

EE 460: Thai Economy

Rethinking growth strategies

Bhanupong

Lecture 2

Main Themes

1. *Rethinking growth strategies*
2. *Early Economic Development Model*
3. Thailand's economic development plans
4. *Sources of Happiness*
5. *Why Nations Fail*

1. Rethinking growth strategies

- Growth is a complex process of economic, social, and political transformation.
- New economic concepts were created to capture some of its dimensions.
- Development *strategies follow* those new concepts in economic ***development theories***.

How many years would it take to double GDP?

The rule of 72

- If an economy grows at x percent per year, output will double in $72/x$ years.
- If Thailand has a 9 percent annual growth rate, then real GDP will take 8 years to double $(72/9) = 8$.
- It would take 18 years to double GDP if it grows at 4% annually,
- It would take 24 years if 3%.
- Thailand's NESDB set 5% GDP growth target for 2017-21
- Too pessimistic (optimistic)?

There's No Such Thing as an Economic Miracle

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.

Successful growers avoided downturns and kept growth *steady*

- Denmark's overall economic record is gloriously boring.
- From 1890 to 1916, per capita growth averaged about 1.9 percent per year, and if in 1916 you had forecast that this pace would continue for another 100 years.
- Denmark had positive growth about 84 percent of the time and **no deep recessions**

The Middle Income Trap

- The 'middle-income trap' - a situation in which countries that have attained a certain level of development 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 category.
- The middle-income trap is a special case of growth slowdowns, which are identified as large sudden and sustained deviations from the growth path.

2. Early Development Theories

- Economic Backwardness
- Dual economy and the unlimited supply of labor
- The big push
- The stages of economic growth
- Dependency theory: Singer-Prebisch Hypothesis
- 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.

- The central notion is the positive role of relative economic backwardness in inducing systematic substitution for supposed prerequisites for industrial growth.
- State intervention could, and did, compensate for the inadequate supplies of capital, skilled labor, entrepreneurship and technological capacity encountered in follower countries seeking to modernize.

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, even as greater Russian **backwardness required a larger and more direct state compensatory role.**

Economic Backwardness

- In Gerschenkron's own hands, his propositions afforded an opportunity to blend ideology, institutions and the historical experience of industrialization, especially in the case of his native Russia.
- His approach has often proved a useful starting point for the historical discussion of other parts of the world, such as Japan, and elsewhere.
- Always, application of the backwardness approach requires close attention to detail, as well as a quantitative emphasis.

Gershkenkron: Continuity of Stagnation

(1) Relative backwardness creates a tension between the promise of economic development, as achieved elsewhere, and ***the continuity of stagnation***.

Such tension takes political reform and motivates ***institutional innovation***, whose product becomes appropriate substitution for the absent preconditions for growth.

Gershchenkron: The more backwardness,
the more intervention is required

(2) The greater the degree of backwardness, ***the more intervention*** is required in the market economy to ***channel capital and entrepreneurial leadership*** to nascent industries.

Also, the more coercive and comprehensive were the measures required to ***reduce domestic consumption and allow national saving***.

Gershchenkron: Capital intensive production

(3) The more backward the economy, the more likely were a series of additional characteristics: an emphasis upon domestic production of producers' goods rather than consumers' goods;

the use of capital intensive rather than labor intensive methods of production; emergence of larger scale production.

Gershkenkron's Historical Perspective

(4) The more backward the country, ***the less likely was the agricultural sector to provide a growing market to industry***, and the more dependent was industry upon growing productivity and inter-industrial sales, for its expansion.

Such unbalanced growth was frequently made feasible through state participation.

