# An Assessment of the Investment Regime:

# THAILAND Country Report

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***By***

***Deunden Nikomborirak***

**Thailand Development Research Institute**

## 1. Overview of the Thai FDI Regime

The investment policy regime in Thailand has been continually revised to reflect the broad development of the economy and its trade regime from the era of import substitution to export promotion, and from pre-crisis industrial boom to post-crisis liberalization. As can be seen in Table 1 in the following page, domestic laws and regulations were promulgated or amended to facilitate FDI since the early seventies when Thailand adopted the export promotion strategy to stimulate domestic growth. As a result, investment policy has become increasingly liberal during the past three decades as the country embarked on the path of industrialization.

The Thai FDI regime is one that concentrates mainly on the provision of fiscal incentives, in particular taxes and duties exemptions. A salient feature of the regime is that, unlike many Asian countries, the government does not have specific industries or sectors that it selectively promotes. There is, however, a general indication that the high-technology investment projects that would help promote the upgrading of the Thai industries are given priority and thus, are likely to receive promotional incentives or be allowed to operate in businesses normally reserved for national commercial entities. Another important feature of the regime is its emphasis on most-favoured nation (MFN) and non-discrimination. All foreign investors are eligible for similar rights and subject to similar obligations under the domestic laws, while local and foreign investors are eligible for the same tax and non-tax incentives offered by local investment promotion agencies.

### 1.1 The legal framework

The FDI regime in Thailand is shaped by three main laws, the Foreign Business Act of 1999, the Investment Promotion Act of 1977 and the Industrial Estate Authority of Thailand Act. The first prescribes the scope of and the conditiond under which a foreign entity may participate in local businesses. The second law guarantees investors' protection from undesirable state measures and establishes the investment promotion regime. The Industrial Estate Authority of Thailand Act 1979 also specifies investment incentives, but specifically for factories located in industrial estates. In addition to these general laws, some sectors—such as public utilities; petroleum, gas, and other natural resources; financial services; and certain business services—are covered by sector-specific legislation setting out the criteria for foreign participation.

**Table 1: Thailand: Major Developments in the FDI Policy Regime**

| **Period** | **Development** |
|---|---|
| State capitalism (1940s–1950s) | • state monopolization in imports and exports in many industries or sectors. |
| Import substitution (1958–71) | • 1st Economic Development Plan (1961–66) focused on the reduction in direct government involvement in the economy and greater promotion of private investment.<br>• Import substitution policy introduced.<br>• High levels of protection provided for capital-intensive industries such as automobiles.<br>• High tariffs imposed on finished consumer products.<br>• Industrial Promotion Act of 1960 establishes an organization which later became the Board of Investment, marking the beginning of tax incentives.<br>• Tariff structure revised several times to give greater protection to domestic industries.<br>• Balance of payments problems arise due to the import of parts and components, leading to discussion of the sustainability of the import substitution policy. |
| Export promotion (1972–92) | • 3rd Economic Development Plan (1972–76) emphasized a shift from import substitution to export promotion.<br>• Investment law revised in 1972 to provide exemption from duties on raw materials and intermediate items for exporting industries.<br>• Alien Business Law of 1972 enacted, prohibiting foreigners from entering several business areas.<br>• 21 of 72 provinces designated as investment zones.<br>• Investment Promotion Act enacted in 1977, introducing income tax holidays and 50% reduction in import duties on machinery.<br>• Four investment zones established in 1978.<br>• Tax incentives in raw materials and machinery reduced for Bangkok and Samut Prakarn, to promote deeper industrial decentralization.<br>• A series of baht devaluations take place between 1983 and 1991.<br>• Investment Promotion Act revised in 1987, introducing tax privileges and refunds, industrial zones and export-processing zones.<br>• 6th Economic Development Plan (1987–91) aims to improve income distribution and reduce economic disparity. |
| Promotion of industrial decentralization (1993–96) | • 7th Economic Development Plan (1992–96) aims to reduce income disparity between urban and rural areas and promote sustainable development.<br>• Investment Promotion Act revised in 1993 to promote industrial decentralization, with generous incentives provided to investment projects located outside Zone 1.<br>• Local content requirements eliminated for motorcycles in anticipation of the TRIMs Agreement of 1993. |
| Post-crisis liberalization (1997 – present) | • Liberalization extended as part of the IMF-led reform package.<br>• Foreign Business Act of 1999 enacted, allowing full foreign participation in most manufacturing industries.<br>• Condominium Act revised in 1998 to allow foreigners to wholly own buildings on two acres or less of land.<br>• Corporate Debt Restructuring Advisory Committee established to monitor and accelerate debt restructuring.<br>• ASEAN Investment Agreement adopted in 1998.<br>• Bankruptcy Act revised in 1999 to establish a central bankruptcy court.<br>• Local content requirements eliminated for vehicle assembly in 1999.<br>• Foreigners allowed to own 100% of shares in promoted manufacturing projects in 2000.<br>• Local content requirements in diary products eliminated in 2003. |

Source: Tangkitvanich and Nikomborirak (2004), forthcoming.

- ***The Foreign Business Act 1999***

The most important law governing alien-controlled businesses is the The Foreign Business Act 1997, which replaced the former Alien Business Law (National Executive Council Announcement No. 281) of 1972. Before the introduction of the Alien Business Law in 1972, foreigners were generally permitted to do business in Thailand with few restrictions. The law passed in 1972 classified businesses into three main categories, each with different foreign ownership restrictions. This law applied to all businesses except those that are subject to *suis generis* laws such as public utilities, finance and the media.

In 1999, a new Act was passed which supercedes the earlier Alien Business Law. The new Act is entitled The Foreign Business Act, B.E. 2542 (1999). The act guarantees most favored nation (MFN) treatment for all except American investors, who are covered by the 1968 Treaty of Amity and Economic Relations between the Kingdom of Thailand and the United States of America. Under this bilateral arrangement, with the exception of seven specified sectors[1], Americans have the same rights as Thai nationals with respect to the ownership and operation of businesses in Thailand. The same rights are reserved for Thai nationals in the United States, but as the latter country generally does not impose any restrictions on foreign investments, in practice reciprocal treatment does not enjoy any special privileges.

This new act maintains the three business categories as mentioned above, but the list of businesses in each category changed (see complete list of businesses in each category in annex 1). Business listed in category 1 are absolutely prohibited to foreigners[2] unless there is an exception contained in a special law or treaty. These include mass media, rice and animal husbandry and other resource-based businesses. Those that appear in the second category are businesses that concern national security or safety, or are involved with local art, culture, handicrafts or natural resource and environment. Foreigners are not permitted to start new businesses listed in this category unless they obtain special permission from the Minister with the approval of the Cabinet. Category Three contains businesses that the government

[1] The seven exceptions are communications, transport, fiduciary functions, banking involving a depository function (including non-bank financial institutions), exploitation of natural resources or land, and domestic trading in indigenous agricultural products.

[2] A " foreigner" refers to a natural person that is not of Thai nationality or a juristic entity that : (1) is established under foreign law; or (2) half or more of its capital is owned by foreigners even if the company is incorporated under Thai law, or (3)half or more of the value of the total capital being invested by foreigners even if more than half the capital is owned by Thai nationals. (The third requirement is effectively a bar on the use of Thai national as nominees.)

believed are not yet "competitive" and thus, are vulnerable to foreign competition. These include mining, salt farming, forestry, fishery, professionals services, and all services unless specified in the Ministerial regulations. Similar to the previous category, foreigners may obtain a permission to operate businesses listed under this category. The only difference is that the power to grant permission is vested with the Director General and the Foreign Business Committee. To obtain a license, applicants must be able to convince the concerned local authorities that the particular investment project could not be competently conducted by local firms.

From the list of businesses appeared in annex 1, it would appear that the manufacturing sector is very much open to foreign investment, bar a few businesses that may concern local small and medium enterprises but are not the major interests of foreign transnational companies. The service sector, however, remain relatively closed. Nevertheless, the new law is generally less restrictive than its predecessor. For example, 21 of the 63 sectors in which foreign majority participation was restricted under the Alien Business Law—including drug manufacture, cement production, and animal feed processing—are no longer restricted under the Foreign Business Act. Certain sectors—construction, broker businesses, auction houses—that were classified under the more restrictive category 2 under the old law were moved to the third category. However, the act still imposes minimum capital requirements for foreign investors; 2 million Baht for businesses listed in category 1 and 3 million Baht or those in categories 2 and 3. The new law also eliminated restrictions on the nationality shareholders and board of directors. The previous Alien Business Law required that the majority of the directors and shareholders must be Thai for the company to qualify as a local juristic entity.

Unlike the former Alien Business Law 1972, however, the new Foreign Business Act impose more severe criminal sanctions. Any foreigner who operates a business that are prohibited to foreigners according to the law without an Alien Business License is liable for a fine from 100,000 to 1,000,000 Baht and imprisonment of up to three years. Further, a Thai national or juristic person that assists a foreigner in circumventing the restrictions stipulated by the Foreign Business Act by means of holding shares as a nominee, or being a nominal owner of the company, shall also be liable for a fine of 100,000 to 1,000,000 Baht and imprisonment of up to three years.

- ***The Investment Promotion Act 1977***

The Investment Promotion Act sets out principles and procedures for investment promotion, including protection guarantees, tax and non-tax incentives offered to foreigners. The act established the Board of Investment (BOI) as the principal agency responsible for promoting investment through the granting of investment incentives and guarantees. Since its promulgation in 1977, it has gone through several amendments in keeping with changes in the government economic policy.

The act empowers the BOI to grant various fiscal and non-fiscal incentives for foreign and domestic investment that meet national economic development. These incentives and privileges currently include exemption from or a reduction in import duties on imported machinery, materials, and components; exemption from corporate income tax for 3–8 years, with permission to carry losses forward; and exemption from dividend tax during corporate income tax holidays. Foreign firms may also (a) receive permission to bring in foreign technicians and experts to work on a promoted project; (b) own land in connection with a promoted project for business offices and living residences and; (c) operate a business prohibited in categoriess 2 or 3 of the Foreign Business Act as mentioned earlier.

The tax incentives currently provided by the BOI are summarized in Table 2. Broadly, they differ according to the zone in which the business is physically located and the sector or industry in which the firm operates. To encourage deconcentration of industrial development, the BOI divided the country into three zones based on proximity to Bangkok. Investment projects located in the zone furthest from Bangkok (Zone 3) are eligible to receive the highest tax incentives. In addition, only investments in certain pre-selected sectors are eligible for tax incentives. However, the sectoral dimension has been greatly diluted by the expansion of the list of promoted sectors.

The Investment Promotion Act also contains provisions that guarantee investors against adverse shifts in government policies, rules, and regulations (such as price controls or export restrictions), as well as competition from state enterprises and other government agencies, except those already in operation.

