

Muddling Toward A Miracle: Thailand and East Asian Growth ¹

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THAILAND AND THE EAST ASIAN GROWTH DEBATE

The factors which have enabled many East Asian countries to achieve high growth rates per capita are the subject of vigorous and vitriolic debate. Recently, a consensus has emerged regarding the basic economic ingredients contributing to the region's rapid and sustained growth (World Bank, 1993).

One important factor has been sound macroeconomic management, marked by low inflation rates and realistic currency valuations. Stable prices and currency values favorable to exports have encouraged high rates of investment to GDP and rapid growth in export earnings. Another ingredient has been increasing factor productivity, marked by high accumulation of physical and human capital. Many East Asian economies have successfully allocated capital and human resources to highly productive investments, while acquiring or developing technologies to deepen the industrial base. These strategies dynamically altered static comparative advantages in natural and human resources.

Debate continues, though, over precisely *how* these economic feats were realized, the focal point being the role of the state and economic policy. Much of this debate is concerned with the extent and consequences of state intervention in the economy.

Advocates of a neoclassical view argue in favor of a minimal state role and reliance upon price signals and low barriers to trade and investment. In this view, growth is achieved because the state has confined itself to the maintenance of macroeconomic stability, the provision of basic infrastructure, and the enforcement of law and order, including property rights. The state has an important role, but one confined to establishing the conditions for the efficient operation of markets.

Advocates of an activist state, on the other hand, suggest that rapid growth in Asia has been achieved because governments have intervened extensively in the economy. By intervening in foreign exchange and credit markets, and through industrial policy, governments have gotten prices deliberately "wrong" in order to channel resources into targetted sectors, industries, and firms. The state has also imposed performance criteria on targetted industries to ensure compliance with development policy objectives.

Thailand's Passively Interventionist State

Thailand's experience has much to contribute to this debate on the state's role in economic growth. The country has achieved impressive growth rates and growth per capita has remained positive for several decades. But in Thailand neither the minimalist nor the activist account accurately describes what the state has done. Moreover, neither a *laissez faire* nor a "picking winners" ideology has guided the state in the allocation of resources. The state has intervened, but in a passive, often ad hoc fashion.

Government policies have been most effective in maintaining a macroeconomic equilibrium conducive to trade, investment, and the growth of firms. Yet, although the state has intervened at the sectoral level, it has been least effective in identifying or implementing any sectoral objectives. Most resource allocations which have boosted factor productivity have been determined by the market and private sector institutions, not state economic policies.

Should Thailand adopt an activist state approach? Upon reviewing the evidence, we argue that an activist state requires certain institutional capacities that have eluded Thai economic policy, notably with regard to the sectoral bureaucracy. The stable macroeconomic environment, combined with the resources and entrepreneurship of private firms, have helped overcome an acute lack of coordination and purpose in sectoral policy. But these factors will not completely substitute for effective, coherent, and competent sectoral management.

Unlike other newly-industrialized countries (NICs) in Asia, where governments helped repair market failures, Thailand has relied on the market to overcome government failures. While we do not advocate increased state intervention in the economy, we do call for more effective government action in those sectoral policy areas where the private sector will increasingly rely upon government to act. These policy areas include education, worker training, public health, social welfare, monitoring and enforcing environmental and safety regulations, and supporting and perhaps coordinating scientific research.

MACROECONOMIC POLICIES: STABILITY HAS PAID OFF

The World Bank's *East Asian Miracle* report concludes that stable macroeconomic policies are necessary for strong growth. Thailand serves as confirmation of this conclusion. Thai technocrats in the Central Bank, Ministry of Finance, and Prime Minister's Office have provided macroeconomic policies conducive to export, domestic and foreign investment, and the growth of a strong private sector which has emphasized productive investment over pure rent-seeking. The stable macroeconomic environment, marked by low inflation and a stable exchange rate, has encouraged the diversification of agricultural exports away from rice and rubber. Stable prices have also encouraged foreign direct investment and a shift away from exporting light manufactures to higher value-added wares, notably electronics.

Exchange Rates

The Bank of Thailand has displayed a sustained commitment to a stable exchange rate regime. From 1959 to 1984, the Thai baht was tied to the U.S. dollar. This gave the baht stability for most of this period, but also caused trouble for Thailand when the U.S. dollar appreciated vis-a-vis other major currencies. The Central Bank has also proven its ability to carry out needed devaluations. The Bank devalued the baht by 9 percent in 1981, and 14 percent in 1984, which boosted export competitiveness and offset the current account deficit of the early 1980s. Since 1984, the baht has been valued according to a "managed float," whereby the Bank of Thailand specifies daily exchange rates in accordance with fluctuations in a basket of major currencies. The purpose has been to maintain the baht/dollar parity within a somewhat wider band.

