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Bruno Jetin

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Ten years after the crisis: A bright future for capitalism in Thailand?

Bruno Jetin, Research Institute for Development (IRD, France) and CEPN-University of Paris Nord (France)⁽¹⁾.

This chapter studies 25 years of evolution of growth in Thailand (1980-2005) to show that: (1) the 1997 financial crisis had deep-rooted productive origins. (2) Despite a nearly eradication of absolute poverty, Thai capitalism is not able to combine long-term growth and social progress and is indeed dependent on permanent labour-income repression⁽²⁾. In section 1, we start by the analysis of the structural change in employment, the distribution of income and the evolution of real income versus labour productivity to show the continuous imbalance of power between labour and capital. In section 2, we analyse the impact of the distribution of income on the competitiveness of Thailand. Our analysis is based on the whole Thai economy and not on only manufacturing. The first reason is that manufacturing may be the driving force of economic development, but in terms of employment, it represents only 15% of the labour force in 2005 and therefore cannot be representative of the distribution of income at the national level. The second reason is that manufacturing, one component of the “formal” economy, cannot be competitive without the support of the “informal” economy, which provides not only food, but also supply industrial products and services, and mitigate the absence of a welfare system.

Section 1. The distribution of income in Thailand. Who benefited from growth?

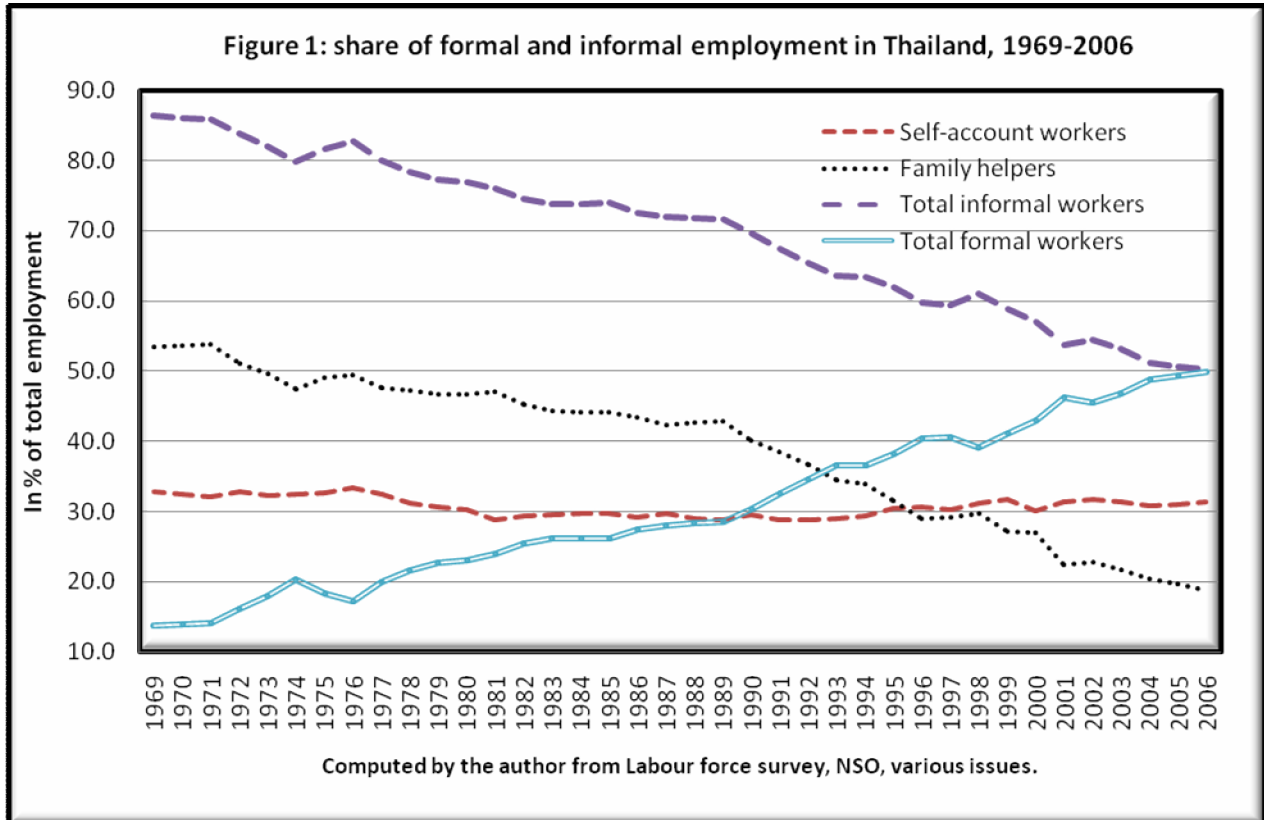
Thailand has witnessed a tremendous change in the composition of its employment (see figure 1). Family helpers, who work mainly in agriculture, accounted for 53% of employment in 1969. They now represent merely 19%. Self-account workers remained stable around 30%. Together, they formed what is usually called the informal employment⁽³⁾ which fell dramatically in Thailand from 86% in 1969 to about 50% in 2006. The other half of employment is essentially constituted of wage earners (in state and private companies) and employers which together form the formal employment. Wage labour, which is the backbone of capitalism, is bound to be the major part of employment in the near future in Thailand while it represented only 14% almost forty years before. Because the labour force is now roughly divided in two equal parts, any attempt to calculate the labour income share of GDP must take into account the income share of “informal workers” and not only the share of

¹⁾ Ideas expressed here are the sole responsibility of the author. Comments are welcomed: bjetin@yahoo.fr

²⁾ To make our point, we use National Income and Product Accounts (NIPA) provided by the NESDB National Economic and Social Development board, www.nesdb.go.th. Data for capital stock comes also from NESDB. Data for employment comes from the Labour Force Survey of the National Statistical Office (NSO). <http://web.nso.go.th/eng/stat/stat.htm> Data for exchange rate come the Bank of Thailand http://www.bot.or.th/bothomepage/index/index_e.asp

³⁾ Defining the informal economy and its workers is controversial and goes beyond the scope of this chapter. We will refer to a simple definition: the informal economy encompasses “all economic activities that contribute to the officially calculated (or observed) gross national product but are currently unregistered”. Quoted in J. Felipe, G. C. Sipin (2004).

