Trade and Foreign Direct Investment

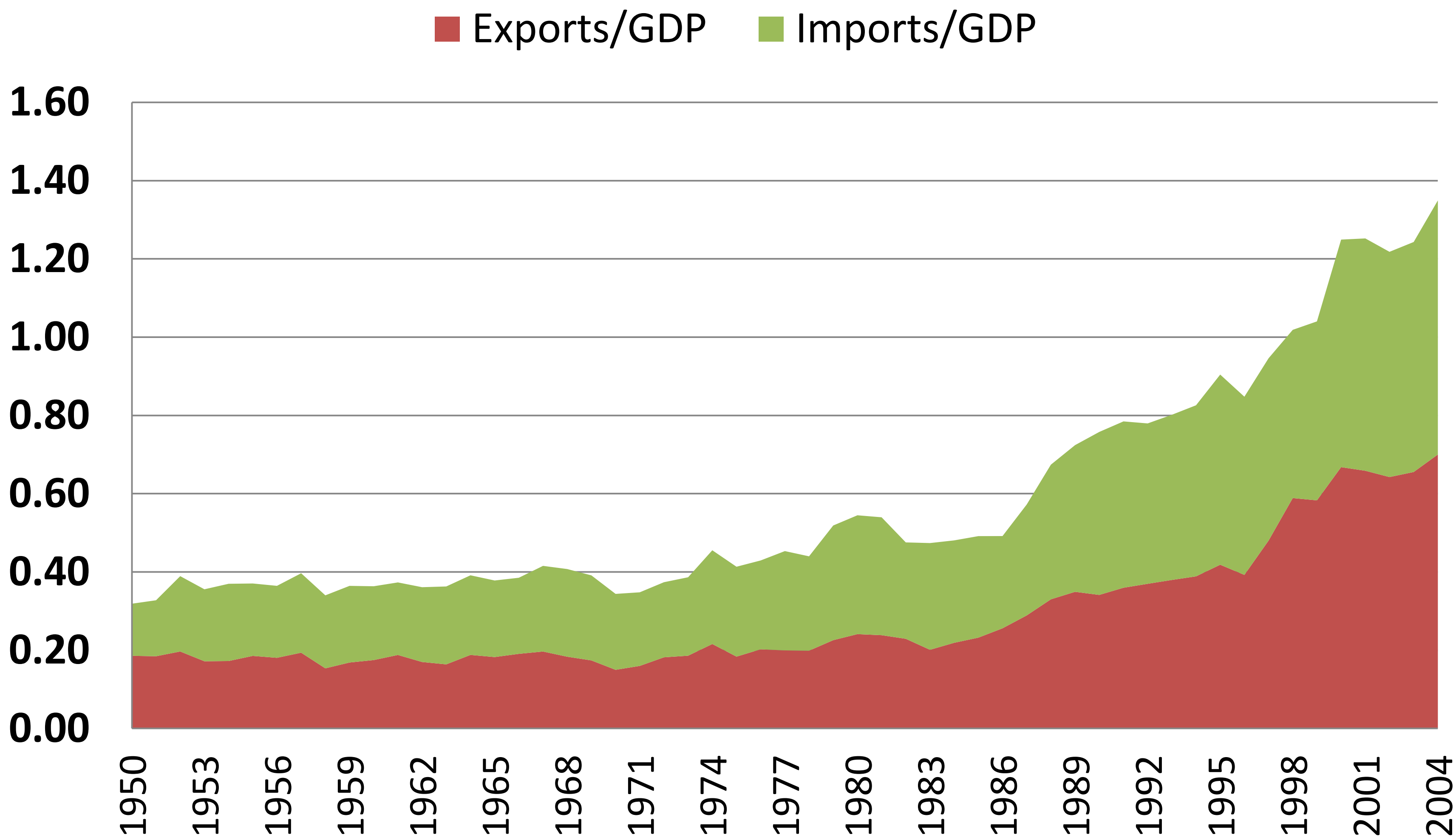
Bhanupong
Lecture 18

"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.***

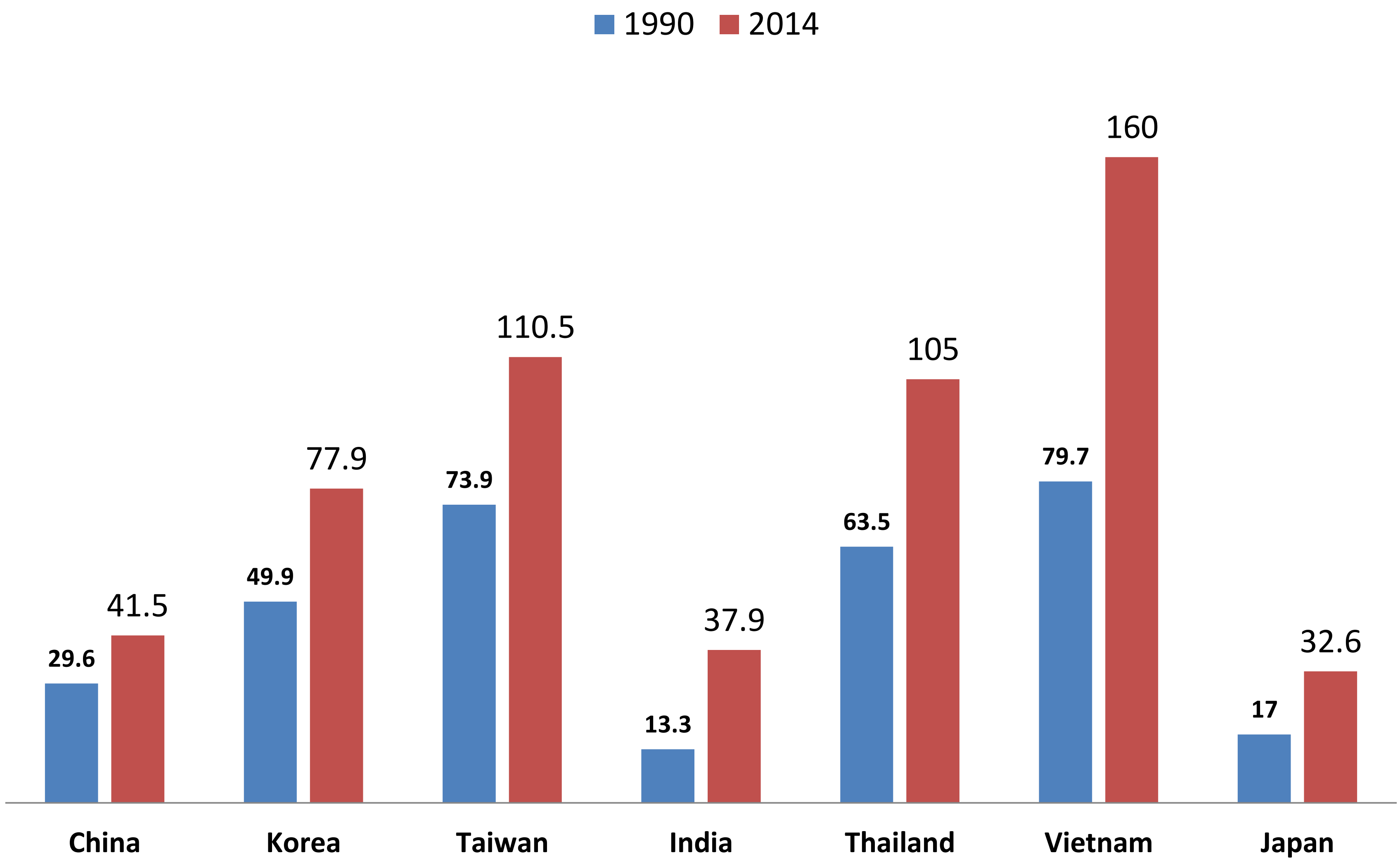
Main themes

- Long-term trend of Thailand's trade sector
- Trade as handmaiden of economic growth
- FDI and network trade
- Trade structure
- GFC and trade

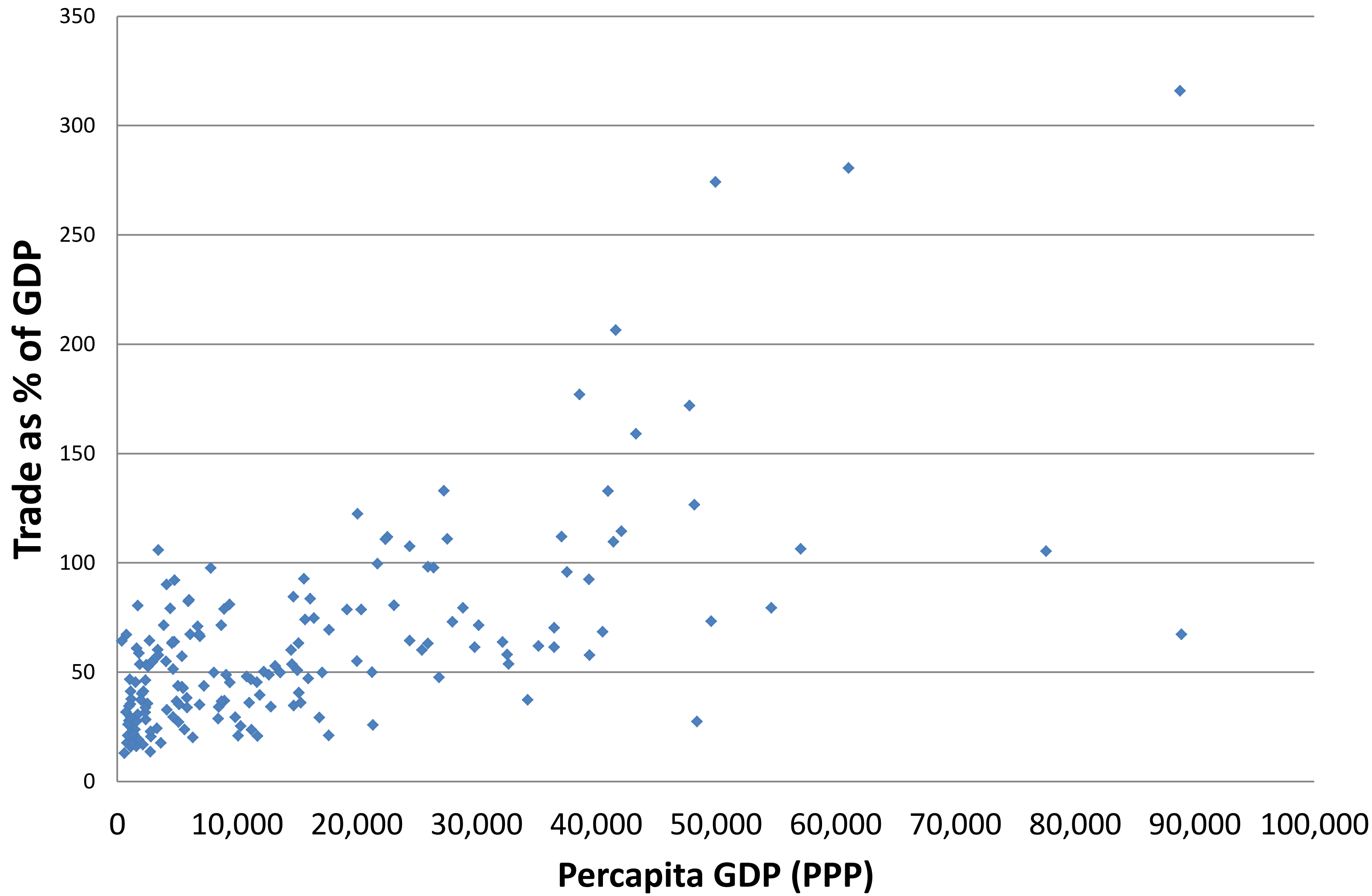
Importance of trade sector since 1950



Trade Exposure
(Trade as % GDP)



