

PERSPECTIVE

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What Thailand Needs to Do to Become a High-Income Country

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EXECUTIVE SUMMARY

- Thailand is caught in the middle income trap. It suffers from a lack of skilled labour; its firms exhibit little innovation; and the national education system has failed, over decades, to deliver the required human resource. Investments in R&D also remain low.
- Thailand needs to identify and develop new sources of growth. One good option is for it to import foreign technology, and through imitation of this, attain the knowledge base required for new domestic innovations.
- Bangkok should also reconsider its import substitution policy and explore export-led growth strategies instead.
- Most importantly, an orderly and predictable political environment is needed if the country is to attract and encourage economic growth.

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INTRODUCTION

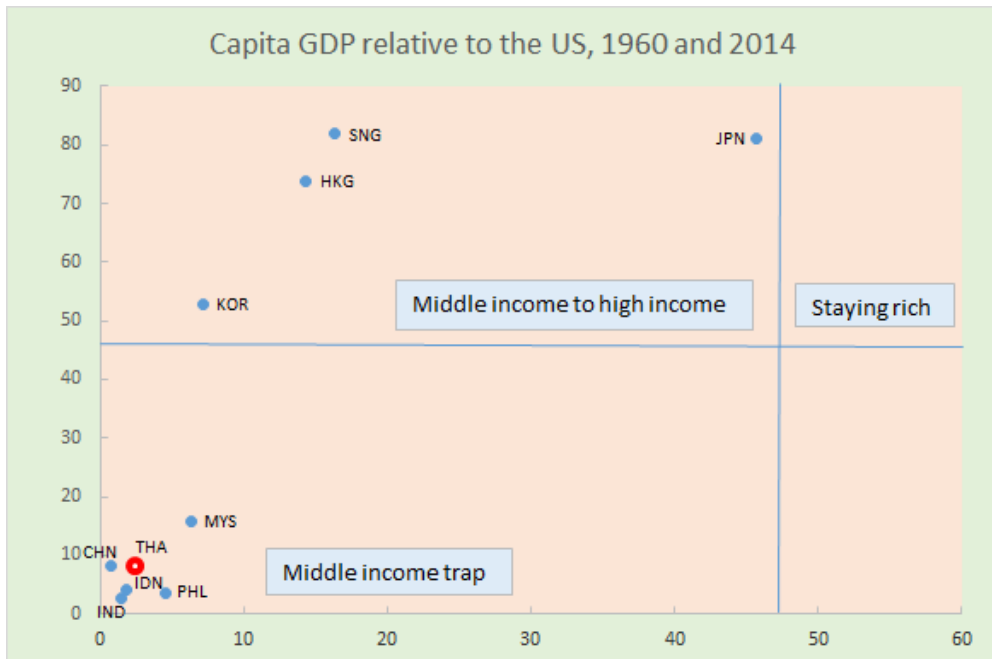
A country caught in the middle-income trap is one that has experienced initial economic growth and achieved middle income status but that has then lost momentum and eventually failed to attain high income or developed country status. A key reason for this condition is productivity deterioration, a process that demands economic strategies to reverse. Escaping the trap therefore requires embracing of a more complex economy, creating a larger tax base, lessening domestic vulnerability to international economic forces, and having higher general income and good public welfare.

This paper examines how long Thailand has been in the trap, the factors holding back the country from further development and, more importantly, the possible steps that the Thai government can take in order to escape the trap.

Various indicators show that Thailand is indeed caught in the middle-income trap. Figure 1 illustrates the GDP per capita of several countries including Thailand relative to the US, from 1960 to 2014. It is clear that Thailand places far lower than Japan, Singapore, Hong Kong and South Korea. Figure 2 depicts in absolute terms a wide disparity in income level, while Figure 3 shows that Thai investments have contracted heavily after the 1997 Asian Financial Crisis compared to rebounded economies such as Singapore and South Korea. Investments flowing into Thailand hit 36.5 per cent on average during 1980 to 1996 and declined to 24 per cent on average after 1997, without ever reaching 30 per cent again. The 1997 financial crisis was partially triggered by a bubble in the real estate sector. Investments in the sector made up on average 24 per cent of total investment during the period 1990-1997. Since the crisis, however, they have stayed at slightly less than 10 per cent.

