The Impact of Culture and Regime Change on Foreign Direct Investment in Thailand

Nicole Labell

Follow this and additional works at: https://chicagounbound.uchicago.edu/international_immersion_program_papers

Recommended Citation
https://chicagounbound.uchicago.edu/international_immersion_program_papers/86

This Working Paper is brought to you for free and open access by the Student Papers at Chicago Unbound. It has been accepted for inclusion in International Immersion Program Papers by an authorized administrator of Chicago Unbound. For more information, please contact unbound@law.uchicago.edu.
The Impact of Culture and Regime Change on Foreign Direct Investment in Thailand

Nicole LaBell
Thailand International Immersion Program 2018
24 June 2018
Foreign direct investment has been an important part of Thailand’s economy for years. However, its foreign direct investment policies have varied greatly with each regime change in the country. Even with the variation in foreign direct investment policy, Thailand’s policy has remained largely protectionist and restrictive of foreign-owned companies. Recently, with the 2014 coup, this has begun to change. At its core, Thailand’s foreign direct investment policy is a reflection of the country’s conservative and preservative culture. As the culture of each regime varies, so too has its foreign direct investment policy.

Before understanding the impact of Thai culture on foreign direct investment, it is important to understand the overall foreign investment landscape. Roughly half of foreign direct investment policy targeted manufacturing until recently. Motor vehicle manufacturing accounts for 8.2% of foreign direct investment and office goods and computer manufacturing account for 8% (Wacker, Grosskurth, and Lakemann 2016). Thailand’s foreign direct investment complexity has grown from 1989 to 2014. The top 10 exports now account for 45.6% of total foreign direct investment versus 64.7% in 1989. Japan accounts for 43% of foreign direct investment in Thailand (Hartley 2017).

It is also important to understand the legislation surrounding foreign direct investment. The first major category of legislation involves property investment rules. The Foreign Business Act was passed in 1999 and governs what kinds of industries foreign companies can participate in. It divides businesses into three lists with different restrictions corresponding to each list. List one covers the media, agriculture, and religious industries, including: newspaper or radio broadcasting stations, TV station businesses, farming, fishing, medicinal herbs, and the making or casting of Buddha images. Non-nationals cannot engage in any of these businesses. These areas are governed by the strictest restrictions (‘‘Thailand Country Commercial Guide’’).
List two and three industries have fewer restrictions under the Foreign Business Act. List two includes: national safety or security related businesses, arts and culture, tradition, and natural resources. Companies owned by a foreign-majority can engage in these activities if Thai nationals hold at least 40% of the total shares of the company. The number of Thai directors must constitute at least two-fifths of the board of directors. With approval by the Cabinet and the Minister of Commerce, the percentage of shares that must be owned by foreign nationals can also be lowered. If a country has a treaty with Thailand that touches on these industries, these restrictions may not apply. List three activities include activities where there are economic protections for Thai nationals. This list covers: accounting, legal careers, architecture, retail, advertising, tourism, selling food or beverages, and service businesses. The restrictions on these businesses are the most relaxed as foreign-owned companies can participate in them if they receive permission from the Director-General of the Department of Business Development and receive a Foreign Business License. Foreign companies can also participate in these activities if their home country is party to a treaty with Thailand that allows them to do so (“Thailand Country Commercial Guide”).

The new regime has somewhat relaxed these lists. In February of 2016, four categories were removed from list three. The restrictions on commercial banking, bank representative offices, life insurance and property and casualty insurance were lifted. However, each area is subject to the specific laws of the Bank of Thailand and the Office of Insurance Commission. This was done to try to reduce redundant laws and promote foreign business (“Thailand Country Commercial Guide”). Recently, on March 19, 2018, the Board of Investment, which has authority over the Foreign Business Act, announced plans to relax the lists of banned industries in an effort to encourage more investment in Thailand (Janssen 2018).
United States citizens receive special rights under the Treaty of Amity. American companies are permitted to maintain a majority shareholding or to wholly own a company in Thailand. They receive national treatment, so firms can engage in business with them on the same basis as Thai companies. American companies are not wholly exempt from these restrictions. American companies still cannot own land and the special rules do not apply to activities in certain industries, including: transportation, communication, fiduciary functions, banking with a depository, domestic trade in indigenous agricultural products, and work with natural resources. To utilize these special exemptions, companies must apply through the US Commercial Service. The US Commercial Service then issues a certification letter that the applicant meets the requirements under the Treaty of Amity and then the Ministry of Commerce must approve the application (“Investment Climate Statements for 2017”).