“formal workers”. One possibility is to use the National Income and Product Accounts (NIPA). Wage earners’ income is registered as “compensation of employees” while informal workers’ income is registered as the “Operating Surplus of Unincorporated Enterprises” (OSPUE). It represents in fact a mix of wages and profits of the self-employed and their employees, which gives an estimate of the informal sector (4).

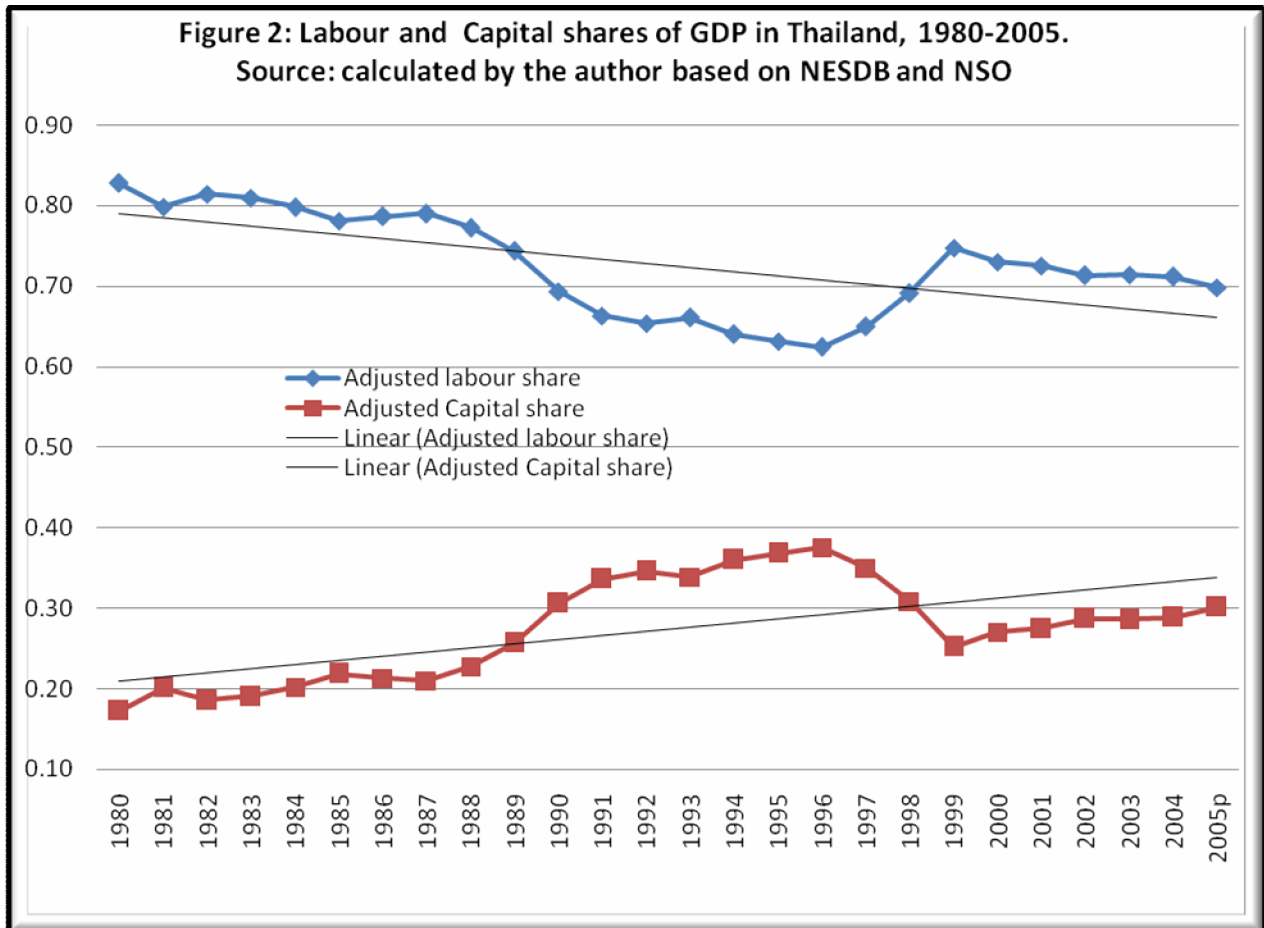


In order to reduce the bias introduced by the presence of profit in OSPUE, the methodology proposed by D.Gollin (2002) is applied (5). The result is the adjusted labour share presented in figure 2. One can see that there is an historical downward trend for the labour share. The labour share fell from about 83% in 1980 to a trough of 62% in 1996, then recovered during the crisis years because of the fall of profit, but declined again to 70% during the period of recovery (see figure 2). These movements are explained by the sharp decline of all categories of informal workers’

4) The share of OSPUE in Thailand has sharply declined from 58% of national income in 1980 to less than 38% in 2005, while the share of formal workers has increased from 32% to about 38%. Together, they represent 76% of national income, which is a bit overestimated because of the presence of profits in OSPUE. The decline in OSPUE is explained by the decreased of family helpers described above.

