

Thailand's ambitions for stable growth

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During the first few months of 2016, "gloomy" was an adjective often used by the Thai press to refer to the country's economic prospects. The situation is somewhat more complex in reality. The weak global economy and uncertainty regarding the situation in China have had a major impact on Thailand's export industry. The country's budget is suffering from high levels of debt and private companies are holding back on new investment because of the fragile political situation in the country. To top it off, a drought has significantly affected agricultural production.

The military government is currently trying to get to grips with development, primarily through high investment in infrastructure. But this alone will not be enough for the country to escape the middle-income trap and to fulfil its objective of transforming itself from one of the better-performing developing countries into a industrial nation. To this end, the economy must become more productive and innovative than it has been up until this point. In any case, success will depend on whether or not the country can overcome political tensions.

Slight economic recovery in 2015

Thailand's economy experienced real growth of 0.8 per cent in 2014, which remained well below the country's potential. The main reason for this was major political turbulence, which came to a head in May 2014 with a military coup. In 2015, development was faring significantly better. Despite the global economic crisis and the downturn in China, economic output increased by 2.8 per cent (National Economic and Social Development Board (NESDB), Gross Domestic Product: Q4/2015, 15 February 2016, www.nesdb.go.th). However, this represented the lowest level of growth out of all the developing and emerging countries in the Asia-Pacific region (World Bank, "East Asia Pacific Economic Update, April 2016: Growing Challenges", <https://openknowledge.worldbank.org>).

The main impetus came from domestic demand. To provide economic development with impetus to compensate for the negative effects of global economic slowdown, the military government had already laid out an economic plan in autumn 2014 after their takeover of power, which was followed by other such plans in the second half of 2015. The plans contained tax cuts and measures to support small and medium-sized businesses as well as rural households, and outlined steps toward creating new jobs. The state had a particularly active role in these plans, increasing government investment in 2015 by almost 30 per cent in comparison to the previous year (NESDB, "Gross Domestic Product", loc. cit.). Money flowed into projects for water management and road construction, to name two examples.

Despite government support, the private sector held back on new investments in the face of weak export prospects and political instability. Foreign investors also massively cut back on direct investment into the country, though partly for different reasons.



Investment plummeted by 90 per cent to 106.6 billion baht, having reached just over 1 trillion baht in 2014 (Thailand Board of Investment, "Investment Promotion Statistics", www.boi.go.th). The main reason for this was the government introducing a new investment incentive scheme at the beginning of 2015 that focused on high-quality products, research and innovation and energy efficiency, while withdrawing its support for projects with little added value (W. Duscha, "Thailand erarbeitet neues Entwicklungskonzept" [Thailand draws up new development concept], Germany Trade and Invest, international markets, 10 December 2015). As a result of this decision, there was a surge of investment applications under the "old" scheme in 2014.

Private consumption increased by 2.1 per cent. The resurgence of spending by tourists and other non-residents was primarily responsible for this. Due to the very uncertain political situation, many tourists avoided Thailand in 2014. Domestic consumer spending increased only slightly by 1.8 per cent. However, an upward trend in domestic consumer spending was recorded on again towards the end of 2015. The NESDB attributes this increase to the low inflation rate, falling oil prices and an increase in consumer confidence, particularly in the second half of the year, among other factors (NESDB, "Gross Domestic Product", loc. cit.).

Foreign trade suffered from a weak global economy. Exports, which contribute around 70 per cent of gross domestic product (GDP), fell by 5.8 per cent to 214.4 billion US dollars, while imports dropped by 11.0 per cent to 202.8 billion dollars (Fiscal Policy Office, Ministry of Finance, "Monthly Economic Report (December and Q4/2015), 28 January 2016, www2.mof.go.th). Almost all of Thailand's trading partners bought fewer of the country's goods than was the

case in 2014, for example China (-5.4 per cent), Japan (-7.7 per cent) or the ASEAN nations (-7.2 per cent). The only notable exception was that of the USA, who increased spending by 0.7 per cent. The reasons for this decline included, among other factors, low energy prices and low demand for raw materials and intermediate goods.

Uncertain times ahead for 2016

The basic pattern observed in 2015 is expected to continue throughout 2016 (World Bank, "East Asia Pacific Economic Update, April 2016: Growing Challenges", extract from Thailand country report, www.worldbank.org): The impetus for growth will primarily come from within the country, while external demand is set to remain relatively low. Political uncertainty is also expected to continue throughout the rest of the year: In August 2016, the people of Thailand will decide on a new constitution, as controversy over the current draft comes to the fore (S. Crispin, "Thailand's Constitutional Referendum: A Hobson's Choice", The Diplomat, 13 May 2016, <http://thediplomat.com>).