Another key component of property restrictions is the Board of Investment. The Board of Investment was created in 1977 and has broad power to encourage investment with various incentives. The incentives can be tax based or non-tax based. The tax-based incentives usually involve an exemption of import, corporate or dividend tax. Non-based tax exemptions include state guarantees, business protection, currency advantages, or higher foreign ownership allowance. In recent years, the Board of Investment has given more incentives to technology-based companies and socially-beneficial companies. This is part of Thailand’s effort to move away from more manufacturing based foreign investment (“Making Foreign Investment in Thailand”).

To begin a business in Thailand, companies need to register with the Department of Business Development at the Ministry of Commerce, which can take three to six months (“Making Foreign Investment in Thailand”). This can be incredibly difficult for foreign
companies as the website for online business registration often crashes and the forms are in Thai. This requires most foreign companies to hire a local law firm to aid with the paperwork. Additionally, if a company would like to produce something in Thailand, it needs to register with the Ministries of Industry and Labor and Social Welfare. It is important to note that most manufacturing companies are not subject to the same foreign ownership restrictions as those activities barred by the Foreign Business Act. Even though registering a business can be difficult, in 2016 Thailand was ranked eighteen out of one hundred ninety countries for ease of registering a business. On average it takes twenty-five days to register and involves five separate procedures (“Thailand Country Commercial Guide”). Foreign corporations must also examine legal penalties for corporate crimes before registering because most of Thai business regulations are governed by criminal, not civil law. Foreigners are rarely jailed, but violations of business regulations can carry heavy criminal penalties (“Investment Climate Statements for 2017”).

The various restrictions on foreign direct investment have influenced the business structure of foreign companies in Thailand. The most common form of business structure is a Private Limited Company because there are no restrictions on the nationality of the board. Restrictions still apply to the nationality of shareholders (“Making Foreign Investments in Thailand”). Public Limited Companies must have at least six directors, half of whom must be Thai, which makes this structure less popular amongst foreign companies. (“Thailand Country Commercial Guide”). Joint ventures, where a group of people enter into an agreement to do business together, are also very popular between foreign nationals and Thai nationals because foreign nationals can utilize Thai nationals’ knowledge of Thailand to create a more successful business. Branch, partnership, and representative structures are also possible, but are not as common (“Making Foreign Investments in Thailand”).
Another important piece of foreign direct investment is the court system of Thailand. As previously mentioned, most business regulations carry criminal penalties. While this might discourage some investment, in general, Thai courts are viewed as impartial. This can be encouraging for investors. Even so, arbitration is heavily favored because it is more flexible. Arbitration results must still be approved by Thai courts but generally give the parties to a dispute more control over the outcome. Arbitration tribunals also usually have experience in the industry, which aids in resolution of disputes. The process tends to be more streamlined and the proceedings are confidential, which is a benefit to businesses (Periera, Beckstead, and Supakijjanusorn 2016). If there is a monetary judgment, it is calculated at the market exchange rate. Additionally, because Thailand is a civil law country, its codes are used to resolve most disputes (“2015 Investment Climate Statement – Thailand”).

