

Rethinking Growth Strategies

Lecture 2

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Five Main Themes

1. *Growth strategies*
2. *Early Economic Development Models*
3. Economic development plans
4. *Sources of Happiness*
5. *Why Nations Fail*

1. Growth strategies

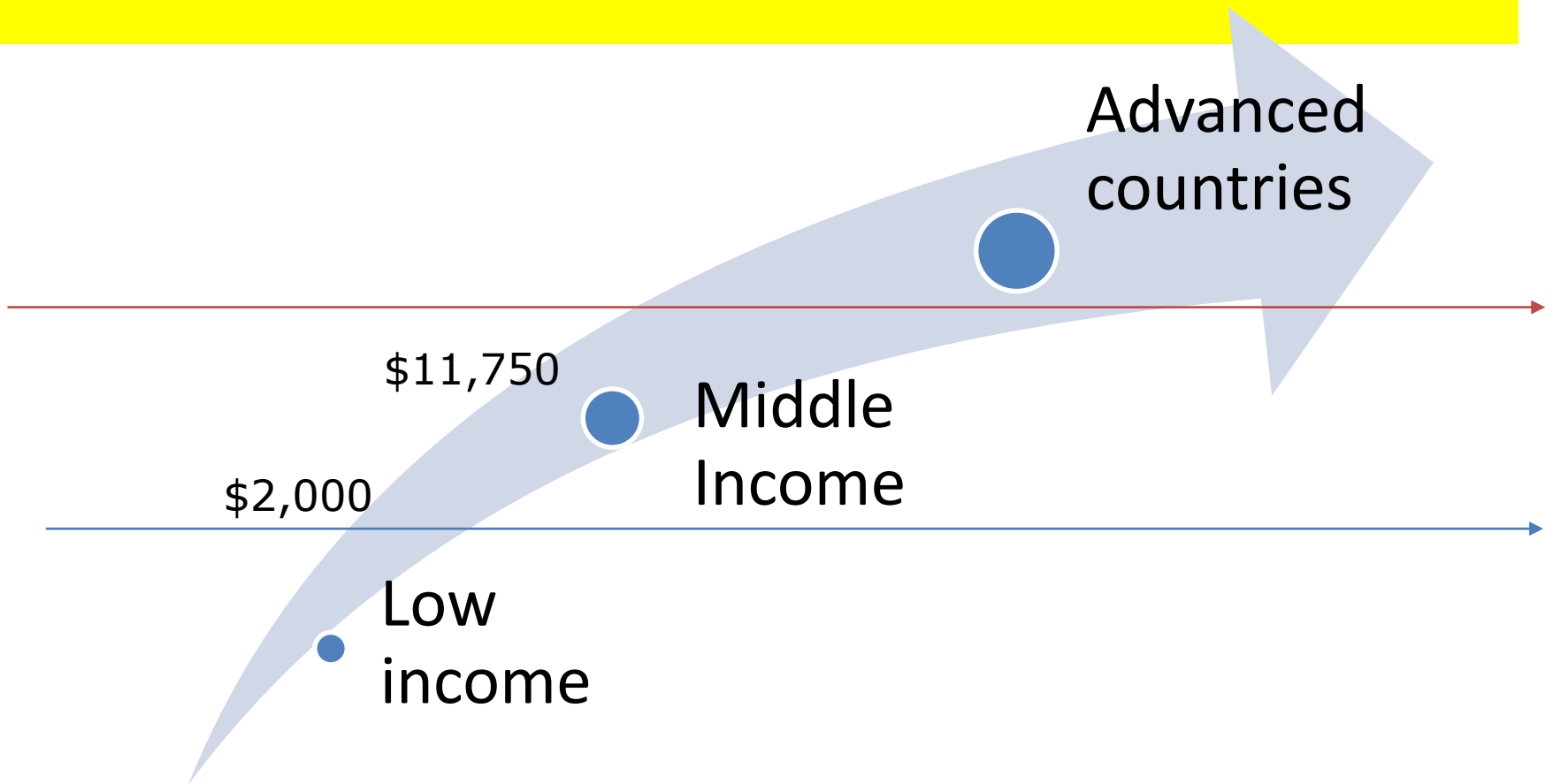
- Growth is a **complex** process of economic, social, and political transformation.
- New economic concepts were created to capture some of growth dimensions.
- Development ***strategies*** follow those new concepts in economic ***development theories***.
- Do we want to leave the MIT? How?

The Middle-Income Trap Countries

per capita monthly income must rise above 30,000 baht

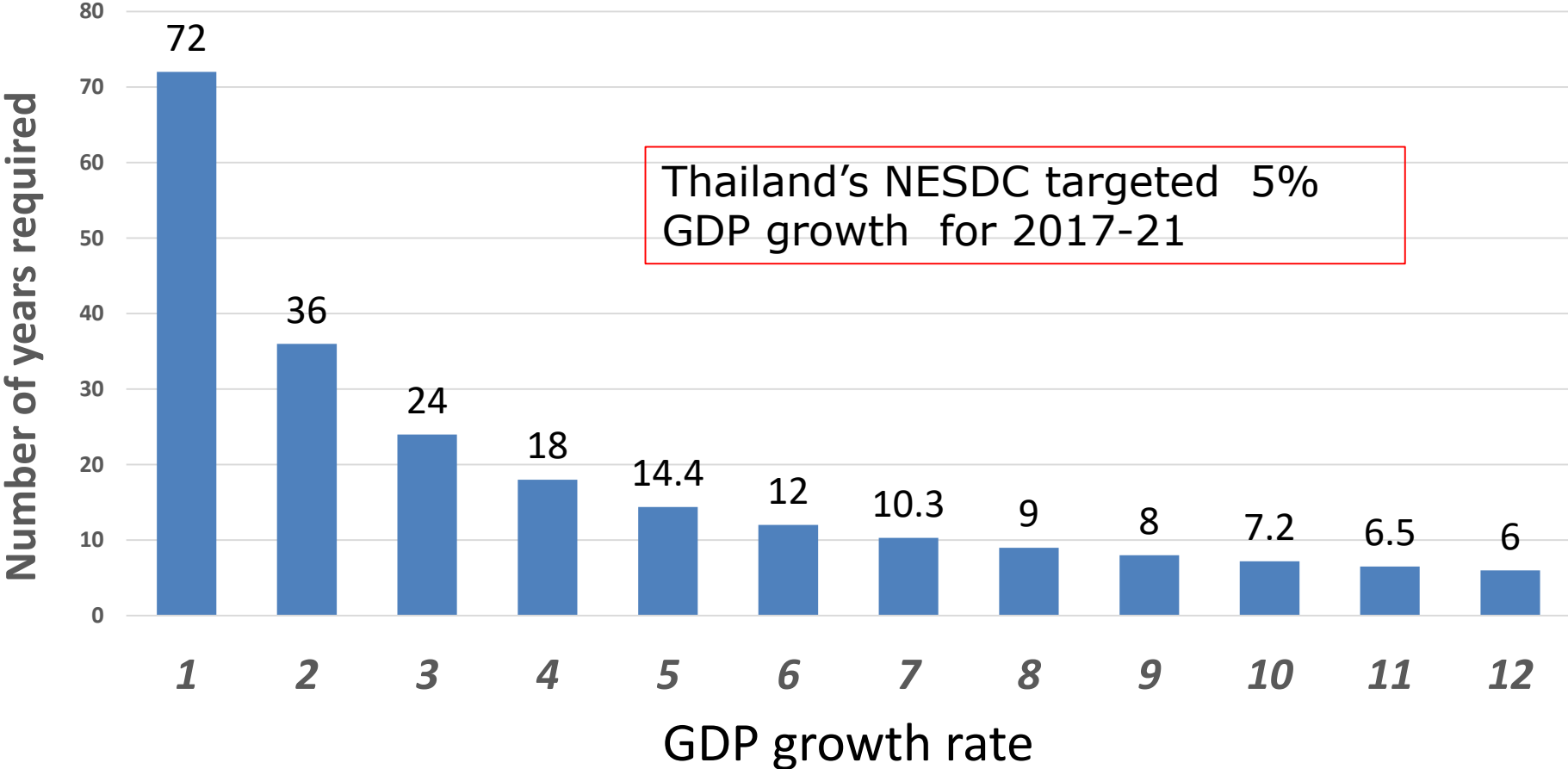
- The 'middle-income trap' is a situation in which countries that have attained a certain level of development but find it *difficult* to make the leap required to become advanced economies.
- Asian Development Bank identifies 35 out of 52 middle-income countries - i.e., with a GDP per capita income of between \$*2,000* and \$*11,750* - as being in danger of falling into the middle-income trap.
- When will Thailand pass the threshold income level of \$*11,750* and become an advanced economy?