Lewis(1954): Dual economy, surplus labor

- Economic Development with Unlimited Supplies of Labor.”
Manchester School 22 (May): 139–191

W. 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.

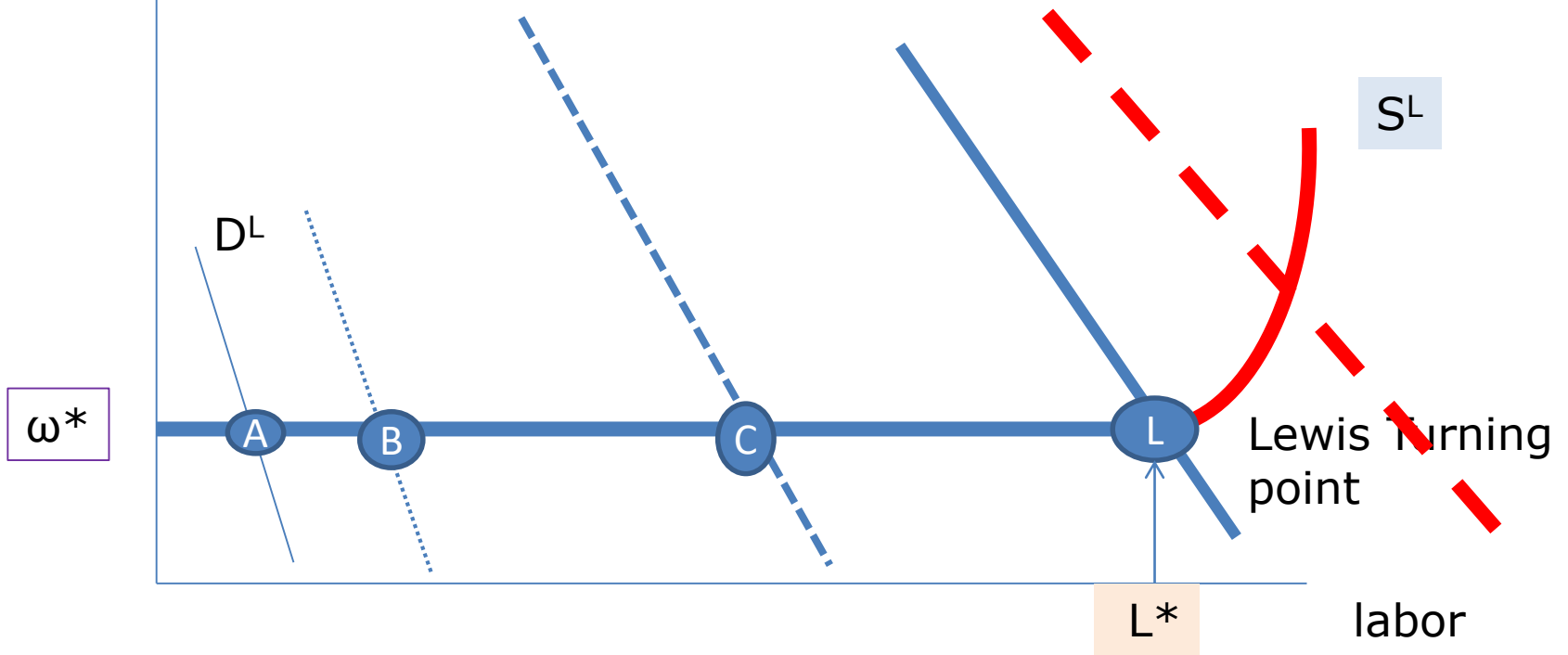
Lewis: Dual economy

- 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.

Transforming agriculture to manufacturing

Wage

Expansion of demand for labor, due to the rise of industrial output
Industrial profit rises as real wage rate remains constant
Until employment surpassing the L^*



Lewis' Strategy: Shift labor from agriculture 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?*

Rosenstein-Rodan (1961)

The Big Push Theory

- The idea behind this theory is this that a big push or a big and comprehensive investment package can be helpful to bring economic development.
- A certain minimum amount of resources must be devoted for developmental programs, if the success of programs is required.
- **Some ground speed is required for the aircraft to airborne.**
- In the same way, certain critical amount of resources be allocated for development activities.

Rosenstein-Rodan (1961)

The Big Push Theory

- This theory is of the view that through 'Bit by Bit' allocation no economy can move on the path of economic development, rather a specific amount of investment is considered something necessary for economic development.
- Therefore, if so many mutually supporting industries which depend upon each other are started the economies of scale will be reaped.
- Such external economies which are attained through specific amount of investment will become helpful for economic development.

