10.1 INTRODUCTION

The objective of the present research has been to examine the role of FDI flows in industrial restructuring in the South East Asian region, using the framework of the “flying geese” (FG) or the catching-up product cycle (CPC) model. Having experienced very large increases in relocative FDI since the late eighties into the early-nineties and also delivered high rates of export growth over this period, Thailand’s industrialisation path approximates the FDI-led catching-up mechanism suggested by the FG model. Thus, for the present study, from the set of second-tier East Asian NICs, Thailand was chosen as the country and electronics industry in particular was chosen as a case, for examining the nature and outcome of an FDI-led industrial catching-up strategy.

For analysing the industrial restructuring experience of Thailand, a conceptual framework was developed based on a critique of the catching-up product cycle (CPC) model. It was found that in its depiction of industrial development in late-industrialising countries as an automatic consequence of FDI, there has been the underlying assumption in the CPC model that there is a natural or automatic inclination for the progression from each phase to the next, that is, from FDI-led industrial production growth to import substitution, exports, outward FDI, etc. It was seen that in doing this, the model fails to give allowance for the interaction between the numerous endogenous and exogenous factors that come into play in the growth process of countries. To provide a more balanced assessment, the present study attempted to provide a conceptual framework incorporating the basic necessary conditions that would need to be satisfied for the progression of a firm, industry and country through the FDI-led industrial catching-up path. It was emphasised that the necessary conditions could be realized from a variety of possible alternative ways, and that they would clearly vary from country to country, industry to industry, or from firm to firm, depending on a range of circumstances.

However, the presence of a state with a long-term vision of self-reliant national economic growth and the capacity for guiding industrial development and transformation was argued to be an essential common condition for effective and sustainable FDI-led industrial growth. The analysis also tried to incorporate the nature of the domestic business classes, which is the basic determinant of the extent and nature of FDI’s involvement in the economic growth process of the country. The study of Thailand’s FDI-led industrial restructuring was carried out within this framework.

Before moving onto the main findings and conclusions, it is useful to briefly
discuss the major features of the overall policy framework in Thailand. Since the late 1950s, Thailand's economic policy orientation has been towards economic growth led by private enterprise, in which foreign investment came to play a very important role. In spite of some operational restrictions imposed on foreign investors, the demand for FDI was quite high among Thai policymakers and domestic capital even before the 1980s, as the domestic private sector's alliance with foreign capital was linked to the Chinese domination in the industrial and financial sectors and the presence of the US in the regional military strategies. Thus, Thailand maintained an open and liberal attitude towards foreign direct investment inflows. As the emphasis of economic policy shifted completely to manufactured export-led rapid growth from the mid-1980s, the demand for FDI multiplied through the eighties and nineties. Subsequent to the 1984 baht devaluation, FDI promotion policies became totally enveloped in an aggressive promotion of exports.

But, throughout the period under consideration, Thailand's FDI policy regime never exhibited the kind of state activism that went into the industrial policies of Korea, Taiwan or Singapore. The development of the promoted industries, their supporting industries, technology capability, human resources, etc. were not planned adequately or coordinated sufficiently strongly, to enable a well-founded and deeper industrial structure to emerge. Thus, Thailand's industrialisation and policy framework was found to have been in contrast to the so-called East Asian model of industrialisation, where states were effective agents of industrial transformation during their periods of high growth. Further, the overall trend in Thailand was in the direction of complete liberalisation of foreign ownership restrictions, reflecting the continuously increasing demand for additional capital and advanced technology generated by the rapid export-led growth paradigm embraced by Thai policymakers and domestic capital, attempting to emulate the leaders in the catching-up product cycle.

Thus, the demand for FDI became much more broad-based from the eighties onwards, driven by a desire for ambitious export-led expansion. The latter in itself may be problematic considering the severe vulnerabilities that can arise from sudden and/or large shifts in external demand, and the consequent pace of restructuring required for maintaining consistent export growth. But, in addition, two other major underlying factors seem to have been of critical consequence in deciding the outcome of Thailand's FDI-led restructuring. Firstly, it was seen that this desire for growth of the Thai domestic capital was largely not based on an independent attitude, which would have instigated them to catch-up technologically and compete with foreign affiliates successfully on a level playing field. Most partnerships of Thai-foreign capital seem to have been largely based on revenue concerns (along with the technology and the market access made available), rather than on independent sustainable growth from the point of view of the local partner. The Thai private sector also failed to develop a 'technology culture'. Secondly, successive Thai governments’ policy formulation has not been based
on a nationalistic approach to industrial development, for fear of not being receptive enough to the required FDI.

This lack of a nationalistic approach to economic development has been attributed variously to the fact that Thailand never experienced colonial rule which gave rise to a local business class (Pasuk and Baker, 1995 among others) and to a dearth of 'social capital' (Unger, 1998). Clearly, several historical and socio-political factors have contributed to Thailand's soft approach on nationalism. This in turn has led to relatively weak ideological and institutional underpinnings for the state's willingness and capacity for industrial transformation. These weaknesses got exacerbated when the pressures for fast-track growth from the industrial and the tertiary sectors as well as the prescriptions under the Washington Consensus led to rapid financial liberalisation and capital account convertibility.

By the mid-1990s, the economic restructuring that took place in Thailand at the macro level was observable in terms of: (a) the decline in the historically dominant role of agriculture; (b) the rapid expansion of the manufacturing sector, particularly after the mid-1980s' shift to export-led growth; and (c) the continuous predominance of the service sector in the economy and the structural changes within it since the late-1980s. While there was indeed the emergence of a vigorous local business class by the early nineties as Laothamatas (1992) has argued, with the relative boom and structural changes within the service sector since the late eighties, the political influence of the service sector businessmen came to outweigh that of the manufacturing sector exporters.

Similar to the growth path of the manufacturing sector entrepreneurs who shifted from import-substitution to export promotion in alliance with foreign capital, the service sector had also witnessed an outward-oriented transformation, which hastened the opening up of the financial sector. Thus, before the indigenous manufacturing production base could make the required transition from the production patterns under the prolonged period of protection and constant tariff changes with a lack of direction, rapid trade and financial liberalisation was undertaken at the regional and international levels. While the export manufacturers also believed this to increase their access to external capital, Thailand’s production structure failed to undergo the restructuring and upgradation necessary to compete in an open regime, as the priority of investors (both domestically and internationally) shifted in favour of the booming and liberalised service sector and towards other non-tradable sectors. At the same time, the government also did not intervene effectively to enable the necessary investments for production upgradation. This has had crucial implications for the sustainability of FDI-led industrial development and export expansion in the country, and has made it dependent on a

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1 Unger (1998) argues that the different social capital endowments specific to the Thai and the Chinese have led to the relative absence of cohesive groups within the Thai polity, which worked against policy deliberations, consensus formation, and the mobilization of broad political support. See Unger, Danny, 1998, Building Social Capital in Thailand, Cambridge University Press.
narrow range of FDI-dependent export sectors.

10.2 FDI AND THAILAND'S INDUSTRIAL RESTRUCTURING, 1987-98

The main attributes of the FDI inflows into Thailand since 1986 were the increase in the total size of the FDI inflows, and the sharp increase in the shares of Japan and the NICs. Although real estate and financial institutions registered the highest growth rates in FDI inflows, on average more than half of all net FDI flows during 1987-91 went into the manufacturing sector alone, followed by trade. These were dominantly in the export-oriented industries, especially electrical appliances. However, the FDI-led export production expansion that took place during this phase was highly import-dependent and capital intensive.

