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Trans-Pacific Rebalancing: Thailand Case Study

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Abstract

Since the Asian financial crisis in 1997, Thailand has become highly dependent on export as the engine of economic recovery and growth. In 2008, the ratio of export to gross domestic product (GDP) was 76.5%. The global economic crisis triggered by the sub-prime loans debacle in the United States has prompted Thailand to rethink her export-led growth strategy. Year-on-year export growth plunged from a positive 22.7% in the third quarter of 2008 to a negative 7.75% in the fourth quarter and remained negative for another four quarters, leading to a negative growth of GDP for five consecutive quarters.

This paper examines the options for external and internal economic rebalancing strategies for Thailand. External rebalancing will require Thailand to rely less on the US market for her exports. The paper thus examines the possibility of promoting greater regional trade by means of trade agreements and exchange rate coordination. As for internal rebalancing, the paper emphasizes the need to boost domestic public and private investment in terms of both quantity and quality in order to narrow the current savings–investment gap, bearing in mind the need to ensure fiscal sustainability. Finally, the paper examines broader rebalancing strategies that will help Thailand to become less dependent on exports. These include the need to (1) improve productivity by means of technological acquisition, innovation, and skills development; (2) increase economic efficiency by exposing the non-traded sectors, in particular the service sector, to greater competitive pressures; (3) deepen the production structure and create new dynamic industries; and (4) generate new growth poles.

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Contents

1.	Introduction.....	1
2.	Trends in External Balance and Saving–Investment Balance	2
2.1	Trends in External Balance	2
2.2	Trends in Saving–Investment Balance	6
3.	Rebalancing Strategies for External Trade and Saving–Investment Balance	11
3.1	Strategies for Trade Rebalancing.....	11
3.2	Increasing Investment to Rebalance Growth.....	15
4.	Broader Rebalancing Strategies	20
4.1	Productivity Improvements.....	20
4.2	Increasing Economic Efficiency.....	21
4.3	Deepening the Production Structure and the Creation of New Dynamic Industries	23
4.4	New Growth Poles and Better Distribution of Growth	23
5.	Conclusions	24
	References	25

1. INTRODUCTION

The 2008 global economic crisis triggered by the sub-prime loans debacle in the United States (US) has had a marked impact on the Thai economy, although in ways that are very different from the 1997 crisis, when Thailand was the epicenter of the financial turmoil.

First, the direct impact of the current crisis on the domestic financial sector has been minimal. This is because very few Thai banks were involved with the complex and risky financial products such as collateralized debt obligations (CDOs) thanks to their lack of financial sophistication and their relatively conservative investment policy, a legacy from the 1997 crisis. When Lehmann Brothers investment bank went bankrupt in September 2008, only four Thai banks held CDOs and, among them, only one had invested in sub-prime CDOs. Their combined exposure was only US\$720 million. Hence, Thailand entered the crisis with a solid financial sector.

Secondly, unlike the 1997 crisis, businesses did not face a sudden surge in their debt burden due to the unexpected sharp depreciation of the baht as the currency was floated. Further weakening of the baht thereafter caused many businesses, in particularly financial institutions that carried large amounts of offshore foreign-currency loans, to become insolvent and, eventually, bankrupt. This time, the private sector has had time to adjust to the sharp drop in external demand following the crisis by cutting back on production and drawing down on inventories to help cut loss. The private sector's main problem was not with its balance sheets, but rather with its income statement.

Thirdly, the economic impact of the crisis was concentrated mainly on major industrialized economies. In contrast to 1997, Thailand has not been able to export its way out of the problem. As a result, the burden of keeping the economic wheels turning to avert a recession falls heavily on monetary and fiscal stimuli. Due to the very different nature of the crisis, lessons learned in the 1997 offer very little practical know-how to policy-makers of the day as to how to deal with the current crisis.

The economic recovery of major industrialized economies, in particular the US, Japan and, more recently, the European Union (EU), has been very gradual, and the longer term economic prospects of the global economy remain somewhat uncertain. Thailand has to rethink the export-led growth model that proved extremely successful in restoring the health of the economy after the severe financial crisis in 1997. Can Thailand continue to rely on exports to be the engine of economic growth when the US is unlikely to be able to sustain such large trade deficits? Can the People's Republic of China (PRC) or other Asian countries replace the US as major trade partners (decoupling)? And how can Thailand lessen its dependence on exports and rely more on domestic demand to drive its economy?

This paper will start by examining the trends in external balance and saving–investment balance since the pre-1997 crisis situation. It will be seen that the recent situation is a complete turnaround from the pre-1997 crisis situation, with large external (and saving) deficits during the pre-1997 period replaced by large surpluses in the post-1997 crisis period. Detailed components of the external and saving–investment balances will be examined to provide insights into strategies that could help to rebalance the growth pattern of the Thai economy.

Rebalancing strategies will be discussed in section 3. On the external trade side, an important part of the trans-Pacific rebalancing will be a greater reliance on intra-regional trade within the East Asian region to replace some of the demand normally coming from North America, particularly the US. This will involve increasing intra-regional trade in final products, which in turn implies a more competitive intra-regional trade environment. This will have implications for Thailand's regional trade strategy. For internal rebalancing, increasing domestic investment will be of key importance. However, fiscal implications and investment efficiency will need to be stressed.

Section 4 examines broader growth-rebalancing strategies. Issues such as increasing productivity, economic efficiency, the deepening of domestic industries, and greater energy efficiency are discussed. The conclusions of this paper are presented in section 5.

2. TRENDS IN EXTERNAL BALANCE AND SAVING–INVESTMENT BALANCE

Striking changes occurred in the period starting before the 1997 financial crisis up to the present. Prior to the 1997 crisis, Thailand faced large external (and saving) deficits. This situation has turned around and there are now large surpluses. The detailed trends and components of these balances are examined here. This will provide insights into the sources of changes in these balances and lead on to the discussions of strategies for rebalancing in section 3.

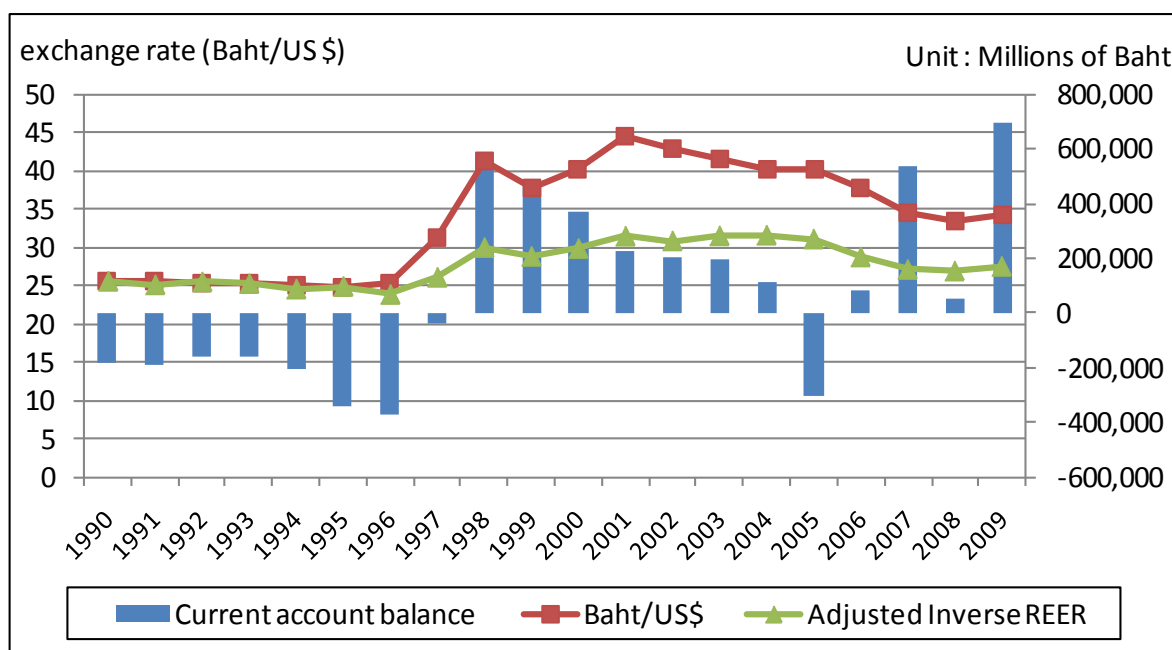
2.1 Trends in External Balance

Oliver Blanchard, the Chief Economist of the International Monetary Fund (IMF), asserts that global recovery from recession depends on a delicate rebalancing of economies, notably between the US and Asia, to sustain it. This section will examine the development of Thailand's external balance in general, and the trans-Pacific balance in particular, to gain an appreciation of the nature of the rebalancing problem.

2.1.1 Current Account Development

Thailand experienced a chronic current account deficit for many years before the financial crisis in 1997. This was partly due to the overvaluation of the baht, which resulted from the fixed exchange rate regime that pegged the baht to the US dollar at 25 baht per dollar. The 1997 financial crisis led to a substantial depreciation of the baht against the dollar. While many other regional currencies also weakened against the dollar, the real effective exchange rate of the baht continued to weaken persistently for a number of years after the crisis (Figure 1). Particularly important also was the fact that the PRC kept its exchange rate fixed to the US dollar after the crisis. The exchange rate shift provided a much-needed breathing space for Thailand's labor-intensive manufacturing export sectors, which were finding it harder and harder to compete prior to the crisis. In the past couple of years, however, as the baht has appreciated as a result of current account surpluses and large capital inflows, the labor-intensive sectors have found it more difficult to compete again, even ignoring the recent impacts from the sub-prime crisis.

