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Economic Development and Institutional Failures in Thailand*

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In the early 1990s, Thailand, along with seven other countries, was hailed as an Asian Miracle. By 1996, Thailand started to encounter a balance of payments deficit, followed by successive revelations of financial plight, leading to massive foreign exchange outflows. Finally, the Thai government decided to convert the fixed exchange rate to a managed float system and announced that real growth, which used to be between 7 and 10 percent, would not exceed 1 percent in 1997. In less than six months, Asia's fifth tiger had turned into a sick cat.

This paper traces the weaknesses underlying the real sectors of the Thai economy and examines public policies for industry, natural resources, tourism and the environment. The paper begins with an overview of Thailand's development, followed by an analysis of the fundamental conditions of the country's progress. The final section explores elements underlying the systematic breakdown of institutional maintenance in Thailand.

THE THAI ECONOMY

Thailand, unlike many other Asian countries, was a land abundant country (in the sense that until the late 1970s its land/person ratio had been increasing). Rice and other primary products have been Thailand's main foreign exchange earners for centuries. The production pattern, which had been skewed toward agriculture, rendered the transition to manufacturing difficult in the early years of industrialization. Labor moved in and out of industries on a seasonal basis. In the 1970s, when land became scarce, the female workforce began to participate in the country's conversion from a rural agricultural to an urban manufacturing-based economy. The large pool of female workers enabled the manufacturing sector to take root in the Thai economy.

Thailand's transformation from an agriculturally dominant structure to an industrially dominant one became statistically apparent in 1981, when for the first time the value added from manufacturing surpassed that of agriculture. In 1985, the value of manufactured exports started to exceed that of agriculture and since that point, manufacturing exports have been accelerating. From 1988 to 1993, the average growth rate of the manufacturing sector was as high as 14 percent annually, and from 1988 to 1990, Thailand registered double digit growth. In 1994, the value added of the manufacturing sector accounted for 28.5 percent of Gross Domestic Product (GDP) and the value of manufacturing exports accounted for 80 percent of the total export value. The expansion of industrial exports was an important feature of Thailand's economic change, and the industrial sector took on a leading role in generating substantial exchange earnings for the Thai economy.

The first period of industrialization in Thailand (1970-1979) can be characterized as import substitution. The 1980s witnessed Thai industrialization becoming more export oriented. There has also been structural changes within subsectors of manufacturing. During the early stage of industrialization, consumer goods had a high market share. Later, the market share of food industries declined noticeably and gave way to textiles and garments. Industries that expanded rapidly between 1987 and 1993 included automobile parts, machinery, electrical components, hide products, basic metal products, preserved and canned food, textiles and clothing, and finally, gems and jewelry.

Rapid expansion was not limited to export oriented industries; mining related industries, especially in areas related to construction, also grew at a high rate to meet expanding domestic demand. Industries that grew at lower rates were basic industries such as timber and timber products, tobacco, food and beverages. Toward the end of the 1990s, the growth and the competitiveness of the export sectors, in particular, food-based sectors, started to slow down. Manufactured exports, which accounted for 25 percent of real GDP growth in the early 1980s, was reduced to 11 percent by 1989-90. Between 1991 and 1993, the overall industrial growth performance subsided for most industries. The few industries whose growth rates continued to increase were automobile parts, electrical components, basic metal products and petroleum products.

Another factor that affected a change in the structure of Thailand's industrialization was foreign investment. Although the country has a long history of foreign investment, foreign investment in Thailand and South Korea was considered among the lowest in Asia-Pacific countries until 1985. Following the yen's appreciation in 1985, foreign investment in Thailand rose rapidly due to the relocation of Japanese production plants (later Taiwan and Hong Kong plants would also move). In 1987, Japanese investment in promoted sectors exceeded cumulative investment from the previous 20 years. In particular, Japanese investment has provided the technical foundation for Thai industries with respect to the automobile parts industry and the electronic industry, among others. It is worth noting, however, that the shift to highly capital intensive industries (such as the iron, steel and petrochemical industries in the 1990s) was mainly driven by local investment. Domestic investment was made possible by the liberalization of local capital markets and by heavy borrowing from overseas banks by Thai private firms.