Trade and Level of Development
Cross-section data: 2009-2011



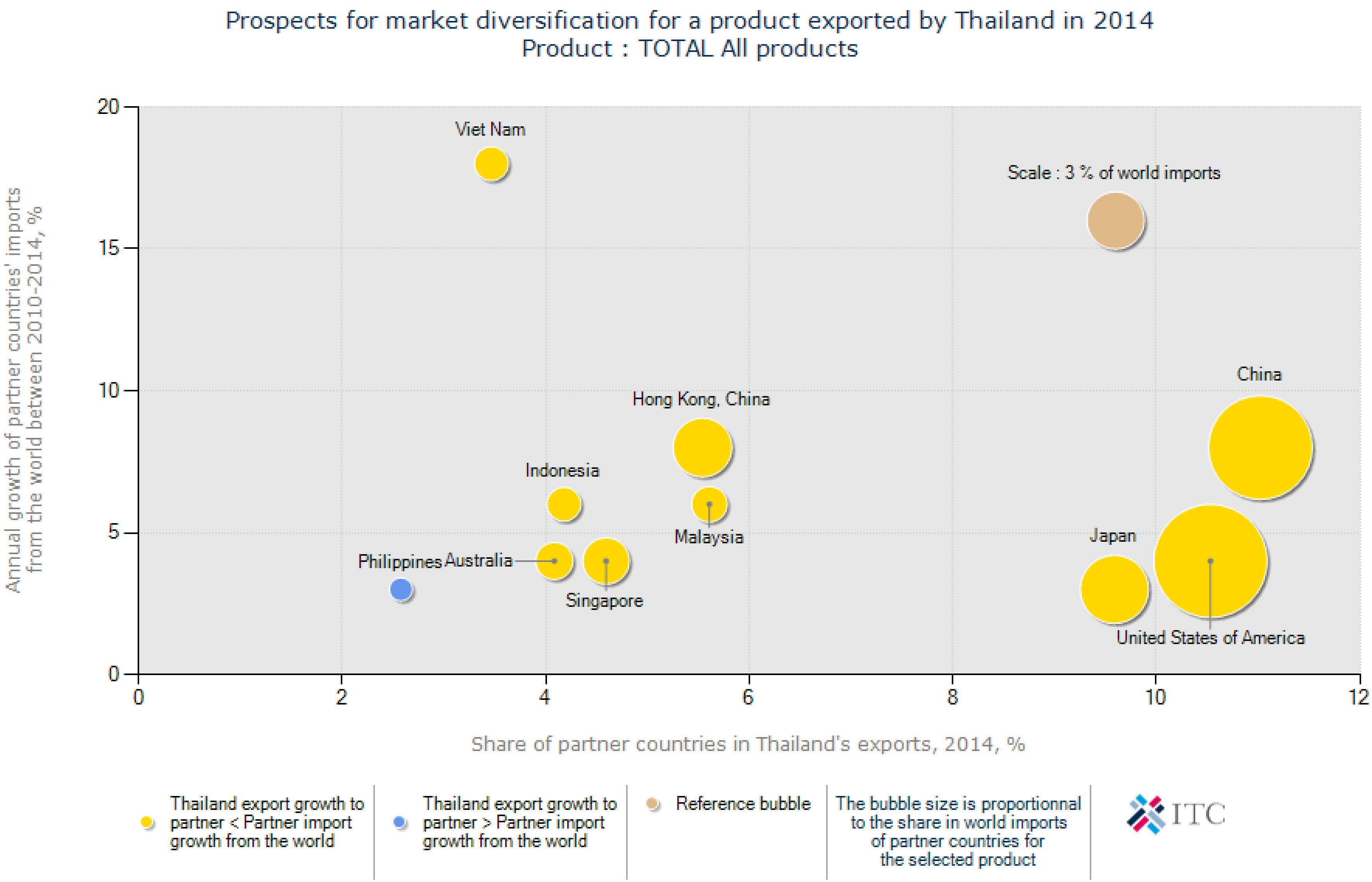
Source of data

ITC | TRADE MAP

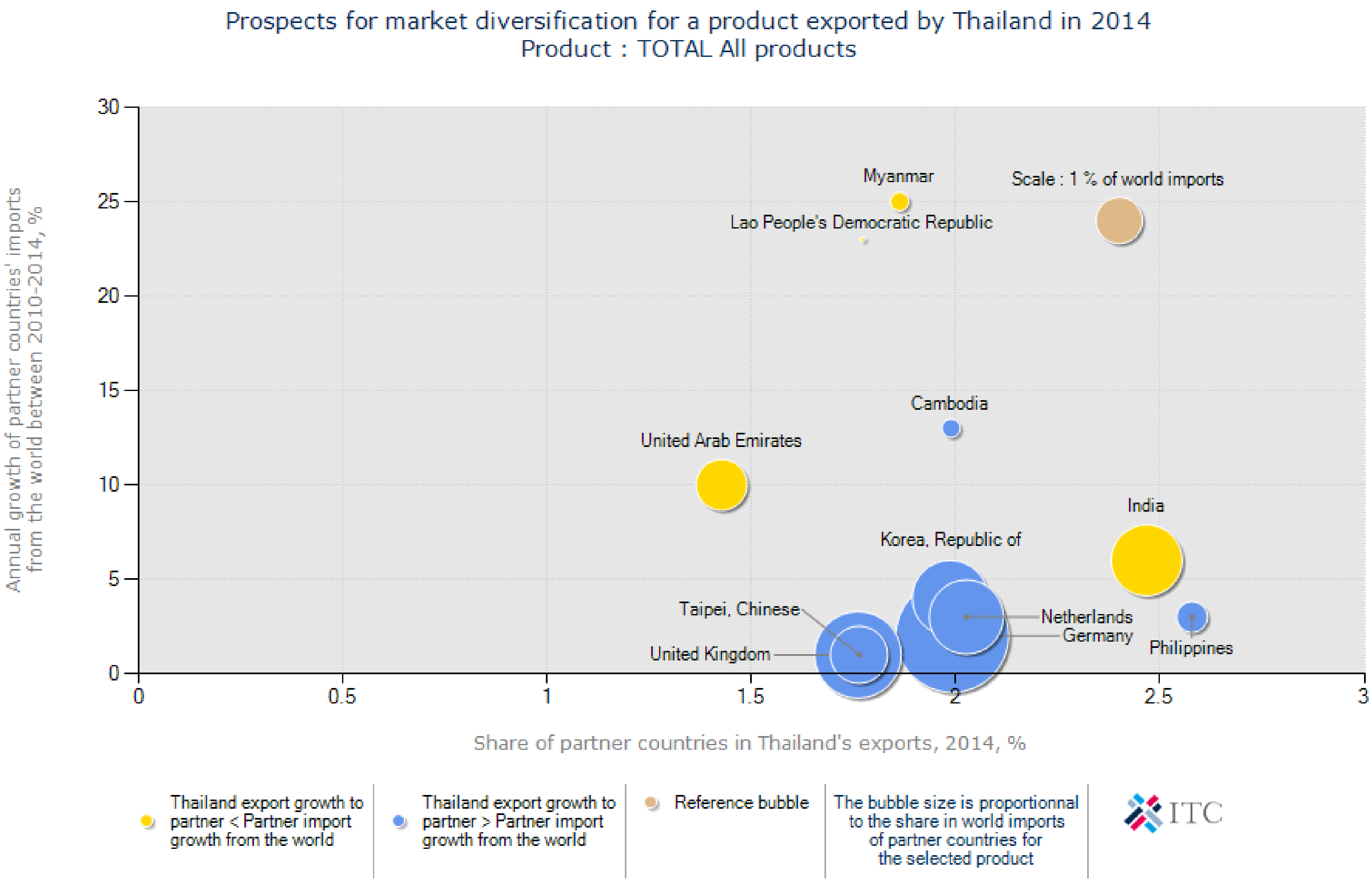
Trade statistics for international business development

Monthly, quarterly and yearly trade data. Import & export values, volumes, growth rates, market shares, etc.

