EE460: Thai Economy

Bhanupong

Lecture 1

Historical Perspectives

Objectives

- The objective of this course is to provide students basic understanding of Thailand's social and economic development by using analytical tools provided by economic theories.
- It is expected that students would be able to understand complex and controversial issues of the Thai economy.

Class Evaluation

- Midterm (25%)
- Homework and attendance (15%)
- Final exam (60 %).
- Class attendance is a necessary condition for passing the exam.

Main Themes: Lecture 1

- Siam and Japan: Historical comparison of early economic development
- Fundamental determinants of growth
- The importance of good institutions

Historical Perspective of Thailand's Economic Development

- What can we learn from historical path of economic development in Thailand?
- Why was Thailand able to grow rapidly between the 1960s and the early 1990s?

Recommended Reading

- J.C. Ingram (1971) *Economic Change in Thailand*, 1850-1970, Stanford University Press

In 1571, the little harbor village of Nagasaki quickly grew into a diverse port city, and Portuguese products were imported through Nagasaki (such as tobacco, bread, textiles and a Portuguese sponge-cake called *castellas*) were assimilated into popular Japanese culture. Tempura derived from a popular Portuguese recipe originally known as *peixinho-da-horta*, and takes its name from the Portuguese word, 'tempero' another example of the enduring effects of this cultural exchange. The Portuguese also brought with them many goods from China.

Trade Routes CC BY-SA 3.0

Initial conditions in Siam and Japan: 1850-1914
(Yasuba and Likit, 1985)

- Both countries shared striking similarities when they were ***forced to*** open trade: Siam in 1855, Japan in 1859.
- Both countries started to modernize in contemporary reigns: King Chulalongkorn (1868-1910), Meiji (1868-1912).
- **Industrialization** was the main trend in Japan, while specialization in **primary commodities** was the major tendency in Siam.

Studying abroad

- Japan had sent **6,000** students abroad by 1881, representing a fairly ***wide segment*** of the society, including former low-ranking samurai.
- Until late 1890s, Siam sent ***only a number*** of royal family to study abroad.
- The early groups of Thai ***middle-class*** students produced the leaders of the constitutional coup in 1932.

Higher education in early Japan

- **Science and engineering** have been emphasized from the start in Japan.
- The first national university was established in Tokyo in 1877 with faculties of humanities, law, natural sciences, and medicine. There was a separate college of engineering.
- Until 1887, the proportion of graduates in natural sciences, medicine, engineering and agriculture exceeded ***80 percent***.

Higher education in different directions

- The forerunner of Chulalonkorn University was the Royal Pages School, established in 1902.
- The aim was to provide a general education with emphasis on training in ***government administration***.
- Chulalonkorn engineering school was established in 1913 (36 years after Japan).

Changes in Japan's pattern of trade

- Japan's initial exports were mostly primary products such as raw silk, tea, and marine products.
- What were Thailand's traditional exports during King Rama V?
- How do we explain this pattern of trade?
- **Heckscher-Ohlin theorem** states that countries will export products that utilize their ***abundant*** factors of production and import products that utilize the countries' **scarce** factors.

From producing primary to secondary products

- In the early 1900s, imports became exports; exports became imports of Japan.
- Domestic manufactures soon started substituting for imports of light industries and eventually became export industries.
- By 1914, exports included former imports: cotton yarn and cloth (manufactured goods).
- ***Primary commodities***: Cotton, sugar, soybeans and petroleum were major imports.
- While Thailand still exported primary commodities (rice, tin, and teak) and imported clothes: no change in the pattern of trade.
- Implications on Japan's improvement in the ***terms of trade (P_x / P_m)***

Chakri Dynasty: Historical Background

- Rama IV: King Mongkut (1851-68)
- Rama V: King Chulalongkorn (1868-1910)
- Rama VI: King Vajiravuhd (1910-1925)
- Rama VII : King Pracjadipok (1925-1935)
  Abdicated the throne, ending the regime of absolute monarchy.

- Rama VIII: King Ananda-Mahidon (1935-46)
- Rama IX: King Bhumiphon (1946-2016)

James C. Ingram: Chapter 1

- Since the beginning of the Chakri dynasty, Thailand has had a period of peace. The British conquest of Burma removed the major source of conflict, but the decline of the **old enemy** in the west was soon followed by the rise of a new one in the east.
- By 1907, Thailand had lost 80,000 square miles of territory due to French colonial aspirations.
- The worst crisis came in 1893 when French gunboats forced their way up to the Cho Praya River and French troops occupied Chandaburi province in the east.

