

THAILAND'S POSITIONING IN A NEW GLOBAL ECONOMY: THE DIAMOND FIVE PARADIGM

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INTRODUCTION

That a slowdown in exports due to slackening external demand would be met with a boost in domestic demand through government policy measures (and conversely that domestic demand is held back when exports pick up) so as to maintain stable economic growth constitutes the essence of the “dual track policy” of Dr. Thaksin Shinawatra, Prime Minister of Thailand. This specific policy approach, together with the Prime Minister’s initiative, the Asia Cooperation Dialogue (ACD), has made a significant contribution to the most recent major paradigm shift in the understanding of how the international economy operates today and in the immediate years to come. The explicit policy focus on the duality of the export and domestic sectors to bring about economic growth with stability adds a new dimension to the nature of the international economy which has until recently been explained under outdated paradigms. In the new model, stable economic growth is brought about through the active and supportive role of the public sector in a multicountry context and that is not necessarily dependent on the traditional economic powers of the world.

HISTORICAL DEVELOPMENT OF THE MACROECONOMIC POLICY PARADIGM SHIFT

Some 70 years or so prior to this latest policy paradigm shift, the Great Depression of the 1930s led to widespread private debt and excess industrial capacity in England. To wait for supply to

create its own demand in the long run (as Say's Law would have it) was untenable. John Maynard Keynes (in his *General Theory of Employment, Interest and Money*) proposed a new and alternative framework for macroeconomic policy analysis in the context of a closed, single economy. He introduced the active role of the government and the multiplier concept in creating the necessary demand to lift an economy out of a depression. After World War II, Sir John Hicks, Paul A. Samuelson, James E. Meade and Bertil G. Ohlin subsequently popularized Lord Keynes' approach by introducing international trade among open economies and we have what is known today as modern macroeconomics. More importantly, the theory was proven successful when put into practice. The New Deal, under which came the advent of the Tennessee Valley Authority with the aim to create employment and income, was a prime and well-known example of policy application of Keynesian economics by President Franklin D. Roosevelt of the United States of America.

Around a quarter of a century ago, a newer concept emerged, whereby a multicountry perspective and international trade were added to enhance our understanding of how the world economy functioned. The three major blocs of the world's foremost economic powers—namely, the United States, Western Europe and Japan—were regarded as the sole engines of growth for the entire world. Whatever happened to this Group of Three, otherwise known as the G-3, would impact the dependent, developing world. It was believed that East Asia and the rest of the developing world could not possibly experience economic growth without the required external demand from and thus necessary growth in the G-3 economies. Hence there emerged the “locomotive wagon” policy paradigm of international macroeconomics, which is still widely held today (Figure 1).

A NEW MACROECONOMIC POLICY PARADIGM IS BORN IN ASIA

The belief that the G-3 economies together was the only source and determinant of world prosperity is, however, being refuted as new quantitative evidence coming out of Asia is beginning to undermine the validity of the model. In this light, the G-3 locomotive wagon paradigm will need to be modified. A major catalyst that has been driving the changes leading to the latest paradigm shift in the way the world economy works is undeniably the miraculous progress made by the Chinese economy in the last 15 years. Increasingly, the People's Republic of China has been making its presence felt on the world scene. Its impact on world trade, in particular, will be even stronger with its accession to the World Trade Organization (WTO). While India's foreign sector is still not all that large given the size of its economy and population, it is inevitable that the economic role and influence of India will be another important force to be considered and analyzed, at least in the Asian context.

In East Asia, China has resorted to domestic demand stimulation through investment and consumption spending in parallel with export promotion for at least a decade without articulating the policy approach as "dual track." The Republic of Korea has also been adhering to a similar policy since the 1997 Asian financial crisis. The same holds true with the policy strand that runs through Malaysia's New Economic Policy, before and after the 1997 crisis.

However, a country that pursues a dual track policy on its own will find that the impact is limited; that is, the impact would fall short of what could be expected from the cooperative action of several economies simultaneously applying similar domestic demand stimulus

packages. As it turns out, there are at least four countries that can be clearly identified as having followed a dual track policy, namely, China, Malaysia, South Korea and Thailand.

Dual track policy and Asia Cooperation Dialogue

The current Thai government has succeeded in articulating and popularizing what has been practiced by at least three other countries in East Asia. Reinforcement of this pattern of policy application can be expected to extend well beyond East Asia to include the member countries of the Thai government–initiated Asia Cooperation Dialogue (ACD), i.e., the Philippines, Indonesia and India. Both the ACD and the ASEAN+3 forums, which include Japan, China, and South Korea, have served as venues for not only policy dialogues among leaders of Asia but also platforms to coordinate action plans, such as, the ASEAN+3 currency swap arrangements, the Asian bond implementation steps and the bilateral free trade agreements.

