Chapter 1

Introduction

The purpose of the first chapter is to present an overview of some important aspects concerning the background of this study. The first section in this chapter states the background, rationale and problem addressed by the study. In the second and third sections, the objectives and scope of this study are considered. The conceptual framework and methodology, benefits of this study and the organization of this study are stated in the fourth, fifth and sixth sections respectively. The analysis in this chapter is intended to provide a starting point for the subsequent examination in the chapters, which follow, of foreign direct investment from the European Union to Thailand.

1.1 Background/ Rationale/ Problem

Globalization has become the main paradigm for explaining current changes in the world economy. The concept refers to 'the integration of goods, technology, labour, and capital' (Slaughter and Swagel 1997: no page number), and increasing international trade, in particular, is the main agent of such integration, with world trade now growing at twice the rate of world output (World Bank 1995). It has been argued that there are two main forces driving the globalization process. The first is technology, which has led to a substantial fall in communication and computing costs. The second consists of the agreements that lead to increasing trade liberalization, for example within the GATT system that is now in the form of the World Trade Organization (WTO).

In such a globalized environment, many countries have now become more interdependent. For example, some countries may act both as debtor or lender. Therefore, in order to analyze an aspect of any country, a single-country analysis is no longer sufficient; and, regional analysis may become increasingly significant. As one main focus of this study, the European Union (EU) is an important and powerful economic grouping in the world. Moreover, as another main focus of this study, the Dynamic Asian Economies (DAEs) such as Thailand, Singapore, Hong Kong, Malaysia, Taiwan and Korea have been attractive for foreign investors during 1980s due partly to from the advantage of abundant low-wage labour. However, such attractiveness might reduce because of the current Asian financial crisis. Such a crisis may lead to circumstances, which could potentially change the incentives for foreign investors to invest in them. This research will focus on Thailand in particular, even though it is inevitable to state some background of the Southeast Asian Nations.

1) Background of the Association of South-East Asian Nations (ASEAN)

Thailand is included in the Dynamic Asian Economies (DAEs) which accounted for one tenth of world trade. The DAEs, especially the Southeast Asian countries, have had several experiences with cooperation and integration. First was the cooperation among South-East Asian countries, which is called the Association of Southeast Asian Nations (ASEAN) and was founded on 8 August 1967. Current ASEAN members are Brunei Darussalam, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. The implicit aim of ASEAN set to counteract communism in the Indochinese region. However, the stated aim according to the Bangkok Declaration and others Declarations was to accelerate economic growth through joint endeavours. At the Fourth ASEAN Summit (January 1992), there was an announcement to create the ASEAN Free Trade Area (AFTA) within 15 years, in order for the ASEAN members to become more powerful collectively in the international economic community and to accelerate economic growth by attracting FDI. ASEAN also expanded its relations to encourage cross-border investments through the ASEAN Industrial Cooperation (AIO) Scheme. The Asia-Pacific Economic Cooperation (APEC) includes members from ASEAN, North America and Asia in order to make commitments on unilateral tariff reductions. There is a new relationship involving ASEAN, China, Japan and Korea, and the EU as created by the ASEAN Europe Meeting (ASEM). Finally, EU also promotes direct European investments in Asia through its 'Asia-Invest Programme', which provides credits and grants for feasibility studies.

By participating in all of these programmes and meetings, ASEAN member countries now follow most international standards for trade and investment. Such cooperation and integration can provide a better investment environment. Intra-ASEAN trade is also increasing. Therefore, one larger regional market with 325 million people, instead of nine individual markets, provides more different types of raw materials and various levels of labour skills, which are benefits to attract foreign investors. The Governments in the region thus have introduced policies to stimulate their economies in accordance with their development situation, e.g. export-oriented strategy, liberalization of trade and investment policies, ensuring macroeconomic stability, promoting human resources and infrastructure development and creating social and political commitments to growth-oriented policies. The previously stated factors enable ASEAN countries to take advantage of the open, multilateral trading system and a favourable international environment, and attract large amounts of FDI. Some other related factors are the international airlines of the ASEAN countries which have improved and become more competitive in EU-ASEAN air transportation. This helps increase the opportunities for FDI. In addition, some ASEAN members, such as Indonesia, Singapore and Thailand, are attractive destinations for tourists from EU.