James C. Ingram: Chapter 1

- The British desire to keep Thailand as a buffer state between British and French possession in Asia, together with British interest in the trade of Bangkok (then 70 percent in British hands) was largely responsible for the use of British diplomacy. **to preserve the independence** of Thailand.
- King Mongkut (Rama IV) came to the throne in 1851, with the conviction that Siam must learn to live with the Western nations if she was to survive as an independent nation.

The Bowring Treaty: 1855

- The treaty was signed in 1855, when British subjects were placed under ***consular jurisdiction***, rather than under the jurisdiction of Siamese law.
- For the first time, Siam granted extraterritoriality to foreign aliens.
- British subjects were given the right to trade freely in all seaports and to reside permanently in Bangkok.

Details of the treaty

- Import duty was fixed at 3 percent for all articles, with two exceptions: opium and gold bullion were to be free of duty.
- Articles of exports were to be taxed just once, whether the tax was called an inland tax, a transit duty, or and export duty.
- The Siamese government reserved the right to prohibit the export of **salt, rice, and fish** whenever these articles were deemed to be scarce.

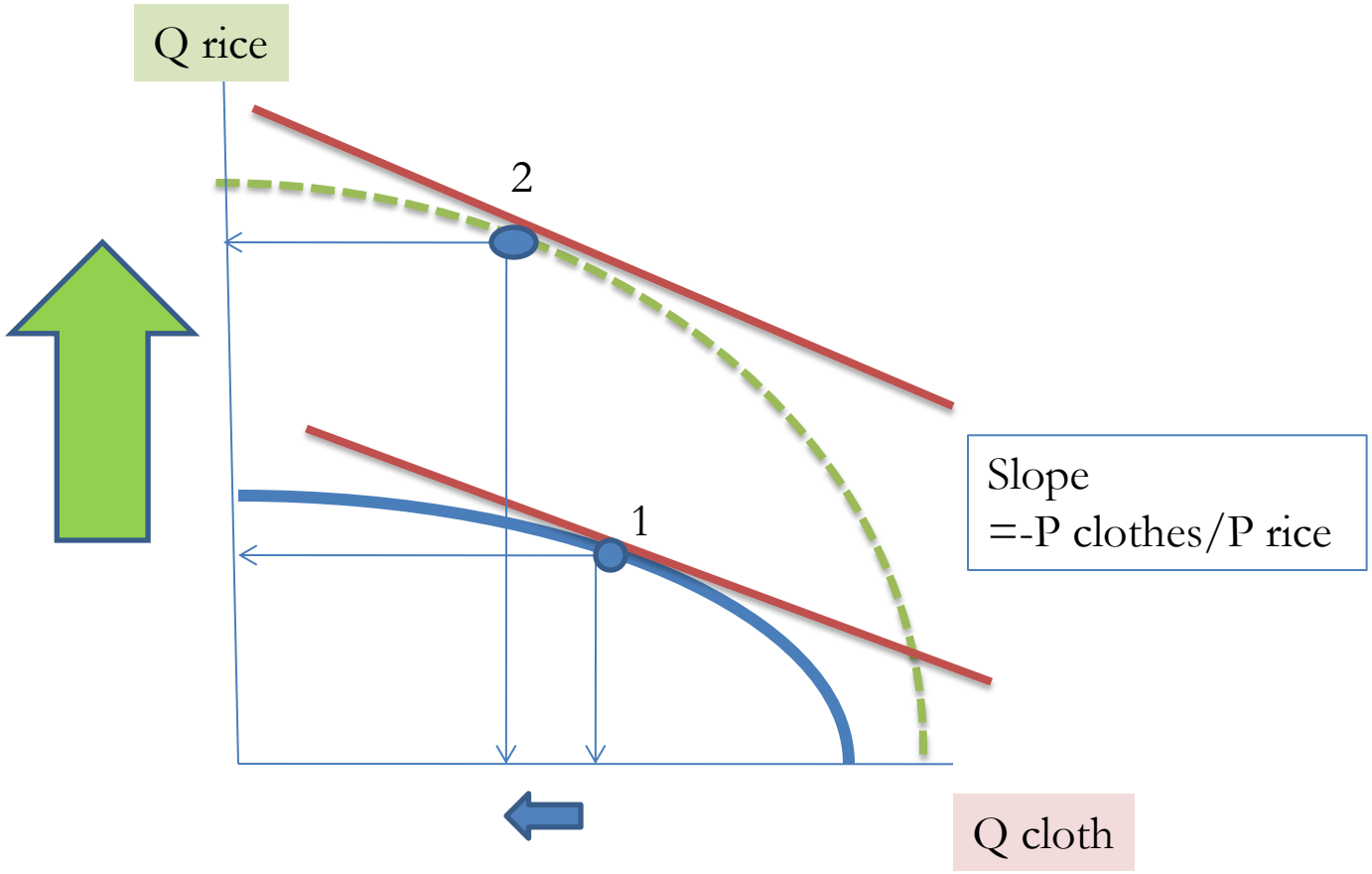
Siam opened trade sector abruptly to the West

