ARTICLE FOR THE EDGE

CAN THAILAND OVERCOME ITS MALAISE?

Thailand's economy has been buffeted by political crises since 2004 when protests broke out against the then Prime Minister, Thaksin Shinawatra. Two military coups, two amended constitutions, several elections and a few bouts of violence later, the country appears to be finally stable again. Now, with a government elected by the people, can this country that so many of us have grown to admire, finally put its 15 lost years behind and gird itself to regain the position that made it an Asian Tiger in the 1990s?

The near term looks more positive as there are several drivers forces that can help the Thai economy to re-accelerate modestly, even in the face of a troubled global economy. However, the longer term outlook is more murky: a review of its structural weaknesses suggests to us that the country could struggle to maintain economic vibrancy in the coming decade.

Why are we so sure about a near-term rebound?

The key engines of growth for the Thai economy are showing signs of a recovery:

First, tourism (roughly 20% of GDP when all its direct and indirect effects are included) is poised for a recovery: After a difficult start to the year, the lead indicators for tourism are flashing positively: Advance accommodation bookings have picked up and the Tourism Authority of Thailand's offices in China report a surge in bookings for the end-of-year holiday season. Chinese tourists account for about one-third of total arrivals, so their return will materially boost the sector's fortunes.

Second, improving farm sector conditions should revive rural spending: Thirty percent of Thailand's work force remains in agriculture, so rising farm incomes would contribute nicely to aggregate demand in Thailand. A serious drought and then severe flooding hurt agriculture through much of this year but the effects of these natural disasters are now dissipating. Indeed, agricultural prices and output have moved up, allowing farm incomes to rise again. A recovering farm sector will translate into stronger consumption demand, especially for non-durable goods.

Third, fiscal spending is about to turn more positive: Disbursements for public infrastructure projects slowed in 2019 but will revive substantially in 2020. Policymakers are working overtime to grow the pipeline of shovel-ready projects that can be quickly implemented once the delayed FY2020 budget becomes effective around the first quarter of next year. In addition, public cash transfers to the poorest segments of the population are being stepped up. This will have an outsized impact on consumption demand because of the higher propensity to spend among lower-income households.

Fourth, a modest recovery in export growth is possible in 2020: The continued growth of the US economy and a rebound in China will help to support external demand. If global trade frictions ease and uncertainties such as Brexit diminish, global business confidence should improve and help bring about the long-expected but constantly postponed uptick in the electronics cycle which Thailand is geared to. All these factors should help crystallise a small recovery in export growth in 2020 compared to 2019.

Fifth, production relocation out of China into Thailand is gaining momentum: So far, the hard data on investment approvals has not picked up the kind of surge in relocation that Vietnam and Malaysia are enjoying. However, feedback from industrial estate developers and surging sales of industrial land suggest that production relocation is about to accelerate.

Sixth, private investment is set to recover: The revival in government spending and the belated pick-up in production relocation should help to crowd in domestic private investment. Political instability in the first half of this year had also weighed on private companies' animal spirits. In the past week, the new government has succeeded in getting the first reading of its budget passed in parliament, giving the corporate sector more comfort that more stable politics will help improve government performance.

We are now less optimistic about Thailand's long term prospects.

In short, we believe that the near term headwinds can be managed. It is the long term where we have downgraded our assessment. The principal reason for this revision is that the political system could impede what needs to be done to offset the strengthening demographic headwinds amid a more troubled global environment.

Existing government strategies to promote integration with the Greater Mekong Sub-Region, substantially raise infrastructure spending and establish the Eastern Economic Corridor remain positive drivers for the Thai economy but they will not be enough to offset three big negatives.

- **Demographic headwinds**: Thailand is one of fastest aging populations in Asia yet there does not appear to be any real strategy to reverse the low fertility rate nor is there a framework to fund the resulting demands for public spending on retirement funding, eldercare and healthcare. The current default strategy of relying on legal and illegal flows of labour from neighbouring countries cannot help for long.

- **Moribund productivity growth**: With virtually no growth likely in the work force, only strong productivity growth can help maintain good economic growth but this is lacking. The first reason is a slow pace of structural transformation of the economy. Agriculture remains a dominant employer in the labour force, reflecting the too-slow relocation of labour from low productivity agriculture to the modern sector. Agricultural productivity is roughly one-third of the economy-wide average. A second reason for lacklustre productivity growth is the low and declining investment share of investment in GDP, partly a result of the previous political instability but probably also because of the inadequate provision of public goods by the government such as good infrastructure and education.

