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EXPORT AND INVESTMENT PROMOTION IN THAILAND

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SUMMARY

By the late 1980s, Thailand had emerged as one of the fastest growing economies in the world, thanks to a boom in manufactured exports. Four major factors underlie Thailand's export success. First, the fundamentals were in place: macroeconomic stability and effective foreign-exchange management with a realistic exchange rate. Second, duty-free import or drawback mechanisms were available to exporters despite the antiexport tariff bias. Third, Thailand was in the right place at the right time. By 1987, the appreciation of the yen and other Asian currencies, coupled with rising wage rates in the newly industrialized countries (NICs), had led investors in developed countries to relocate or source in lower wage cost sites, such as Thailand. Finally, trade promotion and tax-based incentives for export firms, although not critical, had begun to help exporting firms.

A recent study conducted by the Agency for International Development's Center for Development Information and Evaluation (A.I.D./CDIE) examined the contributions of subsidized export and investment promotion services to Thailand's export growth. The study focused on A.I.D.'s Private Sector in Development project (1983-1987), which aimed at increasing investment in export industries in Thailand. The project's underlying assumption was that domestic manufacturers and foreign investors could not take advantage of the real opportunities from investment in export-oriented ventures given the weak market for information. It, therefore, sought to close the information gap facing the private sector to stimulate more U.S. and Thai investment and more rapid export growth. The study came to three conclusions:

1. Thailand's stable policy environment was crucial to its export growth. Its diverse and dynamic export-services market needs no additional donor subsidies to accelerate export growth.

2. Links between buyers and export firms were critical to stimulating exports. An export promotion agency that facilitates ties between buyers and exporters in a favorable policy environment can help overcome market entry barriers facing firms new to exporting.

3. Government institutions are not effective providers of investment promotion services if such services are not a primary institutional objective.

The Thailand case study is part of a larger effort to examine A.I.D. experience with export

and investment promotion services worldwide. The Asia phase of the study examines promotion services in four countries—India, Indonesia, Korea, and Thailand—where A.I.D. has carried out projects in differing policy environments.

The Asia assessment draws heavily on a survey of nearly 300 exporting firms in 6 countries, including Thailand, to identify what services exporters in these countries used, which ones made a significant difference to their export success, and who provided these services.

Thailand is included in the assessment for two main reasons. First, Thailand's outstanding export growth makes a good case for examining promotion programs in a highly favorable policy environment. Second, in the 1960s and again in the 1980s, the A.I.D. program in Thailand had a strong private sector focus.

BACKGROUND

The Policy Environment and Export Growth

Thailand's recent economic growth is unprecedented. Between 1986 and 1989, real gross domestic product (GDP) increased 10 percent annually. Exports as a percentage of GDP rose from 17 percent in 1970 to 38 percent by 1988. Between 1985 and 1991, Thai exports more than tripled in value with totals in constant dollars increasing from nearly $8 billion in 1985 to $26 billion in 1991.

Manufactured exports led Thailand's boom. As Figure 1 illustrates, Thailand's exports to countries in the Organization for Economic Cooperation and Development had been moving from agriculture (principally primary commodities) to manufacturing for more than 20 years, reflecting a shift in the structure of the Thai economy.

For several decades, the Thai Government has supported macroeconomic stability and has practiced sound exchange-rate management— important conditions for outward-oriented growth. Inflation has averaged less than 7.5 percent since 1960. In the early 1980s, the Government tightened financial policies to cope with a rising current-account deficit and escalating inflation brought on by oil price hikes and declining revenue from exports of raw material. It devalued the Thai currency (the baht), keeping it in parity with the U.S. dollar, and supported a realistic exchange rate. By 1985, these measures had resulted in a substantial real devaluation, which gave a strong impetus to Thai exports.

Unlike Taiwan and Singapore, Thailand's Government has not pursued an export strategy based on full liberalization of trade in manufactures. From 1960 to the early 1980s, the Government put a complex system of import substitution policies in place, giving substantial protection to domestic manufacturing. It relied on import tariffs not only to generate revenue and control the entry of luxury goods but also increasingly to protect domestic industry. By the early

1980s, the Government had recognized the need for reform and revised its tariff structure, achieving only minimal improvements.

The Thai Government pursued an export strategy based simultaneously on trade promotion and investment incentives. Throughout the 1980s, it gave credit assistance to exporters through subsidies and discounted promissory notes until U.S. threats to impose countervailing duties led to discontinuation of this practice. The Bank of Thailand also provided significant export credit assistance. In the early 1990s, however, the Thai Government made a serious effort to liberalize trade through tariff reform. The result should be a more neutral and simpler import tax structure, which will not unduly disadvantage exporters.

