

International Trade and FDI

Bhanupong
Lecture 18

*“The propensity to truck, barter and exchange one thing for another is common to all men and to be found in no other race of animal” **Adam Smith.***

Course Syllabus

Lecture 18

How important is the export sector as an engine of growth? What are the factors contributing to the high degree of trade exposure?

The globalization process in Thailand has been ongoing for the last three decades.

The relationship between trade and economic growth is well established.

FDI and its impact on network trade are examined.

Trade structure is shaped by the role of FDI in various industrial sectors.

The impact of the GFC on Thailand's exports.

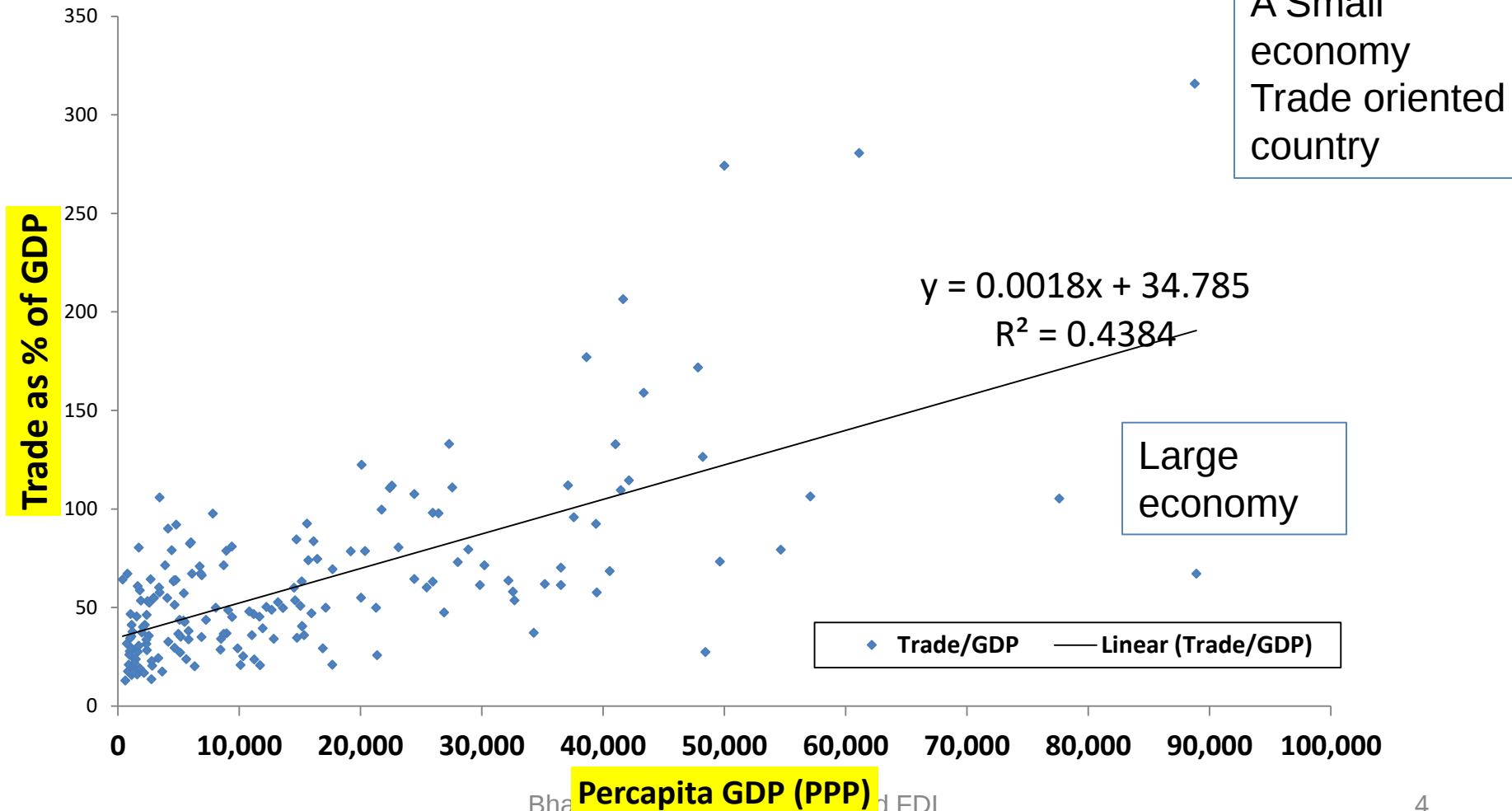
The impact of the US-China trade war in 2018/2019

Main Themes

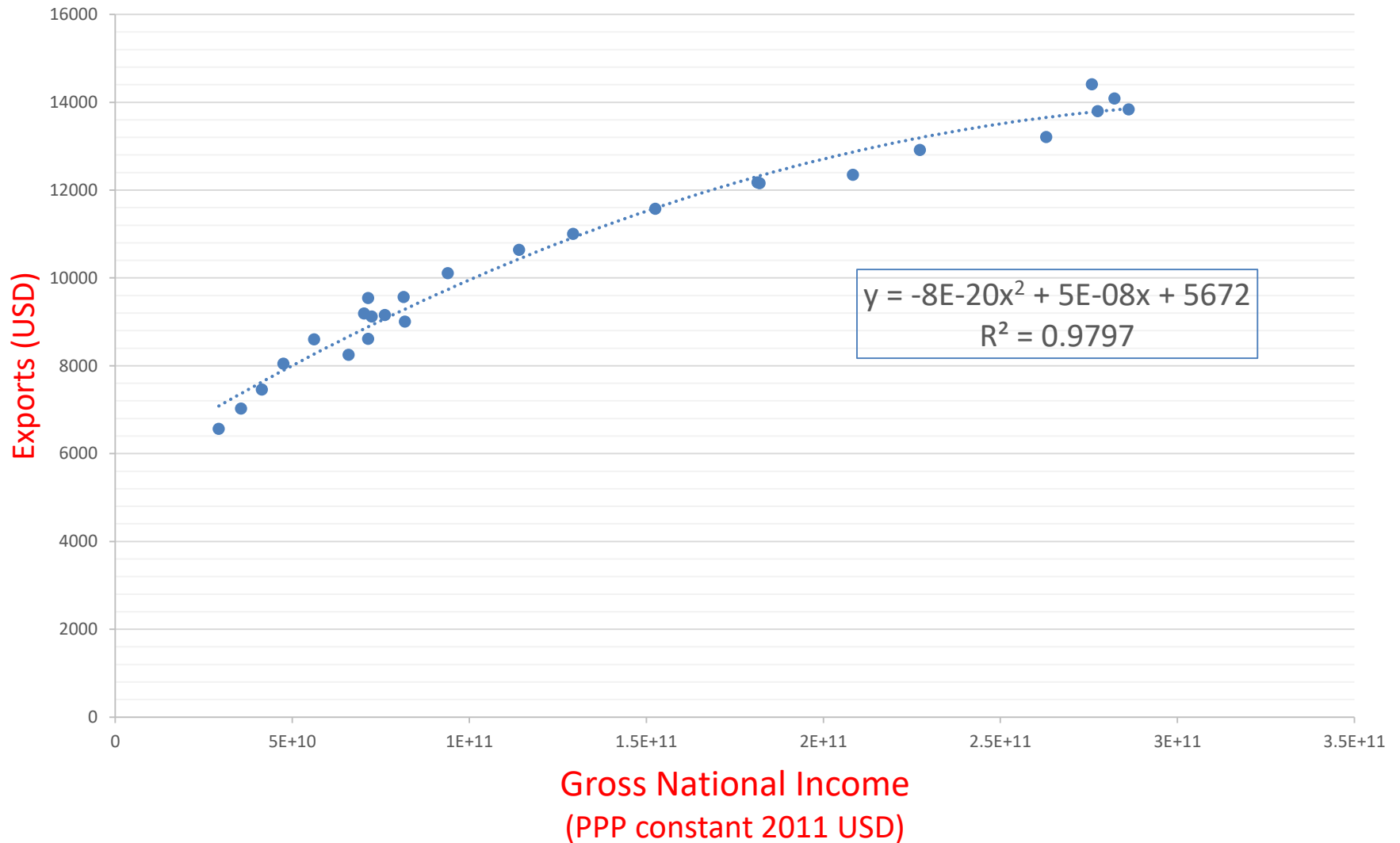
1. Trade and economic development
2. Growing volume of network trade
3. FDI and manufactured exports
4. Dwindling FDI and export capability
5. Trade measures: ADD, CVD, and SG

1. Trade and Economic Development

Trade and Economic Development: Cross-Section Data



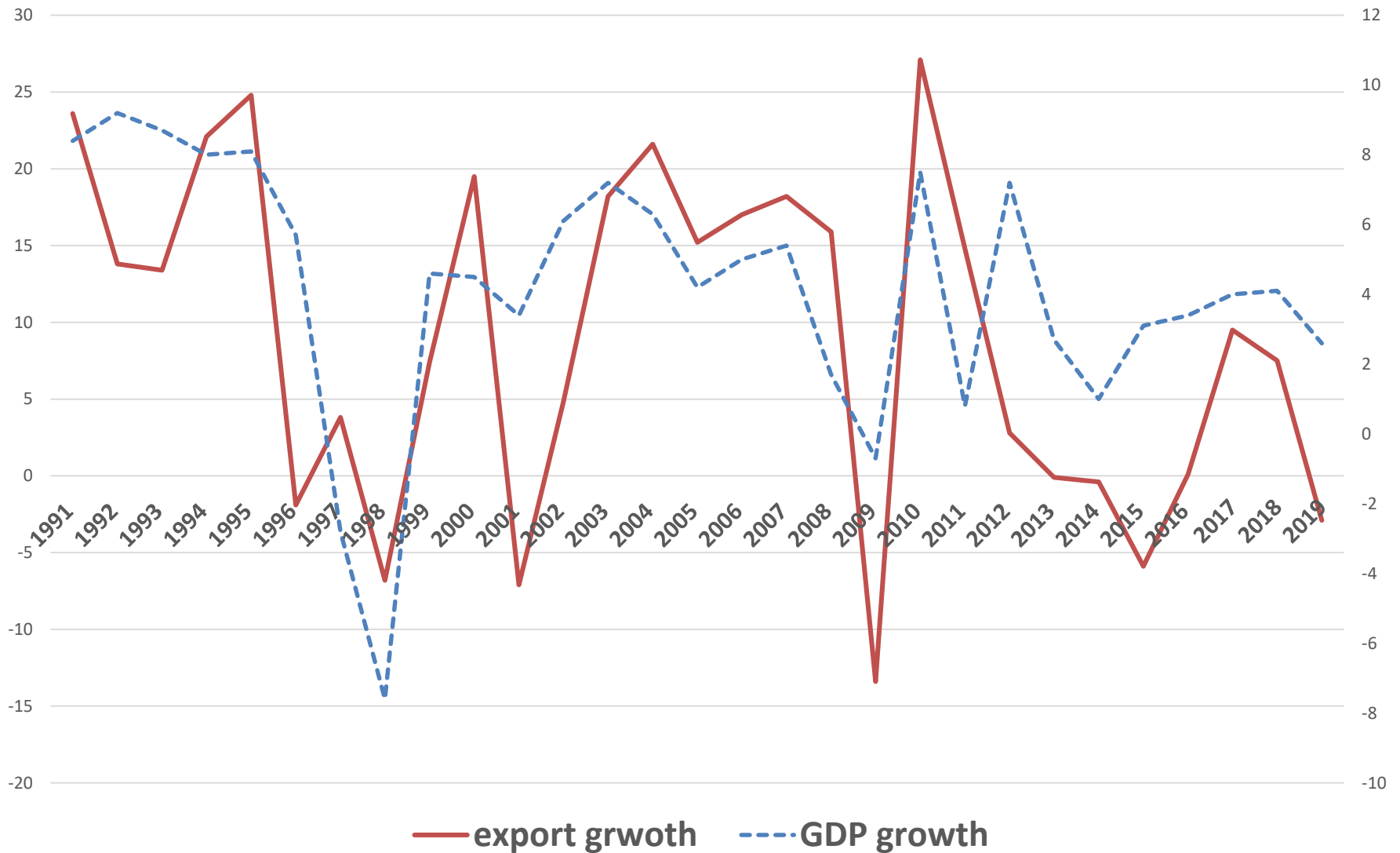
Thailand's Exports: Handmaiden of Growth (1990-2015)



Three views on international trade and economic growth

1. Trade **hampers** growth for natural resource-abundant countries that specialize in the export of technologically stagnant **primary products**;
2. Trade acts as the '**handmaiden**' of growth by improving the **quality of investment** and slowing the tendency of its return to fall.
3. Trade acts as the **engine of growth** by providing a conduit for ***technology transfer***.