**Table 2 Summary of Tax Incentives Currently Offered by the Board of Investment**

| *Duty Privileges* | **Zone 1** | **Zone 2** | **Zone 3** |
|---|---|---|---|
| Machinery | Standard rate of 5% or 50% reduction of import duty on machinery that is subject to an import duty of not less than 10%. | Same as for Zone 1. | Exemption of import duty on machinery for a project located in one of 40 provinces. |
| Raw materials | Exemption of import duty on raw materials used in the manufacture of export products for a period of one year. | Same as for Zone 1. | Exemption of import duty on raw materials used in the manufacture of export products for five years for a project located in one of 40 provinces. |
| Corporate tax | Tax holiday for three years for a project located in an industrial estate or promoted industrial zone, provided that it has invested capital of 10 million baht or more and obtains ISO9000 or similar international certification within two years of start-up; otherwise the tax holiday will be reduced by one year. | Same as for Zone 1 except that tax holidays are granted for five years. | - Same as for Zone 1 except that tax holidays are granted for eight years.<br>- A project located in one of 18 provinces is given the following additional privileges:<br>• 50% reduction in corporate income tax for five years after the period of exemption;<br>• double deduction from income tax for transport, electricity, and water expenditures for ten years<br>• 25 % percent deduction for infrastructure/construction expenditures for ten years<br><br>- A project located within an industrial estate or promoted industrial zone is given the following additional privileges:<br>• 50 % reduction in corporate income tax for five years after the period of exemption; and<br>• double deduction from income tax of transport, electricity and water costs for ten years from the date of first revenue derived from a promoted activity.<br>- A project located outside an industrial estate or promoted industrial zone can deduct 25 percent of infrastructure and construction costs from profit for ten years from the date of first sale. |

Source: Board of Investment, Bangkok

- ***The Industrial Estate Authority of Thailand Act***

To promote the deconcentration of industry away from the Bangkok area, the Industrial Estate Authority of Thailand Act 1979 provides special incentives for investors locating in industrial estates situated in regional areas. These industrial estates comprise both general industrial zones and export-processing zones.

Incentives offered by the Industrial Estate Authority are similar to those offered by the Board of Investment. The only difference is that the investment privileges are available to investment projects that are located in the industrial estates. These include the right to own land in an industrial estate, permission to obtain work permits for foreign technicians and experts, and the right to remit foreign currency abroad. Businesses operating in an export-processing zone are entitled to additional incentives and privileges such as exemptions from special fees, import and export duty, value-added tax, and excise tax applied on exports and imported machinery, equipment, and tools used in the manufacture of goods and in the construction of factories or buildings taxes or goods destined for another export-processing zone.

### 2.2 Judicial and administrative processes

Foreign investors may apply for a Foreign Business License from the Department of Business Promotion (former Department of Business Registration), the Ministry of Commerce and a Permission for Manufacturing from the Industrial Estate Authority. The length of approval for a license is 30-60 days, depending on whether the project receives promotional privileges from the Board of Investment (in which case, the approval will be speedier). The length of approval for the Industrial Estate Authority is only 1 day given that the proposed project satisfy all requirements and conditions set out by the authority.

Thailand is a signatory of the International Convention for Settlement of Investment Disputes (ICSID) since ….. , but has not yet ratified the agreement until to date. The Ministry of Finance has set up a working group to draft the Implementing Act on the Settlement of Disputes between States and Nationals of other States.

### 2.3 Roles of International development agencies in FDI

The role of international development agencies in FDI in Thailand is minimal. This is because Thailand has already graduated from the list of countries that are in need of financial assistance from international development agencies, be it the Asian Development Bank or the World Bank.

**3**. Regional and Bilateral Investment Agreements

### 3.1 Multilateral Agreement

The TRIMs Agreement negotiated during the Uruguay Round of the GATT aimed to discipline investment policies that are inconsistent with Article III.4 (on national treatment) and Article XI.1 (on quantitative restrictions) of the GATT; that is, it deals with the investment dimension of the GATT trade agreement. The TRIMs Agreement obliges all WTO member countries to phase out local content and export performance requirements imposed on foreign firms. Thailand previously imposed local content requirements on three industries—milk and dairy processing, car assembly, and motorcycle manufacturing—and had export performance requirements for investment projects applying for BOI investment incentives. In particular, projects in Zones 1 or 2 were required to export more than 80 percent of their output to qualify for corporate tax holidays, in addition to complying with other conditions.

The TRIMs Agreement was instrumental in achieving investment policy reform in Thailand. To comply with the agreement, Thailand gradually abolished its trade-related investment measures. New projects approved to receive investment incentives after April 1993 were no longer subject to local content requirements, except in the dairy product and vehicle assembly industries. Local content requirements for vehicle assembly were eliminated in 1999, with local content requirements for dairy products to be phased out by the end of 2003. Export performance requirements were lifted in August 2000.

### 3.2 Regional Agreements

As member of the Asia Pacific Economic Cooperation (APEC) and Association of Southeast Asian Nations (ASEAN), Thailand observes the non-binding investment principles of the Asia Pacific Economic Cooperation (APEC) forum, and the binding ASEAN Investment Area.

### *APEC's Investment Principles* [3]

The **APEC investment principles** are non-binding in nature and reflect aspirations to achieve investment liberalisation, rather than legal requirements to carry out immediate policy changes. Reflecting the diversity in investment regimes and the stage of economic development within the region, the non- binding nature was adopted to facilitate agreement on the initiative and to provide a platform for future dialogue on investment issues. The principles The principles also created an important educative process for APEC members not familiar with investment liberalisation.

The principles contains key provisions on national treatment, non-discrimination and transparency. Under the national treatment provision, members will accord to foreign investors treatment no less favourable than domestic investors, subject to exceptions provided for in domestic laws, regulations and policies. These exceptions, however, are not subject to stand still and roll-back commitments. Although not explicitly covered in the principles, rights of establishment are contained in national treatment and non-discrimination provisions. Consistent with the goal of 'open regionalism', the principles call for non-discrimination between members and non-members alike, without prejudice of existing international obligations (regional trading arrangements or bilateral agreements). Members will extend to foreign investors from all countries treatment no less favourable than that accorded to foreign investors from a particular country.

Members agreed to make available and transparent all laws, regulations, administrative guidelines and policies pertaining to investment. However, members were not required to list activities excluded from national treatment provisions. Other relevant principles cover performance requirements, investment incentives, expropriation, repatriation, settlement of disputes, entry and sojourn of personnel, avoidance of double taxation, investor behaviour and removal of barriers to capital exports. Again, the application of these principles is not binding and in practice, members have ample room to decide the extent of investment liberalisation.

With performance requirements, members were only asked to 'minimise' their use. Virtually no limitations were imposed on the use of investment incentives to attract foreign investment — members only agree not to relax health, safety and environmental regulations to attract

[3] This section is an excerpt from Appendix G: International Approaches to Investment, part of the Final Report on "Firm Locating Offshore" submitted to the Australian Government The file can be download from

foreign investment. Members agreed to 'minimise' barriers to investment outflow, and endeavour to 'avoid' double taxation. Temporary entry of key personnel related to foreign investment is permitted, subject to domestic laws and regulations. Expropriation of foreign investment is to be only for a 'public purpose' and on anon-discriminatory basis in accordance with each economy's legislation and principles of international law. Compensation is to be paid promptly. Members are to liberalise towards the goal of allowing free and prompt transfer of funds related to foreign investment.

Reflecting the concern of APEC developing countries, a code of conduct for foreign investors was included in the principles. Foreign investors are expected to abide by the host economy's laws and policies in the same way as domestic investors.

While members are not strictly bound by the principles and, hence, legally no protection for investors is provided, the recognition that disputes may arise led to the inclusion of a provision on dispute settlement. The principles state that disputes between members are to be settled by consultation and negotiation among APEC members. Failing this, matters should proceed to arbitration in accordance with members' international commitments, or to some agreed arbitration procedures acceptable to both parties. In relation to the APEC Investment Principles, the Osaka Action Agenda reaffirmed the Bogor commitment to the objectives of investment liberalisation by progressively providing MFN and national treatment, as well as ensuring transparency. Another agreed objective is the facilitation of investment activities through technical assistance and cooperation. These objectives are to be achieved by members' unilateral as well as collective actions (see complete text in annex 2).

- ***The Framework Agreement on the ASEAN Investment Area (AIA)***

The ASEAN Investment Area, concluded in 1998, provides an investment framework for ASEAN countries (Table 3). It requires members to grant national treatment to ASEAN investors by 2010, covering the manufacturing sector. This date has later been moved forward to the year 2003 for seven members and 2010 for new members, namely Cambodia, Laos and Vietnam. It is not yet decided whether investment in the service sector will be taken up in the AIA or in the service negotiations.

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http://www.pc.gov.au/ic/inquiry/53offshore/finalreport/appendixg.pdf

Although the date of liberalization has been reached, but the impact on investment is hardly visible. This is because of the generous exemptions allowed. As with the ASEAN Free Trade Area, members may list sectors to be excluded from the commitment allowed under (1) temporary exclusions list (TEL) that will gradually be phased out; (2) a list of sensitive items that will not be phased out but will be reviewed periodically by the ASEAN Investment Area Council; and (3) a list of general exceptions consisting of sectors associated with national security, public morals, public health, or environmental protection. These sectors will not be open to foreign investment or granted national treatment. Although the AIA takes the negative list approach to investment liberalisation, some member countries list all manufacturing industries in the negative list. As a result, the liberalisation scheme becomes effectively a positive list approach. Other member countries, including Thailand, simply reproduces the list of restrictions under current laws or regulations and compile them into the sensitive list, which require occasional review but no phasing-out commitments. These practices render the full implementation of the AIA in January 2003 meaningless. Major moves to open up the investment regime, as in the case of Malaysia where 100% foreign equity of ownership is allowed since 1998 on an MFN basis, reflects the country's own unilateral policy shift to attract FDI in light of its dwindling inflows.

**Table 3 The Provisions of the ASEAN Investment Area**

| Core Provisions | Application within the ASEAN Investment Area |
|---|---|
| ***Definition of investment*** | Covers all direct investment except portfolio investment. |
| Scope of framework | Uses a negative list approach, consisting of a temporary exclusion list and a sensitive list, with a transition period for new members. |
| National and MFN treatment | All ASEAN member countries are required to provide national and MFN treatment to all ASEAN investors, with the exception of investments on the temporary exclusion and sensitive lists. |
| Expropriation and compensation | Like those of the bilateral investment treaties, the provisions on expropriation and compensation for the ASEAN Investment Area fall under the Expropriation Act of Thailand of 1987. It guarantees that the investments of signatory country investors will not be expropriated or nationalized except on a non-discriminatory basis for a public interest purpose. In such cases, compensation must be paid that is commensurate with the market value of the investment. |
| Transfer of funds and repatriation | Thailand allows the free transfer of funds and payments, including the transfer of capital and investment returns, the transfer of proceeds from the sale or liquidation of an investment, the repayment of loans, royalties, and fees, and the payment of compensation, which must be made without delay at the rate of exchange applicable on the date of transfer. |
| Dispute settlement | The protocol for an ASEAN Dispute Settlement Mechanism adopted in 1996 provides ASEAN members with a regional dispute settlement mechanism. |

Source: Somkiat and Deunden (2003)

### 3.3 Bilateral Investment Treaties (BITs)

Thailand has concluded 34 bilateral investment treaties since 1954. Most of the treaties signed by the Thai government have the same format and similar substantive provisions, as summarized in Table 4 shown below. The United States receives the most favorable treatment under the Treaty of Amity and Economic Relations between the Kingdom of Thailand and the United States of America, as discussed above. As is also noted above, Thailand is also currently engaged in negotiating a number of bilateral and regional trade agreements with several countries with a view to establishing FTAs as will be discussed in greater details in the following section.

