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Macroeconomic policies for full and productive employment: Case studies of Thailand and Viet Nam

John Weeks

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Preface

The current global policy discourse on macroeconomics and development has created space for much-needed re-thinking in macroeconomic policy in the wake of the Great Recession. The IMF, for example, has suggested the need to adopt a more flexible approach towards inflation targeting, to broaden the goals of central bankers and to build up fiscal space during buoyant economic times so that governments can fortify their capacity to cope with global economic volatility and market uncertainty. Such reflections seemed appropriate in light of the coordinated macroeconomic responses in developed and many developing countries that prevented a global recession from becoming a depression. On the other hand, the commitment to fiscal consolidation in many OECD countries to bring back public finances to prudent levels have re-ignited the long-standing debate on the (causal) relationship between macroeconomic policies, growth, employment and poverty reduction.

The weak global economic climate continues to put downward pressure on Asia-Pacific labour markets in terms of employment creation and the quality of jobs. As the ILO's World Employment and Social Outlook for 2015 shows, the number of vulnerably employed continues to increase in South-East Asia and the Pacific and South Asia. Although overall unemployment remains typically low in most Asia-Pacific economies, young people continue to face considerable disadvantages in terms of securing decent employment.

This study reviews the available evidence and uses available statistics to assess the extent to which macroeconomic management has helped or hindered the goal of attaining full and productive employment, with case studies on Vietnam and Thailand. On the basis of this assessment, the study suggests policy options for the developing countries in the region. Increasingly serious concerns about the benefits of focusing on a narrow definition of macroeconomic stability motivate this study. Of main concern to the study is the tendency over recent decades to equate policy reform with non-interventionist or "neutral" macro policy.

The study, prepared by Professor John Weeks, and funded by the ILO, is also an excellent example of collaborative work by the ILO Regional Office for Asia and Pacific and the UNESCAP's Macroeconomic Policy Division in Bangkok. Technical inputs to the report were provided by both ILO and UNESCAP staff, led by Sukti Dasgupta from the ILO and Anisuzzaman Chowdhury from UNESCAP, and a meeting to disseminate the preliminary findings of the study were held in Bangkok in 2013.

We hope that this study will contribute to the ongoing discussion on macroeconomics and development, which is currently poised at a critical juncture, especially in the context of its labour market impact.

Tomoko Nishimoto
Assistant Director General and
Regional Director for Asia and the Pacific

Contents

Figures

Tables

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Executive summary

Perhaps the most important empirical finding of this study is the stability of quarterly and annual growth rates for Viet Nam and the contrasting instability for Thailand. Evidence strongly supports the view that this contrast results from the difference in macroeconomic policies in the two countries. Once policy-makers discard the ideology calling for continuously balanced budgets, focus can shift to identifying priorities for fiscal policies that facilitate stable growth. Stable growth would engender full and productive employment and an equitable distribution of growth for poverty reduction. These outcomes do not result automatically from the clearing of markets, if they clear at all.

In support of full and productive employment, monetary policy both can and should pursue several objectives in addition to the stabilizing of prices. The two most obvious are: (i) facilitating productive investment through moderate and stable real interest rates; and (ii) reducing exchange rate fluctuations through what might be called exchange rate "smoothing". Exchange rate smoothing does not imply that a central bank attempts to maintain the national currency at a target rate to other currencies.

In the pursuit of full and productive employment, the exchange rate serves as an important instrument. It should be part of a policy to shift resources towards tradables, if that shift is relevant. Interventions to smooth movements in the nominal exchange rate contribute to stability of aggregate output.

Empirical analysis: Thailand

The Thai economy demonstrated a remarkable rate of growth of output, exports and employment for more than 36 years, from 1960 to 1996. Subsequently, output and employment growth have become considerably slower and unstable, though well above the rates for the majority of developing countries. Of more concern for employment, poverty and general welfare, the macroeconomy has displayed substantial instability.

There are obvious policy components to the country's macroeconomic instability. Perhaps most important, Thai fiscal policy has been procyclical since the Asian financial crisis of the late 1990s. Second, the overall impact of monetary policy since 2000 appears ambiguous regarding growth. Third, a shift from mild regulation to strong deregulation of the external sector, especially the capital account, leaves the Government with few tools to cope with what appears to be a major source of macroeconomic instability.

Countries do not achieve full and productive employment without pursuing policies designed for this goal. Until the global crisis of 2008, the Thai economy grew at a rate more than sufficient to provide full and productive employment for its residents. Through application of appropriate policies, the Government can create the tools to convert growth into full employment, rising real wages and job security.

Empirical analysis: Viet Nam

Although the macroeconomic policies of the Vietnamese Government suffered from mistakes of timing and execution, all evidence suggests that they account for the stability of growth over the past 20 years.

This stability is in striking contrast to Thailand's growth performance. The lack of reliable employment statistics covering the two decades makes it impossible to assess progress towards full and productive employment. However, the rate and stability of growth provide a framework sufficient for the outcome if combined with equitable wage and distribution policies.

The growth process in Viet Nam is not without serious problems. The frequently cited need to restructure the financial sector and state enterprises are of secondary importance to a flaw in the growth strategy itself. The Vietnamese Government achieved a remarkably smooth transition from central planning to market regulation by pursing an export-led growth strategy. Rapidly expanding exports combined with long-term capital inflow to stabilize the exchange rate, which facilitated price stability.

For several reasons, the economy now presses against the limits to an export-led strategy. First, an export-led strategy requires the continuous transfer of resources from non-tradables to tradables. Because both categories of goods require that labour have sector-specific skills, the productivity of the transferred labour is likely to decline at the margin. With few exceptions, capital is product specific, which implies that the labour transfer must be accompanied by an increase in investment. With total investment well over 30 per cent of gross domestic product, further increases in investment, like greater labour transfer from agriculture, are likely to generate diminishing growth at the margin.

The likelihood is low that the global economy will soon deliver the high rates of growth of trade that prevailed before the global crisis. A commonly expressed hope among researchers, though less frequent among policy-makers is that the problem of slow growth in international trade might be overcome by the Trans-Pacific Partnership. It is not obvious that this United States-proposed trade agreement will increase export opportunities for Viet Nam. The US Senate might not approve this treaty in the near future and perhaps even reject it. Were it to be approved by the US Senate, Vietnamese policy-makers would need to assess the balance between trade creation and trade diversion. To be specific, it is not clear what advantages the Partnership would bring to Viet Nam that are not currently provided by membership in the World Trade Organization.

There is no doubt that exports drove the rapid growth of the Vietnamese economy over the past 20 years. Global economic prospects and proposed re-organization of domestic finance and state enterprises suggest that a more diversified strategy is now required. This strategy could place greater emphasis on equity via risking wages and domestic demand. Enhancing the voice of workers' organizations would be an important aspect of the broader and more equitable strategy.

About the author

John Weeks is Professor Emeritus, School of Oriental and African Studies, the University of London.

Acronyms

ADB	Asian Development Bank
FDI	foreign direct investment
GDP	gross domestic product
IMF	International Monetary Fund
LIBOR	London interbank offer rate
THB	Thai baht
UNCTAD	Nations Conference on Trade and Development
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme

1. Introduction

This study uses the available analytical and statistical evidence to assess the extent to which macroeconomic management has helped or hindered the goal of attaining fuller, or high, and productive, employment. On the basis of this assessment, the study suggests policy options for the developing countries of the Asia–Pacific region. Increasingly serious concerns about the benefits of focusing on a narrow definition of macroeconomic stability motivated this study. Of main concern to the study is the tendency over recent decades to equate policy reform with non-interventionist, or "neutral", macroeconomic policy.

The standard approach has been to equal macroeconomic stability with inflation targets and a combination of current account and reserve accumulation targets. In line with its terms of reference (see the Annex), this study takes economic growth, social development and environmental sustainability as the primary objectives, with price stability and the external account as flexible constraints. Of the three objectives, this study focuses on the quality and structure of economic growth. "Quality and structure" refer specifically to the interaction of growth with employment, the incomes generated by that employment, and income and wealth distribution.

The central purpose of this analysis is to assess how and whether the macroeconomic policy regimes in Thailand and Viet Nam contributed to fuller, or high, and productive employment. Thailand and Viet Nam represent singularly appropriate countries to make this assessment. Both have enjoyed impressive growth rates over an extended period of time, with this growth generating considerable expansion of formal sector employment. Because of the positive growth and employment performance in both countries, the emphasis of the analysis centres on the quality of growth and the employment generated by that growth.

2. Analytical framework

2.1 Clarifying definitions

To avoid confusion in the analysis that follows, several terms require careful defining. These include phrases commonly used to describe macroeconomic policy and ones that serve as important concepts in analytical and empirical discussions. After defining these, the discussion can move to policies.

Central is macroeconomic stability. Formally, this stability has two aspects: a satisfactory performance of the domestic economy (internal stability) and a sustainable balance of payments (external stability). For decades, the standard framework to analyse the simultaneous achievement of both was the Mundell-Fleming model. This model held the general price level constant, thus contradict the exchange rate flexibility mechanism (Weeks, 2012 and 2013a). In the model, an economy achieves internal stability when it sustained a targeted unemployment rate. External stability required that foreign exchange inflow equal outflow.

Internal stability sets the nominal interest rate and the nominal exchange rate brought about external stability. In the most common version of the model, "free" capital flow required that the domestic and "world" rates of interest be strictly linked. It followed from the Mundell-Fleming framework that the exchange rate "floats" and the interest rate is externally determined, so neither is a policy instrument.

Although the Mundell-Fleming model did not suffer explicit rejection, a shift to emphasis on inflation as the major macro target rendered it irrelevant. By the 1980s, internal stability meant low inflation.[1] In the analysis of the so-called Washington Consensus, low inflation facilitated automatic adjustment to an appropriate unemployment rate, sometimes called the "natural rate of unemployment". Balanced budgets and interest rate adjustments would bring inflation to its target, though this active interest rate management contradicted another element in the Consensus – the free flow of capital. This framework defined the central focus of governments and central banks to be preventing inflation and fiscal deficits. These would be achieved through demand-depressing policies, reducing expenditures and raising interest rates.

A macroeconomic policy framework designed directly to achieve positive outcomes of any type requires a redefinition of stability. This re-defining need not be new, just a return to the prevailing consensus of the post-Second World War period. Following that framework, I define internal stability as: (i) the maximum achievable level of employment and its growth over time; (ii) which is consistent with a flexible inflation constraint; and (iii) minimizes inequality pressures originating from the commodity and financial markets.

At first glance, this definition may seem unmanageably complex. In practice, it is quite simple and was the guideline to macroeconomic policy-making before the Washington Consensus established its negative orthodoxy. Government and central banks should dedicate themselves to policies that leave the fewest people without work. This goal implies a growth policy.

The specific characteristics of each country determine its growth and employment goals in any specific moment. The desired employment outcome requires governments to use all available policy tools in an active manner, which is discussed in the next section. This pragmatic approach to policy requires we abandon the narrow definition of macroeconomic stability.

The economic growth associated with employment growth has three important dimensions: rate, stability and distribution. Any rate of employment growth requires a faster rate of output growth to accommodate increases in productivity. This obvious principle is extremely important for open economies in order that they achieve and maintain external stability. The stability of growth contributes to optimistic expectations for the private sector, as well as job security for employees. Finally, the output structure and distribution between profits and wages at the margin determines the growth of income shares.

[1] This narrow treatment of stability contributed to instability in the South-East Asian countries: In the Asia–Pacific region, such restrictive macroeconomic policies, aimed at stabilization in a very narrow, sense have led to drastic declines in public infrastructure investment, especially in agriculture, and a rise in economic insecurity. The region was also hit by the worst financial crisis, in 1997, despite reasonable macroeconomic stability (MPDD, 2013a, p. 1).

The next concept, "full and productive employment", is not difficult to define. There is, however, an intrinsic ambiguity in the concept because policy-makers over the past several decades have abandoned employment as a goal. The original eight Millennium Development Goals prove perhaps the most shocking example. The first of these pledges the eradication of extreme poverty and hunger, yet nowhere among the eight goals is there mention of the means by which a government might achieve that eradication – employment at wages high enough to bring households out of poverty.[2]

Pursuing this simple idea – of employment that generates incomes above poverty level – will lead to a working definition of "full and productive employment" for macroeconomic policy.[3] To reach this definition, it is first necessary to dispel misconceptions that are engrained in the Washington Consensus approach. The most important of these is the previously noted "natural rate of unemployment". The analytical essence of this idea is the existence of levels of unemployment uniquely linked to rates of inflation (see Friedman, 1968). It carries the policy implication that the level of unemployment associated with some low level of inflation is, by definition, full employment. A closely related and less ideological terminology for the same idea is "structural unemployment". This concept of natural rate suffers from the fallacy of treating the inflation–unemployment relationship as unique and monotonic, which it is not. Especially for an open economy with imported price effects, any given level of unemployment can exist within a range of inflation rates, and vice-versa.

If we discard the ideology of the "natural rate", we can reach the working definition of full employment. In an economy in which the overwhelming majority of people are employees, full employment refers to a policy-determined target for the unemployment rate. Argentina provides an example of a middle-income country of this type. The level at which policy-makers set the target is specific to the institutions and political economy of each country. Thailand is in the process of moving into this category of countries, with lingering elements of its pre-industrial economy.

No high-income country has a large agriculture sector, nor in any is self-employment a major category (except for its misuse in reference to subcontracting arrangements). In the development process, the agriculture sector becomes increasingly characterized by wage employment. Therefore, in countries in which a substantial portion of the adult population is in self-employment or non-market working relations, such as family enterprises, full employment takes on a more dynamic definition. For these countries, full employment refers to the rate at which economic growth transfers labour from low-productivity activities to those providing incomes in excess of the poverty level. Viet Nam falls into this category of countries in the process of transition from a mix of work relations to formal wage employment.

[2] The emphasis on work that lifts households out of poverty can be found in the ILO and Food and Agriculture Organization's joint programme, Decent Employment for Agricultural and Rural Development and Poverty Reduction. Ensuring productive and decent work for rural workers is crucial if they are to escape from poverty and have the means to produce or purchase adequate and nutritious food. However, efforts to reduce poverty and hunger by raising on-farm and non-farm incomes and diversifying livelihoods can be hindered by emerging forms of employment relationships that are based on more flexible and casual forms of work. See www.fao-ilo.org/ilo-dec-employ/en/ [accessed 14 Nov. 2014]. See also ILO/OECD (2011, p. 1).

[3] The term “full and productive employment” is considerably broader than its macroeconomic component. It is subsumed within the ILO socio-economic Decent Work agenda: decent work sums up the aspirations of people in their working lives. It involves opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom for people to express their concerns, organize and participate in the decisions that affect their lives and equality of opportunity and treatment for all women and men. See www.ilo.org/global/topics/decent-work/lang--en/index.htm [accessed 14 Nov. 2014].

From a macro perspective, productive employment has two aspects. The more familiar and more general characteristic refers to employment that lifts people from poverty and maintains them out of poverty. Sustaining non-poverty employment by necessity requires that it be stable. The second characteristic derives from the macroeconomic necessity of a sustainable balance of payments. In each country, that sustainability requires an appropriate balance between employment in the production of tradables and non-tradables and productivity growth in the former.

To summarize, full and productive employment refers to the maximum feasible level of wage employment in the short run and a target for labour transfer in the medium term, both linked to an appropriate balance between tradables and non-tradables.

At the national level, the term “sustainable development” will vary by country. National policies to achieve environmentally sound growth include public investment and the regulatory framework. The meaning is considerably simpler for short-term macroeconomic policy: stability of the growth rate. This stability facilitates the growth of public revenue that governments can allocate to induce more environmentally sustainable practices in the private sector as well as the public sector.

With the key terms defined, the next section develops the macroeconomic framework for achieving full, or high, and productive employment within a stable growth path.

2.2 Analytics of country comparisons

The terms of reference for this analysis of Thailand and Viet Nam ask for a comparison of experiences regarding macroeconomic policies and outcomes: What policy lessons can be learned from the comparative experiences of Thailand and Viet Nam in the macroeconomic policy framework that would be needed to reduce poverty and inequality and promote decent work opportunities?

The terms of reference go on to recommend that in "cross-country comparison purposes, an international data source may be advantageous" because of likely inconsistencies in data definitions and collection methods among countries. This requirement for direct comparison of Thailand and Viet Nam raises questions regarding the purpose and for which issues comparisons are valid.

It is obvious that every country is different, and countries change over time. If difference and change rendered comparisons invalid, little analytical work would be possible. The first issue, then, is what degree of difference renders a comparison invalid? With regard to South-East Asia, a comparison of growth determinants and macroeconomic stability between Singapore and Thailand, between Singapore and Viet Nam or between Singapore and any other South-East Asian country would not be valid. In one case we have a city-state with no primary sectors of any importance. In another case we have the interaction between agriculture and industry, which is one of the most important dynamics of growth and development. The determinants for economic outcomes for a city are unlikely to have much relevance for a country with a diversified economy.

Having eliminated the obviously non-comparable, the question shifts to whether the characteristics of a pair of countries might be so different as to make comparison invalid. One possible difference rendering comparison invalid could be large differences in per capita income. Two considerations cast doubt on non-comparability due to differences in per capita income. First, in the empirical literature there is no methodology to judge at what point a quantitative difference in per capita income becomes a qualitative barrier to cross-country analysis (see the review of cross-country analysis in Quah, 2000).

To use South-East Asian examples, in 2012 the per capita income in Malaysia was $10,400,[4] while in Thailand it was $5,500 and in Viet Nam it was $1,800 (World Bank, 2013). In assessing differences in per capita income for comparative analysis, should the absolute difference, ratios or some other calculation be used? If the first, Viet Nam and Thailand would seem a more valid comparison than Thailand and Malaysia; if the ratio is used, the assessment reverses. Including the Philippines, with its per capita income of $2,600, makes the assessment more ambiguous. Second, it is not immediately obvious why per capita income should render countries non-comparable rather than population and size of the economy. Regarding economic structure, an inspection of statistics would not seem to rule out comparison nor the export orientation of each economy.[5]

In summary, it is possible to validly specify reasons for non-comparability, such as whether a country produces petroleum. But in the absence of a clear and accepted methodology for comparability and non-comparability, there is no alternative to case-by-case assessments. In this study, I place considerable importance on economic stability, as defined in the previous section. The comparability issue then becomes specific – is it valid to compare measures of macroeconomic stability for Thailand and Viet Nam? This is an empirical and pragmatic issue that should be assessed issue by issue.

