

EE460: Resilience of the Thai Economy

1991-2005

Bhanupong

Lecture 4

Outline

- Basic social and macroeconomic indicators
- Fiscal balance and external debt
- Monetary sector and capital inflows
- Asset bubbles
- External influences
- Underground economy

Recap: Economic and social development plans

6th plan (1987-1991)

Maintain economic growth

Upgrade quality of life

7th plan (1992-1996)

income distribution

improve quality of life and **environment**

Recap: Economic and social development plans

8th plan (1997-2001)

Human-centered development

Public participation

Sustainable development

9th plan (2002-2006)

Competitiveness

Financial immune system

Self-reliant and resilient society

Social indicators: 1990

	Per capita GNP 1990 (USD)	Life expectancy at birth (years)
China	370	70
India	350	59
Indonesia	570	62
Malaysia	2,320	70
Thailand	1,420	69

Income distribution in the 1980s

	Bottom 20 <i>percent share of total</i>	<i>Gini Coefficient</i>
India (1983)	8.1	0.42
Indonesia (1985)	8.8	0.31
Malaysia (1985)	4.6	0.48
Philippines (1985)	5.5	0.45
Thailand (1988)	4.0	0.47

Gini in Europe

- UK, Italy 0.34
- Portugal 0.36
- Germany 0.32
- France 0.29
- Sweden, Austria 0.26

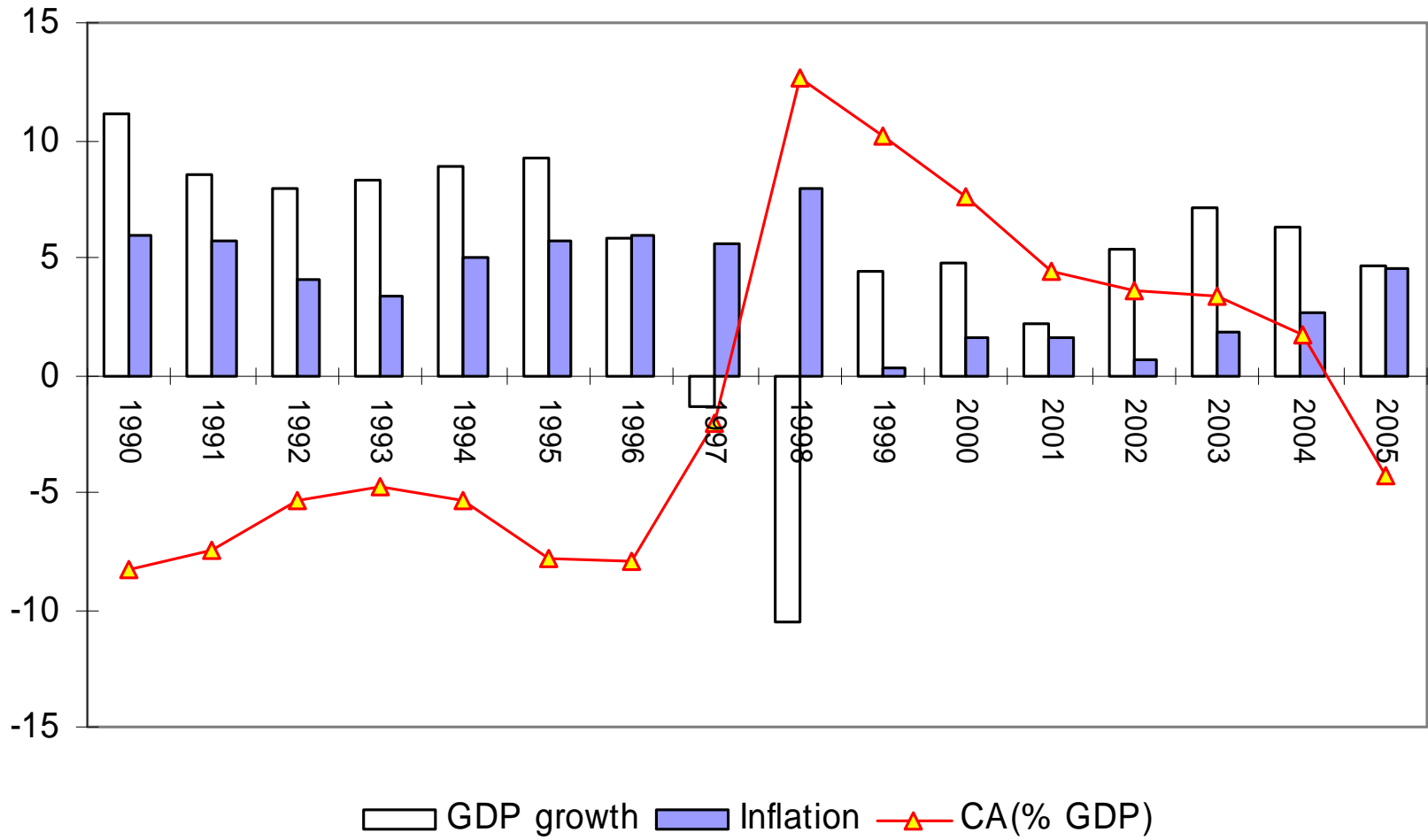
Percentage of population below poverty line

	Total	Rural
India (1983)	48	51
Indonesia (1985)	39	44
Malaysia (1985)	27	38
Philippines (1985)	58	64
Thailand (1988)	30	34

Human capital investment

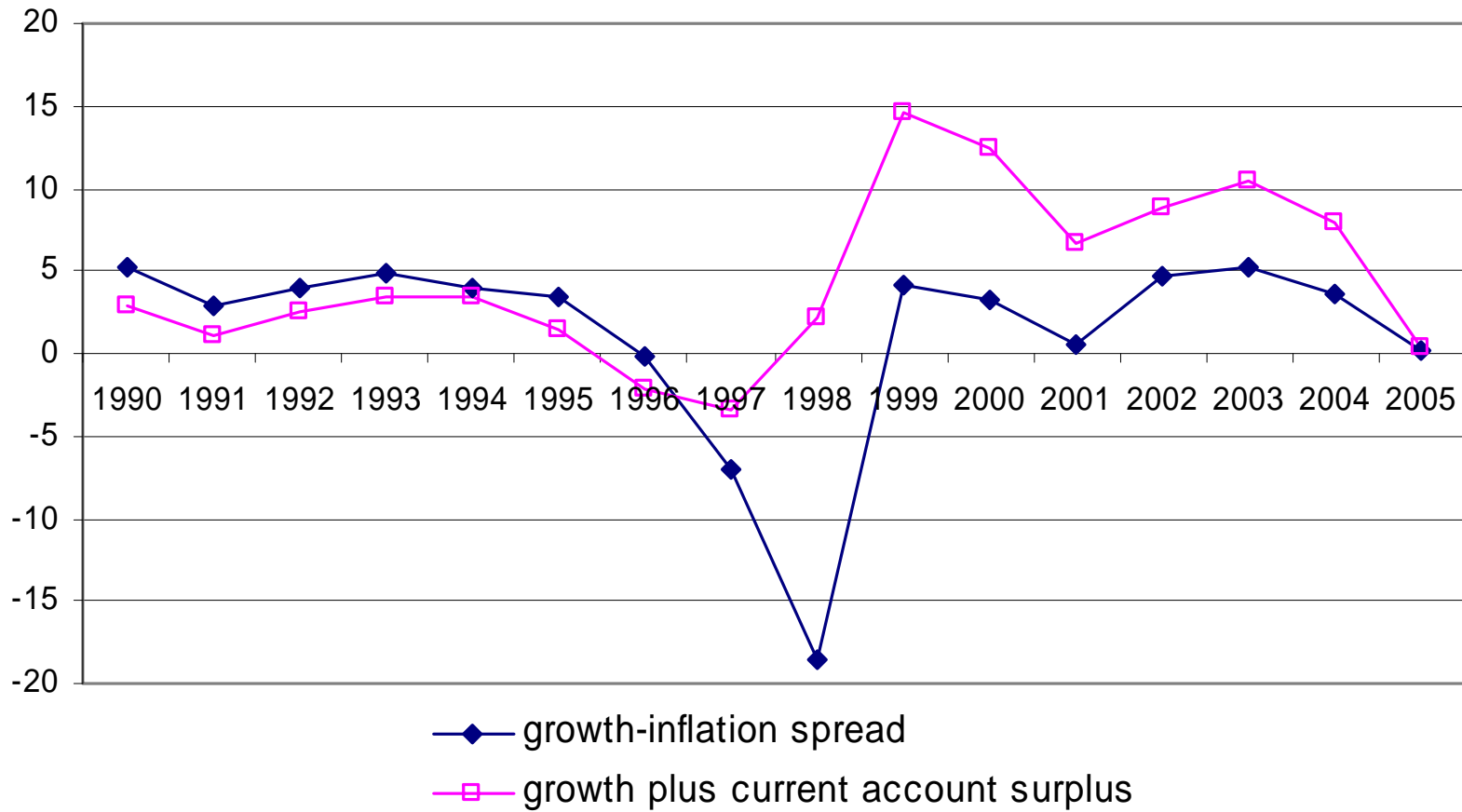
	Public Expenditure on education (%GNP) 1989	Secondary school enrolment (1988-89)
China	2.4	44
India	3.2	43
Indonesia	0.9	47
Korea	3.6	87
Malaysia	5.6	87
Thailand	3.2	28