- **Subpar economy-wide rate of return**: Poor productivity and perennial underinvestment have in turn led to lower return on investment in Thailand compared to opportunities around the region. Thus, businesses remain reticent to invest in Thailand. Thailand's rate of return on inward foreign direct investment, a proxy of the economy-wide return on investment, lags that of China and regional peers Malaysia and Indonesia. That is why production relocation is a double-edged sword for Thailand: while more manufacturing capacity from China is being moved to Thailand, there is also some relocation of activity out of Thailand into neighbouring countries.

Now that a stable government is in place, can these weaknesses be addressed?

The good news is that the years of political turbulence have ended and there is now a government which is making a big effort to pursue long term strategies. The economic technocrats in cabinet and those who run key economic agencies have been empowered to press ahead with well-thought out strategies such as the Eastern Economic Corridor mentioned above.

The question is whether this stability can last?

There remain undercurrents of dissent within the country, but to be fair, that is not unlike many other countries – with one important difference. Unlike the protests now disturbing many places such as Hong Kong or Chile, the Thai people appear to have become tired of protests and instability. They want a period of calm and seem prepared to give the current government the benefit of the doubt.

Bear in mind too that Thailand has demonstrated extraordinary political resilience in the past. Thailand has existed as nation state in some form or other since the 13th century. That it has lasted so long and demonstrated an ability to overcome foreign invasions, the challenge of colonialism and huge social and economic changes, reflects some deep innate strengths. Thailand has shown an impressive capacity to overcome daunting challenges – such as the AIDS crisis in the 1980s or the communist insurgency that threatened it from the 1950s to the early 1980s. The country has also made a smooth transition from the long reign of an outstanding monarch, King Bhumibol, in 2016.

So, clearly, one should not under-estimate Thailand. However, even with these strengths in mind, we are concerned about the future – and mainly because the political economy could be an obstacle to Thailand's smooth development. The crux of the matter is that institutions that once undergirded stability are at risk of losing their vitality, vested interests seem to be growing in strength and the political system is not accommodating the rise of new social forces.

Strong institutions are critical to supporting long term economic development. From the 1960s through the 1990s, Thailand generally outperformed its peers among emerging economies because institutions such as the monarchy and the civil bureaucracy, supported by other institutions such as the Buddhist Sangha provided the ballast needed to keep the country stable as it negotiated its way through a turbulent region marked by decades of war.

Thailand's institutions remain generally intact but are beginning to show signs of corrosion. Some commentators have expressed their discomfort over recent changes that give a key non-parliamentary institution substantial control over what had been considered state assets as well as direct control over elite military forces. Other institutions have also lost some of their prestige and vitality. The military's performance in running the country has been mixed and sometimes controversial: while Prime Minister Prayuth is respected and order and stability have been restored, allegations of corruption and cronyism continue to fester and the economy has not delivered for the common man. The Buddhist Sangha lost some degree of moral authority as a result of scandals, although recent reforms have helped to improve the situation.

Vested interests have always been around in Thailand but it appears that a narrower set of actors, in coalition with politically powerful personages, are capturing the benefits of being close to power. The result is an unusually high degree of market concentration as corporations that enjoy close relations with powerful elements are able to entrench themselves in their sectors. Recent findings by the Bank of Thailand's research institute show that the combined revenues from the 50 largest Thai firms roughly account for a quarter of the corporate sector's total revenues, and that market concentration is growing in severity. It also finds evidence of crowding out of smaller, more productive private enterprises, placing the goal of inclusive growth further out of reach.

Finally, the political system as it is currently structured does not seem to be accommodating the newly emerged forces in society such as the provincial business elites nor is it able to represent the interests of the younger segments of the population. This is dangerous given the growing frustration of the middle and lower income groups who feel neglected by this government, and discouraged by the perceived inequality of opportunities in Thai society. Small businesses and family enterprises in the provinces feel squeezed by the advance of well-connected big corporations who are eating into their businesses.

The bottom line

In short, there is dry tinder on the political ground. The chances of a near term political crisis are low simply because the Thai people are not disposed to protest, after a decade and a half now of political strife. But as the resentments under the surface – merely repressed – eventually grow, the risks of a political shakeout of some kind will rise over time. If not addressed in time, Thailand's long term development could be compromised.

Prepared by Manu Bhaskaran,
CEO, Centennial Asia Advisors