

Direct Measures Affecting to the Problem Solving of the Continual Balance of Payment Deficit of Thailand

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Key words : Direct Measure, Continual Balance of Payment Deficit, Tight Monetary & Fiscal Policies

(Direct measures):

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|---|-------------------------|-----------------------|
| 1). Balance of Trade | 2). Balance of Payment | 3). Recurrent deficit |
| 4). Tight monetary policy | 5). Tight fiscal policy | 6). Fund mobility |
| 7). Exchange rate system | 8). Tariff | 9). Quota |
| 10). Multiple exchange rates | 11). Fund control | 12). Innovation |
| 13). Investment – Saving Equilibrium = IS | | |
| 14). Liquidity Preference – Money Supply Equilibrium = LM | | |

The operations of the direct measures to solve the continual balance of payment deficit of Thailand with the main components consist of:-

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|---|-------------------------------|
| 1. Tight monetary – fiscal policies | 2. Interest rate |
| 3. Tariff | 4. Multiple exchange rates |
| 5. Import Control | 6. Control of Capital outflow |
| 7. Voluntary Export Restrictions (VERs) | |

Introduction

Thai has encountered the continual balance of payment deficit problems since 1969. Before 1969, Thai service account and current transfer could sufficiently exceed to compensate with the occurrence of trade deficit. In 1969, the current transfer has begun to decrease so the current account has been highly deficient. Afterward, in 1972, the international capital movement has played important roles in reducing the deficit of annually high current account that has severely caused balance of payment deficit. Especially, in 1978 and 1983, the deficit of B/P has approximately increased to Million Baht 13,298 and 18,078 respectively.

Considered the import & export structure – the major components in current account, it showed that the increasing rate of import in average is higher than of export. The structure of major Thai exports is mainly the primary goods which are uncertain both in production and higher price level. The origins of exports whose prices are still higher consist of rice and rubber. The new exports are cassavas, fresh prawn & shrimp, textile, jewelry, tobacco leaves, electrical circuits and canned fruits. Since 1978, the exports of fresh squid, canned seafood and shoes have been increased

For the structure of import before 1972, there was a rise of import as a result of the increase of its volume. Afterwards in 1973, the oil crisis has emerged. The increase of import was mainly caused by the price. The import of raw material and semi-raw material has played important roles - that is, metals, chemical products, fiber used in textile industries and paper pulps. However, the importance of capital goods, consumer's goods and other imports was lesser. The import of fuel after the oil crisis has proportionately increased.

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Major Thai service account usually exceeded as a results of foreign government expenditure in Thailand, proceeds from investment in foreign countries, especially income from interest of reserve invested abroad, revenue from tourism increased later on including revenue returned by Thai workers abroad.

For Thai capital, there were the net capital surplus movement resulted from the government loans used by the government enterprise and various development projects, mainly the loans from international institutions, foreign governments, private capital markets abroad. As a private capital, there were the direct investments from abroad as well as private sector borrowed for spending in their business operations. Later, the capital inflows were brought from Singapore and Hong Kong in order to essentially compensate to the current account deficit.

For this research, it was done to study the impact of the direct measure affecting to the problem solving on the imbalance of the continual balance payment deficit, then still exists forever until it might not be adjusted into its equilibrium by itself. Therefore, this research has been made to study the influences of the direct measures for this problem solving with various tools – that is, the tight monetary policy applied for adjusting the imbalance of external public finance by the increase of interest rates so as to reduce the revenue and import. Moreover, it affected to the international capital movement, changes of exchange rates under the flexible exchange rate system. As a result, the trade deficit has caused the Baht Depreciation, so the export has increased and import has decreased depending on the elasticity of demand and supply of export and import as well. For the fiscal policy, the expenditure of public sector has caused the changes in the employment level. For the control measure on trade and the international finance; for example, tariff control, import license, quota, multiple exchange rates, capital control, shall be considered in order to understand the impact of distortion in the resources allocation to control and solve the problem of the continual balance of payment deficit of Thailand.

According to the situation, hardship & severity, causes & effects occurred in society and Thailand severely in the past. Since no one has conducted any researches directly on this issue, the researcher has chosen this topic to study various factors and the real causes of this problem adversely affected to such issue, including studying many points of view for the valuable and most advantageous academic documentary and texts from several sources.

Consequently, the findings shall be applied for the guidance in problem solving, together with targeting policies beneficially for society, our nation as well.

Research problems

Firstly, The developing Thailand usually set the excessive target of economic development and also depends on larger capital goods.

Accordingly, the import was much more than the export in terms of foreign currencies causing balance of payment deficit problem.