**Table 4: Thailand's Obligations under Bilateral Investment Treaties**

| Core Provisions | Details of the Provision |
|---|---|
| ***Definition*** | Thailand has opted for a broad definition of investment to cover every kind of asset held by an investor/company, including movable and immovable property and property rights. |
| ***Scope of the treaty*** | Investment privileges granted by bilateral investment treaties must be approved in writing, with the scope of the provisions depending on the agreement that Thailand has concluded with the signatory countries. |
| ***National and MFN treatment*** | Thailand has granted both national and MFN treatment to signatory countries' investors at the post-entry level. For industries exempted from national treatment, Thailand offers only MFN treatment. Members of ASEAN Investment Area are guaranteed national treatment at a pre-entry level, except for in businesses listed in the temporary or general exclusions lists and sensitive list. |
| ***Expropriation and compensation*** | The Expropriation Act of Thailand of 1987 guarantees that investments of signatory country investors will not be expropriated or nationalized except on a non-discriminatory basis for a public interest purpose. In such cases, compensation must be paid that is commensurate with the market value of the investment. |
| ***Transfer of funds and repatriation*** | Under Thailand's Exchange Control Act of 1942 and Article 8 of the Agreement of the International Monetary Fund, Thailand allows free transfer of funds and payments, including transfers of capital and investment returns, proceeds from the sale or liquidation of an investment, the repayment of loans, royalties, and fees, and the payment of compensation, which must be made without delay at the rate of exchange applicable on the date of transfer. |
| ***Dispute settlement*** | Dispute settlement provisions guarantee standards of treatment and protection offered to investors by relevant Thai laws will be implemented and enforced effectively. Thailand recognizes that disputes may occur between the private investors of states that are party to a treaty, between one state and the investors of another state, or between states themselves. |

Source: Tangkitvanich and Nikomborirak (2003), forthcoming

### 3.4 Free Trade Areas

With the deadlock in the WTO negotiations that leaves progress in multilateral trade liberalisation paralyzed, current trade policy has focused instead on bilateral free trade agreements (FTA). Thailand has initiated bilateral trade agreements with both developing countries such as Bahrain, China and India, as well as developed countries such as the United States, Japan and Australia as shown in annex 3. These FTAs, in particular with the major industrialized countries such as the US, are likely to have major implications to the investment regime in Thailand. This is because, unlike the regional investment agreement ( the AIA), or even the previous investment agreement Thailand had with the United States (the Treaty of Amity), the investment provisions contained in a FTAs include advanced commitments to open up the investment regime described in detailed legalistic text, which is not familiar not only to Thailand, but most countries in the region.

For example, the Thai- US FTA, which is based on the Singapore-US FTA that became effective as of January 1, 2004, contains a very comprehensive investment chapter. The investment provisions in the proposed FTA allow generous sectoral exemptions, but adopts a very broad definition of "covered investment". This includes not only FDIs, but also portfolio investment, debt instruments, loans, futures, options and derivatives, contracts, intellectual property rights, licenses authorization permits and similar rights and other tangible and intangible property and related property rights such as mortgages, leases and pledges. It is not clear whether unhindered flow of potentially "speculative and volatile" capital such as derivatives and options would benefit the country. Moreover, unlike most developed economies, Thailand has not yet built up the capacity required to effectively regulate these highly sophisticated financial instruments.

Another key attribute of the proposed FTA is the provisions on private-government arbitral procedures, which is new to Thailand. Both the Treaty of Amity and the AIA do not have provisions for such a mechanism. In case of the Treaty of Amity, the disputes can be resolved through diplomatic channels. And in the case of the AIA, disputes are resolved according to the "Protocol on Dispute Settlement Mechanism" signed by the ASEAN Economic Ministers in November 1996 in Manila. This Protocol, patterned after the World Trade Organisation Dispute Settlement Understanding, is expected to make the process of resolving economic disputes in ASEAN more expeditious and transparent. The Protocol is applicable to all past and future ASEAN economic agreements.

On the contrary, the FTA allows investor of a Party, as a claimant, to submit to arbitration under the ICSID Additional Facility Rules or under UNCITRAL Arbitration Rules, or any arbitration institution agreeable to both the claimant and the respondent. Decisions, which are binding, may lead to monetary awards or financial compensation for the claimant. .

There are concerns that vague or terms of investors' protection may give rise to excessive arbitration and costly awards. For example, in the case of NAFTA, the terms "fair and equal treatment and full protection and security" and "measures equivalent to expropriation that would impair the value of the covered investment" have not been clearly defined, resulting in many dispute cases. The expropriation cases submitted to the ICSID have jumped in recent years. During the last 4 decades, the body settled 60 cases. It now has 60 cases pending. Many of these cases are brought under NAFTA's Chapter 11 (Hallward-Dreimeier 2003). Recent rulings in the ICSID, however, appear to provide relatively broad interpretation of the terms "fair and equitable treatment", resulting in the settlement of many arbitral awards. It is noteworthy that Canada, US and Mexico, have attempted to limit the principle of "fair and equitable treatment" of investments under the NAFTA investment protection (TDRI 2004).

Besides dispute settlement mechanism, the investment chapter in the proposed FTA also contains provisions disciplining state regulations with regard to transfers and investment performance requirements that were not available under the Treaty of Amity. Article 15.7 prohibits Parties from imposing restrictions on all transfers relating to covered investment. Although no such restrictions are in place to date, by virtue of the Exchange Control Act, the Bank of Thailand is given the statutory authority to regulate the manner in which money is brought in or taken out of the country. Thus, the proposed provision would be inconsistent with the existing law.

In addition, the proposed FTA also prohibits Parties from imposing conditions on the transfer of technology, production process, or other proprietary knowledge requirement, which is beyond TRIMs (Trade-related Investment Measures). This seems to be in contradiction with the current BOI's policy to focus on the "quality" -- i.e., high tech investment -- rather than the "quantity" of FDI. The restriction also raises concern about whether protection accorded to foreign investors may be excessive such that it imposes undue restrictions on host country's sovereign regulatory and policy space.

## 4. Investment Trend under the Existing Regime

- *Historical Trend*

Thailand received relatively small amounts of FDI during the first half of the 1980s. Inflows began to pick up substantially during the second half of the decade, partly because of the 1985 Plaza Accord, which resulted in a sharp appreciation of the Japanese. This coincided with an increase in production costs in the newly industrializing economies (NIEs) in Asia—Taiwan, Hong Kong, and Korea—making them less attractive locations for labor-intensive industries.

This was the period in which the Thai government switched from an import substitution to an export-led growth strategy. The success of the export-oriented policy can be attributed to a number of factors, one being the country's fixed exchange rate regime whereby the Thai baht was pegged to the US dollar until the crisis in 1997. Businesses benefited from the stability of the local currency and hence, that of the economy as a whole as well. Occasional devaluations (in 1973, 1981, and 1984) were carried out to ensure that Thai exports remained competitive in the global market.

Other contributing factors include macroeconomic and political stability country, the absence of ethnic or religious conflicts, relatively cheap labor, strong work ethics among the labour force, coupled with an array of investment incentives. Among these, low wage was one of the key factors that prompted major industrialized countries to relocate production of labor-intensive products to Thailand. This was made possible by the government's conservative minimum wage policy. Thailand became an increasingly attractive destination for FDI, especially from the Japanese manufacturers. The value of net FDI inflows increased twelve-fold between 1980 and 1996, from $189 million to $2.27 billion, while the inward FDI stock increased from $981 million to $28.2 billion

An econometric study by Wisarn and Pussarangsri (1994) on net FDI inflows into Thailand during 1970–90 concluded that prolonged high economic growth, the availability of physical infrastructure, and the appreciation of the Japanese yen against the US dollar were major contributing factors. However, high tariff rates were found to be one of the main barriers to foreign investment after the realignment of major currencies under the Plaza Accord in 1985, which significantly weakened the strength of the Yen.

FDI during the nineties remain healthy. The value of FDI during 1991-1995 was US$ 7.4 billion, a 30% increase over the period 1986-1989, which was US$ 5.6 billion. The growth in FDI was overshadowed by the surge in portfolio investment , which more than tripled in value during the same period of time from roughly US$ 3 billion to US$ 10 billion. Portfolio investment, for the first time, exceeded that of FDI. The influx of short term investment was indeed one of the key factors contributing to the financial crisis in 1997 as can be seen in table 5 below.

**Table 5 Net Private Capital Flows to Thailand**
**($US million)**

| | **1986-1990** | **1991-1995** | **1996-2000** |
|---|---|---|---|
| **Bank** | 1,561 | 2,143 | 3,838 |
| **Non-Bank** | | | |
| *FDI* | 5,658 | 7,392 | 15,633 |
| *Other loans* | 5,821 | 1,748 | - 10,818 |
| *Portfolio investment* | 2,929 | 10,106 | 8,957 |
| *Non-resident Baht account* | 4,068 | 11,907 | - 10,510 |
| *Trade credits* | 1,058 | 2,191 | - 1,140 |
| *Others* | 152 | - 735 | 322 |
| **Total** | **21,247** | **34,752** | **6,282** |

Source: Bank of Thailand

- *Post-crisis Trend*

Following the economic crisis and the depreciation of the baht in 1997, net inflows of FDI increased sharply. FDI doubled between the period 1991-1995 and 1996-2000 as shown above. The growth of FDI in the post-crisis period can be attributed to the increase in loans provided to affiliates, and to the dramatic rise in the number in mergers and acquisitions (M&As). The baht depreciation reduced domestic production costs and asset values, making FDI more profitable during the economic downturn. The more liberal FDI regime, introduced as part of crisis management[4] and corporate-restructuring packages, also opened up new opportunities for cross-border M&As, which increased sharply from $633 million in 1997 to $3.2 billion in 1998 (Table 6).

