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TRIMs and Export Subsidies and their Impact on Investment Policies in Thailand[1]

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1. Introduction

Trade and investment are increasingly related, as can be seen by the growing trade between affiliates and subsidiaries of multinationals. This close relationship has led to the inclusion of investment issues in the concluded Uruguay Round. The Uruguay Round Final Agreement of 15 December 1993 includes the Agreement on Trade Related Aspects of Investment Measures (TRIMs), where basically local content and trade balancing requirements are covered. Export performance requirements were excluded from the TRIMs Agreement because of lack of consensus among the WTO-members. Export subsidies are now partly addressed in the WTO Agreement on Subsidies and Countervailing Measures (Chia, 1995:101).

As a signatory of the Uruguay Round, Thailand has agreed to adapt its investment policies to comply with the WTO rules. In this article, we will review Thailand's investment policies and indicate the necessary modifications of these policies. We therefore, will closely examine the local content requirements, which are a violation of the Agreement on Trade Related Investment Measures (TRIM's)[1], and the export requirements, which are a violation of the Agreement on Subsidies and Countervailing Measures. Following the Uruguay Round rules, developing countries like Thailand will have to give up these requirements within five and eight years respectively.

Before analysing the situation in Thailand, it is interesting to mention that local content and export requirements are found in many countries. In a survey by Guisinger and Associates for the World Bank in 1982, on 74 investment decisions by 30 companies in 20 host countries, it appeared that more than half of the projects were subject to either local content or export requirements, or to some form of foreign exchange balancing. Especially in the automobile industry, many investing companies were subject to performance requirements (9 out of 12 cases), as well as to indirect performance requirements because of governments purposefully discriminating between alternative projects by scaling incentives to the net foreign exchange provided by the investment. (Guisinger, 1985:52-53). The Guisinger study, however, concluded also that TRIMs resulted in the relocation of only 4 out of 74 firms examined and that the impact of TRIMs and export requirements on trade seemed to be exaggerated (Guisinger, 1985:49).

2. Thailand's investment policies

2.1 Legal basis

The fundamentals of Thailand's investment regime are to be found in the *Investment Promotion Act of 1977*. Current orientations and implementations are published in the *Board of Investment Announcement N.1/1993 on Policies and Criteria for Investment Promotion*. This should be read in conjunction with *Board of Investment Announcement N.2/1993 on List of Activities Eligible for Investment Promotion*. *Notification N.C13/2533* of the Ministry of Finance deals with the conditions of import tariff reductions.

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[1] Trade-balancing requirements are also considered as a violation of the Agreement on TRIM's. As Thailand does not impose such requirements, these will not be considered in this article.

2.2 Privileges granted by the Board of Investment and industry yargeting

The incentives given by the Board of Investment (BOI) are the most important vehicle for investment promotion in Thailand. The BOI may grant privileges to investors under the mentioned *Investment Promotion Act of 1977*. According to this Act, promoted investment should comply with general guidelines on economic and technological development contribution, environmental policies, and/or balance-of-payments considerations as stated in the National Economic and Social Development Plans. In order to possibly benefit from the privileges, criteria concerning the invested capital have to be met. The privileges are modulated in two respects: according to the geographical zone in which the projects are located, and according to whether or not the projects are in an industrial estate. Three geographical zones are distinguished: Zone I (Bangkok Area and 5 neighbouring provinces), Zone II (10 central provinces), and Zone III (the rest of the country, including the deep sea port of Laem Chabang). Special status is further given to micro-zones such as: General Industrial Zones, Special Areas, and Export Processing Zones. Specific privileges apply for factory relocation and investments in R&D (BOI,1993a:8-10).

As investment promotion in Thailand involves industry targeting, project proposals should also relate to activities listed in a regularly updated *Eligibility List*.

As far as foreign shareholdership is concerned, promoted projects in agriculture, livestock, fishing, mining and services must have 51% Thai shareholding[2], unless the investment amounts to more than 1 billion Thai Baht (THB) (approximately 40 million USD) in which case foreigners can hold up to 100% (but must reduce their holding to 49% in five years). Foreigners can hold the majority of the shares in Zone III promoted industrial projects producing for the domestic market and/or world market, and in projects located in Zone I or II if exporting at least 50% of total output. Foreigners can wholly-own projects (100 % foreign equity) in Zone III, and in Zone I and II if more than 80% of output is being exported. No foreign ownership limit applies for the following projects: transport concessions, utilities, environmental conservation and technological development. We refer to BOI (1993a) for the details concerning the investment promotion criteria, the eligibility list and the privileges granted.[3]

Table 1 shows the importance of BOI promoted investment.

Generally speaking, BOI 's investment promotion policies can be considered as very successful. A critical note should however be added, as the functioning of the BOI could probably be optimized. According to Warr (1993:38), the main criticism is that there is a lack of continuity in the BOI 's policy and that the granting of privileges (and the extent of these privileges) is a result of exercising its discretionary power. Incentives offered differ among firms within the same industry. A in-depth study of the political economy of the BOI 's industrial policy would probably offer interesting observations.

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[2] Shareholders can be nominees.

[3] Activities on the eligibility list are narrowly defined (5-digit level) and are classified under the following headings: (a) agriculture and agricultural products, (b) minerals, metals and ceramics, (c) light industry, (d) manufacturing of metal products, machinery and transport equipment, (e) electronics and electrical industry, (f) chemical industry, paper and plastics, and (g) services and public utilities (BoI,1993a:13-25). The location of many of these activities is restricted to Zone II and/or Zone III.

