

Strategic Insight

Thaksinomics: A New Asian Paradigm?

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We must accept that the global economic landscape in the new millennium is much different than in preceding decades.

- Thaksin Shinawatra, Prime Minister of Thailand

Introduction

Prior to the Asian Economic Crisis sparked by the collapse of the Thai baht in 1997, Southeast Asia looked like a sure bet for a long period of high sustained economic growth. Its membership in the elite group of industrialized countries seemed assured. The crisis came as a complete surprise to many area experts, and brought an end to the era of the "Asian Miracle." While growth rates are gradually edging upwards, the region has not been able to restore the pre-crisis mechanisms that propelled many of its countries out of poverty and into near affluence.

As a region, Southeast Asia's economies are the most open to international trade. While such openness spurred their growth for several decades, in the post 1997 period it has left them increasingly vulnerable to adverse economic and political shocks. The region suffered a tremendous blow to its technology exports when the 2001-02 recession spread to the region following the collapse in America's information technology investment. Increasing competition with China for foreign investment and export markets is also making it harder for Southeast Asian economies to sustain growth rates approaching those attained in the pre-1997 period.

Greatly compounding the region's economic woes was the powerful Bali terrorist attack and its impact on tourism. U.S. and other Western intelligence sources have confirmed the presence of powerful terrorist networks throughout the region—Indonesia, Malaysia, Singapore, Thailand and Philippines. The openness of these economies makes them especially vulnerable to terrorist acts.

Despite these challenges, the Thai economy began accelerating from a growth rate of 1.9 percent in 2001 (the year Dr. Thaksin was elected Prime Minister) to 5.3 percent in 2002, to a projected 6.5 percent in 2003, with forecasts of even higher rates in the next several years.^[1] Compared with the Thailand that went hat in hand to the IMF in 1997, Thailand today is a nation transformed: in addition to its impressive growth, its foreign debt has dropped by two-thirds, and the stock market soared 69 percent during the first three-quarters of 2003.^[2]

Thailand has built on its recent economic successes to quickly become one of the United States' most valued allies in Asia. The country has cooperated closely with the United States in regional counterterrorism operations and, unlike many nations, has actually made good on its on pledges to send

troops to Iraq as well as Afghanistan.^[3] The payoff is sure to be substantial, as evidenced by the United States' recent designation of Thailand as a major non-NATO ally^[4], and the beginning of negotiations for a free trade agreement between the two countries.^[5]

Finally, the country's recent economic success has in the eyes of many observers^[6] elevated its Prime Minister Thaksin Shinawatra to the status of likely successor to fill the void left as Malaysian Prime Minister Mahathir Mohamad steps down as head of APEC (Asia-Pacific Economic Cooperation).^[7] Clearly, under Thaksin Thailand is becoming one of the pivotal states in Southeast Asia.^[8]

What is especially interesting about Thailand is the unique set of economic policies implemented during this period of accelerated growth. Often dubbed "Thaksinomics," these policies represent a distinct break from the past. To Thaksin's followers the new economic measures are not only capable of returning Thailand to the pre-1997 glory days of high growth, but perhaps even more importantly, enabling the country to successfully coexist economically with China, while, at the same time, making Thailand a less fertile ground for terrorism.

This essay examines the phenomenon of Thaksinomics. What does it replace? What are its main assumptions? The key policies and programs implemented to date? The likelihood of its success? Implications for the United States?

Origins of Thaksinomics

To its defenders^[9] Thaksinomics is a pragmatic response^[10] to the void created by the demise of two key paradigms that formed the basis of much of the pre-1997 economic policy making in East Asia—the Washington Consensus, to a certain extent a set of policies imposed from outside the region; and the East Asia Economic Model (EAEM). A somewhat related factor, the observed decline in productivity in the 1990s, no doubt also played a significant role in the development of Thaksinomics.

Demise of The Washington Consensus

Before the Asia crisis in 1997, most technocrats and businessmen in Thailand believed that the country's economy should be relatively open. This openness provides access to technology and capital. Technocrats have long believed that increasing openness is needed to force Thai companies to become more efficient and to break down old monopolies. Hence liberalization and privatization had been staples of economic policy since the mid-1980s.^[11]

The 1997 Asian crisis brought this view into question, along with a number of related conventional wisdoms of the time, the most notable being the so-called Washington Consensus, an agreement of outlook among the multilateral agencies in Washington—the World Bank and the International Monetary Fund (IMF)—on a set of free market policies that formed the basis for the conditions under which those agencies lent to developing countries.