Before examining Thailand’s more recent policies regarding foreign direct investment, it is helpful to understand the general process for establishing a company in Thailand. First, a corporate name must be reserved. The name cannot be similar or identical to the names of other companies. The name must be approved within 30 days or it is invalid. After a name is reserved, a memorandum of association that includes the name of the company, future location, objectives, capital and names of promoters must be filed. Then a statutory meeting is convened to define the structure of the company and approve the articles of incorporation and bylaws. Within three months of this meeting, the directors must submit an application to establish the company with the required fees. The last step is tax registration. Each company must receive a tax identification card and number from the Revenue Department within 60 days of incorporation or the start of operations. Once these five steps have been followed, the business can begin operating (“Thailand Country Commercial Guide”).
Beyond legislation surrounding property, Thailand’s military regime has played an important role in regulating foreign direct investment. Prior to the military coup of 2014, Thailand’s GDP growth reached 7.3%. In 2014, this decreased to 0.9%. The military coup has been hard on Thailand’s economy; however, the unemployment rate has remained constant at 0.8%. China, the United States, the European Union, and Japan have remained major players in Thailand’s foreign direct investment. Even so, there has been a noticeable trend towards investment in Thailand’s neighboring countries like Cambodia, Laos, Myanmar, and Vietnam ("Thailand Trade policy Review"). This may be due to the political uncertainty in the region since the 2014 coup.

After the first year of instability, 2016 seemed poised to improve Thailand’s economy; however, the death of the King had a large impact on the economy. In response to the death of the king, there was more political instability as Thailand entered a year of mourning. Even so, Thailand’s critical location between China and India and Board of Investment incentives aided foreign direct investment. Thailand remained increasingly reliant on exports in 2016 as net exports reached a record high. Electronics were its main export at 14.6%, followed by automotive goods. Foreign direct investment applications also exceeded the Board of Investment’s 2016 targets. Nine-hundred fifty-two projects were approved and 64% of these projects were 100% foreign-owned projects. The remainder were primarily franchising agreements as well as mergers and acquisitions. Japan continued to be the leading country of origin of foreign direct investment into Thailand with two-hundred eighty-four projects. The main driver for Japanese foreign direct investment is the automotive industry. Japan manufactures and assembles automobiles in Thailand (Handley 2017).
Tourism was heavily impacted by the death of the king. In 2016, 32.6 million tourists visited Thailand, however, the wave of tourists slowed down as Thailand entered a mandatory year of mourning. This is critical because tourism related industries are prime targets for potential investors (Handley 2017). Even with the king’s death, Thailand jumped from forty-six to twenty-six on the World Bank Group’s 2016 ease of doing business index (Janssen 2018). This jump was the largest leap in the index’s history. This came as a surprise because in 2016 the regime attracted just $1.5 billion in foreign direct investment which is well below levels received by rival countries. By comparison, Vietnam attracted $12.5 billion and the Philippines attracted $7.9 billion in foreign direct investment. Thailand’s variable foreign direct investment may also have been impacted by the 2011 flood that required heavy reinvestment by foreign companies in 2012 and 2013 due to the destruction. This may have inflated Thailand’s previous foreign direct investment numbers (Janssen 2017).

Total investment between January and November 2016 decreased by 78% and investments from Japan dropped by 81%. This may be due in part to more competition from Thailand’s neighbors and their relative stability in comparison with Thailand. While there are varying views as to why foreign direct investment took a downturn in 2016, many analysts suggest that years of political instability with two coups occurring in a decade created the downturn. This decade is referred to as the “lost decade”. (“Foreign Investment Plummets 78% in Junta-ruled Thailand”).

In response to the variability of the success of foreign investment in Thailand, the military regime has attempted to create several programs to stimulate foreign direct investment. The first program the military regime announced after the coup, was the creation of ten Special Economic Zones along Thailand’s borders to boost its exports to neighbors. Companies
operating in these zones would receive special tax incentives. This program did little to stimulate foreign investment in Thailand for several reasons. First, Thailand’s borders are very volatile and lack infrastructure. Without better infrastructure, it is difficult for companies to invest in an area. The economic zones did not come with plans to develop infrastructure in these areas, which also made the plan infeasible. Second, Thailand’s aging population and shrinking working-age labor force makes it difficult for foreign companies to have enough of a workforce to justify starting a business in Thailand. This coupled with mounting international pressure to stop exploiting migrant workers has made hiring laborers expensive, which lowers the attractiveness of Thailand for foreign investors in comparison to neighboring countries (Janssen 2017).