Figure 4, based on a 2016 World Bank report, shows that the contrast between Thailand's income and human development index and that of other Asian countries was not great in 1980. However, by 2014, Thailand was trailing. Figure 5 demonstrates a similar disparity between Thailand and other Asian countries with regard to the health and education index from 1980 to 2014. Thailand also depended on low-cost labour to compete in labour-intensive industries, and this had consequently provided little incentive for innovation and productivity improvements.

Figure 1. Capita GDP relative to the US, 1960 to 2014

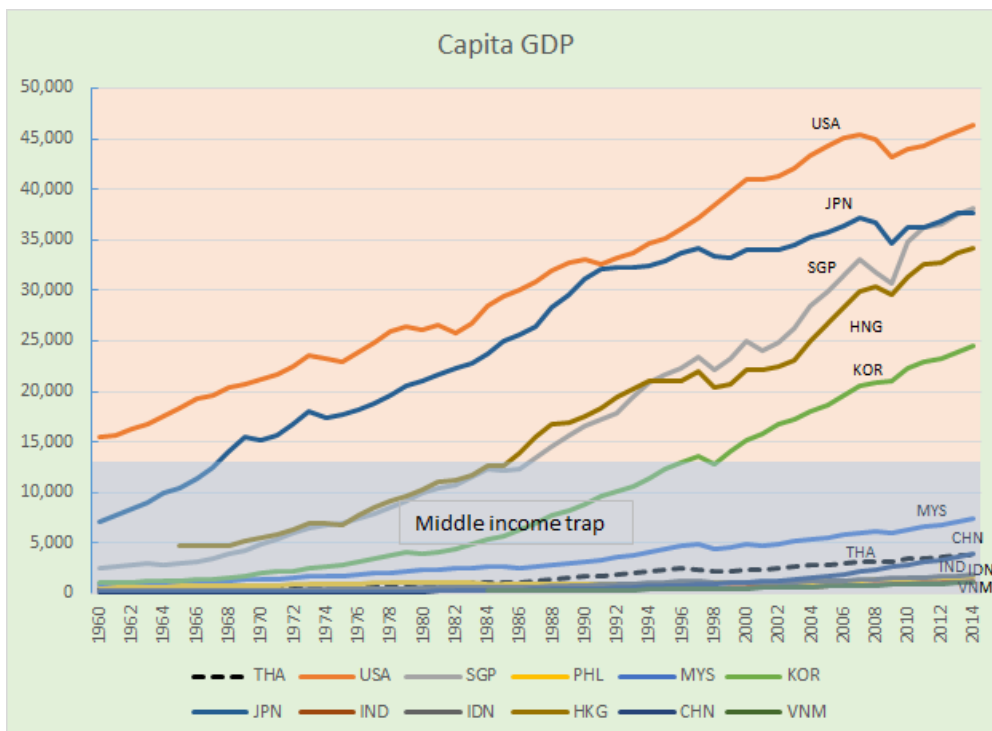


Source of data: World Bank 2016

Vertical axis: 2014 GDP per capita relative to US (%)

Horizontal axis: 1960 GDP per capita relative to US (%)