Raul Prebisch

The 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

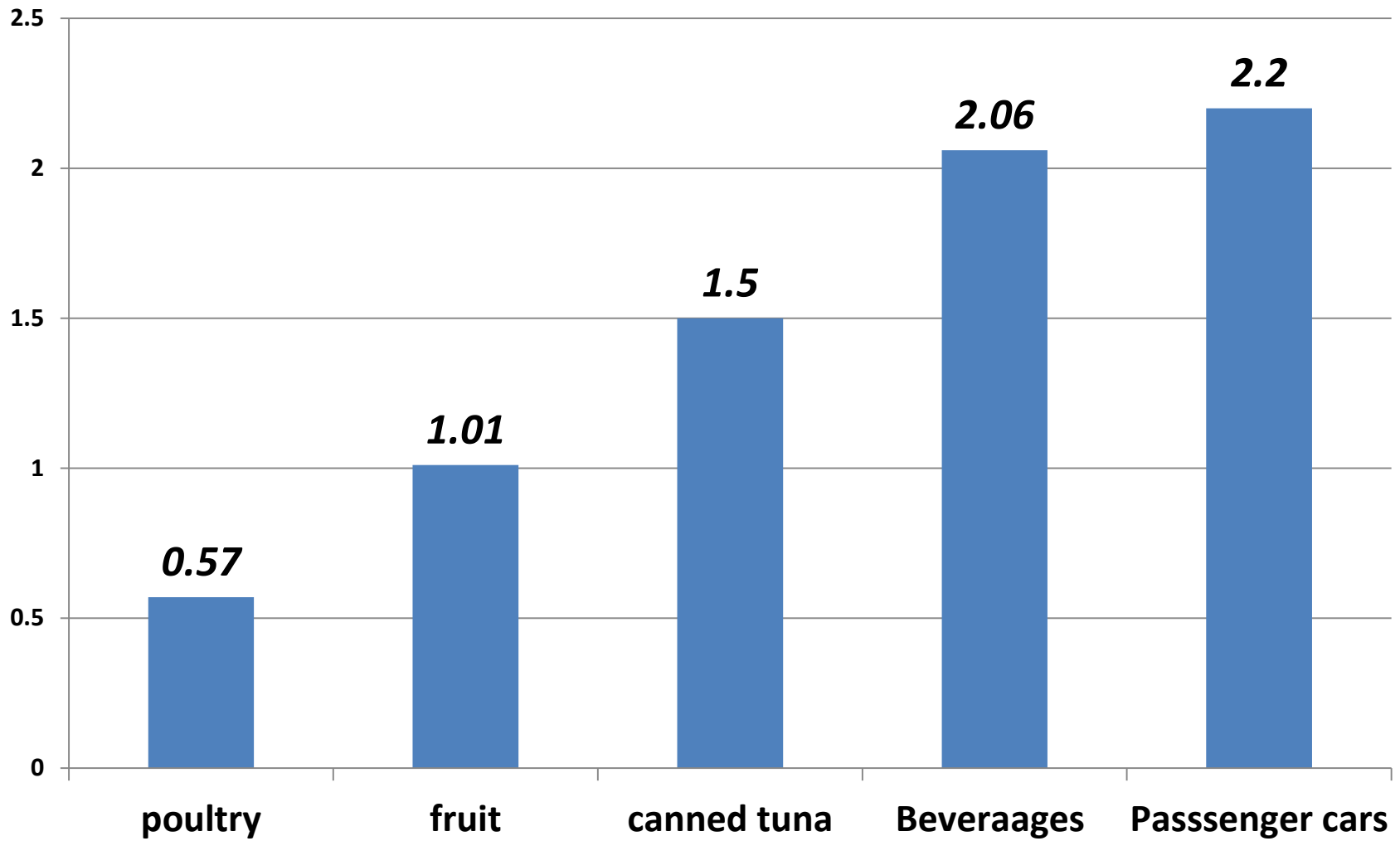
I. Industrialization

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.