Despite rapid economic growth from 1987 to 1997, Thailand's economic structure remains highly unbalanced. This transpired for a number of reasons. Firstly, Thailand's economic growth initially centered around the primary city of Bangkok. In 1990, the population of Bangkok still accounted for as much as 57 percent of the country's urban population, compared to 31 percent in other developing countries with a similar economic performance. Bangkok's urban population ratio was reduced to 36 percent by 1996. The rapid expansion of the city has created several problems, such as overcrowding, traffic congestion, and a deteriorating urban environment. These problems have consumed much of the government's budget, which otherwise could have been allocated to poverty-stricken areas or other more productive uses.

Secondly, although the industrial sector generated high income for the economy, this did not translate into employment opportunities for the Thai labor force. Although the agricultural sector generates substantially less income, it employs a much larger proportion of the labor force. In 1996, agriculture contributed only 12.8 percent to GDP yet this sector absorbed as much as 53 percent of the country's total labor force. Thailand's attempts to decentralize industries have had limited success. Until only recently, many industrial activities remained in close proximity to the Bangkok Metropolitan Area (BMA), the Eastern region, and extended only 200 kilometers toward the Western region.

Thirdly, expectations of sustained growth and increasing land scarcity in the late 1980s and early 1990s created an explosive boom in the land and securities markets, sharply boosting land prices and salaries of white collar workers in real estate and the financial sectors. Wages for blue collars workers also increased but not to the same extent as those of white collar workers.

Lastly, until the 1980s, the growth of the economy was largely nature-based and relied heavily on land and marine resources. These resources were depleted rapidly. For instance, although Thailand is a major world exporter of processed and semi-processed seafood, the productivity of marine fisheries declined substantially during the 1980s and 1990s. Furthermore, fishing effort (as measured by the volume of catch per hour) averaged 42.6 kg/hour in the 1980s, but dropped to about 25 kg/hour by the early 1990s (Vicharn 1996).

An important implication of these changes is that the agricultural sector experienced 'Dutch disease' effects, i.e., resource outflows to the more lucrative non-traded sectors such as real estate and securities. As a result, both agriculture and agricultural-based sectors (the main pillars of the Thai economy) were substantially weakened. Compounding this problem is inadequate human resource development, which has proven to be a major obstacle hindering Thailand's move into high technology industries.

International Trade

Thailand has a long history of international trade. The degree of openness (measured in terms of total exports plus total imports as a ratio of GDP) has increased from 46.2 percent in 1982 to 84.5 percent in 1993. Exports have been the engine of economic growth in Thailand and from 1970 to 1980, industrial sector growth was as high as 39.5 percent annually. For the first time in 1985, the value of textiles and clothing exports surpassed that of rice, and reached a level three times the value of rice by 1991. The four main manufacturing exports that were the driving force of the Thai economy between 1984 to 1987 were canned food, textiles, leather products and machinery and electrical products. These sectors contributed to three-quarters of total economic growth during the period, although toward the end they began to display signs that they were losing steam.

From 1987 to 1993, Thailand, Indonesia and Malaysia had the highest industrial growth rates in the Asia-Pacific rim.

During this period, these countries experienced a similar growth in manufactured exports; 28 percent for Thailand, 29 percent for Indonesia, and 30 percent for Malaysia. Thai exporters have increasingly faced international competition, especially following China and Vietnam's vigorous entries into the world market. In early 1996, the Thai export sector began to display troubling signs, for instance, in the first and second quarters export growth was negative. This downturn triggered concern among investors and eventually led to capital flight.

Competitiveness

A study on Thailand's revealed comparative advantage (RCA) using data collected for the period 1990-1995, provided early warnings that Thailand was becoming less competitive in a number of export industries. These industries included processed canned seafood (of which Thailand is the world's biggest supplier), preserved fruits and vegetables, garments, leather products, rubber products, electrical machinery and domestic appliances. The study indicated that the competitiveness of 13 out of 20 textile and garment products declined between 1990 and 1993.