Table 1: Data on investment promotion in Thailand, 1985-1994*

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
APPLICATIONS										
Number of applications	325	431	1085	2128	1284	1016	631	444	1225	1538
Tot. investment (bn THB)	60	60	209	531	462	525	250	213	279	592
Reg. capital (bn THB)	15	16	57	139	132	113	68	41	68	137
Thai employees (x1000)	76	101	332	533	410	316	178	118	313	323
APPLICATIONS APPROVED										
Number of approvals	210	295	626	1464	1179	932	605	394	852	1189
Tot. investment (bn THB)	54	35	68	202	290	477	279	284	176	281
Reg. capital (bn THB)	7	9	18	60	71	98	84	46	35	73
Thai employees (x1000)	59	60	206	353	335	292	189	103	209	252
PROMOTION CERTIFICATES ISSUED										
Number of certificates	-	-	-	-	848	731	528	357	478	943
Tot. investment (bn THB)	-	-	-	-	183	194	179	446	177	209
Reg. capital (bn THB)	-	-	-	-	44	62	59	37	32	62
PROJECTS STARTING OPERATIONS										
Number of projects	78	145	168	223	277	415	433	440	375	311
Tot. investment (bn THB)	8	21	20	24	31	80	83	97	129	101
Reg. capital (bn THB)	2	4	5	9	13	33	41	39	46	38
Thai employees (x1000)	14	26	41	55	60	98	90	87	88	92

Source: TDRI (1993:20), TDRI (1994:18), TDRI (1995).
* In 1994 1USD ~ 25THB

2.3 The success of Thailand's investment promotion policies

2.3.1 FDI inflows in Thailand

Table 2 shows the net inflows of FDI in Thailand between 1985 and 1994. Comparing the data in Table 1 with the data in Table 2, a rough association can be observed between BOI approved investment and net inflows of FDI.[4] External factors however, also played an important role in explaining the FDI boom (e.g. the appreciation of the Yen, Won and Taiwanese Dollar against the USD and THB).

Table 2: Net inflow of FDI in Thailand (mio THB), 1985-1994*

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Financial inst.	-1240	510	443	2576	2843	4531	6813	6555	2944	-11561
Trade	1082	1783	853	3882	6822	12928	7637	7096	5380	8561
Construction	1585	1235	1349	1841	3926	3301	3351	14534	3483	1752
Mining & quarrying	516	240	192	473	575	1139	2066	3126	2889	1310
Agriculture	77	202	286	315	603	763	598	-151	329	-158
Manufacturing	1358	2124	4749	16162	21866	31003	23350	17467	19088	12872
Food	395	287	437	1065	1962	1757	1683	1284	965	1153
Textiles	60	86	996	1111	686	1777	1124	1462	-104	869
Met.&non-met.Prod.	-126	-23	365	2113	2762	2886	2196	1696	2397	1133
Electrical appliances	280	617	6317	8865	10677	8981	5907	5907	3585	1494
Machinery transp. eqt.	32	-15	160	631	1103	2475	2183	1084	1566	299
Chemicals	488	484	868	1060	2819	4318	3834	1624	4664	838
Petroleum prod.	0	8	-16	770	-1190	3029	-374	1279	4843	4681
Construction materials	38	5	6	26	85	12	146	375	111	129
Others	190	674	797	3070	4773	4073	3625	2757	1060	2275
Services	535	670	749	1109	1594	2054	1776	2150	485	1404
Real estate	528	143	423	1419	7108	8421	3636	1561	4614	-2963
Other				186	361	554	2163	1426	-225	3738
TOTAL	4442	6908	9044	27964	45698	64695	51389	53764	38988	14954

Source: TDRI (1993:18;1994:16, 1995) * In 1994 1USD ~ 25THB

[4] The effect of BOI incentives on inward FDI became also clear when the BOI introduced additional privileges for investment in Zone III in April 1993. In the five months following the introduction, applications doubled compared to 1992 (Bangkok Post,1993a).

The inflow of foreign capital continued to be important in 1992 and 1993, but consisted for a larger part of portfolio investment and deposits, encouraged by higher interest rates in Thailand than in the US and Japan.

In 1993, investment from the US, Singapore, and Hong-Kong declined significantly and Japan became the first investor, maintaining this position in 1994 (Bank of Thailand,1994:93). During the period 1988-92 Thailand was the sixth important receiver of FDI in the world (9.5 bn USD) (Table 3).

Table 3: The 10 largest host developing economies to FDI flows, 1988-1992, 1993 and 1994* (bn USD)

Country	FDI flows in 1988-1992	FDI flows in 1993	FDI flows in 1994*
PR China	25.6	27.5	33.8
Singapore	21.7	6.8	7.9
Mexico	18.4	4.9	4.4
Malaysia	13.2	5.2	4.5
Argentina	10.6	6.3	1.2
Thailand	***9.5***	***1.7***	***2.7***
Hong Kong	7.9	1.6	2.0
Brazil	7.6	0.8	2.2
Taiwan	6.0	0.9	1.3
Indonesia	5.6	2.0	3.0

Source: World Investment Report 1994 and 1995
*Estimates

2.3.2 The export effect of inward FDI in Thailand

The record of economic and export success in Southeast Asia shows country policies with different degrees of outward orientation of investment and trade respectively. Japan e.g., was significantly more restrictive and selective on FDI than Singapore or Hong-Kong (Bhagwati,1990:20). Thailand seems to have opted for a relatively liberal FDI policy partly offsetting its relative protective trade policies.