Low Inflation and Price Stability

The stable exchange rate has helped the Thai economy maintain a very stable price level. Inflation remained low throughout the post-World War II period, approximately 4 to 6 percent annually. Price stability, however, has not been fully immune to external shocks. A few periods of higher inflation have been generated by external factors, such as the oil shocks and peaks in global interest rates. The Bank of Thailand has consistently acted against inflationary pressures through interest rate interventions. But the key factor ensuring stable prices and low inflation in Thailand has been exchange rate stability. *Relatively* stable fiscal policies have also played a role. Fiscal deficits were not allowed to grow out of control.

Minimal Intervention in Foreign Exchange and Credit Markets

The Central Bank does not control markets for credit or foreign exchange. Thailand is unusual in this respect. Most developing country governments have intervened in these markets to guide investments into desired sectors, industries, commodities, and firms, or to boost employment. As the Thai state does not practice this kind of intervention, it has been impossible to have the brand of industrial "targetting" found in some of Asia's other NICs. Moreover, it has been necessary, in the absence of state direction, for the commercial banks to perform many of the investment coordination functions through financial intermediation that have been attributed to the state in many NICs.

The Central Bank has provided credits at discounted rates and in modest quantities for only two "target" activities—export financing and lending for agriculture and farmers. Export financing provided in the form of discounted promissory notes, is given to the commercial banks for allocation to bank clients on a discretionary basis. Agricultural credits are provided to the state-run Bank for Agriculture and Agricultural Cooperatives in the form of low-interest loans from the Central Bank. Neither of these interventions has distorted prices to the extent of creating severe misallocations of resources.

"Insulation" of Macroeconomic Policies

The Bank of Thailand's governor is appointed by the Minister of Finance, and the Bank is technically under the jurisdiction of the Ministry of Finance. In practice, however, the Central Bank formulates policy quite independently of the Ministry and the Cabinet. The Central Bank also retains a tradition of financial conservatism handed down by the British advisors of the early 20th century. The Bank's autonomy from the political process allows it to sustain a tradition of adherence to macroeconomic stability. Successive prime ministers have allowed their finance ministers very little authority over the Central Bank.

Fiscal policy is also somewhat insulated from political decision-making. The Bureau of the Budget is located in the Office of the Prime Minister. Budget appropriations are conducted by the sectoral ministries, not Parliament. The Budget Bureau then approves these appropriations and submits a budget to the Cabinet to present to Parliament. Parliamentarians have no authority over appropriations, and they have only limited authority to reshuffle funds on the allocation side, within a specified ceiling laid down by the Ministry of Finance.

Because fiscal and monetary policy management is effectively out of the hands of parliamentarians, the politicians are virtually unable to use macroeconomic policies to promote social or political objectives. Recently, however, the Central Bank, in response to requests by the ruling Democrat Party, has made efforts to increase low-interest loans for the agricultural sector. Their stated objective is to make more institutional credit available to poor farmers. Thus equity considerations have been introduced into macroeconomic policy, but the Central Bank has so far pursued these goals within the broader objective of price stability.

AGRICULTURE

It is often forgotten that until recently the foundation of Thai economic growth was not industry, but agriculture. Agriculture absorbed a large proportion of the rapidly expanding labor force. During the mid-1970s, agriculture provided the entire labor force increment with employment during the wet season, so that the share of labor in agriculture actually increased (Siamwalla, 1990). This was possible because of a land surplus—until 1980, cultivated land per farmer increased.

Agriculture is not amenable to state "planning." Productivity is highest when farmers make decisions based on their own understanding of their resources and technical constraints. But agricultural growth does require timely and competent state intervention in the provision of infrastructure. The state must also ensure a favorable marketing framework for production, trade, and transmission of price signals. Until the mid-1980s, policymakers performed reasonably well in this regard. Since then, however, their innovations in the farming sector have run out of steam, owing to the rising costs of infrastructure and services and pervasive bureaucratic inertia.

Nevertheless, stable macroeconomic policies and surplus resources have encouraged a vast diversification of Thai agriculture away from rice and staple food crops. This has been an important ingredient in diversifying farm incomes, creating new employment options for farmers, and reducing the incidence of poverty in the rural areas.