5) This consists in two adjustments. Adjustment 1 is calculated as the sum of the shares in GDP of employees plus the share of OSPUE to one, minus the share in GDP of indirect taxes and subsidies and provision for consumption of fixed capital. This adjustment treats all OPSUE as labour income, so it gives an overestimated labour income share. In the case of Thailand, it leads to a labour share that declines from 0.90 in 1980 to 0.77 in 2005. Adjustment 2 is calculated as the ratio of the share of compensation of employee in GDP to one minus the share of OPSUE and minus the share of indirect taxes and subsidies and provision for consumption of fixed capital. The labour share is then underestimated. It declines from 0.75 in 1980 to 0.63 in 2005. The “adjusted labour income” is the average of adjustment 1 and 2. See D. Gollin, 2002 for further details.

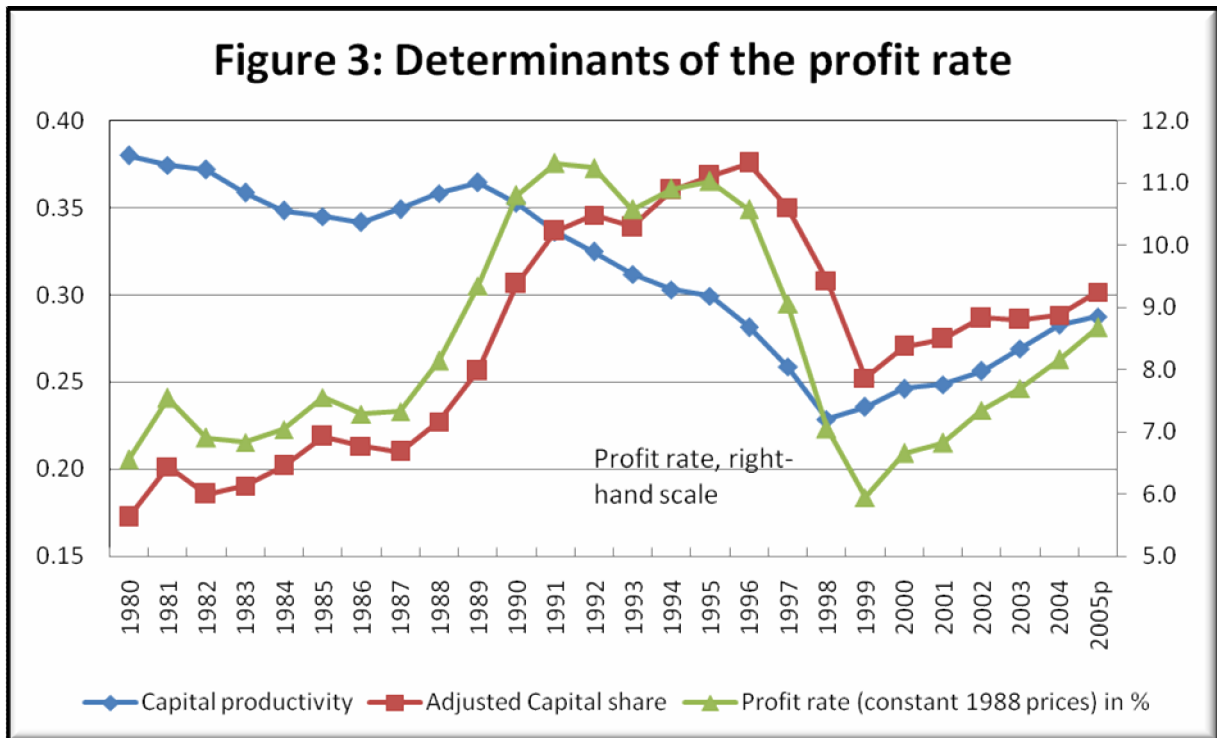
income share until 1996 while the income share of wage earners was progressing at the time, but at a slower pace. Since the crisis, these trends have reversed. Wage earners' share has declined from its peak at 42% in 1999 to 38% in 2005, while informal workers' share has recovered and then also stabilised around 38% ⁽⁶⁾.



The capital share mirrors the evolution of the labour share because it is calculated as 1 minus the labour share. The capital share has increased from 17% in 1980 to a maximum of 38% in 1996 at the end of the boom period (1986-1996), fell to 25% in 1999, and increased again to 30% during the recovery period, benefiting from the decline of the wage earners' income share. The progress in the capital income share until 1996 was crucial for the good performance of the profit rate because the productivity of capital has performed poorly from 1980 to 1996 (see figure 3). The

profit rate can be written as: $\frac{P}{K} = \frac{P}{Y} \times \frac{Y}{K}$ where P is the volume of profit, K the stock of capital and Y the GDP at factor cost. The profit rate is the product of the income

⁶⁾ This reflects probably long-lasting employment movements from salary employment to self-employment. A part of wage earners who have lost their jobs during the crisis and have turned self-employed, have not returned to salary jobs after the crisis. So the income share of self-employed has increased from 22% to 29% of GDP. On the contrary, farmers' income share has continued to decline steadily from 20% in 1980 to 10% of GDP in 2005. There was no durable return to the countryside.



capital share $\frac{P}{Y}$ times the productivity of capital $\frac{Y}{K}$. One can see from figure 3 that the strong progress in the capital share enabled the profit rate to increase sharply from an average of 7% in 1980-86 to an average of 11% during 1990-96. The drop of the capital share during the crisis added to the decline of capital productivity that started in the eighties but deepened in the nineties. In 1995 the decrease of capital productivity could not be compensated sufficiently by the increase in the capital share and the profit rate started to decrease before the financial crisis then dropped in 1997 when the crisis started. The over-accumulation of capital laid the ground for the crisis which was not purely financial but was rooted into the productive sphere. The recovery of the profit rate to around 9% in 2005 was due to the combined increase of the income capital share and the productivity of capital, which, thanks to elimination of excess capital is on the rise for the first time on the whole period.