It is often assumed that Thailand's export success can be attributed completely to the FDI boom. This, however, is only partially true. As Akrasanee e.a. (1991:22-) rightly pointed out. The investment boom did not precede the accelerated export development, given the usual start-up times. The first signs of export breakthrough could be observed in 1985, whereas investments took off only in 1987, resulting in a substantial inflow of FDI in 1988 and therefore probably pushing exports not before 1988 (Table 2). The export successes of the 1980s were thus mainly achieved with domestic capital and partly pushed by excess capacities of protected industries. These excess capacities were the combined result of investment policies and import protection (Akrasanee e.a.,1991:17), and have probably been strengthened by anticipating behaviour of companies faced with capacity controls by the Ministry of Commerce (Herderschee,1993:353).[5] Therefore, an excess capacity effect is able to explain some export entries, although it has not been studied systematically until now.

We are evidently not implying, that inward FDI has not been extremely important in strengthening Thailand's export capacity. If the timing of FDI cannot sufficiently explain the development of Thai exports, there is still a remarkable association in time between both and a causality between FDI and exports can safely be assumed. *Ceteris paribus* (including given investment levels), export growth and industry performance in Thailand depends at least partly on the source of investment (i.e. foreign or

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[5] We refer to Supachalasai (1992) for an overview of capacity controls in the textiles industry.

Thai), with production and export activities in foreign-owned companies differing on average from domestic business operations. This is very likely since the former belong to multinational companies or groups of companies with likely advantages in investment resources, technology (i.e. different production functions), marketing know-how, etc.. An FDI-exports causality further implies that aggregate or net macro-economic effects of FDI on exports will also be positive.

Analytically, the following effects of FDI in Thailand can be distinguished: (a) displacement of Thai domestic sales and exports (+ indirect effects through input-output relationships), (b) generation of demand for Thai and foreign investment goods and for inputs for continuing operations (+ indirect effects, especially indirect import effects of local procurement of manufactured inputs), and (c) factor market effects (market tightening, upgrading, etc.).

Effects (a) and (b) have been studied in detail by Petri (1992), who developed a general equilibrium analytical framework based on Thailand's input-output tables. Petri also endeavoured to trace direct as well as indirect output and trade effects of inward FDI. It was investigated whether the economic equilibrium "with investment" differed from the counter-factual equilibrium, all other inputs being equal. The model input consisted of data on Japanese FDI in Thailand, but for some relevant aspects extrapolations were calculated. The most important results of Petri (1992:190-191) can be summarized as follows:

- Imports of the affiliate are first dominated by imports of capital goods, which are then gradually replaced by imports of intermediate goods.
- Exports are proportional with output, but are unable to pull the trade balance out of the red.
- Aggregate output in the rest of Thailand shows a net increase which is higher than the output effect of the affiliate, because the net displacement and procurement effects of the FDI are initially positive.
- After completion of the investment phase, the output effects are converging, which indicates an approximate balancing of sales displacement and input demand effects.
- Exports created and imports displaced by the affiliate outweigh imports, directly and indirectly generated by its input procurement, and therefore, Thailand's trade balance becomes positive after the investment phase.
- After the investment phase, the trade balance and output levels of the Rest of the World, excluding the investing country (here: Japan), are adversely affected, with displacement effects apparently outweighing procurement effects. For the investing country (here:Japan), however, both output and trade balance effects are positive; even after the initial investment phase, with obvious positive effects because of the supply of capital goods. Petri (1992:191) thus confirms the so-called *triangular trade patterns* generated by FDI in the recent past.[6]

On the basis of Petri's results, it can be concluded that industrial promotion policies in Thailand have had a significant beneficial effect on the Thai economy in general, and have contributed to Thailand's export performance in particular.

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[6] This pattern has been confirmed in a recent empirical study on FDI in Thailand (Pupphavesa & Pussarung-sri,1994): investment for exporting to the home market and cost reduction were found to be the primary reasons for investing.

3. The WTO Agreement on Trade Related Investment Measures and its impact on Thailand

3.1 TRIMs in Thailand

The Uruguay Round Agreement on TRIMs prohibits *local content requirements* and *trade balancing requirements* as conflicting with the GATT principles of national treatment and the prohibition of quantitative restrictions. For an illustrative list of TRIMs, the reader is referred to the Agreement (GATT, 1994:166-167)[7] .

Two government institutions in Thailand are imposing local content requirements, i.e. the Ministry of Industry and the Board of Investment. Thailand intends to maintain TRIMs during the five-year transition period (Committee on Trade-related Investment Measures, 1995:1), although the local content requirement for some products will be removed within this period (see below).

By section 32 of the *Factory Act* of 1992, the Ministry of Industry, upon approval of the Cabinet of Ministers, can determine product items, quality, ratio of raw materials, *sources of raw material*, factors and/or the kind of energy to be used in the production of certain finished goods (Committee on Trade-related Investment Measures, 1995:1). As of now, only the local content obligation for locally assembled motor vehicles has been imposed (see section 3.2).

Moreover, since 1986 the Ministry of Industry imposes local content conditions for dairy products. Producers are required to buy 50 tons of local raw milk daily in the first year of operation and increase these purchase by at least 20 per cent annually. The local content condition can, however, be removed on a case-by-case basis when domestic supply is insufficient (GATT, 1991:193-194).
Section 20 of the Investment Promotion Act of 1977 allows the BOI to stipulate *general conditions* for special investment incentives (BOI, 1992b:6). One of these conditions is *the amount of local raw materials* to be used. At present, this general local supply condition is no longer enforced, but former projects approved under this condition are still subject to it (Committee on Trade-Related Investment Measures, 1995: 3) [8].

Apart from general conditions, the BOI can also impose local content conditions for *specific products*. BOI Announcement No.2/1993, listing the activities eligible for investment promotion, abolished the existing local content requirements for several products, maintaining only these for *dairy products* and *engines.* The production of milk or dairy products is only eligible when the producer uses local fresh milk in proportions as set by the BOI (BoI, 1995:25)[9] .

