

CHAPTER I

INTRODUCTION

1.1 Rationale

During 1990-2006, foreign direct investment (FDI) has contributed to national and provincial socio-economic development, helping Lao government achieve the national goal of poverty eradication by 2010 and graduating the country from least developing country status by 2020. Thus, since Lao government adopted The New Economic Mechanism (NEM) in 1986, FDI has become one of the key elements in realizing this objective for Lao People's Democratic Republic (Lao PDR) and led to major improvement in standards of living for Lao people. Meanwhile, its neighboring country, Thailand; domestic investment has played an important role on regional economic development as well as for poverty reduction. FDI and domestic investment has brought benefits, directly and indirectly, including capital inflows, technology transfer and job creation.

Economic interdependence between Lao PDR and Thailand has increased substantially since the latter formally opened its border with the former in the late 1980s. The level of economic interdependency between these two countries was further boosted in 1992 when they and other countries of the Greater Mekong Sub-region (GMS) embarked on a program of economic cooperation (known as the GMS Program) to promote development through closer economic linkages; and in 1997 when Lao PDR became a full member of the Association of Southeast Asian Nations (ASEAN).

The root of FDI in economic development can be traced to the promulgation of the NEM in 1986. The two objectives of the NEM are growth with equity or the eradication of poverty and the restructuring of society to restore the economic imbalances between the different ethnic groups in Laos. In order to achieve growth, a concerted effort was made to develop the manufacturing sector by utilizing "open"

policies such as export and FDI promotion. On the other hand, the redistribution goal led, for example, to restrictions on foreign equity ownership in all sectors.¹

In other words, Laos integrated up to the point where it was useful for the country to do so, as the case of FDI and trade. What is the impact on Savannakhet of such a selective approach towards the poverty eradication? The main objective of this thesis is to answer this question. Specifically, the thesis aims to analyze the impact of FDI and domestic investment on Savannakhet and Mukdaharn and its economic development policy implications toward the poverty reduction.

Savannakhet province in Lao PDR and Mukdaharn in Thailand is a thriving hub of trade and services in the Greater Mekong Sub-region and it is also one of the river based cooperation and sub-regional economic cooperation in Southeast Asia. Both provinces are located along the East-West Economic Corridor (EWEC) linking Myanmar, Thailand, Lao PDR, and Vietnam (Road No.9). Based on their well placed geographically and potentials, currently Savannakhet and Mukdaharn provinces become an attracting area for local and foreign investment.

Thailand and Lao government seek the full utilization of their vast natural and human resources, and they want the growth of FDI and domestic investment to develop and confer dividends in the form of growth of their societies, the transformation of conditions of living in order to bring prosperity and modernity to their societies. In a sense, it is also a response to apprehension about foreign capitalist domination of their national economies, remembering the unpleasant memories of unrestricted entry of foreign capital during the colonial era (direct impact for Laos and indirect for Thailand) and noting the aggressive instincts of foreign investments when allowed to do or go as they please.

Thailand and Laos have centuries old Theravada Buddhist cultures which are in contrast to the other nations of Southeast Asia. But Thailand is the second richest country in Southeast Asia, while Laos is among the world's poorest countries with very

¹ Gloria Davies and Chris Nyland, Globalization in the Asian Region: Impact and Consequences (UK: Edward Elgar, 2004), p. 63-64.

little economic development in recent decades. Thailand has been cited as one of the most successful in the world in reducing poverty per increment of gross national product (GNP) growth

However, while Thailand has a high democracy rating, the communist party in Laos retains strong political control over the nation and its people. The increasing rhetoric among western political leaders suggesting democracy is a necessary condition for economic development is obviously inaccurate. Good governance and state efficiency are important for economic development, but these conditions are not found exclusively in nations with democratic political systems.

To demonstrate the utility of this research, a comparative analysis focusing on some key countries in Greater Mekong Sub-region. Two of these nations (Lao PDR and Thailand) are keys to the model because they are two nations with similar religious-cultural heritages, but with adopting of very difference economic strategies and situations in today's regional economy.