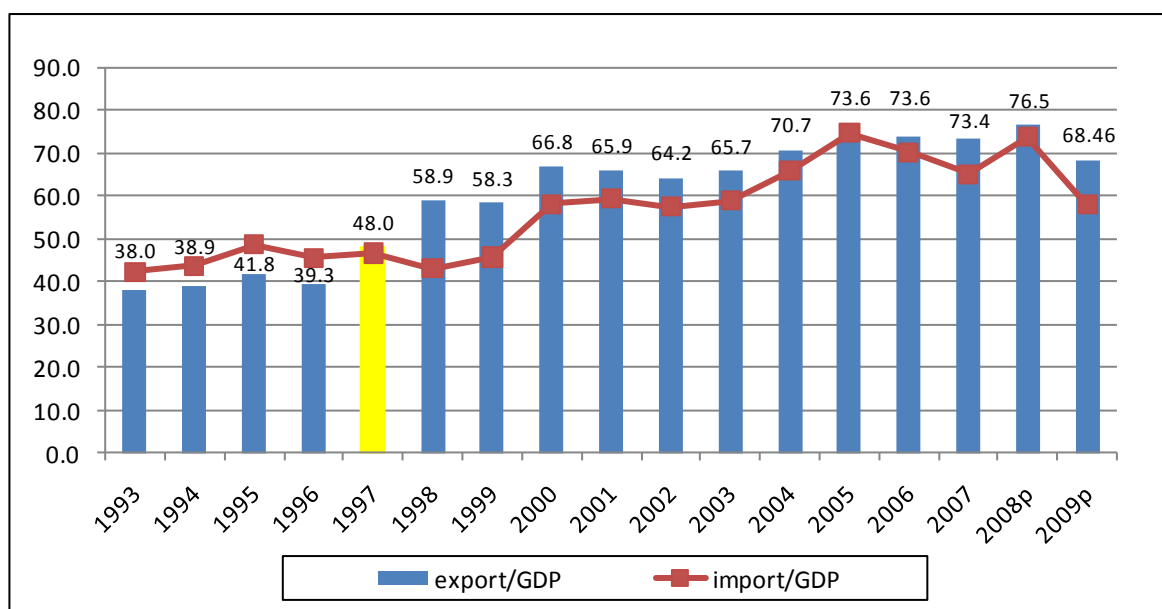
Figure 1: Current Account Balance and Exchange Rate Movement: 1990–2009



Source: The Bank of Thailand.

Note: REER = real effective exchange rate. Inverse REER indicator is adjusted to have the same value (at 1990) as the US dollar.

The 1997 crisis resulted in a major shift in the structure of the Thai economy. The country became highly dependent on exports, as can be seen in Figure 2 below. The share of exports to nominal GDP increased from 38.0% in 1993 to 76.5% in 2008, an increase of almost 40 percentage points over 15 years. Imports moved in parallel with exports, as many exported products, in particular electronics, rely heavily on imported parts and supplies. However, according to Thorbecke (2010), the exchange rate elasticity of Thailand’s imports, estimated at 0.38, is much smaller than that of exports, which is estimated to be 0.69. Thus a real depreciation of the baht led to a significant improvement in the current account balance.

Figure 2: Thailand's Export and Import to GDP ratio 1993–2008

Source: The National Economic and Social Development Board.

Thailand's economy, highly dependent on the export of goods and services, suffered greatly from the sudden collapse of external demand following the outbreak of the sub-prime crisis, marked by the fall of Lehman Brothers in September 2008. After recording double-digit year-on-year growth during the first three quarters of 2008, exports fell by 8.1% in the fourth quarter of 2008 (Table 1) and did not recover until the final quarter of 2009, when the figure became positive at 7.2%. But such growth was only made possible from a very low base, since export in the same quarter in the previous year was 8.1% below that in the year before. In other words, exports in the last quarter of 2009 only returned to the level of exports in the same quarter of 2007.

Table 1: Exports and Real GDP Growth Rates

Year ^a	Export Growth (Year-on-year growth in %; Nominal in Thai baht)	Real GDP Growth (Year-on-year growth in %)
2006	9.8	5.1
2007	7.7	5.0
2008	11.9	2.5
Q1/2008	12.7	6.3
Q2/2008	19.9	5.2
Q3/2008	25.3	3.1
Q4/2008	-8.1	-4.1
2009	-11.6	-2.3
Q1/2009	-12.8	-7.0
Q2/2009	-20.8	-5.2
Q3/2009	-17.3	-2.8
Q4/2009	7.2	5.9

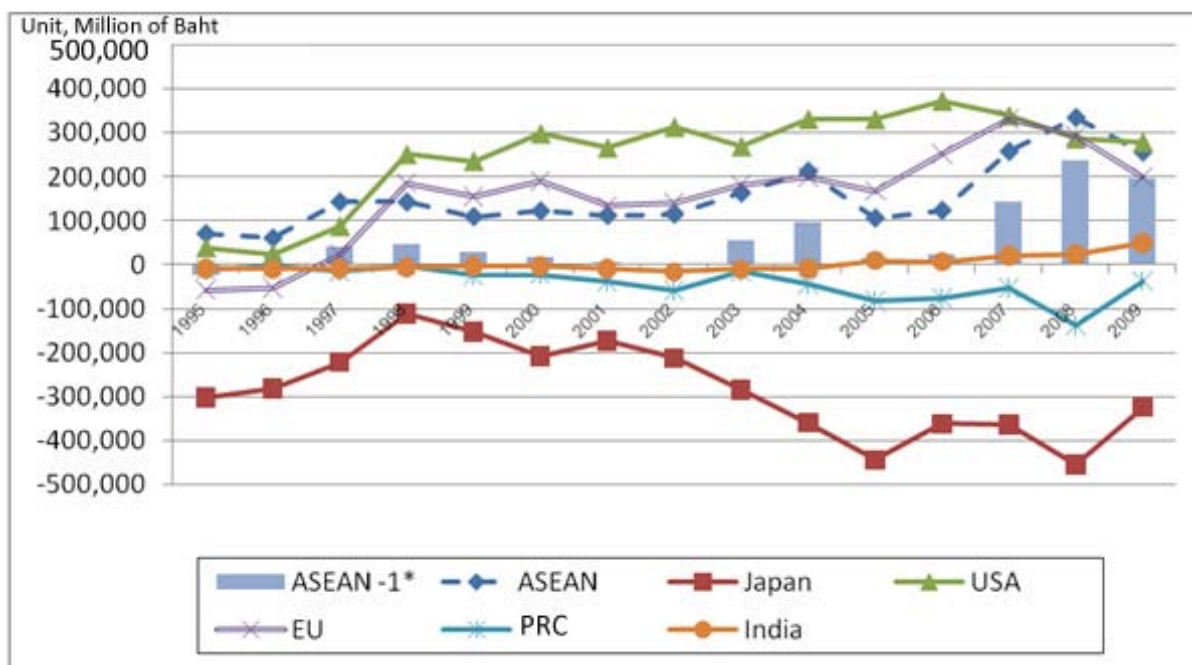
Source: The NESDB.

2.1.2 Trade Balance by Country

As Thailand became a markedly more open economy after the 1997 financial crisis, her bilateral trade balances with different trading partners clearly diverged (Figure 3). As expected, trade deficit with Japan worsened as more imported machinery and supply parts from Japan were required to expand manufactured exports. A larger trade deficit with Japan also reflected the continued relocation of Japanese manufacturing to Thailand. In fact, many joint ventures in auto parts and supplies, and food processing in Thailand were taken over by Japanese partners after the 1997 crisis.

Figure 3: Bilateral Current Account Balance: 1995–2009

(Million baht)



Note: From May 2004, EU had 25 member countries, including Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Slovakia, Poland, and Slovenia. Since Jan 2007, EU has had 27 countries, including Bulgaria and Romania. Prior to 1999, ASEAN did not include Cambodia, Lao PDR, Myanmar, and Viet Nam.

Source: Bank of Thailand.

In contrast, the trade surplus with the US rose sharply in 1998 and continued to grow until 2006, before leveling off. There was also a surge in Thailand's trade surplus with the EU and the Association of Southeast Asian Nations (ASEAN). In the case of ASEAN, it is well known that a large part of the regional trade is made up of trans-shipment through Singapore, the region's entrepôt. In 2008, re-exports accounted for 48.1% of the total Singapore sales to other countries¹. This is evident from Figure 3, showing that Thailand's trade surplus with ASEAN excluding Singapore was negligible before 2007. However, during the last 3 years, Thailand appears to be exhibiting a genuine surplus with ASEAN. This was due in part to progressive tariff cuts under AFTA and better exploitation of preferential tariff rates by exporters².

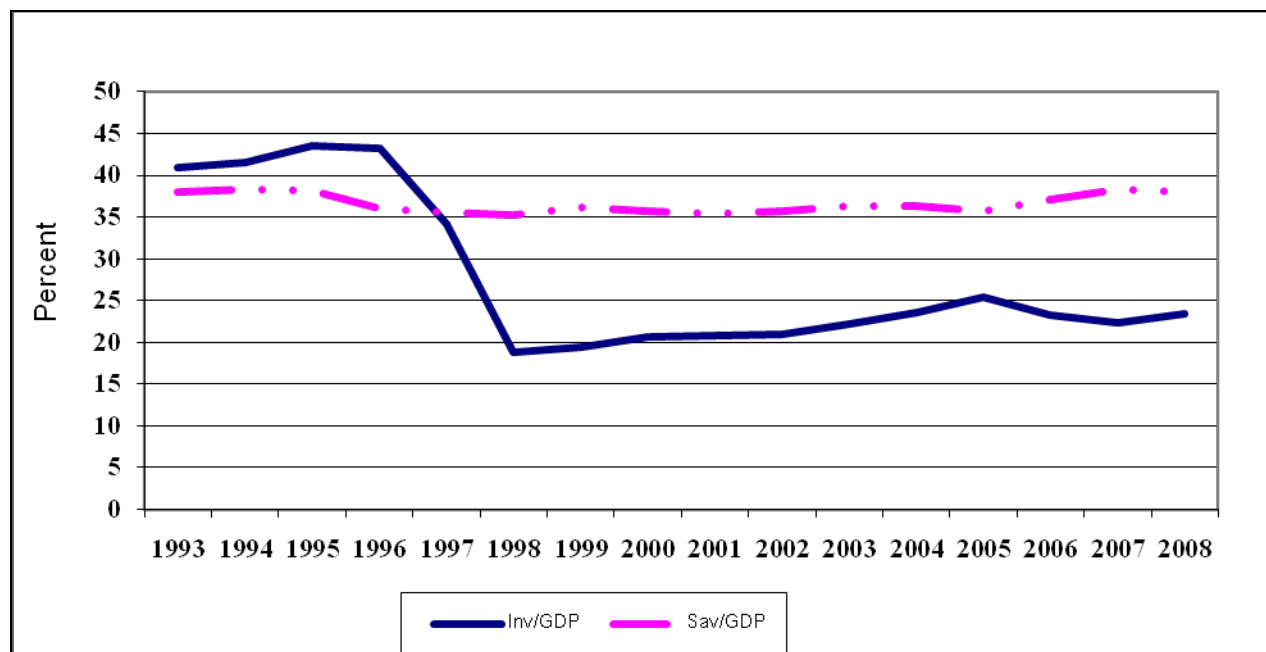
¹ <http://www.state.gov/r/pa/ei/bgn/2798.htm>

² According to Tangkitvanich, Nikomborirak, Rattamanarumit and Laksanapanyakul. (2008), half of exporters eligible for the ASEAN free-trade area (AFTA) preferential tariff rates made use of the privilege, but only 27% of importers did so.