**Table 6**

**Thailand: Cross-border Mergers and Acquisitions by Value, 1990–2002 ($ US million)**

| Year | Amount |
|---|---|
| 1990 | 70 |
| 1991 | 79 |
| 1992 | 498 |
| 1993 | 42 |
| 1994 | 89 |
| 1995 | 161 |
| 1996 | 234 |
| 1997 | 633 |
| 1998 | 3,209 |
| 1999 | 2,011 |
| 2000 | 2,569 |
| 2001 | 957 |
| 2002 | 247 |

Source: World Investment Report (2003).

Financial hardship has not been the only factor contributing to the increase in M&As in Thailand; the government's progressive liberalization of investment regulations has also had an impact on the local industry. For example, the lifting of local content requirements in the automobile industry, which came into effect in January 2000, forced local parts companies into direct competition with foreign suppliers, because auto companies could now source their inputs globally. As a result, many local companies were bought out by foreign auto makers that were more experienced or had access to superior technology.

[4] For example, the 25% foreign equity ceiling on commercial banks and financial companies were lifted in order to allow foreign capital injection into ailing Thai banks and finance companies. Similarly, permissions were granted by the Foreign Business Committee to many foreign takeovers in the Thai retail trade that collapsed under the weight of the crisis.

- *Recent Trend*

Since 2001, the net FDI into Thailand dropped markedly as shown in Figure 1. This worrisome trend is a result of both a fall in the size of gross inflows and a rise in size of gross outflows due to the following factors:

(1) the debt restructuring process that is slowing down implies smaller inflows of capital from overseas

(2) low domestic interest rates due to ample liquidity has encouraged many MNCs to switch from equity investment to domestic borrowing, leading to low FDI inflows

(3) the decline in the competitiveness of Thai industries. As can be seen in Figure 2 , FDI inflows into the manufacturing sector in the year 2002 was only a third of that in the previous year. Factors that are adverse to the competitiveness of the Thai industries include high and distortionary tariffs, high labor costs (compared with new ASEAN members and China) and lack of industrial upgrading

(4) the remittance of profits of foreign companies who invested in the Financial Restructuring Agency[5] assets contributed to a surge in FDI outflows. Also, many financial businesses that were auctioned off during the fire-sale from the FRA were resold to the original owners for a higher price. Proceeds were then repatriated. As can be seen in Figure 6, the financial sector experienced a signifcant FDI outflow

Both gross and net FDI inflows are expected to continue to decline in the near future as indicated by the fall in the value of BOI approved investment during two consecutive years of 2001 and 2002.

- *Source of Investment*

Until recently, Japan was the major investor in the Thai industries. Japanese investment began to expand exceptionally in the late 1980s when Thailand largely benefited from a massive relocation of industries from Japan as a result of currency appreciation in the late 1980s. For example, the net FDI flow from Japan during 1988-1990 constituted about

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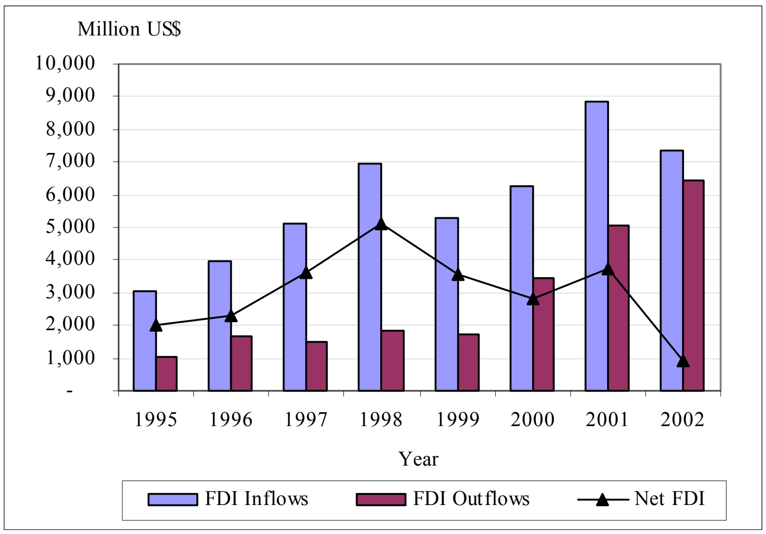
[5] The Financial Restructuring Authority was responsible for auctioning off assets of 56 failed finance companies.

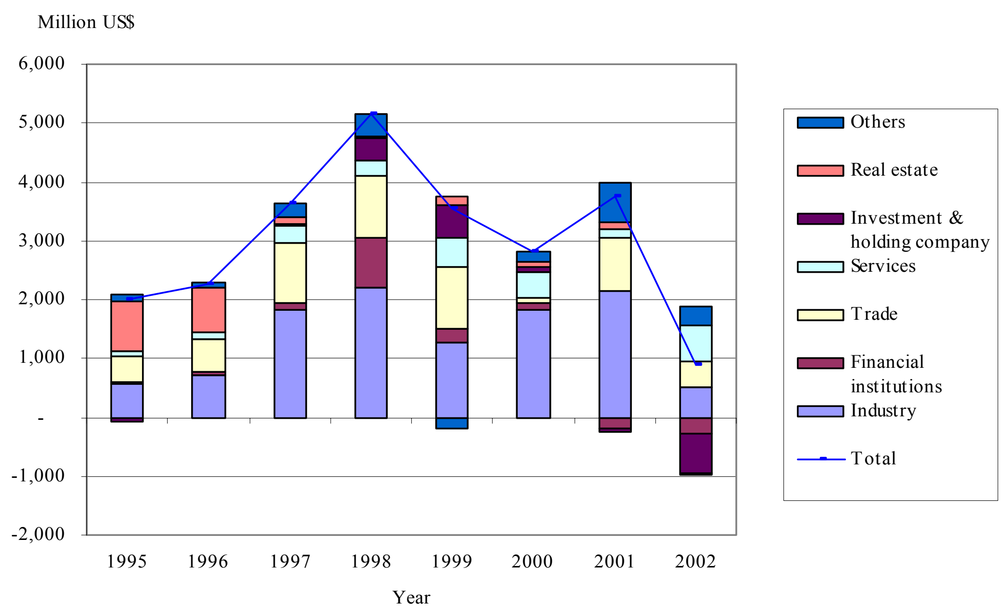
40-50 percent of the total net FDI flow. During the period immediately after the crisis, Japanese FDI surged from merger and acquisition activities as many Thai-Japanese joint ventures in the auto part industry faced serious financial problems. In recent years, however, Japan's FDI share has displayed a downward trend (see Figure 3).

**Figure 1: FDI Inflows and outflows**



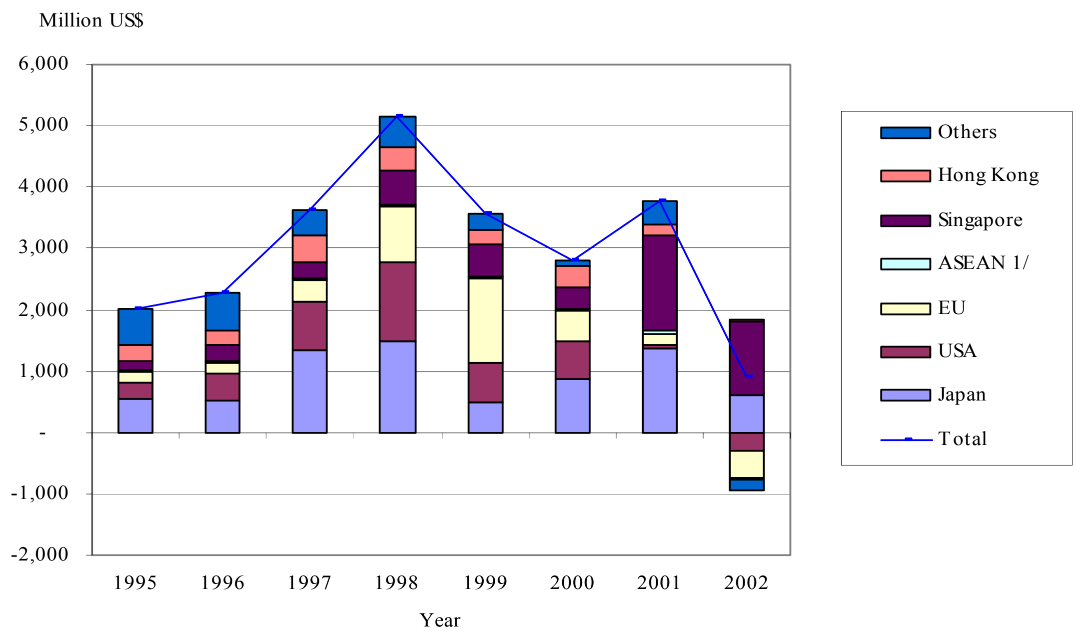

Source : BOT

**Figure 2: Net flows of FDI by sector**




Source: Bank of Thailand, Quarterly Statistics.

**Figure 3 : Net flows of FDI by country**




Note : 1/ Prior to 1999, ASEAN does not include Cambodia, Laos, Myanmar and Vietnam. This ASEAN figure is not included Singapore.
Source : BOT

The last few years, Thailand experienced a sharp rise of the FDI from Singapore, driven by its high public sector savings and an outward looking strategy. According to the Bank of Thailand, Singapore was the biggest source of FDI in 2002, at $1.186 billion, followed by Japan at $660 million. U.S. firms accounted for $298 million in FDI in 2002, while the European Union (EU) accounted for an outflow of $451 million. There are no reliable statistics available for cumulative investment by country of origin. Most investment from Singapore concentrated in finance, petroleum and real estate in the form of loans to affiliated companies. This contrasts sharply with Japanese investment, which focuses in share holding in manufacturing companies.

## 5. An Assessment of the Effectiveness of the FDI Current Regime

### 5.1 An Evaluation of the Foreign Business Act 1997

Although the Foreign Business Act is considered to be more favorable to FDI than its predecessor, several shortcomings remain. First, it is not clear on what basis or rationale businesses are categorized. For example, forestry appears in Category 3. It is classified as a business in which Thailand is not yet ready to compete. Wood fabrication for the manufacturing of furniture, on the other hand, appears in Category 2. It is classified as a business that is related to natural resources and the environment. Common sense would suggest the opposite. It is also not clear why certain activities—such as land trading —are categorized as businesses preserved exclusively for Thai nationals. Such non-transparency leaves a wide margin for discretion on the part of the authorizing agencies.

Second, despite the fact that Article 9 of the Foreign Business Act requires the three categories of businesses in which foreign ownership is prohibited are to be reviewed annually and that a transparent and effective mechanism be established to carry out the task, until to date, the criteria for evaluation have not been finalized. This leaves the FDI regime intransparent and arbitrary.