Thailand's exports and economic growth

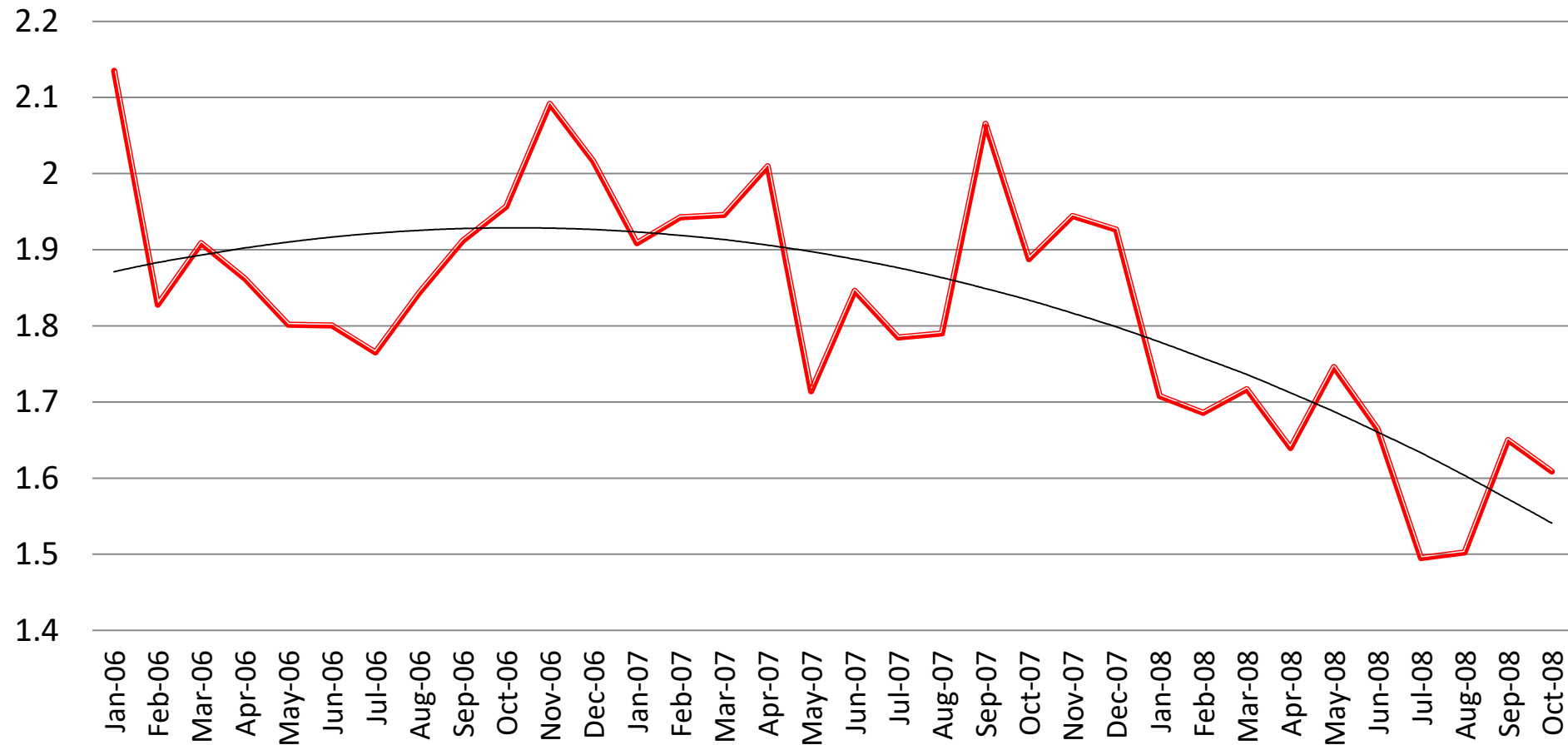


Export and import growth: 1991-2019

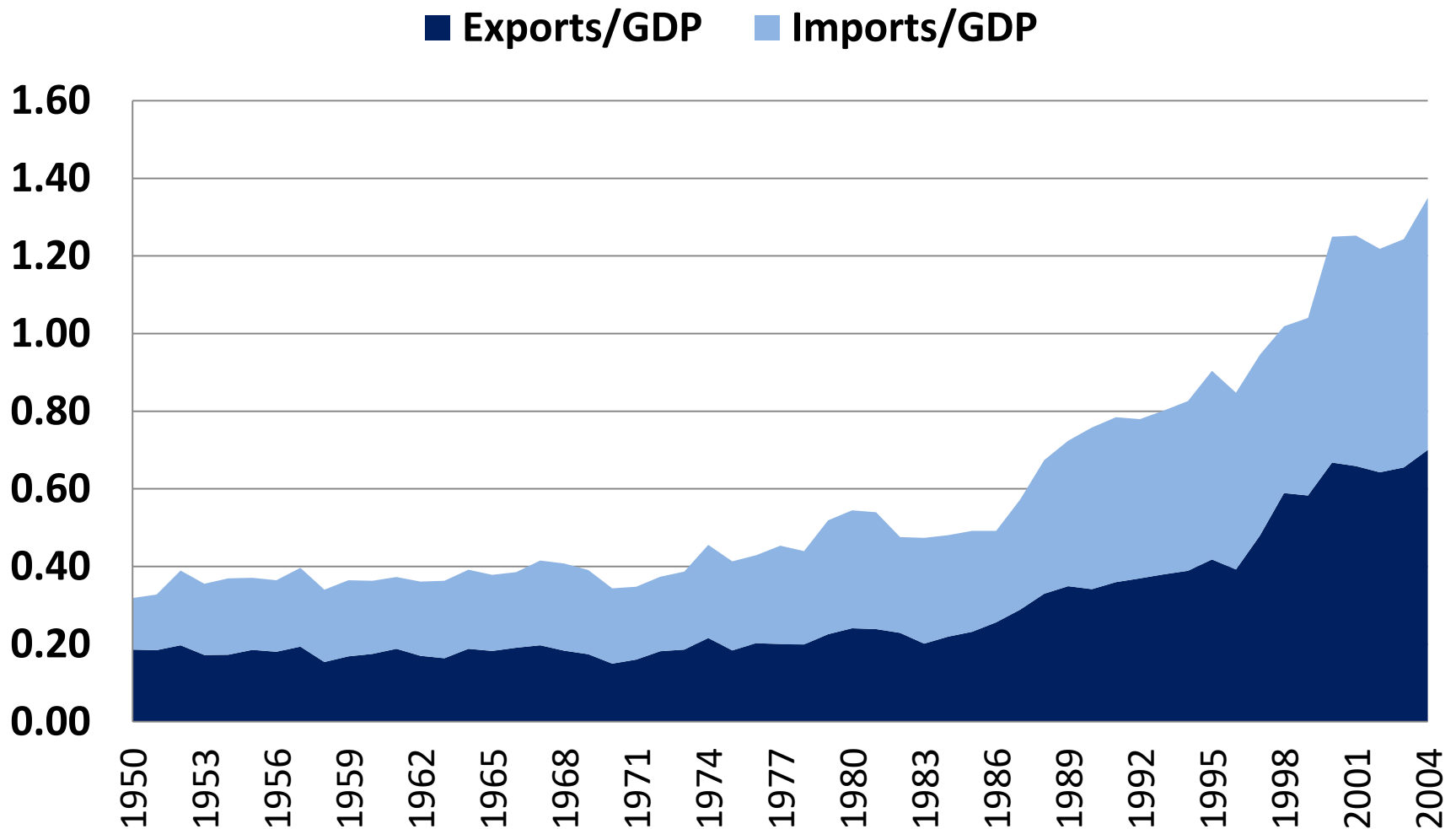


Trade Reform: Reducing tariff rates

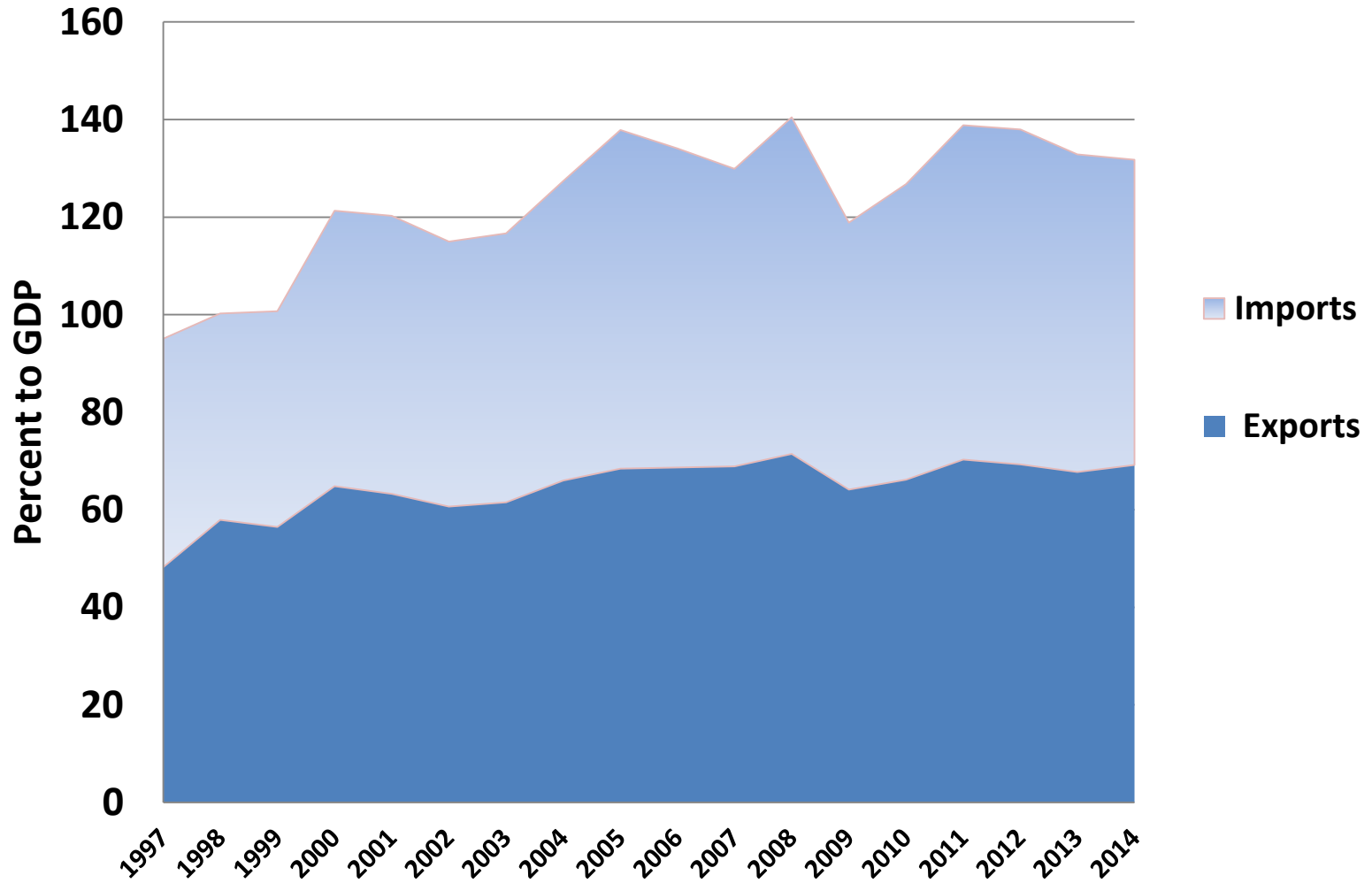
Thailand's implied tariff rate *customs revenue to total imports(%)*



