TDRI Quarterly Review
Published in *TDRI Quarterly Review*
Vol. 6 No. 2 June 1991, pp. 24-26
Editor: Anne Johnson

Thailand's Export-Led Growth: Retrospect and Prospects

Executive Summary

The following is taken from a recent policy study (publication code: PS3) by Narongchai Akrasanee, David Dapice and Frank Flatters.

Thailand is currently one of the world's fastest growing economies. In the 1960s and 1970s relatively continuous expansion of agricultural exports and import-substitution-based growth in manufacturing led to a 7 to 8 percent annual growth. During the first half of the 1980s oil- and commodity-price shocks caused an abrupt slowdown, with rising debt, austerity, and a slower growth of exports and national income. Thailand's post-1985 economic performance, by contrast, is virtually unparalleled; since 1986 improving commodity prices and a 40 percent annual growth in manufactured exports have led to a 30 percent annual growth in total exports and double-digit GDP growth. The patterns of exports, imports and international capital flows have reflected Thailand's increased integration into the world economy.

SOURCES OF EXPORT-LED GROWTH

Possible causes of the manufactured goods export boom include domestic commercial policies, world demand growth, and increases in foreign investment. Yet the evidence provides very little support for any of these explanations.

Although public pronouncements have indicated a shift in the orientation of commercial and investment policies toward a more export-based strategy, the actual incentives created by taxes, import tariffs and export duties have been increasingly import-substitution-oriented. To the extent that these policies have assisted export growth, it has been through the crafting of various exceptions and special privileges to enable exporters to escape their worst effects. Indeed, without some major reforms, such as the recently announced intent to reduce the level and simplify the structure of import tariffs, there is a serious danger that commercial policies could become a hindrance to continued growth.

World demand growth provides a no-more-adequate explanation of recent events. Thai manufactured exports have been growing much more quickly than aggregate world demand or that of any particular products, and many of the exports in recent years have been of new exports for Thailand. In the case of traditional primary—especially agricultural—exports, Thailand's world market shares have been falling. The recent export boom has involved a massive increase in Thailand's penetration of markets for manufactured goods. While growth in world demand may have helped to facilitate this process, it is not clear whether it was necessary, and it certainly was not sufficient. A major part of the explanation of recent events must lie in the structural changes that occurred in Thailand's domestic economy.

Growth of investment, especially foreign investment, does not turn out to be a major part of this story, at least in the 1985-88 period. The growth of manufactured exports began well before any increase in overall investment rates. And even as investment has begun to increase in recent years, the role of foreign investment has remained surprisingly small. The initial growth in manufactured exports appears to have come largely from excess capacity associated with a slumping domestic economy and excessive investment in earlier years. Subsequent growth in capacity has been financed largely from domestic sources.

The export boom began after the baht devaluation against the dollar in 1984 and took off as the baht remained tied to the dollar during its subsequent fall relative to other currencies—especially the yen and those of the NICs. At this time, the NICs were straining the limits of their capacity. As a result, their costs rose, and they began to shift away from labor-intensive exports and into more advanced products. Thailand turned out to be well placed to pick up some of the labor-intensive product demand that was too expensive for the NICs to produce.

A large part of the Thai export story relates to the growth in its market share resulting from an evolving comparative advantage in the world economy. This required both favorable domestic economic circumstances (a slowing of extensive agricultural growth, a developing manufacturing sector, a relatively skilled and well-trained labor force, adequate infrastructure, etc.), and responsive macroeconomic management (a reasonably valued exchange rate, responsible fiscal and monetary policies, etc.). Few other countries were as well positioned as Thailand in all of these respects; the record growth in the latter part of the 1980s is a reflection of this.

IMPLICATIONS OF EXPORT-LED GROWTH

The recent boom in manufactured goods exports has had implications for the structure of the Thai economy, the growth of employment, and the distribution of income.

The initial growth of manufactured exports was facilitated in part by the slowdown in agricultural growth in the 1980s, which made labor and capital resources relatively easily available to the manufacturing sector. Future growth of this sort, however, will require substantially greater investment and a more intense competition with the rural sector for labor. The latter will also have important implications for the distribution of income over the medium and long terms.