At the same time, the weaknesses observed in state capacity for directing and influencing industrial investment and upgradation got exacerbated with the relative boom and structural changes within the service sector since the late eighties. Thus, the boom in export-oriented FDI inflows into Thailand during 1988-90 was not sustained later on, primarily due to the impact of financial sector liberalisation, and partly due to the fact that the traditional export industries had lost relative competitiveness and did not attract more export-oriented FDI into the country, in the absence of an upgradation of technological capabilities. After the introduction of the BIBF, a huge proportion of the BIBF funds as well as the funds through the FDI channel flowed into the real estate and other non-tradable sectors. Given the weight of export-oriented manufacturing industries in foreign exchange earnings, this clearly led to a sectoral imbalance in credit allocation between tradable and non-tradable sectors. Within the manufacturing sector also, the continued growth in the domestic economy increasingly attracted the domestic market-seeking type of FDI. This was also clearly reflected in a conspicuous decrease in the export-orientation of BOI-promoted foreign firms after the early nineties.

If the large FDI inflows received by the export-oriented industries such as textiles, 'other industries', in the earlier periods had indeed led to production upgradation through technology transfer as predicted by the CPC model, exports from these industries should have continued even after the diversion of FDI away from them. However, during 1992-96, exports of garments, and footwear & leather products all showed a decline in growth rates along with food, textiles, and jewellery industries. The detailed analysis of Thai exports based on their technological content also brought forth similar results pointing towards a lack of wider and deeper industrial upgradation. Meanwhile, the shift of FDI into more domestic-oriented and capital-intensive industries and sectors meant that there were no equivalent reductions in imports, even as there was a slow down in export growth in the nineties. In fact, it was clearly seen that Thailand’s import growth in the first half of the nineties was dominated by growth in consumer imports and imports related to the service sector boom in the construction and transport sectors, apart from the growing concentration of imports into the export-oriented
electrical machinery industry. Thus, through the process of FDI-led industrialisation, Thailand is observed to have only moved from one level of import-dependence to another. This clearly establishes that Thailand has not been able to build a strong or viable industrial base through its FDI-dependent private sector-driven industrialisation strategy.

Detailed analyses of the electronics industry at the industry and firm levels were carried out to examine the related issues further. Since 1978, except for a few years, the electrical machinery industry has been the single largest manufacturing sector FDI recipient and one of the fastest growing export sectors in Thailand. With a 45% share, it has come to constitute almost half of total Thai manufactured exports. However, the organisational analysis clearly established the heavy domination of foreign-owned and affiliated firms in this industry. Domestic electronics firms owned exclusively by Thai entrepreneurs were only 9% of the total number of promoted electronics firms, representing a mere 5% of the total investment. The fact that the majority of them were also medium- and small-sized, further brought down their relative influence in the industry.

It was clearly seen that the changes in trade and production structures in the electronics industry have been extremely parallel to the changes observed in the sectoral and product composition of foreign investments into the industry. The analysis of the historical growth process of Thai electronics industry also showed that while the product profile of the Thai electronics industry revealed a climb up along the technology ladder and greater diversification, it has mostly happened at the level of foreign affiliates. Therefore, while the production structure has undergone deepening and upgradation and in that sense appears to have followed a catching-up-product cycle pattern, the major changes in production structure have been at the level of foreign enterprises, and indigenous enterprises have largely lagged behind in this process. This was the dichotomy that prevailed in Thai electronics industry production structure in the second half of the 1990s. The discussion of cases studies of electronics industry firms also corroborated the differences in the levels of operations of the different groups of firms in Thai electronics industry, and established that this had come to be perpetuated through a lack of linkages between the foreign-affiliated and indigenous production bases in the industry.

Thus, due to the fact that strong indigenous firms failed to emerge in the higher-end segments and at the same time, the government failed to intervene in the industry in an effective manner to create a more balanced production structure, with the decline in significance of consumer electronics exports, the rise in concentration on computer sub-sector (EDP) exports made Thai electronics exports increasingly dependent on the latter sub-sector early on in the nineties. It should be noted that the major export product from the EDP sub-sector, namely, hard disk drives, is a labour-intensive assembly-based product. Although two other assembly-based mass-produced products from the parts
components sub-sector, viz., non-digital integrated circuits and printed circuits have also increased their shares subsequently, this has happened at the expense of declining shares of most of the other major electronics exports. By the mid-1990s, Thai electronics exports had thus become highly vulnerable to the changes in international demand for a few mass-produced products belonging to the EDP and parts & components sub-sectors. By looking at the region-wise trends in exports, it was indeed observed that the decline in Thai electronics exports which had started before the crisis was mainly due to the influence of changes in demand originating from the US and the EU markets, which were on a decline during 1992-96.

The slow down in Thai electronics industry’s export performance before the crisis, which got exacerbated post-crisis with world-wide recession was also due to its very high import dependence. It was clearly seen that despite and indeed, in correspondence with, the increasing shift of all major sub-sectors towards exporting, the import-dependence in the Thai electronics industry was constantly increasing. The firm-level case studies confirmed that local production of parts and components in both foreign firms with indirect exports, and in indigenous or joint venture firms that enter into international sub-contracting (direct exporting), has also been enabled only through imports of the required raw materials and components, due to an absence of effective local linkages promoting production and technological capabilities in the required medium-end and higher-end intermediate products. Even in cases where local linkages existed, technological deepening played a limited role.

It was also seen that in the case of subsidiaries and majority-owned foreign affiliates in the electronics industry, the width and depth of the technology transfer process were solely determined by the parent firms, depending on their global strategies. The local managers did not have significant influence on this decision making process. It was found that while the learning process has not been stagnant, it has not been dynamic either. It remained limited to lower or middle levels of capability development due to the division of labour strategy of parent firms, and a shortage of highly skilled labour force. Thus, the industrial deepening process has still remained limited to no more than an assembly-based production of parts and components, again of imported raw materials and more assembly equipment. Thus, ultimately, it seems that mainly more and more assembly technologies for a wider and more advanced range of electronics products only have been introduced into the Thai electronics industry since the late eighties or early nineties. This could be considered as industrial diversification, which is still mostly limited to assembly technologies involving higher levels of acquisitive and operative capabilities, rather than higher levels of technological capabilities involving innovative capabilities. The reluctance and lack of capabilities of indigenous electronics producers to make the substantial investments needed to enter the production of high value-added parts and components and the lack of strategic government intervention to enable such investments in the industry were thus noted to
be fundamental impediments in promoting sustainable and indigenously-rooted growth in the electronics industry.

The lack of investment coordination and the excessive emphasis on export growth figures (without paying attention to import content) which have led to the heavy dependence on Thailand on FDI-dominated computer parts and IC exports, makes the country easily vulnerable not only to another cyclical downturn in these dominant export industries, but also to the change in strategies of the MNCs operating these production networks. Thus, unless Thai electronics producers in the other sub-sectors are able to recover their lost competitiveness and recover from the implications of the crisis and rebuild their market strength through increased investment and improved technological capabilities, it is clear that this precarious export structure with dependence on extremely narrow product lines, will continue. The impact of another demand slow down and price war in the international markets may become too severe for the industry's growth performance. Therefore, in order to have a more balanced export structure, it is imperative that the electronics industry broadens its production base, for which indigenous capability development has to improve drastically. However, the trends in electronics projects approved by the BOI during 1997-2001, suggest that there is an increasing trend towards consolidation of capacities within a few large firms across all the sub-sectors, except parts and components. Combined with the fact that the levels of 100% foreign ownership have gone up drastically across all sub-sectors, these trends clearly point towards more alienation or absence of Thai ownership from more segments of the domestic electronics industry, further weakening the prospects of developing a strong indigenous base for the industry's development.