- The Bowring treat set a pattern which other countries were quick to follow with ***similar treaties*** with Siam.
- US in 1856, France 1856
- Denmark 1858, Portugal 1859
- Netherlands 1860, Germany 1862
- Italy 1868, Spain 1870
- Japan 1898, Russia 1899

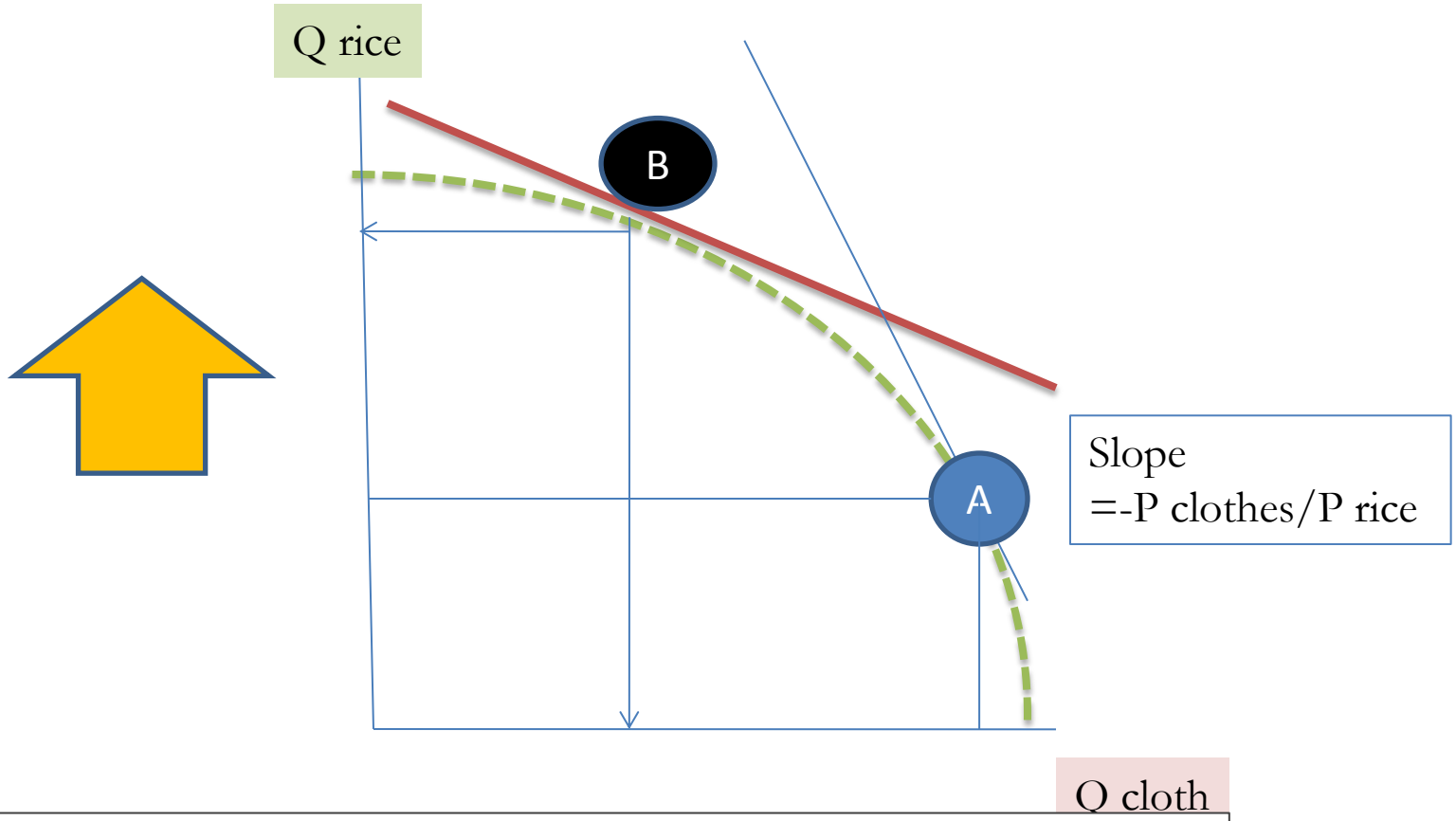
Siam's exports
three major primary commodities
(% total exports)

