

The 1989 TDRI Year-End Conference

Thailand in the International Economic Community

This year's Year-End Conference papers will examine prospects for the Thai economy in relation to changing economic policies and the world economy. The content has been divided into two main themes: the first projects Thailand's future role in the changing global economy; the second focuses on the management of Thailand's external sector in coping with the changing world economic environment. Conclusions and implications emanating from research will be drawn to form Thailand's external economic development policy toward the year 2010. The objectives are to maintain a competitive edge in trade in the various economic sectors, to attract foreign investment, and to manage the external sector in response to changing world trading systems. The policy areas considered are: the extent of trade liberalization in goods and services; agricultural and industrial strategies; technology and intellectual property right policies; taxation policy; investment policy; and various cooperative arrangements with trading partners.

Summary of Major Issues, Research Findings and Strategy Options

This summary report is a compilation of the 1989 TDRI Research Project, "Thailand in the International Economic Community." It summarizes major issues, research findings and strategy options as presented in individual reports.

In its introduction, the report says: "The 1980s will be recorded in Thai economic history as a decade of drastic economic change. ...As a consequence, the economy has become much more internationalized, with profound and wide-ranging effects on the economic activity and well-being of the Thai people."

Four major topic areas are discussed:

1. The Recent Development of the Thai Economy;
2. The Dynamics of the External Sector;
3. The Impact of the External Sector on the Thai Economy; and
4. Policy and Strategy Options for the External Sector.

The following is the executive summary of "Prospects and Perils in the Global Economy" and abstracts of the six other project papers to be presented at the Year-End Conference.

THAILAND: PROSPECTS AND PERILS IN THE GLOBAL ECONOMY

I. Thailand has an enviable long-run and recent economic record. It has had rapid growth, improvement in social indicators, and good macro management, with low inflation and external debt. The last five years have seen especially rapid growth in manufactured exports. Nevertheless, questions have arisen about the sustainability of future export-led growth. These questions are given added urgency by increasing income and regional inequality in Thailand, crowding and congestion in Bangkok, and rising protectionism abroad.

II.1 Why Have Thai Exports Grown So Quickly?

Thailand's export growth has been accelerating over the last 20 years in spite of a slowdown in growth rates of the rich nations. In general, the Thai export growth to any particular country is not plausibly correlated with its GDP growth.

There has been little change in the broad geographic distribution of Thai exports since 1980. About 60 percent of exports go to the OECD, 8 percent to Singapore, and the balance mostly to other LDCs. Geographic diversification cannot explain the recent rapid growth since 1983.

Changes in the real baht exchange rate explain only a minor portion of export growth. Even when the baht was becoming less competitive, exports grew over 8 percent per year, and rapid export growth has continued since 1987 when the baht stopped its real depreciation.

The principal explanation of recent Thai growth lies in the international economic restructuring caused by the success of the "Four Tigers" and Japan, the revaluation of the yen, and the rising labor costs in these countries—all of which have led to the rapid transfer of labor intensive industries to Thailand and the other ASEAN "junior NICs." Favorable economic policies, adequate infrastructure, and supplies of trainable and low-cost labor also have been important in attracting this investment. Failure to maintain these favorable conditions would lead to a sharp slowdown in this economic transformation.

II.2 Is This Growth Sustainable?

Declining labor force growth in the senior NICs and the rich nations in the 1990s, and the lack of a large or mobile workforce in agriculture, will speed up the spinning off of labor intensive industries to the junior NICs.

Fears of market saturation of LDC manufactured exports are unfounded for all LDCs as a group, and especially for Thailand alone. All LDC manufactured exports are only 5 percent of rich nations manufactured production. Thailand accounts for only 2 percent of total LDC manufactured exports. The rapid growth of the senior NICs throughout the 1980s, with world recession, protectionism, and loss of GSP, suggests that their growth will not be seriously limited by demand if costs stay low.

Thailand will remain small relative to the senior NICs. Its *level* of 1988 manufactured exports was less than the *increase* in Korea's or Taiwan's exports in 1987. Its manufactured exports could grow at 15 percent per year for a decade and still be no larger than Korea's current levels. This smallness suggests that it can continue to find market niches for rapid export growth.