The regime’s second attempt at encouraging foreign direct investment was a program called Thailand 4.0. This model focused on local economic development, agricultural reform, physical infrastructure, and the digital economy (Handley 2017). This program was meant to promote ten high-technology cluster industries by incentivizing these industries to invest in Thailand through tax breaks. The ten industries include: next generation automotive, smart electronics, environmental technology, farm technology, futuristic food, robotics, aviation and logistics, biopharmaceuticals and chemicals, and digital and integrated healthcare. It was meant to take Thailand from a low-technology labor-focused economy to a more value-added innovation-focused economy. This plan once again failed because it was very abstract and there was no clear plan to help investors locate tech-savvy manpower. As Thailand has been a country largely based on the automotive industry when it comes to foreign investment, it was unclear to investors where the technology-savvy workforce would come from (Janssen 2017). Based on the level of technology involved in the foreign business, the Board of investment would provide incentives such as an eight-year corporate income tax exemption and double the tax deductions
for the costs of transport, electricity, and water (Handley 2017). Unfortunately, this plan did not drive much foreign investment.

Most recently, the military junta has created a plan for foreign investment based on the Eastern Economic Corridor. This plan targets the same high-tech cluster industries as Thailand 4.0; however, it focuses on one economic zone located on the Eastern Seaboard. This plan includes elements of the Special Economic Zone and Thailand 4.0 plans. The Eastern Seaboard is already home to most of Thailand’s electronics manufacturing, which makes it the ideal area to target for foreign direct investment. Infrastructure in this area is also well-developed as it has ports, highways, railways, water, power and an airport nearby. This should make the area more attractive to foreign investors as well as lower the cost of further updating the infrastructure to attract more investment. Thailand plans to spend $54.7 billion to further update the area’s infrastructure, including the airport, which it hopes will help stimulate tourism. Companies have already begun to receive tax incentives under this plan. Bridgestone received incentives to invest $187.4 million in Thailand to produce aircraft tires. The Board of Investments offers corporate tax waivers for up to thirteen years and a personal income tax of 17% for foreign experts in pioneer projects in conjunction with the Eastern Economic Corridor plan. It is estimated that in 2016, Thailand lost $6.5 billion in taxes to foreign investors which has created some negativity surrounding foreign direct investment (Janssen 2017).

In conjunction with the Eastern Economic Corridor plan, the Business Development Department announced plans to amend the Foreign Business Act. The Foreign Business act allows companies to take on Thai nationals as nominees to meet the Thai national ownership requirements. Nominees often individually have nominal shares and their contractual provisions lack managerial, operational, or legal control. Companies use this to avoid the provisions against
foreign-ownership. Local and foreign law firms help facilitate this work-around the Foreign Business Act through nominees. The Business Development Department hopes to amend the law to make this more difficult to do. Currently the Foreign Business Act allows different classes of shares with different voting rights and the amendment would require majority voting rights for all shareholders. If actually enforced, this could collapse foreign direct investment in Thailand because few companies could comply. For this reason, the Commerce Ministry backed away from this plan in 2015. It remains to be seen if the Business Development Department will follow through with it this time. The amendment seems to be at odds with the Eastern Economic Corridor plan (Janssen 2018).

