

Paths to Sustainable Growth: Strategies for the Post Crisis Environment*

Chalongphob Sussangkarn**

In the aftermath of the 1997/98 financial crisis in East Asia, countries like Thailand and other crisis affected countries, carried out many reforms in order to make the economy more resilient to the risks arising from inherent volatilities from the global financial system. Large amounts of short-term capital inflows, together with inappropriate macroeconomic management regime, led to economic bubbles which eventually burst and led to widespread bankruptcy in the economic system. The large amount of short-term foreign debt, resulting in both maturity and currency mismatches, left the country basically insolvent and had to enter an IMF program with stringent conditionality. Full recovery from the crisis was fairly lengthy in Thailand, requiring eight years before the ratio of Non-Performing Loans (NPL) fell back below 10 percent. However, the reforms that were undertaken, in macroeconomic management, in data transparency, in regulations of the financial system, in corporate governance and many other areas, made the country much more resilient to financial volatilities. Undoubtedly, the 1997/98 crisis experience and resulting reforms helped the country avoid significant exposures to toxic assets that were at the very heart of the sub-prime crisis that grew to become the global financial crisis. Therefore the financial systems in the region were not much affected by the global financial crisis.¹

Unfortunately the indirect impacts of the global financial crisis on the region's exports were substantial.

While the region's intra-regional trade has been growing over time, much of the growth was due to trades in parts and components and the region still depended much on outside destinations, particularly the United States, for demand of final products. The global financial crisis resulted in sharp declines of the region's exports, starting in the last quarter of 2008 and lasting until around the end of 2009. The region has also become much more dependent on exports as a source of growth compared to the period prior to the 1997/98 crisis (see Table 1). Thus, the export declines also led to sharp GDP declines for many economies.

In light of the global financial crisis as well as more recent developments in Europe, there have been much discussions in the region about important changes in the economic environment that Asia will face in the post-crisis world, and needed changes to the region's growth strategy in order to achieve a more sustainable growth trend under these changing environments. Some of the key changes in the economic environment are likely to include the followings:

- Less excessive consumption in the United States and greater fiscal discipline in Europe should mean that demand for East Asian exports from advanced economies outside the region will become less important as a driver of Asian growth than before the crisis.

Table 1 Ratio of Exports of Goods and Services to GDP (Current Prices: Percent)

	1993-1996	1997-2000	2001-2004	2005-2007
China	22.7	21.5	27.8	40.0
Indonesia	26.4	39.3	33.6	31.5
Korea, Rep.	27.5	39.0	36.3	40.3
Malaysia	88.4	112.5	110.3	114.8
Philippines	35.5	52.0	50.0	45.8
Singapore	181.2	185.0	208.9	262.6
Thailand	39.5	58.0	66.6	76.6
Vietnam	34.1	48.2	59.1	73.2
Japan	9.3	10.8	11.8	16.5

Source: World Bank. World Development Indicators (Online through the Global Development Network).

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** Distinguished Fellow, Thailand Development Research Institute.

- Intra-regional trade can play a bigger role in driving the region's growth in the future, replacing the declining role of extra-regional trade. The role of the large dynamic countries in the region, particularly China and India, will be very important. Greater intra-regional trade will also be facilitated by more economic cooperation and greater economic integration within the region.
- Given very high dependence of many countries on exports, a more balanced growth path with other domestic drivers of growth playing a bigger role will be more desirable for sustainable growth, although exports will still remain an important growth driver.
- Infrastructure investment has the potential to become an important growth driver for many countries in the medium to long term.
- Infrastructure investment also has the potential to create economic dynamism for the region as a whole through improving cross-border connectivity and generating more cross-border trade and investment, creating what ADB calls a "Seamless Asia."² Thus, the growth driver for the region as a whole will become more balanced, with intra-regional trade and investment being supplemented and facilitated by a major push in cross-border infrastructure investment.
- With a more balanced and sustainable growth path, the greater dynamism of Asia, compared to other parts of the world, will lead to the