Secondly, major exports were the primary agricultural products and raw materials. The characteristics of demand & supply caused some problems. In short run, the elasticity of supply of the agricultural products was too low. Volume of production was quite still stable, no matter how high the prices were. The price level of the primary products in the world market was unstable.

Thirdly, the terms of trade has been decreased and worsen due mainly to the import price has rapidly increased more than the export price depicting the transfer of income from the developing to the developed countries that has made both of the income gap wider and welfare of the nation worsen as well.

Objectives:

1. To study **balance of payment deficit since 1965 until now**
2. To study import-export structure the major components in current account
3. To study the import as a result of the increase of import
4. To study the surplus of service account as a result of foreign government expenditure in Thailand
5. To analyze the surplus of net capital movement of Thailand as a result of public sector loans to spend in the government enterprises and various development projects.
6. To analyze the direct measures for the improvement of the continual balance of payment imbalance.
7. To analyze the use of tight monetary polices to improve the external imbalance of public sectors.

Research Hypothesis:

1. The analyzed country is small (Thailand). The change of import shall not affect to the expenditure of other countries, or the world. The export is the independent variables so they are free from the domestic income of the country.
2. The impact of the changes in exchange rate on goods & services of import and export considered in terms of Aggregate **Demand** will provide the demand for & supply of foreign currencies.
3. If exchange rate adjusts so as to keep balance of payment balanced, that is - the demand for & supply of foreign currencies will be equal, but how much they will change depend on the elasticity of demand for & supply of foreign currencies
4. The changes of exchange rates will affect to the change of price level. Therefore, the Baht devaluation will relate to the change of demand & supply of goods.
5. The elasticity of demand for & supply of goods will play an important role in determining the impact of Baht devaluation.

6. The equilibrium determination of income and employment in the open economy will relate to the foreign sector and import & export as well.
 - a) Changes of domestic income will affect to the international trade and income of foreign countries.
 - b) There is the relationship among the open-economy multipliers.
 - c) There is the relationship between balance of payment and equilibrium in product markets (IS) and money markets (LM).
7. The impact of Baht devaluation to the balance of payment depends on 2 conditions in
 - a) The unemployment still exists in the economy.
 - b) The economy is still in full employment.
8. The stability issue of the open economy covered to the whole internal stability and equilibrium are measured by the price level and the employment. But the external ones are measured by the status of balance of payment on the international reserve and foreign debts. Consequently, the stability issues have related to foreign countries in many forms/structures caused by the internal characteristics of the host countries.
9. The utilization of simple monetary policy is performed by the decrease of interest rates in the economy that will have an effect to the increase of money supply.

The use of tight monetary policy by the increase of interest rates in the economy will decrease the money supply.

The changes of interest rates will have an effect on investment and the international capital movement that will have an impact on income, employment and balance of payment.
10. The utilization of simple fiscal policy is the increase of government expenditures and/or the decrease of taxes. The tight fiscal policy is applied for by the decrease of government expenditure and/or the increase of Taxes. By the way, The change of government expenditure will have an impact on the employment, income and balance of payment.
11. The utilization of change in exchange rate by the Baht devaluation or appreciation will have an impact on balance of payment through the import & export, income and employment in the economy.
12. There are two types of the exchange rate system that will be applied for the analysis Fixed Exchange Rate, and Flexible / Floating Exchange Rate.
13. The direct control policy on goods and finance will have a direct impact to import, export and foreign currencies movement. Tools applied by government consist of Tariff, Subsidy, Import quota, Capital outflow control □ Multiple exchange rates,
14. The international capital movement related with the investment in securities depends on the differences of the return on capital (marginal product) :-
 - a) The international capital movement will be affect under the fixed exchange rate.
 - b) The capital outflow will cause the country more deficit or less surplus. Under the flexible exchange rate, the direct capital outflow will cause the depreciation of currencies in

those countries, and adversely affects to the consumers and the companies' profits.

15. At last, the country will utilize another policy – that is, changes in the international reserve when those countries have encountered the balance of payment deficit or surplus.

