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The Shifting Paradigm of FDI Policy and Promotion in Thailand

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It is axiomatic that as a country moves up the developmental ladder, it will continuously need to adjust its national priorities, if it wishes to advance to the next level. Clearly this has been the case in Thailand, and this treatment of investment promotion as a living, breathing entity, rather than a "carved-in-stone" monolith, has been extremely successful.

Indeed, since 1985, the BOI has approved 8,500 projects, with total investment of more than 1.5 trillion baht (US$35 billion), and creation of some 2.1 million jobs for Thai workers. In addition, this has led to substantial improvements in quality of Thai-manufactured goods, particularly in the automotive, electronic and fashion industries, and as a result Thai-manufactured products in these industries have gained footholds in even the toughest of international markets.

As I go through the changes to investment policy, you will be able to observe that these revisions to Thai investment schemes corresponded closely with changes in the nation's overall macroeconomic situation and responded to national development objectives.

And, while the Board of Investment is the agency responsible for attracting FDI, there are other government agencies that play a role in creating an investment environment that is appropriate for the country at a given point in time. So, while the focus of this talk will be on investment promotion, not all of the actions described represent policies of the Board of Investment, but rather the government as a whole.

Although investment promotion in Thailand dates back more than three decades, the BOI is officially governed by the 1977 Investment Promotion Act, as amended in 1991 and again in 2002. The Act prescribed that the Board would be chaired by the Prime Minister, with economic ministers, senior civil servants, representatives of major private sector organizations, and academics serving as Board Members or Advisors.

When the Investment Promotion Act came into existence, it is important to understand that there was very little industry in the country, and what there was, was primarily simple assembly. The domestic marketplace was relatively small, and the average Thai consumer had little disposable income.

Capital goods, therefore, had to be imported, as did many raw materials and components, with the obvious exceptions of agriculture and minerals, with the result being foreign exchange losses and balance of trade deficits.

Therefore, the Thai government recognized the need to develop indigenous industries that would minimize the reliance on costly imports, and hence foreign exchange and balance of trade losses, and early investment promotion policy reflected this import substitution focus.

High levels of protection were afforded indigenous industries, particular in the form of import tariffs, which were set at rather high levels, in order to “force” a market for Thai-manufactured goods.

On example of how this worked, in practice, was the automotive industry, which came into existence during the late 1960s and early 1970s, with several joint-ventures assembling vehicles from completely-knocked-down (CKD) kits. During the mid 1970s, investment in auto parts and components began to come into Thailand, but the domestic market was not sufficient to provide the necessary economies of scale that would make these local manufacturers cost-competitive.

It soon became apparent that if the government did nothing to protect local assemblers, a market for Thai-manufactured vehicles would not develop, as the existing tariff structure did not adequately protect assemblers from completely built up (CBU) imports, nor would local parts and component manufacturers be able to develop.

Accordingly, starting in 1978, the government instituted a ban on CBU imports, increased the tariff on completely knocked down (CKD) kits, and through the 1980s, the government protected local parts manufacturers, by increasing the local-content requirements to more than 50%.

By the mid to late 1980s, the policies that were designed to nurture fledgling industries in Thailand began to show results. Indeed, Thailand’s ability to provide cost-effective local inputs (raw materials, labor and infrastructure) started to attract large numbers of industrial projects, including the first wave of Japanese investors, who were looking for relief from the appreciating Yen and resultant increases in labor costs.

Companies that came to Thailand during that period prospered, and word rapidly spread that Thailand was, in many ways, an ideal offshore production site, possessing large pools of affordable and trainable labor, abundant natural resources, government protection for fledgling industries, and policies that gave businessmen to, for the most part, operate as they deemed appropriate.

This inflow of foreign industrial projects continued into the early 90s, as international companies, attracted by explosive growth (Thailand averaged 8.4% GNP per capita growth between 1985-1994) and a high degree of economic freedom, and problems began to emerge.

Bangkok and surrounding provinces had attracted the lion’s share of the foreign investment, and this led to increased pollution and congestion, as well as shortages in skilled labor, as infrastructure development could not keep pace with the demands placed upon it by the extremely rapid growth. In addition, the flood of business activity in the greater Bangkok area led to even greater inequality in economic opportunities between Bangkok and the provinces.