Thailand’s culture has also been a key part of its foreign direct investment policy. Thailand is a largely Buddhist country. Theravada is the main form of Buddhism practiced and most men become monks at one point in their lives even if for a short period. There is a two-tier religious system with monks in the top tier and laypeople in the bottom tier. Monks are revered as a noble class and are governed by their own laws (Liusuwan 2016). However, this has begun to change as fewer and fewer Thais are choosing to remain monks as Thailand’s economy rises (Fuller 2012). While in Thailand, we observed many Buddhist relics and temples. The importance of Buddhism to Thailand’s culture can be seen in the thousands of temples that cover the region. The most revered temple sits on the grounds of the royal palace. The temples we visited were architectural masterpieces and made Thailand visually-distinctive from other countries. The prominence of temples illustrates just how important Buddhism is to Thai culture. Most of the buildings in Thailand emulate the ornate and decorative style of the temples. It is difficult to walk more than a few blocks without seeing another temple, which makes it easy for Thai people to worship at the temple.
Buddhism has influenced business culture by creating a culture of respect and placing the focus of business on relationships. It is common to have several meetings with a business counterpart before actually negotiating anything or doing business to establish a relationship. Relationships are at the center of business culture because relationships determine the nature of communication. Thai communication tends to be more indirect and candor is viewed as embarrassing. Upward communication is more formal and indirect, while communication with subordinates can be more direct. Similarly, emotional displays are to be avoided and smiling is viewed as embarrassing. Business communication should be emotionless and very formal. Dress should also be formal. Tidy dress makes you honorable and casual dress indicates a lack of self-respect (“Traditional Thai Worldview”).

This culture is very different from western culture, where smiling is a sign of appreciation or agreement and no prior relationship is needed before doing business. There are some similarities in that more formal dress is required in professional sectors. However, there are a lot of industries where dressing casual is not viewed as any worse than wearing a suit. Communication in the United States tends to be more direct regardless of relationships. These vast differences in business culture encourages foreign investors to work with Thai nationals, as they are more aware of Thailand’s culture and can be a valuable resource for foreign investors. This may explain why joint ventures are popular, as part of a successful business requires successful cultural integration (“Traditional Thai Worldview”).

On our trip to Thailand, we experienced this culture firsthand. Most individuals we met with were dressed in suits or other business clothes. Answers to our questions tended to be less direct than we were used to in the United States. During each meeting, we were offered food and drinks before, which I now understand may have been to help establish a relationship between us
and the individual we were meeting. This is not as common in Western culture and matches up with the Buddhist culture of hospitality. It was helpful to see the business culture in action, while in Thailand.

The king is also a critical part of Thai culture. Following the king’s death, Thailand entered a one-year period of mourning where the king’s remains were housed at the palace for Thai people to visit (Neuman 2017). The previous king was loved and respected. Over twelve million Thais paid their respects to him (Talamantes 2017). Immediately after his death, the cabinet held a government holiday for mourning, however, the Stock Exchange and other financial institutions operated as normal. Thailand has witnessed nineteen coups since 1932 and the king was the one constant. He was the longest-reigning monarch and Thais worry about a future without him. The Prince is less well-liked; however, there will not be criticism of him due to the strict lese majeste laws. The king was so well-regarded that the government set up a phone line to help people cope with grief. In every house there is a portrait of the king, and while we were in Thailand we noted that many of the portraits had not changed over to that of the Prince even though this was supposed to have taken place. These portraits illustrate the importance of Thailand’s king (“Thailand: One-year Period of Mourning Declared”).

The year of mourning also impacted tourism. It led to quieter weekends and less business. There was a thirty-day ban on entertainment after the death of the king which shuttered bars and most nightlife. Beyond the procedure, Thai people were grieving which hurt an already down economy. SF Cinema saw customer numbers drop by 40%. Citizens had to dress in black for thirty days as well. At first the lantern festival in Chiang Mai, a major tourist attraction, was canceled but then reinstated (Ono 2016).
The death of the king also illustrates how instability greatly impacts foreign investment. Thailand has had twenty constitutions and several coups. When the military junta came to power in 2014, it promised elections and a new constitution. A new constitution was passed; however, elections have been continually delayed, which has scared off foreign investors. After being pushed back several times, elections are scheduled for February 2019. With the uncertainty surrounding the elections, investors have been hesitant to invest in case there is another regime change. Elections have caused uprisings and de-stabilization in the past (Yuvejwattana 2018). This coupled with the death of the king, who was the one constant throughout, has made investors sheepish about getting involved in the Eastern Economic Corridor. It also does not help that the regime has created three distinct policies regarding foreign investment and has only recently settled on the Eastern Economic Corridor. This instability discourages investment because investors like to know that the rules will not change.