Figure 2. Capita Real GDP 1960 to 2014



Source of data: World Bank 2016

Vertical axis: real GDP per capita in US\$

Figure 3. Investment as percentage of GDP from 1960 to 2014

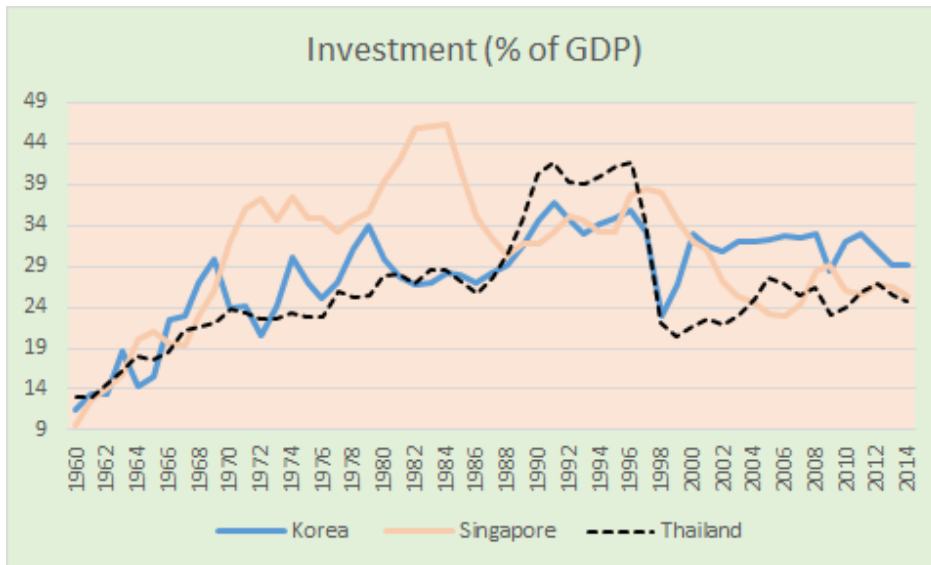
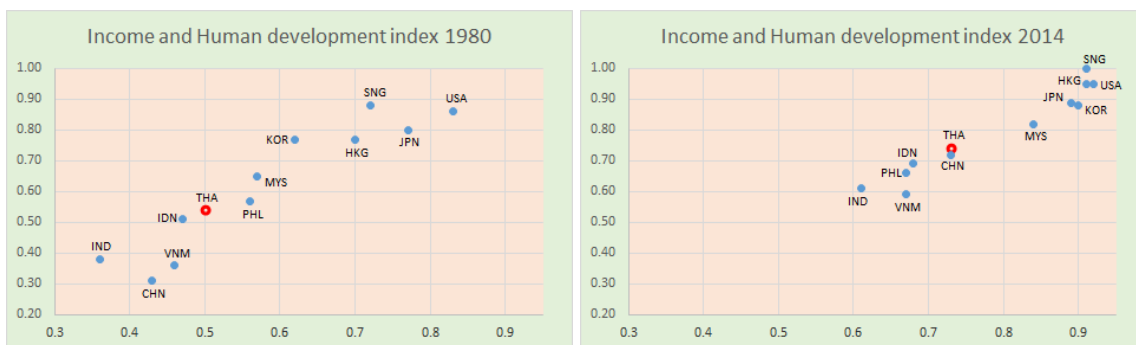


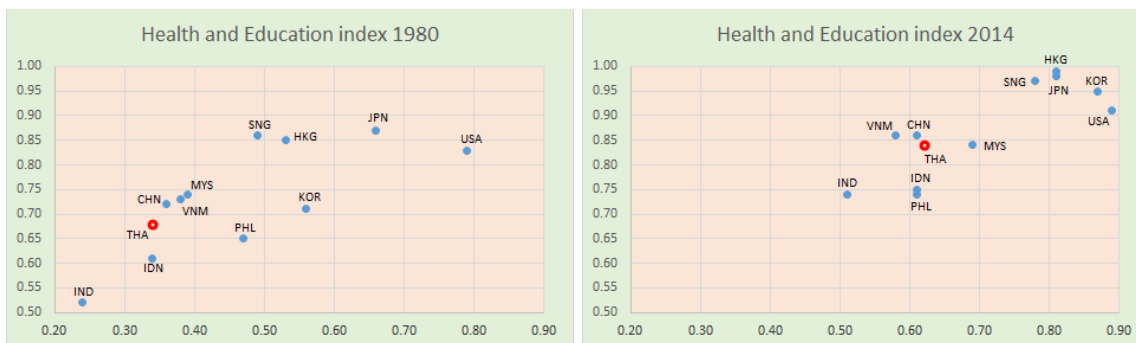
Figure 4. Dynamic Income and Human Development Index 1980 and 2014



