PROGRAM & ABSTRACTS

Bangkok, Thailand
October 28-29, 2002

International Conference on

ECONOMIC RECOVERY and REFORMS

CO-ORGANIZED BY

THE FACULTY OF ECONOMICS, THAMMASAT UNIVERSITY, AND

THE BANK OF THAILAND

PROGRAM

MONDAY, OCTOBER 28, 2002

08:30-09:00 Registration

09:00-09:30 Opening Speech by His Excellency the Prime Minister of Thailand

09:30-10:30 Keynote Speech on

"Financial Market Failure: Problems, Proposals and Prospects for Reform"

Barry Eichengreen,
Professor of Economics and Political Science,
University of California, Berkeley, USA

10:30-10:45 Break

10:45-12:00 Presentation of Country Papers on Economic Recovery and Reforms

- *Christer Gunnarsson,* Lund University, Sweden
- *Ehung Gi Baek,* Sangmyung University, South Korea

12:00-13:00 Lunch

13:00-14:45 Presentation of Country Papers (cont.)

- *Hadi Soesastro,* The Center for Strategic and International Studies (CSIS), Indonesia
- *Rogayah Haji Mat Zin,* Universiti Kebangsaan Malaysia
- *Edita A. Tan,* The University of the Philippines

14:45-15:00 Break

15:00-16:45 Presentation of Country Papers (cont.)

- *Shigeyuki Abe,* Kyoto University, Japan
- *Supote Chunanantathum,* Thammasat University

19:00-21:00 Welcome Dinner

- Hosted by the Thammasat Economic Association

- Dinner Talk by the Governor of the Bank of Thailand
  M.R. Pridiyathorn Devakula

TUESDAY, OCTOBER 29, 2002

08:30-10:30 Panel Discussion on

"Lessons Learned from the Asian Crisis: Prevention and Resolution"

- *Barry Eichengreen*
  Professor of Economics and Political Science, University of California, Berkeley, USA

- *Ejaz Syed Ghani*
  Lead Economist, The World Bank, Thailand

- *Takatoshi Ito*
  Professor of Economics, Research Center for Advanced Science and Technology, the University of Tokyo, Japan
  Visiting Scholar, Asian Development Bank Institute

- *Ammar Siamwalla*
  Distinguished Scholar, Thailand Development Research Institute Foundation, Thailand

Moderator: *Bandid Nijathaworn*
Assistant Governor, The Bank of Thailand

10:30-10:45 Break

10:45-12:00 Concurrent Sessions on

- Macroeconomic Stability 1
- Macroeconomic Stability 2
- Privatization and Decentralization
- Social Capital and the Environment
- Reforms and Development

12:00-13:00 Lunch

13:00-14:45 Concurrent Sessions (cont.)

14:45-15:00 Break

15:00-16:45 Concurrent Sessions (cont.)

Report

by Dr.Sukanya Nitungkorn
Dean, Faculty of Economics,
Thammasat University

Your Excellency the Deputy Prime Minister,
The Rector of Thammasat University,
The Governor of the Bank of Thailand,
Excellencies,
Distinguished Participants,
Colleagues,
Ladies and Gentlemen:

I would like to welcome all of you to the international conference on Economic Recovery and Reforms, which is co-organized by the Faculty of Economics, Thammasat University and the Bank of Thailand.

Ladies and Gentlemen:

Since the Asian economic crisis took place in 1997, we all realize that it has taken a heavy toll on the prosperity, stability and social well being of many countries in this region. Most nations are suffering from widespread business bankruptcy, abnormally high unemployment levels, acceleration of poverty incidence, and social problems.

Accordingly, governments and international organizations have collaborated to contain the impacts and revive the ailing economies. A number of measures have been introduced and implemented. While signs of economic recovery began to show, they are still facing many challenges on this path of recovery.

The purpose of this conference is, therefore, to particularly assess how well the affected economies are recovering from the crisis, and whether they will be able to sustain growths as they did in the past, or they need to embark new direction of development.

We do hope that the conference will generate fruitful ideas that are essential for formulating new strategies for the global sustainable development. Better understanding would be an important input for decision-makers to establish appropriate policies and strategies to deal with the crisis issues in various economic sectors more effectively.

It has now been the second time after the successful conference on "The Challenges of Globalization" that the Faculty of Economics of Thammasat University had organized three years ago.

The conference signals that the Faculty of Economics, Thammasat University, has stepped up increasingly to an international academic platform. Our staffs have, from time to time, joined and presented papers at international conferences held worldwide. More often, they are exchanged with scholars from oversea universities to either conduct researches or to give lectures. These are, all in all, opportunities to widen knowledge and to effectively achieve learning process among scholars from prestigious institutions around the globe.

Organizing the conference has required a great deal of commitment and perseverance. The conference has been successful in generating plenty of interest. The response to the call for papers was overwhelming, and our only regret is that we were unable to accommodate everyone who wants to participate.

I would like to thank all of the staffs at the Faculty of Economics and at the Bank of Thailand who have contributed such a hard-working task, and especially thanks to the conference-organizing committee for their efforts and dedication. This conference would have never been successful without you.

I would also like to extend my deep gratitude to those who kindly support and assist us for holding this conference. We received immense generous supports from many individuals and organizations, in particular, the Bank of Thailand, the Thammasat Economic Association, the Japan Foundation Asia Centre, the Sang Som Group, the Thai Airways International, the Asian Development Bank, the Thailand Research Fund, the Imperial Queen's Park Hotel and the FCB Worldwide Limited.

Once again, we are very thankful for your generous contributions in making this event a success.

Last, but not least, I would like to express my deep appreciation to His Excellency the Deputy Prime Minister, Dr. Somkid Jatusripitak, for accepting our invitation to preside over the opening ceremony of this conference.

Welcome Speech

by Dr. Naris Chaiyasoot
Rector, Thammasat University

Your Excellencies,
Distinguished Participants,
Ladies and Gentlemen,

It is my great pleasure to welcome you to the International Conference on "Economic Recovery and Reforms" organized by the Faculty of Economics, Thammasat University in cooperation with the Bank of Thailand.

The Faculty of Economics at Thammasat University has a long tradition of providing timely and thought provoking presentations. Since its establishment in 1949, the Faculty of Economics has consistently offered high quality academic programs, research and community service in Thailand and the region.

Over the years the Faculty of Economics has presented a number of international conferences, providing a forum for scholarly research and an opportunity for economists, business leaders and anyone concerned about the economic future of Thailand to come together and exchange information, opinions and hypotheses.

Congratulations to the Dean, to the entire faculty, and especially to the organizing committee of this conference for all of the time, energy and creativity that were certainly involved in making this event a success.

Certainly, we will be unable to find all the economic answers during this conference, but I do hope that with the collective wisdom of the insightful participants, presenters, and distinguished panelists, we will move steadily forward on the path toward recover and economic reform and hopefully, learn the valuable lessons to insure that history will not repeat itself.

I wish all of you a productive conference and very enjoyable and pleasant stay in Thailand.

Keynote Speech:

Making the World a Safer Financial Place[1]

by Professor Barry Eichengreen
University of California, Berkeley, USA

This is the time of year when the Boards of the IMF and World Bank meet to congratulate themselves on their progress in making the world a safer financial place. Thus, a few weeks ago Horst Koehler, the IMF's chief in command, gave a speech at the Council on Foreign Relations in Washington, D.C., in which he asserted that the IMF had accomplished much in its efforts to "promote financial stability and growth... [and] safeguard the integrity of the international financial system."

Statements like Koehler's are familiar. We hear them annually. But it would be understandable if listeners regarded them even more skeptically than usual this year. After all, this has been the year of the Argentine and Brazilian crises. It has been the year of Enron and Worldcom. It has been a year of much debate, but no real progress, in implementing the IMF's so-called "two-track approach" to more efficiently resolving financial crises.

Do Argentina and Brazil, together with Enron and Worldcom, suggest that the efforts of the IMF and the World Bank to better prevent financial crises are a failure? At a minimum, they raise questions about the efficacy of official approach. That approach has been predicated on the idea that greater financial transparency will allow markets to anticipate and head off financial problems before they occur. Investors will draw back more gradually and begin rationing credit to emerging markets before lending reaches excessive levels and financial sustainability is threatened.

Enron and Worldcom remind us that transparency is easier to advocate than to practice. Inevitably, clever chief financial officers can always stay one step ahead of the markets and the regulators. John Heimann of the Financial Stability Institute, the organization in Basel that trains bank regulators from emerging markets, calls this the problem of "bloodhounds versus greyhounds."

None of this is to deny that transparency is helpful. But recent revelations in the United States serve the useful purpose of reminding us that there are limits to how much can be achieved through this approach. Borrowers always know more about their own motives, and therefore about how they will use their borrowed funds, than their lenders. Information in financial markets will always be imperfect, in other words. Hence, there will always be unexpected developments, and violent market reactions to them. This is another way of saying that there will always be crises.

From this point of view, the Enron and Worldcom scandals are no surprise. What is surprising is that these revelations did not lead to a financial meltdown in the United States. There has been a flight to quality, but this has not resulted in the failure of a major bank or nonbank financial institution. The scandals have contributed to the decline of the stock market and the weakness of the U.S. recovery, but they have not led to a full-blown crisis like that of the 1930s. What was different in the 'thirties was that the collapse of the stock market was followed by the collapse of the banks and then by the complete and utter collapse of the economy. Today the banking system, to all appearances, is more robust, rendering the economy more resilient to shocks.

Thus, a key lesson of Enron and Worldcom is the importance of rigorous supervision and regulation of the banking system. Strengthened prudential supervision, it so happens, is another focus of the international policy community's crisis prevention efforts. But stronger bank regulation by itself is not enough. We once thought that Argentina had the best regulated banking system in Latin America, and look what happened there.

What happened, to be precise, was that problems of debt sustainability forced Argentina to abandon its pegged exchange rate, and the collapse of the currency then led to the collapse of the banking system because both banks and their borrowers had dollar-denominated liabilities. Argentina's banks collapsed despite the fact that they were well managed and strictly regulated. The conclusion I draw is that strict bank regulation is not enough. Limiting the currency mismatches on bank balance sheets is not enough, for

[1]The author is George C. Pardee and Helen N. Pardee Professor of Economics and Political Science at the University of California, Berkeley. The following is a keynote address to be delivered at the conference on "Economic Recovery and Reforms," Bangkok, 28-29 October 2002. The text draws on my book, *Financial Crises and What to Do About Them*, published by Oxford University Press this month.

example, if those mismatches are simply passed on to the corporate sector, placing the banks in jeopardy when corporations stop paying.

This is not a new observation: careful analysts already drew it from the Thai crisis five years ago. As this audience will know, Thai regulators had required the banks to match the currency composition of their assets and liabilities but allowed those exposures to be passed on to the corporate sector. This "solution" is now recognized as problematic. Unfortunately, we have been too slow to act on the recognition.

The most important action would be to ensue that bank regulation is consistent with the broader macroeconomic framework. Specifically, this means that emerging markets should float their exchange rates. Floating exchange rates are no panacea, but they make it less likely that a previously stable exchange rate will collapse. Gradual adjustments are easier for the financial system to handle. Moreover, continuous exchange rate movements encourage nonfinancial as well as financial corporations to hedge their exposures. Consequently, the private sector is less likely to experience a crisis when the exchange rate moves by a large amount. This is at least one reassuring aspect of events in Brazil, where the currency is weak and financial markets are turbulent but the banking system has so far stood the test.

The IMF has moved some way toward encouraging its emerging market members to embrace greater exchange rate flexibility. But it continues to view the choice of exchange rate regime as a matter to be decided on by individual countries as they please. By now we should have learned that the choice of exchange rate regime has important implications for international financial stability. The IMF should therefore be less ambiguous and more forceful in pushing emerging markets to float. For example, it should have pushed Argentina to abandon its currency board back in 1998.

Of course, a floating exchange rate and a well-regulated banking system have not sufficed to insulate Brazil from financial problems. Everyone says that Brazil's problem is electoral uncertainty. I disagree. There is no question that the new president, be he Lula or Serra, will stick by his commitment to the IMF to maintain a primary budget surplus of 3.7 per cent of GDP. No Brazilian president wants to be seen as responsible for Brazil going the way of Argentina. Even Lula will put other social and political priorities on hold in order to preserve financial stability.

The real problem in Brazil is growth. If Brazil grows by 3 per cent next year, then there is no reason why the government can't service its debts. A primary surplus of 3.7 per cent will do just fine. But if growth slows to, say 1.5 per cent, then that primary surplus will have to be raised to 4 per cent. If real interest rates go up to, say, 12 per cent, reflecting uncertainty about how the government will respond, then the primary surplus will have to be increased further, to 4.2 per cent. While the winner of the election, whomever he is, will stick with the present fiscal targets, it will be hard for him to demand yet additional austerity – that is, still higher taxes and still larger spending cuts. Thus, growth is key to the sustainability of the debt.

But here the danger of a double-dip recession in the United States raises questions about whether there will be a growing world economy for Brazil to export to. The looming war against Iraq further clouds the outlook for the world economy. If the world doesn't grow, Brazil won't grow. Capital inflows will then dry up. The country will have to shift 4 per cent of GDP into exporting and import-competing sectors, that being the size of the current account deficit that will have to be eliminated.

This kind of adjustment is easier for Brazil than Argentina, since Brazil is more open. But redeploying resources on this scale is still difficult. A large depreciation of the *real* will be required to send the requisite price signals. And therein lies the rub. A weaker exchange rate will worsen Brazil's prospects for debt sustainability even further because so much of the country's debt is short-term and foreign-currency indexed. Moreover, Brazilian banks hold about 30 per cent of their total assets (equal to about 300 per cent of their net worth) in government bonds. Thus, a sovereign default could be deeply damaging to the banks.

The implication is that countries should be more cautious about borrowing abroad until they can do so at long maturities, in their own currency, and without indexing their bonds to the exchange rate. They need to develop domestic markets in those instruments. Unfortunately, building markets in long-term domestic currency bonds is a long-term investment. It has taken countries like Chile and South Africa the better part of two decades. It has involved privatizing the pension system to create a market for domestic-currency bonds, and moving toward a more flexible exchange rate to limit the temptation to rely excessively on foreign-currency markets. It has involved building macroeconomic policy credibility and upgrading financial supervision, all of which takes time.

But doesn't borrowing less abroad in the meantime mean that emerging markets will grow more slowly? Doesn't clamping down on international financial transactions mean that their financial markets will develop more slowly? In this sense, the efforts of the international policy community to strengthen the international financial system will only make life more difficult for developing countries. Indeed, this is only one example of a more general point.

- More prudently managing capital inflows – opening the capital account more slowly, only after the trade accounts have been liberalized and markets in domestic-currency-denominated bonds have been developed – will enhance the stability of both domestic and international financial markets, but it will mean less foreign capital for domestic economic development.
- Revising the Basel Capital Standards to require international banks to hold more capital against to sub-investment grade credits will also strengthen the international financial system, but again at the cost of making it more difficult for emerging markets to borrow abroad.
- Encouraging emerging markets to float is good for the stability of the global financial system, but floating rates are particularly hard for poor countries with shallow financial markets to manage. When they float, they often have to pay higher borrowing costs.
- Finally, even enhancing transparency, while good for the stability of the international financial system, may make life harder for the poorest countries. Consider the following example. Think of a case where information is very imperfect and incomplete. I know only about the condition of the bank with which I do business but nothing about other banks. Then, when my bank experiences a problem, I rush to withdraw my money, but I have no particular incentive to run on other banks. Now add a little bit of information about what other banks have superficial similarities with the one with which I do business. Now when I see problems in my bank, I will also have an incentive to run on neighboring banks. Here a little bit of information is a dangerous thing; it makes financial markets more fragile. And the situation I have just described, where the information environment is highly imperfect, is plausibly a depiction of a low-income emerging market. Of course, this is nothing but a particular application of the general principle that economists refer to as "the theory of the second best." But it is an important reminder that, in attempting to make the international financial system more stable, we may also be making life more difficult for the poorest countries. In attempting to strengthen the international financial system, we may force these poor countries to first pass through an intermediate stage of heightened financial fragility.

The implication I draw is not that this crisis prevention agenda is misguided, but that it needs to be married to a significant increase in development assistance, targeted at countries that make real efforts to move in the directions recommended by the IMF to reduce the risk of global financial crises.

What about crisis resolution? There will always be uncertainty about the success of IMF packages, a point exemplified by Brazil. If there is a short campaign against Iraq -- a two week war that results in lower oil prices and a stronger world economy – then Brazil should be able to grow its way out of its problems and repay its loans. But that war could be more protracted. Thus, there is no guarantee that the IMF's package for Brazil will succeed. My own view is that the package for Brazil is a gamble worth taking, but it is still a gamble.

These kind of gambles require putting lots of money on the table to back up the presumption that the country's debt is sustainable. This is an unavoidable consequence of the growth of global financial markets, which are larger and more liquid today than ever before. The IMF hasn't had a quota increase since 1998, and it has much of its liquidity tied up in Argentina, Brazil and Turkey. Both Mr. Koehler, in his speech to the Council on Foreign Relations, and with Guillermo Ortiz, Governor of the Bank of Mexico, in an article published last week, have rightly concluded that it is time to think about more resources for the IMF.

But what about alternatives to bailouts? Specifically, what about the IMF's two-track approach to changing the way we respond to crises? The first track is to add restructuring-friendly provisions– so-called "collective action clauses" – to bond contracts. These would specify who speaks for the bondholders. They would require a critical mass of the bondholders, say 25 per cent, to agree before a lawsuit could be filed against the debtor. They would allow a qualified majority of the bondholders, say 75 per cent, to vote to change the financial terms of a bond contract.

With these provisions in place, the IMF could more easily refuse financial assistance to a country with serious problems of debt sustainability and instead let the borrower resolve those problems in direct negotiations with its creditors. Having specified procedures for restructuring problem debts at the time when the loan was made, the lenders and the borrower could more easily agree on how to write down and stretch out the debt. These clauses will not solve all problems, but they will at least reduce the pressure for the Fund to do what it did for Argentina in August 2001: to provide a loan to a country whose debt was already unsustainable in the vain hope that good news would somehow turn up.

Back then, the IMF and the U.S. Treasury were motivated by the fear that an uncontrolled default would have devastating repercussions for both the crisis country and the international financial system. Having collective action clauses in place would reduce these fears. They would make it easier for the IMF to say no.

Had the IMF said no to Argentina a year ago, the country would have avoided four additional months of agony in which the government depleted its international reserves, firms and households liquidated their bank deposits, and the government ran down its political capital. Argentina's default would still have been painful, but the complete and utter social disaster that followed might have been avoided had adjustment begun earlier.

The other approach to creating an alternative to bailouts would entail amending the IMF's Articles of Agreement to establish a Sovereign Debt Restructuring Mechanism, or SDRM. When that mechanism was activated, there would be a standstill on payments and a ban on litigation. The IMF or an independent tribunal would calculate the total amount of the country's external debt and convene a grand meeting of all the creditors, presumably in cyberspace, who would then take one great big majority vote accepting or rejecting the country's restructuring offer.

But why bother with an SDRM – wouldn't adding collective action clauses to each individual bond issue be enough? Wouldn't it be enough to clarify representation, impose thresholds for litigation, and permit majority voting, bond issue by bond issue? Or would the holders of Argentina's 88 bonds find it too difficult to cooperate with one another? Would it be too easy for vulture funds to buy 25 per cent of one of these 88 issues, enabling them launch a lawsuit seeking to attach Argentine assets and thereby causing the entire restructuring process to unravel? Would the need for 88 separate majority votes create an insurmountable obstacle to orderly restructuring negotiations?

History can shed light on this question, because there has existed an international bond market before, in the 19th century and the 1920s. That experience suggests that creditors, if left to their own devices, can solve these problems on their own. In response to earlier Argentine defaults, they did so by forming a bondholders committee made up of the representatives of investors in different Argentine bonds. Sitting together on such a committee, they effectively resolved their differences. Revealingly, there is now once again an Argentine Bondholders Committee, through which the holders of Argentina's 88 individual bond issues are coordinating their actions. It is worth noting in this context that an expert committee constituted by the Emerging Market Traders Association, the Emerging Market Creditors Association, the International Primary Market Association, and the Bond Market Association, among others, recently suggested that in the future individual bonds should include a clause authorizing the holders of each issue to appoint representatives to just such an omnibus committee, thus regularizing the process of committee formation. Thus, there is no evidence that the need for cooperation in negotiations cannot be achieved by the markets themselves.

Moreover, while there is considerable uncertainty about how an SDRM would work, we already have considerable experience with the operation of collective action clauses. More than a quarter of the international bonds issued by emerging markets – that quarter issued in London – already include the relevant provisions. The market is familiar with these clauses. It knows how to price them. In contrast, it will be much harder for it to anticipate the implications of an experimental statutory process. And greater uncertainty means higher costs for emerging market borrowers.

Recall that the IMF's proposal would involve a total ban on litigation. Investors would view this as a significant dilution of their rights. CACs, in contrast, would still permit litigation but require that a critical mass of the creditors would have to agree before taking legal action. It is the perception that the SDRM would weaken their rights that causes creditor bodies like the Institute of International Finance to oppose the initiative, and that causes emerging markets such like

Mexico and Chile concern about the impact on their borrowing costs.

The sensible approach is therefore to start by encouraging the more widespread use of CACs. If this doesn't solve the problem, then we can contemplate the next step, namely, a Sovereign Debt Restructuring Mechanism. The right way to proceed, in other words, is incrementally.

This leaves me skeptical about the advisability of proceeding on two tracks simultaneously, as the IMF and the advanced industrial countries are attempting to do. (Most recently, the G10 recommended pushing ahead with CACs, but also that the IMF should present a concrete proposal for implementing the SDRM at next year's spring meeting of the IMF and World Bank.) Pushing ahead with the SDRM raises fears that CACs are not an end in themselves, that they are merely a stalking horse for a more ambitious statutory initiative that would put the IMF at the center of the restructuring process and significantly weaken creditor rights. The fear, as Charles Dallara of the Institute of International Finance put it is that CACs would really be the first step down the slippery slope to the SDRM. While bankers and investors "say that they are more open on changing bonds, their cooperation is more or less conditional," as the *Financial Times* put it in an article on September 30th, "on the fund dropping the sovereign debt restructuring mechanism (SDRM), which they have disliked from the beginning."

The U.S. Treasury also supports the more widespread use of collective action clauses. However, it has so far limited its efforts to further their adoption to uttering a few encouraging words. And encouraging words by themselves are not enough. The markets reward countries with high credit ratings that employ collective action clauses, but they penalize sub-investment grade countries that do so by charging an additional risk premium. They fear that clauses which make renegotiation easier will also make renegotiation more tempting and therefore more frequent. Sub-investment grade countries will therefore have to pay higher borrowing costs. There was an article last week in the *Gazeta Mercantil*, a Brazilian newspaper, reporting how European officials had urged Pedro Malan, the Brazilian finance minister, and Arminio Fraga, the Governor of the Bank of Brazil, to include CACs in their bond issues. You will not be surprised that the Brazilians resisted, saying that now is not the time.

If it is correct that the more widespread use of collective action clauses would make for a more stable international financial system, then there is an argument for subsidizing their use. Countries that exchange old bond issues without CACs for new bond issues with them should receive subsidies for this purpose from the World Bank. In addition, national regulations should be revised to give more favorable regulatory treatment to banks and other investment companies that hold these bonds.

This approach is more likely to produce the desired result than simply relying on encouraging words. It is more likely to work than making the use of CACs in new bond issues a condition of IMF assistance. Obviously, it would not have helped to stabilize Brazil had the IMF made this a condition of providing additional assistance last month, given the questions that already existed about Brazil's credit worthiness. And financial incentives for countries in a strong position are more likely to work than simply requiring Argentina to include CACs in its restructured bonds, which the IMF will surely do when Argentina finally gets around to renegotiating its defaulted debt. Because the write-down of the old Argentine bonds will be very substantial, Argentina's restructured debt will not be big enough to create a liquid market in these instruments.

Let me conclude on a positive note, lest my review of official initiatives leaves readers thinking that I am even more critical than is the case.

Official efforts to prevent crises rest, as they should, on two pillars: market discipline and prudential supervision. Although neither can deliver the desired result by itself, together they can go some way toward making the world a safer financial place. Discouraging economic agents from taking excessive risks by ensuring that market participants realize that they stand to make losses as well as gains must be the first line of defense against financial crises in a market economy. But market discipline can work only if investors have the information necessary to form judgments and to act accordingly. Thus, efforts to enhance transparency and encourage information dissemination deserve their place of prominence in the pantheon of architectural reforms.

Information will never be perfect, and as a result adverse selection, moral hazard and market volatility will always be with us. The consequences, especially when they take the form of sudden changes in market conditions, may do damage to innocent bystanders and threaten the stability of the system. These distortions create a case for regulatory and macroeconomic-policy intervention to internalize externalities and preserve systemic stability. But the existence of this financial safety net is itself a source of moral hazard, since the knowledge that they are protected from some forms of failure will lead agents to assume additional risk. Supervision and regulation therefore must be thorough and rigorous to ensure that intervention creates fewer problems than it solves. The critics may quibble over design and implementation; they may disagree over the optimal balance between market discipline and prudential regulation. At some level, however, there is no disagreement that these must be the elements of an effective crisis-prevention strategy.

To the extent that crises spill across borders and threaten systemic stability, the international policy community has an interest in ensuring that all countries active on international financial markets enhance the operation of market discipline and strengthen prudential supervision and regulation. At some level, there is no dispute over the need for international standards as a focal point for its efforts. Standards provide a point of reference for national initiatives and a mechanism for the application of peer pressure. They provide a framework for the surveillance exercises of the multilateral financial institutions and insulate those institutions from the charge of arbitrary and capricious judgments. The dangers associated with this approach should not be neglected: they include limiting the incentive to do better, giving one-size-fits-all advice, and discouraging innovation and experimentation. But standards are preferable to denying the existence of an international interest in financial stability. They are the middle ground between the extremes of treating each country as unique and as seeing all national problems as cut from the same cloth.

The key to success, from this point of view, is to focus on standards that bear on institution and capacity building. If countries develop institutions conducive to transparency, for example by strengthening the rights of creditors who demand financial information, and develop the institutional capacity to effectively supervise and regulate financial institutions and markets, for instance by establishing independent regulatory agencies, then the specific decisions implemented by their markets and the regulations adopted by their governments can be left to their discretion.

The challenge is greatest for the poorest countries, which tend to be where that institutional capacity is least. Efforts to comply are likely to take the form of, say, adopting an insolvency statute that conforms with international principles rather than strengthening the independence of the judiciary responsible for enforcing it, since the latter is likely to be immensely harder. In some cases, the relevant practices can be imported rather than grown at home. Auditing and accounting capacity can be imported by requiring firms to employ international accounting firms. Supervision and regulation can be imported by selling off financial institutions to foreign banks. But these foreign sources of supply are unlikely to adapt what they provide to domestic circumstances.

The international community has an interest in both crisis prevention and institution building in developing countries. It is troubling, therefore, that the two goals can be at odds. Prudential standards that discourage connected lending may limit one immediate source of financial problems, but they can also remove the only viable basis for financial transactions in an economy where the information and contracting environments are weak. Greater exchange rate flexibility, which reduces immediate threats to financial stability by encouraging hedging, may also discourage agents from denominating assets and liabilities in domestic currency and slow the development of the relevant domestic-currency markets. Changes in the Basel Accord designed to limit risky lending by financial institutions may make it more difficult for developing countries to access the external funding required for investment projects. There is thus a danger that in their efforts to contain threats to financial markets and institutions in the middle- and high-income countries, the international policy community will neglect the needs of their low-income brethren, who are in fact the next generation of emerging markets.

Crisis prevention will never be perfect. It will never be feasible to write contracts that take into account all possible contingencies. Information, by its nature, is asymmetric and incomplete. Crises will happen. This makes it necessary to consider not just crisis prevention but also crisis resolution. And here is where official efforts continue to fall short. What is needed is more clarity on which track of the IMF's two-track approach to reforming crisis resolution has precedence, along with meaningful financial incentives for including collective action clauses in new bond issues. Only then are we likely to make real progress in resolving financial crises.

Profiles

Shigeyuki Abe

Dr. Shigeyuki Abe is currently Professor of Economics at the Center for Southeast Asian Studies, Kyoto University in Japan. He has taught and been engaged in research at various institutions including Kobe University, University of Hawaii, East West Center, and UN-ESCAP. Dr. Abe received his Ph. D. from University of Hawaii in 1977. He now serves as a managing editor of Asian Economic Journal, which is a publication of the East Asian Economic Association. He has written extensively on various aspects of Asian economies. His major publications are: Ajia Keizai Kenkyu (Studies on Asian Economics), 1998; Asia-Pacific Economic Linkages (co-edited), 1999; Japan Why It Works and It Does't (co-edited), 1998

Ehung Gi Baek

Dr. Ehung Gi Baek is currently an associate professor of the department of Economics, of Sangmyung University. Prior to this, he was a fellow at the Korea Development Institute. He has been a visiting scholar at the International Centre for the Study of East Asian Development at Kitakyushu, Japan (2001). Dr. Baek earned his Ph.D. at the University of Wisconsin in 1988 and has published papers in academic journals. Dr. Baek has served as an advisory member of several government and public committees including the National Statistical Office, the Bank of Korea, the National Long-term Power Development Planning, etc. Dr. Baek has also worked as a co-editor of the Journal of the Korean Econometric Society and an associate editor of several academic journals including *Kyong Je Hak Yon Gu* (Journal of the Korean Economic Association). He was awarded excellent research prize from the Korean Economic Association and the Nae-Oi Economic Newspapers (1996). Dr. Baek's writings includes "Some Theory of Statistical Inference for Nonlinear Science" (1991, *Review of Economic Studies*), "A Nonparametric Test for Independence of a Multivariate Time Series" (1992, *Statistica Sinica*), *Understading the Complexity Science and Its Application: Chaos Theory and Economics* (1997, Samsung Economic Research Institute), "Effects of Monetary Policy on Bank Lending Behavior" (1999, *Economic Papers*, The Bank of Korea), "A Study on the Korea's Banking Crisis of 1997: What Cause Banking Crises? The Case of Korea", (2001, *Korea Observer*). He has currently been engaged in research covering macroeconomy and financial stability.

Supote Chananuntathum

Dr. Supote Chananunthathum is currently an associate professor of the Faculty of Economics at Thammasat University. He earned his Ph.D. at the University of Oregon, USA in 1977, specializing in international economics and has published various research reports and papers serving both Thai and international organizations. He had been appointed as the Dean of the Faculty of Economics, Thammasat University during 1988-1991. Dr. Chananunthathum's research includes "Economic Crisis: Causes, Policies and Adjustment Process toward Equilibrium," paper prepared for an Annual Symposium on Economic Crisis in Thailand (1998), "International Economic Situation Facing the Thai Economy in *Senathipat* (1993), and "Trade and Financial Strategies for a Sustainable Growth of the Thai Economy in the 1990s," research paper prepared for UNCTAD, Geneva, Switzerland (1992). He has also written chapters in many books. Some of his major ones are "The External Financing of Thailand's Imports" in *Financing Exports to the Developing Countries, Analysis-Synthesis Based on a Five-Country Study Concerned with Tunisia, Turkey, Indonesia, Thailand and Brazil,* Montreal University (1992), "Thailand" in *Trade and Developing Countries, Strategies and Constraints in the 1990s*, Harvester Wheatsheaf, UK (1990), "The Modeling of Financial Markets in Thailand in an Asset Demand and Institutional Framework" in *Pacific Growth and Financial Interdependence* (1986) and "Thailand's International Trade Imbalances: Some Reflections on its Industrialization Policy" in *Western Pacific Trade, Volume 1*, Input-Output Publishing Company, England (1985).

Barry Eichengreen

Barry Eichengreen is the George C. Pardee and Helen N. Pardee Professor of Economics and Professor of Plitical Science at the University of California, Berkeley, where he has taught since 1987. He is also Research Associate of the National Bureau of Economic Research (Cambridge, Massachusetts) and Research Fellow of the Centre for Economic Policy Research (London, England). In 1997-1998 he was Senior Policy Advisor at the International Monetary Fund. He is a fellow of the American Academy of Arts and Sciences (class of 1997). He is a member of the Bellagio Group of academics and economic officials. He has held Guggenheim and Fulbright Fellowships and has been a fellow of the Center for Advanced Study in the Behavioral Sciences (Palo Alto) and the Institute for Advanced Study (Berlin). Professor Eichengreen has published widely on the history and current operation of the international monetary and financial system. His books include *Toward a New International Financial Architecture* (Institute for International Economics, 1999), *Globalizing Capital: A History of the International Monetary System* (Princeton University Press, 1997), *European Monetary Unification* (MIT Press, 1997), and *Golden Fetters: The Gold Standard and the Great Depression, 1919-1939* (Oxford University Press, 1992).

Christer Gunnarsson

Christer Gunnarsson is currently Professor of Economic History at the School of Economics and Management in Lund University, Sweden. Dr. Gunnarsson received his Ph. D. from Lund University in 1978 with his doctoral thesis entitled "The Gold Coast Cocoa Industry 1900-1939." He has taught at Lund University and been engaged in research at various institutions. He is recognized as one of the scholars in Sweden who are specialized in East Asia and has written extensively on various aspects of Asian economies. His major publications are: "Agrarian Structures, Property Rights and Transition to Market Economy in China and the Former Soviet Union" (1996); "Mercantilism Old and New, An Institutional Approach to the Study of Developmental States in Europe and East Asia" (1995); and "Population, Development and Institutional Change: Summary and Analysis" (1994). He has also been involved in many research projects including "Exports of Capital from East Asian Nics - With a Case Study of Taiwanese Investments in China and Southeast Asia," "The Role (s) of Cultural and Political Institutions in the Development Process - A Comparative Analysis in Time and Space," and "The Myth of Export -led Growth in East Asia."

Ammar Siamwalla

Dr. Ammar Siamwalla is currently the Distinguished Scholar of the Thailand Development Research Institute (TDRI) and an active member in discussions and assessments on contemporary issues regarding the agricultural and public economics of Thailand as well as the Asia-Pacific region. Prior to this, he has served as the President of TDRI from 1990-1995. His vast accomplishments and contributions to the Thai economy has been recognized by many national and international institutions. Among such are the Honorary Doctoral Degree in Economics, Thammasat University; Honorary Doctoral Degree in Development Economics, National Institute of Development Administration (NIDA); Award for Best Research Work (Economics) by the National Research Council (NRC), Thailand for *Compendium on Rice* (with Viroj Na Ranong), Distinguished Researcher Award (Economics) by NRC, and the Sir John Crawford Exchange Award in Agricultural Economics from the Australian Agricultural Economics Society and Australian Council for International Agricultural Research. Presently he is the chairman of the Social Investment Fund (SIF); a board member of the Health systems Research Institute, Ministry of Public Health; a member of the Law Reform Commission, Council of State; a member of the Appellate Committee, Department of Internal Trade, Ministry of Commerce; a board member of the National Health System Reform, Ministry of Public Health; and a member of the Board of Directors, Bank of Asia. Dr. Siamwalla has written widely on issues of agricultural, developmental, and public economics. His works have been included in numerous international collections of developmental economic publications. A few among these include "Picking up the Pieces: Bank and Corporate Restructuring in Post-1997 Thailand" (UN, ESCAP, 2001), "The Relationship between Trade and Environment, with Special Reference to Agriculture" (Johns Hopkins University Press, 1997), "Agricultural Sustainability in Rapidly Industrializing Asian Economies" (Winrock International, 1996), and "The Thai Economy—Fifty Years of Expansion" (a commemoration on the King's Golden Jubilee: Archipelago Press, 1996)

Hadi Soesastro

Hadi Soesastro is the Executive Director of the Centre for Strategic and International Studies (CSIS), Indonesia. He was a member of the National Economic Council, an advisory council of President Abdurrahman Wahid, from December 1999 to September 2000. He is a lecturer at the University of Indonesia (Jakarta) and Atma Jaya University (Yogyakarta) and has taught at Columbia University (New York), the Australian National University (Canberra), and University of Colima (Mexico). He is a member of the international advisory boards of various international institutions and organizations, including The Asia Society, New York, and is a member of the editorial board of a number of international journals, including the ASEAN Economic Bulletin (Singapore) and the Bulletin of Indonesian Economic Studies (Canberra). He has been active in PECC (Pacific Economic Cooperation Council) since its inception and is also a member of the International Steering Committee of PAFTAD (Pacific Trade and Development). He is also involved in other "track two" activities through CSCAP (Council for Security Cooperation in Asia Pacific) and CAEC (Council for Asia Europe Cooperation). He has written extensively on energy issues, international trade, regional cooperation (ASEAN, APEC), the relationship between economy and security, and the role of technology in development. He has recently been elected first chairman of the board of the newly established TIFA Foundation, whose main objective is to strengthen civil society in Indonesia.

Edita A. Tan

Dr. Edita A. Tan has just been appointed Professor Emeritus of Economics in the University of the Philippines. She obtained her Ph.D. in Economics at the University of California and has worked in the academe since graduation, including visiting professorship /research fellowship at Thammasat University, Kyoto University, Andalas University in Sumatra, NBER, Palo Alto and the Rockefeller Center in Bellagio, Italy. Her published and unpublished studies covered economics of education, labor migration and development finance. She had been appointed chairman of her department, elected as President of the Philippine Economic society and board member of the Philippine Institute for Development Studies and the De La Salle University King's Institute for Business and Economic Research. She had also been one of the first selected for Ten Outstanding Women in the Nation's Service Award.

Rogayah Haji Mat Zin

Dr. Rogayah Haji Mat Zin is currently a professor and Acting Director of the Institute of Malaysian and International Studies (IKMAS), National University of Malaysia. Dr. Zin earned his Ph.D. at Vanderbilt University, USA and is specialized in public finance, poverty, income distribution and small- and medium-scale industry studies. He has written many books as well as chapters in several other books. He has also published papers in academic journals including *Jurnal Ekonomi Malaysia, Singapore Economic Review, The Asia-Pacific Development Journal, Asia Pacific Journal of Management,* etc. He has held many consultancies for the UN/ESCAP throughout the period of 1989 to 1999, where most of his involvement centered around the impacts of various international economic integrations on Malaysia and the ASEAN region. Dr. Zin is still an active participant in international discussions and conferences. The major conference he had attended in recent years includes 7th Convention of the East Asian Economic Association, Singapore (2000); The World Bank Institute WBI-PIDS Follow-Up Workshop on Strengthening Poverty Data Collection and Analysis, The Philippines (2001); The APEC Study Centre Consortium Annual Meeting, China (2001); and Asia Development Forum 3, Thailand (2001).