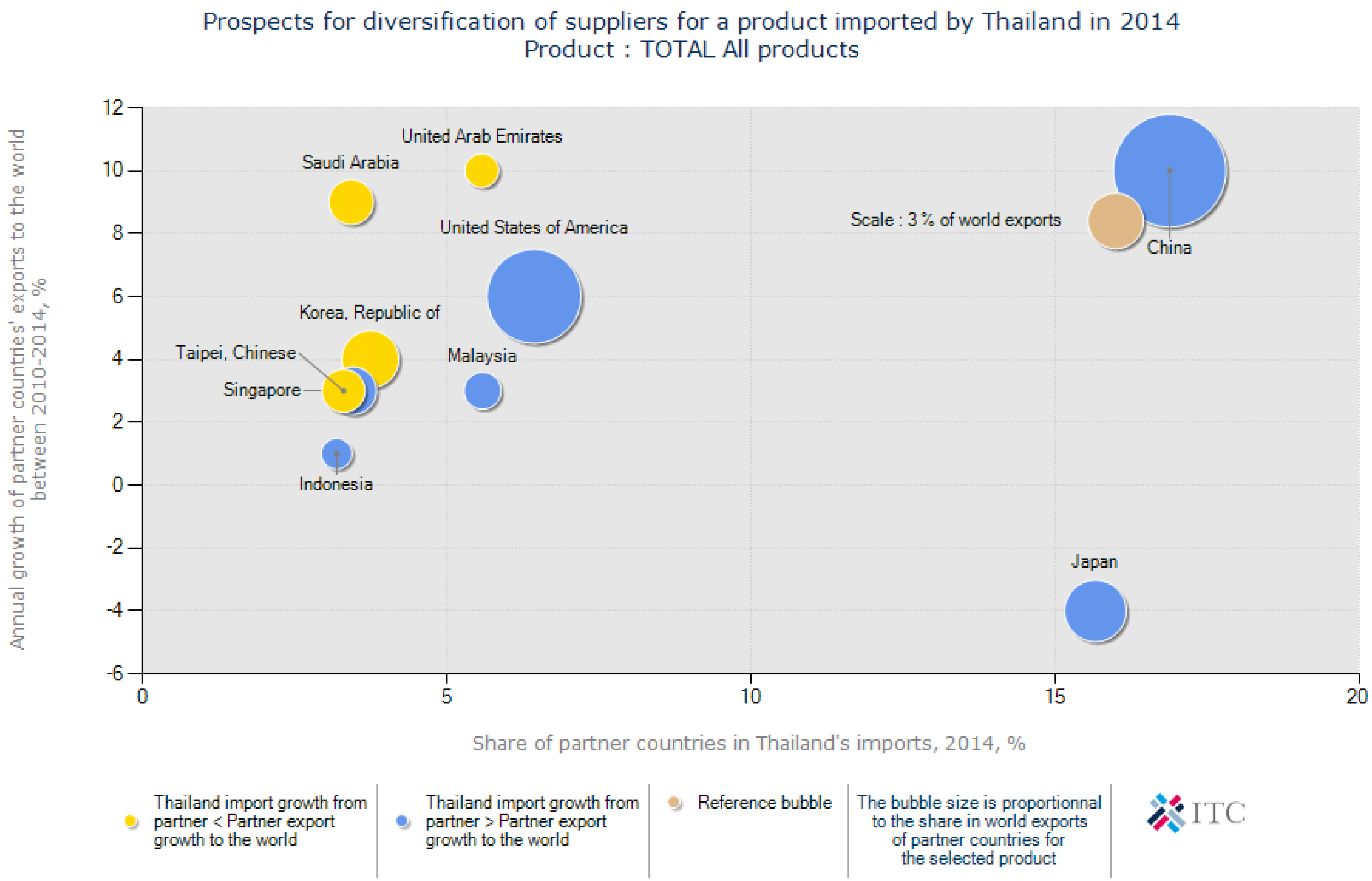
Top 10 Thailand's export markets



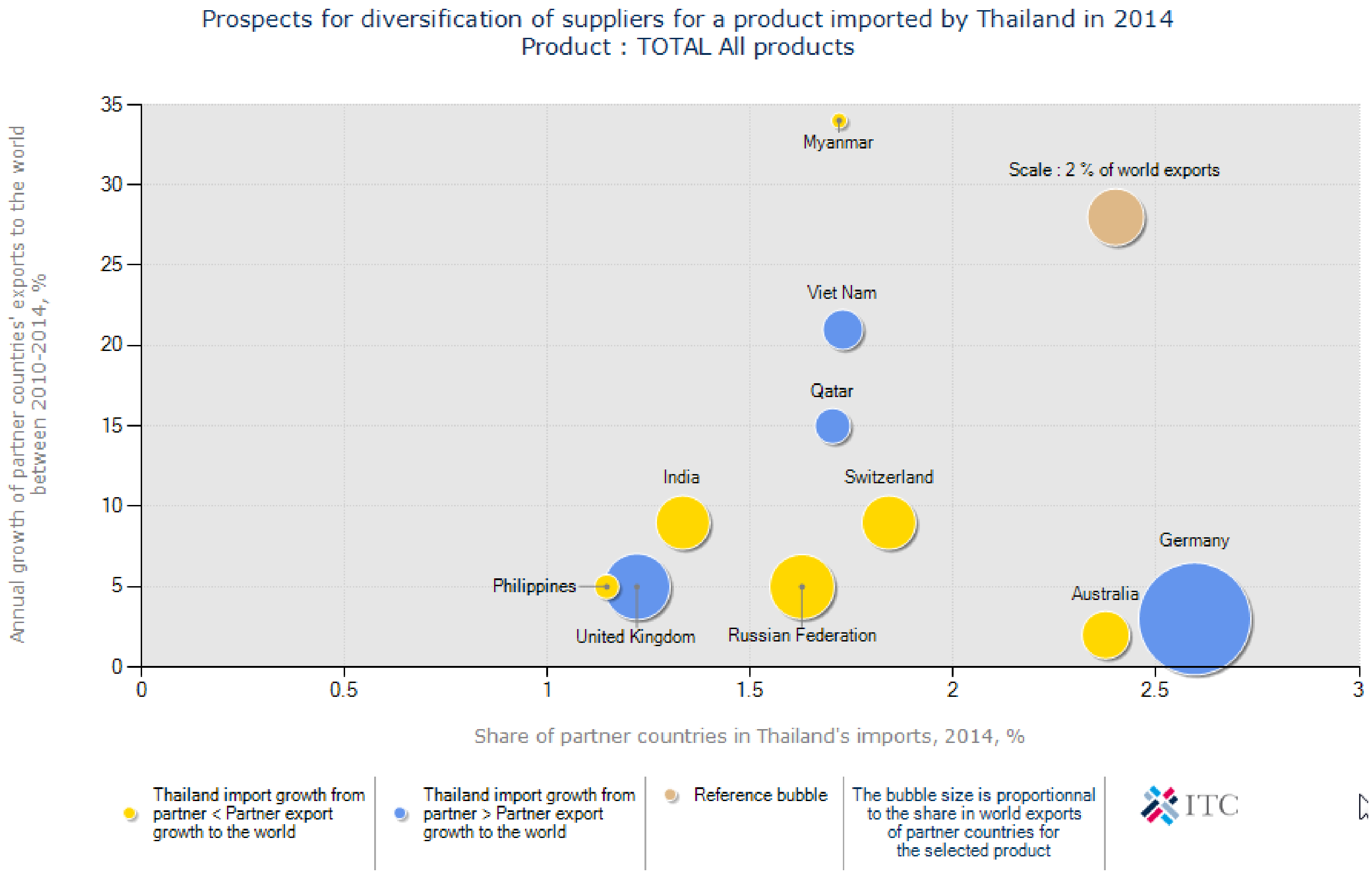
Top 20 export markets



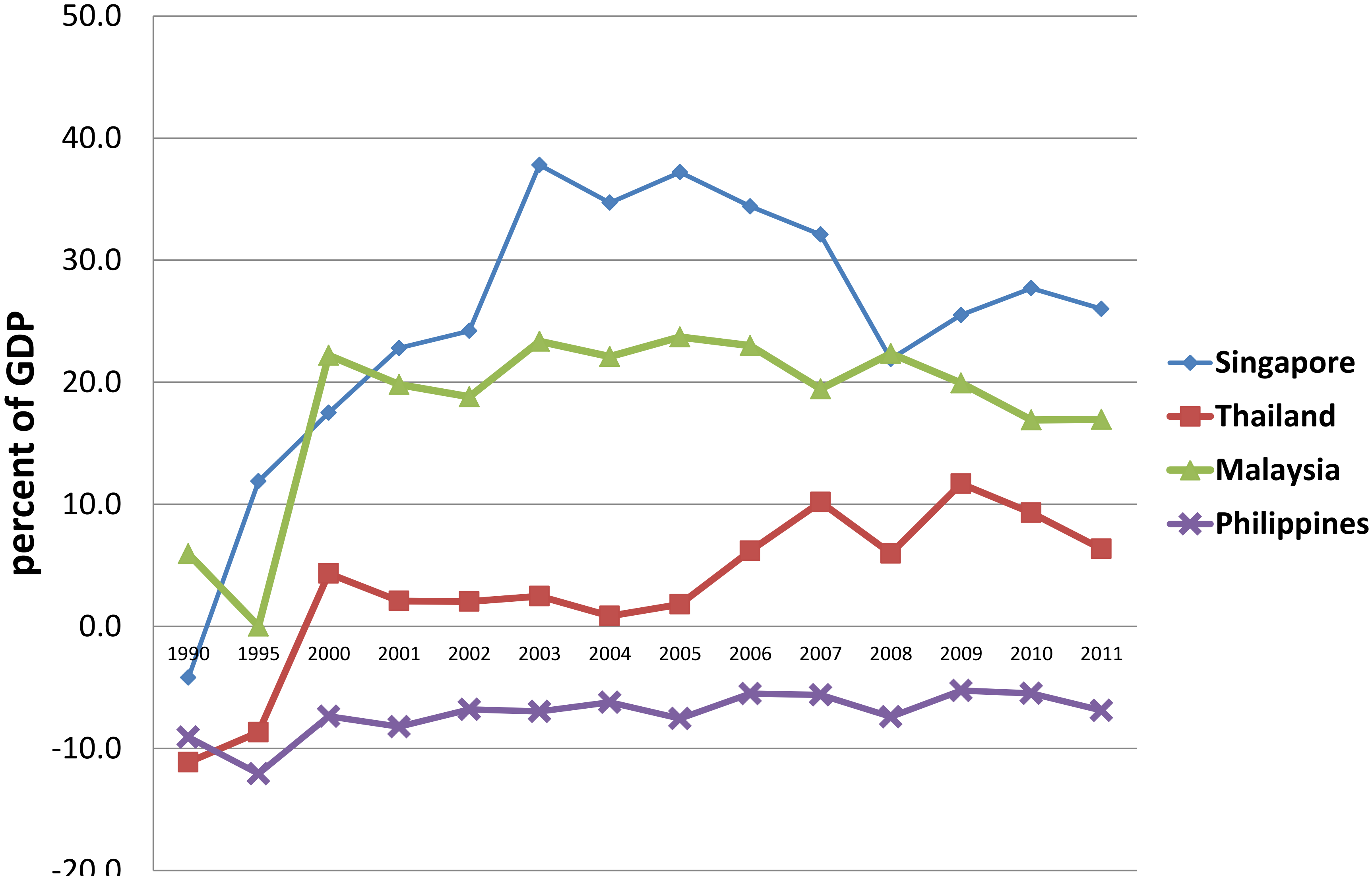
Top 10 Thailand's Imports



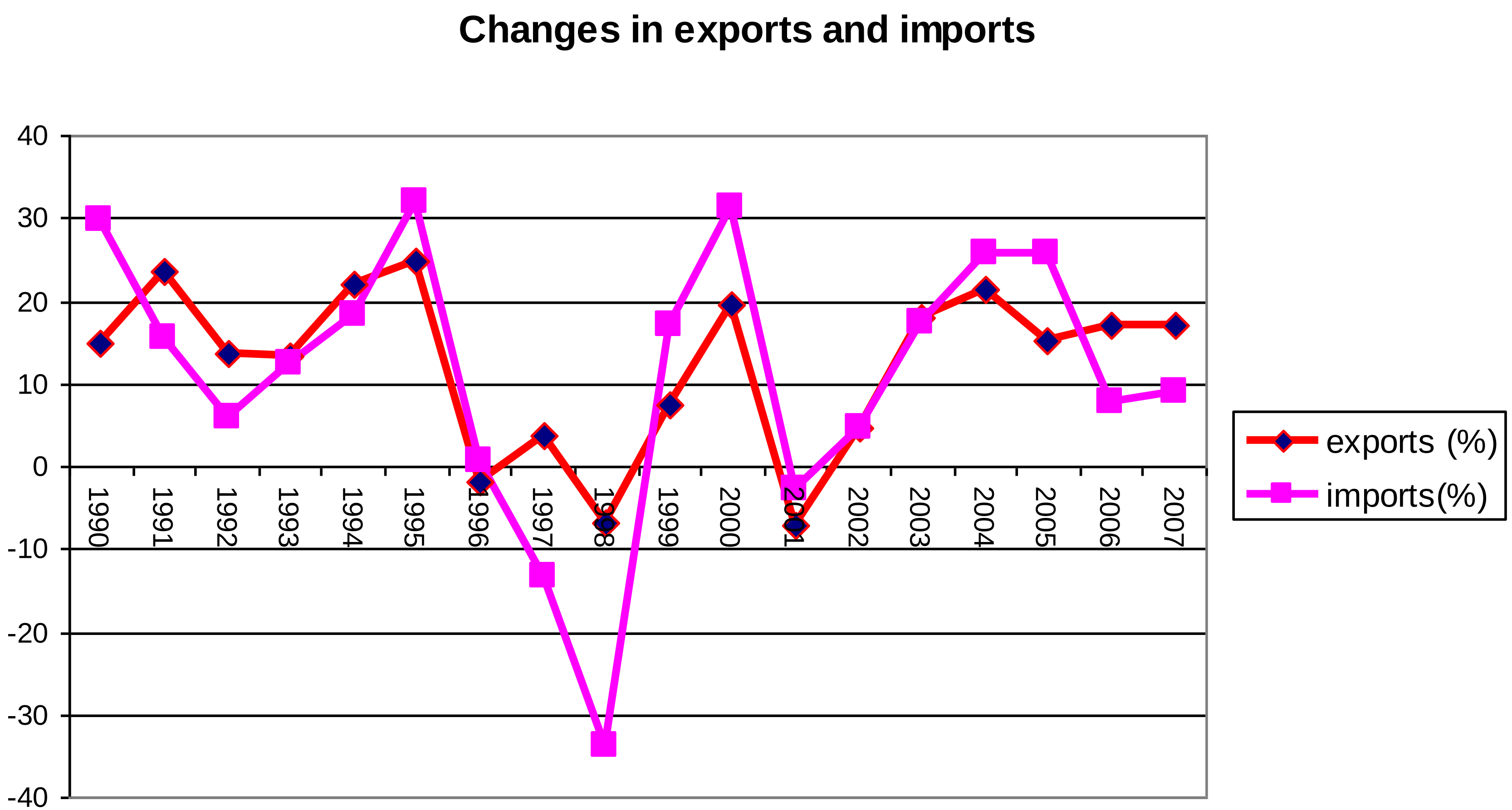
Prospects for diversification of import sources