Source: World Bank 2016

Vertical axis: Income index, Horizontal axis: Human development index

Figure 5. Dynamic Health and Education Index 1980 and 2014



Source: World Bank 2016

Vertical axis: Health index, Horizontal axis: Education index

WHAT IS HOLDING THAILAND BACK?

A variety of factors appear to be holding Thailand back from rising to the next level of economic development. The country's long dependence on natural resources and cheap labour means that growth is negatively impacted when resources diminish or when labour becomes more expensive. The country's lack of skilled labour, particularly in the information technology sector, means that it is unable to climb the value chain to produce and export more technologically advanced products like electronics and automobiles. Instead, the country merely assembles consumer products designed in other countries.¹ In addition, existing government training programmes are not used by the labour market, suggesting that these programmes are out of touch with economic realities.

Perhaps more fundamentally, the Thai education system has contributed to the lack of productivity because of its inability to deliver skilled labour to the market, particularly to the information technology sector. Meanwhile, R&D investment is substantially lower than in Asian countries. The number of researchers and technicians in Thailand is much lower than in South Korea and Singapore, for example.²

Public and private investments have also contracted markedly. Thai firms have demonstrated poor innovation, while foreign investments in the higher-value sector have been low. The consequences of these realities are seen in the decline in short-run income, which reduces capital accumulation and raises the possibility of excessive foreign debt in the long run. There are also few sound macroeconomic policies in place, as a series of coups have disrupted to government policies in recent years.

The country's macroeconomic policy, its fiscal policy in particular, has not encouraged long-term growth. Instead, populist policies enacted to stimulate short-term consumption have led to fiscal deficits.

FROM IMITATION TO INNOVATION

Countries such as Japan, Singapore, Taiwan, Hong Kong and South Korea have shown that innovation and high-value productivity are needed if one is to escape the middle-income trap. The Thai manufacturing sector, however, has failed to transfer foreign technology to local firms, nor has it encouraged local innovation. By importing practical technical knowledge, local firms could contribute to the local knowledge base.³ This would encourage imitation and innovation, which play an important role in promoting technological progress.⁴

One sector with space for innovation and productivity is the automotive industry. In recent years, there has been a shift from gasoline-powered cars towards electric-powered cars. This

¹ Subhanij, Tientup, 2012, "Thailand stuck in the middle-income trap indefinitely." *Bangkok Post*, June 29

² Jitsuchon, Somchai, 2012, "Thailand in a Middle Income Trap." *TDRI Quarterly Review*

³ Glass, 1999, "Imitation As a Stepping Stone to Innovation." *OSU Working Paper No.99-11*.

⁴ Kocenda, Menezes and Uzgalieva, 2010, "Technological Imitation and Innovation in New European Union Markets." *CESIFO Working Paper No. 3039*.

year, the Electricity Generating Authority of Thailand (EGAT), together with the National Science and Technology Development Agency (NATDA), produced an electric vehicle (EV) prototype by replacing the car engine from a car with a motor and a battery.⁵ The government also approved the establishment of electric-car charging stations across the country over the next three years. However, the main components and parts for the control motor unit or ECU, the battery control unit, and the circuit control panel are imported from China. The cost of building and owning electric cars would be significantly lower if these components were produced locally.

