

EE460: Thai Economy

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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 (30 points) covering lecture 1 to 10.
- Homework (5 points) and attendance (5 points)
- Final exam (60 points) covering lecture 11 to 30.
- Class attendance is a necessary condition for passing the exam.
- There is a strong negative correlation between number of missing classes and final exam scores.
- Dress code: Always dress respectfully.

Main Themes: Lecture 1

1. International trade and the wealth of nations
2. Historical comparison between Siam and Japan's early economic development
3. Economic changes in Thailand: 1850-1970
4. Determination of growth process

1. International trade and wealth of nations

**From Lisbon to
Nagasaki
In 1571**



Japan's only channel to world trade

- 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.

Siam's capital city: Ayutthaya

- Ayutthaya was a multicultural city with number of foreign settlers.
- Moors or Muslims from India, Arabia, Turkey and Persia came to Siam for commercial purpose but many ended up settling there.
- **A Portuguese explorer Fernado Mendes Pinto (1506-1583)** wrote that foreigners accounted a quarter of the Ayutthaya kingdom's 400,000 inhabitants; Chinese were the largest foreign population.
- Ayutthaya king set up a department to control trade and monopolize exports and imports.
- Exports were **forest products**, deer skin, sappanwood, an agent in manufacture of red dye, tin, rhino horn, ivory, coconut wine to China and Japan.

Japanese presence in Siam

- The Japanese were present in Siam from the early 16th century.
- Most were Christian fugitives fleeing Shogun Ieyasu's religious persecution.
- Around 1,000 Japanese immigrants settled in Ayutthaya on the bank of Chao Praya River, opposite the Portuguese village.

Yamada Nagamasa

- Yamada Nagamasa (1590–1630) was a Japanese adventurer who engaged in trade between Japan and the Thai kingdom of Ayutthaya. He rose to a prominent position in Ayutthaya and eventually became the governor of the Nakhon Si Thammarat in southern Thailand.
- He became involved in Japanese trade activities with South-East Asia during the period of the **Red seal ships** and settled in the kingdom of Ayutthaya from around 1612.

The red seal ship



Yamada Nagamasa

- Yamada had been able to establish himself as a leader of the Japanese settlement and attained a senior Thai rank of nobility by actively supporting the military campaigns of the Thai king Song Tham.
- His military success secured him the position of “Lord of Ligor” in southern Thailand where he established himself with 300 samurai.

Yamada: Lord of Ligor

- He returned to Ayutthaya in 1628. In the same year his protector King Song Tham died and he got involved in the war of succession.
- In 1630 he was wounded in combat and remained in Ligor to nurse his injuries. He apparently died of poisoning through his wounds.
- After his death the new king and former opponent of Yamada's Prasat Thong (Phya Sriworawong) attacked and destroyed the Japanese settlement. Many Japanese managed to escape into Cambodia, and a few hundred of them returned in 1633.
- The Japanese force were driven out by King Prasart Thong but returned later to trade deerskins (to make armor) and the skin of stingrays(to make scabbards for samurai swords)

Trade Monopoly, Protection, and Wealth

- Red seal ships were Japanese armed merchant sailing ships bound for Southeast Asian ports with a red-sealed patent issued by the early Tokugawa shogunate in the first half of the 17th century.
- Between 1600 and 1635, more than 350 Japanese ships went overseas under this permit system.
- The first ruler of Tokugawa issued red-sealed permits to his favorite feudal lords and principal merchants who were interested in foreign trade.
- By doing so, he was able to control Japanese traders and reduce Japanese piracy in the South Sea.
- His seal also guaranteed the protection of the ships, since he vowed to pursue any pirate or nation who would violate it.

King Prasart Thong (1629-1656)

- Strengthened the system of royal monopoly in commercial activities, making foreigners less competitive.
- Ayutthaya became ***a transit hub*** for trading goods between Bay of Bengal, the main transport route to Europe, and the South China sea, the key route to the East and Southeast Asia.

