Thailand's Long-Term Growth: Aspiration, Reality and Challenges*

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Abstract
This paper discusses Thailand's long-term growth experiences and future challenges for driving growth. Good growth performance between 1960 and 1985, and the boom between 1985 and 1995, led to an aspiration for Thailand to become an advanced economy by 2020. This was completely derailed by the 1997 financial crisis. It took eight years for the economic overhang from the crisis to fully dissipate. Thailand then entered a period of political crisis, which has continued to the present. After 1997, the growth drivers changed substantially, with exports becoming the main growth driver and investment collapsing. Growth has been slower than before the financial crisis and Thailand is now one of the worse growth performers in ASEAN. Export is now less effective in driving growth and there is a need to revive investment as the future growth driver. There remain many challenges to Thailand's long-term growth. The paper suggests a number of policy directions to make investment effective as the future growth driver.

1. Introduction

Thailand's economic development over the past 55 years can be divided roughly into four periods. The first 25 years (from about 1960 to 1985) was a period of basic modernization, focused on basic infrastructure, utilities, institutions such as core economic organizations (e.g., the National Economic and Social Development Board [planning agency], the Bureau of the Budget, and the Fiscal Policy Office), and social services (e.g., the provision of basic health and education to most of the population). During this period, the Thai

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economy grew rapidly, though still slower than the Asian newly industrialized countries (NICs: South Korea, Taiwan, Hong Kong, and Singapore).

The next decade or so, from 1985 to 1996, was a period of accelerated industrialization driven by the realignment of major global currencies after the Plaza Accord in 1985. This led to huge flows of foreign direct investment (FDI) into Thailand and other Southeast Asian countries. Manufactured exports and economic growth accelerated. Confidence boomed and the aspiration to become an advanced economy by 2020 was believed to be achievable. The second part of this period, however, coincided with a rapid increase in financial globalization, which resulted in huge volumes of short-term funding flowing into emerging market economies, including Thailand. This was exacerbated by policy mistakes that encouraged more short-term foreign borrowing, leading to asset price and real estate bubbles and the accumulation of short-term foreign debt that became larger than the total amount of foreign reserves. The burst of the bubble and the futile attempt to defend the value of the baht triggered the Asian financial crisis (AFC) in 1997–98.

The post-crisis period, from 1998 to about 2005, was a period of gradual recovery from the crisis. The growth engines for the economy changed significantly from the pre-crisis period. Exchange rate depreciation made exports more competitive, and the ratio of exports (goods and services) to GDP rose by more than 20 percentage points. Overinvestment prior to the crisis and the financial difficulties of the business sector led to a collapse in investment, however. The investment-to-GDP ratio declined by more than 20 percentage points, and has remained low up to the present. Recovery in the external balance was quite rapid, given the depreciation of the baht and the export-oriented nature of the Thai economy. Foreign reserves increased rapidly and by mid 1999 Thailand did not need further drawings from the IMF rescue package. Recovery of the economy took longer, however, taking five years to get real GDP back to the pre-crisis level. Recovery of the financial and real estate sectors took even longer, about eight years before the ratio of non-performing loans (NPLs) of the financial sector fell below 10 percent. By 2005, one could say that most of the severe hangovers from the crisis had dissipated. Nevertheless, any hope of achieving the 2020 aspiration has been dashed, with a target date of 2035 to 2040 now seeming more realistic.

The period since 2005 to the present is one of continuing turmoil. The 2008–09 global financial crisis (GFC) was obviously important, although—luckily—Thailand (and most economies in East Asia) avoided major exposure to the toxic assets that triggered the crisis. The crisis led to a severe downturn in global trade in 2009, however, and Thailand was affected along with everyone else. Although trade rebounded in 2010, the advanced economies are still not fully recovered from the crisis, which is likely to make the role of exports in driving the Thai economy forward less effective than in the past. The flood in 2011 was also a disruption. Its physical impact was short term, but it may contribute to

doubts in the minds of foreign investors about the potential of Thailand as their key production hub in Southeast Asia. What has probably affected foreign investors much more is the continuing political turmoil—which has lasted almost a decade now, with no clear resolution in sight. This has certainly affected the economy. From being one of the star performers in ASEAN, Thailand has now become one of the group's worst performers.

Irrespective of how the political turmoil plays out over the next few years, there are other fundamental challenges for Thailand in moving up the development ladder. Recent export growth has been disappointing, with negative growth (in US$ value) for 2013, 2014, and the first half of 2015. At the same time, the effectiveness of exports in driving growth appears to be declining. The role of investment in driving growth needs to increase, and the current government is banking on some major infrastructure investment projects (particularly railways) to drive future growth, although the effectiveness of investment in driving growth also appears to be declining. New growth engines will therefore need to be developed, and many questions remain about how to lay the foundation for sustainable growth in the future. This does not mean that Thailand is stuck in the middle-income trap,[1] if there is such a trap. Getting out of the middle-income group, however, will take significant effort and time.

This paper is organized as follows. Section 2 describes Thailand's development from 1960 up to the 1997 crisis. Section 3 discusses post-crisis development. Section 4 focuses on growth drivers that are becoming less effective. Section 5 identifies policy directions that may make investment more effective as the future growth driver, and Section 6 focuses on suggestions for improving the policy environment.

2. Pre-crisis development

2.1 Advantages during this period

Thai economic development over the 25 years from 1960–85 was highly satisfactory. Although the pace of economic development was not as impressive as in the Asian NICs, Thailand nevertheless ranked high in terms of the pace of economic development during this period among all countries in the world. Real GDP grew at a rate of about 7 percent per annum on average (Table 1). Even during the "oil shock" periods (1970–75 and 1980–85), real GDP growth averaged around 5.6 percent per annum. Concurrently, the rate of population growth was reduced from about 3.4 percent per annum between 1960 and 1965 to only about 2.0 percent per annum between 1980 and 1985. Thus, real GDP per capita grew at a rate of about 4.4 percent per annum between 1960 and 1985. Starting from a per capita GDP of about US$ 94 in 1960, by 1985 this had increased 7.7 times to about US$ 725 (current prices). Poverty incidence declined by about half between 1960 and 1985.