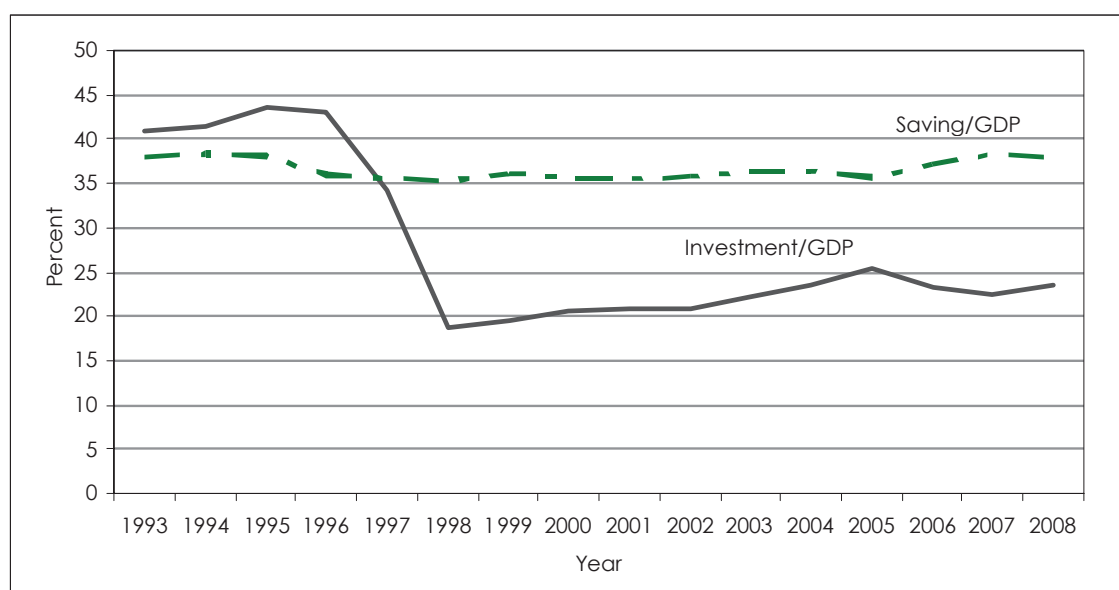
realization of a vision that has been talked about for some time, that of the current century being the "Asian Century."

These changes in the economic environment will create new challenges for all countries as well as for the region as a whole. Appropriate strategies will be needed in order to generate sustainable growth under these new environments. I will briefly highlight some of these strategies, focusing on the Thai case as well as on the region as a whole.

Boosting investment will be particularly important for Thailand, as the role of investment has declined substantially after the 1997 crisis. The share of investment to GDP (real terms) declined from about 40-45 percent prior to 1997 to only about 20-25 percent after the crisis (see Figure 1). While the pre-1997 share was certainly too high (given the economic bubble at the time), the current share is also certainly too low, also much lower than the saving to GDP ratio of about 35-40 percent, which has been very steady for a long time.

An investment push will need to be led by the public sector, as the private sector is still facing a lot of excess capacity, and political uncertainties do not bode well for business confidence. Nevertheless, since Thailand has not undertaken any major infrastructure investment push after the 1997 crisis, there is a lot of potential for a new phase of infrastructure investment, in which the private sector can be brought in through Public Private Partnerships (PPP). However, based on Thailand's own experiences in earlier periods of infrastructure investment, appropriate strategies will be needed to make sure of the full benefits from the infrastructure investment. Three issues will be particularly important.

Figure 1 Ratios of Real Investment and Saving to GDP: Thailand



Source: National Economic and Social Development Board.