Continuity in government, an open foreign investment regime, few international restrictions on capital, and an adequate financial infrastructure all combined to make Thailand an attractive site for exporting manufactures. As Figure 2 shows, foreign direct investment (FDI) rose sharply during the late 1980s, from $351 million in 1987 to $2.4 billion by 1990, a ninefold increase. The manufacturing sector absorbed over 50 percent of total FDI in Thailand from 1987 to 1990, and foreign investors, principally Japan and the Asian Tigers, shifted increasingly into export-oriented projects. Thailand's ethnic Chinese community had strong links to the multinational East Asian Chinese business networks, facilitating ties to buyers and investors. Finally, Thailand offered low wages combined with a literate and trainable labor force—two major factors contributing to the efficiency and competitiveness of the domestic economy.

The Private Sector and Constraints to Export-Led Growth

The private sector has played a critical role in Thailand's phenomenal export growth. However, several factors have influenced the type of growth achieved and will affect future export performance.

First, Thailand lacks a coherent policy for export development. Until recently, entrenched business interests opposed to trade liberalization held back reforms in the tariff and tax structure to ensure control over government incentives. Import-substitution industrialization had helped the private sector grow and become more autonomous of the Government. The large and increasingly powerful Sino-Thai conglomerates in Thailand operated independently of the Government, while gaining increasing control over Government policy through informal lobbying. They placed Thai bureaucrats on the boards of these firms and strengthened private sector control of trade associations. This "feudalization" protected segments of an often inefficient government bureaucracy and made it difficult to counteract the import substitution bias of industrial policy.

Second, key sectors of Thai manufacturing have dual characteristics. For example, one segment of the electronics industry is the highly competitive export-oriented electronics parts and components subsector; the other is the heavily protected consumer and industrial finished electronics subsector, which is not competitive internationally. Government policies have encouraged this fragmentation. The boom in integrated circuit assembly for the export market by

U.S. multinationals did not result in any backward linkages with domestic industry. Rather, domestic industry is reimporting integrated circuits assembled in Thailand for the export market. Thus, government policies may be inhibiting the development of intermediate industries. Indirect exporters, that is, firms subcontracted to produce intermediate goods as inputs to export products, have been denied access to the many benefits offered to direct exporters.

Another major obstacle to continued export growth in Thailand is the shortage of technical and managerial personnel, particularly engineers and technicians. Thailand lacks the highly skilled specialists necessary for technological innovation that its competitors are developing.

A.I.D.'S ASSISTANCE APPROACH

A.I.D. has been committed to stimulating private-sector-led economic growth in Thailand since the late 1960s. A.I.D.'s Private Sector Development Program (1969-1972) aimed to expand the private sector's role in Thailand's economic development through institution building, policy support, and direct promotion of U.S. and Thai investments.

In the mid-1970s, A.I.D. shifted its focus to promoting rural industry to stimulate economic growth and employment outside of Bangkok. By 1979, however, the oil price rise had spurred the Thai Government to concentrate on macroeconomic stabilization and a competitive open trading strategy. Therefore, during the 1980s, A.I.D. targeted export-led growth to support the Thai Government's efforts to expand the role of the private sector. A.I.D.'s Private Sector in Development project (1983-1987) sought to increase private sector investment in employment-generating, export-oriented, natural-resource-based investment to be located primarily outside of Bangkok.

The rationale for the project was that information gaps, institutional limitations, and policy disincentives pose serious constraints to full and effective private sector participation in Thailand's economic development. The project sought to combat three basic problems:

- Thai firms' lack of access to technology, managerial techniques, and market information, which were needed for effective exporter performance
- U.S. firms' poor knowledge of Thai business opportunities, which inhibited investment
- Intense competition for foreign investment from neighboring countries, many of whom had more effective investment promotion programs

The $5.5 million project tried to close the information gap facing the private sector to achieve more U.S. and Thai investment and more rapid export growth. The project had three main components:

1. It provided technical assistance to the Thai Board of Investment (BOI) to mount an investment promotion campaign to attract U.S. direct investment in selected Thai industrial and agribusiness sectors. U.S. and Thai consulting firms provided investment analysis and services

to the BOI. These services ranged from undertaking promotional campaigns in the United States, to developing matchmaking databases to support investment promotion activities, to assisting the BOI with helping U.S. investors find Thai joint venture partners and developing an investment promotion strategy. The assumption was that the private sector had the technical expertise lacking in a government agency to launch an effective investment promotion campaign.