Opinions vary on the extent of growth that can be expected. The Fiscal Policy Office of the Ministry of Finance is confident that real GDP will increase by 3.3 per cent ("Tourism and fiscal stimulus expected to fuel 3.3% GDP growth", The Nation, 29 April 2016, www.nationmultimedia.com). Estimations from the World Bank, on the other hand, are far more conservative, with predictions of a mere 2.5 per cent increase in GDP growth (World Bank, "East Asia Pacific Economic Update", loc. cit.). The Asian Development Bank forecasts growth of 3.0 per cent (ADB, "Asian Development Outlook 2016: Asia's Potential Growth", March 2016, www.adb.org).



One thing all analysts are able to agree on is that government investment in infrastructure will be one of the main growth drivers again in 2016. The government is intending to spend almost 3.4 trillion baht (96.1 billion US dollars) as part of its eight-year plan from now until 2022 on the modernisation of railways, roads, air and sea transport. 20 projects with a total financial value of 1.8 trillion baht will take top priority. There will be a call for tenders for these projects in 2016/2017 (V. Porametee, General Secretary of the NESDB, "Enhancing Infrastructure Development for Thailand's Future Growth", PowerPoint presentation, Thai-Chinese Business Forum 2015, 17 December 2015, www.boi.go.th).

Government investment alone, however, will not be enough to sustain long-term growth, as it only contributes to approximately 5 per cent of GDP, while the private sector accounts for 20 per cent (O. Paweewun, "Storm clouds remain", Bangkok Post, New York Times, "Turning Points 2016, Year-End Review 2015", p. 18, <http://infrappworld.com>).

At the same time, a decision was made to construct super clusters in a number of key industries such as the automotive and supply industry, electronics, digital economy, chemistry as well as in medical technology and food production. Companies which form these clusters will concentrate on the development of new technologies and products and will receive extensive tax cuts

in return (A. Sibunrang, Minister of Industry, "Thailand Moving Ahead with Cluster Development", presentation, 23 November 2015, www.boi.go.th).

In terms of private consumption, Thailand hopes that tourism will once again provide the biggest boost to the economy ("Tourism and fiscal stimulus expected to fuel 3.3% GDP growth", loc. cit.). Expectations for domestic consumption, however, are considerably lower. One factor that will have a negative effect on domestic consumption is the situation in the agricultural sector, which employs 40 per cent of all the country's workers (World Bank, "Employment in agriculture (% of total employment)", <http://data.worldbank.org/indicator>), with the drought possibly set to continue into 2016. This, alongside low prices for agricultural products, will have the effect of reducing income from farming and, in many cases, drive up the levels of debt of many households which are burdened with high debts already (M. Sainsbury, "Extreme drought parches Thailand's farm sector", Nikkei Asian Review, 14 April 2016, <http://asia.nikkei.com>). From 2005 to 2014, the debt burden of all households in Thailand increased from 45 to 80 per cent of GDP ("Household debt makes economy fragile", Bangkok Post, 11 November 2015, www.bangkokpost.com)

Foreign trade has consistently been a pillar for economic development in Thailand in previous years, but due to the weak state of the global economy, this has also sustained a loss. In the face of uncertainty regarding the global economy, it is unlikely that many countries will see any great changes in 2016. The Thai central bank predicts that exports will fall by 2 per cent, constituting the fourth consecutive decline.

Many risks



Although the World Bank, the ADB and other institutions are predicting a significant increase in economic activity for Thailand in 2017, the country needs to be prepared for a number of risks. In particular, the political situation is extremely fragile, and a new wave of the same sort of unrest that affected the country in 2013/14 would have far-reaching effects on economic development. Corruption is another major problem, as well as unfavourable demographic development, as is the case in various other countries. The population is only growing very slightly and, with increasing life expectancy, society is ageing at a rapid rate. However, this development in particular is putting Thailand's social welfare system and the labour market under considerable pressure (K. Dombrowski, "Modernity has arrived", *Development and Cooperation*, 3 October 2013, www.dandc.eu).