Is there a trap?



How many years would it take to *double* GDP?

The rule of 72/g



The happiest country in the world: Denmark

Most of the world's wealthiest and best-governed countries got there **without** super-rapid bursts of growth.

Denmark, which has a per capita income of \$ 52,000 and is frequently ranked as one of the happiest countries in the world, never experienced what anyone would call an economic miracle.

Denmark's overall economic record is gloriously boring. Per capita income grew 1.9 % per year from 1890 to 1916.

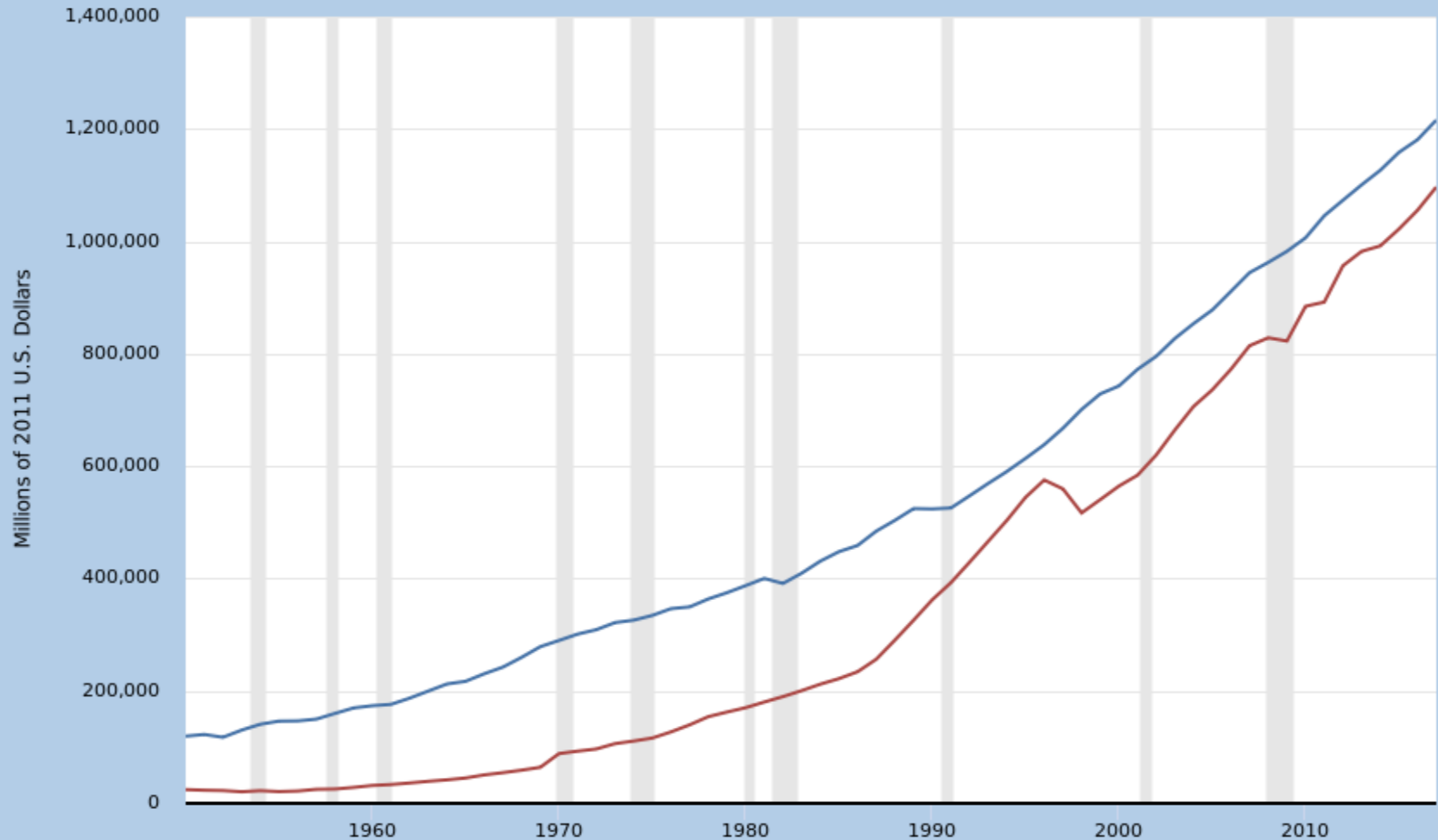
Denmark had positive growth about 84 percent of the time and **no deep recessions.**

The secret of successful advanced countries: Keep on growing and growing steadily without disruption

Avoid downturns and *keep growth steady*

FRED

— Real GDP at Constant National Prices for Australia
— Real GDP at Constant National Prices for Thailand



Source: University of Groningen

myf.red/g/u2yh

2. Early Development Theories

- (1) Economic Backwardness
- (2) *Dual economy and the unlimited supply of labor*
- (3) The big push
- (4) The stages of economic growth
- (5) *Dependency theory: Singer-Prebisch Hypothesis*
- (6) The flying geese

Alexander Gerschenkron, *Economic Backwardness in Historical Perspective: A Book of Essays*. Cambridge, MA: Belknap Press of Harvard University Press, 1962. 456 pp.