The three barometers



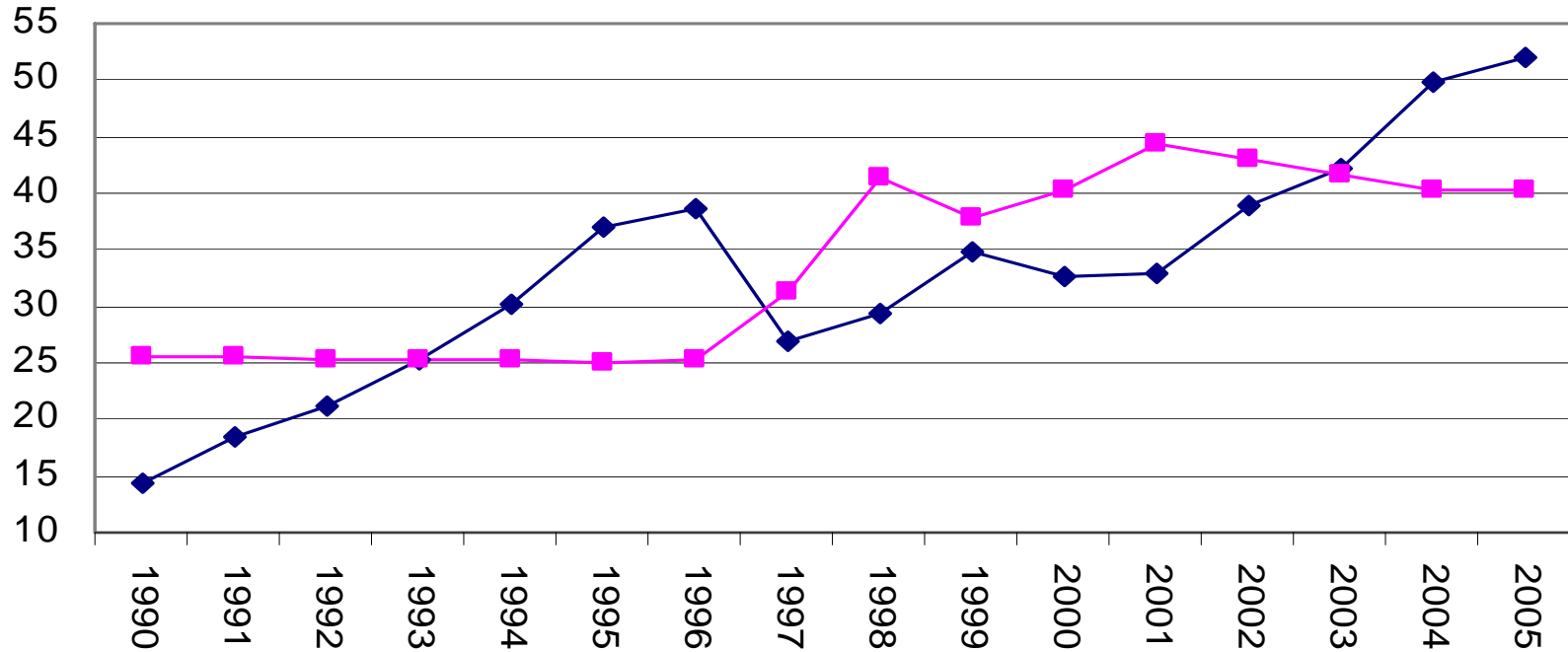
Growth without tears

Indexes of growth sustainability



Source: Bank of Thailand

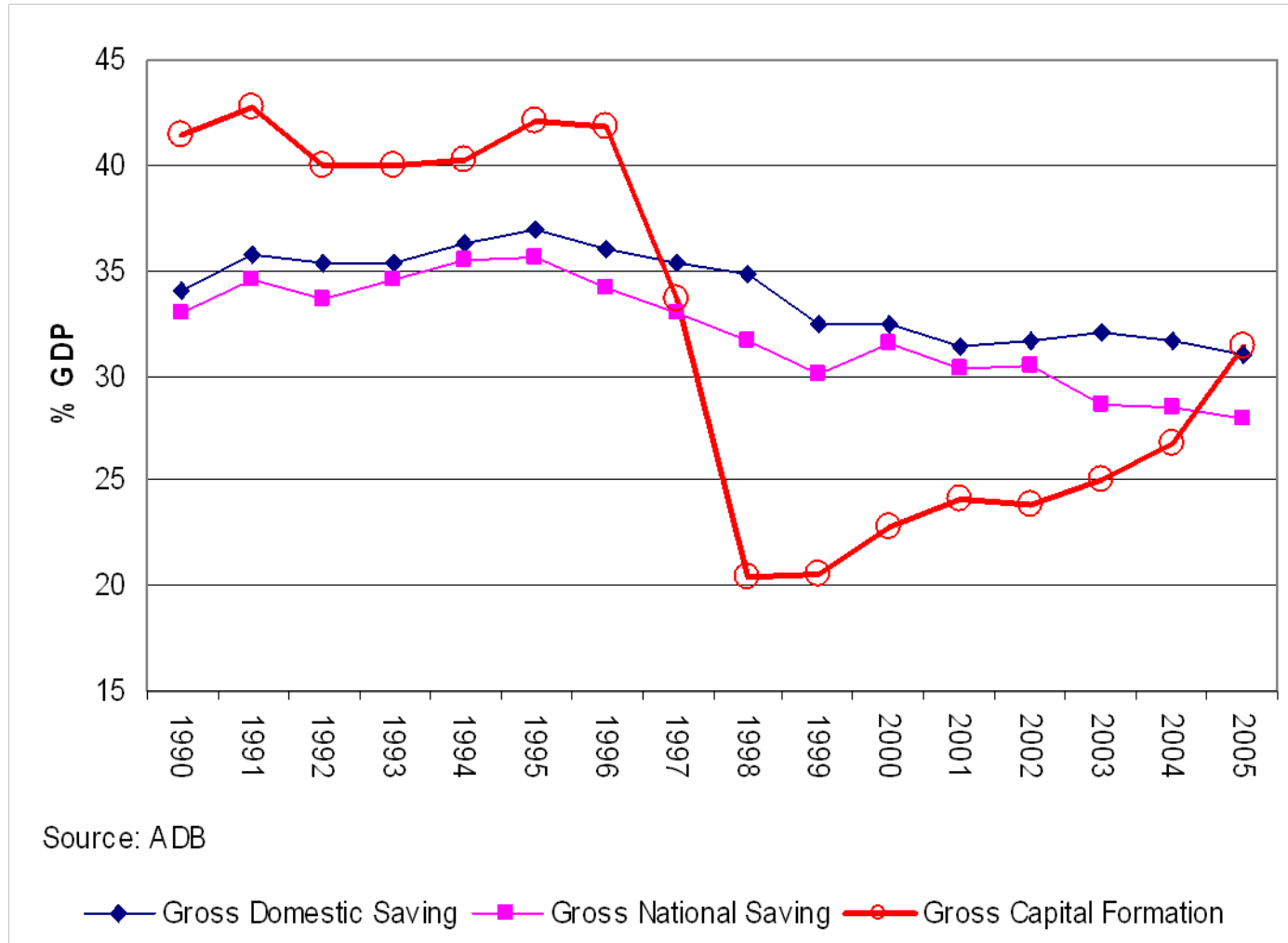
Rising international reserves what was the main reason?



