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Globalization and social development in Thailand¹

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1. Introduction

Prior to the Asian economic crisis in the late 1990s, most public policy makers and enthusiastic business people in advanced countries and developing countries alike had aspired to globalization in trade and investment. Most developing countries, particularly the Southeast Asian countries had directed their economic policy towards participation in the globalization process.

There was, of course, some concern for the under-privileged group of people failing to keep up with the pace of globalization and withstand the pressure of competition. Globalization policy was, however, pursued vigorously in favour of big business without adequate care for the under-privileged, leading to a bubble economy and worsening inequality. Eventually, the bubble burst in 1997. Many people then blamed that globalization and too fast trade and financial liberalization were the causes of the crisis. It is our intention here to discuss what went wrong with the globalization policy pursuance of Thailand that led to the economic crisis and social problems.

The next section reviews Thailand's globalization process and policy measures in the recent period of globalization. The third section discusses some socio-economic process. The last section discusses what led Thailand into crisis.

2. Globalization of Thailand

Thailand has engaged in international trade since the Sukothai Kingdom, the first kingdom of Thailand (1249–1438), trading largely with China. During the Ayudhtaya Kingdom (1350–1767), Thailand's trading partners expanded to include Indonesia, Japan, India, Persia and European countries such as Portugal, Spain, Holland, England and France. The United States began to trade with Thailand in the early period of the Ratanakosin Kingdom (1782–present). In the old days, Thai people lived at subsistence level in a self-sufficiency economy and paid tributes to the government with their surplus products. Exports of the surplus and imports were then monopolized by the government. Major exports were primary agricultural and forestry products such as pepper, sugar, rice, wood, wax, horn, etc. Major imports included silk, ceramics, cloth, guns, handicrafts, etc.

An important modernization of Thailand took place during the reign of King Rama V (1868–1910). To counter imperialism and sustain Thailand's independence and sovereignty, King Rama V initiated and implemented social infrastructure investment, government reform, high level diplomatic relations and trade agreements. He paid visits to leaders, the Monarchs and Presidents of several countries including Russia, Germany, France, Britain, Austria–Hungary, Italy, Sweden, Denmark, Belgium, Spain, Holland, Portugal and Switzerland and discussed trade and diplomatic issues with them once in 1897 and again in 1906–1907. He sent his princes to study in different fields in various European countries such as Russia and

Germany. These princes, then returned to Thailand and were responsible for the reforms and modernization of education, health care, military, public administration, transportation and communication, laws and justice, etc. by adoption and adaptation of the Western models and technology.

Prior to 1855, international trade of Thailand was largely monopolized by the government and the aristocrats. The government also collected different but very high entry fee on ship with goods and without goods based on the ship's width. The Bowring Treaty that Thailand signed with Britain in 1855 and similar treaties with other countries including the United States, France, Portugal, Denmark, Holland, Prussia, Norway, Sweden, Belgium, Italy, Austria–Hungary, Spain, Japan and Russia that followed resulted in liberalizing Thailand's trade. Among other things, the Treaties lifted trade monopolies and ship entry fees and fixed import duties at no more than 3%

Trade liberalization led to expansion of rice production and export, particularly in the Central Plain area, and the gradual transition from a subsistence–economy to a commercial economy. Rice became the top export item. About one half of rice production in 1870 was for exports. Rice production increase was due to an expansion of the cultivation area under irregularity investment. Other important exports were teak and tin. As a result of foreign investment in teak logging, Thailand became a major source of teak, sharing one–fourth of world supply in the early 1900s. The commercialization was, however, slow and taking place only in the Central region although the railway installation helped open commercial opportunities for the North Eastern and Northern region. Most farmers tended to protect themselves against risks of food shortage and income instability by remaining the self–sufficient and sold only the surplus. Chinese merchants then played the role of middlemen taking the surplus from Thai farmers to commerce.

After the World War II Thailand's international trade expanded further in response to foreign demand. Agricultural production was more diversified and geared for exports. Rubber expanded in the South, cassava in the East and North East, maize in the upper Central area, jute in the North East, tobacco in the North, and sugar cane in the East and West. Exports were also more diversified including rubber, maize, tapioca, teak and tin. Agricultural growth was realized mostly through an increase of cultivated land and forest encroachment without yield improvement. The cash economy expanded and replaced the self–sufficient economy. Weaving for own use was disappearing. New commercial banks were established by Chinese merchants and military officers. Due to income growth and better health care, population grew faster, at 3.2% per year compared with 2% per year before the World War II.

Thailand's first Five–Years National Economic and Social Development Plan was launched in 1962. The first two Five – Years Plans focussed on infrastructure development, agricultural diversification, and import substituting industrialization to achieve high and stable economic growth. The Third Plan (1972–1976) turned to export oriented industrialisation, The Fifth Plan (1982–1986) put an emphasis on liberalization, deregulation, and decentralization. The implementation of the plan was however obstructed by the oil crisis and global recession. Some liberalization was undertaken during the Seventh Plan period (1992–

1996). The Eighth Plan then focussed on quality of life and quality of human resource, people participation in development design and process.

2.1. Structural Transformation and Export Growth of Manufactured Goods

Thailand's structural transformation began with the First National Economic Development Plan in the early 1960s. There has been a gradual and steady departure from being primarily dependent on agricultural commodities to relying more on industrial production ever since. It was not until the late 1970s, however, that the manufacturing sector overtook the agricultural sector in terms of share of value added in GDP. The pace of industrialization slowed down during the first half of the 1980s as a result of the oil crisis and the worldwide recession. During the period between 1987 and 1989, Thailand was well prepared to take advantage of the recovery in the world economy and the pace of industrialization accelerated.

During the 1960s, double-digit rates of growth in domestic – demand oriented manufactures reflected the spirit of Thailand's import substitution policy. Natural resource-based export oriented industries grew at a respectable average annual rate of 7% while import-dependent export oriented industries stagnated. The performance of the export oriented industries picked up in the 1970s, and have grown faster than import substituting industries ever since. Import dependent industries, be it export oriented or import substituting, grew faster than natural resource-based industries, except during the first half of the 1980s. This reflects the relatively slow development of the domestic natural resource and intermediate input industries. The worldwide recession and oil crisis in the early 1980s also had a more severe impact on import-dependent industries than on natural resource-based industries (Akrasanee and Wiboonchutikula, 1992).