Under the Consensus, countries were encouraged to promote liberalization by reducing barriers against imports with a view to eventually achieving free trade. Privatization of state owned enterprises and financial deregulation were also key elements in Washington Consensus policies. In short, governments were expected to withdraw from economic activity and intervene as little as possible. Free market prices were seen as the most important factor in promoting successful development.

In the 1990s these policies began to be questioned, not only by academic writers but also by the World Bank itself. The double-digit annual Gross Domestic Product (GDP) growth in China since the start of its economic reform program in 1978 has not been achieved by universal free markets, free trade or widespread privatizations. The Chinese experience suggested that the state can promote development by intervention in the economy. Looking back on the Asian Crisis it is also apparent that its cause was not the result of too much government intervention, but of too little—a failure to regulate financial markets.

Pasuk and Baker's[12] analysis of the 1997 Thai crisis goes even further, arguing that the transformation of Thai institutional structures to conform to the mandates of the Washington Consensus on limited state economic intervention are precisely what caused the crisis.

Increasingly, throughout Asia a post-Washington Consensus outlook is emerging which stresses that markets can fail—especially financial markets and markets for technology— and that governments should intervene to promote domestic competition, regulate financial transactions, promote education and stimulate the inward transfer of technology.[13] This particular view of government intervention has become one of the key elements of Thaksinomics.

Limitations of the East Asia Economic Model (EAEM)

As its name suggests, the EAEM is a development strategy somewhat unique to Asia. The strategy is built around two key features: (a) high investment rates stemming mainly from foreign direct investment (FDI), and (b) an outward orientation emphasizing labor intensive manufactured exports. Multinational corporations often play a dominant role in both aspects—supplying FDI and mass producing goods for the export market. In practice, it is the development model followed by the majority of Asia/Pacific countries, including Thailand, since the late 1970s and early 1980s.

Imbalances created over time by the implementation of the EAEM have undermined its effectiveness in generating high and sustained rates of growth. For example, Lian[14] notes that the common pattern is for the Asia/Pacific region's terms of trade to worsen nearly every time global demand for electronics, agricultural products or primary commodities declines sharply.

[The] Asia/Pacific region's pursuit of the EAEM directly contributes to global imbalances and negatively affects the performance of Asian companies as well as the standard of living of the region's workers and households. The logic is simple, in our view: excess saving exacerbates the global savings imbalance that in turn necessitates imbalances in trade; in turn the nature of trade and production subjects the region to a vicious cycle of price wars and worsening terms of trade.[15]

Breaking this vicious cycle of price wars is another key component of Thaksinomics. Here it should also be noted that even in the hey-day of the EAEM, Thailand's openness[16] relative to other countries, while high, began declining in the early 1990s (Figure 1), suggesting that the EAEM model was encountering diminishing returns in terms of integrating the country into the world economy.

It is also not clear that the EAEM model was enabling Thailand to utilize its resources in the most efficient manner. In his analysis, Porter[17] found a strong relationship between his Microeconomic Competitiveness Index (MCI) and per capita income, with over 81 percent of the differences in country per capita incomes accounted for by the index. However, Thailand's per capita income is considerably lower than one would anticipate, given the country's MCI. In this sense the Thai economy was clearly underperforming in the early 2000 period. Korea, Malaysia, China and Indonesia also fell in the under performer group, while, given their MCI scores, Singapore and Taiwan's per capita incomes were in line with what one might expect. Hong Kong was the only country in the region classified as an over-achiever—incapable of sustaining its per capita income with no improvement in its microeconomic fundamentals.

Adverse Trends in Total Factor Productivity

In part, the increasing limitations on growth imposed by the EAEM manifest themselves in the observed trends in the country's total factor productivity (TFP). TFP measures the efficiency of a given set of input factors, capital and labor in generating output. Alternatively it can be thought of as the level of technological development in the economy—a given amount of factor input will generate more or less output depending on the country's technological capacity. TFP is a critical variable for sustaining long-term growth because unlike increments of capital and labor it is not subject to diminishing returns.

