The Controversy Over Proposed Changes to the Foreign Business Act

Over the last several months the local and international press have carried articles about foreign chambers of commerce and embassies appealing to the Thai government to rethink the draft changes to the Foreign Business Act, B.E. 2542 (FBA), arguing these proposed changes to Thai law will hurt future and existing foreign investors and violate Thailand's WTO obligations. Why are the proposed changes to the FBA so controversial and how might they affect existing and future foreign investment? To better understand this controversy, we start with some background and history on the FBA.

BACKGROUND - WHAT IS THE FBA?

Although foreign investments are encouraged by the Thai government, foreign equity restrictions and Thai participation requirements exist for many businesses. The most important law governing foreign investment is the FBA. The FBA prohibits "aliens" from performing various business activities in Thailand unless they have an alien business license. In practice, it is often difficult and time consuming to obtain such a license.

The FBA covers a broad range of activities, applying to 40 (depending upon how these are measured or grouped) categories of business activities separated into three schedules. Although some of the restrictions may apply to activities involving national security, many if not

most of the restrictions apply to ordinary commercial endeavors. The restriction on "services," for example, is often cited to illustrate the extraordinary breadth of the FBA, since so much of the world's economy is now based on services.

A BRIEF HISTORY OF THE FBA

Before there was the FBA, there was the Revolutionary Party's Announcement of National Executive Council No. 281 (NEC 281), issued by the then military government on November 24, 1972. NEC 281 is very similar to the FBA. NEC 281, like the FBA, divides restricted businesses into three schedules or annexes.

The restrictions imposed by NEC 281 are similar to those imposed by the FBA. Both Annex C of NEC 281 and Schedule 3 of the FBA are justified on the grounds that "Thais are not yet ready to compete with foreigners" in the areas listed on this schedule. And, the definition of a foreign company used by NEC 281 is virtually identical to the definition used in the FBA.

Both NEC 281 and the FBA precisely define foreign companies in terms of "share capital." Neither NEC 281 nor the current version of the FBA refer to or even mention voting or beneficial control. They both provide that a company will be considered an alien company if foreigners hold 50% or more of the registered share capital of that company.

Not surprisingly, this precise definition of a foreign company coupled with the expansive scope of NEC 281 led to the formation of what are sometimes called "preference share structures" – companies where Thai nationals own a majority of the share capital, but foreigners have voting control. It is probably also not surprising that the formation of such companies led to a formal review of their legitimacy by the Thai government.

In 1991 the Thai Juridical Council of State reviewed a preference structure employed by ABB Distribution Co., Ltd. The Juridical Council – which is reviewing the proposed changes to the FBA as this edition of *T-AB* went to press –

is a panel of senior legal experts who review and draft laws for the government and provide advice, interpretations and opinions on Thai laws. After reviewing a submission from the Thai Ministry of Commerce (MOC), the Juridical Council issued a written opinion on August 2, 1991 stating that ABB Distribution was not a foreign company for purposes of NEC 281. The Juridical Council specifically stated that "consideration of whether or not ABB Distribution Co., Ltd." is an "alien…shall be based on actual [registered share] alien capital."

In 1995 Thailand ratified the World Trade Organization's General Agreement on Trade in Services (GATS). A proper discussion of GATS would consume this entire magazine and is therefore beyond the scope of this article, but in very general terms GATS requires members to specify the limitations they place on service providers in the form scheduled restrictions and then move in the direction of further liberalization by phasing out these restrictions. Thailand's main schedules refer to a restriction on the amount of "registered share capital" - the same language employed by NEC 281 - that foreigners can hold in companies engaged in activities covered by GATS.

About four years later, in 1999, the Thai government replaced NEC 281 with the FBA. When the Thai parliament considered the FBA, a proposal was made to draft this law so that alien companies would be defined in terms of Thai majority voting rights, but that proposal was rejected because of fears it would make Thailand less competitive in an increasingly globalized world. Instead, foreign companies were defined in terms of registered share capital alone. When the FBA was enacted, the government promised to periodically review and reduce the scope of restricted businesses on Schedule 3.

In the over 34 years since NEC 281 was issued, thousands of preference share companies have been formed. They have been routinely accepted by the MOC for registration without challenge or review. Indeed, MOC officials publicly acknowledged the legitimacy of such structures. Foreign companies, including some prominent household name multinationals, relied on these structures when making substantial foreign direct investments into the Thai economy.