Trade Agreements

In 1994, Thailand's tariff rates averaged approximately 17.7 percent, a level lower than the World Trade Organization (WTO) requirements. For this reason, the WTO agreement on tariff reductions will not have any significant effects on Thailand's tariff structure (which in turn effects the country's industrialization process). On the other hand, the ASEAN (Association of South East Asian Nations) Free Trade Area (AFTA) agreement is expected to impact the structure of Thailand's industries to a greater extent than the WTO agreement since the average tariff rate of Thailand is higher than those of other ASEAN countries. For instance, Indonesian tariff rates average around 11.6 percent and the Philippines rates average at 6.7 percent, as compared to Thailand's average of 14.2 percent in 1997. Under the AFTA agreement, by the year 2000, Thailand's overall tariff rates must be reduced by 50 percent, leaving the tariff rate for the manufacturing sector at an average of 9.0 percent. In this regard, it is imperative that the Thai industrial sector regain its comparative advantage by increasing skilled labor and by improving efficiency in important industries such as automobile parts and electronics. Basic industries, such as the petro-chemical and steel industries, must also be strengthened. In addition, there should be a reallocation of resources away from industries which are losing their comparative advantage toward new and competitive opportunities.

TOURISM BOOM

The period between 1987-1996 can be termed the Golden Decade of Thai Tourism. The number of foreign tourists increased from 2.6 million in 1987 to 7 million arrivals in 1995. This number is projected to increase to 9.6 million arrivals in 2000 and will continue rising to 11.2 million arrivals by 2003, representing approximately 1 percent of the world's total arrivals. This indicates that Thailand has ample opportunities to attract additional new arrivals and expand its market. Thailand's foreign exchange earnings from international tourism in 1995 were approximately 14 percent of total export earnings and 49 percent of the total income from the service sector. The foreign exchange income from international tourism has been greater than the country's top ranking manufactured exports, including garments, computer components and equipment, rice, jewelry and plastic products.

A number of positive and interactive factors have contributed to the Golden Decade. These factors include the end of the Cold War, the expansion of international trade and investment, the shift of the growth pole from the Atlantic rim to the Pacific rim (especially to the Asian Pacific-rim countries), the opening of new tourism destinations in the socialist countries in Thailand's vicinity, technological progress in the aviation and telecommunications industries, and others. These elements have combined to increase demand for tourism while at the same time increase the comfort level and reduce the costs of long-haul travel.

Thailand has been well placed to benefit from these global changes. The country recognized the benefits of tourism and was an early starter at implementing active tourism campaigns as compared to its neighbors in the region. Its geographical location as a half-way stopover point between Europe, East Asia and Australia, and as a gateway to Indochina and Inner China, provides a strategic position from which to offer diverse tourism packages to international travelers.

Within Thailand, the expansion of the middle income class following rapid economic development has facilitated unforeseen growth in local tourism, especially the demand for nature-based attractions. Increasing incomes have also had a negative impact on the net foreign exchange benefits from tourism by stimulating domestic demand for foreign travel.

TOURISM COMPETITIVENESS

Tourism products are composite products, comprised of a bundle of goods and services from three major areas: tourist attractions, general services used by tourists (or the 'industry component'), and services provided by the government. Attractions include nature-based and historical tourism resources, culture, local cuisine and the availability and quality of shopping. Government management consists of the provision and management of infrastructure, sanitation, safety and other travel-related services such as visa issuance, immigration, customs, etc. The industry component includes transportation, accommodation, catering, guide services, etc.