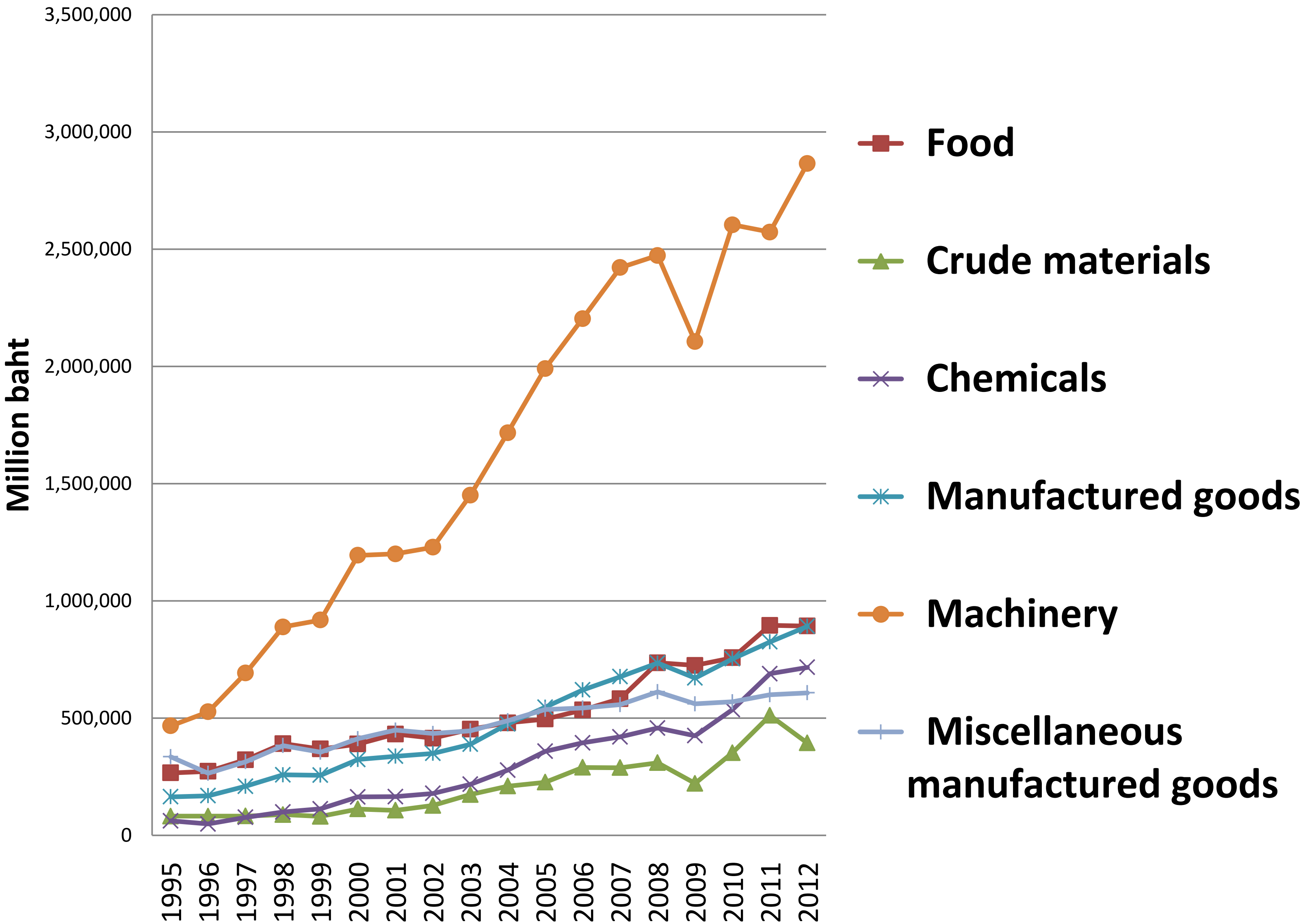
Balance of Trade
Exports - Imports



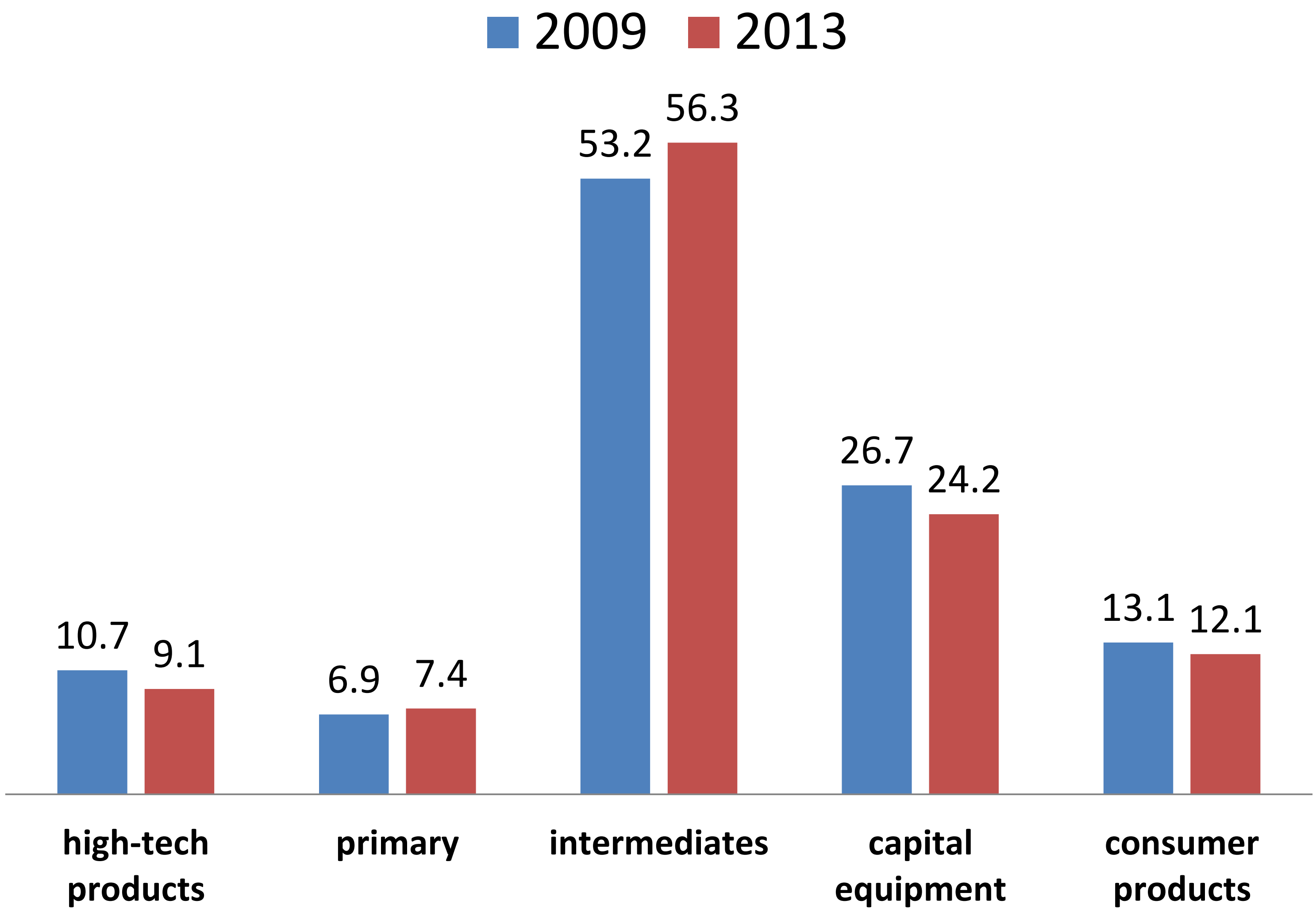
Long-run causal relationship—non spurious