	Rice	***Tin***	***Teak***	Total
1867	41.1	15.6	na	56.7
1890	69.7	11.1	5.5	86.4
1906	69.1	11.0	11.2	91.3
1915-16	70.1	15.9	3.9	89.9

- Rice exports became increasingly dominant.
- Impact of trade opening: specialization and concentration in rice production
- ***Why didn't the pattern of Thailand's exports change until the 1970s?***



An increase in supply of land (reduction in forest areas)shifted the PPF ***disproportionately*** outward in the direction of rice sector.
Production of cloth actually declined, given that
the relative price of cloth remains unchanged (hence a constant slope of Terms of Trade (Pc/Pr).



When price of rice increased faster than the price of clothes, terms of trade was favorable to Thailand.
More resources were allocated to rice production.
More surplus after domestic consumption. More rice for exports.

Expansion of planted area for paddy millions of rai (0.4 acre)

	1903-7	1948-50	Percentage increase
Central Plain	6.5	16.3	151
All other	2.2	17.1	678

Thai rice fetched higher export prices during this period, in particular during and after WWII

Rice is a land-intensive product
Rent went up, benefiting land lords.

Who would gain and lose from the trade openness?

- **Stolper-Samuelson theorem:** A *rise in the relative price of a good will lead to a rise* **in the return to that factor** *which is used most intensively in the production of the good, and conversely, to a fall in the return to the other factor*.
- David Ricardo: The political economy of the corn laws (England , 1804)

What were missing in Siam?

- The abundant supply of land *may* have retarded industrialization, with lagging technical progress in both industry and agriculture.

Is Thailand a resource-cursed economy?

- The lack of infrastructure
- The lack of serious efforts to learn from abroad to propagate knowledge domestically.