This simple case shows that the Thai economy continues preferring assembling to imitating technology. Thai firms have been manufacturing products designed by other countries for more than two decades as Original Equipment Manufacturers (OEM) and should now endeavour to become Original Design Manufacturers (ODM). The Thai government needs to collaborate with leading local universities or the private sector to imitate, for example, the technology needed for these electric vehicle control devices. It could do this by funding Thai players and seeking technical assistance by hiring Chinese researchers, technicians and scientists. After gaining an understanding of how the electric vehicle control units work, the government could proceed to invest in R&D to spur innovation in that field. More importantly, the Thai government needs also to enact policies or initiate training programmes to ensure that technology is transferred to local firms. Additionally, the government should provide incentives such as tax benefits for firms to invest in R&D.

Human capital accumulation is also important for escaping the middle-income trap. One possible solution is to employ larger numbers of foreign scientists and researchers for technical assistance and R&D. Local researchers and students would then be able to learn from them. This can be encouraged in leading universities or in the private sector. The Thai government should also make it mandatory for universities to update their curricula regularly.

CONSEQUENCES OF CORRUPTION

Finally, we have the issue of endemic corruption. A study conducted by Transparency International in 2015 found Thailand a highly corrupted country. The National Anti-Corruption Commission recently discovered former permanent secretaries and politicians to be unusually wealthy, and the courts subsequently ordered the seizure of massive assets. Although Thailand has the necessary legal framework to combat corruption, it has not managed to resolve the issue. Corruption in Thailand is difficult to control for many reasons. The wage level of civil servants is crucial in determining the level of corruption. Low wages make corrupt behaviour much more likely. Furthermore, the presence of time-consuming bureaucratic procedures and the red tape involved for various procedures provide good opportunities for illegal solutions, as do complicated government procurement procedures.

⁵ While EGAT and NATDA provide technological and technical advice to local firms, the information they provide is often outdated.

THE NEED FOR POLITICAL STABILITY

Another role of government is crucial in lifting a country from the middle-income level. Inspiring Thai people to see the vision of the successes to come and making them feel invested in the accomplishment is vital. The Thai government could persuade its citizens to believe in and particularly to consume local products in support of its import substitution strategies.

Furthermore, political stability is immensely important for Thailand. It would help ensure the formulation and implementation of effective government economic strategies. Political stability and economic development are obviously related to each other. While economic slowdown could result in political turmoil and instability, an unstable political climate could lower investment and hinder economic growth. Thailand has so far confronted uncertainties associated with the unstable political environment. In recent years, political instability in Thailand has been exacerbated by power-sharing amongst several political parties and by military coups. Ministerial cabinets formed by coalitions of several political parties have led to a significantly low level of stability. From time to time, the Thai Prime Minister has had no choice but to dissolve the parliament due to quarrels among political parties. The recurrence of a military coups reflects a very high degree of political instability.

While political stability should stimulate private investment and attract the foreign direct investment to Thailand, in terms of promoting innovation, it should moreover enhance mechanisms or policies in creating imitation and spurring innovation.

CONCLUSION

Several indicators suggest that Thailand is caught in the middle-income trap. They include low levels of GDP per capita, investment and human development. Thailand remains caught in the trap for several reasons. The Thai economy has long faced a lack of skilled labor, particularly in the IT sector. Thai firms continue to exhibit little innovation and instead merely assemble products that are researched and designed in other countries. The national education system has also not been able to deliver skilled labour to the market while investment in R&D remains low.

To escape the middle-income trap, the primary mission of the Thai government should be to increase the innovative capacity of Thailand. This national agenda should aim to stimulate economic growth and create high-paying, sustainable jobs.

The Thai government should advocate replacing foreign imports with domestic production. Alternatively, the Thai government may have to reconsider import substitution although this is in itself controversial.⁶ The Thai Government should also increase investment in both

⁶ Thailand has deployed import substitution strategies since 1960 but they have, so far, failed to encourage innovation for the Thai economy. See also Udomkerdmongkol Manop, Chuenchoksan Sra and Varasangasil Natthikarn, 2010, "Investment in Thailand: How to Unleash the New Investment Cycle." Monetary Policy Group, *Bank of Thailand*.

basic and advanced infrastructures, and in human capital, and ensure a business-friendly environment for private investments.

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