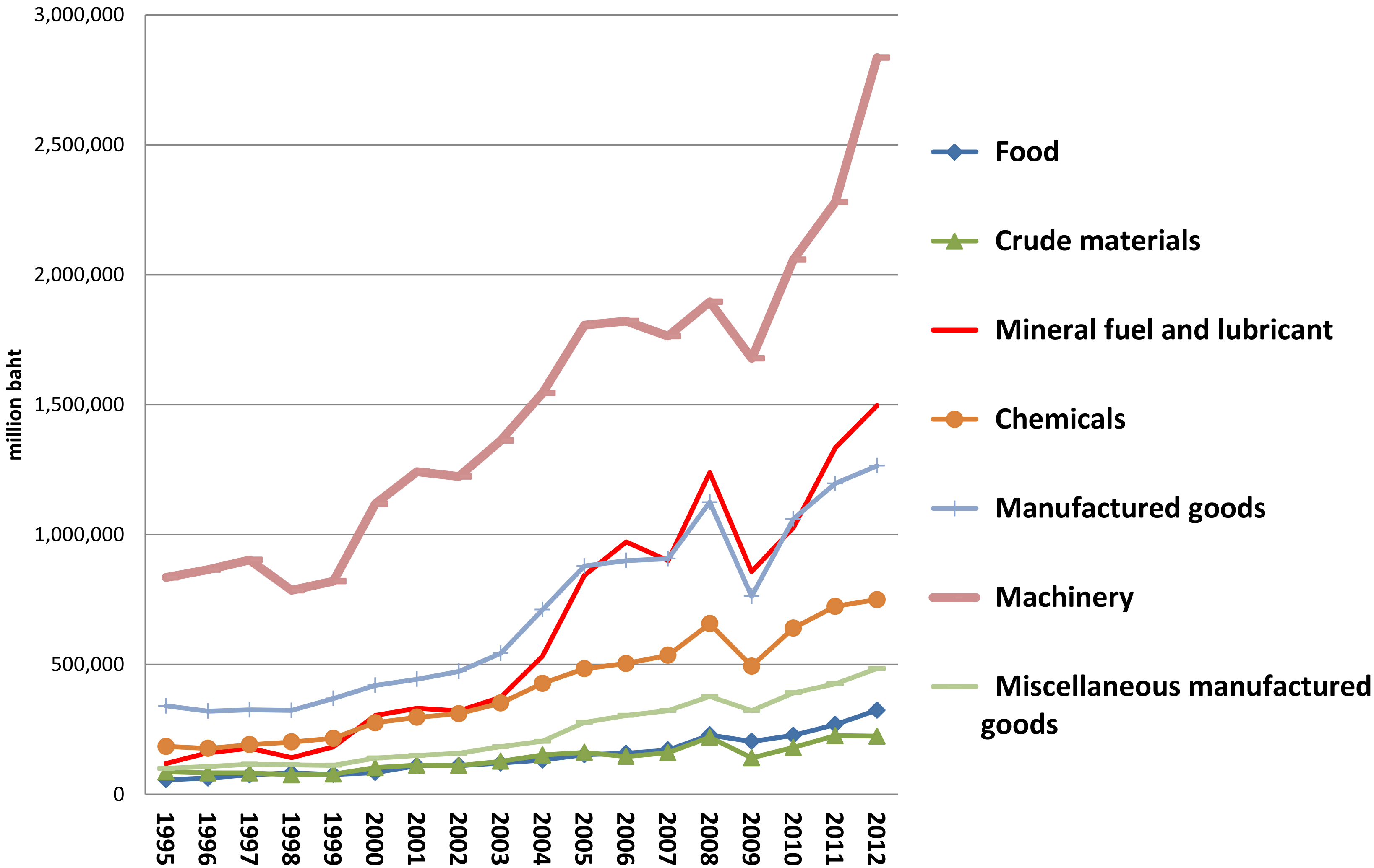
Exports by commodity group



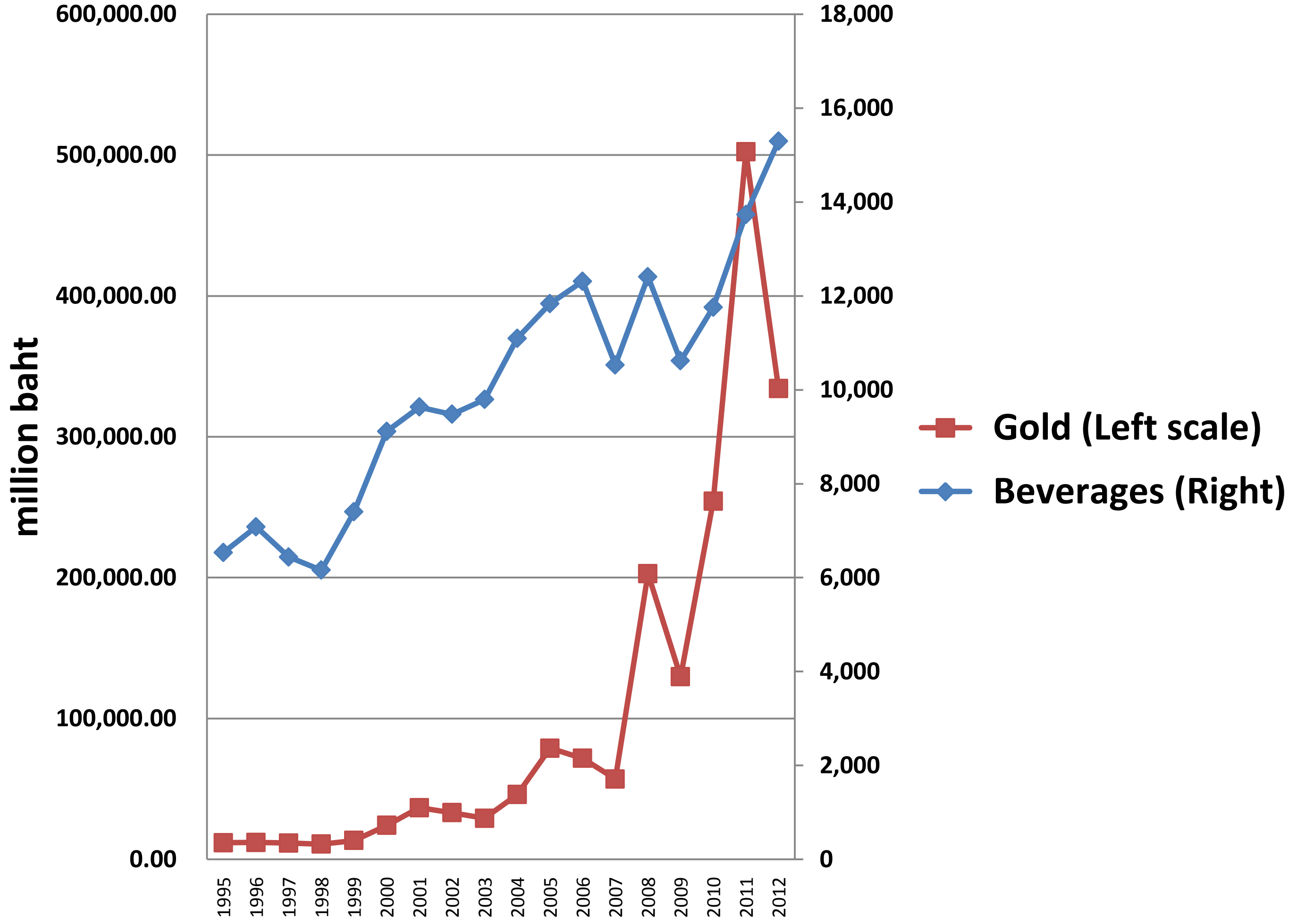
Export Structure



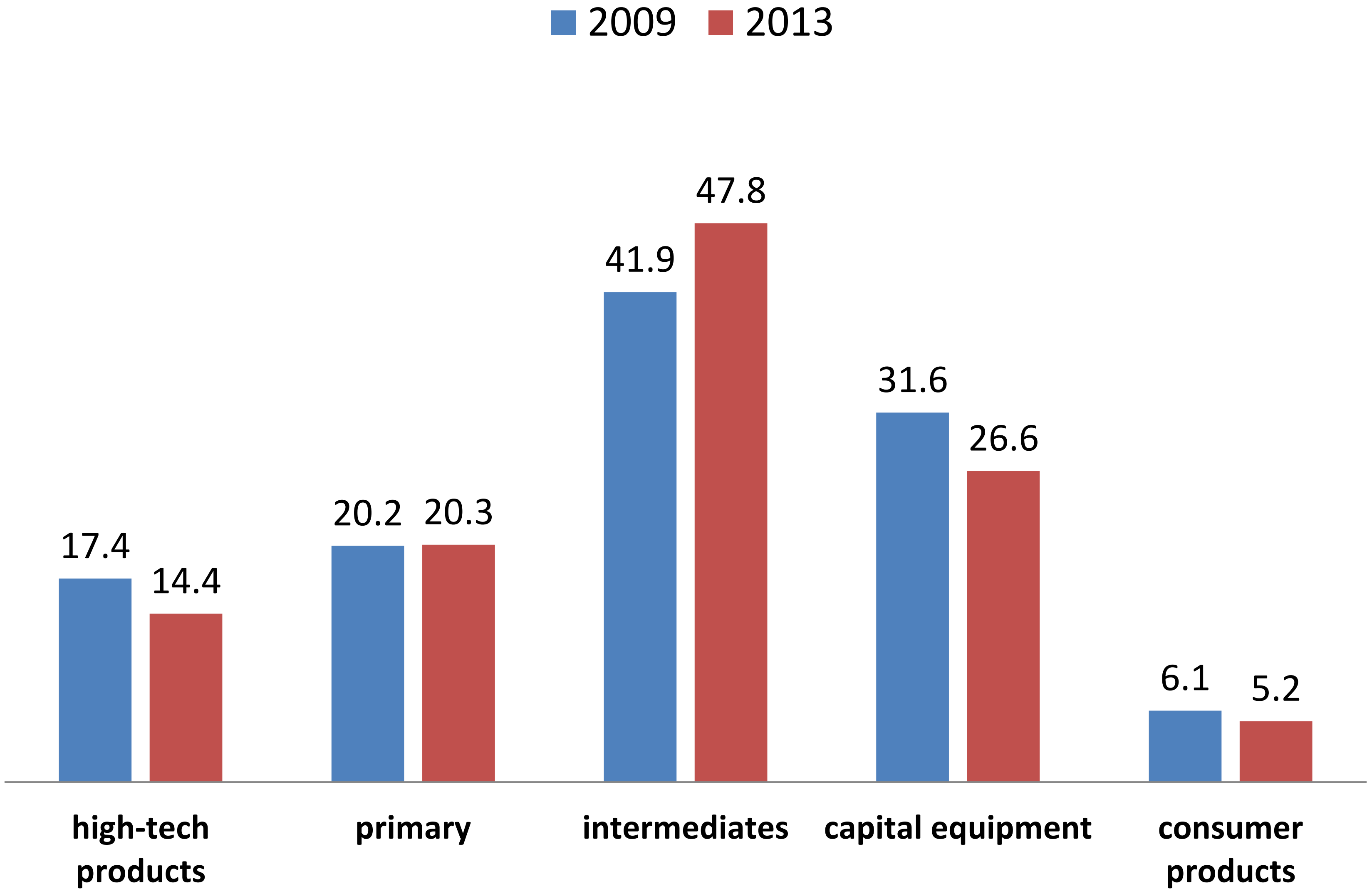
Imports by commodity group



Imports of essential items



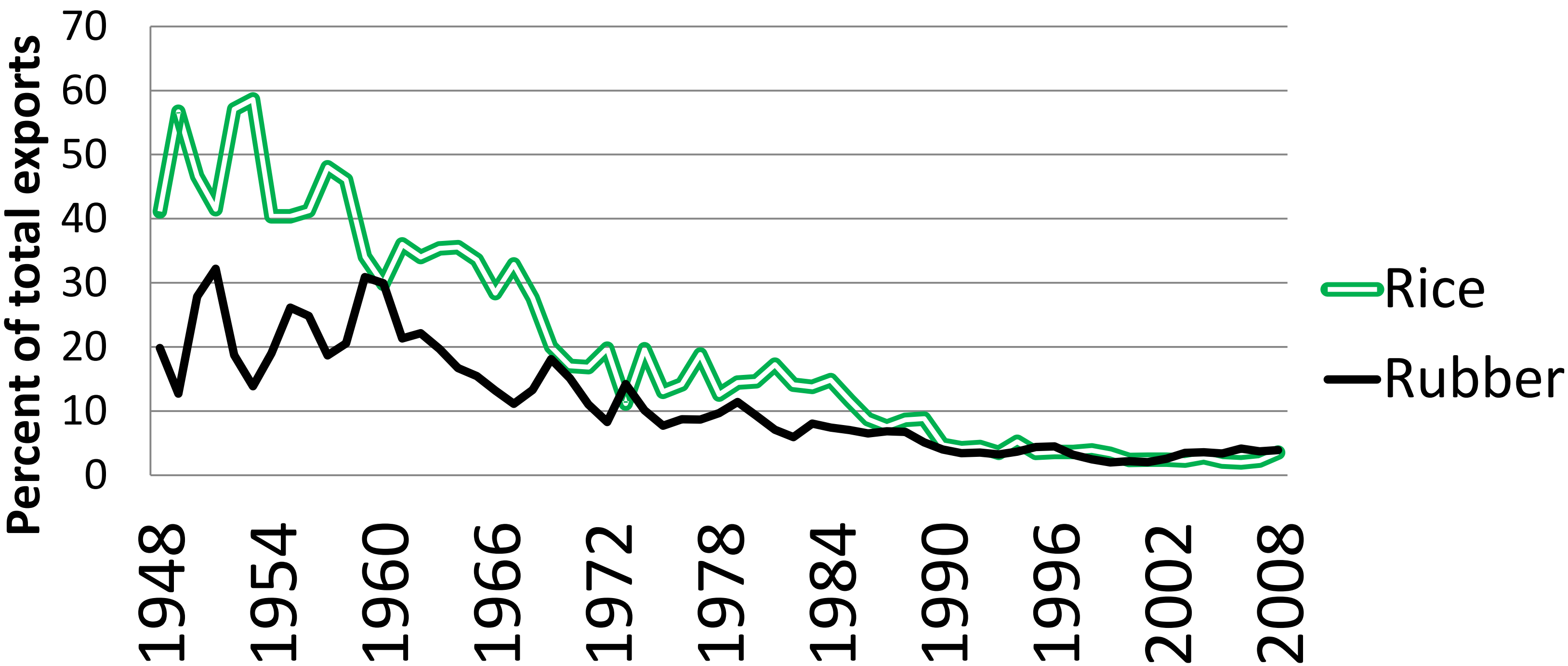
Import structure



10 Year Gold London Fix PM Daily with 60 and 200-day moving averages

Shares of Thailand's traditional primary exports

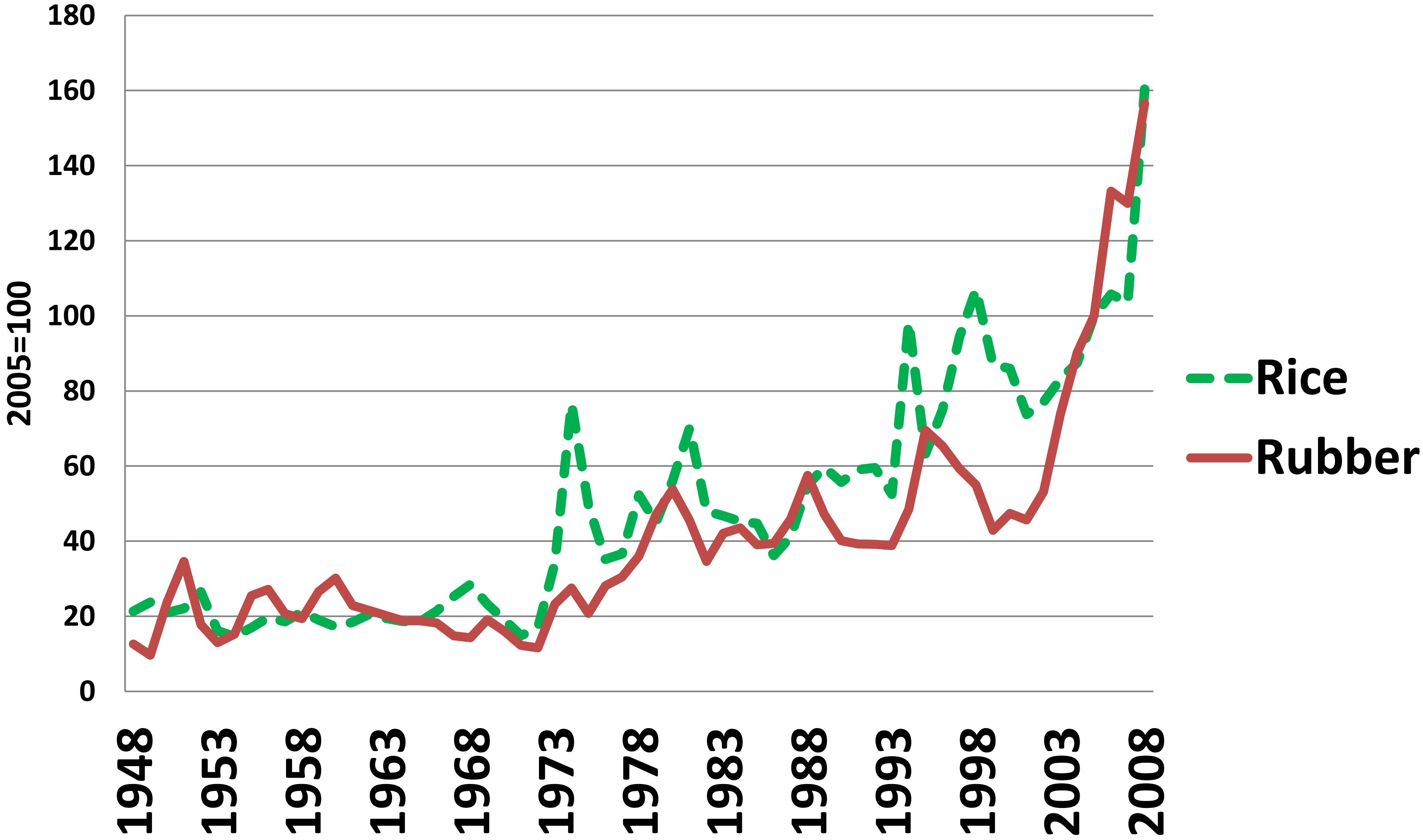
Technology gap and factor endowment determine competitiveness



Trade in primary products

- Primary goods are ***non-differentiate***d 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 determinants of trade in agricultural goods such as rubber and rice.

Rising commodity export prices: 2008 peak



One-billion hungry people

- The number of people who go to bed hungry every night somewhere in our world has reached 1 billion – one in six of the Earth's population, according to a new report by the United Nations' Food and Agriculture Organization.
- Should Thailand focus more on agricultural exports to exploit the rising trend of commodity prices?
- All countries are concerned with food security; FTAs usually exclude food items.

Malthusian vs. Senian view

- Demand is outpacing supply.

  (Thomas Malthus)
- Enough supply but access to food is denied for hungry people. (A.K. Sen)
- The case of Irish potato famine

Why did food prices soar in 2008?

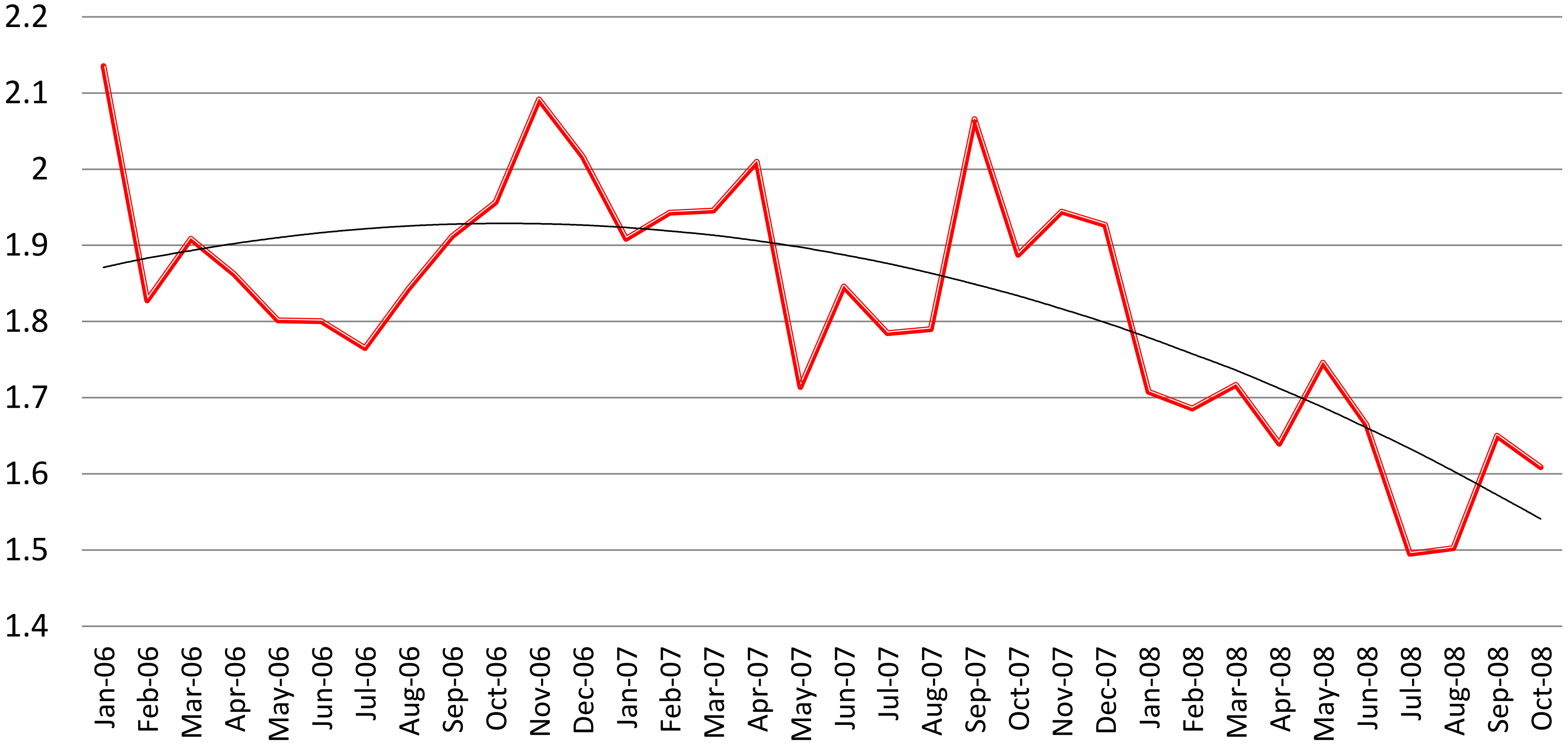
- Things were triggered by the 2007 drought in Australia, the worst for a century, which halved its wheat harvest. But there were more fundamental background factors**.**
- As countries like China, India, Brazil and Russia have got richer they have begun eating more.
- Rich people don't just eat more 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 8kg of grain to produce 1kg of beef – the price of all cereals has been forced up.***

Biofuels

- Added to that was George W Bush's love affair with American biofuels.
- (And what about the Thais' love of the gasohol, Indonesian's palm oil and annual haze?)
- 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 has rocketed as a result***.