- England, the locus of the Industrial Revolution, could advance with **free market** guidance along the lines of Adam Smith.
- France, beginning later, would **need greater intervention** to compensate for its limitations.
- In Germany, the key innovation would be the **formation of large banks** to provide access to needed capital for industrialization.
- Because Greater Russia had high degree of backwardness, it required a larger and more direct **state intervention**. *The invisible hand of free market system would not help.*

(1) *Economic Backwardness*

- Economic backwardness must be overcome by the **government intervention**, which is a *prerequisite for industrial growth*.
- **State intervention** could, and did, compensate for the inadequate supplies of capital, skilled labor, entrepreneurship and technological capacity encountered by countries seeking to modernize.

How to deal with backwardness

- (1) *political reform and institutional innovation***, is a precondition for growth.
- (2) *The greater the degree of backwardness, the more intervention is required*** to ***channel capital and entrepreneurial leadership*** to nascent industries.
- (3)** The country needs measures to reduce domestic consumption and raise savings (*consumption taxes and subsidized long-term savings*)

Gerschcenkron

Focus on Industry and capital goods-not
agriculture or consumer goods

(4) **The more backward the country, *the less likely was the agricultural sector to provide a growing market to industry,***

(5) **The country needs *industry with growing productivity.***

6) Focus on capital goods rather than consumer goods

Apply capital-intensive rather than labor-intensive methods of production to create larger scale of production.

Arthur Lewis

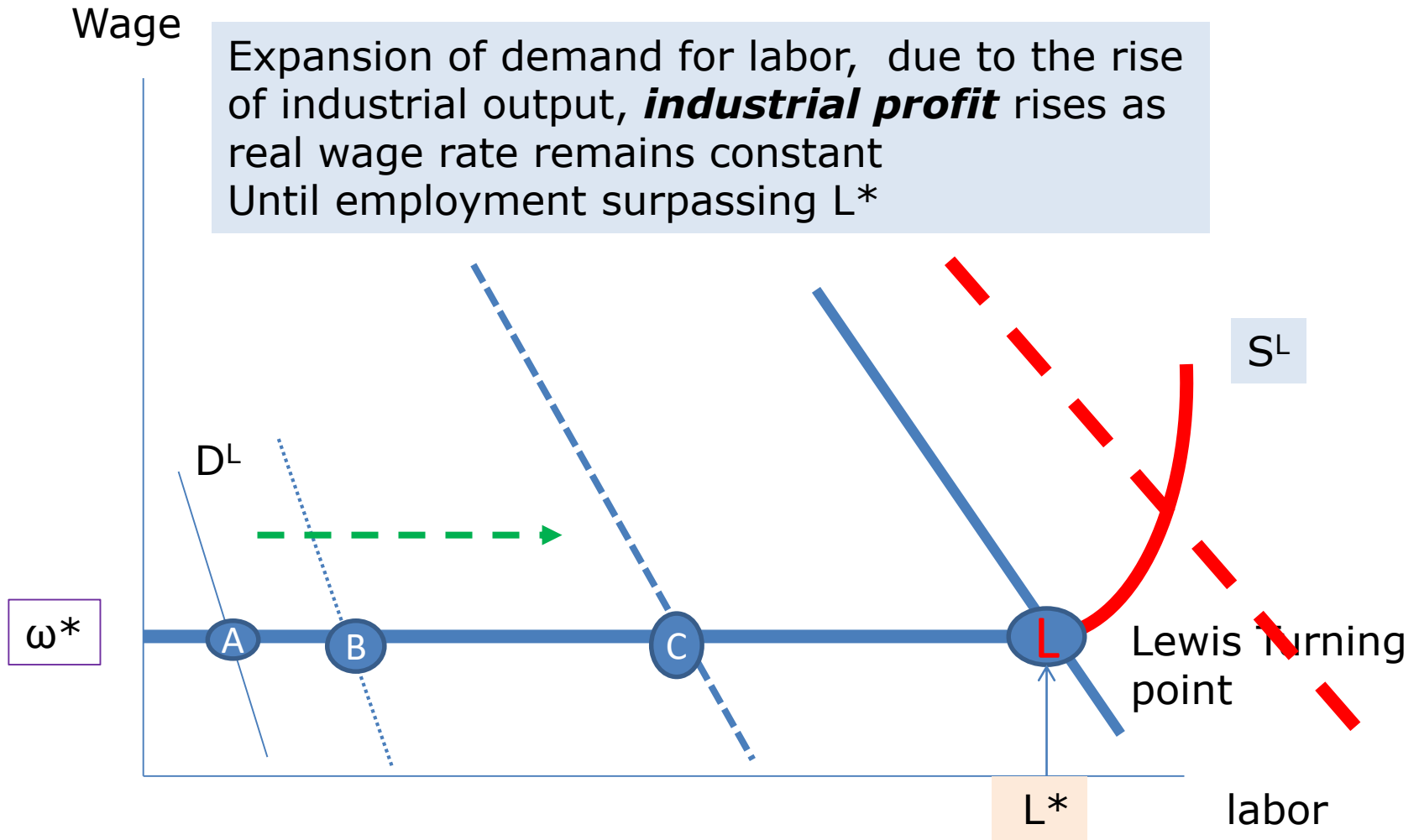
(2) Dual economy and unlimited supplies of labor

- “***Economic Development*** with ***Unlimited Supplies of Labor.***”
Manchester School 22 (May 1954): 139–191
- **Arthur Lewis**, a British citizen, was awarded the Nobel Prize in 1979 along with **Theodore Schultz** for “pioneering research into economic development ... with particular consideration of the problems of developing countries.
- ***Dual economy: The poor country has two characters: the farm sector which has unlimited supply of labor, whose productivity is low, and the industrial sector, employing productive labor.***

Lewis: Manufacturing is the key

- A poor country's economy can be thought of as containing two sectors, a small "capitalist" sector and a very large "traditional" (agricultural) sector.
- Employers in the capitalist sector hire people to make money.
- Employers in the traditional sector, on the other hand, *are not profit maximizing* and, therefore, hire *too many people* so that their productivity is very low. (Is it reasonable?)

Transforming agriculture to manufacturing



Lewis' strategy: Transfer agricultural labor to manufacturing

- Lewis argued on this basis that the way ***to spur development*** in poor countries is to ***shift labor into manufacturing***, where it is more productive.
- The capitalists save out of their profit and use this saving to expand, which then adds to growth.
- *Has China (Cambodia) reached the Lewis turning point?*

(3) *The Big Push Theory*

- A big push or a *comprehensive investment* package can bring economic development.
- A certain *minimum amount of resources* must be devoted for developmental programs.
- *Just like some fast ground speed is required for the aircraft to airborne,*
- Certain critical amount of resources must be allocated for development activities.

The Big Push Theory

Rosenstein-Rodan (1961)

- 'Bit by Bit' allocation cannot move an economy on the path of economic development,
- Rather a **specific amount of investment is considered necessary** for economic development.
- Establishing many mutually supporting industries, which depend upon each other, can create *economies of scale*.