Country Papers

Abstracts Appear as Received

COUNTRY PAPERS ON ECONOMIC RECOVERY AND REFORMS

Economic Recovery and Reform in Indonesia

Hadi Soesastro

ABSTRACT

Amongst the crisis-hit countries in Asia, Indonesia was hit hardest. A great deal has been written about the origin and the unfolding of the crisis in Indonesia. The deterioration of its economic "fundamentals" was not immediately obvious as the economy continued to grow by about 7 percent in the first half of 1997, exports remain strong, the current account deficit was manageable, and the budget exhibited a surplus. Yet, the economy had became very vulnerable to external shocks. Short term debt had accumulated rapidly since the beginning of the 1990s, in part to finance long term projects. The banking system, which expanded rapidly following a major deregulation in 1988, had been under lax supervision. Economic liberalization and deregulation, which began in the mid 1980s, slowed down in the early 1990s. Certain sectors of the economy were re-regulated and a number of activities, in manufacturing and services, were given protection or other favorable treatment because of their close links to the power center. However, the depth of the crisis cannot be explained by these factors alone. In fact, it was the mishandling of the crisis that led to free fall of the economy and the currency (*Rupiah*) in the beginning of 1998. This was followed by the fall of the Soeharto regime that was in power for more than 30 years. The collapse of the regime resulted in an equally deep political crisis. In the four years since Soeharto's fall in May 1998, Indonesia has three presidents.

Given the depth of the economic and financial crisis, coupled, with the political crisis, Indonesia's recovery process had been slow, difficult, and frustrating. With each new government, a new recovery program was introduced, but its implementation was poor due to lack of economic leadership and administrative capacity as well as continuous political interference. The involvement of the IMF has been critical to the setting of the recovery and reform agenda, especially with the changes of government. However, IMF's tendency to "micro-manage" Indonesia's IMF-supported program has added to the difficulties in implementing it.

The Indonesian economy began its recovery in 2000. The economy grew by 4.8 percent, driven to a large extent by domestic consumption and export growth. This recovery, however, was not sustained. Economic growth slowed down to 3.5 percent in 2001. This performance was better than many other Southeast Asian countries. Malaysia, Singapore and Thailand were adversely affected by the slowdown of the US and the global economy, especially since September 11. However, these economies will recover more swiftly with a recovery of the US and the global economy. Indonesia, on the other hand, has to overcome a number of systemic problems internal to its economy and polity. Its slow "recovery without reform" is not sustainable. The banking system remains weak and, in fact, faces the danger of another crisis. The government's budget is experiencing a temporary relief as a result of higher oil prices and the successful rescheduling of public external debt through the Paris Club. The challenge of fiscal sustainability remains great.

Reforms are also necessary to enhance the economy's international competitiveness. The weak currency has been a factor in its international competitiveness, but this cannot be relied upon indefinitely. The competition from China and other economies in the region is real. Increased productivity, moving up to higher value-added production, and a further diversification of the economy requires new investments, especially from abroad. This also requires further reforms and the maintenance of political stability.

Indonesia's recovery and reform agenda has been formulated since the IMF was invited to help support the program. The agenda has not been without criticism, and over the years modifications have been made. Some lessons have been learnt. But the lessons drawn need to take into consideration the overall political environment, which at times had been favorable but at other times had caused severe obstruction.

Implications of Japan's Lost Decade to Asia Perspectives from Japanese Trade and Investment Relationships

Shigeyuki Abe

ABSTRACT

Japan has been struggling to get out the decade long depression. Koizumi government changed its stance of economic policy from the former governments to emphasize reforms rather than fiscal expansion. In this paper a short history of the current Japan's depression will be explored first. Specific problems of recent economic policies will be discussed next. Bad debt

problems, industrial re-structuring, inflation targeting issues, record high unemployment situation, changing Japan models, and etc. are such issues. Lastly, Japan's role in Asia will be discussed.

RM16 billion funding requirement and is expected to close its core operations by end-2003. CRDC has officially ceased operations in mid-August 2002 and has successfully resolved 47 cases.

Economic Recovery and Reforms: The Malaysian Experience

Ragayah Haji Mat Zin

ABSTRACT

Initially, Malaysia implemented IMF-style responses to the Asian financial crisis 1997-1998 but when these exacerbated the economic downturn, the government introduced counter-cyclical measures and announced the National Economic Recovery Plan (NERP) to provide a comprehensive and action-oriented framework to expedite economic recovery. The NERP has six interrelated and complementary objectives, which included the short-term focus of stabilising the ringgit, restoring market confidence, and maintaining financial stability. These were complemented with structural reform objectives of strengthening economic fundamentals, continuing the equity and socio-economic agenda, and restoring adversely affected sectors.

Specifically, the government imposed selective exchange controls on 1 September 1998 and fixed the exchange rate at US1=RM3.80 the next day. The Government also introduced pre-emptive measures to strengthen the resilience of the financial sector. These include strengthening the resilience of the banking sector through a merger programme; the establishment of Danaharta, the national asset management company to address the rise of NPLs as well as Danamodal, an interim funding vehicle to address the erosion of capital in some banking institutions; and the Corporate Debt Restructuring Committee to resolve the debt problems of larger corporations.

The various measures resulted in a speedy recovery when the economy registered a growth rate of 6.1% in 1999 and 8.3% in 2000, inflation was brought down from 5.3% in 1998 to 2.8% in 1999 and 1.6% in 2000 and full employment was maintained. Substantial progress was also made in bank and corporate restructuring. The merger programme consolidated 54 domestic banking institutions into 10 banking groups. Danaharta completed its NPL acquisition phase in 2000 and is currently focussed on implementing recovery measures on the NPLs under its purview. Danamodal utilised less than half of the estimated

Economic Trends and Outlook, Recovery and Reforms of the Korean Economy

Ehung Gi Baek*

ABSTRACT

Korea achieved a strong recovery from the crisis. However, the economic slowdown, which began in August 2000, continued its downward trend for a year. Since then, some of the recently announced economic indicators such as industrial production and shipments showed signs of recovery. Current business cycle status of the Korean economy is now in the boom stage of the ascending business cycle phase. We also show that the Korean economy is expected to grow by 6% this year. Addtionally this report explains reform policies as follows: Financial sector restructuring, corporate sector restructuring, labor market reform, and public sector reform. We evaluate two of important reform policies regarding banking sector in this section, increased concentration ratio in banking industry and inappropriate usage of public funds. Finally, this report contains some of the remaining issues such as presidential elecion in December, fire-day workweek system, introduction of FLC, and new capital adequacy ratio and reduction of NPLs.

Nordic and Asian Crises in Structural Perspective

Christer Gunnarsson

ABSTRACT

The economic crisis in the Nordic countries, Finland and Sweden during the early 1990s exhibit many striking similarities with the Asian crisis of 1997/98. In both cases a crisis in the financial sector triggered a chain reaction that involved a dramatic fall in exchange rates, a collapse in the real estate market, falling stock exchange values and a fiscal crisis for the government sector. The question is why countries at seemingly very different levels of economic maturity came to experience such similar developments. Explanations for the Asian crisis have in large degree circled around the issue of inherent structural weaknesses in an Asian development model, notably connoted by the concepts such as crony capitalism and

moral hazard. The fact that the Nordic crisis exhibits similar characteristics casts serious doubt on these explanations. In the Nordic case explanations concentrated on the alleged over-size of the public sector. In this paper it is argued that the fundamental similarity between the two cases is made up by the changes in the global financial system that altered the scope for national polity making in the 1980s. Financial deregulation led to a movement away from a system characterised by a socialisation of savings to a system where savings were increasingly being circulated in private and international and largely unregulated capital markets. In both cases there was a movement away from a rationing system characterised by capital shortage in which government regulation aimed at influencing resource allocation to a system of capital surplus. In both the Nordic and the Asian cases this surplus capacity coincided with an increasing demand for investment capital. In Asia the Plaza Accord of 1985 that gave the ASEAN countries a competitive edge in exports of manufactured goods. In the Nordic countries, notably in the Swedish case, a booming export sector driven by exchange rate depreciation in 1982 triggered an expansion of the demand for credit. When the export sector slowed down in both cases investments relocated towards the domestic sector, to real estate investments and to the public sector. In both cases it was an expansion based on access to cheap credit. The similarity demonstrates that the "developmental state" was not a typical Asian phenomenon since, in fact, the Nordic welfare state was in large degree built on similar characteristics as the Asian model, the foundation of both being the government control over national savings. When this control eroded in the 1980s it led to similar reactions regardless of development levels. Thus, we conclude that both crises were consequences of a structural change in the financial sector that was to lead to structural effects also in the real economy.

Thailand's Macroeconomic Policy under the Current Administration: A Proposed Alternative

Supote Chunanuntathum
Bhanupongse Nidhiprabha

ABSTRACT

The country report on Thailand will concentrate on analysing the recent macroeconomic situation and long-drawn adjustment toward recovery after the financial crisis in July 1997. Short description of the causes of the current economic crisis will first be summarised. The paper will include various recent macroeconomic policies (monetary, fiscal and others) and measures taken by the Thai authorities to counter the on-going economic downturn. Other specific and relevant measures especially on the banking sector's non-performing loans and the use of quasi-fiscal measures as policy tools will also be described along with the normal Thai fiscal policy.

Bank Performance and Rate of Economic Recovery: The Philippine Case

Edita A. Tan

ABSTRACT

The paper sees imprudent lending by a weak banking system as an important and common cause of the East Asian crisis. The crisis-hit economies' banking systems had not put in place prudential rules and practices and their organization was subjugated to power politics and big business control. Many of their member banks engaged in imprudent connected lending which later turned up as non-performing loans, NPL. These have real and financial costs. Bad investments produce smaller or even zero value added thus slowing down growth. Banks' fund supply falls when loans do not get repaid. NPL also reduce banks' interest income and raise their collection and other transactions costs. The health of the Philippine banking system is analyzed in terms of aggregate and cross-section performance indicators such as sources and uses of funds, NPL/loan ratio, NPL/equity ratio and capital/asset ratio. Performance, as gauged from these ratios, varied widely across banks. NPL ratio ranged from 8% to 69%. Six banks had serious NPL ratio exceeding 20% and NPL/equity ratio much exceeding unity. Bank performance is not explained by size or state-private ownership. Two of the problematic banks were large state banks and four were private of varied sizes. The problematic banks

composed a relatively small segment of the system so that their insolvency did not cause a systemic bank run. A core group of fairly strong private banks had existed and withstood the turmoil of the past three decades including the 1983-1985 economic crisis, the 1989-1991 recession and the Asian crisis. They had acquired a reputation of good banking. It appears that their presence had preserved the people's confidence in banking so that a systemic bank-run was avoided. Depositors did not react in a herding manner, they were discriminating in their response to the crisis and to the news of specific bank failure. NPL has contributed to the slow recovery of the economy as the banks are unable to increase credit and lower interest cost.

Concurrent Sessions

Abstract Appear as Received

I. MACROECONOMIC STABILITY I

Monetary Policy Strategy for a Sustainable Economic Recovery in Post Crisis Indonesia

Reza Anglingkusumo

ABSTRACT

This paper asks how monetary policy in Indonesia can fruitfully contribute to the sustainable and successful economic recovery in post crisis Indonesia? We argue that it depends on the ability of Bank Indonesia (BI) in achieving price stability, which in turns is influenced by (1) the presence of a common understanding between BI and the Government of Indonesia (GOI) on what monetary policy can and cannot do, (2) the availability of a strong form of commitment technology granted to BI, and (3) the expected long run effectiveness of the current design of BI's monetary policy framework and strategy. The vision and mission statements of BI have implicitly suggested the ideal streamlined objective between BI and GOI that is to divide duties in promoting the common long run objective of achieving a sustainable economic growth in post crisis Indonesia That is, BI focuses on achieving and maintaining price stability, while GOI works on the structural adjustments in the long run aggregate supply side of the economy. However, in the climate of a newly found democracy in Indonesia, for the part of BI there is a merit in further quantifying the legal mandate of price stability to guard against future political interventions on BI's long run price stability objective. To further improve the effectiveness of monetary policy in achieving price stability in post crisis Indonesia we propose a modified and stricter form of the European Central Bank (ECB) type strategy. Such a proposal amounts to combining a strict monetary targeting rule with the use of a conditional inflation forecast as a medium term policy guide derived from both the monetary and non-monetary variables. This is because in Indonesia the excess money supply above its demand has strong information content on inflation over the long run. Hence, this variable cannot be treated as a mere indicator variable. It must enter actively into BI's forward looking and pre-emptive decision rule. A failure to do so would considerably weaken the expected success rate of achieving price stability and undermine the expected credibility of monetary policy in post crisis Indonesia.

Short-term Determinants of the Current Account Deficits in Central and Eastern Europe

Alexander Aristovnik

ABSTRACT

The main aim of the paper is to examine the empirical link between current account deficits and a broad set of economic variables proposed by theoretical and empirical literature. The paper focuses on Central and Eastern European countries (the CEECs), which are the most advanced transition economies in the world (period 1992-1999). For this purpose, panel-regression technique (Least Square Dummy Variable (LSDV) approach extended with a time specific effect)) is used to characterize within-country effects, which emphasize the current account response to over-time changes in a given country of Central and Eastern Europe. The paper reveals that domestic output growth has a strong positive effect on the current account deficit, indicating that domestic growth is associated with a larger increase in domestic investment than in national saving. Additionally, the empirical estimates indicate relatively high international capital mobility in the region as a whole. Furthermore, the results provide some evidence in favour of the twin deficits hypothesis in the CEECs. Moreover, an appreciation of the real exchange rate generates an insignificant increase in the current account deficit and therefore induces a plausibility of the validity of the 'fundamentals view' of real appreciation in the CEECs. In addition, positive and significant impact of exports of goods and services is ascertained. Finally, while foreign direct investments have insignificant impact on the current account balance, total external debt reveals negative and significant relationship with the current account balance of the CEECs.

Keywords: CEECs, current account deficit, macroeconomic determinants, panel data analysis

Macroeconomic Stability, Financial and Monetary Policy:Turkish Experience in Recent Years

C. Necat Berberoglu

ABSTRACT

Turkish economy has been struggling with chronic inflation in last 25 years. In this srtuggle, for 25 years, Central Bank of Turkey needed to put under implementation many fiscal and monetary programs with the directives of International Monetary Found (IMF). All of the programs implemented in this period, had many differences in the emphasized goals. Some of them focused on building Macroeconomic stability, some focused only on foreign currency deficit, some on public budget deficit and of course some, on only price stabilization.

In this period sometimes Turkish Goverments worked in a perfect coordination with IMF and gave great importance to the directives of IMF, but sometimes Turkish authorities neglect to work with IMF in a good coordination. One of the most important reasons of loosing coordination with IMF was the changes both in the goals of IMF programs and the reforms advised in them, and another important reason was the change of political priorities of Turkish Governments.

According to the generally accepted point of view, maintaining macroeconomic stability is possible with compatible conduction of fiscal and monetary policies. But in countries like Turkey which have a big rate of population growth, a chronic inflation for 25 years, and a big need for economic growth in order to decrease the development gap with European Union Countries, everything seems more complicated and difficult. So, only in one study, it will be impossible to investigate all of the economic problems related to macroeconomic stability in Turkey.

For this reason the aim of this paper will be to focus on the recent macroeconomic stabilization programs of Turkey, which were supported by fiscal and monetary policies of Central Bank of Turkey.

The Central Bank has officially declared three different fiscal and monetary programs supported by IMF in the years of 1998-2000 and 2001. A look into the recent history reveals that delays in reforms and the changes in program goals, fragility of the banking sector, the fact that problems in the banking system should have been resolved well before the implementation of each program and the lack of additional reserve facilities were among the reasons for all the crisis experienced in Turkey. Moreover, the lack of public confidence in the institutions that designed and pursued policies during the last 25 years with no avail, and the pessimistic expectations arising from delay in reforms did not allow the programs to obtain the most wanted results in the desired periods of time.

In this paper, three fiscal and monetary policies of Turkish Central Bank which were implemented after every crisis since the end of the year 1998 will be examined with this point of view, and the accordance of these policies.

Monetary Policy and the Transmission Mechanism in Thailand

Piti Disyatat
Pinnarat Vongsinsirikul

ABSRACT

This paper examines the monetary transmission mechanism in Thailand. It attempts to quantify the lags associated with monetary policy shocks and investigates the channels through which these shocks are propagated.

When the important role that banks play in Thailand's financial intermediation, the paper pays particular attention on the role of banks and quantifies the time lag associated with the pass-through from changes in policy/money market rates to retail rates. The paper also examines the relative sensitivity of various components of aggregate demand (i.e. investment, consumption, exports) to changes in monetary policy. The results are compared to that in the literature for other countries.

Japanese Financial Reform and East Asia

Christopher A. Erickson

ABSRACT

There are several stylized facts concerning the Japanese economy and its relationship East Asian economies that are of interest. For years, the Japanese economy has been characterized by low earnings, undercapitalized banks, and limited investment. The consequence has been slow growth. This slow domestic economic growth combined with large domestic savings and strong overseas earnings by Japanese corporations has led to increased external investment. Much of this extern investment has been directed toward East Asia. For Japan to return to economic growth, reform of the Japanese financial system is believed to be necessary by many observers. This paper develops a model to evaluate the effect of Japanese financial reform on East Asia. I find that the effects of Japanese financial reform will be to re-divert investment from East Asia to Japan. The results depend critically on the assumption that Japan is a "large" economy in the sense that changes in Japan can influence the global interest rate.

Contagion and Causality Issues in Financial Crises

Christopher EC Gan
Sirimon Treepongkaruna
Hue Hwa Auyong

ABSTRACT

A decade ago, economists were convinced that globalisation has minimum adverse impact on previous financial crises. This is because the financial crises of the 1980s had largely resulted from poor policies that caused large swings in countries' current account balances. With limited globalisation, financial crises countries did not expand their exports rapidly and do not have access to the pool of mobile capital to meet their foreign reserve needs. Thus, economists predict that in the decade of the 1990s, there will be a decrease in the frequency of financial crises with greater degree of globalisation (DeLong, 2001).
However, this prediction is not true since there were 5 major financial crises in the 1990s: the European exchange rate mechanism crisis of 1992, the Mexican peso crisis of 1994-1995, the Asian crisis of 1997-1998, the Russian crisis of 1998 and the Brazilian crisis of 1998-1999. Financial market liberalization to capital flows has in fact been accompanied by an increased frequency of financial crises in both the developed and developing countries.

A puzzle remains as how an initial country-specific shock can rapidly be transmitted to market of different sizes and structures around the world. Fratzscher (2000) argues that the main reason for the poor performance of standard models of currency crises lies in their neglect of the role of contagion. This has prompted a surge of interest on "contagion" effect on financial crisis. With increased globalisation, contagion has been argued as a channel for currency crises to spill across countries.

The purpose of this paper is to explore the changes in the existence and directions of causality of the foreign exchange in crisis- ridden countries following the 1994 Mexican Crisis, 1997 Asian Crisis, 1998 Russian Crisis and 1999 Brazilian Crisis. The paper will also determine whether the currency crisis in a country affects the linkages of the currencies of countries in the same region, in another region and whether a particular crisis create more causality relationship as compare to the other crises.

Fiscal Vulnerability: An Assessment to Thailand After 1997 Economic Crisis

Chawin Leenabanchong

ABSTRACT

After the economic crisis in 1997, Thai economy faced the slowdown in consumption and also investment from private sector. These situations had push government to adopt for a stimulated policy through public spendings. To meet the increasing in expenditures, the ability to raise revenues by government in current situation could not generate enough income from taxes and had to rely on borrowing from public either in form of national domestic debt or central bank's money creation. As a matter of fact, second option seems to be unlikely chosen. Hence, debt financing for government budget deficit is chosen to fight against economic slowdown problem.

However, Thailand seems to follow Japan's experiences in using debt to finance budget deficit, particularly in Mr. Thaksin populist projects such as debt moratorium for farmers, providing health care vouchers for all, pouring 70 billion baht as a loan into villages level, and etc. Common issues of interest is "Is the government's budget deficit too large?" or "Does the government has a fiscal sustainability or not?". Such a kind of these questions are directed to ask whether government is subject to an analogous constraint that when it runs deficit, is it making an implicit promise to creditors to run offsetting surpluses in future or not?

Banking Sector Fundamentals:Learning from the Recent Bank Lending Contraction

Mathinee Subhaswadikul
Don Nakornthab

ABSTRACT

The paper investigates the recent contraction of bank lending in Thailand and its implication for the economy. Analyses are conducted at both aggregate and disaggregate levels. At the aggregate level, a disequilibrium econometric estimation is employed to assess the relative extent in which supply and demand factors have contributed to the credit slowdown. At the disaggregate level, the paper uses individual bank data to analyze relationship between measures of bank condition and bank lending behavior. The paper finds that availability of loanable funds and NPL overhang, both of which played a prominent role during the early stage of the contraction period, no longer appear to be major constraining factors of loan growth.

Keywords: Banks; Credit crunch; Financial crisis; Thailand

II. MACROECONOMIC STABILITY II

Macro Economic Adjustment, Stabilisation and Sustainable Growth in India: Looking Back and to the Future

Mangat Ram Aggarwal

ABSTRACT

India after attaining independence adhered strictly to inward looking import substitution policies behind huge tariff walls and highly restrictive quantitative restrictions and regulations in the different sectors of the economy with attendant disincentives for exports due to gradual realization by the then developmental economists that the market forces or signals won't operate efficiently in achieving optimum allocation of resources and could not be relied in the long run, to tackle the fundamental problems of poverty and unemployment and acceptance of broader Keynesian framework, and analysis which accords a leading role to state as an economic actor, to minimize the impact of "market failures", and to foster and sustain rapid rates of economic and social growth. Hence numerous interventionist measures, both fiscal and monetary, during the different plans, were initiated by the policy makers both in the product and factor markets for increasing the level and rates of growth of gross domestic product (GDP) and to achieve the aim of "shared growth" as quickly as possible.

In the early 1980s besides persistent macro-economic crisis, the economy was confronted with a high rate of inflation due to over-expansionary fiscal policies largely financed through domestic and costly foreign commercial borrowings. The macro-economic crisis reached its peak in 1990 with combined fiscal deficit of Centre and State Govts. standing at 10% as percentage of GDP, current account balance at 3.3 per cent as percentage of GDP backed by a rate of inflat ion of 9.9 percent despite India's record economic performance measured in terms of rate of growth of GDP 6.0 percent due to the high rates of industrial growth of 5.9 percent and domestic savings ratios of 21.9 percent as percentage of GDP. Serious attempts backed by strong economic reasoning through the introduction of various market oriented economic reforms under the "Structural Adjustment" and "Stabilization" Programmes (SAP) of IMF and World Bank popularly known as "Washington Consensus" were initiated in the various economic sectors by the Narasimha Rao Government after assuming office in June 1991, to reduce these internal and external "imbalances" while maintaining the tempo of high rates of economic growth and integrate the economy with the global market.

The paper, besides thoroughly discussing the need and rationale of economic reforms introduced in 1991, critically examines indepth the linkages and impact of SAP (a) on macro-economic record of the economy during the era of post reform years in the light of the stated major goals by the Govt. from time to time, (b) in lifting the people below the poverty line and reducing the incidence of poverty, and regional inequalities of income, (c) creating more productive employment opportunities both in rural and urban sectors particularly in the organsied sectors both in public and private (d) in achieving the goal of stabilization and (e) in reducing the burden of adjustment borne by the poor and weakest sections of the society and pains of margenalization of the poor at the global level. The paper also suggests on the basis of overall statistical findings a pragmatic approach for the coming decade under the current emerging trading and financial environment, for India and South for achieving the goals of overall faster, sustainable growth with equity.

The pertinent conclusions based on theoretical and empirical analysis which emerge from the analysis at the internal level are are that, if the policy makers wish to attain a overall rate of growth, of 8% and respectable rates at the sectoral level coupled with a reduction of poverty ratio by 5 percentage point by 2007 and by 15 percentage by 2012 as outlined as outlined in the Approach Paper to the Tenth Five Year Plan (2002-2007) with macro-economic stability and to avoid to fall back to Hindu rate of growth of the pre-reform decades, then it is (i) essential to expand and deepen the ongoing domestic economic reforms apart from creating a climate for good governance, based on accountability, transparency and predictability, (ii) not enough to curb the rate of inflation but to maintain it at lower level (iii) essential to bridge the gap between revenue account and expenditure account in the revenue budget by increasing tax base both at the Center and more so at the State level where there exists a vast scope as seen in terms of tax buoyancies particularly in the untaxed sectors i.e. agricultural sector which is becoming commercialized these days at a rapid speed and services sector which had registered a remarkable rate of growth, but contributed only 0.33 % services tax as percentage of service sector GDP in 2000-01 and reducing the Govt. expenditure by downsizing the

state, reduction of subsidies introduction of users charges for public goods and services, instead of capital expenditure which is more or less a soft option. (iv) urgent to improve productivity and efficiency of the resources both in the public and organized private sector through better financial management, (v) appropriate to share the burden rather than passing them to the entire, if the states wants to pursue populist measures and finally to increase domestic investment in the social sector which will be helpful to reduce the incidence of poverty and accelerate the process of economic growth with human face. At the external level, on the other hand, the findings of the paper clearly indicate that the success of WTO and the policies of market oriented reforms, from the point of view India and South's overall economic and social growth, will to a large extent depend, iven the increasing degree of regionalism, intra-industry and intrafirm trade among the advanced countries at present, upon the intensity of the desire on the part of the industrialized countries to provide free market access, reduce non-tariff barriers and export subsidies on agriculture overcome internal structural impediments to growth by having low rates of inflation and interest, and adjust their macro-domestic policies consistent with each other in a global framework of co-operation, and not confrontation, keeping in view the larger interests of the Southern World.

Economic Crisis Management in Asia

Tran Van Hoa

ABSTRACT

Recent financial and economic crisis in Asia and its management have produced dismal outcomes, economically, politically and socially, in many respects in several crisis economies. The paper focuses on a critical analysis of this crisis' diagnostics, prescriptions and outcomes, and discusses initiatives to avoid or better manage future and similar crises. The role played by increasing globalisation in economic crisis management at the country level is also assessed. The recent emergence of new Asian regionalisms such as the ASEAN+3 is argued as a promising initiative to overcome some external problems encountered in recent years and to effectively promote trade, investment, development and growth in the region.

Persistency and Dynamic of Economic Growth: An Empirical Evidence of Selected Asian Countries

Abdul Ghafar Ismail
Fathin Faizah Said

ABSTRACT

This paper tries to produce an empirical test that there exists a positive correlation between long-term growth rates and the persistence of output fluctuations. This test is applied to selected Asian countries such as China, Philippine, Japan, Korea, Malaysia and Thailand, between the periods 1975 and 2000. These samples represent the countries that have an experience in facing the output fluctuations due to reforms. However, the real business cycle model with exogenous productivity shocks, cannot account for this correlation. According to the conventional view of the business cycle, fluctuations in output represent temporary deviations from trend. This paper tries to estimate the human capital as endogenous growth to examine persistency of output fluctuations. Previous papers indicate that monetary disturbances affected temporarily to output fluctuations. So, dynamic growth model constructed on this paper tries to show whether real disturbances give a long lasting effect to growth.

JEL Classification: C22; E32; O42

Keywords: Business cycles; Persistence; Growth; Stochastic trends

The Causes of Financial Crisis: A Case Study for East Asian Countries

Piyasak Manason

ABSTRACT

This study considers whether the Ease Asian financial crisis was caused by fundamental weakness or contagion. With the quarterly data from 1993 – 2000, the paper applies time series econometric analysis to individual countries, namely, Thailand, Malaysia, Indonesia, Philippines, and Korea.

Using two main approaches, this study investigates both the general to specific approach, by forming a bivariate AR model to find which series are significantly correlated with the crisis index, and the "combined" variables (or the "discerning") approach

of testing a non-nested hypothesis. The result of the first general-to-specific approach showing that nearly all the variables but the Lending Boom, regardless of the characteristic (i.e. whether it is fundamental weakness or contagion), contributed to the Asian crisis. The results of the "discerning" approach also show that combinations of the money reserve ratio, the real exchange rate appreciation variable, and one of the contagion variables from Thailand and Indonesia, are the pure causes of the crisis. Also, the Devidson-Mackinnon J test result showed that the combined "discerning" model encompassed the general to specific approach. Tests for structural breaks also reveal that the influence of the real exchange rate, money to reserve ratio and the contagion variable was much weaker before the Thai crisis than after the crisis. This gives some support to the wake up call hypothesis.

The study suggested that in order to avoid the next crisis, the carefully management of the indicators, especially the value of real exchange rate and the level of reserve, are needed

IMF Programs, Adjustment and Growth

William A. McCleary

ABSTRACT

IMF programs have always been controversial. The IMF itself argues that countries faced expenditures in excess of output by excessive amounts (i.e. with an unsustainable balance of payments deficit) have little choice but to make adjustments through expenditure-switching policies. They will need to make some adjustments with or without the IMF. To be sure, some output growth may need to be sacrificed in the short-run, but this is a necessary cost of achieving better growth and a more sustainable payments position for the medium-term. The IMF's critics make points such as the following, The adjustment programs are ineffective achieving neither higher growth nor more sustainable balance of payments positions in the medium-term. Or that a different set of policies would work better: that IMF depends too much on expenditure reduction (and on markets rather than controls) and not enough on supply improvements which take longer to achieve. And/or that adjustment falls unduly on the poor and hence incur social costs that are unacceptably high. Or, to take a different extreme, that IMF programs are a source of international disequilibria – i.e. the existence of IMF resources causes borrowers and lenders to behave more recklessly knowing that there is a safety net to catch them, the so-called "moral hazard" problem.

The proposed paper will examine IMF programs – both the theoretical underpinnings and the experience – and attempt to come to a more balanced view as to their effectiveness. The paper is organized in four main sections. The first discusses the nature of IMF programs: what are the key features of these programs and what are the theoretical and practical considerations determining whether they should work? The second section looks at the evidence about IMF programs. It is divided into two parts, one looking at more casual investigations of the "before and after" of these programs and the other taking up a number of econometric studies covering IMF and other adjustment programs. The third section will evaluate a number of proposals for the reform of the IMF. Again it is divided into two parts, the first examining proposals for changing the nature of IMF programs to make them more supportive of growth and poverty reduction while the second looks at grander redesigns for the role of the Fund, for example as a world central bank of an international bankruptcy court. The fourth section will provide a brief summary and attempt and evaluation of the desirability of various reform proposals.

Convergence of Exchange Rate and Inflation Risk Premiums in the Asian and Central European Emerging Market Economies

Lucjan T. Orlowski

ABSTRACT

This study investigates the link between the inflation and the exchange rate risk premiums in the six emerging market economies that have abandoned currency pegs and adopted independent monetary policies with flexible exchange rates. These risk premiums are examined in the selected Asian and Central European emerging market economies in the period following the major international financial crisis of 1997-98. The study is aimed at demonstrating that market interest rates in these countries have in fact responded effectively and proactively to shocks in these two risk premiums. If such responses of short-term market interest rates are apparent, they imply the prevalence of efficient financial markets and prove that monetary policies are capable of providing rational and effective responses to shocks in inflation and exchange rates. A model presenting interactions between both risk premiums is tested with OLS plus ARMA (1,1) as well as GARCH (1,1) procedures. The ability to lower these two risk premiums reflects gains in monetary policy credibility and shall be viewed as a prerequisite for achieving financial stability in these emerging market economies.

JEL classification: E32, E52, P33

Keywords: inflation risk premium, exchange rate risk premium, inflation targeting, monetary convergence, and transition economies

The East Asian Crisis in the Light of Mexican Experience: Causes, the IMF and Recovery Path

Runchana Pongsaparn

ABSTRACT

Mexican crisis in 1994-5 was regarded as 'the first crisis of its kind' involving the largest bail-out ever in the history of the IMF at the time. Unlike earlier typical balance-of-payment crisis postulated in the classic Krugman(1979) model, Mexican and East Asian crises share remarkably similar features under freely-mobile capital market environment which constitute a short, sharp contraction in output as opposed to a prolong effect evident in the 1980s debt crisis. Typical IMF program was applied to both Mexico and certain crisis-stricken East Asian countries - namely, Thailand, Korea and Indonesia. This paper analyses the role of fundamentals and self-fulfilling prophecy as the causes of the crises, while comparing and contrasting experience of Mexico against those of Thailand and Korea. The IMF rescue package is then examined to justify the claim that the IMF was responsible for the deepening of the crisis and delaying recovery path in the case of East Asia through the implementation of the same package as that applied to Mexico, regardless their distinctive underlying features. Finally, it is challenging to compare recovery path followed by these economies and recognise whether policies implemented under the IMF aid have been of success, given different individual characters.

Economic Recovery and Reform: Indonesian Experience

Tulus Tambunan

ABSTRACT

This paper tends to evaluate the process of economic recovery and reform which is still underway, although much slower than in South Korea for example and to discuss the future prospect of the process. The big question of this paper is whether Indonesia is still in danger of facing another crisis in the near future. For this purpose, this paper consists of several sections. In the first section, it presents a statistical sketch of macro-economic conditions in some years preceding the crises in Indonesia, and as a comparison, also in Thailand, the Philippines and South Korea, which may show their fundamental economy prior to the crisis. The second section deals with the crisis and its costs. In 1998 Indonesia was in deep crisis. It started with the depreciation of rupiah, which can be said that the exchange rate volatility of rupiah was the worst among other countries affected by the crisis. And the depreciation of rupiah was then transferred into a financial/economic crisis in 1998. Some costs of the crisis are discussed in this section, including the sharp decline in private investment in the country, the escalating costs of bank recapitalisation and restructuring, and the increases of unemployment, poverty, and inflation. The political and social aspects, which should also considered as costs of the crisis are discussed in the third section. The fourth section presents and discusses recent macroeconomic development after 1998 which shows that the economic recovery, though slow has been under way since 1999 with supports from the International Monetary Fund (IMF) and the World Bank. Based on discussion in this fourth section, then the fifth section deals with discussion about the future prospect of the Indonesian economy and its important determinant factors such as the flow of foreign capital, stability of **exchange rate,** and political as well as social **environment.**

III. PRIVATIZATION AND DECENTRALIZATION

Financial Market and Reform Strategies in Developing Countries: A Case Study of Thai Telecommunications Sector

Sardar M.N. Islam
Sethapong Watanapalachaikul

ABSTRACT

The paper describes and overviews emerging issues of the financial market in developing countries and the Thai telecommunications sector. It analyses the financial characteristics in developing countries such as economic crisis, exchange rate in an open economy, and market imperfection. The recent reforms in the Thai telecommunication such as liberalisation, privatisation and globalisation are analysed to understand the general background of the recent reforms. This paper develops a valuation model which supports the existence of a significant, long-run relationship between macro and microeconomic factors and stock returns, which affects stock prices in ten telecommunications stocks listed on the SET. The model is used to identify systematic and nonsystematic risk as well as the above discussed factors and other macro and micro economic factors affecting the stocks returns. The implications of the valuation model are used for examining the effects of reform by separating the pre-reform and post-reform effects of these factors. No systematic empirical study of these issues has been done yet in the Thai Telecommunications sector. The findings of this study provide enhanced knowledge and understanding of the financial issue of the industry. This paper makes also further quantitative and qualitative investigations of the other financial issues regarding reforms in the sector.

Key words: Stock valuation, Telecommunications, Multifactor model, Arbitrage pricing, Developing economy.

An Overview of Export Processing Zones: Selected Asian Countries

Kankesu Jayanthakumaran

ABSTRACT

This paper surveys the literature on the performance of Export Processing Zones (EPZs) that have used benefit-cost analytical framework and evaluates the future in the light of proposed deregulation by World Trade Organisation (WTO). Survey reveals that as industrial development proceeds, the gap between market and opportunity cost of labour narrow and the interest on EPZs tends to wane. National interest may hold only if the zones generate private profit to domestic shareholders. Some of the recent policy measures of WTO may eventually result in lower rates of private return and may possible threat to the existing and new EPZs.

State Enterprises and Privatization in Thailand: Problems, Progress and Prospects

Praipol Koomsup

ABSTRACT

This paper examines the role and significance of state enterprises in Thailand in the past few decades. It provides a brief overview of their problems related to inefficiency and the worsening of public debt burden. It also reviews past attempts by governments to reduce the role and number of state enterprises and to improve their performance. A series of minor changes eventually culminated in a comprehensive master plan for state enterprise reform, which was approved by the government in September 1998. The plan, as part of a package for post-crisis economic recovery, was designed primarily for public-utility enterprises (electricity, telecommunication, water supplies, and public transport). It proposes privatization in service-providing activities, a clear role separation among policy formulation, regulation, and service provision, as well as a creation of independent regulatory bodies. Subsequent implementation of the plan straddles two administrations, under the leadership of Chuan Leekpai and Thaksin Shinawatra. The paper assesses the progress of the reform, and offers some explanations on factors and issues affecting the pace and direction of the reform under the dynamic political and economic environment during the past three years. Finally, the paper provides a list of research issues which are related to the state enterprise reform and need to be addressed in the future.

The Impact of Privatisation on Wages: Evidence from the Portuguese Banking Industry

Natalia Pimenta Monteiro

ABSTRACT

Although the debate about the desirability of privatisation has included labour market outcomes, most of the previous research on privatisation effects

has focused on firm performance or on the product market. This paper adopts a difference-in-difference estimator to examine the impacts of privatisation on wages in the Portuguese banking industry for the period 1989-97. The design of the reform, also known as re-privatisation, and the structure of the banking industry, provide a particularly notable opportunity to analyse the effects of privatisation using multiple control groups. The empirical evidence suggests opposite impacts according to gender: while female employees are adversely affected by the reform, male employees saw a significant improvent in their wages. These results are robust to alternative wage concepts.