It is not possible to make very precise estimates of the contribution of manufactured exports to the demand for labor. However, a reasonable guess is that about 500,000 jobs—13 percent of labor-force growth—might have been directly associated with manufactured export growth from 1985 to 1989. Even relatively conservative estimates of continued growth of manufactured exports give increases in employment in manufacturing and services that will exceed labor-force growth by 1990-95, so that the agricultural labor force would shrink by one to two million workers over that period. This could have significant effects on wages and the distribution of income and will put cost pressure on Thai exports, unless there are improvements in productivity.

In an economy which has, until recently, been dominated by agriculture, the distribution of income and the incidence of poverty have depended almost exclusively on agricultural prices. Their collapse in the mid-1980s and their projected long-run decrease, together with the end of land-abundant agricultural growth, have had and could continue to have deleterious effects on income distribution and poverty. Manufactured goods export growth does not have much of a direct impact on the rural poor. However, as the share of agriculture in Thai employment falls, continued growth of labor-intensive manufactured exports will have an increasingly important and beneficial effect on both urban and rural wages. Without appropriate policy steps, however, this will also bring new problems of urban poverty associated with urban congestion and environmental degradation.

SUSTAINABILITY OF RECENT GROWTH

Is the external economic environment likely to remain conducive to continued export-led growth?

Thailand's economic growth, and particularly its export growth, has been accelerating over the past 20 years despite a general slowdown in the growth rates of rich nations. Thailand's most recent growth is explained, on the one hand, by a fundamental economic restructuring of the world economy and, on the other, by the ability of the Thai economy to take advantage of these changes. There are no obvious limitations in the external environment that would prevent the continuation of this process for some time to come. Declining labor-force growth in the senior NICs and the rich nations in the 1990s, together with the lack of a large and mobile agricultural labor force in these countries, will tend to accelerate the spinning off of labor-intensive industries to the junior NICs.

Fears of market saturation of LDC-manufactured exports are unfounded for all less-developed countries (LDCs) together, or for Thailand in particular. All LDC-manufactured exports combined are only 5 percent of rich nations' manufactured production; and Thailand accounts for only 2 percent of total LDC-manufactured exports. Thailand is and will remain small relative to the senior NICs. Its *level* of manufactured exports in 1988 was less than the *increase* in Korea's or Taiwan's exports in 1987. Thailand's small size means that there should be no serious barriers to its continuing exploitation of market niches for rapid export growth.

In addition, Thai exports are very well diversified by product type. This diversity provides additional insurance against external shocks. The rapid shift in Thailand's export composition—from reliance on primary products for two-thirds of exports a decade ago to deriving over 60 percent from manufactured exports now—shows a high degree of flexibility and adaptability. This bodes well for Thailand's future adjustment and growth.

A variety of other events are mentioned as possible threats to continued Thai growth. A *major worldwide depression* would certainly cause difficulties for Thailand. But even the worst-case scenario is not significantly worse than the experience of the early 1980s. The senior NICs showed themselves capable of weathering that episode very well. With proper macroeconomic policies, Thailand should also be able to get through a multiyear slowdown with only modest costs. The evidence from previous economic downturns is that outward-looking countries have fared the best, or suffered the least, in these circumstances. Complete insulation from external shocks is impossible—or at least, very costly—to achieve. Outward-looking policies offer the best insurance.

Rich country *protectionism* is a serious problem for LDCs, despite GATT-negotiated tariff cuts. The current stalemate in GATT negotiations will not help. Thus, protectionism could pose a challenge to Thailand's export growth. But the threat should not be serious, especially if proper policies are adopted. The senior NICs have managed rapid export growth in a similarly "hostile" environment, and Thailand should be able to do the same. Liberalization in Japan and in the senior NICs, together with increasing integration between Thailand and these other economies, will accelerate the shift of labor-intensive manufacturing to nations such as Thailand and will open up many new market opportunities.