The regime’s mixed signals regarding foreign direct investment have also discouraged investment. While increasing the number of industries that wholly-owned foreign companies can participate in encourages investment, changing the nominee system would make foreign direct investment very difficult. These conflicting amendments to the Foreign Business Act indicate two different attitudes towards foreign direct investment, which cannot be reconciled by investors. This coupled with the political instability in the region and lack of a clear vision for spurring foreign direct investment has discouraged investors from partaking in the Eastern Economic Corridor plan.

Les majeste also seems to discourage investment. While in Thailand, we spoke with the Solidarity Center, which explained that in Thailand, it is illegal to speak ill of the king, which can lead to criminal fines. This may explain why media is a list one business. The media in
Thailand is largely pro-regime and pro-monarchy and foreign companies may not show the same respect towards the king as Thai companies, which are aware of lese majeste law. Investors may also fear inadvertently breaking a law like lese majeste because in the West it is commonplace to criticize the government. These stark differences in cultural norms can impact foreign investment because it almost requires having a Thai national on the board of your company. This may be some of the motivation behind the strict laws regulating foreign investment.

A business will be more successful if it is aware of Thailand’s culture and that requires working closely with Thai nationals. If a foreign business had remained open during the year of mourning, that would have reflected poorly. Thai citizens may be less enticed to frequent that business and the government may have even taken legal action against the business. Perhaps instead of being protectionist, Thailand’s foreign direct investment policy is a reflection that various countries have different cultures and in a country like Thailand, where political change is frequent, having a close relationship with Thai nationals can be profitable for all. Thai nationals are more likely to be familiar with Thailand’s culture and rules for operating a business and this knowledge is valuable for foreign citizens. Encouraging foreign companies to work with Thai citizens in this way, makes all better off. Thailand receives the foreign direct investment it needs, and foreign companies receive the guidance they need to operate in Thailand. In this way, Thailand’s culture impacts foreign direct investment.

Regime change also influences foreign direct investment policy. Some of the changes the military junta has made, like the Eastern Economic Corridor, may be more of a reflection of a need for legitimacy than true policy goals. While it is clear that Thailand would like to attract more foreign direct investment, the continuing changes in the regime’s policy towards foreign direct investment indicate attempts to create legitimacy and respond to concerns. After the first
two plans (Special Economic Zones and Thailand 4.0) struggled to gain traction because of the lack of infrastructure, the Eastern Economic Corridor program addressed these concerns with more infrastructure. Attracting more foreign investment and improving the economy would also give the military regime more legitimacy since it has not held an election. Citizens tend to rate regimes more favorably when the economy is doing well. In this way, foreign direct investment is directly tied to Thailand’s political state.

In conclusion, Thailand has a long history of being open to, yet restrictive of, foreign direct investment. These policies regarding foreign direct investment, which require foreign companies to work with Thai nationals, seem to be a reflection of the cultural differences between Thailand and it largely western trading partners. Encouraging Thai citizens and foreign companies to work together makes everyone better off. In a country that has had several regime changes in recent years, it also provides some familiarity with each regime change and stability in that foreign companies can rely on Thai nationals to guide them through regime changes. If Thailand cannot achieve more political stability, this forced marriage between foreign companies and Thai nationals may continue to be the solution to its foreign direct investment problems. Going forward, the military junta may roll back some of these restrictions on foreign companies, which could usher in a new era for foreign direct investment in Thailand.
Works Cited