Market Structure and Innovative Activity: An Econometric Analysis of Selected Indian Industries Under Economic Liberalisation

Subodh Kandamuthan

ABSTRACT

The Economic Liberalization in India was expected to boost the economy especially the industrial sector through the faster technological development. The Schumpeterian hypotheses which studies the relationship between the market structure variables like firm size and market concentration and their relationship with innovative activity have been exhaustively tested in the developed and in the Indian context. In the present study an attempt is made to study this relationship in the context of economic liberalization in India. It tries to develop a new analytical framework to study the relationship by overcoming some of the problems in the earlier studies conducted in India. The present study tries to analyse the firm-specific, product-specific and industry-specific factors affecting the decision to invest in innovative activity and its intensity after economic liberalisation in India. Probit and tobit models are used to study the decision to engage in innovative activity and its intensity respectively. The study is carried out by taking the case of two industries from the manufacturing sector viz. drugs and pharmaceuticals and electronics to take care of technological opportunities. The innovative activity is conceptualised as a combination of in-house R&D and technology import after liberalisation in India. The probit and tobit estimates thus shows that the factors affecting the decision to invest in innovative activity and its intensity differ for both the industries viz. drugs and pharmaceuticals and electronics, highlighting the presence of technological opportunities across industries. The results also showed that there is no evidence to show that firms with large size and market power are more innovative. There are also inter-industry differences in the factors affecting innovative activity, which confirms the role of technological opportunity after economic liberalisation in India.

Globalization Strategies of Automobile Assemblers in Thailand and Adaptation of Local Parts Suppliers

Kriengkrai Techakanont
Yoshi Takahashi

ABSTRACT

This paper discusses the adaptation process of assemblers and local parts suppliers in the Thai automobile industry after the economic crisis in 1997. Several changes in assemblers' investment strategies in Thailand brought about significant challenges to local parts suppliers. Structural changes in the industry, brought about by the assemblers' global purchasing and production policy of using Thailand as an export base, unquestionably imposed difficulties upon local parts makers. Survey results indicate that local firms were found lacking in 'process engineering' and 'design' capabilities, which are crucial for them to maintain orders from their customers. This study suggests that, in order to survive and sustain their growth, local firms have had to improve their technological capabilities. In the short run, they have needed to promote 'continuous improvement' in three basic areas: quality, cost, and delivery (QCD) performance, while over the longer term, they have to improve their engineering capabilities and acquire design and testing technologies. There is a great need for technological and financial alliances with foreign partners, public support in forms such as training and parts-testing centers, and the local firms' own efforts. Close collaboration between the private and public sectors is necessary for the whole industry to sustain its growth.

Foreign Direct Investments and Economic Reform in Singapore: The Importance of Ownership Structures in the New Economy

Shandre M. Thangavelu

ABSTRACT

The paper highlights the importance of local and foreign ownership structures for Singapore's growth

as the City-State stucturally adjust itself to the "Knowledge-Driven Economy" to meet the challenges of the New Economy and Globalization. The paper suggests that the ownership structures are very important for creating efficiency in local economy and thus an important conduit for knowledge creation.

Putting the Cart before the Horse: What Went Wrong with the Shareholding System in China

Damian Tobin

ABSTRACT

The Asian Crisis exposed the weak institutional structures of many Asian economies. In pursuing economic growth, many Asian countries ignored the importance of a proper institutional infrastructure, necessary to regulate economic activity. The development of the shareholding system in China clearly demonstrates the problems associated with creating a capitalist system, while failing to create the institutions that regulate such activity. A review of the shareholding system reveals that many of the problems associated with its development stem from poorly defined property rights and institutional development. The failure to create a secure system of property rights has resulted in large scale asset stripping and manipulation of shareholders. This paper indicates that in paying piecemeal attention to the development of institutions that may threaten its control over enterprise governance, the state has neglected fundamental issues concerning the corporate governance of enterprises under the shareholding system. Until these issues are addressed, it is unlikely that governance practices under the shareholding system can converge to international standards of corporate governance.

III. SOCIAL CAPITAL AND THE ENVIRONMENT

Thailand's Financial Crisis and the Social Welfare Implications

Sardar M. N. Islam
Mathew Clarke

ABSTRACT

The Thai financial crisis was a watershed in Thailand's economic development. The crisis generated considerable analysis, literature and conferences on what caused the crisis. However, comparably little work has been undertaken on exploring the development and social welfare implications of the crisis for Thailand's immediate and mid-term future. The most immediate implication of the crisis was the initial drop in income throughout the Kingdom. New numerical estimates are developed and presented in this paper that reflect the movements in social welfare resulting from the crisis. It is shown that whilst the financial crisis had a dramatic negative impact on average income levels, the processes of financial liberalisation and globalisation that preceded the crisis, were also having negative impacts on the social welfare levels of Thailand. Conventional measures of social welfare, such as Gross Domestic Product or economic growth provide misleading information on social welfare movements. By adjusting this measure for the net benefits of financial liberalisation, a more intuitively correct measure of social welfare is possible. This paper will develop a time series, 1975-1999, which estimates this new adjusted-GDP measure of social welfare. It shows that stark differences exist between unadjusted GDP measures of social welfare and financial liberalisation adjusted GDP over this time period. Following this, it is possible to undertake new analysis on the development and social welfare implications. This paper explores the opportunities for changes in public policy that can prevent further crisis. Various public policy initiatives can now be more fully considered than was possible in the past. *This paper therefore represents a significant contribution to both development and welfare economic literature.*

Keywords: Thailand, Financial Crisis, Cost-Benefit Analysis, Welfare Economics

Social Policy Responses to Economic Crisis in Four Affected Asian Countries: Thailand, Indonesia, Republic of Korea and Malaysia

Sauwalak Kittiprapas
Nimal Sanderatne
Gamini Abeysekera

ABSTRACT

The paper discusses nature of socioeconomic development, strengths and weaknesses of the four countries affected by 1997 Asian crisis: Thailand, Indonesia, Republic of Korea and Malaysia. Those factors influence the build up of the crisis and the severity of adverse impacts as well as the difference in policy and program management in response to the crisis. Impacts of the crisis on social sector, particularly on children, are synthesized. Government responses in social policies are also discussed. The paper draws some lessons learned from the crisis and policies in these four countries as well as provide some recommendations for social policy framework.

Globalization and Development: Some Issues and Empirical Facts

Somesh K Mathur

ABSTRACT

The main objective of this paper is to discuss the opportunities and the constraints imposed by globalization on the ability to undertake autonomous national development and articulate ways and means to manage the tensions and problems of globalization and to seize the opportunities of globalization. Our objective will be also to examine two long-term goals of equal importance: Environmental sustainability and Socio-economic equality. These goals often stand in contradiction to each other but strategically seen, they are nevertheless interdependent. A partial or total a renunciation of any one of these goals would endanger achieving any of the others. Globalization, then, is a process which has to be structured quickly and in a positive way. If this is to be systematically achieved, the population of the world will have to assume a high degree of responsibility for a common future. Humanity's future will only be secured if our intercourse with nature becomes more respectful, sparing, and sustainable. This will require not only all of our efforts to make use of technical advances to increase efficiency, but will also demand that we develop new sustainable life-styles which, at least, in

part will require some material renunciation. It is against this background that this paper is structured.

Income distribution and Social Sector After Crisis in South East Asia

Pundarik Mukhopadhaya

ABSTRACT

This paper examines the social impact of the recent Asian Economic crisis, drawing on the results of studies in two countries: Singapore and Thailand. The economic crisis had interrupted three decades of steady growth that had been accompanied by remarkable progress in poverty reduction and a betterment of social indicators like health and education. In particular, this crisis is feared to have a large negative effect on household welfare. It is found that absolute poverty became more acute in Thailand and with the wake of unemployment and decrease in real wages, income inequality increased both in Singapore and Thailand. This paper has examined the effect of crisis on other social indicators, such as school enrolments, dropouts and health. It is observed that the crisis has exposed significant limitations in the ability of social safety nets to cope with a negative shock of this magnitude, and manifested the need for better targeting to help households tide over their difficulties.

Strengthening the Community: Thailand's Struggle toward Sustainable Development

Patamawadee Pochanukul
Apichai Puntbasen

ABSTRACT

Localism is the mainstream ideology for alternative development in Thailand. Given the existing unbalanced and centralized development, Thai scholars focus on self-reliance as a key performance of strong community. However, the accomplishment of ultimate goal of improving community welfare is sometimes ignored. Often, it is implicitly assumed that there is a certain and positive relationship between self-reliance and welfare improvement.

This paper aims at exploring the possibilities of Thailand to develop strong communities in order to achieve a balanced and sustainable development. The desirable development implies pluralistic society in which the 4 capitals: namely, human capital, social capital, man-made capital and environmental capital, are not depreciated. By reviewing the past and present state of scattered strong communities, the paper concludes that the relationship among civil society, market and the state has evolved from the top-down control by the state towards business politics whereby the state and the market are closely bound and have control over communities. The paper foresees that the recent trend of localization will bring in a more balanced relationship between the state, the market and communities. It is also observed that no matter how communities are formulated at the beginning, the strong communities must be able to expand activities to raise welfare of community members in the long run. Being neglected by local dark influences and business politics is another characteristics of strong communities.

The paper also concludes that Thai rural community is on the right path towards sustainable development. In practice, however, confusion does exist. The study argues that the relationship between self-reliance and welfare is not always certain and automatic. Rather, being self-reliant implies risk minimizing. Moreover, a single community is not perfect and community networks are needed. Currently, any policy that leads to capacity building and learning process of rural communities can contribute to community strength. In this respect, either community business or money injection measures like village fund can empower the community. On the other hand, a policy that simply encourages exploitation of cheap community labour, either by local entrepreneurs or businessmen from outside, cannot contribute much to community empowerment. "One Tambon (Sub-district) One Product" program might fall in this trap so long as the policy makers and officials cannot distinguish or ignore different characteristics of business existing in a community.

The Marketing System of Organic Agricultural Product in Japan: Investing Social Capital to Protect the Ecology

Wanna Prayukvong

ABSTRACT

This study was undertaken to observe the marketing of organic agricultural products such as the "Tei-Kei" System or "Sanchoku" Scheme, etc., and if and how this differs from conventional marketing of normal agricultural products. A study of how conventional

marketing might be used to open a market channel for organic agricultural products was also undertaken.

The data collection was done in 2 parts: 1) a review of secondary data, and 2) in-depth interviews with representatives of successful consumer & farmer groups, which were involved with the organic agriculture movement in Japan.

The results of the study, based on a field trip in Japan in September 2001, showed that the marketing system for organic agricultural products was directed in such as way as to bypass the middlemen which are prevalent in normal marketing. The system is focused on not only exchanging products, but also, and perhaps more importantly, on creating an alternative community by establishing a relationship between farmers and consumers who have the same goal of protecting the ecology and environment of their community.

The ongoing development of this system has been underway since 1960, by using the existing social capital, an "intangible asset", and existing social organizations such as networks that facilitates social trust to be used for mutual or collective benefits or purchasing. This is in contrast to the conventional market methods, with such things as their price mechanism, property rights and enforceable rules. The alternative markets in Japan, such as SANCHOKU and the TEIKEI system, are community mechanisms based on individuals helping each other and actively helping to preserve their local environment and ecology through their consumption of essential goods. The SANCHOKU system is used by consumer cooperatives, with consumer's representative to deliver safe products from farmer to consumer. The TEIKEI system was established by the Japanese Organic Agriculture Association to be a market channel for organic agricultural products. Both systems try to foster other values also, such as philanthropy or ecological awareness, by communication, shared activities, and mutual help. The TEIKEI system is succeeding in creating alternative communities, such as Myoshi Village or Kakinoki Village.

The development of both systems continues today. The delivery systems have dramatically progressed through computer technology and modern management, but they still maintain their fundamental principals and collective participation. Various kinds of organizations, such as NGOs (Dai chi Wo Mo mura Kai) and Private Corporations (Polan Hiroba), are now active agents to expand this system in Japan.There are many obstacles to the future development of organic cooperatives such as TIEKEI or SANCHOKU, especially the rapid growth of technology and consumerism, and an aging population. But on the plus side, more people than ever are becoming aware of the need to take more care in preserving the environment, and the current trend seems to indicate good growth potential for such movements.

The Fall of the Technocrats and the Genesis of the 1997 Economic Crisis in Thailand

Apichat Satitniramai

ABSTRACT

A crucial aspect to understand the causes of the 1997 economic crisis in Thailand can be delineated in terms of the degradation of one of the strongest elements of the Thai state; namely, the macroeconomic technocratic institutions. The paper asks important questions of how the technocrats, especially those in the Bank of Thailand, who had been renowned for their integrity and expertise in macroeconomic policy making, could lead the Thai economy to such a catastrophic state. What went wrong? What was the genesis of their misguided policy decision? This study argues that the root cause of the series of poor decisions made by these technocrats, which ultimately led to the crisis, can be best understood in terms of a weakening of the technocracy as an institution. In particular, it shows that the decline in the degree of the technocrats' autonomy in decision making from the ruling elites, was caused by the deterioration of technocratic institutions—their incentive structure; their ethos and their cohesiveness—upon which their influence rested. This weakening opened up the door for intervention by the ruling elites, hence giving rise to the inconsistent decisions of the technocrats.

Community Values and Conservation: A Case Study in Ayudhya Province

Euamporn Tasarika

ABSTRACT

The temporary prosperity during the economic boom of the late 1980s and early 1990s in Thailand along with other East Asian countries had eventually disclosed its fragile reality. In retrospect, the late 1990's economic downfall is looked upon as the collapse of the misleading "bubble economy". The tragic experience somehow suggests a more humble

approach towards maintaining and firming our basic economic bases. The cause-effect rationale, then, follows that true growth is the consequence, though not strictly the outcome, of an economy with solid foundation and on-going productive activities. Observations, thus, show that post-crisis priorities have increasingly shifted from constructing growth model to creating sustainability model.

The concept of sustainability in discussion extends beyond those of impressive numerical economic indicators. What must come into serious consideration is a wider range of factors nourishing the most important component that keeps the economy alive-the workforce, which constitutes the nation's human resource. This simply relates to anything affecting the welfare of the population. In this respect, environment, the core issue of this paper, should receive no less attention than other issues. The quality of the environment not only determines the present well-being of the nation's human resource but also the long-term availability and usability of other significant non-human resources. Congruently, the other side of the equation says that the activities carried out by the workforce can, in turn, have tremendous impacts on the environment. This two-way causality now sets up the vital groundwork of this paper.

The formation of the above-mentioned rationale leads to the following systematic structure of the paper. First, a scene of discussion opens with a large non-specific paradigm, portraying the generality of the model of sustainability via social capital activities. Second, a more specific linkage between social capital and the environment is deduced and established from the general model. The main focus is on the local community level. In its application, the paper investigates the degree of influences and externalities imposed by the local-level social capital on conservation in selected districts in Ayudhya province. The paper goes on to the assessment of the case studies and policy implications that might help promote further success and alleviate any existing difficulties or problems encountered by the local – level social capital.

IV. REFORMS AND DEVELOPMENT

Development, Crisis and Localism The Search for Sustainable Development with Decentralisation in Thailand

Mogens Buch-Hansen

ABSTRACT

Globalization is not a new phenomenon and Thailand has ever since signing the Bowring Treaty in 1855 been heavily involved in all phases. During the "golden era" of colonization from 1870 to WW1 Thailand maintained its sovereignty due to the concessions given by the Bowring Treaty and skilful diplomacy by Rama IV and V.

The second phase of globalization - the development epoch - beginning with the reconstruction after WW2, was characterized by the emergence of development economics and the related development discourse. The failure to provide world-wide economic development, the debt crisis promoted by the recycling of petro-dollars through Western commercial banks, the weaknesses of the UN institutions and the emergence of the Washington consensus supported by neo-liberal economics, prompted the third phase of globalization: the triumph of neo-liberalism.

The new phase, now commonly referred to as the globalisation where strong global institutions, not least the WTO imposing legal bindings across national borders is simultaneously characterised by a process of democratisation and decentralisation in many developing countries. The economic growth rate in Thailand since the mid-1980s to the financial crisis broke out in July 1997 was for most years a two-digit figure and Thailand counted among the highest growth rates in the world. During those years, the East and Southeast Asian economies were seen by the Washington institutions as good examples of the neo-liberal prescription of liberalising trade and capital accounts that worked in promoting economic growth. The rapid growth in volume and strength of the Thai civil society during the same period is equally part of the third wave of globalisation. The economic growth had resulted in rapid deterioration of natural resources through the conversion of pristine tropical forest to agricultural land without proper maintenance of neither soil properties nor bio-diversity. Also the export-oriented manufacturing industry grew rapidly with very little attention to environmental degradation. The civil society especially after 1992 has become very active and involved in the political work of restructuring the society. The financial crisis, therefore, had wider implications than the breaking down of the financial system and the fire sale of Thai assets. The local communities and the civil society at large requested for a change of the political system through devolution of power that would ensure sustainable utilisation of natural resources.

The request for a post-Washington consensus prompted the concept of social capital, which was however severely criticised for being a concept through which conventional economists could exert their influence over social sciences. Instead this paper calls for the development of local political ecology that analyse the contradictions and possible synergies in local development and on location environmental changes in the context of environmental managers acting at various levels from the national to the global. Localism is seen as an important concept in the new phase of globalisation as the ecological, economical, socio-political and other perspectives of sustainable development only make sense when seen in their totality. This only makes sense at the local level.

Globalization and Thai Economic Reforms

Pichit Likitkijsomboon

ABSTRACT

Globalization has been widely discussed and commonly characterized by free international capital movement and weakening trade barriers. This results in intensified international competition, shorter product life cycles and large and rapid international capital and commodity movements. The Washington Consensus as the free-market economic policy agenda is seen in the globalization context as the ideological summary of the neo-liberalist nature of the ongoing globalization. While the growth generating capacity of the free-market policy is easy to accept, its welfare distribution capacity is still doubtful. Thailand must learn from its lessons from the 1997 crisis and implement an overall economic reform program further to liberalize the economy and its trade regime in order to achieve an economic recovery and sustainable economic growth in the long run.

The Emergence of the Knowledge Economy in the Financial Markets and its Reform Implications

Kok Boon Oh
Sardar M. N. Islam

ABSTRACT

The knowledge economy as a new market system for intellectual assets has created an ever-broadening spectrum of industries crucial for economic growth and the continuing economic recovery and reform of the regional economies. The emergence of e-commerce, facilitated by the rapid advances made in information and communications technology, is helping to make the regional markets more fluid and transparent. This contributes to economic development and competitiveness of the regional economies. The transformation of traditional markets to an intellectual-asset value chain is largely encouraged and facilitated by the development of e-commerce. The advance of e-commerce has been hastened by the interest in e-commerce equity investment and is a new phenomenon in the financial markets. In this paper, we conduct a review of the equity capital market as a primary source of funding for e-commerce business venture in terms of market efficiency, equity returns, volatility and predictability, and their implications for economic reforms and development in the region. The factors contributing to e-commerce equity value in the financial markets are identified, analysed and explained using a recent approach to econometric specification, including stationarity tests and cointegration modelling. This paper provides an empirical analysis of the important financial issues in the e-commerce financial market and draws on the Australian findings of various economic variables that influence Australian e-commerce equity value. From the empirical findings of the Australian study we are able to extrapolate and hypothesise the inferences on both regulatory and monetary policy formulation for the regional countries. The issues and their implications for creating an intellectual-asset value chain to advance the recovery and reform process are also discussed.

From Crisis to Recovery and Transformation: India's Experience with Economic Reform of 1990s

Sahadevan Kaithayil Bangadha

ABSTRACT

India like many emerging economies in Asia eventually joined the bandwagon of liberalization in the early 1990s. The reform which began as an emergency solution to the crisis of 1991 was subsequently transformed into a comprehensive policy packager for overall economic turnaround. It has undoubtedly led the country from deep crisis to recovery and prepared the ground for faster and sustainable growth in future with a change in the mind-set to accept the market dictum. In addition to building up of massive foreign exchange reserves through increased inflow of foreign capital, growing trends in aggregate production, improved monetary, fiscal and price situations are the indications of recovery. Notwithstanding all achievements, certain areas raise concerns about the sustainability of achievements. In order to take the entire process of macroeconomic adjustment to its logical end the quality of fiscal adjustment and monetary management need further fine-tuning. Moreover, the growing saving-investment gap and its financing through reliance on volatile foreign capital source calls for measures to step up domestic saving which has not undergone any breakthrough even after a decade of reform.

An Assessment of Thailand's Health and Education Sector Reforms in Alleviating Social Impacts

Somchai Suksiriserekul

ABSTRACT

A number of studies have pointed out that a shortage of adequate and appropriate human resources development is one of major causes of economic crisis in Thailand in 1997. Long before the outset of the crisis, reforms in education and health sectors were initiated to deal with enduring problems in the two sectors. Though the problems addressed by the reformists share common features with the causes rooted in the crisis, the social impacts derived from the latter were much more extensive than those affected by the former. The underestimation of the impact severity could imply insufficiency of the reforms originally designed. The reforms have focused on inputs and structure of the service delivery systems such as the financial support for 12 years of schooling

by the government and the universal coverage of health insurance. The importance of output and outcome of the services rendered are not emphasized so that the sustainability of Thais' education attainment, skills and health status are skeptical. As a result, the reforms designed in this way are not likely to alleviate the social impacts in the two sectors caused by an economic crisis.

Three issues are recommended to strengthen the education and health reforms. Firstly, the reforms should emphasize on the performance of strategies chosen. Priorities go to the strategies with clear and desirable performance. Secondly, the reforms should target disadvantaged groups vulnerable to the crisis. These groups are likely to be people who can supposedly afford education and health services in a normal circumstances and obtain least attention by most health and education schemes. Finally, appropriate indicators should be developed and employed in monitoring the performance and targets set out in the reforms. They can direct the reforms appropriately modifying and adjusting strategies compatible with uncertainties created by an economic crisis.

Poverty Reduction and Sectoral Growth: Evidence from Southeast Asia

Peter Warr

ABSTRACT

In recent decades, absolute poverty incidence declined in most countries of Southeast Asia. This paper examines the relationship between outcomes on poverty incidence and the rate of growth of output in the agricultural, industrial and services sectors. It assembles time series data from the 1960s to the 1990s on the headcount measure of poverty incidence for Thailand, Indonesia, Malaysia and the Philippines in aggregate and in both rural and urban areas. It then uses this pooled data set to analyse the economic determinants of changes in poverty incidence.

The results indicate that the achievement of poverty reduction was overwhelmingly attributable to the aggregate rate of growth; changes in the sectoral composition of the growth had much less impact. The poverty reduction outcome was strongly related to growth of agriculture and services, but *not* to the growth of industry. A one percentage point increase in GDP originating in agriculture makes a larger contribution to poverty reduction than a corresponding increase in GDP originating in services. But in three of the four countries growth of services made a larger net contribution to poverty reduction than growth of agriculture because the contribution that services growth has made to overall economic growth has been much larger. More surprisingly, the results indicate that the growth of industry has not contributed to poverty reduction in Southeast Asia. The paper attempts to explain these findings in terms of the economic characteristics of the sectors concerned and the policy environment in which they developed.

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Country Paper: Thailand
Thailand's Macroeconomic Policy under the Current Administration: A Proposed Alternative

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Thailand's Macroeconomic Policy under the Current Administration: A Proposed Alternative

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ABSTRACT

The country report on Thailand will concentrate on analyzing the recent macroeconomic situation and long-drawn adjustment toward recovery after the financial crisis in July 1997. Short description of the causes of the current economic crisis will first be summarized. The paper will include various recent macroeconomic policies (monetary, fiscal and others) and measures taken by the Thai authorities to counter the on-going cyclical economic downturn. Other specific and the use of quasi-fiscal measures as policy tools will also be described along with the normal Thai fiscal policy.

1. Introduction

It has now been more than five years since the eruption of the Thai financial crises (the twin crisis of currency and banking including the financial companies) in the middle of 1997. The financial crises have caused, as is now well known, menaced real economic consequences especially in the first two years following the forced domestic currency floating on July 2, 1997. Nevertheless, the Thai economy has been adjusting all along in the responses not only to the previous long-run fundamental current account (and hence balance of payments disequilibrium) with a huge accumulated external debt amounting to US$ 90.54 billion (or 60 percent of GDP) in 1996, the huge financial institution problem loans (still remaining according to the Bank of Thailand at Baht 1.04 trillion or 20.84 percent of total credit outstanding in June 2002), the ever changing external economic conditions, but also the Thai government own macroeconomic policies.

Though much progress have now been made to foster the Thai economy back toward the path of recovery, the current macroeconomic recovery remains frangible with the domestic output still below the potentially full - employment GDP level. The purpose of this short paper is a follow - up of the changing macroeconomic situation of the Thai economy. The emphasis will, however, be on the current short-run or intra-cyclical economic fluctuation and stabilization policies adopted by the Thai government in the past one to two years. The paper begins by investigating the fluctuations of various relevant macroeconomic variables of the Thai economy. This information from the collected data will be described only briefly. Then it will be followed by an analysis of the macroeconomic policy mix adopted by the present administration. The paper describes how the mix develops and changes. An alternative and better macroeconomic policy mix is then proposed if the present policy combination is

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founded to be inappropriate. The paper also makes a final comment on the intervention policy of the government.

2. Macroeconomic Variables and Relevant Facts

a. Aggregate Production

There are many important macroeconomic variables which indicate that Thai economy is now on the path of recovery. Figure 1 shows the fluctuation of output or GDP after the crisis (1997 - 2002). The total real Thai output fell precipitately from an unsustainably high average economic growth rate of 9.53 percent per year during the economic boom and asset-price bubble period (1988 - 1996) to -1.37 percent in the initial year of the crisis in 1997 and by -10.51 percent in the following year of 1998. The graph also shows that there was a recovery in production of goods and services by 4.43 and 4.64 percent during 1999 - 2000. The growth rate of real GDP was then only 1.8 percent reflecting an overall economic slowdown in 2001, as compared to the 1999 - 2000 period. However, the year-on-year quarterly growth rate of the domestic output has again recovered in the first half of 2002. The year-on-year quarterly real production rebounded to 3.89 and 5.1 percent respectively for the first and second quarter of 2002 as compared to 1.68 and 1.83 percent in 2001.

b. Employment

The employment statistics from the National Statistical Office's labor force surveys indicate a low open unemployment rate of approximately 1.5 percent in the two-year period of 1996 - 1997. But it rose after the economic crisis to peak at 5.3 percent in May 1999 after which the average unemployment rate fluctuated downward to 3.3 percent in 2001. The latest available figure of the unemployment rate for May 2002 is 3.0 percent. Unemployment is often considered to be a lagging adjusted variable relative to the leading economic recovery of production.

Employment has moved along without much lag to real output. Table 1 shows the fluctuation of the unemployment rate during 1996 - 2002-Q1.

c. Components of the Aggregate Demand

Components of the demand also change after the economic crisis. As a result of the forced floating of the value of the foreign exchange against the baht and the contractionary aggregate demand policies, severe domestic retrenchment occurred especially in the immediate 1-2 year period that followed after the midst of 1997. Private consumption fell by an average of about 5.54 percent in the last two quarters of 1997 and then declined further by as much as 11.51 percent in 1998. Private investment plunged even more i.e. by 30.44 percent in 1997 and 52.28 percent in 1998. Private investment recovered after 1999 and grew positively by 17.29 and 5.14 percent respectively in 2000 and 2001. It remains, however, volatile.

Government consumption fell marginally by only 2.83 in the first year of the crisis, 1997. But as a result of the changing government fiscal policy from a surplus (an initial IMF conditionality of a fiscal surplus together with a restrictive monetary policy targeting at the exchange rate) to an allowable fiscal deficit, the government consumption grew by 1.56 to 3.9 percent during 1998-2001. Turning to the public investment. Unlike the government consumption which can hardly be cut back due to its generally fixed current expenditures (wage compensations to state employees and debt repayments), government or public investment, after only a fiscal expenditure drag in 1997, had continued to decline up to 2001. Public investment grew negatively by 28.73, 3.13, 9.93 and 6.60 during 1998 - 2001. This may not be a good sign because public investment in infrastructure and human capital is important to provide a sustained economic development in the long run. Thailand, as a developing economy, still needs such public investment.

When the private and public investment are combined, it is found that the aggregate investment in the economy fell respectively by 20.51, 44.32 and 3.18 in the first three years after the crisis or 1997 - 1999 and then recovered very marginally by 5.46 percent in 2000 and only 0.80 percent in 2001. As for the total consumption expenditure, private and public, it fell 1.57 percent in 1997 and by 9.49 percent in 1998 and then rose by 3 to 5 percent per year during 1999 - 2001. Figure 2 gives the growth rate of private consumption, government consumption and total consumption of the economy. Figure 3 does the same for investment.

Export, as a result of the real depreciation of the domestic currency after its floating and depending also on the growth of the economy in the importing countries, expanded by 7 to 9 percent in 1997 - 1999. It grew very strongly by 17.57 percent in 2000 due basically to a strong economic growth in the trading partner countries. But Thai export fell by 4.23 percent in the following year of 2001, again due basically to the economic downturn in the importing countries especially the United States and Japan. The real value of the baht also contributed to the slowdown in the Thai export. Import declined drastically along with severe domestic contraction in the 1997 - 1998 period after which it rose more strongly than export in 1999 - 2000. But, the Thai import also fell, more than the falling export, by 8.29 percent in 2001. Thus, there has been a continuous current account surplus after the crisis. The cumulative current account surplus amounted to U.S. $ 42.33 billion during 1998 - 2001. Despite a smaller current account surplus both absolutely as well as in relation to output, Thailand's overall foreign debt has substantially declined from a peak of approximately U.S. $ 109 billion (or 70.1 percent of GDP) in 1997 to U.S. $ 64.4 billion (or 55.5 percent of GDP) in the first quarter of 2002. Figure 4 shows the current account position as a percentage of GDP and Table 2 shows the external debt situation before and after the economic crisis.

It should also be noted that the Thai economy, as expected from the baht floating, has become relatively more open as measured by an increasing share of the average export plus import - output ratio. The openness of the Thai economy rose from 45.73 percent during 1993 - 1997 to 51.69 percent during 1998 - 2001. Export itself constituted as much as 59.71 percent of output during the period of 1998 - 2001 as compared to 44.39 percent in 1993 - 1997. Even in 2001 where export in the domestic GDP statistics grew negatively at 4.23 percent, the export - output ratio remained higher at 61 percent. Export has become a more dominant part of the aggregate demand and output running counter to the policy debate and resultant desirability of the present Thai Rak Thai (TRT) government for a lesser role of the external real economic forces on the Thai economy. The fact points to a larger role of the external sector or lesser domestic self - sufficiency. The fact also has an important implication for the overall macroeconomic management policies which will later be analyzed below. Figure 5 illustrates the share of consumption, investment and export in GDP.

d. International Terms of Trade

The international terms of trade is exogenous for a small open economy. It is, however, noted that the terms of trade of Thailand fluctuated downward resulting in a deterioration of approximately 27 percent during 1996 - 2002-Q1. Though the fall in the relative price index of export to import may not be permanent, the substantial decline in a number of years after the crisis can by itself potentially depreciate the value of the baht in the floating exchange rate regime. But in the Thai case, the rise in the relative export - import volume, due basically to the supply response under the available excess capacities, has generally more than offset the decline in the relative price. There is, as explained above, a continuous trade (and current) account surplus after the crisis. However, in the 2001 world recession especially in the major Thai trading partners, the trade balance in dollar fell from U.S. $ 5.5 billion in 2000 to U.S. $ 2.5. But the current account remained a surplus of U.S. $ 6.2 billion in that same year.

e. Balance of Payments

Figure 6 shows the situation of the balance of payments during 1991 - 2002-Q2. There has been a net capital outflow made possible basically by a current account surplus after 1997. Net private capital outflow which is also very sensitive to the expected net rate of return differential between the domestic and foreign asset has been negative all along since 1997. However, the overall net annual capital outflow with an exception of 2000 was generally less than the annual current account surplus giving rise to a favorable balance of payments during 1998 - 2001. International reserve has increased while the country's external debt as explained above falls in the process of the macroeconomic fluctuation and adjustment after the crisis.

f. The Assessment of Country Risk

As a result of an improvement in the external liability of the economy as well as the turnaround of the Thai economy to a positive growth path, the market assessment of the country risk has now improved considerably. This can be seen in the calculated spread of the government bond yield denominated in the same currency between Thailand and the United States of America. The positive spread refers to the extra charge (risk premium) expected by the market for the additional risk in buying (investing in) the Thai government sovereign debt relative to the similar U.S. bond. As shown in Figure 7, this risk premium was quite small 0.035 percent prior to the economic crisis in 1997. But, it increased substantially to a height of 7.4 percent in February 1999 after which it fluctuated downward to be approximately 1.5 percent in 2001. The market - assessed risk premium for the Thai sovereign debt still remains higher by about one percentage point than the level before the crisis.

g. Inflation, Real Interest Rate and Real Exchange Rate

Inflation rate, real interest rate and real exchange are the other three variables to be observed before the analysis of the macroeconomic policy management of the current business cycle be analyzed.

Inflation, as shown by the CPI in Figure 8, indicates a temporary and continuous rise from the monthly average of 4.24 percent in the first half of 1997 and before the crisis to a peak of 10.12 percent in June 1998. Thus, there was, as expected, a rapid rise in the price level in the first year after the baht floated in July 1997. After that, the inflation rate fluctuated downward and even turned negative during May to June 1999. Then the general price index rose only 1.54 percent in 2000, 1.65 percent in 2001 and very marginally by 0.39 percent in the first half of 2002. Inflation is not, in fact, an immediate or even an emerging problem for the Thai economy at the present time. This fact has an important implication for the macroeconomic policy management.

Figure 9 also plots the inflation rate together with the interest rate both in nominal and real terms. The fluctuation of the Thai real interest is due to the movement of the inflation rate and the nominal interest rate. In the initial period under the IMF program, the restrictive monetary policy is targeted at the exchange rate stability, while the contractionary fiscal policy is meant to help raduce aggregate demand, with an intention of allowing the switching effect of the floating and much depreciated domestic currency to result eventually for a current account surplus. The nominal interest rate then rose to a historically high (about 20 percent) to dampen inflation which, as explained above, increased to peak at about 10 percent around the middle of 1998. The domestic interest rate adjusted by inflation was, therefore, very high during July 1997 to July 1998, after which it began to fall rapidly. Both inflation and the nominal interest rate tended to be much lower and the real interest rate was approximately 2 to 4 percent during the negative inflation rate of March - October 1999. The short - term interest rate in real terms was less than one percent or even negative during 2000 and the first half of 2001. But when the central bank raised the policy interest rate (14 - repurchase market rate) by a full percentage point from 1.5 percent to 2.5 percent in June 2001, the nominal interest rose pulling, given the inflation rate, the real interest rate upward. And in spite of the monetary authority's decreases of the repurchase market rate by a total of half a percentage to 2 percent on December 25, 2001 and January 21, 2002, the real interest still moves up due to a more than proportionally fall in the domestic inflation rate.

The movement of the nominal and real domestic interest rate is important not only in terms of stimulating domestic spending and some of the recent private investment recovery in certain sector notably housing sector but also helps importantly in the debt restructuring (non - performing loans in the banking sector). In the small open economy with capital account mobility, the domestic interest is also linked to the given world or external interest rates in different currencies. This leads to the international interest - rate differential and expected change in exchange rate and risk premiums or discounts among different assets as important variables, among others, determining the movement of the nominal exchange rate. This nominal exchange rate change and together with price change affect the real exchange rate which in turn will produce impacts on the aggregate demand especially the trade account and hence the growth of output and economic recovery eventually. Figures 10 shows the movement of the nominal and real effective exchange rate for the baht during January 1995 to May 2002 as calculated by the Bank of Thailand. A fall in the rate indicates a real depreciation for the baht and vice - versa for a rise. Figure 11 is also provided to indicate the real value of the baht in terms of the U.S. dollar. The graph indicates a real appreciation of the baht against the U.S. dollar especially basing on the use of the producer price index. This information is also important for the analysis of the paper below.

3. Macroeconomic Performance under the Present Administration, 2001-2002

The Thai Rak Thai's (TRT) landslide victory in the general election early last year (2001) and the eventual amalgamation of other smaller parties to the TRT has resulted in the absolute one - party dominance both at the parliament and the government usually unseen in the recent history of Thai democracy. It is highly probable that the present government is able to push through most of its own policies and reforms without much difficulty.

The TRT government has assumed the office with a different approach in the economic aspect from the relatively more market - oriented reform of the previous Democrat party - led coalition government. To the TRT own belief and its campaign platform, an economic development should also embrace a number of elements, including, for example, harnessing the hidden entrepreneurial talents of the so - called SMEs and local communities through various state support measures, strengthening the grassroot ability to make an investment and spending decision on production, commerce and finances. This has been attempts on an interventionist international trade policy especially against the foreign competition on both import and service trade and a desire to form an economic strategic alliances with Japan, China and India to open up domestic markets and increase leverage vis - a` - vis other major economic powers. The government also attempts to push exporters to move up a value chain closer to the end consumers hoping to capture a marginally more value added along the product chain, as well as forming a regional cartel on rice and rubber, two major Thai agricultural commodity exports.