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[7]As mentioned before, Thailand does not impose any trade-balancing requirements. This section will therefore focus only on the existing local content requirements.
[8] Additional incentives for using domestic supplies were the granting of an additional year of corporate income tax and an exemption on taxes on imported machinery (Committee on Trade-Related Investment Measures, 1995: 3).
[9] The BOI still challenges that its local content requirement for dairy products is covered by the TRIMs Agreement or the Agreement on Agriculture. In both cases, however, the local content obligation will have to be removed anyway.

The BOI domestic content requirement for engines is related to the type of engine as follows (Committee on Trade-Related Investment Measures, 1995:8):

- engines for automobiles: 20 % locally manufactured parts and components during the first year, increasing annually to 70 % by the seventh year, and a requirement to manufacture some parts locally;
- engines for motorcycles: 30 % locally manufactured parts and components during the first year, increasing annually to 80 % by the fifth year, and a requirement to manufacture some parts locally;
- diesel engines for agriculture: 20 % locally manufactured parts and components during the first year, increasing annually to 80 % by the fourth year, and a requirement to manufacture some parts locally;
- multi-purpose benzene engines: 30 % locally manufactured parts and components during the first year, increasing annually to 85 % by the fourth year.

The requirement to use 70 per cent local inputs in *motorcycle* assembly has been removed by the Ministry of Industry in November 1995, in order to comply with the TRIMs Agreement. The government removed the local content requirement before the deadline, as most motorcycle assemblers were using more than the required percentage of local parts. Increased competition from imported parts will also improve local product quality. The ban on the opening of new motorcycle engine plants has also been removed, together with the ban on built-up motorcycle imports (Bangkok Post, 1995 h).

Before 1993, local content was also encouraged by the BOI for paper products (50 per cent local supply of pulp), transformers (80 per cent local parts), compressors for airconditioners (60 to 80 per cent of local raw materials), gas-pressure thermostats (30 to 70 per cent local content), some packaging materials (100 per cent local raw materials), TV picture tubes (5 to 35 per cent local supplies) and coated aluminum sheets (only local aluminum sheets can be used). These requirements have been abolished, although projects approved under these criteria are still subject to it (Committee on Trade-Related Investment Measures, 1995: 10).

3.2 Local content requirements in the automotive sector

The automotive sector is protected by local content and export requirements in several countries, especially in South America. In a study on the protection of the Philippine motor vehicle industry, Takacs (1994:127) mentions similar regimes in Australia, Brazil, Argentina, Mexico and Uruguay.

In Thailand, the local content requirement in the automotive sector is stipulated by the Ministry of Industry. Engines, however, are under the jurisdiction of the BOI. In 1971, the Ministry of Industry announced a local content obligation for passenger cars of 25 per cent, to be effectively starting January 1974. As a result, many Japanese assembly firms responded by establishing affiliated companies to locally produce components and parts.

Besides the local content requirement, the Thai government has endeavoured to protect existing industries by limiting the number of assembly plants. In 1969, nine assembly plants were in operation and no additional passenger car plants could be established (BOI, 1993c:21). The import substitution policy came to a peak with an almost complete ban on imports of Completely-Build-Up (CBU)-units between 1978 and 1991 (the ban on CBUs of over 2300 cc. was lifted in 1985) (Atkins, 1994: 24). At times when CBU-imports were allowed, very high tariffs were imposed: 610 per cent for CBU-units with engines larger than 2300 cc. and 400 per cent for CBU-units with engines smaller than 2300 cc. (BOI, 1993c:9). The limitation on imports increased the domestic prices of motor vehicles and encouraged domestic assembly.

In the early 1980s, lists were drawn up of existing components and parts, which were also assigned a score (see Table 4). A mandatory list shows all the components which have to be sourced locally, whereas a selective items list contains components that the assemblers can choose to source locally in order reach the required local content condition. A higher score is assigned to parts which the government considers as more important to produce locally, irrespective of that particular part's value. Assembly activities score points, as well as the local manufacturing of parts. Locally made parts for passenger cars can only account e.g., for about 30 per cent of the value of the finished product, but local assembly activities may bring the local content score up to 54 per cent (EIU, 1993:16). The actual percentage of local parts can thus be smaller than the required 54 per cent of total value. Atkins (1994:24) has estimated that the scores of local parts normally add up to only about a quarter of the total value of a car's parts and that, overall, the total of locally value added (including parts and labour) represents about 35 to 40 per cent of a car's ex-factory cost.

Table 4: Local content assignment for passenger cars by major groups of components/Parts

Major Group	Number of Sub-Group	Number of Components/ Part	Assigned Points
1. Base	5	31	15.30
2. Engine ancillary component	7	29	7.00
3. Electrical component	3	16	4.00
4. Wiring	2	6	2.00
5. Exhaust system	3	4	2.00
6. Fuel system	3	7	2.00
7. General component	2	4	10.00
8. Trim panel & soft trim	4	24	4.25
9. Seat	3	5	5.00
10. Glass	2	5	2.50
11. Lamp	3	6	1.00
12. Suspension	2	9	3.50
13. Brake system	7	27	3.10
14. Clutch	3	10	1.90
15. Body	7	41	23.00
16. Other body	2	5	1.45
17. Transmission	4	22	4.30
18. Steering	6	11	2.95
19. Final drive	4	20	3.75
20. Instrument	2	12	1.00
TOTAL			**100.00**

Source: BOI (1993c:7)

Another problem with this score system is that the components list was initially based on the components used in a simple Japanese car. Newer cars and models, however, may contain components that did not exist before, and therefore are not included in the local content lists, implying that the components if produced locally, cannot be added to fulfill the local content percentage.