Because the increase in the capital share has played such a determinant role in maintaining the profit rate at a high level, it is necessary to understand the evolution of its counterpart, the labour income share. Table 1 presents the determinants of the evolution of the labour income share. If the real average compensation ⁽⁷⁾ per worker increases less than labour productivity, then the labour income share decreases and vice-versa. One can see that before (1981-1985) and during the booming years (1986-1996), the labour productivity increased nearly two times more than the real average compensation per worker. Clearly, the growth did

⁷⁾ For the sake of simplicity, we use the term compensation both for “formal” and “informal” workers, although it is not appropriate for the last category which is composed of workers with various statuses.

not benefit workers, the surplus created by productivity being canalised in favour of profit.

Table 1: The determinants of the decline of the labour income share.

	<u>1981-1985</u>	<u>1986-1996</u>	<u>1997-98</u>	<u>1999-2005</u>
Real average compensation	0.6	3.4	-1.3	2.7
Labour productivity	1.7	6.7	-6.5	3,8
Labour income share	-1.1	-3.3	5.2	-1.1

Calculated by the author based on NESDB and NSO data.

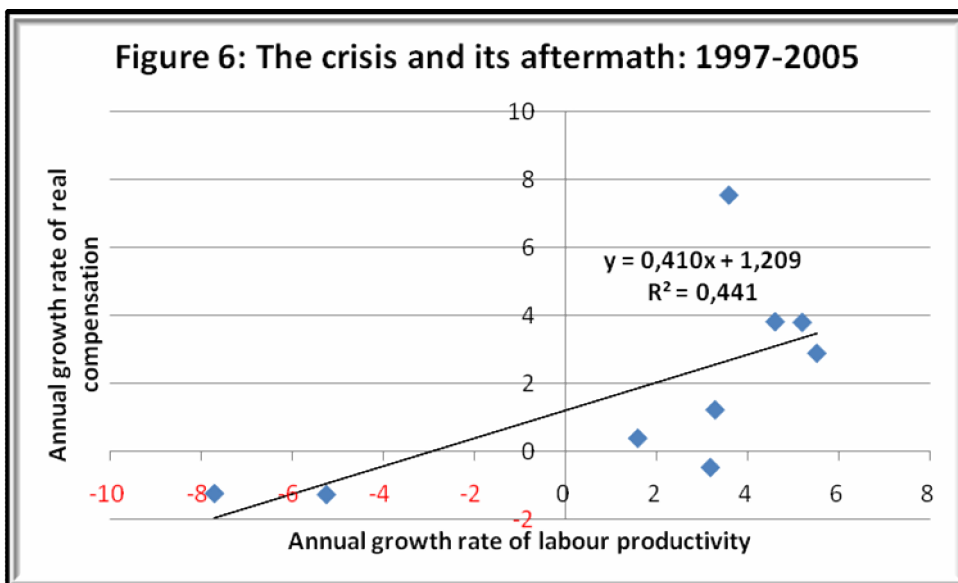
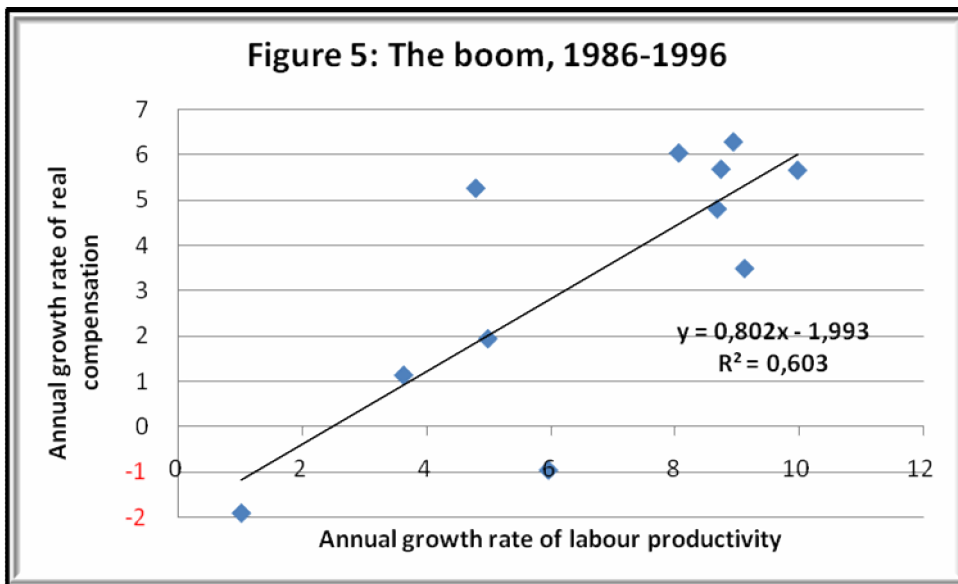
This was not the result of any economic law, but the result of an unfavourable balance of power between workers, submitted to a long series of dictatorial governments, and companies which increased their share of income. After the episode of the crisis, where both productivity and real compensation registered a negative growth, it is worth noting that real compensation has resumed its previous pattern. Its growth rate (2.7%) is not negligible but still lower than the pace of labour productivity (3.8%), although the gap has narrowed. As a consequence, the labour income share has declined at the rate of -1.1% per year, from 75% in 1999 down to 70% in 2005. Figure 4 shows that the coefficient of restitution of productivity gains



to workers has been 46% for the whole period. During the booming years, it was much higher (figure 5), with 60% of labour productivity growth being devolved to workers through compensation increases. But since the crisis, it has fallen down to 44%, back to the long-term average. Since the working hours in Thailand are among the highest in the world (S Lee., D. McCann, J.C. Messenger, 2007), we can be sure

that productivity gains have not been used to reduce the working time ⁽⁸⁾.