A disaggregation of the manufacturing sector reveals that most of the high growth industries were export oriented. The industries showing strong growth rates during 1980–1990, were leather products, apparel, plastic products, electrical machinery, food processing, professional and scientific instruments, chemical products, non-metallic products, machinery, and other manufactures including jewelry, toys, artificial flowers, and sporting goods. Most of these industries experienced accelerated growth after 1985. In addition, following previously mediocre performances, rubber products, textiles, transport equipment, and paper and paper products were among those industries which experienced high growth during this period (Table 1). Products with growing export shares over this time frame included processed foods, textiles and textile products, clothing, footwear, leather products, electrical and electronics products, toys, jewelry, and plastic products (Table 2). In the late 1990s, machines and transport equipment became more important and dominant export products (Table 3). The structure of imports also changed significantly. In the 1960s, consumer goods and capital goods were major imports followed by transport equipment, intermediate goods, and raw materials. In the 1970s, the share of oil and intermediate goods imports increased significantly due to sharp increases in the price of oil and to the growth of import-dependent export industries, respectively. The share of consumer good imports declined as a result of domestic substitution. In the 1980s, high growth imports included intermediate products, capital goods, and vehicles and parts. Imports of durable and non-durable consumer goods grew at lower rates. The share of fuel imports,

however, dropped in the mid–1980s because of increasing local oil and gas production as well as decreasing world oil prices. The growth of consumer goods, intermediate goods and capital good imports accelerated after 1985 in response to the investment boom. Those intermediate goods with high rates of import growth consisted mostly of inputs for high growth export industries such as fish, yarn, wood, basic metal products, electronic products, jewelry and precious stones (Tables 4, 5). In the 1990s machines and transport equipment became the most dominant import item (Table 3).

In the late 1980s, Thailand's export-led industrialization helped it to become one of the fastest growing economies. Following a shift of policy emphasis from import substitution to export promotion, Thailand's manufacturing sector grew at an average annual rate of 8.6% during 1980–1989, compared with 4.5% for the agricultural sector. Most of this rapid growth took place after 1985 when the average annual rate of growth was 13.9% for the manufacturing sector and 4.1% for the agricultural sector. During the same period manufactured exports grew at an average annual rate of 29.63%. Similarly, the growth of manufactured exports accelerated after 1985 to an average annual rate of 30.16% compared with 9.94% during 1980–1985 (Wiboonchutikula, 1990).

The share of the manufacturing sector in GDP rose from 21.7% in 1980 to 24.7% in 1990, while the share of the agricultural sector fell from 20.6% to 14.4%. Thailand's role as an exporter of primary commodities has also diminished as exports of manufactured goods have grown. By 1987, manufactured exports made up 50.8% of the value of total exports compared to only 5% in 1970. At the same time the share of primary exports, which was as high as 89.5% in 1970, decreased to 48.3%.

Thailand's export market and import origin changed noticeably. Japan was the largest market of Thailand in 1980 and became even more important after 1985 absorbing 17.2% of Thailand's exports in 1990; her share declined in the latter half of the 1990s due to her weak demand relative to other markets. The United States market took over Japan as the single largest market of Thailand in 1990 and has remained so until now sharing about 20% of Thailand's exports. The EU's share in Thailand's export declined from 26% in 1980 to 16% in 2001. Similarly, the Middle East countries' share declined steadily over the last two decades. The ASEAN market, on the other hand, grew rapidly to take up nearly 20% of Thailand's export in 1995 but fell down to around 16% after the Asian crisis. Thailand's exports also tended to diversify to other APEC members including China, Taiwan, Hong Kong and Australia (Table 6).

With respect to source of imports, Japan has been the most important source. Her market share rose from 21% in 1980 to 30% in the first half of 1990s and fell to 27% in 2001. The market shares of the United States, EU and the Middle East countries all tended to fall while the ASEAN share rose. The market share of other APEC members, particularly China, Hong Kong, Korea, Taiwan and Australia also show increasing shares over the last two decades (Table 7).

The changes in market shares seemed to suggest regionalization of EU, ASEAN, APEC, and East Asia. It is observed also that Thailand has been involving more in intra-industry trade. The intra-industry trade index rose from 33.6 in 1985 to 63.2 in 1997. There were many industries where the intra-industry trade indexes rose considerably and became higher than 80 by 1997. The high intra-industry trade sectors included petrochemicals, machines and equipment and telecommunication equipment etc. (Table 8). The increase in intra-industry trade reflected greater trade-FDI relations, trade liberalization, and globalization participation of Thailand.

2.2. Source of GDP growth

The GDP growth of Thailand during the 1980s has been mainly attributable to capital accumulation and total factor productivity (TFP). There has been however a noticeable shift in the source of growth. In the late 1970s to the beginning of 1980s, the growth of the Thai economy was mainly originated from labour input especially improved quality of labour while TFP was declining. In the second half of the 1980s, the contribution to growth came mainly from capital accumulation and TFP (Table 9).

There were also some differences in the source of growth among sectors (Table 10). TFP played a more important role in the agricultural sector (25.7%) compared to other sectors such as the manufacturing sector (9.1%) and services and others (2.2%). Non-agricultural sector growth rates mostly resulted from expansion of factor inputs, most importantly capital for the manufacturing sector (55.5%) and labour for services and others sector (55.8%). It is noteworthy also that improved labour quality played a marginal role in the manufacturing sector (4%) compared with the agricultural sector (21.4%) and services and the other sectors (20.2%).

2.3. Source of Growth of Manufactured Export

The growth of manufactured exports of Thailand was phenomenal during the mid 1980s, equal only by China while Indonesia was a distant runner up. The success of these three countries was similarly attributable to their improvement in competitiveness in spite of unfavorable markets. In contrast, Hong Kong and Taiwan were losing their export competitiveness while other Asian economies had relatively small improvement in competitiveness (Table 11).

2.4. Changing Comparative Advantage

It can be observed from Thailand's revealed comparative advantage indexes of exports (RCAX) that during the past decade of the 1980s, Thailand has undergone changes in comparative advantage (Table 12). Thailand gained comparative advantage in base and crude materials products in the first half of the 1980s; but few of them continued to maintain or gain comparative advantage after the mid-1980s, although many still enjoyed above world average RCAX ($RCAX > 1$).

In contrast, Thailand gained comparative advantage in several products of higher–technology and higher–skill requirement such as machinery and transport products and miscellaneous manufactured products after 1985. Note also that, while Thailand's comparative advantage in apparel and clothing accessories remains above world average, there have been many items experiencing declining comparative advantage and few with increasing comparative advantage after 1985.

In comparison with other ASEAN countries, among Thailand's top 200 export items, Thailand is still more competitive than ASEAN average ($RCAX > 1$ where 1 is ASEAN average) in 166 items of which the competitiveness of 101 items have been declining relative to other ASEAN countries while 24 out of 34 below ASEAN average items have experienced increasing competitiveness (Table 13). Thailand appears to have still stronger competitiveness than other ASEAN countries in textiles and apparel, leather products, and consumer electronics. On the other hand, Thailand is less competitive than other ASEAN countries especially Malaysia and Singapore in computers and parts (Table 14).