As part of the ASEAN cooperation programmes, parts imported from Malaysia and the Philippines under the Brand-to-Brand Complementation (BBC) Scheme are considered as local. Moreover, a 50 per cent reduction of the import duty and business tax on Completely-Knocked-Down (CKD)-kits and CBU passenger cars, vans, pick-ups and trucks is offered under this scheme. Many car assemblers, like Toyota, Honda, Mitsubishi, Nissan and Volvo, have evolved BBC-schemes (BOI, 1993b:20), enabling ASEAN companies to produce larger quantities of some products and to acquire economies of scale. In December 1995, the ASEAN Ministers decided, however, to phase out the BBC-scheme in order to accelerate the CEPT (Common Effective Preferential Tariff) reductions under AFTA. The BBC-scheme and the AIJV-scheme (Asean Industrial Joint Ventures) is replaced since April 1996 by the Asean Industrial Co-Operative (AICO) scheme with more relaxed conditions (e.g., only 30 per cent required Asean ownership). Joint ventures under the AICO can benefit immediately from the final AFTA tariffs of 0-5 %. Besides auto manufacturers AICO will also include components makers.

Table 5: Autoparts imports and exports in Thailand under the BBC-scheme (Million THB)

	Import	Export
1992	82	58
1993	547	108
1994	832	228

Source: Bangkok Post (1995d).

The required local content percentage has increased over time and is presently reaching 54 per cent for passenger cars, 60 to 72 per cent for pick-up trucks and 45 per cent for large trucks (BOI, 1993c:7). Nevertheless, some major policy changes have been devised to offset the protection in the automobile industry and to enforce competition. In 1985 and 1990, the ban was abandoned on imports of CBUs with engines above 2300 cc (see above) and of CBUs with engine size of 2300 cc or smaller respectively (BOI, 1993c:9).

In 1991, the government also drastically lowered the tariffs on automobiles from 610 per cent to 68.5 per cent for CBU units with engines larger than 2300 cc, and from 400 per cent to 42 per cent for CBU units with engines smaller than 2300 cc. Tariffs on imported CKD-kits were lowered to 20 per cent for both categories. The total tax burden on automobiles remains high, however, if the excise tax (35.75 per cent and 41.8 per cent for automobiles below and above 2400 cc, respectively) and VAT (7 per cent) are taken into account (BOI, 1993c:9). The effective tax burden for CBU-units still amounts to 137.23 per cent, 210.55 per cent and 257.76 per cent for automobiles below 2400cc, above 2400 cc and above 3000 cc, respectively (Nation, 1996a).

As of now, there is still a ban on new assembly plants for passenger cars (but not for commercial vehicles), although existing assemblers may expand their operations (BOI, 1993c:39)[10]. The government states that otherwise the automotive assembly capacity would be too large, with too many factories producing a limited output of cars.

The protection offered to the automotive sector through the local content requirement, the high taxes (especially before 1991) and the ban on new assembly plants, may have had an inverse impact, giving local autoparts makers little incentive to increase innovations and improvements in their operations.

[10] A ban on new assembly plants of passenger cars has been imposed several times (e.g., in 1969 and in 1980-1984) (BOI, 1993c:21).

The local content condition has also increased the components prices, making cars more expensive for the customers.

Very recently, the Ministry of Industry has agreed to remove the local content regulation by Mid-1998, as a response to one of the requests of General Motors to invest in an assembling plant in Thailand (Nation, 1996a). Another reason might well be that the local content of car assemblies seems to increase and to establish at levels above the requirement. In 1995, Toyota e.g., the largest assembler of vehicles in Thailand, planned to increase the local content in its cars from the required 54 per cent to 60 per cent in two years and to 70 per cent in five years. Siam Motors, the local Nissan assembler, will increase the local content to more than 70 per cent by 1998 and thirty new joint ventures will be established, most of them as affiliates (Bangkok Post, 1995f). The strong Yen and the global competition in the automobile industry has urged car assemblers to cut costs by using more locally-made components instead of importing car parts. Local autoparts producers, mainly affiliates of foreign automobile assemblers, have become also more productive. Local parts makers have entered into technical agreements with foreign partners to improve their R&D. However, although the local autopart industry is now expanding rapidly, technology mainly remains under foreign control (particularly Japanese).

With Thailand trying hard to become the assembling centre for the region, vehicles and autoparts have recently been increasingly exported. Exports of vehicles, parts and accessories from Thailand increased between 1991 and 1994 with more than 420 per cent, reaching a total value of some 26 billion THB (about 1 billion USD). Major export markets are the United States, Singapore, Belgium, Cambodia, Laos and Vietnam. The total value of exports for 1995 is estimated at 37 billion THB, again an increase with more than 40 per cent compared to the previous year (Nation, 1996a).

According to a recent survey by BOI among some assemblers and parts makers in Thailand, most European assemblers are agreeing with the abolishment of the local content requirement. Japanese assemblers, however, appear to be opposed to it, as they invested heavily in parts factories and assembly plants in Thailand, and as the removal of the local content requirement will limit government protection and intensify competition (Bangkok Post, 1995g).

3.3 Alternatives for the local content requirement

In a study on the motor vehicle industry of the Philippines, Takacs (1994) estimated that the removal of local content and export requirements[11] would benefit consumers but would boost the effective protection to assembly operations because of the substantial decrease in the cost of components. She, therefore, suggested to have the elimination of local content and export requirements accompanied by a decrease in tariffs on assembled vehicles. In Thailand, a drastic decrease in taxes has been undertaken in 1991, although taxes are still very high.