Assessing and comparing economic stability for Thailand and Viet Nam raises another analytical issue: the impact of non-policy factors, especially natural phenomena and political instability. Considerable research has addressed the impact of natural disasters, such as the flooding in Thailand, on economic growth. An Inter-American Development Bank study concluded:

> “Once these political changes are controlled for, even extremely large disasters do not display any significant effect on economic growth. It is also found that smaller, but still very large natural disasters, have no discernible effect on output.” (Cavallo et al., 2010)

A study published in *World Development* in 2012 reached a similar conclusion:

> "Despite the tremendous human suffering caused by natural disasters, their effects on economic growth remain unclear, with some studies reporting negative, and others indicating no or even positive effects." (Christiaensen et al., 2012, p. 1317)

[4] All $ currencies are US$.

[5] In 2012, what the World Bank, in its *World Development Indicators*, defined as industry accounted for 44 per cent of GDP in Thailand and 39 per cent in Viet Nam. Agriculture contributed 13 per cent in Thailand and 20 per cent in Viet Nam. In Thailand, export revenue represented 75 per cent of GDP and 80 per cent in Viet Nam.

Although the people of Thailand suffered severely from the catastrophic floods of 2011, economics has no accepted methodology to assess the macroeconomic impact. The direct cost of natural disasters can be calculated with some accuracy. However, measuring relative impact of economic and non-economic factors on macroeconomic indicators is not possible. Finally, it should be stressed that Viet Nam has also suffered from severe weather. Attempts to quantify the growth impact in each country are unlikely to provide definitive results.

Since 2000, Thailand has shown considerably more political instability than Viet Nam, especially in late 2013 and into 2014 (not covered by the statistics in this study). Whether this can account for differences in macroeconomic performance for the two countries is more difficult to assess than the macroeconomic impact of natural disasters. Two fundamental problems arise at the outset. First, there is considerable debate over the direction of causality – does growth instability generate political tensions, or the reverse (Paldam, 1998). Second, we have a consensus on the definition of a natural disaster. No such consensus exists for "political instability", whose definition is likely to vary across countries.

To summarize, when possible, research should assess the likely impact of natural phenomena and political events on macroeconomic behaviour. This assessment, by its nature, will be qualitative and, to a degree, subjective. In the following analysis, I deal with these ambiguities by inspecting the likely economic factors on macroeconomic outcomes. That does not exclude non-economic influences that others might consider relevant. Demonstrating their relevance, however, should be evidence-based rather than speculative.

2.3 Neutral and active policy regimes

Achieving socially acceptable employment and distributional outcomes within the Decent Work framework requires a short-term macroeconomic strategy that uses all available policy instruments. Policy-makers implement the instruments simultaneously to balance the multiple objectives within the internal and external constraints. This balancing matches each instrument with an appropriate outcome, to thus phase outcomes over the short, medium and long terms.

The non-interventionist approach to macroeconomic policy gained ideological dominance during the 1980s. It derived from the pre-Keynesian ideology in which market economies automatically adjust to full employment with stable prices. This approach neutralized or nullified each area of macroeconomic management. The requirement that public sector budgets should be governed by a deficit target made fiscal policy endogenous, with respect to growth, rather than an instrument to manage growth. Current and capital account deregulation, combined with the insistence that unmanaged floats or market-determined exchange rates represent "best practice", removed public policy from any effective role in influencing external stability. So-called central bank independence completed the nullification, leaving governments without macroeconomic policy instruments.

The combination of a balanced budget guideline, an inflation target and non-intervention in foreign exchange markets leaves little policy space. This approach might be defensible for high-income countries with a relatively stable economic structure and efficient markets. For countries undergoing structural change, it replaces macroeconomic management with micro-based nihilism. Few

governments of Asian countries, and only for short periods, adopted the extreme version of the neutral, or non-intervention, framework. This generalization applies to the two countries chosen for this study, Thailand and Viet Nam, though their policies had substantial differences. It is these differences as well as the policies that give this study the potential to generate lessons for other countries.

This study links fiscal policy to short- and medium-term growth, exchange rate policy to current account outcomes, capital account management to overall external stability, and monetary policy to medium- and long-term domestic investment. This approach treats inflation as the outcome of all of the foregoing rather than the sole preserve of monetary policy (see the Annex, Monetary policy).

Fiscal policy

An employment-focused fiscal policy comprises complementary short-term and long-term components. In the short term, the purpose of policy instruments is to maintain output at near potential, and in the long run, policy interventions seek to increase potential output. Short-term macroeconomic management relies on the current fiscal budget and tax instruments (Hailu and Weeks, 2009). The long-term component employs public investment to directly increase the productive potential of the economy and to "crowd-in" private investment. The employment focus also is both short- and long-term in nature. The countercyclical interventions attempt to stabilize or reduce unemployment in the labour market. The long-term objectives are employment growth to match labour force growth and economic diversification to shift workers to more productive activities. Policy-makers in both Thailand and Viet Nam have achieved both.

When countercyclical fiscal intervention is institutionalized into macroeconomic policy, as it would in a rational strategy, it implies that the aggregate demand effect over the economic cycle would be neutral in the specific sense defined by Ackley (1965) and Heller (1966) – as no "fiscal drag".[6] The concept of fiscal drag is central to an active macroeconomic policy. It states that for an unchanged level of public expenditure, a fiscal deficit can result from tax rates too high rather than two low.

Consider an economy operating at below full potential with a negative fiscal balance. Assume that, *deus ex machine,* the economy moves to full potential with no change in the level of expenditure of the tax structure. At full potential, there are three possibilities: (i) the increase in tax revenue that results from the increase in output is not sufficient to eliminate the negative fiscal balance; (ii) the increase in tax revenue exactly closes the fiscal gap, rendering the balance zero; and (iii) the increase in tax revenue results in a fiscal surplus. In the first outcome, fiscal drag is negative, in the second it is zero, and in the third it is positive.

In the first case, the level of fiscal expenditure is excessively expansionary, and in the third it is less than what is required to achieve full potential.[7] The implication for short-term macroeconomic

[6] In testimony before the US Congress, Ackley (1965) defined fiscal drag as "a constant set of tax rates and a constant level (total) of government expenditures exerts an increasingly restrictive influence as time passes… [O]ver the years we need to offset much or all of the drag in order to permit the growth of demand to keep up with the growth of potential output".

[7] The algebra of fiscal drag is simple. Let Y be national income, and I and G be private investment and government expenditure. Let α be the marginal propensity to consume and β the marginal propensity to tax. Assume that at a less than full potential

management should be clear. At less than full potential, a fiscal deficit can indicate that taxes are too high (low?) or expenditures are too low (high?). The current fiscal parameters generate a drag on the level of output. This insight allows movement beyond the narrow approach that calls for contractionary fiscal measures whenever a deficit appears.

In the specific cases of Thailand and Viet Nam, the fiscal drag concept facilitates analysis of the extent to which public expenditure and revenue have reinforced or dampened the impressive growth rates of the countries over the past 20 years. Of special importance is the stability of quarterly and annual growth rates for Viet Nam and the contrasting instability for Thailand. Once policy-makers discard the ideology calling for continuously balanced budgets, which is an impossible outcome, discussion shifts to identifying the priorities for fiscal policy. Central among these priorities could be full and productive employment and an equitable distribution of growth for poverty reduction. These outcomes do not result automatically from the clearing of markets.

Monetary policy

Essential to the design of a rational monetary policy in support of employment expansion is: (i) recognition that inflation is not a purely monetary phenomenon; and (ii) that the mandate of the central bank should allow for multiple objectives and not be limited to suppressing inflation.[8] The mandates of the central bank in Thailand and Viet Nam allow for multiple objectives.[9]

The narrow monetary interpretation of the causes of inflation suffers from two general analytical problems (see the discussion in Choudhury, 2005b). First, the argument that price increases result from increases in the money supply presumes that the latter is exogenous and within the control, or at least under the influence, of public sector policy instruments. The simplest version of this argument comes from the quantity theory of money, in which economic agents carry out all transactions with a means of payment derivative from a monetary basis determined by the central bank. For decades, economists have hotly contested the presumption that money is exogenous with respect to changes in output (see Lavoie, 2006; Dow, 2006). If the means of circulation are endogenous to any extent, the monetary interpretation of inflation collapses (Howells, 2006). For small open economies with largely unregulated capital accounts, the practical capacity of the central bank to control the

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level of income, savings equal investment and the public budget is balanced. In the simple case of a closed economy, national income equals: $Y_0 = \mu[I_0 + G_0]$, with $\mu = [1 - \alpha(1 - \beta)]$, the multiplier.

Given the propensity to consume, the marginal propensity to save out of post-tax income is $(1- \alpha)(1 - \beta)$, so the level of saving is: $S_0 = [(1-\alpha)(1-\beta)]Y_0$. If by magic, income rose to its full potential level: Y_f, then total leakages would exceed total injections because savings would exceed investment and the public budget would be in surplus. National income would fall back to Y_0. Reducing tax rates eliminates the fiscal drag.

[8] A United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) policy brief states this clearly, that monetary policy should accept "moderate inflation and the use of instruments, such as credit, other than the policy rate" (MPDD, 2013a, p. 2).

[9] The mandate of the State Bank of Vietnam allows for multiple objectives, a heterodox approach that has brought criticism from mainstream central bankers. The IMF has repeatedly urged that the State Bank be made legally independent. The mandate of the State Bank can be found in its web pages (www.sbv.gov.vn) [accessed 14 Nov. 2014]. Although lower in profile in its implementation of a heterodox approach, the Bank of Thailand's flexibility of its policy is obvious on its website: "The Bank of Thailand Act, B.E. 2485 was later amended in order to put emphasis on BOT's social responsibility, to create a mechanism to guard against economic crisis, as well as to set up BOT's decision making process to ensure good governance and transparency in the organization. Moreover, members of the public will be able to audit and increase the understanding of the BOT's operations." See www.bot.or.th/English/AboutBOT/Pages/default.aspx [accessed 14 Nov. 2014].

monetary base is extremely limited. Thailand and Viet Nam qualify as small in this context. Through controls over capital flows, the Vietnamese Government has created for the central bank a degree of flexibility in monetary policy.

Second, in practice, inflation is a complex process involving three types of commodities: (i) tradables whose prices respond to global markets; (ii) non-tradables whose prices reflect domestic demand and supply; and (iii) prices linked to institutional agreements that are inflexible in the short run. For both Thailand and Viet Nam, the international price of hydrocarbons has a substantial impact on the overall price level, completely beyond the influence of domestic policy. The de facto mechanism for a central bank to restrain prices is through non-tradables. The most important non-tradable is likely to be unskilled labour.

From the complex, non-homogenous character of the components of the price level, it follows that policies to suppress price changes can have substantial distributional effects. Governments can, to a certain extent, moderate or compensate for these effects with other polices, such as fiscal expenditures. Therefore, an equitable, employment-focused public policy requires the coordination of monetary policy with fiscal policy – not pure independence.

In support of full and productive employment, monetary policy both can and should pursue several objectives along with price stability. The two most obvious are facilitating productive investment through moderate and stable real interest rates and reducing exchange rate fluctuations with what might be called exchange rate "smoothing". Exchange rate smoothing does not imply that a central bank attempts to maintain the national currency at a targeted rate to other currencies (see Weeks and Mungule, 2013, pp. 7–21).

Exchange rates and capital flow

The conventional approach to the external sector presumes that the government and the central bank leave the nominal exchange rate free of intervention (see the Annex, Exchange rate policy). The putative outcome should be an exchange rate that produces the "correct" relative return between traded and non-traded commodities. Even in theory, this outcome occurs only at full employment,[10] which should make it of limited interest for policy-makers.

A policy framework for the external sector aimed at full and productive employment would not leave the current and capital accounts to market regulation. Substantial short-term exchange rate fluctuation provoked by global instability can have a depressing effect on investment by both domestic and international businesses (MPDD, 2013e). As a practical matter, in the short run, central bank exchange rate policy typically seeks to reduce fluctuations without attempting to reverse or alter a trend. Before the 1980s, many governments of developing countries practised a multiple exchange rate regime. This approach fell out of use for both ideological and practical reasons. In practice, multiple exchange rate regimes proved difficult to manage effectively, and governments could achieve the desired outcome in administratively simpler ways, such as through taxation of imports or

[10] The conclusion derives from the Heckscher-Ohlin model in which all equilibria lie on the production possibilities frontier. The Mundell-Fleming model treats changes in output in a one-product economy and makes no such efficiency claim.

exports. An exchange rate policy for full and productive employment pursues exchange smoothing in the short term and manages depreciations in the longer term. The first aims at price and output stability and the second at fostering tradables.

Foreign exchange monitoring is a policy of great importance to central banks and governments with or without foreign exchange controls. During the "deregulating 1990s", multilateral lenders tended to discourage monitoring as unnecessary. As a result, central banks had no accurate estimate of foreign exchange flows, which made a rational exchange rate policy impossible. In practice, liberalizing the trade and capital accounts makes monitoring more important. It is the source of key information that allows governments and central banks to anticipate external shocks.

In addition, foreign exchange monitoring is both the necessary condition for an effective capital account policy and a policy in its own right (see the Annex, Capital account management). Monitoring should enable the public revenue authority to verify whether importers and exporters obey tax regulations. Monitoring is the basis for all market-based capital controls. It can take the strong form of a requirement that all foreign exchange transactions pass through the central bank, or it can make the softer requirement that all only must be reported to the central bank.

The policy on foreign exchange flows in Thailand is close to the reporting end of the spectrum, while the State Bank of Vietnam follows a considerably stricter approach.[11] In both countries, the authorities pursue a policy of exchange rate management. However, in Viet Nam, the Government manages the external sector in a much more interventionist manner. In both cases, the tools exist to integrate foreign exchange policy with fiscal and monetary policy.

Advocating an active exchange rate policy can result in analytical and empirical confusion because of use of terms that carry implicit or explicit subjective judgements. It is common to read that the exchange rate "strengthens" or "weakens", meaning appreciation and depreciation, respectively. In the same vein, the phrase "improvement in the exchange rate" invariably refers to an appreciation and "deterioration" to a depreciation.[12]

The terminology in which a "strong" exchange rate is one whose value is high or increasing with respect to other currencies is a serious obstacle to rational policy, especially for employment. If an exchange rate "strengthens" when it appreciates, it would be rare to expect a policy-maker to favour

[11] In practice, the State Bank of Vietnam closely monitors and regulates foreign exchange flows. See www.seacen.org/GUI/pdf/publications/bankwatch/2012/17-SBV.pdf [accessed 14 Nov. 2014]. The Bank of Thailand gives the following instructions for people and companies receiving and sending foreign exchange. Foreign currencies can be transferred or brought into Thailand without limit. Any person receiving foreign currencies from abroad is required to repatriate such funds immediately and sell to an authorized bank or deposit them in a foreign currency account with an authorized bank within 360 days of receipt, except for foreigners temporarily staying in Thailand for not more than three months, foreign embassies, international organizations (including their staff with diplomatic privileges and immunities) and Thai emigrants who are permanent residents abroad or working abroad. Purchase of foreign currency from authorized banks is generally allowed upon submission of documents indicating international trade and investment. Companies in Thailand can engage in derivatives transactions with authorized banks to hedge against foreign exchange risk, provided that supporting documents indicating future foreign currency receipts or obligations are submitted. Any person bringing into or taking out of Thailand foreign currency bank notes in an aggregate amount exceeding $20,000 or its equivalent must declare it to a customs officer. See www.bot.or.th/English/ForeignExchangeRegulations/FXRegulation/Pages/ExchangeControlLaw.aspx [accessed 14 Nov. 2014].

[12] This inference comes from interviews with several officials in both Viet Nam and Thailand.

depreciation. Nominal exchange rate movements should be assessed in the context of three types of commodities: exportables, importables and non-tradables. Figure 1 demonstrates the implications of the three-commodity context (taken from Liang, 1992). The vertical axis measures the price ratio of exportables to non-traded commodities and the horizontal axis reflects the ratio of importable prices to non-tradable prices.

Non-tradables include most services, transport and commerce. The distinction between exportables and importables is country specific and changes over time. For example, in Thailand and Viet Nam currently, manufactured commodities are almost all importables, but over time, productivity increases could make them internationally competitive and exportable.

At some point in the two dimensional space diagram in figure 1, the production of exportables and importables equals their level in the absence of any policy intervention (with X the “on-intervention" point). Through this point pass two lines: AA, which is the locus of all points for which exportable production is constant at the non-intervention level, and BB, which is the same locus for importables. The locus AA shows that as the price of importables rises relatively to non-tradable prices, the production of exportables can remain constant, only if exportable prices also rise. The same interpretation applies to line BB.[13]

A so-called strong currency tends to drive relative prices into the region indicated as IV, or "pro-non-tradables". Nominal and real currency appreciation drives the ratio of exportables to non-tradables below the non-intervention ratio and also for importables. Thus, the effect of pursuing a strong currency policy is to reduce the production of all tradable commodities. The decline of tradable production implies a persistent balance of trade deficit, which will make the strong currency policy impossible to maintain.