1 As coined by Gill and Kharas (2007).

Table 1. The Thai economy: 1960–85

	1960	1965	1970	1975	1980	1985	
Population (million)	27.09	32.02	36.40	41.40	46.72	51.58	
GDP per capita (US$, current prices)	94.07	126.59	194.70	359.50	687.60	725.70	
Average growth (%)		**1960–65**	**1965–70**	**1970–75**	**1975–80**	**1980–85**	**Period 1960–85**
Population		3.39	2.60	2.61	2.45	2.00	2.61
Real GDP		7.23	8.56	5.60	7.94	5.65	6.99
Inflation (CPI)		2.05	2.49	8.76	8.34	4.91	5.27
Foreign trade (%)	**1960**	**1965**	**1970**	**1975**	**1980**	**1985**	
Total export/GDP	17.5	18.3	16.5	20.1	26.7	27.4	
Total import/GDP	18.9	19.6	20.7	24.7	33.8	31.9	
Average ratio (%)		**1961–65**	**1966–70**	**1971–75**	**1976–80**	**1981–85**	
Current account deficit/GDP		1.75	3.00	1.76	5.68	5.29	

Source: *National Economic and Social Development Board, Nation Income Accounts of Thailand, Bank of Thailand, Monthly Bulletin, various issues.*

During this period, there were major structural changes in the economy. The share of agriculture in GDP declined from 39.8 percent in 1960 to only 15.8 percent in 1985. The importance of foreign trade to the domestic economy also increased gradually during this period. The shares of exports and imports to GDP both increased by over 1.5-fold.

Apart from improvements to the general economic conditions of the population, this period also saw vast improvements on basic health and education fronts. Life expectancy at birth increased from 58 to 66 for women and from 54 to 62 years for men between 1965 and 1986. Substantial progress was made in the provision of basic education and almost universal primary enrollment was achieved toward the end of the 1970s. This was rather impressive considering the high rate of population growth during the 1960s and early 1970s. A rough indicator of the improvement in basic education of the population is the adult literacy rate, which reached about 91 percent by 1985 and was one of the highest in the region.

Past studies have identified a number of key factors behind Thailand's development success during this period.[2] Some key factors can be highlighted as follows.

Macroeconomic stability. Thailand managed to maintain macroeconomic stability throughout this period. A fixed-exchange-rate system (mainly tied to the US$) was adopted and Thailand managed to keep inflation close to the U.S. level. This focus on macroeconomic stability guided Thailand through the two oil shocks without serious macroeconomic overhangs, though between 1976 and 1985 the average current account deficit rose to above 5 percent of GDP (Table 1) and a couple of devaluations were needed after the second oil shock.

2 This draws mainly from Sussangkarn (1992), but also Warr (2009).

Relative political stability. Although there were coups and changes in government during the period, the changes generally took place relatively painlessly, except for a few tragic episodes. Situations of continual conflicts between different factions struggling for power and revenge were generally avoided. Also, changes in government had little effect on the basic development philosophy or development direction of the country. There were no distinct differences in development philosophy (for example, socialist versus conservative) between different political factions, be they military factions or the various political parties. Continuity was provided through bureaucrats and technocrats, who generally stayed through several changes in government.

Quality of agricultural resources Agricultural expansion in the 1960s and 1970s was mostly through increased exploitation of land resources. Forests were converted to cultivable land, and until the late 1970s the land–labor ratio in agriculture was increasing. The quality of Thailand's agricultural resource base, which has persisted to this day, is reflected by its position in world agricultural trade, being one of the world's largest exporters of rice, cassava, rubber, sugarcane, and aquaculture. Although agriculture's contribution to GDP has continually declined, this sector has remained important to the livelihood of the majority of the population in Thailand, and in fact up to 1985 agricultural exports were larger than manufactured exports.

Quality of human resources. The expansion of basic education was an important factor behind Thailand's historical development success. A large pool of workers with good basic education supported increases in agricultural productivity and the expansion of industries and services. This also positioned Thailand in the mid 1980s to take full advantage of changes in major exchange rates and in international comparative advantages, allowing Thailand to embark on the next phase of rapid industrialization and growth. Apart from human resources at the basic education level, Thailand also had well-educated elites, with many educated abroad. In addition, women played and continue to play an important role in the economy and this became even more important with the expansion of labor-intensive manufacturing and services such as hotels and restaurants, where most of the workers were female. Finally, the broad entrepreneurial base in the Thai economy also needs to be acknowledged. Basically, Thai society has been able to harness the available entrepreneurial talents, whatever their racial, religious, or socioeconomic background. The diversity of informal sector activities in Thailand played an important role in developing the entrepreneurial skills. This sector effectively became a "school for entrepreneurs," in which learning by doing shaped many of the top entrepreneurs and entrepreneurial families in the Thailand of today.

Social cohesion. The "middle path" nature of Thai society tends to encourage tolerance, compromise, and practicality. Thai people are generally not inclined to rigid dogmatic beliefs. Most things introduced into Thai society end up being adapted to suit the

practical order of the day, be they food, styles, culture, or religious beliefs. This flexibility enabled Thai society to avoid long-lasting and damaging social conflicts. Of course, the recent almost-decade-long political turmoil raises the question as to whether these "middle path" characteristics of Thai society have vanished. The even longer conflict in the Deep South also raises the same question.