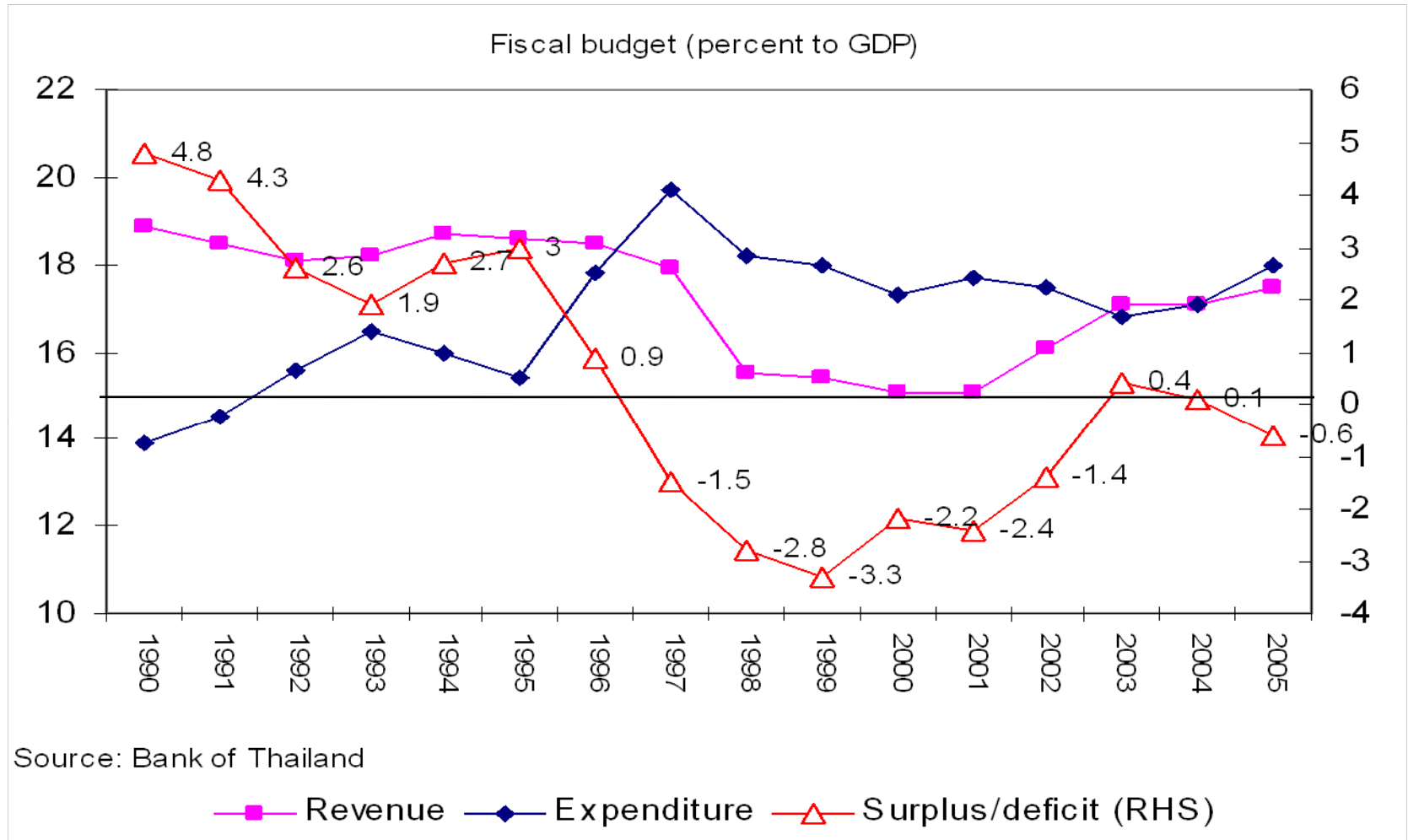
Source: Bank of Thailand

—◆— Int. reserves (bil USD) —■— Baht/USD

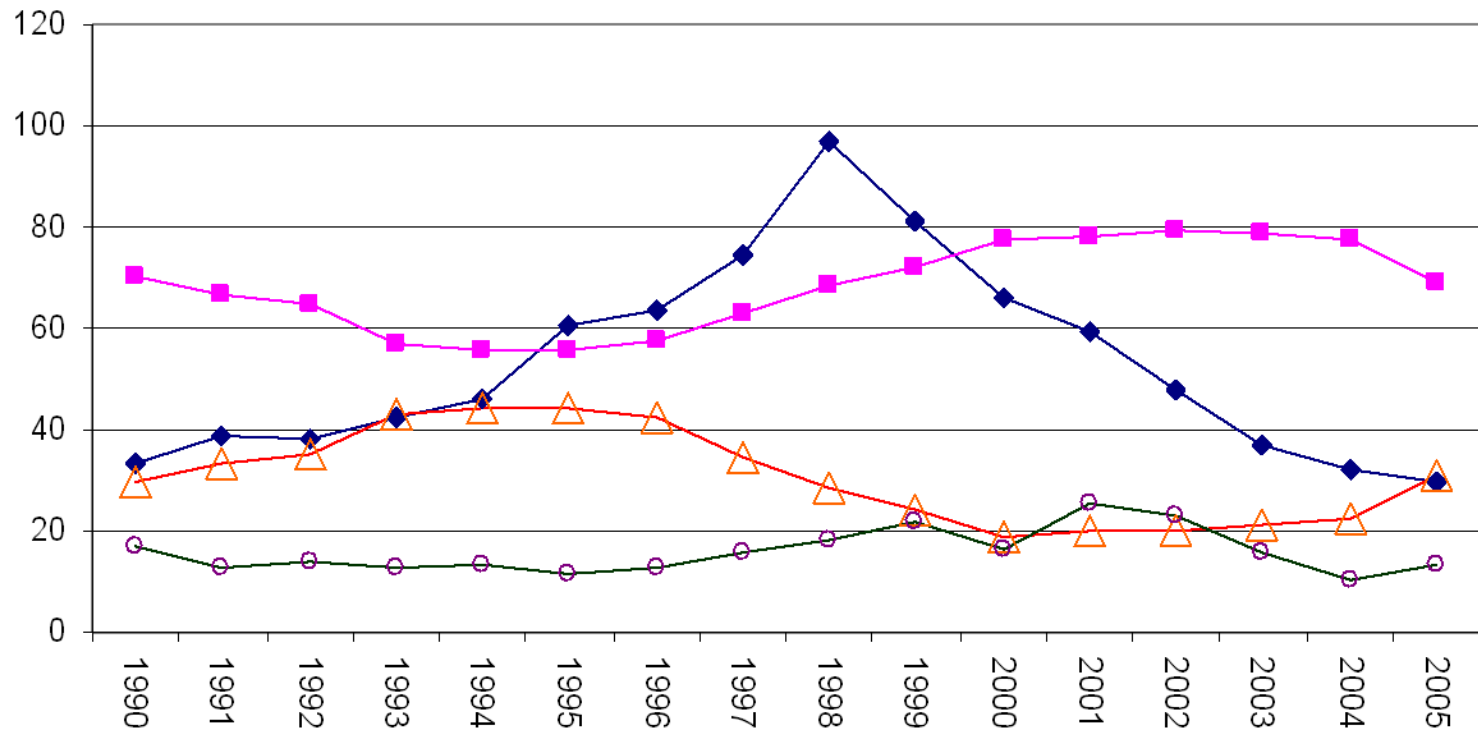
Investment-saving gap: Implications?



