Thailand

Thailand's economy has made remarkable progress over the past ten years. Real GDP rose at an average rate of 9 percent per annum while inflation was limited to around 4 percent. Exports of manufactured goods have grown very rapidly and now figure more prominently than do agricultural products in Thai exports. Investment also surged and the flow of foreign investment from Japan and the newly industrializing economies helped in significant ways to ease the current account deficits that in recent years have become a conspicuous feature of the Thai economy.

The economy is likely to continue its strong performance in 1996 and 1997. However, containing inflation may prove difficult and the current account deficit may widen further. Although the medium-term outlook remains bright and the country is well positioned to take advantage of the newly emerging world trading environment, it needs to continue its efforts at stimulating structural change. To promote a shift to higher value-added products, it will be necessary to increase significantly the availability of skilled labor and the quality of physical infrastructure. Liberalization of the financial sector should be widened and deepened if the Government's hope of turning Thailand into a regional financial center is to be realized.

Recent Trends and Prospects

Growth, Investment, and Employment. Buoyed by strong domestic demand and further expansion in exports, GDP continued to grow rapidly at 8.6 percent in 1995, almost the same rate as in 1994. Heavy flooding seriously affected agricultural production, especially that of rice; in consequence, agriculture sector growth fell to 3.2 percent in 1995 from 5.5 percent in 1994.

Industrial output expanded by nearly 12 percent in 1995 compared with below 10 percent in 1994. Production of automobiles and automobile parts, petroleum products, integrated circuits, compressors, and plastic products increased strongly; textile output increased only marginally because of raw material shortages. Construction output grew by 9.4 percent in 1995 compared with 8.2 percent in 1994, as the demand for commercial and factory buildings strengthened. The tourism sector experienced a sharp increase in its growth rate to about 14 percent in 1995 from only 5 percent in the previous year.

Domestic demand was strong in 1995. Rural incomes benefited from the increase in agricultural export prices as well as in domestic food prices, while increased wages and salaries of public and private sector employees lifted urban incomes. Private investment expanded by 12 percent, a slightly higher rate than in 1994, reflecting greater investment in infrastructure and production capacity for the domestic and external markets. The growth of public investment expenditure moderated in 1995 to 14 percent, from above 16 percent in 1994 when sizeable public investment expenditure occurred.

The share of resources devoted to saving and investment in Thailand has grown rapidly in the past decade. Gross domestic saving, which was 24 percent of GDP in 1985, reached over 34 percent in 1995. Somewhat

Table 2.12 Major Economic Indicators: Thailand

		1993	1994	1995	1996	1997
Gross Domestic Product	% change	8.3	8.7	8.6	8.3	8.0
Agriculture	% change	-1.9	5.5	3.2	4.0	3.0
Industry	% change	10.6	9.9	11.9	11.5	11.0
Services	% change	9.2	8.5	7.1	6.4	6.2
Gross Domestic Investment	% of GDP	40.4	41.0	40.0	41.0	41.0
Gross Domestic Saving	% of GDP	35.0	35.2	34.2	35.0	35.0
Inflation Rate	% change in CPI	3.4	5.1	5.8	5.5	5.5
Money Supply Growth	% change	18.4	12.9	17.4	16.0	15.0
Merchandise Exports	$ billion	36.4	44.5	55.4	64.8	75.2
	% change	13.4	22.2	24.5	17.0	16.0
Merchandise Imports	$ billion	40.6	48.2	61.9	74.2	89.1
	% change	12.1	18.5	28.4	20.0	20.0
Current Account Balance	$ billion	-7.0	-8.4	-12.3	-13.9	-15.7
	% of GDP	-5.6	-5.9	-7.5	-7.6	-7.6
External Debt Outstanding	$ billion	45.8	61.0	68.2	75.0	85.0
Debt-Service Ratio	% of exports	18.5	15.6	11.7	14.0	14.0

Sources: Data collected from the Bank of Thailand by EDRC for the Asian Development Bank *Annual Report 1995*; Royal Thai Government, National Economic and Social Development Board, *National Income of Thailand*, 1994 Edition (Bangkok, 1995); International Monetary Fund, *International Financial Statistics* (Washington, DC, February 1996); World Bank, *World Debt Tables 1996*, Vol. 2 (Washington, DC, 1996); and staff estimates.

in parallel with the rise in domestic saving was a secular decline in household saving. A large part of this decline reflects consumption smoothing. As the financial market was liberalized, consumers' ability to borrow against wealth and future income increased, thereby bringing about an adjustment in the pattern of lifetime consumption and saving. Gross domestic investment rose from 28 percent of GDP in 1985 to 40 percent of GDP in 1995. The savings-investment gap, as reflected in the current account deficit, stood at more than 7 percent of GDP in 1995.