Trade Liberalization: 1950-2004

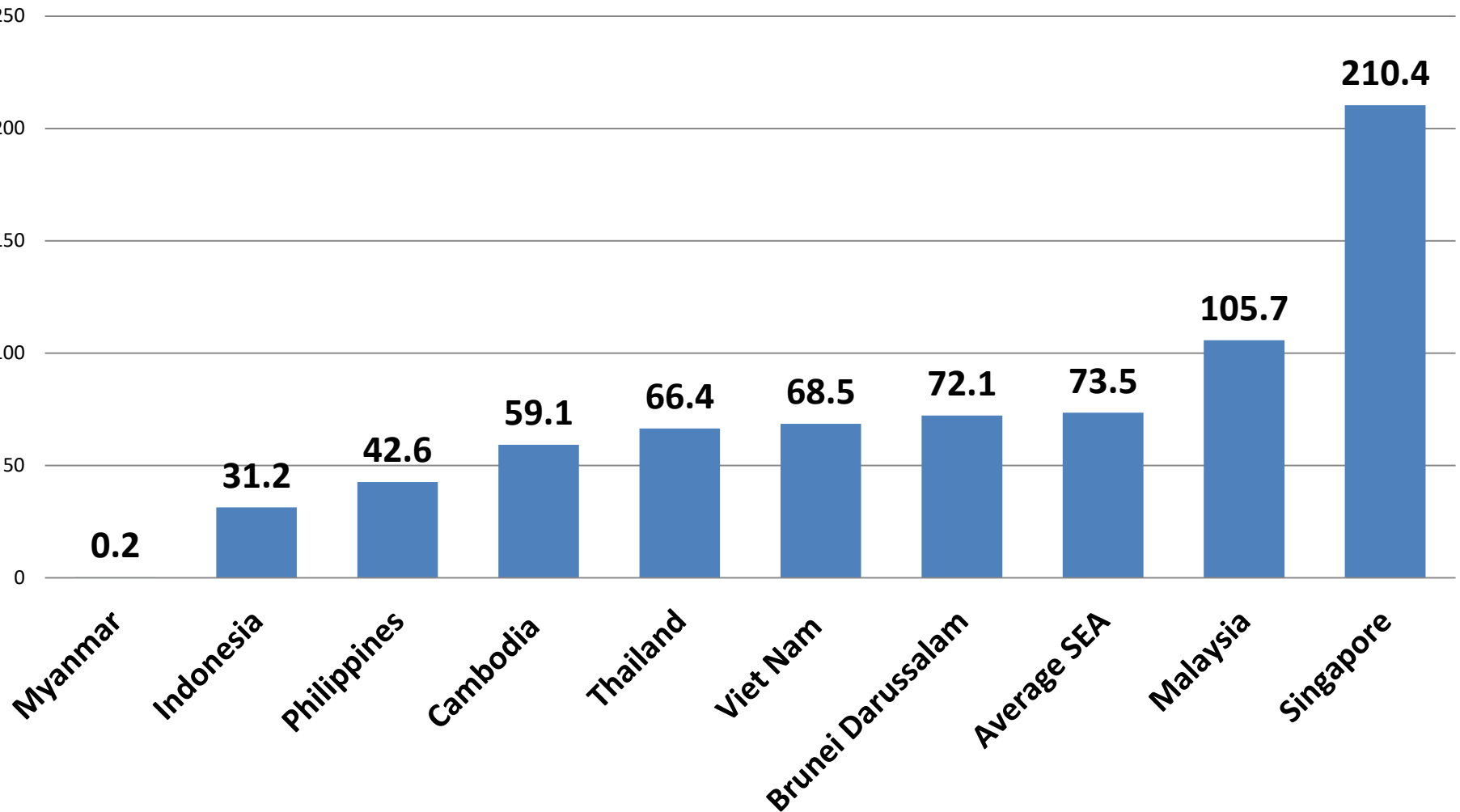


Thailand's **Trade Exposure** After AFC 1997-2014



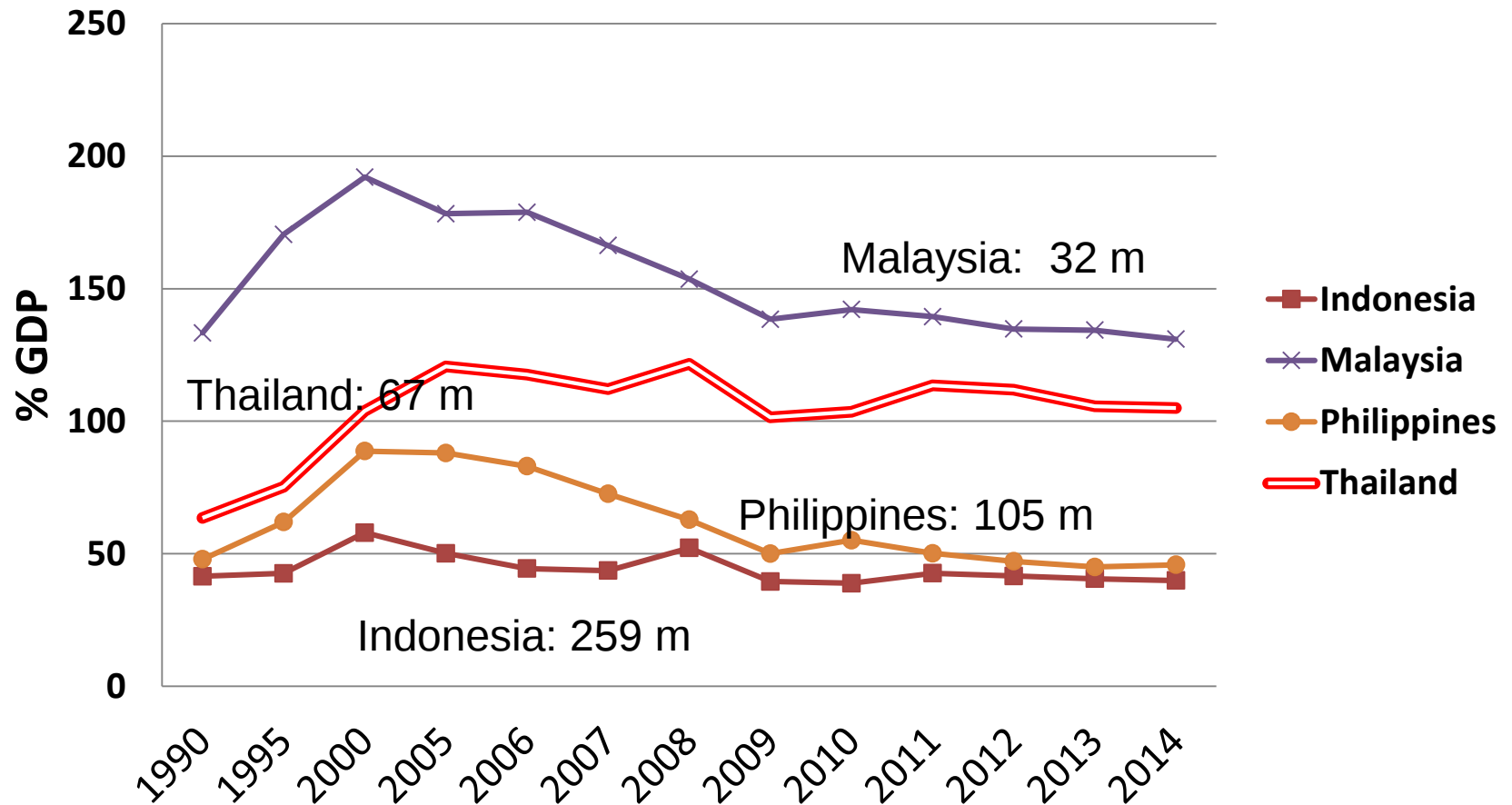
Outward vs. inward oriented SEAs

2000-2011



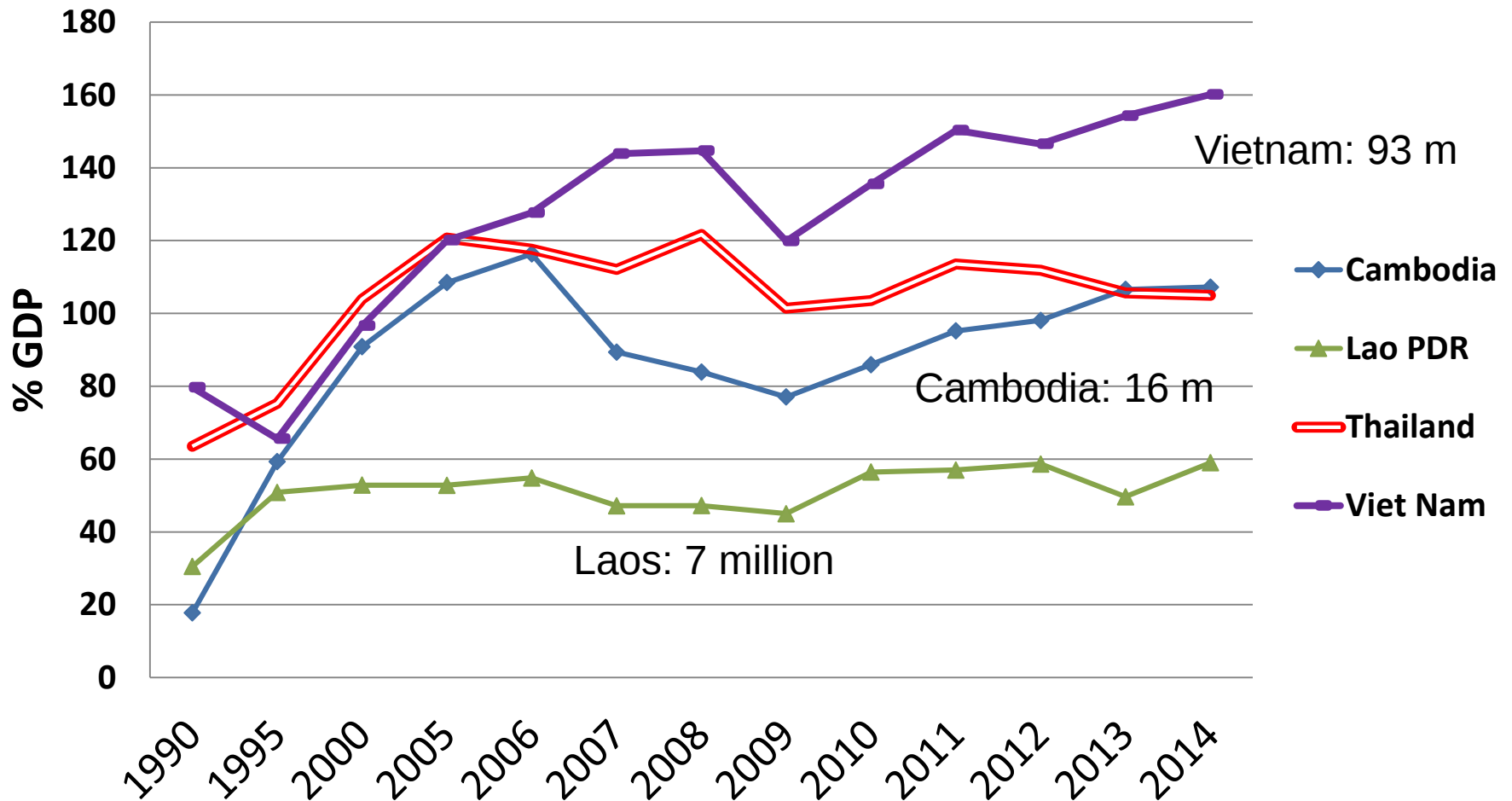
■ Average exports share in GDP

Trade Exposure: Sum of merchandise exports and imports (% GDP) ASEAN



Degree of Trade Openness: Sum of merchandise exports and imports (% GDP)

CLV vs Thailand



Adverse impacts of globalization

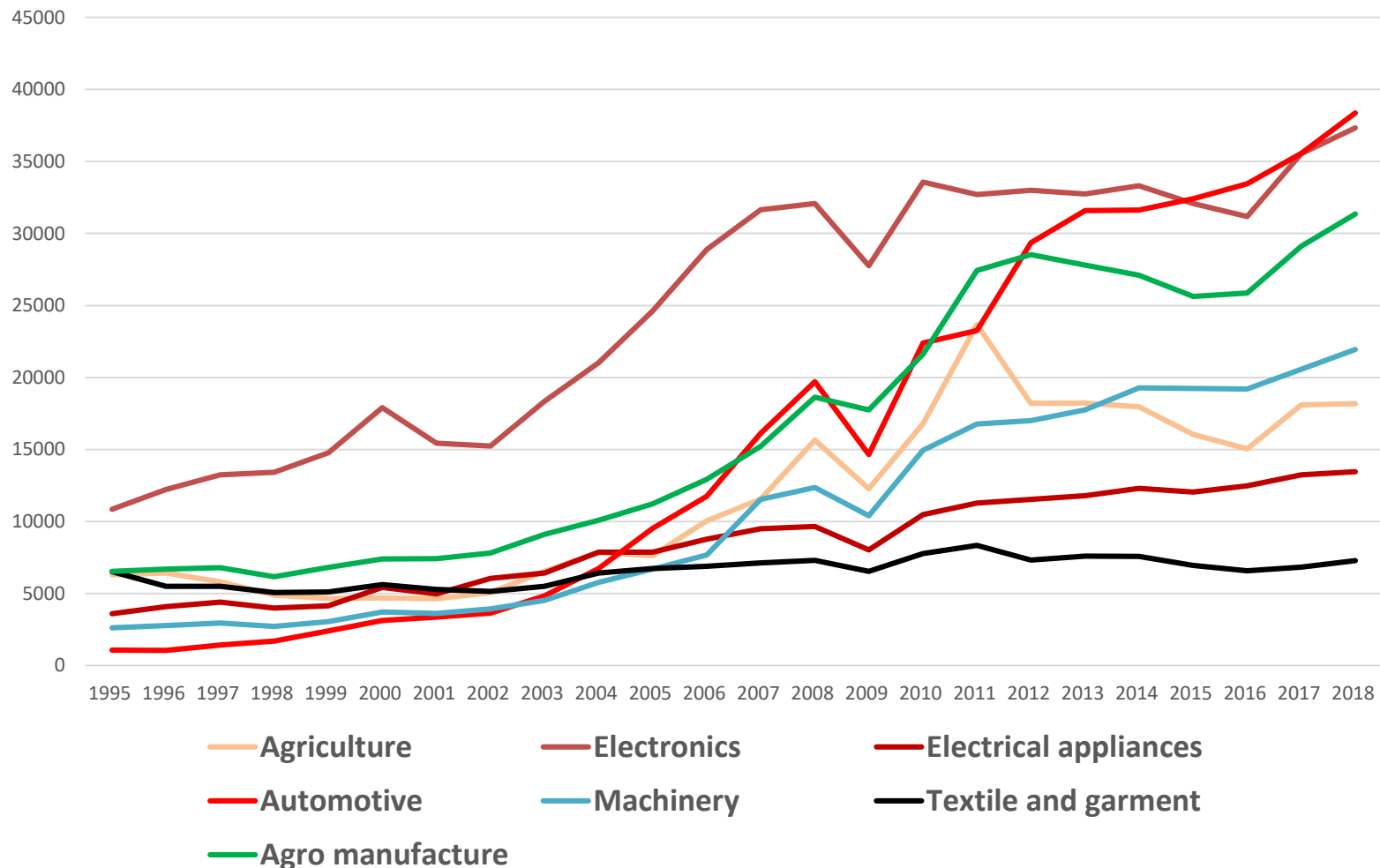
- Destroyed traditional (uncompetitive) sectors
- High exposure to external shocks: trade war, Covid-19 and specific sector shocks, supply chain disruption,
- Export dependency: China factor
- World financial markets and transmission via stock markets
- Increased business cycle synchronization and vulnerability to systemic shocks

Benefits of globalization

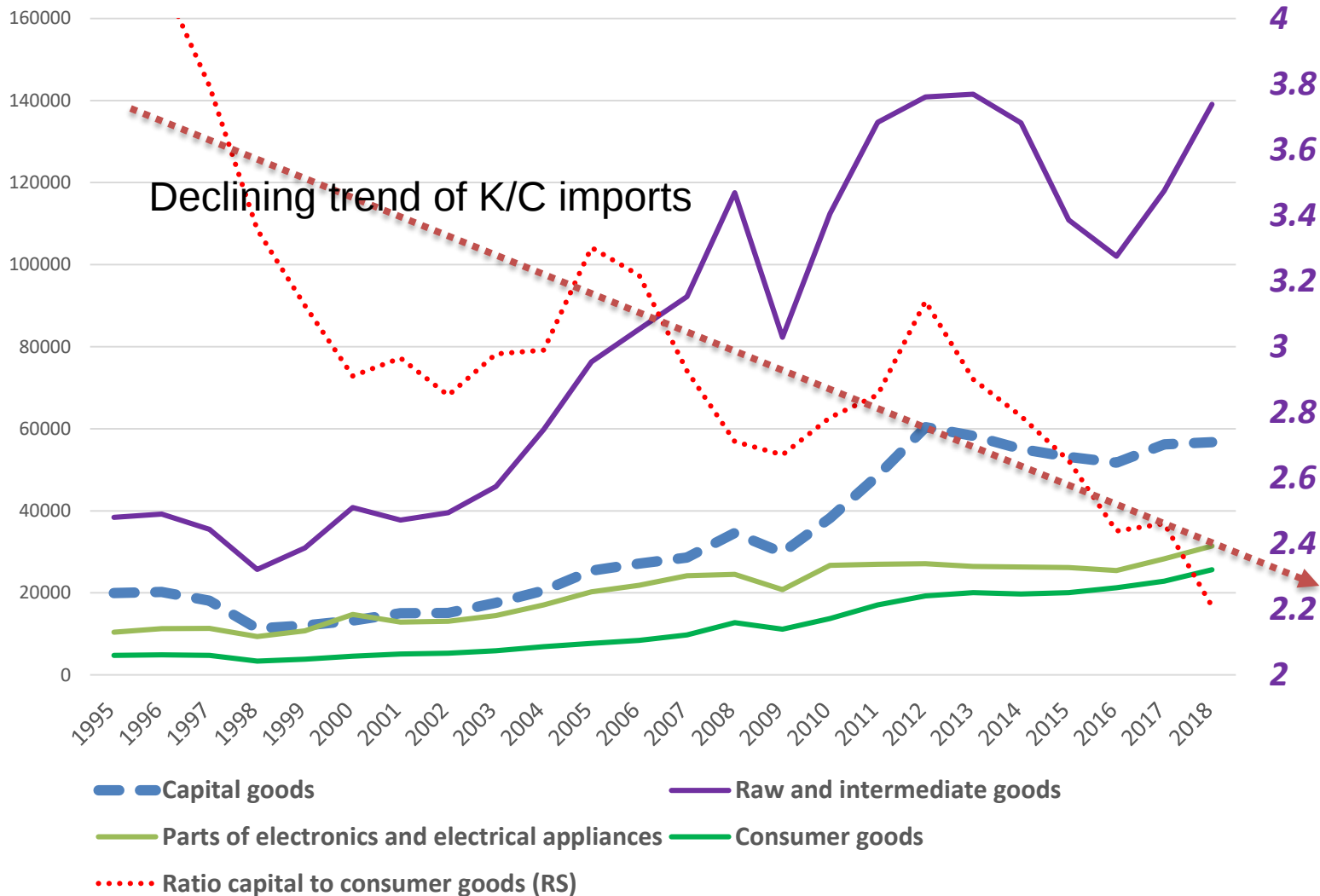
- High exports sustain output growth
- Imported capital goods raise *productivity*.
- World competition exposure leads to *efficiency improvement*.
- Exploitation of the *economies of scale*
- Outward-oriented development strategy improve *resource allocation* as production is dictated by comparative advantage.
- Encourage *inflows and outflows* of foreign direct investment

Trade acts as the *engine of growth* by providing a conduit for technology transfer

Thailand's exports (million dollars: Automotive products)



Thailand's Import structure: Rising intermediate products



Trade acts as the '*handmaiden*' of growth by improving the quality of investment

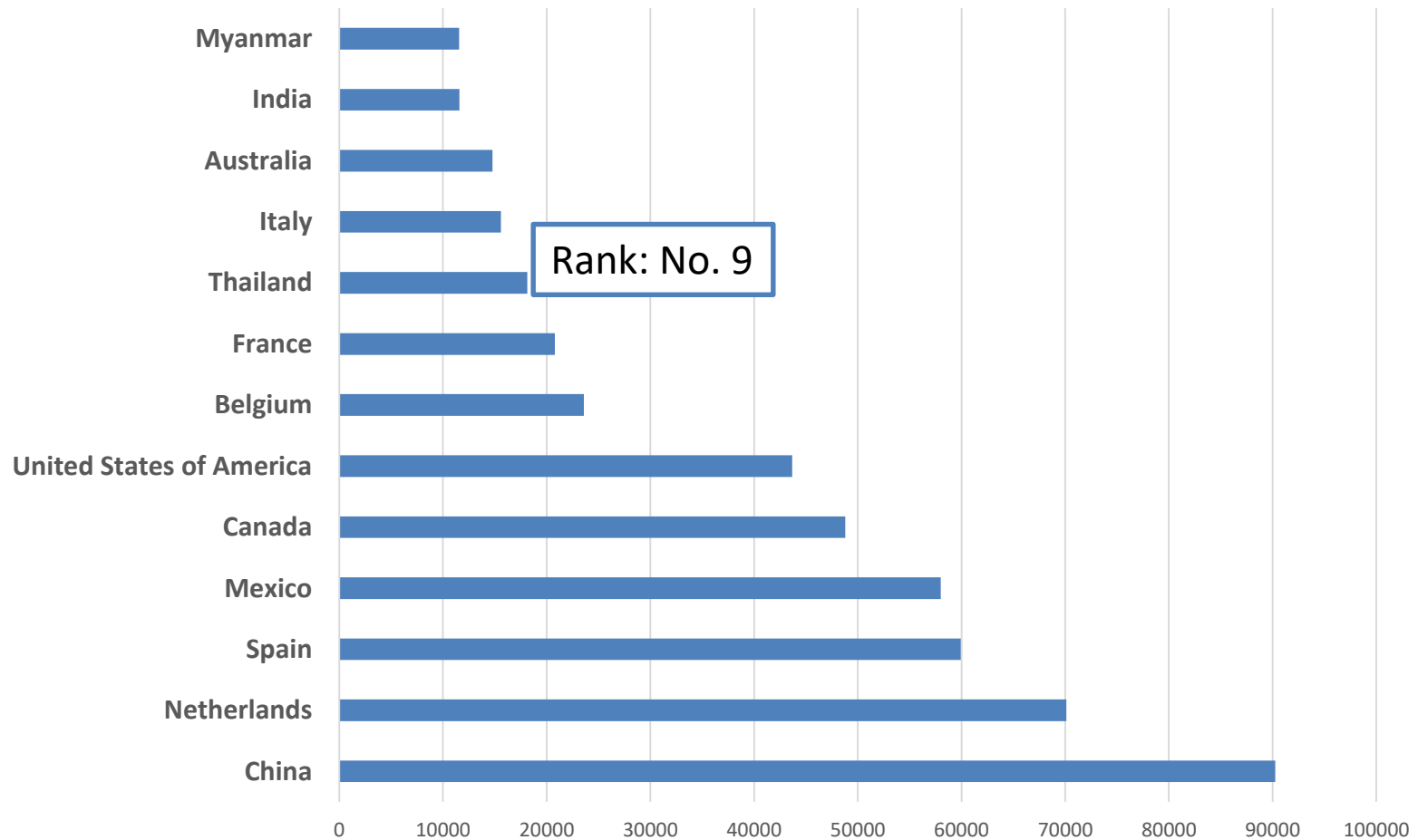
Trade in primary products is driven by *factor endowments and technology gap*

- Primary goods are **non-differentiated** commodities whose prices are mainly set in commodity exchanges.
- **Factor endowments** are the main determinant of trade in mineral and agricultural commodities.
- With **dissimilar production functions**, **technology gaps in agriculture**, along with factor endowments, are also determinants of trade in agricultural goods such as rubber, rice, and vegetables.

