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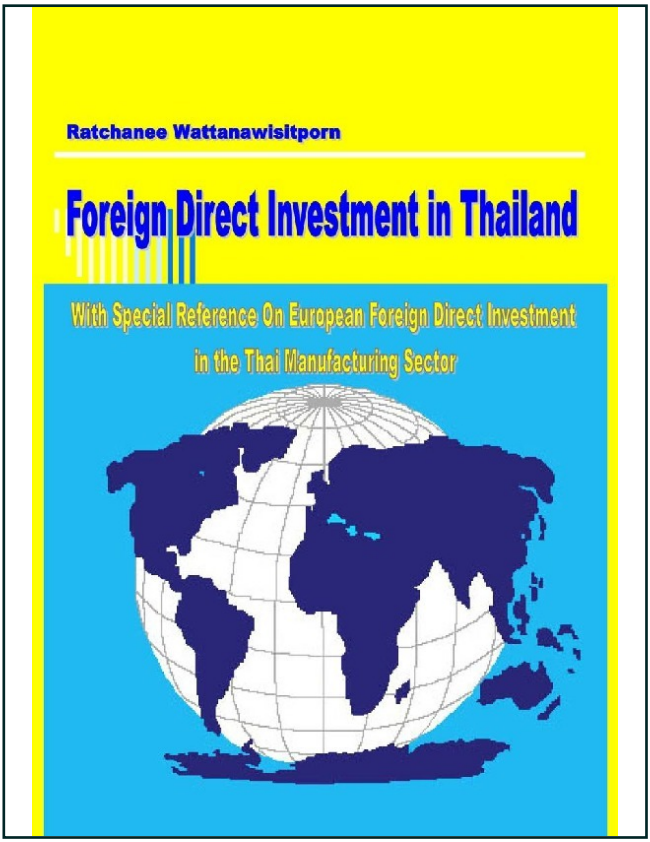
Foreign Direct Investment in Thailand: With Special Reference on European Foreign Direct Investment in the Thai Manufacturing Sector



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CHAPTER 1

Introduction

1.1 Introduction

The terms of foreign direct investment (FDI) is frequently considered as concurrently being one of the consequences and drivers of globalisation which result from the existence and actions of multinational corporations (MNCs). In the process of opening up economies to participate in some of the positive impacts of globalisation, most of the countries position themselves in respect of attracting foreign direct investment. Besides, the power to attract investment from abroad and its positive impact in improving economies is valued as an important ingredient of the path to successful economic growth and development. The major reason supporting the importance of FDI as a factor in economic growth, particularly in developing countries, is that it can bring to the host economy a number of benefits such as employment generation, business culture, technology transfer, and capital formation.

Thailand has not been an exception. FDI has played an important part of the economic transition, business liberalisation, and macro-economic growth story in Thailand for over two decades up to the onset of the Asian financial crisis in the middle of 1997. At least three major trends were clearly evident in investment patterns. First, Thailand was one of the world's fastest growing economies and, since the 1960s, it has been one of the most successful developing countries.[1] Second, remarkably high real growth rates of 8-9 per cent were maintained almost 30 years.[2] Third, first formulating the Promotion of Investment Act in 1972 focusing on labor-intensive industry has driven Thailand more successful in attracting FDI inflows into manufacturing sectors, especially export-oriented industries such as clothing, textiles, footwear and toys, including labour intensive assembly activities in electronics and electrical goods industries.

[1] OECD Proceedings (1999b), Foreign Direct Investment and Recovery in Southeast Asia, Centre for Co-Operation with Non-Members, Paris, France, p. 207.
[2] Pakkasem, P. (1974), Development Planning and Implementation in Thailand, in Baldwin, W. L., Maxwell, W. Davis, The Role of Foreign Financial Assistance to Thailand in the 1980s, Lexington Books, Lexington, Massachusetts, Toronto, London, pp. 6-19.

Thailand has started industrialisation under the conditions of shortages in capital, technology, and skill manpower since 1960s. During the same period, the agricultural sector expanded much more slowly. This changed the structure of the Thai economy from dependence on agriculture to dependence on industries and services. A dramatic change occurred in the economic relations between Thailand and foreign nations. International trade expanded, and foreign investment rapidly increased, especially investment from the United States and Japan, major investing countries.

In terms of economic growth in Thailand as mentioned earlier, it is important to know that this rate of growth did not happen in short period of time, but had started in the late 50's, building up the economic progress for over 30 years. Thus, Thailand used direct investment as a driving force to economic growth, obtaining linkages with global and regional production networks, shifting the economy away from agriculture towards manufacturing and within manufacturing, away from textiles into electronic goods.[3] Thailand's industrial structure then has been crucial changed through FDI. In particular, foreign affiliates have dominated production and sales in many manufacturing industries in Thailand and have contributed significantly to the growth of exporting industries. It is undoubtedly that FDI has been a dynamic force in the development of Thai industries, then gave Thailand the necessary technology and capital, which lead to direct inward investment, thus came close to the level that are referred as NIEs countries .