In its assessment of the trends of TFP in Thailand, the IMF [18] found that the high rates of growth in the pre-1997 period were driven by capital accumulation, rather than TFP growth. Even more significantly, IMF estimates show that TFP growth slowed during the 1990s. This finding is similar to that of other researchers (Table 1).

These patterns no doubt account for the fact that in terms of the overall competitiveness of its products, Thailand lags behind several of its East Asian competitors: Singapore, Hong Kong, Taiwan, Korea and Malaysia, with China quickly closing the gap (Table 2). It should be noted that Thailand did improve its competitiveness during the first two years (2001-02) of the Thaksin administration.

Given likely demographic and investment patterns in the country, the IMF concluded that medium-term economic growth in Thailand will have to be driven by TFP growth rather than accumulation of capital and labor. This shift in the country's growth mechanism represents a sharp contrast with the pre-1997 growth pattern driven largely by capital accumulation.

The need for TFP-led output growth underscores the importance of maintaining an environment that is conducive to efficiency gains and technological development. It is in this light that Thaksinomics will be examined below—is this new approach to development in Thailand likely to succeed in creating the necessary conditions for expanded productivity and growth?

The Core Elements of Thaksinomics

Like Reaganomics in the 1980s, Thaksinomics is controversial. It is an eclectic strategy that combines the traditional element of the EAEM model, emphasizing mass manufacturing spearheaded by foreign direct investment—dubbed the First Track—and a more domestic focus on local enterprises leveraging indigenous skills and resources, known as the Second Track. A distinctive feature of Thaksinomics is the emphasis given the Second Track.

As in the past, the First Track is oriented towards creating relatively high paying jobs and earning foreign exchange. The Second Track on the other hand focuses on activities that will not come into direct competition with China. A major goal of Thaksinomics is to pursue both goals in a manner that gradually shifts the Thai economy from export dependence to greater reliance on the more controllable domestic market. Thaksin envisions this process increasing domestic consumption to 60% of Gross Domestic Product (GDP) from the current level of 55%. Simultaneously the goal is to reduce exports as a proportion of GDP from 60% to 50%.

The rationale for the two track strategy is straightforward: most developed countries have a smaller proportion of exports to GDP than do the East Asian economies. Therefore, they are less vulnerable to external shocks like the terrorism incident in Bali, the SARS epidemic, or a slowdown of the U.S. economy.

The idea is to stimulate domestic demand in the short run through increased government expenditures, while simultaneously searching for new local industries to develop as part of the diversification away from EAEM activities. At the same time, domestic market focused policies can achieve structural change by assisting business in moving up the value added chain, thus keeping ahead of direct Chinese competition.

While it might appear that Thaksinomics represents a retreat from globalization, this is not the case. Although the policies are more domestically focused, they are not meant to discriminate against foreign capital. In fact Thailand is still aggressively attempting to attract foreign direct investment (FDI).

Implementation—First Stage

Implementation of Thaksinomics has evolved through various stages. One of the key elements in Thaksinomics is the focus on poverty alleviation, especially in rural areas. Initial policies were geared

toward providing small fiscal doses aimed at reviving rural demand and creating housing demand for low-wage government workers, rejuvenating underdeveloped resources and indigenous skill-rich small and medium sized enterprises (SMEs) with good growth potential. Another key element was assisting under-leveraged households to achieve higher levels of consumption. Implementation has occurred through a variety of unique projects. The most urgent policies that the Thaksin government initially implemented were those aimed at empowering the grassroots.

Farm Assistance

The first programs were focused on the agricultural sector, starting with a three-year moratorium on farmers' debt payments to the Bank for Agriculture and Agricultural Cooperatives (BBAC). This was the initial step in reforming the debt structure and maturity profile of the agricultural sector to match the crop production cycle. At the same time, the government is attempting to upgrade land rights to be used as bank collateral.

Urban Relief

The urban poor also benefit from incentives brought about by the government. Small loans for street-side vendors are provided through the Government Savings Bank (GSB). The GSB provided individuals loans worth 30,000 baht each for a total of 10 billion baht in 2002.