However, when the present government took office in early 2001, the world economy was on the way toward a downturn. There was a substantial fall in the economic growth rate of the Thai major trading partners especially the U.S. where real GDP growth declined substantially from 3.8 pecent in 2000 to 0.3 percent. The

Japanese output, with its long - run financial problem, also fell miserably to - 0.2 percent after a spurt of growth by 2.4 percent in 2000. The export component in the Thai GDP then, as shown above, fell by 4.23 percent. This contributed negatively to the growth of GDP by 1.52 percent in 2001. The government, keeping its populist policies under the election campaign promises, began to pursue its fiscal stimulus programs. But the budget for the fiscal year 2001 (October 1, 2000 to September 30, 2001) had been already prepared by the previous government. So, not much could be altered by the present government. The planned budget deficit had been set at baht 105 billion or 2 percent of GDP. The government then decided to resort to finance its additional spendings and subsidies on various programs by means of the quasi - fiscal channels mainly through the state banks. These spending programs include principally the village and urban community fund, debt moratorium for three years on farmers debts (or debt deduction) at the Bank for Agriculture and Agricultural Co - operatives and other state - bank lendings along the government policy lines. Of all these special programs, the village and urban community fund is of short - run macroeconomic importance simply because of its sheer size (baht 80 billion or about 1.6 percent of GDP) and its flexibility in use. The committee at the level of village or the urban local community administers the fund independently under the distant oversight of the national committee. Under the village and urban community fund, 1 million baht revolving investable fund is set up for each village and local urban community to finance selected micro - credit projects for the small scale enterprises throughout the country's approximate 75,000 villages and urban communities. This micro - credit facility has begun to be disbursed since August 2001. Total outstanding disbursement up to the middle of 2000 amounted to approximately baht 60 billion. Funding for the micro - credit program is initially from the Government Savings Bank. But the principal and the interest cost will be eventually reimbursed by the government over a period of 8 years. The total and final financial cost to the government is not yet estimated or known.

To show the extent of the overall fiscal spending injection in the economy, the public - sector balance under the relatively broader concept (GFS basis) is adopted. The main benefit of a public - sector fiscal balance for the immediate analysis of this paper is that the broader and net of inter - sectoral transfer concept includes not only the central government's budgetary balance but also the other forms of balances directly outside the normal budgetary balances of the central government, local government and the non - financial public enterprises. The extra - budgetary balance includes, among other funds, the village and urban community fund. It does not include other - extra - budgetary stimulus programs notably, the debt deduction for nation - wide farmers. The total cost of this subsidy (interest and debt deduction) program is to be financed annually from the normal government annual budget beginning in 2002. The total cost is for the debt deduction for farmers estimated to be baht 18,000 million.

The public - sector fiscal balance in Table 3 shows an actual budgetary deficit of baht 110.6 billion or 2.20 percent of GDP in 2001. There was, however, a small surplus in the other combined balances, resulting in an overall deficit for the comprehensive public sector of 1.7 percent of output. But the embarkment of a substantial rise in the intended government spending in the 2002 fiscal year gave rise to a planned budgetary deficit (not shown in Table 3) of as much as baht 200,000 million or 3.6 percent of GDP. It includes the new 58 billion baht stimulus budget allocated under the central emergency reserve fund. This fund is to be used for different areas including financing training programs, programs to strengthen local communities and labor - intensive projects in agriculture and tourism and the SMEs production sector. But, as it turned out, this large and normal budgetary stimulus is not totally expended. Approximately 20 - 30 percent may have actually been spent and or in the process of disbursement. The government then expects to continue spending the unused portion in the fiscal year of 2003. The government stimulus program from the village fund is producing a relatively much stronger impact especially in fourth quarter of 2001 and the first quarter of 2002 where the total disbursement amounted to as much as baht 47,373 million or approximately

63.16 percent of the budget. However, with a rebound of the real economic growth in the first and second quarter of 2002, the central government balance as planned initially has changed. Revenue is reestimated to rise marginally while the 12.42 percent increase in the planned expenditure in 2002 is not all spent in spite of the attempted rapid disbursement of up to 70 percent of the planned 200,000 million baht deficit in the first half of the fiscal year (quarter 4, 2001 to quarter 1, 2002). Approximately 90 percent of the planned government expenditure budget for 2002 is disbursed, which is about 4 - 5 percentage point higher than 2001. The overall actual central government deficit is now estimated to be 2.7 percent of GDP instead of the earlier planned 3.6 percent. If it is compared to the same actual deficit of 2001, the central government deficit for the 2002 fiscal year is expected to be 36.33 percent higher. Moreover, when the overall public sector is included, the public sector comprehensive deficit is estimated to be 2.9 percent of the aggregate output in 2002 as compared to 1.7 percent in the previous year. (See the last line of Table 3.)

The central government actual deficit in the 2002 fiscal year is estimated to have risen by as much as 36.33 percent as compared to the last fiscal year. And even though the government budgetary short - fall (3.2 percent of GDP) is planned for 2003 to be lower than the planned deficit in 2002 (3.6 percent of GDP), the central government deficit in 2003 is still expected to be only slightly lower at 2.5 percent of expected output. (See line 7 in Table 3.) The present government has clearly adopted a much more expansionary fiscal policy in the current business cycle management. This will likely lead to a further rising public debt. The over - all public debt, including the central government debt, the FIDF or Financial Institutions Development Fund debt resolution associated with the past and on - going restructuring and debt of the non - financial public enterprises, has risen rapidly from 14.5 percent of GDP before the economic crisis to nearly 58 percent in 2001.

Though the actual expansionary fiscal policy stance of the TRT administration especially for the latter part of 2001 and first quarter of 2002 was very clear, the central bank's monetary policy was changing in a somewhat confusing manner in the middle of 2001. The short - run interest rate in the U.S. was raised in 2000 under the FED's policy of tightening in an anticipation of the expected overheating and hence higher inflation. Given the interest rate in Thailand being lower, the interest rate differential in favor of the dollar asset was then generally higher, resulting in a net private portfolio capital outflow. There was a balance of payments deficit in 2000 by approximately $ 1.6 billion. This put pressure, under the floating exchange rate regime, on the domestic currency to depreciate and in fact it depreciated from about 37 - 38 baht per dollar in the early of 2000 to around 43 baht toward the end of 2000. But when the world economy entered into a recession in 2001 the world interest rate tended to fall especially very rapidly in the U.S. to reverse its cyclical business downturn after a historically long economic expansion. The interest rate differential between Thailand and abroad became narrower and the net private capital outflow began to fall. The balance of payments deficit was also falling in the first half of 2001 to a negligible low of U.S. $ 0.232 billion. The value of the baht continued to depreciate to an average of 45.50 baht per dollar in the second quarter of 2001. As such, the event of the baht depreciation had been taking place when the present government assumed its office in early 2001. The baht had in fact been adjusting quite nicely and fundamentally right in response not only to the arbitrage outflow but also to the emerging much weaker export market. The exchange rate was playing an important role to shore up the sagging Thai export.

The depreciation of the domestic currency, however, might be of concern to the government. The government (up to the time of this writing) has also tended to oppose the falling domestic market interest rate with the belief that the lower interest rate may not be stimulating the economy while a depreciation of the domestic currency causes the baht value of foreign debt to rise and a lower market interest rate hurts depositors' interest income and hence their consumption. But, there is another important part which is not well considered by the government which is logically related to the household inter - temporal consumption behavior. A higher interest rate lowers to - day household consumption for a possible higher future consumption. Lower interest rate then should help to stimulate domestic investment and consumption. There are plenty of evidence now. A lower interest level also makes the on - going restructuring of the remaining huge corporate debt overhang less difficult. Nevertheless, the government has long signaled that it opposes the lower market determined interest rate as well as a continuous decline in the value of the baht as seen during the period of 2000 and the first half of 2001.

Thus, placating the government, the monetary authority under the change of a new leadership made a decision to raise the 14 - day repurchase rate (a monetary policy instrument which is akin to the U.S. FED - funds rate) from 1.5 to 2.5 percent in early June 2001. The reason given by the independent Bank of Thailand was, however, different. The increase was justified in its own perception to the distorted structure of the local interest rates among domestic foreign banks and Thai banks. The foreign banks borrowed from the inter - bank market and relent it to their customers at a higher interest rate creating a disadvantage to the Thai banks. A rise in the repurchase rate by the central bank would then help to correct this perceived distortion. It, of course, importantly also reduced the gap between the foreign and domestic short term interest rate. Hence, it made the net capital outflow less attractive. The baht then appreciated both nominally and in real terms. The appreciation did not nelp the dollar export situation which was already showing sign of weakness from the early 2001. The episode indicated an opportunity loss to allow the exchange rate under the managed exchange rate regime to work itself out to a marginally increase in the Thai export and hence helping to lessen the slowdown of the Thai economy in 2001. This was a short period of an inconsistent macroeconomic policy management. While fiscal policy was exceptionally expansionary, the central bank engineered the interest rate policy toward the exchange rate stability causing the baht to appreciate amidst a situation of the declining external demand due to the downturn of the current business cycle.

eless, the central bank changed its monetary policy direction by reducing ırchase rate by 0.25 percentage point twice on December 25, 2001 and 21, 2002. The 14 - day repurchase rate was down from 2.5 percent to 2.0 per annum and it has still remained at that level. This has, therefore, 1 that the monetary authority is taking a monetary policy stance in support esent government's expansionary fiscal policy to revive the growth of the y. With a return to the balance of payments surplus after the middle of e central bank has been adopting a sterilized foreign exchange intervention he monetary base rather stable and the nominal baht from appreciating too ıich can jeopardize export growth. This is clearly depicted in Figure 12.

:luding Remarks

years (1997 - 2002) of a continuous actual government budget deficit y with the ever largest deficit (inclusive of quasi - fiscal activities) . in 2002 of approximately 2.7 percent of GDP and the already agreed ion of the total expected loss of 1.4 trillion baht of the Financial ns Development Fund in the Thai financial crises, the public debt which 58 percent of GDP in 2001, will certainly rise further. This means that the ent future debt service will have to increase. Given the relatively fixed xpenditure and the rising public debt services, the government will face an g inflexibility in using the discretionary fiscal stance. Since the ent investment expenditure in the Thai government budget has usually tively more discretionary than the above two categories of relatively fixed ıre, it has already been taken the cut during this economic crisis. This, in ould not be good for the country's future economic growth and ıent.

public debt is, therefore, having an implication on the current ınomic policy mix. It is proposed that the budget deficit be reduced (preferably through tax reforms, increase in efficiency of government spending, as well as efficient corporatization and privatization of public enterprises) and the role of monetary policy and exchange rate management to support high growth with stability be adopted. Since the Bank of Thailand has also taken a relatively more and clear burden on the FIDF's debt, this part of the public debt management should also be managed such that it will not hinder the role of the monetary policy and exchange rate to support future economic growth. Though the difficulty of an appropriate and timely coordination of different macroeconomic policies should not be underestimated, the present situation of a very low inflation should allow a more expansionary monetary policy. The private sector's spending can be stimulated through the low interest rate policy. A large and continuous budget deficit through the domestic bond financing can potentially cause the interest rate to rise or not falling enough crowding out private spending as well as net export through the nominal and hence real exchange appreciation.

Furthermore, though the revolving village and urban community fund is a one - shot injection program, there are other intervention programs which cover a span of many more years. Many of these populist interventions are not well thought out and run against the concept of economic rationality. The government has paid a relatively less attention to the prudential and correct rule of marginal cost and benefit of public spending. The idea of setting up a government agency to curb imports through creating both tariff and non - tariff barriers also suggests a return to protectionism.

Moreover, the operation of the international rice and rubber cartel are likely to be unsuccessful in the long run causing an additional cost to the treasury at a time when a large public debt service is already an emerging constraint on the government's investment spending.

Table 1
Unemployment Rate, February 1996 – May 2002

1996	Feb	2.0
	May	2.0
	Aug	1.1
1997	Feb	2.2
	May	N.A.
	Aug	0.9
1998	Feb	4.6
	May	5.0
	Aug	3.4
	Nov	4.4
1999	Feb	5.2
	May	5.3
	Aug	3.0
	Nov	3.3
2000	Feb	4.3
	May	4.1
	Aug	2.4
	Nov	3.6
2001	Feb	4.2
	May	4.2
	Aug	2.1
	Nov	2.4
2002	Feb	2.8
	May	3.0

Source : National Statistical Office, as published in Bank of Thailand, Economic and Financial Statistics, June 2002.

Remark: Since 1996,the concept of "Labor Force" was revised to cover persons with the age of 15 years and over,as opposed to the original concept of 13 years and over.

Table 2
Thailand's External Debts and International Reserve to Short-term Debt, 1995-2002 Q2

	External Debts			Debt / GDP (%)	International reserve per Short-term debt (%)	Debt service ratio (%)		
	Long-Term	Short-Term	Total			Public sector	Private sector	Total
1995	48,434.0	52,398.0	100,832.0	60.0	70.7	2.8	8.6	11.4
1996	60,999.0	47,743.0	108,742.0	59.7	81.1	2.5	9.8	12.3
1997	70,982.0	38,294.0	109,276.0	70.1	70.4	2.7	13	15.7
1998	76,641.0	28,421.0	105,062.0	93.2	103.9	3.3	18.1	21.4
1999-Q1	76,590.0	25,610.0	102,200.0	86.4	116.9	3.9	17.8	21.7
1999-Q2	75,810.0	23,550.0	99,360.0	82.5	133.5	3.6	15.5	19.1
1999-Q3	75,916.0	21,471.0	97,387.0	78.9	150.7	5.4	18.8	24.2
1999-Q4	75,512.0	19,539.0	95,051.0	77.6	178.0	2.9	10.2	13.1
2000-Q1	73,602.0	17,952.0	91,554.0	73.9	179.8	5	11.1	16.1
2000-Q2	70,111.0	17,066.0	87,177.0	69.8	188.3	3.5	11.8	15.3
2000-Q3	68,467.0	15,240.0	83,707.0	67.4	211.6	3.8	13.1	16.9
2000-Q4	65,021.0	14,694.0	79,715.0	65.1	222.3	3.9	9.7	13.6
2001-Q1	61,261.0	14,545.0	75,806.0	63.5	222.0	6.8	14.2	21
2001-Q2	59,141.0	15,158.0	74,299.0	63.9	208.5	7.4	9.6	17
2001-Q3	58,158.0	14,617.0	72,775.0	63.4	223.3	9.1	15	24.1
2001-Q4	54,122.0	13,389.0	67,511.0	58.8	246.8	8.9	11.9	20.8
2002-Q1	51,248.0	13,166.0	64,414.0	55.5	255.3	10.4	11.5	21.9
2002-Q2	51,711.0	13,389.0	65,100.0	-	274.8	7.2	6.8	14

Source : Bank of Thailand, Economic and Financial Statistics, June 2002.

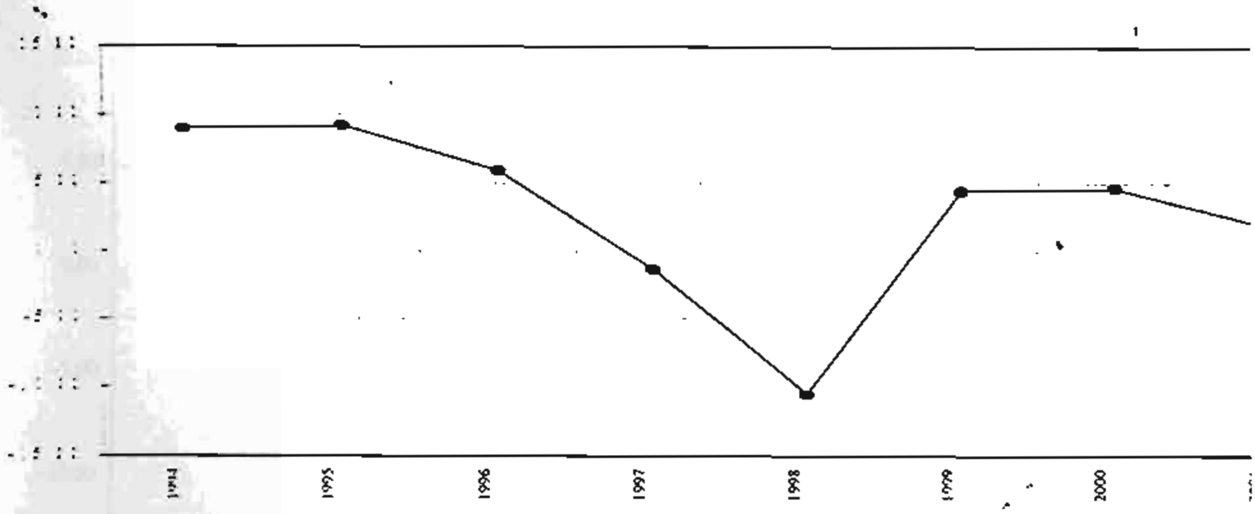
Table 3
Public - Sector Fiscal Balance (GFS Basis), Fiscal Year 2001 -2003

Fiscal Year	2001		2002 e		2003 e	
	Millions of Baht	% of GDP	Millions of Baht	% of GDP	Millions Of Baht	% of GDP
Central Government						
1. Revenue	765,396.9	15.1	833,232.0	15.9	797,000.0	14.4
2. Expenditure from Budget	875,986.8	17.3	975,849.9	18.7	967,559.0	17.5
3. Budgetary Balance (1-2)	-110589.9	-2.2	-142617.9	-2.7	-170559.0	-3.1
4. Non - Budgetary Balance Other than External Loans	25,537.3	0.5	-	-	-	-
5. Expenditure from External Loans	36,610.4	0.7	21,530.1	0.4	26,000.0	0.5
6. Extra - Budgetary Balance	18,802.0	0.4	23,914.3	0.5	59,949.9	1.1
7. Central Government Balance (3+4-5+6)	-102861	-2	-140233.7	-2.7	-136609.1	-2.5
Local Governments						
8. Revenue	144,186.8	2.8	171,975.1	3.3	196,803.0	3.6
9. Expenditure	141,721.8	2.8	169,107.7	3.2	193,028.0	3.5
10. Local Government Balance (8-9)	2,465.0	0.0	2,867.4	0.1	3,775.0	0.1
Non-Financial State Enterprises						
11. Retained Income	168,263.0	3.3	127,163.0	2.4	105,186.1	1.9
12. Capital Expenditure	152,271.0	3.0	139,472.0	2.7	120,945.9	2.2
13. Non-Financial State Enterprises Balance (11-12)	15,992.0	0.3	-12309	-0.2	-15759.9	-0.3
14. Overall Public Sector Balance (7+10+13)	-84404.0	-1.7	-149675.3	-2.9	-148593.9	-2.7

Source : Fiscal Policy Office, Ministry of Finance, August 2002
e = Estimated Value

Figure 1
Thailand's Real Economic Growth Rate

A) Yearly Data : 1994 to 2001



B) Quarterly Data : First Quarter 1994 to Second Quarter 2002

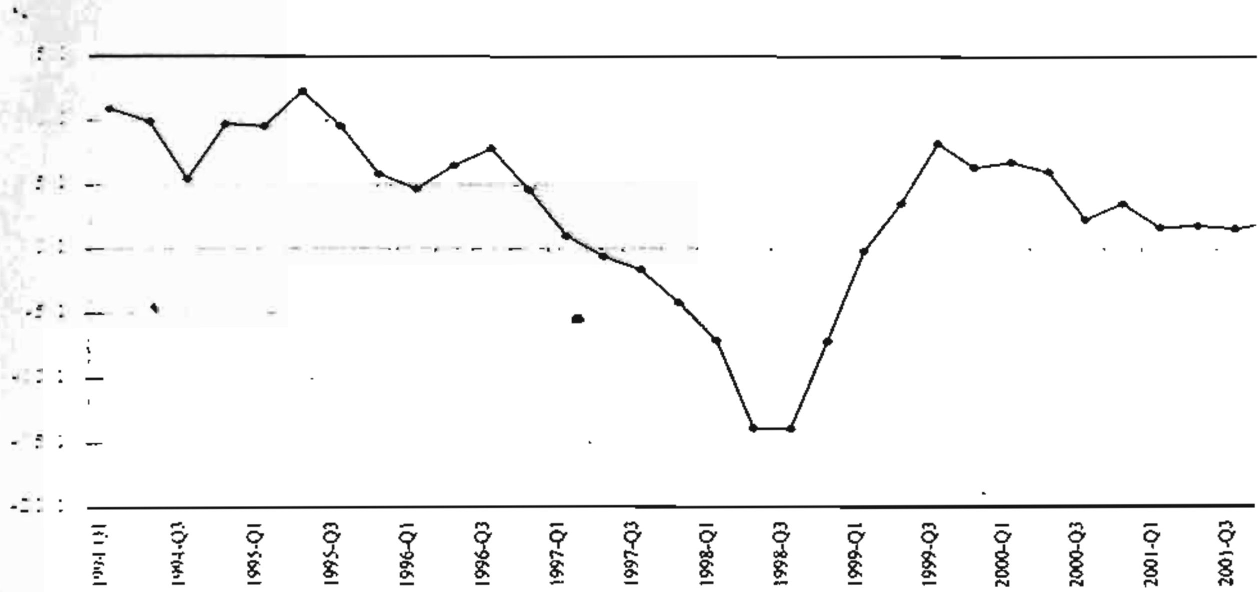


Figure 2
Growth Rate of Consumption Expenditure, 1996 - 2001

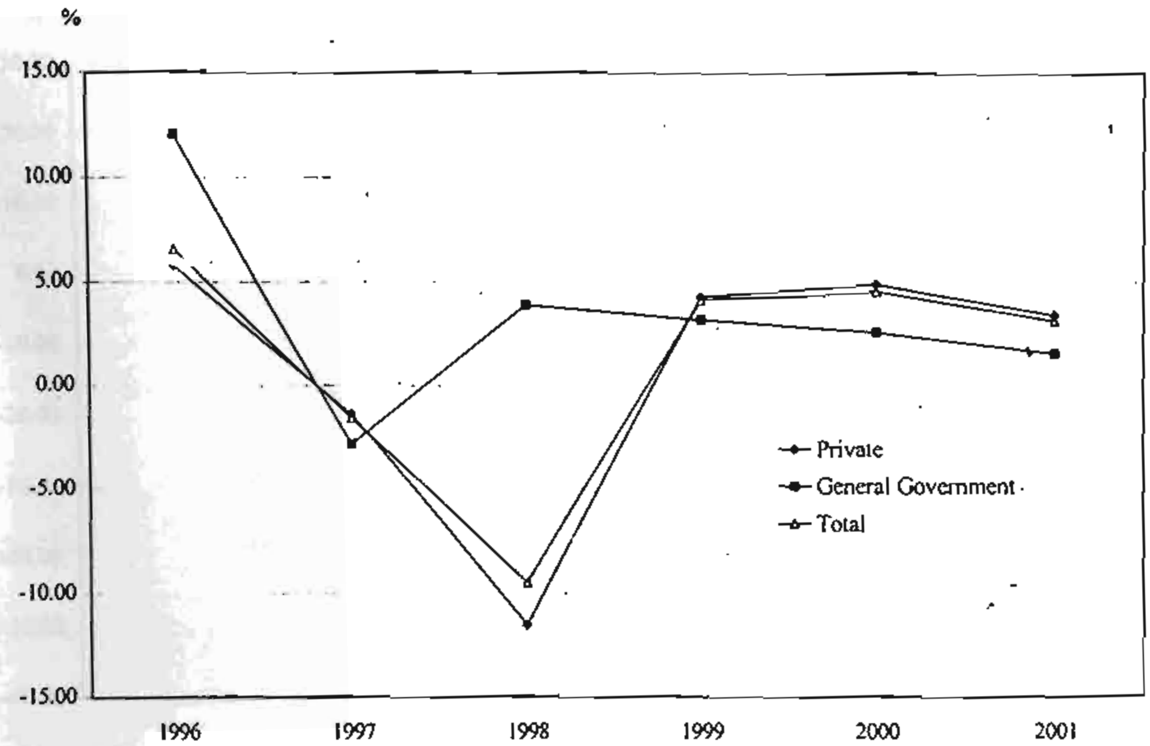


Figure 3
Growth Rate of Investment, 1996 – 2001

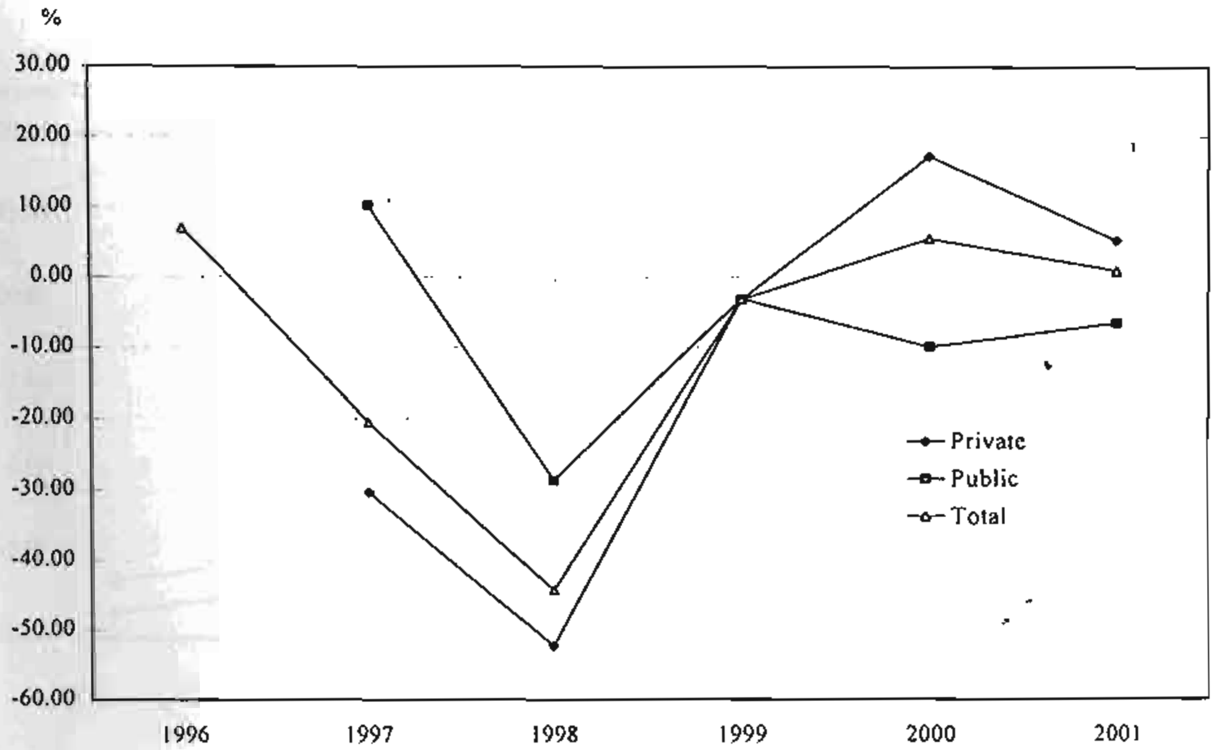


Figure 4
Thailand's Current Account Position as a Percentage of GDP,
1999 - 2001

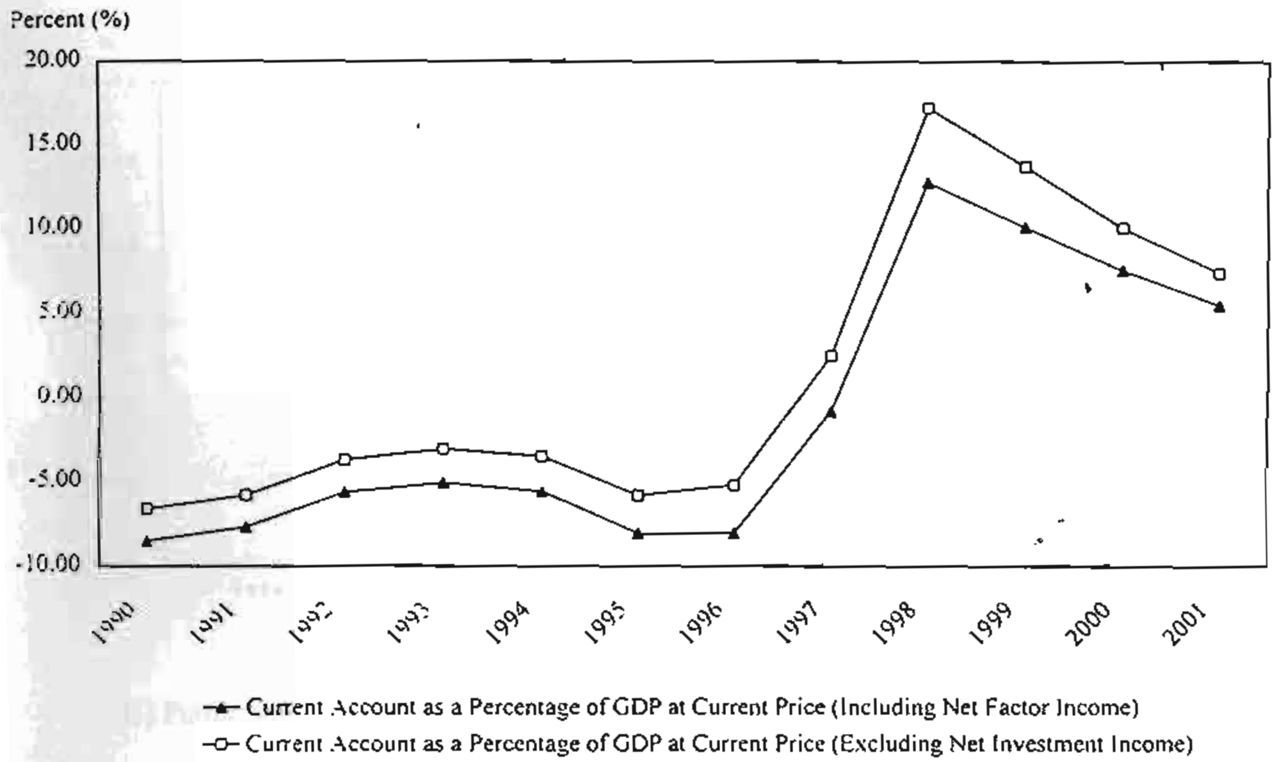
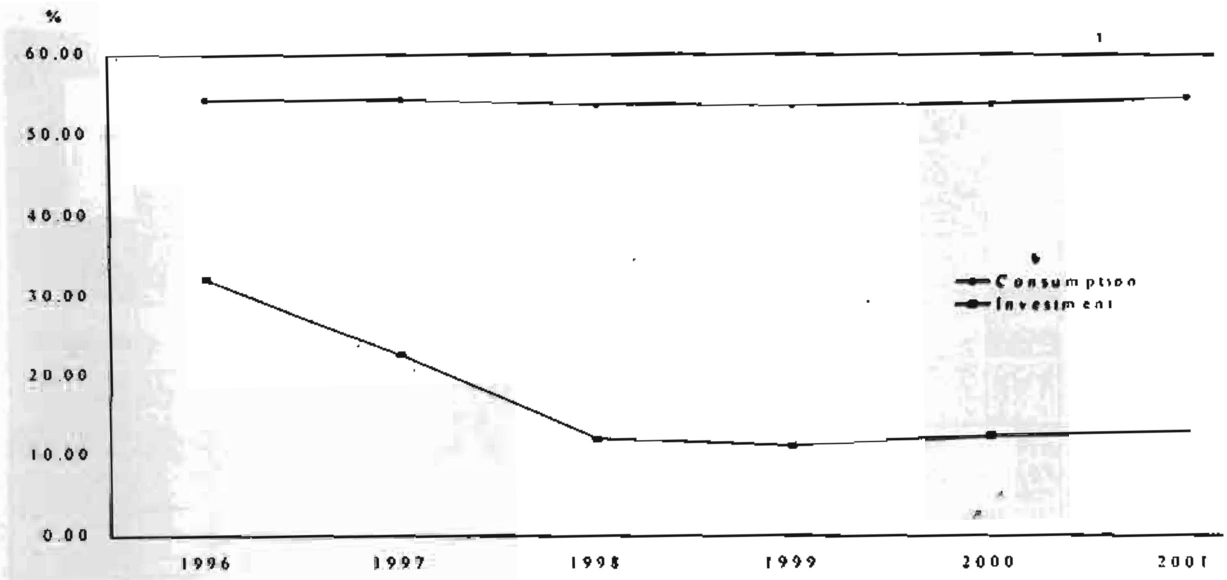


Figure 5
Consumption, Investment and Export as a percentage of GDP,
1996 - 2001

A) Private Sector



B) Public Sector

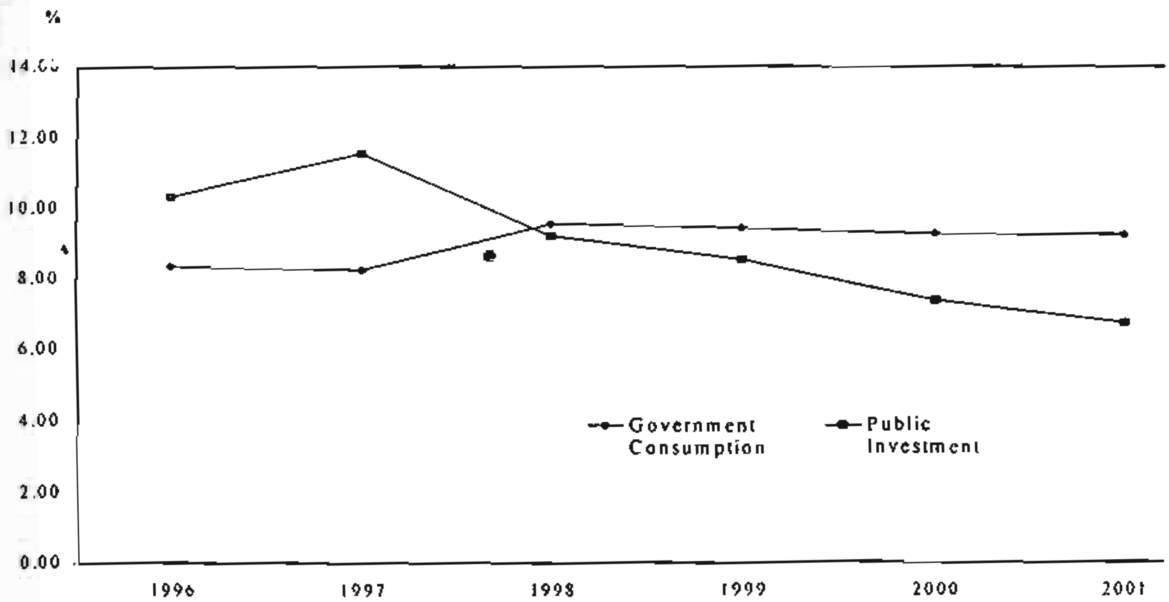


Figure 5 (Continued)