2.2 Trends in Saving–Investment Balance

The other side of the coin of the trend in external balance, discussed in the previous section, is the saving–investment balance. Figure 4 shows the trend in real investment and savings compared to GDP (based on constant 1988 prices). The figure shows quite clearly the changes in the saving–investment balance since the 1997 crisis and the reason for the change. Prior to the crisis, Thailand had a saving deficit. This averaged about 4.7% of GDP annually (in real terms) between 1993 and 1996. After the crisis, the situation was reversed, and from 1998 onward, Thailand had a very large saving–investment surplus every year, averaging almost 14.5% of GDP annually between 1998 and 2008.

Figure 4: Ratios of Real Investment and Saving to GDP



Source: National Economic and Social Development Board.

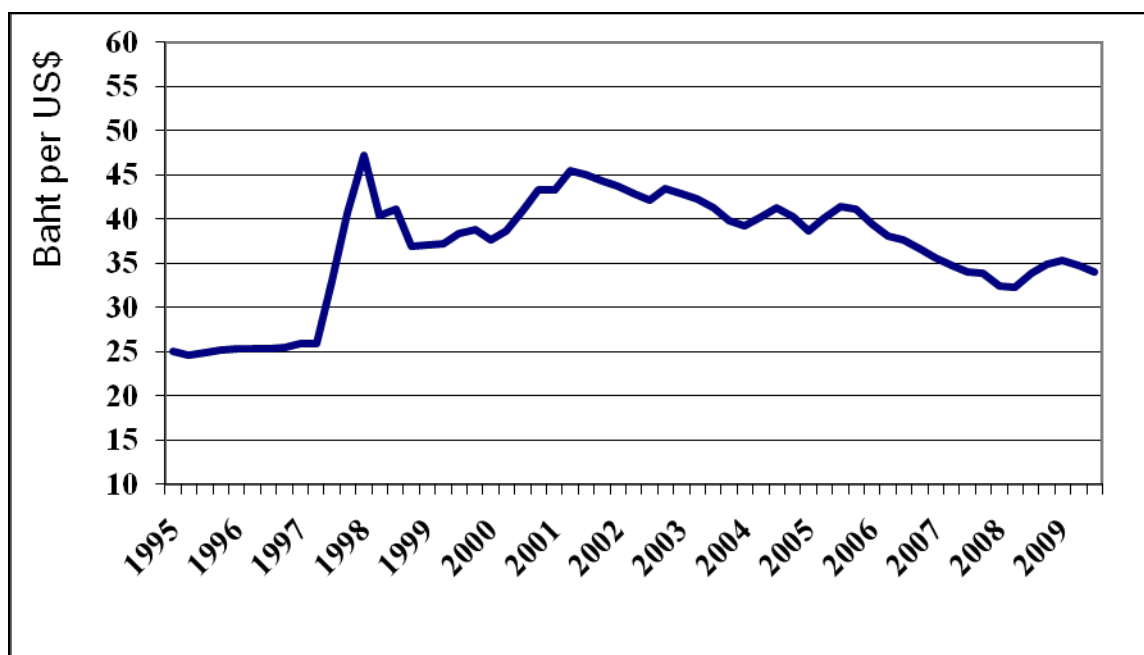
The figure also shows very clearly the reason for the turnaround. The ratio of real savings to GDP has been very stable throughout 1993–2008. The ratio was around 38% at the beginning of the period, falling to just above 35% for most of the post-1997 crisis period, and rising to about 38% more recently. What has changed in a striking way is investment. Prior to the crisis, the ratio of gross investment (including changes in stock) to GDP was very high (about 41–43% of GDP). Indeed, it can be said that the ratio was driven by the economic bubble at the time and was much too high. After the crisis, investment basically collapsed. The ratio of investment to GDP fell to below 20% in 1998 and 1999 and has remained below 25% for most of the period since then. There has been a slight upturn since 1999 and the ratio of investment to GDP reached just above 25% in 2005. However, the investment climate was damaged by the political turmoil that started in 2006 and more recently by the global financial crisis. After the 1997 crisis, the collapse in investment led to the huge saving–investment gap.

The business sector was seriously affected by the 1997 financial crisis. Thailand accumulated a huge amount of foreign debt prior to the crisis. This added fuel to the economic bubble. By the end of 1996, the amount of outstanding short-term foreign debt was greater than the amount of foreign reserves. When the central bank used up most of the foreign reserves in a futile attempt to defend the value of the baht³ in 1997, the country

³ The baht was fixed to a basket of currency dominated by the US dollar at that time.

ended up in the situation of not having enough foreign currencies to meet its foreign currency obligations. The baht had to be floated on 2 July 1997, and Thailand had to enter into an IMF-assisted program.⁴ Given that the country was basically insolvent in terms of not having enough foreign currencies to meet its obligations, it was not surprising that the flotation of the baht led to a large depreciation in its value. By the first quarter of 1998 the value of the baht had fallen by almost 50% (see Figure 5). This meant that the local currency value of the country’s foreign debt increased correspondingly and most of the companies and financial institutions that had accumulated these foreign debts could not repay them. The deep recession that followed the crisis added further gloom to the business sector, and the proportion of non-performing loans in the financial system jumped to 45% by the end of 1998. The business sector remained weak for a long time after the crisis. It took 8 years before the proportion of non-performing loans in the financial system fell to below 10% (Table 2).

Figure 5: Exchange Rate (Average by Quarter)



Source: Bank of Thailand.

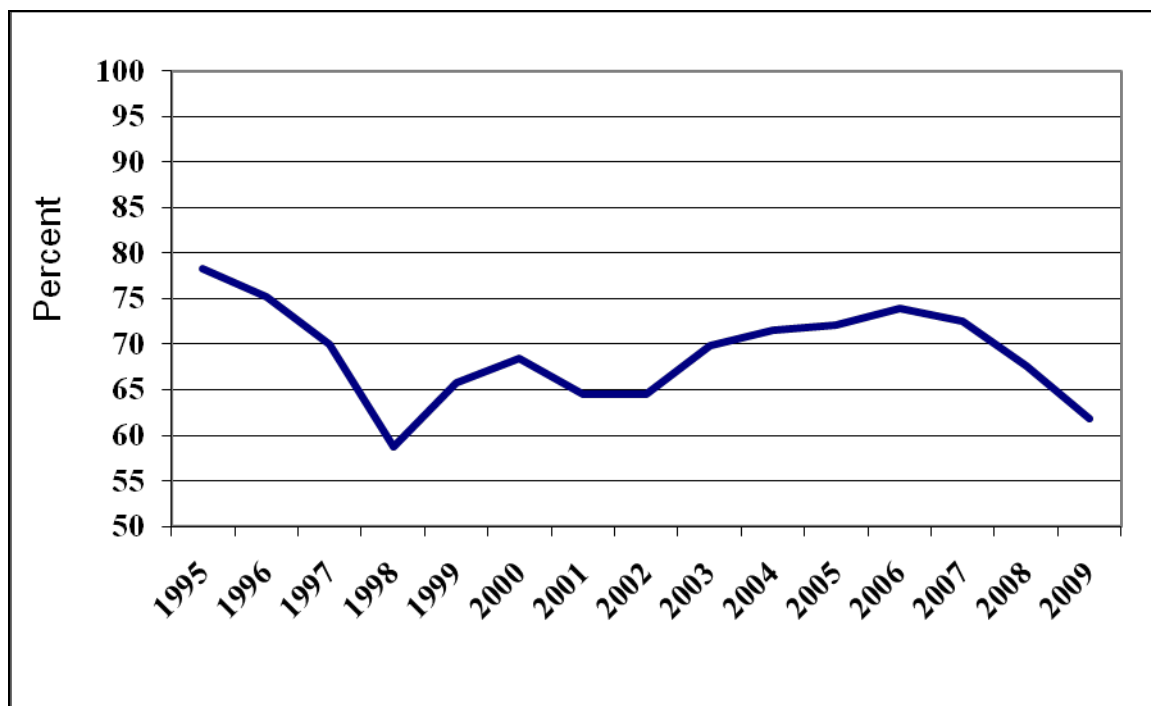
Table 2: Ratio of Non-Performing Loans (Percent)

	1998	1999	2000	2001	2002	2003	2004	2005
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec
Commercial banks	42.9	38.6	17.7	10.5	15.7	12.9	10.9	8.3
Finance companies	70.2	49.2	24.5	9.5	14.0	10.1	7.6	3.7
Financial system	45.0	38.9	17.9	10.5	15.7	12.7	10.8	8.2

Source: Bank of Thailand.

In 1998, the economy went into a deep recession, with real GDP contracting by about 10.5%. After that, as the export sector began to pick up, taking advantage of the large depreciation of the baht, the economy began to recover. However, it still took 5 years before output returned to its pre-crisis peak (Figure 6). Because of the slow recovery, there was a sharp drop in industrial capacity utilization, starting in 1997 and 1998, and capacity utilization remained well below the pre-crisis level of about 75% until about 2005–2006 (Figure 7).