⁸⁾ According to the ILO report, 46.7% of Thai workers work more than 48 hours a week, defined as the threshold of excessive hours. 57% of self-employed are working more than 50 hours. Thailand is the only country in the sample of 50 countries where the average working hours in manufacturing are over 59 hours per week superseding the working hours in the service sector. Most recent data for Thailand are for 2000.



This means that 54% of productivity gains are on average transformed into profit. If we compare the Thailand case with the historical experience of Europe taken as a benchmark, we can draw the following lessons: During the “golden age” of post-war growth (1960-1973), labour productivity gains in Europe reached 4.5% on average, and real wages followed very closely with 4.4% (M. Husson, 2000). In comparison we can see that labour productivity gains in Thailand (6.7%, see table1) were quite high during the boom. The real difference lies in real compensation that lagged behind. Real compensation increases never followed closely productivity gains.

Section 2. The distribution of income and its impact on competitiveness.

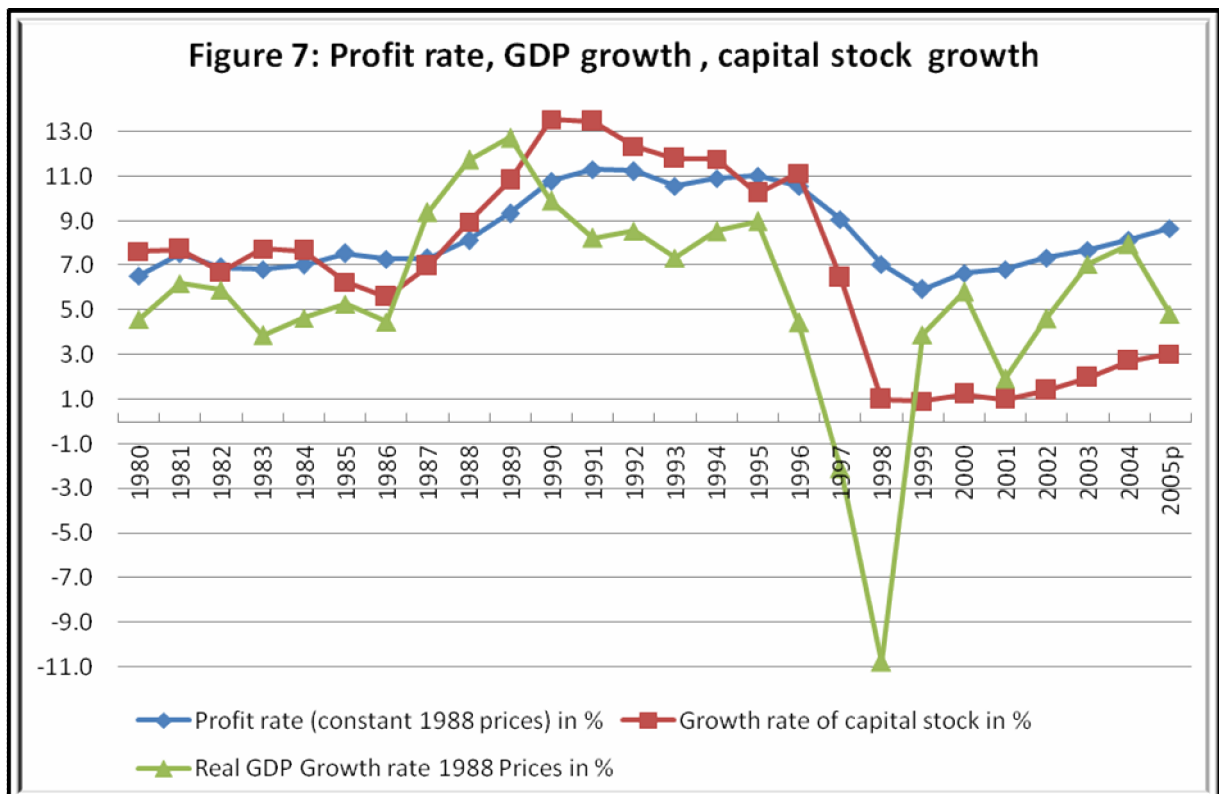
The accumulation process depends on the rate of profit: $r = \frac{\pi}{K}$, where π is the volume of profit and K the stock of capital. If the country is not in the middle of a crisis and if the future is not too uncertain, a high rate of profit raises the degree of entrepreneurs' optimism and induces them to invest more. The "Cambridge equation" (L. Pasinetti, 1962) formalises this idea (also at the core of Marxian economics, see A. Shaik, 1999) by stating that the propensity to save out of profit multiplied by the profit rate determine the growth rate of capital stock, i.e. the pace of accumulation.

$$\frac{I}{K} = g_k = s_p \frac{\pi}{K} = s_p r$$

Where s_p is the propensity to save out of profits and g_k is the growth rate of the capital stock. It follows that when all profits are saved ($s_p(p) = 1$) and turned into investment (I_{max}), the maximum rate of accumulation ($(g_k)_{max}$) is achieved:

$$I_{max} = \pi, \text{ so that } \left(\frac{I}{K}\right)_{max} = \left(\frac{\Delta K}{K}\right)_{max} = (g_k) = \frac{\pi}{K} = r$$