C) Export, Investment and Consumption

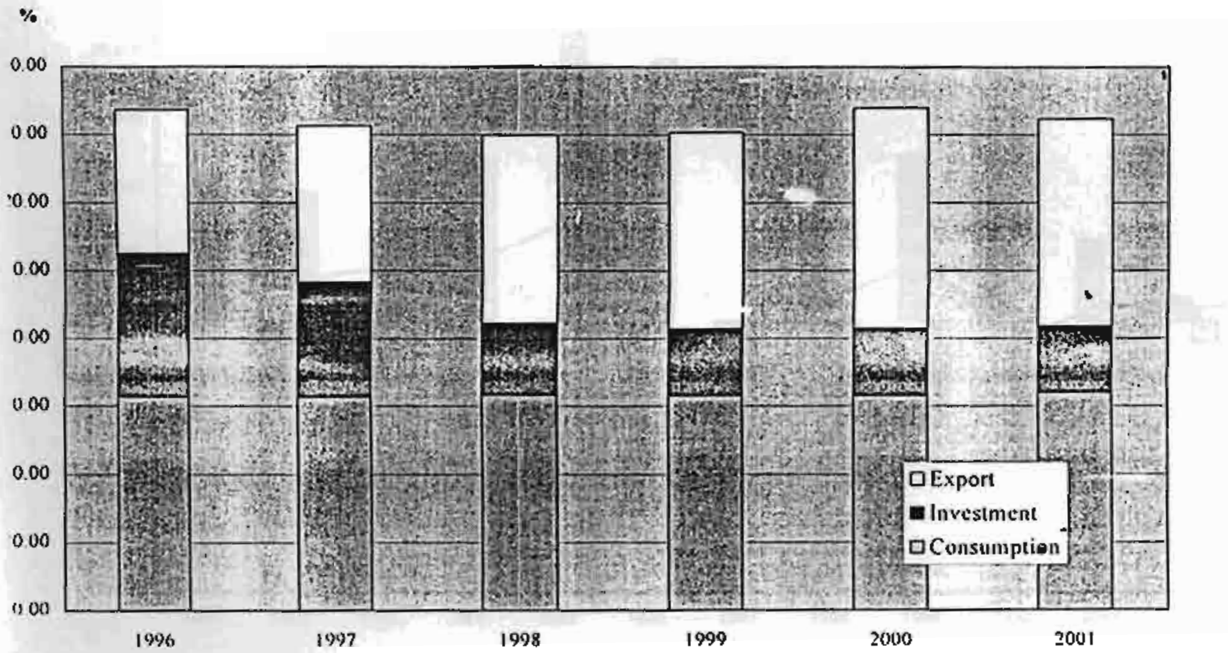


Figure 6
Balance of Payments (US$), 1991 - 2002 Q2

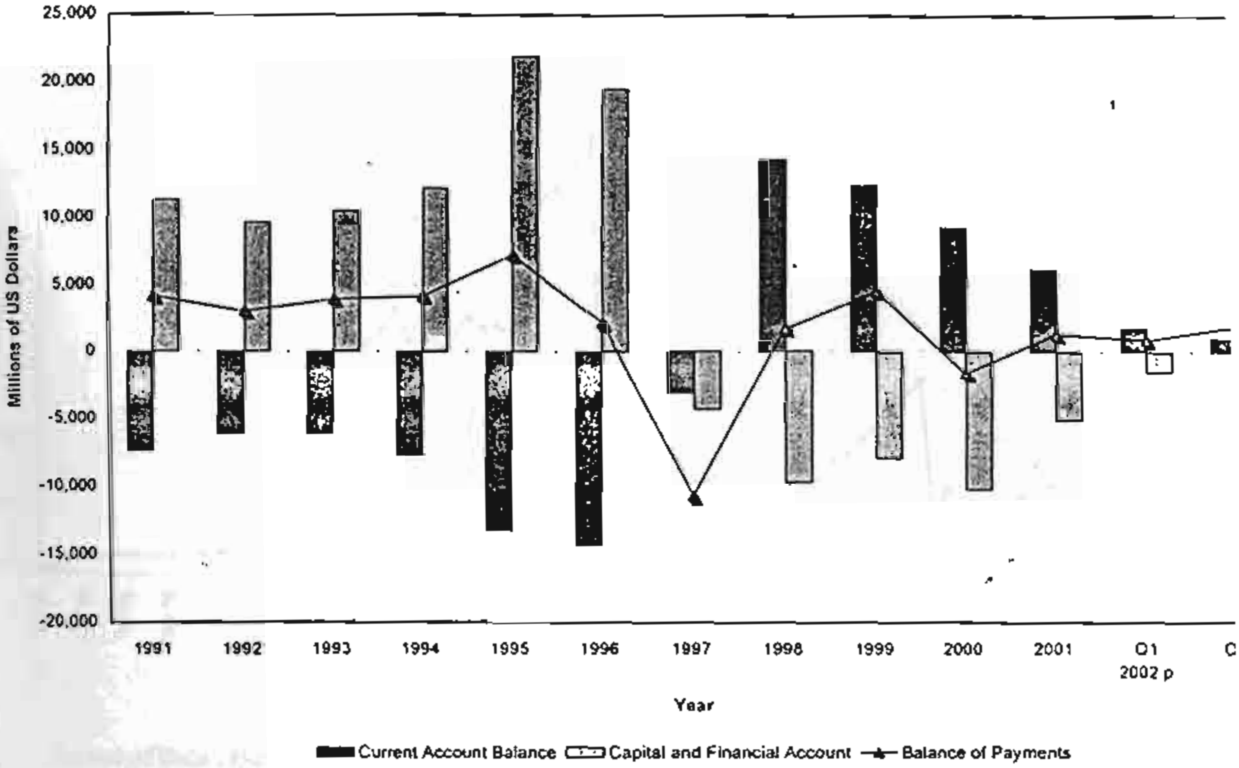
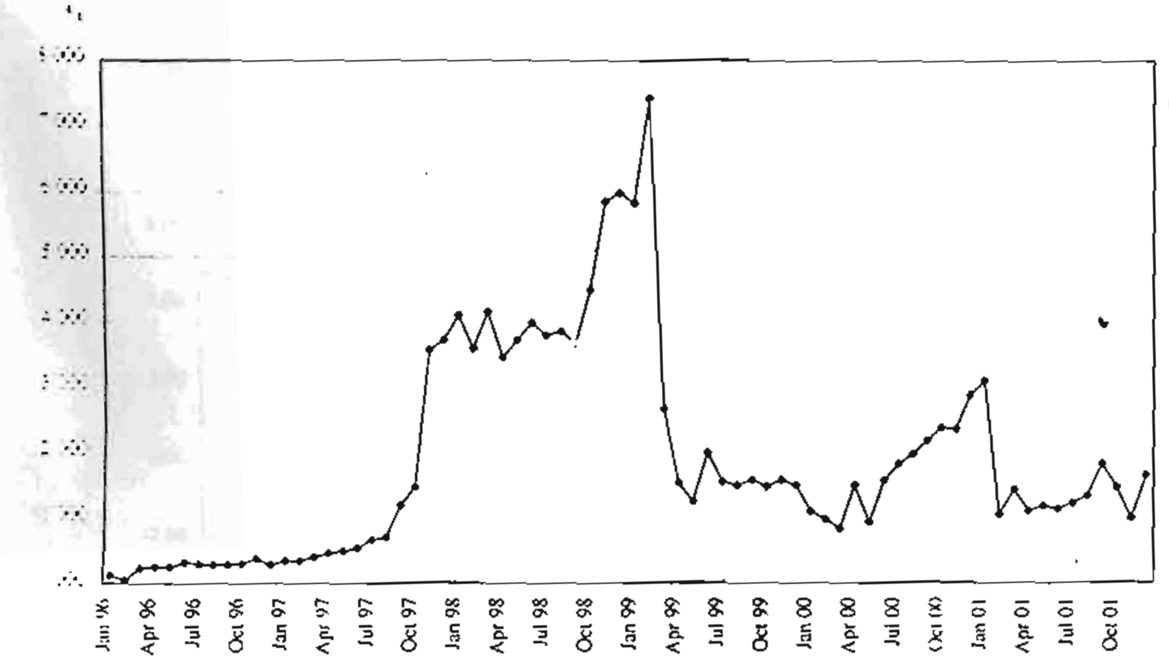
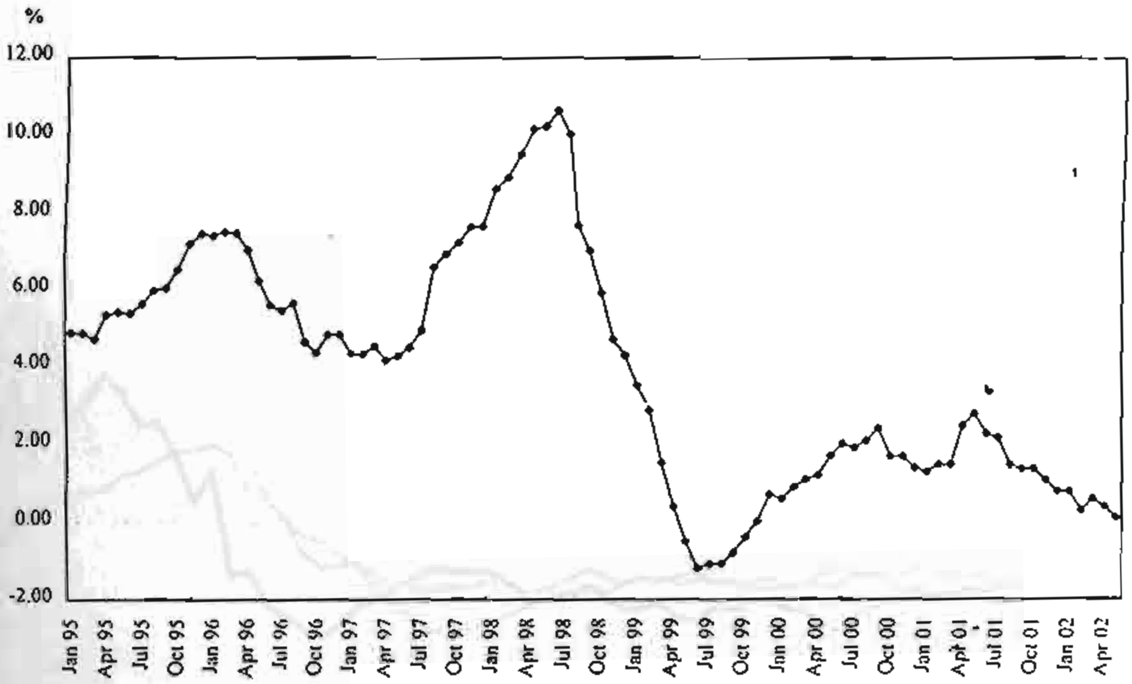


Figure 7
Estimates of Country Risk Premiums for Thailand,
January 1996 to December 2001



Source of Data : Datastream

Figure 8
Thailand's Inflation Rate (CPI), January 1995 to May 2002



Source of Data : Bank of Thailand

Figure 9
Inflation Rate (CPI), Nominal and Real Interest Rate,
January 1997 -- June 2002

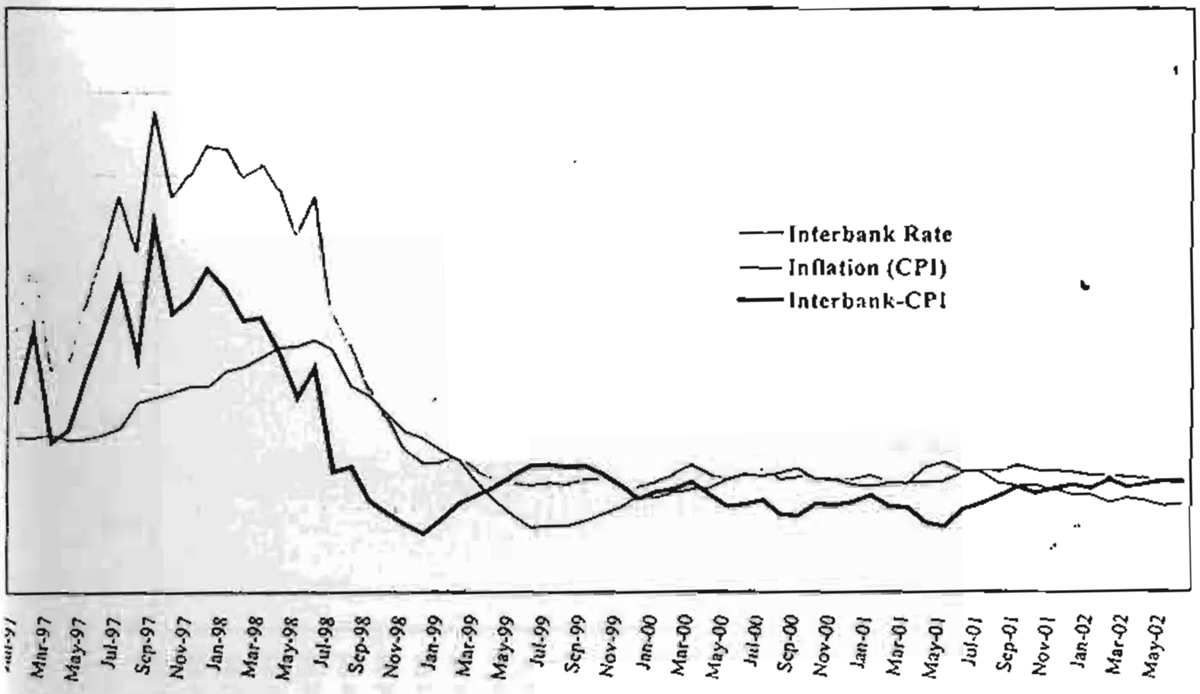


Figure 10
Nominal and Real Effective Exchange Rate of Baht in Terms of Foreign Currencies, January 1995 – May 2002

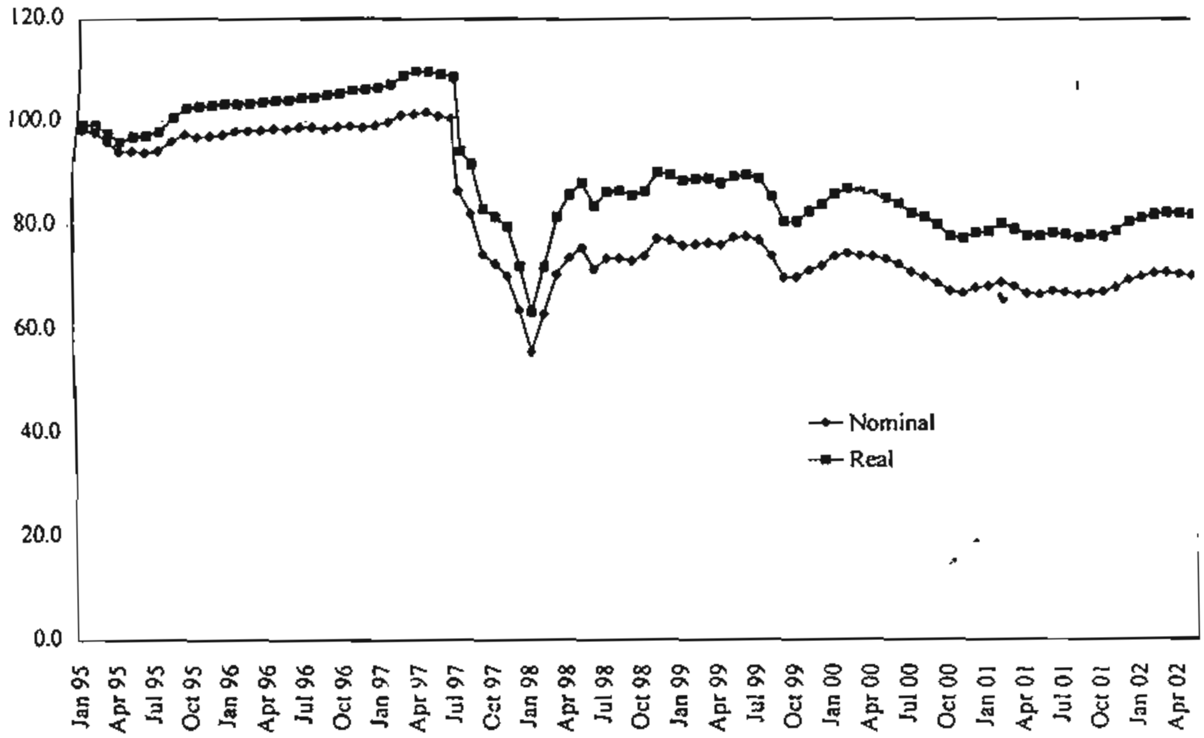
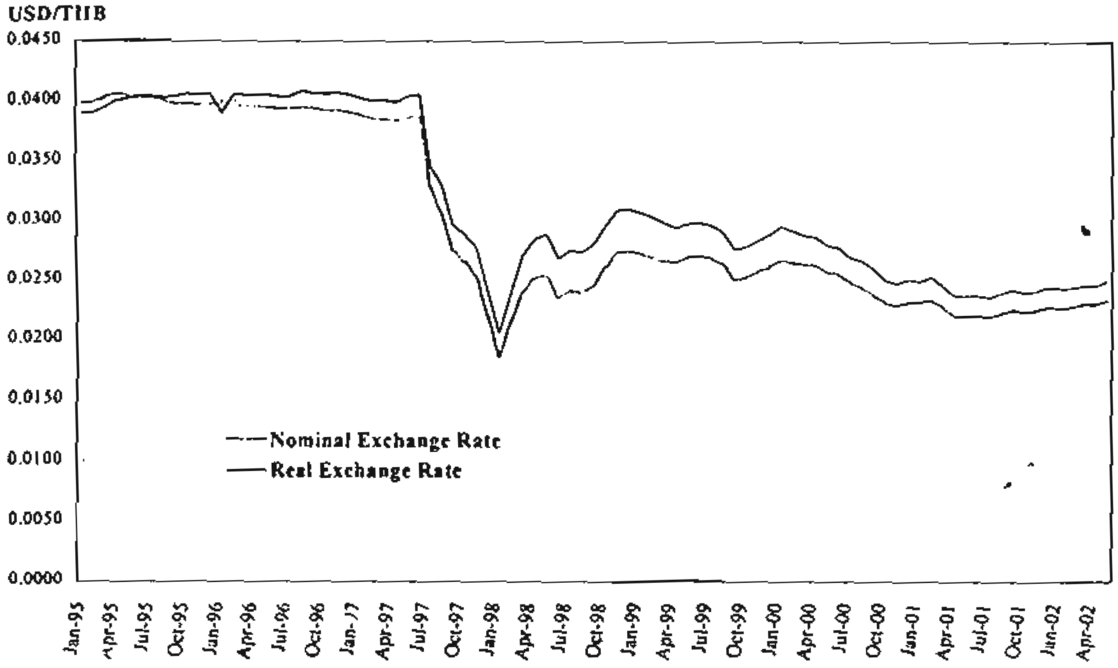


Figure 11
Nominal and Real Exchange Rate of Baht in Terms of U.S. Dollar,
January 1995 - May 2002

A) CPI Base



B) PPI Base

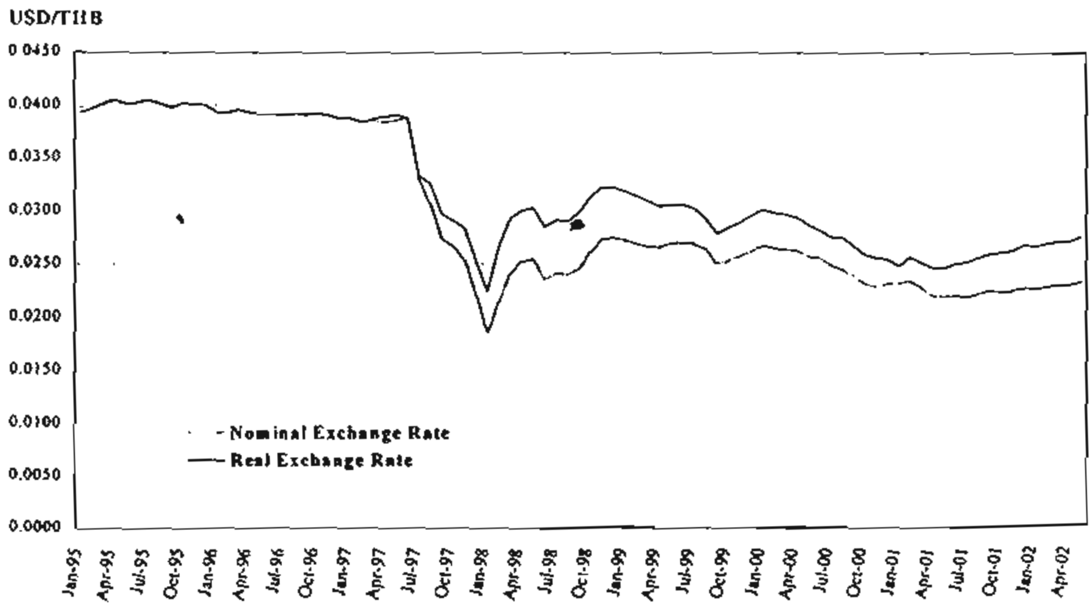
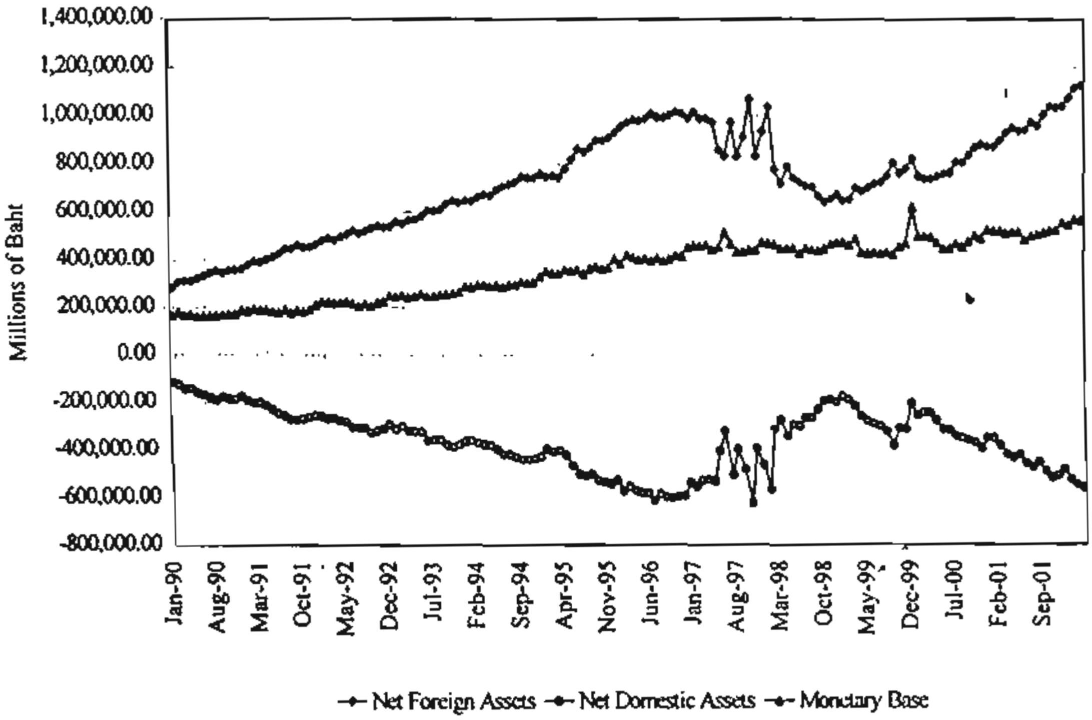


Figure 12
Net Foreign Assets, Net Domestic Assets and Monetary Base,
January 1990 – March 2002



State Enterprises and Privatization in Thailand: Problems, Progress and Prospects

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State Enterprises and Privatization in Thailand: Problems, Progress and Prospects

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Abstract

This paper examines the role and significance of state enterprises in Thailand in the past few decades. It provides a brief overview of their problems related to inefficiency and the worsening of public debt burden. It also reviews past attempts by governments to reduce the role and number of state enterprises and to improve their performance. A series of minor changes eventually culminated in a comprehensive master plan for state enterprise reform, which was approved by the government in September 1998. The plan, as part of a package for post-crisis economic recovery, was designed primarily for public-utility enterprises (electricity, telecommunication, water supplies, and public transport). It proposes privatization in service-providing activities, a clear role separation among policy formulation, regulation, and service provision, as well as a creation of independent regulatory bodies. Subsequent implementation of the plan straddles two administrations, under the leadership of Chuan Leekpai and Thaksin Shinawatra. The paper assesses the progress of the reform, and offers some explanations on factors and issues affecting the pace and direction of the reform under the dynamic political and economic environment during the past three years. Finally, the paper provides a list of research issues which are related to the state enterprise reform and need to be addressed in the future.

This paper is presented in the international conference on "Economic Recovery and Reforms", organized by the Faculty of Economics, Thammasat University, in Bangkok, on October 28-29, 2002. Financial assistance from the Thailand Research Fund, and logistical support from the Faculty of Economics, Thammasat University are gratefully acknowledged.

State Enterprises and Privatization in Thailand: Problems, Progress and Prospects

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Introduction

In the past two decades, wide-scale privatization in most industrialized countries and a number of transitional economies of former socialist countries has created worldwide interest in private participation in state enterprises and other government activities. After the 1997 financial crisis, the Thai government has paid more attention towards privatization of its enterprises, and a master plan for state enterprise reform was drawn up. The reform has been regarded as part of the policy measures designed to promote economic recovery and long-term sustainable growth. Although the plan was endorsed by the government, the issue of how to deal with problems related to state enterprises is still controversial, leading to numerous debates and some delays in implementation.

This paper first examines the role and significance of state enterprises in Thailand and gives an overview of their problems. It then briefly reviews past attempts by governments to improve state enterprise performance, culminating in the master plan in 1998. Some salient points of the plan are discussed, and criticisms of the plan are also summarized. The paper assesses the progress of plan implementation, and explains factors and issues affecting the pace and direction of the reform under the previous and present governments. Finally, the paper provides a list of research issues which are related to the state enterprise reform and need to be addressed in the future.

Role and Significance

State enterprises in Thailand have been set up for different purposes. In general the main objectives are to provide essential services in areas where private operations are considered to be neither economically and socially desirable, nor strategically adequate, nor commercially viable. They can be classified by objective into four main groups.[1] (See the list of present state enterprises in Table 1.)

The first group primarily provides basic infrastructure-related services which are of strategically economic and social importance. This includes state enterprises in electricity, water supply, telecommunication, petroleum, and transport (including buses, trains, expressways, airports, ports, and an airline). The second group operates exclusively to extract monopoly rents from vice-related activities which include tobacco and lottery. The third group was established to support military logistics by producing textiles, leather products, glass containers, preserved/canned food, and batteries to the armed forces, as well as providing dockyard facilities to the Navy. These goods and services are no longer necessary for the government to have its own production capability, since they can be readily supplied by local private firms. Thus, several of the state enterprises in this group have been, or are in the process of being, either liquidated or privatized.

The last group has its main functions in promoting the development of certain specific economic sectors or the provision of "social welfare" services. Some state enterprises are designed to provide "public goods" services, e.g. sports promotion, zoos, and botanical gardens. Some promote the development of specific sectors, e.g. wood products, rubber, dairy farming, agricultural marketing, cold storage, public warehouses, industrial estates, tourism, and scientific research. Some are designated to provide services in housing, pawnshops and pharmaceutical products for the poorer section of the population. The rest of the state enterprises in this group are state-owned financial institutions which include development banks for savings promotion, agriculture and cooperatives, housing, and export promotion. The government also owns three commercial banks: one has always been majority-owned by the government, while the other two were taken over by the government in the process of bailing out financial institutions after the 1997 financial crisis.

There are about 60 state enterprises in Thailand. Several of them, especially those in the first group, have played a significant role in providing the infrastructure vital and necessary for the function of modern economies. The total assets of all state enterprises, excluding the financial institutions, are valued at about two trillion baht, or about 40% of the present GDP. Their annual expenditure has been larger than the annual government budget in the past six years. Their total debt outstanding is about one-third of the total public debt, and most of their debts are guaranteed by the government. However, their profit remittances to the government has not been particularly significant, contributing to only about 6% of total government revenue. In terms of employment, about 250,000 workers in these state enterprises account for only 1% of the country's total labor force. (See Table 2.)

Problems

While the importance of state enterprises in the Thai economy has always been recognized, their problems have also been widely discussed. The main problems can be characterized by two symptoms: providing poor services, and creating a large financial burden to the government.

Although there has never been a systematic and comprehensive assessment of state enterprises' performance based on customers' satisfaction, it is a well-known fact that the services provided by some state enterprises, particularly those in public utilities, are not satisfactory. Their services are poor in terms of quality, coverage and reliability. The most notable cases are inter-provincial passenger trains, Bangkok buses, Bangkok ports, and water supplies. Power failures, particularly in provincial areas, are too frequent for modern factories. Telephone services in the past were regarded as totally inadequate, as subscribers had to wait for years to obtain new telephone numbers. Admittedly, improvements have be made over the past years, but serious problems still exist.

The financial burden caused by state enterprises has not been so much in terms of direct subsidies by the government. Rather, the burden is in the form of debt creation. For all state enterprises, excluding the financial institutions, the total losses which need direct government subsidy have always been much less than their combined profits. Therefore, the remittances of their profits to the state treasury have always been positive. In the fiscal year 2002, for example, the expected total profit is about 75,000 million baht, the total loss is estimated at about 11,000 million baht, resulting in the expected net profit of around 64,000 million baht; and the government plans to take in a remittance of 40,000 million baht. (National Economic and Social Development Board, 2001) It should be noted that, when the state-owned financial enterprises are included, the crisis-related losses in the three government-owned commercial banks tended to offset the net profit of non-financial state enterprises in some years after 1997. However, the more serious problem comes from the fact that the government has to guarantee most of the state enterprises debts, the outstanding of which has increased continuously over the last 15 years. Out of the total long-term debt outstanding of all state enterprises (excluding financial institutions) of 868 billion baht in 2001, over 92% are either guaranteed or directly borrowed by the government. (National Economic and Social Development Board, 2001) Before the 1997 financial crisis, state enterprises debts had risen to more than half of total public debt. The proportion is now down to one-third, but only because the government has to shoulder the massive debt created by financial institution losses as a result of the crisis.

Causes of the Problems

Causes of the problems for state enterprises in Thailand, like in many other countries, are complex and varied. Some are external to the state enterprises themselves, while others are inherent in their institutional set-up. These causes can be discussed under three groupings: financial constraints, organizational arrangements, and lack of competition.

Financial Constraints

Most state enterprises in Thailand are faced with very severe financial constraints caused by very limited revenue earnings and investment gaps. There has always been political pressure on the government against adjusting upwards the prices of services provided by state enterprises, particularly those in the "public utility" sector, such as electricity, water, passenger rail, expressways and Bangkok buses. In some cases, the issue of pricing is so much politicized that any rate adjustment has to finally be approved by the Cabinet. Since the first oil crisis in 1973-74, several state enterprise services were allowed to be sold at unrealistically low prices, despite the fact that the prices of oil and other inputs (including labor) had increased substantially. The State Railway of Thailand (SRT), which had consistently operated with profits since its inception as a state enterprise in 1951, suffered its first loss in 1974 when its rail fares were frozen as the oil prices quadrupled. Even though several fare adjustments were granted subsequently, they were simply not adequate for cost increases and SRT has continued to show losses since 1979 (the second oil crisis). For most public-utility services, some degree of cross subsidy between poor consumers and high-income (and commercial) customers is adopted. But again, in many cases the overall rates are so low that the so-called "public services" cannot be adequately subsidized by the "commercial" services. Losses in state enterprises are normally financed either by direct government subsidy or by short-term borrowing.

The rapid economic growth in the late 1980's and the first half of the 1990's created increasing demand for most services from the state enterprises. However, while there were needs for investment on facilities expansion to cope with the soaring demand, funding for the needed investment was subject to various constraints. Most new investment projects have invariably been financed by long-term borrowing with government guarantee, because most state enterprises never accumulate enough "retained income" [2] for total financing requirements. In each year these new loans are subject to two constraints: the state enterprises' ability in debt repayment, and the ceilings set on total public debts (especially foreign debts). The first constraint primarily depends on the ability of the enterprises to earn income, which, as explained above, is usually impaired by infrequent and insufficient rate adjustments. The second constraint is determined by the overall public debt situation and the country's macroeconomic performance. For most state enterprises, particularly those with large investment projects, both constraints tend to limit their ability to undertake necessary investment and productivity improvement, resulting in shortages and low quality of their services. Among those most affected by investment limits are rail, telephone, water and electricity.

Organizational Arrangements

A number of researchers have cited problems which are specifically related to the nature and characteristics of state enterprise organizational arrangements. [See Chesada Loha-Unchit (1984), Krirkkiat Pipatseritam (1984), Nipon Puaponsakorn (1984), and Kraiyudht Dhiratayakinant (1990)] These are as follows:

- Although state enterprises need some flexibility for efficient commercial operation, they actually operate under the rules and regulations which are rigid and are applied for all types and sizes of enterprises. Most of these rules and regulations seem to resemble those adopted in bureaucratic government agencies. As a result, state enterprise operation is said to be tardy and not conducive to innovation.

- The incentive and remuneration system used in state enterprises is not appropriate. Labor unions (or associations, as it is called) in state enterprises are relatively powerful, and tend to succeed in demanding for excessive wages and salaries, including bonuses and other fringe benefits. The management, on the other hand, is normally acquiescent to workers' demand for pay rises, probably because their salaries tend to rise with workers' wages. Moreover, promotion and punishment do not seem to promote work efficiency.

- The line ministries are empowered to nominate board members of the state enterprises under their supervision. For some political and bureaucratic reasons, most board members appointed tend to be high-ranking government officials and political advisors. In many cases, these appointees are not knowledgeable about the business of the enterprises, and thus cannot play an effective and active role of directors.

- The control structure indicates that at least seven government agencies control and regulate state enterprises.[3] Different agencies focus on different aspects of operation, and yet there is no one agency which looks at the overall picture. Consequently, this leads to duplications and bureaucratic delays, while no control on the overall performance of state enterprises can be achieved. Some authors explain this "lack of control" situation in terms of the principal-agent problem, where information is asymmetric between the state enterprises management (acting as an agent) on the one hand, and the ministers and government officials (acting as a principal) on the other hand.[4]

- Inappropriate interference by politicians in certain aspects of personnel management, procurement and investment project contracting in state enterprises is said to create obstacles to efficient operations. These practices may result in the politicians' financial gain and/or their political popularity. In any case, they tend to add extra costs to the affected state enterprises.

Lack of Competition

A number of state enterprises operate as monopolies, made possible by laws or by policy design. Tobacco and lottery are made state monopolies for the purpose of consumption control and government revenue. Others, like electricity, telephone and ports, are justified on the grounds of being a natural monopoly --- an activity with economies of scale. In addition, it has been argued that these public utilities have to be government-owned because it is expedient for the government to control (or regulate) prices and cross-subsidize among different consumer groups for welfare purposes. However, the problem is that these monopolies tend to discourage efforts to minimize costs and improve services. While consumers have no alternative suppliers, these state monopolies are under no market pressure to be responsive to individual consumers' needs. It is true that low-quality services are in response to the prices that have been kept low. But to some extent the quality problem is likely to be caused also by the lack of competition.

Based on the experience of privatization in various countries, it is widely accepted now that, due to technological advancements, not all activities in a utility sector have the economies-of-scale properties of being a natural monopoly. For example, in the electricity sector, some activities (transmission and distribution) do have "natural monopoly" characteristics, while others (generation and retailing) can be open for competition among different producers. In fact, some degree of competition has been introduced in Thailand in certain areas previously monopolized by state enterprises. Concessions have been granted to private firms in such sectors as telecommunication, power generation, port management, and bus services. However, there is still a problem related to regulation. In most cases, state enterprises not only regulate these concessions, but they also operate and compete with these private concession-holders. This potentially creates conflicts of interest --- a situation which could lead to unfair and discriminatory practices for private operators and consumers.

Past Improvements before the Master Plan

Efforts have been made to improve state enterprise performance since 1961 when the first national economic and social development plan was introduced. In almost every plan some measures to solve problems related to state enterprises have been included. However, actual implementation had been rather sporadic in the first three decades of the national plans. Real and active changes were made in the 1990's when high economic growth created increasing demand for the services provided by state enterprises.

The privatization process in Thailand began in earnest in the 1990's when concessions were actively granted to private firms by state enterprises in electricity, telecommunication, buses, expressways, water supply and ports. Significant service improvements were clearly observable when two telephone build-transfer-operate concessions added 3 million lines to the network within a relatively short time period. Private investment in mobile phones and other telecom services under concessions from the Telephone Organization of Thailand (TOT) and the Communication Authority of Thailand (CAT) brought more choices for the mass. In the power sector, under the Small Power Producer (SPP) and Independent Power Producer programs, private firms were given long-term contracts to invest and supply electricity to the Electricity Generating Authority of Thailand (EGAT). The total contracted capacity accounts for about 25% of the country's total generation capacity at present. These and other privatization measures have helped to expand capacities and raise qualities of infrastructure services significantly. In addition, the private participation has relieved the already heavy burden on state enterprises in new investment, thus reducing future debt burden.

However, while granting concessions to the private sector, these state enterprises still retain a high degree of asset ownership and monopoly rights in regulation and operation. Private investors in telecommunication have to transfer all equipment to

TOT and CAT before they can operate. EGAT is still the single buyer of the power produced by privately owned power plants. As already mentioned, most state enterprises in infrastructure regulate and compete with private concession holders, making it difficult to have a level playing field in competition. It seems that the purpose of these privatization measures is more to reduce the government's financial burden, rather than to promote fair competition.

For those other state enterprise activities where private enterprises are already operating commercially, the government has started to dissolve or sell or lease to private investors. Some are manufacturing factories producing gunny bags, paper, preserved food, glass, textiles, and sugar. Others include provincial trading companies, cold storage, offshore mining, and hotels. As a result, in the past decade, the number of state enterprises has been reduced from more than 100 down to about 60. [Royal Thai Government (1998)]

A plan was made to improve corporate governance and performance monitoring of state enterprises. The corporate governance system was to be made consistent with that of enterprises formed under the Public Limited Company Act, requiring certain standards of independence and qualification of board members. Recently a new set of rules was introduced for the selection of state enterprise chief executives to make it more transparent and competitive. Currently, two performance evaluation systems are adopted for state enterprises: the Good Enterprise System and the Performance Agreement System. It remains to be seen if these enterprise-level measures will yield any positive result.

<u>The Master Plan</u> [See the details in Royal Thai Government. (1998).]

It is not quite clear how the master plan for state enterprises (or the Master Plan for the rest of the article) was conceived, but apparently it is based on the belief that improvements in state enterprises will never be substantial and sustainable without a reform. The Master Plan adopts the approach which is by far the most comprehensive, compared with past efforts since 1961. It involves not only privatization, but also structural, institutional and legal changes. It was approved by the Chuan government in September 1998 and has become part of the overall economic reform program undertaken to achieve a full and sustainable recovery from the disastrous impact of the 1997 financial crisis.

As stated in the Master Plan, the reform is expected to achieve a number of objectives: stimulating overall economic growth and efficiency; providing quality services at reasonable prices; reducing the financial burden on government resources; and activating local capital markets.

Inherent in the Master Plan is the basic concept about the role of the state. The Master Plan foresees the primary role of the state as a policy maker, a planner and a regulator. The aim is for the state to ensure that quality services are properly and efficiently delivered, consumers are protected, and competition (where possible) is fair and open. The state should not operate any enterprise unless the operations are non-commercial or socially obligatory --- a situation similar to a market failure. This implies that the private sector should be allowed to operate and compete in commercial activities. In addition, the Master Plan advocates clear separation of the following three functions: policy making, regulation, and operation.

The Master Plan focuses mainly on the four infrastructure sectors, namely energy, telecommunication, transport and water. The recommended guidelines for sectoral and market restructuring are to separate each sector into different activities, allow competition in the activities where more than one operator is economically desirable, and introduce proper regulation in those where monopoly is unavoidable. The restructuring involves the corporatization, reorganization and privatization of existing state enterprises, as well as different types of private participation in service provision. Another important feature of the restructuring is the introduction of an effective regulatory regime.

A good example of details in the sectoral restructuring can be shown by the restructuring plan for the energy sector, which so far has more details than the other three sectors. According to the Master Plan and subsequent detailed studies,[5] the future of the electricity sector will follow the competitive model adopted in several countries which have privatized their state enterprises. The electricity supply industry can conceptually be divided into four parts: generation, transmission, distribution, and retailing, all of which are currently handled by three state monopolies, namely the Electricity Generating Authority of Thailand (EGAT) in generation and transmission, and the Metropolitan Electricity Authority (MEA) and the Provincial Electricity Authority (PEA) in distribution and retailing. The recommended changes will lead to separation of generation companies from power transmission --- the former to be open for competition and the latter to be a regulated monopoly (due to economies of scale). A competitive market, the "power pool", where wholesale trading will take place, is planned to be established by 2003. Distribution will become more competitive and regionally disperse, though distributing companies will be regulated because of their "locality" monopolistic nature. Retail competition will be introduced, initially for large customers, and would gradually expand to cover household users.

To run the power pool efficiently, three new entities are recommended. An Independent System Operator (ISO) is needed to monitor and control the power system operation in accordance with specified standards, and to ensure that the overall generation cost of the system is kept at the minimum by allowing generators to be run according to the generation cost merit order. A Market Operator (MO) is needed to administer the power pool, and a Settlement Administrator (SA) is to manage the billing and settlements among market participants.

EGAT would have to undergo significant changes with separation between generating and transmission businesses. It was suggested that EGAT's generation assets be divided into four groups: Ratchaburi power plant (which is now 45% owned by EGAT), two groups of its thermal plants (called Powergen 1 and Powergen 2), and its hydropower plants. The first three groups will be corporatized and eventually privatized. The final scenario is to have competition in generation among these three groups, the independent power producers, the small power producers, and sources in neighboring countries (Laos, Myanmar, and South China). The transmission company will initially be owned by EGAT, but may be privatized after the power pool is set up.