To address the issue of unequal distribution of wealth and prosperity, the government's 6^{th} and 7^{th} National Plans, developed by the National Economic and Social Development Board, focused on narrowing the gap in economic activity between Bangkok and the provinces.

In support of those plans, and to address some of the problems created by the rapid development of Bangkok, the Board of Investment enacted new measures designed to promote industrial decentralization by dividing the country into three zones, based on location.

Simply put, projects that locate in Zone 2, the provinces surrounding Bangkok received greater incentives than projects locating in Bangkok and surrounding provinces, while the greatest amounts of incentives were reserved for provinces that located in Zone 3, the areas 150 km or more from Bangkok.

To further promote decentralization of industry in 1993, the BOI removed the requirement that foreign-owned companies in Zone 3 export at least 80% of their products.

These policies proved quite successful in terms of attracting investment upcountry, but it should be noted that the policies were less successful in impacting each province equally; rather it established industrial hubs close to the boundaries of each zone.

Investment promotion policy remained relatively unchanged until 1997, with minor adjustment being made to increasingly liberalize the program or open new categories.

In 1997, Thailand fell victim to the financial crisis that ultimately impacted much of the region. As a result, the government reacted swiftly to restore lost investor confidence. In addition to implementing measures mandated by the International Monetary Fund, Thailand began an impressive series of reforms to outdated economic laws. Indeed, by early 1999, more than 100 new laws or revisions had been implemented.

By strengthening the country's legal and regulatory framework, Thailand improved the overall economic climate, one key element of the investment environment. One of the objectives of the government at that time was to increase Thai-manufactured exports, as a means to generate much-needed foreign currency earnings, as that would enable the country to build international reserves and strengthen the baht.

Accordingly, in 1997 and 1998, the BOI adopted a number of short-term measures that facilitated increased export of Thai-manufactured goods and save foreign currency through promotion of import substitution.

For example, we let existing projects operate at full capacity in order to permit them achieve economies of scale and to find new markets; we relaxed zoning requirements for export-oriented projects; we provide import duty waivers for new machinery in 61 categories of export-oriented industries; and we offered exemption of import tax on raw materials to non-BOI promoted companies, thereby helping them become more competitive in the global market place. In addition, the import duty guarantee requirements were reduced for the 500 top exporters from 50 to 5 percent of the import duties payable on inputs imported for processing into export products.

Were these measures successful? Well, after dropping by 6.6 percent in 1998, exports grew from US$54.5 billion to US$69.9 billion from 1999 to 2001. And while there are many factors that support export growth, it is fair to say that the measures adopted by the BOI, at least contributed to this revitalized growth in exports.

During that time, it also became increasingly clear that viable joint ventures were experiencing financial difficulties arising from the impact of the financial crisis. To solve this problem, the BOI permitted foreign partners to own a majority or all shares in manufacturing projects.

In doing so, we enabled foreign partners to inject needed capital into joint ventures, in the event the liquidity crunch has impinged upon their local partner's ability to do so in proportion to the previous shareholding requirements.

The BOI also took steps to improve the overall investment environment by implementing measures to facilitate investment and improve industrial competitiveness.

We established a One-Stop Service Center for Visas and Work Permits that processes work permits and long-term visas in three hours or less, and we granted promoted companies permission to own land for residential and business purposes.

And, to improve industrial competitiveness, the BOI promoted new activities, such as logistics and international procurement offices, and required new projects to obtain international certification, such as ISO 9000, within two years of start-up.

Which brings us to the present day.

In 2001, Thailand elected a new Prime Minister, Thaksin Shinawatra, and he had plans to restructure the Thai economy, and he has implemented a “dual-track plus” policy that embraces not only export-generated growth, but domestic-led growth and poverty eradication as well.

His vision includes attracting investment that draws talent and promotes R&D and skills development, as well as technological development and transfer, for he understands that in the 21st century, productivity-driven wealth creation is more desirable than capital-driven wealth creation.

He also believes that the government should encourage the development of clusters, as they will enable businesses to take advantages of economies of scale and efficiency all throughout the supply chain, and will foster increased amounts of R&D as well.

To accomplish these objectives, the BOI has adopted a series of seven key strategies.