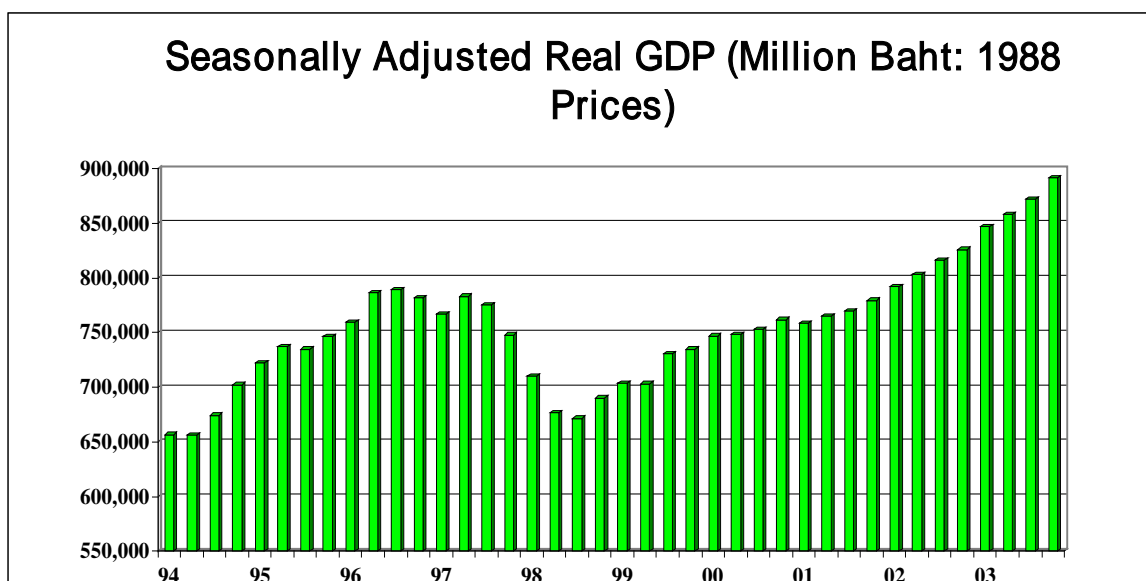
⁴ For more detailed discussions of the 1997 crisis in Thailand, see Sussangkarn (2002) and Sussangkarn and Vichyanond (2007).

Figure 7: Industrial Capacity Utilization Rate

Source: Bank of Thailand.

Given the low industrial capacity utilization level, and large excess supply in sectors such as real estate, which was the main sector involved in the economic bubble, there was not much incentive for businesses to carry out major new investment projects. In any case, the business sector was still financially weak, with a significant proportion of non-performing loans (NPL). It is therefore not surprising that investment has remained well below the pre-crisis level. The slight uptrend in the ratio of investment to GDP since 1999 generally coincided with the uptrend in capacity utilization. Similarly, the downtrend in capacity utilization and share of investment in relation to GDP from around 2006–2007 resulted from the political turmoil and the global financial crisis.

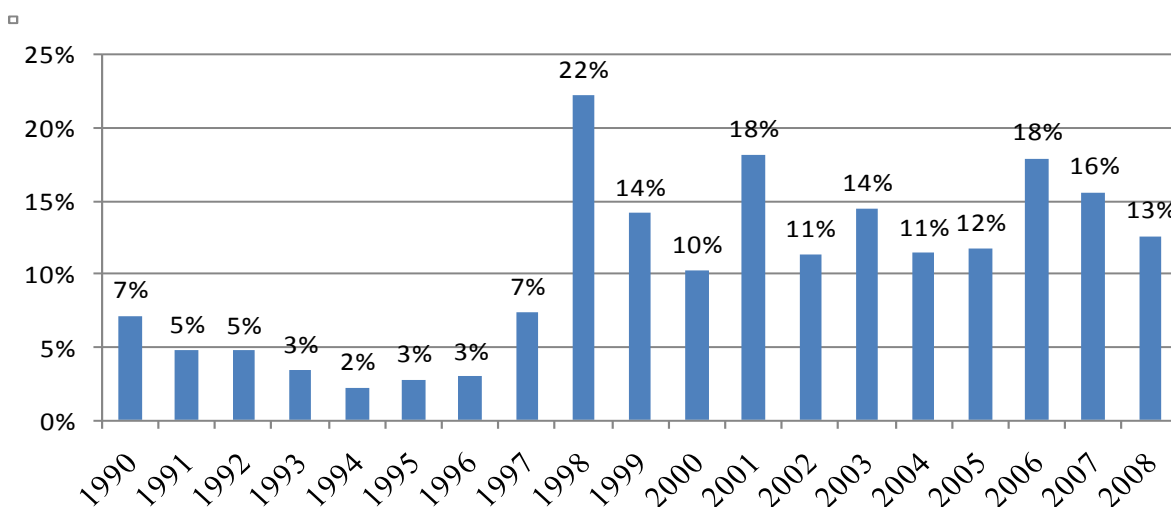
Figure 6: Real GDP Trend



Source: National Economic and Social Development Board.

The above picture of the collapse of investment does not tell the full story of investment by domestic businesses. In conjunction with the decline in the share of investment in relation to GDP indicated above, the share of foreign direct investment (FDI) in total investment also increased after the crisis (Figure 8). Of course, it should be borne in mind that in the first few years immediately after the 1997 crisis, much of the FDI inflows were not green-field investment but rather FDI to take over existing enterprises that had gone bankrupt as a result of the crisis. However, the increased share of FDI in total investment persisted well after the immediate aftermath of the crisis; the post-crisis investment situation of domestic businesses was therefore even weaker than indicated by the aggregate investment picture.

Figure 8: Ratio of FDI to Total Investment, 1990–2008

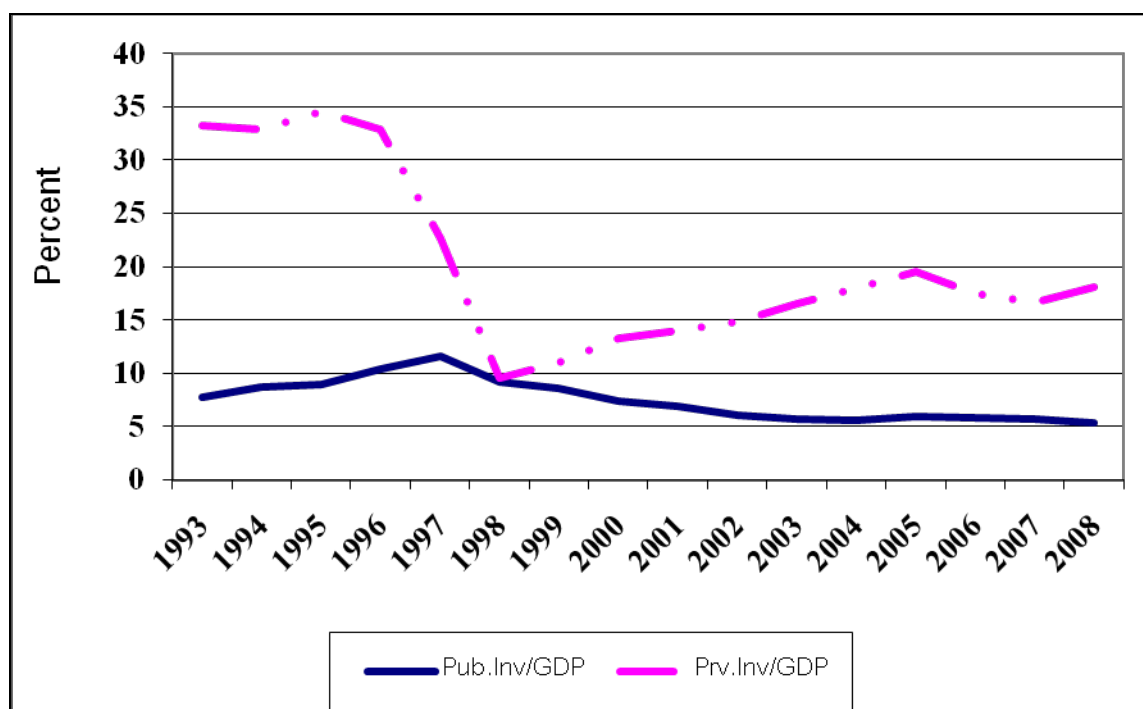


Source: Bank of Thailand.

The decline in investment was particularly severe immediately after the crisis for private investment, with the ratio of private investment to GDP declining by almost 25 percentage

points in 1998 compared to pre-crisis levels. However, there was also a downward trend in the ratio of public investment to GDP. In recent years, the ratios of both private and public investment to GDP were at about half the level they were before the crisis (see Figure 9). After the crisis, the government was put on an austere fiscal and monetary program by the IMF.⁵ The fiscal cost of cleaning up the financial system was very high and there was therefore not much room for increased public investment. Also, prior to the crisis, public investment was, like private investment, overly high. This was due to the expectation that the Thai economy would continue to grow at very high rates in the future and therefore public investment plans tended to be based on high demand projections. In actual fact, Thailand basically experienced zero growth for the first 5 years after the crisis. Thus, the available supply of public services and infrastructure was sufficient to meet the demand for some time. Only in the past 3–4 years has attention been turned back to public infrastructure investment as a future source of economic growth. However, the political turmoil and the global financial crisis affected the implementation of most of the planned public sector investment projects. This remained the case up to the end of 2009.

Figure 9: Ratios of Public and Private Investment to GDP



Source: National Economic and Social Development Board.

A further breakdown of the saving–investment balance by different types of institutions can be seen from flow of funds data. This is shown in Table 3 for the period 1993–96 (prior to the crisis) and 2003–2006 (recent period).⁶ The main changes in domestic institutions are for the private corporations and public corporations (non-financial). Their combined annual net saving deficit before the crisis was more than 16.5% of GDP. This changed to just about zero in the recent period, reflecting the collapse in investment after the crisis, discussed above. Other domestic institutions' net saving ratios to GDP remained fairly similar to pre-crisis levels. The dramatic changes for private and public corporations are reflected in the

⁵ The fiscal side was relaxed after it became clear that the initial IMF assumption that the Thai economy would continue to grow in 1997 and 1998 was far off the mark; see Sussangkarn (2002).

⁶ After 2006, the flow of funds data did not consider the public corporations separately, so it is difficult to compare these data with the old series.

changes in foreign saving. In turn, this is reflected in the large accumulation of foreign reserves by the central bank. Gross official foreign reserves were about US\$39 billion at the end of 1996, and rose steeply to about US\$143 billion at the end of 2009.

**Table 3: Ratio of Real Net Saving to GDP by Institutions
(Annual Average)**

	1993-96	2003-06
Households	4.48%	4.58%
Private corporations (non-Financial)	-14.08%	-0.69%
Public corporations (non-financial)	-2.52%	0.45%
Government	4.04%	5.50%
Financial institutions	3.40%	2.94%
Rest of the World	4.69%	-12.79%
Total	0.00%	0.00%

Source: Flows of Funds Data, National Economic and Social Development Board.

Note: Data are in nominal terms and are adjusted to real terms by assuming same saving deflators across domestic institutions.