MEA and PEA will be transformed into about 13 regulated entities, providing distribution services and supplying power to all consumers in their respective geographical areas. At the retail level, other private firms will be allowed to compete fairly with them. Eventually these 13 entities could concentrate on the distribution business, and leave the retailing activity to active competition among private firms.

In the natural gas sector, where the Petroleum Authority of Thailand (PTT) hold a monopoly in pipelines, the Master Plan calls for separation between transmission pipelines, distribution pipelines and gas trading. Competition will be promoted by introducing the third party access rules on the transmission services, which will be regulated to ensure fair pricing and nondiscriminatory treatment in pipeline services. PTT is to be corporatized and listed in the stock market.

In the telecommunications sector, there is a master plan for the sector which was approved by the cabinet in November 1997. The main objectives in of the plan are to separate the roles of operators and regulator, to corporatize and privatize the two state enterprises (TOT and CAT), and to liberalize the industry. The plan also provides a framework for the formation of a holding company in which both TOT and CAT become operating subsidiaries. The holding company was designed to prevent wasteful competition between the privatized TOT and CAT in the future, and to be a channel through which profits from the telecom business can be used to cross-subsidize the loss-making post service (which is currently part of CAT operations). Privatization of TOT and CAT was expected to lead to some strategic partners holding shares of no more than 25%.

Complete liberalization in the telecom market is expected in 2006, in accordance with Thailand's commitment made in a WTO agreement. The telecom master plan suggests a market structure which allows for three types of operators: the service provider, the network provider, and the network-and-service provider. In the liberalization process, the first type will be allowed to compete in a relatively free market, while the other two types will be regulated because of their monopoly in the network service. There are currently about 30 concession contracts between the two state enterprises and private firms. The issue which remains unsolved is whether and how these contracts can be converted in such a manner that is fair to both parties to the contracts, and is also conducive to free and fair competition in the future liberalized market.

In the transport sector, there are 14 state enterprises operating in the three modes (land, water, and air). As in other sectors, the principle of role separation (policy, regulation, and operation) and market restructuring is advocated for the sector in the Master Plan. There is also a proposal to have transport authorities, whose function is to act as a landlord managing concessions granted to private operators. However, The main issue for the transport sector is how to solve the losses of train and Bangkok bus operators. A detailed study suggests that the railway operations be divided into four groups: rail infrastructure (rail tracks, and signaling), train operation, maintenance, and non-rail assets. These groups should be managed separately, with funding from different sources. While some are financed by the government (e.g. infrastructure), and some are operated by state enterprises, the rest should be privatized. In the case of Bangkok buses, a proposal was made to transfer the operation to the Bangkok local government, so that any subsidy would have to come from taxes and fees collected from the Bangkokians.

A number of privatization options for the water sector are suggested in the Master Plan. Two options for the Metropolitan Water Authority (MWA) are: to horizontally separate into two companies which grant concessions to private operators in some activities, and to corporatize MWA and find strategic partners to operate and manage through management contracts. For the Provincial Water Authority (PWA), it was proposed that after horizontal unbundling, PWA act as a contract manager overseeing concession arrangements for different regions.

For successful state enterprise reform, the Master Plan emphasizes that, there is a need not only for clear separation of policy making, regulation and operation, but also for appropriate regulatory regimes which provide confidence to investors and stability to markets and consumers. Individual regulatory bodies are recommended in each of the four infrastructure sectors, particularly for areas where some monopolistic activities are unavoidable and, therefore, must be regulated. The functions of the regulator are: issuing licenses, setting prices (tariffs), regulating service quality, regulating network access, ensuring fair and transparent competition, addressing consumer complaints, and advising the government in policy and planning. To be effective, the regulator must have adequate resources and autonomy (or independence) to avoid undue pressure from interested parties (i.e. the government, the consumers, and the operators). The regulator should be consistent and fair in his decisions, and should demonstrate reliability, accountability and transparency in his actions. The role of the regulator is to ensure that consumers are protected, competition is fair among operators, while investors get reasonable profits, and sufficient investment is attracted.

<u>Progress and Dissent</u>

During the Chuan government, some progress in state enterprise reform had been made along the guidelines provided in the Master Plan. Most of the changes were in preparatory work in the form of detailed studies made for specific state enterprises, including the three electricity authorities, PTT, the Port Authority of Thailand, and a few transport entities. In terms of actual privatization, the Ratchaburi Electricity Generating Holding Public Co., Ltd. (RHCO) was the only state-owned company that had been listed on the Stock Exchange of Thailand and 65% privatized in 2000. Forty percent of RHCO shares were sold the general public, and 15% were sold at par value to EGAT employees and the EGAT Provident Fund, while 45% were retained by EGAT. The sales brought in over 50 billion baht to EGAT, and alleviated EGAT's liquidity problems to some extent.

Two laws were enacted to facilitate the reform. The State Enterprise Corporatization Act was passed by the Parliament in December 1999. Objections were raised on the grounds that the law was unconstitutional, but the Constitutional Court eventually ruled against the objections. The law enables state enterprises to convert equity into shares, thus transforming them into liability-limited companies, paving way for privatization. Another law, called the Frequency Allocation Commission Act, was enacted in 2000 to establish the National Telecommunication Commission (NTC) which is the regulator for telecommunication services. The law was in fact required by the 1997 Constitution to make broadcasting of television and radio free from government influence by creating an independent commission for frequency allocation. It was later found that the task of this commission must somehow include allocating telecom frequencies, and thus NTC was conceived. It is interesting to note that the independence and roles of NTC, as specified by the law, are similar to the guidelines for a regulatory body proposed in the Master Plan.[6]

The approach of economic regulation by independent bodies, as proposed in the Master Plan, is new to Thailand.[7] It is therefore important to create a regulatory framework which can function within the Thai context. A subcommittee was set up to draw up detailed guidelines for such a framework, and they were approved by the cabinet in 1999. The guidelines propose sectoral commissions, each of which consists of 3 – 5 members, headed by an executive chairman with power to establish a secretariat for the commission. [See the guidelines in State Enterprise Policy Committee (1999)] Details are also given about the powers and duties, the qualifications, the tenure and conditions of appointment, and the criteria and procedures of dismissal of commission members to ensure competence and independence. The guidelines also include recommendations on how the commission is funded, how consumers are represented and how disputes among different parties are resolved. To be accountable, the commission is required to present an annual report to the Parliament and make it available to the public, as well as to have the accounts audited. Based on these guidelines, a Draft Energy Industry Act was developed to establish an independent regulatory body in the energy sector. The Act also includes a legal framework for creating the power pool and the new entities, as proposed in the restructuring plan for the energy sector.

Setting up an independent regulatory body requires personnel with a mix of skills and other resources which are difficult to acquire. A training and development plan was prepared to address the technical manpower problem. The training programs include short course training, structured training, placement in overseas regulatory authorities, scholarships for graduate programs, and the establishment of a regulatory research institute.

Like any other reforms, the state enterprise reform has been a subject of much controversy. The Master Plan has been criticized by different groups based on various motives and reasons. The state enterprise employees are opposed to it mainly for fear of losing their jobs; and they occasionally made their case known by staging public demonstrations. Some academicians argue against it because of their intellectual belief. Some businessmen, politicians, and activists do not agree with the reform due to their nationalistic, or even xenophobic, behavior. Their views against the Master Plan can be summarized as follows.[8]

- Many expect that privatization would lead to massive unemployment among state enterprise workers, particularly those with low-skill jobs. This would worsen the unemployment situation which has become very serious since the 1997 financial crisis. This argument is often heard despite the insistence by the government that any retrenchment must be gradual and voluntary, and that those terminated due to privatization will be generously compensated.
- Some believe that state enterprises providing utility services should remain state-owned, and that, with some improvements in their organizations, they can become efficient. There is no need for privatization. Some even believe that a few state enterprises in Thailand are already operating efficiently, and the only problem comes from government finance. [For example, in the case of EGAT see Kasem Chatikawanit (1990).]

- Just after the financial crisis which has weakened the Thai private businesses, privatization would certainly amount to selling state enterprises' assets to foreign multinational corporations. Under financial distress, the government may be forced to sell them at low prices. Eventually, the economy will be excessively dominated by foreign investment. Since the reform is part of the economic recovery package required by the IMF, some people even imply that the IMF conditionality is intentionally biased in favor of industrial countries, from which most MNCs are operated. This argument is sometimes used against the so-called "Washington Consensus".
- The sale of state enterprise shares would not be transparent and accountable. This would lead to corruption among politicians and officials who are involved in privatization.
- Some of the proceeds from privatization is earmarked for the Financial Institution Development Fund (FIDF) to reduce the debt burden incurred during the financial crisis. This is regarded as a bail-out to help the rich -- owners of banks and big businesses – at the expense of the tax payers.
- Privatization and market restructuring would not lead to efficiency, reasonable prices and stable markets. The services provided by private operators would in fact become more expensive, because they would only try to maximize profits and the regulator would never be as effective as envisaged in the Master Plan. Some critics cite the California energy crisis in 2000, and Argentina's financial crisis in 2001 as examples of failure caused by privatization and market liberalization.

"New Thinking, New Doing": Emphasis Shift or Direction Change?

The Thaksin government came to power in February 2001. Its political slogan of "new thinking, new doing" suggests its new approach in tackling the crisis-related problems. The new economic team seemed to put more emphasis on fast economic recovery, and regarded the privatization part of the state enterprises reform as a driver in stimulating the economy. The concept was that by selling newly issued shares of state enterprises in the stock market, the increased volume in the market would encourage more investment and consumer spending, promoting economic growth and recovery.

Fourteen enterprises were identified as candidates for "fast track" corporatization and listing on the Stock Exchange of Thailand by 2003. Among them are state enterprises in petroleum, electricity, telecom, airports, ports, banks, tobacco and water supply. The total assets of these candidates was estimated at 1.6 trillion baht, or about 79% of the total assets of all non-financial state enterprises. [See National Economic and Social Development Board (2002).] Further share selling to private investors was also planned for four other state enterprises which have already been listed in the stock market. Up to August 2002, two state enterprises (Internet Thailand, Co. Ltd., and PTT) have been listed, and some of their shares have been floated in the stock market. The Airport Authority, TOT and CAT will soon be corporatized and listed in the stock market, where about 30% of their shares will be sold to the public. It is interesting to note that, even with all these listings and share selling according to the plan, the government would still maintain its majority ownership in most of these 18 enterprises. In this case, privatization is therefore only partial, with control and management still in the hands of the government.

Related to these partially privatized enterprises is the idea of creating a state-owned super-holding company – the State Investment Corporation (SIC). [See Ministry of Finance (2001) and the Draft SIC Act.] To ensure "professional" management, efficiency and good governance in these enterprises, SIC would be established to oversee their business policies and manage the government's investment portfolio – the concept similar to the roles played by a state-owned holding company in Singapore. SIC board of directors would be chaired by the Minister of Finance, and it would also be a channel through which revenues and profits from privatization and operation are remitted to the Ministry of Finance. The remaining state enterprises, which would not be privatized and would provide "non-commercial" but essential services, would be overseen by line ministers as before. A newly created National State Enterprise Policy Committee (NSEPC), chaired by the Prime Minister, would set policy for both "commercial" enterprises (under SIC) and "non-commercial" enterprises (under line ministries).

Some observations can be made on the Thaksin government policy of state enterprise reform:

Firstly, the selling of state enterprises' shares in the stock market will bring revenues to the government and lighten its fiscal burden in the short run, as in the case of the privatization of RHCO and PTT in the past. But the sale represents partial privatization, and the government intends to remain a major shareholder. In the long run, if these enterprises are still majority-owned by the government, future investment by these enterprises will mainly be the responsibility of the government. If so, then the problem of investment constraint imposed by the public debt situation, which is likely to worsen in the next decade, will never be solved. Moreover, it has been argued that the stock market will bring market discipline to these state enterprises: the board and the management give high priority to efficiency, and the companies are immune from any political pressure. However, there is no guarantee that the government as a major shareholder will refrain from interfering without affecting the companies' profitability. For instance, it is a moot point whether the government will use PTT as a tool to keep retail oil prices down, lowering its profit, when the world prices of oil become very high. It is not clear at this point whether and to what extent government ownership will eventually be reduced.

Secondly, assuming that some sectors will be open for competition, the government's major shareholding in these enterprises could raise a question of fairness in the markets. Government ownership could deter new entrants, thus discouraging future competition. It is possible that some laws and regulations could be designed in such a way as to be biased in favor of state enterprises. Being a state entity, SIC itself is likely to be exempted from profit taxes. While its mandate is to manage government assets commercially with a profit motive, its tax-exempt status may put private holding companies at a disadvantage.

Thirdly, the government decided to sell state enterprise shares mainly (or only?) to individual Thai investors through initial public offering or IPO. This is perhaps in response to the criticism that privatization is selling national assets cheaply to foreigners, leading to foreign domination. Such a restriction excludes the possibility of attracting foreign strategic partners, thus losing the opportunity of benefiting from the technology, marketing and management experiences of multinational corporations.

Fourthly, the policy shift toward fast-track corporatization and partial privatization has drawn the attention and efforts away from market restructuring and regulatory reforms – the other essential programs in the Master Plan. Appointment of the National Telecommunication Commission (NTC) – the regulator in the telecom sector-- has been delayed for two years, because the Senate rejected the candidate selection process and the government has so far refused to take further action. There has been a rethinking on the market design for electricity, as the competitive power pool model, approved by the Chuan government, was thought to have some flaws. A number of alternatives have been proposed, including the "third party access" model and the Nordic model, but no decision has been made on the type of market arrangement in the power sector. The Draft Energy Industry Act containing a blueprint for future market and regulation has been shelved. There is at present no definite and detailed plan on the sectoral and regulatory restructuring of the whole transport sector, including ports and airports. The delay and uncertainty has been caused partly by the indecision at the policy level, partly by the state enterprises' opposition against privatization, and partly by the bureaucrats' resistance against losing some of their existing regulatory power.

It is likely that the Thaksin government will push for further fast-track corporatization and privatization before the issue of market and regulatory reforms can be clearly decided. This may create uncertainties among private investors and could push prices of the floated shares below what they should be. More serious is the problem that, without a proper design of market and regulatory reforms, privatization may not lead to fair competition and economic efficiency --- the objective more important than maximizing government revenue.[9] Experiences of privatization in Chile, Mexico and the United Kingdom show that a regulatory framework that "sets out the tariff regime, establishes goals for universal service, develop targets for minimizing costs" is necessary for subsequent privatization to ensure confidence among private investors and consumer protection. [See Kikeri, Sunita, John Nellis, and Mary Shirley (1994) p. 258.]

Fifthly, the plan for creating SIC chaired by the Minister of Finance, and the National State Enterprise Policy Committee, having a department in the Ministry of Finance as its secretariat, seems to assign much power and responsibility to one ministry. Other ministries end up overseeing those state enterprises which are likely to be small and not profitable. Based on past experience of rivalry among ministries for the control over large and profitable state enterprises, the plan may not be very well accepted by other ministries.

Concluding Remarks

It can be expected that privatization will proceed in the future in the shape and form that could be in some ways different from what has been recommended in the Master Plan. The path of changes depends so much on the political directives set by policy makers who, under the present government, seem to demonstrate strong leadership and even overrule or ignore technocrats' recommendations in some instances. A good example is the issue of independent regulation, which government officials at the NESDB and the Ministry of Finance recognize its importance, but the government seems to ignore by paying attention almost exclusively to selling state enterprises' shares in the stock market and setting up SIC.

Whatever path the state enterprise reform will follow, there are a number of relevant issues which need to be addressed by way of conducting research. These are as follows:

- Some non-commercial state enterprises will not and should not be privatized, e.g. the Tourism Authority of Thailand, the Zoological Park Organisation and the National Housing Authority. According to the Master Plan, even some subsectors in electricity and railway should remain government-owned. An interesting research question is how these government-owned entities be reorganized in such a way as to become more efficient and responsive to public needs. The issue involves not only the institutional aspects of the organizations, but also the performance evaluation systems which will work effectively for different types of state enterprises.
- Partial, rather than complete, privatization of state enterprises seems to be the policy of the Thaksin government. For those enterprises which are listed in the stock market, it is therefore relevant to investigate if there is a degree of government ownership which can be regarded as "optimal". There is a trade-off between government ownership and private shareholding. More privately held shares in the enterprises tend to allow more influence from the market discipline, leading to higher degree of efficiency and profitability. On the other hand, some government ownership may be needed to provide long-term stability and public responsibility.

  Similarly, there needs to be a study on the optimality of foreign ownership in state enterprises. For instance, the costs and benefits of introducing foreign strategic partners in some utility sectors should be compared, and conclusions should be reached as to provide practical guidelines for future policy on privatization.
- For some state enterprises, increasing in efficiency inevitably involves reductions in the number of employees. According to the Master Plan, any employment retrenchment should be done gradually and with adequate compensation to those who will be affected. However, more studies are needed to devise an action plan which makes the costs of the transition ---

including both the costs to the employees who will lose their jobs and the costs to the government as owner of the enterprises — as mutually acceptable as possible. The plan may include not only monetary compensation, but also retraining and other programs which allow former state enterprise workers to be productive members of the society.

- For public utility services such as electricity, telephone, and public transport, it is generally accepted that the government must provide some minimum levels of services at subsidized rates to the underprivileged groups in a society. This so-called "public service obligation" (PSO) is normally a condition in granting an operating right to an operator. In Thailand, it has never been clear how this PSO principle should be properly applied, since decisions on tariff adjustments have been much politicized. It is therefore important that this issue be examined to provide guidelines for setting the scope of the PSO, and to determine how much and how the subsidies related to PSO should be given.
- Except for the telecom sector, in other sectors it is not clear what type of organization the regulatory body will be. It is possible that the regulatory power will be with the line ministries in most cases. But whoever performs the tasks of the regulator will have to deal with a number of regulation-related issues, e.g.
    - Which activities can potentially be competitive (and not a natural monopoly), and therefore more than one competitors can be allowed to operate?
    - How should prices of regulated services be regulated (price caps, rate of return, etc.)?
    - What mechanisms should be used to ensure effective consumer protection?
    - How can the "independence" of the regulator be realized under different forms of regulatory bodies?

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Table 1: List of State Enterprises in Thailand

Sector and Name	Allocated Grouping
Communication	
Telephone Organization of Thailand (TOT)	1
Communications Authority of Thailand (CAT)	1
Mass Communications Authority of Thailand (MCOT)	4
Water	
Metropolitan Waterworks Authority (MWA)	1
Provincial Waterworks Authority (PWA)	1
Transportation	
Land Transport	
Expressway and Rapid Transit Authority of Thailand (ETA)	1
Metropolitan Rapid Transit Authority (MRTA)	1
The State Railway of Thailand (SRT)	1
The Transport Co., Ltd. (TCL)	1
The Bangkok Mass Transit Authority (BMTA)	1
The Express Transportation Organization of Thailand (ETO)	1
Air Transport	
Airports Authority of Thailand (AAT)	1
New Bangkok International Airport Co., Ltd. (NBIA)	1
Aeronautical Radio of Thailand (ART)	1
Civil Aviation Training Center (CATC)	1
Thai Airways International Plc (TG)	1
Water Transport	
Port Authority of Thailand	1
Thai Maritime Navigation Co., Ltd.	1
Bangkok Dock Co., Ltd.	3
Energy	
The Electricity Generating Authority of Thailand (EGAT)	1
The Metropolitan Electricity Authority (MEA)	1
The Provincial Electricity Authority (PEA)	1
The Petroleum Authority of Thailand (PTT)	1
Banking	
Bank for Agriculture and Agricultural Co-operatives	4
The Government Savings Bank	4
Krung Thai Bank Public Company Limited.	4
The Government Housing Bank	4
Export-Import Bank of Thailand	4

Table 1: List of State Enterprises in Thailand (continued)

Sector and Name	Allocated Grouping
<u>**Industrial**</u>	
Liquor Distillery Organization	2
Thailand Tobacco Monopoly	2
Playing Card Factory	2
The Glass Organization	3
The Battery Organization	3
The Tanning Organization	3
The Police Printing Press	4
The Industrial Estate Authority of Thailand	4
<u>**Commercial & Services**</u>	
The Government Lottery Office	2
The Marketing Organization	4
Public Warehouse Organization	4
The Tourism Authority of Thailand	4
The Syndicate of Thai Hotels & Tourists Enterprises	4
<u>**Agricultural**</u>	
The Forest Industry Organization	4
The Botanical Garden Organization	4
Office of the Rubber Replanting Aid Fund	4
Fish Marketing Organization	4
Rubber Estate Organization	4
Dairy Farming Promotion Organization of Thailand	4
The Thai Plywood Company Limited	4
The Marketing Organization for Farmers	4

Table 1: List of State Enterprises in Thailand (continued)

Sector and Name	Allocated Grouping
Social & Technology	
Sports Authority of Thailand	4
The Zoological Park Organization	4
The Institution for the Promotion of Teaching Science & Technology	4
Thailand Institute of Scientific & Technological Research	4
The Government Pharmaceutical Organization	4
Office of the Public Pawnshop	4
National Science Museum	4
National Housing Authority	4

Note: The following state enterprises have been liquidated or privatized in the past few years:Sugar Factories Inc., The Textile Organization, Prachinburi Province Commercial Co., Ltd., Lumpoon Province Commercial Co., Ltd., Surin Province Co., Ltd., The Preserved Food Organization, Offshore Mining Organization, The Government Cold Storage Organization

Source : Master Plan for State Enterprises Sector Reform, Royal Thai Government, September 1, 1998

Table 2 : Selected Important Data for State Enterprises in Thailand

Source : National Economic and Social Development Board

Unit : Million Baht

	1996	1997	1998	1999	2000	2001	2002
Assets	1,358,993	1,548,042	1,694,539	1,831,373	1,989,767	2,075,440	2,168,361
Liabilities	724,655	947,097	1,031,965	1,167,413	1,290,444	1,310,183	1,313,611
Revenue	705,362	853,310	915,946	920,262	1,137,424	1,209,621	1,289,530
Expenditure	607,702	806,418	837,320	947,524	1,074,391	1,151,545	1,225,794
Profit (Loss)	97,660	46,892	78,626	-27,262	63,033	58,076	63,736
Remittances	39,857	48,100	53,800	47,813	39,904	57,278	40,000
nvestment	159,645	173,223	170,617	172,314	171,300	178,337	160,505
Retained Income	NA	NA	131,826	109,400	122,727	173,275	144,684
Number of Employee persons)	277,445	268,511	261,590	255,748	246,878	248,258	245,840
nvestment-Retained ncome	NA	NA	38,791	62,914	48,573	5,062	15,821
Liabilities/Assets	53%	61%	61%	64%	65%	63%	61%
Debt Repayment Capability :1)	2.6	1.3	1.8	1.4	1.1	1.0	1.1
Rate of Return on Assets	7.19%	3.03%	4.64%	-1.49%	3.17%	2.80%	2.94%
Expenditure on Personnel s % of Total Expenditure	11.8%	9.6%	9.3%	8.4%	7.6%	7.3%	7.0%

ource : National Economic and Social Development Board

Endnotes

[1] The state enterprises in Thailand can also be classified according to the line ministries they are supervised under, or be classified by purposes, which are similar to the approach used in this paper. See Kraiyudht Dhiratayakinant (1990) for the classification by purposes.

[2] Retained income is defined as all remaining incomes available for investment expenditure in each year.

[3] These seven agencies are a line ministry, the General Controller Department, the Budget Bureau, the National Economic and Social Development Board, the Auditors' Office, the National State Enterprise Committee, and the Cabinet.

[4] We can regard taxpayers and voters as a principal, if there is a collusion between the management and the government.

[5] One of these detailed studies is National Energy Policy Office (2000) ***Electricity Supply Industry Reform and Thailand Power Pool.***

[6] In fact NTC is more than a regulator. It can also make policy decisions, thus potentially reducing the role of the government in the future of the telecom sector, or creating conflict between the regulator and the government.

[7] Independent regulation is also new to most developing countries. An observer in Argentina comments that "regulation of public services enterprises has proven to be a complex challenge." See Galiani, Sebastian, and Diego Petrecolla. (1996)

[8] A number of articles which are critical of the Master Plan appear in Narong Petprasert (editor, 2000).

[9] The importance of efficiency objective is clearly stated on page 4, Part II of the Master Plan, and also in National Economic and Social Development Board (2002).

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Economic Recovery and Reforms: A Synthesis and Critique

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Economic Recovery and Reforms: A Synthesis and Critique

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Abstract

Soon after the Asian economies collapsed in 1997, questions and debates have spread over as to whether the Miracle disappeared. An examination of the recovery status in this paper reveals that these countries are recovering at satisfactory rate, though the extent of recovery is still weak. Besides, the paper attempts to draw similarities and differences of experiences encountered by those countries affected by the crisis. By survey and critique, the paper produces a consensus that 'recovery without reforms' is not sustainable, and that institutional reform is an essential if a country wishes to nurture its growth alongside preventing possible future crises.

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1) Introduction

The year 1997 was a striking year for a number of persons around the world especially those in Asian nations. Southeast and East Asian countries, which seemed to make a miracle to global economic environment in the early 1990s, became to crash. The double-digit growth rates enjoyed earlier drastically dropped, and a number of countries encountered the first-ever negative growth rate in decades. Economies nonetheless' attempted to recover afterwards. However, the extent to which recovery has taken place in different countries was at varying speeds. This is not surprising, as different economies with different fundamentals have implemented a variety of measures. Yet, after 5 years, the likelihood of reverting the country to the level of ever prosperity is low.

The myth has added to another field of research that produces countless journal articles as well as dissertations. Further, conferences, meetings and round-table discussion were organised for economists worldwide to debate and rethink upon a number of issues relating to policy recommendations as well as economic thoughts underlying economic growth and development. The conference on '*Economic Recovery and Reforms*' recently held by Faculty of Economics, Thammasat University, in cooperation with the Bank of Thailand, was an example that provided scholars with the forum to share experiences upon successes and failures of undertaking an assortment of policies.

As the title says, this paper is a synthesis. Its primary aim is therefore to synthesise the seven papers presented at the international conference on Economic Recovery and Reforms held in Bangkok with a particular attempt to draw lessons and the issue of concern that needs urgent action.

The paper is organised as follows. Section two provides a review on economic conditions of countries that were affected by economic crisis, both pre- and post- the event. The Asian countries are, of course, major emphasis. Sweden, as well as some Latin American countries, which experienced the problem earlier, may be occasionally referred to as a body that provides some lessons we can learn. Section three identifies common and different causes underlying the problem. Section four reviews and assesses the reform measures that each country adopted in order to provide an inference regarding the duration of the crisis and on the extent to which each country can recover. It also briefly compares and contrasts different sets of measures that different countries have implemented. The purpose is, however, not to evaluate policy effectiveness; rather, it is to address lessons learned which is summed up in section five. Last, section six concludes.

2) Economic Situation of Crisis Countries: An Overview

The seven papers available in this proceeding provide very scrupulous report on the situation as well as relevant facts of crisis-experiencing countries. It would therefore be unwise to repeat their work here. Rather, the discussion presented in this section is to provide readers with the economic situation during pre- and post-crisis in a comparative manner.

There are a number of statistical evidences indicating a stylised fact that these Asian countries are now on recovery path. A commonly used statistic to indicate economic performance is the growth of Gross Domestic Product (GDP). Table 1 demonstrates that all the crisis countries experienced the sudden drop in GDP following the Thai Baht collapse in 1997, and hit the bottom of the recession in 1998, as shown by the negative growth rates. Among them, Indonesia faced the greatest contraction of output whereby the economic growth rate in 1998 was –13.1 per cent. The drop was higher than other countries, including Thailand that faced contraction of 10.5 per cent. If one could recall the situation in Indonesian economy at the end of 1990s, one could say that the hardest hit in Indonesia was deteriorated because the economic crisis was intertwined with the political crisis.

Considering Table 1 again, economic rebound took place in 1999 when all Asian crisis-experiencing countries enjoyed positive economic growth rates. In this sense, Korea could be considered the most successful country that was able to bring the economy back on the track. Its economic growth rate in 1999 was nearly 11 per cent, following the drop in GDP by 6.7 per cent in 1998. Part of its success can be due to its tight and strict measures on recovery and reforms. The second is Malaysia – the only single country that did not accept the IMF recovery programme. Economic growth in Malaysia in 1999 was 6.1 per cent and continuously enjoyed high economic growth rate in the following year, whereby its growth rate in 2000 was 8.3 per cent, the level that all countries but Korea were unable to reach.

Table 1: Economic Growth Rates

Year	Indonesia	Korea	Japan	Malaysia	Philippines	Thailand
1995	8.2	8.9	3.0	9.8	4.7	9.2
1996	7.8	6.7	3.2	10.0	5.8	5.9
1997	4.7	5.0	0.6	7.3	5.2	-1.4
1998	-13.1	-6.7	-1.2	-7.4	-0.6	-10.5
1999	0.8	10.9	0.9	6.1	3.4	4.4
2000	4.9	9.3	2.8	8.3	6.0	4.6
2001	3.4	3.1	-1.1	0.4	3.0	1.9
2002	3.7	6.3	0.3	4.2	4.4	5.2

Source: Asian Development Bank Outlook 2003, and OECD

While the recovery in Korea and Malaysia is relatively strong, what happened in the cases of Indonesia and Japan was different. They are the two countries that had small increase in GDP in 1999, whereby the growth rates were 0.8 and 0.9 per cent respectively. Recovery in Indonesia was getting better in 2000, when the growth rate reached nearly 5 per cent and stayed approximately at 3.5 per cent in 2001-02. The Japanese case is different. It had an increase in output by 2.8 per cent in 2000 but a decline in output again in 2001 when the GDP growth was –1.1 per cent before turning on the positive side. This is, according to Abe (2002), largely a result of bubble economy that when it bursted, it made Japanese economy difficult to come back to the normal growth pattern. In 2002, its positive growth was hence very small, which was 0.3 per cent, indicating that Japanese economy is still precarious.

The economic recovery in Asian countries would have seemed to be right, had there been no further shocks, such as the recession in the United States and Japan as well as the 11th September event in 2000, that produced the a downward trend of economic growth rates during 2001-02. This can be witnessed from a decline in the economic growth rate to be approximately 3 per cent in Indonesia, Korea and Philippines, 2 per cent in Thailand and 0.4 per cent in Malaysia in 2001. When the world situation has weakened the effectiveness of a number of reform measures, further attempts for recovery are inevitably required.

Closer inspection on economic record of the Asian economies shows that these countries' economic growth rates were above the world growth rates for decades. While the world GDP grew on average by 3 to 5 per cent, Asian countries grew as large as 9 per cent in certain years. The report by Asian Development Bank (ADB, 1999) concludes that the success of Asian economies was built upon a particular kind of economic strategy. Precisely, they emphasised on export orientation, centralised coordination of production activities, and implicit government guarantees of private investment projects, as well as a close operational relationship and interlinked ownership between banks and firms. Besides, these countries adopted financial liberalisation in the late 1990s. The openness to globalisation, especially in financial sector, allowed a great deal of foreign direct investment, resulting in substantial rate of growth of investment and contributing significantly to the growth of GDP.

A stylised fact of Asian countries is that investment is, to a great extent, related to the economic growth rate. Figure 1 shows that in all countries, while investment is growing, total output of the country also grows, and vice versa. Before the crisis, the gross investment in these Asian countries grew largely, as high as 20 per cent in Malaysia and nearly 15 per cent in other countries. Soon after the crisis hit the Asian region, some countries sill maintained positive change in gross fixed capital formation. Two countries that responded immediately were Korea and Thailand, whose growth rates of capital formation reduced by 7.5 per cent and by 22 per cent respectively.

Every country was alike in 1998 when change in investment was negative everywhere. Thailand faced the highest contraction. Its growth rate of capital formation was –51 per cent, followed by Malaysia's figure, which was –43 per cent (see Table 2). Korea and Indonesia also faced negative growth rates of investment of 38 and 33 per cent respectively. The contraction of investment was carried on in 1999 in Indonesia, Malaysia and the Philippines, while Korea and Thailand started to enjoy positive change.

Figure 1: Growth Rates of GDP and Gross Fixed Capital Formation

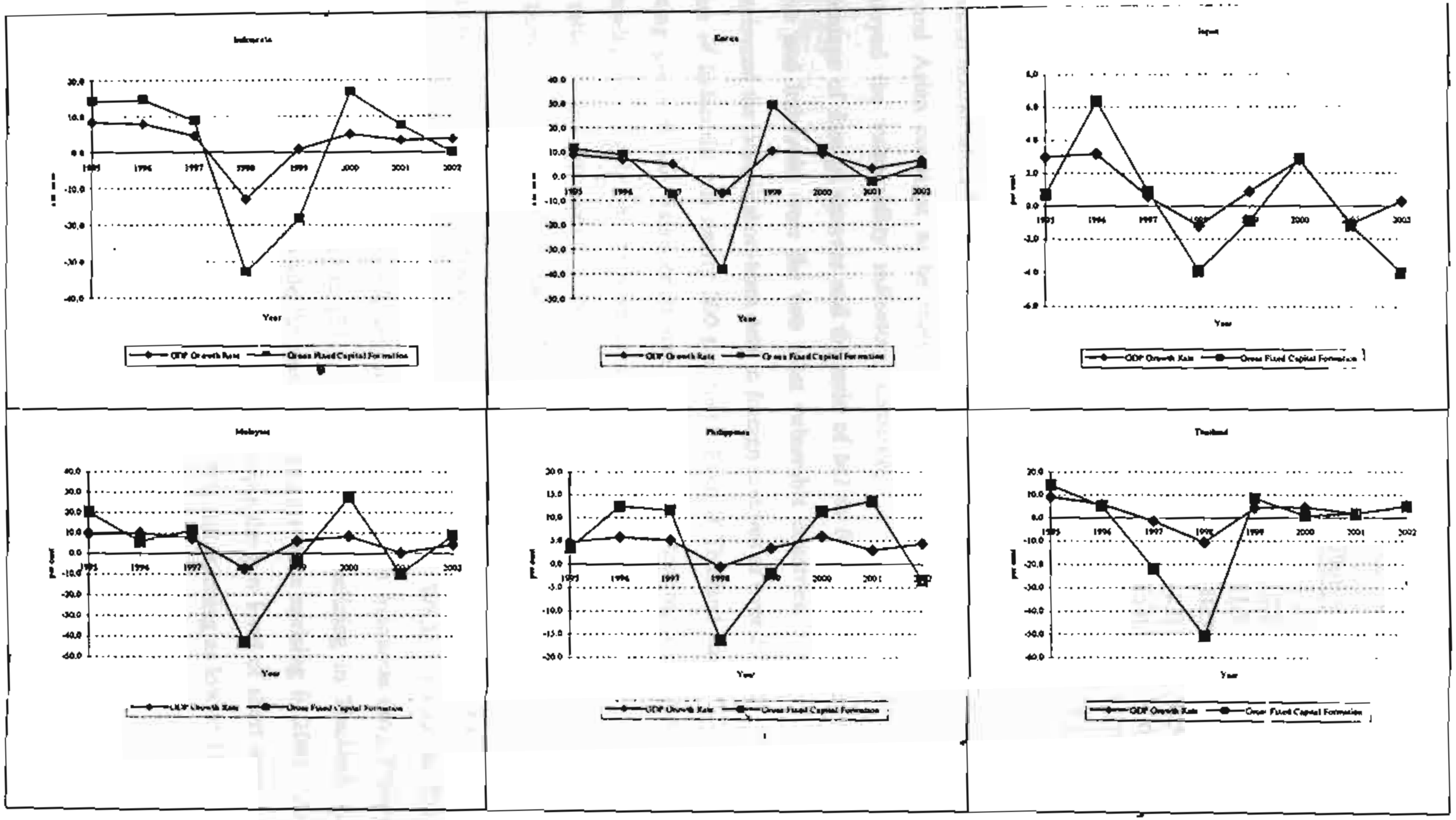

Table 2: Growth Rates of Gross Fixed Capital Formation

Year	Indonesia	Korea	Japan	Malaysia	Philippines	Thailand
1995	14.0	11.4	0.7	20.3	3.5	14.3
1996	14.5	8.7	6.4	5.8	12.5	5.2
1997	8.6	-7.5	0.9	11.2	11.7	-21.9
1998	-33.0	-38.4	-3.9	-43.0	-16.3	-50.9
1999	-18.2	29.5	-0.9	-3.9	-2.0	8.5
2000	16.7	11.2	2.9	27.4	11.4	1.0
2001	7.7	-2.4	-1.2	-9.9	13.6	1.7
2002	-0.2	4.3	-4.0	8.8	-3.5	5.1

Source: Asian Development Bank & OECD

Financial liberalisation has created not only a tremendous increase in investment but also exposed Asian countries to be more vulnerable to external shocks. Kawai (2001) employed the vulnerability indicators, consisting of figures of short-term debt as percentage of foreign reserves and the ratio of M2 to foreign reserves, to indicate that Korea and Indonesia were the two most vulnerable countries. In June 1997, Korea experienced the ratio of short-term debt to foreign reserves of over 200 per cent, while the figure of Indonesia was nearly 200 per cent. Even if Thailand has been considered a starting point of the Asian crisis due to the forced changing exchange rate regime following the speculative attach on Baht, Kawai's indicators indicate that Thailand, with the ratio of short-term debt to foreign reserves of approximately 150 per cent, was merely the third rank following Korea and Indonesia.

In 1998, all of these Asian countries look safer (see Table 3). All but Thailand had the ratio of short-term debt to foreign reserves less than 100. While the ratio in Thailand stayed at just 100, the ratios are descending respectively in Indonesia (86), Philippines (69), Korea (54) and Malaysia (33). The ratio keeps declining in Thailand, Korea, Philippines and Malaysia, while the ratio in Indonesia turns uprising in 2001. Among them, Malaysia is the most successful in maintaining the low level of short-term debt to foreign reserves, to be below 20 per cent since 1999, and reaching as low as 16.7 per cent in 2001.