2.5. Pattern of FDI in Thailand

Throughout the 1980s, FDI has become an increasingly important source of capital in Thailand. The continuing gap between saving and investment has necessitated inflows of capital to finance Thailand's economic growth. FDI as a percentage of total foreign capital inflows increased from 10% in the early 1980s to 30% in 1990. Over the same period, FDI as a percentage of total private investment increased from 3% to about 10%. During the domestic and international economic instability in the first half of the 1980s, FDI inflows to Thailand were small and variable. FDI inflows accelerate from 4,402 million baht in 1985 to a peak of 64,695 million baht in 1990, leveling off just around 50,000 million baht in the early 1990s. In that period the exchange rate of the baht was approximately 25 baht/US\$. Rising production costs and currency appreciation in Japan and the NIEs were major causes of these increased inflows.

The largest investors in Thailand have been Japan, the United States, the Newly Industrialized Economies (NIEs), and the EU (see Table 15). While the percentages have fluctuated from year to year, the NIEs accounted for 31.7% of total FDI into Thailand in 1992, with 27.1% from Hong Kong. Similarly, the FDI from the United States and Japan fluctuated between 9.5% - 53.8% and 13.8% - 43.2% respectively. In recent years, Singapore has also increased in importance as an investor in Thailand, with its percentage of total FDI increasing from approximately 6% annually in the late 1980s to over 41% in 2001.

FDI flows primarily into the industrial sector in Thailand, with electrical appliances, chemicals, and the metal based and non–metallic industry receiving the most investment (see Table 16). The industrial sector accounted for nearly 48% of total FDI in 1988 and 1989, declined to 17.2% in 1992 and rose to 35% - 65% during 1997–2000. The decline was not only in relative share of total FDI, but also in absolute terms across various industrial sectors, including electrical appliances, chemicals, food, textiles, metal–based and non–metallic, and machinery and transport equipment. This reflected a shift of investor's interest to

China which seemed to be more cost competitive for export industries and provided a large domestic market to penetrate while Thailand was experiencing rising wages and infrastructure bottlenecks. The renewed interest in the late 1990s was primarily to take over troubled firms in the crisis. During the late 1980s and early 1990s, the trade and construction sector have also had large inflows in selected years with trade receiving 20% of FDI in 1990, and construction accounting for 27% in 1992. Note that after 1990, only financial institutions, construction, services, real estate and mining and quarrying received increasing flows of FDI relative to FDI in 1990.

2.6. Determinants of FDI

An attempt was made to identify the determinants of FDI in Thailand for the period of 1970-1991³. The model adopted for this purpose is specified as follows:

$$FDI = F(GDP, TRR, EGKC, NTELP, EY, D*TRR, D*NTELP)$$

where	FDI	=	Amount of annual net FDI inflow
	GDP	=	Gross domestic product
	TRR	=	Average tariff rate
	EGKC	=	Electricity generation in kilowatt hours per capita
	NTELP	=	Number of telephone lines per capita
	EY	=	Exchange rate of the Japanese yen per US dollar
	D	=	Dummy variable being 0 for 1970–1985, and 1 for 1986-1991

GDP represents economic performance and market size of the host country which is an important consideration for investors and market induced FDI. TRR is included as a regressor to test whether the trade policy regime has any effect on FDI. A high TRR implies a protective regime, while a lower rate indicates a more liberal regime. Ideally, the tariff rate on finished goods should be distinguished from the tariff rate on intermediate and raw material inputs. The first represents the degree of protection in the host country. A higher rate should induce more FDI as implied by the oligopolistic and eclectic theories of FDI. (Kindleberger, 1966; Hymer, 1960; and Dunning, 1981) The latter imposes additional costs to producers. A lower tariff on intermediate and raw material inputs should therefore induce a greater amount of FDI. Due to time and resource constraints, such a separation of tariff rates was not made for the study. The average tariff rate was derived by dividing the annual tariff revenue by the correspondent annual import value. The average tariff rate so obtained therefore is the actual collected rate, reflecting some piecemeal liberalization in the form of import duty exemptions, rebates and refunds. Instead, a dummy variable is combined with the tariff rate to distinguish the effect, if any, after 1986 when FDI shifted to be mainly export oriented.

EGKC and NTELP represent infrastructure vital to FDI. The more readily available these infrastructure facilities and services, the more conducive the host country will be for FDI.

³ The material in this section is based on Pupphavesa, et al. (1994).

Since Japan and recently the Asian NIEs have been the major sources of FDI in Thailand and Southeast Asia, the exchange rate of the Japanese yen is included as an explanatory variable of FDI. The stronger yen shifted the comparative cost advantage from the home countries to host countries. The exchange rates of the Asian NIEs also rose during the same period as the Japanese yen, and therefore, can be proxied by the yen.

The empirical results in Table 17 show that GDP significantly attracted FDI, although at a rather low level of confidence. All other variables were found to have a statistically insignificant effect on FDI. However, there appeared some strongly significant differentiated effects of the tariff rate and electricity supply on FDI in the two periods before and after the mid-1980's. After 1986, the lower tariff rate and the increase in electricity supply has significantly induced FDI. This result confirms our expectation that a lower cost of input and the availability of infrastructure facilities are important to the export oriented FDI which has been predominant since 1986. The tariff rate could have a positive effect on FDI under an import substitution regime but be offset by a negative effect in the later period, resulting in a non-significant effect for the period as a whole.

Similarly, infrastructure might not be a crucial factor under the longer period of the import substitution regime, as the handicap could be compensated for by a protective tariff structure. Hence, for the period as a whole there would be a revealed non-significant effect on FDI. Similarly, the insignificance of the yen exchange rate variable might also reflect its lack of importance during the earlier yet longer period of import substitution.

An attempt to use panel data to explain the flows of FDI to the ASEAN countries did not yield satisfactory results. All variations of model specifications yielded rather low explanatory power and most explanatory variables were found to have an insignificant effect on FDI. However, variables representing infrastructure facilities, amenities and cheap labour appeared to have significant positive effects on FDI inflows (Pupphavesa, et al., 1994).

In conclusion, it is quite safe to say that the recent trend of FDI has been export oriented. Thus, an attractive environment for FDI in the host countries would be not only one that enhances the comparative cost advantages of these locations, but also that provides an adequate and convenient infrastructure network.

3. Government Policy

Initiated in the First National Economic Development Plan (1961–1966), Thailand's industrial development strategy placed an emphasis on promoting import substitution industries and using domestic raw materials. Despite continued promotion of import substituting industries such as those producing consumer durables and intermediate goods, a shift in policy was made in the Third Plan (1972–1976) to

promote export oriented and labour-intensive industries. Realizing that the persistently high levels of protection in the 1970s had bolstered inefficient import-substitution industries and discriminated against export industries, the drafters of the Fifth Plan (1982-1986) emphasized restructuring and improving efficiency and competitiveness in both the domestic and international markets. This policy continued through the Sixth and Seventh Plans (1987-1991 and 1992-1996).

The policy measures which affect international competitiveness can be classified into three groups: macroeconomic management, sector related, and others. Those adopted during the 1980s are discussed selectively below.