Easy relationship with foreigners. The relationship between Thais and foreigners benefits from the historical fact that Thailand has never been colonized. Thus, the negative hangovers from past imperialistic dominance are not present. The adaptable and tolerant nature of Thai society also eases the integration of foreign residents and visitors into the Thai way of life and vice versa. This helps boost the image of Thailand as a good place to do business or just to visit. In the current age of increasing internationalization, this "friendship" factor between Thais and foreigners yields significant economic benefits. The tourism sector certainly benefits substantially.

2.2 Disadvantages during this period

The Thai development experience during the period in question was highly satisfactory, yet there were major downsides. The most important problem was the imbalanced nature of the development. Disparities existed in many dimensions. There was an imbalance between the employment and production structure. Although the contribution of agriculture to GDP continually declined, the employment share of agriculture declined much more slowly. This meant that the gap between value-added per head in agriculture and in non-agriculture was continually widening. The disparity between agriculture and non-agriculture is reflected in the disparity between the urban and rural areas. Furthermore, the extreme primacy of areas around Bangkok led to big differences between the economic conditions in the Bangkok Metropolitan Region and the rest of the country. In 1985, the per capita GDP of the Bangkok Metropolitan Region was more than seven times that of the Northeast, the poorest region. This increased rapidly from a ratio of 5.3 in 1975.

Another major imbalance was the educational structure. Although almost universal primary enrollment was achieved by 1980, Thailand lags far behind other countries at a comparable level of development in secondary enrollments. This was partly due to the way the education system was organized, but also due to the structure of the economy, with most people engaged in traditional agriculture. In the mid 1980s, about half of all students who finished primary school did not go on to secondary school. At that time, primary and secondary education levels were under separate departments in the Ministry of Education. Primary schools existed in almost every village in the country, but there were fewer secondary schools, so many students who wanted to attend secondary schools had to move away from home to attend one. This was a major obstacle. As policymakers became aware that Thailand was falling behind other countries, the problem was solved in the early 1990s by allowing primary schools to open secondary school classes. This led to

Table 2. Income shares of household quintiles

	1962–63	1975–76	1980–81	1985–86
Richest 20%	49.8	49.3	51.5	55.6
Next richest 20%	21.6	21.0	20.6	19.9
Middle 20%	12.1	14.0	13.4	12.1
Next poorest 20%	8.6	9.7	9.1	7.9
Poorest 20%	7.9	6.1	5.4	4.6
Ratio of richest 20% to Poorest 20%	6.30	8.14	9.51	12.23

Source: *Calculated from National Statistical Office, Socioeconomic Surveys, various years.*

rapid increases in secondary enrollment. Nevertheless, the low secondary enrollment in the past still has an impact on the educational structure of the labor force today, with the ratio of the labor force with only primary education or less still above 50 percent in 2013.

The various imbalances noted here are obviously reflected in income imbalances or worsening income inequality over the course of the period (Table 2). The income shares of the richest 20 percent of households increased from 49.8 percent of total household income in 1962–63 to 55.6 percent in 1985–86, while the income share of the poorest 20 percent declined from 7.9 percent to 4.6 percent during the same period. This meant that the ratio of the income share of the richest 20 percent to that of the poorest 20 percent almost doubled from 6.3 in 1962–63 to 12.2 in 1985–86. The high income disparity in Thailand, which has remained, is often regarded as an important factor underlying the political turmoil of the last decade.

The exchange-rate realignments resulting from the Plaza Accord were significant for the Thai economy. The substantial appreciation of the Japanese yen against other major currencies led to changes in comparative advantages between Japan and the Asian NICs (South Korea, Taiwan, Hong Kong, and Singapore) and allowed the latter to push more strongly into the export market for technologically and skilled intensive manufactured products. By the mid 1980s, the Asian NICs were already near to losing their comparative advantage in labor intensive semi-skilled manufactured products to other economies with a plentiful supply of low wage semi-skilled workers. The changes in the international economic environment in the mid 1980s accelerated the transition of the Asian NICs upward.

The comparative advantage for semi-skilled labor-intensive manufactured products shifted to countries at a lower level of development compared with the Asian NICs, in particular Thailand and some of the other East Asian economies such as Malaysia and Indonesia. The changes in comparative advantages boosted the local production and export of semi-skilled manufactured products in this latter group of countries. In addition, Japan and the Asian NICs also relocated some of their medium technology production processes to these countries, thus boosting the latters' investment and growth.

Table 3. Per capita GDP in 2010 (US$)

Norway	84,538	Brazil	10,710	Indonesia	2,946
Switzerland	67,464	Turkey	10,094	Egypt, Arab Rep.	2,698
United States	47,199	Mexico	9,123	The Philippines	2,140
Japan	42,831	Malaysia	8,373	India	1,475
United Kingdom	36,144	South Africa	7,275	Vietnam	1,224
Korea, Rep.	20,757	Bulgaria	6,325	Lao PDR	1,177
Czech Republic	18,245	Peru	5,401	Cambodia	795
Estonia	14,345	Thailand	5,026	Tanzania	527
Croatia	13,754	China	4,428	Ethiopia	358
Chile	12,431	Tunisia	4,199	Burundi	192

Source: *Thailand National Accounts and World Bank, World Development Indicators.*

The boom in Thailand's inward FDI and exports led to a decade of accelerated growth. Between 1985 and 1995 exports of goods and services grew by 21.2 percent per annum on average compared with about 13.4 percent per annum between 1960 and 1985. Real GDP growth accelerated to an average of 9.2 percent per annum between 1985 to 1995 compared with 7.0 percent per annum between 1960 and 1985.

2.3 Aspirations during this period

Given the decade of rapid economic growth, economic confidence was high and a number of projection exercises were carried out in the latter part of this period to see if Thailand could reach the aspiration of becoming an advanced economy by 2020, a goal that Prime Minister Mahathir bin Mohamad had set out for Malaysia in 1990.