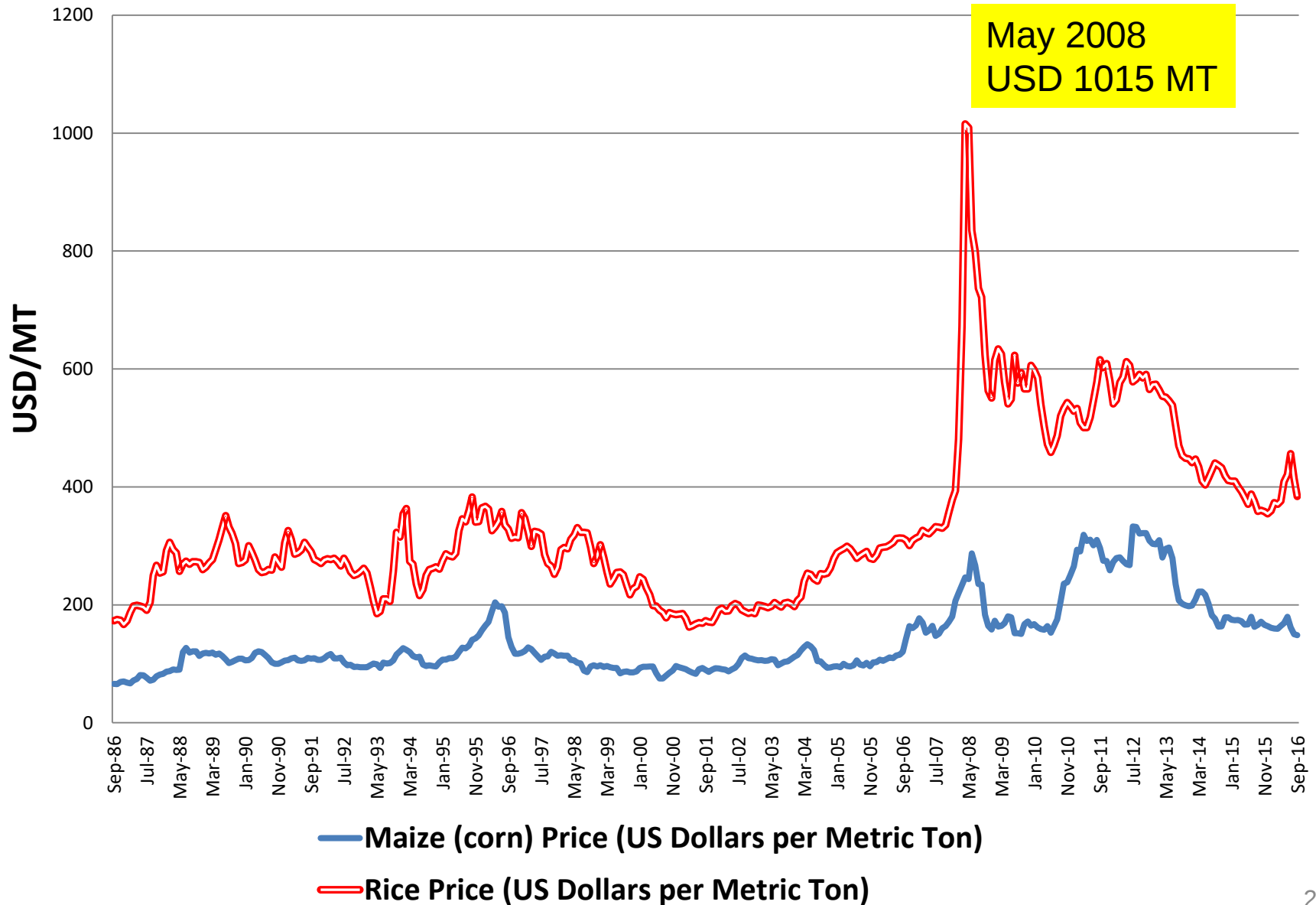
Trade in Primary Products: Vegetables

Edible Vegetables: Product 07

Value exported in 2015 (USD thousand)



Export Prices of Rice and Maize Sep 1986 / Sep 2016



Why did food prices soar in 2008?

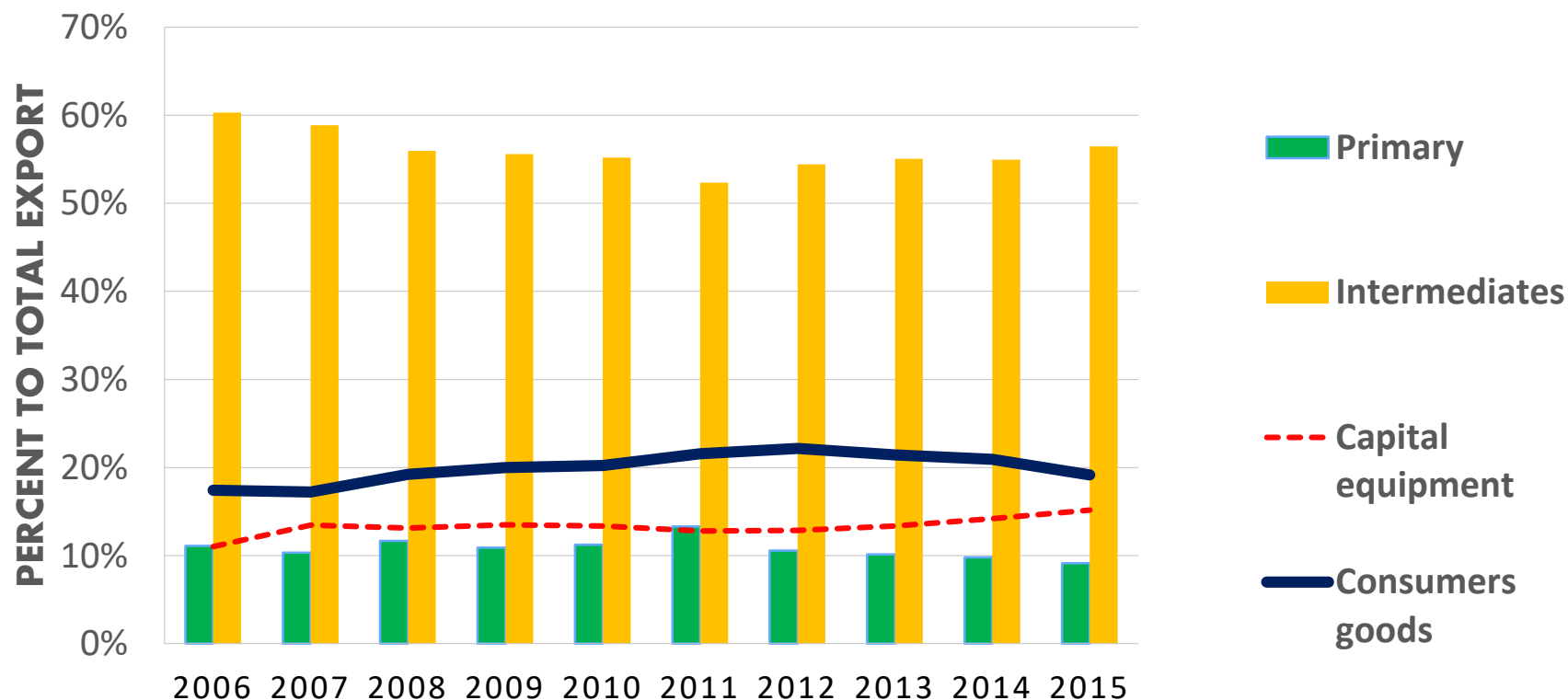
- High prices were triggered by ***the 2007 drought in Australia***, the worst for a century, which halved its wheat harvest. But there were more fundamental background factors on ***the demand side***.
- As countries like China, India, Brazil, and Russia have become more affluent, they have begun eating more.
- Rich people don't just eat more than poor people; they *eat differently*.
- The ***demand for meat in developing countries has doubled*** since 1980; In India, it is up 40 per cent, China 50 per cent.
- And because cattle and chickens are fed on corn – it takes ***8 kg of grain to produce 1 kg of beef*** – the price of all cereals has been forced up.

Biofuels

- *Added to that was a love affair with biofuels.*
- Instead of buying **plant ethanol** from sunshine states like Brazil, the Americans have been trying to grow their own – with oil-based fertilizers and by subsidizing US farmers.
- A third of its **maize crop goes to fuel cars**, in a bid to lessen its dependency on oil from dodgy dictators in the Middle East.
- ***In 2008, the price of cereals had rocketed as a result.***
- A decade later, grain prices have dropped sharply, Thanks to China's slowdown and the U.S.-China trade war.

2. Growing Volume of Network Trade

PERCENTAGE OF EXPORT VALUES BY STAGE OF PROCESSING



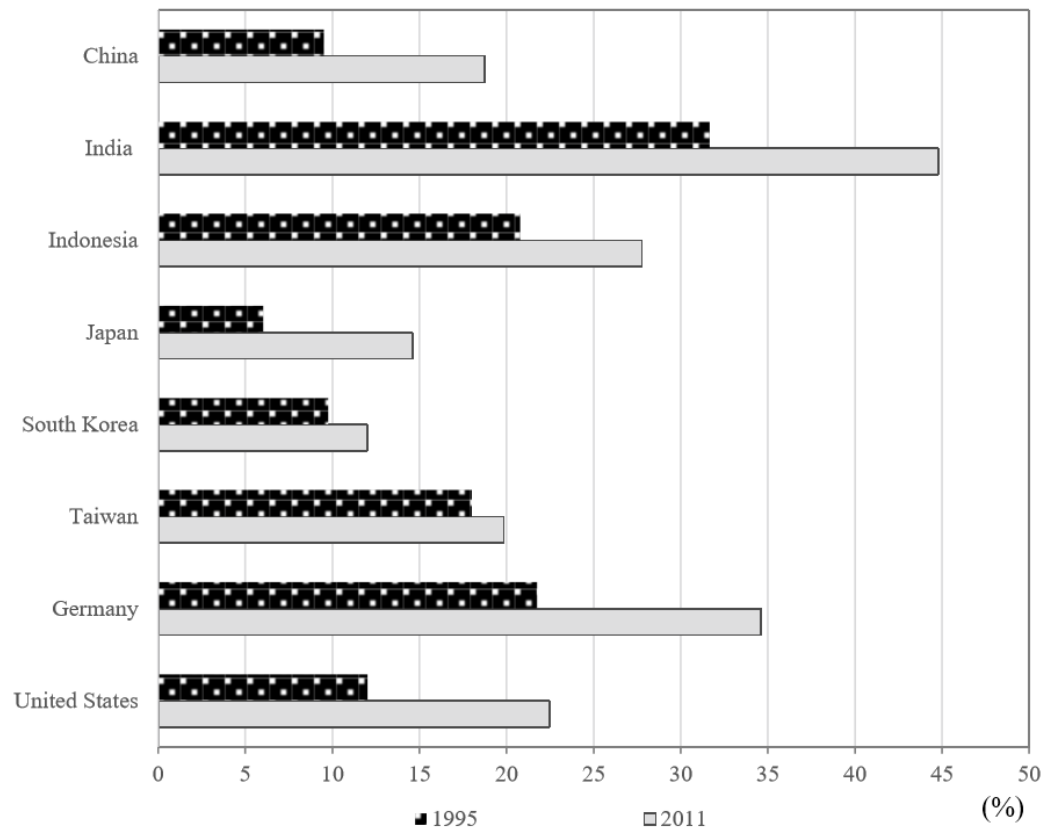
Network trade in East Asia

- The degree and intensity of participation ***of East Asian Economies in network trade*** is much greater compared to countries in other parts of the world.
- China has become an integral part of global production networks—***a premier center of final assembly*** (The world's assembly plants).
- Clear evidence of **trade complementarity** rather than crowding out (substitution) effect.

Rapidly rising share of imported intermediate inputs in total intermediate inputs in manufacturing industries

From 1995 to 2011

Figure 3. International Fragmentation of Production



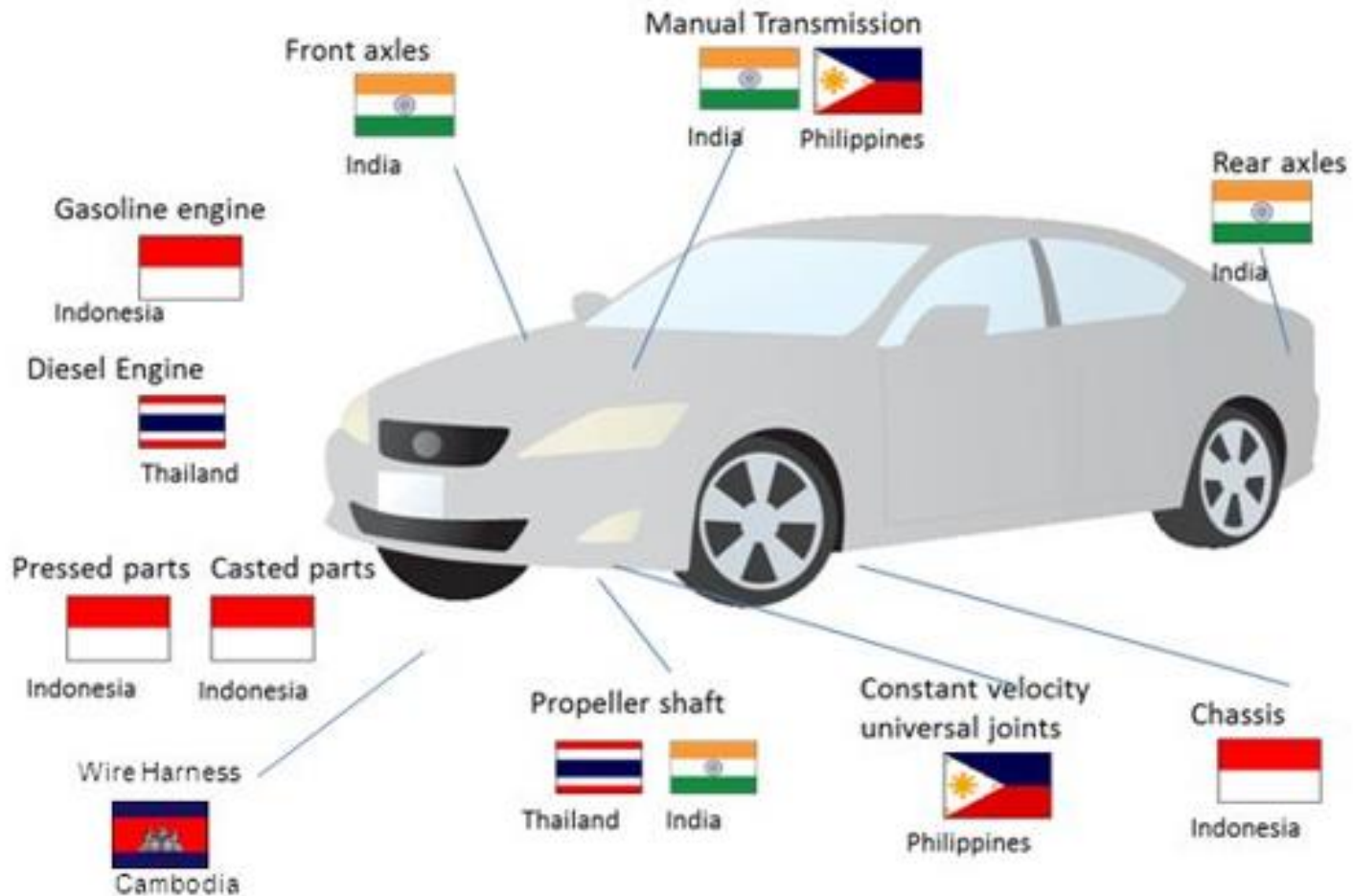
Note: The figure shows the shares of imported intermediate inputs in total intermediate inputs in manufacturing industries in 1995 and in 2011.