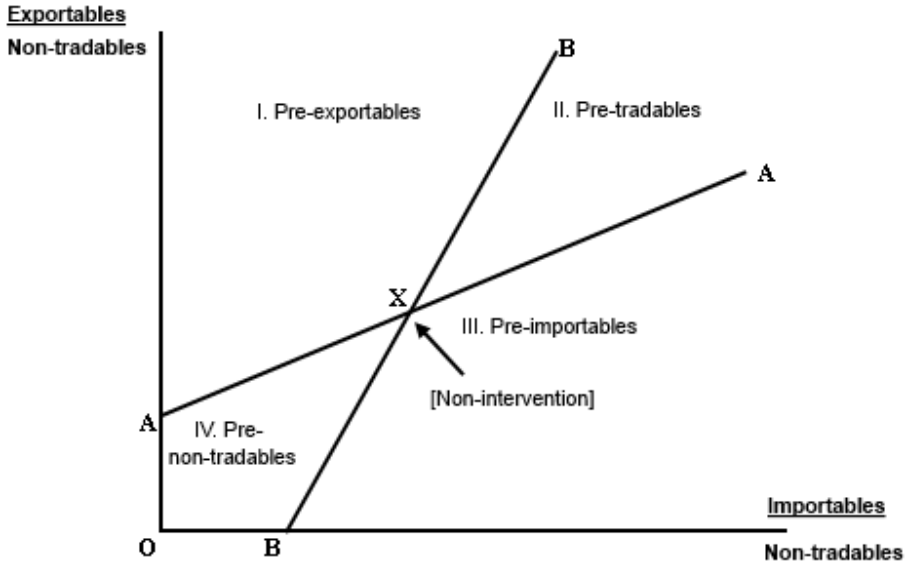
The diagram shows three alternatives to the dysfunctional policy of discouraging both exports and import substitutes. Region I represents export promotion in the strict sense, shifting resources from both import substitutes and non-tradables into exportables. It is probably the case that this combination of policies applies to Thailand. Region III is the mirror opposite, with stereotypical import substitution, where relative prices shift resources out of exportables and non-tradables. Historical experience, especially in Latin America but also in sub-Saharan Africa, indicates that this policy approach is unsustainable because it tends to generate trade deficits, though not as extreme as in region I.

Finally, region III results in relative prices that promote both exports and import substitutes. This corresponds to policies followed by several of the industrializing Asian countries, most obviously the Republic of Korea but also Viet Nam. Achieving this combination requires currency depreciation in line with domestic inflation. Figure 1 demonstrates how a strong currency policy can undermine growth in the short run and diversification in the medium term. This conclusion does not imply its opposite. A "weak currency" does not necessarily result in a "strong economy". To assess in more detail the appropriate exchange rate policy for a country, it is necessary to be country specific.

[13] The lines AA and BB would pass through the origin if, and only if, the economy produced no non-traded commodities.

Rate management should avoid ideology of the non-intervention "free market" variety and the dysfunctional strong currency approach. The most important guides to effective exchange rate policy are (i) the economic objectives of the government and (ii) country-specific exchange rate dynamics. Policy-makers in Thailand and Viet Nam have followed different strategies that, in both countries, are pragmatic rather than ideological.

Figure 1. Relative prices in a three-commodity economy: exportables, importables and non-tradables (the Liang diagram)



During the three decades after the Second World War, external imbalances tended to stifle growth in developing countries, especially in Latin America. The shift to an emphasis on the production of tradables, balanced between importables and exportables, facilitated overcoming the external constraints to growth, most notably in East and South-East Asia. This shift should not lead to a neo-mercantilist growth strategy in which trade surplus becomes a driving objective.

On the contrary, part of the growth and diversification in Thailand and Viet Nam has been and will be inflows of direct investment. Except in rare cases, direct investment simultaneously generates and finances an increase in intermediate and capital imports. Thus, we would expect a rational policy outcome to be a current account deficit financed by a capital account surplus, especially in Viet Nam, which is considerably less developed than Thailand.

Exchange rate regimes

Another analytical issue requires clarification prior to initiating the empirical part of the case studies included in this paper. The standard analytical approach to exchange rate regimes, whether in textbooks or policy discussions, divides them into two broad categories: "fixed" and "flexible", with "floating" and "market determined" used as synonyms for the latter. Both in practice and in theory, this dichotomy is far too simplistic (Chowdhury, 2005a, p. 37ff).

The fixed/flexible dichotomy represents a holdover from the Bretton Woods system in which all exchange rates other than those of countries in the trading system of the Union of Soviet Socialist Republics were linked via membership in the International Monetary Fund (IMF), with the US dollar the reserve currency to which all were tied. This arrangement had the status of an international treaty. By formal agreement, no government would alter its exchange rate to the dollar without advising the IMF that it intended to do so (though no rational government could adhere to this obligation).[14]

Under the Bretton Woods system, the link of each currency to the US dollar was both fixed and formal, in the sense that countries could seek support from the IMF to maintain the rate. In an interesting irony of unintended consequences, black market or multiple exchange rate mechanisms supported the "fixivity" of the official currency rate. With the passing of the Bretton Woods system in 1971, exchange rate regimes differed by the extent to which governments intervened to maintain a targeted rate, the mechanisms used for the intervention and the policy framework to support the intervention.

The IMF annual reports illustrate the descriptive inadequacy of the dichotomy in a table – located at the end that lists exchange rate regimes in 13 categories.[15] The descriptive inadequacy follows from the theory of exchange rates. To maintain a specific currency rate, or to "fix" it, a central bank must buy or sell foreign exchange. That action would occur in response to a deviation of the exchange rate from its fixed target, either an appreciation or depreciation. During the time requiring action to realign the currency to the target, the exchange rate is in theory flexible. Thus, it is more accurate to use the term “degree of intervention”, with a spectrum from high to low. Finally, countries have a choice as to what the targeted rate will refer (a single currency or a "basket"), making the term "fixed" all the more problematic.

The analysis of this section reaches a conclusion similar to that for fiscal and monetary policy. In the pursuit of full and productive employment, the exchange rate serves as an important instrument. It should be part of a policy to shift resources towards tradables if that shift is relevant. Interventions to smooth movements in the nominal rate contribute to the stability of aggregate output.

3. Empirical and statistical analysis

3.1 Analytical introduction

This study combines qualitative and quantitative information to characterize the macroeconomic practices in two South-East Asian countries (see the Annex, Collection of information). The terms of reference mandate this approach. The study also includes information gathered from discussions with major stakeholders, including government policy-makers. Of central importance is a clear understanding of the major macro tendencies. Of equal importance is the perception of policy-makers

[14] For a discussion of what some call the First Bretton Woods and its demise, see Weeks (2013b).

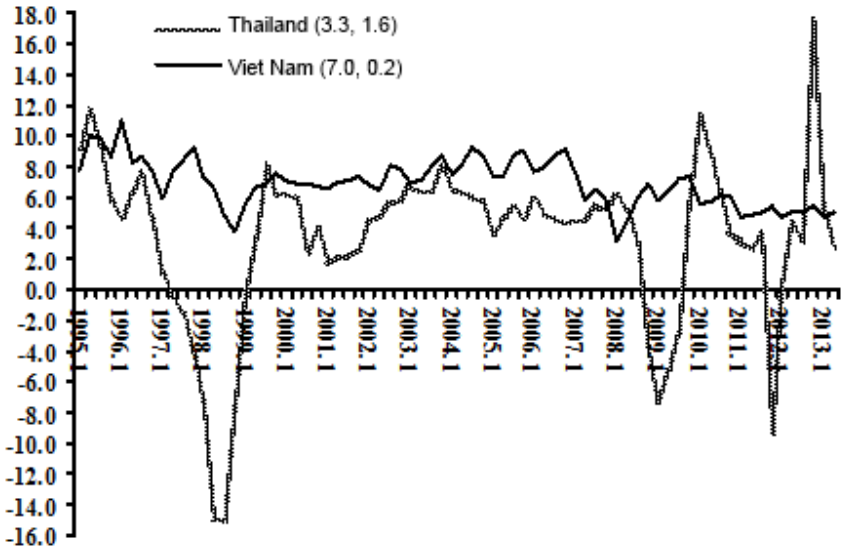
[15] Of the 188 members of the IMF, only 25 fell into what could be reasonably interpreted as freely floating. See www.imf.org/external/np/mfd/er/2006/eng/0706.htm [accessed 14 Nov. 2014].

as to their motivations and of the outcomes of their policy interventions, be those perceptions accurate or inaccurate.

In its statistical analysis, this study separates short- and long-term tendencies and dynamics. Because of the structural changes in South-East Asian economies, it is not analytically sound to seek long-term parametric estimates of behavioural dynamics. Long-term and even many short-term interactions are appropriately treated with qualitative, non-parametric techniques. For the short term, econometric techniques are potentially useful. The guiding principle for all the statistical analysis is that it should be clear and understandable to non-economists and directly relevant to policy discussions. In this context, it is extremely important to form a clear impression of the priorities and major stakeholders within and outside governments.

A central theme of the case studies is the extraordinary difference in the stability of the growth rates of the two countries. Figure 2 reflects this difference clearly. Over 19 years (74 quarters), the Vietnamese economy grew at an annual equivalent rate of 7 per cent, with a coefficient of variation of 0.2. By contrast, the Thai economy grew at 3.3 per cent, a rate associated with a coefficient of variation of 1.6 (standard deviation of 60 per cent larger than the mean). To a great extent, this huge difference in variability can be explained by the macroeconomic policies of the governments of the two countries.

Figure 2. Annualized quarterly growth rates in Thailand and Viet Nam, 1995q1–2013q2 (period average and coefficient of variation in legend)



Sources: See Figures 4 and 16.

3.2 Case study of Thailand

Economic trends pre- and post-global crisis

Twenty years ago, the World Bank published its controversial *Asian Miracles* report (World Bank,

1993), in which Thailand had a major role as a model of rapid growth with an equitable distribution of that growth. During the subsequent two decades, several major regional and global crises have cast doubt upon some of the policies and outcomes previously hailed as "best practice", all the more as the global recovery appears sluggish at best (MPDD, 2013c).

Figure 3 traces two macroeconomic variables, the aggregate growth rate and the overall external balance of goods and services. The time series divide themselves into two obvious periods. During 1961–96, gross domestic product (GDP) grew at an annual average of 7.7 per cent, with a strikingly low coefficient of variation of slightly less than one third. During these 36 years, the trade balance was negative in all but three (1961, 1986 and 1987). Per capita income increased by a factor of 6.5, growing at 5.6 per cent per annum.

After these years of rapid and steady growth, the economy plunged into severe growth instability, averaging barely 3 per cent per annum during 1996–2012, with a coefficient of variation five times what it had been in the previous period. This instability and slow growth coincided with a dramatic shift from trade deficits to trade surpluses. By definition, the trade balance reversal manifests itself in a capital account reversal. From experiencing net capital inflows during 1961–96, the Thai economy became a net capital exporter.

Figure 4 takes a closer look at GDP performance, inspecting quarterly movements during 1994–2013. Here the statistics suggest three periods: first, the 16 quarters from 1995q2 through 1999q1, inclusive of the Asian financial crisis. These years include a reversal of the growth by more than 25 percentage points, from 11.6 per cent (1995q2) to -14.9 and -15 per cent (1998q2 and 1998q3). The next period, 1993–2000, almost eight full years, the growth rate averaged 5 per cent after an initially uneven recovery. However, the instability during the Asian crisis returned in 2008 in a more extreme manifestation. The continuing instability into the 2010s suggests that the enthusiasm over the 2010 recovery was premature, reflecting excessive optimism.[16]

Table 1 indicates that the two external crisis periods were simultaneous, with little shift in the output structure between tradables and non-tradables. The years of recovery and relatively stable growth, 1999–2007, included a substantial rise in the tradable sectors' contribution to aggregate value added. Even though employment statistics are less likely to be accurate than national income statistics, the numbers seem consistent with sector-output growth. The statistics indicate that agricultural employment grew at a trend rate of 0.4 per cent during 1995–2012, while output increased at 2.7 per cent. The implied labour productivity, at 2.3 per cent, is consistent with an agriculture sector’s ongoing technological modernization.[17]

If accurate, the higher rate of productivity growth in manufacturing, at 3.6 per cent, indicates a rate of employment expansion that would be insufficient to bring a substantial shift of people out of low-productivity activities. However, annual employment expansion, at 1.8 per cent in manufacturing, is more than sufficient to provide employment for increments in the labour force, given the country's

[16] In an IMF article entitled "Thailand, Roaring Back Boosted by Trade and Sound Economics", the first sentence reads: "After suffering the double blow of a collapse in global trade and domestic political disturbances, Thailand’s economy has staged a remarkable comeback". See www.imf.org/external/pubs/ft/survey/so/2010/car101510d.htm [accessed 14 Nov. 2014].

[17] Labour productivity is discussed in more detail in ILO, 2013, pp. 44–47.

low rate of population increase (less than 1 per cent per annum). The contraction of the economy after 2007 substantially reduced the rate of growth of manufacturing employment.[18]

Earnings statistics indicate more complicated outcomes. Figures 5 and 6 reflect quarterly average monthly earnings in constant prices. The deflator is the private consumption index from GDP statistics for 2001–10. To reduce seasonal fluctuations in the quarterly statistics, the original time series are converted to four-quarter moving averages. Each quarter's values are measured as percentage-point deviations from the previous quarter. In the legend, the baht (THB) figures for the previous quarter are converted to US dollars.

In Figure 5, earnings are divided between private and public employees. After stagnating during 2001–04, private sector earnings began a steady rise to the end of 2008. Earnings fell during 2009, then recovered in 2010. At the end of 2010, private earnings in real terms were less than 5 per cent above their value at the beginning of the decade. Public sector earnings rose rapidly and began a decline after early 2005. Nevertheless, public earnings were more than double the private earnings by the end of 2010.

Within the private sector, as shown in Figure 6, real earnings rose substantially in agriculture but stagnated in the other major sectors of manufacturing, construction, and trade and vehicle repairs. For the non-agriculture sector, real earnings at the end of 2010 were less than their peak during the decade. Particularly striking is the real earnings stagnation for manufacturing, the country's most dynamic sector. During 2001–2010, manufacturing value added increased at an annual average of 5.7 per cent. Over the same period, real earnings rose by slightly less than 0.1 per cent per annum.

The stagnation of non-agricultural wages while output and productivity rose rapidly implies a substantial redistribution of value added from employees to employers in the private sector. Jiyuan Wang, Director for the ILO Country Office for Thailand, Cambodia and the Lao People's Democratic Republic, cited this redistribution and the associated decline in the aggregate income share of labour as a present and future constraint on equitable growth: "Wages are a vital component of domestic demand, making wage policy central to this debate, as well as to a more equitable future for Thailand."[19] Despite the obvious stagnation in wages during the first decade of this century, the IMF warned the Bank of Thailand to be "vigilant" for inflation-generating wage increases.[20] The following discussion on monetary policy demonstrates the low probability of Thailand suffering from a rate of inflation sufficient to cause policy concern.

The stagnation of non-agricultural wages and the implied redistribution from labour to capital casts some doubt on the statistics in Table 3 for poverty head count ratios and the national Gini coefficient.

[18] Son and San Andres (2009, p. 24) comment on this decline: "In Thailand, as exports declined due to weak consumer demand abroad, workers in the industrial sector were the first to get laid off as early as the first quarter of 2008. At the same time, employment in agriculture significantly increased, suggesting that laid-off workers returned to the fields."

[19] The full text of his article on wage policy in Thailand in the global context is found at www.ilo.org/asia/info/public/WCMS_161480/lang--en/index.htm [accessed 14 Nov. 2014].

[20] The IMF made the warning in a press release on 17 June 2013: "The Bank of Thailand's accommodative monetary stance is appropriately supporting the economy. However, the Bank of Thailand should continue to be vigilant to demand and wage pressures, and stand ready to normalize interest rates if overheating pressures emerge or inflation picks up." See www.imf.org/external/np/sec/pr/2013/pr13212.htm [accessed 14 Nov. 2014].

Even without considering the possible wage impact, the numbers in the first two columns indicate a non-credible decline in head count ratios for the international and national measures from 2006 to 2010, which includes the global crisis. The combination of five consecutive quarters during 2008–09, when GDP contracted in real terms with stagnant real wages, does not render a fall in poverty impossible, but certainly unlikely.

For the same reasons, the reported decline in the overall Gini coefficient, from 42 in 2006 to 39 in 2010, defies explanation. Easier to rationalize but still not entirely credible are the urban and rural Gini coefficients in the final two columns. In the case of the latter, its decline after 2006 coincides with falling agricultural wages after several years of increase (see figure 6). The near constant urban Gini coefficient would not seem consistent with stagnant real wages in manufacturing, construction, and trade and repairs (again, figure 6).

If the statistics in table 3 are valid, they should be complemented by other measures of inequality and well-being. There can be no reasonable doubt that the impressive growth performance of Thailand has not in recent years been equitably distributed. To generate greater equity at the margin, the role and strength of trade unions needs enhancing. The Government could use the minimum wage to enhance inclusive growth (MPDD, 2013d). Although output and employment growth have been sufficient for the objective of full and productive employment that would reduce poverty, the instability of that growth and the stagnation of wages have served as a constraint on achievement.

Table 1. Major tradable sectors, share of national income in Thailand, 1995–2011

Year	Agriculture	Mining	Manufacturing	Tradables
1995	9.3	1.4	27.0	37.7
1996	9.3	1.6	26.6	37.5
1997	9.4	1.9	27.6	38.9
1998	10.7	2.0	28.5	41.2
1999	9.2	2.0	29.3	40.5
2000	8.7	2.4	29.2	40.3
2001	8.8	2.5	28.9	40.2
2002	9.0	2.5	29.8	41.3
2003	9.9	2.6	31.1	43.5
2004	9.7	2.6	31.0	43.4
2005	9.7	3.1	31.3	44.0
2006	9.8	3.2	31.6	44.7
2007	9.7	3.2	32.0	44.9
2008	10.5	3.4	31.9	45.7
2009	10.2	3.3	30.9	44.3
2010	11.0	3.3	32.8	47.2
2011	11.8	3.4	30.6	45.8

Source: ADB, 2013, www.adb.org/statistics [accessed 14 Nov. 2014].

