also established an Indochina & Myanmar Business Unit in its Thai subsidiary, indicating its increasing regional market orientation. It has already obtained authorization to build a fully owned factory for Milo and Nescafe in Vietnam.

IBM went through an extensive restructuring in 1994, the same year as Nestlé's, involving the shift of authority for many of IBM Thailand's business units to regional offices outside Thailand. Seven business segments now report directly to worldwide and regional business headquarters. These segments include finance, insurance, manufacturing, banking, petroleum, transport, and travel. The country managing director retained responsibility for general business, which includes government, health, utilities, communication, education, cross industries, and construction.

In the PC business, IBM centralized the entire inventory and warehousing for individual countries into a few centers, namely Hong Kong, Singapore, and Korea. All PC shipments to countries in ASEAN are carried out through Singapore, IBM also set up a headquarters in Singapore to supervise the Southeast Asia PC business.

Both local and foreign companies realize that human resource problems act a growth inhibiting factors and are slowly incorporating human resource aspects into their strategies. Toyota's reorganization included development of training programs to provide its local employees with opportunities to advance to higher positions in the administrative hierarchy. These MNCs have made significant efforts to globalize their top management teams.

Although Unilever is the only one of the six MNCs that had a Thai Managing Director as of 1995, local nationals occupy many positions on the top management teams of all companies. All these MNCs recognize and emphasize the human resource problems of Thailand, in particular the fact that the type of education provided in sometimes ill-suited to labor market requirements. Nestle implemented its attempt at improving human relations by encouraging involvement in the "Five S's Program" (Kaizen" originated by its subsidiary in Japan. It incorporates five steps: identify waste, organize, clean the plant, clean one's self, and maintain self-discipline. P&G enhanced teamwork to improve production efficiency through a "vertical start-up team," whereby a product core team is assembled to identify areas that need support or improvement. The team then develops an execution plan to ensure efficiency of production systems, the operating capability of personnel, and overall system standards. Matsushita will relocate its training courses for Thai employees from the regional office in Singapore and house them in their new $28 million head office.

The ability of Thailand to sustain its economic growth and to play a more vital role in the globalization process of MNCs depends very much on how Thailand develops its human resources and increases its ability to absorb high-value-added technology. The government has already committed to pursue this objective, at least in the next five years of the NESD plan. Some Thai companies have tried to catch up through the short-cut strategy of strategic alliances. Foreign MNCs already present in the country should try to incorporate technology transfer and human resource development strategies into their overall corporate and regional strategies.

Thailand's electronics industry has made major strides in the past decade and now produces many types of electronics equipment, subassemblies and components. The electronics industry has played an increasingly important role in the manufacturing sector, particularly with product manufactured for export. Among the leading industrial and professional electronics products are hard disk drives for computer, keyboards and telephones. Thailand also has become a major manufacturing and assembly base for a number of electronic and related components, including integrated circuits, printed circuit boards, miniature ball bearings, computer cards and cables. During the rapid economic growth of 1986-1994, higher value-added and higher technology products such as facsimiles and cellular telephones began to be produced. Firms that manufactured components for export gradually started supplying parts Dan components to be assembled into export products.

Some of the most promising investment opportunities in Thailand's electronics industry are in the areas of consumer electronics, computers and peripherals, communication equipment, electronic assemblies, and supporting industries such as molds and dies, metal plating, transformer winding.

Engineering plastics, with their superior properties, are finding increasing uses in applications demanding higher performance than commodity plastics. Engineering plastics include polyacetal nylon, polycarbonate, and thermoplastic polyester molding compounds. Now only nylon is produced in Thailand mainly for the synthetic fiber industry. Thailand has been exporting an ever-larger part of its synthetic fiber production.

Engineering plastics have seen excellent growth over the past few years and the Board of Investment announced in April 1994 that it will begin granting special investment incentives for the production of engineering plastics as part of its strategy to encourage growth in Thailand's supporting industries.

Investment opportunities for engineering plastics include polyacetal, nylon, PET, and PBT. Production of these compounds is promoted by the BOI. The growing demand for PBT at around 1,500 to 2,000 tons a year is a possible investment opportunity.

The expansion of production facilities for the three main synthetic fibers (polyester, nylon and acrylic) for domestic and export markets is being met by new investments. New investment opportunities will depend entirely on the export market and it is expected that foreign investment will play an important role in this development

General Attitude towards Foreigners and Foreign Investments

- Relatively open society and does not vigorously oppose foreign influence. Thai nationalism exists in a more subtle form, which foreign investors can easily learn to avoid.
- Foreign employment is subject to the Alien Occupation Law. It requires all aliens to obtain work permits. However, special treatment may be given under the Investment Promotion Law.

CONCLUSION

Foreign firms have played an important role in the structural transformation of the Thai economy in its exports. Through FDI, the Thai economy has been transformed far more rapidly than could have been achieved through internal resources alone. Furthermore, through this investment MNEs have transferred technology to their affiliates in Thailand. To some extent, the failure to upgrade and the growing threat that factories would shift to China or Vietnam as wages in Thailand became uncompetitive were part of the structural problems faced by the Thai economy which ultimately made the high growth rates of the recent past unsustainable. The problems are easy to identify by the inadequate human capital, infrastructure bottlenecks, overly-protected industries, too great an emphasis on export promotion and the Government had taken steps to alleviate many of these problems even before the crisis erupted.

To expand the skill level of the population, the Government increased the number of years of compulsory education, encouraged private schools, provided scholarships for foreign study, etc. To relieve the pressures on infrastructure in the Bangkok area and to reduce the regional disparities in income levels, the BOI promoted a greater decentralization of investment projects away from the Bangkok Metropolitan Area. Tariff levels were also coming down in protected industries before the crisis; such in the automobile sector, and remaining local content requirements were being phased out as part of the TRIMs agreement. These later policies were given a strong vote of confidence when three major US investors decided to establish a regional hub in Thailand for the export of cars and parts.