Retired Civil Servants

A special spending package was also set up for retired civil servants. Under this program the government will pay an amount equivalent to 30 times salary to the families of civil servants who pass away. A new ruling permits retired civil servants to spend half of that amount before their death. It is estimated that the total amount of spending power created from this initiative would be roughly 45 billion baht.

To boost grassroots access to financing, the Thaksin administration set up a number of new institutions:

The Village Fund

The first was the Village and Urban Revolving Fund. To many, Dr. Thaksin's election campaign pledge to provide 1 million baht (\$24,000) to each of Thailand's 70,000 villages was a populist handout. It's actually a revolving loan program. The program is unique in that it specifically targets projects aimed at stimulating the rural economy. Village leaders and bankers will identify projects and provide loans at 4% interest (commercial farm loans cost 5%-8%) to be guaranteed by community groups. The intent of the \$1.6 billion Fund is to enable farmers to increase productivity, and value added, through developing new activities such as processing and packaging. The Fund can also be drawn on by individuals, households or groups to start their own small or micro-enterprises.

The People's Bank

This newly created bank is another grassroots credit facility set up to provide credit to micro-enterprises. In addition to providing financing to groups without access to the formal banking system, the goal of the Bank is also to promote entrepreneurship among the poor and the small traditional producers in villages.

The Bank for Small- and Medium-Sized Enterprises (SMEs)

SMEs play a critical role in Thaksinomics and the Bank for Small-and Medium Sized Enterprises is the financial component of the Government's overall SME promotion program. SMEs account for 40-50 percent of the Thai economy's GDP, 38 percent of the total value of exports and 69 percent of the country's jobs. Thaksinomics singles out SMEs because of their potential to adjust to fast changing

conditions, to reach certain market niches more rapidly than bigger companies and to innovate in terms of products and process.

One Tambon Project

This program is nationwide, covering nearly all of Thailand's 7,252 districts. One Tambon is predicated on the idea that every Thai tambon (sub-district) has a variety of specialized local products. The key assumption of the project is that each community has a comparative advantage in one or more of these traditional products. The project's role is to assist the communities in modernizing the production and distribution process of these products so that they can be competitive at the national and international levels. The government's role is to identify candidate products and then to assist their development through providing necessary support for their eventual success.

The program is clearly intended to find new niches in foreign markets and develop new winners that will provide an alternative to the foreign direct investment-based and mass produced exports products that the country has been fast losing to China and other countries in the region with cheaper labor.

Other programs introduced during this period include:

- Housing projects for state workers and the low income masses introduced in 2001 and 2002, respectively;
- Various small and medium sized enterprise (SME) development initiatives introduced since 2001; and
- The comprehensive State-Enterprise Privatization Program started in 2001.

Clearly, it is a bit early to critically evaluate these initial attempts. However it is safe to say that these programs, along with some of the government's other fiscal activities have contributed to terminating asset deflation, reviving domestic demand and bringing about positive asset demand and asset price expectations.[\[19\]](#)

In addition there are some encouraging results stemming from the One Tambon project. Government figures put total sales of village enterprises under the program at \$558 million in 2002, with an average profit margin of 26 percent. Their products are also finding their way to the shelves of luxury shops in Japan, the United States and Europe, thus enabling the village producers to earn four or five times more on each item than when sold in the local market.

Implementation—Second Stage

The second stage of Thaksinomics is intended to build on the first. In large part this is a more innovative albeit controversial stage.

The Capital Creation Scheme

Tentatively scheduled to start in December 2003, the Thai government plans on introducing a new program to redefine or reclassify assets so that they carry the underlying legal rights or documentation necessary for collateralized bank loans. The program has an ambitious agenda including the reclassification of land assets, intellectual-property assets, machinery assets, public pavement and stalls assets and rental-right assets. The basic idea is to legalize different assets so that the owners can use them fully to get access to capital. This should be a particular benefit to poor or low income earners.