(4) Dependency Theory

American Economic Review (1959)

INTERNATIONAL TRADE AND PAYMENTS IN AN ERA OF COEXISTENCE COMMERCIAL POLICY IN THE UNDERDEVELOPED COUNTRIES

By RAÚL PREBISCH*

United Nations Economic Commission for Latin America

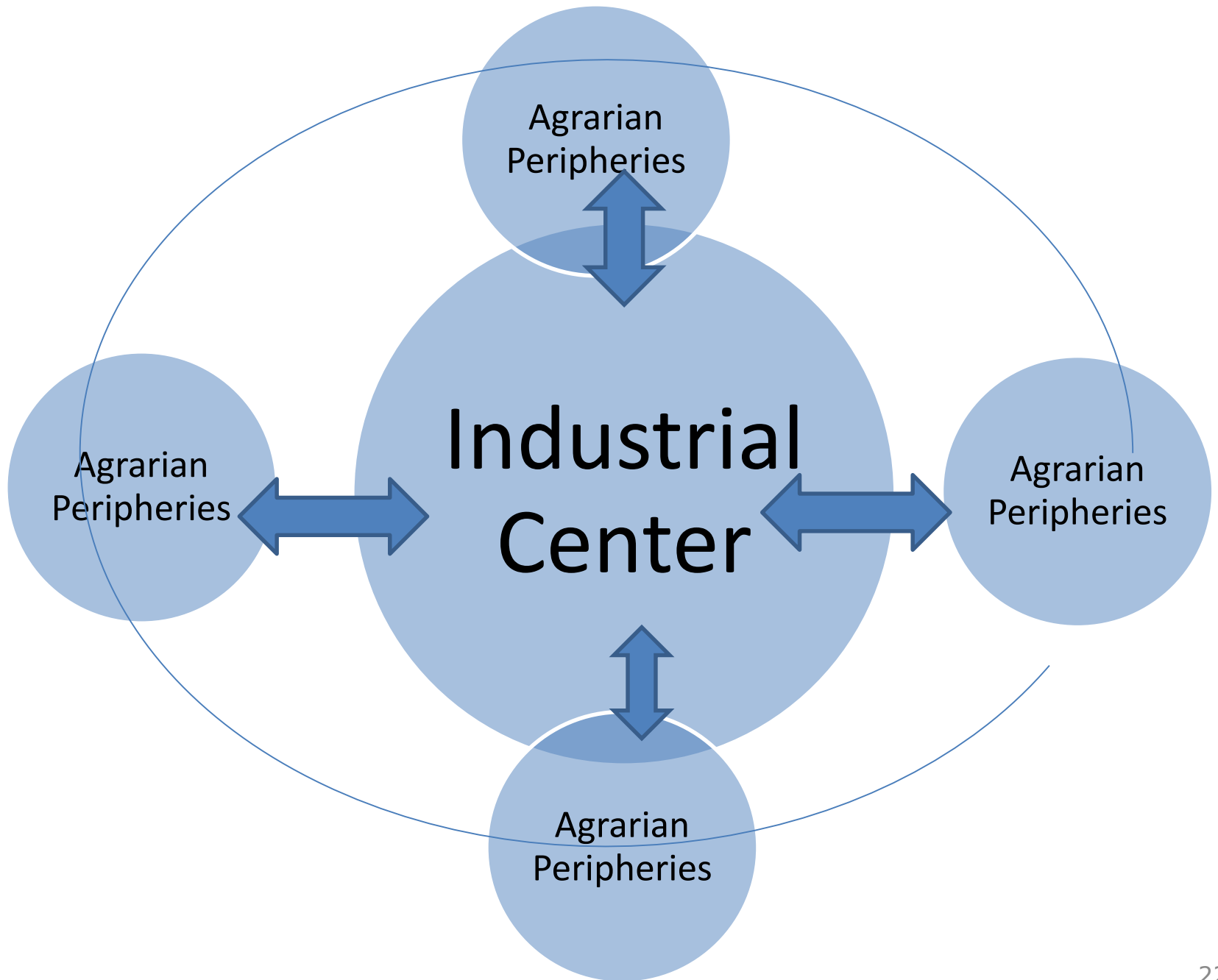
I. Industrialization

Historically, the spread of technical progress has been uneven, and this has contributed to the division of the world economy into industrial centers and peripheral countries engaged in primary production, with consequent differences in income growth. We are now at a transitional stage, in which this division is being gradually weakened, but it may take rather a long time to disappear. As the spread of technical progress into the periphery—limited originally to exports of primary commodities and related activities—is advancing more and more into other sectors, it brings with it the need for industrialization.

Prebisch-Singer thesis

Industrial centers vs. periphery

- The periphery countries depend on exporting primary commodities to industrial countries.
- The hypothesis focuses on ***terms of trade*** between **primary products** (raw materials and resources used in the productive process - metals, agricultural products) and manufactured goods.
- The terms of trade for primary commodities have a ***tendency to decline*** since the income elasticity of demand for manufactured goods is greater than that for primary goods, especially **food**.



Engle's Law

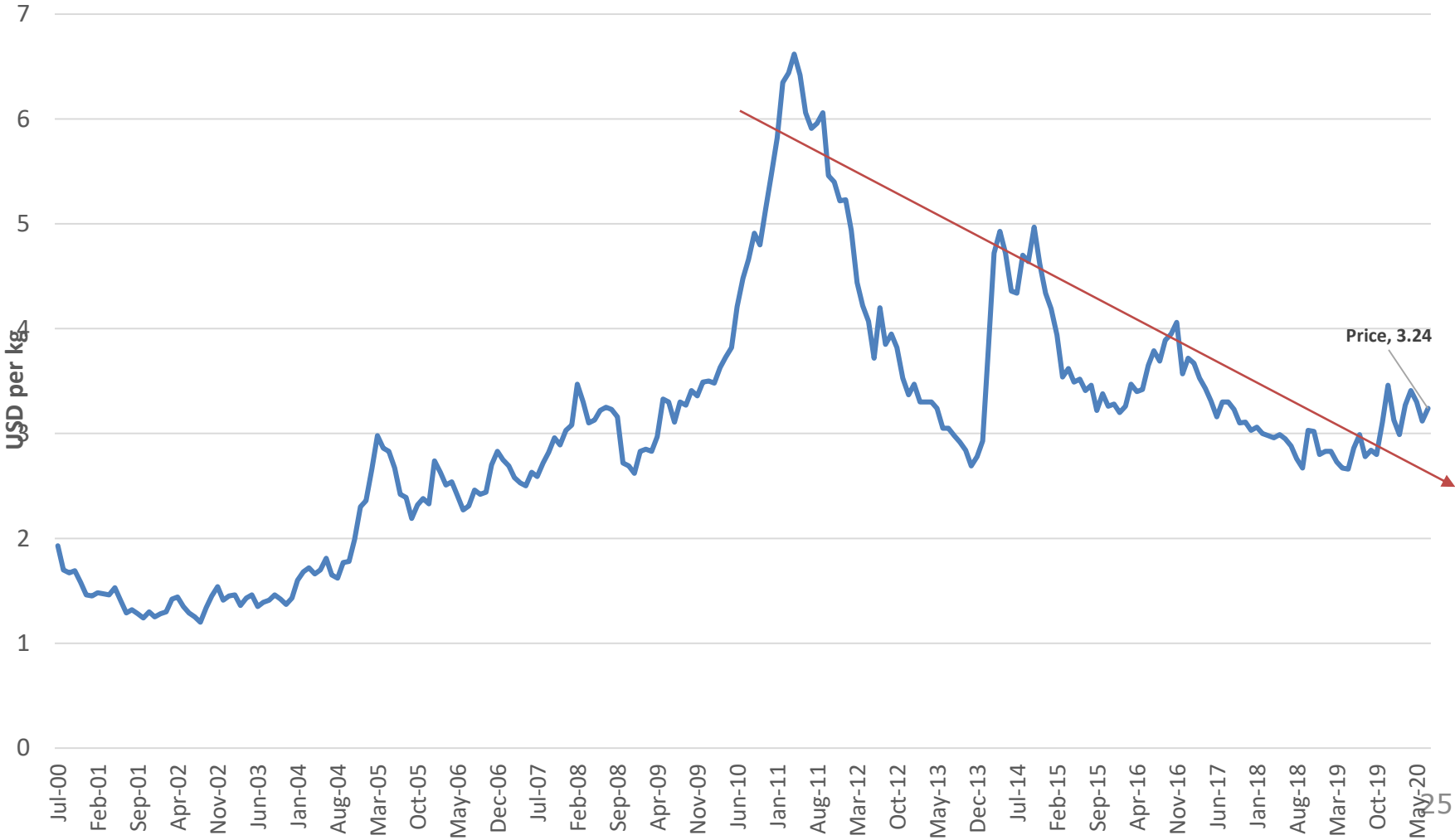
- As income rises, the *proportion* of income spent on food falls—even if *absolute* expenditure on food rises. In other words, the income elasticity of demand of food is between 0 and 1.
- The law was named after the Ernst Engel (1821–1896).