Empirical facts supporting the new paradigm

Relative to East Asia, growth of the G-3 economies as well as their external trade (i.e., imports and exports) is currently not high. For the United States, the European Union and Japan, the latest data on real GDP growth ranges from 0.3–2.4 percent in 2002 (or a weighted average of 1.3 percent). Export growth (measured in US\$ value terms) ranged from -1.9 to 7.3 percent (or a weighted average of 3.0 percent, given the following weight shares: U.S. = 0.45, EU = 0.23 and JP = 0.32), and import growth, ranged from -3.0 to 4.0 percent (or a weighted average of 2.4 percent) (Table 1, Figures 2 and 3).

Meanwhile, the corresponding figures for the East Asia-9 countries (defined as the nine East Asian economies of China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand) are 1.8–7.9 percent for real GDP (or a weighted average of 5.8 percent), 2.4–18.5 percent for exports (or a weighted average of 8.6 percent), and 0.1–14.6 percent for imports (or a weighted average of 6.6 percent). Incidentally, the relative growth of real GDP and imports for East Asia are self-confirming, given the well-established, positive empirical relationship between real imports, real output and real income for practically all countries of the world (Table 2).

Of course, the theory relating to the traditional “locomotive wagon” paradigm cannot explain the fact that currently the economic growth rate of East Asia as a bloc significantly exceeds that of the G-3 bloc. What the empirical evidence above suggests, however, renders the observation totally unsurprising. With such high growth in intraregional trade, intra–East Asian trade shares have increased substantially during the last four years (1999–2002) following the 1997 Asian financial crisis, and this has been well documented by many economists and analysts. Intra–East Asian merchandise trade (in this case, including Japan) alone has come to account for no less than one-half of the region’s entire foreign merchandise trade worldwide, not to mention the impact of the recent interest in both intraregional investment and tourism cooperation.

The case of Thailand is illustrative of this widely observed, but not yet appreciated, phenomenon. The magnitude of Thailand’s foreign trade with East Asia excluding Japan has more than doubled that of its foreign trade with Japan. Its export shares to fellow ASEAN countries and four other Northeast Asian economies (namely China, South Korea, Taiwan and

Hong Kong) increased from 15.7 percent and 13.1 percent, respectively, in 1998 to 20.3 percent and 15.9 percent in 2002. The corresponding shares to the United States and the European Union declined from 23.0 and 18.4 percent in 1998 to 20.2 and 15.3 percent, respectively, while the export share to Japan rose slightly from 14.1 percent to 15.0 percent. Thailand's import shares from other countries of East Asia and from the G-3 countries changed even more dramatically as the interdependent nature of the intra-East Asian trade increased, ironically thanks partly to the 1997 financial crisis that resulted in marked declines in the currency values of most East Asian countries relative to the US\$, except China and Hong Kong. Studies of other East Asian countries' trade patterns have arrived at the same conclusion as in the case of Thailand.

MACROECONOMIC AND MICROECONOMIC REASONS FOR THE NEW PARADIGM

While imports into the G-3 economies have not gained much for East Asia lately, both exports and imports of the East Asian economies on the whole have managed to expand during the same time period. The trade expansion of the latter has evidently not been at the expense of one another. An important macroeconomic explanation for the phenomenon is obviously the success of the coordinated intraregional demand stimulation measures undertaken within the dual track policy framework in many East Asian countries. A microeconomic explanation can also be found in the nature of the production and exchange that has evolved within the region. A large share of the additional exports of East Asia is no longer destined to the G-3 markets in order to find necessary outlets. As industries in the region grow increasingly vertically integrated across countries, the domestic value added to be reaped in each of the regional economies that participate in a particular line of product manufacturing—such as, information and

communications technology (ICT) and electrical and automotive goods—is shared and dispersed more equitably. Thus, the value chain involved in such an activity increasingly completes much of its international production and consumption network well within the region itself, resulting in a natural enhancement and augmentation of intraregional trade. Under an environment of overall world slowdown, East Asia has managed to generate sufficient intraregional demand such that its rate of economic expansion actually outpaces that of the traditional locomotives by a clear and decisive margin. In other words, East Asia has developed the capability to sustain its own growth. A new “locomotive,” known as East Asia, thus may have arrived on the world scene.

MODELING THE PARADIGM SHIFT

In line with the above paradigm shift, enhanced by the concerted application of the dual track policy in the context of East Asian regional cooperation and coordination, the Fiscal Policy Research Institute (FPRI) of the Thai Ministry of Finance is developing a world macroeconomic model linking domestic economies through international trade flows of goods and services among five major blocs—i.e., the United States, the European Union, Japan, East Asia-9 (including Thailand) and the rest of the world (Figures 4 and 5). The model is to be used in conjunction with the institute’s own Thailand macroeconomic model. The forecasting and simulation exercises for the Thai economy as published in the *ThailandOutlook.com* Web site are based on the FPRI Thailand Country Model, which is in turn linked with the FPRI World Model. The new overall conceptual framework can be called the Diamond-5 policy paradigm to reflect the diamond-shaped structure of the new world economy that is made up of five equally important and interacting blocs, as opposed to the one-way “locomotive wagon” paradigm that is becoming outdated.