All components must be taken into account when evaluating the competitiveness of tourism. In September 1996, a TDRI survey was conducted that included 389 international tourists and 45 international travel agencies. The purpose of the survey was to rank Thailand in comparison with its competitors in the Asia-Pacific region in terms of the three components explained above. The survey illustrated that in terms of overall appeal and efficiency, foreign tourists ranked Thailand third (preceded by Australia and Japan and followed by Singapore and Indonesia). Tourist agencies, however, ranked Thailand as second only to Australia. Among the twelve items listed under attractions, Thailand was ranked the highest in five categories: historical sites, culture, people, food and night-life.

An evaluation of government management revealed it as a major obstacle to a sustained tourism boom. Apart from visa applications, Thailand ranked low in several aspects of government management, including entry services (such as immigration and customs service) to the broader management of infrastructure (inter- and intra-country communications, urban traffic, health and sanitation). Among the areas which need the greatest improvements are Bangkok's traffic congestion, pollution control and tourist safety. It can be concluded from these results that government management is the major constraint to further expansion of the tourism sector.

Among the eight items listed under industry competitiveness, Thailand ranked first in 'value for money' and hospitality categories. Japan tended to top in almost all other areas, and followed Thailand in the 'value for money' and hospitality sectors.

The results of the survey clearly indicate that Thailand has relied almost entirely on its natural and historical endowments to attract tourists. This reliance makes the industry similar to mining or any other extractive industry in that it is not likely to be sustainable without adequate investment combined with prudent and careful management of natural and historical resources. As the tourism sector expands, competition for resources between the tourism and manufacturing sectors will intensify. Government sponsored mega projects, such as the Eastern and Southern Seaboard, which support of manufacturing industries, have slowly penetrated those areas considered to be prime locations for tourism. In addition to environmental stress, rapidly increasing demand for tourism also competes for infrastructure improvement funding.

Natural resources and the environment are strained not only because they are used as production inputs for the tourism industry, but also because they must absorb the outputs from industry. Despite the impressive evaluation of Thailand's tourism competitiveness, there are clear warning signs that Thailand's tourism resources are overstressed. A study by the Tourism Authority of Thailand (TAT) revealed that 172 tourist sites in 49 provinces are in critical condition and in urgent need of restoration (TAT 1997). This is additional evidence in support of the argument that tourism problems in Thailand are the result of supply stress, not demand shortage.

NATURAL RESOURCES AND THE ENVIRONMENT

The change in the structure of industrialization from agricultural processing (or simple production) to large scale production (involving sophisticated technology) has led to an increase in industrial pollution and hazardous wastes. For example, a joint study by the Department of Industry and the Department of Pollution Control indicated that, at present, Thailand has more than 1 million tons of industrial hazardous waste and it is expected that this will increase to nearly 3 million tons in the next 5 years. Currently, the hazardous waste treatment facility (originally a pioneer project) can only process 10-15 percent of the total amount of hazardous waste produced. The remaining untreated waste is stored in factories or released into waterways, the atmosphere, or dumped in forest reserves.

Thailand's economic development has relied heavily on the accelerated depletion of its valuable natural resources and on treating the environment as a waste sink. Water and air pollution increasingly require attention, as well as a sizable budget. A study by the Asian Development Bank reported that by the year 2000, the amount of pollution in Thailand will be 2.5 times 1990 levels, resulting in a situation where Thailand's pollution problems exceed those of every other Asian country, with the exception of South Korea.

PLANNING AND POLICY MAKING IN THAILAND

To understand policy making in Thailand, one has to first understand political development in Thailand. Up until 1992, the Thai political regime evolved from authoritarianism and military control, through various periods of 'semi-democratic' regimes (for example, Prem's 1980-88 reign as a non-elected prime minister leading an elected parliament). Since 1992, Thailand could be described as a fully democratic system, with a rural based, elected government, i.e., elected and installed by the rural population (Anek 1995). Ministers are largely parliamentarians from various provinces who think locally, rather than nationally (let alone internationally). The influence of primarily Western trained economic technocrats varied under different political regimes. Their glory days were those under the Prem (1980-88) and Anand (1991-92) governments.