The Singer-Prebisch thesis

- It focuses on terms of trade between primary products (raw materials and resources used in the productive process - metals, agricultural products) and manufactured goods.
- By examining data over a long period of time, Prebisch suggested that the terms of trade for primary commodities did have a tendency to decline since the income elasticity of demand for manufactured goods is greater than that for primary goods, especially food.

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



The Singer-Prebisch thesis

- As income increases, the demand for manufactured goods increases more rapidly relative to demand for primary products.
- 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.

The Singer-Prebisch thesis

- Due to the declining terms of trade primary products face, they concluded that developing countries should strive to diversify their economies and lessen dependence on primary commodities export through ***developing their own manufacturing*** industry by structural change and industrialization.
- Then came the idea of *inward-looking strategy*.

Rostow, W.W. *The Stages of Economic Growth*.
Cambridge: Cambridge University Press, 1971

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)

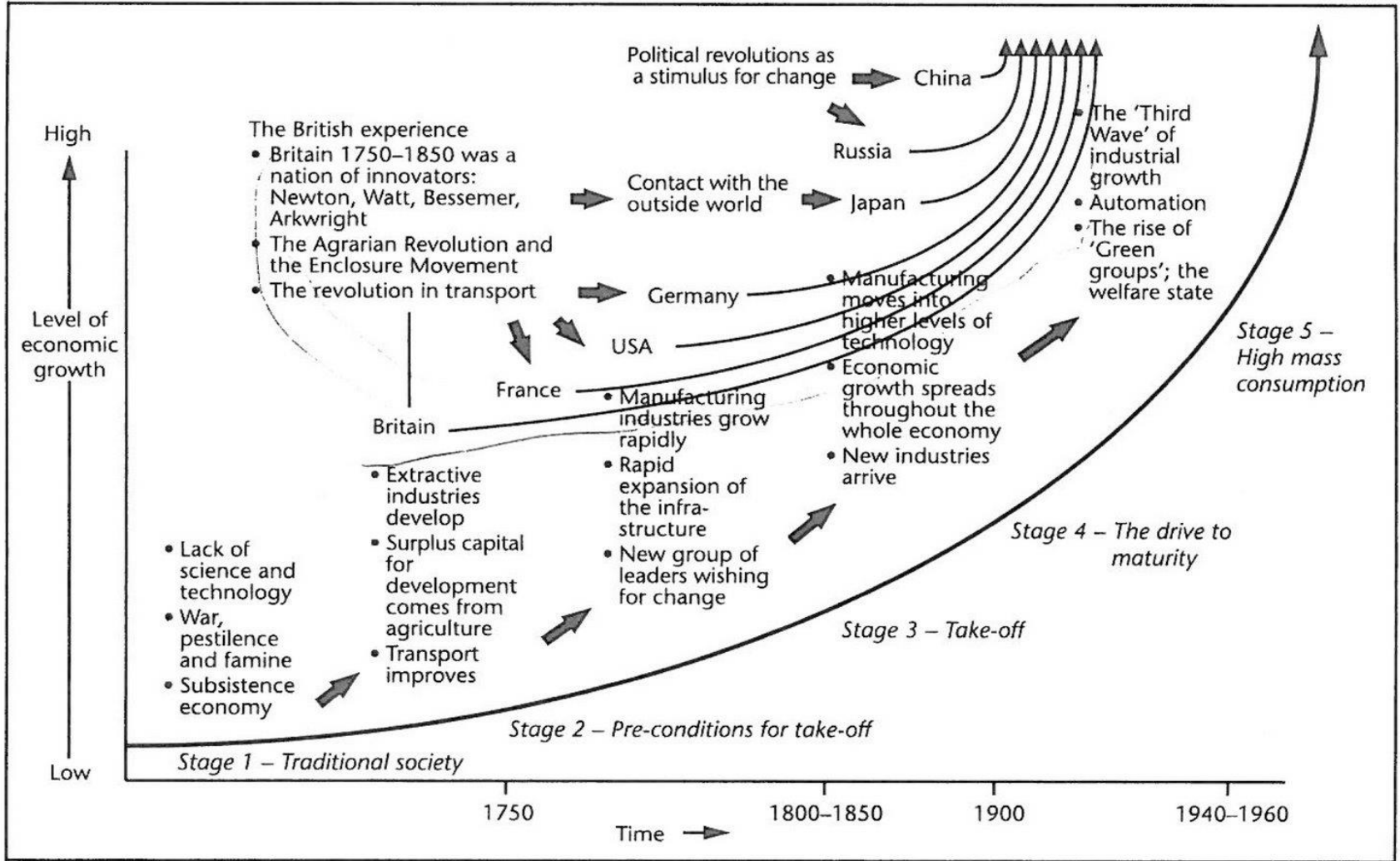
Rostow, W.W. *The Stages of Economic Growth*.
Cambridge: Cambridge University Press, 1971