Development divergence

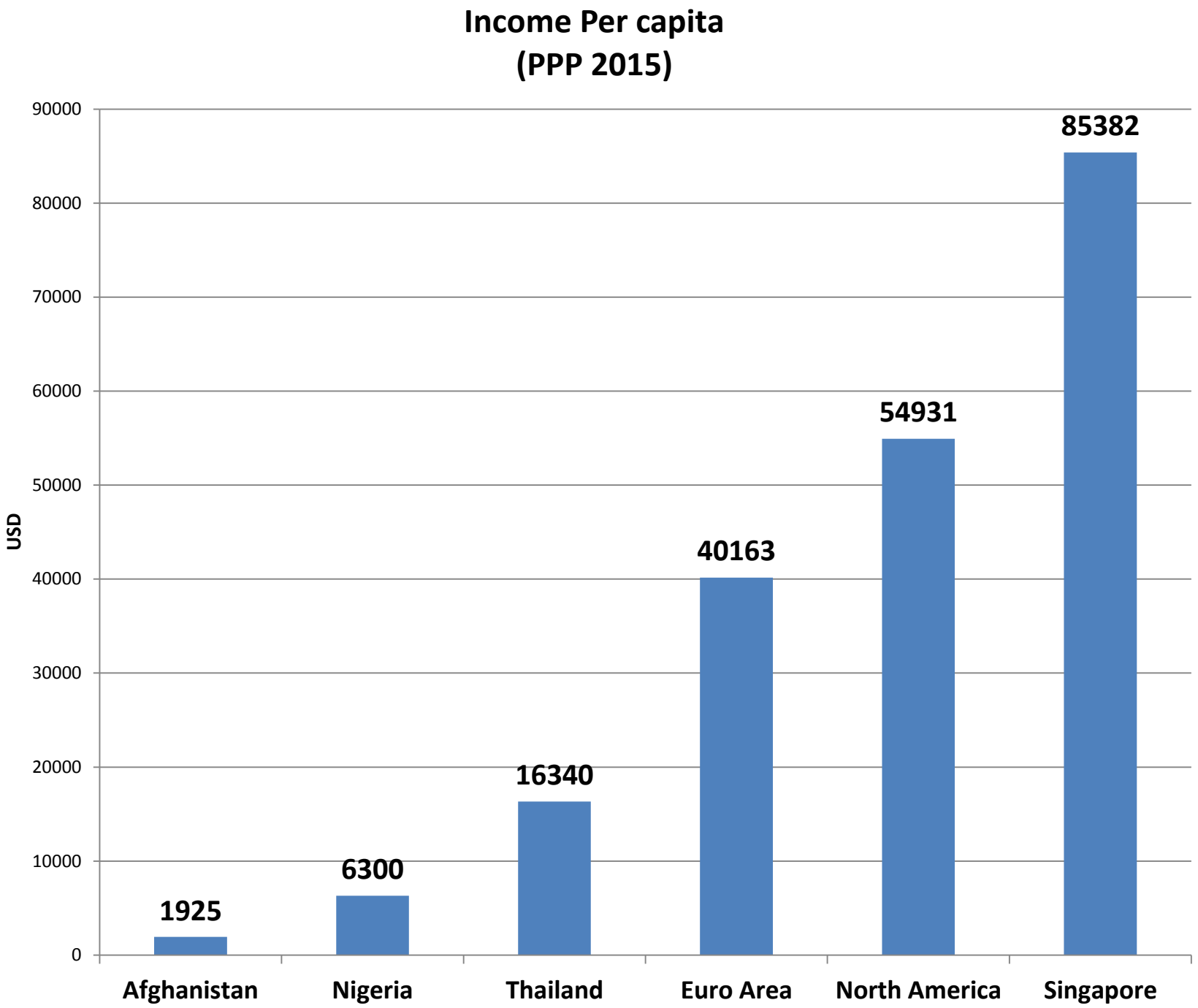
- The Meiji Restoration drastically *redistributed Japanese income* and provided opportunity for the private sector to grow.
- Development was enhanced by *subsidies* of early private factories and a strong emphasis on infrastructure and education.
- Given a contrast in initial conditions, institutional changes and policies, economic development divergence between Thailand and Japan emerged.

Why is there a spectacular income gap of the world's rich and poor nations?

- Average income of Sierra Leone is one hundred times ***lower*** than that in Luxembourg.
- Two-thirds of the world's population lives in countries where average income is only ***one-tenth*** the U.S. level.

Per capita income in $ (PPP) in 2011:

• Qatar	98,948	U.S.	48,328
• Singapore	59,710	Cambodia	2,239
• Thailand	9,398	Congo	349


Income Per capita
(PPP 2015)
USD
90000
80000
70000
60000
50000
40000
30000
20000
10000
0
1925
6300
16340
40163
54931
85382
Afghanistan
Nigeria
Thailand
Euro Area
North America
Singapore

In Search of Prosperity
Dani Rodrik (2003)

What do we learn from country narratives?

- A cursory look at the cross-national record of the last few decades
- Rodirk: There are deeper determinants of economic performance beyond economic variables (such as physical and human capital and price distortions).
- Rodrik attempts to provide answers to these questions:
- How has China managed to grow so rapidly despite the absence of full-fledged private property right?
- What happened in India after the early 1980s to lift its growth rate by three percentage points?

Explain why they differ

- How have Mauritius and Botswana managed to avoid problems that other countries in sub-Saharan Africa have succumbed to?
- Why did Brazil and Venezuela do so well until the early 1980s and so poorly thereafter?
- Why does Venezuela continues to stagnate despite a sharp improvement in their fundamentals since the 1980s?
- BRIC, IC, or just India?