The Singer-Prebisch thesis

- As income increases, the demand for manufactured goods increases more rapidly relative to demand for primary products. (*income elasticity of demand*)
- As many developing countries tend to export primary products and import manufactured products, this implies the *need to increase the volume of exports* in order to keep importing the same level of manufactured and capital goods, or otherwise experience a deterioration of the trade balance.

Coffee production in Colombia has a reputation as producing mild, well-balanced coffee beans. Colombia's average annual coffee production of 11.5 million bags is the third total highest in the world, after Brazil and Vietnam, though highest in terms of the arabica bean. The beans are exported to United States, Germany, France, Japan, and Italy.

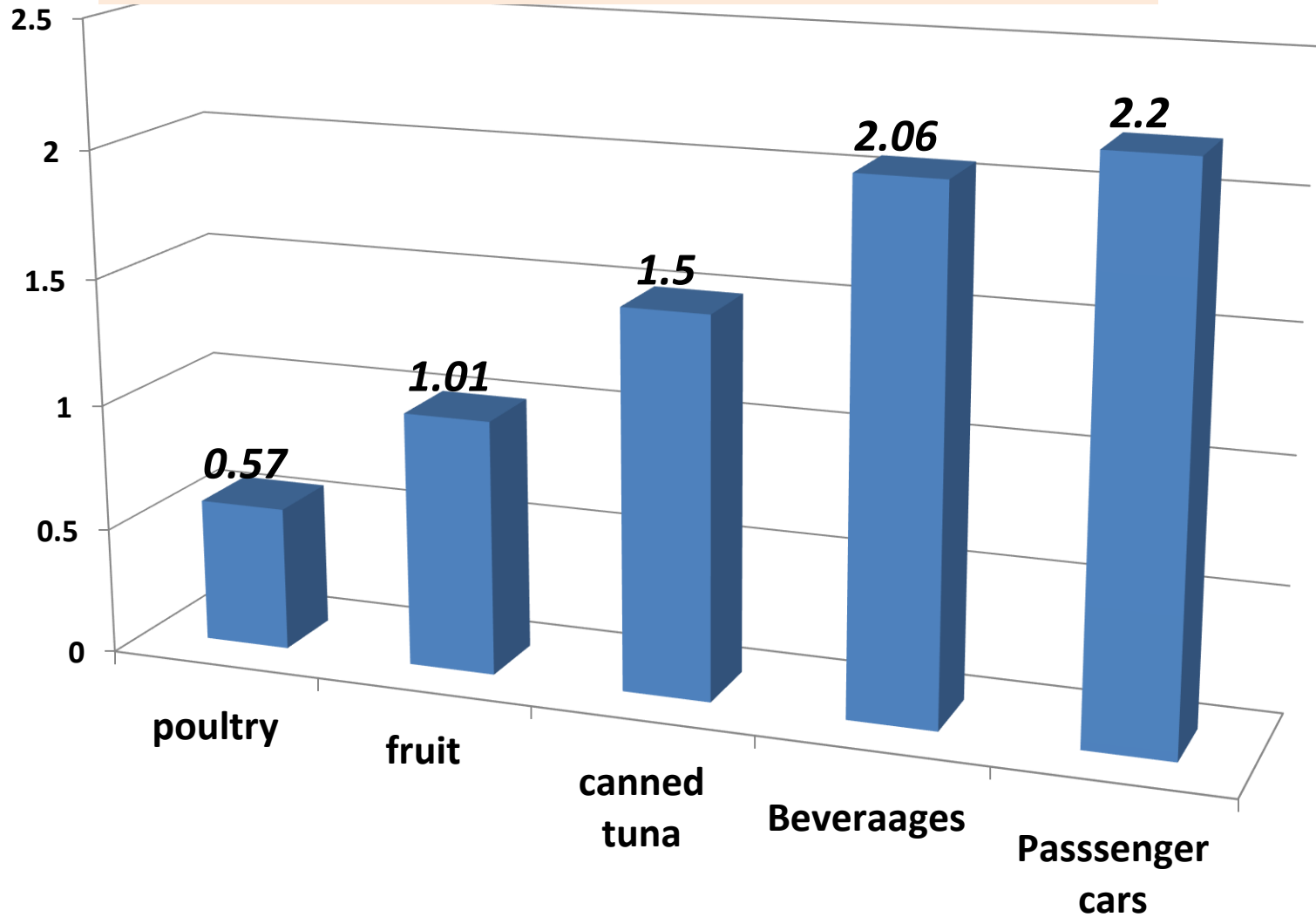
Prices of Mild Arabicas Coffee Beans



The Singer-Prebisch thesis

- Developing countries should strive to diversify their economies and ***lessen dependence on exporting primary commodities*** by establishing ***their own industries***.
- The idea of ***inward-looking development strategy: industrial protection through high tariffs***

World-income elasticity of Demand for Thailand's exports (1995-2015)



(5) Rostow: *The Five Stages of Economic Growth*

1. *Traditional society*: lack of science, subsistence economy
2. *Preconditions for take-off*: surplus from agriculture, extractive industries and transportation develop
3. *Take-off*: rise of manufacturing, rapid infrastructure development, new leaders wishing for changes

Rostow, W.W. *The Stages of Economic Growth*.