Thailand's implied tariff rate

customs revenue to total imports(%)



Adverse impact of globalization

- Exposure to external shocks
- Export dependency
- Increase business synchronization
- Destroy traditional (uncompetitive) sectors
- Tariff and economic growth

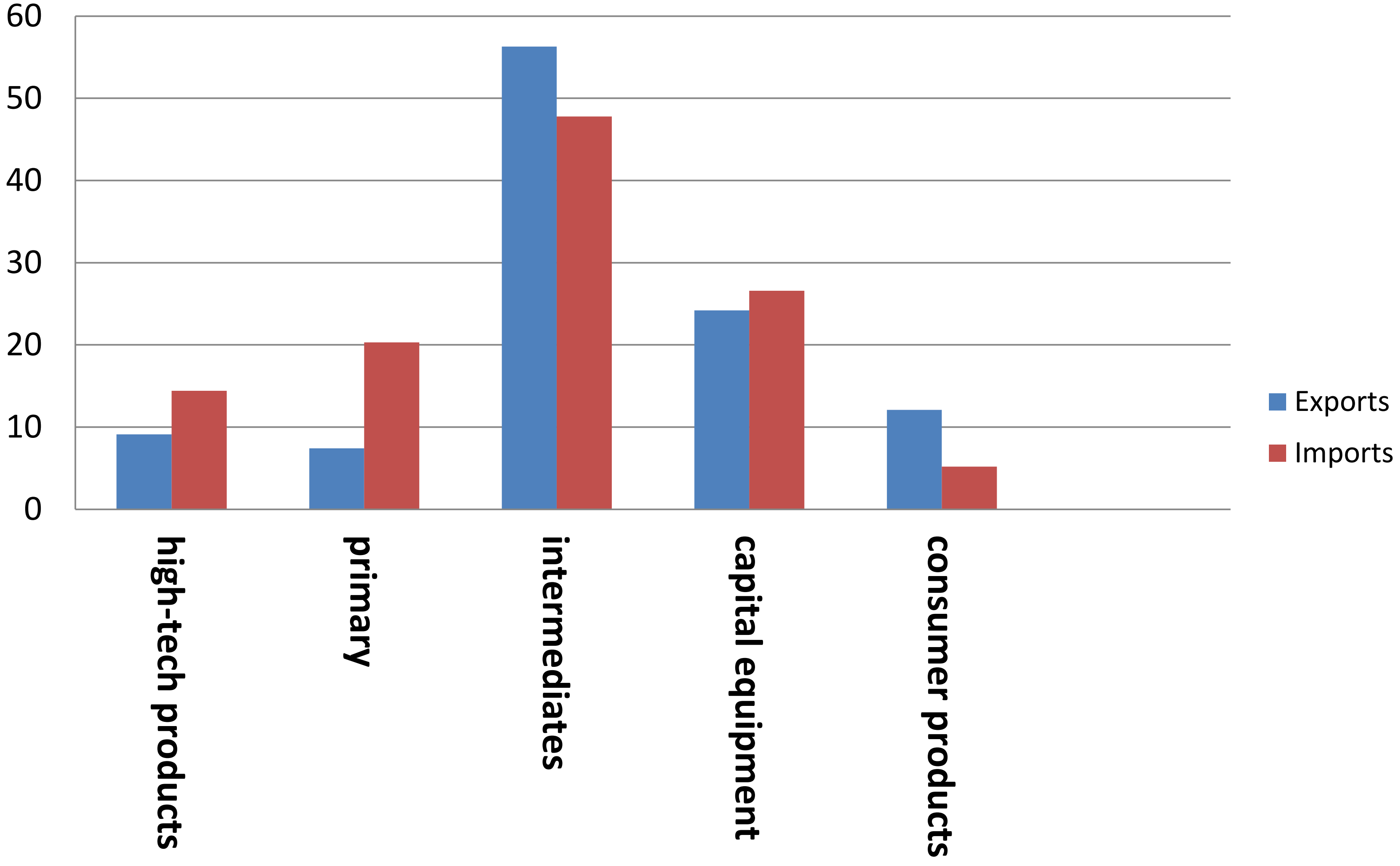
What globalization can do

- High exports can sustain growth
- Imported capital goods raise productivity
- World competition exposure leads to efficiency improvement.
- Exploitation of 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

Growing ***network trade***

- Network trade is expanding much faster compared to conventional product-based trade (24 % of total manufactured exports in 1993, 45.5% in 2007).
- There is a shift away from mature industrial economies towards developing countries .
- Developing countries' share in network exports rose from 25 % in 1993 to 41% in 2007.
- 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 factory"**
- Clear evidence of trade complementarity rather than crowding out effect.

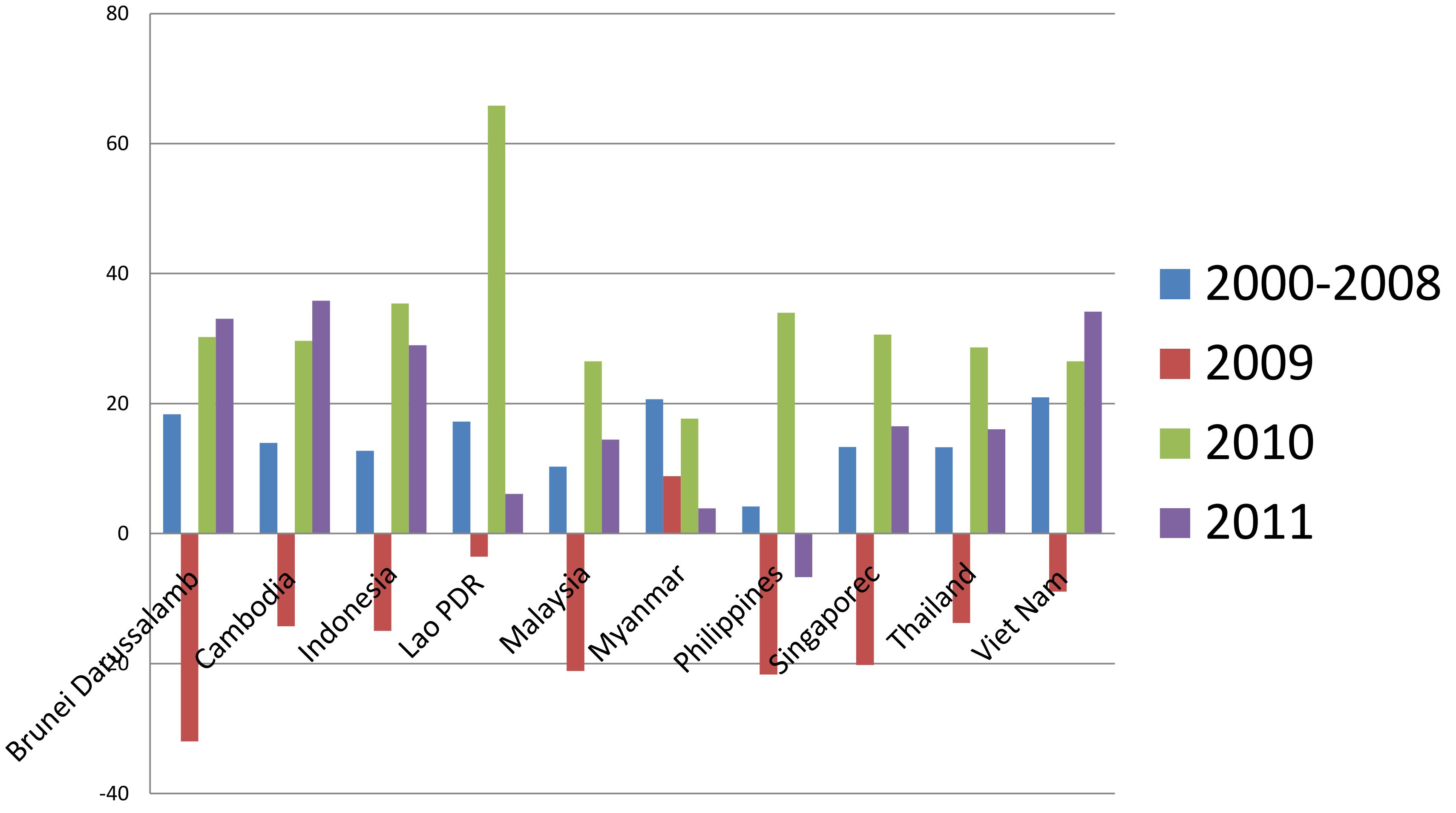
Trade by stage of processing 2013



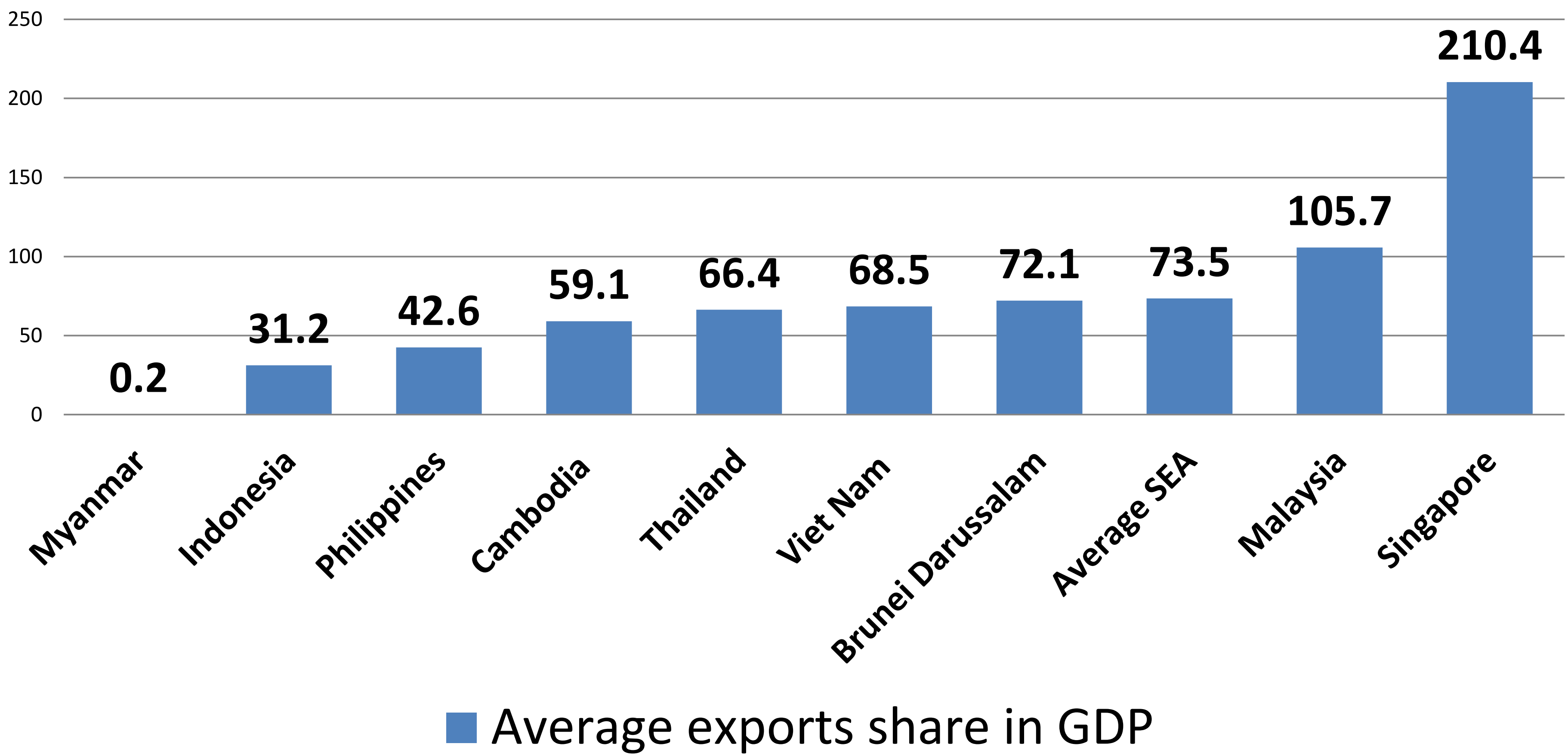
Impact of global slowdown: The Great Deceleration

- A sharp contraction in world trade following the onset of the global financial crisis at a faster rate than in the Great Depression
- Trade contraction experienced by the East Asian countries has been even faster.
- Contraction of trade credit (global financial crisis)
- Greater share of consumer durables
- Parts and components trade have been more susceptible to the global economic slowdown compared to trade in final assembly and total trade.