2. It established a mechanism for the Thai private sector to undertake policy studies and dialogue on issues affecting private sector development. To address policy obstacles facing the private sector, the second component supported greater private sector dialogue with the Thai Government through research on key policy issues.

3. It assisted the Thai counterpart of the U.S. Joint Agricultural Consultative Corporation in establishing linkages with U.S. organizations to encourage business cooperation and technical transfer.

EVALUATION FINDINGS

Do such export and investment promotion services contribute to export growth? Which services and providers are most effective? To elicit firms' views on service use and impact, the assessment team interviewed managers of 43 exporting firms based in Thailand. The team also contacted more than 22 service providers, including government export and investment promotion agencies, industry associations, chambers of commerce, trading companies, retailers, importers, consulting firms and other private institutions that provide such services, as well as A.I.D. officials and experts on the Thai economy.

The questionnaire covered five categories of services provided directly to exporters or investors: information (e.g., information on export markets and investment climate); contact making (e.g., buyer contacts, trade shows, investment missions); preinvestment or preexport support (e.g., feasibility studies, investment profiles); technical assistance (e.g., assistance in production, marketing, and training); and government facilitation (e.g., paperwork, customs). The team interviewed firms in five leading manufactured export sectors in Thailand: food processing, garments, footwear, electronics, and automotive parts. Of the 43 firms surveyed, 34 were 100 percent Thai-owned, 7 were Thai-foreign joint ventures, and 2 were wholly owned subsidiaries of foreign companies. Firms evaluated each service based on whether the service had a significant impact on their export entry or decision to invest.

The assessment team also surveyed the market for investment-related services, which has greatly expanded since 1987. This market, which includes consulting firms, accounting firms, law firms, and investment banks, is small but increasingly competitive. Moreover, in recent years, Thai firms have become more active and sophisticated as service providers compared with foreign competitors. However, Thai firms tend not to use private firms to find joint venture partners, largely because of the high cost and uncertainty about the quality of the final product. Rather, the majority of Thai firms rely on buyers, brokers, or personal connections.

Several barriers exist to entering the investment services market. The first is product differentiation. Firms need to tailor their services to specific client groups, especially given the high cost of investment services, particularly consulting. They also require access to important information about the domestic economy, which local firms are reluctant to share for fear of leaking production and trade secrets. Another barrier is human resources, a significant problem, given the shortage of highly skilled professionals and restrictions on the entry of foreign nationals. A fourth constraint is government policies and regulatory requirements that limit entry to certain sectors, such as banking, shipping, and insurance.

Was A.I.D.'s Assistance Approach a Success?

A.I.D.'s Private Sector in Development project aimed at accelerating the rate of foreign investment in export-oriented ventures and, in turn, the rate of export growth in Thailand. The project assumed that investment missions to the United States arranged by private consulting firms for the BOI would be the most effective tool for generating U.S. investment. These assumptions proved incorrect.

The three A.I.D.-assisted investment promotion missions to the United States focusing on the electronics, metal fabrication, and agribusiness sectors were successfully completed. The investment missions were effective in educating U.S. managers about the investment climate in Thailand, and U.S. managers who attended the mission events found them informative. The A.I.D.-contracted consulting firms launched a public relations campaign to "sell Thailand" to potential investors in 1985, but the United States and international news media did not extensively profile the Thai economy until several years later when Thai exports really boomed.

With contractor assistance, the BOI set up a database of 150 Thai firms seeking joint ventures with U.S. investors, but this matchmaking database fell into disuse. Not until 1991 did the BOI reestablish a joint-venture matchmaking service, in part, because its role as a provider of investment incentives was disappearing.

Although these efforts may have stimulated investor interest, they did not generate investment deals as expected. Only one U.S. firm started operations in Thailand as a result of these investment promotion efforts, and that firm went bankrupt. U.S. firms contacted had increased investment in the Thai electronics sector, but these ventures took place before and independently of the A.I.D. project. Twenty U.S. companies contacted made return visits to Thailand, but no investments resulted.

Why did U.S. direct investment in export-oriented activity in Thailand not increase as expected? First, A.I.D., the consulting firms, and BOI had unrealistic expectations about generating investment in export firms in Thailand. Selling the country, or attracting investment, became the primary objective even though the original intent was to generate U.S. investment in priority export sectors. Although promoting a country's economic prospects can be the most appropriate technique at some point, it does not immediately generate investment.