When considering the ratio of M2 to international reserves, Table 3 also indicates that these countries are less vulnerable. However, if we just simply examine the proportion of broad money (M2) in GDP and its growth rates prior to and post crisis, we would, to a certain extent, be able to indicate the vulnerability of an economy. All Asian countries experienced significantly high rate of growth in M2 during the year of crisis; that is, approximately 23 per cent in Indonesia and Malaysia, 20 per cent in Philippines and Korea, and 16 per cent in Thailand. However, the rate of growth of M2 kept rising in 1998, and it was as high as 62 per cent in Indonesia. This rate of growth was very substantial especially if compared with other countries' experiences. In 1998, broad money in Korea grew by 24 per cent, while the rates of change were merely single-digit growth rates in other countries (see Table 4).

Table 3: Vulnerability Indicators

Year	M2 to Foreign Reserves					Short-term Debts to Foreign Reserves				
	Indonesia	Korea	Malaysia	Philippines	Thailand	Indonesia	Korea	Malaysia	Philippines	Thailand
1995	652.3	1,462.4	327.4	370.5	355.7	175.6	142.5	30.4	67.9	119.4
1996	628.2	1,850.6	347.2	283.3	376.5	167.2	195.4	40.8	67.9	123.5
1997	439.6	1,495.7	359.3	301.7	341.5	188.9	263.6	71.5	135.0	140.7
1998	305.9	1,020.9	303.9	270.4	438.6	85.5	54.1	33.0	69.4	100.4
1999	334.6	798.0	289.5	224.4	449.2	73.5	46.9	19.6	38.3	67.3
2000	266.0	581.8	315.6	189.5	356.1	77.3	42.1	15.6	39.8	45.6
2001	289.7	566.4	312.5	178.6	358.9	77.8	34.2	16.7	38.6	40.0
2002	313.1	605.5	294.5	194.0	320.3	na	na	na	na	na

Source: Data from Asian Development Bank, Author's computation using Kawai's (2001) index.

Table 4: Money Supply Indicators

Country	Broad Money (M2)	1997	1998	1999	2000	2001	2002
Indonesia	*Growth (%)*	23.2	62.3	11.9	15.6	13.0	4.7
	As % of GDP	56.7	60.4	58.8	59.1	58.2	54.9
Korea	*Growth (%)*	19.7	23.7	5.1	5.2	8.1	14.0
	As % of GDP	114.1	143.9	139.3	135.6	138.7	146.2
Malaysia	*Growth (%)*	22.7	1.5	13.7	5.2	2.2	5.8
	As % of GDP	103.7	104.7	112.1	103.7	108.3	106.1
Philippines	*Growth (%)*	20.5	8.0	19.3	4.8	6.9	9.5
	As % of GDP	43.4	42.7	45.6	42.4	41.4	41.4
Thailand	*Growth (%)*	16.4	9.5	2.1	3.7	4.2	2.6
	As % of GDP	91.7	102.7	104.7	102.4	102.3	99.0

Source: Asian Development Bank

Most of attention that attempted to understand the situation of the crisis-experiencing countries has emphasised strongly on financial sector, with far less attention on real sector. An extension to consider the impacts on aspect of welfare and social dimension would be even smaller. It is probably because of the delays of the impact. Past evidence as outlined in other chapters in this proceeding indicates that some common social consequences of the crisis that each country has faced include unemployment and employment instability, widening inequality and the problem of social integration.

As shown by Table 5, unemployment rate in all crisis countries has jumped tremendously. In Korea, the rate increased from, on average, 2 percent prior to the crisis to 7 per cent in 1998. Philippines' unemployment rate increased from 7.9 per cent in 1997 to be 9.6 per cent in 1998. Indonesia's experience is similar; that is, its unemployment rate raised from 4.7 per cent to be 5.5 per cent. Thailand experienced a more substantial figure; that is, the unemployment raised from below 1 per cent in 1997 to 3.4 per cent in 1998.

While the immediate impact of the crisis on unemployment in these Asian countries is the same, the pattern of change over time is somewhat different. Over time, Thailand, Korea and Malaysi have declining unemployment rate but Indonesia and Philippines still have to conquer the increasing unemployment rates, which respectively climbed up to be 9.1 per cent and 10.2 per cent in 2002. The problem led to reduction in income, less secured life and a deterioration of overall welfare.

Table 5: Unemployment Rate (as % of Total Labour Force)

Year	Indonesia	Korea	Malaysia	Philippines	Thailand
1995	7.2	2.1	3.1	8.4	1.1
1996	4.9	2.0	2.5	7.4	1.1
1997	4.7	2.6	2.4	7.9	0.9
1998	5.5	7.0	3.2	9.6	3.4
1999	6.4	6.3	3.4	9.6	3.0
2000	6.1	4.1	3.1	10.1	2.4
2001	8.1	3.8	3.6	9.8	2.6
2002	9.1	3.1	na	10.2	1.8

Source: Asian Development Bank

3) Causes of the Problem: Compelling and Competing Explanations

Publications that attempt to address the causes of crisis are abundant and have intensified over years. Among a number of the most cited literature, examples are Krugman's (1998) article published in his website, a book by McLeod and Garnaut, *eds* (1998), and a great deal of the World Bank's publication, one of which is *East Asia: The Road to Recovery* published in 1998. Some of them also assess the effectiveness of policy responses and suggest further actions for achieving prolonged growth rates.

The discussion, based on a variety of approaches, does not only providing explanations regarding causes of the Asian economic crisis, but has also been extended to a debate upon two strands of methodologies to understanding the crisis – the history-based descriptions vis-à-vis econometric modeling. In terms of model-based studies, McKibbin (1999) categorised that there are three broad types; namely, studies that *predicted* the crisis; studies that have used multi-country models to *explain* the crisis *ex-post*; and studies that have examined the *adjustment process* in response to the crisis in the individual countries as well as globally. More or less, a consensus is that while there are a great deal of models that explain the crisis *ex-post*, "there would seem to be no modeling studies that predicted the crisis in Asia *ex ante*" (Haggard, 2001). Understanding causes of the crisis is therefore a history-based and, inevitably, an ex-post manner that heavily depends on a descriptive research particularly via an examination of the data of the key economic indicators, as the key economic indicators would be translated to the revisions of public's expectations on future growth prospects (McKibbin and Martin, 1998).

Among a number of excellent overviews of causes of the crisis, there are two major explanations. The first one, which, so far, has received greater interest, is based on macroeconomic behaviour and management of macroeconomic policies; and another one focuses on the corporate sector, with particular attention on micro behaviour of risk-loving individual firms. A majority of literature produces an appealing statement that both types of causes involving several underlying factors are intertwined to worsen the overall economic atmosphere and exacerbate the crisis (see, for example McKibbin, 1998; Sachs, 2000; Tan, 2000; and Wade, 1998).

3.1 Explanations relating to financial markets

Prior to the crisis, all the Asian countries adopted financial liberalisation so as to fit in the change in the world financial architecture. So unsurprisingly, the financial sector could be unstable. Survey of literature provides evidence concerning the causes of the crisis in terms of financial sector in that its weakness, in particular the inadequate supervision and prudential regulation of bank-dominated financial systems permitted excessive risk taking, (Haggard and MacIntyre, 2001). Financial liberalisation was particularly more vulnerable to external shocks when the weak characteristic of financial sector was combined with existence of moral hazard in domestic business as well as foreign banks.

These basically followed changes in the world financial architecture that created rapid flow of private capital worldwide. All the Asian countries adopt this change, as can be seen from a series of liberalisation measures taken place during the late 1980s and the early 1990s (see, for example, Alba, *et. al.* (2001) for a very concise, but comprehensive, list of financial sector liberalisation measures in Thailand). However, the liberalised, but insufficiently regulated, domestic financial markets allowed large inflows of short-term unhedged capital. Bank credit growth rates had substantially exceeded GNP growth rates. Alongside the mounting political uncertainty, they exposed the East Asian countries to be vulnerable to external shocks (Kawai, 2001).

The financial liberalisation is particularly asserted as a cause that led to excessive non-performing loans (NPLs). The NPLs, as agreed by authors of country papers in this proceeding, have worsened the macroeconomic situation of Asian countries. According to Tan (2002), these NPLs are costs to economy, as they reduce the banks' supply of loanable funds, profits and net worth, which in turn deteriorate banks' reputation and confidence. A consequence was lowering credit-rating scores of Asian countries and contracted large amount of foreign direct investment.

Exchange rate regime can be considered another cause. When access to foreign market was particularly made easy as a result of financial liberalisaiton, while all the countries engaged in international business under the fixed exchange rate regime, the fixed exchange rate arrangement provided the perception of being assured for both domestic borrowers and international lenders. Excessive loans were therefore unsurprising.

It was empirically found that short-term debts, inflation and overvaluation caused by long periods of pegs increased the probability of the crisis (Burkart, 2002). The result obtained from the Burkart's econometric model that attempted to identify fundamental determinants of crises and to build an early-warning system was consistent with Krugman-type models. Particularly, the losses in foreign reserves, which took place as a consequence of pegged system could constitute one of the crisis-leading indicators. This is evident in 1997, when Korea lost reserves by 40 per cent, Thailand by 30 per cent, Malaysia and Philippines approximately by 25 per cent and Indonesia by 10 per cent (see Table 6). But then they recovered and have had international reserves filled up.

Table 6: International Reserves Indicators

Year	End of Year, USD million				
	Indonesia	Korea	Malaysia	Philippines	Thailand
1996	19,280.6	34,073.1	27,129.7	11,744.7	38,645.2
	30.4	*4.2*	*13.5*	*51.0*	*4.6*
1997	17,396.3	20,404.9	20,899.2	8,738.3	26,892.5
	-9.8	*-40.1*	*-23.0*	*-25.6*	*-30.4*
1998	23,516.5	52,040.8	25,675.2	10,780.6	29,536.3
	35.2	*155.0*	*22.9*	*23.4*	*9.8*
1999	27,257.5	74,054.4	30,644.8	15,011.9	34,780.9
	15.9	*42.3*	*19.4*	*39.2*	*17.8*
2000	29,267.8	96,198.1	29,576.0	15,024.3	32,661.3
	7.4	*29.9*	*-3.5*	*0.1*	*-6.1*
2001	28,018.4	102,821.1	30,525.9	15,658.6	33,040.7
	-4.3	*6.9*	*3.2*	*4.2*	*1.2*
2002	31,577.1	121,414.0	34,277.2	16,180.1	38,915.4
	12.7	*18.1*	*12.3*	*3.3*	*17.8*

Note: Figures in italic represent rates of change in international reserves.
Source: Asian Development Bank

3.2 Explanations relating to the real sector

Quigley (2001) addressed one stylised fact that took place throughout East Asia. That is, the economic growth prior to the crisis was attributable to extraordinary growth of the construction and real estate sectors – the particularly risk-loving sector. During the 1990s, the ratio of new office and housing supply to historical increases in supply was extraordinary large, and the likely effect was the unacceptable rate of vacancy that ultimately resulted in lower rental rates. Besides, it seems to be common that most of the countries experiencing the problem had never established appropriate mechanisms that allow smooth management of assets and/or affairs of distressed companies, such as rapid acquisition and disposal of bad assets arising from poor management in the real estate sector. These ultimately lead to the firms' difficulties of raising profit, or even maintaining break-even. As a consequence, a number of companies had to be suspended or shut down. This was very evident in Thailand, when 56 financial institutions were forced to close in 1997, which created a large contraction in its economy.

Overexpansion of the real estate and its collapse did not by itself did cause the crisis, but the failure of banking in perceiving true valuation of assets, the discipline of competition as well as moral hazard and non-transparent and imprudent practice of financial institutions have devastated the Asian economies.

One might argue that this is a common phenomenon, which could be due to the downward trend of the business cycle. In other words, sooner or later, the macroeconomic performance of the real sector would be declining and exposes the country on the downward growth. Or one could argue that this is because of the laws of diminishing returns. That is, if the law also works with investment behaviour, there should always been diminishing returns to capital. Then at some point, growth must slow down as the incremental gains from further investment are expended. Even though this is acceptable, Baer (1999) raised a query that who would know the point at which incremental returns on investment starts to diminish. Theoretically again, such the diminishing returns can delay in such a way that the increasing pattern of incremental returns can be enhanced and prolonged via a number of tools such as an improvement in financial environment that facilitates the investment. When these had never happened, it indicated a lack of appropriate instruments to do so in Asian countries.

3.3 In the context of political economy

Weak institutions and inappropriate role of public sector intervention were largely asserted as causes that deteriorated the situation in Asian countries. Baer, *et. al.* (1999) pointed out that a number of free-market proponents' ideas were somewhat misinterpreted. Particularly, it was questioned that why so many mainstream economists as well as international institutions were so wrong in evaluating the performance of East Asian economies, and so reckoned that

> "... it was the excessive reliance on the neoclassical paradigm that led many economists to neglect paradigm that led many economists to neglect an examination of the true institutional framework within which economic activity in East Asia was carried out." (Baer, 1999)

They also highlighted that whatever the cause, "... the crisis exposed the extent of intervention, which was not acknowledged by many free-market proponents." In details, they argued that this could be attributed to the current state of the economics profession that far concentrate on quantifiable phenomena as well as highly sophisticated analytical and quantitative techniques, while neglect less easily measurable factors, such as the operation of institutions, both public and private. Besides, they doubt that though the government is able to get prices right, there is an inability in getting policies right.

Close relationship between political authorities and private sector is also widely accepted as a cause of the crisis (Gunnarrson, 2002). It particularly brought out mismanagement of macroeconomic policies, which favoured a certain groups of interest, rather than focused on economic growth and stability. The strength of the central bank is the main body that has received major critique. Satitniramai (2002) strongly argues in his thesis that the Thai authorities failed to make appropriate response to attack the problem, and particularly that impossible trinity was made in Thailand. In other countries, problems were not less severe. For example, the system of licensing and supervising commercial banks in Korea was inadequate.

4) Performance of Reform Measures: An Assessment

There is a consensus that economic recovery involves three distinct phases (Sachs and Woo, 2000). First, it is the end of the panic where some of short-term debts were repaid, some were rescheduled and some were simply defaulted upon. Interest rates then began to return to normal levels and exchange rates strengthened. Second stage is the cleanup of debt. Accordingly to Sachs and Woo, this step is much trickier, taking months or years, and requiring a number of packages to be implemented so as to revert the confidence lost earlier. Essential measures include, for example, recapitalisation, rehabilitation, privatisation, and renegotiation schemes, which definitely adds to the administrative and political complexities of the needed adjustment.

After the end of panic and the cleanup of debt, the third stage involves how to raise long-term competitiveness. One solution, though inadequate, is to adopt the flexible exchange rate. A number of following reforms are required accordingly, so as to improve the effectiveness of basic political and economic institutions as well as to improve the quality of human capital as well as social welfares.

These three steps of Sachs-Woo recovery path are also parallel to the IMF's programme initiated by the International Monetary Fund. Specifically, its attempt to restore macroeconomic stability and confidence was built generally on the basis of three main pillars – a strong macroeconomic framework to achieve an orderly adjustment in the external current account, a comprehensive strategy to restructure the financial sector and a broad range of structural measures to improve governance.

A survey of series of policies and measures implemented in different countries, as provided in other chapters in this proceeding, shows that they all in all involve the Sachs-Woo three-required-phase framework, although they have been implemented in different orders. It is common that an immediate action that every country responded to the crisis was targeting to the financial sector, rather than the real sector. The fact that the main emphasis was placed on financial restructuring in order to promote domestic demand, while the welfare-related sector was ignored for a short while, is therefore unsurprisingly[1].

No matter it is Sachs-Woo framework or IMF programme, the reform needs to take place in, at least, five sectors. As demonstrated in Table 7, they are reforms of financial sector, public sector, private or corporate sector, external affairs, and, probably the most important, the institutions.

Some policies are common while some are different. A number of common measures, such as enhancement of domestic capacity and the promotion of financial stability, transparency, efficiency as well as competitiveness, was yet utilised in different phases. In most countries, these were implemented one at a time, but with different orders. The exception was what took place in Malaysia where debt restructuring was made to borrowers alongside with the corporate sectors. Related laws were amended for this purpose.

Solving the problem it essentially involves revaluation of assets and refinancing. These ultimately need financial reforms. Indonesian government cancelled a number of large government-financed projects and reduced a great deal of subsidies on fuel. But the

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[1] South Korea seems to be an exceptional case because something was acted directly to the labour market from the beginning.

question is whether it is successful. A common impact upon announcement of stabilisation policy is that private companies have had difficulties to meet their external debt service obligations. This has led governments of Thailand and Indonesia to implement further policy packages.

Soon after the crisis, many countries realized the fact that lack of prudential of the central bank, especially in terms of supervision of the commercial banks, was a cause of the problem. In response to this, institutions were set-up, such as the Financial Supervisory Service (FSS) in South Korea.

Table 7: Summary of Reform Measures Implemented in Response to the Crisis

Reform Measures	Countries						
	ID	JP	MY	PH	SK	SW	TH
Adopting of the IMF programme	Yes		No	Yes	Yes		Yes
Financial reforms							
• Banking restructuring (consolidation of commercial banks)	*		*	*	*		
• Lowering interest rates			*				
• Establishment of related financial organisations			*	*	*		
• Libaralisation of capital market				*	*	*	
Public sector reforms							
• Fiscal consolidation	*	*			*		
• Reallocation of expenditures	*	*			*		*
• Public sector's Pro attitude						*	
Corporate sector reforms							
• Strengthening the corporate sector	*	*		*	*		*
• Promotion of SMEs			*				
• Enhancement of corporate governance		*			*		*
External affairs reforms							
• Rationalisation of imported goods		*	*				
• Reduction of the current account deficit	*			*	*		*
• Selective exchange controls			*				*
• Promotion of FDI				*	*	*	
Institutional reforms	*	*	*	*	*	*	*

Source: Synthesis from Country Papers

5) Lessons Learned

A good list of lessons learned from the Asian crisis can be found by Kawai et al (2001). In their paper, all lessons can be grouped into four interdependent types, including prevention, management and resolution of the crisis as well as strengthening regional arrangements in order to accommodate the first three objectives. To prevent the crisis, a country is advised to avoid large current account deficits financed through short-term private capital inflows, regulate and supervise financial systems aggressively, and put incentives in place for sound corporate finance. These would allow a country to ensure that banks and corporations manage risks prudently as well as to avoid high leverage ratios and excessive reliance on foreign borrowing.

However, once the crisis took place, an appropriate management should be set in. External liquidity should be mobilised timely, and sound policies should be designed in order to restore market confidence. They also noted that there is no one size fits all prescription for monetary and fiscal policy stance in response to crisis.

Cushioning the effects of crisis on low-income groups is necessary. A country needs to pursue social policies to ameliorate the inevitable social tensions associated with adjustment. The mechanism for crisis prevention, management and resolution should be nonetheless adapted from time to time.

What happened in Asian region prior to the crisis was the sparkling growth for which nobody would have thought about the collapse and economic crisis. More importantly, the 1997 Asian crisis was not the first time ever in this globe. A number of crises happened earlier, including the 1994 teguilla crisis and the 1990 Nordic crisis. An interesting query is whether we learn something, whether we made mistakes in interpretation of our growths, or whether we were too optimism. If there are any kinds of genuine indicators of the crisis existing, what are they?

A certain similarities exist in the 1997 Asian crisis. Gunnarsson (2002) explains that there are a number of striking similarities between 1990 Nordic and 1997 Asian crises. They include a collapse in the real estate market, the burst of stock market, the threatening financial market, and, most spectacularly, the currency as well as banking crises. The synthesis shows that some statistical evidence can be employed to signal the likelihood of future crises to be taking place in other parts of the world, such as the ratio of short-term and international reserves, change in investment and level of broad money. In addition, failure to sustain a feasible current account deficit/GDP ratio in the long run, to monitor the health of the financial system, and to maintain a stable real exchange rate are all mentioned as warning sign indicator. Besides, when there was a dramatic growth of the foreign debt that was based on optimistic export growth projections, and actual exports grew at a much slower rate, experts should have put out alarm signals of an impending problem. Yet, not only was little notice given, the public was also blinded by the 'miracle'.

The synthesis, however, shows that 'recovery without reforms' cannot be sustainable. This is especially relevant as a number of institutional factors underlying economic crisis were totally disregarded.

6) Concluding Remarks

This paper is a synthesis of the seven papers available in this proceeding. It outlines the situation of Asian countries that faced the economic crisis in 1997 as well as assesses how strong the recovery has taken place. It demonstrates that all of these countries perform well in recovery, which is a consequence of a series of earnest attempts in order to bring about the country back on the track. A large fraction of recovery has come from government fiscal and monetary stimulus package, including expansion of public expenditures and of a reduction in interest rate, as well as an increase in private consumption. However, these countries are still not successful in attaining the level of economic growth as in the pre-crisis years. More importantly, there is risk arising from changing global economic situation. While the situation is not yet stable, recovery could be slow and weakened. The effects could be nonetheless cushioned provided there is sufficient response from private sector as well as reforms on fundamental institutions.

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Strengthening the Community: Thailand's Struggle towards Sustainable Development

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Strengthening the Community: Thailand's Struggle towards Sustainable Development[1]

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Abstract

Localism is the mainstream ideology for alternative development in Thailand. Given the existing unbalanced and centralized development, Thai scholars focus on self-reliance as a key performance of strong community. However, the accomplishment of ultimate goal of improving community welfare is sometimes ignored. Often, it is implicitly assumed that there is a certain and positive relationship between self-reliance and welfare improvement.

This paper aims at exploring the possibilities of Thailand to develop strong communities in order to achieve a balanced and sustainable development. The desirable development implies pluralistic society in which the 4 capitals: namely, human capital, social capital, man-made capital and environmental capital, are not depreciated. By reviewing the past and present state of scattered strong communities, the paper concludes that the relationship among civil society, market and the state has evolved from the top-down control by the state towards business politics whereby the state and the market are closely bound and have control over communities. The paper foresees that the recent trend of localization will bring in a more balanced relationship between the state, the market and communities. It is also observed that no matter how communities are formulated at the beginning, the strong communities must be able to expand activities to raise welfare of community members in the long run. Being neglected by local dark influences and business politics is another characteristics of strong communities.

The paper also concludes that Thai rural community is on the right path towards sustainable development. In practice, however, confusion does exist. The study argues that the relationship between self-reliance and welfare is not always certain and automatic. Rather, being self-reliant implies risk minimizing. Moreover, a single community is not perfect and community networks are needed. Currently, any policy that leads to capacity building and learning process of rural communities can contribute to community strength. In this respect, either community business or money injection measures like village fund can empower the community. On the other hand, a policy that simply encourages exploitation of cheap community labour, either by local entrepreneurs or businessmen from outside, cannot contribute much to community empowerment. "One Tambon (Sub-district) One Product" program might fall in this trap so long as the policy makers and officials cannot distinguish or ignore different characteristics of business existing in a community.

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1. Introduction

Rural development in Thailand is now shifting to a new paradigm of community-based development. The description of the new approach mixes between "what the community is" (the empirical fact) and "what the community should be" (the ideal and normative community) (Kitahara 1996). The ideal community ranges from an autonomous and independent community (anarchistic radical localism) to a self-reliant community that cooperates with the state and the market (moderate localism) (Connors 2001).

It is widely agreed that strong community is a prerequisite for successful development. As stated by Phra Subin Panito, the spiritual leader of Bann Pret and the founder of a well-known saving group.

> *" If you don't have a strong community, anything you do will be set to fail. No matter how much the government or authorities might try to help, nothing will be accomplished. But with a strong community, coupled with government support, you can foster development which can stand on its own."*
>
> (Bangkok Post, January 11, 1999, quoted by the World Bank 2001)

Given the existing unbalanced and centralized development, Thai scholars focus on self-reliance as the key performance of a successful or strong community. As stated in a World Bank report, "empowering the community in Thailand means building social capital and promoting self-reliance" (World Bank 2001: 60). Determination of the level of self-reliance and community strength encompasses several aspects and is often fragmented. Indicators based on the social aspect include number of members, people participation and learning process, creation of social capital and networks. The political aspect focusses on community power to counteract outside influences as well as local dark influences in order to protect communal rights and rights of rural people. Business and economic aspects take into account size of economic activities such as repayment rate of saving groups, management ability, self-reliance on local inputs and output market, increases in sale value, and so on. The accomplishment of ultimate goal of improving community welfare is sometimes ignored. Often, it is implicitly assumed that there is a certain and positive relationship between self-reliance and welfare improvement.

By exploring the past and present state of scattered strong communities in Thailand, together with the current institutional and policy changes towards community-based development, this paper aims at investigating the possibility of Thailand to develop strong communities to achieve a balanced and sustainable development. In this paper, the community is viewed under the empirical description in which the community is partially a sub-system of civil society under the nation state. Given the current unbalanced relationship among the state, the market and the community and the weakening of social capital, human capital, and environmental capital in rural economy, the desirable development path as proposed by the paper is sustainable and more balanced development. Sustainability can be derived from an improvement or at least maintenance of the existing level of local human capital, social capital, man-made capital, and environmental capital. It, thus, incorporates the concept of welfare in both social and economic aspects. Political aspects at the macro level can be considered from the tendency towards balanced development with pluralistic society that is made possible through the formation of groups and group pressure at the local level. Community empowerment is needed so that the desirable development can be achieved in order to improve the well-being of rural people. Self-reliance is considered here as a means rather than a goal.

<u>Empowerment</u>
Learning process through
Group lending,
Community business,
etc.

<u>Goal</u>
Sustainable development
(Human, man-made, social, natural capital)
Balanced development (pluralistic society)
(State, market, community)

Self-reliance -→→ Strong community
(Social, political, economic dimensions)

Among several strategies for community empowerment, the paper will explore the case of community business that is considered as *a means* to strengthen the community. Community business aims at achieving community's self-reliance in production and marketing and improvement of community welfare. Given constraints to each individual rural household such as imperfect market information and capital constraints, group sharing in investment and production can ease the constraints and diversity risk. In addition, group sharing of benefits can improve welfare as well as the four capitals at the community level. By reducing the dependence of rural households on the external market and the bureaucratic system, self-reliance can be achieved but it does not imply the rejection of any linkage among them at all.

2. Formation of Scattered Empowered Communities in Thailand

The community can be considered as a part of civil society . It is an institution that is formulated under a certain economic and social environment. Thus, characteristics of strong communities and civic groups could be changed or transformed through time as the social and economic environment has changed. Often, a strong community in the Thai context refers to the community that is able to protect rights and able to adjust to changing circumstances 1999 whereas community self-reliance and identity can be restored (Narong 2001; Prawes 1999 ; Seri, Vichit and Chamnong 2001; Chattip 2001).The ideology, however,varies regarding the relationship between the community, the state and the market (Connors 2001). Means to achieve community strength is the learning process, either through learning by doing and gain more, or learning from experiences of others (Vichit 2001). However, less effort is made to explore other factors, apart from learning and experiences, that might contribute to the rise and fall of strong communities.

This section describes when, why and how strong communities have emerged and evolved in Thailand. An attempt is also made to extract factors that coincide with strong and weak communities.

2.1 Historical background

The reality of Thai society in the past was an important factor which undermined the strengthening of the community. The problem stemmed from the vertical linkages since the advent of the Thai nation state in a form of centralized feudalism--which differed from feudalism in medieval Europe or Japan during the Meiji period. This was complemented by a deep-rooted culture of political and social patronage which reinforced centralized feudalism -most pronounced during the reign of King Chulalongkorn (Rama V), partly as a means to defend itself from the colonial expansionism from the West. Even after Thailand became a constitutional monarchy in 1932, the centralised system of administration remained intact and resulted in a bureaucratic hierarchy still consisting of a strong patronage system.

In the 1950s during the Cold War when the United States was the leader of the Free World in the fight against Communism, military means was used together with capitalist economic development to strive for the country to develop into an industrialised nation. Emphasis was given to investment in infrastructure. The government of the day was more than happy to accept foreign assistance and investment. This in turn strengthened the position of the military government, supported by the bureaucracy in very much the same way as the patronage system so rampant in Thai society. The communist movement in Thailand at that time was based on the principle of the rural countryside encircling urban centres and this again served to make it necessary for the state to respond by increasing its firm grip on power in the centralized structure. The argument used at the time was that decentralisation would provide opportunities for the Communist Party of Thailand to operate more easily.

The result of this type of national development led to Thai society becoming a commanded society which emphasised issuing of orders from top down. The penetration of capitalism into rural Thailand following the defeat of the Communist Party of Thailand in 1980 more than ever weakened the rural community generally. At the same time, the national policy to support foreign investment, as prescribed in the National Economic and Social Development Plan since the 1st Plan onwards in the 1960s, gradually made the private business sector able to grow stronger and eventually began entering the sphere of political influence for the first time in the brief period of so-called "Open Democracy" (between 14 October 1973 to 6 October 1976). But this influence of private business which began to clearly emerge over the bureaucracy, especially the military, was only during the era of Prime Minister General Chatichai Choonhavan (1988-1991) which led to the May events of 1992. Since that time, the real and absolute political power have been in the hands of the business elite. This has led to the business politics of today.

The most obvious benefit of business politics is the awareness of the inefficiencies of the bureaucratic system and the impotence of a commanded society in their very negative impact on Thailand's competitiveness against other countries. As such, even though business politics does stress the interest of the private business sector as a priority, it does still recognise the importance of promoting horizontal relations/linkages as an important tool in improving the economic potential of the country. The idea of empowering the community has therefore also been embraced by business politics, although it remains secondary to the interest of the private business sector. At the same time, another important obstacle to empowering the community is local dark influences which, again, evolves from the deep-rooted culture of patronage. Local influence provides the fundamental economic and political power base for business politics at the national level. As such, even though business politics play an important role in strengthening the community to a certain extent, the situation could easily become problematic or even confrontational if the community is empowered to a point which affects the political base of the local influential element.

It should be noted that within the political framework which is dominated by business politics, the civil society movement has more opportunity to grow than in a commanded society framework. This creates both opportunity and grounds for capacity building of civil society groups which are scattered in areas of little or no interest to business politics. The reason for this could well be that those groups have no potential to impact negatively on the business politics, or that they are strong enough to not be affected by attempts on the part of local dark influence or business politics to create legitimacy for entering that area. Under this scenario, the strength of the community could be sustained within the area outside the boundaries of interest to the business politics or the local influences, or alternatively within the boundaries where the community itself is stronger and able to withstand pressures from local influences and business politics.

2.2 Formation of civic groups and scattered strong communities

The formation of civic groups can be traced back to the latter half of the 1970s and the early part of the 1980s especially in the era when NGOs were leading the development activities in rural Thailand which coincided with the defection of former student activists from the Communist Party of Thailand. Some of these former activists went to work for these rural development NGOs[2]. Another key development was the "military defeat" of the CPT through the change to the Politics Ahead of Military Policy advocated by General Prem Tinsulanonda and General Chavalit Yongchaiyudh in Order 66/2525. This helped to promote the work of NGOs in rural development which, in turn, supported the formation of civic groups which were no longer branded as communist sympathisers.

The governments under the leadership of General Prem also gave priority to strengthening "people's organizations" which at the time meant "Tambon Councils". They were actually formed by the State under the Revolutionary Council Order No. 326 dated 13 December B.E. 2515 (1972) which was active up to 26 November 1994.

A strong or empowered community has many diverse characteristics, but the important characteristic is the coming together of people who share common economic interest. Forming groups on this principle did not arouse suspicion from state agencies that these were political groups formed to defy state power. In many cases, these groups actually received support from government agencies especially

[2] See also Amara (1995)

from the Community Development Department whose role and responsibility is directly in rural development. The formation of these groups might have been primarily to solve the economic problems of the groups themselves starting out as youth groups, housewives groups, and other activity-based groups such as a small savings group, rice bank group, cattle and buffalo bank, alternative farming groups, local handicraft groups, food processing groups etc. The objective of these groups is to solve their own economic problems, with no political agenda. For this reason, state officials rarely regard them as insurgents or those who pose any security risks to the state. At the same time, these groups were often neglected by local influences as they were generally located outside the desired sphere of influence, as these groups were most often in the poorer areas, possibly more remote and distant from markets or economic centres. These factors contributed to the development and empowerment of the communities. And with good management, these groups were able to establish savings for the welfare of their community.

The formation of another type of civic group resulted from economic and political injustices which the people could not resolve their own problems unless they mobilised themselves to fight. The alternative would have been to allow the community to disintegrate. The struggles which have achieved success are those which were directed against state projects or projects that the state had some involvement. Once the public saw that those projects did not follow due process or had no legitimacy, support shifted to the opponents of the project, at least on the part of the mass media. Examples of these are cases where communities have been evicted from an area where the state wanted to build dams such as the Pak Moon Dam and others in the Northeast, Kaeng Sua Ten Dam in Phrae and Nam Chone Dam in Kanchanaburi. The affected communities were uprooted and lost their rights to the community forest areas when the Forestry Department declares the area a national conserved forest. In the East, there was conflict over salinity of farm areas resulting from a state project to set up a salt industrial plant; demands for compensation from the state for agricultural promotion projects which went wrong.

In the eastern and southern parts of the country conflicts arise where the state awarded concessions to mangrove forests and the concessions are abused or there is encroachment by private shrimp farmers into mangrove areas, as well as fishing techniques which destroy the habitat or breeding ground of marine life. In many of such cases, there is also the involvement of state officials and this has forced citizens to unite to protect their livelihood. There has also been a case where residents have had to collectively fight for their right to protect public land such as in the case of the Kaoseng Slum Community in Songkhla.

The lessons learned from these struggles have taught the people and the community that if they do not unite in their struggle, they will never get justice or any semblance of an effort from the state to solve the problem they face. And the more they are united, the stronger they become. This is why the various groups in the northeast joined forces to become the Assembly of the Poor of the Northeast. Individually, the groups, with their different problems and issues, putting forth separated demands to the Government to address their problems, were just not vocal enough for the state to take notice. The success to a certain extent of this particular group has led to the formation of a national Assembly of the Poor and the mobilisation professional groups such as the Farmers of the North, the Network of

Forest Communities of the North, Congress of the Small Farmers of the Northeast, the Southern Rubber Growers, etc..

Another model in the formation of civic groups resulted from opposition to a major infrastructure project initiated by the state which might have a negative impact on the local people or on the general environment as a whole. Examples of these would be the opponents of the Thai-Burma gas pipeline project in Kanchanaburi Province. While the group has not been entirely successful in derailing the project, it has succeeded in raising social awareness. At the same time, there is also the group opposing the Thai-Malaysian gas pipeline project, and those who protest the building of Bor Nok and Hin Krud Power Stations in Prachuab Khiri Khan Province.

It should be noted that in these cases the formation of the groups were mainly based on economic needs or economic reasons–whether to improve their economic standing or to protect their livelihood, or to prevent destruction of the environment which would adversely affect the well-being of the community. When the group is formed for economic reasons, it rarely comes into conflict with local influences as the group is usually located outside the area of interest to the local influences. As such, the success or the strength of the community depends on the management skill of members of the group in effectively dealing with their specific problem as well as their credibility which could gradually build up to the national level and serve as a case study or example for others. The fact that it does not come into conflict with any local dark influences means that its growth is unlikely to be hampered and members of the group themselves will be empowered, their knowledge, experience and management capabilities will be accumulated to eventually allow for sustainable development.

In cases where the forming of groups was mainly for the purpose of opposing a state project, an important factor is also whether and to what extent the local influences share a common interest with the state project. In many instances, the strength of the group and the community is initially tested by opposition from the local influences and state officials, as well as the legal system eventually. Therefore, if the groups can withstand all these pressures and hold out for success, it shows that members of the group and the community were strong and committed enough. A good example of this is the struggle by the group to protect the mangrove areas who succeeded in preserving the area as well as their livelihood and economic security. Other examples are a community rice mill of Baan Naa So (Yasothorn Province) and In-paeng group (Sakonnakorn Province). The groups were suppressed under the government policy against the communist party in 1970s. They, however, revived and are currently successful in developing community business and networks with strong economic and welfare improving performance. These groups will be further strengthened whereas those ad hoc groups which oppose the Nam Choan Dam Project, Kaeng Sua Ten Dam or the Thai-Burma, Thai-Malaysia gas pipeline projects, or the power plant projects in Bor Nok and Hin Krud of Prachuab Khiri Khan have no guarantee that they will continue to flourish without longer term activities which would promote sustained economic development of the community.

It can be concluded that a strong community which will benefit from long-term development is the one which is united by economic interest and has become successful to the point where the benefits have reached the community as a whole. In the case of a group which had been fighting for long-term economic benefits, its activities must be supplemented by community welfare exercises. As such, regardless of how the group was formed in the first place, if its activities are not limited to the exclusive economic benefits of the group itself but can be expanded to cover the welfare of the wider community and surrounding areas, then a lasting and sustainable empowerment process is more likely.

3. Why "Strengthening the Community" Is Needed?

Regarding the fact that the strength of communities in Thailand is still scattered as described above , it needs more efforts to empower and strengthen communities and their networks for more balanced and sustainable development. Without balanced and sustainable development, it is hard to protect rights and improve welfare of rural people in the short and the long run. Three major reasons will be raised. First, there is a need to substitute the community for an inefficient market. Second, there is a need to develop strong horizontal linkages to replace an inefficient top-down administration. Finally, it is necessary to strengthen four types of local capitals, namely human capital, physical capital, social capital, and natural or environmental capital. In the last part of this section, hypothetical analysis for desirable path of balanced and sustainable development will be presented.