Given the growing role of foreign direct investment and multinational corporations (MNCs) in developing countries in the age of globalisation, its contribution is expected to continue playing an important element of Thai economic development process. The question is still not only that FDI is needed, but how foreign capital and technology should be put to work in the Thai economy and such transfers can be accelerated and enhanced through FDI promotion policies and can keep Thailand as an attractively investing location.

This study examines the impacts of FDI on economic growth and related policies at the macro-level as well as the promotion activities at the micro-level in order to synthesize and provide key lessons from the Thai experience on utilizing FDI as a tool of economic development. A special reference is made to conduct a survey on the factors affecting FDI

[3] OECD Proceedings (1999b), Ob cit., p. 249.

from European Enterprises in Thai manufacturing sector dealing with the technology transfer and exports relationship with FDI in Thailand.

1.2 Background to the Study

In this era of increasingly globalised world economy, FDI is a particularly significant driving force behind the interdependence of national economies. In other words, FDI plays a key role in the globalisation process, generating both challenges and opportunities for several countries. As mentioned earlier, Thailand has not been an exception. Since first formulating the Promotion of Investment Act in 1972, Thailand has been very successful in attracting FDI inflows into this developing, transitional economy. Indeed, FDI has been an important part of the economic transition, business liberalisation, and macro-economic growth story in Thailand over the last decade or so.

In today's highly competitive international economic environment implies that it is difficult to build up an industrial capacity behind closed doors. The establishment of high policy standards and an attractive environment for FDI has become a necessity. FDI, together with trade, are the main vehicles for globalisation since the absence of transborder discrimination, complete freedom of establishment and national treatment for foreign affiliated of MNCs is comprised.[4] Failing to attract FDI causes the risk that a country, however economically successful in the past, may be deprived of the main sources of economic growth, namely capital, managerial and production capacity, jobs competitiveness and productivity. For this reason, many developing countries have now included FDI in their development strategies, as a means of fostering industrialization and enhancing the integration of their economies into the global economy and their trade competitiveness. Host countries expect that the diffusion of knowledge and technology controlled by TNCs will exert a positive impact on the upgrading of local capabilities and add to the dynamic efficiency and competitiveness of their economy. The amount of knowledge diffusion depends partly on the extent to which foreign affiliates establish and deepen linkages with local enterprises.

As with other countries actively involved in the world economic system, Thailand needs to set the conditions right to harness and promote her competitive advantage. By encouraging and

[4] Gray, H.P. (1995), The Modern Structure of International Economic Policies, Transnational Corporations, Vol. 4, no. 3, December 1995, UNCTAD, United Nation, Geneva, pp. 49-66, here p.51.

seeking to improve its attractiveness to foreign direct investment, the policy challenge for governments is to identify ways to promote the use of local firms in such a way that it contributes to a strengthening of the local enterprise and sector. In the context of development planning, the government ought to influence the performance of FDI, but in carry out this task, it is important that foreign investors, big or small, play a part in the renewal and expansion of economic activities and work hand in hand with local enterprises toward this end.

On the other hands, Thailand should be aware of the potential contribution of FDI because the foreign investor has less commitment to the host economy and is also more mobile. But most of developing countries attract MNCs to invest because they are relying on managerial and technology transfer through direct investment. Also, these types of transfer cause a spill-over effect which regards as external effect and growth in productivity in invested countries.[5] With this in mind, direct investment plays a major role in economic growth and that why it is important for Thailand, especially policymakers who put policy into practice, to analyze the country and the way to economic development in aware of the need to maintain the economic attractiveness and find out the best-practice policies to make openness work for development, including the role policies towards FDI plays in enhancing economic growth.

1.2.1 A Question of Definition: What is Foreign Direct Investment?

It is crucial to note the principle used in distinguishing between FDI and portfolio and other types of foreign investment. Base on the definition of FDI given by World Investment report, this definition specifies that:

> "Foreign direct investment (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by the resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among

[5] Blomstroem, M. and Sjoeholm, F. (1998), Technology Transfer and Spillovers: Does Local Participation with Multinationals Matter?, Working Paper 6816, National Bureau of Economic Research, Cambridge, p.1.

affiliated enterprises, both incorporated and unincorporated. FDI may be also undertaken by individuals as well as business entities."[6]

The general feature of the above definition lies in terms like long term relationship, lasting interest and control which distinguish FDI from foreign portfolio investment in international stocks and bonds and other financial instruments, since the last type of investment does not search for those terms as above defined. In keeping long-lasting relationship between foreign countries, FDI must consists of three possible components; setting up new equity from parent company to a subsidiary company or branch, expanding or taking full control of existing enterprise; reinvested profit of a subsidiary company; and long or short term loans (5 years or more) from the parent to the subsidiary.[7]

Generally, a direct investment enterprise is defined as an incorporated and unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise.[8] However, sometimes, the 10 per cent limit should be treated with flexibility as other factors can also be taken into consideration to determine a direct investment relationship such as a representation on the board of directors, participation in the policy-making processes; material inter-company transactions; interchange of managerial personnel, provision of technical information, or provision of a long-term loan with preferential interest rates.