First, an effective system of project scrutiny and selection, with careful project evaluations and cost-benefit analyses, will be needed. The current system of checks and balances is too weak and vested interests can push through economically unviable projects too easily. A good test case will be the soon to be opened "Airport Link" train. With the Suvarnabhumi Airport fairly near to the Bangkok city center, and with excellent expressway links, road transportation to and from the city is very convenient, so taking the Airport Link to the city terminal, from where it is likely to take about as much time to various major city destinations as road transport direct from the airport, is unlikely to be very attractive. It will be interesting to monitor the rider-ship once the train operates.

Second, and related to the first, is the need to ensure good connectivity of various infrastructure projects, particularly the transportation projects. With many agencies responsible for their own projects, strong central planning is needed to ensure that the various projects form part of an integrated and unified system. The system to ensure this has not yet been developed. The two mass transit rail systems in Bangkok still do not have an integrated ticketing system, and new mass transit rail systems have been initiated without yet clear blue prints on how to merge them into the existing ones into one integrated system. This could lead to a nightmare for commuters in the future.

The third issue relates to a relative lack of capital goods industries in Thailand. This means that the import content of investment is very high (around 40-50% and likely to be much higher with infrastructure investment). With high import contents, investment will generate low growth multipliers. In addition, investment driven growth can quickly lead to external imbalances. Thus, an investment driven growth strategy should be undertaken together with a strategy to promote more capital goods industries, especially those capital goods used in the types of investment being implemented. This is not so easy for a relatively small country like Thailand, as the demand for capital goods from domestic investment may not justify developing these capital goods industries. A large country like China can of course use its size to full advantage in this matter. However, there should be a conscious strategy to try to promote more capital goods industries, where feasible.³

The focus on cross-border infrastructure investment is also particularly important for Thailand. As a member of the Greater Mekong Subregion (GMS), Thailand has been closely involved with cross-border investment with its GMS neighbors, and is part of the so-called "North-South," "East-West" and "Southern" corridors. I believe that Thailand should concentrate even more on these cross-border strategies. The border areas to our GMS counterparts are the poor areas, far from the industrial centers of Greater Bangkok and Eastern Seaboard regions. More investment in cross-border projects will create more cross-border trades and investments. Studies have shown that these cross-border

linkages benefit the poor in the border areas. Greater economic dynamism in the GMS border areas can certainly help to reduce poverty and income gaps in Thailand, and given the current political turmoil, a focus on these border areas should be one of the most important priorities of the government.

The next strategy relates to the greater role of the region in driving trade of the region, particularly the role of the big countries, China and India. These countries are certainly very important, and their dynamic growths have helped the region to recover fairly quickly from the global financial crisis. In Thailand, while export growth has bounced back since the last quarter of 2009, the average export level in 2009q4 and 2010q1 is still lower than the average level in the first three quarters of 2008. Comparing the average export levels for these two periods broken down by export destinations, it is significant to note that, for Thailand's major trading partners, exports to China, India and Australia are higher in the latter period compared to the former, while exports to all other major destinations are lower. These three economies are those that have performed well through the crisis period, and the size and dynamism of China and India in particular indicate that they will become more and more important growth drivers for the other economies in the region over time if they can sustain their growth momentum.

As the large economies become more dynamic and there are closer linkages to and freer trade with the rest of the region, apart from the benefits in generating more demand for the region's exports, there is also the risk that the small economies will be overwhelmed by the exports from these large economies, each with still a very large pool for relatively cheap semi-skilled labor. This is why for a country like Thailand, which is part of ASEAN, I believe that it is extremely important to attach priority to the development of the so-called ASEAN Economic Community (AEC). From the official statements, "AEC envisages the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy."⁴ The target to achieve this (or most of the main elements) is 2015.

While many ASEAN countries are still apprehensive about the AEC, as they feel that the increased intra-ASEAN competition may harm them, I believe that the AEC is essential otherwise all of the ASEAN countries could become marginalized in the shadow of the giants of the region, China and India. China has shown clearly that "size does matter." The only way for ASEAN countries to be able to compete on relatively equal terms with China and India is to develop the main features of a single market and single production area. Only then can ASEAN offer the benefits of scale economies to be comparable (although still less) than China and India. ASEAN countries need to understand that it is not AEC versus the status quo, but rather AEC or the risk of becoming marginalized within the region.

