

CHAPTER VI

CONCLUSION

The three determinants of the money stock reflect the behavior of three sectors of the economy. The high-powered money stock reflects the behavior of the government; the reserve ratio, of the commercial banks and the currency ratio, of the public.

Cagan found that 90 per cent of the secular growth of the money stock in the U.S. was accounted for by the expansion of high-powered money, and the remaining 10 per cent by declines in the reserve and currency ratios. The movements in high-powered money came from the changes in gold stock, Federal Reserve System operations, Treasury operations and the issues of national bank notes. However, the currency-money ratio was found to be the chief contributor in accounting for the short-run cyclical movements in the money stock.

In the case of Thailand, Grachangnetera (1972) found that, during 1964-69, the average change of money stock due to the high-powered movement was 117 per cent. Using a similar approach, Jinachitra (1975) got about the same result during the period 1964-73. He found that the average change in the high-powered money contributed about 100 per cent of the change in the money stock. This author, using the yearly data from 1948 to 1975, found that the

average increase in high-powered money alone accounts for 86 per cent of the changes in the total money stock while the average contributions of the currency ratio and the reserve ratio are 15 and -0.58 per cent respectively. Perplexingly, this result is almost the same result that Cagan got for the U.S..

A further statistical investigation showed that capital movements, U.S. aid and military expenditures and commercial bank loans are underlying factors accounting for the major portion of the changes in the high-powered money stock. Interest rates on time deposits and per capita income also significantly affected the currency ratio. An analysis of the reserve ratio showed that the demand deposits and time deposits play a significant role as expected. Another regression analysis showed that excess reserves are determined by demand deposits. For the analysis of currency ratio, we got an interesting result which is opposite from what Cagan proposed. It might be true that, in the developed country like the U.S., the income elasticity of deposits is greater than that of currency but it is not true in the case of Thailand. In Thailand, the use of checks is limited, therefore people prefer currency to demand deposits. It was confirmed by the empirical results that for Thai economy the income elasticity of currency was greater than that of demand deposits.

However, the empirical work revealed that the currency ratio is not affected by non-monetary gold and the number of bank offices.

It can be concluded that the results of the previous studies mentioned above and this study are the same in that the high-powered money stock is of paramount importance in the determination of the changes in the total money stock. The empirical results suggest that the money stock may be controlled if the high-powered money can be controlled. Economists agree that the money stock is determined by both demand and supply. The monetary authorities, however, can pursue monetary policy influencing only the supply side. Therefore, high-powered money should be a monetary-policy target for Thailand.

The analysis of changes in the money stock by studying the behavior of the three sectors of the economy that determine the amount of money supplied has some advantages over analysis using the consolidated balance sheet of the monetary system. It shows the contribution of each determinant to a change in the money stock while the consolidated balance sheet only shows the movement of aggregate items. One cannot see any behavioral analysis from the consolidated balance sheet which poses a problem for the monetary authorities. This study shows the magnitude of the contribution of each determinant and goes further to show the various factors that influence the three determinants. Therefore, policies that can achieve the control of factors

affecting high-powered money should be employed in order to control the money stock in Thailand.

The high-powered money stock, from the source of base, can be classified into three main categories: foreign assets, claims on government and claims on banks. It is obvious that foreign assets should be treated as exogeneous. The only thing that the government can do, in the author's opinion, is to keep a favorable atmosphere to attract foreign investment. This atmosphere should come from political and economic stability, tax reduction and exemptions, and other laws that facilitate foreign investment.

Thailand has continued its long tradition of conservative monetary policy. One aspect of this policy is the relatively large holding of foreign exchange reserves. In fact, the nation's external debt has stayed at approximately one third of the foreign reserves from 1960 to present. Thailand could have financed from its own resources rather than borrowing from abroad. A reason for the monetary authorities pursuit of such a policy is because they regard the balance of payments surplus as a temporary phenomenon that could quickly be transformed into a large deficit. It might be an advantage for the Thai economy if the monetary authorities reduce the level of foreign reserves and use them for the purpose of developing import substitution industry or in a way that can increase the amount of export goods in order to gain a surplus in the balance of trade.

Prior to 1960, monetary policy was dominated by the financing of government deficits. A substantial increase in interest rates in the mid-1950's made it possible for the government to sell its securities to the public. The Commercial Bank Act of 1962 allowed the BOT to decrease the amount of claims on government. Since then, government deficits have been financed largely through bond issues placed with commercial banks, and through foreign loans and grants. The BOT has pursued a conservative policy in that the growth of BOT credit to the government was kept to a minimum except for a large increase in 1969 due to the economic development program. However, the BOT's moral and political role as the guardian of the currency and of financial virtue in Thailand can effectively control the amount of claims on government.

It was predicted in the last chapter that the claims on banks would play a central role. BOT should facilitate the expansion of the banking industry. To increase the degree of competition, BOT should set up and announce standard requirements for banks which want to open a new branch and should not limit the number of bank branches in each area. In order to protect the depositors, BOT should set up insurance institutions like Federal Deposit Insurance Corporation (FDIC) and Federal Savings and Loan Insurance Corporation (FSLIC) in the U.S.. The expansion of banking system will lead banks to make greater use of

the discount facility of the BOT. Therefore, discount policy can be regarded as an effective monetary instrument of the BOT beside the reserve requirement policy.