Global Value Chains

- *Global Value Chains (GVCs) are transforming global trade by breaking production into steps that can be carried out in different countries;*
- *GVCs have helped advance developing countries, but **some have benefited more than others**;*
- *Cutting trade costs is crucial to building more **inclusive GVCs** that deliver greater benefits to developing countries and smaller companies.*

Example of production network for auto parts

East Asia



3. FDI and Manufactured Exports

5.1 Life cycle of manufactured goods

5.2 FDI in ASEAN countries

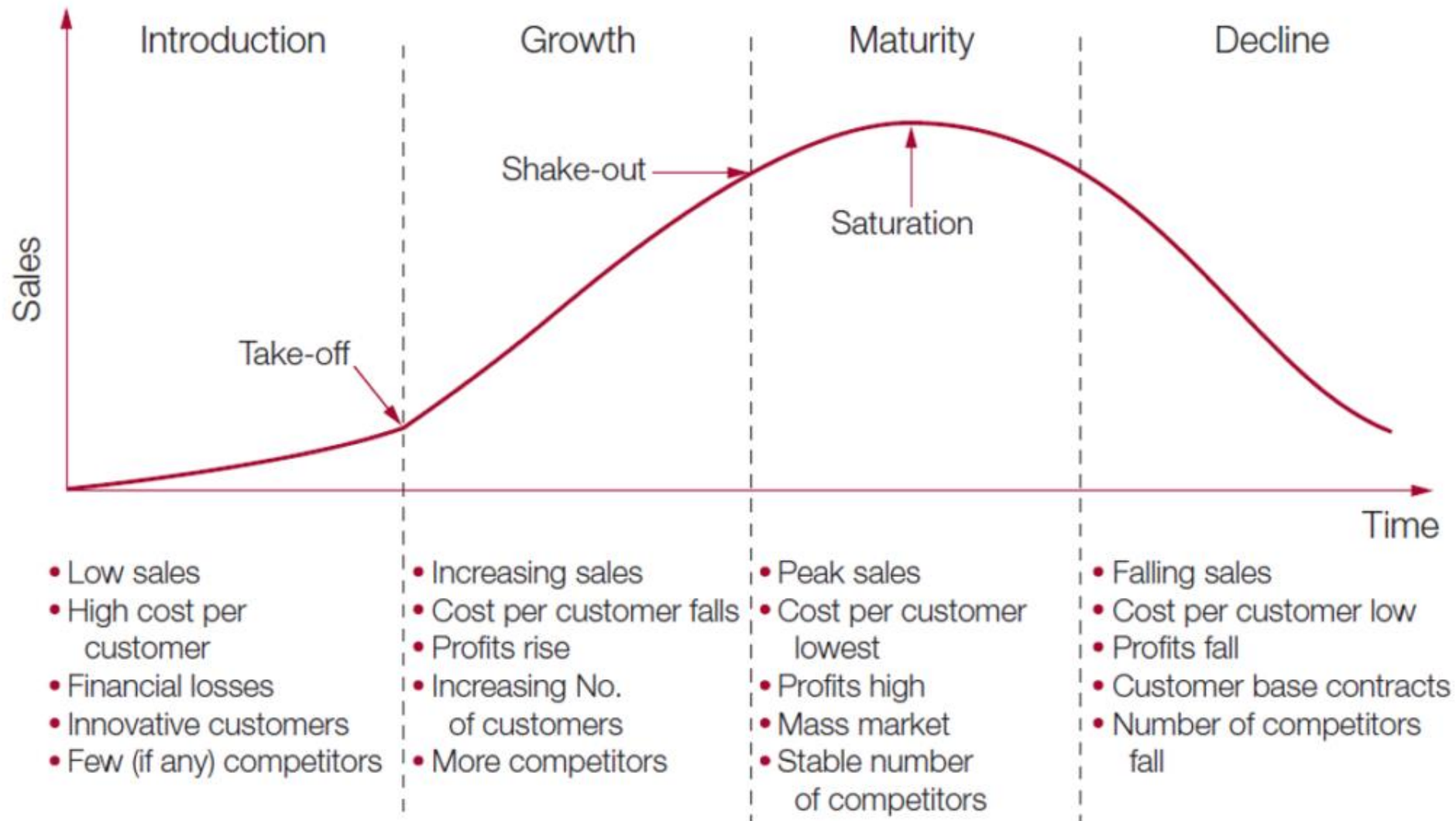
5.3 Costs and Benefits of FDI

5.4 Theories of FDI

3.1 The life cycle of manufactured goods

- In the early phase, when the product is new, comparative advantage derives from **technology gaps**.
- In the middle phase, when imitators exist, **product differentiation**, accompanied by economies of scale, become principal determinants of comparative advantage.
- In the late phase, the product loses differentiation, **factor endowments and economies of scale** emerge as the dominant influences of comparative advantage.
- MNCs need to innovate and come up with unique products (Ipod, Ipad, Iphone, etc.)

The 4 Life Cycle Stages and their Marketing Implications

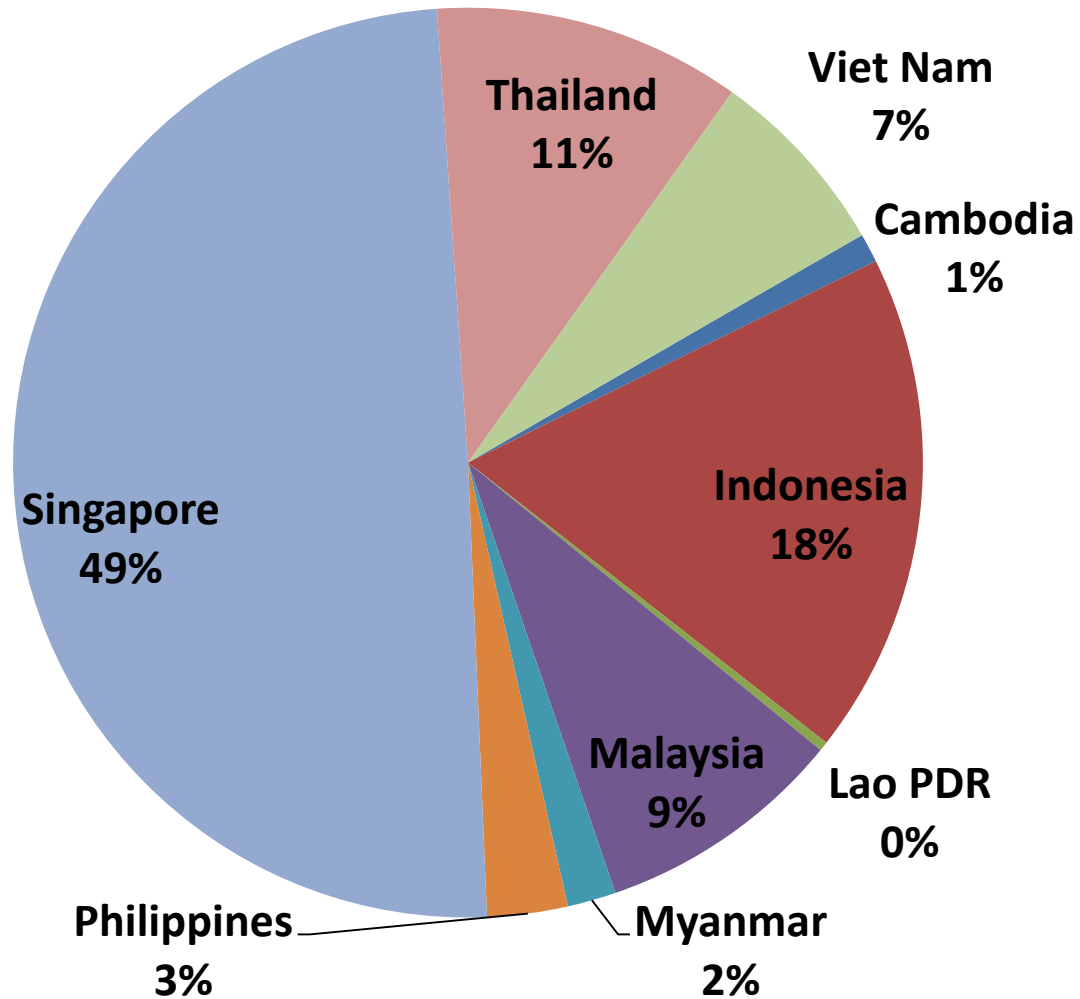


MNCs and market power

- **Technology gaps, economies of scale, and product differentiation** provide individual firms some degree of **market power**.
- Trade in newly differentiated manufactured products reflects the marketing, production, and investment ***behaviors*** of Multi National Corporations (MNCs).

3.2 Inflows of Net FDI in ASEAN: 2013

% share of ASEAN inflows



3.3 Benefits and costs of FDI Inflows

- Infrastructure and technology transfers
- Increased productive efficiency due to competition from multinational subsidiaries.
- Improvement in ***quality*** of the factors of production
- Investment inflow ***benefits*** the balance of payments, in particular to countries experiencing chronic current account deficit.

Further FDI benefits

- Faster growth of output and employment
- Consumer benefits
- Increase in exports
- Increase in savings
- Increase investment (crowding- in effect vs. crowding-out effect on local investment)
- Reduce vulnerability to currency crisis (FDI is a long –term capital flows)

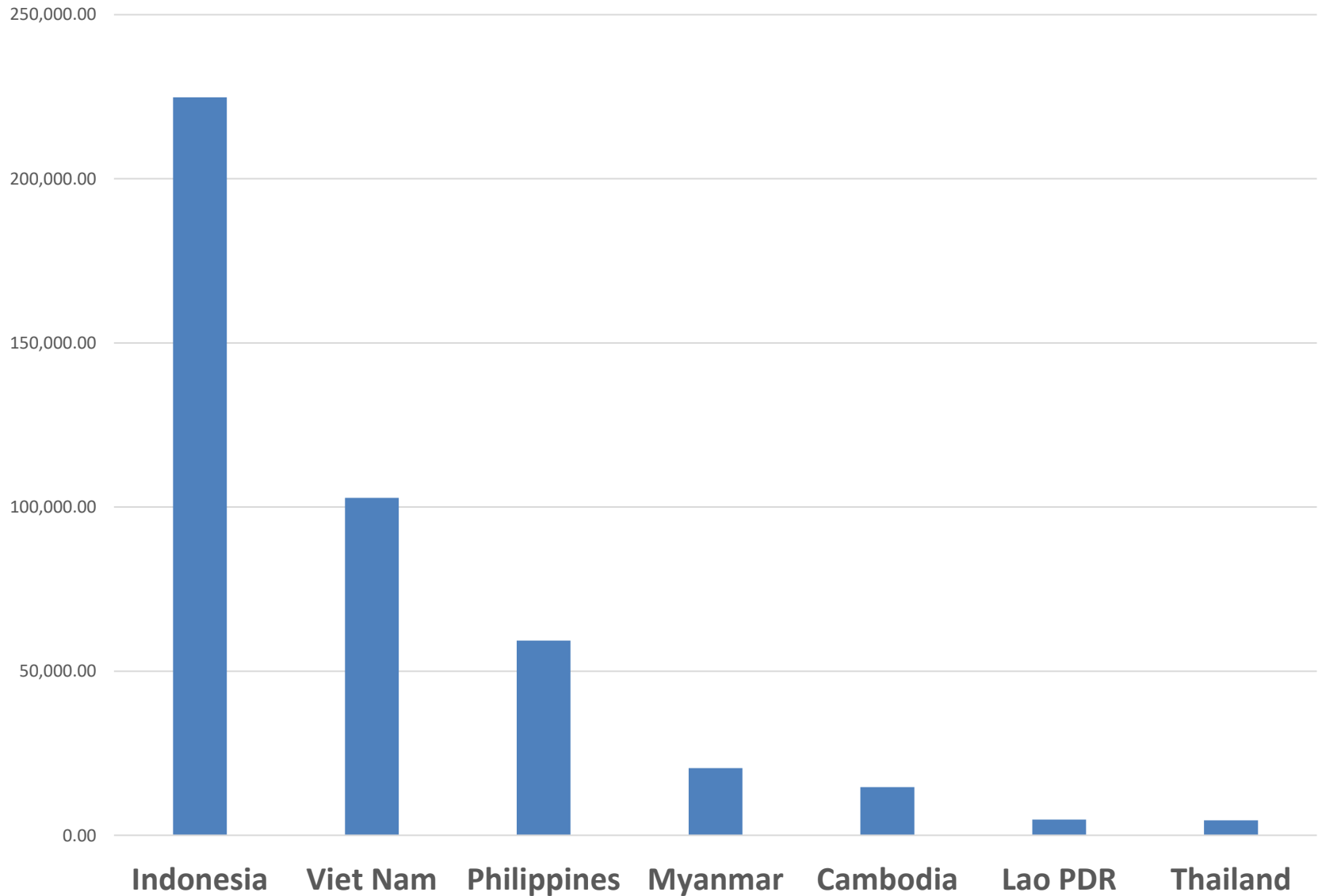
Costs of FDI to host countries

- Negative effects on the balance of payments (imported goods from home countries, repatriation of profits).
- **Discourage** *local* development of technical know-how (no product engineering process)
- **Detriment** to growth of domestic producers (too weak and too *inefficient* to compete with MNCs).
- *In March 2019, Alphabet's google Inc.'s search engine was slapped with \$ 1.69 billion fine by the European Commission*

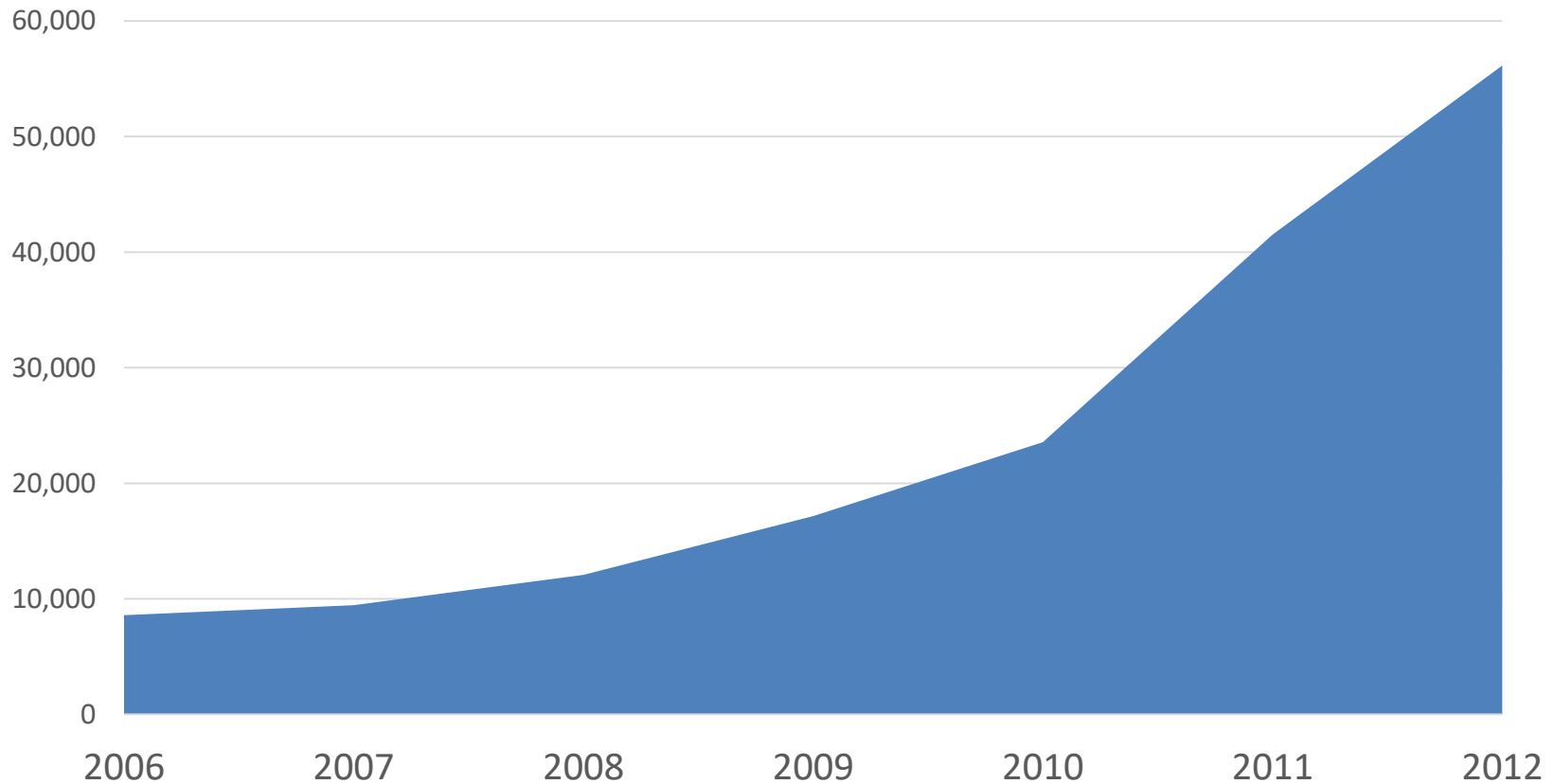
Furthre costs to host countries

- Transfer pricing and tax evasion
- *In 2017, Apple agreed to pay Ireland \$15.4 billion in back taxes to appease the EU*
- Enviroment and natural resource costs
- *Pollution heaven hypothesis*
- Damages to local culture and traditional exports
- Politico-Strategic Interests
- Facilitate hegemony by dominant Janpanese and Western cultures.
- Country sovereignty is at stake (invasion by the Chinese).
- But some CLMV countries do not care much.