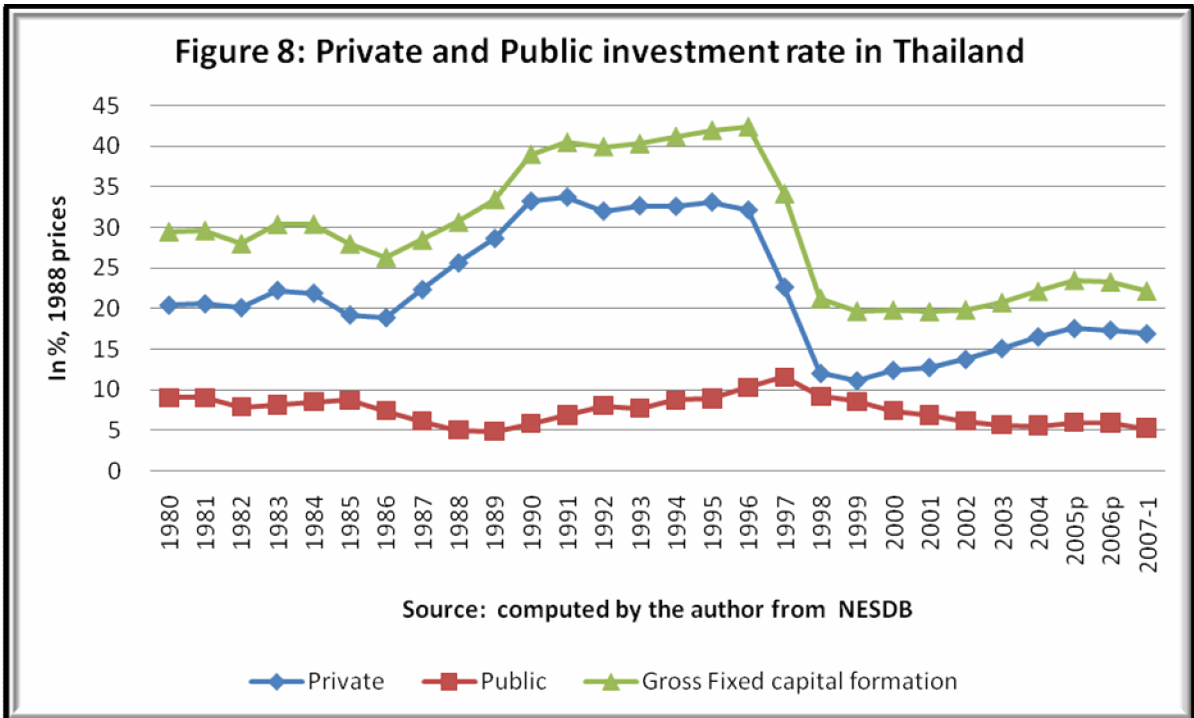
When this is the case, the ratio of the actual growth rate to the maximum growth rate of capital ($\frac{g_k}{r}$) can be interpreted as an indicator of the degree to which the growth potential of the economy is being utilised (A. Shaik, 1999). If the ratio is close to one, the growth potential is fully utilised. If it is superior to one, then there is excess demand inducing inflation rather than higher growth. If it is inferior to one,



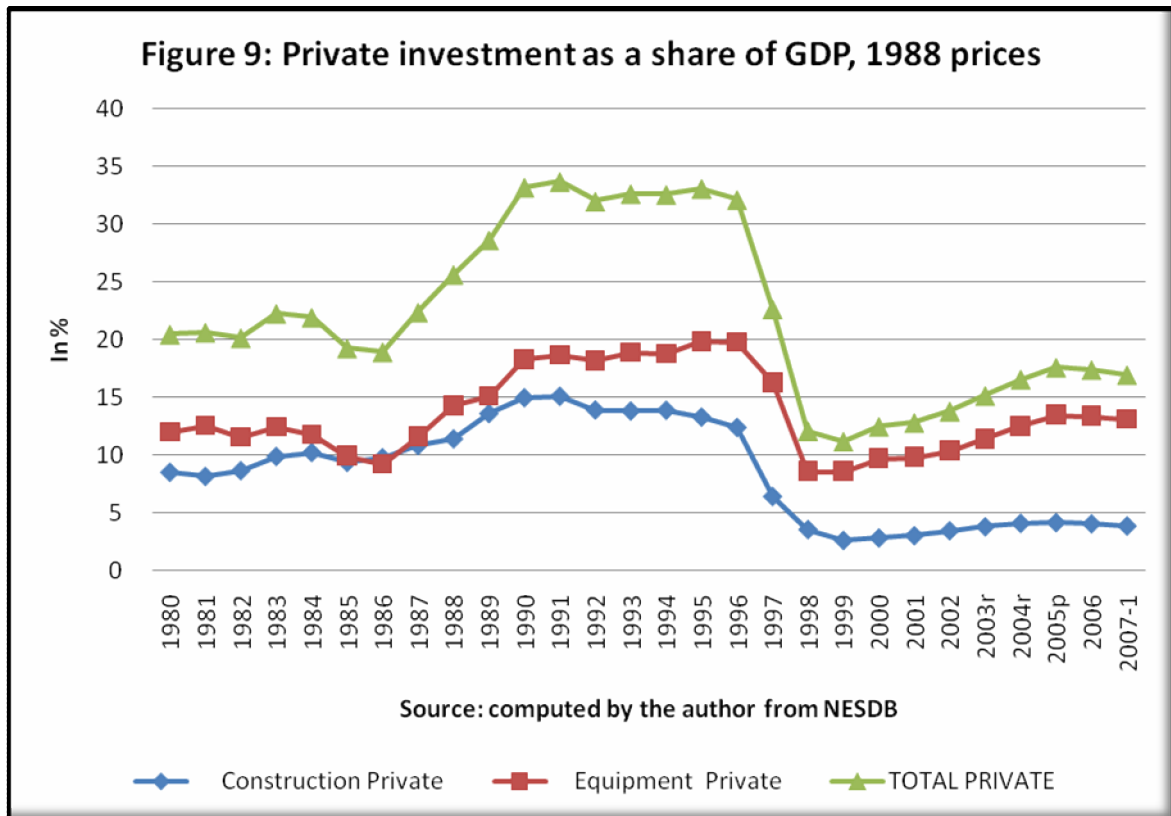
there are idle capacities and slow growth. This has been the case in the Philippines since the mid-eighties until at least 2002, where the capital stock growth (around 3% on average) has been well under the rate of profit (around 11% on average) (J. Felipe, G.C. Sipin, 2004). In Thailand, it has been quite the contrary until the 1997 crisis. The growth of the capital stock (6.8% on average) has been close to the profit rate (7.2%) during 1981-1985, but far exceeding the profit rate during most of the boom period (1986-1996), leading to over-accumulation (see figure 7). Inflation has been in fact moderate ⁽⁹⁾ because the GDP growth rate declined from 13% in 1989 to 4% in 1996, and because of wage repression. The sharp drop of the accumulation rate from 11% in 1996 to 1% in 1997 until 2001, testifies to the violence of the crisis. The accumulation of capital resumed only in 2002 at a slow pace and reached 3% in 2005, well below the profit rate (9%). This explains why the present GDP growth rate is well under its potential rate because investment remains low (see figure 8).