Cambridge: Cambridge University Press, 1971

4. *Drive to maturity*

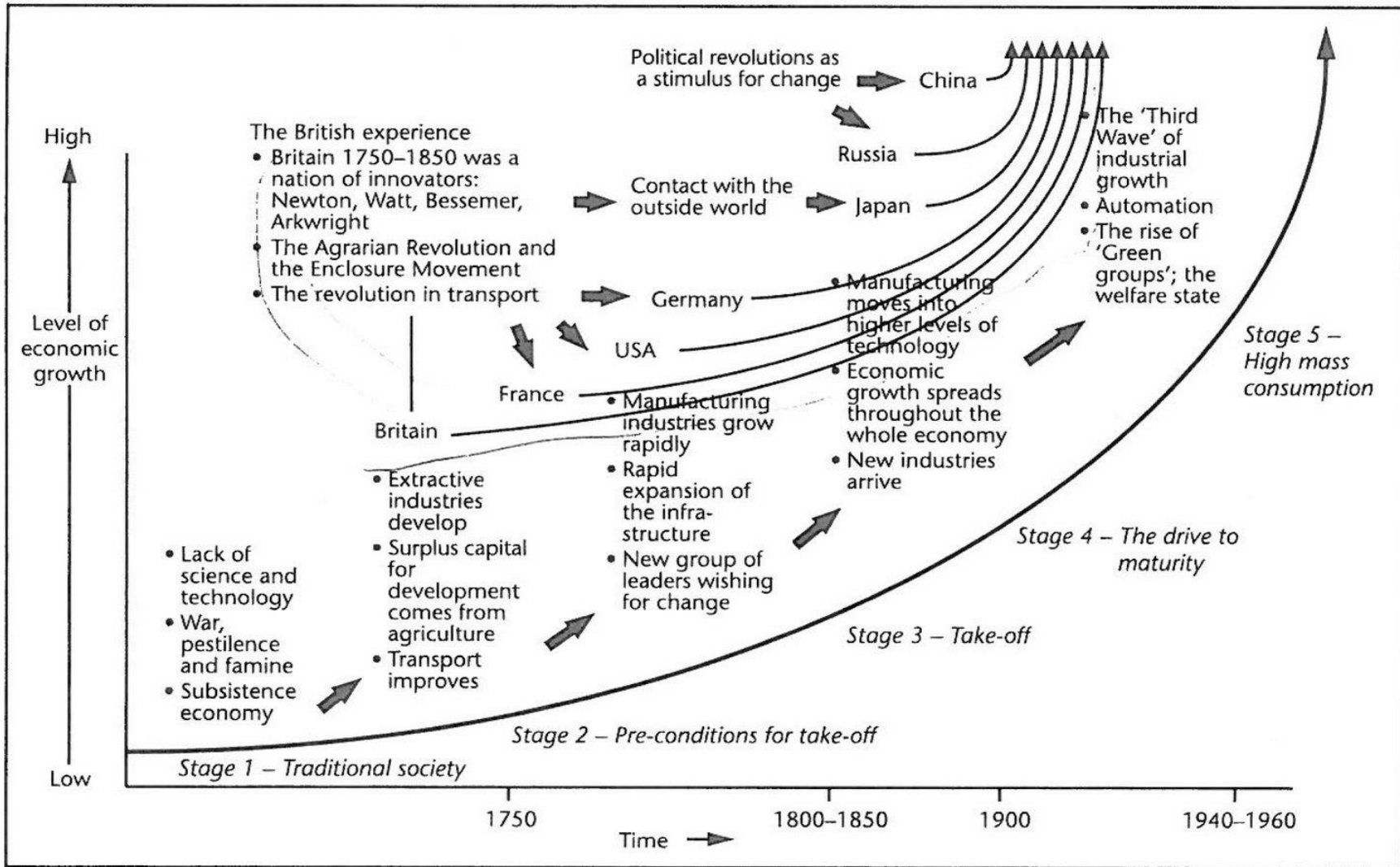
New technology and new industries, **growth spread** through out the country

5. **High Mass Consumption**

Third wave of industrial revolution, **automation**, and *welfare state*

Rostow, W.W. *The Stages of Economic Growth.*

Fig. 15.3: Rostow's model of economic growth as applied to selected countries.



(6) Flying geese model

Asian nations will catch up with the West as a part of a regional hierarchy where the production of goods would ***continuously move from the more advanced countries to the less advanced ones through FDI from Japan.***

Akamatsu (1962) provides a model for international division of labor in East Asia based on ***dynamic comparative advantage.***

“The underdeveloped nations aligned successively behind the advanced industrial nations in the order of their different stages of growth in a wild-geese-flying pattern.”

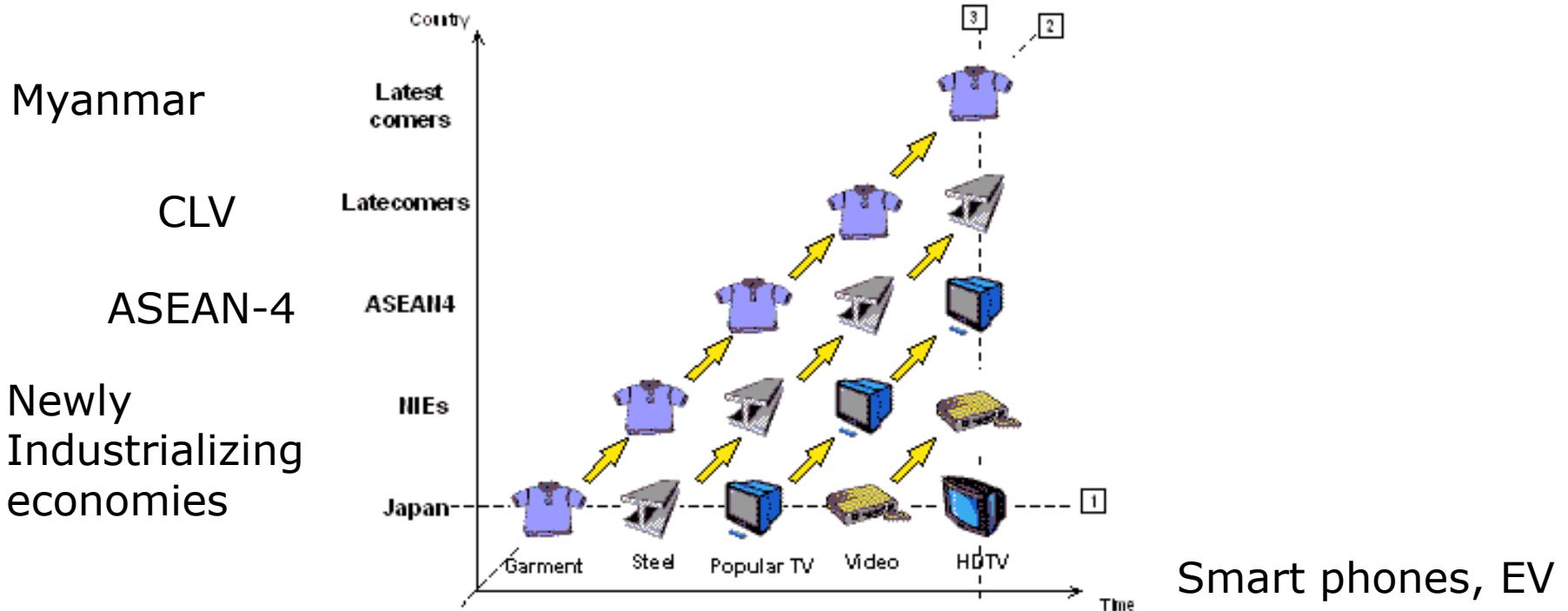
The hypothesis depicts the catching-up process of post-war industrialization in Japan—a model successfully emulated by the ***East Asian ‘miracle’ economies***, bringing hope to many other developing countries in Asia.