Another concern relates to the volatility and long-term trends of *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. Diversification of export commodities, together with low covariance of their prices, further diminishes these effects. In the longer run, Thailand has either improved productivity and maintained profitable production of goods with declining prices or has switched into more promising products. Neither short-term fluctuations nor long-term trends in prices of primary exports should be a major obstacle to continued Thai growth.

The outlook for oil prices remains uncertain. As recent events show, they are subject not only to somewhat volatile economic forces but also to political events. Between 1982 and 1988, however, Thailand's oil imports fell from 38 percent to 9 percent of total exports. But rapidly growing domestic consumption, together with a large price shock such as that which has occurred since August 1990, makes another large increase in this ratio a real danger. However, sharp price increases are almost certainly to be followed by later reversals; cycles of this sort have been observed for over a century. A doubling of oil prices, assuming *no* domestic demand response, would cost Thailand 2.6 percent of GDP. When Korea lost 6 percent of its GDP due to similar shocks in the early 1980s, growth stopped for only one year before resuming its rapid rate of increase. Since Thailand is less energy-intensive and since world markets in general would respond more quickly than in the earlier episodes, future adjustments should be less painful. Once again, appropriate economic policies—especially allowing domestic energy prices to move in response to changing world market conditions—are the key to facilitating the necessary adjustments.

Another concern is that rapid *technological change,* in the form of computer-integrated manufacturing, for example, will reduce the demand for labor-intensive exports from countries such as Thailand. Through appropriate investments and adjustments, the senior NICs have been able to stay abreast of and competitive with advancing technologies. The most serious impediment to Thailand's ability to emulate this performance will be its acute shortage of technically-skilled secondary-school graduates. Thailand's current secondary-school enrollment ratios are more than 25 years behind Taiwan's and are well below those of Indonesia and the Philippines today.

The opposite concern is increased competition from countries with *lower labor costs* than Thailand's. So far at least, Thailand has benefited more from the recent export boom than have nations with lower labor costs. Evidently, the infrastructure, skills, and policy environment also matter, not just labor costs. However, if Thailand fails to provide large numbers of skilled people, inputs at world prices, and an adequate infrastructure, its costs will rise sharply. In this sense, the concern about lower-cost competitors is valid. Sustained export-led growth will require continuing social as well as private investment for Thailand to remain competitive.

Thailand has made extensive use of *foreign financing* for investment in excess of domestic savings. Much of this inflow has been 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), a realistic exchange rate, a high investment ratio (30 percent of GDP), and conservative fiscal and monetary policies suggest that it should be able to continue borrowing on favorable terms without undue risk, at least as long as these policies continue.

Foreign investment is an important vehicle for the transfer of technology and marketing skills. The large jump in Board of Investment (BOI) approvals, from US$1.3 billion in 1986 to nearly US$8 billion in 1988, has not yet been manifested in investment startups, which have remained at about US$750 million in the last three years. However, this should soon increase. The opening up of new investment possibilities in Eastern Europe, the current stock market declines in major world markets, and the demand for loans in the Middle East and to finance the U.S. deficit mean that—in the short-run at least—there will be much greater competition for scarce investment funds. This is likely to slow down the inflow of foreign capital. But, as with world markets for goods and services, Thailand's small size means that it could continue to exploit its niche market in the demand for world investment resources. Once again, this will depend on the continued execution of appropriate macroeconomic policies.

The growth of *environmental concerns,* both domestically and worldwide, is of considerable potential importance for Thai growth. Domestic issues of erosion, deforestation, and the fouling of fishing grounds are serious. This sort of resource depletion, extending now even into neighboring countries, is likely to slow Thai growth. Similarly, the increase in pollution and congestion in Bangkok is a major threat to both public health and economic growth. Attention to these issues must be an increasingly important priority for Thai economic development policies.

The conclusion is that although Thailand's external economic environment might be sometimes bumpy and challenging, it will not be fundamentally hostile to a continuation of export-led growth. On the Thai side, alert, skillful, and responsive economic management is required. 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 in both infrastructure and human resource development, or a continuation of—or worse still, further increases in—domestic protectionism could slow future progress. Thus, the major dangers to continued rapid development are more likely to be internal than external.