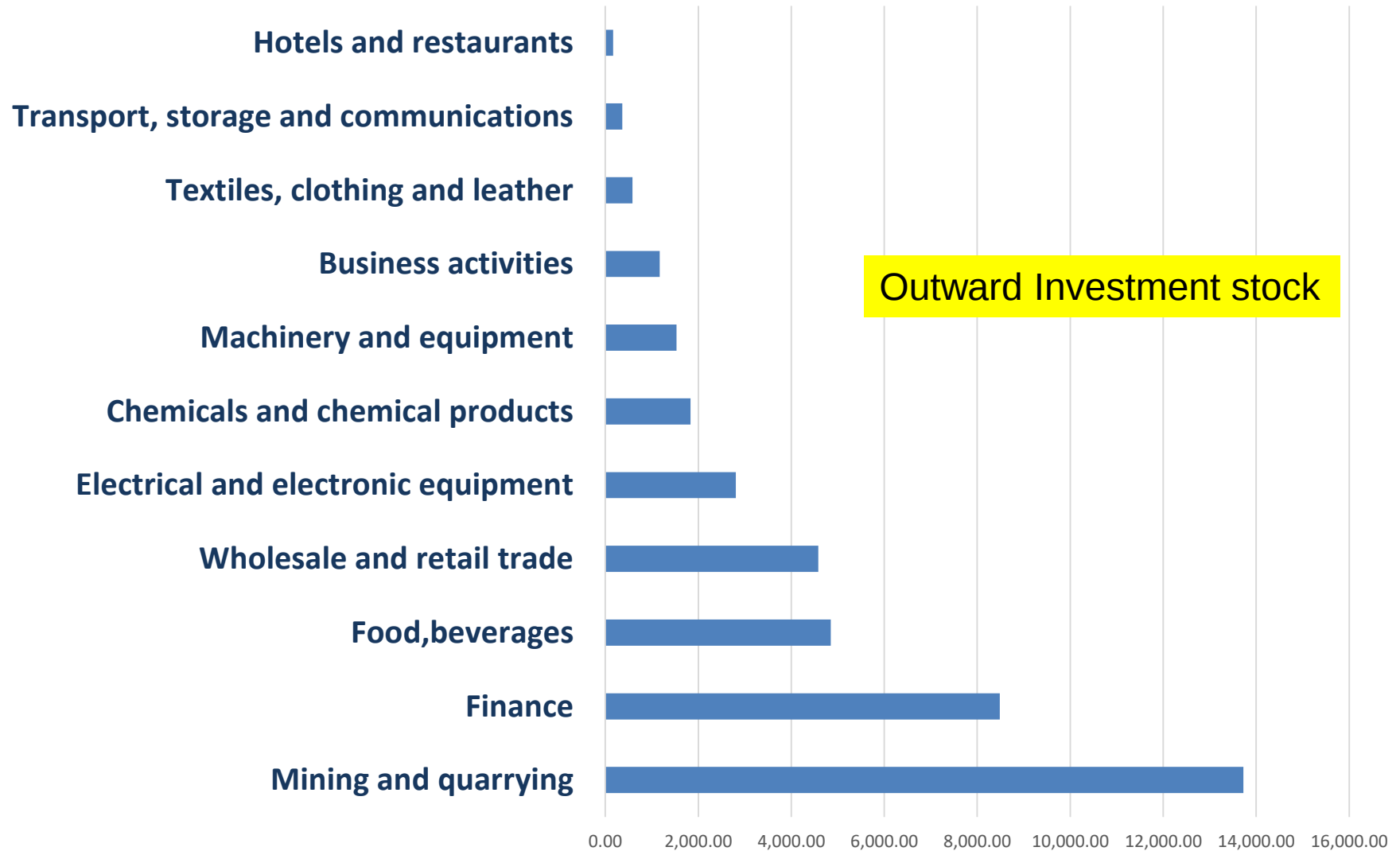
Inward stock of FDI in secondary sector: 2015



Thailand's Outward Investment Stock
Million USD
Source: ITC



Thailand's outward investment stock in 2012 (m\$)



Name Thai companies which have invested abroad

3.4 Eclectic Theory of FDI

John Dunning (1981)

- FDI implies that *location-specific advantages* favor a foreign host country (abundant resources).
- **Ownership-specific advantages (knowledge assets)** favor the investing firm such as McDonald and 7Eleven.
- International production is attributable not only to firms' monopolistic advantage and its ability to ***internalize that advantage*** but also to the **presence of foreign country** in which production brings unique benefit to the firms.

Dunning's *Eclectic* Theory of FDI

- The eclectic theory draws on the theories of **comparative advantage**, **location advantage**, **monopolistic advantage** and **internalization**.
- MNC would invest only when it is most profitable for an MNC to *internalize its monopolistic advantage* in a foreign country
- **Vertical intergration**: Obtain control of needed **raw-materials and intermediate inputs** by ensuring uninterrupted supply at the *lowest cost and high quality* .
- Otherwise MNCs enter the host country's markets through exporting or lisensing.

Monopolistic and oligopolistic advantages

- MNCs have some unique **production knowledge** or *managerial skill* that could easily and profitably be utilized abroad and over **which the corporation wants to remain control**. (Hotel Chains..Sheraton, Dusit Thani etc., DHL and Kerry delivery).
- **Horizontal integration**: production of *differentiated products* that are also produced at home and host countries (Honda's Fit in Japan, or Honda Jazz in Thailand)

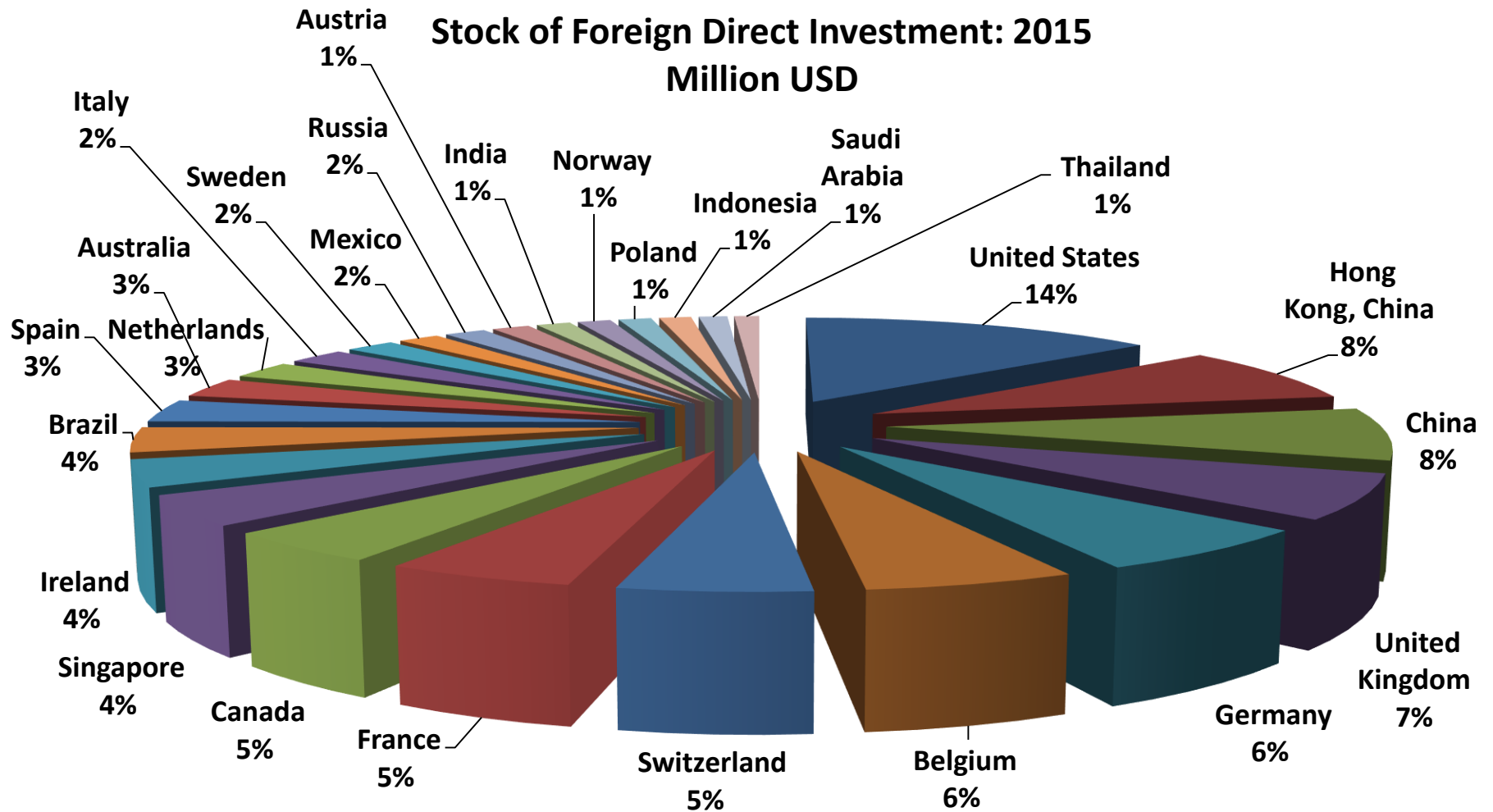
Why investing in particular host countries?

- **Ownership advantages** arise from economies of scale concerning **intangible assets** such as **skill management** and know-how by investing abroad. (Greyhounds restaurant in London and Nara restaurant in Manila)
- **Locational advantages** in host countries (Transportation hub in Singapore).
- Can Thailand establish these regional hubs: Medical hub, tourist hub, fashion hut, jewelry hub, and etc.?

Why do MNCs invest in particular host countries?

- **Product cycle** (When new technology produced and used in the home country to export before new technology can be standardized and employed in other countries)
- **Standardized technology** permits moving high cost plants at home to host countries abroad (production fragmentation, global value chain)
- **Low tax rates** (Apple in Ireland), *Double Irish and a Dutch sandwich*
- **Low labor cost**, and host countries' government policy (Uniqlo and Samsung smartphones factories in Vietnam)

Stock of Foreign Direct Investment: 2015 Million USD



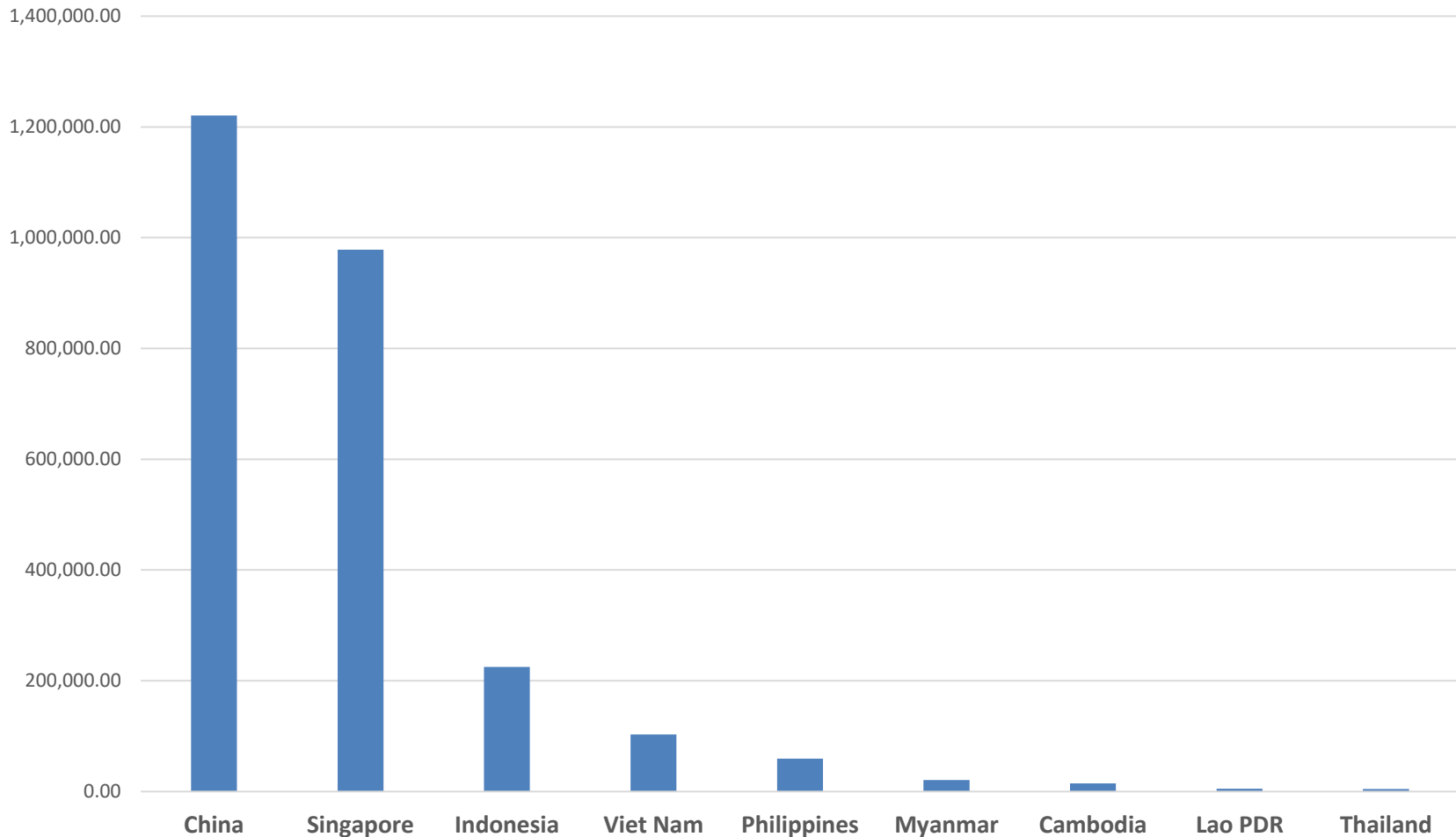
Source: CIA World Fact book

Factors affecting FDI

- Repatriation of profits
- Economy and market size
- *Risks and uncertainties*
- *Political stability*
- *Policy consistency*
- External debt discourages FDI
- Market potential and accessibility
- Product fragmentation
- *The ease of doing business*