The Thai policy towards inward investment-although relatively open by developing country standards could still be characterized until recently as an appendage of more general import substitution and export promotion policies. Firms wishing to export most of their output faced few restrictions. They could locate anywhere; hold all of the shares in the affiliate, as well as the land on which the factory was build, etc. They also received tax holidays and exemptions on duties for imported inputs. In contrast, firms wishing to sell mostly in the local market were either prohibited or restricted in a number of ways depending on the sector. They often had to settle for minority ownership and could only lease land for a fixed period. In some cases, they had to receive an authorization through a lengthy and not always transparent process.

Unlike the policy initiatives in other areas, this dualistic policy towards foreign investors was changing only slowly before the crisis. There have been proposals to amend the Alien Business Law in the past, but it is only now that such an amendment is expected to pass through Parliament. The reforms proposed as a result of the crisis represent a significant step towards a more open and unified approach to FDI policy. Nevertheless, the fact that reforms have been enacted during an economic crisis and that some, such as in banking or the majority foreign ownership of joint ventures, appear to be temporary might suggest to potential investors that they are not based on a fundamental reappraisal of development strategies and hence will not survive the return of economic growth.

The on-going financial crisis in Thailand and the structural problems which it has brought to light present an opportune moment to reassess whether existing policies towards FDI in Thailand, as part of more general growth strategies, have best served the interests of economic development. Export promotion policies based on foreign investment had proved highly successful at generating massive exports in sectors in which Thai firms had no experience. But at the same time, the years before the crisis were characterized by growing concerns over shortages of skilled labor and rising wages not matched by productivity. As a result, Thai low-technology exports were declining in the face of stiff competition from China, Bangladesh and Vietnam, and this shortfall was not being offset by sustained growth in medium-to high-technology exports.

Experience in both OECD and non-OECD countries suggest that too great an emphasis on export promotion does not always yield the expected benefits. Not only has the resulting export growth often proved unsustainable, but also such exports are also often highly dependent on imported components because of the need for high quality inputs in order to compete effectively in export markets. This dependency reduces both the potential benefit to the balance of payments and the responsiveness of the economy to exchange rate changes. In addition, because high export-oriented firms are less likely to source locally, such investment limits potential technology transfers between foreign affiliates and local suppliers.

In contrast, local market oriented firms are more likely to source locally and hence to transfer technology in many cases. Furthermore, because they often offer goods and services of higher quality and lower prices, they make it easier for Thai firms which make use of these goods and services to compete in world markets, thus assisting in the development of indigenous exporting capabilities. Recent reforms in FDI policies in Thailand have reduced this strong bias in favor of export-oriented investment projects and could open the way for more FDI by firms wishing to supply the Thai market. If these reforms prove to be durable, the Thai economy may be poised in the medium term for a period of more sustainable growth, with local firms contributing more to export growth.

Net Flows of Foreign Direct Investment Classified by Countries **(Millions of Baht)**

Line	1997	1998	1999	2000p				
				Q1	Q2	May	June	July
Japan	42,371.0	60,477.8	18,558.0	8,243.4	1,586.2	771.8	292.9	2.606.4
Hong Kong	14,816.0	16,571.2	8,862.1	6,164.6	1,775.7	1,173.8	262.0	1.224.9
Taiwan	4,604.9	4,073.2	4,581.9	2,445.5	2,364.7	931.1	622.6	543.7
U.S.A.	25,835.2	51,800.4	24,137.2	7,130.9	1,905.2	939.2	-357.8	1,269.4
EU	10,713.1	37,570.8	51,941.7	3,344.0	2,685.3	141.4	1,347.0	1,289.6
of which: Belgium	-104.8	1,296.7	-1,380.0	-562.9	34.9	8.6	17.8	8.2
France	-35.9	10,926.9	8,983.1	-480.9	111.2	9.7	-105.5	836.6
Germany	2,101.6	4,074.3	10,973.2	2,097.5	305.8	5.3	96.9	-151.7
Netherlands	4,424.2	13,836.2	24,584.0	-62.0	21.2	42.3	-58.8	39.1
U.K.	3,693.6	4,814.6	7,009.4	1,952.1	1,996.0	200.7	1,042.8	360.9

ASEAN	10,675.0	23,817.0	21,259.9	-1,287.2	2,428.0	2,192.9	260.6	9.2
of which: Indonesia	203.1	111.4	46.1	10.4	-1.8	-37.6	35.8	118.0
Malaysia	371.2	710.7	1,043.8	415.0	93.2	78.7	15.5	125.2
Philippines	248.9	320.0	122.7	-	5.0	1.6	3.4	-2.3
Singapore	9.851.8	22,673.6	20,047.4	-1,712.6	2,331.5	2,150.1	205.9	-231.7
Switzerland	3.942.7	3,078.7	2,267.9	83.5	-661.2	-716.4	112.1	154.0
South Korea	914.3	2,799.4	205.3	7.3	74.8	1.0	14.4	-3.9
China	-284.4	217.2	-81.2	3.6	56.0	11.0	38.7	12.7
Australia	3,824.3	1,525.6	489.8	43.9	233.6	163.5	38.6	25.4
Canada	52.8	128.1	113.2	12.9	166.6	2.4	164.3	3.7
Others	231.3	7,828.9	2,255.8	-655.9	1,205.9	-18.9	553.5	260.9
Total	117,696.3	209,888,3	134,591.7	25,536.6	13,820.7	5,592.9	3,348.8	7,396.0

1/Direct Investment = Equity Investment plus loans from related companies

Source: Bank of Thailand

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