A HISTORICAL PATTERN OF ECONOMIC GROWTH IN DEVELOPING COUNTRIES

The Developing economies 1(1) 1962

Kaname Akamatsu

Structural Transformation in East Asia



Kaname Akamatsu

The metaphor of flying wild geese: driven by FDI

Sequential *shifting of comparative advantage* across economies unleashed trade-fueled economic development.

Contributing factors are structural changes, infrastructure development, human capital accumulation, industrial policy, and FDI.

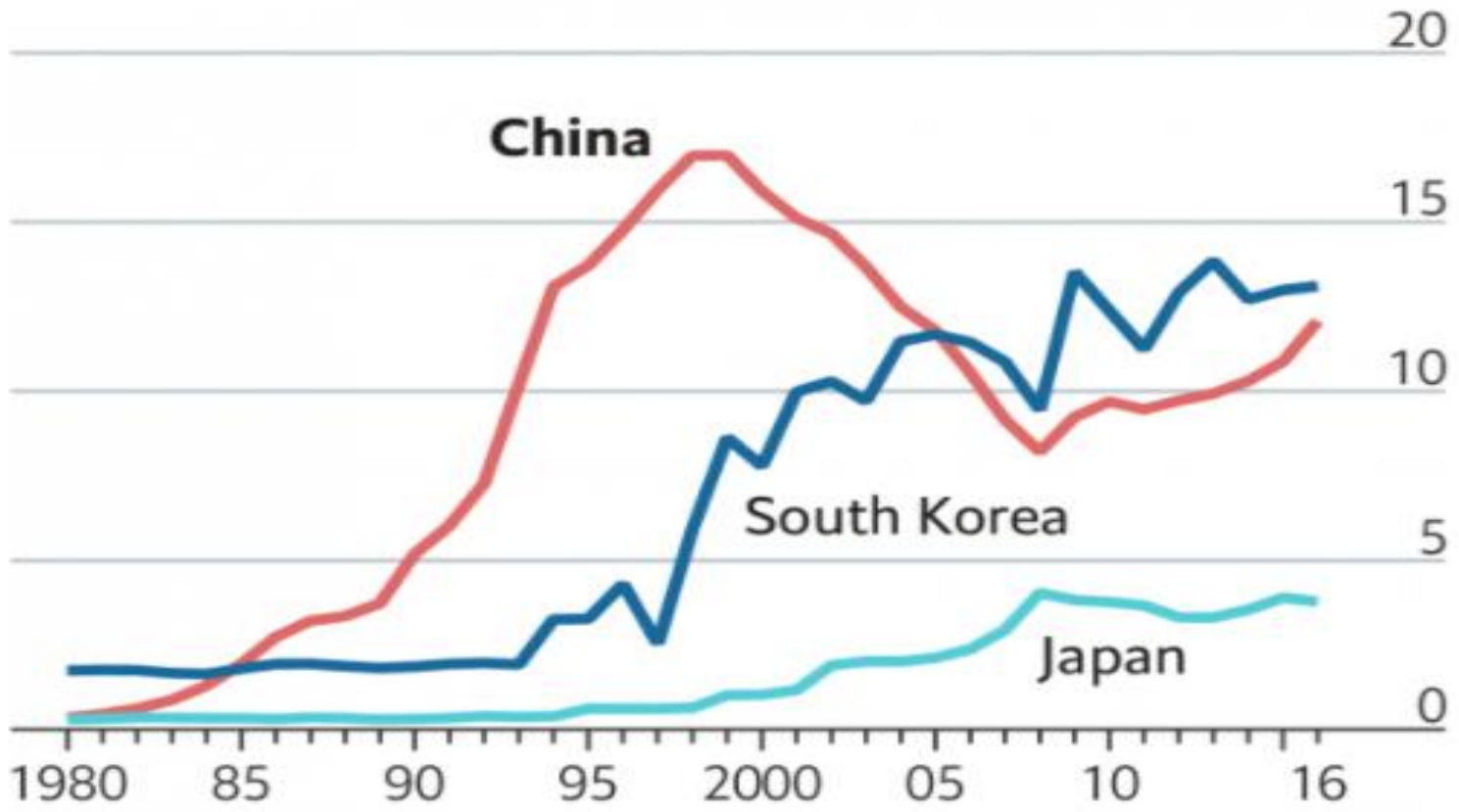
The FDI-driven economy hypothesis

FDI-driven economy: foreign direct investment is the major motive power for the economy.

To what extent can we describe Thailand as an FDI-driven economy?

Inside attractions

Stock of inward FDI as % of GDP



Sources: UNCTAD; IMF

High-income countries grow at a slower pace than low-income countries

- Slow growth in the 19th century doesn't mean that the U.S. or Denmark were failures.
- It's hard for advanced economies at the *technological frontier* to rapidly improve living standards, because technological invention is usually slower than developing countries which *borrow technologies* from wealthier nations.

Characteristics of Asian Tigers

- The Asian tigers borrow know-how, along with (1) export growth engine, (2) human capital investments, and (3) heavy infrastructure development
- The Asian tigers of Japan, South Korea, Taiwan, Hong Kong, Singapore and China achieved growth rates of 8 percent to 10 percent a year in their earlier development stages.
- *Can Thailand succeed by following the Asian Tiger model?*

3. Thailand's development plans

1st Development Plan (1961-1966)

Import substitution (inward orientation)

Infrastructure Investment

Promotion of private investment

Economic Office Establishment: Board of Investment (BOI) National Economic and Social Development Board (NESDB), Bureau of the Budget (BoB), Fiscal Policy Office (FPO)

Early economic plans: Objectives and Missions

2nd Development plan (1967-1971)

Export promotion (outward orientation)

3rd Economic and social development plan
(1972-1976):

Investment in rural area and education
(kind of late)

Economic and Social Development Plans

4th Plan (1977-1981)

Increasing *security spending*,
Reducing social gaps,
Restoring *natural resources*

5th plan (1982-1986)

Public and private **cooperation**,
Rural development and investment

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 live and ***environment***

Trend of (indicative) economic 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

A policy shift in the 10th plan (2007-2011)

Sufficiency economy

Green growth

Sustainable development

The 11th National Economic and Social Development Plan (2012-2016)

- To develop Thailand into a *happy society* with *equity, fairness, and resilience*.
- Promoting a peaceful society with good governance,
- Promoting sustainable development through the restructuring of the economy, society, and politics, while nurturing natural resources and the environment.
- Preparing people and community to be *resilient to changes*.