To achieve such an aspiration, it was not necessary for Thailand to sustain the extremely rapid growth achieved during 1985–95. A somewhat lower, but sustained, pace of growth can take Thailand to an advanced economy status by 2020. For example, an average real per capita GDP growth of 6.5 percent per annum between 1995 and 2020 (about 1.3 percentage points per annum lower than what Thailand had achieved in 1985–95) would take 2010 GDP per capita to about US$ 10,500, and to about US$ 19,700 (in 2010 US$) by 2020 (assuming constant real exchange rate with the US$); around the level of the Czech Republic (advanced Eastern European economy) in 2010 (see Table 3). Even if Thailand could only achieve the same average real per capital GDP growth as that achieved for the whole period of 1960–95, which was about 5.33 percent per annum, then it would require only another five years (to 2025) to achieve the aspiration. Of course, this aspiration was completely derailed by the AFC.

Signs of potential problems could already be seen in the external balance during the second part of the period. The average current account deficit was almost 7 percent of GDP between 1991 and 1995.[3] What masked this problem were the huge inflows of short-term capital that more than financed the current account deficit. This led to rapid increases

3 For detailed discussion of the evolution of the Thai crisis, see Sussangkarn and Vichyanond (2006).

in foreign reserves, which covered more than six months of imports, and appeared to be a sign of strength. Not monitored by the authorities at the time, however, were the even more rapid increases in the stock of short-term foreign debt, which by 1995 became larger than total foreign reserves. These inflows were encouraged by the wrong policy regime, which was a classic example of Mundell's (1963) impossible trinity of a fixed exchange rate, open capital account, and an attempt to maintain an independent interest rate policy.[4] The inflows fueled asset prices and real estate bubbles. The authorities' attempt to maintain the value of the baht by using up almost all of the country's foreign reserves led to Thailand's insolvency, with insufficient foreign currencies to fund the country's obligations. The baht was floated on 2 July 1997 and assistance was sought from the IMF. The economic bubble burst and was made worse because much of it had been funded by foreign borrowing, the repayment of which became prohibitive given the large depreciation of the baht.

3. Post-crisis development

Recovering from the crisis took varying amounts of time, depending on the particular dimension. There was rapid depreciation of the baht, declining from 25.8 baht/US$ at the end of June 1997 to about 53.8 baht/US$ by the end of January 1998. The baht strengthened after that but the average exchange rate in 1998 was still about 41.4 baht/US$, a depreciation of about 38 percent compared with levels before the float. With the baht depreciation and the severe economic recession, the current account turned into a substantial surplus starting in the fourth quarter of 1997 and averaged over US$ 1 billion per month through to the end of 1999 (compared with a deficit of about US$ 1 billion per month prior to the crisis). As a result, net foreign reserves increased from US$ 2.8 billion in the middle of 1997 to US$ 16.2 billion by the middle of 1999. In August 1999, Thailand decided to forgo further disbursements from the IMF package, just about two years after entering into the IMF assistance program. As a result, the conditionality imposed by the IMF was no longer binding.

Whereas Thailand's foreign exchange position turned around relatively quickly, it took much longer to clean up problems in the domestic economy. The baht depreciation put a severe strain on much of the financial and real sectors. Because of the large depreciation of the baht, those with un-hedged foreign debt were driven to bankruptcy, and the country experienced a deep recession in 1998 (real GDP declining by more than 10 percent) with broad adverse economic and social consequences throughout the economy. It took five years before real GDP returned to the pre-crisis level.

4 Between 1989 and 1996, short-term interest rates in Thailand averaged almost 4 percent higher than that in the United States.

Restructuring corporate debt was another crucial element for both financial sector reform and economic recovery, because successful debt restructuring will help reduce NPLs of financial institutions and resuscitate economic activities. The process was not straightforward,[5] and it took eight years, until 2005, for the ratio of NPLs to fall below 10 percent. By 2005, most of the severe hangovers from the crisis had dissipated.

Problems for the Thai economy did not end then, however. Turmoil has continued from a variety of factors. The GFC was obviously important although Thailand (and most economies in East Asia) avoided major exposures to the toxic assets that triggered the crisis. This is probably related to the lessons that bankers had learned from the AFC, as they have become much more conservative and have avoided derivatives that they could not really understand. Nonetheless, the GFC led to a severe downturn in global trade in 2009, and Thailand was affected along with everyone else. Although trade rebounded in 2010, to this day the advanced economies are still not fully recovered from the crisis, with the United States and UK doing better than Eurozone countries and Japan. In addition, China's economy has also been slowing down. These have affected potential demand for Thai exports and may make export's role in driving the Thai economy forward less effective than in the past.[6] Recent export performance has been disappointing, with negative growths (in US$ value) in 2013, 2014, and the first half of 2015.

The flood in 2011 was also a disruption. Its physical impact was short-term, but it may contribute to doubts in the minds of foreign investors about the potential of Thailand as their key production hub in Southeast Asia. What has probably affected foreign investors much more, however, is the continuing political turmoil, which has lasted almost a decade now with no clear resolution in sight. This has certainly affected the economy. Since the crisis began, Thailand has never been able to match pre-crisis performance during any five-year period, even levels achieved during the 5 years after the oil shocks. Also worrying is the fact that average growth appears to be slowing. Growth in 2014 was only about 0.7 percent. Thailand has gone from one of the star performers in ASEAN to one of the group's worse performers; indeed, the worst performer since 2005 if the small oil-based city-state of Brunei is excluded (see Table 4).[7]

The post-crisis performance of the Thai economy means that any hope of achieving the 2020 aspiration has been dashed (Figure 1). Because of the post-crisis currency depreciation and slower growth, in terms of real 2010 US$, it actually took Thailand 12 years to get back to its pre-crisis level as opposed to five years in terms of real GDP. So actual average

