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Private Investment: Trends and Determinants in Thailand

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Summary. — This paper examines patterns and determinants of private investment in an attempt to understand why levels of private investment in South East Asia have not yet fully recovered, using Thailand as a case study. The private investment equation is estimated during the period 1960–2005. We find that it was capital fund shortages rather than existing spare capacity that hindered short-run investment recovery. While the health of the financial institutions must be kept in check, policy attention should be geared more toward credit availability to ensure that prudent investors can access credit adequately and accelerate investment recovery. In the long run, policy emphasis should be on promoting a conducive investment climate.

Key words — investment-saving glut, investment determinants, Thailand

1. ISSUES

Private investment plays a vital role in the growth generating process in developing Asian economies. Even though investment typically represents a much smaller component of aggregate demand than does consumption, it determines the rate at which physical capital is accumulated. Hence, it plays an essential role in the expansion of the economy's production capacity and long-term economic growth. Private investment has become even more policy-relevant in the recent years, as after the 1997 financial crisis private investment in the crisis-affected countries has not yet fully recovered. Such a slow recovery process could hinder the efficiency of resource use and generate negative signals to foreign investors (Chhibber, Dailami, & Shafik, 1992).

The movements of private investment in crisis-affected Asian economies also become policy-relevant worldwide given the recent concerns over persistent global payment imbalances, reflected in the growing current account deficits, mainly in the United States, and surpluses in Asian and oil-exporting economies. For East Asian economies, with the exception of China, instead of an increase in savings rates, there has been a private investment drought that induced these Asian countries to run successive current account surpluses. [1] Hence, examining factors hindering the recovery of private investment in these countries would also assist in redressing the global imbalances problem.

Given the nature of data availability, the existing empirical studies on the determinants

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of private investment, particularly for the developing Asian economies, tend to be dominated by multi-country, cross-sectional, regression analysis. [2] The clear fundamental limitation of such an analysis is that it is based on the implicit assumption of "homogeneity" in the observed relationships across countries. This is a very restrictive assumption because there are considerable differences across countries in relation to various structural features and institutional aspects which have a direct bearing on the private investment behavior. In addition, there are also vast differences among countries with respect to the nature and quality of data available, which make any cross-country comparison a rather risky business (Athukorala & Sen, 2002; Chhibber *et al.*, 1992).

This points to the need for an in-depth, time-profile analysis of private investment in an individual country in order to build a sound empirical foundation for informing the policy debate. Unfortunately, systematic single-country studies of this nature are few and far between. [3] Therefore, this paper aims to examine patterns and determinants of private investment, using Thailand as a case study. A single equation of private investment determinant is estimated, where a comprehensive set of explanatory variables are well incorporated with a view to understanding the reasons behind private investment still not fully recovering.

Thailand is a suitable case study for the subject at hand for three reasons. Firstly, during the past three decades Thailand has exhibited a boom-and-bust cycle in private investment. After the recent 1997 crisis, private investment in Thailand has not fully recovered. Its share of GDP has not only been lower than the average level of the past three decades, but has also been relatively low compared with the other crisis-affected countries in the region. Hence, the analysis of patterns and determinants of private investment in Thailand would not only contribute to the ongoing debate in the policy circles, but would also shed light for other developing countries in designing policy to promote private investment.

Secondly, the incomplete recovery of private investment seems to involve several factors, such as real exchange rate depreciation, credit availability, and excess capacity, some of which have theoretically ambiguous effects on investment. Their relative importance is also crucial in forming policy to speed up the investment recovery. Consequently, a systematic empirical analysis is required.

Finally, there has not been any systematic and up-to-date study of private investment in Thailand. [4] The most recent study was conducted by Mallikamas, Thaicharoen, and Rodpengsangkaha (2003), in which private investment function in Thailand was estimated, but whose results are subject to two serious limitations. The first limitation is that they ignored a number of key variables, that is, public investment and various aspects of economic uncertainty. However, based on the previous studies (i.e., Athukorala & Sen, 2002; Chhibber *et al.*, 1992; Pattillo, 1998), [5] these variables play a significant role in determining private investment in the context of the developing countries. Second, the proposed functional form for estimation is problematic. It is based mainly on Tobin's q theory. However, Tobin's q theory has met very limited empirical success in the developing countries (Agénor, 2001). This is especially true for Thailand where total capital in the stock market was limited, accounting for only around 7% of the country's total capital stock during the period 2001–05.

The rest of the paper is structured as follows: Section 2 provides an analysis of patterns of private investment in the Thai economy in order to set the stage for the empirical analysis. The analytical framework and the model are presented in Section 3. Time series properties of data and the econometric procedures used are described in Sections 4 and 5, respectively. Section 6 presents and discusses regression results. The final section summarizes the key inferences.

2. PATTERNS OF PRIVATE INVESTMENT IN THAILAND

Thailand experienced a considerable expansion in private investment during 1986–96, before the financial crisis starting in mid-1997 ended the boom. Before 1986, the share of private investment in GDP was less than 25% (Figure 1), while the average annual growth was 9%. [6] From then on, the private investment boom began and reached a peak in 1991. The share increased to 34% in 1991 and remained more or less at this level up to 1996. Its annual growth rate during this boom period averaged out at around 15%. The Asian financial crisis starting in mid-1997 affected private investment significantly, and in 1999, the share of private investment in GDP dropped to 11%. This was the largest contraction in