Rural Infrastructure

The state heavily invested in the national road network, especially during the 1960s and 1970s. These

investments were driven by military rather than economic considerations. The transport network made it possible for the state to increase its presence in the countryside in efforts to combat the communist insurgency. A spin-off benefit of the extensive road network was the far-reaching positive impact it had on agricultural growth. Moreover, much of the capital invested in the road network was provided by multilateral lending agencies, notably the U.S. Agency for International Development and the World Bank.

Multilateral lending agencies also assisted in irrigation development. The key investments were in the Chao Phraya River basin, where Thailand's richest rice-growing areas are located. Only about one-seventh of the country's total cultivated area is irrigated. Moreover, most of the present irrigation infrastructure consists of very basic facilities—primary and secondary canals. Tertiary and quaternary canals, which are necessary to achieve on-farm water level control and greater efficiency, make up less than 20 percent of the system. This has been a subject of negotiation between the irrigation authorities and lending agencies. Officials admit that the level of operations and maintenance capacities in the irrigation bureaucracy are inadequate for revamping the infrastructure.

Pricing and Marketing

Distortions in the macroeconomy which created prices unfavorable to producers were evident in the form of export taxes on rice and rubber. Because Thailand was a food surplus country, there was no need to promote staple food production to achieve self-sufficiency, and thus the government taxed rather than subsidized farm output. During the commodity boom of the 1970s, the state raised the premium, at times as high as 45 percent of the world rice price. Although these taxes lowered farmgate prices, they also stabilized them. In the meantime, the land surplus allowed for extensification of production, while stable monetary policies encouraged growth in farm exports.

Thailand is something of a rarity among developing countries in that the government has left most commodity trading to private business. It is one of only two countries in the world that allows private traders to trade rice freely on international markets (the other being the United States). This contrasts markedly with many African countries which assigned procurement and trading to government marketing boards. In many cases, the marketing boards procured farm commodities at low prices to provide urban consumers with cheap food. The result was often to discourage farm productivity, foster corruption, and encourage parallel markets.

Thailand has avoided these inefficiencies. Internal trading is conducted by a competitive marketing system of small, independent traders, while the export of most farm commodities has been managed by a dozen or so private traders with strong affiliations to the largest commercial banks. Bangkok Bank, for instance, played an important role from the 1950s to the late 1980s in bearing foreign exchange risks for the rice exporters. It was the first Thai bank to provide a letter of credit to foreign rice buyers, and its massive foreign exchange dealings helped to coordinate a market for risk and enabled traders to arrange forward contracts.

Growing Pains: The Structural Shift

In the 1980s, the land surplus disappeared, followed almost immediately by a long decline in agricultural prices from the peak of the 1970s. Both these developments imposed heavy pressure on farmers' incomes. Rural poverty increased between 1981 and 1986. As agriculture solved its income problems by shedding its younger (mostly female) labor force, manufacturing was given a boost. Throughout these developments, the state was a mere spectator. To date, there has been no *effective* action taken by the government, either to hurry the structural shift along, or to provide a safety net for farming families subject to the adverse turn of events.

PHYSICAL AND HUMAN INFRASTRUCTURE

Until the economic growth surge of the latter 1980s, the Thai government had chalked up a fairly good record in its provision of roads, railroads, electricity, and ports. Today's transport bottlenecks are primarily

the result of the slowdown in infrastructural investments during the economic austerity program of the mid-1980s, which coincided with an anticipated surge in investment and economic growth. Government capital expenditures, which are directed primarily at infrastructure, declined from 5.4 percent of GDP in the 1970s to 4.0 percent in 1980, falling further to 2.7 percent in 1990.

Transport bottlenecks are also caused by an ad hoc and largely unsuccessful bid to privatize major infrastructure projects. In many areas, the overseeing state enterprises have monopoly powers under the law; therefore the only way to have private firms participate has been to grant them concessions, often on a build-operate-transfer (BOT) basis. These concessions have become a battleground for politicians, state enterprises, and technocrats. One key constraint has been the lack of a legal framework which could inspire investors' confidence. Another has been leadership turnover, as successive groups of ministers have subjected existing contracts to new rounds of negotiations.

Education

Thailand's primary school enrollment rates have been historically high, and they correlate with growth in both agriculture and labor-intensive manufacturing. In 1960, primary school enrollment was about 83 percent. Thailand's secondary school enrollment rates, however, rank among the lowest in Asia. The share of the workforce with a primary education or less was 83 percent in 1990, the highest among the rapidly industrializing Asian countries. The secondary school enrollment rate in 1988 was 29 percent, while tertiary enrollment stood at only 10 percent. The government has yet to introduce mandatory education through the ninth grade level.