5 See Vichyanond (2002) for discussions of complications involved in debt restructuring.

6 There are also other problems with the export engine; see the subsequent discussion.

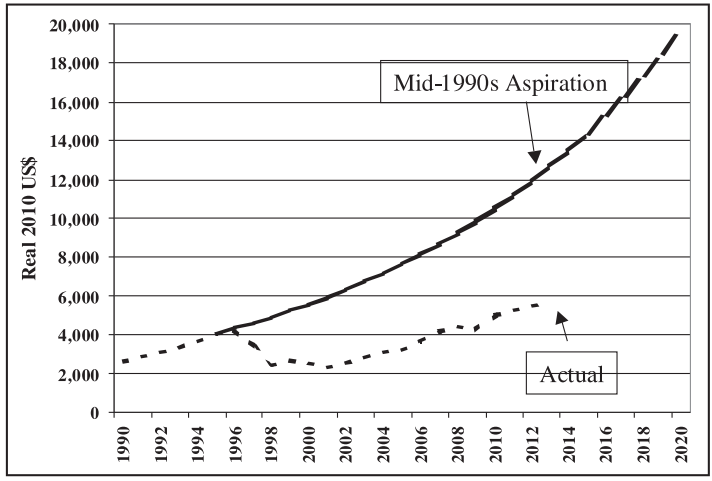
7 The post-AFC slowdown of Thai economic growth is unlikely to be related to the trend for fast-growing economies to slow down found in Eichengreen, Park, and Shin (2012) as Thai income when the slowdown started was far below the threshold found in that paper.

Table 4. Average real GDP growth (percent)

	2005–10	2010–13	2005–13
Brunei	0.66	0.85	0.73
Cambodia	6.66	7.28	6.90
Indonesia	5.71	6.18	5.90
Lao PDR	7.56	7.97	7.98
Malaysia	4.49	5.15	4.73
Myanmar	10.80	6.60	9.79
The Philippines	4.93	5.87	5.28
Singapore	6.39	4.13	5.75
Thailand	3.62	3.49	3.60
Vietnam	7.01	5.64	6.06

Source: *ADB, Key Indicators for Asia and the Pacific, 2014.*

Figure 1. Real GDP per capita (2010 US$): Mid-1990s aspiration and actual



Source: *NESDB, Bank of Thailand, and U.S. Bureau of Labor Statistics.*

Table 5. Real per capita GDP scenarios (2010 US$)

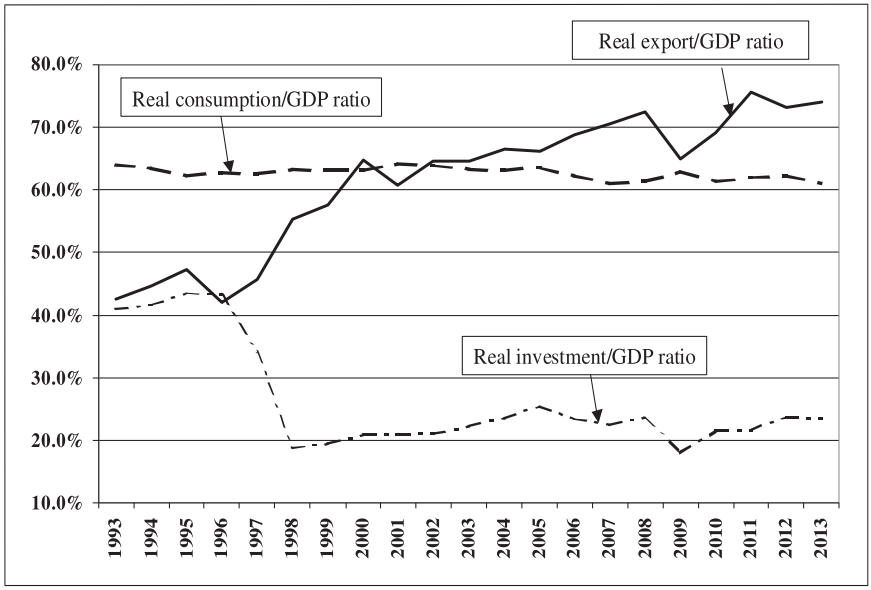
Average population growth 2013–30	0.20%				
Average real GDP growth 2013–30	3.0%	4.0%	5.0%	6.0%	7.0%
Real GDP 2030 (2010 prices)	9,119	10,751	12,654	14,871	17,450
Similar to countries in 2010	Mexico	Brazil	Chile	Estonia	Czech Republic

Source: *Calculated by the authors assuming constant real exchange rate with the US$.*

annual real US$ per capita GDP growth between 1995 and 2013 was only 1.88 percent, reaching about US$ 5,700 (in 2010 US$).

Table 5 shows some scenarios based on alternative assumptions about real GDP growth (in constant 2010 US$). Only in the high case of 7 percent annual real GDP growth

Figure 2. Main growth drivers



Source: *NESDB.*

between 2013 and 2030 will the Thai economy reach the level of the Czech Republic (regarded as an advanced Eastern European economy). This is still far from the United States, Japan, and other advanced Western European economies, and still below the level of South Korea in 2010. With lower growth, the level that Thailand can reach by 2030 will be correspondingly lower. If Thailand continues growing at about 3–4 percent per annum (which is about the recent pace of growth), then it will only be able to reach a level somewhere between Mexico and Brazil (in 2010) by 2030. So in all likelihood, it may take a decade and a half to two decades further beyond 2020 to achieve the mid-1990s aspiration of becoming an advanced economy.

4. Less-effective growth drivers

After the AFC, the growth engines for the Thai economy changed significantly (see Figure 2). Exchange rate depreciation made export more competitive, and the ratio of export (goods and services) to GDP continued to rise and reached over 70 percent in 2013. On the other hand, the over-investment prior to the crisis and the financial difficulties of the business sector led to a collapse in investment. The investment to GDP ratio declined by more than 20 percentage points, and has remained low to the present. Consumption, on the other hand, has remained at a relatively stable ratio to GDP.