Global income distribution:
GDP per capita and cumulative percentage of world population

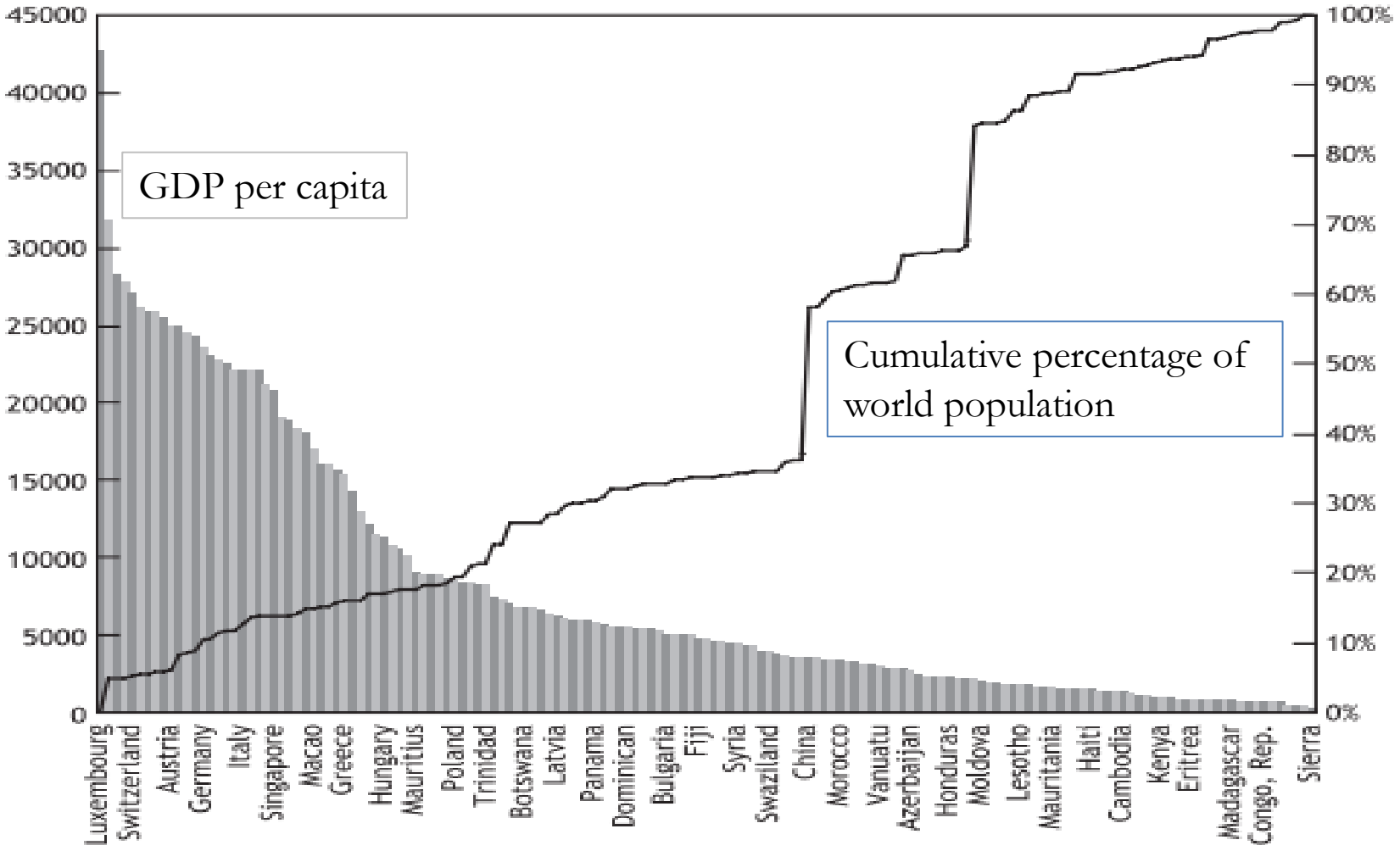


Figure 1.1. Global income distribution: GDP per capita in 1999 (PPP-adjusted, left axis) and cumulative percentage of world population (right axis)
Source: World Bank, World Development Indicators 2001