In terms of foreign trade, uncertainty regarding China's development poses one of the most significant risks. China's economy has slowed down substantially and the country is also shifting the focus of its development model from labour-intensive manufacturing and investments to industrial innovation, consumption and services. This transition is unlikely to be a smooth one and will probably affect Thailand in some form or other for several reasons.

Firstly, China is one of Thailand's most important trading partners: In 2015, the country was responsible for around 11 per cent of Thailand's exports. In real terms, this was worth 23.7 billion US dollars. Thailand exported almost 30 per cent of its agricultural products and more than 9 per cent of its most important industrial goods to China. On the other hand, Chinese goods made up over 20 per cent of Thailand's imports. The rate for consumer goods reached over 36 per cent and almost 28 per

cent for capital goods ("Foreign Trade Statistics of Thailand", loc. cit.).

Secondly, China is also a very active investor in Thailand. According to UNCTAD, China had invested approximately 2.5 billion US dollars into Thailand by the end of 2012 (UNCTAD, "Bilateral FDI Statistics 2014", <http://unctad.org>). The amount for subsequent years has been the same or higher (Thailand Board of Investment, loc. cit.). In 2015, 11.7 per cent of foreign direct investment (FDI) came from China. This figure was exceeded only by Japan, Singapore and Indonesia.

Chinese interest in Thailand is set to remain strong in the future, with Bangkok's plans to expand and modernise infrastructure fitting in perfectly with Beijing's "Silk Road Strategy" (One Belt, One Road). As part of this strategy and through improved infrastructure, China is hoping to open up new sales markets and trade routes and exploit new energy sources in South-East Asia, (Mercator Institute for Chinese Studies, "One Belt, One Road: Mit der Seidenstraßeninitiative baut China ein globales Infrastrukturnetz" [China builds a global infrastructure network with the Silk Road initiative], June 2015, www.merics.org).

Thailand welcomes this initiative in principle, and also supports the Asian Infrastructure Investment Bank (AIIB), founded by Beijing. However, not everything is running smoothly. On 23 March 2016, Prime Minister Prayut announced that the planned construction of a rail link between the South of China and Thailand via Laos would now not be going ahead. Apparently, the two sides were unable to come to an agreement regarding the financial arrangements (S. Crispin, "China-Thailand Railway Project Gets Untracked", *The Diplomat*, 1 April 2016, <http://thediplomat.com>).



However, this setback is not expected to have long-term repercussions for the bilateral relationship, as Thailand is extremely keen to encourage increased involvement by China in light of the difficult economic situation the country is facing (P. Parameswaran, "Thailand Expects More Investment from China in 2016", *The Diplomat*, 3 February 2016, <http://thediplomat.com>). Bangkok has high hopes for closer collaboration with China, particular with regard to the construction of a new high-tech cluster, although they will also be looking to Japan for involvement. The development these clusters was the focus of the government's revised investment promotion strategy from 2015 (W. Duscha, "Thailand erarbeitet neues Entwicklungskonzept" [Thailand draws up new development concept], Germany Trade and Invest, international markets, 10 December 2015, www.gtai.de). In an interview with Chinese news agency Xinhua, the Minister for Industry, Atchaka Sibunruang, called for Chinese investment in engineering, medical technology, bioengineering and software, to name a few examples ("More Chinese investment welcomed in Thailand's high-tech sector", *China Daily*, 22 January 2016, <http://europe.chinadaily.com.cn>).

Japan, Thailand's most important foreign investor, held back somewhat on investment in new projects in 2015. However, the Board of Investment predicts a renewed increase in involvement for 2016. Clusters and the promotion of high-tech sectors, which is now taking precedence in Thailand, are areas in which Japan boasts a great deal of expertise, according to BOI General Secretary Hiriyuna Sujinai. The BOI will announce its new investment promotion policy at a roadshow in Japan in 2016 ("China to succeed Japan as biggest FDI investor", *The Nation*, 20 October 2015, www.nationmultimedia.com).

The way out of the middle-income trap

There is no doubt that Thailand has achieved a lot over the last decades. Per capita income climbed from just over 800 US dollars in 1984 to almost 6000 US dollars 30 years later. The country has also made a lot of progress in its fight against poverty. In addition, Thailand has become a major industry name in certain fields; the nation became the twelfth largest car producer in the world in 2015 as well as one of the largest manufacturers of hard disk drives.