Fiscal discipline



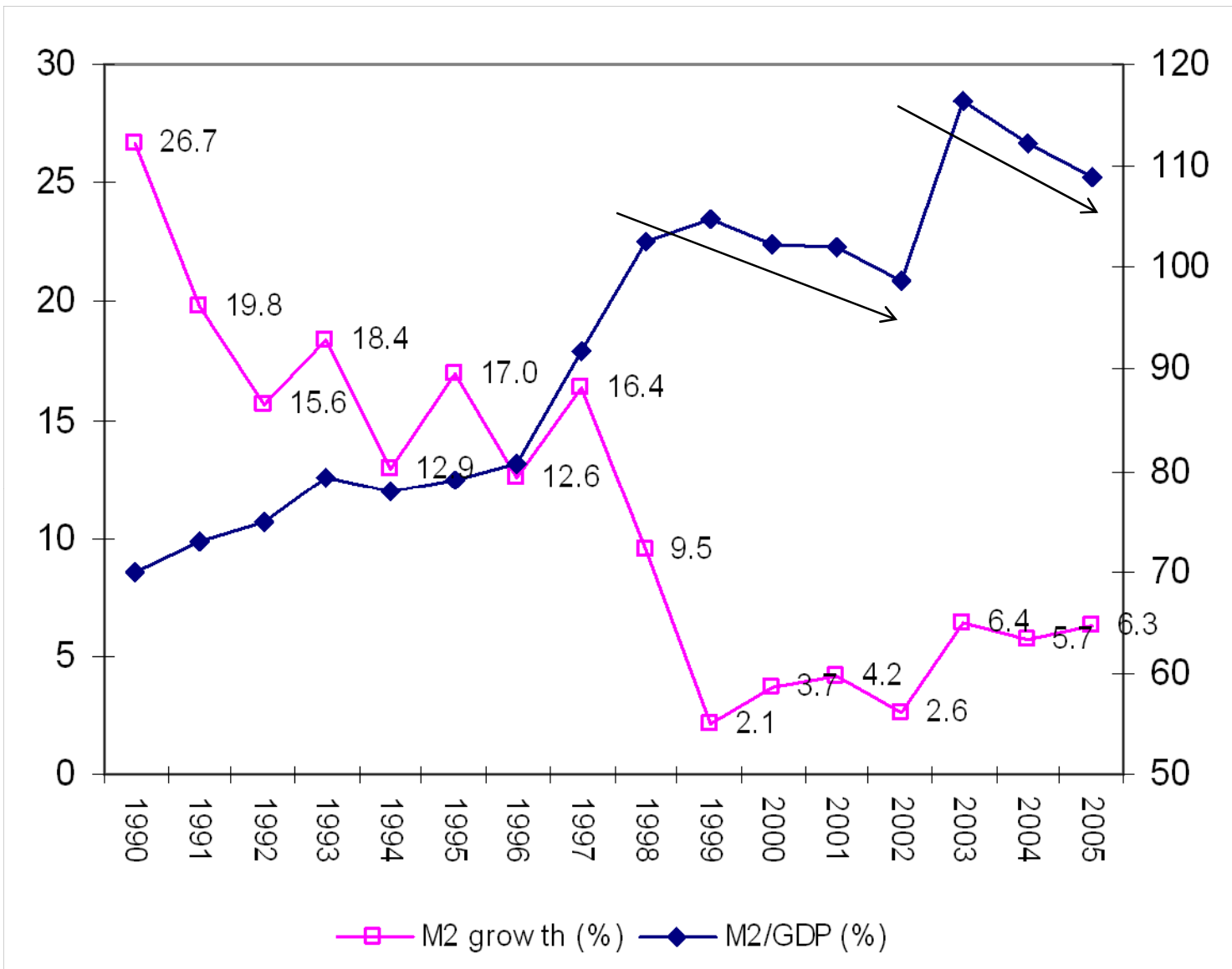
External debt structure



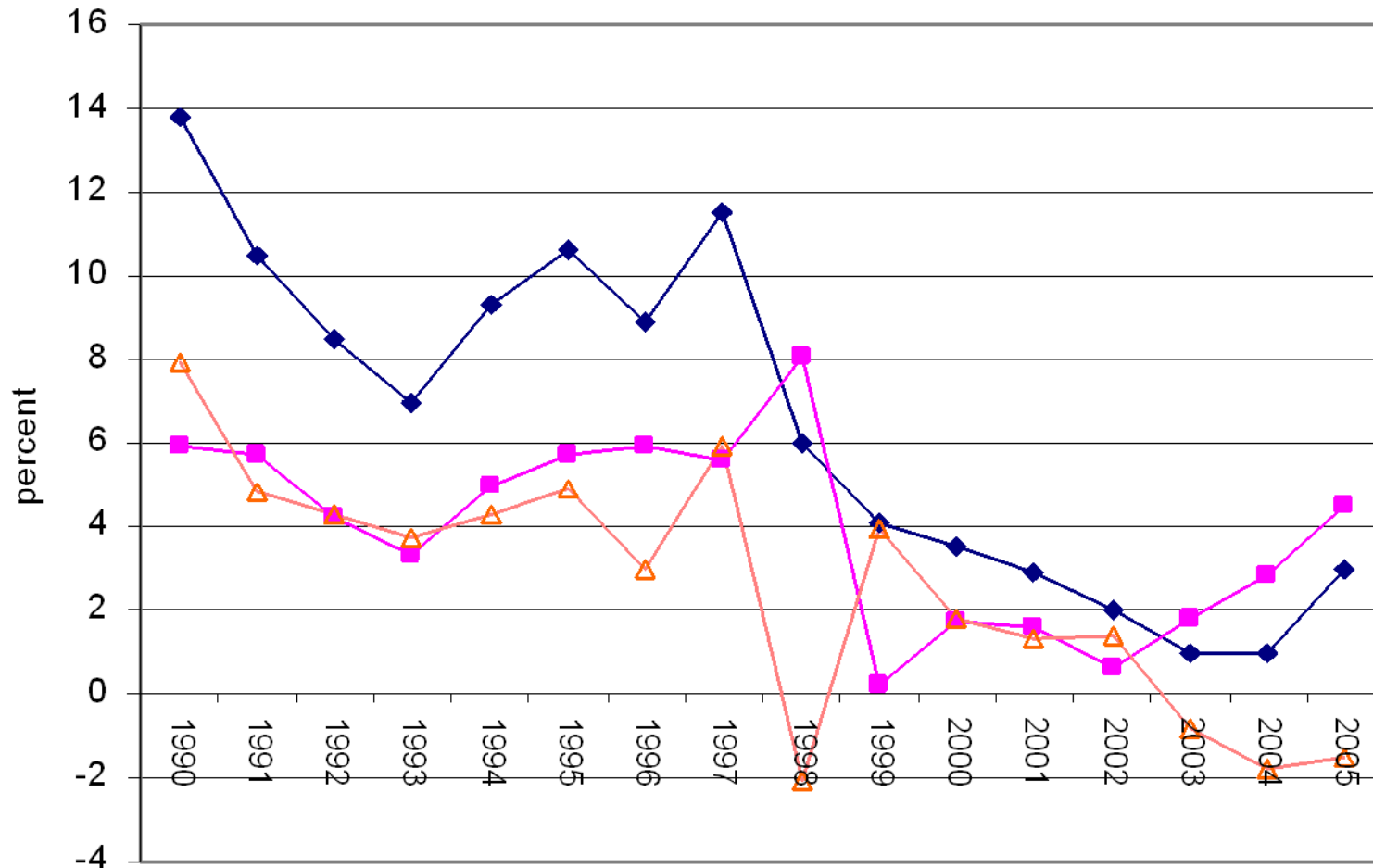
Source: Bank of Thailand

- ◆ External debt (% Gross National Income)
- Long-term Debt (% total debt)
- △ Short-term debt (%)
- Debt service ratio