4. The 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.

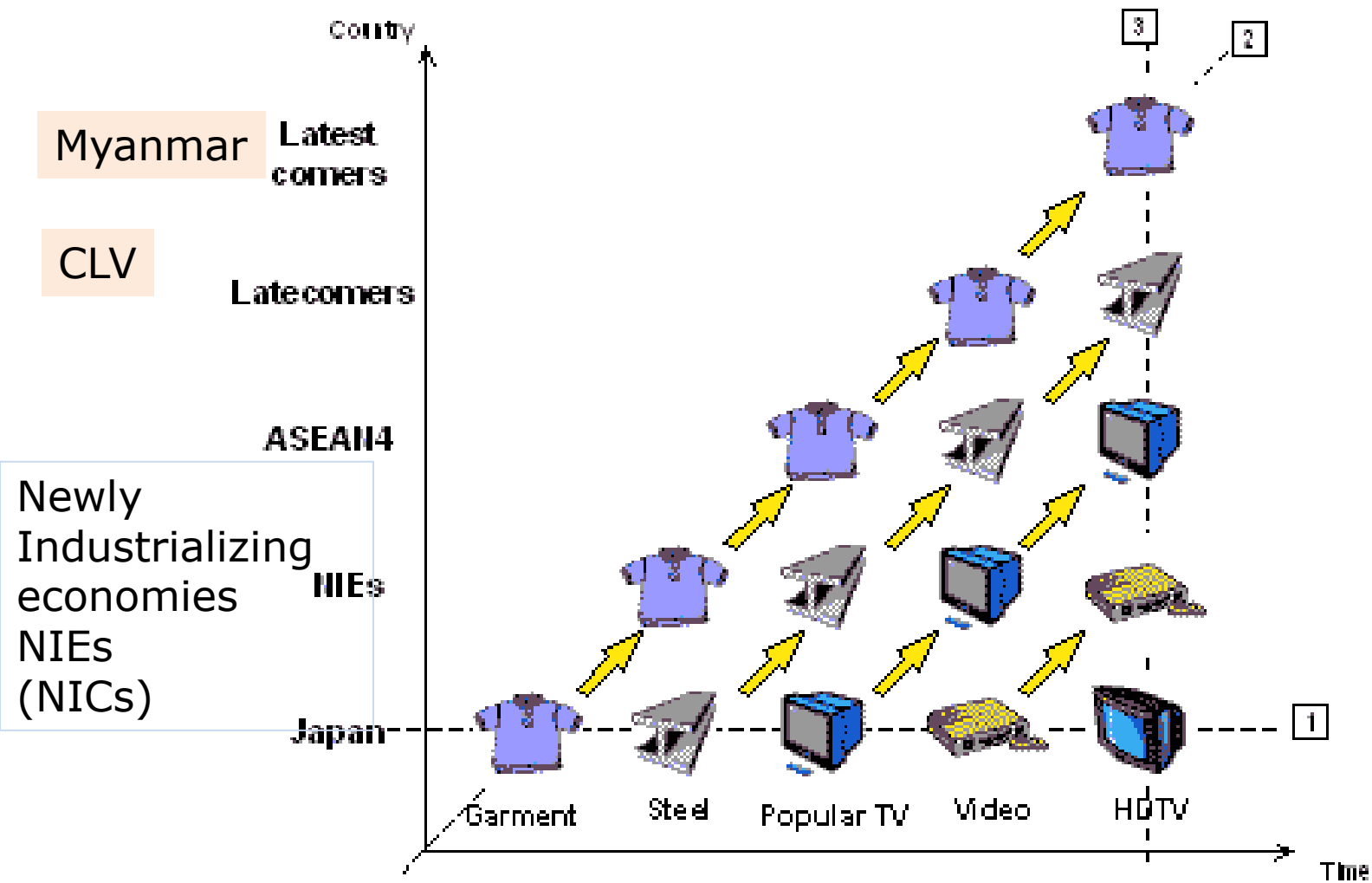


- Akamatsu provides a model for international division of labor in East Asia based on ***dynamic comparative advantage***.
- The paradigm postulated that Asian nations will catch up with the West as a part of a regional hierarchy where the production of commoditized goods would ***continuously move from the more advanced countries to the less advanced ones***.

Flying geese paradigm