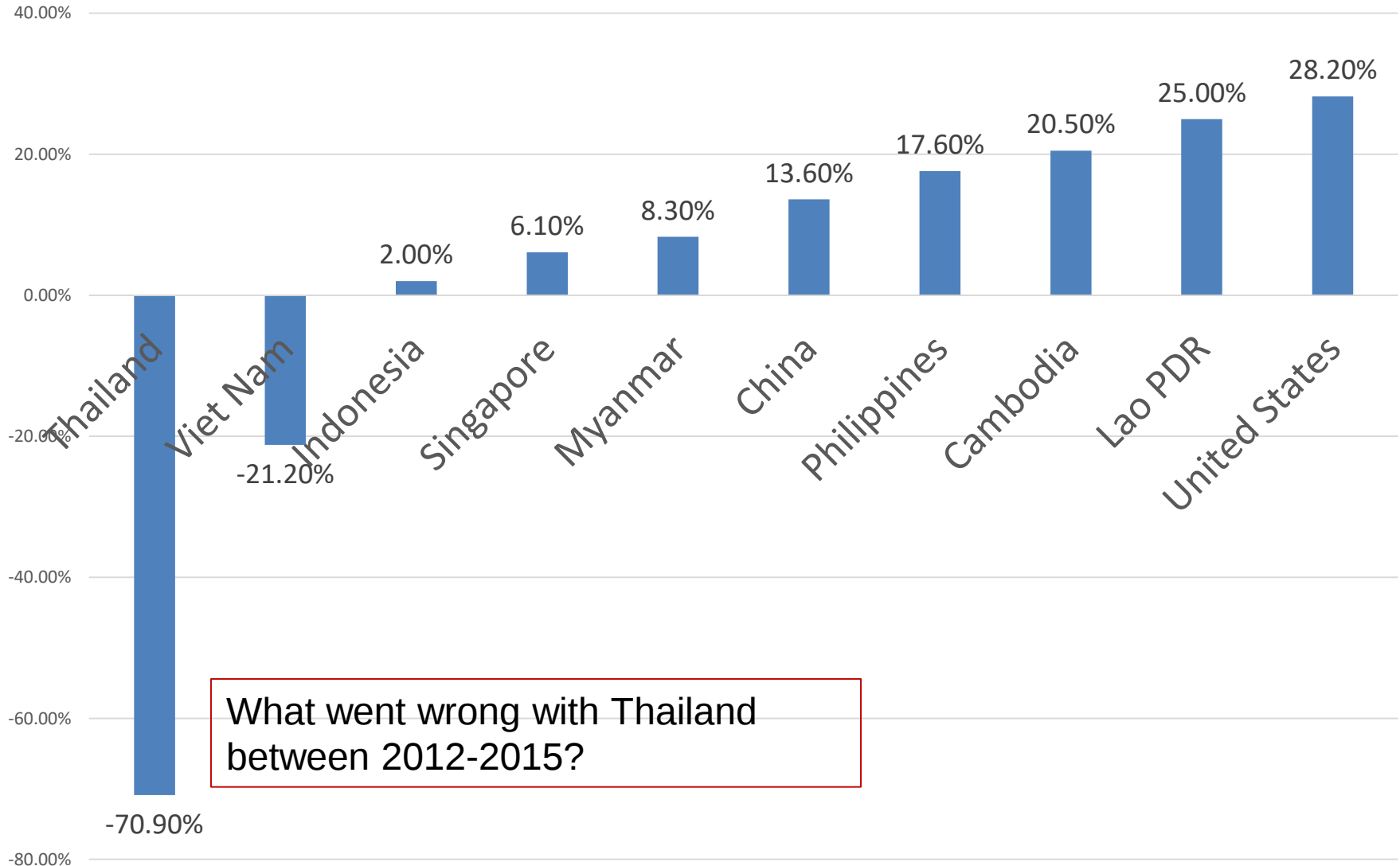
4. FDI and Thailand's Export Capability

Asia's inward FDI stock in 2015



Inward FDI stock: 2015

Percentage change per annum since 2012

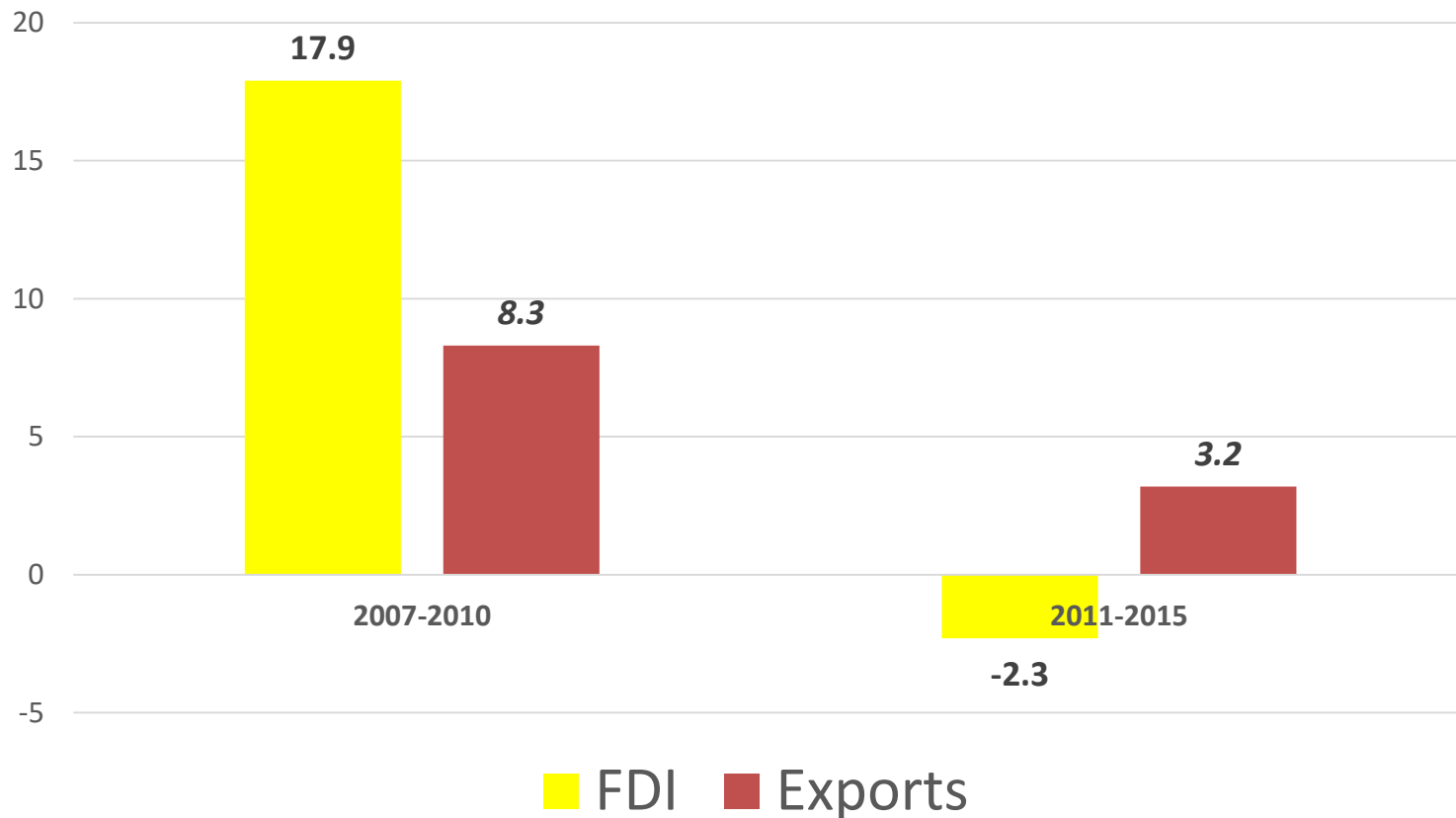


What went wrong with Thailand
between 2012-2015?

Sectoral FDI inflows and Exports

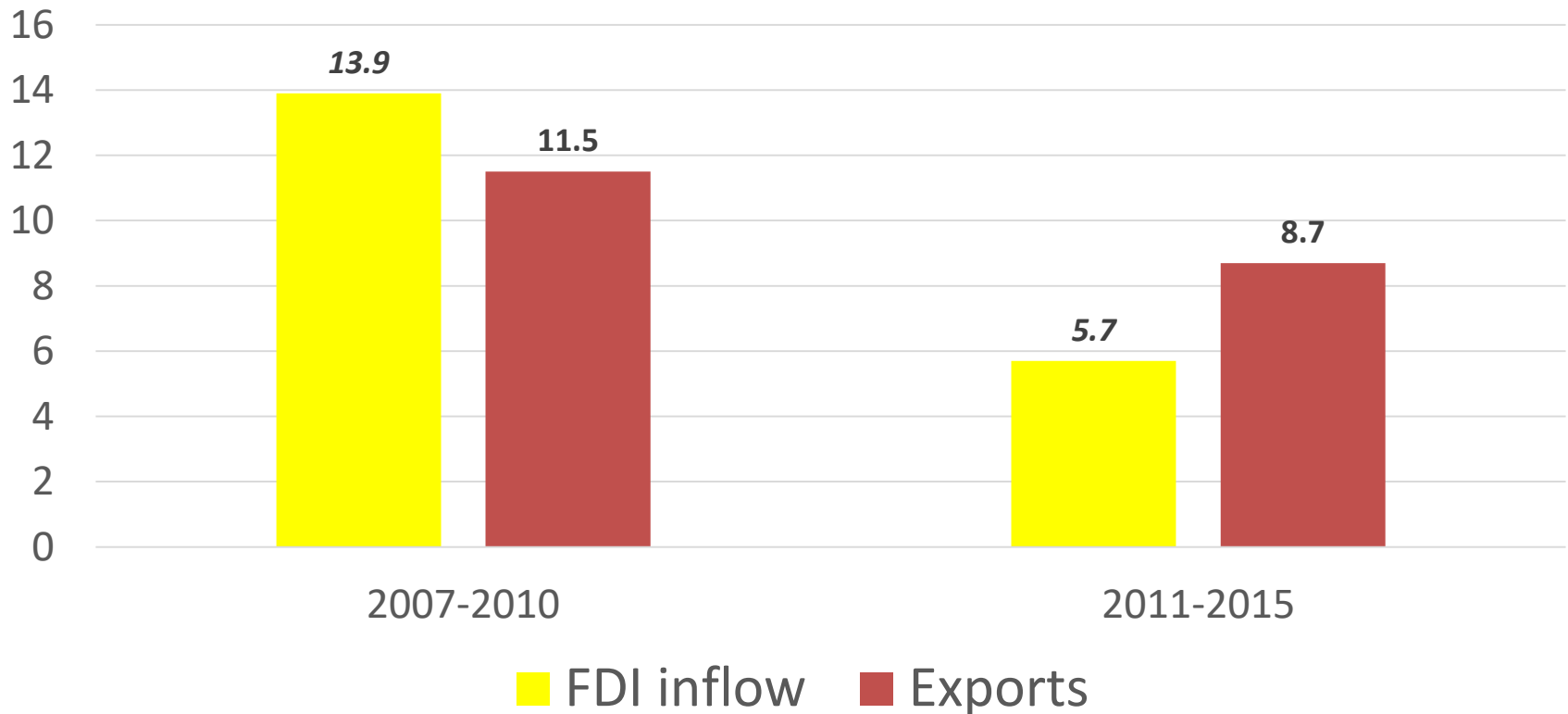
Percentage Change

Chemicals



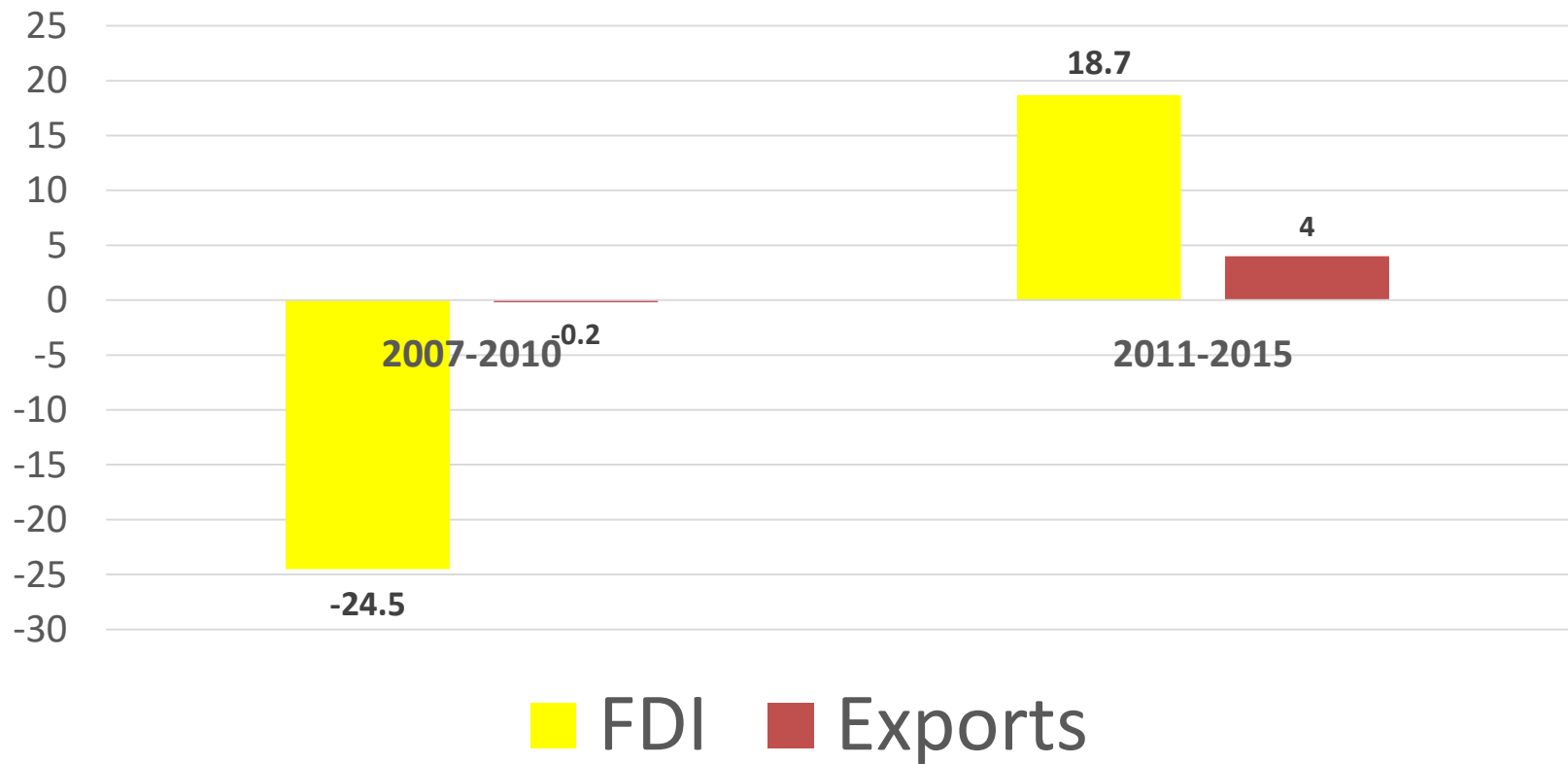
FDI Inflows and Export Growth (percentage Change)

Vehicles

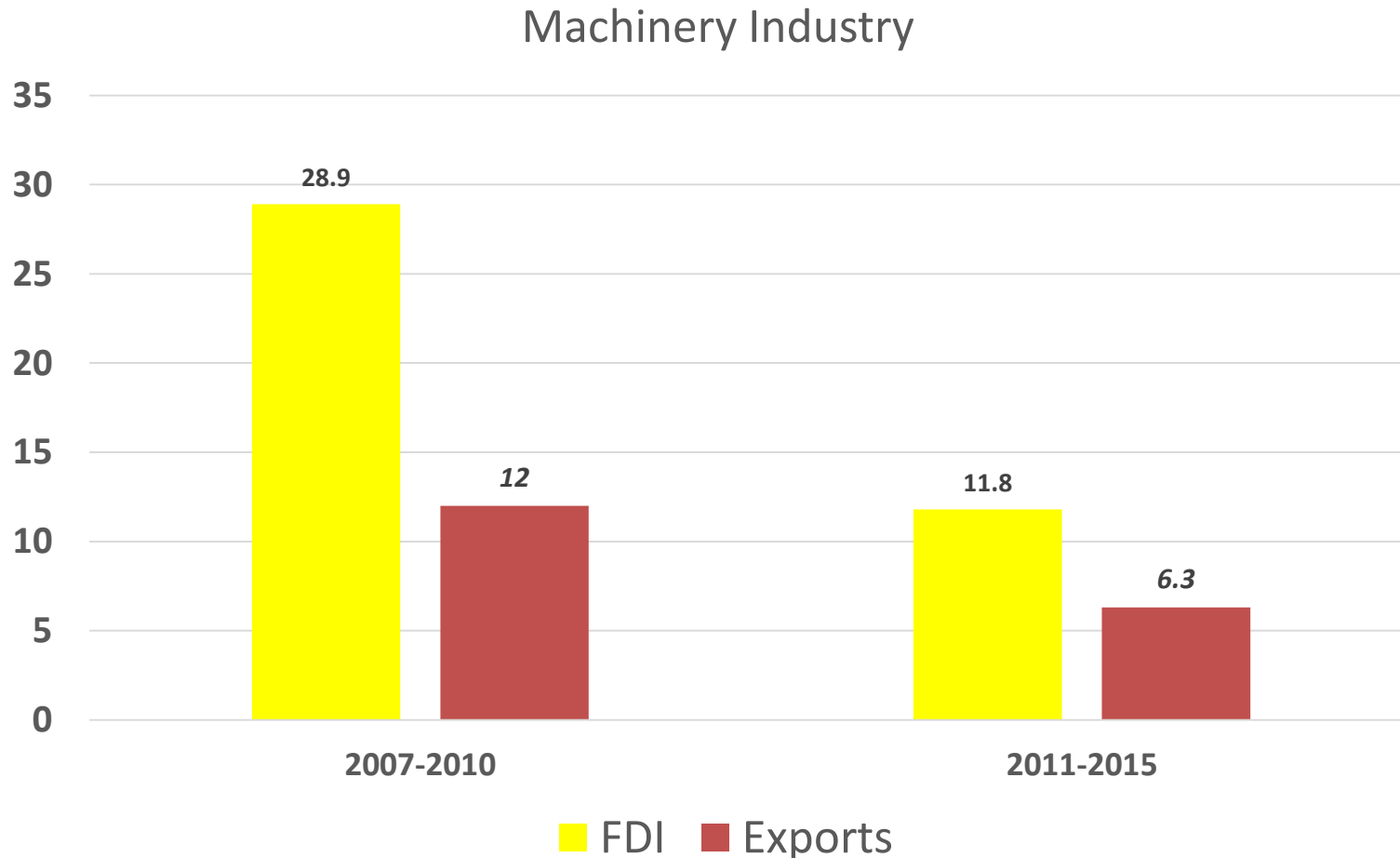


FDI Inflows and Export Growth (percentage change)