Finally, as Asia becomes more integrated, it should be clear that the risks from shocks from within the region will become larger and larger, and is likely one day to become larger than risks from extra-regional sources. Even today, the sustainability of growth of an economy like China, with its extensive links to other parts of the region, is tremendously important to every other countries in the region. However, in my view as someone who has been involved in the ASEAN+3 Finance Ministers' process, the regional surveillance mechanisms that we have at present is far from adequate, and this is also true of surveillance through the Central Bank process.

After about a decade of developing a regional foreign exchange liquidity support mechanism, Chiang Mai Initiative (CMI) and Chiang Mai Initiative Multilateralization (CMIM), the ASEAN+3 has finally agreed to set up a regional surveillance organization, the so-called "ASEAN+3 Macroeconomic Research Office (AMRO)" (due in May 2011). While commendable, in my view this should not simply be a "Research Office," but rather a technical secretariat of the ASEAN+3 Financial Surveillance Process. I believe Asia needs to set up a formal surveillance mechanism involving Finance Ministers and Central Bank Governors. The membership should be the ASEAN+6 (including also India, Australia and New Zealand), and this should be the common membership composition of the Finance Ministers and Central Bank Governors processes. There are ways to bring India, Australia and New Zealand into the CMIM without rocking the status quo, and the EMEAP membership⁵ can be expanded to become the ASEAN+6.⁶ There should be more regular meetings of Finance Ministers and Central Bank Governors, both separately and jointly. These meetings should be the centerpiece of the regional surveillance process, and given the huge foreign reserves under the control of Asia, there is no doubt that global attention will be paid to these meetings. The surveillance should of course also cover situations outside the region, particularly in the advanced economies, because Asia invests a lot in these markets. These meetings could also lead to more significant regional financial cooperation initiatives, such as on macroeconomic policy framework coordination, further financial integration or even exchange rate regime coordination. This would be a significant step in

dealing effectively with important global issues, such as the global imbalance.

This last point fits in well with the vision of the Asian Century. With a prominent, and even a leading, role for Asia in the global economic system also comes the need for Asia to take on greater global responsibilities. Just as a more balanced growth path in Asia can bring about greater sustainability of growth for the region, a more balanced growth path for the world as a whole will reduce risks of major crises in the future. This will be of benefit to Asia, as well as to the other regions. Asia is of course an important part of the global imbalance problem, and it is not a problem of any single country in Asia, but a problem that can only be effectively dealt with by the main countries in the region acting jointly. Building up the regional institutional framework so that the main Asian countries can cooperate and coordinate on macroeconomic and financial matters on a regular and frequent basis will be an important step for Asia to take on greater global financial responsibilities in line with the realization of the Asian Century.

ENDNOTES

- ¹ However, the stock market declined substantially in line with global trends, and some countries suffered severe US dollar liquidity shortages.
- ² Asian Development Bank and Asian Development Bank Institute. 2009. *Infrastructure for a Seamless Asia*. Tokyo: Asian Development Bank Institute.
- ³ There is also room for promoting more part and component industries to deepen the country's industrial structures. This will also contribute to greater domestic components of growth. See Chalongphob Sussangkarn and Somchai Jitsuchon. 2009. "The Sub-Prime Crisis and Thailand's Growth Rebalancing." *TDRI Quarterly Review* 24 (2): 3-9.
- ⁴ See the ASEAN Website at <http://www.aseansec.org/18757.htm>.
- ⁵ EMEAP stands for Executives' Meeting of East Asia Pacific Central Banks.
- ⁶ Hong Kong is a member of both CMIM and EMEAP.