Thai exports are well diversified by product type. The largest item is tourism, with 16 percent of export earnings. The next top 20 products account for only 54 percent of total export earnings. Among these, only clothing and textiles are over 10 percent of exports. This diversity helps insure against external shocks.

Thailand has shifted its export product composition rapidly, from reliance on primary products (two-thirds just a decade ago to only one-third today) to manufactured exports, now over 60 percent of total exports. This is the same type of flexibility exhibited by Taiwan, and bodes well for future adjustment.

II.3 Specific Market Prospects

The USSR and Eastern Europe now account for about 0.5 percent of Thai exports. Both their total hard currency imports and imports from nonoil LDCs are small. These might grow if restructuring increases efficiency quickly; but declining oil exports, aging technologies in key export products, and limited borrowing capacity make significant medium-term gains unlikely. Priorities for imports do not favor light consumer goods, and India and Vietnam could be preferred suppliers.

East and Southeast Asia, excluding Japan, now takes a quarter of Thai exports; but this share has fallen slightly in the 1980s, despite rapid income growth in many of these nations. Most imports from Thailand are raw materials, and most of these nations are competitors in labor-intensive exports. The socialist nations of Southeast Asia—including Myanmar (Burma)—are likely to increase purchases and enter into investment, service, and entrepot relationships. But their initial share (one half of 1 percent) of Thai exports is low, and they will not soon be major customers.

The Middle East will remain a solid market, with slow to moderate growth. It now takes 6 percent of Thai exports. But the small populations and successful import substitution in agriculture will limit Thai export growth, even if oil prices allow increased imports. Thai worker immigration is one important link to this region that could increase.

Other LDC regions are relatively unimportant and unlikely to become major customers, except for sporadic purchases of food and raw materials.

Growth projections for the rich countries have not been very reliable, but now center in a range of 2 percent to 3 percent per year—the same values seen in the last fifteen years. Protectionism is rising in the United States and Europe but is subject to negotiation and various coping measures. Japan and some of the senior NICs should be liberalizing their import restrictions.

III. Major Perils in the World Economy

1. A major, prolonged *world-wide depression* would have severe implications for Thailand. The probability of this is small because: a) the US deficit is inherently manageable at a relatively low cost; b) the greater economic interdependence among nations supports the lessons learned from the 1930s about the high costs of trade wars; and c) better economic management and "safety net" measures make a 1930s-style collapse unlikely. A major, sustained inflation is also unlikely, but a repeat of the early 1980s is possible. However, this degree of world recession can be handled easily by Thailand, as it was by the senior NICs.
2. Rich country *protectionism* is a serious problem for LDCs, despite GATT-negotiated tariff cuts. Quotas and "voluntary" export restraints on labor-intensive LDC exports have slowed exports, and the benefits under the GSP are only a limited offset. Section 301 of the US Trade Law, which targets import restrictions of foreign nations, "Europe 1992" and the integration of Eastern Europe into the EC raise further concerns about export prospects. Lesser fears of a US-centered trade bloc also exist.

These moves do pose a real challenge to Thailand's export growth, but not a severe one if proper policies are adopted. First, the senior NICs have managed rapid export growth in this "hostile environment," and Thailand could do the same. Second, several aspects of the MFA favor Thailand by restricting exports of competitors. Third, liberalization in Japan and the senior NICs will speed the shift of labor intensive manufacturing to nations like Thailand. Finally, further opening up of Thailand's domestic markets will serve not only to speed up the process of export led growth, but will also, by improving Thailand's image as a responsible member of the world community, enable it to negotiate important concessions from major trading partners.

3. There is concern about the volatility and long-term trends of primary *commodity prices*. For exports, the macroeconomic effects of short-term fluctuations are not large because of the declining importance of primary exports and production in the economy and because of diversification in the commodities exported, as well as low covariance of their prices. In the longer run, Thailand has either improved productivity and maintained profitable production of products with declining prices, or switched from these into more promising products. Neither short-term fluctuations (which can frequently be managed using futures markets), nor long-term trends should be a major obstacle to continued growth.