King Narai (1656-1688)

- There were around 4,000 Portuguese lived in Auuthaya and most of them were mestizos. They engaged in mercenaries, jewelers, navigators, translators, doctors and confectioners.
- Many Thai deserts are of Portuguese origin.
- Siamese kings were open to foreign trade and engaged to generate commercial wealth.
- Imports were textiles, furniture, metal mortars, ready-made partitions, wooden furniture and bronzeware.
- It is evident that wealth of the nation depends on international trade
- And this conclusion remained true ***150 years later...***

2. 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?

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***.

Siam: Higher education in a different direction

- The forerunner of Chulalongkorn University (CU) was the Royal Pages School, established in 1902.
- The aim was to provide a general education with emphasis on training in ***government administration***.
- The CU 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.
- 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.

Changing pattern of Japan's external trade

- Imports became exports; exports became imports.
- 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.
- Implications on Japan's improvement in the ***terms of trade*** (P_x / P_m)
- Favorable terms of trade led to export-led growth in Japan

3. *Economic Change in Thailand,* 1850-1970,

- J.C. Ingram (1971) *Economic Change in Thailand, 1850-1970*, Stanford University Press
- The first version of this book was published in 1955, based on Ingram's doctoral dissertation submitted to Cornell University in 1952.

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 between Siam and Burma, 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 an 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.

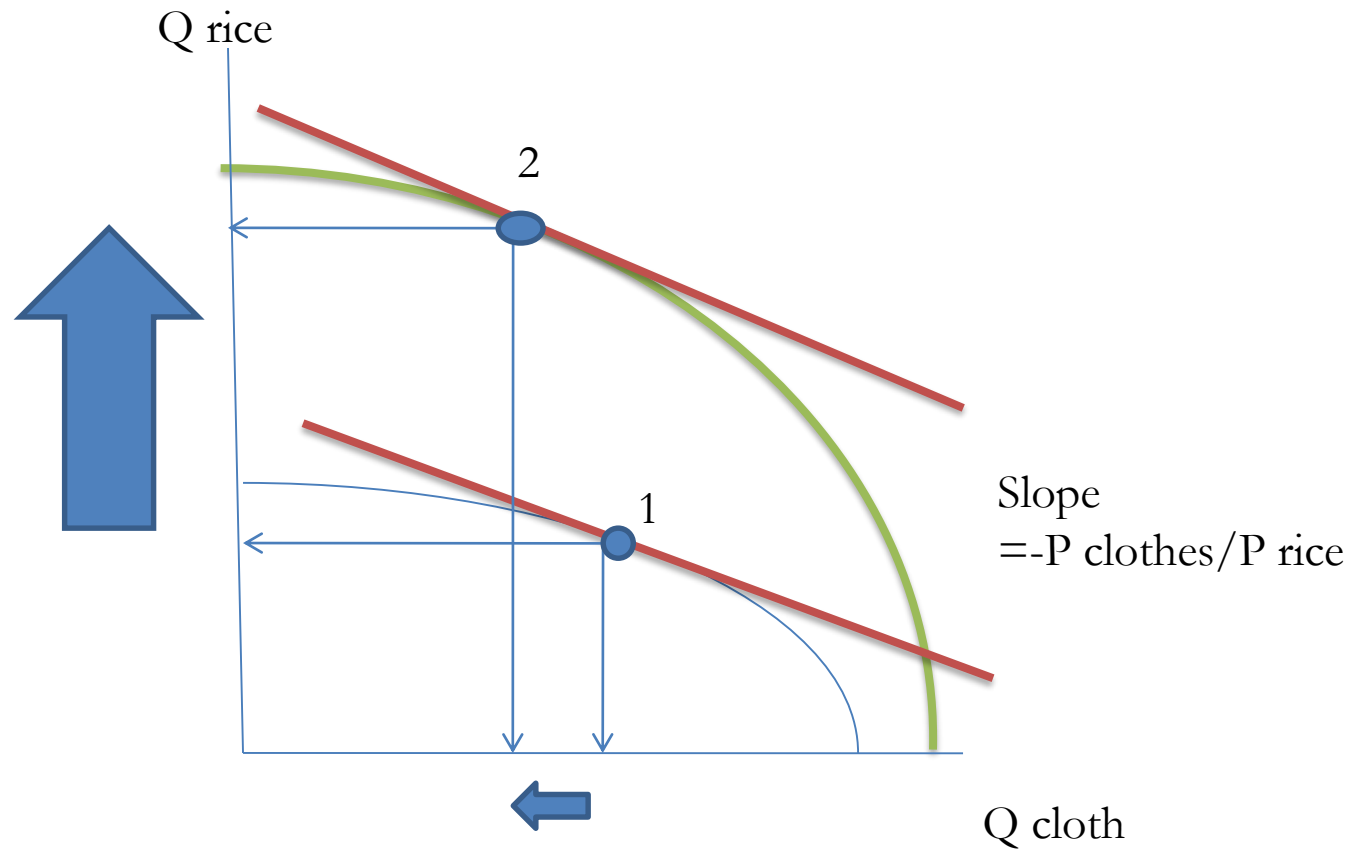
Siam opened trade sector abruptly to the West