Current government policies are considering the promotion of *export supporting industries*, e.g. automotive parts, electronic parts and other components, mainly aiming at a surge in exports. The BOI approved a list of 10 supporting industries. Regardless of their location, an 8-year income tax exemption is granted, as well as a reduction of 50 per cent, or an exemption, of import duties on machinery (according to the location). No limitation on foreign ownership is imposed, and the products can be sold in the domestic market (BOI, 1995b:17-18). These BOI -incentives are regarded as actionable subsidies by the WTO as they are geared to specific sectors.

Moreover, the government endeavoures to promote the use of local subcontractors and supporting industries by its *BUILD*-Programme. In 1992, the BUILD-unit (the BOI Unit for Industrial Linkage Development) was established in order "to encourage the development of supporting industries and promote the deepening of Thailand's industrial structure; to strengthen linkages between "principals" - companies producing final products - and "suppliers" - companies producing components and parts or supplying technical services; to assist small and medium supplier companies in improving efficiency, productivity and quality; and to remove impediments to subcontracting and to lobby for policy reforms to improve the environment for backward linkage development." (BUILD, 1994:5).

A recent plan by the Ministry of Industry to create a *Supporting Industry Centre* aiming at the promotion of the development of small and medium-sized industries, should also be seen as a new move from Thailand to develop its local industry (Bangkok Post, 1995i).

4. The WTO Agreement on Subsidies and Countervailing Measures and its impact on investment policies in Thailand

The WTO Agreement on Subsidies and Countervailing Measures distinguishes between prohibited, actionable and non-actionable subsidies. Prohibited subsidies are these granted upon export performance and upon the use of local over imported goods. Actionable subsidies are these which may cause serious prejudice to the interests of other WTO members, whereas non-actionable subsidies are basically granted for R&D-projects and for regional development.

As a developing country, Thailand will have to phase out its export requirements within eight years from the date of entry into force of the WTO Agreement. During this 8-year transition period, no new export subsidies may be granted. If a product has reached export competitiveness within this period, export subsidies will have to be abolished within two years[12](GATT, 1994:299-300).

4.1 Export requirements for particular products

Before 1993, products were only eligible for BOI-promotion in Thailand if an indicated percentage of production was exported. In this way, the government endeavoured to protect local industry against the larger, mostly foreign firms which are selling in the world market. Should there be no export requirements, these firms would also sell in the domestic market, where at full capacity, prices are

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[11] Besides the local content requirements, Philippine automotive assemblers also have to export automobile industry products equal to specified percentages of the value of imported kits.

higher because of the tariff protection,. Using export requirements, BOI promotion therefore killed two birds with one stroke by protecting domestic industry and by promoting exports. The activities eligible for BOI promotion under export conditions included types of processed food, rubber products (at least 80 per cent export), leather products, mineral and metal products, ceramics, chemical products, electronic goods (100 per cent exported if at least 25 per cent foreign owned, otherwise 50 per cent exported) and a variety of manufactured items.

In April 1993, the BOI abolished most of these export requirements through BOI Announcement No.1/1993. Since then, the new BOI-policy classifies investments eligible for investment promotion *only* according to the geographical zone of location. No minimum export level is imposed anymore for specific products, except for 12 to 27 inches colour television picture tubes, which had to be fully exported until 21 January 1995 (BOI, 1995:31).

4.2 Export requirements by ownership and location

Export requirements by ownership will also have to be removed in order to comply with the Agreement on Export Subsidies. These include:

- the requirement for wholly foreign-owned projects in Zone I or Zone II to export at least 80 per cent of production[13];
- the requirement for majority foreign-owned projects in Zone I or Zone II to export at least 50 per cent of production;
- the permission for activities which are normally required to be located in Zone III to locate in industrial estates or promoted industrial zones in Zone II *only* if at least 80 per cent of total production is exported; and
- the permission for activities which are normally required to be located in Zone II to locate in Zone I and these locating in Zone III to locate in Zone I or Zone II, *only* if, among other conditions, at least 80 per cent of the production is exported [14] (BOI, 1995:24).

Many BOI-registered investments are export-oriented. In 1993, however, the BOI removed all export requirements for particular products. Since then the number of projects with lower export intensity have increased dramatically. Another reason for the decrease of export-oriented projects is the relocation of smaller export-oriented projects to lower labour cost countries, with larger supporting industries for the domestic market taking their place (BoI, 1995:10) (Table 6).

Comparing export-orientation with ownership structure of BOI approved applications, more detailed data for 1990 reveals, that, although all firms in Thailand export on average 66 per cent of their output,

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[12] Export competitiveness of a product is reached when it has a share of at least 3.25 per cent in world trade for two consecutive calendar years.

[13] The permission for foreign companies in Zone III to sell in the domestic market is only granted since September 1995 (Bangkok Post, 1995c). The objective of the removal of the export requirement was: a) to comply with the WTO Agreement on Subsidies, and b) to make Zone III more attractive to foreign investors as compared to the other zones.

[14] Other conditions are that the factory is located in the same area, that no machinery import and income tax privileges will be granted and that applications must be submitted by the year 2001.

wholly-owned foreign firms export 91 per cent of their total production, mainly because of the export requirement (Page, 1994:173).