The unemployment rate in 1995 remained at less than 3 percent and the labor market is experiencing worsening shortages, as reflected in rising wages in Thailand. The minimum wage rate in Bangkok and six major provinces was increased in July 1995 by 32 percent from Thai baht (B) 110 to 142 per day, making Thailand's minimum wage rate four to five times higher than that of regional competitors, such as China, Indonesia, and Viet Nam. While Thailand continues to export unskilled and semi-skilled labor to other Asian and Middle Eastern countries, it suffers from an acute shortage of the skills required to move Thai industries into more sophisticated skill-intensive production.

The outlook for the Thai economy remains bright with overall GDP growth projected at 8.3 percent in 1996 and 8 percent in 1997. Agriculture sector growth is expected to be 4 percent in 1996 and 3 percent in 1997, while the industry sector should continue to grow strongly at about 11 percent per annum over the same period. Services sector output is expected to increase by over 6 percent in 1996 and 1997. Though financial sector liberalization will continue in 1996 and 1997, it will be at a slower pace and have a more limited scope than previously expected.

Gross domestic investment is projected to increase slightly to about 41 percent of GDP in both 1996 and 1997, while domestic saving will increase marginally to about 35 percent of GDP, thereby reducing the savings-investment gap. The unemployment rate will remain low at less than 3 percent over the next two years. The persistent shortage of labor is likely to put further upward pressure on labor costs, unless these constraints are eased by the freer movement of labor from neighboring countries.

Budget, Money, and Prices. In 1995, the Government achieved an overall budget surplus of 2.8 percent of GDP, much the same as in 1994. Strong economic activity and improved tax administration, particularly as regards the value-added tax, enabled revenue to increase by nearly 11 percent. Total expenditure was 10.5 percent higher than in 1994. There was a significant increase in public sector wages and salaries, an increased emphasis on education, and greater attention to infrastructure projects, notably for the alleviation of Bangkok's serious traffic congestion.

Notwithstanding a tighter monetary policy adopted by the Government, money supply (M2) grew by 17.4 percent in 1995 as compared with about 13 percent in 1994, reflecting continued foreign capital inflows and credit growth generated through domestic banks. To limit the expansion of credit, the Bank of Thailand introduced a number of monetary and prudential measures, including raising the bank rate, issuing Central Bank securities to absorb liquidity and sterilize capital inflows, monitoring credit expansion including that by offshore banks, and imposing indicative credit expansion limits for banks.

Inflation continued on an upward trend, rising to 5.8 percent in 1995 compared with about 5 percent in 1994. Food prices rose by 8.1 percent compared with an increase of 6.9 percent in 1994, reflecting both a fall in domestic output as a result of severe flood damage and an increase in international food prices. Nonfood prices rose less strongly at 4.2 percent compared with 3.8 percent in 1994.

Though it is proposed that the budget for 1996 will be in balance, the increase in total expenditure by nearly 18 percent in 1996 compared with less than 11 percent in 1995 will add to inflationary pressure in the economy as will the adverse effects on output caused by the floods. While the measures taken by the Bank of Thailand to check credit expansion are expected to moderate inflationary pressure, the inflation rate is not likely to decline to less than 5.5 percent in 1996.

A plan for the reform and development of the financial and banking system was announced in February 1995. The objectives of the plan include improving the mobilization of both domestic and foreign saving, promoting competitiveness in the financial sector, and channeling credit to provincial areas to stimulate development outside Bangkok. To improve the competitiveness of the financial sector, a number of new banking licenses are to be issued. The new banks are to locate their headquarters outside Bangkok, presumably to ensure a more equitable spatial distribution in credit supply. The plan also allows for 7 of the existing 21 foreign banks, which at present operate as offshore banks in Thailand under the Bangkok International Banking Facility (BIBF), to open full branches in Thailand. As financial market liberalization deepens and widens, the Bank of Thailand will have to rely more on indirect instruments of monetary control, such as the bank rate and open market operations in interest-bearing securities, and less on direct mechanisms such as the credit plan, which sets quantitative guidelines on the amount of credit each bank can extend. Indeed, the efficiency of the credit control mechanism has already been significantly eroded by the operations of the BIBF, which are not included in the credit plan.