Impact of GFC on Thailand's Exports (% change)



Outward vs. inward oriented Southeast Asian economies: 2000-2011



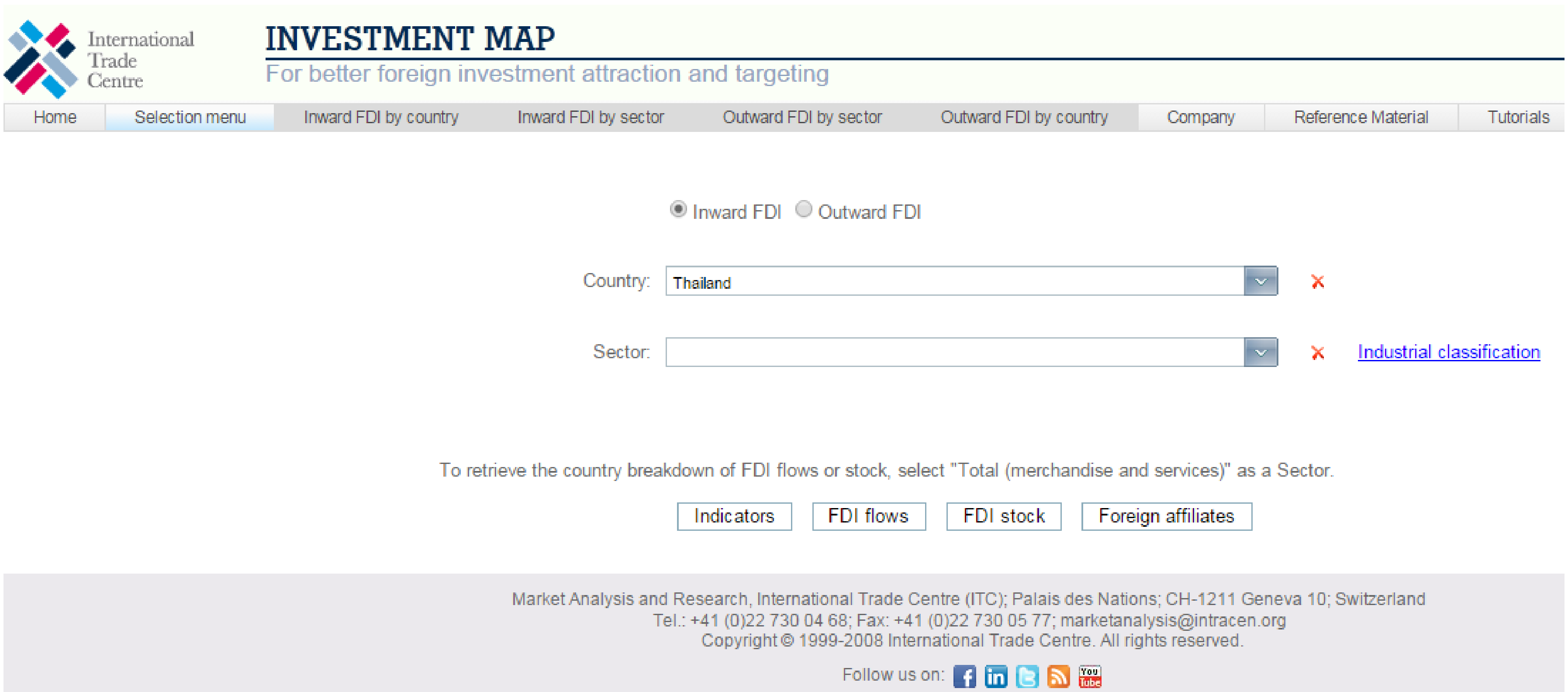
Source of comparative advantage in manufactured goods: Their life cycles

- 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 explanation 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.

The role of MNCs

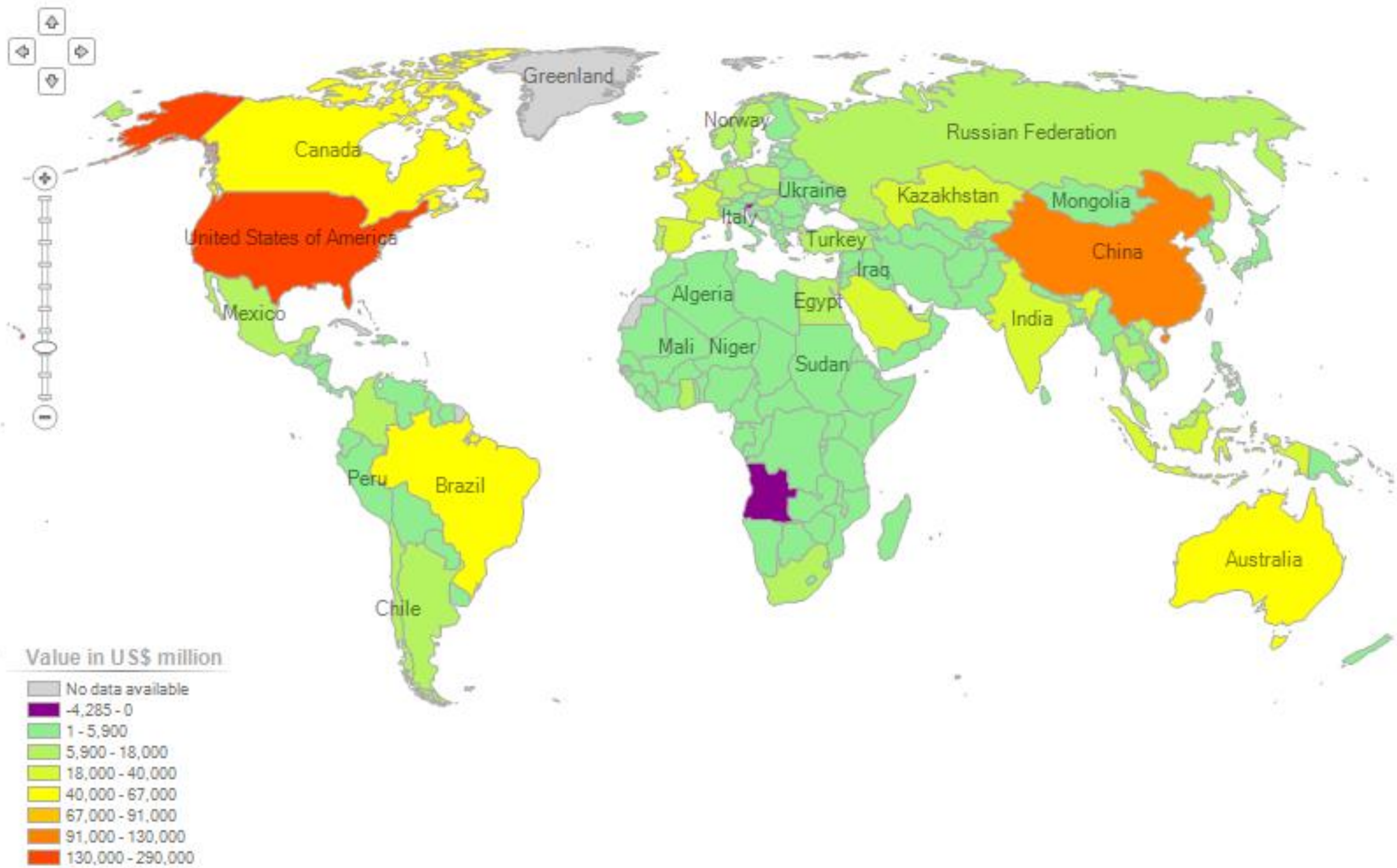
- Technology gaps, economies of scale, and product differentiation give to the individual firm some degree of market power.
- An explanation of trade in new and differentiated manufactured products must pay attention to the market behavior of Multinational Corporations (MNCs).

Source of data

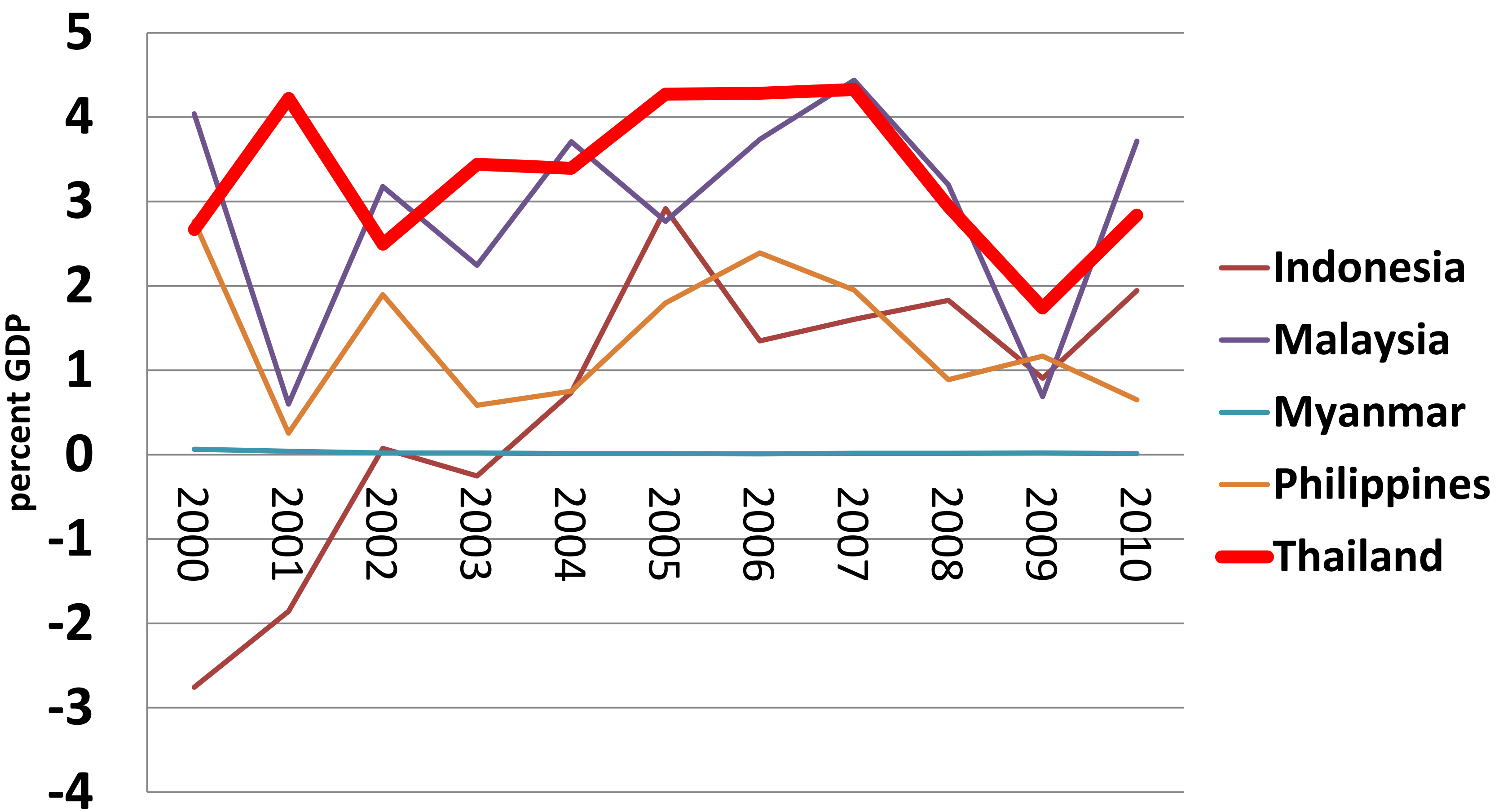


Countries attracting investment in sector: Total (merchandise and services)

Inward FDI flow Last available year



FDI Inflows



5
4
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2
1
0
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-3
-4
percent GDP
2000
2001
2002
2003
2004
2005
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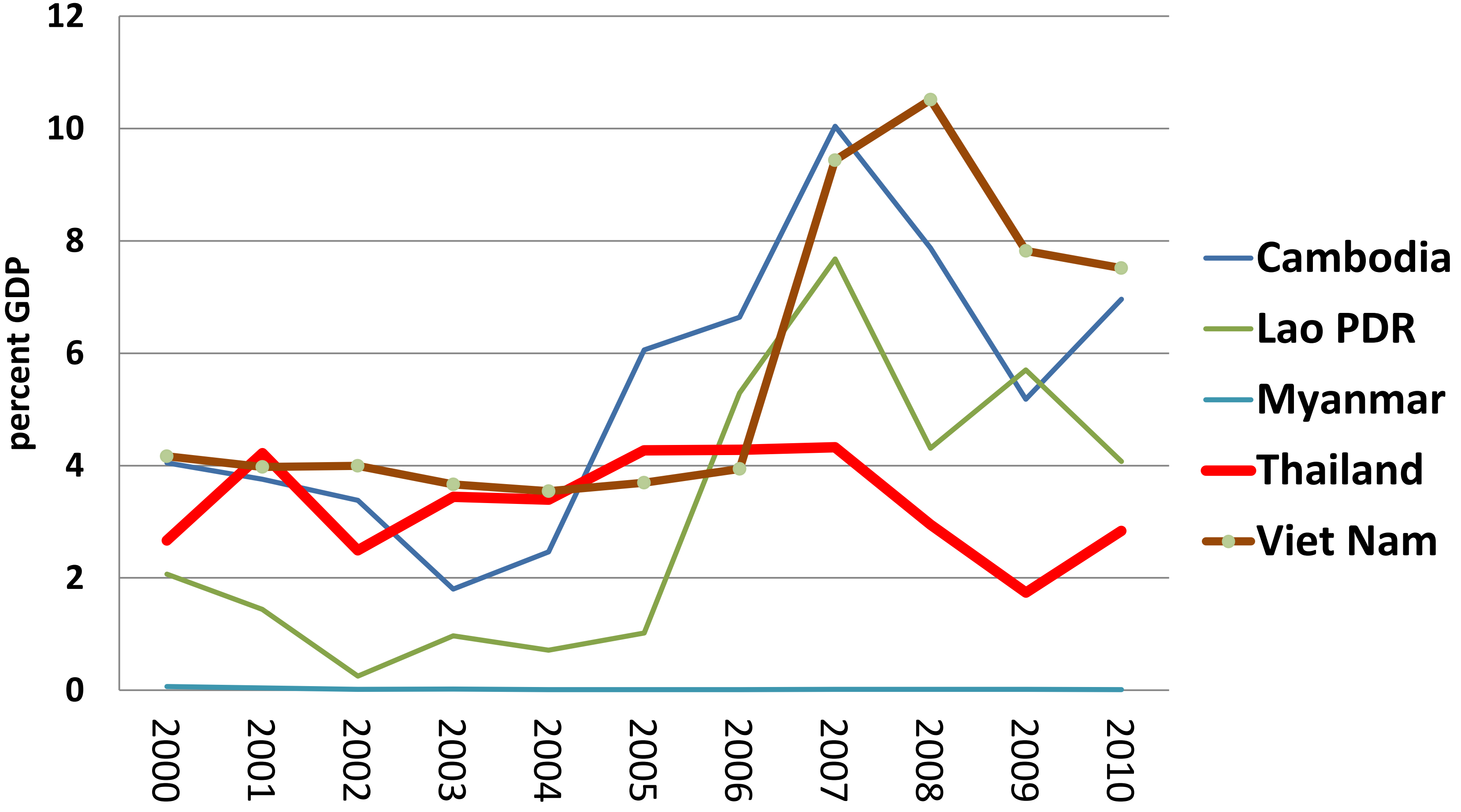
2009
2010
Indonesia
Malaysia
Myanmar
Philippines
Thailand