- 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)

	<i>Rice</i>	<i>Tin</i>	<i>Teak</i>	Total
1867	41.1	15.6	2.0	58.7
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 exports change until the 1970s?***



An increase in supply of land (reduction in forest areas) shifts the PPF *disproportionately* outward in the direction of rice. Production of cloth actually declines, given that the relative price of cloth remains unchanged.

Ingram: Chapter 6

Imports and Home-Market Industries

- Textiles: Silk and cotton were exported in small quantity from Bangkok. Dutch and English traders established factories in Ayutthaya during the seventeenth century.
- The production of cloth was a slow, painful process. Tools and equipment were primitive. The yield of raw cotton and silk was low because of plant diseases, insects and poor strains.
- The finished product was coarse and expensive, though strong and durable. The local dyes were somber and less appealing than the bright colors of the imported clothes.
- The locals were eager to buy the cheaper, if less durable, foreign cloth.

Area planted in paddy millions of rai (0.4 acre)

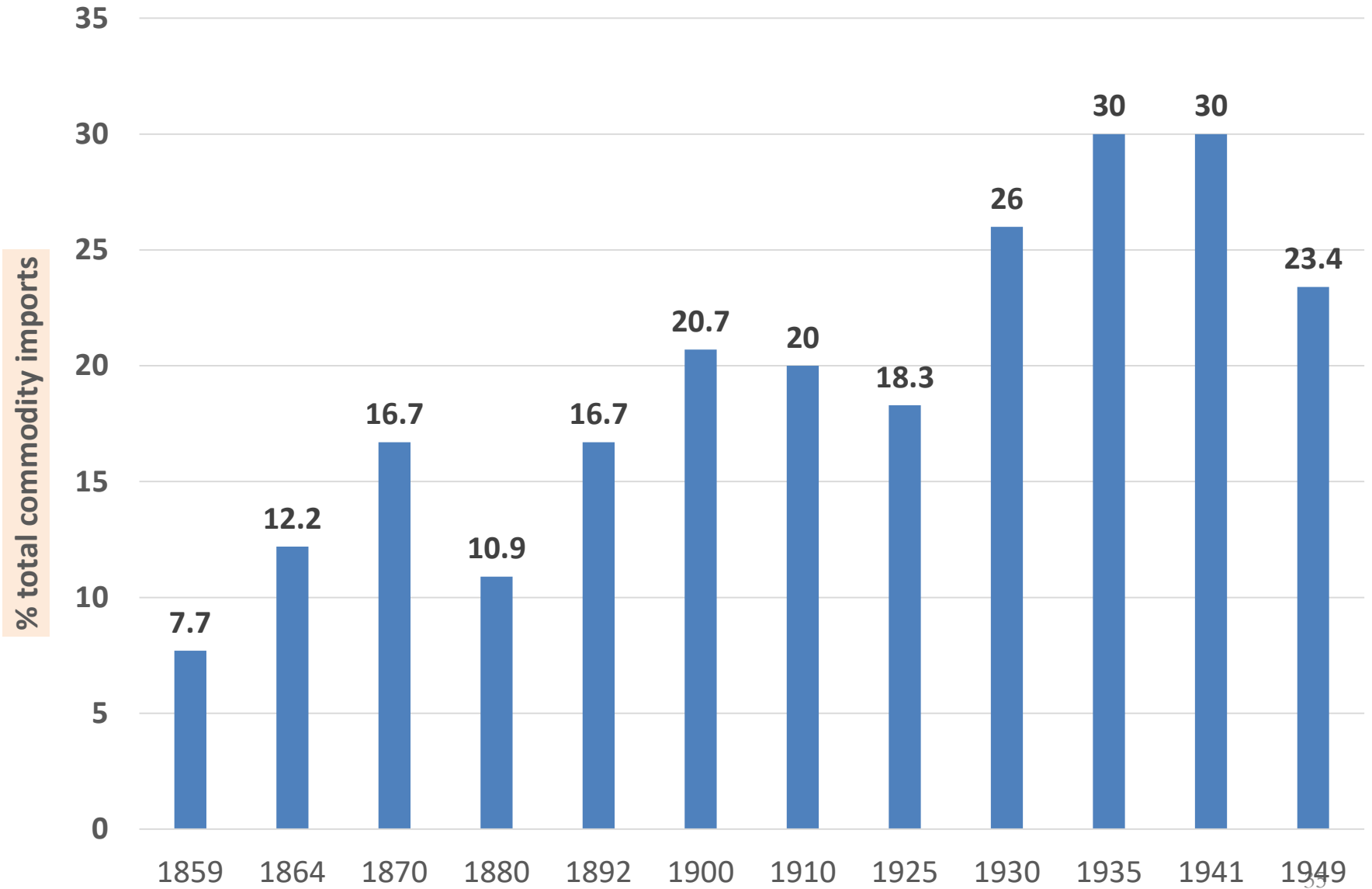
	1903-7	1948-50	Percentage increase
Central Plain	6.5	16.3	151
All other	2.2	17.1	678