The 12th National Economic and Social Development Plan (2017-2022)

- Strengthen competitiveness
- Reduce income inequality
- Provide safety net for the *ageing population*
- Infrastructure development and logistics
- Special economic zones
- Cooperation with neighboring countries for greater connectivity (integration)
- Development of technology and innovation by increasing *R&D expenditures* (Thailand 4.0 Model)

4. Sources of Happiness

Richard Layard

New York: Penguin Press, 2005

- Once subsistence income is guaranteed, making people happier is **not easy**.
- If we want people to be happier, we really have to know what factors generate happiness and how to cultivate them.
- **How can you make me happy?**

Facts about human beings

- We are programmed to seek happiness.
- Humans are **social beings**, wanting to **trust each other**.
- People are deeply attached to the **status quo**.
- Human beings are *status conscious*.
- Human beings are very **adaptable**.

Sources of happiness

1. People who say that other people can be **trusted**. (Do you trust your government, and your teachers?)
2. People who belong to **social organizations**.
3. Happy family (low divorce rate)
4. Low unemployment rate
5. **Religious belief**
6. **Quality government**

Can public policy make people happy?

- Extra income increases happiness *less and less* when people get richer.
- Public policy can more easily *remove* misery than *augment* happiness.
- By giving 11.3 million Thais welfare smart cards ?
- To live happily is an inward power of the soul” Aristotle. Hence, happiness depends on your **inner life** as much as on your outer circumstances.

Preventable death: Suicide statistics

- Thailand: 6.3/100k population
- Global: 12/100k
- In 2018, male 3,327, female 810
- Regional share: NE 31.2 % Central 30.6 %, North 25.4 % and South 12.8%
- Highest age group: 30-49 years old about 30%

5. Why Nations Fail

- A book by Daron Acemoglu and James Robinson (AR)
- A Book Review by William A. McCleary in Thammasat Economic Journal, 31(1) March 2013
- **AR rejected** three alternative explanations of why various countries experience different growth paths:
- The three *rejected* factors are: **Geography, culture, and ignorance of correct policies.**
- *AR argued that quality institutions matter most.*
- *Extractive institutions are the worst kind of institutions that would drag down the growth path in the long run and explain why nations fail.*

Extractive institutions

- Nations are poor because they do not have institutions which allow them to **generate growth potential**.
- Political institutions in ***which power is heavily concentrated***,
- The **extractive institutions** do not create an environment in which ***a large proportion of population can share in the benefits***.
- Extractive societies of Soviet Russia and China which have experienced years of ***spectacular growth finally slowed down***.

Inclusive institutions

- **Politically inclusive institutions *share power to mass people.***
- ***Many groups* can *participate* in the decisions which affect their prosperity and access to public services.**
- Inclusive institutions generate opportunities to invest, create new or ***better products and policies,*** self-improvement.
- Securing property rights, an **objective system of law** (not subjective or double standards), with limited ***monopoly privileges.***

The Glorious Revolution

- England in the industrial revolution was an example of inclusive institutions
- The Glorious Revolution (1688): **the king could exercise power *only* with the consent of parliament** and ***(2) the government must be more responsive to a wider groups*** in society.
- <https://video.search.yahoo.com/search/video?fr=mcafee&p=the+glorious+revolution#id=8&vid=726e5c6a3a985377df4c8e4252743324&action=view>

THE GLORIOUS REVOLUTION

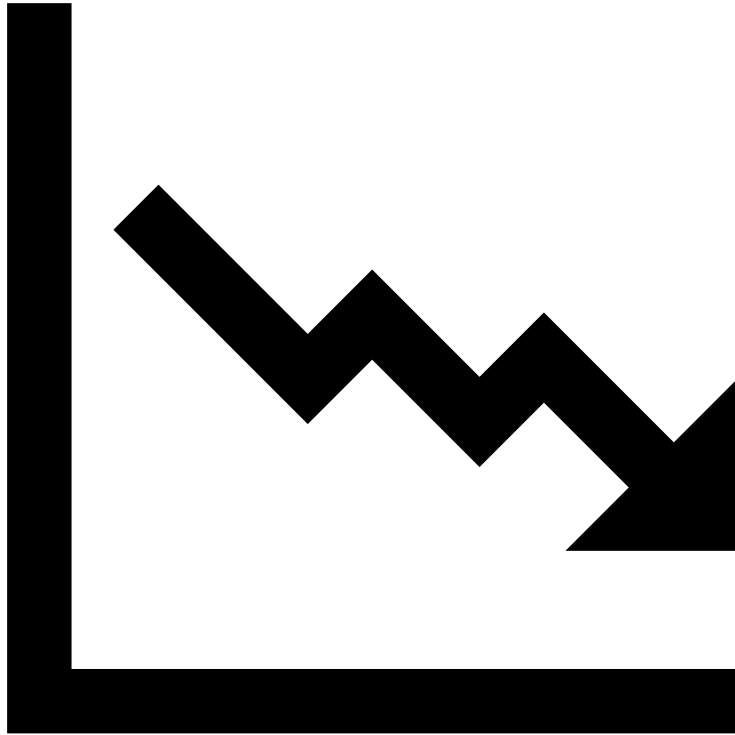
“Our duty to God obliges us to protect the Protestant religion...Therefore gentlemen...and fellow Protestants welcome to my camp...it is our principle to die in a good cause than die in a bad one ”

King William,
Prince of Orange



How to measure quality of government

- Governance indicator
- Press freedom index
- *Regulatory quality*
- Political stability
- *Voice and accountability*
- Rule of law
- www.govindicators.org
- The Worldwide Governance Indicators (WGI) provided by the World Bank



The worst contraction in 22 years

- The NESDC reported GDP shrank 12.2% year-on-year in the second quarter, the biggest contraction since the Asian financial crisis of 1997-98.
- It reduced the economic outlook for the whole year to a 7.3%-7.8% contraction.

Quiz yourself

1. Explain how Thailand's economic development plans evolved around development theories and changing socio-political environment.
2. Utilize Layard's sources of happiness to examine the impact of economic development on happiness of the Thais over the past three decades.
3. Select two development plans that you think they had provided the highest contribution to the Thai economy. Provide evidence to support your arguments.

Quiz yourself

4. Can sufficient economy principle serve as immunization for a country under global growth slowdown?
5. Is the concept of Gross National Happiness (GNH) superior to Gross National Product (GNP)?
6. Is there still any sign of economic backwardness in Thailand in 2020? Are we ready for Thailand 4.0 model of development? Is it a claptrap?