Finally, although the new investment law appears to be more liberal in that it takes a "negative list" approach to defining the sectors that are subject to investment restrictions, a "positive list" approach still applies in practice in the services sector. This is because category 3 includes "other categories of service business except those prescribed in the ministerial regulations (see annex 1)." As a result, while the foreign investment regime in Thailand is relatively open for the manufacturing sector, it is very much closed for services. More over, sector-specific law may impose even more stringent condition for foreign participation. For example, the Telecommunications Act 2001 caps the foreign equity share of a facility-based operator at only 25 percent. The relatively closed service sector contributes to inefficiencies, which, in turn, impose costs on the manufacturing sector.

### 5.2 An Evaluation of the Cost-effectiveness of the Investment Promotion Regime

One cannot gauge the success of an investment regime simply from the size of investment inflows. Indeed, attracting FDI costs. It is therefore necessary to keep track of the cost of providing investment incentives and to evaluate it against the benefits realized from FDI.

As mentioned earlier, investment promotion in Thailand concentrates almost entirely on tax privileges. It is a complex exercise to assess the impact of tax incentives on investment. The marginal effective tax rate on company income, roughly defined as the proportional difference between the pre- and post-tax rates of return, provides a simple summary of the relative magnitude of taxes and tax incentives. For example, if the rate of return is 6 percent when taxes are applied and it rises to 10 percent after tax concessions, the marginal effective tax rate will be (10 – 6)/10 = 40 percent.

Table 7 compares the marginal effective tax rate for Thailand, Singapore, Malaysia, and the Philippines. After adjustment for interest deductibility, Thailand's rate is considerably higher than those of Singapore and Malaysia and is on a par with that of the Philippines. However, after adjustment for tax holidays, Thailand's marginal effective tax rate drops to only 7 percent, which is lower than all three countries except Singapore which shows a negative tax rate. This implies that Thailand offers more generous tax privilege schemes than do Malaysia and the Philippines, resulting in potentially higher tax losses for the government. For example, tax losses due to investment incentives for 1996 were estimated to be Baht 18,370 million, or 0.39 percent of GDP.

**Table 7 Marginal Effective Tax Rates in Selected Asian Countries**

| | Thailand | Singapore | Malaysia | Philippines |
|---|---|---|---|---|
| With interest deductibility | 46 | 33 | 30 | 47 |
| Adjusted for customs duty concessions | 35 | 33 | 22 | 40 |
| Adjusted for tax holiday | 7 | 14 | 22 | 21 |
| Adjusted for depreciation carried forward | 7 | -7 | 22 | 21 |

Source: FIAS (1999).

This could be justified if the incentives had proved effective in attracting additional investment, which generates large positive externalities for the society. However, the Foreign Investment Advisory Service found that at least 70 percent of the promoted investments would have occurred even without tax incentives (FIAS 1999). It also estimated that these investment projects had created only 76,000 direct jobs between 1991 and 1996. Dividing the total tax revenue forgone by this number generates a net cost of Baht 242,089 per job per annum. By 2001, the net cost of this job creation is expected to rise to Baht 347,000, with a marginal cost of Baht 1,171,000. This implies that the average tax revenue forgone per job created has been significantly higher than the opportunity cost of labor, as measured by the average rate of remuneration in the industrial sector of only Baht 80,000 per person per annum.

Despite these adverse findings, the BOI continues to use tax-based incentives as its main instrument to encourage FDI. But this may be the case because it is only empowered to do so in the absence of a clear and coherent industrial and economic policy. Unlike Malaysia, the Thai government is made of a several coalition parties or different factions within the same party. Each Minister answers to the head of his or her faction or party. This results in the lack of cooperation and coordination among key ministries, in particular the Ministry of Commerce that is responsible for the trade regime and foreign investment regulation and the Ministry of Industry, where the BOI resides[6].

Another vital shortfall of the investment promotion regime is that, as in other countries in this region, is that an effective cost and benefit analysis (CBA) of the promotional schemes is not available. What is required is an estimate of the revenue forgone through tax incentives, the expected benefits and the actual results. In the absence of an *ex-ante* CBA and an *ex-post* project monitoring, it is not possible to assess the extent of success or failure of these schemes. Given that the investment authority is charged with promoting investment but not with collecting revenue, is often quick to hand out generous tax incentives.

### 5.2 Contribution of FDI to Overall Economic Development

- ***Economic Growth***

Even though it is widely believed that FDI contributes to growth, the economist Jagdish Bhagwati among others has long argued that the growth-enhancing effect of FDI is not automatic but depends on various country-specific factors. In particular, Bhagwati claimed that the gains from FDI were significantly smaller, or even negative, under a strict import substitution regime compared with an export promotion regime. To test the Bhagwati hypothesis for Thailand, Archanun (2003) examined the effect of the trade policy regime on the contribution of FDI to economic growth using time-series data for 1970–99. GDP was used as the dependent variable and a number of variables—including total labor force, domestic capital formation, education expenditure, FDI, and the trade regime—were used as explanatory variables. **The results confirmed Bhagwati's hypothesis that FDI contributed positively to the growth of the Thai economy under an open trade regime.**

The positive economic contribution of FDI is also validated in a study by Kinoshita (2001), who examined the contribution of FDI to GDP growth through three channels: fixed capital formation, imports, and exports. Results from a simulation model revealed that a 10 percent increase in FDI would increase fixed capital formation by 44.3 percent, imports by 2.0 percent, exports by 2.3 percent, and GDP by 1.6 percent at the peak period. The study thus confirmed that FDI has been one of the main drivers of economic growth in Thailand, in addition to other factors such as the appreciation of the Japanese yen and economic conditions in the United States and Japan. It also concluded that crowding-out impacts from FDI are unlikely.

- ***Exports, Imports, and the Balance of Payments***

It is widely believed that FDI promotes exports because large foreign companies that operate on a global scale enjoy significant economies of scale in marketing and possess a superior capability to access overseas markets. Foreign firms can also serve as a catalyst for domestic firms to increase their levels of exports. According to BOI statistics, following the crisis the share of approved projects that were export-oriented (that is, that exported more than 80 percent of their total output) jumped from 30 percent of the total number of projects approved in 1997 to 65.5 percent in 1999, and remained relatively high through to 2001. **These figures suggest that FDI has played a very important role in Thailand's export performance since the crisis.**

Conversely, FDI may contribute to a deterioration in the trade account, since foreign firms generally display a higher propensity to import capital goods and raw materials than do local firms, as exemplified by FDI in the Thai electronics industry. Profit repatriation can also lead to a deterioration in the capital account. Since most MNEs do not have roots in the local economy, they are likely to repatriate profits at the earliest sign of an economic downturn. For an economy that is dominated by MNEs, a mass repatriation of profits is likely to exacerbate its economic difficulties during a downturn. The net impact of FDI on the balance of

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[6] Prior to the restructuring of the state ministries and agencies in the year 2002, the BOI was under the purview of the Office of the Prime Minister.

payments is thus ambiguous. The net effects are found to be country-specific and sensitive to the type of investment, the industry mix, and the maturity structure of the investment.

Fry (1996) examined the effects of FDI in six Asian economies: Indonesia, Korea, Malaysia, the Philippines, Singapore, and Thailand. Through regression analysis, he found that balance of payments outcomes were explained by five factors, namely savings, FDI, exports, imports, and economic growth. The first four variables, including FDI, were found to contribute positively to the balance of payments, with a lagged response for exports. The results of a dynamic simulation showed that inflows of FDI were strongly associated with higher imports during the early stages of industrialization and thus tended to worsen the current account. However, **in the long-run steady state, their contribution to economic growth generated net savings, thus leading to an improvement in the current account.**

- ***Labor Productivity***

Ramstetter (2001) compared labor productivity in local and foreign-owned manufacturing plants in Thailand. **His regression results showed the productivity difference to be insignificant.** Even in a few isolated cases where a significant productivity gap was observed, there was little consistency in productivity differentials across years, industries, or nationality of ownership.

A study by Ito (2002) investigating productivity in foreign and local plants in the Thai automobile industry confirmed Ramstetter's findings. She found, as expected, that labor productivity was higher in foreign plants. However, this higher productivity was mainly attributable to the fact that foreign firms tended to employ capital more intensively than did Thai firms. There was no evidence to suggest that foreign plants had relatively higher total factor productivity. As we will see in the next section, however, the higher labor productivity of foreign firms has tended to translate into higher wages, irrespective of the causes of the productivity differential.

- ***Wages***

**Matsuoka (2001) found evidence of a positive wage differential between foreign and local plants for both non-production and production workers**, based on a survey of plants in 12 industries situated in and around Bangkok in 1996 and 1998. In the first round, 2,407 plants were included in the survey. This was doubled to 5,122 in the second round. The 1996 round found that the average wage paid by foreign firms was 20 percent higher for non-production workers and 8 percent higher for production workers than the average wage paid by local firms. The wage differential was even larger in 1998, with foreign firms paying 28 percent and 12 percent more to non-production and production workers respectively.

The same study found that the foreign equity share and nationality of ownership of the foreign firm contributed to the wage differential. Surprisingly, the **wage differential between a wholly owned foreign firm and a local firm was small and statistically insignificant. The difference between a joint venture and a local firm was, however, much more pronounced**. This contradicts the finding of earlier studies (for example, Ramachandran 1993) that the larger a firm's foreign equity share, the higher its labor productivity and, hence, wages. The explanation was that the greater the corporate ownership and control, the more willing TNCs would be to transfer technological know-how to its subsidiaries.

Matsuoka found a larger wage gap for companies whose headquarters were in Japan, the European Union, or the United States. The gap was almost halved for firms from less developed countries such as the Asian NIEs. This can be explained by the fact that NIE companies tend to invest more in industries with low wages, such as textiles and electronic components. In contrast, firms from developed countries tend to invest in industries employing more sophisticated technology, and thus require higher-skilled and better-paid workers.

In order to factor out the wage differential attributable to variables unrelated to a firm's nationality, Chatree (2003) conducted a similar regression analysis, but controlled for other possible explanatory variables such as the level of education and skills of the worker, firm size, industry, and the location of the firm. The results confirmed Matsuoka's finding that foreign establishments offer a wage premium. However, in the case of **the least skilled workers, the wage differential disappeared** when other variables were controlled for. A wage differential was still present for highly skilled workers, but it was much smaller than that found in the previous study. Chatree attributed the wage differential for highly skilled labor to search costs for professionals and skilled workers in the local labor market, as well as the firms' attempts to retain highly skilled employees by offering them higher wages.

- ***Regional development***

FDI has always been considered a tool to promote regional development and industrial decentralization. In 1978, four investment zones were established to promote decentralization. Apart from investment incentives, however, a number of factors may affect the location of firms within the country. In some sectors, such as automobiles and electronics, firms tend to establish in clusters in order to take advantage of agglomeration economies. It is thus interesting to evaluate the extent to which the BOI's locational policies have contributed to industrial decentralization in Thailand.