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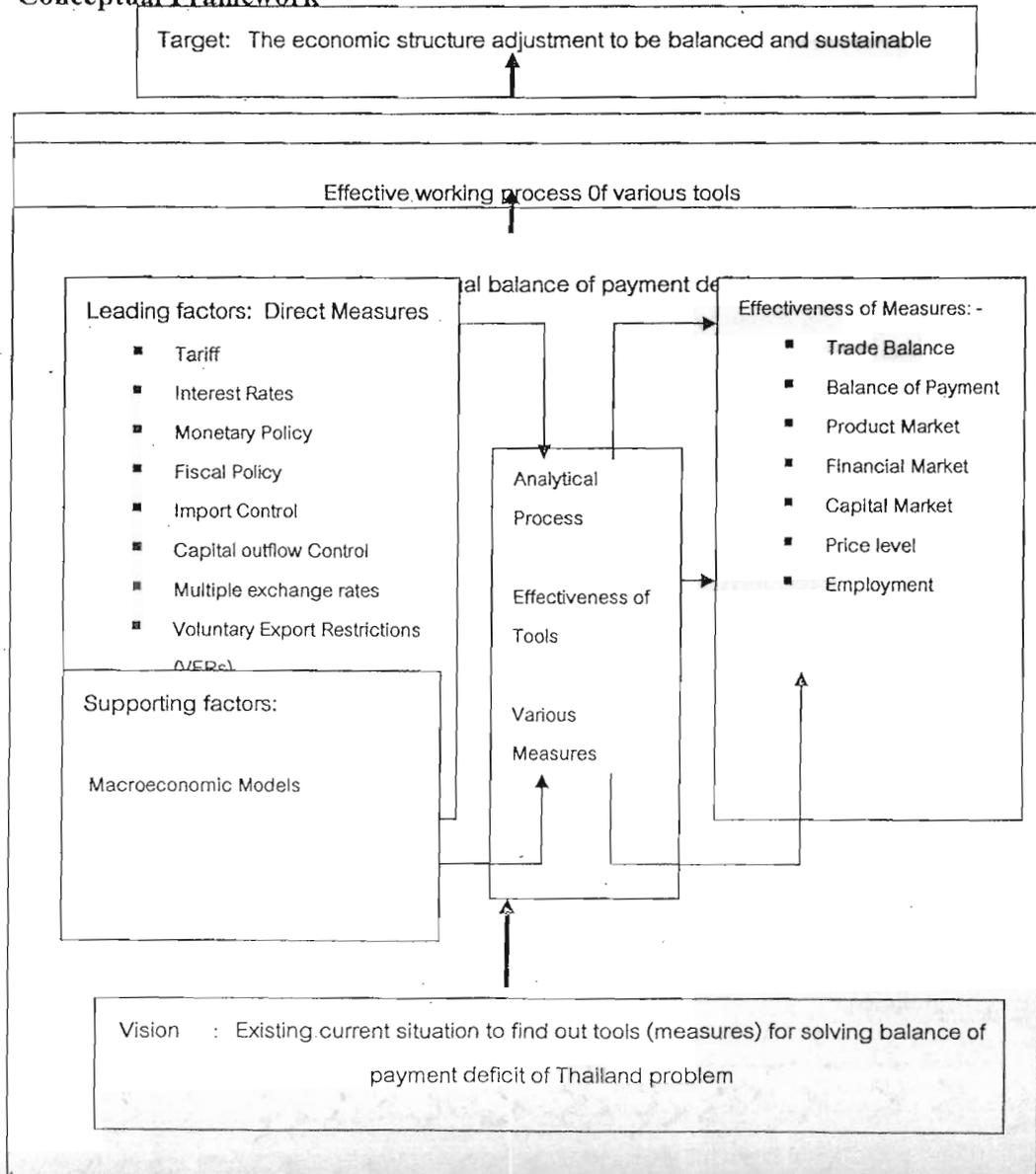
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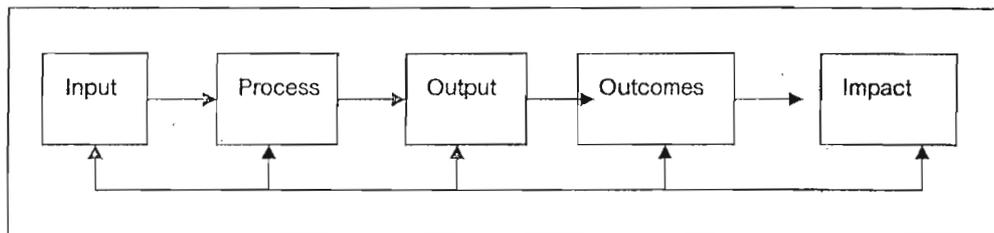
Conceptual Framework



Research Methodology

This research aims at studying the problem of the continual balance of payment deficit of Thailand so as to build the effective tools for solving such problems.

- 1). **Tools:** Academic documentary, Texts & Theories. Information retrieval from internet as well as academic articles
 - I. Academic Seminar, Symposium
 - II. Macroeconomic Models
 - III. Database retrieval
- 2). **Data Analysis:** Both of quantitative & qualitative Techniques to analyze contexts, according to theories and conceptual framework, from past to present.



- 3). **Result Presentation** analytical techniques of both quantitative & qualitative methods.