Monetary growth slowdown



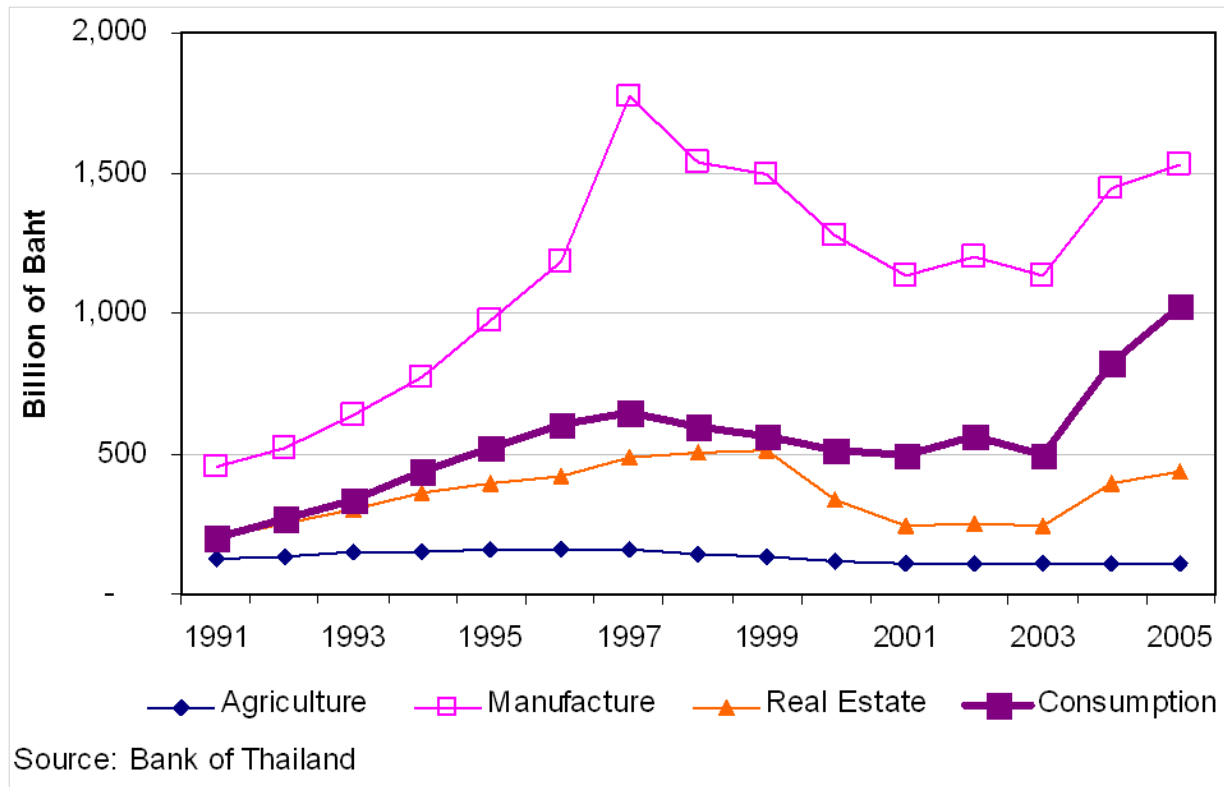
Incentive for financial savings



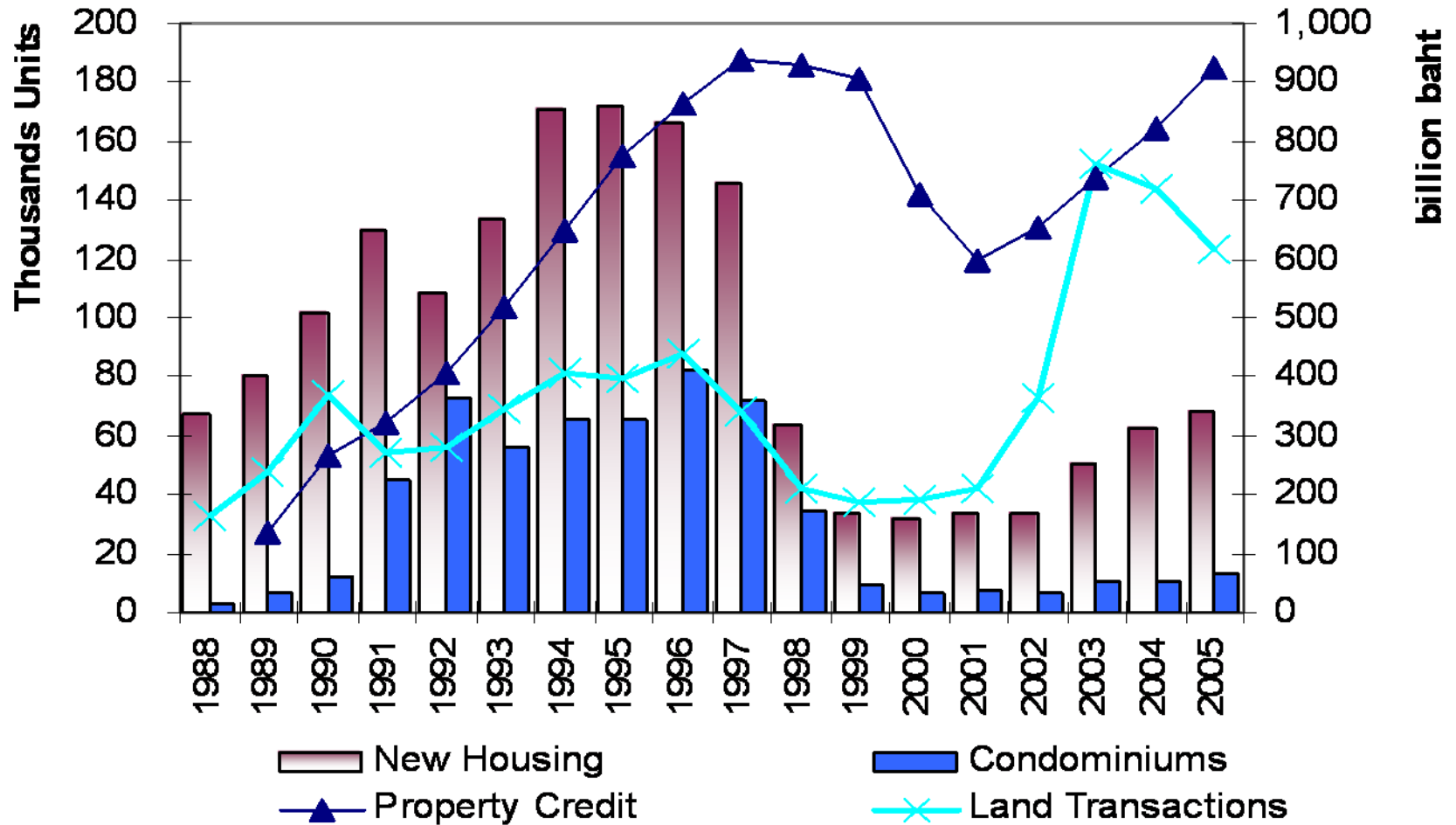
Source: ADB

◆ Deposit Interest rate (12 months) ■ CPI ▲ Real interest

Bank loan extension

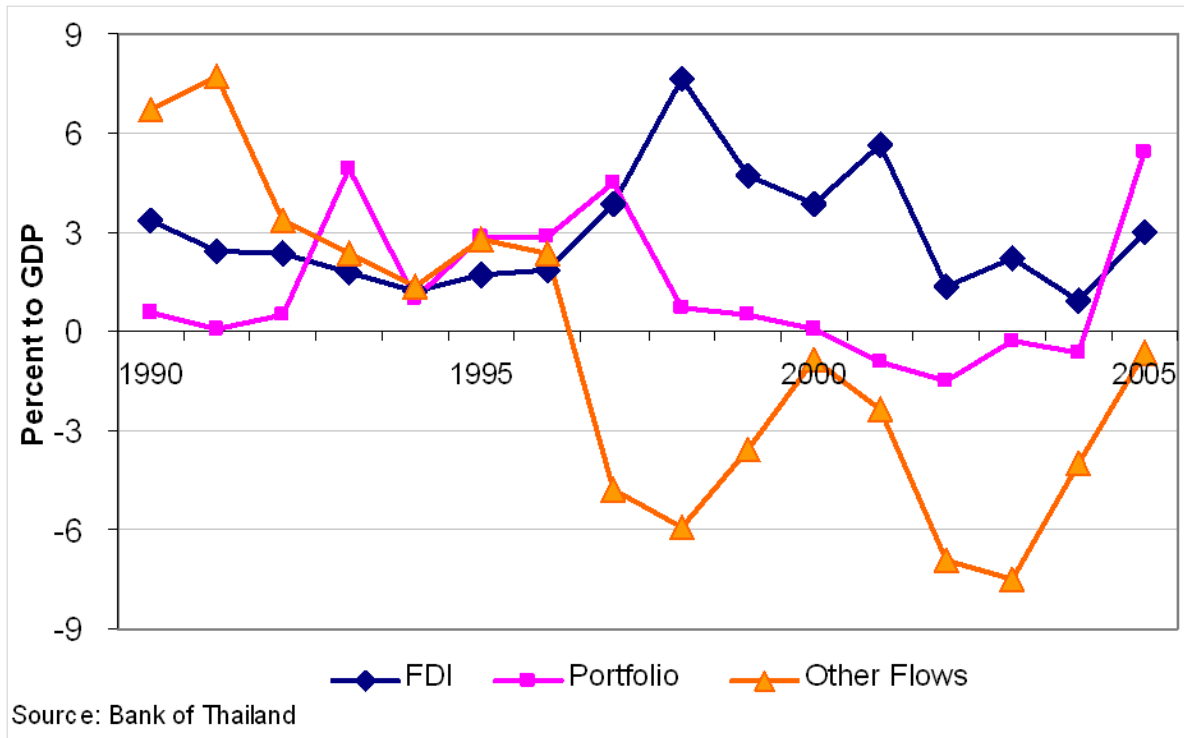


Property bubble

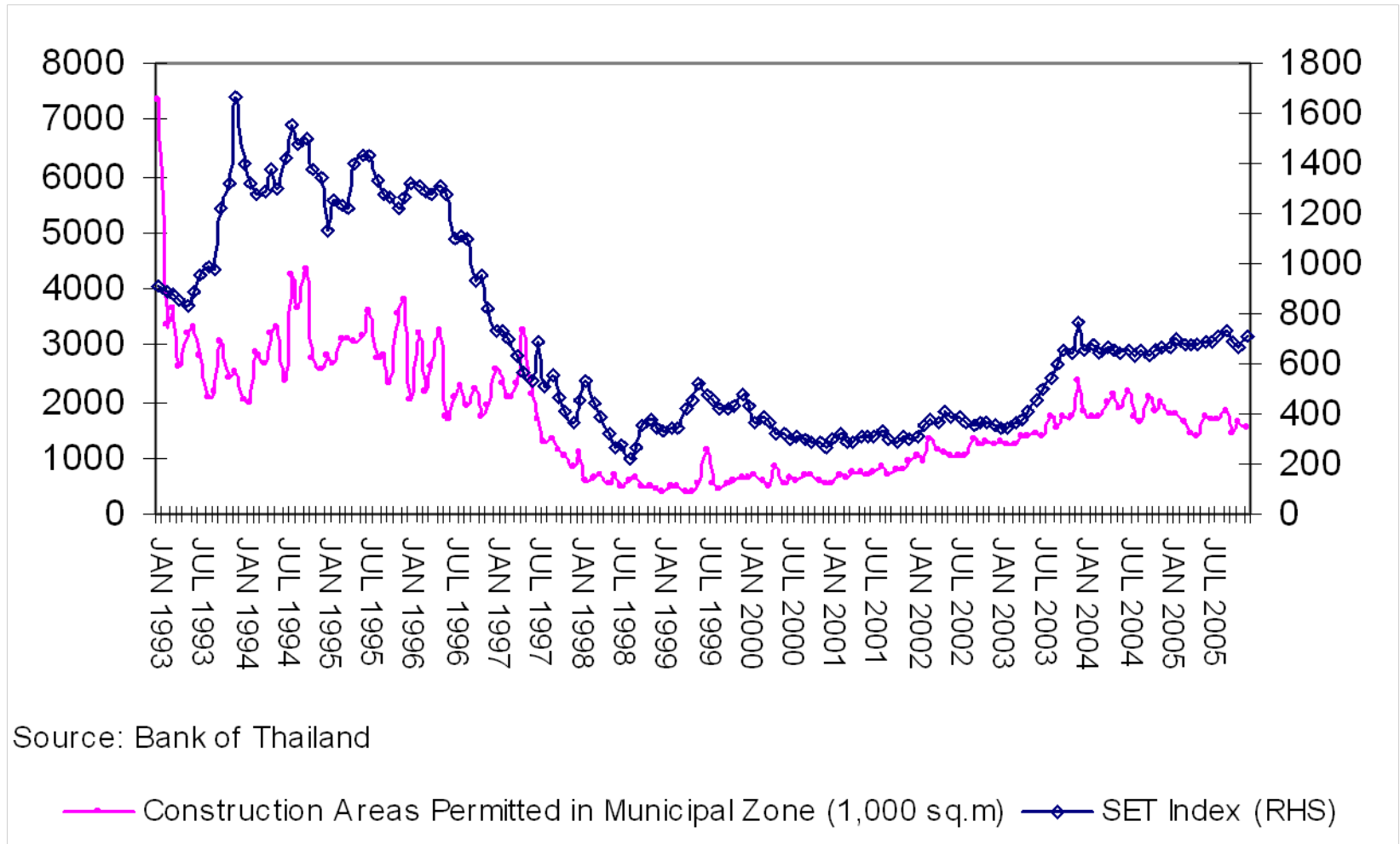


Source: Bank of Thailand

Hot and cold capital flows

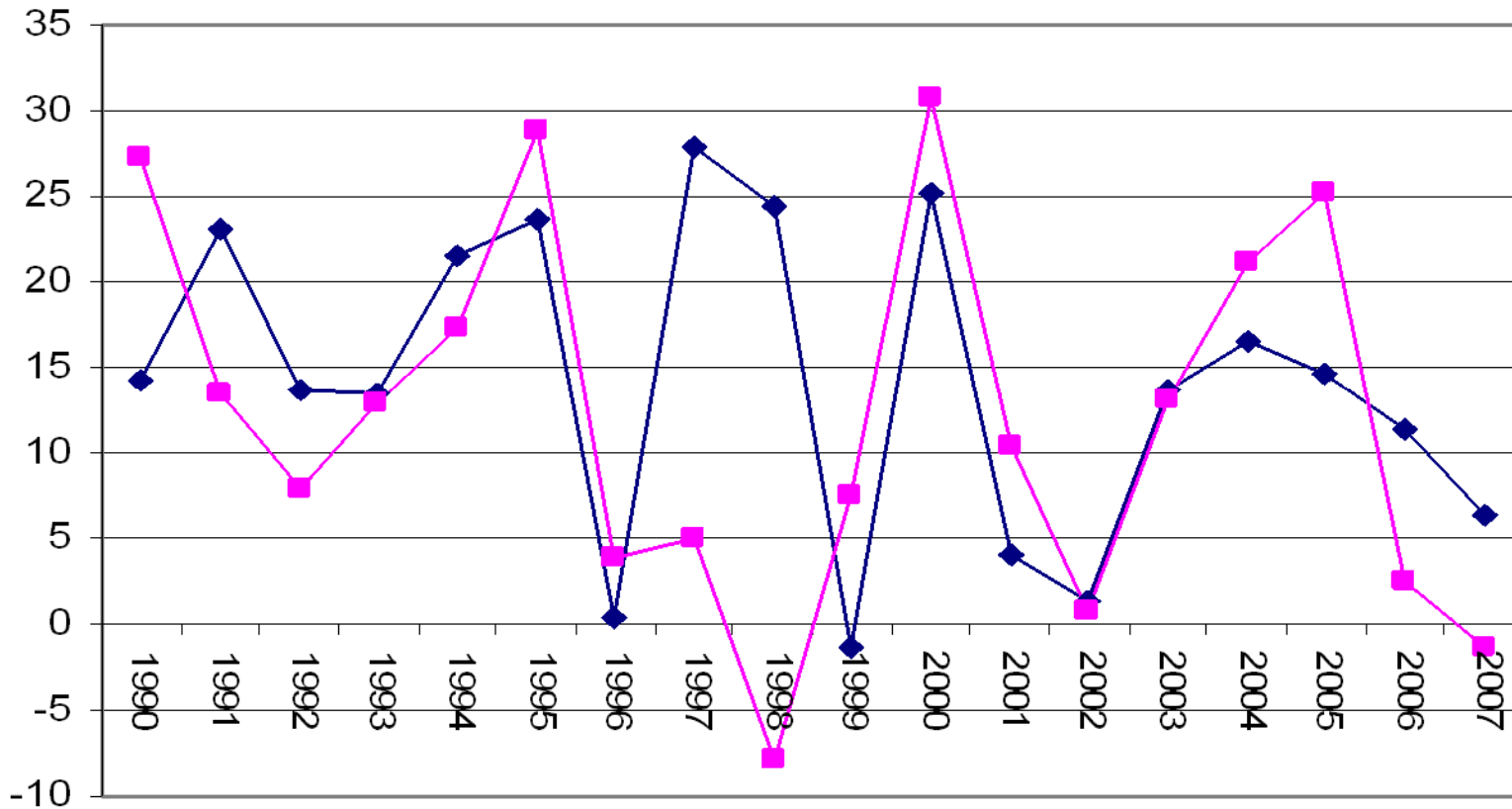


Property and stock bubbles



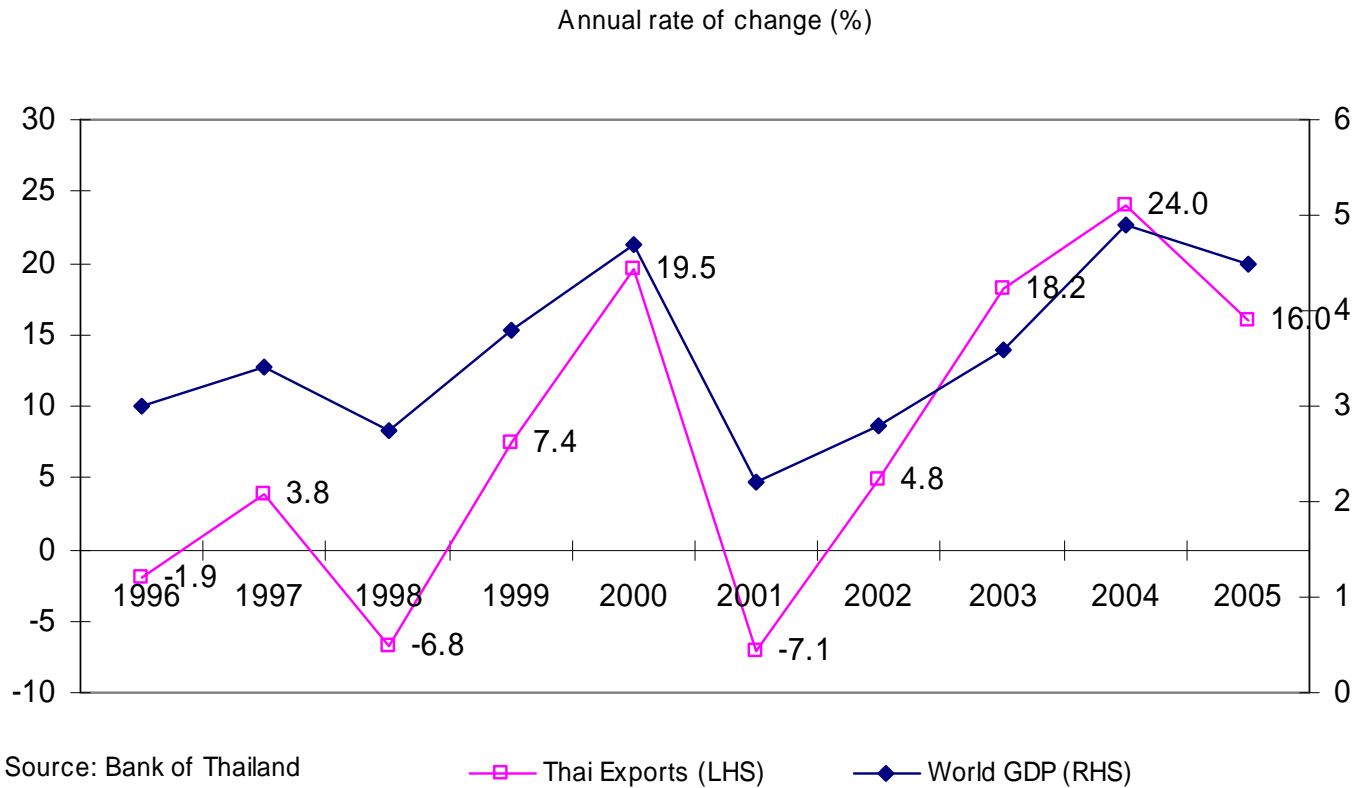
Co-movements

Exports and Imports (% change)



Source: Bank of Thailand — Exports — Imports

Compare and contrast fluctuating effect of world business cycle on the Thai exports: 1990-1995 and 2006-2010



Conclusions

- Resilience of the Thai economy had been demonstrated after the financial and exchange rate crises in the period 1997-98.
- Realistic exchange rates are the key for successful external imbalance adjustments.
- Fiscal balances and external debts depend on fiscal discipline.
- Capital flows are related to exchange rate movements.
- Asset bubbles are associated with expectations and monetary expansion.
- External influences on the Thai economy increase with the degree of globalization.

Research questions

- Has the Thai economy become less resilient since 2006?
- What is the appropriate exchange rate policy that can sustain growth in the presence of external shocks?
- Should the Central Bank prick asset bubbles?
- How far can a country rely on domestic demand stimulus?
- What are consequences of populism policy?