Public policies in Thailand are manifested in national and sectoral plans. The major function of the National Plan by the National Economic and Social Development Board (NESDB) is to provide a reference for budgetary purposes; subsequently, each ministry develops its own plan in accordance with this National Plan. Government projects will be approved by the Bureau of the Budget if they are consistent with the National Plan. Generally, national and sectoral plans do not set priorities according to cost-benefit estimates, nor do they take into account budget constraints. After the plans have been translated into investment programs and projects, the Bureau of the Budget will consider them in the context of resource constraints. As a result, all ministries tend to include as many ideas as possible in the plans. Moreover, the National Plan is ineffective with regard to policies and projects involving government spending. National plans are generally ineffective at providing guidelines for institutional reform, such as the implementation of the Polluter-Pays-Principle and the innovative uses of economic instruments, for example taxes or charges.

In the early 1990s, national planning evolved into a more people-centered rather than project-oriented approach. The 8th National Plan is indicative of this viewpoint. Line ministries resorted to more and more sectoral planning which, if approved by the Cabinet, can also be used as a budget reference. In addition, sectoral master plans are also used to divide responsibilities (and also the cake) of involved agencies, both in the public and the private sector. The Telecommunication Master Plan is a case in point.

Another important feature of Thai policy making is that legislation supporting each line minister is usually brief, vague and bestows substantial discretionary powers to the ministers via ministerial regulations and in particular, notifications (notifications being the actual means for policy implementation). The parliamentarians' incentive is therefore to hold executive posts in these ministries rather than to legislate.

INSTITUTIONAL FAILURES: CASE STUDIES

(1) Macroeconomic Policies

Until 1996, Thailand's success in stimulating growth while maintaining stability was attributed to its prudent macroeconomic management. The country had nine years of fiscal surplus and public debt was only 15 percent of GDP (1977), making Thailand one of the least publicly indebted countries in the world (TDRI 1997).

The macroeconomic management of Thailand was generally conservative. Yet in 1993, the Finance Ministry made a bold move and opened the Bangkok International Banking Facility (BIBF) in the hopes of promoting Thailand as another financial center of Southeast Asia. Foreign, low interest loans poured into Thai financial intermediaries who busily dished out loans to local investors without proper project feasibility and risk assessments. Many of these loans went to the bubbly real estate sector and the securities sector. Finally, when export stagnation triggered a warning sign to international creditors, the real estate sector was the first to collapse, followed by their financial backers. The economic meltdown that followed is briefly described in Box 1.

The economic turmoil that ensued was not simply the result of policy failures. It is a result of a breakdown in the institution that governs macroeconomic management. The existing macro-policy institution is a legacy from a major reform in 1958. Macroeconomic policies are managed by four agencies: the NESDB and the Bureau of the Budget, both under the Prime Minister's Office, the Ministry of Finance, and lastly, the Bank of Thailand. Until recently, these four agencies were armed by a corps of highly competent, Western trained economists known as 'the technocrats.'

Until recently (three-four years ago) macroeconomic policies were left in the hands of the technocrats in the four agencies. The sectoral policies (i.e., the line ministers' policies) were the playing field of ministers who wished to distribute rent among their own factions, constituents and in all likelihood, their own pockets. Following 1994, political ministers started to make their presence felt in both the Ministry of Finance and the Bank of Thailand. The most outstanding indication of their influence is the Bank of Thailand's reluctance to devalue the baht in 1997, out of fear of political repercussion (TDRI 1997).

The decline of the quality of the technocrats owing to brain drain into the private sector during the boom years was thought to be key to the penetration of the patronage system into these core agencies. Although this explanation may describe what happened in three of the agencies, it is not applicable for the Bank of Thailand. The Bank's remuneration system was far above that of the civil service and it has been able to retain high quality staff. In the Bank's case, an outdated management structure—it was designed in early 1960s—grants a very high level of power and autonomy to the governor. This may have been appropriate during the period of human resource scarcity, but it has become untenable in 1990s when a cadre of equally competent officers are now available (TDRI 1997). Intense competition for top jobs eventually invited factionalism and patronage from the politicians who had finally reached the Bank of Thailand through the Ministry of Finance.