Over the period 1982–2000, industrial decentralization was essentially limited to Zone 2, despite the BOI's adoption of a zoning policy. The share of GDP in Zone 1 grew continuously from 1982 to 1990, then declined steadily as a result of the congestion in and near Bangkok. The GDP and manufacturing shares of provinces that were either adjacent to Zone 1 or had access to the industrial estates along the eastern seaboard then rose dramatically, confirming that some progress had been made in industrial decentralization. This pattern indicates that, in response to the BOI's zoning policy, firms tried to locate as close to Zone 1 as possible, in order to maximize their access to good infrastructure while minimizing their taxation and transaction costs.

Very little decentralization has occurred in Zone 3. However, the GDP and manufacturing shares of some of the larger provinces—notably those situated in the north and northeast of the country—have increased, reflecting growth in the manufacturing production base of large provinces where an industrial estate is located and lower wage rates prevail. Industrial decentralization remains insignificant in the south, again with the exception of the largest provinces where most manufacturing industries are concentrated. In sum, the BOI's policies may be inducing industrial decentralization, but only in a specific pattern and in conjunction with the availability of infrastructure.

A survey by the Foreign Investment Advisory Service confirms that the BOI's zoning policy has not made a significant contribution to industrial decentralization, particularly in Zone 3 (FIAS 1999). It found that 82.5 percent of the promoted firms in Zones 2 and 3 would have made the same choice of location even if they had been offered the same incentives as firms in Zone 1. Thus, while the level of investment in Zone 3 has no doubt increased, it is not conclusive that this was attributable to the investment incentives offered. The results from these studies seem to confirm the importance of infrastructure in FDI decisions.

- ***Technology Transfer***

Wisarn and Bunluasak (1994) examined technology transfer between manufacturers and suppliers in Thailand through a survey of 23 suppliers, 11 of which were foreign-owned and the remaining 12 of which were Thai subcontractor firms. **They found that all 23 suppliers had acquired a basic level of three types of technology: product technology, quality control technology, and process technology.** This included a knowledge of product specifications, the ability to provide feedback on product performance, process, and basic operation. However, only three had acquired a medium level of all three types of technology, and only one claimed to have accessed a high level of technology, including product design, improvement of product/process performance, and process operation and adaptation skills.

Urata (1996) reached a similar conclusion. His survey found that Japanese firms operating in Thailand were more willing to transfer technology relating to manufacturing or assembly operations. Less than half of the firms had transferred technology related to tools development and only 20–30 percent had transferred knowledge and skills related to technological improvements and development of the manufacturing process.

In contrast, a recent examination of interfirm technology transfer in the Thai automobile industry by Kriengkrai (2002) found that Japanese firms were willing to transfer technology, not only to their own affiliates but also to local suppliers. The technology transferred included information sharing and the provision of advice with regard to technological activities such as value analysis, value engineering, and quality control. However, the relative success of local parts suppliers in Thailand cannot be attributed entirely to the Japanese automobile manufacturers: Japanese parts suppliers have also played an important role as partners in joint ventures. The author concluded that the creation of strong technical linkages has been the key factor in the successful development of a local supporting industry.

As mentioned earlier, technology transfer may occur through job mobility. Wisarn and Bunluasak (1994) showed that the degree of job turnover was much lower in foreign firms than in Thai firms. They also found that workers in foreign firms tended to move to other foreign firms rather than to Thai firms. So did workers in Thai firms, partly because of the higher salaries and greater job security offered by foreign firms. **The authors were thus skeptical about the possibility of mobility from foreign firms to Thai firms being a vital**

**channel of technology diffusion**: the direction of job mobility reflected a "brain drain" rather than a diffusion of technology.

- ***R&D and Innovation***

Many studies have found that MNEs conduct little R&D outside their home bases (see, for example, Amsden, Tschang, and Goto 2001). A survey of 1,019 Thai firms in 2001 conducted by the Brooker Group (2001) confirms the above pattern for Thailand. **It found that wholly locally owned firms had an R&D intensity ratio (defined as the ratio of R&D expenditure to annual sales) that was on average twice that of foreign companies**. Interestingly, R&D intensity was considerably lower among joint ventures, implying that **firms are less willing to invest in R&D when ownership is shared**. The same study found a similar pattern for innovation. Again, wholly locally owned firms exhibited an innovation to sales ratio that was roughly three times that of the other groups (Table 11). One possible explanation is that local firms may have more limited avenues to acquire new technology than foreign firms, and thus have to resort to in-house R&D. Another hypothesis is that local and foreign firms may be producing different products that require different levels of technology. For example, the former may face a greater need to customize products for the local market than the latter.

It should be noted that very little R&D is conducted by the private sector in Thailand, regardless of the nationality of the firm. According to the IMD (2003), private sector R&D was equivalent to only …. Of GDP, compared with …. For Malaysia and …. For Singapore. The major reason lies in the lack of a well-developed human capital base. Thailand has been criticized for under-investing in post-primary education and training, with the result that Thai employees have a limited capacity to absorb and benefit from technology transfers and spillovers.

**Table 11 Thailand: R&D and Innovation Intensity by Ownership**

| | R&D Expenditure/Sales | Innovation Expenditure/Sales |
|---|---|---|
| Wholly locally owned | 2.15 | 3.25 |
| More than 70% locally owned | 0.17 | 0.66 |
| 50–70% locally owned | 0.65 | 1.33 |
| Less than 50% locally owned | 0.23 | 0.61 |
| Wholly foreign-owned | 1.06 | 0.90 |

Source: Brooker Group (2001).

- ***Competition and Concentration***[7]

How FDI affects concentration and the level of competition in the domestic market will depend largely on the degree of contestability of the particular market. If the market is open and conducive to competition from new entrants and imports, then the nationality of the players in the market matters little, as no firm will not have the market power required to carry out anti-competitive practices. The concern arises when the market is not contestable, in that new entry or competition from imported products is obstructed either by regulatory restrictions (such as licensing or import duties) or by market failure (whereby the industry displays significant economies of scale, giving an advantage to the larger players in the market). In this case, the type of FDI may have an impact on market concentration and competition, at least in the short run.

The experience in Thailand has been mixed. In banking, the post-crisis emergence of several foreign banks following a series of acquisitions of ailing domestic banks, has contributed significantly to creating a more competitive environment. The pre-crisis banking industry was one in which a market leader (the largest bank) set interest rates for all other banks to follow. This practice of "parallel pricing", which eludes the grasp of the competition law in many countries, guaranteed healthy profit figures for the banks, but contributed very little to improvements in service quality and service differentiation. The Association of Thai Commercial Banks provided a convenient forum for collusive practices. The entry of foreign banks such as ABN Amro, United Overseas Bank, United Bank of Singapore, and Standard Chartered Bank has broken the cartel, bringing about a remarkable improvement in service. Customers now enjoy longer banking hours, more diversified savings packages, more competitive lending rates, and an improved range of credit card services.

The story is different for industries with few players such as the cement industry, however. Cement was one of the industries worst hit by the crisis: the local construction industry came to a halt with the collapse of the finance and real estate markets. A few firms were taken over by foreign companies such as Holcim of Switzerland and Cemex of Mexico. In 2001, the second largest player in the market, Siam City Cement (which is majority owned by Holcim), made a bid for the largest cement company, TPI Polene Co. Ltd, which was subject to a debt-restructuring process. Holcim reportedly announced that it expected to see a

[7] This section draws on Niomborirak (2000).

doubling of the price of cement in the domestic market once the takeover was completed. The merger appears invincible since the merger provision in the Trade Competition Act of 1999 was not (and still is not) effective. This is because the threshold post-merger market share that would require pre-merger notification has not yet been established. According to the analyses of many security houses, the merger will likely lead to collusion and, hence, an increase in the price of cement.

Retailing is another industry that has fallen into foreign hands as a result of the crisis. Most discount stores in Thailand are now owned by foreign multinationals such as Tesco of the United Kingdom, Carrefour and Casino of France, and Royal Ahold of the Netherlands. This is because the Foreign Business Act 1997 allows wholly foreign owned retail stores that meet total minimum capital requirement of 100 million baht. While these foreign retail companies compete vigorously among themselves and with Thai department stores. Because of their sheer size, they were able to squeeze local suppliers' margin. The competition resulted in lower prices for consumers. However, their extremely aggressive business culture has created tremendous friction with suppliers. Some of their business practices, such as mandatory enrollment of suppliers in price promotion schemes, preferential treatment for house brand products, and the collection of various service fees, borders on anti-competitive conduct. The Thai Trade Competition Commission has recently published a Retail Industry Code of Ethics in response to suppliers' complaints. The Code does not seem to provide effective protection against unfair trade practices for small suppliers, however.

These three cases show that FDI may promote or restrict competition. It would be fair to say that all companies, whether foreign or local, will try to exploit their market power in restricting competition if it is in their interest and legally feasible to do so. Therefore, in markets where concentration tends to be high due to economies of scale or scope, or due to the presence of a strong industry network, the best protection against the restrictive business practices of MNEs is to ensure that the market is contestable. That is, that new competitors and imported substitutes are able to enter the market freely. In addition, an effective competition regime needs to be established to guard against potentially abusive practices that cannot be solved by competitive pressures alone, and to ensure that the market structure is conducive to competition.

- ***Conclusion: Impact of FDI on the development of the Thai Economy***

According to various studies, FDIs have contributed to economic growth, employment and higher wages. At the sectoral level, the entry of foreign competitors may help break the monopoly grip of several local suppliers, which ultimately benefited Thai consumers.

It is less clear, however, whether FDI served to promote a sustainable economic growth that would require the support of skilled human resources, advanced technology and research and development. Unlike Malaysia, the Board of Investment of Thailand does not provide incentives for human resource development. The government itself lacks a clear human resource plan, which resulted in a shortage of skilled workers -- a pre-requisite for the re-location of high technology industries.

Evidence of technological transfer is at best sketchy. Past studies indicate that, in general, only basic knowledge is transferred. There are few success stories, however. Diffusion of the knowledge through movements of workers was found to be insignificant since most workers that have worked for a foreign company are not likely to move to a Thai firm.

Finally, in terms of R&D, there is no evidence that foreign companies invest in R&D. In face, past studies found that wholly-owned Thai firms spend more on research and development than do wholly owned foreign firms. In light of these findings, FDI may play little role in developing the country's long term manufacturing capability and competitiveness, that is the basis from which the country can hope to embark on a sustainable growth path on its own. Of course, these shortcomings can be attributed partly to the inability of the host country to create a more "enabling" environment that are more conducive to technology transfer and research and development.

## 5.3 Economic, Social and Environmental concerns related to FDI

- *Environmental concerns*

Indeed, all countries seek to attract FDI. In competing for limited foreign capital, host countries may be tempted to lower their environmental standards in order to increase the relative attractiveness of the location to multinational companies. This "race to the bottom" allows multinational companies to take advantage of weak environmental laws in host countries.