- “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.
- "Depicting 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.

Structural Transformation in East Asia



Kaname Akamatsu

The metaphor of flying wild geese

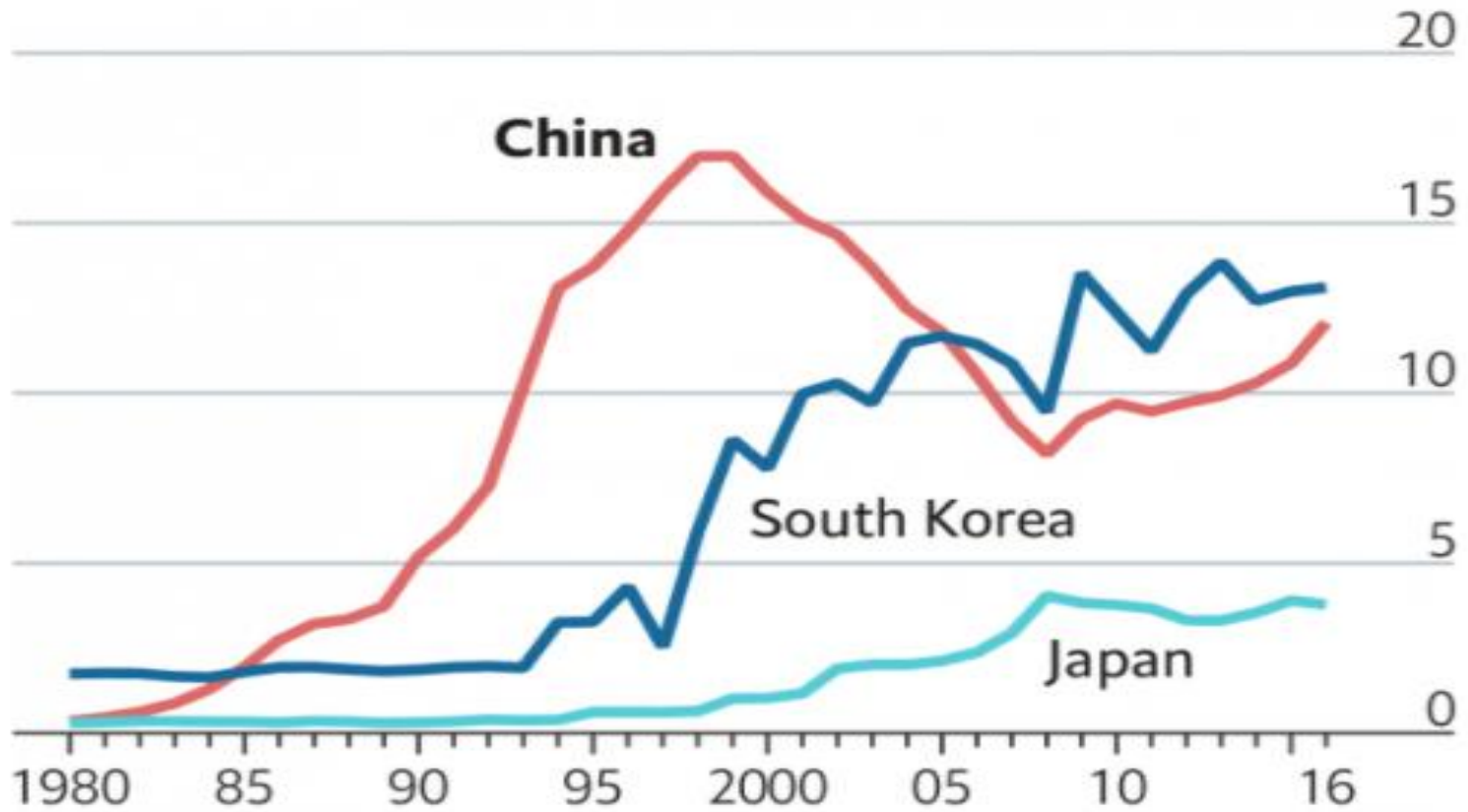
- Sequential ***shifting of comparative advantage*** across economies, aided by factors such as foreign direct investment (**FDI**), structural change, infrastructure development, human capital formation, and industrial policy, unleashed trade-fueled economic development.