Estimates on the number of preference share companies range from the thousands to 14,000 to 100,000, but no one really knows the exact number. Indeed, the debate about the exact number is a red herring, since the more important and indisputable point is that there are many such companies, and that many of them are important contributors to the Thai economy.

DEFINITIONS MATTER

Under the current FBA, the definition of an "alien" does not include any reference to voting rights. This is why the proposed change to Thai law by the addition of "voting control" to that definition is so controversial. This has fueled fears about how this change in Thai law will affect future investment in Thailand and even greater fears about how it will affect current foreign investors in Thailand.

Looking forward at new investment, newcomers will be prevented from using structures that had been legally employed for decades without challenge. Because of the importance of a competitive world class service sector to technical innovation and future economic growth, the proposed change to Thai law raises specific concerns about the viability of Thailand's manufacturing sector and future economic growth more generally.

Existing businesses operating in areas subject to Schedule 3 will be subject to "grandfathering" and permitted to operate indefinitely, provided they register and are not using "illegal nominee" shareholding. Interestingly, even though the amendments were presented as a means to increase transparency and improve corporate governance by clarifying what does and does not constitute "illegal nominee" shareholding, the proposed amendments do not define or provide any guidance on what constitutes illegal nominee shareholding. The uncertainty that surrounds this issue will therefore continue even if and after the amendments are adopted.

Because these proposed changes to Thai law will be applied retroactively, existing companies

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now operating in areas covered by Schedule 1 and 2 will face some hard choices. Foreign controlled businesses in these areas will need to try to obtain an alien business license (impossible under Schedule 1), shut down operations or divest themselves of foreign control within two years of enactment of the amendments. This led the Joint Foreign Chambers of Commerce Thailand to state in a recent position paper that the amendments "necessarily criminalize structures that are legal under current law."

NOT ALL COMPANIES AFFECTED – AT LEAST NOT IMMEDIATELY & DIRECTLY

The proposed amendments will not directly affect all sectors; indeed many foreign majority owned foreign businesses will be unaffected – at least directly. Companies in the manufacturing sector are generally not covered by the FBA (although their service providers may be). Companies benefiting from treaty exceptions should also not be affected, such as companies that are entitled to the benefits of the 1966 Treaty of Amity and Economic Relations between the US and Thailand (generally known as the "Amity Treaty") and Australian companies benefiting from the recently enacted Thai-Australian Free Trade Agreement. If the Japanese-Thai Free Trade Agreement is adopted, Japanese ownership of some companies currently restricted by the FBA will also be permitted. Companies subject to promotional privilege by Thailand's Board of Investment (BOI) will also remain unaffected. Indeed, recognizing the high level of concern in the foreign business community over the proposed amendments, a recent BOI newsletter emphasizes that the proposed amendments will not affect BOI promotional privileges.

CONSEQUENCES

When NEC 281 was enacted in 1972, the world was a very different place than it is today. There was a Cold War in 1972. Vietnam was a divided country at war; it is now a member of WTO. Many still believed in the efficacy of state controlled economies (and, to be fair, some still do, in places such as Venezuela and North Korea). Although there is still debate about the proper role of markets and governments, the breadth of serious debate over these matters has narrowed substantially.

The world is also a more open place than it was in 1972, and it has prospered as a result. In East Asia, excluding China, the number of people in extreme poverty has declined from 114 million people in 1987 to 57 million in 1999; when China is included, the decline is even more dramatic. Restrictions on foreign investment around the world, and particularly in Southeast Asia, are on the decline. It is no accident that Asia has prospered in this period of increasingly open markets.

The proposed changes to the FBA are therefore ultimately not a matter that should pit the foreign investment community against the domestic interests of Thailand. The proposed changes will directly affect Thai workers, Thai consumers and the domestic Thai economy generally. Imposing further restrictions on foreign investment will also have significant consequences for Thailand on non-economic matters as well.

Starting with the economics, there is no doubt that Thailand has prospered enormously from having a globalized economy. According to the Asian Development Bank, exports accounted for 70% of Thailand's economic growth from 1993 to 2003. The facilities, factories and operations that produced those exports were largely the result of foreign direct investment. Foreign direct investment has also contributed substantially to Thailand's tax base, improved Thailand's infrastructure, given Thai consumers more choices and created well paying jobs for a large number of Thais. In brief, it has improved the quality of life.