Table 6. Total import content (percent) of export, direct and indirect

	1980	1985	1990	1995	2000	2005
Total export	16.3	19.2	31.5	35.1	42.6	47.7
Food export	8.5	10.9	17.5	17.4	20.3	24.6
Manufactured export	18.4	20.4	34.0	38.2	45.8	48.7

Source: *Calculated from input–output tables (using Leontief inverse).*

Recent poor export performance is certainly a major source of concern looking forward. There have been worries that the flood and political crisis may drive foreign investors out of Thailand. Certainly, if Thailand continues to be near bottom of the ASEAN growth table, FDI will be less of an option as it makes more sense for investors to go to faster expanding markets.

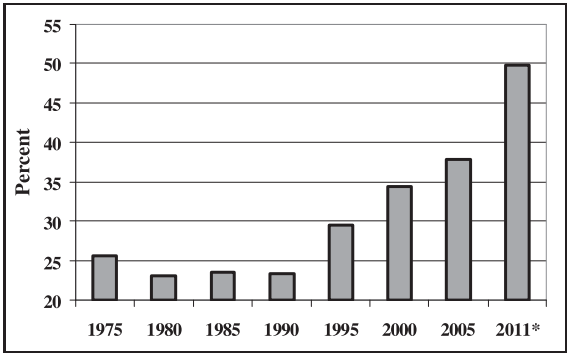
But adding to this is another worrying trend. Data show that the total import content of Thai exports (direct and indirect) has been increasing over time and is now high (Table 6). This basically means that Thailand lacks depth in intermediate-goods industries (although there are cases of success, such as in the auto sector). It also means that the growth multiplier effects of exports have been declining, further reducing the effectiveness of export in driving growth.

It could be argued that the increase in import content of exports is a natural outcome of Thailand's integration into the global supply chain network. This may be the case, but then—for exports to be effective in driving growth—supply chain integration should be accompanied by faster export growth (to make up for the lower growth multiplier effect). This may have been the case in the past. Nevertheless, at present the high import content is accompanied by almost zero growth in the export sector, implying that the export engine is no longer playing its role in driving growth as it has in the past.

What is clearly needed is to rebalance the growth drivers and revitalize investment as a source of growth,[8] and recent governments including the present one have been focusing on carrying out major investment projects (particularly in the rail sector) as a way of stimulating growth. The focus on investment also fits with past experiences in many countries that investment is key in giving the economy a "big push" to get a country out of the "middle income group." Asian economies that have successfully industrialized (such as Japan, Korea, Taiwan, and, to a certain extent, China) all experienced a decade of high investment-to-GDP ratio. But quantity does not suffice. The effectiveness of investment in generating growth is also important.

8 For more discussions on rebalancing, see Sussangkarn and Nikomborirak (2012).

Figure 3. Import content of investment



Source: *Except for 2011, from input–output tables for various years; for 2011, estimated from national accounts and import data by type of imported goods.*

For Thailand, as with the case of exports, the import content of investment has been increasing rapidly, and is now close to 50 percent (Figure 3). This reflects a lack of capital-goods industries in Thailand. It also means that the direct impact of investment on growth is likely to be rather low as much of the investment will leak out as imports.

The impact of investment on growth can also be roughly indicated by the incremental capital output ratio (ICOR), the ratio of investment (change in capital) to the change in GDP. Lower ICOR values indicates fewer investment units are required to generate a unit of economic growth, and hence greater investment efficiency.

As can be seen in Table 7, with the exception of Taiwan, Asian countries all experienced an average investment-to-GDP ratio of at least 30 percent during the period of rapid economic expansion. The ICOR during this particular period ranged from Taiwan's 2.7 (most efficient) to Japan's 3.9. China sustained two decades of high economic growth from 1991–2011, during which the investment-to-GDP ratio averaged a remarkable 40 percent and an ICOR of 3.9, similar to what Japan attained three decades earlier. Although China continues to invest extremely heavily, the quality of its investment clearly has fallen. The same story goes for Thailand, but, unlike China, both the quality and the quantity of investment have fallen markedly during 2000–12, dragging down with it the country's overall economic growth.

5. Making investment effective as a future growth driver

Going forward, the need for more and better investment to drive the Thai economy is imperative, especially when the country can no longer rely on a labor productivity

Table 7. Investment and economic growth of Asian industrialized economies and Thailand

Country	Year	GDP growth (%) (1)	Investment/ GDP (%) (2)	ICOR (2)/(1)
Japan	1961–70	10.4	32.6	3.9
South Korea	1981–90	9.2	29.6	3.2
Taiwan	1981–90	8.0	21.9	2.7
China	1991–2011	10.4	40.4	3.9
	2009–11	9.6	48.2	5.0
Thailand[a]	1985–95	9.5	36.3	3.8
	2000–12	4.4	25.5	5.7

Source: *FT Alphaville (2013), China's Challenge, explained in three easy charts. Downloadable from ftalphaville.ft.com*

Note: *Calculated from Thailand's national income account, NESDB.*

increase generated from moving labor out of the low-productivity agricultural sector into the high-productivity manufacturing sector to drive economic growth as in the past. As exports stall, the manufacturing sector can no longer absorb labor. Additionally, with rising wages, Thailand can never hope to regain its competitiveness in labor-intensive exports in the face of fierce competition from countries such as India, China, Vietnam, and Indonesia. Moving forward, it will be necessary to revitalize investment to increase its role as the key growth driver for the Thai economy. This section will suggest a number of policy directions that could make investment more effective as Thailand's future growth driver.