Eight men as rich as world's half

- The gap between the super-rich and the poorest half of the global population is starker than previously thought.
- Forbes list: Microsoft Corp founder Gates is the richest individual with a new worth of $75 billion. Ortega the Spanish founder of fashion house, Warren Buffett, Mexican business magnate Carlos Slim Helu, Amazon.com boss Jeff Bezos, Facebook creator Mark Zuckerberg. Bloomberg, former mayor of New York

Trapped in poverty by inequality

- " It is obscene for so much wealth to be held in the hands of so few when one in 10 people survive on less than $2 a day" Oxfam International Director.
- Inequality is trapping hundreds of million in poverty; it is fracturing our societies and undermining democracy"

How economists think of income determination

- Total output is a function of resource **endowments**(labor, physical, human capital) and the **productivity** with which these endowments are deployed to produce GDP.
- The growth of per capita income can be expressed in terms of:

(a) Physical capital deepening;

(b) Human capital accumulation;

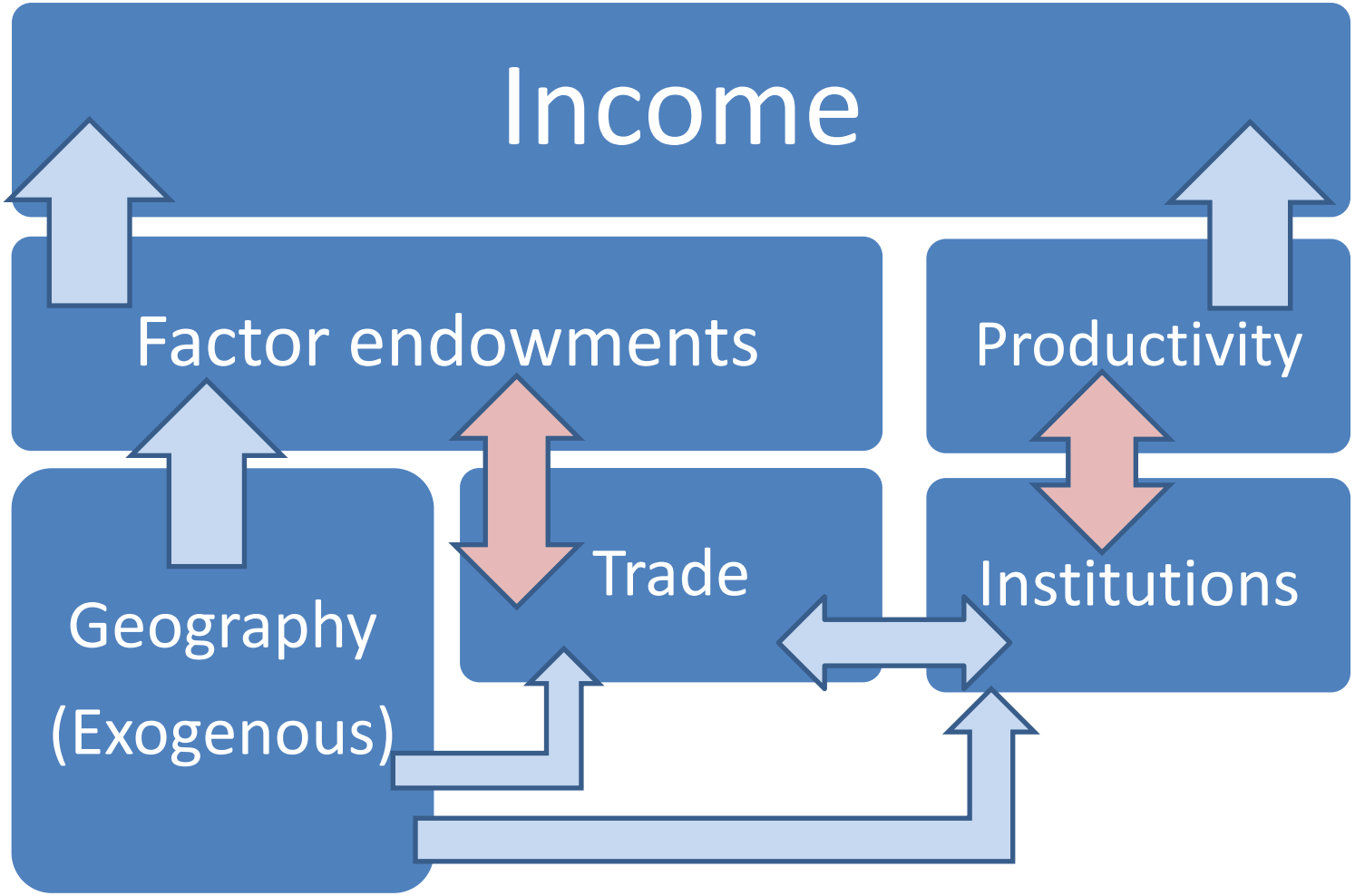
(c) Productivity growth.