3. REBALANCING STRATEGIES FOR EXTERNAL TRADE AND SAVING–INVESTMENT BALANCE

External rebalancing is driven by the likelihood that trans-Pacific demand for East Asian (including Thai) products will not be increasing as rapidly as before the sub-prime crisis. Greater intra-regional trade within East Asia could be the answer. However, this will involve strategies to increase intra-regional trade in final products, and will inevitably bring about greater intra-regional competition. This has implications for how a country such as Thailand should prioritize its regional trade strategy. Exchange rate issues are also touched upon. This section will also discuss the role that greater domestic investment can play in rebalancing the country's growth, given the collapse in investment that has occurred since the 1997 financial crisis. Fiscal sustainability and the effectiveness of investment projects in boosting growth are also examined.

3.1 Strategies for Trade Rebalancing

This section addresses key issues concerning the rebalancing of trade. The composition of trade between Thailand and the US is compared with that between Thailand and other Asian countries, namely, the PRC, India, and Japan, in order to determine the extent to which trans-Pacific trade can be replaced by intra-ASEAN trade. Secondly, the role of free-trade agreements in promoting regional trade is examined. Finally, a rebalancing strategy is proposed for Thailand, namely a trade policy and an exchange rate management strategy.

3.1.1 Composition of Trade

Although the PRC almost surpassed the US as the most important export market for Thailand in 2009, most of Thailand's exports to the PRC consist of raw materials and intermediate goods rather than final goods, unlike exports to the US. Consumer goods contributed to 39.52% of US imports from Thailand in 2009, whereas the figure for the PRC was 35.63% (Table 4). The figures for intermediate goods were 14.09% for the US and 33.91% for the PRC. Japan's imports from Thailand consist mainly of consumer goods, but Thailand can hardly rely on Japan with her ailing economy to absorb more exports from Thailand.

Table 4: Composition of Thailand's Exports to Major Trade Partners: 2009
(% share)

	Consumer goods	Raw material & intermediate goods	Capital goods
US	39.52	14.09	5.94
Japan	53.44	24.94	9.05
PRC	35.63	33.91	1.77
India	32.68	55.77	9.97

Source: Calculated from tariffs schedule of commitments, Customs Department

Notes: figures exclude HS-CODE 84, 85, and 87 since the online customs data are not sufficiently disaggregated. However, the figures will be revised in later drafts once detailed data become available. (HS-CODE 84 = nuclear reactors, machinery and mechanical appliances, parts thereof; HS-CODE 85 = electrical machinery and equipment; HS-CODE 87 = vehicles.)

Looking at Table 4, it is obvious that Thailand's trade with emerging Asia-Pacific economies is oriented heavily towards trade in raw materials and intermediate goods, reflecting the region's increasingly integrated production platform, rather than final goods.

3.1.2 Trade Agreements

If Asia-Pacific states want to rely more on trade among themselves and less on trade with the US, they will have to lower the current tariff barriers among themselves, in particular tariffs on final consumption goods. On that front, Thailand has had several trade agreements with other countries in the region.

Thailand's very first trade agreement was the ASEAN Free Trade Agreement (AFTA) in 1992. It is currently the most comprehensive free trade agreement to date for Thailand. As of January 2010, tariffs on all products, with the exception of 93 products contained in the sensitive list specified in 1999, have been removed. Thailand has only four products on this sensitive list, fresh-cut flowers, dried coconut, potatoes, and coffee. In the remaining four member countries, Cambodia, the Lao People's Democratic Republic (Lao PDR), Myanmar, and Viet Nam, all tariffs bar those in the "sensitive" and "very sensitive" list have been cut to 5% or lower, and will be removed in 2015. Tariff reduction for certain products in the temporary exclusion lists may be delayed until 2018.

Thailand also signed several bilateral free trade agreements with various trading partners namely, Australia, New Zealand, Japan, and India. It is also part of agreements that ASEAN signed with the PRC and Japan. Despite all these agreements, preferential export contributes to only 14.81% of total export in 2009 (Table 5), half of which is export under AFTA.

Table 5: Volume of Trade under FTAs: 2009

	<i>Value (mil US\$)</i>	<i>Percentage of Total FTA</i>
AFTA	9,670.38	42.81
TAFTA	4315.52	19.11
JTEPA	4258.56	18.85
ASEAN-PRC (ACFTA)	3990.24	17.67
Thai-India	352.75	1.56
ASEAN- Japan	4.93	0.02
Total FTA	22,587.45	14.81 (% of total trade)
Total Trade	152,498.32	

Source: Calculated from data published by the Department of Foreign Trade

The ASEAN–PRC free trade agreement concentrates more on intermediate products in comparison with other agreements, i.e., those with Japan and Australia (Table 6). This is not surprising given that the PRC is the most formidable competitor of ASEAN in terms of exports of manufactured products. Thus, the agreement has been tailored to promote trade in raw materials and intermediate goods that complement production in member countries, rather than trade in final products that substitute for locally produced products.

Table 6: Composition of Products Subject to Tariff Reductions under Major FTAs

	Asean-PRC	TAFTA	JTEPA
Number of products subjected to tariffs reduction	6,659	6,236	8,367
Number of intermediate products subjected to tariffs reduction	3,614	3,096	2,811
Percentage of the number of products subject to tariffs reduction	54.27	49.65	33.60

Source: Calculated from tariffs schedule of commitments.

3.1.3 Thailand's Regional Trade Strategy under Greater Regional Competition

If trade within the Asia-Pacific needs to be re-oriented towards final consumption goods in lieu of intermediate goods, tariffs on final products will have to fall, intensifying competition between member countries. On that note, Thailand urgently needs to increase its ability to compete with the likes of the PRC and India, which enjoy the advantage of a vast domestic market that allows their producers to easily attain scale economies in production. Given the relatively small size of Thailand's domestic market, it would need to take advantage of ASEAN, with a population of 550 million and a GDP of US\$1.4 trillion.

Although ASEAN has been very successful in terms of removing tariff barriers among member countries, its achievements in other areas, in particular investment and other "behind-the-border issues" such as trade facilitation, standards, and technical barriers to trade, have been much more limited, despite the ambitious goals of the ASEAN Economic Community (AEC) blueprint concerning these issues. For example, by 2008, ASEAN-6 countries should have implemented the "ASEAN single window", which would enable importers to make a single submission of data and information required for custom clearance. But, to date, Thailand has not integrated its own internal customs procedures into a national single window, and Indonesia only launched the service in early 2010.

ASEAN urgently needs to focus on behind-the-border issues such as harmonizing technical regulations and standards with international standards. This will be crucial to establish and maintain high product standards and to differentiate domestic products from poor quality imports from developing countries. The product quality differential will provide the domestic companies with an opportunity to maintain their domestic market share while capturing a global market share. The development and harmonization of product standards within the region will be a key factor in the development of a global production value-chain in the ASEAN region and will help maximize the benefits of regional free trade agreements.

Besides harmonization of standards and trade facilitation, ASEAN needs to take up the investment issue more seriously, as various attempts in the past to liberalize the flow of capital within the region have failed. For example, although the ASEAN investment area (AIA) technically came into full effect in 2003, members were allowed to list exemptions as they so wished. Thailand basically carved out the entire service sector and other sectors according to its domestic laws and regulations, such that the prevailing restrictive investment regime was preserved and no real liberalization occurred.

Once again, the AEC established an ambitious goal of making ASEAN a single investment area by 2015. However, it has already missed several deadlines for opening up the four priority service sectors; namely healthcare, tourism, e-ASEAN⁷, and air transport. For example, by 2010, ASEAN investors should have already been allowed to hold up to 70% of equity share in these service sectors, but Thai law continues to prohibit foreign ownership in any service sector. It is imperative that member countries shed their respective protective stance in favor of an integrated regional market that facilitates free flows not only of products, but also of factors of production, i.e., capital and labor, in order to create a production base on a scale compatible with that of the PRC and India.

3.1.4 Exchange Rate Management

The exchange rate is obviously an important variable in any discussion of external balance. As with most countries in East Asia, Thailand has been running a sizeable current account surplus as well as experiencing net FDI inflows for some time. Thus, from a “real sector” point of view (i.e., not including impacts from volatile short-term capital flows) Thailand has been in surplus for many years. If exchange rates are market-driven, then the Thai baht should be strengthening in line with these surpluses. And, in fact, there has been a strengthening of the baht vis-à-vis the US dollar, which is the currency in which most trade and investment are denominated, as shown earlier in Figure 6. Nevertheless, given the size and trend of continual surplus, market determination of the exchange rate should see the baht much stronger than at present.

However, most of East Asia is not under a market-based exchange rate system, and the issue is particularly difficult to deal with. Thailand has been relying on the export sector as the main (or even only) engine of growth for most of the period since the 1997 crisis. In a situation where most of Thailand’s competitors in the region (the PRC and other ASEAN countries, for example) studiously manage their exchange rates to prevent them from becoming too strong vis-à-vis the US dollar, it is difficult to explain to the business sector or the general public why Thailand should not do the same. Thus, Thailand has also been actively managing the value of the baht so that it does not get too much out of line with its East Asian competitors. Thailand even tried to resort to capital controls in December 2006 to deal with large capital inflows that were putting large upward pressure on the baht. However, the measures were not well designed and had to be partially reversed after just 24 hours, and were eventually removed a year or so later.

⁷ e-ASEAN is an initiative to establish a region-wide approach to making comprehensive use of information and communications technologies in business, society and the government.

Countries in this region are all competing with each other in the third-country export market and they intervene to keep their currencies from strengthening too much, with the result that global imbalances keep building up. And while it would be wrong to blame the global imbalance (particularly the trans-Pacific imbalance) for the sub-prime crisis, one cannot deny that the global imbalance does provide liquidity that increases the risk of a financial crisis, particularly if combined with other crisis-initiating factors, such as ineffective financial supervision and regulations in key countries.

However, effective trans-Pacific rebalancing cannot be achieved by a unilateral exchange rate policy involving only one or a few countries. If, for example, Thailand were to let the baht appreciate substantially, Thailand's trade balance with the US might shrink but the trans-Pacific balance would be unlikely to be greatly affected. This is not just because of the relatively small size of Thailand's trade with the US but, much more importantly, because the reduction of Thai exports to the US will simply be replaced by increased exports from other countries in East Asia (Thailand's competitors) to the US. Thus an effective trans-Pacific (or global) rebalancing through exchange-rate adjustments will need to involve most or all of the East Asian countries, i.e., a coordinated regional strategy is necessary.⁸

3.2 Increasing Investment to Rebalance Growth

The main reason for the high saving–investment balance in recent years has been the low ratio of investment to GDP (see discussion in section 2.2). Both the private and public sector investment ratios have declined substantially since the pre-1997 crisis period. While the investment ratio prior to the 1997 crisis was certainly too high, given the economic bubble at the time, the current ratios are certainly too low, especially considering the fairly high saving rates in Thailand. Therefore, an important strategy to rebalance growth, moving away from the current almost exclusive reliance on the export sector is to focus on increasing investment.