Necessity of FDI considered as one of the priority development strategy for Laos government is now being implementing by Savannakhet province, while its twin city, Mukdaharn, adopts domestic investment strategy as a key element of economic development since it contributes an increasingly subsequent improvement of living standard of their people. This leads to the idea that with investment projects/activities funded by FDI and domestic investment in the area of Savannakhet and Mukdaharn provinces, local population will benefit from employment opportunity, offering some benefits to those working in the projects, as well as participating in certain facilities made available by the projects, etc.

There are nevertheless, many indicators of disparities in the pattern and current direction of economic development. The serious indictment is that investment generates profits, but these profits largely remain unshared by the people of the host country and numbers of people living in poverty are still high.

However, negative impacts during the courses of FDI and domestic investment are likely to be norm. The key is to make sure that unconstructive impacts do not become too big and destabilizing, or get beyond the critical thresholds of impacts.

Nevertheless, the negative impacts of FDI and domestic investment sectors raise major concern for Lao and Thai governments, such as involuntary resettlement, land acquisition, loss of traditional livelihood, accidents, illegal migration, the spread of transmitted diseases, human and drugs trafficking, loss of biodiversity to construction and risk to the livelihoods of ethnic minorities. These impacts can be barriers to achieve the poverty reduction goal. However, a review of what modern world system theory and research has suggested about foreign investment and economic development in less developed countries is necessary.

By assembling scattered anecdotal evidence on how past and current practices of impact of FDI and domestic investment have hurt the poor, this study will show that the adverse of FDI and domestic investment on the poor is real, systematically affects many people, and undermines the efforts to reduce poverty in the country. However, there are exists evidence of positive impact on poverty reduction for some regions.

1.2 Literature Review

Up till now, it is rare to find academic works in Savannakhet (Lao PDR) and Mukdaharn (Thailand) provinces, looking at the role and impact of FDI and domestic investment consequence on poverty reduction. The impacts from project funded by FDI and domestic investment have been by and large left unexplored.

Poverty eradication using FDI and domestic investment as key has more than just economic elements. According to Rostow, W.W, The Stages of Economic Growth: A Non-Communist Manifesto. Cambridge: Cambridge University Press, 1960, discussed in relation to the linear model for economic growth, switches from one stage to another may be assessed through economic output, but many of the driving forces of a shift from subsistence agricultural societies to urban industrial ones relate mainly to social structures. In Rostow's argument, for take-off to be achieved, there need to be shifts in the nature of national elites. Rather than elite groups using their money for family and clan purposes, for economic development to take place there needs to be a move to investment in new infrastructure and means of production. Thus, development theories refer not only to economic changes, but to social transformations as well. The

social evolutionary ideas which from part of Rostow's model have a basis in the nineteenth-centuries theories about social change based on the capitalist experience.²

The modernist aims of many communist or socialist governments, Lao PDR also resulted in the implementation of development strategies which are extremely environmentally destructive. The control or taming of nature has often been a key element in the development strategies of centrally-planned economies, with rhetoric regarding superiority of such societies being reflected in the domination of nature.

According to Marx, K, Capital, Volume 1. London: William Glaiser, 1909. It was Marx who provided the first detailed criticism of capitalist societies and what he believed would be rapidly growing inequalities, he had relatively little to say about how dominant capitalist societies would affect the poor. According to Marx, development involved human ability to transform nature to increase standards of living. In *capital*, Marx's perspectives on humans' dominance of nature reflected in this description: 'He [sic] develops the potentialities slumbering within nature; and subjects the play of its forces to his own sovereign power'. Some of largest individual development projects have been implemented within centrally-planned economies. This is partly a reflection of the desire to be seen to be achieving greater infrastructure successes, but also because of the ability of governments in such economies to marshal resources to achieve these aims.³ The environmental impacts of such mega-projects are still on-going and this has not prevented the continued use of such projects in some centrally-planned countries.