- *Causality may run backwards from growth to accumulation and productivity.*

Deeper Determinants of Growth

- **Geography**: advantages and disadvantages posed by a country's physical location (latitude, proximity to navigable waters, climate), but geography is not destiny.
- **Integration** (trade): market size and the benefits of participation in international trade in goods, services, capital, and labor.
- **Institutions**: quality of formal and informal sociopolitical arrangement—from legal system to political institutions.

Dani Rodrick: All growth economics on one page



Partial association between income and fundamental determinants

- income and distance from the equator
- income and quality of institutions
- income and trade (weaker).
- Jeffrey Sachs and Andrew Warner (1995) argue that countries that are ***open to trade*** experience *unconditional* convergence to income levels of the rich countries.
- Rodrik: Trade or government policy toward trade does not play nearly as important a role as the **institutional setting**.

Good institutions

- Good institutions can **overcome** geographical constraints and poor initial conditions.
- Good institutions can be acquired, but doing so often requires experimentation, willingness to depart from orthodoxy and attention to **local conditions.**

Good institutions

- The onset of economic growth does not require deep and extensive institutional reform.
- Good institutions provide public officials with the incentives to provide **market-fostering public goods** at ***least cost*** in terms of corruption and rent seeking.
- Good institutions: Property rights, appropriate regulatory structures, the quality and **independence of the judiciary and bureaucratic capacity**.

Quality of institutions is the key

- Institutions that provide dependable property rights, ***manage conflict***, maintain **law and order**, and ***align*** economic incentives with ***social costs and benefits*** are the foundation of long-term growth.
- ***Sustaining high growth*** in the face of adverse circumstances requires ever ***stronger*** institutions.
- But does Thailand has such quality of institutions?

	15/1/2014	14/1/2015	11/8/2016
Dow Jones	16,481	17613	18,576
SET (Stock Exchange of Thailand)	1,277	1529	1552
Baht/dollar Baht/Euro	33.2	32.8	35.1 38.8
Yen/dollar	104.7	117	101
Gold (15.2 gram)	19,300 baht	19,000 baht	22,150
Brent (dollar)	94.3	45.9	46.6

	15/1/2014	16/1/2017	18/5/2017
Dow Jones	16,481	19,885	
SET (Stock Exchange of Thailand)	1,277	1571	
Baht/dollar Baht/Euro	33.2	35.3 37.5	
Yen/dollar	104.7	114	
Gold (15.2 gram)	19,300 baht	20100	
Brent (dollar)	94.3	55.5	

Review Questions

- What do these key indicators tell us?
- Why did they change and how were they related?
- From the precious table, what are other key prices that affect living conditions of the Thais?
- How does democracy affect economic development?

Controlled inertia: Thailand's economy
Source: The Economist, August 15, 2016

- The GDP-growth figure released at around 3% camouflaged the mounting economic cost of the 2014 coup.
- Thailand's output gap is now among the biggest in Asia; private investment has stalled.
- The economy is being kept afloat by government spending and foreign tourists' cash.

Controlled inertia: Thailand's economy

- But Erawan shrine bombings on August 11, 2015 might deter visitors, and autocratic rule is stifling economic progress.
- Household debt is at a historic high; low agricultural prices have depressed farm incomes.
- The country's old-style route to prosperity is blocked: exports will fell for the fourth consecutive year in 2016.

Problems of Thailand's economy

- Thailand's economy is bigger than those of fast-growing Vietnam, Myanmar, Laos and Cambodia combined.
- But its population is ageing and economic policy is deeply conservative.
- Future growth will have to come from capital accumulation or increases in productivity.
- Yet the new constitution puts the army in charge, making it responsible for the economy, education and innovation.
- What could possibly go wrong?