On the other hand, comparing the percentage of wholly-owned foreign investment projects with the percentage of projects which export total production (Table 6), it is clear that the number of projects exporting 80 percent or more of their production largerly exceeds the number of 100 per cent foreign firms. This indicates that there are also many joint ventures and Thai companies which export a large part of their production, even if they are not required to do so. Moreover, this might also indicate that foreign affiliates exporting 80 per cent or more of their production, prefer not to own all the shares, but to enter into a joint venture agreement with a local partner. This could imply that by and large, the removal of the export requirement for 100 per cent foreign companies (and for joint ventures) will have limited impact on domestic sales, as still many companies will continue exporting. Of course, the sectoral impact will differ. For some industries, like the automotive industry, Thailand is becoming a main regional centre, exporting to Indochina and other Asian countries. For other industries, foreign investors are eagerly waiting to penetrate the local market (see also 5.2). The relaxation of the export requirements by the BOI after 1993 shows already an increasing number of approved projects exporting less than 30 per cent, resulting in 57 per cent of the projects selling mainly to the domestic market in 1995.

Table 6: BOI approved applications by export orientation and ownership (Number of projects)

Export orientation	**1990 (%)**	**1991 (%)**	**1992 (%)**	**1993 (%)**	**1994 (%)**	**1995 (%)**
Exports 80-100 %	545 (60.0)	334 (56.2)	219 (57.2)	267 (37.0)	305 (26.0)	303 (25.3)
Exports 30-79 %	24 (2.6)	33 (5.6)	27 (7.0)	134 (18.6)	211 (18.0)	213 (17.8)
Exports 0-29 %	340 (37.4)	227 (38.2)	137 (35.8)	320 (44.4)	657 (56.0)	681 (56.9)
Total projects	909 (100)	594 (100)	383 (100)	721 (100)	1173 (100)	1197 (100)
Ownerships	**1990 (%)**	**1991 (%)**	**1992 (%)**	**1993 (%)**	**1994 (%)**	**1995 (%)**
100 % Thai owned	292 (32.1)	204 (34.3)	128 (33.4)	402 (55.8)	665 (56.7)	582 (48.6)
100%Foreign owned	144 (15.8)	93 (15.7)	67 (17.5)	79 (10.9)	105 (8.9)	133 (11.1)
Joint-ventures	473 (52.0)	297 (50.0)	188 (49.1)	240 (33.3)	403 (34.3)	482 (40.3)
Total projects	909 (100)	594 (100)	383 (100)	721 (100)	1173 (100)	1197 (100)

Source: BOI

BOI promoted activities in Zone III can also avail of financial assistance by the *Bank of Thailand* through *refinancing schemes,* which are regarded by the WTO as actionable subsidies[15]. Additional conditions are that these are *new* projects and with capital funds not exceeding 200 million THB (excluding land cost and working capital). The Bank of Thailand purchases from commercial banks or the IFCT (Industrial Finance Corporation of Thailand) promissory notes up to 40 per cent of the face value for financing fixed assets (excluding land) and working capital. The term of the notes may not exceed 120 days for working capital and 5 years for fixed assets. The Bank of Thailand charges 3 per cent while the commercial banks and the IFCT may not charge more than 11.25 per cent. The total credit line until 30 December 1996 for these refinancing schemes is 12,000 million THB (Committee on Subsidies and Countervailing Measures, 1995:6).

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[15] The Bank of Thailand also offers other financing schemes, which are actionable subsidies according to the WTO definition as well. These are mainly to promote rural development and small scale industries (Committee on Subsidies and Countervailing Measures, 1995: 2-5).

4.3 Additional incentives for exporters

The BOI also considers to review section 36 of the Investment Promotion Act to comply with the WTO Agreement on Subsidies. The section at issue deals with the additional incentives given to exporters which consist of (BOI, 1992b:11-12):

- "exemption of import duties on the raw materials and essential materials imported for use specifically in producing, mixing, or assembling products or commodities for export;
- exemption of import duties on items which the promoted person imports for re-export;
- exemption of export duties on products or commodities which the promoted person produces or assembles;
- permission to deduct from the assessable income for payment of juristic person income tax an amount equal to five per cent of the increased income over the previous year, derived from the export of products or commodities produced or assembled by the promoted person, exclusive of overseas insurance and freight charges."

The import duty exemption and reduction for BOI promoted firms in Thailand almost equals the amount of the regular taxes received by the Customs (see Table 7).

Table 7: Import duty and tax exemption granted to BOI -promoted firms (MillionTHB)

	1990	1991	1992	1993	1994
Machinery					
Value of import by invoice	45,655	63,527	45,229	56,846	64,605
Regular tax *	14,274	15,013	12,384	8,758	13,114
Tax exempted and reduced	10,609	13,066	9,467	7,343	10,977
Raw Materials					
Value of import by invoice	108,626	125,109	101,615	150,367	252,239
Regular tax *	48,152	66,758	49,503	55,191	73,889
Tax exempted and reduced	46,220	64,978	48,666	45,814	65,204

* Regular tax includes import duties and business tax (before 1992) or VAT (since 1992).
Source: Customs Department

The exemption or reduction of import duties for raw materials and components and of export duties is considered by WTO as an actionable subsidy. The exemption or reduction on imported machinery and equipment has to be removed, as well as the 5 per cent deduction from taxable corporate income of the increased income from exports of the previous year. However, no specific removal time frame has been set by the government yet.

4.4 BOI investment incentives allowed under the WTO Agreement on Subsidies

Some subsidies are allowed under the Agreement on Subsidies. These non-actionable subsidies are (GATT, 1994:273-277):

- assistance for research activities;
- non-specific regional assistance under a regional development programme;
- assistance to all eligible firms to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations.