2) The role of foreign direct investment

Most developing countries need external resources to finance the resource deficits resulting from the drive toward a desired high rate of growth and high-spending society. There are two main sources of external resources: borrowing and private foreign investment. Foreign investments have played an important role in Thailand is economic development to fill the saving-investment (I-S) gap.

Japan has the largest proportion of FDI in the DAEs, the United States is in second place, and third place belongs to EU countries. During the 1980s, FDI in the DAEs was largely in export-oriented manufacturing and services. However, in Hong Kong, Korea, Taiwan, and Singapore, FDI has shifted to high technology manufacturing and services industries, while Malaysia and Thailand still attract FDI in labour-intensive, export-oriented manufacturing.

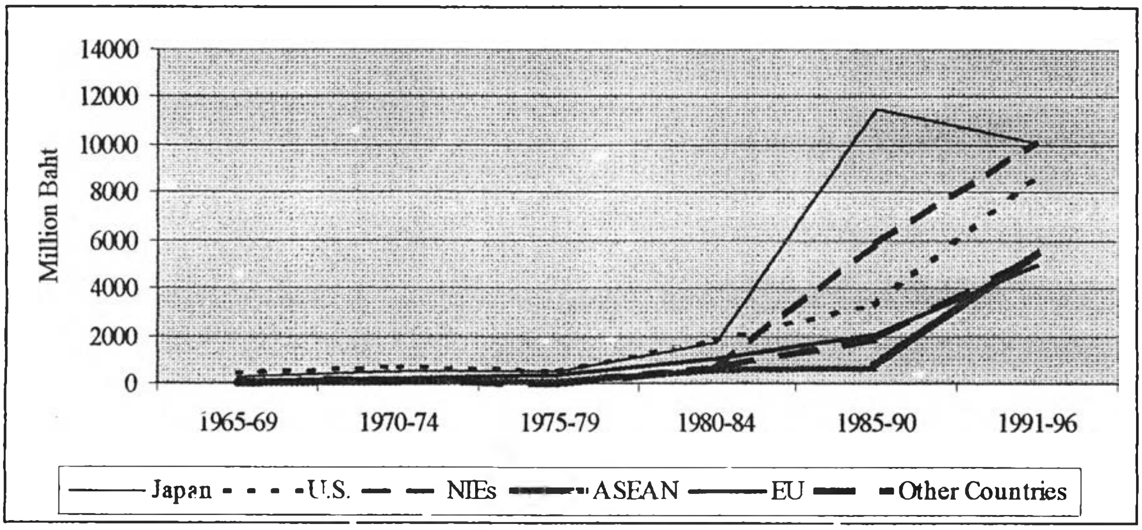
Generally, FDI policies are different in each of the DAEs. Even though most of them have adopted more liberalization policies, they still control FDI in the form of different laws and regulations. The DAEs also provide many kinds of incentives in order to attract FDI and to guide investments under their economic development plans, such as tax incentives and lower wages in the industrial zones.

Private foreign investment comes both in the form of portfolio investment, which invests for income only (e.g. bonds, securities, debentures and bank loans), and direct investment, which is investment for both income and control over the sources of income such as equity investment and loans from parent companies (Buakanta, 1978). On the one hand, portfolio investment often comes in as a short-term investment which is mobile and difficult to control. On the other hand, direct investment can be easily controlled and more stable because is concentrated in a real sector, as a long-term investment. FDI can contribute to the transfer of technologies and skills and provide management and training for local employees. Moreover, it helps establish contact with overseas banks, capital factors and production markets (Streenten, 1972).