External Trade and Payments. The revival of growth in the global economy, and the continued strong performance of the East Asian economies, helped Thailand to maintain vigorous export growth at nearly 25 percent in 1995, after growth of 22 percent in 1994. Agricultural exports, including rubber, tapioca, sugarcane, raw coffee beans, and frozen shrimp, as well as manufactured goods, especially footwear, plastic products, computers and computer parts, and electrical appliances, experienced rapid growth. The Association of Southeast Asian Nations (ASEAN) has now emerged as the most important trading partner for Thailand, followed by the US, Japan, and the European Union. Major exports to ASEAN include footwear, rubber, rice, computers and computer parts, and integrated circuits.

Imports grew strongly at about 28 percent in 1995 compared with 18.5 percent in 1994, reflecting high domestic investment and consumption. Imports of raw materials and semiraw materials increased by 39 percent, while imports of both capital and consumption goods were 25 percent higher than in 1994.

The services account continued to be in surplus, largely because of the strong performance of tourism and workers' remittances. However, the services account surplus as a percentage of GDP has been declining over the years as Thailand spends more on royalties and copyrights, dividend and interest payments, and tourism.

The current account deficit reached an historically high level of 7.5 percent of GDP in 1995 compared with 5.9 percent in 1994. Large capital inflows continued to cover the deficit and raised the official foreign exchange reserve from $30 billion in 1994 to over $36 billion in 1995. However, there was a change in the composition of capital inflows; portfolio and direct investment weakened while short-term inflows to the banking system increased. Net external borrowing also increased because of a surge in lending by foreign banks through the BIBF. This heavy reliance on foreign saving is a source of some concern as a sudden change in international perception about the soundness of the Thai economy could cause serious difficulties for the economy (Box 2.4).

There has been a significant decrease in the net inflow of foreign direct investment, from $1.7 billion in 1993 to $0.6 billion in 1994 (Figure 2.15). The trend was not reversed in 1995. This decline in net inflow of foreign direct investment is attributed to delays in the implementation of some large infrastructure projects and delays in the repayment of loans to foreign banks, as well as to Thailand's declining attraction as a location for investment in labor-intensive industries. However, although foreign investment in traditional Thai export industries such as textiles is on a downward trend, inflows in more technologically advanced areas appear to be on the rise. Yen appreciation has increased the attractiveness of Thailand as a production center for Japanese car producers seeking to expand in the fast-growing markets of Asia.

At the end of 1995, outstanding external debt was $68.2 billion, equivalent to about 41 percent of GDP, which represents a slight increase in absolute terms over what it was in 1994. Over the years, the structure of external debt has undergone significant change. Private sector debt has increased more than has public sector debt. Of the total outstanding debt, about $18 billion is public and $50 billion is private. The debt-service ratio declined to 11.7 percent in 1995 from 15.6 percent in 1994.

Merchandise exports are forecast to increase by about 17 percent in 1996 and by 16 percent in 1997. The share of primary commodities in the country's export structure will continue to fall as the economic structure is diversified and moves toward services and industrial goods. Import growth in both 1996 and 1997 is projected at 20 percent. A large proportion of these imports will be capital goods for upgrading and expanding the country's industrial production capacity. The current account deficit is likely to increase marginally, to be sustained by inflows of foreign capital. Foreign borrowing is expected to raise the outstanding debt to about $75 billion in 1996 and $85 billion in 1997. However, rising exports should allow the debt-service ratio to remain at 14 percent in both 1996 and 1997.

Steep depreciation of the dollar against the yen in the first half of 1995 triggered discussion of possible changes in the exchange rate regime. Although unwilling to embrace a floating rate, the Bank of Thailand is likely to adjust relative weights of currencies in its peg basket to reflect changing directions of trade more adequately, diminishing the weight of the dollar and increasing that of the yen and the deutsche mark, and also possibly bringing in some regional currencies such as the Singapore dollar and the Malaysian ringgit.