Table 2. Employment and constant price output in Thailand, 1995–2012

Year	Employment ('000)		CP output (THB billion)	
	Agriculture	Manufacturing	Agriculture	Manufacturing
1995	14 389	4 608	412	118
1996	13 986	4 329	433	126
1997	14 145	4 303	431	135
1998	13 407	4 264	434	137
1999	13 804	4 274	455	136
2000	13 830	4 650	486	151
2001	13 612	4 927	501	165
2002	14 042	5 052	502	177
2003	13 880	5 299	562	184
2004	13 634	5 476	555	198
2005	13 617	5 588	555	208
2006	14 171	5 504	577	216
2007	14 306	5 619	588	228
2008	14 699	5 453	605	240
2009	14 693	5 374	597	249
2010	14 547	5 350	593	265
2011	14 619	5 480	627	269
2012	15 142	5 733	n.a.	n.a.
Growth rate	0.4	1.8	2.7	5.4

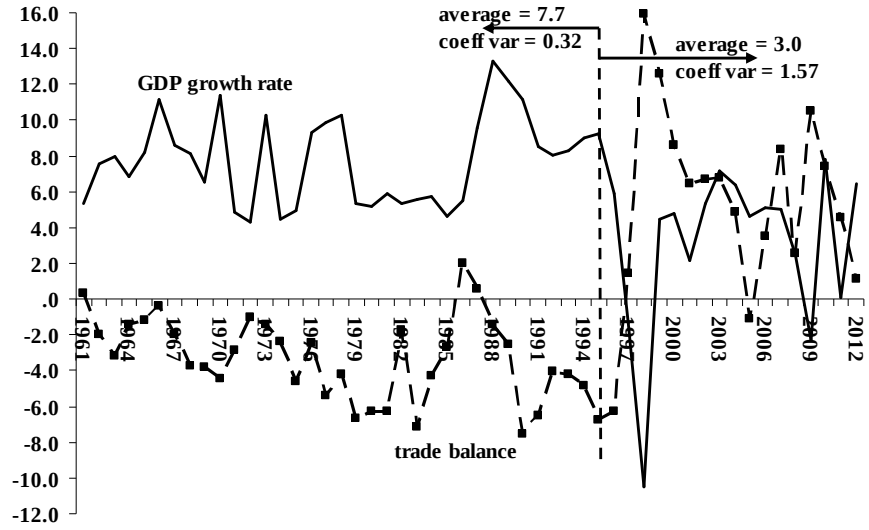
Notes: CP=output in constant prices of 2002. Growth rates are from simple linear regression lines. THB=Thai baht. n.a.= not available.
Source: ADB, 2013, www.adb.org/statistics [accessed 14 Nov. 2014].

Table 3. Poverty head count ratios and the Gini coefficient in Thailand, 1988–2010

Year	PHCR (%)		Gini coefficient		
	$2/day	NPL	National	Urban	Rural
1988	41.0	65.3	44		
1990	37.1	58.1	45		
1992	30.0	50.1	48		
1994	20.5	42.7	44		
1996	14.6	35.3	43		
1998	15.3	38.7	42		
2000	18.1	42.6	43	47	45
2002	13.4	32.6	42	47	44
2004	n.a.	26.9	n.a.	46	44
2006	7.6	23.4	42	47	47
2008	5.0	20.5	41	47	45
2010	4.1	16.9	39	47	44

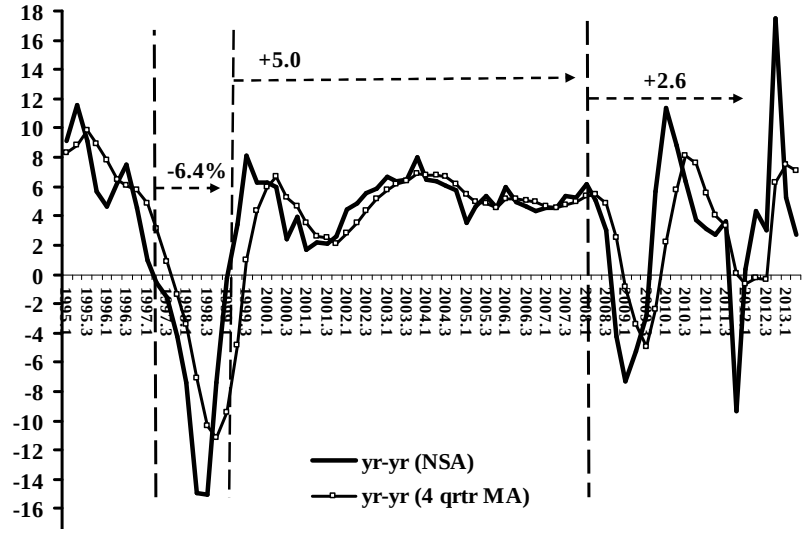
Note: PHCR=poverty head count ratio; $2/day=% living below; NPL=national poverty line.
Sources: Poverty head count ratios are from World Bank, 2013, as are the Gini coefficients for 1988–98, which are for the entire country. The urban and rural Gini coefficients are from ILO, 2013, p. 66. The last two from the ILO reference are for 2007 and 2009.

Figure 3. GDP growth and overall trade balance in Thailand, 1961–2012 (% GDP)



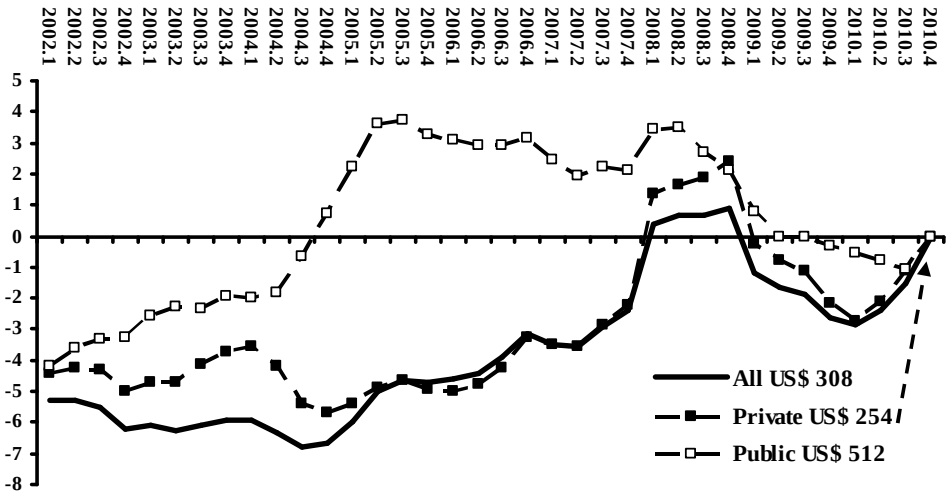
Source: World Bank, 2013, constant 2002 US dollars.

Figure 4. Quarterly GDP growth in Thailand, 1994q1–2013q2



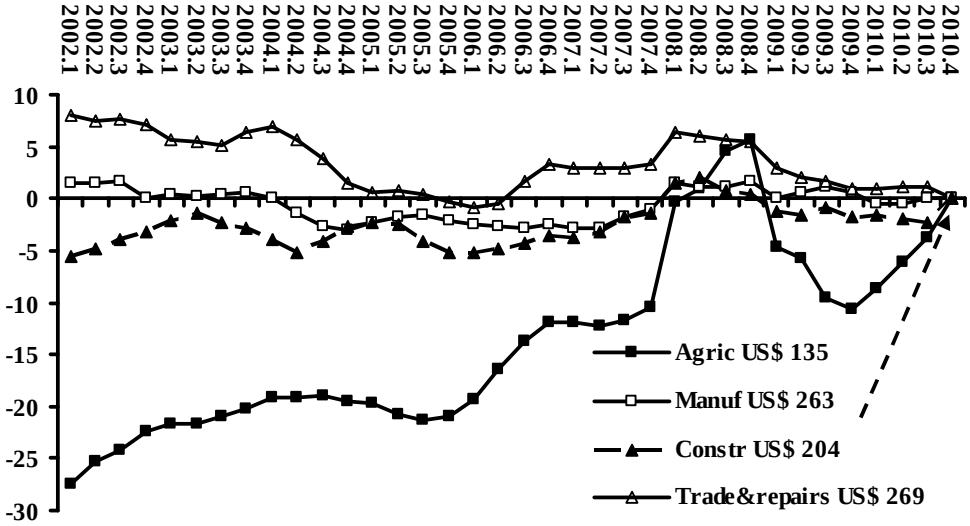
Notes: yr-yr (NSA)=rate of growth compared with the same quarter in the previous year, not seasonally adjusted;
yr-yr (4 qrtr MA)=moving average of current three preceding quarters of same time series.
Source: National Economic and Social Development Board (NESDB), http://eng.nesdb.go.th/Default.aspx?tabid=95 [accessed 14 Nov. 2014].

Figure 5. Average monthly earnings in constant prices in Thailand, 2001q1–2010q4 (all employees, four-quarter moving average, percentage point deviations from 2010q4)



Note: Numbers in the legend are monthly earnings, four-period average for 2010q4, using the official exchange rate of THB29.9 to the US dollar, deflated using private consumption price index.
Source: Bank of Thailand, Table EC_RL_014: Average wage classified by industry, www.bot.or.th/English/Statistics/Standard/SDDS/Pages/sdds.aspx [accessed 14 Nov. 2014].

Figure 6. Average monthly earnings in constant prices by sector in Thailand, 2001q1–2010q4 (four-quarter moving average, percentage point deviations from 2010q4)



Note: Numbers in the legend are monthly earnings, four-period average for 2010q4, using the official exchange rate of THB29.9 to the US dollar, deflated using private consumption price index.
Source: Bank of Thailand, Table EC_RL_014: Average wage classified by industry, www.bot.or.th/English/Statistics/Standard/SDDS/Pages/sdds.aspx [accessed 14 Nov. 2014].

Fiscal policy

Over the past 20 years, Thailand experienced two major economic contractions, both coming from

the global economy: the Asian financial crisis at the end of the 1990s and the global financial crisis at the end of the 2000s. The principle task of this section is to assess the response of fiscal policy to those crises.

Figure 7 shows the annual Thai fiscal balances during 1995–2012, divided between the current and capital accounts. Over those 18 years, the balances behaved as would be expected – a relatively stable capital account balance and a current account balance responding to the short-term movements in national income. The chart relates a simple story: Capital expenditure was financed in part by borrowing and current expenditure covered by revenues closely linked to the current level of output.

Figure 8 compares the growth of GDP to that for constant-price public expenditure and the overall deficit as a share of GDP. The movement in the deficit has a cyclical pattern, becoming negative during the two crises periods (1997–99 and after 2007). The 2010 *World Economic Situation and Prospects* report listed Thailand as one of more than 30 developing countries to introduce a fiscal stimulus in response to the global financial crisis. The report assigned the stimulus a value of $39 billion, which implied the largest stimulus relative to GDP of any country in the table (at 14.3 per cent, see UNDESA, 2010, p. 20). However, Thailand does not appear in a much shorter list of countries initiating stimuli in the *Trade and Development Report 2011* (UNCTAD, 2011, p. 43).

The percentage changes in real fiscal expenditure in Figure 8 support the United Nations Conference on Trade and Development (UNCTAD) finding rather than that of the United Nations Department of Economic and Social Affairs (UNDESA).[21] Whether matched for the same year or with a one-year lag (not shown), the changes in expenditure and GDP suggest a procyclical relationship. This interpretation clearly applies to 1997–98 and 2010–13. However, the IMF interpreted fiscal policy as expansionary during 2011–12:

> "Against the backdrop of the global financial crisis and the devastating 2011 floods, the expansionary fiscal policy pursued in recent years was justified, aimed at supporting aggregate demand and reconstruction activities. But now, the strength of the ongoing economic recovery provides an opportunity to gradually withdraw the fiscal stimulus, create fiscal space for priority infrastructure spending, and rebuild policy buffers to address future possible shocks." See www.imf.org/external/np/sec/pr/2013/pr13212.htm [accessed 14 Nov. 2014].

The IMF provides no statistical evidence in support of an expansionary fiscal policy. An IMF Working Paper in 2013 refers to fiscal expansion in Indonesia and the Philippines but not Thailand (IMF, 2013, pp. 1–2). The annual data in Figure 8, as well as the quarterly data from the same source, indicate that movements in the growth rate and expenditure were simultaneous. Given the well-documented lag between fiscal expenditure and the output response it provokes, simultaneity implies a procyclical not countercyclical policy.

The IMF optimism about the post-crisis recovery follows their optimistic assessment of the impact of the global economics crisis on the Thai economy. Their view is summarized in a chapter title in the 2008

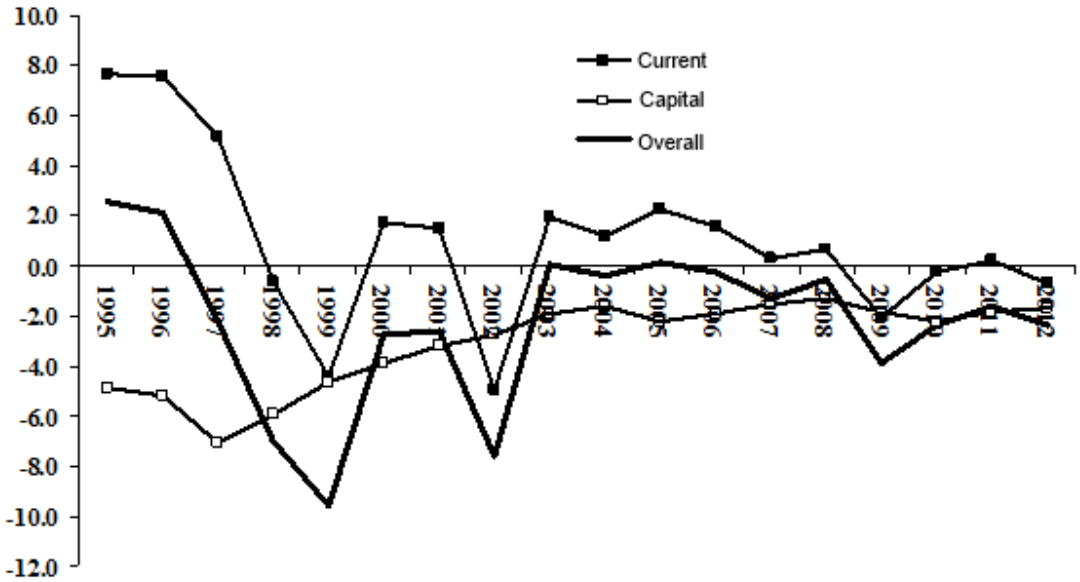
[21] No specific sources are given for the statistics in the table of stimuli in the UNDESA report. Both the UNDESA and the UNCTAD sources note that fiscal policy does not include all forms of economic stimuli. Both seek to focus on the fiscal policy affect, narrowly defined as central government expenditure.

Selected Issues report, "Much ado about nothing?" (IMF, 2008). As shown in Figure 4, the downturns proved considerably more severe than the IMF or national policy-makers anticipated, at a negative 8 per cent in 2008 and even greater in 2011. In contrast with the IMF, the Asian Development Bank's *Outlook Update 2013* refers to the likelihood of fiscal contraction rather than expansion (ADB, 2013, pp. 164–167).

The ADB interpreted the Government's fiscal policy response to the Asian financial crisis of the second half of the 1990s as expansionary: "The recovery that began in 1999 continued in 2000, stimulated by strong export growth and three fiscal packages" (ADB, 2000, p. 37).[22] Inspection of Figure 8 provides some support for this judgement, with real fiscal expenditure increasing by about 5 per cent in 1998, followed by a reversal from GDP contraction to expansion in 1999.

To summarize, the Thai Government may have used fiscal policy actively to counter the severe contraction during the Asian financial crisis. In contrast, no strong evidence supports its use of fiscal policy as a countercyclical tool after 2007. Partly as a result of the procyclical nature of fiscal policy, GDP growth was extremely unstable. This instability slowed the growth of employment and real wages. As a result, little progress was made towards achieving full and productive employment.

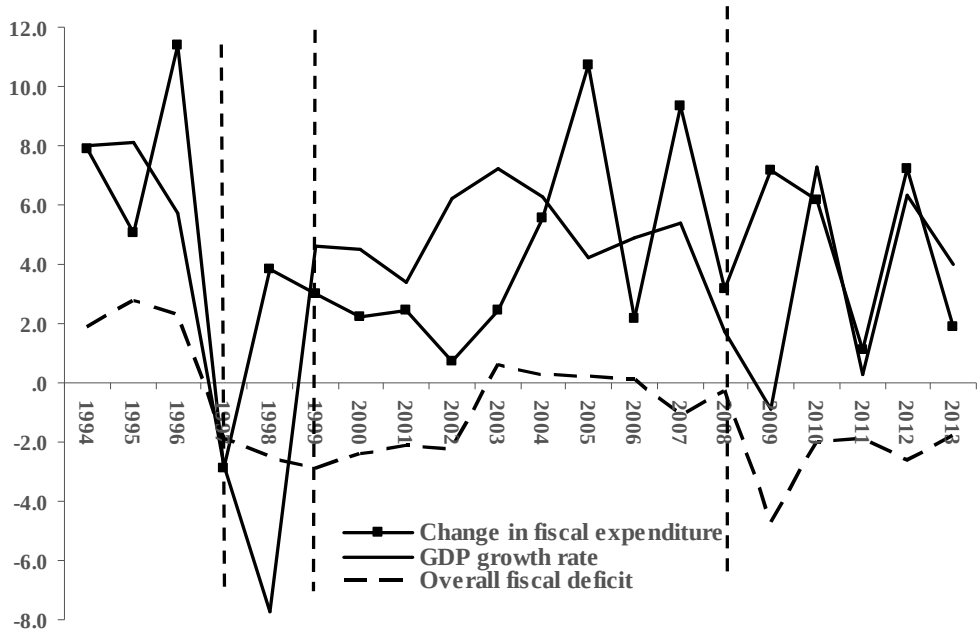
Figure 7. Annual fiscal balances in Thailand, 1995–2012



Source: ADB, 2013; National Statistical Office of Thailand (NSO), http://eng.nesdb.go.th/Default.aspx?tabid=95, Table 2 [accessed 14 Nov. 2014].