3.1. Macroeconomic Management

In order to maintain economic stability and to improve efficiency in resource allocation by reducing market distortions, Thai macroeconomic policy during the 1980s was categorically conservative and restrictive. The policy package included control of inflation through financial and fiscal discipline, and the reduction of distortions through exchange rate adjustment, relaxation of interest ceilings, and price liberalization on agricultural products, energy, and public utilities. Thailand's adjustment to the external shocks in the 1970s was initially delayed. The domestic price of energy was maintained at well below world market levels. Lacking proper price incentives, the campaign to conserve energy was ineffective and imports of high priced oil continued to grow. The trade balance deteriorated sharply and the current account deficit was exacerbated by a decline in service receipts following the closure of United State bases in Thailand at the end of the Vietnam war.

Public expenditures - particularly in the realm of massive infrastructure investments - increased sharply after the first oil shock, resulting in substantial fiscal deficits which needed to be financed by foreign loans. Consequently, Thailand entered the 1980s with large current account deficits (7 % of GDP in 1980), critically rising foreign debt-service ratios (to 18.7% of exports of goods and services in 1980). Domestic prices were seriously distorted by price controls and high rates of tariff protection. Because it was tied to the appreciating U.S. dollar, the baht was increasingly overvalued. And since the deposit and loan interest rate ceilings were lower than the rate of inflation, the real rate of interest turned negative.

a. Exchange Rate Adjustment

In response to these structural imbalances and price distortions, in April 1981, the government devalued the baht by 1.07%. Pressured by the panic purchases of U.S. dollars by speculators anticipating further adjustments, the government devalued the baht again by 8.7% in July of the same year. An emotional response by the uninformed public, members of Parliament, and the mass media forced the resignation of the finance minister. Since the baht remained tied to the U.S. dollars, the effect of devaluation was offset, however, by the appreciation of the U.S. dollar resulting in an appreciation of the effective exchange rate of the baht between 1980 and 1982. The original plan to unpeg the baht from the U.S. dollar was called off

because the business community showed strong opposition fearing further devaluations. It became necessary to temporarily maintain a fixed exchange rate, however it remained fixed for more than a few years (Uathavikul, et al., 1987).

The current account deficit deteriorated severely again in 1984 as a result of the overvalued baht tied to the appreciating U.S. dollar. The Bank of Thailand tried to curb imports by imposing a limit on the expansion of credit at 18% for commercial banks. While the current account did not improve, the credit rationing turned out to be unfavourable for small and medium size enterprises. This indirect measure was later dropped. Another devaluation took place in November 1984: this time the baht was decisively weakened against the U.S. dollar by 14.8%. Instead of remaining pegged to the U.S. dollar, the baht was also floated with a basket of currencies. Once again strong objections emanated from a key military leader putting political stability in doubt. However, better public relation this time swung public opinion in support of the needed adjustment. Thailand has been free of the problems of an overvalued baht temporarily.

This public acceptance of the exchange rate adjustment was an important turning point for Thailand. Public opinion, as observed through commentaries in the mass media, tended to equate the exchange rate devaluation with a depreciation of personal and national wealth. They thought that a devaluation meant inflation, and that the baht in their hands would have a lower value and thus they would become poorer. Devaluations were therefore almost a taboo subject for any government in the past to broach and were adopted only as a last resort. The variable exchange rate involving variable prices and the market mechanism was an important lesson for the public during the 1980s.

b. Price Adjustment

Another important correction for price distortions was the increase in domestic prices for energy and public utilities. The domestic price of oil was raised to a level more or less in line with the international prices. The price of electricity was raised by 17% in October 1980 and a further 16% in January 1981. Bus and train fares were also increased in January 1981. These price increases were necessary to reflect real costs, and to encourage energy conservation and improve the financial standing of the government and its state enterprises. The prime minister at the time, General Kriengsak Chamanamunt, was forced to resign amidst public opposition to the price increase, but the public has since learned to accept and adjust to the more accurate prices.

There remained strong resistance to allowing the market mechanism to completely determine prices, however. This is partially due to fears of oligopolistic power in the oil market, and given the importance of oil as an input for production and services, price fluctuations could have significant adverse effects on the economy. The government stabilized oil prices by placing taxes into an oil fund when imported oil prices were low and drawing from the fund to subsidize oil companies when imported oil price were higher than the set prices. Nevertheless, relative price distortions between diesel and gasoline were gradually corrected. It was not until 1991, that controls on the domestic retail price of oil were lifted.

c. Interest Rate Adjustment

Interest rate rigidity was another source of structural imbalance. Interest rate ceilings were imposed out of fear that the thought-to-be oligopolistic commercial banks would charge excessive rates of interest, as well as in an effort to promote private investment. High rates of inflation, however, caused the real rates of interest to be negative. The savings–investment gap therefore widened resulting in a greater dependence on external borrowing which in 1980 was more costly due to rising international interest rates. In response to this, interest rate liberalization was initiated through the introduction of a law empowering the minister of finance to vary the interest rate ceiling offered by commercial banks and finance companies. The ceilings for deposits and loans were raised by 3% points in early 1980.

During the 1980s, however, financial reform efforts concentrated on rescuing financial institutions experiencing difficulties, and strengthening the supervisory and regulatory framework. By the end of the 1980s, interest rate liberalization was then initiated as part of a comprehensive financial reform to support real sector growth, and to strengthen the efficiency of the financial system needed for international competition. Interest rate ceilings on time deposits with maturities of more than one year were lifted in June 1989, and in March 1990, they were also lifted for time deposits with less than one year maturity. Ceilings on loans were raised and freed later on further liberalization is also planned along with other aspects of financial reform.

d. Conservative Fiscal Policy

Mindful of critical levels of government deficit and external debt, the government tried to curb public spending and raise government revenues in various ways in the early 1980s. Current expenditures were restrained by freezing government pay scales from 1982 to 1989, reducing capital expenditures in successive budgets, and increasing prices for services of, lowering investment in, and imposing limits on the external debt of public enterprises. The government also tried to increase tax revenues by increasing import duties and excise taxes, introducing an exit tax for residents traveling abroad, increasing the tax base for income and corporate taxes, and improving tax administration and collection.

These effort were not adequate to reduce the government deficits in the early 1980s due to the rising interest payments on public debt, the tendency to overestimate government revenue, and the lack of flexibility in scaling down expenditures after they were budgeted. Conservative estimates of revenues have been adopted since 1986 and have helped to check budget expenditures and a bias towards fiscal surplus has followed (Robinson, et al. 1991, p. 14).

Government revenues expanded from less than 16% of GDP during the first half of the 1980s to nearly 20% by the end of the decade. This tax revenue buoyancy came about in spite of the elimination of most export taxes in 1985 and a downward revision of corporate and income tax rates in 1986. Revenue increases derived mainly from a growth in business taxes (due to economic growth in the second half of

the decade, as well as to the shift in output from agriculture to manufacturing), the income and corporate tax bases, and the share of imports in GDP increasing the tax elasticity.