Electrical Appliances

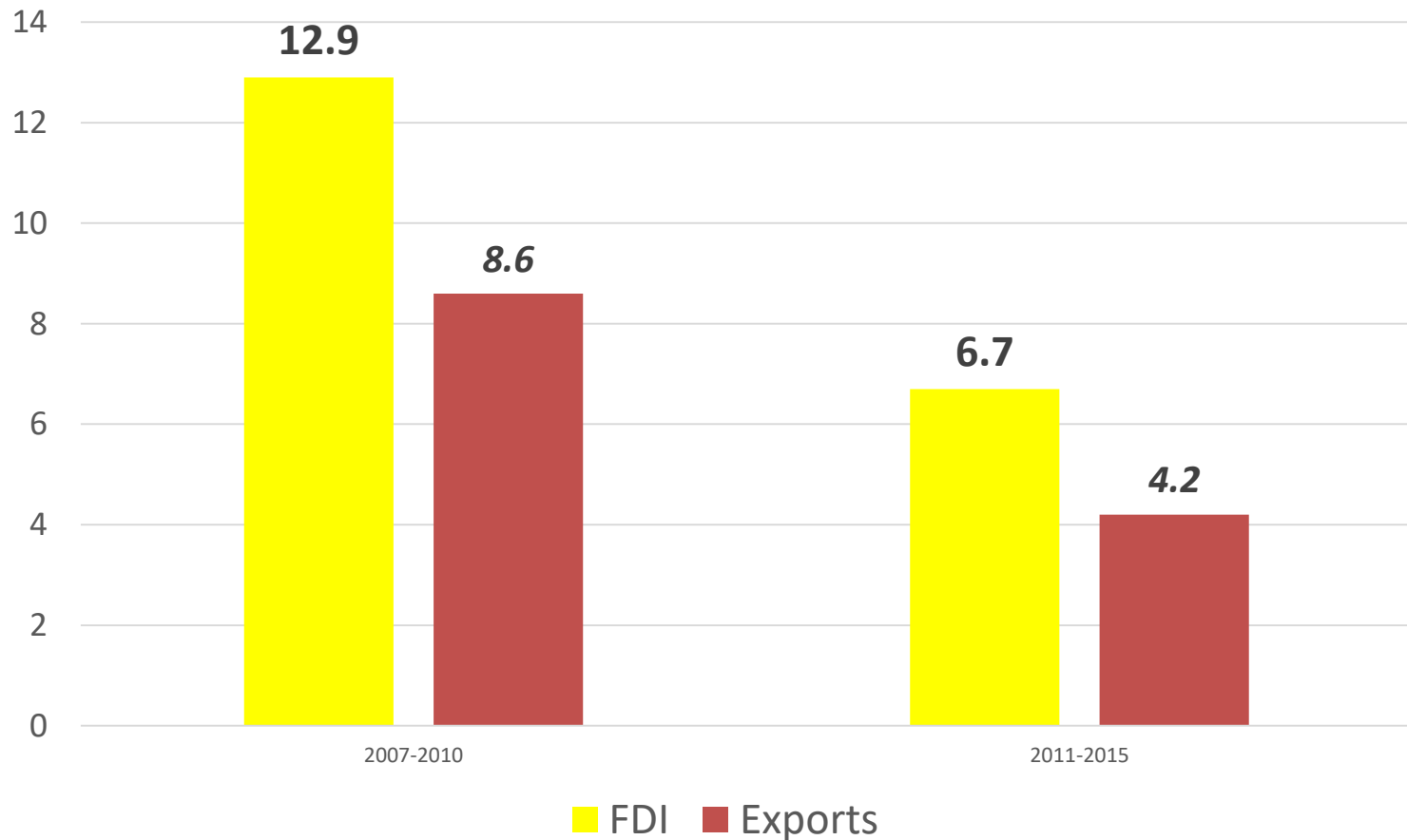


FDI inflows and export growth percentage change

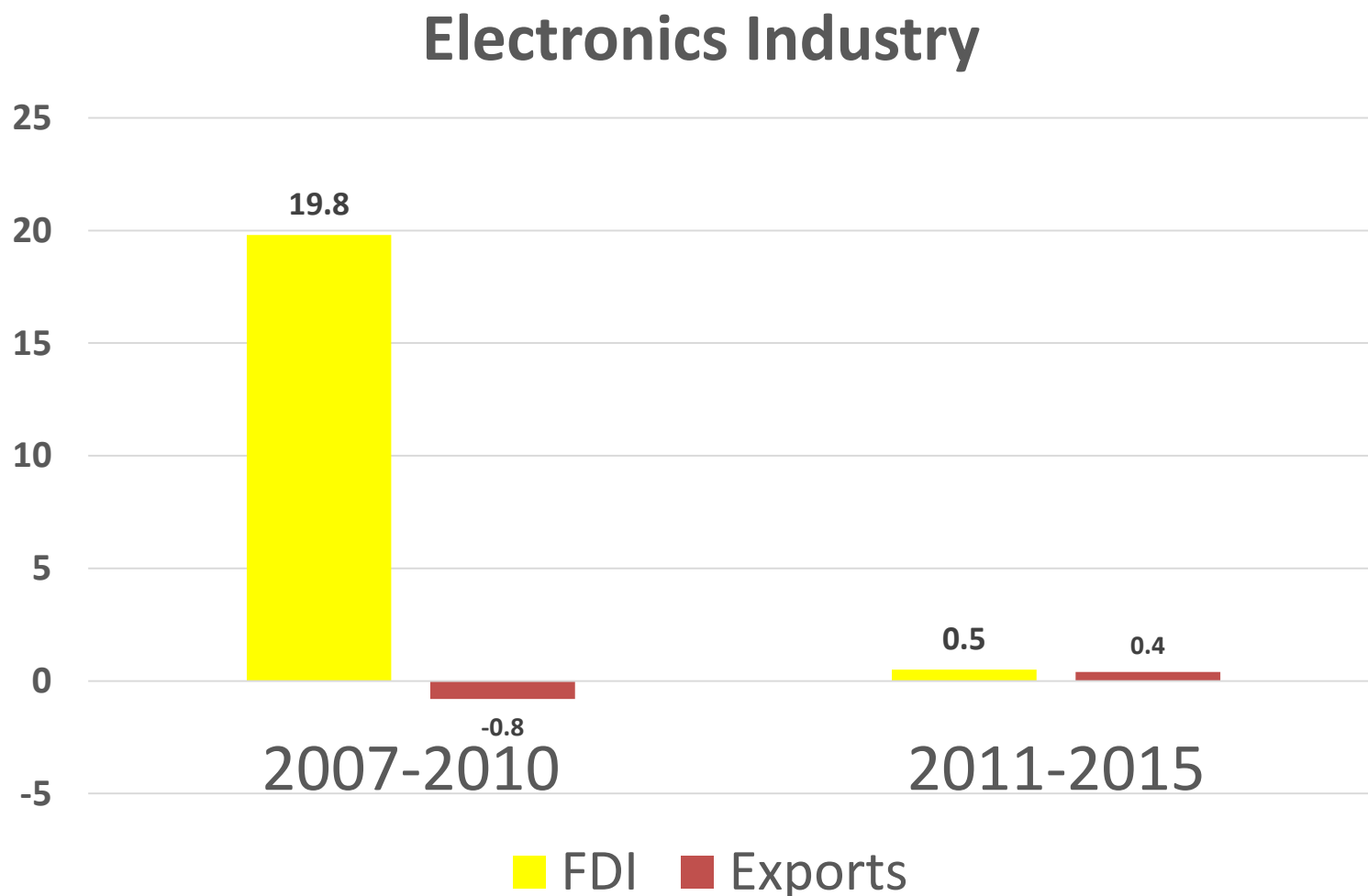


High FDI, High Exports

Processed Food Industry



Is this the beginning of the end?



5. Trade measures

- **Anti-dumping (AD), countervailing duty (CVD) and safeguards (SG)** for three categories of products: steel and aluminum; chemical products; and frozen seafood.

The World Trade Organization does not regulate the actions of companies engaged in dumping, but instead focuses on how governments can—or cannot—react to dumping

Anti-Dumping Duty (ADD)

- An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value.
- Dumping is a process where a company exports a product at a price lower than the price it normally charges in its own home market. For protection, many countries impose stiff duties on products they believe are being dumped in their national market, undercutting local businesses and markets.
- The US has imposed AD tariffs on certain **frozen fish fillets from Vietnam** at a rate of 63.9% of CIF (cost, insurance and freight), with an exemption for Thai products.
- The US also imposed AD measures on certain frozen warm-water **shrimp from China, India, Brazil and Vietnam at rates of 112.8%, 110.9%, 67.8% and 25.8%** of CIF.
- **Thai shrimp** products are also subject to the AD, but at a lower rate of 5.3% of CIF.

THAI AD/SG MEASURES ON IMPORTED PRODUCTS

AD

Thailand has exercised anti-dumping measures on 13 items of imported products from 20 countries

Item	Types of products subject to AD
Steels	12
Chemicals	1
Total	13



China is the country subject to the highest AD measures from Thailand, followed by South Korea and Taiwan

Thai AD measures

China	12 items
South Korea	6 items
Taiwan	6 items
Vietnam	4 items
Japan	2 items

Safeguard measures

Thailand has exercised SG measures on three items of imported products

1. Alloy hot-rolled steel flat products in coils and not in coils
2. Non-alloy hot-rolled steel flat products in coils and not in coils
3. Structural hot-rolled H-beams with alloy



Source: Foreign Trade Department

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Safeguard measures (SG)

- Safeguard measures **restrict imports of a product temporarily** if a domestic industry is seriously injured or threatened with serious injury caused by a **surge in imports**.
- The availability of a safeguard mechanism gives WTO Members the assurance that they can act quickly to help industries adjust to import surges, providing them with flexibility they would not otherwise have to open their markets to international competition.
- At the same time, WTO safeguard rules ensure that such actions are of **limited duration** and are gradually less restrictive over time. Under certain circumstances, compensation is also authorized.

Countervailing duties (CVDs)

- Also known as **anti-subsidy duties**, are trade import duties imposed under WTO rules to neutralize the negative effects of subsidies.
- They are imposed after an *investigation* finds that a *foreign country subsidizes its exports*, injuring domestic producers in the importing country.
- Airbus vs Boeing: subsidies by the EU and The U.S. The WTO ruled that the U.S. can apply CVDs to Airbus

Change on a year earlier, \$bn



Conclusions

- Since the first oil shock, Thailand's terms of trade has been declining.
- Primary commodities have become less important over time.
- Comparative advantage is changing, reflected by changing capital intensity.
- Demand for biofuels, if increasing, will keep cereal prices high – making staples beyond the reach of the poorest .

NESDC: Call for foreign firm perks

Trade war's victims need lures

Thosaporn Sirisamphand, the secretary-general of the National Economic and Social Development Council (NESDC), said the special investment packages may need to be introduced to attract foreign companies that are being affected by the trade war to relocate to Thailand.

"In times of trouble like this, many foreign companies are believed to be seeking greener pastures for investment," he said. "Investment policies should be attractive enough to entice them to choose Thailand as a base, not only for factory relocation but also production capacity expansion."

Mr Thosaporn said the NESDC's study found that trade squabbles between the US and China since 2018 have led a number of industrial factories in the two countries to consider relocating their production bases to other countries.

American Chamber of Commerce in China

More than 40% were considering moving their firms out of China to Southeast Asia

He cited a recent survey by the American Chamber of Commerce in China (AmCham China) that showed increased tariffs between Washington and Beijing hurting the competitiveness of US firms operating in China.

Many are moving or planning to relocate their factories elsewhere in the world, the survey said.

On May 22, AmCham China said in a report that US companies were facing increased government inspections, slower customs clearance and slower licence approvals.

Nearly 75% of the 250 companies that responded to the group's survey said the recent tariff hikes by the US and China were having a negative effect on their business.

The survey was conducted after China and the US raised tariffs on each other's imports earlier this month.

More than 40% were considering moving their manufacturing facilities out of China or had already done so, AmCham China said.

Their preferred destinations were Southeast Asia and Mexico. Less than 6% of the respondents said they were considering moving to the US.

An earlier survey conducted between August and September 2018 showed that nearly 65% of respondents wanted to stay in China.

One in five US companies said they had faced increased inspections by Chinese authorities, while 20% said their goods entering the country had been delayed by customs.

Mr Thosaporn said the trade war is likely to change the production base of the world for electronics products from China to Southeast Asia.

The relocation would become especially visible in the latter half of this year when the trade war is expected to become heightened.

COMPANIES REPORTEDLY RELOCATING THEIR PRODUCTION BASE SINCE EARLY 2019

Company	Sector	Status/possibility
■ Quanta Computer	Electronics	Considering feasibility of relocating to Southeast Asian countries
■ Foxconn	Electronics	Considering feasibility of relocating to Vietnam or back to Taiwan
■ Compal Electronics	Electronics	Considering feasibility of relocating to Vietnam
■ Kenda Rubber Industrial	Rubber products	Considering new investment in Vietnam
■ Samsonite International SA	Bag products	Considering a move out of China
■ Macy's Inc	Product distribution	Moving production out of China
■ Fossil Group Inc	Product distribution	Moving production out of China
■ Nitto Denko	Chemical products	Considering lowering production in China and raising production capacity in other countries
■ Kobe Steel	Steel products	Considering relocating its factory
■ Harley-Davidson	Big motorcycle	Building factory in Thailand
■ Ricoh	Electronics	Expected to move its factory to Thailand in 2019
■ Delta Electronics	Electronics	Made a conditional voluntary tender offer for all ordinary shares of Delta Electronics Thailand worth US\$2.14 billion before production expansion in Thailand
■ Wistron	Electronics	Considering feasibility of relocating to India
■ Samsung	Electronics	Considering relocating to India

Source: Compiled by NESDC

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Conclusions

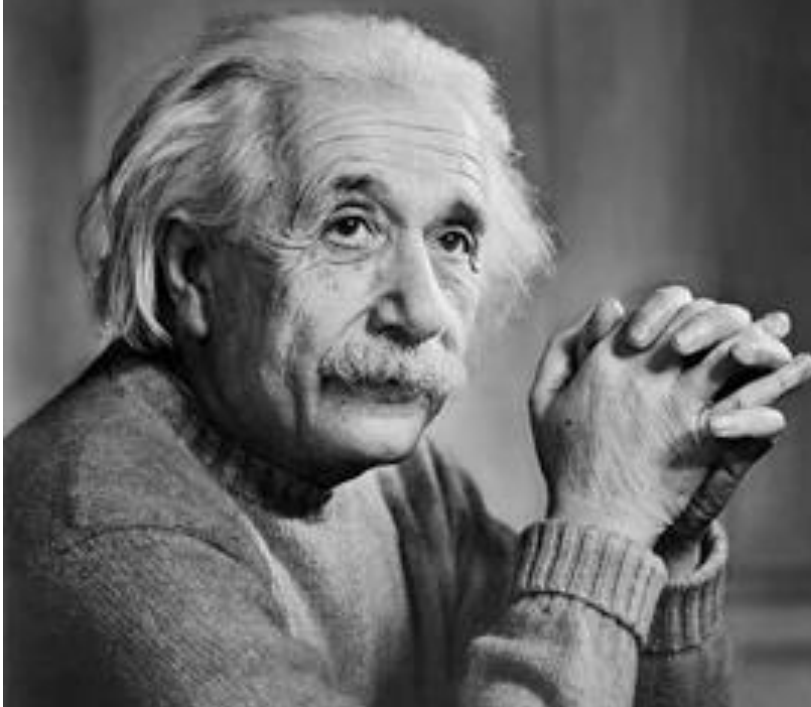
- Thailand benefitted from participation in network trade and the rapid recovery of exports in Japan and China in 2010 after the export collapse due to GFC in 2009.
- The severity of the impact of GFC on Southeast Asian economies depend on each country's export dependency, and trade intensity among them.

Review questions

- What would be the impacts of the U.S.-China trade war on Thailand?
- What will be the impact on Thailand's growth due to the Covid-19-led global recession in 2020?
- Explain why network trade can lead to business cycle synchronization in Asia?

If you can't explain it **simply**, you
don't understand it well enough.

– Albert Einstein



Grading scores

Writing Quality	Shallow subject Understanding	Deep knowledge
Good	5	8
Poor	4	6

Incomprehensible, irrelevant, verbose, fudge the answers drop a few notches.

Extra efforts constitute an increase by two notches.