[22] Again, one finds a contrast with the IMF position, "Despite uncertainty about the evolution of the global economy, the Thai economy is expected to rebound sharply." (IMF, 2012, p. 1)

Figure 8. Percentage change in GDP growth rate and fiscal expenditure and the fiscal deficit as a share of GDP in Thailand, 1994–2012



Note: Expenditure for 2013 was estimated from the first two quarters, applying a seasonal adjustment multiplier.
Source: NSO, http://eng.nesdb.go.th/Default.aspx?tabid=95, Table 2 [accessed 14 Nov. 2014].

Monetary policy

In contrast to its fiscal policy, it appears that the Bank of Thailand applied monetary instruments in a countercyclical fashion. Such was the judgement of the IMF in 2013 when it said, "The Bank of Thailand's accommodative monetary stance is appropriately supporting the economy." However, it is not clear that, in Thailand, the accommodating monetary policy on its own had a substantial countercyclical impact.

Recent monetary statistics appear to support the IMF assessment that monetary policy was "supporting the economy". Figure 9 shows nominal interest rates for the Thai one-month treasury bill (T-bill), for ten-year bonds and the London interbank offer rate (LIBOR). Through mid-2009, the T-bill rate tracked the LIBOR down, before rising in 2010–11. Figure 10 shows the rate of change of the price-deflated monetary base (M1) and the ten-year bond rate, adjusted for inflation. Although the real growth of the monetary base could be interpreted as accommodating after 2008, its impact during 2005–08 is less clear. The movement of the bond rate shows the opposite – it is more favourable to economic expansion before 2008 than after. During the first 15 quarters in the chart, the real bond rate averaged slightly less than 0.5 per cent and only once rose above 2 per cent. During the subsequent 18 quarters, the average was 1 per cent, rising above 2 per cent in six quarters.

More important than real interest rates and the monetary base, following the Asian financial crisis the Thai Government adopted an inflation-targeting policy for the central bank (IMF, 2006, p. 2). In principle, inflation targeting need not subvert other macroeconomic objectives. If the inflation target was set in the low teens, for example, it should be possible in most developing countries to pursue active fiscal

policy and purposeful exchange rate management. An inflation target of 10 per cent would, in most circumstances, allow for moderate real wage increases and nominal depreciation to foster a shift from non-tradables to tradables.[23]

In practice and almost without exception, inflation targeting seeks to maintain inflation rates that constrain growth. For 36 years, from 1961 to 1996, the Thai economy grew at an average rate of almost 8 per cent, with 7.3 per cent in the 1980s the lowest decade average.[24] During the seven years from 1990 to 1996, growth averaged 8.6 per cent (see the discussion in Weeks, 2010, pp. 172–174). When the economy recovered from the Asian financial crisis, the growth rate for 2000–07 fell to 5 per cent under the inflation-targeting regime.

It is not difficult to understand why a low inflation target resulted in a reduction of growth. From 2000 to 2007, the rate of change of the GDP aggregate output deflator averaged 2.9 per cent. As is well known, the measured rate of inflation overstates actual price increases because of changes in the quality of products and the introduction of new products (Lisman, 1980). In the United States, the congressionally mandated Boskin Commission concluded that about 1.1 percentage points of the United States' GDP deflator represented quality change and new products (Boskin, 1996). On the website of the European Central Bank, a non-technical discussion of inflation states that 2 per cent per annual should be interpreted as price stability.[25]

If the contribution of quality change and new products is slightly more than 1 percentage point in the United States, which has a mature economy with relatively slow changes in the structure of output and consumption, it would be considerably higher in Thailand, perhaps closer to 2 percentage points. Further, in a market economy, the mechanism by which resources are reallocated among sectors is through price increases that signal rising profits. These two considerations alone suggest that an annual rate of price increases in the 3–4 per cent range would imply non-inflationary growth. Therefore, it is probable that the actual rate of inflation during 2000–07, at 2.9 per cent, reflected a deflationary pressure forced on the economy by the inflation-targeting regime, as standard theory would predict.[26]

In addition to the possibility that monetary policy has been deflationary since the Asian financial crisis, the effect of low inflation has probably contributed to growing inequality. As Chowdhury has argued (2005b), contrary to oft-repeated assertions, low inflation harms those at the lower end of the income distribution, most obviously but not only through repressing nominal wage growth (see also Nidhiprabha, 2013, pp. 5–6); her argument was verified empirically in a paper by Galli and van der Hoeven (2001).

In addition to the direct distributional effect of a low inflation policy, it appears that in Thailand, the successful attempt to repress inflation was associated with an inequality that reinforced change in relative prices. From 1995 through 2012, the food component of the consumer price index rose by almost 120 percentage points, while non-food items increased by less than 50 percentage points (Figure 11). At the

[23] The 10 per cent rate represents a conservative interpretation of Bruno and Easterly (1998), who estimate that considerably high inflation has no statistically significant impact on growth. This is supported by the Ayisi study of Ghana (2013).

[24] Inflation, by decades, was relatively low, at 3.1 per cent (in the1960s), 7.2 per cent (1970s), 5.2 per cent (1980s) and 4.9 per cent (1990–96) in the *World Development Indicators 2013* (World Bank).

[25] See European Central Bank, www.ecb.europa.eu/ecb/educational/html/index.en.html [accessed 14 Nov. 2014].

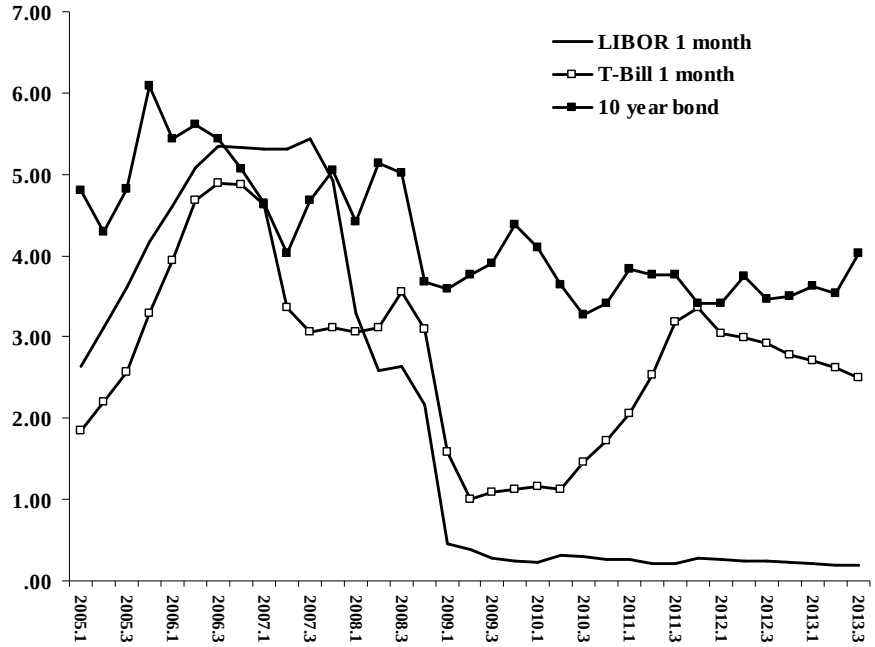
[26] If an economy is at less than full employment with imperfectly adjusting markets, monetary restraint will tend to depress out.

same time, producer prices rose at a similar rate to food prices, another inequality generating relative price change. Rising food prices reduced real incomes and rising producer prices raised profits of producers. This pattern follows the analysis in section 2.

To repeat that analysis, in an open economy, the monetary authorities have little impact on the price of tradables. Therefore, non-tradables must bear most of the weight of adjustment. It follows that in an open economy, reducing inflation in practice often means wage restraint.

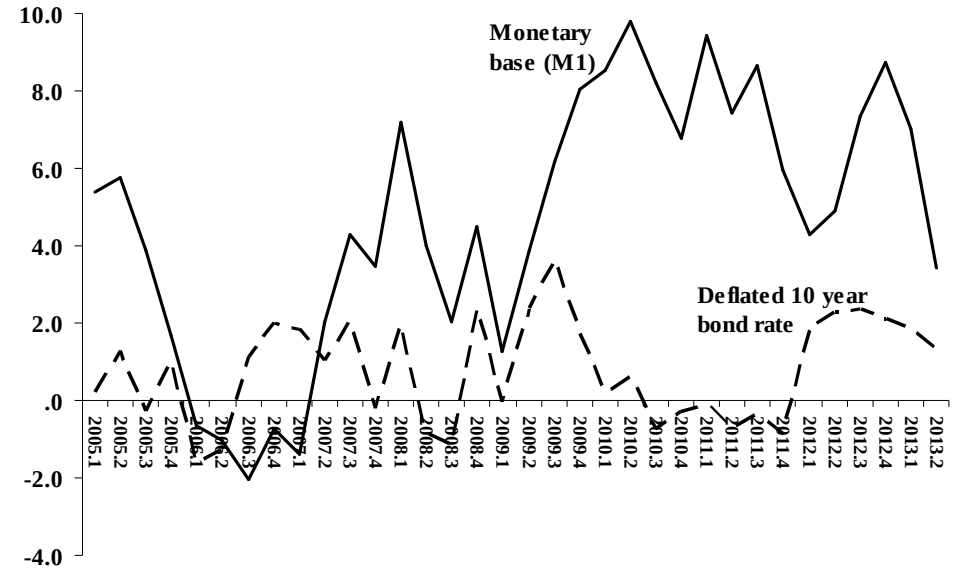
In summary, it is unlikely that monetary policy in Thailand made a contribution towards full and productive employment. To the extent that policy suppressed the overall inflation rate, it also suppressed nominal wage growth. Subsumed within the lower inflation calculations were relative price changes unfavourable to poverty reduction and presenting the increase of inequality. The Thai Government should reconsider its inflation-targeting policy and redesign it into a more flexible approach (see MPDD, 2013b).

Figure 9. Quarterly interest rates, LIBOR, T-bill and ten-year bond rate in Thailand, 2005q1–2013q2



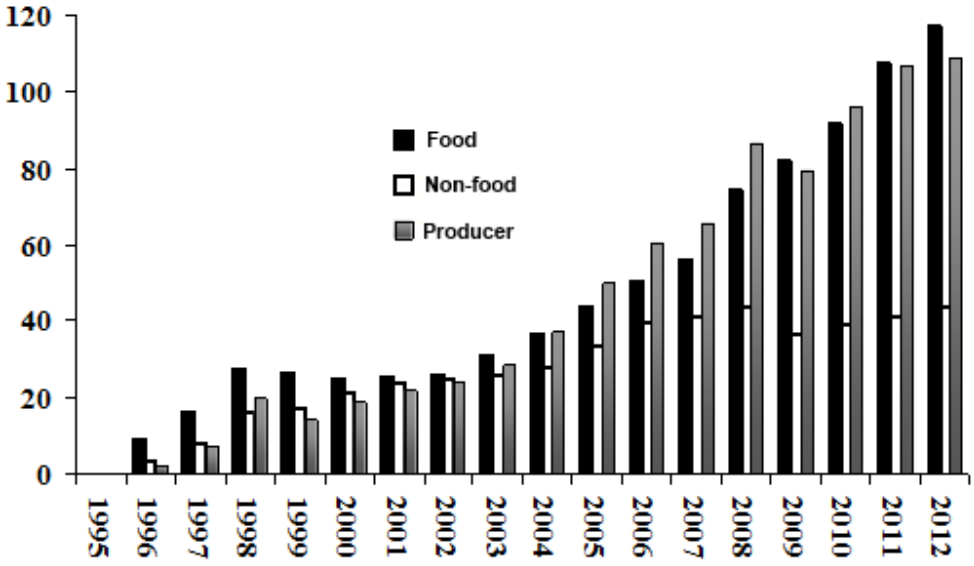
Source: Bank of Thailand, www.bot.or.th/English/Statistics/Pages/index1.aspx [accessed 14 Nov. 2014].

Figure 10. Quarterly price deflated M1 and ten-year bond rate in Thailand, 2005q1 to 2013q2



Source: Bank of Thailand, www.bot.or.th/English/Statistics/Pages/index1.aspx [accessed 14 Nov. 2014].

Figure 11. Price indices in Thailand, 1995–2012 (percentage point deviation from 1995)



Note: The food and non-food indices are from the national consumer price index. The producer price index refers to wholesale prices.
Source: ADB, 2013.

External policies

The Thai economy has been extremely successful in generating exports. This section suggests that policy-makers have shown less success in preventing the openness of the economy from generating internal

instability. The instability provides a prima facie case for policy action on the capital account in addition to measures introduced in the mid-2000s.

As Figure 12 shows clearly, since 2000 the baht has undergone an almost continuous appreciation, with the official dollar rate and the trade weighted rate virtually the same. Nominal appreciation is not a source of concern. On the contrary, if productivity in tradable sectors grows faster in one country, compared with its trading partners, its exchange rate should appreciate. To prevent it from doing so would imply a mercantilist trade policy.

In an open economy such as Thailand's, the relevant measure of the real exchange rate is the price ratio of tradables to non-tradables. Figure 13 presents this measure, treating agriculture and manufacturing as tradables and construction and services as non-tradables (services include the financial sector). This measure raises policy concerns, especially for agriculture, whose price index fell continuously from early 1993 through 2008, after which it stabilized before declining again. In contrast, the internal terms of trade for the manufacturing sector have fluctuated around a ten-year average, with no trend.

The downward trend for the agriculture sector could be cause for concern because employment in that sector in 2012 was three times employment in manufacturing, although it grew slower over the past decade. And even though a shift of labour from agriculture to industry in the process of Thailand's rapid growth is expected, this does not explain a fall in the internal terms of trade of the sector. The trend is all the more puzzling because food prices rose faster than prices for non-food (see figure 11). These trends might imply lagging productivity in the food-producing sectors.

The external sector has functioned as the driving force in Thailand’s growth and development. Over the past decade, it has also been the driver of instability, especially in the growth rate. Figure 14 illustrates that the terms of trade, measured as the ratio of border prices of exports to imports, manifest a pronounced cyclical pattern.[27]

More important has been the instability of the capital account. Figure 15 shows the most volatile element in the capital account – net portfolio flows – along with the GDP growth rate. The former is measured as a percentage of the eight-year average and the latter as a percentage of the growth rate. Most of the quarters of stable growth, from 2005q1 to 2008q1, coincided with relatively low and stable portfolio flows (until the last quarter of 2007). Subsequently, the severe fluctuations in the growth rate, a swing of 20 percentage points during 2009, occurred simultaneously with large reversals in portfolio flows.[28]

The destabilizing effect of capital flows prompted the Government to introduce regulations in 2006. Perhaps the most important of these was the requirement that banks hold reserves at 30 per cent of the short-term inflows, which would be released when the funds had remained in Thailand for one year.

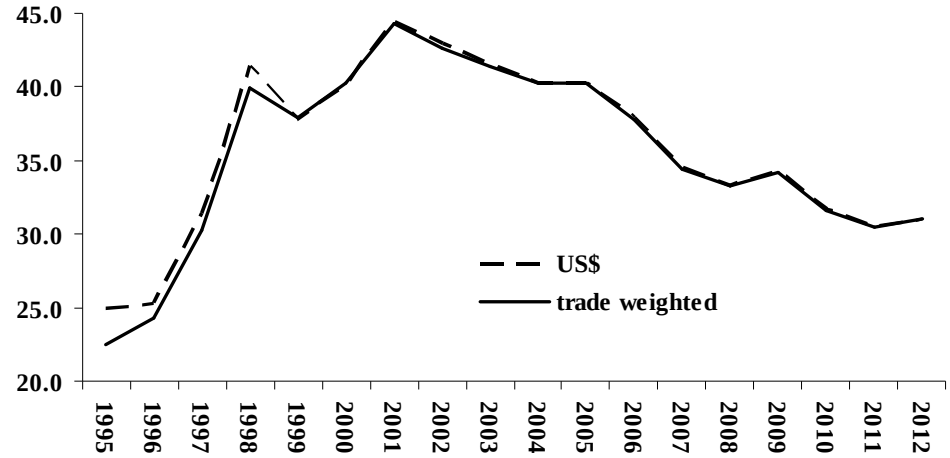
[27] The measure in Figure 13 is not seasonally adjusted. For the purpose of assessing its impact on domestic stability, seasonal adjustment is not appropriate.

[28] The even larger change in the growth rate after 2011q4 was, in great part, the result of the severe flooding during the monsoon season.

However, subsequent deregulation probably left the Government less able to influence short-term flows.[29]

Although considerable more research is required, it would appear that an extremely liberalized external sector has contributed to macroeconomic instability in Thailand and not to welfare gains, as some have suggested (Townsend and Ueda, 2007). This instability has weakened the ability of the Government and the economy to generate full and productive employment. Also, the external instability has strengthened tendencies to greater inequality, because those at the higher income levels can take advantage of speculative opportunities created by macroeconomic instability.

Figure 12. Two measures of the nominal exchange rate in Thailand, 1995–2012 (percentage-point deviations from period average)



Source: ADB, 2013.

[29] An IMF working paper on capital controls in the region summarizes the de-regulation as follows: "The authorities also extensively liberalized capital outflows to stem appreciation pressures. During 2007–08, the BOT raised the limit on overseas portfolio investments by residents, including certain institutional investors and Thai-listed companies. The ceiling on outward foreign direct investment (FDI) was also raised for investments in affiliated companies in January 2007. The deadline for repatriating foreign exchange proceeds was extended in February, allowing residents to keep their proceeds abroad in foreign currency longer, thereby relieving some of the pressure on the exchange market. In the same vein, regulations governing residents' foreign currency deposits and real estate investments were relaxed in July 2007 and February 2008" (Baba and Koykenyne, 2011, p. 10).