The outlook for oil prices is uncertain. While oil imports relative to total Thai exports have fallen (38 percent in 1982 vs. 9 percent in 1988), the risk exists of another large increase, especially since petroleum consumption is growing rapidly. Attempts to estimate future oil prices have not been successful, and there is a wide range of estimates for the year 2000. However, if prices did increase sharply, there very probably would be a later reversal; cycles of this sort have been observed for over a century. A doubling of oil price (assuming zero demand response to higher prices) would cost Thailand 2.6 percent of GDP. When Korea lost 6 percent of her GDP in the early 1980s, growth stopped for only one year before resuming its rapid growth. Since Thailand is less energy intensive and since world markets would respond more quickly, any future adjustments should be less painful. Taxation of petroleum use and increased use of other fuels or more efficient equipment could lower

the growth of oil use in Thailand.

4. Another concern is that rapid *technological change*, for example, in the form of computer integrated manufacturing, will reduce demand for labor intensive exports. In such an event, there are likely to be several years to adjust, a variety of ways to upgrade productivity or change products, and opportunities for Thailand to adopt improved technology, if it invests in the skills and materials needed to stay abreast of these changes. The same adjustments will be needed simply to remain competitive with existing technologies. However, the lack of adequate secondary education—enrollment ratios more than 25 years behind Taiwan and well below Indonesia or the Philippines today—are a serious impediment to Thailand's ability to adjust to and take advantage of technical change.
5. The opposite concern is increased competition from countries with *lower labor costs* than Thailand. At one level, this concern is misplaced. The most successful exporters are still the senior NICs, with much higher labor costs than any of the junior NICs; Thailand has benefitted more from the recent export boom than lower-labor-cost nations. Evidently, the infrastructure, skills, and policy environment also matter, not just wage costs. In addition, the extent of LDC penetration of rich country markets is still low—even for garments and textiles, where all LDC exports are worth less than 20 percent of rich country consumption. However, if Thailand fails to provide large numbers of skilled people, inputs at world prices, and adequate infrastructure, its costs will rise sharply. In this sense, the concern about low-cost competitors is realistic. Sustained export led growth will require continuing investment for Thailand to remain competitive.
6. Thailand has made extensive use of *foreign financing* for investment in excess of domestic savings. In the 1979-83 period, the current account deficit was 7 percent of GDP. This has dropped to only 2 percent (after deducting the positive errors and omissions) in the last five years, but is apt to be closer to 5 percent in 1989. Much of this inflow is for export-oriented private investment. This is likely to generate sufficient income to cover servicing costs as well as net foreign exchange. Thailand's low current debt-service ratio (under 15 percent), realistic exchange rate, high investment ratio (30 percent), and conservative fiscal and monetary policies suggest that it should be able to continue attracting capital on favorable terms without undue risk, at least as long as these policies continue.

In less aggregate terms, foreign investment is an important vehicle for technology and marketing skills. The large jump in BoI approvals—from \$1.3 billion in 1986 to nearly \$8 billion in 1988—has not yet shown up in investment startups, which have remained at about \$750 million in the last three years. However, this should soon increase sharply, but not so far as the value implied by approvals.

7. *Exchange rate volatility* is another concern to both private and public decision makers. Forecasters have not accurately predicted the magnitude, or even direction, of the swings of major currencies. Careful attention to the currency structure of the public debt is necessary, given that most export earnings are in dollars and much debt is in yen. Similarly, the baht should be managed so as to maintain Thai competitiveness, but not devalued so much as to cause uncertainty among savers. The increased riskiness of individual projects can best be handled by improving financial markets, so that the costs of spreading ownership are low. It appears that Thai investors have not been overly discouraged by recent currency fluctuations, suggesting that they have managed to reduce these risks to an acceptable level.
8. The growth of *environmental issues*, domestically and worldwide, is potentially important for Thai growth. The worries of the rich nations regarding ozone depletion or carbon dioxide should not be of great concern to Thailand unless compensation is offered, since the rich countries are the major sources of these problems. However, domestic issues of erosion, deforestation, and fouling of fishing grounds are serious. This sort of resource depletion, extending now even into neighboring countries, is likely to slow Thai growth in the medium run. Similarly, the rise of pollution and congestion in Bangkok is a growing threat to both public health and economic growth. Attention to these problems is necessary for Thailand's growth to continue.