Underground economy

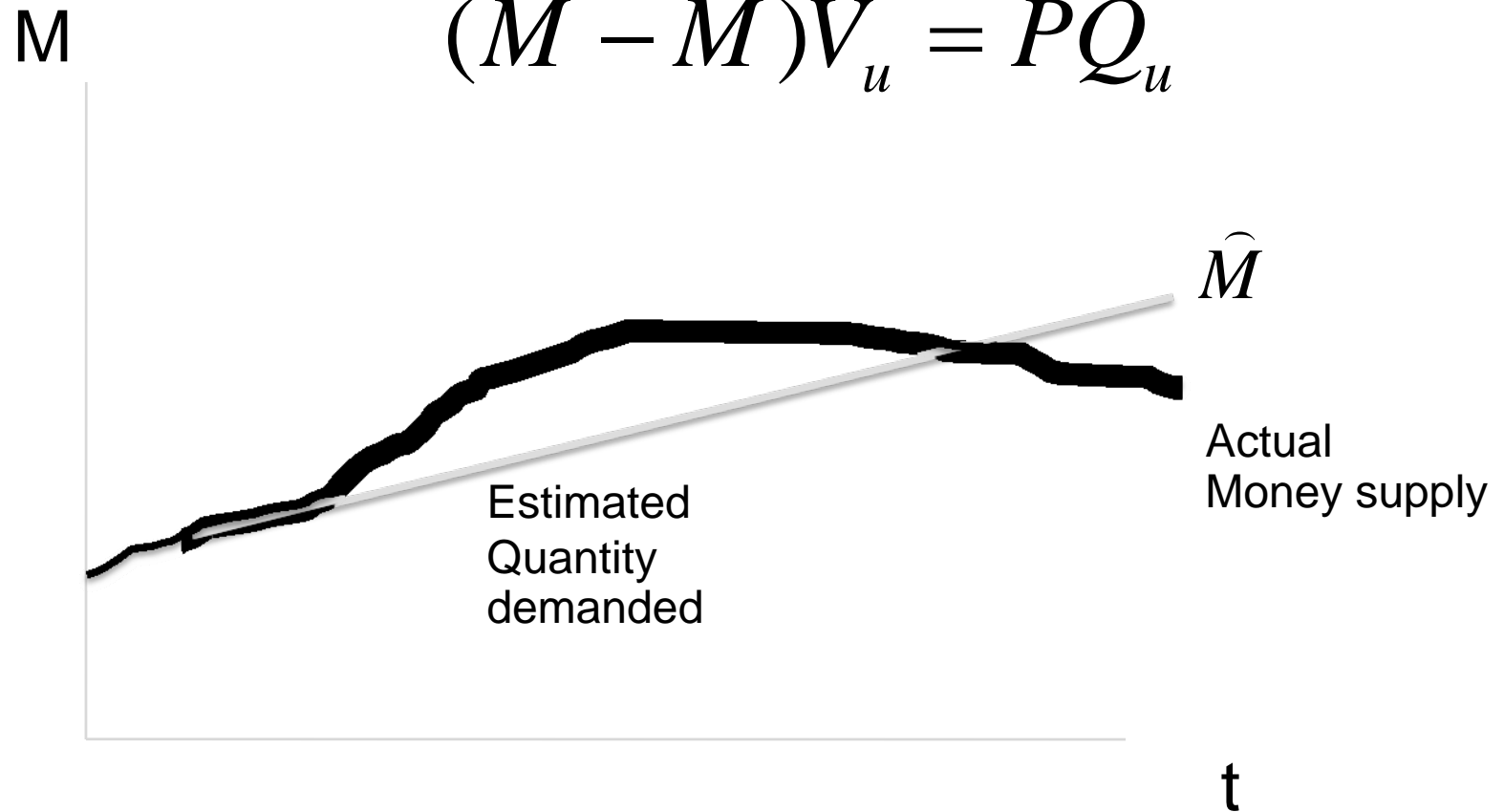
- In the shadow economy (informal sector, or underground), business goes off the books.
- The shadow economy is spreading, including both legally earned income and illicit activities, such as drug dealing, prostitution, and gambling.
- The government knows less about what is really going on in the economy
- The underground economy overstates the actual level of unemployment
- The government has difficulty taxing those earned income.

Missing quantity of money

- Friedrich Schneider, a professor at Austria's Linz university, estimated unreported activities in **17** rich countries by examining the amount of **unexplained** cash sloshing around the economy.
- The basic assumption is that the shadow economy works on cash, so more unreported transactions mean greater demand for cash.
- Schneider estimated that the shadow economy account for more than one-fifth of GDP in Belgium, Italy and Spain.

$$MV=PQ$$

$$(M - \hat{M})V_u = PQ_u$$



The size of the underground economy

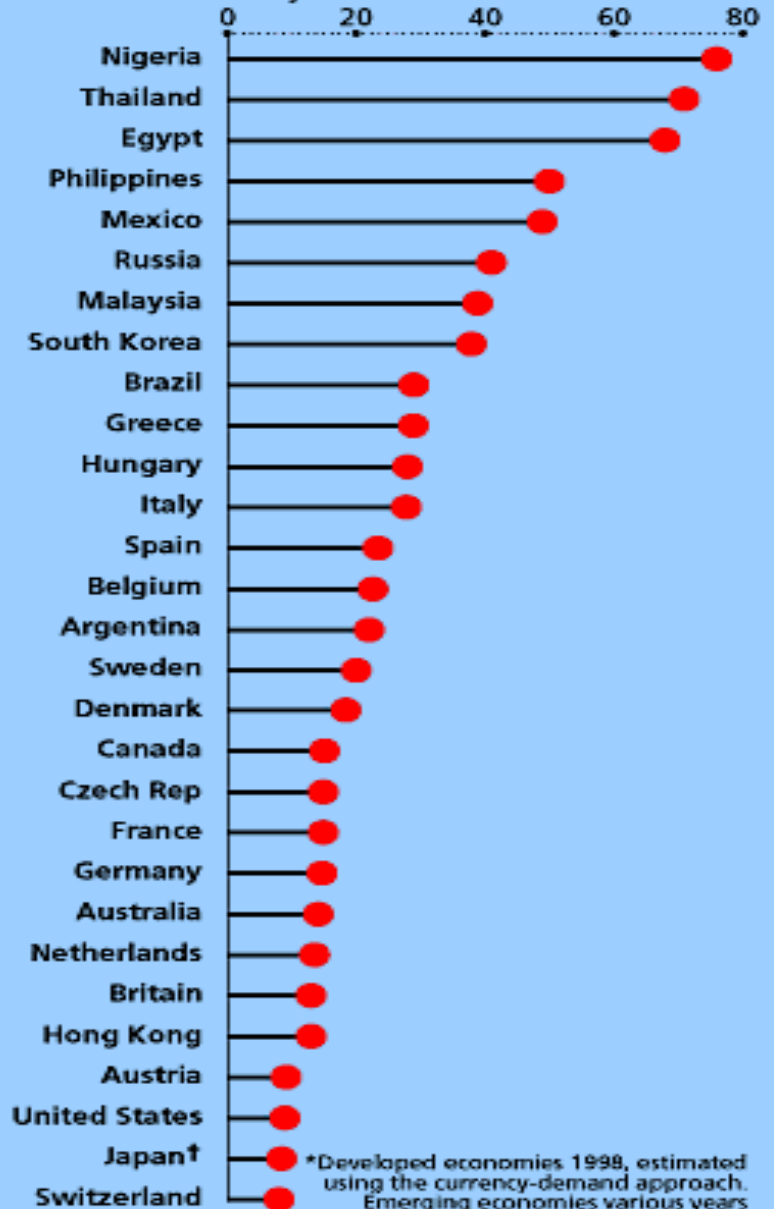
(% official GDP)

Emerging economies: 1990-95

Developed economies: 1998

Economic penumbra

Shadow economy as % of official GDP*



Source: Friedrich Schneider

*Developed economies 1998, estimated using the currency-demand approach. Emerging economies various years 1990-95, estimated using the physical-input method. †1993

Tax burden and tax evasion

- Nigeria and Thailand had the world's largest black economies, accounting for more than 70% of official GDP.
- Note that China was excluded from the study.
- The shadow economy is not so much driven by the incentive to evade taxes as by a desire to evade the law.
- How many Thais pay income tax? How many people pay at the 37% tax bracket and how many percent of total income tax revenue?

Cash approach

- Thailand's thriving shadow economy largely consists of crime: gambling, narcotics and the sex industry (according to Prof. Schneider).
- Thailand was ranked ahead of Egypt, Philippines, Mexico, Russia, Malaysia, South Korea, Brazil and Greece.
- Shadow economy in the OECD countries is usually attributed to high taxation and onerous labor regulation.
- In transition economies and LDCs, the driving forces of shadow activities are usually tax and regulation avoidances, corruption, and general distrust by citizens of the political system.

Substitution or complement to above ground activities ?

- According to Schneider, the underground economy would mark a turnaround in its fortunes after nearly a decade of decline.
- He estimated the value-added of the shadow economy in 21 of the 30 OECD countries.
- On average, it was equivalent to 16.8% of GDP in 1999.
- By 2008 that figure had fallen to 13.3%.
- In 2009 he forecast it would *rise* to 13.8%.
- Relationship between GDP growth and the size of the underground economy?

Discussion question

- In his recent study, Mr. Schneider's calculations exclude illegal activities.
- The size of the underground economy is equivalent to less than 8% of GDP in the United States, whereas in Greece it reaches 25% and in Italy 22%.

Source: The Economist, April 2, 2009

The underground economy in Thailand expands during recession and contracts during recovery (True, false, or Uncertain?)