Policy and Development Issues

Notwithstanding its impressive performance over the last two decades, the Thai economy is faced with a number of policy and development issues that merit serious attention. First, despite the rapid growth of the economy, the benefits of this growth have been far from equitably distributed among income groups and regions of the country. There is substantial evidence to suggest that, while the incidence of poverty has generally declined in Thailand during the past two decades, both the regional and size distribution of income have worsened. In terms of size distribution, the position of Thailand compares unfavorably with that of other Southeast Asian countries. Similarly, there is wide divergence of incomes among various regions of the economy. For example, the difference in average income

Box 2.4 Thailand and the Current Account Deficit

The external balance on current account is one part of a country's overall balance of payments, which records all transactions between the country and the rest of the world. The current account includes not only trade in goods but also trade in services, interest and dividends to foreign investors, receipts on overseas investments, and migrants' transfers. The capital account records borrowing and lending and other financing items such as foreign aid. The current account deficit must be paid for by a capital account surplus (i.e., an equivalent amount of foreign borrowing or lending or grants) or by drawing on the reserves of foreign exchange at the Central Bank.

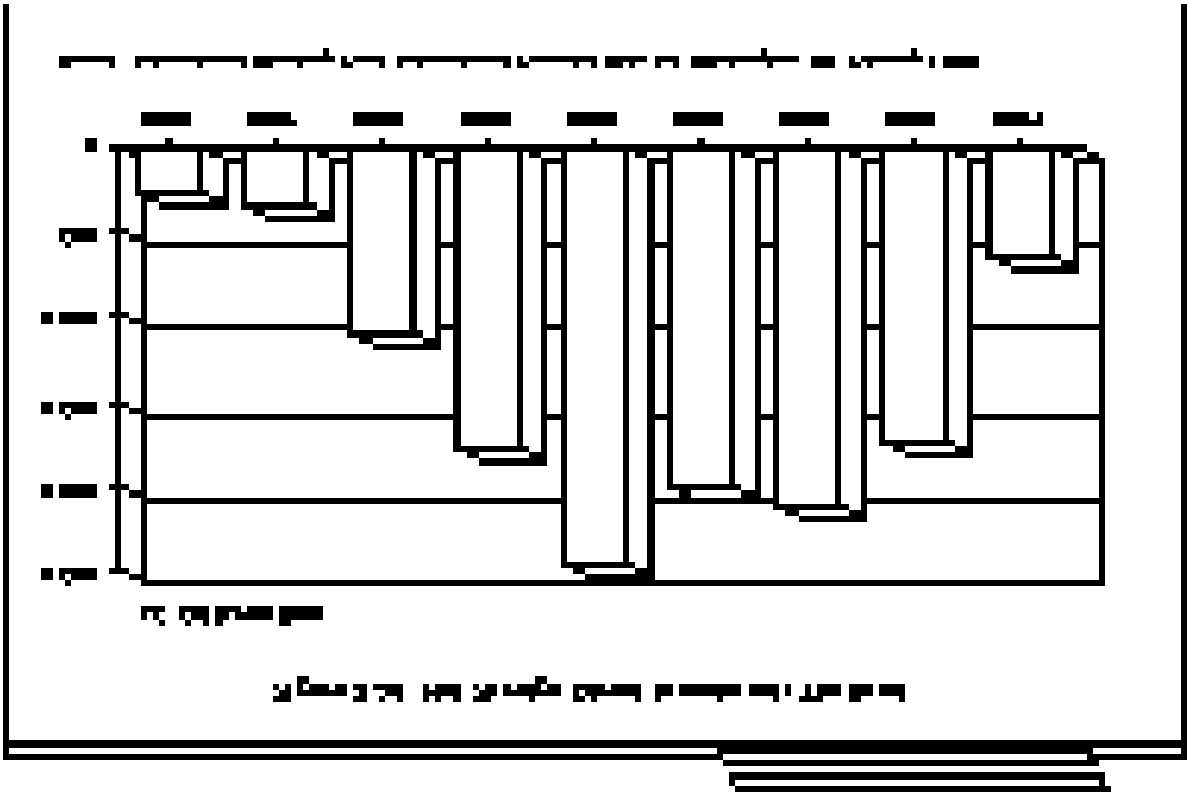
In itself, the current account balance reveals very little. A persistent large surplus may not always be a sign of strength. It could mean that investors find it more profitable to invest abroad or that there is excessive saving. For a poor country, running a current account deficit may make sense if it arises from increased investment. What size of current account deficit is safe depends, among other things, on the stage of development, how the money is being used, and market perceptions about that usage. What is certainly clear is that current account deficits are not always deleterious to the macroeconomic soundness of a country.