First and foremost, with the impending implementation of AFTA, WTO, etc. and the further reduction of tariffs on machinery and raw materials, it is undeniable that the importance of tax-based incentives is rapidly diminishing. Therefore, if Thailand is to remain an attractive site for foreign investment, the BOI must remove impediments and create an **enabling environment for investors**.

To learn what investors considered the most pressing issues, the BOI is consulting with foreign investors, both at home and abroad. Issues not already being addressed by a joint public-private sector committee headed by the Prime Minister were then taken up by the BOI.

In addition, to help sort out investor problems, the BOI has reorganized internally and has set up an investment facilitation unit, tasked with working with investors in areas such as domestic sourcing and subcontracting, human resources development, and coordination with other government agencies.

We also removed location requirements for projects in all but a handful of environmentally-sensitive activities, thereby giving investors almost total control of their project.

If tax incentives are a priority, the investor can locate in our least developed provinces and take advantage of maximum incentives. If, on the other hand, it an investor's business model deems it most important to be located close to suppliers or end users, and that location is in Zone 1, he is now free to do so.

We believe that by lifting this restriction, we have both removed a barrier to investment, and have paved the way for cluster development.

A **second** strategy involves **proactive targeting of investors**, both by sector and by region, in order to improve both the quality and quantity of investment, which will help develop and enhance sustainable growth in the Thai economy.

Accordingly, three major regions have been targeted as the focus for advertising, marketing and promotional efforts. Europe, Asia (especially Japan), and North America will be beneficiaries of this new focus. These regions will see more missions, as well as more visits from the BOI's mobile units.

In addition, additional overseas offices will be opened in these regions to ensure that they receive more individualized service to investors in these countries, and within the next 12 months, we expect to open new offices in Shanghai, San Francisco and Osaka that will be staffed by some of our best people, fluent in the language of the country.

From a sectoral perspective, the BOI identified five industries that will be aggressively targeted: Agro-industry; Automotive; Fashion; ICT including Electronics; and High value-added services.

Having identified the industries, the next step is to develop policies, measures, and marketing strategies specific to each industry, taking into consideration their needs, based on factors such as competitiveness, market potential and levels of technology.

We believe this is the kind of government support for key industries will almost certainly lead to cluster development, and all the benefits, described earlier, that come with it.

Our **third** strategy is to improve the way we market Thailand, by **improving our networking** in target regions. To accomplish this, we are actively seeking cooperative agreements with public and private sector organizations, including other investment agencies, banks, and provincial governments.

Earlier this year, for example, we signed joint marketing pacts with the four largest banks in Japan, as well as a major European bank, and we have also signed joint promotion agreements with several investment promotion agencies in the region. The advantages to this kind of collaboration is clear; by working together, we can improve the bilateral flow of information for the investment community, and this will help us meet investor needs.

The **fourth** BOI strategy involves helping to upgrade Thai competitiveness at the SME level. To help SMEs become more productive, we will expose Thai SMEs to "industry-best" practices and technologies and the importance of skills training and technology transfer. In addition, we will work with foreign investors to attract technologies new to Thailand and introduce them to Thai SMEs.

Another of our strategies is to transform our regional offices into marketing organizations to help improve the capabilities of Thai SMEs at the grass-roots level.

The object of this **fifth** strategy is to choose the most promising enterprises for marketing, and then encourage foreign SMEs to participate in these "**community enterprises**," by providing technical assistance and input on how to best reach overseas markets. By focusing on selected quality projects and trying to improve them, the BOI is trying to create success stories that can then be replicated in other villages around the country.

Our **sixth** strategy involves tracking changes in the international investment marketplace to determine the appropriateness of BOI policies. The BOI will, therefore, **monitor investment regimes** from around the world, in order to help the BOI **identify investment trends**. In doing so, the BOI will be able to provide both investors and the government with early warning about the impact of legislative and procedural changes resulting from international agreements.

The **seventh**, and final, strategy is to improve the way the BOI does business. While we have already earned ISO 9002 certification, thereby ensuring fair treatment for all investors, the BOI will be working to improve the level of service we offer investors. More importantly, we will be looking to find ways to speed up processing times by **streamlining procedures and cutting through unnecessary "red-tape."**

From the experiences I have shared with you this morning, I think you can see that Thailand's Board of Investment has worked closely with other government agencies to develop an investment framework that is, on the one hand, among the most liberal and attractive in the Asia, yet on the other hand meets changing developmental objectives of the central government.