Who would gain and lose from trade?

- **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.*
- Land lords gained from rising rent as the price of exported rice went up sharply. Rice is a land-intensive product.
- David Ricardo: The political economy of the corn laws (England , 1804)

Imported Capital goods

Source: Ingram (p.129)



Imports of capital and consumer goods

- In 1929, imports of textile, yarns, kerosene, and canned milk were widely consumed by two million people, while imported items of high values such as canned fruit, confectionary, and biscuits were consumed by only 10,000 customers in foreign community, including Europeans, upper-income Thais.
- Low tariff policy accounted for the increase in imported capital goods since 1926, while government imports of machinery and equipment for railways and irrigation works accounted for the long run increase.

Thailand's trade in 1950

- “Thailand has an extremely broad subsistence base onto which the money economy has been grafted. The nature of her imports and their relation to the economy gives Thailand an extremely **high income-elasticity of demand for imports**, which in turn is a major reason why she has been able to consistently to maintain a strong export balance of trade.
- When export falls, thus reducing incomes, imports tend to fall immediately in the same degree. Since **Thailand normally had an export surplus**, 1850 to 1950, this adjustment process acted to preserve that position even when exports declined sharply.”
- (Source: Ingram's chapter 6, p. 128)

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.

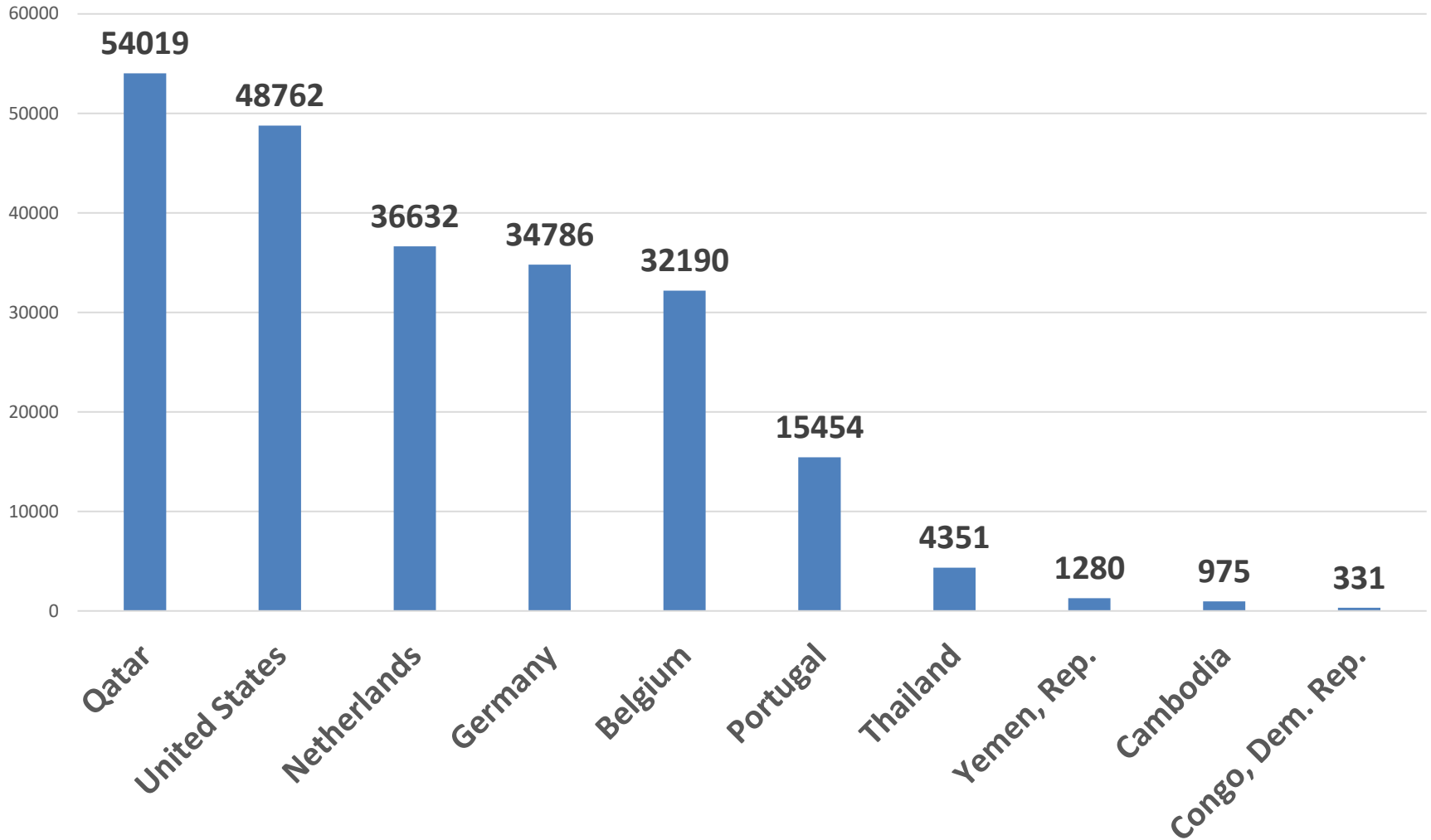
Development divergence between Siam and Japan

- 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.

4. Determination of Growth Process

- 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 2015 USD



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
- Rodrik: 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 did Venezuela continue to stagnate despite a sharp improvement in their fundamentals since the 1980s? What has gone wrong to Venezuela in the last few years?
- A resource cursed country?