The analysis of policy formulation in the electronics industry suggested that the lack of technological deepening and diffusion in Thai electronics industry is a direct consequence of Thai policy makers' decision to leave it to an FDI-dependent private sector-led export growth policy. The main policy maker in the Thai industry namely, the Board of Investment (BOI), believed in providing a level-playing field for foreign and indigenous firms and seems to have emulated Singapore in its liberal FDI policies. However, it did not believe in pursuing active industrial technology policies along the lines of Singapore, which formulated and carefully propelled industrial deepening and technology upgradation in their electronics industry. Even in the late nineties, it was seen that the government has looked at the industry from a export growth point of view, rather than from a developmental one. On the other hand, Thailand’s private sector, which has been responsible for most of the country’s economic growth phenomenon, has also been equally negligent when it came to indigenous technology development. While the Thai government launched various initiatives to boost science and technology since the early 1990s, they did not elicit the required political support and were thus inadequate relative to the restructuring requirements of the industry.

Therefore, in spite of the fact that Thailand may be credited with having built up
considerable capabilities in terms of mastering and using imported technologies, the
growth in FDI-led export production has failed to deepen technological development
beyond operational capabilities. Thus, Thailand's case clearly exemplifies that in the
absence of a 'developmental state' which coordinates and harnesses private sector
dynamism for a broader national development project, FDI-led production does not by
itself enhance technological development in the country or lead to sustainable export-led
growth as predicted by the CPC model, and amply demonstrates the problems
associated with market failures. Thailand failed in not having long-term national
industrial and technological capability policies.

10.3 CONCLUSION AND POLICY SUGGESTIONS

10.3.1 Conclusions
First of all, the present study argued that the contemporary versions of the flying geese
or the CPC model which puts forth FDI-led industrial catching-up as the rational or
ideal strategy for latecomer developing countries is a clear departure from the particular
characteristics of indigenously-driven industrialisation strategies that were adopted by
Japanese and the first-tier East Asian developmental states during their periods of high
growth. Then, as a country whose industrialisation experience in fact closely resembles
the neo-classical idealisations of the CPC model, the detailed analyses of Thailand
established that industrial upgradation is not an intrinsic part of an FDI-led industrial
catching-up strategy, as propounded by contemporary versions of the 'flying geese'
theory. Technology transfer and backward linkage creation required for industrial
upgradation do not occur naturally or automatically. Thus, as argued in the conceptual
framework, for FDI to lead to technology upgradation and diffusion enabling industrial
upgradation in a country, the production by foreign-affiliated firms in the country should
be necessarily linked to indigenous firms in the supporting and other related industries.
Further, indigenous technology development and non-internalised forms of technology
transfer should take place along with FDI, for breaking the cycle of foreign technology
dependence. It was clearly seen that an FDI-dependent private sector-led export growth
policy with a hands-off approach by the government did not lead to effective industrial
transformation or industrial deepening.

Thirdly, it was seen that while the export performance of the Thai electronics
industry arising from the export-oriented FDI may be a measure of its international
competitiveness, the former should not be confused with the technological strength of
the indigenous production base, nor therefore, be confused with the sustainable
development of the industry. An exclusive focus on the aggregate export profile of a
country will not tell much about the technology content of these exports. The impressive
export figures for the so-called high technology electronics industry cannot be
considered in isolation. The crucial points that have been overlooked in the discussion
on industrial upgradation are (1) the actual ‘value-addition’ by indigenous firms vis-à-vis foreign affiliates, and (2) the import content of FDI-led exports. An enhanced export role in itself does not benefit the country more than foreign exchange earnings and employment. As argued in the conceptual framework, these will also tend to be transient, if long-term capabilities in skill and technology upgradation are not put in place and continuously upgraded. Therefore, the claim of the proponents of ‘flying geese’ theory that FDI-led development of the Thai electronics industry has made it a highly technologically advanced export industry, is seen to be misplaced, both from the point of view of technological content of its exports and from that of foreign production domination in this industry.

Fourthly, the major structural changes in the Thai industrial landscape subsequent to the crisis in terms of a heavier domination of foreign ownership across several prominent industries, appear to return Thailand to the pattern of export-oriented industrial growth with another set of MNC-dominated sectors in apparently higher value-added industries such as transport equipment, chemicals, plastic products, non-metallic mineral products, etc. along with the electrical machinery industry. However, given that these are the very industries in which FDI has become increasingly prominent since the mid-1990s, detailed studies of each of these sectors are needed to understand the position of Thai operations in the global production value chain for each of these industries. Given the earlier pattern, this also may not reflect any significant upgradation in indigenous production capabilities, in the absence of a dramatic improvement in state intervention in technology policies and indigenous private sector participation in technology development. If indeed they follow the earlier pattern, such heavily increased levels of foreign ownership with increased imports, while exports take place with very low value added from the host country might also lead to a situation of constant trade deficits, similar to that of the Latin American countries. Such a permanently defaulting current account balance, along with an open capital account can lead to heightened vulnerability for Thailand towards external shocks.

Thailand’s experience unequivocally proves that dependence on FDI cannot be a substitute for national (indigenous) technology capability development and strategic interventions by the state for creating a locally entrenched and broad production structure. While opportunities for industries and firms wanting to attract FDI may have gone up due to increase in production disaggregation by MNCs from various home countries in various industries, indigenous capabilities become the deciding factor of where a host country will be placed along the value chain of various production activities. Clearly, in the medium term at least, Thailand’s dependence on imported technologies is not foreseen to decrease. However, for Thailand’s industrial development and its previous export success to be repeated, a deepening and widening of the technological capabilities of its human resource base is required, for reducing the costs of importing and absorbing new technologies. More crucially, in the medium to long-term, only such technological deepening will enable
Thailand to undertake the production of more sophisticated products and higher-end manufacturing and related functions, even when it will be dependent on foreign innovation as mentioned above. Further, along with the development of indigenous firms in various end-product industries, the establishment of a diverse set of locally entrenched supporting industries is also required for a dynamic model of industrial development, as argued in the conceptual framework.

At the micro level, indigenous companies would also need to have a larger vision of basing their growth plans on their competitive strengths and should be capable of creating R&D activities to consistently build on their competitiveness. The creation of such a ‘technology culture’ among the indigenous private sector may be dependent on a larger change in the underlying traditional trading mentality of the indigenous private sector and a wider spread of an entrepreneurial culture. Government participation and policies have a crucial role in generating and galvanising both, and would require a break of tradition away from state’s historical role in providing a loose framework of protection and leaving the rest to the private sector. Therefore, overall, government policies for upgrading the productive structure of the country will be required at two levels: (1) putting in place a long-term strategy for building a national system of innovation; and (2) changing the historical role of the state to provide visionary as well as targeted industrial development/restructuring goals at the macro and enterprise levels.