Though, it is hard to define how much property ownership one has in terms of the amount of stock each own, usually having 10 per cent or more of the total stock or share is considered as ownership of assets and management which gives foreign affiliates an effective authority on the management of the enterprises.[9] The majority of MNCs are of this type which they have the right to control the production and sell the product across the nations. In the case of Thailand, this specific perspective has been adopted as well. Practically, at least 10 per cent of

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[6] World Investment Report (2002), Transnational Corporations and Export Competitiveness, UNCTAD, United Nation, New York and Geneva, p. 291. This general definition of FDI from WIR is based on OECD, Detailed Benchmark Definition of Foreign Direct Investment, Third Edition (Paris, OECD, 1996) and International Monetary Fund, Balance of Payments Manual, Fifth Edition (Washington, D.C., IMF, 1993)

[7] South Centre (1997), Foreign Direct Investment Development and the New Global Economic Order: A Policy Brief for the South, Atar, Geneva, p. 27.

[8] Bellak, C. J. (1993), Effekte aktiver Direktinvestitionen im Ursprungsland, Europäische Hochschulschriften, Verlag Peter Lang GmbH, Frankfurt am mein, p. 23, from: "Summary of OECD Detailed Benchmark Definition of Foreign Direct Investment".

[9] Framework for the Collection, Compilation and Dissemination of Foreign Direct Investment Statistics. [Online] Available: http://www.fias.net/html/services_framework.htm (14.04.2003)

foreign equity that companies participate in the registered capital is known as foreign affiliates and taken into account as FDI.

1.2.2 Overview of FDI in Thailand

Thailand is an open economy which has significantly received an increased share of FDI. In the 1960s and 1970s, FDI flow were mostly channelled into import completing industries such as textiles, automobiles, and chemicals., but in the 1980s following the Thai government's policy of promoting manufactured export, more export-oriented industries were induced to the country such as clothing, textiles, footwear and toys. More recently, labour intensive assembly activities in electronics and electrical goods industries have been the main attraction to foreign investors. In the late 1980s, after the realignment of major world currency and rapid depreciation of the Japanese Yen, FDI inflow to Thailand increased sharply. Much of these inflows had been channelled to intermediate and capital goods industries such as electrical appliances, and electronic parts and components. FDI has therefore contributed to the rapid increased in manufactured exports and also to the deepening of industrial structure in Thailand. FDI is therefore necessary for country's industrialisation.

Table 1.1: Foreign Direct Investment Net Inflows in Thailand During the Period of 1970-2002

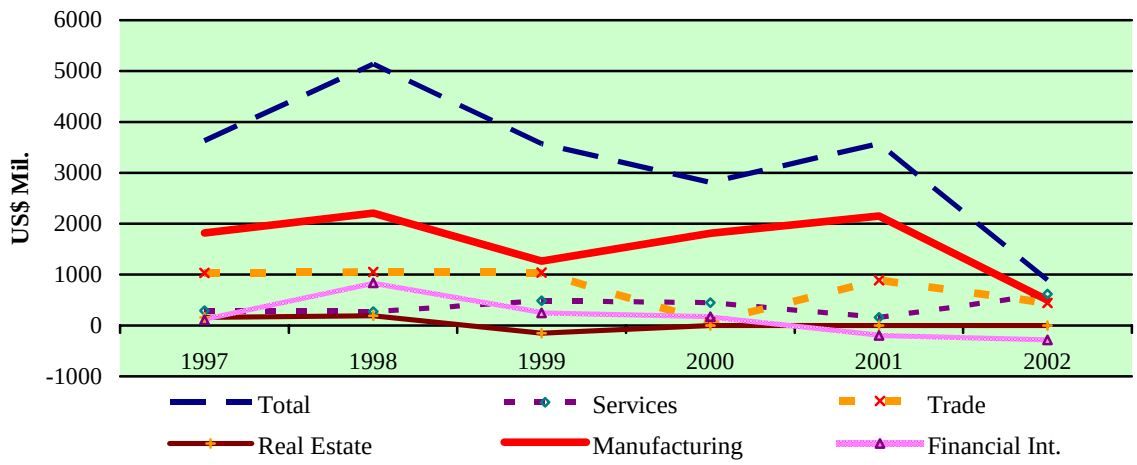
Period	Value (U$ Million)	% Manufacturing FDI of Total FDI
1970-1974	416	30
1975-1979	382	39
1980-1984	1,487	31
1985-1989	3,687	44
1990-1994	3,174	30
1995-1999	6,565	37
1995	567	28
1996	708	31
1997	1,859	50
1998	2,165	43
1999	1,267	36
2000	2,813	64
2001	3,759	57
2002	899	56