IV. Conclusions

The attractiveness of some variant of Thailand's current growth strategy is underlined by considering the unsatisfactory alternatives. An attempt to return to agriculturally-led growth is not feasible. With only 17

percent of GDP, and possible growth of only 3 percent or so, the sector would contribute only about one-half of 1 percent to total GDP growth. It also faces unfavorable demand elasticities at home and abroad. It does not appear that this sector can be an engine of growth or a provider of the numbers and types of jobs now wanted.

The costs of a return to greater reliance on import substituting growth also would be high. Such policies actually increase vulnerability to world economic shocks, even though they reduce the trade ratio. The overvalued exchange rates, inefficient industries, low employment, high capital intensities, and concentration of imports in capital and intermediate goods all lead to poorer performance than export-oriented nations over a wide variety of international conditions.

The overall conclusion is that the international environment will be bumpy and challenging, but not fundamentally hostile to export-led growth, if Thai economic management is alert, skillful, and responsive. The major risk is not insurmountable external shocks, but rather slow, weak, or counterproductive government responses to any that do arise. Even without shocks, inadequate public investment—especially in human capital—or excessive domestic protectionism could slow future progress. These are the major dangers to continued rapid development.

THE MANAGEMENT SYSTEMS OF THE WORLD ECONOMY AND THE RESPONSE OF THAILAND'S EXTERNAL SECTOR

This report deals with Thailand's international economic relations with different countries and groups. The emphasis is on Thailand's external sector, which has continued to increase in its importance to Thailand's economy as a whole. The report aims at elucidating the management systems that are most characteristic of change of the world economic system—unilateral, bilateral, multilateral, regional, and sub-regional systems—and their impact on Thailand's external sector.

The research findings indicate that the world trading system is moving toward a more managed trade system and away from a free trade system. The 1988 quantitative assessment indicates that managed trade affected about one-third of Thailand's exports to its three major trading partners. Managed trade accounts for 18 percent of Thailand's overall exports. Therefore, the future performance of Thai exports depends strongly on how Thailand adjusts to the managed trade system.

THAI AGRICULTURE IN THE WORLD ECONOMY

World agricultural trade over the next decade will continue to be depressed by problems of oversupply, and it is unlikely that the present GATT round of trade negotiations will be successful in making a sizable dent in the oversupply. Although prices are not expected to be as low as they were in 1987, they are expected to be only slightly above them on average.

These developments will not affect the trade orientation of Thai agriculture. The crop subsector is expected to continue to produce a net exportable surplus in the aggregate over and above domestic demand. A study of comparative advantage in the fisheries subsector indicates that Thailand enjoys favorable production conditions for much of that sector (except fishmeal) so that it will probably continue to generate surpluses in this area as well. Our own studies also show that within the livestock sector, the Thai poultry industry enjoys substantial comparative advantage. The swine industry does as well, although the margin of advantage is not as decisive. Thailand, however, has no comparative advantage in the dairy industry, which can only be sustained by protection.

Despite some exceptions, Thai agriculture is therefore expected to be producing an exportable surplus, despite the expected fall in prices (relative to levels ruling in 1989). Therein lies some of the problem, for it implies that without an increase in productivity, incomes cannot be expected to rise. Policies designed to shore up their incomes would imply a net outlay from the government, which is unlikely, given past behavior patterns.

Increases in productivity can be generated only by putting more effort into research on new technology. Unfortunately, such research tends to help farmers only in areas that are already productive; therefore, it would enhance inequalities among different regions in the country.