10.3.2 Recent Policy Initiatives

In the post-crisis period, the pressures of liberalisation agenda following the adoption of IMF credit and the pressures of economic stabilisation led Thailand to emphasize on financial sector restructuring, measures to encourage private investment, “good governance” reforms in law and administration, education, a return to international

2 Restructuring the debt-ridden financial sector was done by: (1) segregating unviable financial institutions and addressing the FIDF problem; (2) strengthening and recapitalising viable financial institutions; (3) strengthening supervision especially by introducing new loan classification and provisioning (LCP) requirements, restructuring the Bank of Thailand, and putting in place a new Financial Institutions Act to support financial sector regulatory framework; and (4) addressing the NPL problems. See Ministry of Finance, November 1999, p. 16-24. After liberalising the foreign equity restrictions in the banking and financial sectors as discussed in Chapter III, Thai government also encouraged foreign investors to assist in re-capitalizing Thai financial institutions, by taking large equity positions in domestic firms. A total of four (out of thirteen) Thai commercial banks are now majority owned by foreign banks.

3 This included a reduction in the VAT rate from 10% to 7% from 1 April 1999 to 31 March 2001, the elimination of VAT collected on gross revenue from small enterprises with annual sales between 600,000 and 1,200,000 million baht. The government had also adopted measures to reduce energy prices. The government also established an Equity Fund to invest in large-scale enterprises (the Fund involves capital from international investors too), Thailand Recovery Fund for investing in competitive medium-scale enterprises, and a Fund for Venture Capital Investment in SMEs. See MOF, November 1999 for details.
capital and finance markets, and a social safety net.\footnote{To deal with the severe social impacts of the economic crisis, this included programs under the Social Investment Project (SIP), the Social Sector Program Loan, and others. The SIP was initiated with financial support from the World Bank ($300 million), the Overseas Economic Cooperation Fund (OECF-13412 million yen), as well as the national budget, and included short- and long-term programs. The Social Sector Program Loan was funded by a 500 million USD loan from the ADB and other funds from the national budget. Ibid.}

The new Foreign Business Act of 1999, which lays out the overall framework for foreign investment in Thailand also became effective on March 4, 2000. Although it replaced the 1972 Alien Business Law, the definition of an "alien," remains similar to that in the erstwhile Law and the classification of activities into three lists also remain. However, while businesses in categories A and B were completely closed to aliens, under the new law only activities that fall under List 1 are strictly prohibited to aliens (See Annexe 7 for the list of businesses). On the other hand, although businesses covered by List 2 are prohibited to aliens, specific permission can be sought from the Commerce Ministry. However, alien juristic entities allowed to engage in List 2 activities must meet the following conditions: (1) At least 40 percent of all shares are held by Thai persons or non-alien juristic entities (This may be reduced to 25 percent on a case-by-case basis); and (2): two-fifths of the members of the Board of Directors must be Thai. Activities in List 3 are also prohibited to aliens, unless permission is granted by the Director General of the Department of Commercial Registration, Ministry of Commerce, by and with the approval of the Foreign Business Board. However, as before, promoted foreign investors under either the Investment Promotion Act, the export businesses under the Industrial Estate Authority of Thailand Act, or other laws, can engage in businesses in Lists 2 or 3, and then notify and procure a Certificate from the Director-General. All of these are essentially meant to develop Thailand as a good host for foreign capital.

The present Thaksin Shinawatra government which campaigned and came to power on an explicitly nationalist platform in February 2001, however, is seen to be more directly supportive of indigenous entrepreneurship, small and medium enterprises and a more active state role in industrial planning,\footnote{See Pasuk and Baker, 2000. The Report of the MOF's and NESDB's Task Force for Drafting Strategy Plan explicitly acknowledged the excessive reliance Thai economy had on foreign capital and technologies, and low wages of unskilled labour. Ministry of Finance and NESDB, 2001, etc.} and has emphasised the so-called "Dual Track Plus" Development Model. According to the latter, the government would establish linkages with the world economy and simultaneously develop the domestic economy to become more knowledge-based and more creative. This vision has been based on a recognition that the economy cannot rely solely on the external sector. Thus, in fact, the Ninth National Economic and Social
Development Plan (2002-2006) has adopted the philosophy of sufficiency economy. The macroeconomic policies include monetary measures and liquidity management for ensuring macroeconomic stability. Important among these is the development of the capital market by improving the tax system and related legislation so that new firms are encouraged to register their companies in the stock market. The government also proposes to support the capital market and mutual funds to be alternative sources of fund to venture capital. The government will emphasise launching new products in the stock market, particularly by setting up the Public Enterprises Holding Corporation and bringing in state-owned enterprises to be listed.

Measures for restructuring production sectors include:

- Restructuring the agriculture sector by improving agriculture-related technology, improving value-added and marketing strategies, and developing biotechnology in order to enhance the country's production capacity.

- Restructuring the manufacturing sector by enhancing value added and improving the quality of products. Government policy would also pay attention to the entire production chain, including the development of clusters. The emphasis was to be on three groups: (1) The group that requires broadening, which includes manufacturing products in which Thailand has unique skills and talents, such as herbal products, and cultural and art products. (2) The group with high potential and needs to be strengthened further includes agro-based industry, high technology textiles, auto and parts, heavy industry, and entertainment. (3) The group of industries to be invested for future growth such as biotechnology, microchip, software, and electronics.

- Enhancing the role of specialised institutions by providing them clear objectives and sufficient resources to strengthen SMEs. The lending targets and credit insurance for all leading state-owned banks including Export-Import Bank, Krung Thai Bank, IPCT, and Government Housing Bank have been raised to increase the provision of credit to SMEs, while the Small and Medium Industrial Finance Corporation has been transformed into the SME Development Bank. At the same time, the Small and Medium Industrial Credit Insurance Corporation has been asked to increase credit insurance target in order to support SME Development Bank and investors that

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6 Thus, while it is envisaged that during the plan period, the Thai economy will grow at an annual average rate of 4-5 per cent (with an average annual current account surplus of approximately 1-2 per cent of GDP), exports are envisaged to expand only at the annual average rate of 6 per cent (and not at the double digit levels during the boom period). The total factor productivity in the agricultural and industrial sectors is set to grow at an annual average rate of 0.5 per cent and 2.5 per cent, respectively.

7 The latter include monitoring capital outflow, maintaining the level of international reserves, maintaining the levels of interest rates and exchange rates favourable for economic expansion, evaluating and managing the NPLs in the financial system, simulation of construction and real estate sector, etc. Ibid.

8 The Ninth Plan also emphasises cluster formation involving urban and rural linkages, as well as networks linking public, private and civil sectors.
borrow from other financial institutions. The government has sought cooperation from commercial banks also to extend credit to SMEs. In line with the Thai Government policy to support the development of small and medium-sized enterprises, in June 1999, the Stock Exchange of Thailand (SET) established a new secondary market for trading SME shares called the Market for Alternative Investment (MAI).

Overall, the emphasis is on the quality and sustainability of growth rather than on quantitative growth. Thus, strengthening local economies and communities is an integral part of the measures to build up the quality of growth. Measures have also been taken towards revitalising natural resources for economic benefit and eco-system balance. A significant measure that has been suggested in environment quality management is the monitoring and development of the environmental quality and standard of export goods to meet international standards so that Thai products can comply as per the non-tariff barriers (NTBs) in importing countries.