Determination of economic growth

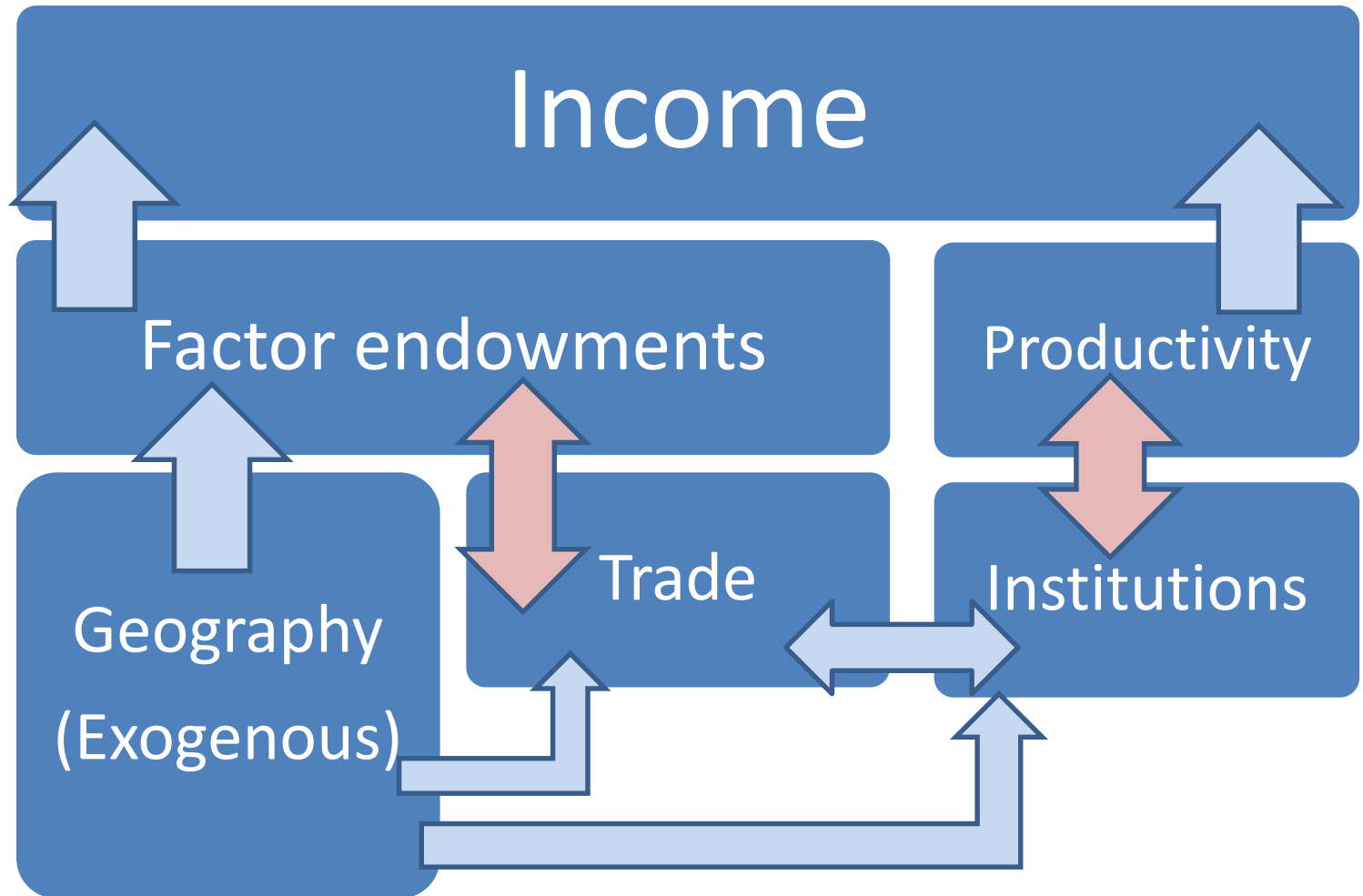
- Total output is a function of resource **endowments**(labor, physical, human capital) and the **productivity** with which these endowments are deployed to produce GDP.
- In general, income growth stems from three channels:
 - (a) Physical capital deepening;
 - (b) Human capital accumulation;
 - (c) Productivity growth

However, there are deeper determinants of growth than those three channels.

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?

	15/01/2014	16/7/2017	10/01/2017
Dow Jones	16,481	21,998	
SET (Stock Exchange of Thailand)	1,277	1,567	
Baht/dollar	33.2	33.2	
Baht/Euro		39.0	
Yen/dollar	104.7	110	
Gold (15.2 gram) (baht)	19,300	19,950	
Brent (dollar)	94.3	51.0	

Questions

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

Main Conclusion from Lecture 1

- Trade and the economic prosperity
- Siam and Japan differed in their path of early economic development
- Fundamental determinants of strong growth include high quality of institutions