During the course of economic development; the relationship between poverty and the environments is complex one, but it is clear that there are some connections. Poor people are often forced to live in environmentally-fragile or degraded areas. These locations may include unstable hillsides, areas prone to flooding and pollution, as well as lacking basic infrastructure such as drinking water. These poor environmental conditions may lead to health problems, such as respiratory disease or water-borne infections, which in turn can affect individuals' ability to earn a living, so exacerbating their economic and social vulnerability. In addition, people living in poverty can often

² Katie Willis, Theories and Practices of Development (Routledge, 2005), p. 116-117.

³ *Ibid.*, p. 152-153.

not afford to improve their local environment and in many cases may be forced to contribute to environmental degradation through, for example, using local forest resources for building materials and fuel.

These inter-connections demonstrate that environmental protection measures are about more than just the natural environment; rather, attempts at sustainable development need to be placed within the much wider context of poverty alleviation, meaningful community participation in decision-making and recognition of the importance of social and cultural contexts.⁴

Predictably perhaps, it is those rapidly developing economies –Laos and post New Economic Mechanism (NEM) or *Chintanakhanmai* – that have more actively facilitated the overall process of “opening up”. In this context, if the state like Laos has most substantially benefited from global and regional markets and foreign capital inflow. It is also the most exposed to external economic and cultural forces. FDI is thus a double-edged sword with regard to the rewards and cost it brings to the local economy and society. This is the rule of game of FDI, and perhaps Laos had discovered in their struggle to lift themselves out of the economic crisis.⁵

The Policy Statement of the Government of Prime Minister Thaksin Shinawatra (delivered to Parliament on Monday, 26 February 2001) identified priorities for different part of the Government and sets out a holistic framework for action to reduce poverty and generate more employment. Recognizing that people at all levels have faced economic difficulties because of unemployment, falling prices of agricultural produce and the decline in purchasing power, the statement identified a set of nine “urgent” policies. These include three-year debt suspension for small farmers, the establishment of a one-million-bath revolving fund for each village for community development, the setting up of a people’ bank, the introduction of universal health

⁴ FAO, Gender Responsive Technology for Poverty Alleviation in Thailand (Thailand: UNDP, 2003), p. 17.

⁵ Nick J. Freeman and Frank L. Bartels, The Future of Foreign Investment in Southeast Asia (London: Routledge Curzon, 2004), p. 172.

insurance, and the promotion of public participation in preventing and suppressing corruption.⁶

Since the mid-1980s Thailand has been among the fastest growing economies in the world, stimulated by enormous expansion of export goods, tourism and foreign direct investment. Manufacturing has also been dynamic. During the last two decades Thailand has succeeded in reducing poverty. Nevertheless, poverty still exists. According to the Thailand Development Research Institute (TDRI), Ammar Siamwalla, Thailand's Economic Structure: Towards Balance Development?. Synthesis Report. Thailand TDRI Foundation, 1992. Around 25 per cent of the population is estimated to be living below the poverty line of 20,705 *bath* per year for a rural family. Economic growth, especially the relatively high growth rates achieved in the recent past and expected in the future, tends to improve living standards.⁷

Along with the new thinking on government, donors/investors also incorporate a new thinking on poverty and the relationship between these two variables. They recognize that poverty is a multidimensional concept and is not limited to economic terms alone. Besides a lack of income, the poor also suffer from a lack, or a complete absence of, services (public utilities, public transportation, healthcare, education, credit, etc.) and lack of participation in social, economic, and political decisions at the local, regional, and national level. Because of this, the poor often feel that they are excluded, and helpless when their rights are violated and exploited by the wealthy and the powerful.⁸

Gunder Frank, Latin American: Under Development and Revolution. New York: Monthly Review Press, 1969. Frank has suggested that if developing countries depend on capitalism, they would never get rid of poverty because monopoly capital hinders

⁶Ibid.

⁷ Mason C. Hoadley and Christer Gunnarsson, The Village Concept in the Transformation of Rural Southeast Asia: Studies from Indonesia, Malaysia and Thailand. (Great Britain: Curzon Press Ltd, 1996), p. 93.