Most bilateral investment treaties (BITs) do not address environmental concerns. This is because most BITs The non-binding APEC Investment Principles does contain a general provision concerning investor behaviour as mentioned earlier. It states that " *Acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should*". As for the AIA Framework Agreement, Article 13 on General Exceptions merely states that nothing in the Agreement shall be construed to prevent the adoption or enforcement by any Member State of measures necessary to protect national security and public morals; human, animal or plant life or health as well as safety. The Agreement contains no clauses on the obligations of foreign investors, however.

As for the case of FTAs, the draft Thai-US FTA, which is based on the Singapore-US FTA, does contain a specific provision on environment. It states that *"nothing in the agreement in the investment chapter shall prevent parties from adopting, maintaining, or enforcing any measures that are of environmental concern"*. The provision serves to ensure that -- in the process of protecting the rights of foreign investors, the sovereign regulatory space on environmental issues are preserved. That is, should the host government undertake environmental policies or measures that adversely affected foreign companies, the latter will not be able to file for arbitral awards.

It is interesting to note that none of the mentioned bi-lateral and regional agreement addresses corporate responsibilities or code of conduct beyond what is stipulated by the host country's law, which tend to be weak in terms of both the legal provisions and its enforcement. This has resulted in a spade of controversies surrounding the conduct of MNCs involved in projects or undertakings that have extensive environmental impact such as electricity generation, mining, construction of dams, plantations, etc.

Thailand has had its share of environmental problems associated with MNCs. The first involved with the licensing of a large-scale potash mine in the Northeast region of the country to a Canadian mining company (see box 1). The second concerns the promotion of eucalyptus plantation in the national forest areas (see box 2). Both cases demonstrate the potential devastating impact of FDIs and more importantly, the apathy on the part of responsible state agencies.

In most developing countries, when it comes to government policies, private commercial interests often supercede those of the public such as environment, health, safety and livelihood. This is often the case when money and politics are deeply entangled and when there is no effective check-and-balance within the political machinery. In such an environment, pressures from non-government sector, be they the media, local villagers, NGOs, civil societies or academics are the only force that can push forward the public agenda.

## Box 1

## Potash Mining in Thailand

**Potash Mining in Northeast Thailand: Amendment to Minerals Act a threat to environment and landholder rights**

Adapted from Watershed Vol.8 No.1 July-October 2002

In May 2003, several hundred villagers from the Northeastern region gathered in Bangkok to protest against the planned potash mine in Udon Thani province to be excavated by Asia Pacific Potash Corporation (APPC). The company holds a 85,000 hectares (ha) exploration and mining concession in Udon Thani province. It is 90% owned by Asia Pacific Resources Ltd based out of Canada and 10% owned by the Thai Government. The company plans to mine a thin layer of potash salt located 300 m below the surface. Potash refers to a group of potassium mineral salts used in the production of agricultural fertilisers. APPC estimates potash production for it's mine to be 2 million tonnes per year.

This particular project has raised three major issues. The first concerns property rights. To allow private operation of the mine, the Mineral Act was revised to transfer all underground mineral rights to the state. That is, it is now legal for corporations to mine beneath private land (below 100 meter) without having to ask permission from the land-owners. The amendment was challenged as being unconstitutional by a group of senators. In late 2002, the constitutional court's ruled that the new Mineral Act did not violate the constitution, rendering the law effective.

The second concerns the environmental impact assessment (EIA). The EIA produced by the APPC was not comprehensive. First, it does not specify whether the information assessed relates to the 170 ha mine site area, or the 2,500 ha concession area that spans beneath residential areas, farmland, a national highway and railway. Local communities are concerned that as the mined out tunnels progressively collapse their land and property will be damaged. The Environmental Impact Assessment (EIA) for the project predicts subsidence of more than 70 centimetres (cm) resulting in depressions in the land surface over the entire 2,500 ha area affected by the mine. Further subsidence following mine closure after 22 years is expected but the EIA does not predict how much. The new controversial Mineral Act requires a more comprehensive IEA, however.

**Box 1(cont.)**

In addition to structural damage to homes and infrastructure, it is likely to disrupt groundwater quality and flow and drastically alter natural drainage patterns, sending streams off course and potentially creating waterlogging and flooding problems. A severe salt contamination of agricultural land and water resources is anticipated as the mined mineral is composed predominantly of rock salt (sodium chloride). The pure potash product will have to be extracted on site, leaving the rock salt, chemicals and other waste to be stored at the surface until further reprocessing. Salt dust will be continually emitted from an exhaust stack during extraction and mineral processing, eventually settling on adjacent farmland, destroying crops and degrading soil. These adverse impacts were not properly assessed.

In August 2003, the Council of State ruled that the APPC, awaiting a licence to mine potash in Udon Thani, needs to re-conduct its environmental impact assessment (EIA) as its current version is not applicable under the new Minerals Ac, which contains a higher standard for EIA.

**Box 2**

**Eucalyptus Plantation**

Eucalyptus plantation has always been a controversial business since large-scale monoculture plantations tend to have many negative environmental and social impacts. During 1976-77, the government promoted eucalyptus plantation as a substitute for natural forest. Many foreign companies, including those from Japan, Australia and Finland, The fast-growing plant was commercially attractive to the pulp and paper industry, which faced increasingly shortage of raw materials supply as national forest areas dwindled as a result of excessive logging concessions. The initial projects were aimed at reforestation that would help reduce saline soil, alleviate flooding and to make commercial use of Eucalyptus trees. The public land within each community was leased to a plantation project for 6 years, after which the community would own the plantation.

But after implementations, many families lost their food sources and animal raising area as natural forests were turned into eucalyptus plantation. In Thailand, much of the struggle against eucalyptus plantations was based on their depletion of water resources in areas where water is crucial for rice growing. In this country, local people call eucalyptus “the selfish tree”, precisely because of the way it depletes the water resources.

In 1985, Northeasterners began to fight for their rights. That year, more than 2000 villagers entered the Eucalyptus plantation and destroyed the trees and burned the nursery house. Widespread protests by local community, in particular those that were forced to resettle to make way for the plantation, pressured the government to shelve many projects.

But in late 2001, the Thaksin administration is set to revive a highly controversial Thai-Chinese pulp-production and eucalyptus-plantation joint venture project. The same project was proposed under the previous government, but was shelved due to strong resistance form villagers and non-government organizations and civil society groups. However, the National Economic and Social Development Board said the project was unclear in many respects. It proposed a public hearing and a plan to mitigate the environmental impact of the project. In 2003, the government again, indicated the intention to expand the "economic forest plantation". Until to date, it is not clear whether the government will continue to proceed with the plan.

- *Market foreclosure/Anti-competitive practices*

Given the relatively small size of the host country's market and its relatively underdeveloped competition regime, there are real risks of market foreclosure or anti-competitive practices on the part of large multinational companies.

Thailand promulgated its competition law known as the Trade Competition Act in 1999. The law relatively comprehensive in terms of its substantive provisions compared with its predecessor. The Act automatically applies to all enterprises and business activities with the exception of state enterprises, co-operatives and agricultural and co-operative groups and government agencies. The main substantive provisions of the law include abuse of dominance in section 25, merger control in section 26 and collusive practices in section 27. Due to political interference and intense lobbying on the part of large companies, however, the law remains inoperable. Specifically, after 5 years, the Commission has not yet established the definition of "dominance" -- i.e., the size of the market share threshold -- that would, in effect, subject large corporations to rules governing anti-competitive practices. As a result, small and medium enterprises are vulnerable to restrictive practices undertaken by their larger competitors, suppliers or distributors, be they local or foreign.

It should be noted, however, that foreign companies, especially those without a well-connected local partner, are subject to greater public scrutiny than do local companies. It is always easier to build a case against a foreign company in particular when the public harbor some nationalistic sentiment. This is the case in Thailand. Among many anti-competitive cases filed against various corporations, those that involved foreign-owned entities seem to be taken more seriously by the authority. These are the case of a Japanese motorcycle manufacturer and large foreign discount stores such as Tesco, Carrefour and Big C (the Casino Group of France).

In the first case, the manufacturer, which occupies approximately 80% of the market share, prohibits retailers from selling products of competing manufacturers. In the second case, the large retailers were alleged of carrying out "unfair" trade practices against small suppliers by demanding high entrance fees as well as shelf fees. They are also alleged to have carried out anti-competitive practices against their smaller competitors, the mom and pops store, by selling products below cost.

While it is clear that the first case constitutes a violation of the competition law, the second case is less clear. This is because there is intense competition among the foreign retailers such that consumers have benefited from lower product prices. Many mom and pops store also buys from these discount stores as they can obtain better prices than through direct purchase from the (large) manufacturers that have a greater bargaining power. The retail distribution sector involves sensitive non-economic issues concerning the preservation of small local stores as well as complex economic issues concerning whether the state should intervene in case of imbalanced bargaining power between 2 commercial entities.

## 6. Policy Recommendations

Although Thailand has benefited significantly from FDI in many respects, it has yet to realize the full potential of FDI, especially in the areas of technology, human resource development and research and development. Moreover, current investment promotion practices are very costly. It is therefore recommend that a comprehensive cost and benefit assessment of all incentive schemes be thoroughly assessed. The investment promotion agencies need to estimate revenues forgone and justify them against the potential benefits to be reaped by the country. In the absence of a performance assessment, investment schemes can be easily exploited to the benefit of particular business groups that are politically well-connected at the expense of public resources.

Many studies suggest that tax holidays are not a cost-effective means of attracting FDI. Since profits of firms, however large, are tax exempt, the most profitable investment projects are the greatest beneficiaries of the scheme. Projects like these are likely to be implemented even without the provision of incentives. Tax holidays are rarely important enough to materially affect firms' investment decisions. It is often argued that tax holidays are needed to compensate firms for the high costs arising from poor infrastructure and a lack of qualified labor. If that were the case, it would be more cost effective to abolish tax holidays and use the tax revenue thus recovered to build better infrastructure and train workers. Another option would be to lower the corporate tax rate and cut tariffs across the board.

We have argued that local firms benefit from the transfer of basic production technology from MNEs. However, the transfer of more advanced technology, including product design, product and process improvement, is virtually absent. The acquisition of advanced technology is essential if Thai firms are to climb the comparative advantage ladder and compete with countries with lower labor costs such as China and Vietnam. The Thai government should therefore place more emphasis on technology transfer by giving incentives to MNEs at the post-entry level as provided in the National Science and Technology Development Act of 1991. To qualify for a subsidy, an MNE would have to introduce a technology that is more sophisticated than what is currently available, and that is likely to foster technological upgrading in other firms and industries, including suppliers. Modest incentives for in-house training by MNEs for the staff of other companies could also be considered, as MNEs also have a part to play as training suppliers.

Finally, with regard to the environmental and social concerns, Thailand should think about adding provisions on Corporate Codes of Conduct into the bilateral and regional agreements along the line of the Corporate Code of Conduct Bill 2000 of Australia. This particular Act imposes standards on the conduct of Australian corporations that undertake activities in other countries. Indeed, it is not desirable to impose overly burdensome regulations that may turn off potential investors. A simple information compliance report and disclosure can go a long way in ensuring the conduct of TNCs.