It was also emphasised that Thailand must radically improve its educational system to build a stronger foundation for national technological development, which was still lagging behind in the nineties. The new highly ambitious and visionary education reform package as contained in the education bill prepared by the Office of the National Education Commission and passed by the House of Representatives in October 1998, is thus, a step in the right direction. This consists of measures affecting not only the formal system of education, i.e., the extension of compulsory school years to 9 or 12, but also, the non-formal sectors of continuing education for people from all walks of life, that is, life-long learning.9

The measures also include the establishment of an operation plan to boost competitiveness in four areas, where Thailand is currently ranked bottom of the list such as infrastructure, management, quality of labour, and science and technology (S&T). The National Science and Technology Development Plan (1997-2001) proposed by the MOSTE is considered to be the long-term plan for S&T development. The Plan aims to

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9 Two major strategic components of the package are the reform of learning and the reform of education management. The reform of learning takes a comprehensive view of human development, looking at human learning needs from early childhood throughout a child's life: basic child development, basic education, national competitiveness, and lifelong education. The reform package on management, on the other hand, focuses first on the new administrative structure under which local educational commissions are empowered with decision-making responsibility. It also welcomes new partners in educational administration, i.e., parents, local community leaders, Buddhist monks and local religious leaders, etc. Second, it highlights the increasing role of the private sector in educational provision. Third, it stresses a radical reform in the higher education sector as a cutting edge in the educational development scheme of the country. Fourth, it emphasizes the importance of quality assurance mechanisms as a basic rule of the twenty-first century educational management. Finally, the management reform emphasizes the mobilization of resources from various sectors for the betterment of educational service. See NESDB, 1998.
develop S&T at both basic and applied levels in four categories, namely, personnel (with emphasis on S&T manpower), R&D, technology transfer, and infrastructure. Thus, innovation that builds on local knowledge and has potential to reduce reliance on foreign technologies is to be encouraged. Further, the development and application of information and communication technologies (ICT) are to be strongly supported to create robust systems for dissemination of knowledge and information.

In fact, a number of initiatives that had been in the pipeline have eventually taken off. Thailand's plans to promote S&T through the establishment of the first science park focusing on R&D had become delayed owing to the budgetary constraints following the crisis. After eight years of development, the Thailand Science Park (TSP) opened in early 2002. The country has also made significant progress in information technology (IT). The Software Park and Internet Thailand's IT Park run by the IFCT also made their debut in 2002. The IT Park aims to serve entrepreneurs in software development and the e-commerce business.

The Science Park is a government initiative to move Thailand towards a knowledge-based, learning and high-performance economy, by facilitating collaboration among the government, private and university sectors. Incentives offered include tax exemptions on imported raw materials, special investment incentives, financial support, training courses and expert assistance. The park also provides high-speed Internet connections via a fibre-optic network provided by Internet Thailand, up to 5,000 telephone numbers, laboratory facilities and research consultants. The project is scheduled to be completed by 2007 at a total cost of around seven billion baht. The government has targeted three groups as recruits for the Thailand Science Park (TSP):

10 It is now full with over 40 companies, 17 of which were doing business with foreign partners.
11 It was the National Electronics and Computing Technology Centre (Nectec)'s pioneering of Internet services that enabled the smooth start-up for the commercial services of Internet Thailand (Inet). NECTEC did early research into the Internet and established ThaiSarn, Thailand's Scientific and Academic Research Network.
12 There are also plans to accelerate developments that will provide a cluster of IT development centres in all major regions of the country, many of the components in what should become an interlinked network or "cluster". There is also a vision to turn Thailand's second largest city-Chiang Mai into an IT City, a concept that has had private sector support for a year now, spearheaded by the Prime Minister. Another important piece that is about to fall into place that will serve to link a national cluster of IT development centres is broadband satellite communications, and this should happen when Shin Satellite's iPSTAR broadband satellite is launched and goes into service. See Bangkok Post, 24 December 2002, 8 January, 2003.
13 The Science Park now also hosts the R&D offices of the National Science and Technology Development Agency (NSTDA), including the National Centre for Genetic Engineering and Biotechnology (Biotec), the National Metal and Materials Technology Centre (Mtec) and the National Electronics and Computer Technology Centre (Nectec).
14 Internet Thailand now also provides links between The Science Park, Software Park and IT Park.
graduate and post-graduate students; specialists in the academic, public and private sectors; and overseas Thais. To make the Science Park into an incubator for talent from the three groups, the “best and the brightest programme” will offer incentives to do research in Thailand, tax incentives for businesses, an innovation development fund, as well as capital funds from the Small Industry Finance Corporation.

Meanwhile, the BOI has revised its Investment Promotion Policy in August 2000, to make it congruent to its commitments under the WTO. It has totally done away with the linking up of tax-based subsidies to export requirements and has adopted a focused approach on technology issues. It has identified five industries for aggressive targeting: agro-industry; automotive; fashion; ICT including electronics; and high value-added services. The BOI is also taking a case-by-case approach instead of a ‘one-size-fits-all’ attitude while offering promotional privileges.

10.3.3 Policy Suggestions
The government has thus identified several areas for improvement and a number of initiatives are underway. However, given the fact that technological development has a time lag, Thailand’s success in improving its competitiveness and building a sounder indigenous foundation for industrial development will depend on how successfully and consistently it carries out these programs. It will also depend on the relative speed of restructuring that takes place in Thailand in comparison to major competitors such as Malaysia. Further, at the trade and investment policy levels, a variety of options that were previously available for explicitly promoting local entrepreneurs will become difficult, if not impossible to use, under the changed international regulatory framework of the WTO regime and due to commitments under the AFTA. But, the way forward is to recognise that there are still alternatives available to proceed with careful regulation, if the states concerned want to pursue some notion of a ‘national interest’ and take a more strategic outlook. It is then possible to look at the following various short-

15 Under the ruling of the Committee on Subsidies and Countervailing Measures, WTO following negotiations related to export subsidies in late 2002, the BOI is permitted to continue to retain the conditions for existing projects with export requirements for one more year. Further, the automatic two-year grace period from the expiry date of the extension granted by the WTO means that the conditions and incentives granted can remain for at least three more years. Projects that received investment promotion privileges from August 1, 2000 have not been subject to any export conditions and old projects without export requirements will also not be affected. Projects that may be potentially impacted are promoted projects prior to 2000, which had export conditions as part of their certificate of promotion, and which is normally in force for 10 years. For most of the projects, the time period of the export condition has already expired and so, they will not be impacted. Meanwhile, in the ensuing 2-3 years, the BOI is to consider how to resolve those remaining projects impacted by the WTO ruling, in order to minimize the impact. See BOI Announcement Number 232/45 (O.120), December 27, 2002. Under TRIMS, Thailand has requested an additional extension (which was earlier granted till 2000) of the local content requirement for dairy products. This request remains pending in the WTO.
term and long-term strategies.

- First of all, given the vulnerability associated with such a highly external demand-driven strategy, increased priority should be attached to the development of industries and sectors catering to domestic demand, including in agriculture (even though a large part of agriculture also consists of traded goods). It is also important that Thailand builds upon its comparative advantage and develops sustainable and environmental-friendly farming methods in the agricultural and fisheries sectors, which are crucial export earners for the country.  

- It is imperative that a framework or mechanism for monitoring industry-specific competitiveness sensitivity should be developed for constantly monitoring the leading industries and identifying those facing collapse. Required industry-specific safeguard measures should be implemented for such industries and sectors. Temporary barriers to imports for balance of payments and infant industry concerns are possible to be imposed to protect industries under siege. But, early identification and ability to negotiate the possible safeguard measures with the major trade partners are essential for their effective implementation under the WTO regime. Production upgradation assistance should simultaneously be put in place for industries that are facing loss of competitiveness, which will then also ensure that there is no sharp diversion of FDI and other credit away from them.