As of the beginning of 2010, the investment climate in Thailand is still not good. Political uncertainties continue, and recovery from the global financial crisis is still fragile. The economic recession in 2009 led to further declines in capacity utilization rates (Figure 8). Thus, it is unlikely that the private sector can be the driver of a new investment spurt. It is therefore the role of the public sector to lead such investment. A couple of issues related to this will be discussed in this section, First is the issue of fiscal sustainability, especially given that the government has had to provide fiscal stimulus to shore up the economy in response to the global financial crisis. Secondly, there is the need to make sure that investment can be effective in driving growth.

3.2.1 Public Investment and Fiscal Sustainability

There is no doubt that, in the immediate future, government spending will have to assume the leading role in pump-priming growth in the Thai economy. To help prop up the economy, the government has implemented two stimulus packages. The first package (SP1) entails (1) direct transfers to the public to boost short-term domestic consumption in the form of cash handouts and expenditure subsidies for basic services for lower income households; (2) agricultural price support to help boost farmers' income; and (3) tax reduction for small business enterprises (SMEs) and the property sector to keep vulnerable small businesses afloat in the midst of sharp economic downturn.

In addition, in anticipation of a prolonged global crisis, economic ministers agreed in May 2009 to launch a second round of economic stimulus packages (SP2), which they hope will jump-start the domestic economy. The package, estimated at 1.41 trillion baht (US\$41.7 billion) for the fiscal year 2010–2012, is targeted at restructuring the economy. The planned

⁸ See Thorbecke (2010) for analyses of impacts of exchange-rate adjustments on the trans-Pacific balance.

investment projects include large-scale mass transit, transport and logistics, and energy projects, irrigation, community development, and healthcare (Table 7).

Table 7: Stimulus Package 2 for FY 2010–2012

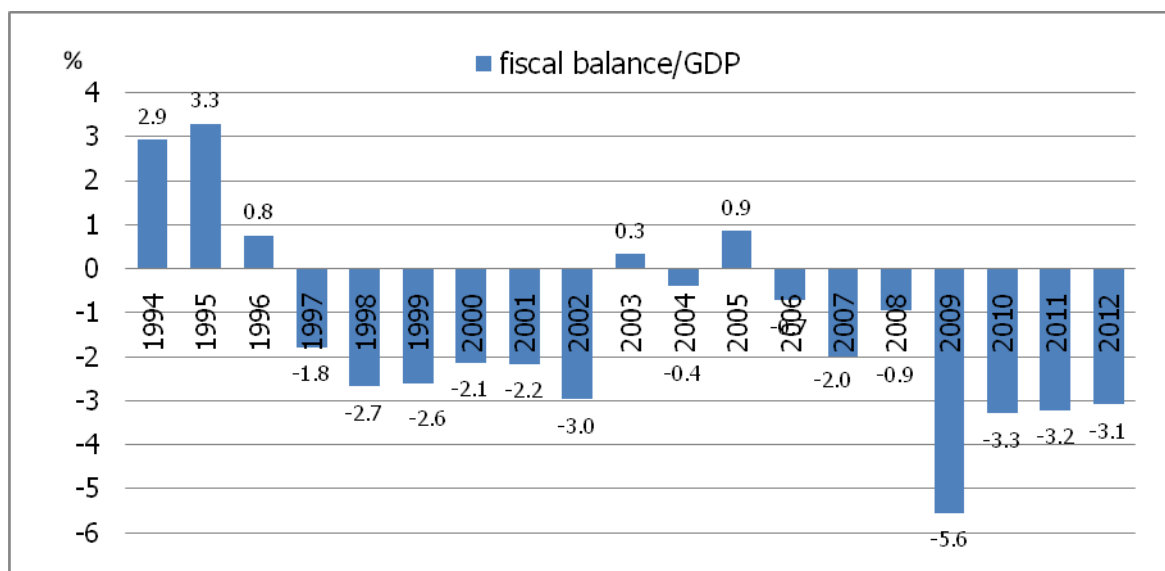
(million baht)

Stimulus package 2	2010	2011	2012	2010–2012	Proportion 2010–2012
1. Water Resource and Agriculture	70,068	77,192	83,385	230,645	14.72
2. Social welfare	355,722	365,107	419,188	1,140,016	72.76
2.1 Transport & Logistics	179,756	227,963	268,532	676,251	43.16
2.2 Energy & Alternative energy	86,352	52,186	74,212	212,893	13.59
2.3 Telecommunication	15,952	8,422	3,880	28,254	1.80
2.4 Tourism infrastructure	1,836	4,703	3,698	10,237	0.65
2.5 Basic infrastructure/Human resource development in Education	24,295	28,541	30,433	83,269	5.31
2.6 Basic infrastructure/Human Resource Development in Public Health	31,139	31,113	27,362	89,614	5.72
2.7 Basic infrastructure for public welfare	2,762	6,604	5,788	15,154	0.97
2.8 Basic infrastructure in Science and Technology	4,000	3,950	3,950	11,900	0.76
2.9 Basic infrastructure in Natural Resource and Environment	9,686	1,680	1,245	12,611	0.80
3. Tourism promotion	4,368	1,751	517	6,637	0.42
4. Innovative economy	5,798	7,751	6,585	20,134	1.28
5. Upgrade the quality of education	19,056	19,832	21,257	60,145	3.84
6. Reformation the quality of public health	1,130	3,930	4,230	9,290	0.59
7. Investment at community level	30,000	35,000	35,000	100,000	6.38
Total	486,142	510,562	570,163	1,566,867	100.00

Source: Fiscal Policy Office.

How much fiscal space does Thailand have to accommodate the planned fiscal expansion? Unfortunately, unlike during the 1997 crisis, Thailand started off from a relatively weak fiscal position in 2008, as it had just barely recovered from the previous crisis that kept the country's fiscal balance negative for six consecutive years. Internal political unrest, culminating in a coup in September 2006, took its toll on economic growth and also contributed to a persistent weak fiscal position (Figure 10). According to the Public Debt Office, Thailand will continue to experience a fiscal deficit until 2012. Will the country be able to maintain fiscal discipline standards in view of these anticipated large expenditures?

Figure 10: Thailand’s Fiscal Balance 1994–2012



Source: Fiscal Policy Office.

The four fiscal discipline benchmarks established by the Ministry of Finance are shown in Table 8. According to the projection made by the Fiscal Policy Office of the Ministry of Finance, the government will be able to maintain only one of the four benchmarks. First, debt service as a percentage of the annual budget is estimated to remain well below the 15% threshold, with a peak in 2010 at 13.6%. Secondly, the public debt as a percentage of GDP is expected to rise sharply, from 37.4 % in 2008 to a peak of 58% in 2012, the final year of the planned stimulus package. Thereafter, the figure is expected to decline to 55.8% in 2012. Hence, there is no doubt that Thailand will be breaking the 50% public debt to GDP ratio fiscal discipline threshold. Thirdly, the government will not be able achieve a balanced budget until 2014. Fourthly, the proportion of the budget dedicated to investment projects will fall well below 25%, as was the case in 2009 when the government had to inject large sums of money to shore up domestic consumption.

Table 8: Fiscal Position for 2008–2014

Fiscal discipline	Benchmarks	2008	2009	2010 E	2011 F	2012 F	2013 F	2014 F
1. Debt service/total budget	15% (max.)	10.4	10.2	12.6	13.3	14.1	14.5	15.6
2. Public debt/GDP	60% (max.) ⁹	37.4	45.9	52.8	55.6	58.0	57.5	55.8
3. Balanced budget	balance	Unattainable						
4. Investment/total budget	25% (min.)	24.2	22.0	12.6	16.5	25.0	25.0	25.0

Source: Fiscal Policy Office.

Despite the inability to comply with these fiscal discipline rules, Thailand is unlikely to face macroeconomic instability arising from fiscal expansion, as the ratio of its debt to GDP still remains below the 60% threshold. However, the increasingly fragile fiscal position will render the country particularly vulnerable to future interest hikes, as debt service to total budget ratio will have exceeded the 15% threshold by 2014. At the same time, with its borderline fiscal resources, Thailand can ill afford to deal with another economic crisis, given that the

⁹ Minister of Finance approved this rate on 17 August 2009.

government is expected to continue to experience a budget deficit until 2014 and the public debt service will be hovering very close to the 60% threshold.

3.2.2 Strategies to Increase the Effectiveness of Investment Contributions to Growth

Given the burden on the government's fiscal position, a public sector investment push to rebalance growth needs to ensure that investment projects that are carried out are as effective as possible. To do this, a number of issues should be carefully considered.

First, it is important to put in place an effective system of project scrutiny and evaluations to ensure that the projects that are carried out are financially viable and yield adequate economic returns. Thailand should have learnt important lessons from the period in the late 1980s and early 1990s when, due to a legal loophole, politicians were able to push through mega-projects with almost no details provided or any serious evaluation. Even in cases where evaluations were carried out, completely unrealistic assumptions of future demand were used to come up with high rates of return figures. In many cases, particularly in the transport sector, actual utilization after projects started providing service was one-tenth that assumed in the project evaluations. Most of the mega-projects approved and built during that time ended up in severe financial difficulties, and many had to be bailed out by the government, or the people who financed these projects had to take substantial haircuts.

The loophole alluded to above concerned projects that were carried out through concessions to the private sector. At that time, Thailand had a fairly stringent system of project evaluation requirements for large-scale projects carried out by the public sector. Most of these projects had to be evaluated and scrutinized by the National Economic and Social Development Board (NESDB), Thailand's planning agency, and there was a process of cross-checking the methodology and assumptions used in the project evaluation analyses. This was quite effective in weeding out bad investment projects.

However, many public sector agencies (state enterprises) were not very efficient, and service provisions to the public tended to be inadequate. At that time, there was also the idea floating around within the international arena (from agencies such as the World Bank and others) that the private sector could play a very useful role in providing infrastructure investment for the public sector. This can be beneficial in many ways, particularly because, by giving a concession contract to the private sector, the government did not have to raise the funds to finance the project. In addition, private sector implementation tended to be much more efficient compared with the public sector.