Figure 13. Two measures of the real exchange rate in Thailand, by quarter, 1993q1–2013q2 (percentage-point deviations from period average)

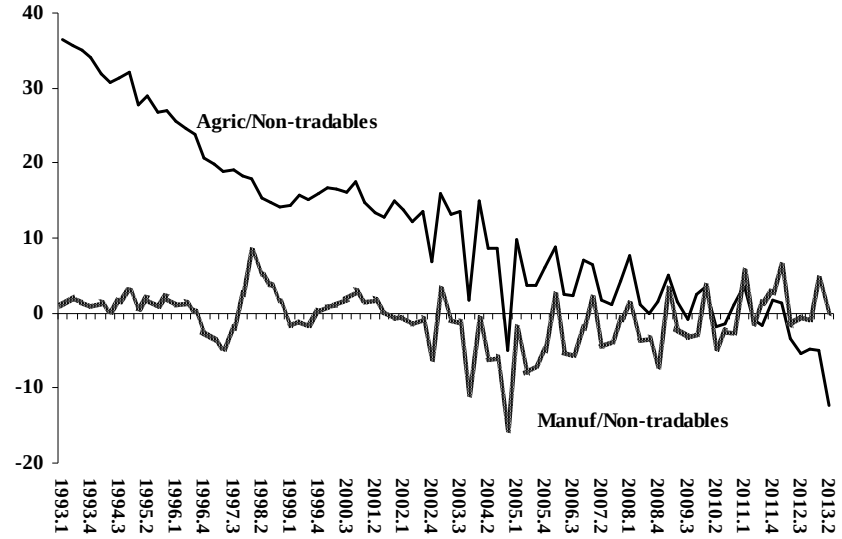
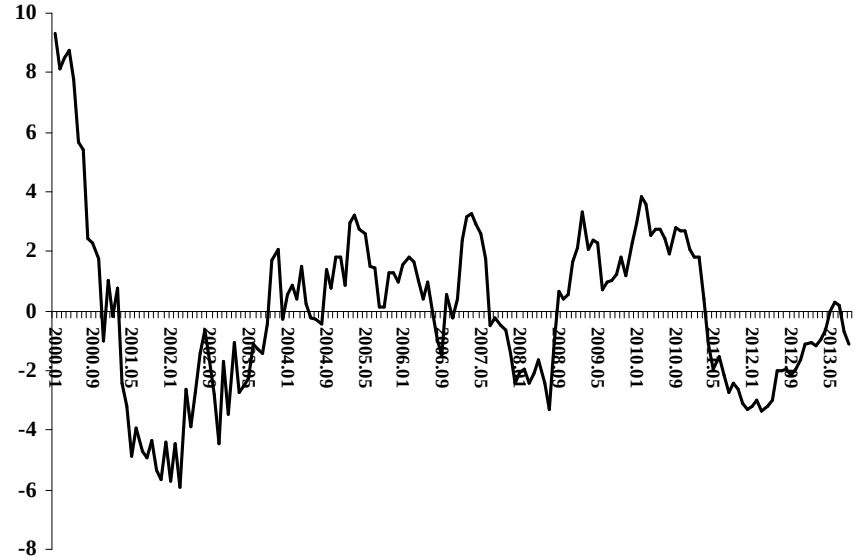
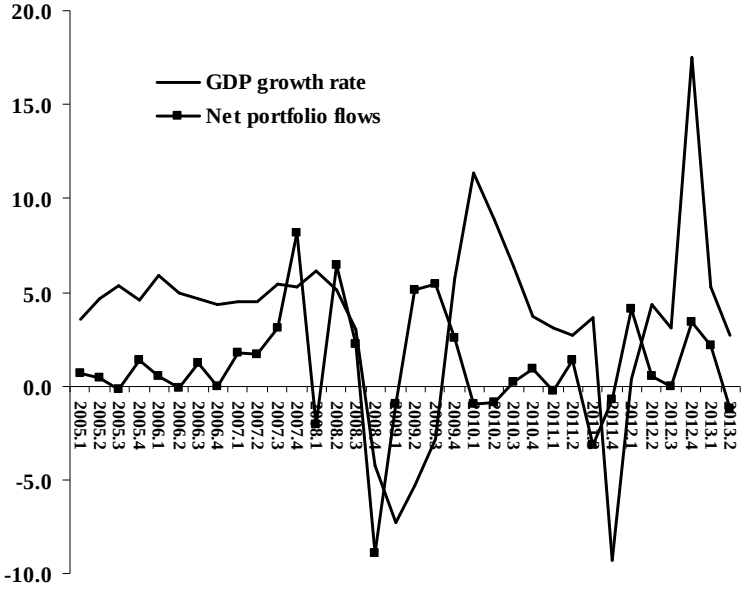


Figure 14. Monthly terms of trade between export and import prices in Thailand, January 2000–September 2013 (percentage-point deviations from period average)



Source: Bank of Thailand, excel file (EC_EI_019: Trade Indices and Terms of Trade).

Figure 15. GDP growth rate (%) and net portfolio flows in Thailand, 2005q1 to 2013q2 (relative to its average for the period)



Source: Bank of Thailand, www.bot.or.th/English/Statistics/Pages/index1.aspx [accessed 14 Nov. 2014].

Summary and assessment

The Thai economy demonstrated a remarkable rate of growth of output, exports and employment for more than 30 years, from 1960 to 1996. Subsequently, output and employment growth have become considerably slower, though well above rates for the majority of developing countries. Of more concern for employment, poverty and general welfare, the macroeconomy has displayed substantial instability.

There are obvious policy components to the instability. First and perhaps most important, since the Asian crisis, fiscal policy has been procyclical. Second, the overall impact of monetary policy since 2000 appears, at best, ambiguous regarding growth. Third, a shift from mild regulation to strong deregulation of the external sector, especially the capital account, leaves the Government with few tools to effect what appears to be a major source of macroeconomic instability.[30]

Countries do not achieve full and productive employment without pursuing policies designed for this goal. Until the global crisis of 2008, the Thai economy grew at a rate more than sufficient to provide full and productive employment for its residents. Through application of appropriate policies, the Government can create the tools to convert growth into fuller or high employment, rising real wages and job security.

[30] To quote from a UNESCAP policy brief, "Asia–Pacific countries have already introduced several measures to manage excessive short-term capital flows while still encouraging FDI. Therefore, capital account openness should not be viewed as an all-or-nothing proposition. Capital account can be open to equity flows – both portfolio and FDI, even when money and bond flows are managed." (MPDD, 2013a, p. 2)

3.3 Case study of Viet Nam

Economic trends pre- and post-global crisis

With few exceptions, general discussions with policy-makers and researchers in Viet Nam have focused on a perception of declining growth potential for the economy. The explanations given for this decline are a weak financial sector burdened with non-performing loans and failure by the Government to restructure state-owned enterprises. The argument concludes that if these structural obstacles were to be overcome, further export growth would be the driving force for higher growth rates.

Some discussions extended a pejorative assessment of current growth rates to the entire period since the re-orientation of the economy under the Dổi Mới policy (explained in Vuong et al., 2011). The central contention is that economic growth in Viet Nam over the past two decades compares unfavourably to the performance of China. The simplest statement of this position is: China grew consistently at 10 per cent, why not Viet Nam?

An assessment of the health of the financial sector in Viet Nam and of the need for change in state-owned enterprises lies beyond the scope of this paper. However, some general comments apply. First, for almost 20 years, bilateral and multilateral development agencies predicted that the lack of fundamental changes in the financial sector and state enterprises presented an imminent barrier to rapid growth. During much of that time, Viet Nam enjoyed a growth rate far above the average for low- and medium-income countries.

Second, citing the financial sector and state enterprises as obstacles to faster growth requires a clear explanation of the nature of these obstacles and how proposed structural changes would overcome them. Without specifics, the argument for changes in financial institutions and state enterprises is of limited usefulness, rather like past assertions that "pro-market reforms" would automatically result in faster growth.

Finally, the argument that China's faster growth provides prima facie evidence of an inadequate growth performance in Viet Nam should not be taken seriously. In effect, the argument poses the question, why did Viet Nam not grow faster than the fastest-growing country in the world? The simple answer to that question is, by definition, only one country can have the fastest-growth rate, and which country achieves it reflects many influences, some of them domestic and others external. The more complex answer involves identifying the sources of China's rapid growth rather than treating that growth as the normal outcome to which every other country can or should aspire.

The comparison of China to Viet Nam, or any other country, raises a fundamental issue. What is the appropriate growth target for policy-makers in each country? Seeking the fastest achievable growth rate cannot be justified by either economic or social arguments. Basic economic theory informs us that faster growth requires a larger share of investment in national income. As rapid growth continues, the economy approaches full capacity, and increasing investment requires foregoing current expenditure by households or the public sector. A rational economic design of growth policy thus requires assessment of the trade-off between current expenditure and future expenditure. Only by chance would that assessment result in

policy-makers choosing the maximum achievable growth rate.

The social costs of growth can be quite high, as China's performance over the past 20 years demonstrates. The most obvious of these costs are environmental damage, income and wealth inequality and unmanageable rates of urbanization. For example, the severe level of air pollution in Hanoi demonstrates clearly a major cost of growth.

An assessment of the growth performance in Viet Nam should be placed in the context of four principles: (i) Seeking the maximum achievable growth rate is not rational policy; (ii) Comparisons to China are of limited relevance; (iii) Structural changes in finance and state enterprises should be assessed for their own sake, not their growth impact; and (iv) The contribution of growth to generating full and productive employment is more important than the rate of growth itself. These considerations provide the guidelines to interpret figure 16. It is important to stress the third point. Reform of the financial sector should be designed to address its specific internal weaknesses. If done successfully, this will contribute to growth and development. If done for some derivative reason, such as the probable impact on growth, the result might contribute to the goal in the short run while laying the basis for future financial instability.

In the early and mid-1990s, economic growth in Viet Nam proceeded at an extremely rapid rate, in excess of 10 per cent in 1995. The Asian financial crisis of 1997–99 brought a sharp decline in growth, although the impact on Viet Nam proved considerably less than on any other country in the region, with the possible exception of China (Weeks, 2010). Following that crisis, growth recovered, averaging more than 7 per cent per annum from 1999 to 2006. In 2007, the global economic crisis again caused a sharp decline in the growth rate, followed by recovery to a level at about 1.5 percentage points below the pre-crisis rate.

The growth performance shown in Figure 16 prompts several conclusions. First, compared with most countries in the region, especially Thailand, economic growth in Viet Nam over the past 20 years was rapid and stable. Second, the growth performance demonstrates a clear pattern of adjustments to lower sustainable growth, in excess of 8 per cent per annum in the early 1990s, to about 7 per cent in the pre-crisis 2000s, and 5–6 per cent after the global crisis.

A United Nations Development Programme (UNDP) report on the Vietnamese economy in 2004 predicted this pattern of step-wise movements to a slower sustainable level, on the basis of the following analysis (Weeks et al., 2004). In the first years of the transition from central planning to market regulation, the Vietnamese economy expanded rapidly as households and businesses exploited the advantages of greater flexibility in production and consumption. Government policies in favour of export growth provided a strong external growth stimulus (Weeks, 2001). At the same time, labour migration from low-productivity agriculture to industry raised output per worker. Large inflows of private investment supplemented domestic sources of capital formation.

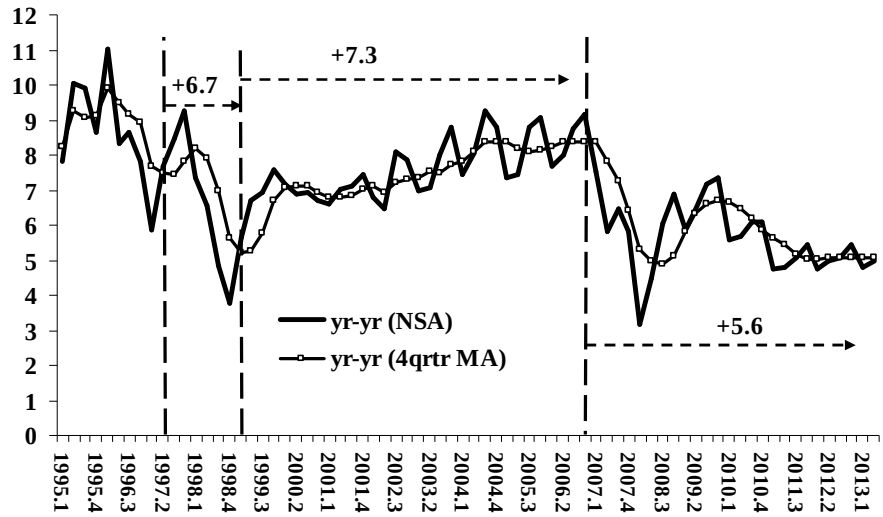
Through the 2000s, the impact of growth-enhancing factors associated with structural transition declined, leaving investment in capacity and improvements in the labour force as the central sources of increases in economic potential. As in the 1990s, the external sector provided a major stimulus on the demand side. Figure 17 indicates that domestic capital formation reached its peak of almost 40 per cent of GDP just before the global crisis of 2008, then returned to nearly that level in the 1990s and early 2000s, at 30–35 per cent. If net capital formation were about 5 percentage points lower and the capital output ratio in the

range of 4–5 per cent, the implied growth of capacity would be 5–6 per cent, the actual rate after the crisis.

Inspection of Figure 17 also suggests that it would be highly unlikely that the external sector will continue to be a major source of demand stimulus. In 2012, export earnings reached 80 per cent of GDP.[31] If the external sector were to continue to function as an engine of growth, this would imply that exports were growing faster than GDP and that the export-GDP ratio was approaching 100 per cent. While this is conceivable, it would be unprecedented for a country with Viet Nam's population and would be subject to diminishing returns at the extensive margin.

These key statistics for the investment and export shares indicate that 5–6 per cent represents the sustainable growth rate for Viet Nam. With a population growth rate of 1 per cent, this growth rate implies a doubling of per capita income in 15 years. Since 2006, this rate of growth has been consistent with a stable distribution of income (ILSSA, 2012, p. 79), which contrasts with the strong trend towards inequality in the 1990s and first half of the 2000s (Weeks et al., 2004, pp. 47–49). If this growth rate remains consistent with no increase in inequality, it should be sufficient to provide for full and productive employment, with declining poverty rates.

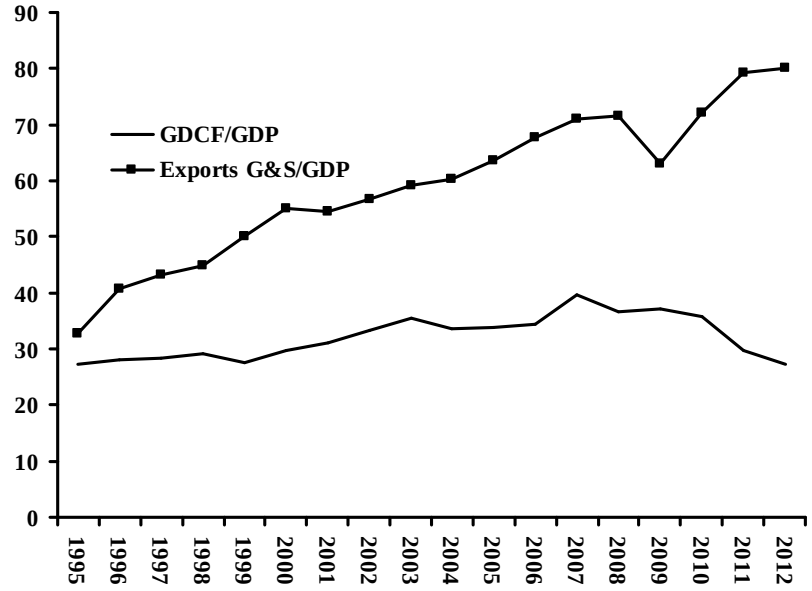
Figure 16. Quarterly GDP growth in Viet Nam, 1994q1–2013q2



Notes: yr-yr (NSA)=rate of growth compared to same quarter previous year, not seasonally adjusted; yr-yr (4 qrtr MA)=moving average of current three preceding quarters of same time series.
Source: ADB, http://aric.adb.org/indicators/Real_Sector_and_Prices/R_VIE_Q_Real_Sector_and_Prices.htm [accessed 14 Nov. 2014].

[31] The ratio of export value added to GDP was considerably smaller.

Figure 17. Gross domestic capital formation and exports of goods and services, percentage of GDP in Viet Nam, 1995–2012



Source: ADB, www.adb.org/statistics [accessed 14 Nov. 2104].

Fiscal policy

As in other transition countries, Viet Nam suffered from large public sector deficits with the end of central planning. These deficits occurred because in the central planning period, revenue derived from the surpluses of state enterprises whose profitability collapsed with the change to market regulation. The Vietnamese Government achieved a shift to a tax-based revenue system relatively smoothly.

Figure 18 shows the current and overall fiscal balances. For the 19 years from 1994 to 2012, only once did the overall balance exceed 3 per cent of GDP (in 2001). The current account balance averaged a surplus of more than 6 per cent of GDP. This large surplus financed public sector investments, which made a major contribution to growth, accounting for up to 20 per cent of the demand stimulus in the 1990s (Weeks et al., 2004, p. 33). This is in contrast to Thailand, where public investment was relatively small and the current account surplus over the same years was just 1 per cent of GDP.