TRADE IN MANUFACTURED GOODS AND MINERAL PRODUCTS

This paper describes the development of the manufacturing and mineral sectors in terms of production, exports, and imports in the 1980s, and makes projections for the long-term future. It also examines changes in trade and industrialization policies during the period and discusses their impact on exports, employment and industrial location dispersion. Finally, an assessment of export performance using the constant-market-share analysis is done, in order to explain how exports were affected by world demand growth and various domestic policies. From the results of the study, implications are drawn about trade and industrialization policies, particularly for international trade competitiveness enhancement.

TRADE IN SERVICES

The primary objective of the trade in services project is to analyze the external sector's role in Thailand's economic development. Specific objectives are to keep Thailand competitive in trade and in being an attractive place for foreign investment, and to manage the external sector so that it will contribute the most to Thailand's development. To achieve these objectives, the study begins by examining the direction and identifying factors that determine the pattern of trade in services, as well as the regulations and barriers affecting them. Merchandise trade theories have been applied to trade in services in order to determine the pattern of trade and to recommend policies to increase their competitiveness in international markets. The study examines the following service activities: Tourism, Transportation, Banking, Labor Services, Insurance and Telecommunications.

DIRECT FOREIGN INVESTMENT AND CAPITAL FLOW

There have been major changes in the role and the pattern of net foreign capital flows into Thailand during the 1980s. The net flow share in net capital formation substantially declined. The significance of foreign loans—especially long-term loans—has declined throughout the decade, having been replaced by direct and portfolio investment. Within each group of capital formation, foreign involvement increased in the case of direct and portfolio investment, but declined in the case of loans. Foreign direct investment (FDI) in recent years comes mainly from Japan. The next largest sources of FDI were the United States, Taiwan and Hong Kong. The manufacturing sector attracted the largest share of FDI in recent years—especially in industries such as electrical appliances, chemicals, metal-based and non-metallic products and textiles. Among non-manufacturing sectors, construction, trade, services and financial institutions attracted a sizable share of FDI in recent years. About 60 percent of promoted FDI projects approved during 1986-1988 were made in accordance with the product life cycle hypothesis—i.e., to maintain or regain cost advantage. Among the other 40 percent, most were invested to make use of domestic natural resources and to gain the advantage of domestic demand. Portfolio investment has been important in recent years and came from three major sources—Great Britain, the United States, and recently, Japan. Sectors that found a sizable share of foreign funds were baking, finance and securities, commerce, construction materials and textiles/clothing. The next inflow of foreign portfolio investment was influenced mostly by Thailand's economic prospects and market investment returns. The pattern of foreign loans has changed in concentration, from the public sector to the private sector. There has been little change in loan sources for public foreign borrowings, except for an increase in bilateral sources, mainly from Japan. The net private loan inflows in recent years were found to be influenced by current account deficits and exchange rate risk.

The increasing participation of foreigners in securities transactions is found to contribute positively to the Thai economy. It improves efficiency of capital allocation by reducing the cost of funds and increasing the return on investment. The impact of FDI in recent years is more far reaching. A dramatic shift of FDI from import-substitution industries to export-oriented industries will contribute to the country's exports and will have a significant impact on production efficiency, due to more technology transfer and training. Since most of these promoted FDI projects involve relatively labor-intensive activities, they will greatly contribute

to the country's employment. Aside from this contribution, however, some local entrepreneurs are complaining that FDI caused a considerable increase in land prices and shortages of skilled labor in fields such as engineering and science. FDI also had a crowding-out effect on local producers in domestic markets and local sources of materials.

THE IMPACT OF THE EXTERNAL SECTOR ON THE THAI ECONOMY AND ITS DETERMINANTS

This study assesses the impact of Thailand's external sector on its domestic performance. A modified LINK model consisting of 157 behavioral equations and identities was used to analyze the impact of export expansion on structural growth change, import dependence, and external and internal stability. At the same time, CGE was utilized to assess the impact of export growth on income distribution. The study confirmed a favorable effect of export expansion on growth, financial stability and structural change. It has also been found in the study that a unit value of increased export leads to the highest amount of induced imports compared to other final demand components. Finally, the result from CGE suggests that although exports have increased the income of all classes, they have benefited the higher income classes more than the lower income classes. Thus exports are not favorable in terms of income distribution.

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