Source: Adapted from Bank of Thailand, Table 63.1: Net Flows of Foreign Direct Investment Classified by Sector (Yearly 1970-2002). Online Databank: http://www.bot.or.th/bothomepage/databank/EconData/Econ&Finance/Down load/Tab63-1.xls (21.04.2003)

Statistically, inflows of FDI to Thailand increased from around US$ 400 million during the period of 1970-74 to over US$ 14,031 million during the period of 1995-2002 (see Table 1.1).

Moreover, the share of total FDI mainly comes into the manufacturing sector over the years. During the early 1970s, manufacturing sector accounted for 30 per cent of total inflows. This increased to about 44 per cent in the period of 1985-1989. There was a mild decline in the share to around 38 per cent in the latter half of the 1990s. This was mostly due to reduced profitability in domestic market oriented investment following the on-set of the currency crisis in late 1997. However, the inflows of foreign direct investment have increased significantly, and contributed not only the foreign capital needed to manage outstanding debt, but also the technical and managerial skills needed for the restructuring of operations.[10] In 2002, the share of FDI in manufacturing sector was increasingly up to 56 per cent of its total amount.

Figure 1.1: Net FDI Inflows Classified by Sector



Source: Adapted from Bank of Thailand, Table 63.1: Net Flows of Foreign Direct Investment Classified by Sector (Yearly 1970-2002). Online Databank: http://www.bot.or.th/bothomepage/databank/EconData/Econ&Finance/Down load/Tab63-1.xls (21.04.2003)

As Thailand has been a favourite location for foreign firms escaping appreciating currencies and escalating labour costs. The flow of foreign firms has been matched by local investors who, stimulated by lower interest rates and a booming economy, have also increased investment activities. Manufacturing has been the longest recipient of FDI. Despite a decline in other sectors, FDI in manufacturing continues to expand (Figure 1.1) with various types of industrial activity such as food and sugar, textiles, electronical machinery and appliances, machinery and transport equipment, chemical, petroleum products, construction materials and so forth.

[10] Kokko, A. (1999), Thailand After the Crisis: challenges and opportunities., no page number. [Online] Available: http://www. ekh.lu.se/ac/Abstracts/Kokko.html (20.02.2003)

1.3 Theoretical Background of Foreign Direct Investment

1.3.1 FDI and Its Determinants

To understand the nature of FDI as well as its determinants is necessary for government and policy makers to improve the attractiveness of their locations to FDI. As the global situation has rapidly changed, the nature and attitude of FDI might change also. In providing and implementing the right policy to attract FDI inflow, the determinants of FDI, especially the factor affecting their decision making in choosing one particular location and not the others, are still the most essential issue till the present time. There are many theories explaining about FDI determinants. OLI approach proposed by Dunning has been mostly employed, including this study, since it is able to provide the understading of the determinants of FDI. This theory roughly lists three advantages explains how these three factors create the enterprise to direct investment. First, there must be advantage in ownership of particular assets. This means that enterprise can overcome disadvantage problem in abroad by having special assets such as technology, business management, and name of brand, investing in the ease condition of taking profit in abroad. Second, there must be the advantage of condition of location meaning that doing business abroad has more advantage than home country. And finally, there is internalisation advantage. This occurs when the transaction of special assets between the corporations become difficult to carry out by a cause of market failure. Therefore, the transaction becomes internalized within the same production or business group, avoiding the loss from the market and creating a benefit to direct investment.

1.3.2 FDI and Its Effects

In the current process of globalisation, multinational corporations play significantly a starring position. The share of international capital flows accounted for by FDI of multinationals has been increasing in recent decades. UNCTAD (2001) reports that from 1986 through 2000, worldwide cross-border outflows of FDI rose at an annualised rate of 26.2 per cent, versus a rate of just 15.4 per cent for worldwide exports of goods and non-factor services. In the second half of the 1990s this difference widened to 37 per cent versus just 1.9 per cent.[11]

As mentioned earlier, the term FDI has distinguished itself from other types of international capital such as portfolio investment or dept purchases due to the connection of some degree of

[11] UNCTAD (2001), World Investment Report 2001: Promoting Linkages, United Nations Conference on Trade and Development, United Nations Publication, New York and Geneva. p. 10, table I.1.