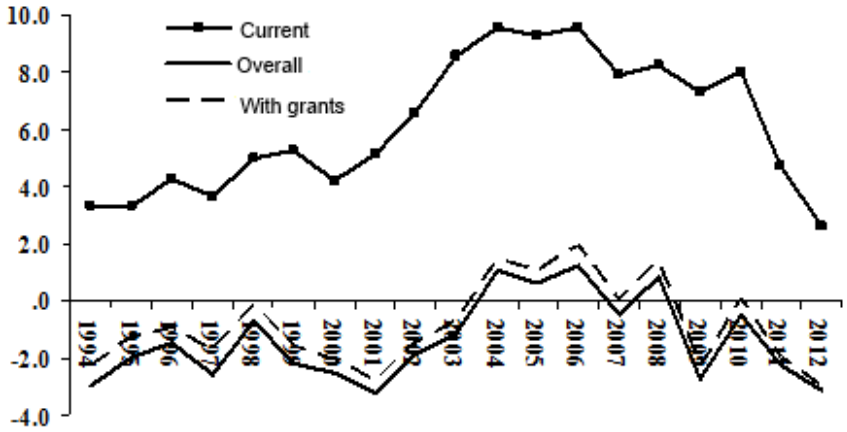
The major role of public investment in Viet Nam and its comparative absence in Thailand partly explains the stability of growth in the former country, compared with the latter. In every country, private investment displays a procyclical pattern and, along with external demand, is the major cause of cyclical output instability. Public investment is inherently countercyclical, and its absence strengthens procyclical disturbances. Unlike current expenditure, the countercyclical role of public investment is non-discretionary. Because investment projects typically take several years to construct, they impart stability to aggregate demand over the cycle.

Current expenditure was also considerably more stable in Viet Nam than in Thailand. The stability of public sector current demand in Viet Nam is demonstrated in figure 19, which should be compared with

the same chart for Thailand (figure 8). During 1994–2012, the coefficient of variation of current expenditure in Viet Nam was 0.3; that is, the standard deviation was only a third of the mean variation. By contrast, for Thailand the coefficient of variation exceeded 3.

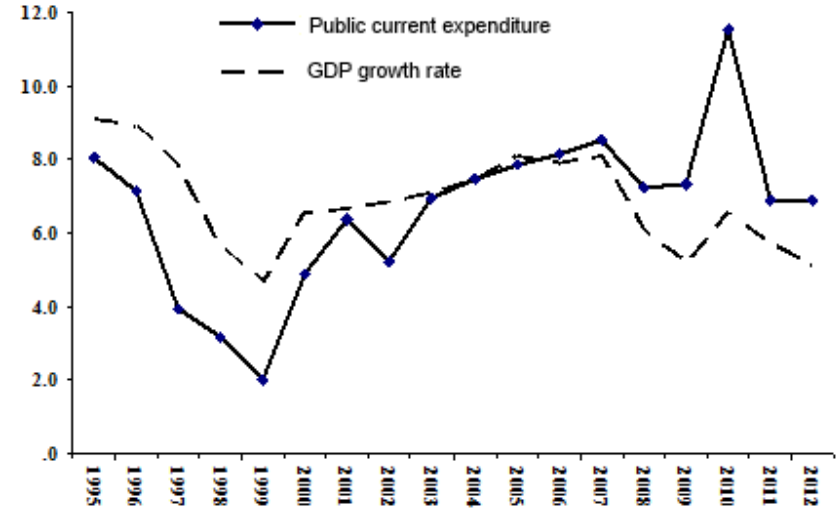
In summary, growth stability in Viet Nam resulted from the stability of public expenditure, both current and capital. Stability of public expenditure provided countercyclical smoothing of aggregate demand to compensate for external shocks to exports and private investment. Stability of growth maintained stability in revenue flows, which maintained low variability in the public sector fiscal balances. The Vietnamese case demonstrates the effectiveness of sound, countercyclical fiscal policy.

Figure 18. Fiscal balances in Viet Nam, 1994–2012



Source: ADB, 2013.

Figure 19. Percentage change in constant price current account expenditure and GDP growth rate in Viet Nam, 1995–2012



Source: ADB, 2013.

Monetary policy

The State Bank of Vietnam functions as the country's central bank and takes responsibility for monetary policy. Unlike all the other central banks in the region, the State Bank operates under guidance from the Government. The absence of so-called independence facilitates the coordination of the monetary and fiscal policies.

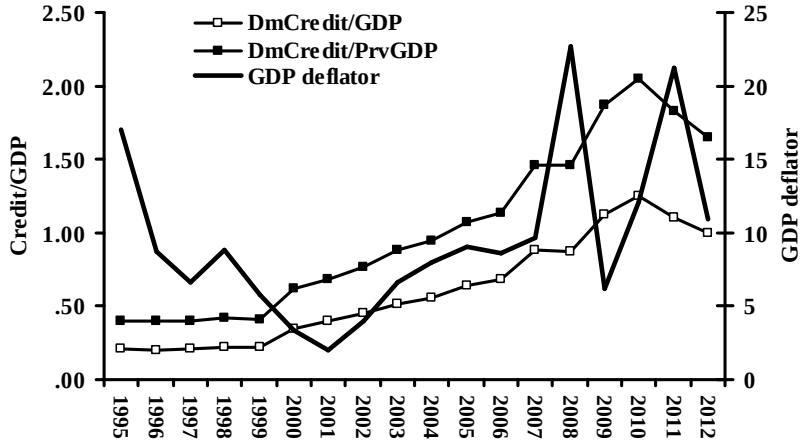
Experts from the State Bank describe monetary policy as supportive of fiscal policy. During the global crisis of 2008–09, the State Bank implemented an expansionary monetary policy in an attempt to mitigate the impact of external shocks. The internal assessment by State Bank officials was that the monetary policy was successful overall, though in some cases excessively expansionary.

Figure 20 tends to support the State Bank narrative. The chart shows the ratio of domestic credit to total GDP and to "private GDP" (total GDP minus agriculture, public administration and the "other" category). The second measure seeks to approximate the ratio of credit to private enterprises, organized along capitalist principles. The credit measures are compared with movements in the GDP deflator. The slow growth of the credit to GDP ratios in the 1990s coincided with a fall in the GDP price deflator. During 2001–07, the continuous rise in the credit ratios matched a similar trend in the deflator.

The domestic credit ratios rose rapidly during 2008–10 and then declined in 2011 and 2012. The highest rates of inflation occurred during 2008–12, though the annual movements do not match those of the credit ratios. Comparing the changes in the GDP price deflator with the credit ratios suggests a considerably more complex inflationary process than in the various manifestations of the quantity theory of money hypothesis. Nonetheless, credit expansion appears to have been unnecessarily expansionary after 2007, as State Bank officials suggest. This excessive credit expansion was associated with sharp fluctuations in the rate of inflation rather than an inflationary spiral. Despite the moments of excessive monetary expansion, the accommodating monetary policy could be judged as successful.

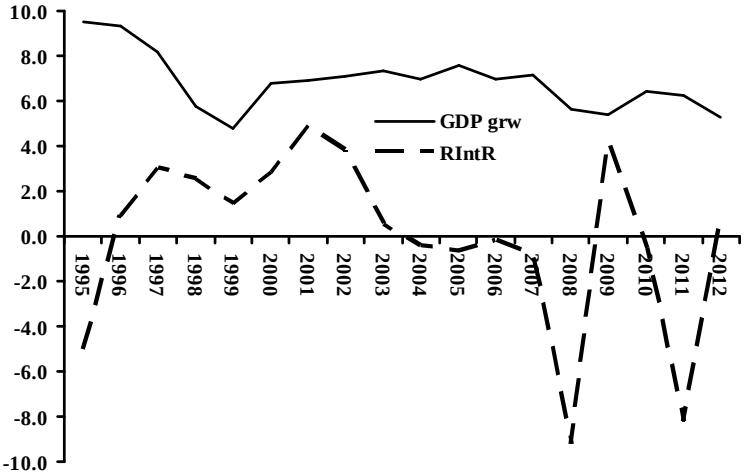
Figure 21 reflects another indicator of monetary accommodation of fiscal policy – the inflation-deflated deposit rate, which is not a policy instrument but an outcome. With this in mind, it would appear that the measures implemented by the State Bank resulted in low and negative interest rates after 2007. The extent to which these low rates mitigated falls in private investment cannot be assessed with the available statistics. The rates, however, provide further support for the conclusion that the State Bank implemented a countercyclical monetary policy that supported the growth of the real economy without generating destabilizing inflation.

Figure 20. Domestic credit and the GDP deflator in Viet Nam, 1995–2012



Notes: DmCredit/GDP is the ratio of domestic credit to total GDP. DmCredit/PrvGDP is the ratio of domestic credit to private GDP (total GDP minus agriculture, public administration and "other").
Source: ADB, 2013.

Figure 21. Change in the real borrowing rate and GDP growth in Viet Nam, 1995–2012



Note: The real borrowing rate is the 12-month deposit rate minus the GDP deflator.
Source: ADB, 2013.

External policies

The most striking aspect of the external account of Viet Nam is the extraordinary growth of trade. In 1994, exports of goods and services were $4 billion and rose in 2012 to $115 billion (figure 22). Equally striking, the increase in export revenue did not result in sustained trade surpluses. On the contrary, a trade balance in 1999 was followed by 12 consecutive years of deficits, until a tiny surplus of $1 billion in 2012.

To a great extent, the growth of exports in the 1990s resulted from a conscious state trading policy that sought to avoid the extreme instability of the countries of central Europe and the former Soviet Union.

Policy-makers in Viet Nam attributed much of the macroeconomic instability in those countries to a combination of sudden price deregulation and massive trade deficits. For Viet Nam, the solution to this apparently intractable dilemma was a trade policy bordering on mercantilism that resulted in the country becoming the world's third-largest rice exporter (Weeks et al., 2004). Export promotion continued after 2000, stronger than before. By 2010–12, export earnings reached 80 per cent of GDP.

The rapid growth of exports did not result primarily from the exchange rate policy. As Figure 23 shows, the nominal exchange depreciated almost continuously from 1994 to 2012, as measured by the official rate and the implicit export and import rates. Figure 24 provides the real exchange rates associated with the nominal movements. The commonly used measure of purchasing power parity (PPP) shows a substantial and continuous appreciation of 40 per cent from 1994 to 2012.

The PPP rate provides little insight into competitiveness in trade. More relevant are the ratios of tradables to non-tradables, which indicate relative domestic returns. These show trends quite different from the PPP rate. The relative price of agricultural products to non-tradables substantially depreciated, while that for manufacturing remained almost constant. Real depreciation for agriculture might account for the export growth of that sector. But this does not explain the growth of manufacturing exports.

It is possible that non-agricultural exports increased so rapidly due to more rapid productivity increases in Viet Nam, compared with its export competitors. This explanation seems unlikely for two reasons. First, such a phenomenal growth of exports would imply a cross-country advantage in productivity growth that is hardly credible. Second, rapid productivity growth in tradables is typically associated with a trade surplus – not the deficits experienced by Viet Nam.

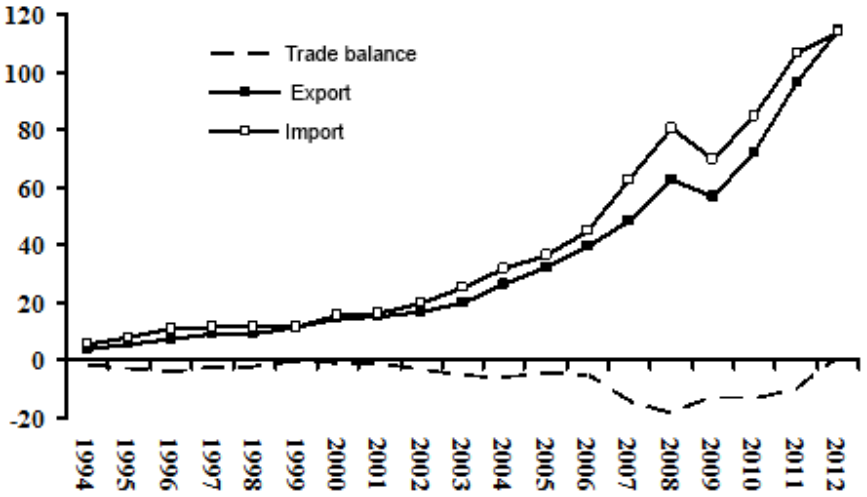
Government policy interventions provide a probable explanation of the growth of trade rather than relative prices. If this is a correct interpretation, trade promotion policies may be approaching their practical limit. Further growth of exports would require further transfer of resources from non-tradables to tradables. As the share of resources in non-tradables declines, the productivity of further transfer would be expected to decline. Vietnamese policy should consider a growth strategy more focused on domestic investment, both public and private.

As a final observation on external policies, the discussion returns to the theme of the stability of Viet Nam's growth rate. Figure 25 shows the three major external balances: for trade, the current account and the capital account. These are complemented by Figure 26, which presents long-term capital flows and foreign reserves in months of imports. The external balances demonstrate shocks to exports, which resulted in a substantial trade deficit in 2008. In the short term, a large increase in the capital account balance covered the current account deficit, followed by a rapid increase in exports to re-establish external stability in the medium term.

Figure 26 elaborates on the external adjustment during 2008–12. A sharp de-accumulation of reserves in 2008 mitigated the potential short-term instability. The capital account surplus resulted from increases in direct investment and other long-term flows (including official inflows from bilateral and multilateral sources). The Vietnamese adjustment to external shocks stands in marked contrast to the Thai adjustment in which severe fluctuations in the trade and capital accounts reinforced each other to destabilize the growth rate (see Figures 3 and 15).

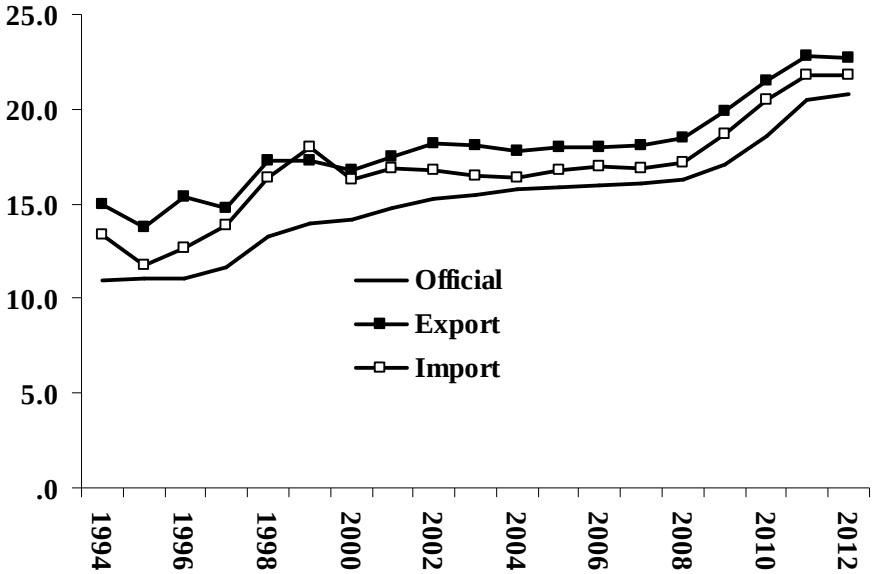
The contrast between smooth and unstable adjustment to the global shocks at the end of the 2000s has an obvious explanation: regulated versus liberalized external accounts. In Viet Nam, limitations on the convertibility of the dong combined with relatively small portfolio flows. This combination had two important policy consequences: (i) It imparted to the external account an automatic countercyclical mechanism; and (ii) it facilitated management of the capital account by policy-makers. The countercyclical mechanism resulted because the restrictions on convertibility prevented capital outflow when the external account weakened.

Figure 22. Exports, imports and trade balance in Viet Nam, 1994–2012 (current $ billion)



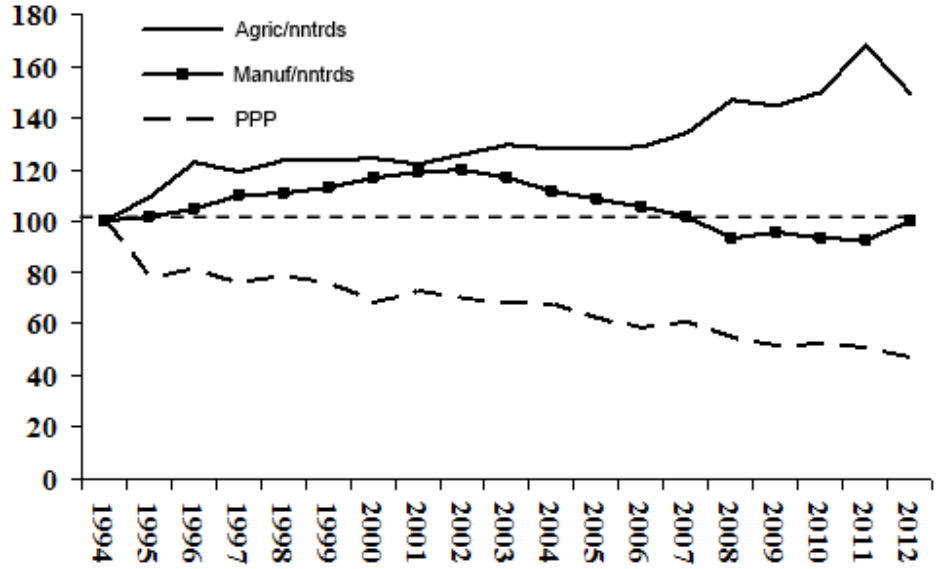
Source: ADB, 2013.

Figure 23. Nominal exchange rates in Viet Nam, 1994–2012 (dong '000 per $1)



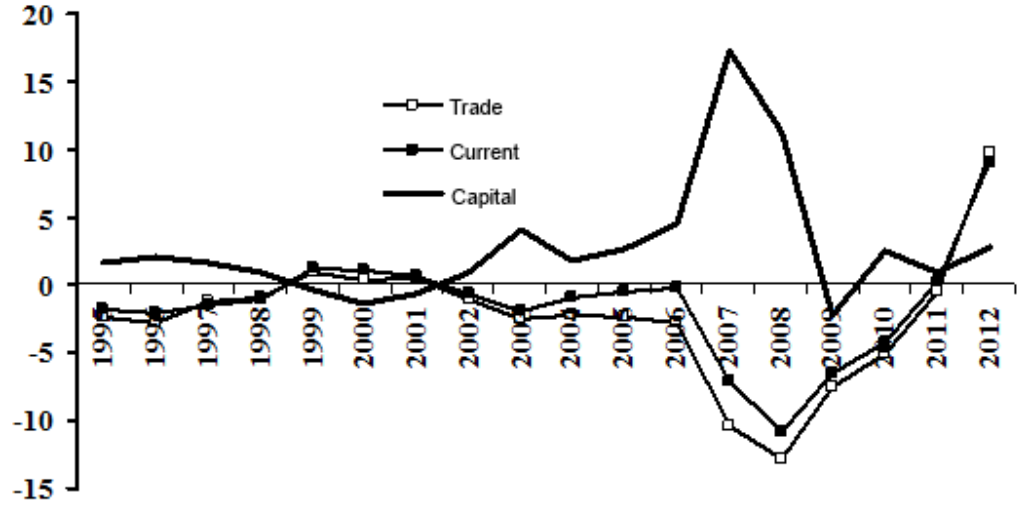
Note: The export and import rates are calculated by dividing trade in dong by trade in US dollars.
Source: ADB, 2013.