⁸ Yasutami Shimomura, The Role of Governance in Asia (Singapore: Institute of Southeast Asian Studies, 2003), p. 30-32.

development of the "Third World". As a result, the only way the "Third World" could develop would be by rejecting capitalism and taking on socialism. According to Baran, P, The Political Economy of Growth. New York: Monthly Review Press, 1960. The argument of Baran on the political economy was based on his pessimism about the possibility of growth in developing countries because he and others believed that developed countries would suffer from secular stagnation, and that if they suffered from secular stagnation, the forces of monopoly capitalism would then not allow rivals to exist and to come into world markets. Markets would be restricted and competition would be deleterious, and so developed countries would keep developing countries out of market.

It is interesting to note that it was not only economists who were pessimistic. Politicians have also been pessimistic about developing countries ever getting out of poverty.⁹

What happened in the second half of the 20th century was the defeat of the Leninist model as an alternative path of development for all developing countries. This model was unsuccessful, although the Leninist political program survives in Laos. But the story of Laos is a quite remarkable example of first having tried the Leninist economic model, then abandoning it in the middle half of 1980 and latching into a different path and achieving success.

Another remarkable thing about the history of Southeast Asia, especially from 1970 onward, is the extraordinary reduction mass poverty. The figures for Thailand show real success story. The story in Laos is not so good. Given that many people live in Southeast Asia, the reduction of poverty in this region absolute could mean one of the largest reductions. From the mid 1970s onward, a number of Southeast Asia countries acknowledge the need for an open economy policy. This is not necessarily related to the concepts of free markets or free trade.¹⁰

⁹ Gloria Davies and Chris Nyland, Globalization in the Asian Region: Impact and Consequences (UK: Edward Elgar, 2004), p. 52-53.

¹⁰ Ibid.

The 1996 UNDP Human Development Report stated that Thailand had paid a high price for its rapid economic growth. It noted that the growth had, to a large extent, been “ruthless, futureless and voiceless.” Income distribution had been skewed in favor of the wealth urban elite. There was unsustainable use of natural resources such as forestry with one million *rai* of forest destroyed each year. The growth has been “voiceless” in so far as decision making had been concentrated in the Bangkok corridors of power, and there had been a “lack of popular participation in the country’s future development.” Nevertheless, the report ended on optimistic note attesting that Thailand had “now recognized the dangers of imbalance growth, income inequality and environmental degradation. If there was “full and energetic implementation of the Eight Plan which addressed the above problems, then there was hope for the future.”¹¹

In Savannakhet and Mukdaharn, a large number of populations live below the poverty line. The lack of employment opportunities in rural is driving people into cities and those who can afford it seek to escape form rural altogether to lands of opportunity in capital city like Vientiane and Bangkok. Savannakhet and Mukdaharn’s case study of the poor in rural have thrown up multiple examples of how such mismanagement by investor and policy maker exacerbated poverty by introducing inappropriate technology, create new local “community” structure that have dispossessed the poor and insisting on tough ‘user pays’ principles which poor and marginal farmers cannot meet. The drought-prone areas are the most affected by new “development initiatives”.

If the wealth is distributed among individuals very unequally, all those conditions are violated. Privileged and underprivileged social classes arise. We get an exploitative society. Similarly, if wealth is distributed among nations very unequally, the ensuring social polarization generates exploitation.¹² The rich are strong and they exploit the poor which are weak. This exploitation proceeds in innumerable ways. The most obvious form is political domination. Economic pressures, military threats, preventive wars and occupations, various subtle and less subtle interference in domestic

¹¹ William J. Klausner, Thai Culture in Transition (Thailand: Amarin Printing, 2002), p. 11.

¹² Gloria Davies and Chris Nyland, Globalization in the Asian Region: Impact and Consequences (UK: Edward Elgar, 2004), p. 103-104.

affairs, are familiar ways of running the world on behalf of a higher civilization. Next, even in a utopian world of political non-interference, completely free trade would act strongly against the poor and in favor of the rich. By now it is well known that in a situation of sufficiently different levels of development, free market generates economic polarization and not a compensatory movement of resources. And even if multinational corporations move to an underdeveloped country in search of profit, profit is maximized from the point of view of the corporation not of the host country.