During the same period, government expenditure as a proportion to GDP declined from nearly 20% to about 15%. The decline resulted from a tightening of current expenditures on government wage bills and spending on goods and services, and a reduction of interest payments following successive fiscal surpluses resulting in declining government debt. Capital expenditures were also reduced by scaling down and rescheduling major planned government investment projects. Fiscal policy was essentially counter cyclical through most of the 1980s as a result of both discretionary policies and automatic stabilizers (Robinson, et al., 1991, p. 16).

The conservative fiscal policies did have some costs. The cuts on government investment project resulted in infrastructure bottlenecks during the high growth period of the late 1980s. This began to erode Thailand's international competitiveness. The restraints on government salaries also made it difficult for the government to retain and recruit qualified personnel. The flip side of this issue is, however, that with more highly competent officials and university graduates turning to business. The private sector has become stronger and is in a better position to play the leading role in industrialization and development of Thailand.

e. Conclusion

The solid macroeconomic management helped improve Thailand's international competitiveness in various aspects. The exchange rate adjustment significantly reduced the existing bias against and therefore boosted up Thai export competitiveness. This was especially the case for manufactured exports the demand for which tends to be relatively price elastic. The macroeconomic stability led to lower risks and costs for foreign and domestic investment alike. The interest rate liberalization enhanced the mobilization of domestic savings, rationalized investment decisions, improved the allocative efficiency of capital and labour, and hence led to better exploitation of Thailand's comparative advantages in terms of both the industrial mix and the choice of technology. The liberalization of energy prices has encouraged conservation and improved the efficiency of energy utilization.

The sound macroeconomic policies alleviated various problems experienced in the first half of the 1980s, and set the stage for Thailand to take off and take utmost advantage of the favourable external environment in the second half of the decade. The growth of Thailand's real GDP rose from a rock bottom of 3.5% to a peak of 13.2% in 1988 and remained high in later years, while inflation stayed low at around 6% or lower. The unemployment rate declined to below 4% in 1989. Gross national saving rose sharply from around 23% in the mid-1980s reaching 33% in 1990. The public sector deficit of 6.0% of GDP in 1985 turned to a surplus of 4.3% in 1989. The current account deficit declined while the balance of payment surplus rose. By the end of the decade, Thailand's foreign exchange reserves accumulated to

the equivalent of 5 months of imports of goods and services. The country's external debt was reduced from 46.5% of GDP in 1985 to 32.9% in 1989 and the debt–service ratio was reduced from 27.5% to 13.0% during the same period.

3.2. Sectoral Policy

Two major policies have affected sectoral competitiveness: 1) trade and industrialization policy reflected in the structure of protection, and 2) investment promotion policy.

a. Tariff and Trade Policy

Thailand has been an economy for quite some time. Despite its import substitution industrialization strategy adopted in the late 1950s, the country's tariff rates, which ranged from 15–30% and served as a major trade policy instrument, were relatively low compared to most other developing countries. Surprisingly, while there was a policy shift during the 1970s toward a greater export orientation, tariff rates were raised substantially to counter balance of payment problems. This was also accompanied by exemptions, surcharges, and non–tariff barriers on various products. The result was a doubling of the average effective rate of protection over the decade (Robinson, et al., 1991, p. 27).

In 1982, an effort was made to reduce the dispersion of the tariff rates; with the exception of a few luxury items including automobiles, the maximum rate was reduced to 60%. However, for revenue reasons, a surcharge of 10% - later raised to 20% - was added temporarily; by the end of 1984 all but a few products were free of a surcharge. Again for purposes of raising government revenues, in 1985, tariff rates on raw material and intermediate goods were raised by 5%, and by 10% for finished goods. As shown in Table 18, this resulted in consecutive rises between 1981 and 1985, in both weighted and unweighted average nominal tariff rates from 14.3% to 18.5% for the former and from 31.0 to 33.8 for the latter, except for slight drops to 15.3 and 29.9 respectively in late 1984.

The dispersion of tariff rates was reduced slightly over the period from a standard deviation of 30.1 to 27.3. The unweighted average effective rate of protection, however, declined slightly from 66.7% to 65.9%. On the other hand, weighted average effective rate of protection rose from 27.9% to 30.0% accompanied by a reduction in the dispersion from a standard deviation of 140.2 to 132.0 during the same period. Due to various tax exemptions on imported raw materials, intermediate inputs, and capital goods under export promotion and investment promotion schemes, collected import duties were much lower than the nominal weighted average rate. They did, however, rise from 9.51% in 1981 to 11.84% in 1985 but declined to 8.7% in 1992.

The tariff structure however remained escalating in nature. In other words, the average level of tariff protection was relatively low for raw materials and relatively high for finished products, increasing

according to the degree of processing of the product. The protection structure strongly favoured the manufacturing sector over agriculture and production of other primary products (Table 19). It also had an inherent anti-export bias (Table 20). The degree of the bias apparently increased over the decade; while the effective rate of protection for export oriented industries increased by less than 2% points from 9.40% in 1981 to 11.0% in 1987, the import-competing industries enjoyed an increase in their effective rate of protection of 8.30%. Thailand's nominal tariff rate was higher than those in Indonesia, Malaysia, Philippines and Korea although the country's non-tariff barriers - quantitative restrictions included - were relatively low (Bhattacharya and Lin, 1988).

Trade policy, therefore, hindered rather than enhanced Thailand's international competitiveness and globalization during the 1980s. The export boom and export-led growth were possible in spite of this anti-export bias due to partial reductions of, or compensation for distortions through export and investment promotion mechanisms - the second of the two major policies mentioned above.

b. Investment Promotion Policy

Investment promotion has been an important instrument for industrial policy since the establishment of the Board of Investment (BOI) and enactment of the Investment Promotion Act in 1960. The BOI is empowered to provide fiscal incentives and non-fiscal privileges and services to investors. The fiscal incentives consist of deductions of, or exemptions from various taxes - especially business and income taxes, and import duties - and also temporary but renewable import surcharges on competing imports. The initial investment promotion policy emphasized import substituting industries. The shift to export promotion began in the 1970s. Under the Investment Promotion Act, amended in 1977 to provide more incentives to export industries, export oriented projects receive priority status for promotion and may receive preferential fiscal incentives additional to those received by non-export oriented projects. The preferential incentives include longer periods of corporate income tax exemption, and exemptions from import duties and business tax for raw materials and intermediate inputs used in the production of exports or re-exports. Foreign investors may own 100% of the promoted projects if they export 80-100% of their output.