Gross fixed capital formation has remained around 21% since 1999, 20% below the record level of the 1990-96 period (41%) and well below the pre-boom years (29% in 1980-85). Figure 8 shows that part of the decline is due to the State that used to invest more than 8% in the pre-boom period, reached 10% in 1996 and is down at the 5% level in 2007. The State did not play a counter-cyclical role after the crisis although it had paid its debt to the IMF. Private investment has increased from its minimum of 11% in 1999 to 17% in the first half of 2007, close to its pre-boom level (20%) and is therefore the sole responsible for the modest recovery of investment. Had the state maintain its investment expenditure at the 10% level, gross fixed capital formation would be at 27%, close to the pre-boom years (29%).

⁹⁾ The inflation rate (GDP deflator), although positive, has been moderate for a developing country: 4.1% per annum in 1981-1985, 4.8% during the booming period 1986-1996, and 1.3% when the accumulation of capital resumed in the years 1999-2006.



When we look at the structure of private investment (figure 9), we note that the recent increase of investment is due to expenditures on equipment (13% in 2007) while investment in construction remains depressed around 4% against 13% on average in the boom years and 9% in the pre-boom years.



One limit of this positive trend in productive investment is that most of it comes from multinational companies. In 2006, “private investment growth was supported almost entirely by the 18% real growth in FDI. This reflected low, if not negative, investments by domestic investors amidst political uncertainties” (World Bank, 2007, p 28). This will be probably not the case in 2007. There is no return of domestic investors’ confidence which represents around three fourth of total private investment. At best, there is a return to the investment rate pattern of the pre-boom years at 11%. If this was the case, Thailand would enter in a new period of slow growth.

At short-term, this situation is due to several factors. First, there are still excess capacities in the economy that have not been eliminated by the crisis. Second, there is also a fundamental uncertainty regarding the future due to the political instability and the absence of long-term growth strategy from the part of the State. If excess capacity can be eliminated, the capacity of the State to define a new strategy for development remains an open question.

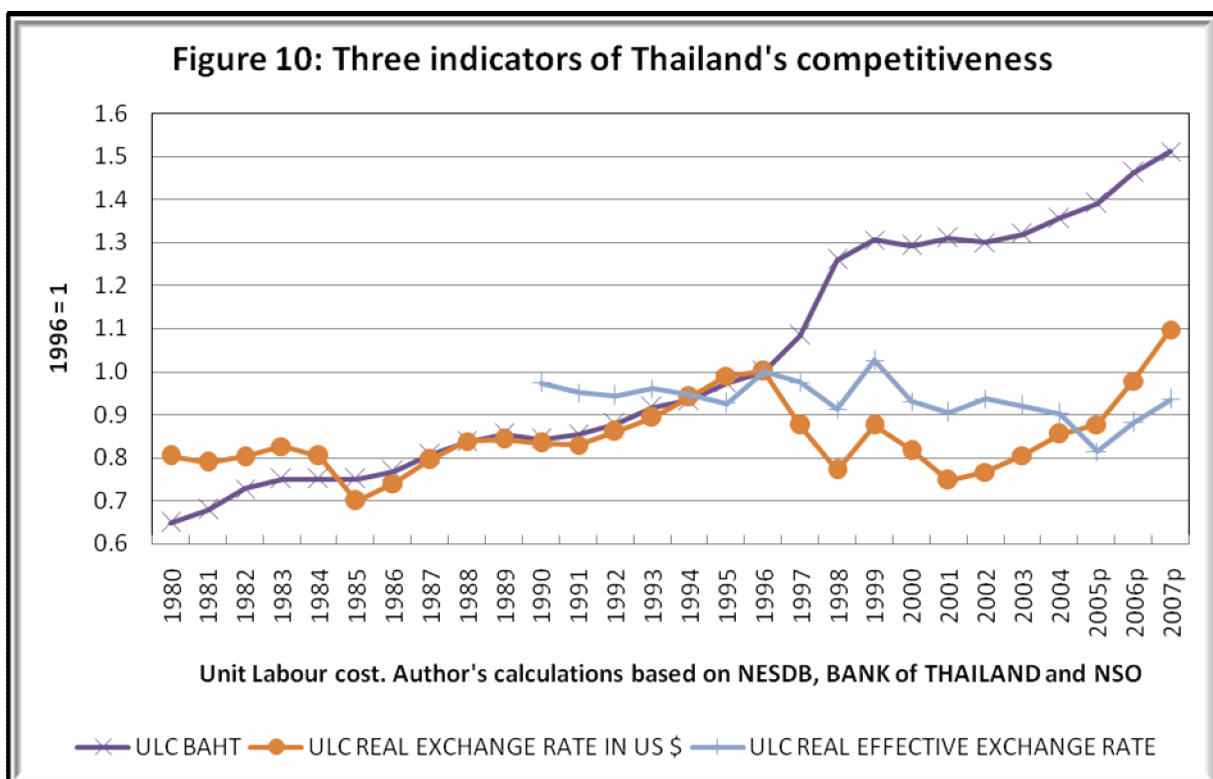
Another source of concern is the evolution of the unit labour cost which is one measure of cost competitiveness. The unit labour cost is defined as the ratio of the nominal compensation rate (baht per worker) to labour productivity, where the latter is defined as the volume of GDP per worker ⁽¹⁰⁾. Therefore:

$$ULC = \frac{W_n}{\frac{VA_n/P}{L}} = \left(\frac{W_n L}{VA_n} \right) P = SI \times P$$

Where W_n denotes the nominal compensation rate, VA_n is the nominal value added or GDP at the aggregate level, P is the output deflator, L is the employment, SI the labour income share. The equation shows that the unit labour cost can also be expressed as the labour income share multiplied by the GDP deflator. When one wants to assess the competitiveness, the GDP deflator can be divided by a foreign exchange index. There is therefore a direct link between the distribution of income and the competitiveness as expressed by ULC (J. Felipe, G.C. Sipin, op.cit, p 6-8). Neo-classical economists would say that the lower the labour income share, the better competitiveness is. As it is easier to repress compensation than increase labour productivity and growth the temptation is high to engage in a race to the bottom. The counter-argument is that in the long-run the repression of compensation depresses domestic demand leading to a reduction of investments that affects

¹⁰⁾ « A specific characteristic of unit labour cost measure is that the numerator, which reflects the labour cost component of the equation, is typically expressed in nominal terms, whereas the denominator, which is productivity, is measured in real or volume terms”. Ark Van B., Monnikhof E.J (2000). This apparent contrast can be understood when interpreting the unit labour cost measure as an indicator of cost competitiveness. It then adequately represents the current cost of labour (the numerator) per “quantity unit” of output produced (the denominator) which can only be proxied at the aggregate level by deflated value added.

productivity negatively. Figure 10 ⁽¹¹⁾ presents three indicators of the of Thailand's cost competitiveness, namely the unit labour cost expressed in baht (ULC Baht), the unit labour cost expressed in US \$, and the unit labour cost expressed in a basket of currencies of Thailand's main trading partners (ULC Real Effective exchange rate). One can see that despite the decline of the labour income share from 83% in 1980 to 70% in 2005, the unit labour cost expressed in baht has increased steadily all along the period. The reason is the continuous increase of inflation (the GDP deflator), which more than compensated the decrease of the labour share. In terms of international competitiveness, it is worth observing that due to the dollar peg that prevailed in the eighties until 1996, the unit labour cost expressed in US \$ followed closely the unit labour cost expressed in baht. As consequence, the competitiveness shrunk by 43% from 1985 to 1996. This contributed strongly to the deficit of the



current account that eventually led to the massive outflows during the crisis.

The adoption of the “dirty float” regime after the crisis changed the situation dramatically. Following the sharp devaluation of the baht in 1997-1998, the dollar remained at a low level in the following years reaching a post-crisis low in 2001. This “cheap baht” period turned the rising “domestic” unit labour cost into a decreasing unit labour cost in dollar terms. The evolution of the real effective exchange rate was less favourable, but still helped to decrease the unit labour cost of Thailand compared to its main trading partners. This favourable period is now finished. Since 2001, the baht is appreciating against the US \$, with an acceleration since 2005. In

¹¹⁾ Figure 10 is based on the following hypotheses: because the data was not yet published, the income labour share for 2005, 70%, was supposed constant for 2006 and 2007, which is reasonable because income do not fluctuate a lot from year to year. For 2007, the foreign exchange rates used cover the first semester only.

real effective terms, the appreciation of the baht started only in 2005 but is following the same path. This means that the rising “domestic” labour cost is no more compensated by a depreciation of the baht, but quite to the contrary the two factors are adding together to erode Thailand’s competitiveness. This is putting Thai exporters under stress because the investment failure makes it difficult to increase productivity as a way to improve unit labour cost. As a consequence, the downward pressure on workers’ compensation will probably be stronger.

Conclusion.

The evidence presented in this assessment of Thailand ten years after the crisis leads us to the following conclusions. The first is that the origin of the crisis has to be traced back to the over-accumulation of capital inherited from the boom. The pace of accumulation was slowing down since 1990 and the productivity of capital was also declining all along the period. The financial crisis was the factor that triggered the economic crisis but not the deep cause. The second conclusion is the surprising capacity of the profit rate to remain at a high level, even during the crisis and to recover rather quickly. A characteristic that is also observed in the Philippines (J. Felipe and G.C. Sipin, op cit p 27) and is due to the capacity of employers to capture the major part of labour productivity at workers’ compensation expense. Third, the rate of accumulation which had moved in line with the profit rate in the past, seems now to be disconnected with profit, a feature which is also found in developed countries since the beginning of the eighties (M. Husson, 1999). This disconnection has given birth to the financialisation of capitalism, the excess of profit being invested in financial markets instead of being invested in the productive sphere. This financialisation has not been observed as such in developing countries up to now, at least in Asia, because the rate of growth has been staying at a high level for decades. The slowdown of growth in Southeast Asian countries since the crisis, to the difference of China and now India, raises the question of the emergence of financialisation in these countries. Is the difference observed in Thailand between the rate of profit and the rate of accumulation (5.6% on average on the period 1999-2005) a transitory phenomenon or a new permanent feature? If it proves permanent, financial crises have unfortunately a bright future.

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