FDI Inflows


12
10
8
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2
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percent GDP
2000
2001
2002
2003
2004
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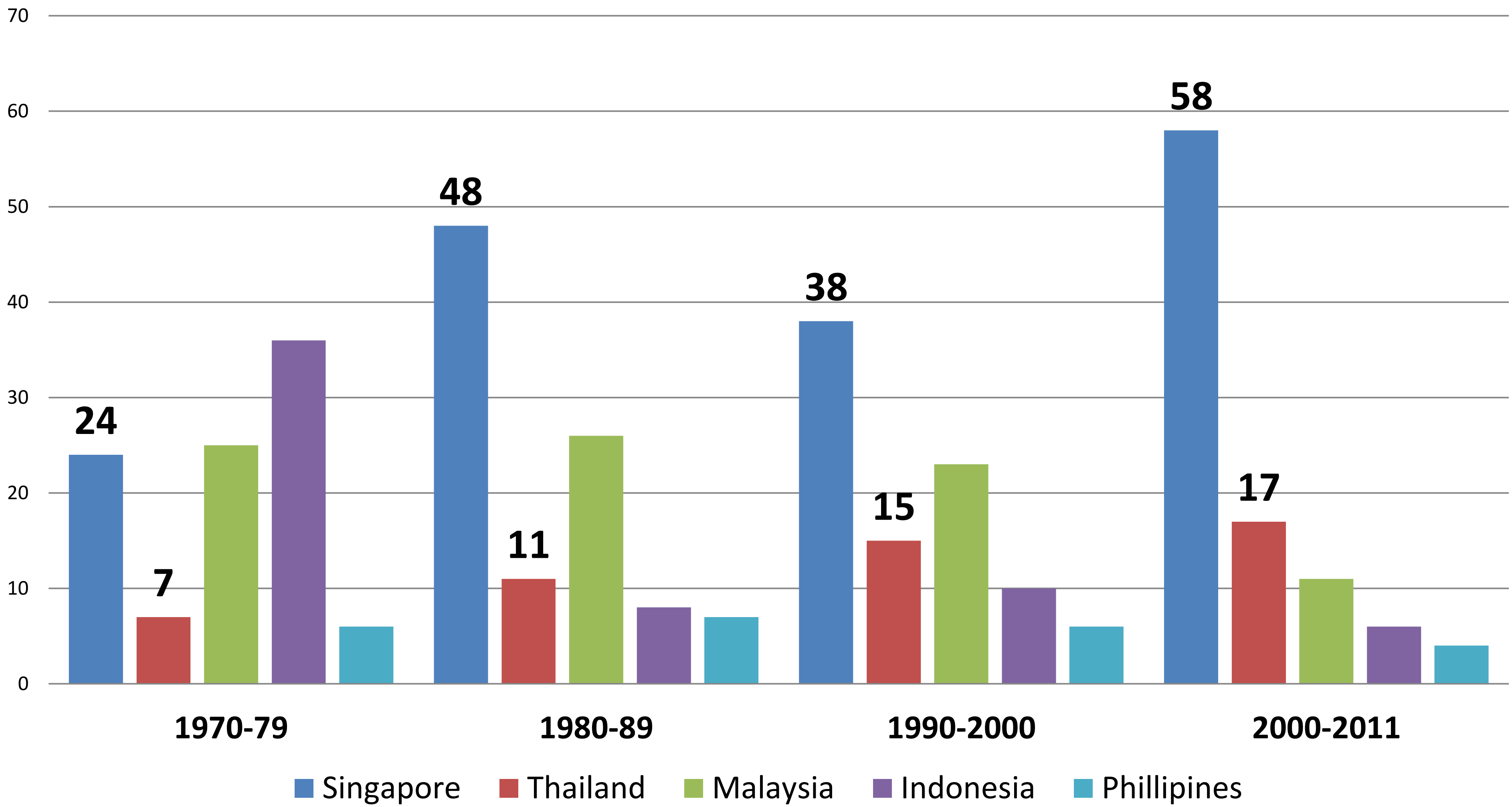
2006
2007
2008
2009
2010
Cambodia
Lao PDR
Myanmar
Thailand
Viet Nam

Benefits from FDI Inflows

- Infrastructure and technology trasfer
- Increased productive efficiency due to competition from multinational subsidiaries.
- Improvement in quality of the factors of production
- Inflow in investment funds (benefits to the balance of payments)

Share of FDI inflows to Southeast Asia



More FDI benefits

- Faster growth of output and employment
- Consumer benefits
- Increase in exports
- Increase in savings and investment (crowding-in vs. crowding-out effect on local investment)
- Reducing vulnerability to currency crisis

World Investment Report 2015

- The Philippines is one of the top 10 foreign direct investment (FDI) recipients in East and Southeast Asia, the World Investment Report (WIR) 2015 of United Nations Conference on Development and Trade (UNCTAD).
- The WIR 2015 showed that the Philippines has attracted some US$6 billion worth of FDI in 2014, up from US$4 billion in 2013.

World Investment Report 2015

- This lifted the country's ranking in East and Southeast Asia from 10th in 2013 to ninth last year.
- **The UNCTAD report said China remained the highest recipient of FDIs in 2014, with inflows of US$129 billion, followed by Hong Kong with US$103 billion.**
- **Other ASEAN member-countries that topped the Philippines were Singapore with US$68 billion, Indonesia with US$23 billion, Thailand with US$13 billion, Malaysia with US$11 billion, and Vietnam with US$9 billion.**

Global FDI slowdown

- South Korea's share of US$10 billion placed it at seventh in the region.
- For East Asia alone, FDI inflows increased by 12 percent to US$248 billion. Southeast Asia has attracted FDI worth of US$133 billion in 2014, up by 5 percent year-on-year.
- "Combined FDI inflows to East and Southeast Asia grew by 10 percent in 2014, despite a slowdown in economic growth, to reach a historical high of US$381 billion," according to the UNCTAD report.

Global FDI slowdown

- **The report said global FDI inflows in 2014 declined by 16 percent to US$1.23 trillion brought by fragility of the global economy, policy uncertainty for investors and elevated geopolitical risks.**

John Dunning (1981) ***International production and the Multinational Enterprises***

- FDI implies that **location-specific** advantages favor a foreign host country.
- **Ownership-specific** advantages favor the investing firm.
- 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.

Determinants of FDI

- Ownership advantages arise from economies of scale with respect to intangible assets such a skilled management and know-how by investing abroad.
- Locational advantages in host countries
- Product cycle (new technology produced and used in home country)
- Standardized technology permits shifting high cost plants abroad
- Low tax, low labor cost, and governent policy

Internalization

- Theory of internalization: **MNCs invest abroad to capture market externalities**: economies of scale in production and marketing, the ownership and public-goods chracter of knowledge, and government-imposed market constraints.
- Market imperfections are related to country-specific endownments, the benefits of internalization for the MNCs vary across countries.

Eclectic theory of FDI

- The eclectic theory (Dunning, 1981) draws on the theories of comparative advantage and location and also on the theories of *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
- Otherwise it exploits the country market through export or lisensing.

Factors affecting FDI

- Repatriation of profits
- Economy and market size
- *Risks and uncertainties*
- *Political stability*
- *Policy consisteny*
- External debt discourages FDI
- Market potential and accessibility
- Product fragmentation

Ranking of business climate
In Southeast Asia: 2012

Singapore	1
Malaysia	12
Thailand	18
Brunei	80
Vietnam	99
Indonesia	128
Cambodia	133
Philippines	138
Laos	163

Monopolistic and Oligopolistic Markets

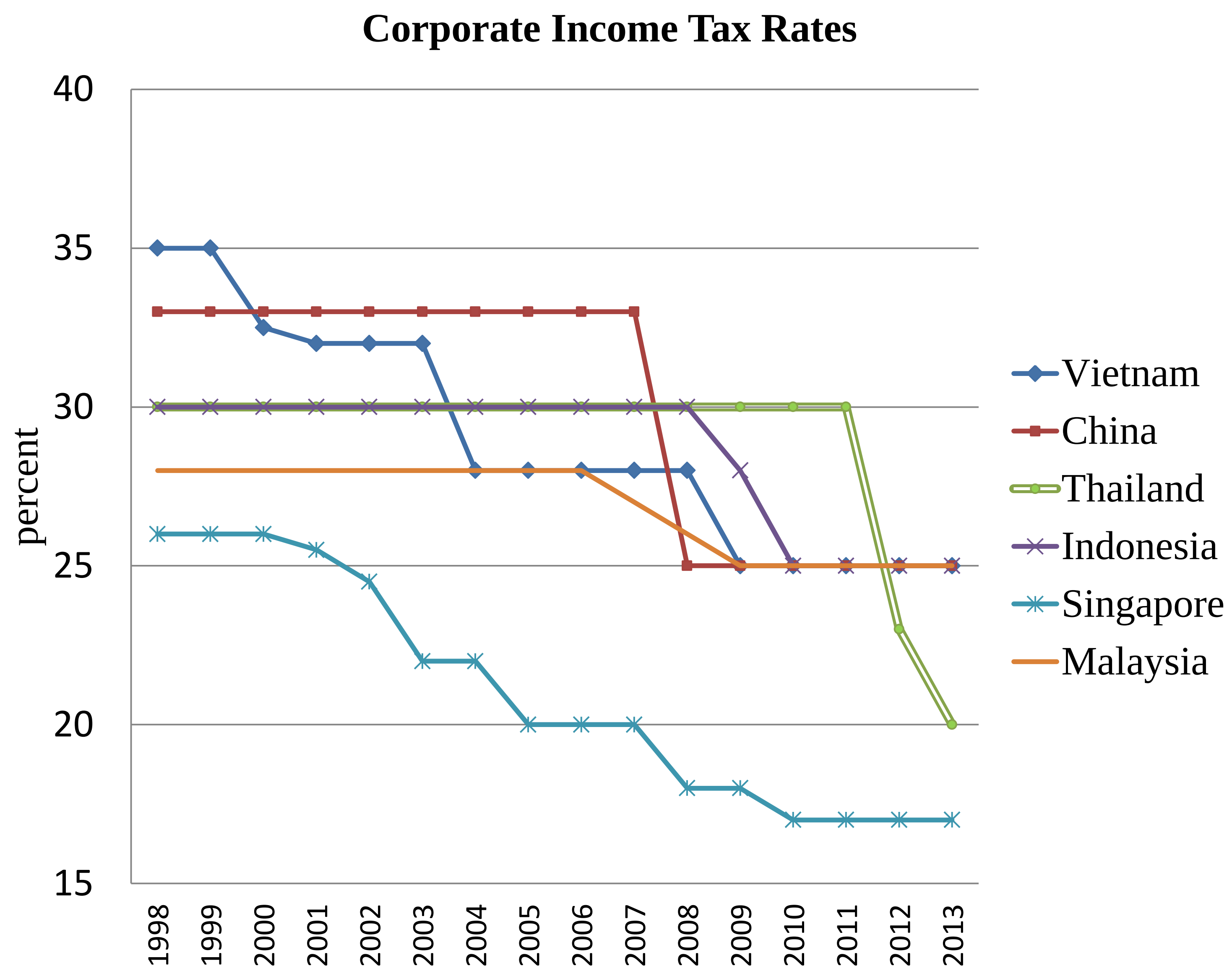
- MNCs have some unique production knowledge or managerial skill that could easily and profitably be utilized abroad and over which the corporation wants to remain control.
- **Horizontal integration**: production of diffrentiated products that are also produced at home
- **Vertical intergration**: to obtain control of needed raw-materials by ensuring uninterrupted supply at the lowest cost

Possible costs from FDI

- Negative effects on the balance of payments.
- Discourage development of technical know-how
- Detriment to growth of domestic producers

Social costs

- Enviroment and natural resource costs
- Damages to local culture and traditional exports
- Politico-Strategic Interests
- Facilitate hegemony by dominant Janpanese and Western cultures.
- Country sovereignty is at stake.


Corporate Income Tax Rates
40
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30
25
20
15
percent
1998
1999
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2008
2009
2010
2011
2012
2013
Vietnam
China
Thailand
Indonesia
Singapore
Malaysia

Conclusions

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

Conclusions

- Agriculture protection is on the rise for the sake of food security.
- FDI and trade are related through production fragmentation.
- The lack of FDI implies low rate of technological adoption and hence lower standard of living.
- The rise of production sharing is a major structural shift in the world trade.

Conclusions

- Thailand benefited from participation in network trade and the rapid recovery of exports in Japan and China in 2010.
- Impact of GFC on Southeast Asian economies depend on export dependency and trade intensity among them.

Further questions

- What are the impacts of the war on corporate income tax cut?
- What will be the impact of the Great Deceleration on Thailand's economic growth in 2015?
- Explain why network trade can lead to business cycle synchronization in Asia?