INDUSTRIAL POLICIES

Industrial policies have not been marked by industrial sector planning or by any industrial targeting strategy. As noted above, the Thai state does not control the markets for credit and foreign exchange, thus depriving policymakers of perhaps the key tools for conducting industrial targeting. Furthermore, there has been little coordination or coherence in the use of existing industrial policy instruments—tariffs, investment promotions, capacity controls, and local content regulations.

Nevertheless, an overall bias can be discerned when reviewing the consequences of various industrial policies. Thailand followed a broad import-substitution strategy from WWII until the mid-1970s. This favored capital-intensive industries, such as automobiles, chemicals, and electronics, but Thailand then shifted to an export-oriented strategy involving the promotion of manufactures exports. This strategy is not guided by any vision of what Thai industry should become. Indeed, the composition of the manufacturing sector is largely determined by the investment and trade strategies of the multinationals, upon whom Thailand has become increasingly reliant for markets and technology.

No Effective "Planning"

Thailand's brief experiment with state-led industrialization during the 1940s and 1950s saw the creation of nearly 100 state enterprises and the allocation of government revenues and loans to a number of disastrous industrial ventures. This strategy was aborted between 1958 and 1960 during a series of economic policy reforms which effectively pulled the ministries out of direct production and curbed the activities of the state enterprises, with the exception of those involved with public infrastructure. A planning board—the National Economic and Social Development Board (NESDB)—was created in 1959 to draft five-year "development plans." Production was turned over to the private sector, which was to become the "engine" of growth.

To call the NESDB a planning board is a misnomer. The agency does not plan production, nor does it command markets. Its real function is to outline a public investment program for five-year periods, in line with the agency's assessment of market trends. Its earlier duties concentrated on infrastructure planning. Lately it has broadened its plans to include a broader range of public investment and policy activities. During the 1980s, the agency even devised an industrial development plan for the Eastern Seaboard

region. But with no implementation powers, the agency could do little more than advise other state agencies which pursued projects suggested in the NESDB "plan." Though the plan was set down 13 years ago, the Eastern Seaboard project is only partially completed.

Ad Hoc Sectoral Strategy

Policies for the industrial sector have not been guided by any coherent ideology or developmental purpose, with the partial exception of the investment promotion policies implemented by the Board of Investment. Tariffs, for instance, were not a tool for industrial protection, but were used predominantly as a source of government revenue by the Ministry of Finance.

The Ministry of Industry's factory capacity controls have been loosely applied and have not been effective in achieving stated policy objectives. Controls applied to the textile industry between 1971 and 1987, for example, did not prevent surplus capacity in the industry, as large firms successfully bypassed the controls and small firms illegally imported machines. Indeed several of the larger firms boosted their capacity in anticipation that more controls would be put into place (Kaosa-ard, 1992). Often the controls simply acted as an official lever to extract rents through corrupt means.

One lesson is that regulatory controls that are incoherently or ineffectively applied create opportunities for rent-seeking. In this case, the lack of adequate information about the market, and the industry at hand, and the lack of effective monitoring and enforcement of performance criteria rendered the capacity control instruments ineffective.

Local content policies have had more success. They have played a more important role, for example, in supporting the growth of the automobile parts industry. Tariff protection for automotive assemblers also provided support to that industry. One cost has been the channelling of resources into a capital-intensive activity, requiring sustained tariff protection to survive. This has had adverse effects on consumers.

Board of Investment and Growth in Exports: Don't Be Quick to Correlate Them

The Board of Investment (BOI) was established in 1960. As one of the chief instruments of industrial policy, its major portfolio was to grant tax holidays, to grant exemptions from import duties on machinery, components, and raw materials, and to impose bans and surcharges on competing imports. BOI began by promoting mostly import-competing and capital-intensive industries, though the record shows that privileges had been allocated to most industries. The agency never espoused a coherent import-substitution policy per se, and it never developed or enforced performance criteria to ensure that promoted firms had complied with BOI terms.

During the 1980s, BOI shifted more decidedly toward an export-promotion strategy. Promoted firms were required to export a certain percentage of their output to qualify for promotions. These incentives attracted a wave of investment from Japan, and later from Hong Kong, Singapore, and Taiwan. Total FDI averaged about US\$270 million annually from 1980 to 1985; by 1990 it had risen to US\$2.4 billion. The level of FDI in 1992 stood at about US\$2 billion.

The FDI influx coincides with a boost in exports of both traditional light manufactures, including garments and footwear, and new manufactures, including electronics and consumer goods. Recently there has been a surge in consumer electronics exports, notably televisions, air conditioners, video machines, and refrigerators, in addition to other electronic goods, such as printed circuit boards and integrated circuits. Total exports have risen from US\$7.8 billion in 1985 to US\$36.8 billion in 1993.