Foreign direct investment not only creates these static economic gains, but has also provides dynamic economic benefits. One of the primary economic dynamic benefits of open markets is the pro-competitive effect it has on domestic economies. If a country opens to international trade and investment, local monopolies lose their power over local markets, leading to more efficient production and fewer resources devoted to wasteful rent seeking behavior. On the other hand, across all countries, once vested interests have enjoyed the benefits that these forms of protectionist monopolies provide, it becomes very difficult to move towards a more open and

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competitive environment, even though the country, as a whole - particularly consumers and ordinary workers- clearly benefit from the greater competition, transparency and higher living standards that open markets indisputably provide.

And there are the other, non-economic, benefits to open investment, which are all too often neglected in discussions about these matters. As Amartya Sen, the 1998 Nobel Prize Winner in Economics, observed, allowing individuals to engage freely in transactions that they wish to engage in is an important value in and of itself separate and apart from the role markets play in increasing wealth and economic opportunities: "[A] denial of opportunities of transaction, through arbitrary controls, can be a source of unfreedom in itself." Other considerations and values are at stake. Because they compel divestiture, the proposed changes to Thai law raise issues about the violability of property rights. In terms of transparency and good governance - as valuable matters separate and apart from their affects on economic performance – free trade in services, particularly in the financial sector, reduces corruption and strengthens the rule of law; as a corollary, further restrictions can be expected to have the opposite effect.

These are not just matters of concern to the foreign business community. They are matters of even greater domestic concern to Thailand, since the true beneficiaries of a more open investment environment in Thailand are the Thai people themselves. And the controversy surrounding the proposed changes to the FBA ultimately concerns these core values and matters. ■

Written by: Douglas Mancill, Partner, Deacons, Bangkok (Price Sanond Prabhas & Wynne), and Co-Chair of AMCHAM's Tax & Legislation Committee. He can be reached at: dmancill@deaconsbkk.com

Does The United States Have A Foreign Business Act?

No. There is nothing remotely similar in U.S. law to Thailand's Foreign Business Act, B.E. 2542 (FBA). There are no broad prohibitions in the U.S. on foreign ownership of ordinary commercial endeavors. Foreigners can own and control, for example, service, retailing, wholesaling, construction, newspapers, advertising and land trading businesses. Indeed, there is no federal law prohibiting foreign ownership of land.

There are some specific prohibitions on foreign ownership, but most of those relate to sensitive areas pertaining to communications and national security (areas that many argue overlap), such as the Communications Satellite Act of 1962 or the Atomic Energy Act of 1954. There are also a very few specific laws that are hard to justify on national security grounds, but these are mostly hangovers from the 1930s, an era famous for the Great Depression and protectionist legislation, such as Smoot Hawley Tariff Act, which most economic historians now believe exacerbated and prolonged the Great Depression. In the few areas where U.S. law regulates foreign ownership, the law looks beyond registered share ownership.

The most important potential restriction on foreign ownership is the national security review provisions the Exon-Florio Amendments to the Defense Production Act of 1950 (Exon-Florio). Exon-Florio does not prohibit foreign ownership of any specific category of business per se, but instead authorizes the U.S. President, following a review the inter-agency Committee on Foreign Investment in the United States (CFIUS), to block an acquisition by a foreign person if the acquisition threatens to impair the national security of the U.S. Most CFIUS applications are voluntary, and most are approved on a routine basis.

AMCHAM's Christine Davies served as a working group representative for CFIUS from the U.S. Department of State before becoming AMCHAM's trade specialist, and notes that the vast majority of cases considered by CFIUS are resolved in the first 30 days of consideration – thus negating the need for the statutorily required 45 days of investigation and required Presidential consideration when CFIUS consensus is not achieved. This reliable and relatively short period for resolving cases stands in marked contrast to the longer time period often taken by other governments when assessing foreign investments. Since the establishment of CFIUS, there has only been one divestment case ordered by The President (February 1, 1990 by George H.W. Bush: China National Aero-Technology Import and Export Corporation's divestiture of MAMCO Manufacturing of Washington). ■