The downside in the case of Thailand was that the legal requirements for careful project evaluations did not cover projects that were financed entirely by the private sector, and therefore politicians and public sector agencies could legally push through these projects without careful evaluation or, in many cases, without much detail about the projects.

Clearly politicians tend to like these mega-projects, as do the public sector agencies responsible for giving the concessions because they can claim them as their output. Without the required scrutiny by agencies such as the NESDB, any evaluations of these projects tended to be very optimistic, because those who did the evaluations wanted the projects to be implemented. The surprising thing was that the private sector also tended to want to implement these projects. It could be that they really believed in the optimistic assumptions used, particularly those concerning the demand for the projects and estimated the revenue stream. However, in many cases the demand assumptions were so unrealistic that it was hard to believe that the private concessionaires could believe them. It appears that the private sector could probably find ways to benefit from carrying out these projects even though the project ended up in financial difficulties.

Many mega-projects initiated through private concessions at that time, particularly in the transport sector, ended up in severe financial difficulties and had to be bailed out by the government or had to go through a long process of debt restructuring (in some cases these

are still ongoing). These last were, however, in areas with more successful outcomes for the private concessionaires, particularly in the telecom sector.

The lesson from these experiences is that if Thailand is moving into another phase of infrastructure investment, whether carried out by public agencies or initiated by public agencies to be carried out by the private sector, an effective system of scrutiny, project evaluations, and cross-checking should be put in place before embarking on such a course. Unfortunately, the effectiveness of agencies such as the NESDB, which could provide independent scrutiny to counterbalance the views of the implementing agencies, has been eroded over time, as politicians understandably do not like agencies that could oppose their pet projects. Unless the government pays more attention to these issues, Thailand could easily end up with another round of failed mega-projects.

Another related issue is to make sure that the various mega-projects are designed and implemented as part of an integrated system, particularly projects within the same sector, such as transportation. Because many different agencies are responsible for projects within the same sector, ensuring that there are good links between projects and that they yield the largest benefit to the public is not straightforward.

For example, mass transit systems in Bangkok are not yet integrated. The two urban rail mass transit systems, the sky train and the subway, do not operate on a common ticketing system. There are no existing rules to make sure that the many new rail mass transit projects, together with the existing ones, become one integrated system. However, many new lines are in the process of being built. It is likely that Bangkok could end up with four or five rail mass transit systems independent of each other, each requiring its own ticket. This will become a major problem for the public and will take years of effort to solve successfully, if this can be done at all. Thus, the overall framework governing how these various projects have to link up to form an effective system for the benefit of the public needs to be developed quickly to govern the structure of the concessions that will be given out to the private sectors for these projects.¹⁰

Finally, a broader issue should be considered. This is related to the increasing dependence of Thailand on imports as part of its economic structure. This is shown clearly in Figure 2. There is also greater dependence on import investment. Table 9 shows the share of imports in investment at producer prices (i.e., not including trade and transport margins). The data are from various input-output tables produced by the National Economic and Social Development Board (NESDB). Investment has become much more dependent on imports after the crisis. This indicates that the utilization of imported products in investment is fairly inelastic with respect to relative price changes because Thailand does not have much capability in high technology capital goods industries and there has not really been any concrete strategy to develop these industries in the past.

**Table 9: Share of Imports in Investment
(at Producer Prices)**

	Import Share
1975	28.1%
1980	25.6%
1985	25.6%
1990	26.0%
1995	32.5%
1998	39.6%
2000	59.8%
2005	43.3%

Source: National Economic and Social Development Board, input-output tables for various years.

¹⁰ It is likely that many of the mega-projects will have Public-Private Partnership (PPP) components.

The high dependence of investment on imports means that the multiplier impacts of investment on GDP tend to be rather low. In fact, based on a social accounting matrix (SAM) for Thailand built in 1999, and applying the method of fixed price multipliers, it was found that the investment GDP multiplier was well below 1.¹¹ In fact, because of the high dependence on imports of the economy as a whole, most of the final demand expenditures also had GDP multipliers close to 1. This means that the effectiveness of investment in generating growth will not be that high. If a major investment spurt is to become a major strategy for generating future growth, considerable investment will be needed, and this could put more strain on the fiscal burden and public debt than the above projections might suggest.

If investment is going to play a much bigger role in stimulating growth in the future, then serious thought needs to be given to developing a larger domestic capital goods industry, so that investment becomes less dependent on imported goods. This would increase the investment GDP multiplier, and the new capital goods themselves could be additional drivers of future growth. However, without a clear policy to promote this, it will not happen. Certainly, for private investment, the investor will be concerned with price and quality of the capital goods, and it is difficult for a new domestic capital goods industry to compete on these fronts. Public investment or publicly initiated investment (such as concessions to the private sector) could lay down conditions that would promote some new capital goods industries that are not too technically advanced. Unfortunately, in the past, public agencies tended to favor turnkey imported purchases for investment, so there was no impetus to develop capital goods industries. The military also tended to follow the same path. In the future, if a clear policy to promote capital goods industries can be developed and implemented, apart from increasing the impacts of investment on growth, the industries could help to lift Thai industries to another level of development and boost the country's growth, rebalancing its high dependence on exports.

4. BROADER REBALANCING STRATEGIES

Broader rebalancing strategies are basically aimed at promoting a more balanced growth in Thailand. Focusing on investment to make it a more significant growth driver in the future and taking up some of the slack created by a smaller role for exports is certainly very important, but there are also many other policy areas that will promote a more balanced growth path.

4.1 Productivity Improvements

The great benefit of increasing total factor productivity (TFP) for a more balanced growth path was already discussed in Jitsuchon and Sussangkarn (2009) and will only be mentioned briefly here. Clearly, if one can create more output from the same inputs, then growth will be boosted, and can replace growth that was previously generated by other factors, such as exports. In Thailand, there appears to be room to increase TFP. Past study of TFP by Tinakorn and Sussangkarn (1998) showed that industrial and services sectors tended to have negative TFP, and this reflects casual observations by many that Thai enterprises invest relatively little in research and development, mostly buying in technology and operating as assembly type enterprises. If Thai enterprises are to move up to the next level, then a focus on productivity will be crucial. Appropriate policies also need to support technological acquisition and innovation, entrepreneurship, and worker skill acquisition and formation.

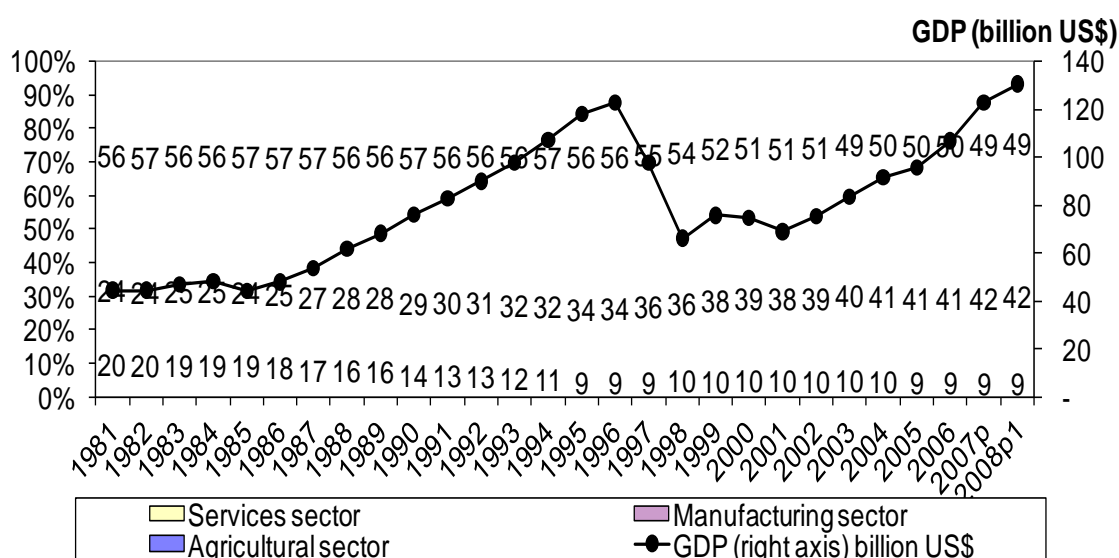
¹¹ The SAM and some of the results are reported in Sussangkarn and Tinakorn (1999). For the theory behind the fixed-price multiplier, see Pyatt and Round (1979). This methodology is quite suitable for a small, open economy like Thailand.

4.2 Increasing Economic Efficiency

Since efficiency is fostered by a competitive environment, it is important that various sectors of the economy are promptly exposed to competitive forces in the market. Nikomborirak and Lertampainond (2009) found that the Thai economy has become increasingly concentrated as large businesses assume an ever larger share of the revenue. In 2008, the top 20% of listed firms claimed 86.28% of the total revenue of all listed firms, a marked increase from 81.02% in 2004. The authors found that almost all of these large businesses operate in the non-traded service sector such as construction, energy, telecommunications, and finance. Moreover, several large companies are state-owned. In fact, state-owned enterprises and their subsidiaries contribute to 48.7% of stock market capitalization.

Decades of successful export-oriented economic policy strategy have made the services a forgotten sector. Economic achievement is often described by impressive export and GDP growth, even though services have always contributed to a larger share of the country's GDP than manufacturing does (Figure 11).