The proportion of export oriented projects to the total number of BOI promoted projects increased rapidly in the 1980s from 37.1% in 1983, to 77.3% in 1987, before declining to 59.4 in 1990. The share of investment in export oriented projects also peaked in 1987 at 66.2% of total BOI promoted investment. The proportion of the amount of investment in export oriented projects fluctuated widely due to variations in project size. The absolute number of BOI promoted export oriented projects and the amount of investment in such a projects, however, peaked in 1988 at 1,057 and US\$ 4,518.8 million, respectively. BOI promoted projects were relatively diversified and consisted mostly of labour-intensive industries such as food processing, textiles, electrical machinery, rubber products, plastic products, leather products, and footwear, and miscellaneous products including jewelry, toys sports goods, etc.

The BOI's role of improving the international competitiveness of Thai manufactured exports was designed mainly to provide promoted firms with relief from the heavy burden associated with tariff protection on capital and intermediate goods, as well as to provide income tax exemptions. Since the application of BOI incentives were made on a case by case basis, the impact was limited to only those which operated under BOI promotion.

It has been estimated that the taxes forgone as a result of exemptions from import duties under BOI promotion schemes constituted about 2% of total exports of relevant projects in 1986 and about 5% in 1989 (Akrasanee and Wiboonchutikula, 1992, p. 24). This can be interpreted as an approximation of the enhancement of price competitiveness for promoted projects. A caveat for this interpretation, however, is that since promoted firms must go through cumbersome - and thus relatively costly - procedures to claim their benefits, the realized gains in competitiveness may be 1 to 2% points lower. Our interviews with managers support this assertion.

A significant portion of BOI promoted investment in the late 1980s was foreign direct investment originating in Japan and the Asian NIEs - particularly Hong Kong and Taiwan. These investments were an effort by investors from these countries to relocate their labour intensive export industries to Thailand since their own economies had lost their comparative advantages in such industries due to their rising wage rates and appreciating currencies. The contribution made by BOI-promoted export oriented projects to Thailand's export growth in the 1980s was not significant, however, because the majority of these projects received their promotion between 1987 and 1989. About 60 to 70% of these promoted projects probably reached the operations stage (Pupphavesa, et al., 1991). Almost one half of those reaching the operations stage probably exported as planned only in 1990 or later when they reached full operation. Therefore there is much more behind the growth of exports in the 1980s than just BOI investment promotions.

c. Other Export Promotion Measures and Facilities

Other export promotion measures include export processing zones (EPZs), bonded warehouses, tax rebates, tax refunds, and export credits, all (except the last one) designed to relieve export producers from the burden of import duties on their imported raw materials and intermediate inputs. These measures resulted in cost reduction for exporters ranging from an average of 4% of export value in the case of tax rebates to as high as an average of 64.4% in the case of EPZs depending on imported inputs which were subject to different tariff rates. The application of these measures ranged from 0.22% of total export value in the case of EPZ to 39.9% of total export value in the case tax refunds depending capacity limitation of the measures.

d. Conclusion

The growth of Thai manufactured exports in the 1980s occurred despite a biased tariff structure. The bias has partially been offset or compensated by various policy instruments each of which require, however, that the individual firm make official requests or applications. Costs to both the government and to the private beneficiaries have resulted from the often lengthy procedural requirements. Furthermore, the benefits are limited in scope and depend on the judgment and cooperation of government officials. In effect, the compensations have not fully offset the loss in competitiveness caused by tax distortions. The corrective measures have also favoured large scale firms and exporters whose marginal cost savings have been substantial due to factors of scale. At the same time, smaller firms have generally been deprived of their rights to receive the benefits since their marginal gains have not sufficiently justified the cost of their participation. The efficiency and effectiveness of these compensation measures will likely deteriorate as the number of eligible exporters and the volume of exports grow and become unmanageable. In spite of the limited degree of compensation and export coverage, these piecemeal efforts have helped to strengthen the competitiveness of Thai exporters under the unfavourable tariff structures in the 1980s. They, however, could not be relied on for the future growth due to their obvious limitations.

4. Social Development

With trade, Thailand has been quite successful in promoting economic growth and development. Thailand had enjoyed a relatively steady growth of about 7% per year over the last four decades until/except of the recent economic crisis. As shown in Tables 21, 22 and 23, Thailand's per capita income rose steadily from 18,404 baht in 1983 to 77,632 baht in 2000. Structural transformation from the predominantly low income–low growth agricultural sector to modern high income–high growth manufacturing and services sectors has been continuous both in terms of employment and output. The unemployment rate has been quite low at 3% or lower. The rate of aggregate saving rose from 22.2% of GDP in 1980 to 35.6% in 1995, while capital formation increased from 30.4% of GDP to 41.9%.

The quality of life of Thai people has improved tremendously. Adult illiteracy was reduced from 10.7% to 4.7% during 1983–1999. Health care services and facilities availability were almost double while access to transportation and telecommunication increased manyfolds. Life expectancy has been stable at 68 years over the last decade. The rate of growth of population was reduced to 0.75% per year.

While trade has helped to reduce poverty, it failed to reduce the income gap. During the last decade when globalization was accelerated the income disparity as measured by the Gini Coefficient remained high and even increased after the crisis (Table 24). In a more rigorous study, Israngkura (2001) found that income generated from globalization would worsen income distribution in Thailand because the economic structure of Thailand would channel the benefits more to the higher income families. The structural factors that would worsen income distribution were identified as education inequality, unequal credit accessibility,

and market concentration of industries. He also found that globalization of the agricultural sector would have less inequality impact than globalization of non-agriculture (Israngkura, 2001). Another study by Pupphavesa et al. (1995) also found that agricultural liberalization under the Uruguay Round would worsen the rural poverty in Thailand as the rural workers would suffer from the higher cost of living. Another study, in addition, supported that education made significant wage differential such that globalization which favours educated workers would lead to more income inequality (Patamasiriwat, 2000).

Government policy and measures tended to aggravate income inequality among regions as well as among income classes. Centralization in the public sector implied discrimination in favour of central region and against provincial and rural areas. Government expenditure tended to concentrate in infrastructure investment in Bangkok and its surrounding area favouring high income groups. On the other hand, the overall tax effect has been regressive, despite a progressive income tax structure. Investment promotion have been biased for big business and hence equivalent to penalizing SMEs and consumers. The Government Saving Bank plays an important role in mobilizing rural savings to finance government and state enterprise investment projects.

Despite the export promotion policy, the custom tariffs structure still maintains high and uneven protection to domestic producers. Export producers however get tax rebates, refunds, or exemptions of import duties on imported inputs. As shown in table 25 the collected import duties constituted only about 3% of the total import value while the simple average tariff rate is as high as 17% indicating a substantial magnitude of tariff exempted imports. The measure is, however, discriminatory against SMEs and domestic consumers as well as discouraging decentralization of industrial location. Evidently, the income inequality increased in favours of Bangkok and nearby provinces and some provinces in the East and South and against the North and Northeast provinces. (Patamasiriwat and Pachoe, 1999)

5. What Went Wrong

Despite warnings by some analysts after the Mexico's financial crisis that Thailand would probably face a similar problem, most Thai people could hardly believe that it would actually happen. It was beyond imagination indeed that Thailand would so suddenly get into this deep crisis of 1997. Once certain information were revealed and put together, the sudden crisis became so obvious although it could have been avoided or averted. The crisis needed not be this deep, should the early curing measures have been correct and timely and the subsequent measures adequately flexible and comprehensive. Political economy also played an important role in the depth of the crisis and the pace of recovery. Thailand's economic crisis offers an excellent lesson in economic management in a globalization era.