It would be difficult, though, to attribute these trends to BOI incentives. The real driving force behind FDI and trade flows has been the currency realignments occurring since 1985. BOI's main contribution has been in making investment in Thailand *at least as attractive* as investing in other Southeast Asian countries.

DYNAMIC BUSINESS GROUPS AND CAPITAL MARKETS

Thailand's industrial structure is not characterized by a few huge, major conglomerates similar to those of Japan or South Korea. Its structure is more akin to that of Taiwan's, where a large number of firms dominates a broad range of industrial activities.

A coordinating mechanism exists in the form of business "groups" and commercial banks. These institutions have reduced transaction costs, resolved information dilemmas, and facilitated industrial investments. While there are disparities in wealth and opportunity between larger and smaller firms, strong banks and groups have also created a dynamic and flexible private sector that offers attractive partnerships to foreign investors, and that can move adeptly into new production processes and export markets.

Financial Intermediation

At the core of the economy are a dozen or so leading commercial banks. These banks have been responsible for financing Thailand's transition from an agricultural export economy to an industrial- and services-based economy. The allocation of credit and the coordination of investments have fallen almost entirely upon the commercial banks. Through a strong network of family ties and ethnic affiliations with traders and other entrepreneurs, the banks have somewhat successfully managed the allocation of capital earned from agricultural exports into manufacturing investments.

The usual risks associated with credit allocation, combined with problems of imperfect information, have caused the private banks to favor large borrowers over medium and small-scale businesses. As the banking system has become more complex, the Central Bank has pressured banks to bring down their rates for small borrowers, especially those in the provinces.

Business "Groups" as Coordinating Institutions

The banks are also at the core of business "groups" built up primarily by Sino-Thai families since the 1950s (Leff, 1979). Such business groups have emerged in almost all Thai industries. The supply of capital from the commercial banks, allocated through dominant business families, and the creation of vast business empires spanning multiple stages of production, have helped to create economies of scale and build entrepreneurship in the manufacturing sector (Christensen, 1993).

Capital Markets Are Diversifying

Firms are now able to raise capital, not only through commercial loans and foreign investors, but also through equities and bond instruments. Equities and bonds have diversified the sources of capital available and put pressure on the commercial banks to lower their interest rate margins and improve their services. The issuance of bonds, however, has been constrained by the absence of a secondary bond market. There is a demand for state intervention to help coordinate a market in bonds. The Central Bank has begun this task by encouraging state enterprises to issue their own paper and set up mechanisms for bond trading.

CONCLUSIONS

A simple description of Thai economic policymaking might convey the impression that the state has been active in promoting economic growth. But much of the action, while full of sound and fury, has signified very little. The Thai state has been particularly lax at the sectoral level, where any attempt to delineate a systematic policy has been defeated either by corruption or by frequent personnel shifts. Also lacking has been any powerful tool to discipline firms and sectors to "deliver."

In macroeconomic management—an area essential to solid economic growth—the state has performed extremely well. A calm monetary environment has made it possible for the private sector to grow and for the banks to assume investment coordination functions.

The key to even better performance in sectoral policy is not a more activist state, i.e., one that conducts extensive interventions at the industry and firm levels. The Thai state has intervened in the past, but its interventions have not been very effective, well-coordinated, or conducted with a clear purpose in mind. Some might argue that *better* sectoral interventions could assist the economy to grow more rapidly. But this requires a type of state apparatus that Thailand—and many other developing countries—simply do not have.

In this respect, the Thai state's information base at the sectoral level has been quite inadequate. Intelligent intervention requires some vision of the changing industrial structure. Moreover, there needs to be some investment coordination not only among private firms, but also between the private and public sectors. Thailand's experience here has been variable. Finally, Thailand could have used more sectoral vision concerning infrastructure. Privatization of urban projects has now yielded a whole new set of problems, but there is a big opportunity for policymakers to better coordinate infrastructure development in the provinces.

Overall, the state is struggling to keep up with the demands of a rapidly changing economy. Even though Thailand has enjoyed some success, it is not well prepared for the next stage of industrialization. Its investments in secondary education and its output of technicians and engineers fall seriously short of the country's needs. Moreover, the state is institutionally ill-equipped to assume the monitoring, enforcement, and social welfare functions for regulating an advanced industrial economy. At present, Thailand hardly needs an activist state. Instead it needs a more effective minimalist state able to anticipate the complex problems that will inevitably arise down the road.

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