- Thailand should refrain from carrying out unilateral liberalization of trade and investment measures. In general, preferential tariff rates should be offered only to ASEAN members. Further, where the present levels of MFN tariff rates under the unilateral liberalization carried out by Thailand are lower than the Uruguay Round bound rates, Thailand could consider raising them, in order to give more time to its industries to catch-up. Post-crisis, Thailand did raise the tariff rates in the automobiles and textiles and clothing sectors. More such products/industries can

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16 Meanwhile, Thai domestic producers will face increasing competition, as Thailand has committed to reduce its import tariffs under its Uruguay Round agriculture obligations in the WTO. Duties on agricultural and processed food goods are currently as high as 55% and the average tariff rate is 29.32%. It is estimated that duties on many high-value fresh and processed food products will remain high (30-40%), even after the WTO reductions. Source: US Thailand Trade Summary 2000.

17 In order to enhance economic recovery and promote growth (basically through the commitment to export-led growth), the ASEAN leaders agreed to accelerate the realisation of the ASEAN Free Trade Area (AFTA). The six original signatories to the Agreement on CEPT (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) were to advance the implementation of AFTA by one year from 2003 to 2002. They also agreed to achieve a minimum of 90% of their total tariff lines with tariffs of 0-5% by 2000, which would account for 90% of intra-ASEAN trade. By 2002, 100% of items in the Inclusion List were to have tariffs of 0-5%, with some flexibility.

18 After a continuous process of tariff reduction from 1994 to 1996 where by tariff on clothing were reduced from 100% to 45%, and then to 10% for some products (in early 1997), tariffs were raised to 60% on fiscal grounds and to assist crisis-stricken industries. Similarly, tariffs on motor vehicles
be identified in which this flexibility can be used.

- While import-substitution subsidies and those linked to export targets are explicitly prohibited, subsidies openly permissible under the WTO for industrial promotion include those to promote R&D, regional development, and environmentalism. Subsidies for technology development could therefore be given both extensively and selectively, and should be based on a performance monitoring and reward mechanism.\(^{19}\) Performance requirements can be related to the percentage of technology personnel employed, the percentage of sales contributed by new products, etc. Further, exports can be promoted directly through 100 per cent export requirement provisions in export processing zones (EPZs) and indirectly through the establishment of science parks. Employment generation can also be an important criterion for investment promotion and industrial development, and can be used for various support programmes for SMEs across the primary, secondary and tertiary sectors. There is also a third set of subsidies that are permitted under the WTO and are "actionable", only if the complaining country shows that the subsidy has an adverse effect on its domestic industry.\(^{20}\) Thus, Thailand should consider the various options available under such provisions.

- At the regional level, products enjoying the Common Effective Preferential Tariff (CEPT) under the ASEAN Free Trade Area (AFTA, which now commits all goods, including unprocessed agricultural goods) need to have a CEPT Certificate of Origin to prove that the product has a minimum of 40% ASEAN content. This regional local content requirement could be increased were also raised from around 40% to 80%. Peak rates have also been applied to protect agri-food products. Thus, in fact, Thailand’s peak tariffs remain as high as 80%. Some tariff increases have corresponded with implementation of trade liberalization measures; for example, tariffs on completely knocked down (CKD) auto kits increased from 20 to 33 percent, when local content requirements were eliminated in the automotive industry in 1999. See WTO Trade Policy Review: Thailand December 1999 and US Thailand Trade Summary 2000.

\(^{19}\) Lall (1997), Amsden (2000), etc. point to the fact that whatever the instrument of promotion, to be successful it must be tied to a monitorable performance standard, and operate within a reciprocal control mechanism that disciplines all parties involved in industrial expansion. For example, in Taiwan’s Hsinchu Science Industrial Park and Taiwan State Industrial Park, etc., only firms that fit the target industry list are considered and they had to meet criteria related to operating objectives, product technology, marketing strategy, pollution prevention and management. Benefits included grants up to 50% of necessary funds from government programmes, tax exemptions, low interest loans as well as special educational facilities. See Amsden, Alice, 2000, p. 12 and Lall, Sanjaya, 1997.

\(^{20}\) In this category, the complaining country has to show that the subsidy has an adverse effect on its interests. Otherwise the subsidy is permitted. The agreement defines three types of damage they can cause. One country’s subsidies can hurt a domestic industry in an importing country. They can hurt rival exporters from another country when the two countries compete in third markets. And thirdly, domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country’s domestic market.
progressively to 60% and above, to ensure that there is a steady improvement in the value addition taking place from within the region. However, this can be pragmatically implemented only by simultaneously developing technological capabilities that would facilitate such increased local/regional value addition. Further, rather than applying such rules of origin (RO) requirements across-the-board, the ASEAN members should cooperate on basing the regional RO levels on the need and technological levels of specific industries. Further, given the fact that the ASEAN countries compete on several similar product lines, there is also a need to cooperate in identifying industries for production diversification.

It is imperative that Thailand continues to take active participation in the process of various negotiations related to both trade and investment, at the regional and international levels. When such negotiations take place, Thailand should evaluate and consider not only the immediate investment or trade effects, but also the second-stage and longer-term effects that arise from the direct impact (such as FDI locational decisions and subsequent trade effects). The above-mentioned competitiveness sensitivity monitoring mechanism can be utilised for this. Such evaluation should also be taken into account while selecting industries to be included in potential exclusion or sensitive lists of agreements. Further, Thailand should identify competitors in its export segments and closely monitor their industrial, trade and investment promotion policies not only to monitor trends in the flows of trade and investment, but also to be able to apply the provisions/countervailing measures available to protect the relevant industries.

It is thus necessary to improve the capability and increase the bargaining strength of the country to incorporate country interests into multilateral negotiations. The negotiations themselves may also be better addressed at the regional level. Most significantly, given the fact that ASEAN has become integrated into the global production networks in several industries, ASEAN should utilize this as leverage to retain or obtain specific industrial development measures in their own preferential agreements, rather than embark on a race to the bottom in terms of giving away preferential tax treatments to foreign investors. This can occur while Thailand (and others) put in place medium-term and long-term measures to improve national technological capability. ASEAN should also strongly put forward its views in the negotiations in TRIMs and GATS, which attempt to include investment under the umbrella of the multilateral framework of regulations. In fact, attempts to take away the scope of individual countries to differentiate between the various kinds of

21 Both NAFTA and EU have regional value addition criteria of 60% and above, wherever substantial transformation takes place. Further, there are certain specific process criteria applied for ensuring utilisation of regional manufacturing capabilities.
Chapter X

foreign investments and design appropriate policies should be resisted.

- With respect to the electronics industry (as well as other high-technology industries), in order to move beyond the role of an assembly-exporter in international production networks and to achieve deeper industrialisation, Thailand has to first of all, allocate it the (political) priority it warrants. As the Taiwanese and South Korean electronics industry successes amply demonstrate, it is also necessary to promote national champions in the Thai electronics industry, which can effectively cooperate with MNCs in production and technology development. Such champions have been typically developed through firm-level targeting in high-technology industries. Such national champions can then become effective agents for deeper linkage creation with indigenous supporting industry firms and help lead to wider and deeper technology transfer and diffusion in the economy. Given that the physical proximity of design to manufacturing is a key issue now, more so than in the past, because new product cycle times are reduced, this also gives Thailand opportunities to get more design technology transfer for at least the mid-end products. However, Thailand has to drastically improve the quality of its S&T technology human resource base to be able to take advantage of such trends in the electronics industry.