The crisis setting could be traced back to the economic boom period. It might be argued that mishandling of the economic boom led to Thailand's economic crisis. Furthermore, mishandling of the crisis has led to

a much deeper and more severe crisis than necessary. Following the successful implementation of financial and fiscal discipline and various macro- and micro-economic policy adjustments including foreign exchange regime change, price liberalization in various commodities and public utilities such as rice, casava, sugar, rubber, oil, electricity, water supply, and public transport, more aggressive export oriented industrial policy, privatization of some state enterprises, and deregulation and decentralization of public administration, the Thai economy rapidly recovered from the severe current account deficit, foreign debt crisis, and economic stagnation in the early 1980's and leaped forward to becoming a highly dynamic economy in the region and the world in the second half of 1980s. With perceived strong economic fundamentals and political stability, Thailand attracted enormous flows of foreign capital from investors seeking competitive production location for the world market and a fast growing domestic market. There were some important concomitant changes in Thailand that lent the economy more vulnerable to instability.

First the changes in socio-economic-political conditions had gradually but persistently brought about a deterioration in the quality of governance in Thailand. Certain Asian values and particularly Thai values as well as the change in the value system also played an important role in this process of governance deterioration. The economic boom in the late 1980s had brought many of these changes in the socio-economic-political conditions and the value system that worsened the governance while hiding as well as accumulating the economic vulnerability. In stead of being a miracle, the boom was the beginning of misery.

Good governance calls for public participation, honesty and transparency, accountability and political legitimacy in the decision making process and the implementation of public policy. The policy decision must serve the public interest. Good governance would provide for a fair legal framework and efficient and effective public services (World Bank, 1994; Sopchokchai, 1998). The past socio-economic-political development tended not to be conducive to good governance. Such development reflected as well as affected some Thai social values.

One of the reasons for the governance problem was the weakening of the Thai bureaucracy and technocracy (Siamwalla, 1998). In the old days, Thai people placed highest occupational value to government officials. Government official served the King and governed the people. Being a government official was to be a boss or a master (Jaw Kon – Nai Kon) of the people. Thai people invested in their children's education to become government officials. Competitive government salaries plus most generous fringe benefits, job security and prestige attracted the best minds to fill up the government posts. The Thai bureaucrats and technocrats had, therefore, been the brain and the driving force of Thailand's development. The bureaucrats and technocrats had also provided a high degree of policy stability and continuity despite frequent changes of government due to coups d' etat or elections. Government after government relied on the strong and competent bureaucrats and technocrats to formulate and carry out public policy and administration. High ranked bureaucrats and technocrats were often appointed to ministerial posts in various governments. Rapid private sector growth, however, began to bid away

competent persons from the government sector. During the last two decades, new young graduates became more interested in joining private business for better income and greater opportunities and challenges. Many competent junior and senior government officials also fled from the boring bureaucratic system of red tape, rigidity, patronage, hierarchy and low pay in the government sector to enjoy the greater challenges and higher return in the more flexible, dynamic and merit-based rewarding private sector. This had been reinforced by budget constraints and the policy to improve efficiency in public administration by limiting the growth of government employment at 2% per year. However, government salaries had been rarely adjusted to keep pace with the growth in private sector salaries and inflation and become a disincentive for government officials to improve efficiency. Prestige alone could no longer attract the best minds to join the public sector. The occupational value had gradually changed. The prestige of government officials was on a decline. A government official was no longer a “boss” or a “master” but a public servant in the eyes of modern, educated Thai people, although many government officials still act like “masters” in the provincial and rural areas, especially in their relations to the poor and uneducated people. More and more people regarded those who remain in or just join the public sector as less competent and less motivated than those in the leading private corporations.

Since the mid-1980s, elected politicians have gained more political power as Thai people demanded more democracy. To most Thai people, democracy meant election of the government, policy makers, leaders, and public administrators. The elected politicians claimed their rights to act on behalf of the people. They claimed that they knew the people’s problem and the answers to those problems better than the bureaucrats and technocrats. They intervened in the movement and promotion of government officials at various levels for the sake of compliance to their policies. The real reasons for such interventions were wide ranging in motives, including patronage of relatives and friends, returns of favours to political supporters, facilitation of corruption attempt, and even money-for-post deals, etc. Consequently, the bureaucratic system was undermined and weakened and, hence, the problem of governance proliferated.

After the mid 1980s, many countries entered into an economic growth race. Political leaders fell into the misconception of international competition in exports, international investment and globalization (Krugman, 1996). Thailand’s political leaders were no exception. Their leadership and visionary images were projected and tested by the economic growth records of their administration. Until now, the late Prime Minister Chatichai Chunhawan is still regarded by most people and mass media in Thailand as the best leader with respect to economic performance for the highest economic growth record of 12–13% during his regime and for his policy statement of “turning the battle field into the market place”. Just a few people would question his policy mistakes of creating economic instability, overheating, and excessive spending.

There tended to be mutual interest between big business and elected governments in Thailand. Big business provided financial support to political parties and politicians and received favourable government policies, treatments, and concessions to their business. The big business’s interest was mistakenly

perceived to be the public or national interest. This was one source of the governance problem - incorrect identification of public or national interest.

Thai elected politicians were also in favour of high economic growth because high growth meant big government spending and hence greater opportunities to allocate a substantial amount of budget to their constituency and greater chance to win the next election. Big budgets also meant big and many projects to award the politicians, relatives, friends, financiers as well as big kick-back money and commission fees. Therefore, in time of excess demand inflation, the government failed to use appropriate fiscal policy, i.e. cutting down government expenditure and instead adopted a high interest rate policy which was destined to fail under a fixed exchange rate and free external capital movement regime. There was a clear case of technical error in policy decision-making, another source of the governance problem.

The high growth bias implied a downward bias in the cost of risk and instability and thus was associated with over-confidence, over-optimism, over-investment and over-consumption. This then created excessive capacity, excessive trade deficits, excessive domestic and external debt. The crisis has then revealed that the damage was widespread across the economy beyond those who were directly involved in the risk taking decisions, i.e. the social cost much exceeded the private cost of risk. This constituted another governance problem - inefficiency caused by a downward bias in the cost of economic instability. The excessive investment and consumption could as well reflect the shift in values of Thai people from content to greed, from prudence to risk, from debt free to indebtedness, and from saving to consumption.