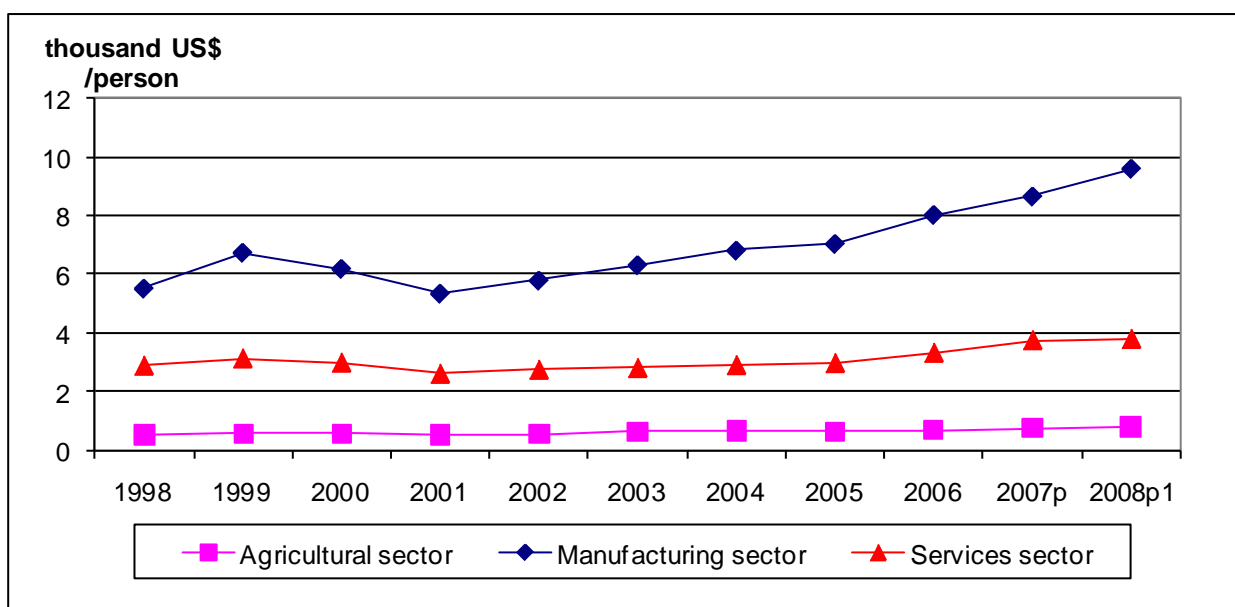
Figure 11: Thailand's Service Sector GDP Share 1990–2008



Source: The NESDB National Account Data.

The service sector in Thailand remains highly protected and hence inefficient. The Foreign Business Act of 1999 prohibits foreign entities from engaging in any service businesses and state-owned enterprises continue to dominate many of the infrastructure services, in particular transport and utilities. As a result, labor productivity growth in the service sector has remained stagnant in comparison with that of manufacturing (Figure 12).

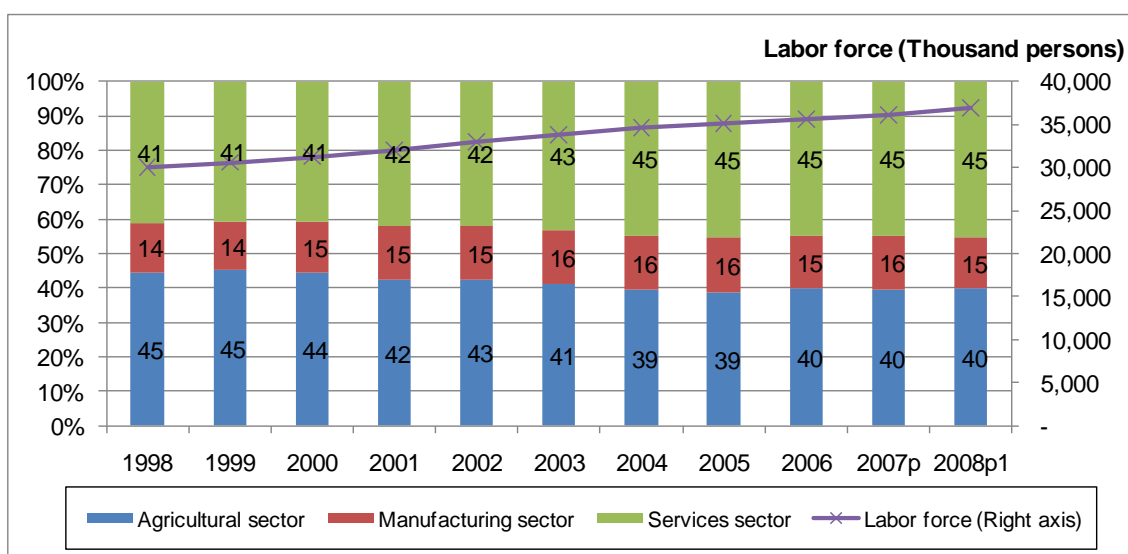
Figure 12: Thailand's Labor Productivity Trend 1998–2008



Source: NESDB National Account Data.

Boosting service sector productivity can significantly increase the level of income and hence domestic consumption, since the service sector employed 45.6% of workers in the labor force in 2008 compared with only 14.7% in manufacturing, a number which remained stagnant despite spectacular manufacturing output growth (Figure 13). If Thailand can rely more on the domestic market to be the engine of growth, then it will be in a better position to correct the external imbalance. At the same time, improved service sector efficiency will have a direct positive impact on the level of competitiveness of the manufacturing sector, since services such as logistics, finance, and telecommunications constitute important inputs in manufacturing activities.

Figure 13: Labor Share by Sector 1998–2008



Source: Labour Force Survey, National Statistics Office, Author's calculations

To boost service sector productivity the government needs to expose the sector to greater competition. State monopolies in many service sectors need to be reviewed, as do regulatory rules that favor large incumbents or limit entry of new players into the market. The highly

restrictive foreign investment law will certainly need to be revised to allow foreign investment into service sectors where competition and technology are lacking, such as telecommunications, transport, and finance. Finally, investment promotion that has long focused solely on attracting export-oriented manufacturing will have to refocus on productivity-enhancing service businesses.

In addition to opening up the service business sector and privatizing inefficient state enterprises, Thailand also needs to properly implement its competition law, promulgated since 1999, in order to prevent large firms from exploiting their market power to entrench their market dominance at the expense of smaller, and perhaps more innovative, firms.

To ensure an effective implementation of the competition law, an overhaul of the current structure of the competition committee will be required. Private sector representation on the committee would need to be abolished and the Trade Competition Office would need to become more independent of the Ministry of Commerce in order to shield competition law from politics, which often involves vested business interests.

To conclude, significant efficiency gains can be made from exposing the non-traded sector to greater competition by opening up the service market to foreign players and by circumscribing the role of state monopolies in the provision of many basic services. Enforcement of the competition law will help to ensure that competition is not only free, but fair. It should be noted that market liberalization and privatization will also bring much needed private investment. Public and private investment is reckoned to be the second type of rebalancing that will be required for a sustainable global economic recovery.

4.3 Deepening the Production Structure and the Creation of New Dynamic Industries

This was also discussed in Jitsuchon and Sussangkarn (2009) and is related to the discussion above on the need to increase or deepen Thailand's capital goods industries to lower investment's dependence on imports. Deepening other industries will also have similar impacts on the economic system as a whole. For example, a deepening of the parts and components industries can lead to less dependence on imported goods (which is very high in some industries, such as electronics). This will lead to more domestic linkages among industries, and will also increase the GDP multipliers for all types of exogenous demand increases.

The deepening of industries also creates new industries, which could become dynamic industrial leaders in the future. A concrete example is Thailand's strategy to develop a new niche segment in the automobile industry. The Eco-car project gives special tax breaks for a new type of Eco-car, cars with a small engine size (less than 1,300 cc for gasoline cars and less than 1,400 cc for diesel cars) that can cover more than 20 km/liter, and must comply with the Euro-4 environmental standards and stringent crash safety standards. This type of strategy can bring about numerous simultaneous benefits. It creates a new niche product in line with current concerns about energy and the environment, and can become an important future source of growth of Thailand's auto sector. As well, it would provide a more energy-efficient transport system, reducing the energy ratio of GDP, which is friendlier to the environment and leaves more external resources to be used in other investment areas. A number of manufacturers are now producing these cars and the first model (Nissan March) has come on to the market in 2010.

4.4 New Growth Poles and Better Distribution of Growth

Finally, in addition to creating new industries to be future sources of growth, one can also try to create new growth poles in a geographical sense. In the Thai context, the areas of great potential are those linking Thailand to her less developed neighbors, more specifically the

other Greater Mekong Sub-region (GMS) countries.¹² This is in line with the current renewed attention by many countries and organizations to the potential of cross-border connectivity to bring about new sources of growth. Much infrastructure has been built to provide better links between the GMS countries and more is planned. This should create a great deal of new economic activity along Thailand's border areas. These areas have much lower income levels than the central parts of the country. Thus, better connectivity to Thailand's GMS neighbors should also help to reduce income gaps within the country. Reducing income gaps is generally accepted as an important step in increasing domestic consumption. If new growth poles along Thailand's border areas can be created, this will be part of an effective strategy to bring about a more balanced growth path for the country.

5. CONCLUSIONS

The 2008 global economic crisis has prompted Thailand to rethink her export-led growth strategy that served Thailand well in putting her economy back on track after a severe downturn following the Asian economic crisis in 1997. Clearly, Thailand cannot hope to continue to rely on exports as the main engine of growth, as the chronic trans-Pacific trade imbalance cannot persist for much longer given the ailing US and EU economies. What are the rebalancing options?

To address the trans-Pacific trade imbalance, exchange rates need to be coordinated among competing Asian countries. Unilateral currency appreciation by Thailand would merely benefit export from neighboring countries and would not lead to the desired rebalancing of interregional trade. At the same time, Thailand will need to re-orient her trade towards Asian countries. Intra-Asian trade today is still concentrated mainly on parts and components rather than final products. Greater regional liberalization of trade in final goods will open up vast market opportunities for member countries.

This study reveals that the persistent trade imbalance can also be explained by the widening saving–investment gap that occurred after the 1997 crisis. Because of the excessive production capacity in the private sector following the collapse of the bubble economy, and the over investment in public service and infrastructure prior to the collapse, both private and public investment have remained at historically low levels for many years. Industrial capacity utilization recovered to almost pre-crisis level by 2006, but then domestic political instability thwarted any hope of investment returning to normal in the immediate future.

To address the internal imbalance, public investment needs to be boosted to narrow the current saving–investment gap. Investment in basic infrastructure, which has been neglected since the 1997 crisis, can help improve the country's competitiveness. However, given the increasingly limited fiscal resources, Thailand would need to ensure the "quality" of the investment projects by putting in place an effective project screening process. At the same time, to maximize the investment multiplier, attempts should be made to lower the imported components of the investment projects by developing the domestic capital goods industry.

Finally, as a broader rebalancing strategy, Thailand needs to pay more attention to opportunities and potentials in her own domestic market. For example, liberalization of the highly protected service sector and investment in technological acquisition and innovation can help deepen the country's industrial structure and boost domestic demand.

¹² Cambodia, Lao PDR, Myanmar, Southern PRC, and Viet Nam.

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