The particular focusing point of this research is in the early 1980s, when the Thai economy transformed from agriculture-dominated to manufacturing-dominated. The share of agricultural value added in GDP fell from 27 percent in 1970 to 20.6 percent in 1980, while that of manufacturing sector rose from 16 percent to 21.7 percent at the same time. This shift appeared to be greatest during 1985-1990. By 1990, output from the agricultural sector accounted for only 14.4 percent of GDP, while the manufacturing sector accounted for 24.7 percent (Pupphavesa, 1993).

Since the beginning of the 1980s, Thailand has been successful in attracting FDI, mostly from Japan and the Asian Newly Industrial Economies (NIEs). A large part of FDI has been export-oriented. This can be illustrated by the fact that exports accounted for 25 percent of Thailand's GDP at the beginning of the 1980s; the figure rose to nearly 40 percent in the second half of 1980s (Urata, 1994). In addition, FDI tended to concentrate in the service sector, with a share of 54.75 percent of the total stock of FDI (Pupphavesa, 1993).

Exhibit 1.1: The Net Flows of FDI in Thailand Classified by Country.



Source: Bank of Thailand.

According to Exhibit 1.1, the sharp growth in the NIEs' share mostly came from Hong Kong, Taiwan and South Korea. The proportion of net flows of FDI in Thailand from Japan, the NIEs, the United States; EU, other countries, and ASEAN during 1988-1994 were 33, 26, 16, 11, 8, and 6 percent, respectively, of total FDI in Thailand. There was relatively less FDI in Thailand from EU, even though there is European Business Information Centre in Bangkok. Other interesting points about this pattern shown in exhibit 1.1 will be discussed in detail in Chapter 5 after the empirical analysis of FDI in Thailand.

It is thus interesting to explore which determinants of a country such as Thailand have an impact on FDI. This thesis will focus on how these determinants can be an incentive for FDI from EU.

1.2 Objectives of the Study

This study aims to look at FDI from EU into Thailand and to emphasize finding methods which may be appropriate to induce more FDI from EU into Thailand.

1.3 Scope of the Study

This study considers the total amount of FDI inflows into Thailand, particularly the inflow of FDI from EU into Thailand. It will be based on annual time series data covering 1970-1997. This study uses the Ordinary Least Square (OLS) method in order to find the relationship between FDI and its determinants.

1.4 Conceptual Framework

This study will follow previous studies based on the Eclectic Paradigm and the Product Life Cycle theories by Dunning and Vernon, respectively. The three conditions for encouraging FDI are ownership-specific advantages, internalization-incentive advantages and location-specific advantages, and the three stages of the product life cycle. These are used in the process of this research's analysis.

1.5 Methodologies

This study proposes to find determinants which have an impact on the total inflow FDI to Thailand and FDI from EU into Thailand. The methods employed will involve both quantitative and qualitative approaches. The first approach is to undertake an econometric analysis, which involves creating a one-equation model, the specification and the test of a number of alternative hypotheses by using the OLS regression method to find out that which determinants are significant. Second, the qualitative method would be used to analyze the current situation and trends for FDI from EU into Thailand.

1.6 Benefits of the Study

After analyzing the data in this study, the pattern of total FDI in Thailand and the pattern of FDI from EU in Thailand should be found. This will enable choosing the right determinants which should be emphasized in order to induce more FDI from EU (e.g. the tariff rate, the discount rate, the exchange rate, or other supporting fiscal policies).

1.7 Organization of the Study

This study is organized into six chapters. The first chapter covers the background, objectives, scope and the organization of the study. The second chapter is a literature review of studies in the area of FDI. The third chapter considers the relationship between EU and Thailand in terms of trade and FDI. The fourth chapter introduces the model and the reasons for using each variable. The empirical results are presented and interpreted in chapter five. The last chapter summarizes the main findings and main arguments of the thesis.