The BOI promotes research and development (R&D) projects. On top of the regular tax exemption it allows a corporate income tax exemption for another 3 years, (but not exceeding 8 years), provided that the additional investment in R&D activities is equivalent to the value of the additional income tax exempted. Machinery and equipment for R&D activities can be imported for a period of 8 years (duty-free for projects located in zone III and 50 per cent import duty reduction in zone I and II), starting at the arrival date of the first shipment, provided that the machinery and equipment used and the number of qualified Thai personnel are approved by the BOI (BOI, 1995:10). R&D projects in Zone I and II are granted a 50 per cent import duty reduction, whereas projects in zone III receive a 100 per cent import duty exemption (BOI, 1995:35).

Under the WTO Agreement, regions are regarded as disadvantaged if they meet criteria such as income per capita or household income per capita or GDP per capita not exceeding 85 per cent of the average of the territory concerned and/or an unemployment rate of at least 110 per cent of the average of the territory concerned as measured over a three-year period. As stressed above Thailand is divided under BOI regulation, into 3 zones, according to the distance from Bangkok. Although the WTO criteria do not apply specifically to zone III, it is the least developed zone, which the Thai government and the BOI endeavour to promote as much as possible.

5. The impact of the WTO TRIM's Agreement and Subsidies Agreement on Thai industries

A study for the BOI by researchers of the Economics Department of Thamassat University (1992) examined the impact of the abolishment of the local content and export requirements for Thai industries. The major results of the study, based on the database of BOI -supported industries from 1986 until 1990 are as follows.

5.1 The impact of the WTO TRIMs Agreement

Both the finished goods industry and the parts industry will be affected by the removal of the local content requirement. The major factors include:

- the ratio of local content to the total value of the finished goods: the abolishment of local content requirement will lead to reduced prices of parts and components as a result of increased competition. Finished goods industries, currently using many local parts because of the local content obligation, will experience a substantial reduction of costs. On the other hand, non-competitive parts manufacturers might be negatively affected;
- domestic sales price versus import price, inclusive of tariffs: the removal of the local content condition will urge parts makers to adjust their prices to international levels. If local prices are higher than international prices, parts makers may experience a drop of their profits;
- tariffs of imported parts and finished goods: as long as tariffs on imported parts and finished goods remain high, the abolishment of local content requirement will have little effect on the industries thus protected;

- exports of locally made parts: locally made parts that are exported, apparently can compete on the world market, and the removal of the local content obligation will have little impact on their competitiveness;
- the technological development of the local parts industry: if well developed, the impact of the removal of the local content obligation will have little impact.

The Thamassat research team conducted several surveys and interviews with affected firms in 11 industry groups and came to the following results:

- the impact on most *agricultural raw materials* (fresh and raw milk) will likely be very high, as local firms are not competitive because of badly managed farms and low productive breeds. A possible alleviation for these industries could be to offer some subsidies allowed under the WTO Agreement for Agriculture, or to temperarily impose some import surcharges;
- the impact on *vehicle parts* will be very considerable as well, as the local technology is not up to world standards yet. However, as mentioned before, as a result of external factors such as the strong Yen and the recent technological improvement of local part manufacturers, the local industry is catching up.

5.2 The impact of the WTO Subsidies Agreement

Both BOI -eligible companies under full or partial export conditions and companies selling in the local market can be affected, depending on the local price as compared with the export price in the industry, the size and nature of the local market and the competitiviness of local firms.

The Thamassat research team conducted several surveys and interviews with affected firms in 11 industry groups and came to the following results[16] :

- the impact on industries such as *jewelry, canned seafood, canned vegetables and fruits, other processed food, yarn, textiles, sport shoes, sport and musical instruments, toys, optical products, plastic products, ceramic products and animal meat products* will be very minimal as exporting companies in these industries are not interested to sell in the local market. Export-oriented firms and local-oriented firms are not competiting. Moreover, many firms producing for the local market are already sufficiently competitive.
- the impact on industries such as *home electronics and electrical appliances* will be very substantial. Exporting firms have more up-to-date technology, are larger in size and are mostly foreign owned. If the export requirements are removed, foreign companies will try to capture the growing local market. Small companies serving the local market will not be able to compete.

6. Conclusion

Investment promotion policies have been, and still are an important element in Thailand's development strategy. The contribution of FDI to growth and exports has sufficiently been demonstrated.

As a developing country, Thailand will have to remove its local content and export requirements within five and eight years respectively, in order to comply with the WTO Agreement on Trade Related Investment Measures (TRIMs) and the Agreement on Subsidies and Countervailing Measures. Much of the investment incentives, especially these granted before 1993, were trade-related. The BOI and the Ministry of Industry are now gradually removing these requirements. All export requirements for specific products have been removed in 1993, while the export requirements for foreign companies and joint ventures have been recently removed for companies located in Zone III. The local content requirement in the automobile industry will also be removed ahead of schedule.

The BOI and the Ministry of Industry are realizing that the abolishment of the requirements are not only necessary to comply with WTO, but also to enhance competitiveness of the local industry. Protection of local industries has continued for a long time, often leading to negative results. Especially taking into account the growing competition from neighbouring countries, the Thai local industry needs to restructure and to improve its efficiency as soon as possible. Looking at the growth rate of Thai major exports, many industries are already in a position to compete successfully in the world market. Protection of these industries has become unnecessary. On the other hand, the booming Thai consumer market will attract a lot of foreign consumer producers. For these sectors, the Thai government temporarily will have to cushion the impact of the WTO Agreements in order to allow the local companies to adjust.

As less fiscal incentives can and will be granted to investors in the future, the BOI will evolve more and more to a servic centre for local and foreign investors.

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[16] The reader should bear in mind that during the time of this survey, a lot of export requirements were imposed, whereas at the time of writing, the majority of these had already been removed. The list of industries affected is therefore smaller. See earlier in this paper for more details.

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