The FDI-driven economy

- *“FDI-driven economy” is the phrase used by many economists, meaning that foreign direct investment (FDI) is the major motive power for the national economy.*

Inside attractions

Stock of inward FDI as % of GDP



Sources: UNCTAD; IMF

A Model of Asian Tigers

- Slow growth doesn't mean that the U.S. or Denmark were failures in the 19th century.
- It's hard for economies at or near the technological frontier to rapidly improve living standards, because invention is usually slower than playing catch-up by borrowing technologies from wealthier nations.

A Model of Asian Tigers

- **Borrowing of know-how, along with export engine of growth, and rapid investments in education and infrastructure**
- The Asian tigers of Japan, South Korea, Taiwan, Hong Kong, Singapore and China to achieve growth rates of 8 percent to 10 percent a year.
- Can Thailand succeed by following the Asian Tiger model?

3. Thailand's development plans

1st Development Plan (1961-1966)

Import substitution

Infrastructure Investment

Promotion of private investment

Institutional 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

Growth was driven by public investment in infrastructure

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

Investment in rural area and education

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

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.
- Apart from promoting a peaceful society with good governance, the 11th Plan also aims to promote sustainable development through the restructuring of the economy, society, and politics, while nurturing natural resources and the environment.
- Another objective is to prepare the people and the 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
- 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 conditions generate happiness and how to cultivate them.

Sources of happiness

1. Proportion of people who say that other people can be **trusted**.
2. Proportion of people who belong to **social organizations**.
3. Divorce rate
4. Unemployment rate
5. Religious belief
6. **Quality of government**

What makes people happy

- 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**.
- **Extra income** increases happiness *less and less* as people get richer.

Can public policy make people happy?

- Public policy can more easily remove misery than augment happiness.
- 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.

A Discussion Question

- **The 2014 coup leader General PCOC promised to return happiness to Thai society. Has he succeeded?**

5. Why Nations Fail

- Daron Acemoglu and James Robinson (AR)
- Book Reviews by William A. McCleary in Thammasat Economic Journal, 31(1) March 2013
- **Rejection** of three alternative explanations of why experiences of various countries has been different: Geography, culture, and ignorance of correct policies.

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.***

Inclusive institutions

- Political institutions in ***which power is widely shared and many groups*** can participate in the decisions which affect their prosperity and access to public services.
- Institutions that generate opportunities to invest, create new or better products, self-improvement.
- By securing property rights, an objective system of law, and limited monopoly privileges.

Examples of inclusive and extractive institutions

- 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 made the government more responsive to a wider set of groups in society.
- Extractive societies of Soviet Russia and China which has experienced years of spectacular growth **could** slow down.
- The slowdown is now occurring in Russia and China.

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

Review questions

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 most important contribution to the Thai economy. Provide evidence to support your arguments.
4. Can sufficient economy principle serve as immunization for a country under globalization?
5. Is Gross National Happiness (GNH) more superior than Gross National Product (GNP)?
6. Is there still any sign of economic backwardness in Thailand in 2018? Are we ready for Thailand 4.0 model of development? Is it a claptrap?