Result:

Concepts underlying the standard components of the balance of payments and the international investment position of an economy. The importance of this accounting and statistical reporting framework describing a country's international transactions derives primarily from the links between these transactions and the domestic economy. These links go in two directions: (i) from the external to the internal side of the economy and (ii) from changes in domestic economic conditions to changes in a country's transactions with the rest of the world. This section discusses some of these major links and a number of important connections between the major components of the balance of payments and between these components and a country's international investment position. This discussion directs particular emphasis to the factors influencing external transactions and the extent to which such factors are sustainable. Finally, some of the implications of balance of payments adjustments for economic policy are considered, it is assumed, by and large, that international and domestic transactions are not constrained by formal or informal administrative controls and that market participants are free to respond to price signals and macroeconomic policies.

Conclusion:

The general conclusion of such an analysis is that, when no government policy actions are aimed at achieving a surplus balance of payments position, it may be difficult to establish that an economy is investing too much of its saving abroad. However, it may be somewhat easier to reach a conclusion with respect to *reserve assets*. Rather than leading to a rise in net foreign assets held by the private sector, a current account surplus can be reflected in a buildup of foreign *reserve assets*. A buildup represents specific government policy action in the form of foreign exchange market intervention. Intervention, which involves the sale of domestic currency in exchange for foreign currency, has the tendency to keep the foreign exchange value of the domestic currency lower than it otherwise would be. The accumulation of *reserve assets* may therefore limit the extent to which the currency appreciates and thereby prevent the operation of the self-correcting mechanism that would tend to reduce the current account surplus.

Thus, one aspect of balance of payments analysis for a country with a persistent current account surplus involves an appraisal of the level of external *reserve assets* held by monetary authorities. The accumulation of such assets is excessive if the assets exceed, by a wide margin, the amount required to finance short-run balance of payments deficits. In such a situation, the country's resources may well be better invested in domestic capital formation. If the private and government sectors are unlikely to increase domestic capital formation, cessation of reserve asset accumulation would lead to an increase in domestic absorption and/or to a rise in net foreign investment by domestic residents.²² In either case, allocation of the economy's resources would tend to be more efficient as the allocation would be responding to market forces.

General Framework

The relationship between the balance of payments and the domestic economy has already been described (in Chapter 3 and Appendix 1) in terms of the SNA and the **current account**. Embodied in an identity derived in Chapter 3, this relationship shows that the current account balance is equal to the difference between gross domestic saving (**S**) and investment (**I**):

$$(1) \text{ CAB} = \text{X} - \text{M} + \text{NY} + \text{NCT} = \text{S} - \text{I}$$

when

X = exports of goods and services

M = imports of goods and services

NY = net income from abroad

NCT = net current transfers

Thus the **current account** balance mirrors the saving and investment behavior of the domestic economy. In analyzing changes in the **current account** position of a country, it is therefore important to understand the manner in which these changes reflect movements in saving and investment. For example, an increase in domestic investment relative to domestic saving will have the same

impact on the **current account**—at least in the short run—as a decline in saving relative to investment. However, the longer-run implications for the **external** position of the country may be quite different. More generally, equation (1) shows that any change in a country's current account position (e.g., a larger surplus or smaller deficit) must necessarily be matched by an increase in domestic saving relative to investment. This highlights the importance of ascertaining the extent to which any policy measures designed to alter the current account balance directly (e.g., changes in tariffs, quotas, and exchange rates) will affect domestic saving and investment behavior in such a way as to achieve the intended effects of the policy measures on the external sector.

This link between the domestic and external sectors of an economy can be expressed alternatively in terms of the difference between gross national disposable income (**GNDY**) and expenditure on goods and services by domestic residents (**A**). These two variables are defined as:

$$(2) \text{GNDY} = \text{C} + \text{I} + \text{G} + \text{CAB}$$

(3) $\text{A} = \text{C} + \text{I} + \text{G}$ = domestic absorption or expenditure From these two equations, it follows that the balance on goods, services, and net income plus net current transfers is equal to the difference between gross national disposable income and the use or absorption of this income through expenditures by residents:

$$(4) \text{CAB} = \text{GNDY} - \text{A}$$

The implication of this relationship for balance of payments analysis is the same as that already noted: improvement in a country's **current account** requires those resources must be released through a fall in domestic absorption (i.e., a reduction in expenditure relative to income).

$$(5) \text{S} - \text{I} = \text{S}_p + \text{S}_g - \text{I}_p - \text{I}_g$$

Use of the definition of the **current account** from equation (1) then gives:

$$(6) \text{CAB} = (\text{S}_p - \text{I}_p) + (\text{S}_g - \text{I}_g) = \text{S} - \text{I}$$

$$(7) \text{CAB} = \text{NKA} + \text{RT}$$

When NKA = net capital and financial account (i.e., all capital and **financial** transactions excluding *reserve assets*) RT = reserve asset transactions