Second, the BOI and U.S. consulting firms had insufficient knowledge of the motivation of potential U.S. investors and the capability of Thai firms. Investment opportunities in Thailand during the 1980s were primarily in labor-intensive industries, which typically involved investment in joint venture or contract production. Managers of U.S. firms approached by the missions were dismayed by the lack of concrete information and followup by the BOI and potential joint venture partners. Requests by U.S. firms for samples were ignored or responded to well after the promised date. In some subsectors, Thai firms were too underdeveloped to be effective investment partners. The lack of a tool and die industry in Thailand, for example, put off U.S. investors contacted during the BOI metal fabrication mission.

Third, A.I.D. assumed that private consulting firms could strengthen the BOI's investment service capacity, but this assumption proved wrong. The BOI had concentrated on granting investment incentives, not on services to generate investment. The BOI bureaucracy needed to be streamlined and technically upgraded to fulfill its investment services function, but limits on civil service salaries restricted the BOI's ability to obtain the necessary technical expertise. Foreign subsidiaries and joint ventures interviewed used the BOI for "government facilitation" services not for help in identifying joint venture partners. Finally, the timing was off, because the investment missions coincided with the U.S. recession in the mid-1980s. U.S. firms were reluctant to invest abroad in the mid-1980s despite the best intentions of the investment missions.

Other Investment Promotion Providers

Foreign donors are playing an increasingly active role in the investment services market in Thailand. Japan, France, and Germany, for example, have advisers at BOI to assist firms from their countries that are interested in investing in Thailand. The United States does not have an adviser at BOI, but the U.S. Foreign Commercial Service, and the American Chamber of Commerce of Thailand provide much the same services. These entities act as "information and contact brokers" for foreign investors to explore their options. However, Japan offers a more comprehensive package of services to potential Japanese investors, often helping them with every stage of the process. Moreover, the Japanese Government is building up the capability of Thai firms to be effective partners with Japanese investors. It is providing Thai firms with sector-specific technology services and training through JETRO, its investment promotion agency, and supporting intermediate-industry development in Thailand.

The BOI's role in this market has primarily been to give tax breaks to foreign and Thai investors in export industries. Although BOI provides promotion services to investors (a "one-stop shop" investment services center, government facilitation, partner identification services to promote joint ventures, and investment missions), it has given these services very low priority. Only recently has it devoted some effort to improving promotion services now that its function as a provider of tax incentives is becoming obsolete. Firms surveyed gave the BOI "fair" to "good" marks for its facility in dealing with the Government.

Export Promotion Services

As the table illustrates, exporters valued most the following export promotion services, in rank order: buyer contacts, foreign market information, sector specific information, production-related technical assistance, and marketing.

The importance of buyer contacts and foreign-market information holds across all five industrial groups. Technical assistance for production was another service that most firms considered critical to their investment decisions and export success. The high use and value of buyer contacts, market information, and production-related technical assistance reflect a specific pattern of Thai manufactured exports.

Contrary to typical trade theory, which describes the exporting firm as producing identical or similar products in response to market demand, many Thai exports are components of or parts of a product under contractual arrangements with either multinational corporations, retail outlets, or trade brokers. This is particularly true in exports of electronics and automotive parts and in a large share of footwear exports. The dramatic rise in Thai exports also reflects the fact that firms in developed countries or NICs set up sourcing arrangements with low-wage-cost Thai firms or invest in export operations in Thailand. Under such a trade pattern, it is not surprising that buyer contacts, knowledge of specific markets, and sector specific technical know-how are in demand.

The survey revealed that Thai-owned firms differed in their information and service needs from joint ventures or wholly owned subsidiaries. For example, Thai-owned firms used three times as many services as did joint ventures or firms wholly owned by foreign investors. Thai-owned firms also placed a higher value on buyer contacts, foreign market information, and technical know-how than did the other companies. These differences reflect the greater need of Thai-owned firms for market-related information, contacts, and technical assistance from the outside world, principally from buyers. In contrast, joint ventures and foreign subsidiaries already have a service-provider link in a foreign investor, who brings corporate access to market information, buyers, and technical know-how.

Export firms used different types of services depending on their sectoral specialization. For example, electronics firms placed great importance on customs assistance, reflecting their reliance on diverse imports of capital goods and semifinished products. Any delay in receipt of these imports results in higher production costs; consequently, speedy customs clearance is in demand.

Barriers to accessing buyers were greatest for firms just getting into exporting. These firms were eager for information about overseas markets and identifying buyers, since they lacked access to the networks of retailers and importers available to more established firms. The more experienced companies were interested in buyer contacts and production-related assistance giving them greater direct access to buyers and less dependence on intermediaries.