5.1 Leveraging on mega-project investment to deepen the industrial structure

Using investment in mega-projects to jumpstart the Thai economy has been on the policy agenda of various Thai governments over the past decade. Project implementations have been affected by continual political instability and changes in government, however. The current government also plans to implement many infrastructure mega-projects, hoping to boost economic growth and improve economic efficiency. Most of the investment will be in the transport sector, totaling about US$ 90 billion over the eight years from 2015 to 2022, amounting to about 2.5 percent of GDP per year. Of these, about 70 percent will be for railway development/upgrading, including mass transit rail lines in and around Bangkok, new routes and double tracking of some existing inter-provincial meter gauge rail lines, new medium-high speed standard gauge lines from the Bangkok/Eastern Seaboard area to Nong Khai on the border with the Lao People's Democratic Republic (PDR), which could be extended into and through Lao PDR up to Kunming in Southern China in the future, and a high speed rail line between Bangkok and Chiang Mai in the north.[9]

9 The government has targeted China as the strategic partner for rail development from the Bangkok area to Nong Khai, and Japan as the partner for the Bangkok to Chiang Mai route.

There is no doubt that investment in these mega-projects will provide some boost to economic growth. Unless Thailand can leverage these projects to generate new industries and deepen the industrial structure, however, the boost may be rather limited. The previous section already indicated that the import content of overall investment is close to 50 percent. For rail-related investment the import content is even higher as Thailand has almost no manufacturing industries that produce rail equipments and parts. Therefore, the growth multiplier from rail investment will be rather low. Note also that if these projects do not lead to the development of rail related industries, Thailand will be almost totally dependent on imports for future development and maintenance of the rail sector. This will impose a high burden on Thailand's future external balance.

Thailand needs to leverage the scale of these mega-project investments by setting local content targets for the rail sector. As Thailand is already a base for auto production in the region, the capability to develop rail-related industries, particularly the manufacturing of parts and components, is there. This needs to be negotiated with Thailand's main strategic partners for these projects. For small rail investment projects, developing rail-related industries in Thailand is unlikely to be feasible. But with the planned scale of rail investment, developing rail-related industries should be feasible and, if successful, will help to deepen Thailand's industrial structure, increasing the extent of intermediate goods and capital goods industries, and boosting economic growth in the future.

5.2 Promoting new niche products

Promoting new niche products could also boost investment and create new sources of growth. Of course, this falls to some extent into the realm of state industrial policy, where the debate on its appropriateness is a long-standing and inconclusive one. The neoliberal position stressing a free market mechanism leaves no room for the government to form industrial policies. This position, however, has been heavily criticized, as it seems to contradict empirical evidence from countries such as South Korea and Taiwan that have been able to transcend the middle-income level to become industrialized economies with much state prodding. On the other hand, one should also bear in mind that there are numerous examples of failures resulting from government industrial policies.

The well-known work of Hausman and Rodrik (2006) posits that private investment and public investment need to go hand in hand. This is because the development of a new industry requires not only private capital, but also state regulations and support in terms of availability of skilled labor, finance, transport and communications, and research and development. Without clear government support, the private sector would be reluctant to commit capital investment in developing new products, services, or industries.

The key here is "promoting" the private sector to invest in the development of new niche products by providing appropriate incentives and support rather than the public sector

developing the products itself. A good example in the case of Thailand is the strategy to develop a new niche segment in the automobile industry, the so-called Eco-car project, initiated in 2007. This provided 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 created a new niche product group in line with current concerns about energy and the environment. The project has been successful and five auto manufacturers participated in the project. The second phase of the Eco-car project (greater fuel efficiency and more environmentally friendly compared with phase 1) was launched in 2013 with nine auto manufacturers participating.

This strategy can be used to guide the development of the auto sector in Thailand in the future. For example, Thailand may want to position the auto industry to become one of the leading producers of electric cars and cycles. Special tax privileges can be provided in a similar manner to the Eco-car project. Close consultations with auto producers would be needed to gauge the feasibility and appropriate timing for such a project.

5.3 Using investment to develop new growth poles

Investment can also bring about new growth poles in a geographical sense. In the Thai context, improved connectivity to Thailand's less-developed neighbors in the Greater Mekong Sub-region (GMS)[10] can boost intra-regional trade and investment. This is in line with the attention of many countries and organizations to the potential of cross-border connectivity for bringing about new sources of growth. Much infrastructure has already been built to improve the links between the GMS countries, and more is planned. The development of railways between the Bangkok area and Nong Khai on the Lao PDR border can be viewed as part of a future Kunming to Bangkok (or even Singapore) rail link, which will reduce logistic costs along the route. If this comes about, then products from the inner provinces of Southern China can be distributed globally through ports on Thailand's Eastern Seaboard.[11] Thai products will also a gain greater foothold in Southern China. In addition, a great deal of new economic activities will emerge 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, bringing about a more balanced growth path.

5.4 Improving the efficiency of state investment

Thailand currently has roughly 57 state-owned enterprises (SOEs), excluding their subsidiaries that are not supervised by the Ministry of Finance, the state shareholder. Many

10 Cambodia, Lao PDR, Myanmar, Southern China (Inner Provinces), and Vietnam.

11 This will be nearer than distributing them through ports on China's Eastern coast.

Table 8. Asset and financial performance of SOEs and private operators

Industry	Company	Return on assets (%)	Net profit margin (%)	Asset turnover (x times)
Telecommunications	CAT*	−19.54	−122.32	0.16
	TOT*	−17.50	−128.08	0.14
	AIS	25.51	20.58	1.22
	DTAC	10.03	12.76	0.79
	TRUE	−1.64	−3.51	0.50
	SingTel	9.81	21.56	0.46
Aviation	Thai Airways*	0.49	0.99	0.67
	Bangkok Airways	2.21	3.67	0.57
	Singapore Airlines	3.06	4.56	0.65
Energy	PTT*	6.26	3.90	1.60
	Petronas	11.25	19.18	0.59
Broadcasting	MCOT*	5.77	13.12	0.43
	BEC (Channel 3)	38.10	29.83	1.27
	BBTV (Channel 7)	13.38	44.49	0.30

Source: *Listed SOEs and private companies: Annual reports. Non-listed SOEs and private companies: Registered companies database, the Department of Business Promotion, Ministry of Commerce.*

Note: **signifies state enterprise. Revenue of state enterprises is net of government subsidies.*

of these enterprises operate in direct competition with private operators. To gauge the efficiency of investment of SOEs, we compare the rate of return on assets, the net profit, and the asset turnover rate figures of state enterprises with their private competitors, both foreign and domestic, as shown in Table 8.