The basic idea underlying this program is not new, but instead one that has been advocated for years by Peruvian economist Hernando de Soto.[\[20\]](#) What de Soto has found is that most people in the developing nations hold defective forms of assets such as properties and stalls that lack the documentation or legal

status that give them access to capital. Because the right to these possessions is not adequately documented, these assets cannot readily be turned into capital, cannot be traded outside the narrow local circles where people know and trust each other, and cannot be used for collateral for a loan. Apparently, the government aims to have the state-owned banks make available some 200 billion baht to support the next wave of loans arising from this asset-reclassification scheme.[\[21\]](#)

The question is whether this program will further help low income people or saddle them with more debt; and whether the program will have adverse financial consequences to the country in the long term. Will it jump start a large segment of the economy, formerly marginalized, or will it simply create a new round of non performing loans? If de Soto's examples from Peru and other countries are any indication, the project should be highly successful.

By one estimate[\[22\]](#) the Capital Creation Scheme in the next 6-7 years could convert at least US\$10 billion of dead capital into pledgeable capital and transfer US\$10-15 billion worth of underground economy activities into the real economy.

Grand Project Schemes

In a break from grassroots-type projects and programs, the Thai government has been proposing a number of grand projects designed to create new regional centers of economic activity:[\[23\]](#)

- In January 2003 for example Thaksin announced a 28 billion baht (\$650 million) plan to make the northern city of Chaing Mai an international aviation hub. The initiative aims to upgrade airport facilities and capacity to promote Chiang Mai as an alternative site to Bangkok for foreign trade and investment.
- Also in January 2003 Thaksin unveiled a 100 billion baht plan to transform the resort island of Pyhuket into a laboratory for high-tech research and development. The software industry is one of several export businesses the authorities hope will be centered here.
- In another major initiative, the government has recently resurrected centuries-old plans for cutting a canal through Thailand to shorten shipping routes between Europe and East Asia. The proposed project, including construction of two harbors, a monorail and a highway across the Isthmus of Kra would cost around \$35 billion.

While EAEM model cannot serve as the sole basis for future growth, it's not clear that massive expenditures of this nature will necessarily come up with new services in which the country has a clear comparative advantage.

The Vayupak Mutual Fund Initiative

While the Capital Creation Scheme is aimed chiefly at reviving dead capital in the rural sector, a complementary new initiative, the Vayupak (named after a mythical bird that sometimes lays a golden egg—but other legends depict the avian creature as half-demon[\[24\]](#)) introduced late in 2003 is focused on monetizing the dead capital held by the government. Estimates are that this initiative[\[25\]](#) has the potential to mobilize an additional several billion \$US worth of excess liquidity from the banking system. In all, it could add US\$7-8 billion or an additional 10% of the market capitalization of Thailand.

Assessment

Dr. Thaksin Shinawatra was elected Prime Minister of Thailand through one of the biggest electoral victories in Thai history. His dramatic victory can be largely attributed to his vision for the Thai people. He was able to articulate a coherent economic program that was a distinct break from the malaise that had set in after the 1997 crisis. His innovative approach focused on empowering the grassroots population, giving them command over resources and enabling them to become active participants in the overall development of the country.

As implemented, however, his program is difficult to characterize—and in this sense it is much easier to say what it isn't: it is definitely not pure populism as many have labeled it. Certainly it is not the populism practiced by Alan Garcia[26] in Peru in the 1980s. Nor does it resemble many of the quasi-populist heterodox—incomes policy alternative IMF programs introduced in Latin America.[27] It is non-confrontational, so it does not fall into the non-market solution programs often advocated by the South in the North-South New International Economic Order (NIEO).[28]

On the theoretical level, Thaksin's program combines elements of demand management (Keynesianism), supply side incentives[29] (Reaganomics), entrepreneurial development (Schumpeterism[30]), grassroots empowerment (de Sotoism) and the structuralist—non-price system reorienting—state led growth of Albert Hirschman.[31] It embraces globalization and comparative advantage, while at the same time attempting to shape the country's comparative advantage through non-price incentives.

Because of these varied themes the program can only be dubbed Thaksinomics—a unique and complex approach to the challenges posed by globalization in general and the rise of China in particular.