However, development has stalled in the last few years. The economy has consistently grown at a rate much lower than what it is actually capable of, with potential growth currently rated at 4 to 5 per cent (ADB, "Asian Development Outlook 2016", loc. cit., p. 51). Within this context, there is a very real danger that Thailand could remain at its current level of development. For one thing, it cannot compete with more developed countries in terms of technology, but at the same time, it is no longer as competitive as low-wage countries because of its comparatively high income level.

This will not be an easy situation to change. The country's export structure is considered to be too vulnerable ("Thai export sector needs structural changes, economists warn", *The Nation/Asia News Network*, 28 April 2015, <http://business.asiaone.com>), with agricultural and agro-industrial products, which constitute one fifth of exports, being hit by low agricultural prices. The electronics sector in Thailand, whose share of the export market was around 15 per cent in 2015, is subject to fierce international competition. This is exacerbated by the fact that hard disk drives, one of Thailand's most important export products, are slowly becoming obsolete due to the



rise of cloud computing, as former Minister of Finance Chatikavanij points out (S. Cendrowski, "For Thailand's economy, bombs aren't the biggest problem", *Fortune*, 28 May 2015, <http://fortune.com>).

In order to find its way out of the middle-income trap, Thailand must become more innovative and productive, he adds. There is no shortage of proposals, but panaceas are non-existent. "We know that we need new products [for our export market]," said one Professor of Economics at the Chulalongkorn University in Bangkok. However, a mixture of weak copyright protection laws and an ingrained tendency to compete with others on the basis of price alone but not quality are obstacles to the development of new products, according to the same source (*ibid.*).

This is only one factor, however. It is also necessary, for example, to improve secondary and tertiary education as well as vocational training in order to promote research and development (R&D) and bring qualified employees onto the labour market ("Thailand's growth to stay below potential in 2015, predicts ADB", *The Nation*, 20 December 2014, www.nationmultimedia.com). Another suggestion is for Thailand to follow in the footsteps of South Korea – which has successfully managed to develop into an industrial country – and establish a national R&D system, set up specialised research institutions and create a close link between the R&D sector and the economy (B. Chalise, "Can Thailand Avoid the Middle-Income Trap", *The Diplomat*, 8 April 2016, <http://thediplomat.com>). Thailand will have to invest more overall into R&D as a prerequisite for developing a similar model. In 2011 (latest figures), spending on research and development was as little as 0.4 per cent of GDP (World Bank, "Research and development expenditures (% of GDP)", <http://data.worldbank.org/indicator>). At the

same time, the financial sector will require further development and corruption and inequality will need to be dealt with (Chalise, loc. cit.).

The new ASEAN Economic Community (AEC), which was established on 1 January 2016 and is set to transform the economic area of the South-East Asian group of nations into a large free trade zone, is a significant opportunity for Thailand to make advances in terms of the necessary structural change through more economic integration (D. Schrey et al., "Zwischen Vision und Wirklichkeit - Die Wahrnehmung der ASEAN Economic Community in Thailand, Kambodscha und Indonesien" [Between vision and reality - perceptions of the ASEAN Economic Community in Thailand, Cambodia and Indonesia], international information by the Konrad-Adenauer-Stiftung 1/2016, 4 April 2016, p. 119-138, www.kas.de). Similar impetus can be expected from the Regional Comprehensive Economic Partnership (RCEP), which allows Thailand to negotiate with China, India, Japan and other countries as part of the ASEAN group. Finally, the Trans-Pacific Partnership (TPP), which has already been signed and which Thailand has not yet joined, is being regarded as a "wake-up call" for the country to reflect on its trade policies (P. Arunmas, "Treading with caution", "Turning Points 2016, Year-End Review 2015", loc. cit., p. 30).

The AEC provides Thailand with many opportunities, although it comes with its fair share of risks. For example, the health industry will be able to benefit from the expected increase in regional economic growth and the planned freedom of movement (Schrey et al., loc. cit. p. 123). Efforts to move towards more high-quality production and faster innovation could also be boosted as potentially labour-intensive production moves to cheaper neighbouring



countries for cost-related reasons. However, this type of structural change would cause considerable problems, at least temporarily. The same applies to agriculture, which employs many poorly trained people and is already having to contend with major productivity problems. This sector is expected to encounter difficulties as a result of increasing competition (*ibid.*, p. 122).

Developments in the coming years will determine how Thailand solves these problems, as well as others. If major social conflicts re-emerge, the consequences are likely to be very negative. Ultimately, Thailand will only be able to meet its objectives if it achieves peace within society and consensus.

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