The reason why Thai SOEs have clearly inferior asset performance is that many of them are still managed like a government bureaucracy, subject to myriad rules and regulations governing procurement, investment, personnel management, and so on. More importantly, however, these SOEs are susceptible to political manipulation—especially when it comes to large procurement projects. As a result, investment by SOEs often generates assets that are not fully utilized. For example, the rate of usage rate of the State Railway of Thailand's tracks is only 50 percent for the Northern route, 48 percent for the Northeastern route, 41 percent for the Southern route and only 20 percent for the Eastern route. The lack of locomotive engines partly explains the low usage.[12] This is because of 258 engines, only 149 are still useable.

It is clear that the state has been too heavily involved in the operation of commercial businesses through SOEs. As these enterprises are weighed down by state bureaucracy and political opportunism, it is no surprise that their investments are unproductive and may even crowd out their more-efficient private counterparts. Hence, the government needs to minimize its presence in commercial businesses.

There are several means by which the government could reduce its role as a commercial operator. First, it needs to privatize many of the existing 57 SOEs involved in many

12 Nikomborirak et al. (2014).

industries, including banking, insurance, energy, electricity, land transport, telecommunications, and broadcasting, which compete directly with private operators. In the absence of market failures, it is difficult to justify the existence of many of these SOEs. Second, in cases where an SOE provides both commercial and social services, the scope of operation should be confined to the latter. Third, SOEs that continue to compete with private enterprises should be stripped of any "privileges" such as a statutory monopoly and exemptions from competition law or the need to compete for government procurement projects. Over time, it is expected that market forces will "shrink" the role of the inefficient SOEs and lead to efficiency improvements for the country's overall investment.

6. Enabling policy environment

During the past decade, Thailand has become the "sick man" of Southeast Asia because of both internal political turmoil and declining competitiveness. Reviving growth will require a major restructuring of the economy, and for this the role of the state is vital. Apart from reducing the state's role as operators and service providers, the state needs to provide an appropriate enabling policy environment to regulate and support the operations of the private sector.

In many sectors, such as transport and telecommunications, state regulations have played important roles in determining market outcomes. Regulations are often designed to achieve three main objectives: efficiency, stability, and equity. But these goals can at times be conflicting. Regulators in Thailand tend to put greater emphasis on the stability of the system, which often translates into the financial stability of operators, at the expense of competition and efficiency. For example, most price regulations in Thailand adopt the cost-plus or rate-of-return approach, which allows the service providers to pass on investment inefficiencies directly to the consumers. In fact, such regulations have been known to distort business incentives in favor of overexpansion (known as the Averch–Johnson effect[13]). For example, the regulation of the gas transmission service tariffs operated by PTT, the state-owned petroleum company, is based on the rate of return model. The relatively high guaranteed rates of return, namely, 18 percent internal rate of return on equity for older pipelines and 12.5 percent for newer ones, have allowed the company to expand its network without sufficient consideration of the efficiency of such investment. In contrast, more economically advanced economies often adopt an incentive-based price-cap regime to regulate prices in noncompetitive markets.

13 The Averch–Johnson effect is the tendency of regulated companies to engage in excessive amounts of capital accumulation to expand the volume of their profits. If companies' profits-to-capital ratio is regulated at a certain percentage then there is a strong incentive for companies to overinvest to increase profits overall. This investment goes beyond any optimal efficiency point for capital that the company may have calculated because higher profit is almost always desired over efficiency.

The government needs to overhaul its role as the regulator. In key businesses such as energy, transport, and telecommunications, state regulatory bodies need to focus more on "efficiency" and put less emphasis on "security or stability." Regulations should be revised to accommodate freer and fairer competition and provide regulated businesses with the incentive to operate efficiently. For example, Thailand should consider adopting price-cap regulation in place of cost-plus counterparts, which allow inefficient firms to pass on all costs to the consumers. In the past, the rate-of-return regulation had encouraged SOEs to overinvest because of guaranteed investment returns. Measures to promote new entries, such as third-party access to essential facilities (e.g., gas transmission pipelines or electricity grids), should be encouraged, and infrastructure sharing, say, in telecommunications, can help reduce costly investment duplication such as cellular phone towers.

As a policymaker the government will need to commit to certain planned investment schemes that will complement the private sector's investment to lift the country's long-term competitiveness. Policies needed to upgrade human capital, innovation, and infrastructure development demand complex institutions that pose great challenges to any government. Indeed, getting the industrial policy right is most challenging in particular for those governments with limited administrative and technical capabilities. The right policy will not come out of closed-door meetings between bureaucrats but can only emerge from extensive consultations with the private sector as well as experts outside the bureaucratic realm. The government and the private sector should identify directions in which the economy is expected to evolve.

How should Thailand balance the focus on advanced agro-industries, tourism, health-related services, and higher value-added manufacturing? A particular path will require particular policies and investment. The risk of a policy failure is certainly there, but Thailand cannot hope to move above the middle-income level without an effective strategy. It will take much effort, but it is time to think seriously about the long-term growth road map.

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