While it is premature to gauge the eventual success or failure of Thaksinomics, the program does appear off to a good start. The next several years are critical for the program's implementation and the following considerations will weigh heavily in determining the ultimate success or failure of Thaksinomics:

1. *Diagnosis of economic situation.* Thaksinomics directly addresses the limitations of the EAEM and the Washington Consensus. It also is oriented toward solutions to the two key challenges facing the Thai economy: the rise of Chinese exports and investment competition, and the slowdown of the economy's productivity in the 1990s. To date, it appears to be the correct diagnosis of the economic problems facing the country. The major problems encountered will be likely caused by implementation difficulties rather than conceptual limitations.
2. *Medium-term performance.* The recent surge in growth may simply be more utilization of capacity stemming from a Keynesian fiscal stimulus. The true test will come when the economy reaches full capacity. Will the country be able to achieve a high sustainable growth rate generated on the supply side through total factor productivity increases? Given China's closing of the competitiveness gap (Table 2) progress in this area will be the major telling factor in the ultimate success or failure of Thaksinomics.
3. *Over-correction on consumption.* Managed asset deflation through consumption stimulation was the correct policy response (2001-2003) to the lingering fall-out of the 1997 crisis. However, as the economy moves into the medium-term (2004-08), the government must be careful that a movement toward consumption and away from the EAEM investment led model does not reduce investment to the point that productivity gains are jeopardized.[32]
4. *Macroeconomic management in the medium-term.* In this regard, the proper balancing of aggregate consumption-led demand and investment-led supply into the medium-term may prove to be the most challenging task facing Thaksin's management team.
5. *Industrial policy,* as applied in the One Tambon Project, has not been carried out very successfully, even in countries like Japan. In other countries, the main difficulties have involved objectivity, with choices more often than not made on political rather than economic grounds. The One Tambon Project is vulnerable to the same difficulties, including corruption/cronyism. In addition to an objective project selection process, the key here will be the extent to which market prices are allowed to define comparative advantage at the village level. If this occurs then the system should be able to develop a number of new and unique exports.
6. *Dualism.* The dual path program must be focused on integrating the economy; otherwise it may only compound the existing problems of dualism (the coexistence of a modern/foreign multinational and a more traditional economy). Here again a common set of market prices must be present in both tracks.
7. *The underground economy.* The government's recent attempts[33] to integrate much of the booming underground economy into the formal market economy suggests it is willing to tackle dualism, while at the same time expanding the government's revenue base.

8. *Financial soundness.* Thaksinomics is being applied on a rather fragile foundation. As the IMF notes: "prospects for sustained high growth depend on action to address remaining structural weaknesses, especially in the corporate and banking sectors. While enterprises made some advances in de-leveraging, their balance sheets remain fragile. Lending activity has gained some steam, but mostly at state-owned institutions and resolution of nonperforming loans at private banks continues to be slow." [\[34\]](#)
9. *Fiscal capacity.* While tempting, the government must not get carried away with many of the grand infrastructure projects under consideration. These appear to be of somewhat questionable value and would severely strain an already fragile financial system. There is also the danger that because more and more fiscal items are "off-budget" the real deficit is already considerably larger than reported.
10. *Bubble economy.* The recent stock-market boom must not be allowed to turn into another bubble. The government must constrain speculative flows while maintaining its overall objective of managed asset reflation. It is encouraging to note that unlike the run-up to the 1997 bubble, the Thai authorities appear willing to closely monitor [\[35\]](#) and to respond quickly to quell speculation in the consumer economy and segments of the stock and property markets. [\[36\]](#)

Conclusion

Thaksinomics is off to a very promising start in reorienting the Thai economy to the new challenges brought on by the rise of China and diminishing returns associated with the pre-1997 EAEM model of growth. The system is still evolving to meet new economic challenges, a sign of its pragmatic problem-solving orientation.

On broader issues like the war on terrorism, Thaksinomics appears well suited to increasing participation of broad segments of the population. Unlike most economic systems in the Middle East, Thaksinomics attempts to empower people. If large scale alienation, economic exclusions and disenchantment are associated with terrorism, then Thaksinomics, with its grassroots orientation, may well pay great dividends in this area. The United States in particular and the West in general has a high stake in the success of Thaksinomics. Certainly many countries like the Philippines, Malaysia, and Indonesia currently experiencing increasing terrorist activity will be carefully watching the Thai experiment.

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