After reaching a trough in 1992, Thailand's current account deficit rose steadily to about 5.9 percent of GDP in 1994 and further widened to 7.5 percent in 1995, reflecting both an increase in investment as well as an increase in the cost of imports due to the appreciation of the yen and deutsche mark. The increase in investment was driven by the following factors. First, since 1992, the economy has been experiencing a high degree of capacity utilization. Many of the industries concerned began expanding their capacity, thereby accelerating the investment rate. Second, in the face of increasing global competition and rising domestic labor costs, Thailand began upgrading its industrial capacity, especially industries such as automobile production, chemicals, electrical and electronic products, and basic metals. Third, despite some earlier delays, investment in infrastructure projects, such as the mass transit system and telecommunications, picked up in 1995.

The key question is whether the present level of deficit is sustainable. First, it seems that the persistence of the deficit is related to the continuing high level of investment. The failure of domestic saving to match this level must be a cause of concern; however, at the same time, there is scope for effective policies to raise the savings rate, especially in the household sector. Second, the deficit would be more of a concern in a sluggish economy with weak export performance, which is not the case for Thailand. Third, countries with a large current account deficit often have a large budget deficit. However, Thailand has historically maintained budget surpluses, not deficits. Fourth, the financing of the current account deficit does not consist overwhelmingly of short-term inflows but of more stable components such as foreign direct investment, portfolio investment, BIBF inflows, and public borrowing and trade credits. Finally, Thailand has a relatively strong external financial position. While total external debt at the end of 1995 was relatively high at $68.2 billion, about 41 percent of GDP, the debt-service ratio at 11.7 percent is low by international standards. Also, the country's stock of international reserves stood at $36 billion at the end of 1995, equivalent to seven months of imports.

Thailand's current account deficit is not expected to increase substantially over the next few years and the present strength of the Thai economy indicates that the country should have no major difficulty in financing it. Nevertheless, prudence would suggest the desirability of strong efforts to mobilize domestic saving so that the level of investment and economic growth is less vulnerable to adverse external and internal events that could affect the supply of foreign saving.

per capita between Samut Prakarn Province, adjacent to the Bangkok Metropolitan Area, and Si Sa Ket Province in the Northeastern Region is almost 18 times. Such income disparities contain the seeds of discontent and need to be addressed on a priority basis for the sustenance of longer-term growth and development. The Eighth Plan, which is to be launched in 1997, focuses on human resource development, particularly on expanding and improving rural secondary and tertiary education. The Plan also underscores the need to reduce the concentration of industry in Bangkok and to raise the level of investment



in rural physical infrastructure. These are no doubt moves in the right direction. Thailand also needs to emphasize policies that foster development of, and encourage technological progress in, the agriculture sector, which employs a large part of the labor force.

Second, rising labor costs are already leading to a loss of competitiveness vis-à-vis labor-rich countries such as China, Indonesia, and Viet Nam. The Thai economy will, therefore, need to undergo rapid structural change if its growth performance is to be maintained in the future. Thailand relies heavily on primary commodities and labor-intensive manufactured products for its export revenues. The country needs to reorient its export structure from these categories to more value-added, skill-intensive commodities. At the moment, however, the acute shortage of various skills stands in the way of a rapid advance in such structural change of the economy. The Government needs to intensify its efforts to expand the supply of required skills through its education and training programs. The Government should nevertheless be cautious in its use of fiscal incentives to industries and activities intended to help upgrade the technological base of the economy, for reasons of both effectiveness and to avoid the distortions in resource allocation that such incentives can generate.

Third, Thailand's rapid growth over the past two decades has led to severe strains and imbalances in the economy. One critical imbalance is that of infrastructural bottlenecks, including the transport chaos in Bangkok, which appear to have impeded the process of industrialization of the economy and reduced the attractiveness of Thailand as a destination for foreign investment. The Government has undertaken measures to upgrade infrastructure and tax incentives to relocate industries from the congested Bangkok region to other areas of the country. While these measures are in the right direction, the ultimate success of the effort will depend on the efficiency with which such infrastructure projects are carried out.

Finally, Thailand has emerged as the country with the highest incidence of acquired immuno-deficiency syndrome (AIDS) in Asia, and this problem can place severe strains on the Thai economy. For example, tourism is an important source of income for Thailand and the high incidence of AIDS has the potential to diminish the attractiveness of the country for both foreign tourists and foreign investment.