Ranis proposed that in the nature of things the rich exploit poor. But no one likes exploitation. Tensions mount. Social explosions are inevitable. They occur from time to time. Since we live in one single small world, we cannot afford to ignore them. Thus the socialist viewpoint is likely to become the point of view of our epoch, if the human race is to survive.¹³

In recent years two big defects have been widely visible in the economic development process – unemployment and inequality. Indeed such clues as we have suggested that both these problems are growing more acute. Unemployment is one of the main root of inequality, both directly (because, in a society with only limited social security systems, most of the unemployed live at the margin of subsistence) and indirectly (because the existence of unemployment often prevents the poorer workers from forcing up wages or peasants leaving smallholding). But conversely inequality promotes unemployment, because of the tendency of the rich and of town dwellers to spend their income on luxuries which are imported or which incorporate a high import content, thus pre-empting the use of foreign exchange for capital equipment and there by reducing the potential long run growth of output and employment. Unemployment and inequality have, between them, meant the persistence of poverty and of related evils such as causes of unemployment and inequality.¹⁴

¹³ Gustav Ranis, The Gap between Rich and Poor Nations: Proceedings of a Conference held by the International Economic Association at Bled, Yugoslavia (London and Basingstoke: The Macmillan Press LTD, 1972), p. 96-97.

¹⁴ Ibid., 369-370.

1.3 Objectives

I am motivated to investigate the role of the different approach on poverty reduction between foreign direct investment in Savannakhet (Lao PDR) and domestic investment in Mukdaharn (Thailand).

The aim of the study are: (1) to study the role of foreign direct investment activities in Savannakhet (Lao) and domestic investment activities in Mukdaharn (Thailand); (2) to study the impact of foreign direct investment and domestic investment activities on poverty reduction in Savannakhet (Lao) and Mukdaharn (Thailand)

1.4 Hypothesis

Savannakhet (Lao PDR) and Mukdaharn (Thailand) provinces are well placed geographically to attract FDI and domestic investment. FDI and domestic investment activities play an increasingly significant role in poverty reduction in the past decade; for example, FDI and domestic investment have led to major improvement in standards of living for Laotian and the Thais. However, FDI and domestic investment activities have both positive and negative impact on poverty reduction and the poor are still lagging behind in the rapid growth of foreign direct investment and domestic investment. The negative impacts of FDI and domestic investment at the present may not lead to achieving the poverty reduction goals by the year 2020.

It is hypothesized here: "Both Savanvankhet and Mukdaharn follow the national direction of economic development with emphasis on economic growth and encouraging modernization and industrialization. Poverty reduction is also aimed at by both provinces; Savannakhet prefers using foreign direct investment as means while Mukdaharn opts for domestic investment. Both approaches may not be successful to reduce poverty."

1.5 Methodology

From vantage point my thesis will apply to quantitative and qualitative research. I will show the direct relationship of FDI and domestic investment with economic development and poverty reduction. I also together show the general picture by collecting data at the regional level (Savannakhet and Mukdaharn). Then I will focus on economic development projects/activities financed by FDI and domestic investment which are supposed to reduce poverty or to increase income.

I will give the figures of those projects and statistics dealing with projects of economic development, with impact of poverty reduction, and then I will turn to qualitative aspect by interview a number of people as to why poverty is not reduced, or reduced only a little. In depth interviews are made of bureaucrats, administrators and donors who implement those projects and then ask a number of people who are within the area where projects are being implemented as to what they think of the impact of those projects.

1.6 Significance and Usefulness of Research

- Hopefully, the finding will be important for recipient countries and the poverty reduction strategy for the future as well as it will be useful for Savannakhet and Mukdaharn provinces.
- To give a better knowledge of the impact of FDI and domestic investment activities on poverty reduction in Savannakhet and Mukdaharn provinces.