- Simultaneously, the technological capabilities of Thai small and medium enterprises (SMEs) in the electronics and related industries should be developed. Multinational electronics companies are forging new relationships with suppliers so that they can focus on the upstream part of the R&D process and delegate more responsibility to subcontractors and contract manufacturers on the downstream side. However, this requires the sub-contractors to be able to move beyond quality, cost and delivery (QCD) requirements towards having the abilities for building to shorter lead-time requirements, maintaining the firm’s brand identity, and developing new products in partnership with them. Therefore, government support programs to assist SMEs have to be made effective so that more Thai manufacturers are able to satisfy at least the quality, cost and delivery (QCD) requirements and then strengthen their production capabilities to the higher levels. Global sourcing adopted by assembly industries will lead to high competition for intermediate producers, not only from within the region, but also from other countries. Therefore, cost management and human resource development remain crucial to retaining competitiveness of indigenous producers. Further, quality systems such as ISO 9000, QS 9000, ISO 14000, etc. have become very important and indigenous firms have to be strongly

22 South Korea’s Samsung Electronics, which has grown from being an OEM producer to a highly competitive innovator of high-end electronic products, forming strategic alliances with US companies such as Sprint, Microsoft, Dell etc. is a relevant example.


24 Ibid.
supported to acquire such international standard accreditation.

With China attracting an ever-increasing number of foreign electronics firms, Thailand faces tough competition in continuing to attract increased FDI inflows into the electronics industry. The only way for Thailand to contain the flood of foreign direct investment into China is to accelerate the creation of an upstream electronics industry. Therefore, ongoing and future efforts to introduce the ‘cluster approach’ should take care of linkages between the end-producers and supporting industry firms, and be focused on developing core capabilities. Research and development into electronics parts, new materials, and auto parts can go a long way in complementing each other’s requirements towards higher value addition and product differentiation.  

Some of Thailand’s main exports such as agri-food and textiles and clothing still face quantitative restrictions, few of which have been eliminated. However, in textiles and clothing, importing countries that have quotas must eliminate them and liberalise the textile and clothing sector by 2004. This will provide opportunities for Thailand to increase its textile and garment exports. However, facing severe competition from low-end producers in Indonesia, China, and South Asia, Thai producers have to drastically improve their productivity and enter high-end products soon enough to benefit from the expanded export potential.

While acceleration of the efforts for upgrading the overall technological base of the electronics industry is of paramount importance, Thailand also needs to quickly implement a set of holistic programmes aimed at further developing its basic industries and heavy industries without limiting it to the existing steel and automobile industries. This should be complemented strongly with R&D into identified technically feasible fields in the materials (including metals, alloys, chemicals, among others), material processing, and fabrication and machining technology categories.

At the level of data requirement to support policymaking, it may be suggested that there is a need to undertake detailed studies of sectors and industries where FDI has become increasingly prominent. Such empirical studies and constant updating of them is a prerequisite not only for building up a database and providing a systematic foundation for the industrial competitiveness monitoring mechanism (which cannot be based on trade trends alone), but also to equip the country’s negotiating group during bilateral and multilateral negotiations. At a more macro level, it is also important for the BOI to undertake an exercise to synchronise its foreign investment

25 While electronics were expected to account for 20% of the value of a passenger car by 2000, new materials are being introduced in automobiles to reduce vehicle weight and enhance possibilities for product differentiation and flexible manufacturing.

26 Effective January 2000, Thailand eliminated tariffs on 153 IT-related products under its obligations under the WTO Information Technology Act (ITA), and tariff rates of another 37 IT products are also to be eliminated by 2005.
projects data with the ISIC two-digit level classification, while the Bank of Thailand's FDI data also needs to be further sub-divided.\footnote{For example, the machinery and transport equipment industries need to be bifurcated, while the 'other industries' category that includes a whole lot of labour-intensive export industries need to be clearly categorised into separate industries.}

- In the financial sector, local resource generation should be enhanced for making local capital available for indigenous entrepreneurs. In this direction, the domestic financial system, that is, capital market and banking sectors should be streamlined and regulated to direct investment into the required sectors so that financial sector growth may not get greatly divorced from the requirements of the real economy. The financial authorities should monitor the total allocation of credit into the leading sectors on a quarterly basis or so, in order to avoid excessive investment diversion away from productive sectors (into consumption, asset purchases or speculative activities), and also to avoid over investment in specific sectors during periods of boom that could lead to price crashes and financial instability. While the financial sector prudential norms that have been reformed to comply with BIS standards cannot involve sectoral credit allocation requirements, once overheated industries/segments are identified, the central bank should consider imposing caps on further investments into such sectors, to avoid any eventual crash. Such measures should be included in the financial sector regulatory framework's safeguard measures, by provisioning against the risk of financial crisis.\footnote{In the case of the modalities for the treatment of autonomous liberalisation in GATS, agreement remains to be reached regarding the scope of the modalities, particularly with reference to developing countries, (and the situation of recently acceded Members). See WTO, TN/S/4, 25 November 2002, Special Session of the Council for Trade in Services, Report by the Chairman to the Trade Negotiations Committee.}

- As was demonstrated so tragically in the nineties' Thailand, apart from the financial sector, the temptation of global finance (through easily and cheaply accessible funds) is very real for a manufacturing sector in pursuit of fast growth also. Therefore, regulations need to be in place to ensure financial restraint externally as well, so that there is no excessive build-up of external debt.\footnote{It has been pointed out that the provisions allowing offshore banking (International Banking Facilities) to operate as a conduit for domestic borrowing and the associated tax privileges have not been amended. See WTO Trade Policy Review: Thailand, December 1999. This may be reviewed.} This would mean the regulation of capital inflows not only in the form of external borrowing, but also of inflows of FDI, which too create foreign exchange liabilities.\footnote{Even if FDI is somewhat less volatile than other capital flows, there are implications of FDI for a host country's BoP given that an FDI project creates foreign exchange liabilities not only now, but also in the future. This characteristic leads to the danger that unfettered FDI (apart from the danger of creating FDI-dependent industries as we have seen in this study) may create a time profile of foreign exchange outflows (in the form of dividend payments or profit repatriation) and inflows (fresh FDI), which may be time inconsistent. The evidence from the Asian crisis countries regarding such incompatibility suggests that even in the short-run this could degenerate into a solvency crisis with serious adverse consequences for economic development. See Singh, Ajit, 2002, “Capital Account Liberalisation, Free Long-term Capital Flows, Financial Crises and...}
under the GATS, given that the timeframe for concluding negotiations on emergency safeguards under the GATS has been extended till 15 March 2004. Further, until emergency safeguards rules are agreed and in place, any GATS Member, in terms of Article X.2 of GATS, will be free to notify the Council and modify or withdraw a specific commitment already made, after a period of one year from the entry into force of the commitment.31 The emphasis should be on the logic that to be able to regulate the outflows of external liabilities, the inflows that create such liabilities would also need to be under some form of regulation. This can be achieved through the scope and application of investment definitions, which is still under negotiation at the WTO Working Group on Trade and Investment (WGTI).