Buyers have dominated the market for export-related services. They have been the most valued source of foreign market information, sample preparation, and technical assistance for production and marketing services. Foreign partners are also valued players in these service markets. However, the Thai Government, specifically the Department of Export Promotion, has been actively providing buyer contacts and overseas representation—services that facilitate access to buyers, a critical link in the export service market. Firms interviewed gave the most credit for their entry into exporting or their export expansion to their buyers but still gave nearly one-fourth of the credit to the Thai Government. This reflects strong demand from firms new to exporting.

The private market for export support services has grown significantly in recent years, as evidenced in the rapid increase in the trading companies currently operating in Thailand. Industry observers estimate that the number of trading companies went from fewer than five in 1980 to several dozen in 1992. Japanese trading companies, such as Mitsubishi, have been very active suppliers of information and services to Japanese firms investing in export-oriented ventures in Thailand. Cost considerations have limited the clientele to larger Japanese companies, while the smaller ones have relied more on brokers, personal contacts, and Japanese Government agencies promoting offshore investment. Major Thai conglomerates have set up separate trading companies to serve as export divisions of their firms since the Government lifted its ban on Thai trading companies in 1985. Importers from developed countries have been establishing highly successful trading companies in Thailand, largely because of their strong links with retailers abroad.

Competition within this market varies substantially by sector. Buyers specializing in canned seafood, shoes, and garments face severe and rising competition from importers, retailers, and other buyers. However, those specializing in the higher technology exports, such as frozen foods, are fewer in number and face less competition. There are more barriers to entry in higher technology exports because of strict quality control standards for such products in importing countries.

Thailand's Department of Export Promotion has complemented the services provided by buyers and investors. The Department maintains a computerized trade information database, arranges trade fairs and missions, conducts training for exporters and provides advisory services to both foreign buyers and exporters. Demand for its services has risen sharply over the last decade because of the inflow of buyers and the dramatic increase in the number of exporting firms. Buyers, other private sector providers, and exporting firms interviewed remarked on the high quality of the Department's staff in Bangkok and in its overseas offices, the high caliber of its information services and trade missions, and its good reputation as a government agency. Still, Thailand's sustained export success is leading the Government to reassess its continued subsidy of the department.

CONCLUSIONS

1. A stable macroeconomic policy regime, a realistic exchange rate, and a flexible, efficient manufacturing sector were key to Thailand's outstanding export growth. This expansion

led to the emergence of a dynamic and diverse market for export and investment services. The growth of service-provider markets in the late 1980s closely paralleled the rapid expansion of manufactured exports. The emergence of this service sector provides little rationale for future donor subsidies aimed at boosting export growth in Thailand.

2. Thailand was in the right place at the right time. In the mid-1980s, the devaluation of the Thai baht, the appreciation of the Japanese yen and other Asian currencies, rising wages in NICs, a literate workforce, and low wages in Thailand contributed to increased interest in Thailand. Firms in Japan, the United States, Western Europe, and even NICs were eager to relocate or source in lower wage cost sites in Asia, such as Thailand.

3. Links between buyers and exporters are critical to stimulating export growth. Buyers, and often foreign partners, are an essential source of information and services for exporters in developing countries. An export promotion agency that facilitates ties between buyers and exporters in a favorable policy environment can help overcome entry barriers facing firms new to exporting. The Department of Export Promotion complemented the private market for export promotion services because of its service-oriented mission, outstanding staff, well-run overseas trade centers, and high-quality services.

4. Government institutions are not effective providers of investment promotion services when the task is not a primary institutional objective for them. The BOI's longstanding focus on tax-based investment incentives, its serious technical and bureaucratic limitations, and its uncertain commitment to investment promotion undermined its ability to attract and generate investment. Moreover, contracting promotion services to others did not lead to investment deals. Promotion institutions must develop a clear vision of their mandate and sufficient staff motivation to have an impact.

5. There is currently no compelling evidence of significant market failures in Thailand warranting donor intervention. In the information market, the Thai Department of Export Promotion was already responding to information gaps facing Thai exporters. The U.S. Foreign Commercial Service and the American Chamber of Commerce of Thailand were playing a similar role for potential U.S. investors.

This Evaluation Highlights summarizes the findings from the forthcoming technical report Export and Investment Promotion in Thailand, A.I.D. Technical Report No. 17. The Technical Report can be ordered from the DISC, 1611 North Kent Street, Suite 200, Arlington, VA 22209-2111, telephone (703) 351-4006; fax (703) 351-4039.