(2) Industrial Policies

Thailand does not have industrial targeting or pick-the-winner policies. The industrial sector of Thailand has been primarily shaped by the nation's trade tax regimes (tariffs and export taxes mainly on agricultural products) and various sectoral policies, e.g., capacity controls, local content requirements, etc. Box 2, "Level of Industrial Protection and Domestic Resource Costs in Thailand," describes the current level of protection and its social cost.

Industrial policy in Thailand can be described as moving toward a lesser degree of market-distortion for a number of reasons. Firstly, tariff policy is the responsibility of the Ministry of Finance, which until recently had not been manipulated by executive decisions. Secondly, important sectoral policies, especially capacity control, were abolished under the Anand governments. Thirdly, a freer trade regime is required by WTO and AFTA. Finally, after decades of academic attacks, the case against arguments supporting infant industry has perhaps received some respect from ruling technocrats.

(3) Natural Resources and Environmental Policies

Natural resource and environmental policies are areas where interventions from executive decisions are severely intensive. This renders law enforcement weak. On a positive note, Thailand's electoral boundary was small enough to allow local patrons to enter national politics (Anek 1995). These influential people tend to have a substantial stake in their local natural resources and gaining political power at the national level allows them to change the rules of the game, as well as the rule keepers. One example of negative national influence outside local areas occurred with a land scandal whereby land that had previously been a forest reserve was transferred to an urban millionaire, although under the law only farmers were legally eligible. Legal cases on coveting public land are often related to politically influential people. Another incident occurred in 1997 when an environmental tax on granite production was quickly dropped because it would have affected the constituents of one of the government's coalition parties. Thus, environmental protection policies that conflict with interest groups are often not implemented and remain only on paper. Box 3, "Natural Resources and Environmental Policy of Thailand," highlights several important environmental issues in Thailand that will require legislative and political action in the near future.

(4) Tourism Policy

For almost a century, tourism policy in Thailand has emphasized expanding the number of foreign tourists visiting the country through aggressive international advertising campaigns. This policy exists despite the fact that tourism problems in recent years have been the result of excess demand on resources. As indicated by Table 1, the emphasis placed on advertising is manifested by the large budget share of the Marketing Department in the TAT.

Tourism policy is an area which to date, has not been greatly intervened into by executive decisions. One major reason for this is the small government budget involved. Much of the tourism budget is utilized for promotional purposes overseas. This occurred because higher level government officials incorrectly perceived tourism in Thailand as suffering from demand problems. In the new tourism master plan approved by the Cabinet in 1997, budget requests for the rehabilitation of tourism sites in the provinces are requested. However, owing to budget constraints, the budget package has been postponed until the present fiscal situation improves.

FINAL REMARKS

In the late 1980s, the Thai economy evolved to the stage where growth could not be sustained without a substantial injection into the accumulation of new productive capital for the purpose of overcoming natural capital depletion. Instead, massive capital, both domestic and borrowed, was poured into speculative sectors. During the same period, brain drain from the public sector rapidly weakened administrative capacities. Political developments, which fostered links between the administrative and business sectors, brought about changes in the rules of the game, which resulted in management favoring more opportunistic groups. The public sector brain drain not only shook management's ability, but also its integrity. Moreover, frequent changes in the ministerial portfolios forced the relatively uninformed government to concentrate on addressing emergencies and short term problems, rather than formulating a long term vision and undertaking structural and preventative changes. Policy decisions are often made without sufficient and solid studies supporting them. The breakdown of governing institutions observed in the natural resource and environment sector finally reached the financial sector and as a result, financial crises are occurring one after another and the economy dives deeper and deeper.

Until the current political system is reformed, Thailand has little hope of remedying its economic ills and implementing sensible public policies. Meanwhile, the only mechanism at work is the reduction of real wages, which if occurring rapidly and to a large enough degree, will eventually stimulate the export sector.

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