In general, given the ambiguities surrounding existing commitments and the ongoing negotiations, and given the binding nature of all such commitments, without adequate assessment of the impact of existing liberalisation on the Thai financial services and other service sectors, it might be better for Thailand not to make more commitments under the GATS.32 This is because, it is not be possible to envisage all the future implications of a specific commitment, and once commitments are made, the country loses the flexibility to develop appropriate mechanisms to deal with any adverse impact on the domestic sectors. Further, it is always true that Thailand can go in for liberalising a sector if it deems appropriate,

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31 In fact, based on this, as Raghavan (2002) has argued, Thailand (and developing countries) could seriously assess the possibility, in terms of Article XXI of GATS, of modifying or withdrawing some of the commitments already made. Since they received no benefits in the services sector in terms of reciprocal market access (in traditional goods sectors), the threat of 'withdrawal' of equivalent concessions by Members affected by any such modification will not necessarily harm them. See Raghavan, Chakravarthi, 2002, “GATS Council Extends Time for Safeguards Agreement”, in Third World Network, 1-15 March 2002.

32 Thailand's present commitments under the GATS include commitments in financial services, transport, telecommunications, tourism, professional business services, etc. However, the national schedule of commitments contains some restrictions on market access and national treatment. For example, there is prohibition on direct branching in all financial sectors. In banking and other financial services (other than insurance), there is limitation to 49% for foreign portfolio investment in domestic companies; limits on new access to domestic market for foreign banks with existing offshore licences; limitation of foreign banks to three full branches, with only one inside Bangkok; limitation of off-site ATMs by defining as a branch; requirement applied to foreign banks lending domestically to pay withholding tax on funds brought in from outside the country; limits on the number of foreign banks entering offshore banking market; stricter capital requirements for foreign firms than for domestic firms; foreign banks' branches are not allowed to use parent firm's capital to meet prudential requirements; limitations on the number of foreign personnel; etc. In the insurance sector too, there are similar kind of measures. In many service sectors and for many of the modes, Thailand has not made commitments and these remain open for negotiations from WTO Members. There are other areas where Thailand has made commitments, but with several direct and indirect restrictions. There is tremendous pressure from countries like the EU for removing restrictions listed in the national schedule and for making binding commitments. Based on EU, 2000, GATS 2000: Request from the EC and its Member States to Thailand. (European Commission)
without making binding commitments under the GATS. Therefore, whatever flexibility the present national schedule of commitments allow Thailand (where many areas remain unbound), should be retained and reviewed periodically. Extreme caution should be taken while renegotiating (removing) existing restrictions, especially those such as the one which restricts foreign banks’ branches from using parent firm’s capital to meet prudential requirements, etc.

Meanwhile, the ASEAN Framework Agreement on Services (AFAS), which is aimed at expanding the scope of liberalisation in intra-regional trade in services beyond those already undertaken under the GATS, has completed two rounds of negotiations. The third round is to be completed in 2004. It has been pointed out that in the financial services sector, Thailand’s commitments are GATS-plus only in the sense that limits on foreign equity shareholding of up to 49% of paid-up capital under the GATS has been raised up to 100% in the AFAS in the areas of securities brokerage, securities dealing, and underwriting services, as well as in collective investment schemes involving asset management companies. It is not clear if there are any provisions to ensure that financial service firms of non-ASEAN origin with branches in ASEAN member countries are included in the definition of regional firms. If they are not excluded by definition, non-ASEAN firms also will be able to enjoy free market access and control through the AFAS. Such provisions should be clarified. Further, it is important that Thailand should opt for prudential restrictions wherever possible. Also, Thailand should ensure that it retains the right to accord favourable treatment to those service providers of member countries that accord similar treatment to Thai financial service suppliers in their country.

It is also glaringly clear that in the increasingly interlinked global economy, individual countries, (especially externally dependent economies) are highly vulnerable to rapid shifts in market sentiments. Therefore, given the fact that the sudden heightened foreign penetration of Thailand which came about due to the crisis, in turn, leads to even more increased vulnerability for the economy in the future, it is imperative for Thailand to recognise the early warning signals portending a crisis of confidence in the economy. A gradualist approach to financial

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33 The AFAS was signed in December 1995, aimed at enhancing cooperation in the service sector among ASEAN member countries, by eliminating intra-regional trade restrictions. AFAS commitments are meant to be “GATS-plus”. As with GATS, the AFAS requires countries to list their horizontal (all-sector) and sector-specific national treatment and market access commitments in a schedule that specifies the conditions of entry and treatment of foreign service providers in these sectors. Although the commitments are considered to be binding once they are listed, the specific commitments may be modified in certain cases. See Ramkishen and Rahul Sen, 2002, Liberalisation of Financial Services in Southeast Asia Under the AFAS”.

34 However, Thailand has not made any commitments in the banking and insurance service sectors. See Rajan and Sen, 2002.

35 For instance, in spite of being the financial services hub of the region, Singapore has made very few commitments for financial liberalisation under the AFAS. It also has limitations on national treatment. For example, each offshore bank cannot lend more than S$ 300 million (S$ 200 million under the GATS) in aggregate to residents. Further, its related merchant banks should not be used to circumvent this limit. Ibid.
liberalisation and a controlled capital account are clearly the optimal choices for countries that still have not opened up their capital accounts completely. As mentioned above, there should be appropriate prudential restrictions on both capital inflows and outflows. But, for those which have already carried out full capital account liberalization, given that there is no escape from the speculative movements of international capital flows in the absence of a restructuring of international financial system, imposing temporary capital controls may be the only way to mitigate the degree of damage inflicted on the host country in wake of any such capital flight. There is every incentive to go for such measures, if the experiences of Thailand and other crisis-hit countries have any lesson to offer.\textsuperscript{36} In this context, it may be suggested that the ASEAN Investment Area (AIA) could agree on bringing in capital inflows other than FDI into its agenda and put in place certain common or similar policy requirements—say, tighter reserve requirements imposed on foreign credit and foreign institutional investments in the case of short-term capital flows.

\begin{itemize}
\item Overall, the essence of the survival strategy for developing economies may only be conditional or controlled linking with the global economy. In other words, globalisation has to be state-directed as opposed to one that is corporate-led. Only then will the political leadership have the ability to make the necessary trade-offs between national interest and market demands. While some painful lessons have been learned in the aftermath of the crisis, it will be necessary to keep policy discussions on capital account liberalisation and other options alive in the public domain so that past mistakes are not forgotten when better times arrive. The civil society in Thailand will have a large role to play in this sphere.
\end{itemize}

In conclusion, it may be said that while Thailand has taken some important steps and measures to promote the technological and entrepreneurial development of indigenous enterprises across various sectors, it is important to keep reviewing their performance to ensure that the target groups achieve their objectives. Further, the policy opinion on national capability development must obtain and retain political will; only then will the country be able to move on with the planned industrial development programmes in any effective manner. Therefore, government’s ability to enlist the cooperation of the various players in the economy remains a prerequisite to ensure the required coordinated response. Ultimately, the nature and outcome of actual policies will crucially depend on how the government is able to balance external pressures for liberalisation against the demands of the internal support groups in the political and economic arenas. Further, since many of these measures may come under renewed negotiation under the WTO, it will be imperative for Thailand to make sure that it retains the leverage for adopting some of the crucial protective measures to protect its national interests.

\textsuperscript{36} Thailand lost about 12\% in terms of real GDP growth during 1997-98.