The private sector also had its own problem of governance. Big corporations had grown from family business and remained more or less family business although becoming registered public companies with appointed professional and distinguished persons to the management and the board of directors. The professional management and the board seemed to be accountable to the family owner rather than to all stakeholders. There were lack of transparency and disclosures in the companies' management and financial status. There were a number of conglomerates and holding companies with some of their subsidiaries registered in the Stock Exchange of Thailand. It was curious that the major shareowner could transfer profit between the registered and the unregistered subsidiaries to influence the stock prices of the registered subsidiaries. There were inside trading by managers and directors in the stock market and personal benefit was disguised by various complex systems (Todhanakasem, 1998).

Some big businesses had close relationships with certain political parties while some others diversified their associations and contributions among several political parties to take business advantage or to protect themselves from unfavourable treatment. Some corporations bought their executives out of the government regulatory agencies to take advantage of their insider knowledge and connections. Based on close relations with the ruling political parties, some corporations had made giant investment projects in uncompetitive industries under high protection and strong investment incentive measures justified by strategic industry arguments. These big investments were financed by unhedged short term-roll-over foreign debt. These corporations had probably caused the government's reluctance to devalue or float the

baht, but had suffered severely from the baht depreciations and became major non-performing loans (NPLs). Some owners of these corporations were Senators and members of the Senate Ad Hoc Committee on Economic Crisis Correction Monitoring. One of them became so infamous by his public remarks of “no pay, no talk, no escape” on his NPL. These Senators often made public statements criticizing the government measures to solve the economic crisis. They strongly opposed the Bankruptcy Law and trade liberalization on their product of interest. This made a necessary compromise on government measures to solve the crisis more difficult.

Second, although the real sector liberalization policy was in progress, the government chose to do it partially, gradually, and selectively rather than transparently across-the-board. Export industries were given exemption of import duties on machineries, raw materials and parts and components used in the processing of exported products. Certain upstream industries such as petrochemical products and steel were considered strategic industries to be promoted and therefore provided with strong tariff protection. That was costly to downstream industries where Thailand had comparative advantage. As other countries reduced import duties on upstream industries sooner and deeper, the competitiveness of Thai exports eroded. A distorting structure of protection also gave incentive to invest in the uncompetitive industries. As foreign capital became cheaply available following the liberalization of the external capital account, enormous amounts of foreign debt was created by these sectors especially petrochemicals and steel resulting in considerable excess capacity and prolonged protection that undermined competitiveness of the entire industrial sector. Credits to these particular sectors later became the largest NPLs accounting for about 2 million million baht.

Third, trade and investment competition become excessive and mistakenly adopted by politicians to be of national interest. The Board of Investment actively competed for foreign direct investment by offering generous investment promotion incentives. The major incentives included import duties exemption on machineries and imported inputs together with corporate income tax exemption and reduction for an extended period of time up to 8 years, plus accumulated losses deductible for 5 more years after the tax exemption/reduction period. This incentive package provided strong a incentive to transfer-pricing abroad. The higher over-pricing of imported inputs (with duties exemption) and the greater underpricing of exports, the larger the accumulated loss for tax deductible in the later years. The overpriced imports could get by unnoticed and often used as reference prices for import duties assessment on those similar items used for domestic sales. This indeed undermined the seeming protection for those producers who used these inputs but sold their products in the domestic market and created severe unequal competition between the promoted producers and the non-promoted producers in the same industry. It was suspected that such transfer-pricing might be widely practiced, which resulted in ever enlarging trade deficits while concealing its negative effect and the real trade deficit problem by the notion that the deficit due to large and rising imports of machineries and inputs would be soon covered by exports made of these imported inputs. The international competition in exports and foreign direct investment in various strategic industries might have led to over-investment and excess capacities region-wide.

Fourth, ambition to make Thailand a financial and trade centre in the Indochina region, together with a sincere belief that foreign exchange and financial liberalization would greatly improve Thailand's economic efficiency and welfare led the Thai monetary and finance authorities to implement the liberalization and deregulation plan including setting up the BIBF. This then facilitated and encouraged large and fast inflows of foreign capitals. The domestic financial market liberalization and re-regulation, however, failed to keep pace with the external market liberalization and deregulation. Availability of enormous amounts of cheap foreign capital together with still a rigid, limited, and small domestic money and capital market resulted in excess liquidity in the formal progressive market that was followed by prudence relaxation, over-investment, less-productive investment, and speculative investment. Meanwhile, there still existed great opportunities for good investment in many SME business and in provincial areas that were inaccessible to this cheap capital. The interest rate in the informal market remained as high as 5% per month.

Moreover, the growing stock prices indeed became regarded as a thermometer of economic temperature. The government and the regulating authority tended to intervene on the downside and thus created an upward bias that was favourable to speculative investment. In addition, securities and finance companies were important registered companies. Their performance and stock prices, however, correlated highly with the stock exchange activities and hence aggravated the instability in the stock exchange market in Thailand.

Fifth, the liberalized capital movement policy would have called for macroeconomic management adjustment. Large inflows of foreign capital would create strong inflationary pressures and large trade deficits. Government budget cuts would be a necessary and appropriate measure to cope with inflation. The government, however, continued to increase the budget and thought that balanced budgeting was an adequate disciplining policy. It turned out that the government spending increased from 13–14% of GDP to 18% of GDP and doubled the absolute size in a few years. In stead, maintaining high interest rates was the main instrument to cope with inflation and hence resulted in a vicious circle of capital inflows–inflation and trade deficit–high interest rate, as the exchange rate was almost fixed to the US\$. A flexible exchange rate would to some extent work as an automatic stabilizer of capital inflows and against such divergent imbalance.

Sixth, failing to control inflation effectively, given a fixed exchange rate implied over-valuation of the baht. Although the inflation was only about 7–8%, it was high relative to inflation in Thailand's major markets and export competing countries. Thailand's export competitiveness, therefore, was eroded by this factor.

Finally, the investment boom together with inflationary pressure rapidly pushed up the wage rate. The competitiveness of Thailand in labour intensive industries consequently eroded. On the other hand Thailand was too slow in upgrading technology and labour skills to take up the room left by the more advanced economies such as Korea, Taiwan, Hong Kong and Singapore. Furthermore, infrastructural

bottlenecks and inefficient state enterprises providing utilities and supporting services also contributed to higher producer costs than necessary.

In short the Thai economy was indeed structurally and fundamentally in trouble. The troubles were from various different angles and not getting adequate attention. There could have been more time to correct and avert the Titanic crash, should the insolvency of a small commercial bank be corrected appropriately and timely. The insolvency of the bank was due to banking misconduct, mainly giving credits in large amount without adequate collateral and protection, inflating the value of the collateral assets. The problem was an individual bank problem, not a systemic problem of the financial system. It could have been liquidated quickly after write-off. In stead, the Financial Institution Development Fund (FIDF) tried to bail out the bank without write-down and in that attempt lost some 60 billion bath. Once the problem was publicly exposed, the loss of confidence in the financial system began. Foreign creditors then started to pull out.

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APPENDICES

See Tables 1 to 25 :

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