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# ANNEX 1

**Foreign Business Act of B.E. 2542 (1999):**

| **Sector** | **Nature of Exception**<br><br>(e.g., prohibition, limitation, special conditions and special screening) |
|---|---|
| **List 1**: The businesses not permitted for foreigners to operate due to special reason:<br>(1) Newspaper business, radio broadcasting or television station business<br>(2) Rice farming, farming or gardening<br>(3) Animal farming<br>(4) Forestry and wood fabrication from natural forest<br>(5) Fishery for marine animals in Thai waters and within Thailand specific economic zones<br>(6) Extraction of Thai herbs<br>(7) Trading and auctioning Thai antiques or national historical objects<br>(8) Making or casting Buddha images and monk alms bowls<br>(9) Land trading. | Foreign equity participation must be lower than half of the registered capital. |
| **List 2**: The businesses related to the national safety or security or affecting arts and culture, tradition, folk handicraft or natural resource and environment:<br>Group 1: National safety/security-related businesses<br>(1) Production, selling, repairing and maintenance of<br>(a) Firearms, ammunition, gun powders, explosives<br>(b) Accessories of firearms, ammunition and explosives<br>(c) Armaments, ships, air-crafts, or military vehicles<br>(d) Equipment or components, all categories of war materials<br>(2) Domestic land, waterway, or air transportation, including domestic airline business<br>Group 2: Businesses affected to culture, traditional and folk handicrafts<br>(1) Trading antiques or art objects being Thai | Foreign equity participation must be lower than half of the registered capital except permission by the Minister with the approval of the Cabinet<br><br>Foreigners operating business under this list must meet the following two qualifications:<br><br>(1) At lest 40% of all the shares must be held by Thai persons or juristic persons that are not foreigners. (Given reasonable cause, the minimum may be lowered to 25% by the Minister with the Cabinet's approval.)<br><br>(2) The number of Thai directors shall not to be less than two-fifths of the total number of directors. |

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| arts and handicraft<br>(2) Production of carved wood<br>(3) Silkworm farming, production of Thai silk yarn, weaving Thai silk or Thai silk pattern printing<br>(4) Production of Thai musical instruments<br>(5) Production of goldware, silverware, nielloware, bronzeware and lacquerware<br>(6) Production of crockery of Thai arts and culture<br>Group 3: Businesses affecting natural resources or environment<br>(1) Manufacture of sugar from sugarcane<br>(2) Salt farming, including underground salt<br>(3) Rock salt mining<br>(4) Mining, including blasting or crushing<br>(5) Wood fabrication for furniture and utensil production | |
| **List 3:** The businesses which Thai nationals are not yet ready to compete with foreigners:<br>(1) Rice milling, and flour production from rice and farm produce<br>(2) Fishery specifically marine animal culture<br>(3) Forestry from forestation<br>(4) Production of plywood, veneer board, chipboard or hardboard<br>(5) Production of lime<br>(6) Accounting services business<br>(7) Legal services business<br>(8) Architecture service business<br>(9) Engineering service business<br>(10) Construction except for:<br>(a) Construction rendering basic services to the public in public utilities or transport requiring special tools, machinery, technology or construction expertise having the foreigner's minimum capital of 500 million Baht or more<br>(b) Other categories of construction prescribed by the ministerial regulations<br>(11) Broker or agency business, except:<br>(a) Being broker or agent for underwriting securities or services connected with future trading of commodities or financing instrument s or securities<br>(b) Being broker or agent for trading or procuring goods or services necessary for production or rendering services amongst affiliated enterprises<br>(c) Being broker or agent for trading, purchasing or distributing, or seeking both domestic and foreign markets for selling domestically manufactured or imported goods in the manner of international business operations having | Foreign equity participation must be lower than half of the registered capital except in case of permission granted by the Director- General with the approval of the Committee. |

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| the foreigner's minimum capital 100 million Baht or more<br>(d) Being broker or agent of other category as prescribed by the ministerial regulations<br>(12) Auction, except:<br>(a) Auction in the manner of international bidding not being the auction of antiques, historical artifacts or art objects which are Thai works of arts, handicraft or antiques or having the historical value<br>(b) Other categories of auction as prescribed by the ministerial regulations<br>(13) Internal trade connected with native products or produce not yet prohibited by law<br>(14) Retailing all categories of goods having the total minimum capital less than 100 million Baht, or less than 20 million Baht per shop<br>(15) Wholesaling all categories of goods having the total minimum capital of each shop less than 100 million Baht<br>(16) Advertising business<br>(17) Hotel business, except for hotel management service<br>(18) Guided tour<br>(19) Selling food or beverages<br>(20) Plant cultivation or propagation business<br>(21) Other categories of service business except that prescribed in the ministerial regulations | |

Source: APEC website

# ANNEX 2

## APEC Non-Binding Investment Principles

**Jakarta, November 1994**

In the spirit of APEC's underlying approach of open regionalism,

Recognising the importance of investment to economic development, the stimulation of growth, the creation of jobs and the flow of technology in the Asia-Pacific region,

Emphasising the importance of promoting domestic environments that are conducive to attracting foreign investment, such as stable growth with low inflation, adequate infrastructure, adequately developed human resources, and protection of intellectual property rights,

Reflecting that most APEC economies are both sources and recipients of foreign investment,

Aiming to increase investment including investment in small and medium enterprises, and to develop supporting industries,

Acknowledging the diversity in the level and pace of development of member economies as may be reflected in their investment regimes, and committed to ongoing efforts towards the improvement and further liberalisation of their investment regimes,

Without prejudice to applicable bilateral and multilateral treaties and other international instruments,

Recognising the importance of fully implementing the Uruguay Round TRIMs Agreement,

APEC members aspire to the following non-binding principles:

***Transparency***

- Member economies will make all laws, regulations, administrative guidelines and policies pertaining to investment in their economies publicly available in a prompt, transparent and readily accessible manner.

***Non-discrimination between Source Economies***

- Member economies will extend to investors from any economy treatment in relation to the establishment, expansion and operation of their investments that is no less favourable than that accorded to investors from any other economy in like situations, without prejudice to relevant international obligations and principles.

***National Treatment***

- With exceptions as provided for in domestic laws, regulations and policies, member economies will accord to foreign investors in relation to the establishment, expansion, operation and protection of their investment, treatment no less favourable than that accorded in like situations to domestic investors.

***Investment Incentives***

- Member economies will not relax health, safety, and environmental regulations as an incentive to encourage foreign investment.

***Performance Requirements***

- Member economies will minimise the use of performance requirements that distort or limit expansion of trade and investment.

***Expropriation and Compensation***

- Member economies will not expropriate foreign investments or take measures that have a similar effect, except for a public purpose and on a non-discriminatory basis, in accordance with the laws of each economy and principles of international law and against the prompt payment of adequate and effective compensation.

***Repatriation and Convertibility***

- Member economies will further liberalise towards the goal of the free and prompt transfer of funds related to foreign investment, such as profits, dividends, royalties, loan payments and liquidations, in freely convertible currency.

## *Settlement of Disputes*

- Member economies accept that disputes arising in connection with a foreign investment will be settled promptly through consultations and negotiations between the parties to the dispute or, failing this, through procedures for arbitration in accordance with members' international commitments or through other arbitration procedures acceptable to both parties.

***Entry and Sojourn of Personnel***

- Member economies will permit the temporary entry and sojourn of key foreign technical and managerial personnel for the purpose of engaging in activities connected with foreign investment, subject to relevant laws and regulations.

***Avoidance of Double Taxation***

- Member economies will endeavour to avoid double taxation related to foreign investment.

## *Investor Behaviour*

- Acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should.

## *Removal of Barriers to Capital Exports*

- Member economies accept that regulatory and institutional barriers to the outflow of investment will be minimised.

# ANNEX 3

## Table 1.5 FTAs between Thai and other countries

| Countries | Progress | Expected Date of a full FTA | Details on Early Harvest |
|---|---|---|---|
| Thai – Bahrain | - Framework on Trade and Investment Agreement became effective as of 29 December 2002<br>- Immediate tariff reduction on “Early Harvest” for 626 products to tariff rate 0% and 3%<br>- Reduce tariff rate on “Early Harvest” from 3% to 0% by 1 January 2005<br>- For tariff reduction of others 5,000 products, Thai offers to categorize into 3 groups which are<br>- Fast Track, having 40% of all other products, reduce tariff rate to 0% by 1 January 2005<br>- Normal Track, having 40% of all other products, reduce tariff rate to 0% by 1 January 2007<br>- Other Products, having 20% of all other products, reduce tariff rate to 0% in 1 January 2010. | 2010 | Early Harvest 626 products, i.e. seafood, fruits, vegetables, textile, chemical products, cement, natural gas, jewelry, etc. |
| Thai - China | - Framework on Trade and Investment Agreement signed on 18 June 2003<br>- Reduce tariff to 0% for vegetable and fruit under the tariff classification 07–08 since 1 October 2003. | - | Early Harvest on fruits and vegetables, i.e. potato, tomato, bean, coconut, cabbage, carrot, lettuce, pineapple, prune, apricot, etc. |
| Thai - India | - Framework on Trade and Investment Agreement signed on 9 October 2003<br>- Tariff on 84 products will be cut in half by March 2004, three fourths by March 2005, and to be zero by March 2006. | 2010 | Early Harvest on 84 products, i.e. fruits, prepared and preserved seafoods, precious stones, forms and plastic, machines, electronic parts, electrical appliances, etc. |
| Thai - USA | - Trade and Investment Framework Agreement singed in October 2002.<br>- The expected FTA negotiation would be in | | |

| Countries | Progress | Expected Date of a full FTA | Details on Early Harvest |
|---|---|---|---|
| | April 2005.<br>- US. desires Thailand to solve intellectual property rights and customs valuations problems before FTA negotiation starting. | | |
| Thai - Australia | - The negotiation will be concluded by October 2003.<br>- Thailand initial offer is covering 5,505 products, that tariff is immediately 0% for 2,934 products.<br>- Australia offers 6,108 products that tariff is reduced to 0% for 5,123 products.<br>- Both countries agree to have the Progressive Liberalisation every 3 years. | | |
| Thai - Japan | - Framework on Trade and Investment Agreement signed in late 2002.<br>- But there is no formal negotiation because of agriculture products, which are Japan's sensitive sectors.<br>- They expect to formally negotiate by the year 2003. | | |
| Thai - Peru | - Both countries would establish a framework on trade and investment including transport and tourism.<br>- The agreement would eliminate tariff and reduce non-tariff by 2015.<br>- The expected FTA negotiation would start in January 2004 and finish it by the end of 2005. | | |

Source: Department of Trade Negotiations, August 2003.