Figure 24. Real exchange rates in Viet Nam, tradables, non-tradables and PPP, 1994–2012



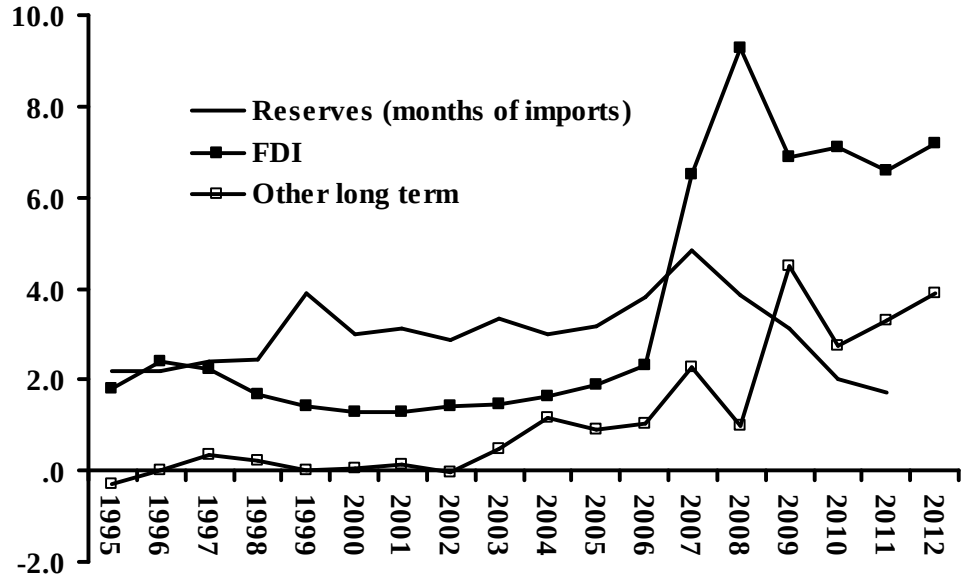
Source: ADB, 2013.

Figure 25. External balances in Viet Nam, 1995–2012 ($ billion)



Note: Capital account measured as the overall balance minus the current balance.
Source: ADB, 2013.

Figure 26. Long-term capital flows and reserves in Viet Nam (months of imports), 1995–2012



Source: ADB, 2013.

Summary and assessment

Although the macroeconomic policies of the Vietnamese Government suffered from mistakes of timing and execution, evidence suggests that they contributed to the stability of growth over the past 20 years. This stability is in contrast to the growth performance in Thailand. The lack of reliable employment statistics covering the two decades makes it impossible to assess progress towards full and productive employment. Any attempt to assess the employment impact of growth by necessity is speculative. With this in mind, I assessed that the rate and stability of growth provided a framework sufficient for the outcome, if combined with equitable wage and distribution policies.

The growth process in Viet Nam is not without its problems. The frequently cited need to restructure the financial sector and state enterprises may prove of secondary importance to a flaw in the growth strategy itself. As explained in previous sections, the Vietnamese Government achieved a remarkably smooth transition from central planning to market regulation by pursing an export-led growth strategy. Rapidly expanding exports combined with long-term capital inflow to stabilize the exchange rate, which facilitated price stability.

For several reasons, the economy may now press against the limits of the export-led strategy. An export-led strategy requires the continuous transfer of resources from non-tradables to tradables. Because both categories of goods require that labourers have sector-specific skills, the productivity of the labour transfer is likely to decline at the extensive margin. With few exceptions, capital is product specific, which implies that the labour transfer must be accompanied by an increase in investment. With investment well over 30 per cent of GDP in Viet Nam now, more investment is likely to generate diminishing growth.

Second, the likelihood is low that the global economy will soon deliver the high rates of growth of trade that prevailed before the global crisis. A commonly expressed hope among researchers in Viet Nam, though less frequent among policy-makers, is that the problem of slow growth in international trade might be overcome by the proposed Trans-Pacific Partnership. It is not obvious that this US-proposed trade agreement will increase export opportunities for Viet Nam. The US Senate might not approve this treaty in the near future and perhaps even reject it. Were it to be approved by the US Senate, Vietnamese policy-makers would need to assess the balance between trade creation and trade diversion. It is not clear what advantages the Partnership would bring to Viet Nam that are not currently provided by membership in the World Trade Organization.

There can be no question that exports as well as employment creation drove the rapid growth of the Vietnamese economy over the past 20 years. Global economic prospects and proposed re-organization of domestic finance and state enterprises suggest that a more diversified strategy is now required. This strategy could place greater emphasis on equity via rising wages and domestic demand. Enhancing the voice of workers' organizations would be an important aspect of the broader and more equitable strategy.

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Annex. Relevant extracts from the terms of reference

1. Fundamental objectives and constraints

"…[A]n approach that focuses on engendering predictability and stability in key nominal aggregates that are used to depict both **internal balance** (inflation, fiscal sustainability) and **external balance** (current account deficits and external indebtedness) using either implicit or explicit prudential thresholds (such as low, single digit inflation or pre-determined limits on fiscal deficits regardless of understanding countries existing economic structures and conditions) remains disconnected from the broader economic goals of growth, structural transformation, employment and poverty reduction. Furthermore, the conventional focus on macroeconomic stability has not adequately equipped policy-makers – both in rich and poor countries – to either anticipate or readily cope with global economic volatility and interdependence. The Survey 2013 highlighted that a long-term macroeconomic simulation exercise showed that governments could pursue inclusive and sustainable development while maintaining fiscal sustainability and price stability at the same time. The report suggested that there was not necessarily a trade-off between economic growth, social development and environmental sustainability. The three pillars of sustainable development can support and strengthen each other, thus challenging the 'grow first' paradigm."

2. Policy areas

"The country-level studies will seek to establish by examining **four policy areas** – monetary policy, fiscal policy, exchange rate policy and capital account management – the alignment between macroeconomic management and the broader economic goals of growth, structural change, employment and poverty reduction, and their potential impact on macroeconomic sustainability since the 1990s. A list of salient issues – and the pertinent methods of enquiry –that should be applied in the country studies by each policy area is enumerated below, especially by drawing lessons from the 1997–98 Asian financial crisis and the 2008–09 global financial and economic crisis in these two countries under consideration. The relevant policy recommendations will then follow from such an investigation."

3. Policy instruments

"(A) Overall, identification of key macroeconomic outcomes of concern in the country, from the perspectives of macroeconomic management, employment and labour market outcomes and inclusive growth

1. Some broad assessment should be made on whether the concerns are of short- or longer-term nature, and whether the current macroeconomic policy responses and framework are adequate in addressing such macroeconomic concerns. By macroeconomic policy framework, it is meant to address cases where certain macroeconomic instruments may not be 'effective' and play a secondary role to other macroeconomic policy targets and key instruments used to attain these targets (e.g. fiscal policy may play a secondary adjustment-oriented role, as against proactive allocative or redistributive role, to inflation-

targeting monetary policy). In the case of Thailand and Viet Nam, the macroeconomic outcomes of concern may include: fiscal sustainability, current account deficits asset price, inflation, and exchange rate movements, among others.

2. An assessment of the mechanism by which macroeconomic outcomes affect employment and labour market outcomes, as well as the likely extent of such impact. In other words, to what extent are macroeconomic outcomes and policy framework acting as a constraint or an enabler to generation of decent work and enhancement of productivity (within the existing sectors and mobility towards productive employment opportunities)?

3. An assessment of the compatibility of macroeconomic policy framework and macroeconomic outcomes with the objectives of poverty reduction, inclusive growth and decent work for all.

4. To what extent can differences in macroeconomic policy framework and responses explain the differences in outcomes between the 1997–98 and 2008–09 crises in terms of poverty and decent work?

5. What policy lessons can be learned from comparative experiences of Thailand and Viet Nam in the macroeconomic policy framework that would be needed to reduce poverty and inequality and promote decent work opportunities?"

4. Monetary policy

"(B) Key macroeconomic policy instruments and their impact on employment and poverty: monetary policy

1. What are the current de jure and de facto goals and targets of monetary policy with respect to: (a) inflation; (b) growth; and; (c) employment and poverty?

2. What are the salient institutional and socio-economic forces (both domestic and external11) that have shaped the de jure and de facto goals and targets since the 1990s?

3. Has the central bank been actively engaged in: (a) directed credit allocation to influence structural transformation; (e.g. through designation of priority industries/sectors); (b) promoting initiatives that enhance access to credit by small and medium-sized enterprises (SMEs) and microenterprises; and (c) promoting microfinance institutions? Has the central bank's policy on these changed as a result of financial sector deregulation in the 1990s?

4. Does the central bank use any early warning signals to anticipate external shocks and/or monitor asset price bubbles, especially after its experience in the 1990s?

5. Does the central bank systematically use any monitoring and evaluation system to gauge the impact of their policies on employment and poverty?

6. Did the central bank use expansionary monetary policy in coping with the consequences of the Great Recession of 2008–09? How does that differ from its stance during the 1997–98 Asian financial crisis?

7. What is the current and projected stance of monetary policy?

8. After taking stock of (1) to (7) above, is it possible to arrive at an overall assessment on the extent to which monetary policy either helped or hindered the process of durable and productive employment creation, poverty reduction and lower income inequality?

9. What needs to change for monetary policy to more effectively support the process of employment creation, poverty reduction and lower income inequality?"

5. Fiscal policy

"C) Key macroeconomic policy instruments and their impact on employment and poverty: fiscal policy

1. What are the current de jure and de facto goals and targets of fiscal policy with respect to: (a) fiscal sustainability and avoidance of 'fiscal dominance'; (b) growth; and (c) employment and poverty?

2. What are the salient institutional and socio-economic forces (both domestic and external13) that have shaped the de jure and de facto goals and targets since the 1990s?

3. Does the analysis of public finances enable one to ascertain the extent to which: (a) expenditure and tax policy is being used to support the process of structural transformation (e.g. through designation of priority industries/sectors); and (b) promoting and enforcing labour market policies and institutions within the context of a social floor, especially for SMEs and young entrepreneurs that require sustainable fiscal resource allocations?

4. What is the current government spending/expenditure profile on the key elements of productive employment creations, health care, education, vocational education and training systems, employment services, and other labour market institutions?

5. Does the finance ministry use any early warning signals to anticipate external shocks and/or engaging in "stress tests" to assess the capacity of fiscal policy to respond to external shocks, especially after the experience in the 1990s?

6. Does the finance ministry systematically use any monitoring and evaluation system to gauge the impact of their policies on employment, poverty and inequality?

7. Have proactive measures been put in place to enhance fiscal space during buoyant periods of economic growth to finance various components of the social protection system including policies to reduce labour market inequalities by improving unemployment protection schemes and public investment in physical infrastructure?

8. Did the finance ministry use expansionary fiscal policy in coping with the consequences of the Great Recession of 2008–09? How does this differ from the fiscal policy stance during the 1997–98 Asian financial crisis?

9. What is the current and projected stance of fiscal policy? Is there evidence of fiscal consolidation?

10. After taking stock of (1) to (9) above, is it possible to arrive at an overall assessment on the extent to which fiscal policy either helped or hindered the process of durable and productive employment creation, poverty reduction and lower income and labour inequality 11. What needs to change for fiscal policy to more effectively support the process of employment creation, poverty reduction and lower income and labour market inequality?"

6. Exchange rate policy

"(D) Key macroeconomic policy instruments and their impact on employment and poverty: exchange rate policy

1. What are the current de facto and de jure goals and targets of exchange rate policy with respect to (a) international competitiveness; (b) protecting domestic and import-competing sectors; and (c) using exchange rate policy as part of an ant inflation strategy?

2. How can one characterize the current exchange rate regime: (a) fixed; (b) floating; and (c) managed?

3. What are the salient institutional and socio-economic forces (both domestic and external) that have shaped the de jure and de facto goals and targets and the evolution of the exchange rate regime since the 1990s?

4. Was exchange rate policy systematically used to support the process of structural transformation, most notably by stimulating the development of export-oriented sectors, especially for the SMEs?

5. Have policy-makers systematically made use of monitoring and evaluation system to assess the impact of exchange rate policy on employment and poverty?

6. Was exchange rate policy used (e.g. a significant, one-off devaluation) as part of counter-cyclical policies to deal with the Great Recession? How does that differ from the exchange rate policies during the 1997–98 Asian financial crisis?

7. After taking stock of (1) to (6) above, is it possible to possible to arrive at an overall assessment on the extent to which exchange rate policy either helped or hindered the process of durable and productive employment creation and poverty reduction?

8. What needs to change for exchange rate policy to more effectively support the process of employment creation and poverty reduction?"

7. Capital account management

"(E) Key macroeconomic policy instruments and their impact on employment and poverty: capital account management

1. What are the current de facto and de jure goals and targets of capital account management with respect to: (a) encouraging financial integration through capital flows; and (b) enhancing national policy space?

2. How can one characterize the current capital account regime: (a) open; and (b) regulated?

3. What are the salient institutional and socio-economic forces (both domestic and external) that have shaped the de jure and de facto goals and targets and the evolution of the capital account regime since the 1990s?

4. What has been the interaction between exchange rate policy and capital account management? What are the consequences – both direct and indirect – for employment and poverty? How does this policy help to stabilize financial sector?

5. Have capital controls and other prudential measures been used to cope with global economic volatility and during the Great Recession? How does that differ from the capital account policies during the 1997–98 Asian financial crisis?

6. After taking stock of (1) to (5) above, is it possible to arrive at an overall assessment on the extent to which capital account management has either helped or hindered the process of durable and productive employment creation and poverty reduction?

7. What needs to change in the sphere of capital account management to more effectively support the process of employment creation and poverty reduction?"

"(F) Institutional arrangements for design and delivery of macroeconomic policies

The country studies should also offer a succinct account of the institutional arrangements for the design and delivery of macroeconomic policies at the country level. While the mandate for such policies usually lies with the Central Bank and the Ministries of Finance, to what extent is there an attempt at policy coherence through interministerial coordination? Is there any agency within the government that monitors such coherence? To what extent are contemporary institutional arrangements (such as central bank independence) shaped by external forces (such as IMF agreements)? Has there been any policy and institutional change after the 1997–98 Asian financial crisis and/or the Great Recession of 2008–09? And if so, what is the format of the new institutional arrangements in Thailand and Viet Nam?"

8. Collection of information

"Multiple methods of analysis and assessment will be used. These include (but are not limited to):

1. Literature review on macroeconomic policy debate at the global level and in the context of the country under review, including evaluation of official policy documents and guidelines, especially incorporating the policy stance during 1997–98 Asian financial crisis and the Great Recession of 2008–09.

2. Consultations with at least 10–15 key informants**.** The institutions that can be covered include: Ministry of Finance, Ministry of Planning, Central Bank, Ministry of Labour, Ministry of Education, Ministry of Health, trade unions, employers' organizations, United Nations system, including UNDP, IMF, ADB, World Bank, key research institutes (on macroeconomic policy, development studies, employment and labour), business media and members of the civil society. These consultations should seek to highlight the diversity of views on macroeconomic policy in the country under review. The consultation should be guided by the issues specified above under each policy instrument.

3. Use of online global databases, especially IMF assessments. There is a growing literature that utilizes IMF country assessments (such as article IV consultations and IMF agreements with Member States) to delineate and evaluate both actual and projected macroeconomic policy developments at the country level.[14] In addition, one can use such global databases, apart from the United Nations Economic and Social Commission for Asia and the Pacific and ILO, as the global competitiveness surveys maintained by the World Economic Forum, which usually includes country-specific data on macroeconomic stability.

4. Use of national appropriate national data sources. On the main macroeconomic indicators (inflation, growth, etc.), there can be notable variations between indicators derived from national data sources as against those published in international data bases. An assessment and a decision need to be made on the choice of data sources. For cross-country comparison purposes, an international data source may be advantageous. At the same time, on labour market indicators, national sources may provide greater information content that are not available in the international databases.

5. Analysis, using appropriate empirical techniques, of the link between macroeconomic policies, conventional policy targets and broader economic goals pertaining to growth, employment, structural

change, poverty reduction and lower income and labour market inequality using national and international data sources.”

Macroeconomic policies for full and productive employment: Case studies of Thailand and Viet Nam

Perhaps the most important empirical finding of this study is the stability of quarterly and annual growth rates for Viet Nam and the contrasting instability for Thailand. Evidence strongly supports the view that this contrast results from the difference in macroeconomic policies in the two countries. Once policy-makers discard the ideology calling for continuously balanced budgets, focus can shift to identifying priorities for fiscal policies that facilitate stable growth. Stable growth would engender full and productive employment and an equitable distribution of growth for poverty reduction. These outcomes do not result automatically from the clearing of markets, if they clear at all.

In support of full and productive employment, monetary policy both can and should pursue several objectives in addition to the stabilizing of prices. The two most obvious are: (i) facilitating productive investment through moderate and stable real interest rates; and (ii) reducing exchange rate fluctuations through what might be called exchange rate "smoothing". Exchange rate smoothing does not imply that a central bank attempts to maintain the national currency at a target rate to other currencies.

In the pursuit of full and productive employment, the exchange rate serves as an important instrument. It should be part of a policy to shift resources towards tradables, if that shift is relevant. Interventions to smooth movements in the nominal exchange rate contribute to stability of aggregate output.

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