3.1 Needs for strong communities in the Thai context

Need to replace inefficient markets

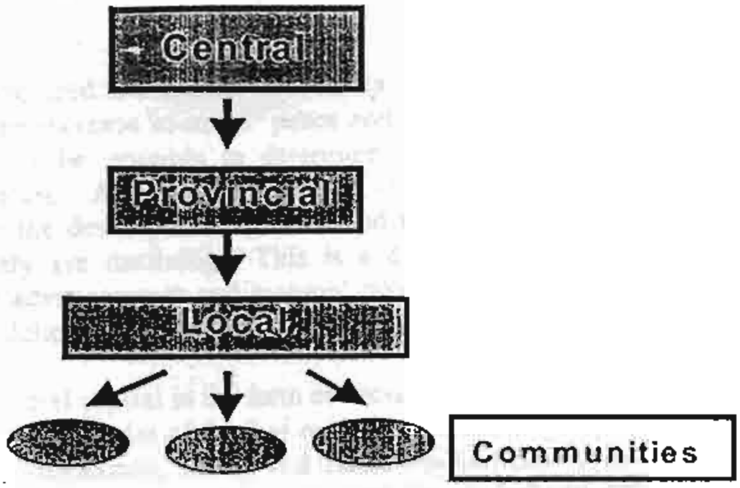
Economic functions of a rural community as an "escape out of the state-market dilemma" can be summarized in four ways: (i) the community as an insurance supplier in a world full with pervasive uncertainties; (ii) the community as a trust-enforcing agency in exchange within a world where written contracts do not exist due to widespread illiteracy; (iii) the community as a producer of collective goods that helps overcome the free rider problem inherent in the production of local public goods; and (iv) the community as a rights-enforcing agency to govern natural resources at the local level (Platteau 2000, Hayami 1997). Nevertheless, Platteau made arguments with evidences that, like markets and the state, communities are not always efficient as they are also fraught with imperfections. However, these imperfections can be largely remedied through capacity-building programmes aimed at strengthening the collective action abilities of village society (Platteau 2000).

In Thailand where the community is characterized by "loose structure" (Kitahara 1996), any decision made by a group can be more costly than the one made by individual. However, the benefit from collective actions to overcome a set of individual's constraints can be even higher than the cost of collective actions. The constraints include imperfect market information, uncertainty in natural-based livelihood, an individual's shortage of capital, a lack of power to protect an individual's rights due largely to the unbalanced development policy and top-down administration. Negative experience of modernization in the past 40 years calls for a new way to survive by collective actions, such as co-funding, labour sharing, group saving, and group provision of welfare; to prevent adverse impacts caused by imperfect markets and center-peripheral development. As a result, the number of community business groups in rural Thailand is rising through time (Patamawadee et al 2002)

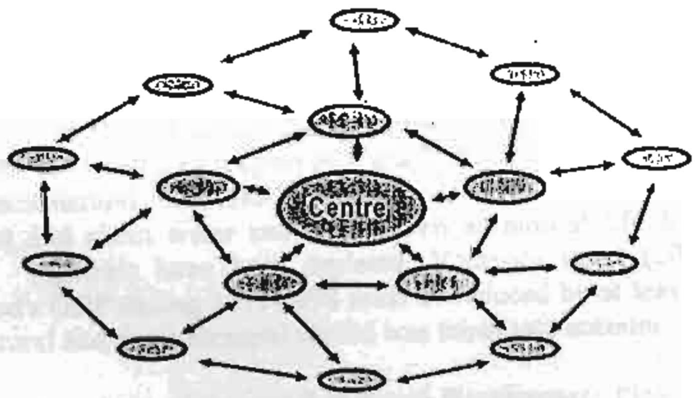
Need to develop strong horizontal linkages

A basic idea for community empowerment is that the strengthening of the community at every point in the country must begin in the smallest unit, namely the family, to the various groups within the community, within the village, within the sub-district (tambon), within the district, within the province as well as the network of communities in a region of a country and between different countries. The strengthening or empowerment of a community plays a vital role in easing the burden of the administration of the country and the solving of national problems from the central government. This is because of the basic assumption that the community has the knowledge and understanding of local problem, possess the resources to better deal with and resolve the problem more effectively than some analytical unit in the central government. The administration of a country which is centralised in terms of political and economic authority, with the administrative structure being vertically applied is undoubtedly less efficient than management and administration of local problems through horizontal linkages within the community and among communities.

If it is certain that every social unit which are linked horizontally have more or less the same degree of resources and potential to solve problems, these horizontal linkages or relations should prove to be a more effective social model to deal with problems. At the same time, each unit (of the community) in that society may act independently to assist members of its own community to reap the most benefits. However, communities which have these horizontal linkages can only really work efficiently under three conditions 1) the overall social climate must be an open and pluralistic society where every unit in that society can utilise its knowledge and capability to equally benefit from available information; 2) each community must have similar level of knowledge and ability to manage the community's resources; and 3) the problem must not be too big for the community to tackle by itself. Without these three conditions, especially the third and first pre-requisites, it would be difficult for a community to solve its own problem. It therefore remains necessary to have a strong administrative centre to serve as a coach, rather than as a superior or ultimate authority.



VERTICAL RELATIONSHIPS



HORIZONTAL RELATIONSHIPS

Need to strengthen local capitals

'In the theory of sustainable development, it is generally explained that the important elements for sustainable economy are human capital, physical capital, social capital and environmental capital (Pearce, Barbier and Markandya, 1990). In Thailand, the overall picture of development in the past 40 years depicts great material progress at the expense of exhausting Thailand's environmental and social capital. Since the First National Economic and Social Development Plan in 1961, emphasis has been placed on increasing physical capital at a rapid rate.

There are evidences of an improvement in human capital including an improvement in general level of literacy, an increase in number of the educated population at all levels within relevant age groups of the population, and the increase in the life expectancy of the general population (UNDP 1999). However, such improvement in education did not contribute much to improvement of human capital in the rural economy because of migration of young and educated rural population.

The study by Pranee and Chalongphob (1994) found that improvement in quality of labor in agricultural sector was minimal and approach to zero in the period of high economic growth.

Moreover, if the index used is Buddhist Economics, namely increasing in the development of Mind and the increase in social peace and harmony, the results can be problematic. It might not be possible to determine whether there has been development of human capital. A general reading of the reality of the existing situation could well be that the development of Mind and the level of peacefulness and harmony for the society are declining. This is a direct result of the more sophisticated technological advancements and material progress which have severe repercussion on Thailand's delicate social fabric.

At the same time if social capital in the form of social fabric is considered, the overall picture that emerges is that a lot of this has eroded as evident from increasing individualism in society. Compassion, caring and social commitment seem to be diminishing. Social relations and human relationships are being replaced more and more by financial relations. The relation within a family in the form of extended families is also declining. In fact, the rural family unit is often broken due to migration. It can almost be said that the past economic development efforts played a key role in destroying rural social capital.

Development in the past was achieved at the expense of the country's natural resources and environmental capital (Varaporn et al 2002 , Patamawadee 2001). The country's most important natural resources--forests, mangrove forests, bio-diversity, soil fertility, abundant and clean water and air, as well as natural life forms--all severely diminished. Minerals have been depleted. Varaporn et al (2002) has estimated that Thailand's GDP during 1977-1998 must be reduced by at least 24% if the depreciation of natural and environmental capital was taken into account.

In 1996 at the assessment of the past 7 National Development Plans prior to the beginning of the Eighth Plan (1997-2001) it was concluded that **"A flourishing economy, proliferation of social problems, unsustainable development."**

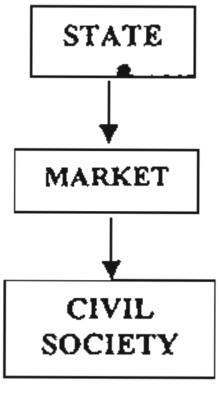
3.2 Hypothetical analysis for the desirable path of balanced and sustainable development

The impact of development patterns in the past has made it necessary for a review of development trends which might better serve to rehabilitate human, social and environmental capital. As a starting point, it is essential to come back to the community and look at the economy of the community which consists of the four capital components .The emphasis here is on the rural community and its economic system.

When considering the economic system of the community, it is apparent that even if the development of human capital measured in terms of quantity has been slowly increasing, or in many cases, actually decreasing--the index which measures quality of which local wisdom as a key factor, has not really been affected as much. And even in cases where there is considerable impact, it is still in a state which can be rehabilitated. The reason for this is because accumulation of physical capital in the rural community was not at such a rapid pace as was the case in urban areas or at the national level. This resulted in the social capital in the rural community still being intact to provide essential communal fabric as long as the community is still existed. As such, rehabilitation of social capital in the rural community stands a much better chance of succeeding than in an urban community.

As for environmental capital in the rural area, the extent of damage to this depends on the real circumstances in each area. A strong community might be able to better protect and preserve its natural resources and environmental capital. A weak community could lose more of these. However in general terms, the natural resources and environmental capital in the care of the community remains to be better protected for in relative terms because the natural resources which have been destroyed or depleted are mainly those which were open access as well as being public property which belonged to the state and was looked after by government officials whose interest was not coincided with sustainable use of resources and their capabilities and efficiency were limited.

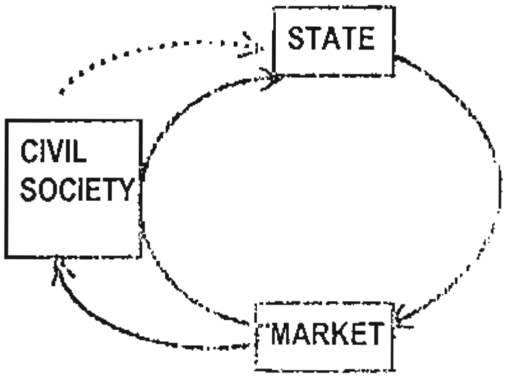
From this fact, it is therefore possible to use both rural and urban communities as units to rehabilitate human, social and environmental capital all at the same time. But before it is explained how the community can be used as a base for development and rehabilitation of the capital which have been destroyed, it must first be explained what factors contributed to the destruction of these capital components. It was already mentioned earlier that the characteristics of a commanded society as prescribed in the First National Economic and Social Development Plan came about at a time when Thailand was under a military dictatorship led by Field Marshal Sarit Thanarat and followed by Field Marshal Thanom Kittikachorn in a scenario where the World was in the era of Cold War with the United States acting as leader of the Free World, whose major policy was that of military strength to defeat any possible aggression by communism. At the same time, the US government also advocated a capitalist economy which emphasized industrial development .The promotion of foreign investment was also the main national development strategy. Under such scenario of a strong military state, the state actually controlled the market and the market, in turn, controlled civil society, as shown in the diagram below.



This development strategy was actually the one which used the state to control the market and used the market to control the populace in a vertical structure that did not allow the populace to have any control over the state. Behind the state, of course, was the United States and other multilateral agencies led by the World Bank which was the most influential of all at the time.

Development Paradigm and Actual Implementation:

(1961-1973)



(1974-1976)

The Image of Development :

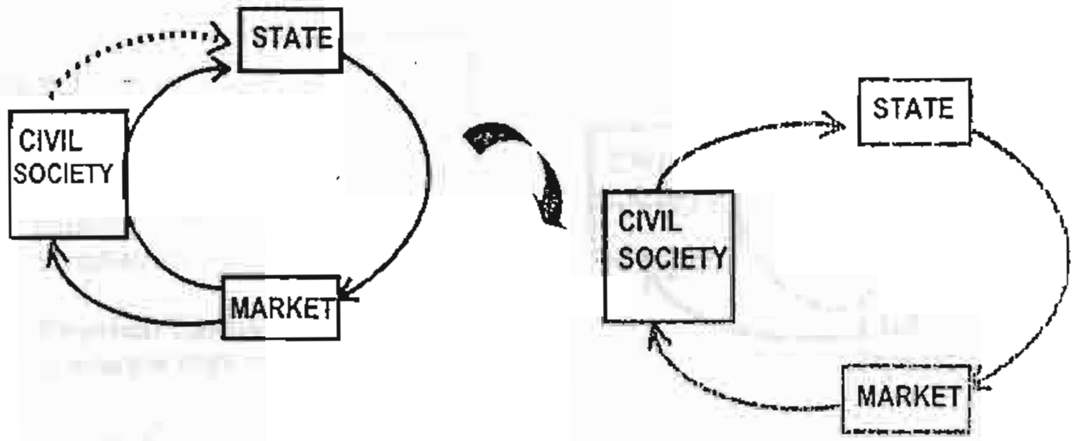
National Economy

- **Human Capital** +/-
- **Physical Capital** +
- **Social Capital** -
- **Environmental Capital** -

Communal Economy

- **Human Capital** +/-
- **Physical Capital** + (less than national average)
- **Social Capital** - (less than national average)
- **Environmental Capital** -

Following the end of the era of military dictatorship, the period between 14 October 1973 to 6 October 1976 was the turning point which allowed the market or private business to begin having some influence over the state, which was originally partly controlled by external influences especially the United States and the World Bank under the atmosphere of the Cold War between 1977 to 1988. This was a time of fierce rivalry between business politics and power politics. The latter gradually lost its legitimacy with the easing of the Cold War. From 1988 onwards, it can be said that business politics truly overpowered the state while in 1992 business politics won a decisive victory over the state. The economic crisis which started in 1997 provided the opportunity for the emergence of people's democracy or the sprouting of movements of the civil society . The most tangible outcome is of course the new constitution which is regarded as one which for the first time promotes the role of civil society in Thailand and allows citizens to participate in the political process, much more so than any other constitutions in the past. At the same time, the influence of business politics remains a strong force which is shown in the chart below:



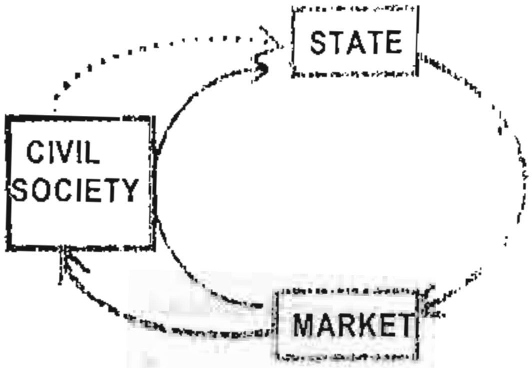
The bold arrow points to the market having control over the state and at the same time controlling civil society while civil society remains weak and incapable of controlling the state. The image which should emerge in the future to reflect democratic pluralism is the one which civil society can control the state so that the state becomes more responsive to the needs of the people. In the meantime, the strength of business politics should also be lessened by the fact that the state has to control the market so that it (the market) operates under a more competitive code and regulations. The state must also intervene in the market to allow those who are disadvantaged to have better opportunities in society. Ultimately the image that is mostly desired is that of perfect democratic pluralism --which means that the state, market and civil society exist together in a balanced and harmonious arrangement whereby civil society can control the state, the state controls the market and the market controls the management and use of the resources of the civil society in an efficient and effective manner. (As the image on the right.) The immediate obstacles in the transitional phase in the local level is the local influences while at the national level it is the business politics. In order to attain the desired developmental trend in the future, the following chart should explain:

Desirable Path of Development

Stage 1

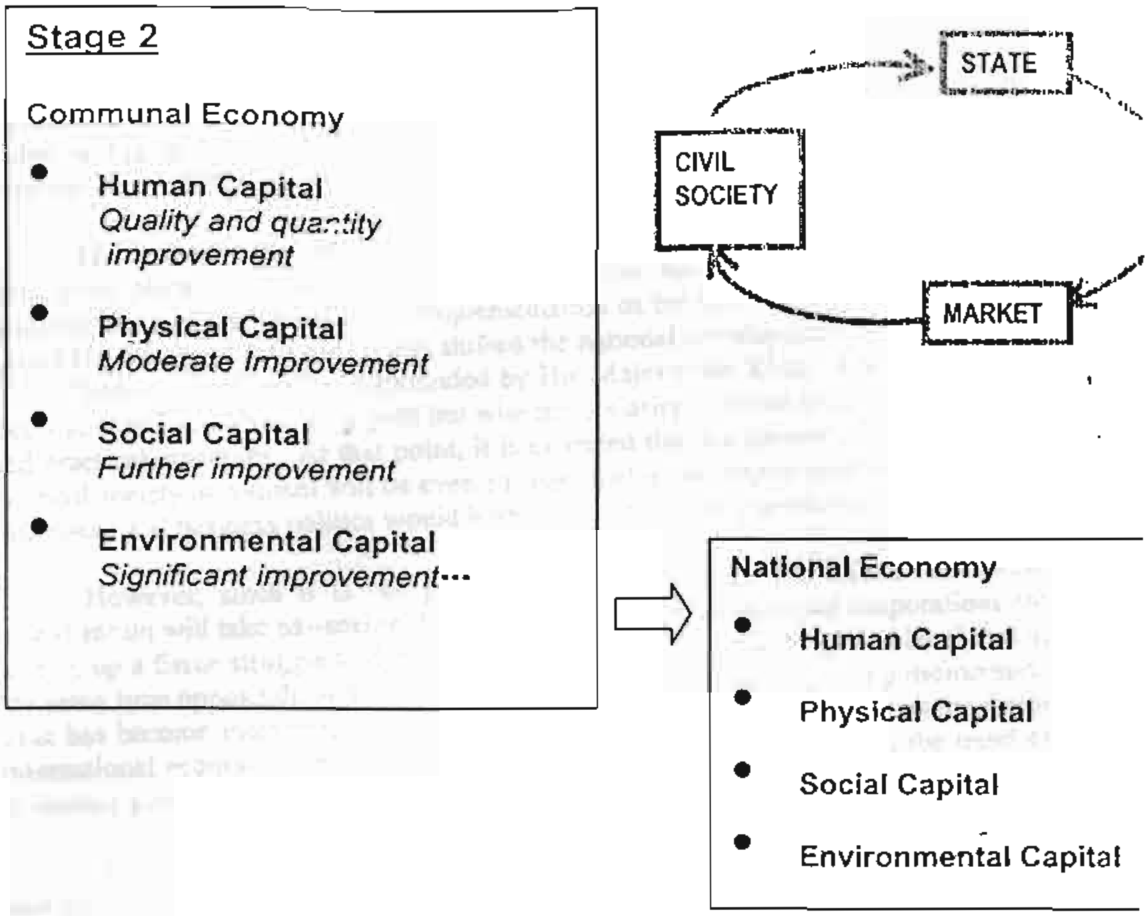
Communal Economy

- **Human Capital**
  Emphasis on quality
- **Physical Capital**
  Moderate Improvement
- **Social Capital**
  Significant improvement
- **Environmental Capital**
  Moderate improvement



National Economy

- **Human Capital**
- **Physical Capital**
- **Social Capital**
- **Environmental Capital**



The above charts separate development into two stages. In the first stage, the local influences and business politics were dominant forces while civil society was not yet as strong as it should have been. At the level of community economy, it is necessary to further develop human capital, with an emphasis on development in terms of quality and not quantity. As mentioned earlier, Thailand has had some success in human capital development in terms of volume. Development in terms of quality here means mental development and wisdom, placing emphasis on strengthening and further improving of local wisdom while at the same time advocating for well-being from non-consumerism. Development of physical capital within the community should be gradual with an emphasis on capital which gives access or uses information technology more efficiently, rather than accumulation of other forms of physical capital which might have a negative impact on the environment.

At the same time, it would also be appropriate to improve the quality of human capital for the purpose of developing the community's social capital especially to compensate or replenish what had been depleted by past development in the last 40 years. As for environmental capital, it would not be possible to increase this quickly in this initial phase because of resistance from local dark influences and business politics which have traditionally relied on these natural resources and environmental capital as important factors in building their own power base. Concerted efforts to increase environmental capital, therefore, will pitch civil society in direct confrontation with the local influences and business politics. Examples of this include the coal-fire power plants in Bor Nok and Hin Krud of Prachuab Khiri Khan

Province, and the Thai-Malaysia gas pipeline project. Once the various forms of capital within the community economy increase, so will the capital of the national economy be rehabilitated.

The second stage would be the decade after this first initial period, when democratic pluralism under the current constitution has been operating relatively smoothly for a while, and after the implementation of the 9th National Economic and Social Development Plan which has shifted the national development strategy to that of "sufficiency economy" as expounded by His Majesty the King. The 10th Plan is likely to continue on this same path but with more clarity in terms of tangible methods and practical processes. At that point, it is expected that the people's democracy and the civil society movement will be even stronger and more empowered while the local influences and business politics would have been significantly weakened.

However, since it is not possible to foresee where the tide of economic globalization will take us--seeing that on the one hand multi-national corporations are putting up a fierce struggle to dominate the business politics at the global level, but at the same time opposition and resistance to this movement is also gaining momentum. This has become increasingly evident from the mass protests at almost every major international economic forum or summit meeting. It could well be that the trend of economic globalization would have become less severe by that time.

If this situation eventuates, then it is even more important for the accumulation and improvement of human capital to continue both in terms of quality and quantity. This is to say that even though there has been considerable development of human capital at the national level in terms of volume, when one looks at the rate of human capital development in the rural community, the ratio is lagging a great deal behind the national average. It is, therefore, necessary that emphasis is to be given to development of human capital in the rural community level in terms of quantity, while accumulation of physical capital can be more gradual with emphasis being given to developing the information technology infrastructure as this will substantially contribute to development of human capital as mentioned earlier.

Social capital must also be accumulated as the community becomes more confident that its goal should be empowerment and peace and tranquility rather than material progress which normally resulting in environmental and social problems. This is an ideal period for the rehabilitation of the environment. If the objective of development is no longer materialistic, the local influences and business politics should also diminish as their struggle to control the resources and environment of the community subsides, thus allowing the local community to focus on efficiently improving and managing their natural resources and environment.

The next question is if this is the hypothetical analysis then how do we proceed from here...from this point where the strength of communities are still scattered, to a point where future two tiers development is attainable. These issues must be considered when formulating the national development policies by the government because the policies play such an crucial role in determining the future path of development.

4. Thailand's Strategies towards strong communities after the crisis

The importance of community was placed in Thailand's new Constitution promulgated in 1997 and in the 8th and 9th National Economic and Social Development Plan (1997-2001 and 2002-2006). Efforts made by the state have been enhanced after the economic crisis in 1997, followed by the new policy of the Thaksin government aiming at supporting communities. Apparently, a new paradigm of cooperation between the state, NGOs, academics, and communities has emerged.

This section discusses efforts made to strengthen Thai rural community after the economic crisis since 1997.

4.1 Institutional Reform

The 1997 Constitution

Promulgation of the new constitution in 1997, "the People's Constitution", is the key to social reform in Thailand (World Bank 2001: 61). The community's right on natural resource management and conservation has clearly stated in Article 46. In Article 56, 58 and 59, a person shall have right to access to information and right to participate in the decision making process at all levels. Obviously, the Constitution provides the legal foundation for community empowerment, which is the decentralization of power to the local level and to the people.

The Eight and Ninth Economic and Social Development Plan

To achieve the goal of community empowerment, the 8th and 9th National Economic and Social Development Plan focus on the means of political and economic decentralization. The 8th Plan (1997-2001) differed from previous plans in 2 aspects. First, the process of formulating the plan involved people from public sector, private sector, NGOs, local people, communities, and mass media. Nine workshops were held at the sub-regional level. Secondly, the main focus of the plan was a holistic people-centered development. The holistic targets included economic, political, social and cultural targets while the mechanism required the partnership of a wide range of stakeholders or people's participation whereas the public sector is supposed to take the supportive role (NESDB 1999; Sansern 2001: 157-158). Unfortunately, the economic crisis in 1997 obstructed the implementation and achievement of the plan even though the crisis helped proving that the plan was going to the right direction (Apichai 2002).

The 9th National Economic and Social Development Plan has the endorsement of a wider circle of civil society groups. In addition to the Office of the National Economic and Social Development Board which is responsible for formulating policies and setting the direction of medium-term national development, a National Advisory Council has been established from the people's sector as prescribed in the constitution to offer counsel on economic and social development issues. The Council comprises of the best brains recruited throughout the country whose most important responsibility is to give its endorsement to the 9th National Economic and Social Development Plan in the direction as set in His Majesty the King's initiative regarding the sufficiency economy and sustainable development. Even though this Council only has an advisory role and no real decision-making authority, its views and recommendations will be disseminated and publicized so that the general public can take part in scrutinizing the national development plan. In all counts, this will mean that the ultimate benefit and national interest are considered and protected. In this way, it will be easier for development policies which benefit or serve the interest of a wider group of the populace to get approval. It will also mean that those projects which are questionable or which serve the interest of only a certain group will be closely monitored and scrutinized.

a) Sufficiency Economy

The 9th Plan emphasizes sufficiency economies and sustainable development. The problem of how the Plan can be practically implemented depends on whether the concept of "sufficiency economy" is fully understood. Principally, sufficiency economy refers to the building of sound economic foundations within the community, the local area, the region and then the country—before expanding to economic competition at the international level. Moreover, the principle emphasizes sufficiency in terms of moderation—meaning that one must not be too greedy, must be honest and not take advantage of others. The emphasis is similar to that of the teachings in Buddhism and other ethical standard available in most religions.

b) Decentralization

The plan has set out the trend for devolution of authority to local administrative bodies, including a plan of action which prescribes the boundaries in preparing for their new role with some modification to the role of civil society to learn and participate in such administration process for the first 10 years. The emphasis has been to transfer power to local administrative bodies which demonstrate their readiness within 4 years. As for those bodies which are not yet ready, the transfer of power will take place in the next 10 years with the initial authority being devolved having to do with raising the standard of living and promoting the quality of life of the people in the community, followed by the basic local infrastructure needs to strengthen the community in the first instance.

There are provisions dealing with taxation and other income for the local administrative bodies which stipulate that the income of the local administration should increase in 2001 by no less than 20 percent of all state revenue and increase by no less that 35 percent by the year 2006.

4.2 Community Strengthening by the state, CSOs and the community

Government Policies and Programmes

After the crisis, several programmes aimed at supporting community, were initiated by the Thai government. New development partnership with civil society has taken steps. Collaboration with several other foreign agencies and donors such as the World Bank, the United Nations, Australia, New Zealand, Canada, was attempted in order to strengthen the decision-making capacities of local communities and to provide them with an opportunity for their demand to be heard. (World Bank 2001: 66-67)

The Government established the National Social Policy Committee (NSPC) to address social issues, to empower communities to respond to the impact of the crisis at the community level. NSPC set up a community Empowerment for Response to Crisis Action Plan. NSPC provided funding in the amount of 40 million bath (approximately US$1 million) for a pilot project to create more opportunities for civil groups at the local level to participate in local policy formulation. The Pattana Thai Foundation was created. There is no report of the clear impact of the project.

In September 1998, the Government, with support by the World Bank, United Nation Development Program (UNDP), and AusAID, has launched the Social Investment Fund (SIF) which provides grants to community-based organizations to undertake investments designed and implemented by the community. The SIF's menu of eligible investments covers five main categories. They are : (i) Community Economy, (ii) Community Welfare and Safety, (iii) Natural Resource Management and Cultural Preservation, (iv) Community Capacity Building and Networking, (v) Emergency Community Welfare. The SIF is widely recognized as a pathway towards government collaboration with CSOs.

Early 2001, the present government led by the Thai Rak Thai party has formulated many policies to stimulate the economy at the grass roots level such as the 30-baht universal health care scheme, the farmers debt suspension program, the people's bank/credit project, the one sub-district one product project, promotion of community businesses as a juristic entity, the one-million-baht per-village fund,etc These projects and programs are expected to stimulate investment and spending at the grass roots level. The health care program will ease the burden of medical costs while farmers' debt suspension will allow them to breath more freely and have more cash flow. These monies in the system will be used to pay for goods and services from SMEs. Thus also helping to generate business for them and causing a chain of economic activities.

All of these projects, although not directed at empowering local community, can have a positive effect in empowering the community. In practical terms, the one sub-district one product program and the village fund project, if properly managed, will provide the community with the means to initiate a community business venture. On the other hand they provide the opportunity for members of the community to participate in the management of the funds which should be a positive learning process. Probability of success and size of the impacts, however, may vary among communities.The projects will have a direct effect in strengthening communities which do not have local influences, and communities which already possess basic knowledge and certain level management skills. The study by Apichai et al (2002) found that preparation of a village group to make self assessment prior to receiving any assistance is a prerequisite to the success of the project. However, there might be certain negative effects in that relationships within the community could become more individualistic and people have become more money oriented. In the final analysis, whether it is the one sub-district one product project or the village fund project that can develop and evolve into a viable community welfare system in the same way as the community savings groups or the small community business which have proved to be successful in the past; then they would serve the purpose of strengthening and empowering the community without having to go through that confrontational process as the time when the struggle was for the survival of the community to protect its environment.

If analysed in accordance to the theory of sustainable development as explained earlier, these projects initiated by the government while beginning with the injection of physical capital into the community, and at the same time it promotes improvement of the human capital within the community through the learning process. This is very important because if human capital is improved then this will lead to more efficient management while also increasing the potential and local knowledge within the community—thus bringing the community together rather than breaking it up. Increasing the capability of the community in this way also results in increasing the level of social capital while whether or not the environmental capital of the community increases, depends largely on the awareness of the people in that community.

At the same time, the fact that the current Thai Government is facing serious problems in collecting government revenue to spend in implementing these policies. is not necessarily a threat but rather an opportunity in that this will ensure that the Government proceeds with the greatest caution. Instead of squandering the budgêt to secure its popularity and support from the people, it looked for better alternatives. For example, the Village Fund Project, which was to allocate 1 million baht to each village, did not pool the funds from the national budget but used a credit facility arrangement with the Government Savings Bank. This requires repayment of the loan and thus ensures that the village committee be more prudent in approving such loans. However, in practice, whether the fund was allocated among village groups properly at the beginning is still a major concern. .

In short, the new policy apparently goes in line with the framework set by the new constitution and the national plan. However, more direct efforts on capacity building of rural people are needed, particularly, efforts to strengthen agricultural-based development.

Civil Society Organizations (CSOs)

Since the mid 1990s, civil society has been playing an increasingly important role in Thai politics and society through their active participation in drafting the new Constitution and in preparation of the 8th and the 9th National Economic and Social Development Plan. After economic crisis, the organizations of civil society have "pushed for political reform and government policies that are more responsive to the need of lower income and vulnerable groups". (World Bank 2001: 61). Non-Governmental Organizations (NGOs), in particular, are key actors in the process of community strengthening and empowering.

Approximately, 18,500 NGOs are registered and many are operating without legal status (World Bank 2001:65). They are forming themselves into networks.

playing a vital role in development debates and in protection of communal rights. Traditionally, the work of NGOs focussed on ideology, rather than managerial skill (Jaturong 1996). Supports from NGOs in promoting community business were limited and basically in the forms of provision of production equipment or investment fund. An example is the donation of fund by Suppanimit Foundation to silk weaving groups in the Northeast for purchasing hand-weaving machine[3]. Not until recently do NGOs put more efforts to support community business. Focussing on the learning process, NGOs are good connectors that facilitate knowledge transfers between community business groups with best practice and those with poor practices.

Academics, particularly regional universities, are also playing active roles in community empowerment. They can substitute NGOs in transfer of technical and management skills to communities and complement with NGOs in analysis of local problems and project evaluation. They are, however, have limited capacity due to their limited numbers and time constraint.

Apparently, there is an increasing number of community organizations and the demand for formation of organizations in rural communities. (Apichai et al 2002(a); World Band 2001: 65-66). With supports from the government, NGOs and academics, the growing grassroot movements among the people themselves seeking a larger role in policy formulation and in tackling poverty are indeed crucial in further strengthening the community.

Cooperation between the Government and CSOs

Cooperation between the government and CSOs are mixed. Many NGOs engage in activities to support communal right and right of rural people and thus, apparently confront with the government in several development projects. On the other hand, there are some activities that NGOs receive financial and institutional support from the government. For instance, Ministry of Labor and Social Welfare has established 19 provincial NGOs Coordinating Centers to coordinate activities of NGOs working on social welfare and safety nets in each province.

In 1999, Ministry of Agriculture and Cooperatives, with the support by UNDP, initiated the project aiming at capacity building of both communities and its officials. The project subcontracted the Village Foundation, an NGO, to work with its local officials in building capacity of local farmers through learning in the process of self-assessment, project initiation and management. Similarly, the Ministry of Industry worked successfully with the none registered CSOs and Khon Kaen University in implementing the project on capacity building of rural communities through community industry. The success of the UNDP supported projects demonstrated the possibility of cooperation between the government and CSOs in real practice particularly in capacity building activities at the local level which is an area NGOs have more advantages both in terms of ideology and expertise in working with villagers. (Apichai et al, 2002).

In July 2000, the Community Organization Development Institute (CODI) was established by the government. The main objective is to help strengthen community-

3 Interview with leaders of silk weaving groups in Khon Kaen in April 2002.

based organizations through financial and technical support. CODI helps to define community based organizations which are legally eligible to receive direct financial support from the government and civil society organizations (World Bank 2001 :68).

5. The possibility of Thailand to develop strong communities and sustainable development

5.1 Lessons from community business[4]

Among several aspects of strong community, the importance of economic aspects cannot be denied. In the circumstance that most of rural households are subject to imperfect market information, imperfect capital market, high risk in agricultural production, market failure in natural resources and environment, and in some cases over-consumption, dependency on the external market makes the rural households especially vulnerable to uncertain and changing market conditions. Persistent poverty, debt, loss of land, and limited job opportunities in the rural community push rural people to seek for jobs in urban area. To overcome such constraints and problems, formation of the community economic activities has taken place in several forms. Saving groups initiated and developed by a village leader in the South are among successful and widespread one. Others are community business, communal banks, communal shops, and so on.

"Community business" is defined here as a business group at the community level of which members share investment, share their labour in production of goods or services, and share income and welfare derived from the business returns. The production aims primarily at serving local needs. The rest, then will be sold to the external market. Even though a certain level of accounting profit is needed, the ultimate goal is to enhance the well-beings of the community members. Therefore, community business is highly possible to accomplish or serve the ideology of self-reliance and sufficiency economy. Failure to distinguish different types of business existing at the community level can lead to failure of policy to support community economy, particularly when self-reliance and sufficiency is a major concern.

From our primary survey all over the country in April 2002, it is astonishing to find that about 80 percent of 300 groups of community businesses whose names were reported by government were either fake or cannot truly be classified as community business. Some have their name in official lists but the groups never existed or were already dissolved. Some near the border ran illegal businesses. Many use the name of "group" to receive official support but actually were private business that simply

[4] The observation reported in this paper is based on field survey and visits of 146 community groups in the Northeast Thailand, two-day seminar with the groups, in-depth interview with 10 group leaders, and attendance in many sub-group discussions, each comprising of about 10 individual groups. The whole process was conducted during April-August, 2002. Details are discussed in Patamawadee et.al 2002.

exploit cheap community labour, mostly through a subcontracting system. Many successful groups were already taken over by local or urban businessmen. Quite a number of products in "One Tambon (Sub-district) One Product" Program were basically produced by privately-owned small or medium firms . It cannot be denied that there is social benefit from those privately-owned businesses as they generate employment in a village and can support happy family institution within the village community. Unfortunately , the community cannot be strengthened under such a business system since the learning process will not function properly among members of village community and the community must rely more on the owners. Whether villagers are compensated fairly is also unclear .

It is also found that many of the "genuine" community business have never been included in any official lists. Roughly estimated, there are not more than 300 groups of community business all over the country that earn at least 500,000 baht[5] of total sale per year. The maximum sale found in the Northeast was about 30 million baht a year. It is a community rice mill owned by 1,000 farm-households in Ban Naa So, Kudchum District, Yasothorn Province. Naa So group used to be suppressed by the government under the anti-communist policy. Recently, the group is successful and obtains wide supports from several agencies . Naa So group is a good example that supports Kitahara's conclusion that positive or negative acceptance of community can change based on normative judgement (Kitahara 1996).

Lessons Learned

- Community business are dynamics. In other words, they are volatile to change due to the changing internal and external conditions, particularly if the groups are not strict to the ideology of sufficiency (which incorporates the idea of self-reliance) and if the ultimate goal of improving community welfare and sustainability is ignored. Rising external demand for goods induces an expansion of the business which makes it need more of external inputs and open more to the external output market. On the other hand, a fall in the demand for the product can also lead to business difficulty , especially, the industry that has a problem of cash flow[6]. This is why many groups of which names once appeared in an official list has been transformed or do not exist at present.

- Some groups which are not firmly established want to achieve profits, sales and growth rather than being self-reliant. Self-reliance composes of several dimensions. Some groups which aims at maximizing local employment may not be self-reliant on raw materials. This is a clear evidence that self-reliance is not always an indicator of welfare, at least when it is measured in terms of employment. However, it is obvious that if raw material is the key factor of production measured in terms of cost share, such a weak level of self-reliance imposes constraints, financial problems and risk to the group business. In this respect, it is preferable to interpret self-reliance as a means to reduce risk.

[5] US$1 is approximately 43 baht.

[6] An example is the silk weaving industry that requires relatively large amount of fund for initial investment. Long period of time is needed for production and sales.

- Empirical evidences show that the community in practice does not deny the linkage with the market. The level of linkage and self-reliance depends very much on nature of industries and ability to expand or find networks at the community level. One characteristic of strong communities is that they have networks to share/exchange inputs and labour in the period of business boom, and to share the output market and risk in the period of business recession. Nevertheless, an ability of the community and its network to diversify risk is limited as long as members of the group and the network are producing the same products. Product diversification at the community level is not too hard to implement, but it requires initiative, understanding of local wisdom, as well as learning from other groups.

- Based on observation from the case study of 146 community businesses in the Northeast, it can be concluded that community business founded on the ideology of sufficiency economy is a challenging means to strengthen community and sustainable development. Certainly, it strengthens local wisdom and improves human capital in terms of knowledge, employment, and provision of community welfare. To a greater deal, it strengthens social capital through coperation, rather than competition, within a community and among community networks. The contribution to an accumulation of man-made capital is smaller than other types of capital . This is partly due to the fact that accumulation of man-made capital, investment on environmental capital, and spending on community welfare are competing uses of business surplus. The Northeastern groups tend to give higher priority to human welfare and the social capital.

- To achieve sustainable development, it is likely that community business can do better than saving groups if the poorest in the community can join the groups. Coleman (1999) concluded from his empirical study that although the estimation is overestimated, group lending and saving in Northeast Thailand has little impact on income, accumulation of assets, and spending on education and health care. While his study mixed strong and weak groups, this suggests that the real impact of group activities such as group lending may simply be the improvement in social capital. It is hypothesized here that if saving groups can contribute more to sustainable development the saving fund is also allocated for production, not just for consumption.

5.2 Issues to be considered

In addition to the issues and subjects already discussed above, there could be other related issues which have not yet been considered in as much detail as they should. This is a reference to the idea of whether there should be special measures which will effectively and expeditiously lessen the influence of business politics and local dark influences. This leads to the question of what can be done for communities which are weak currently. Another issue which has not yet been widely discussed is how the negative impact of a globalised economy can be limited and prevented from having a negative impact on the strengthening or the empowering of the community. And finally, should there be some change in the

developmental indices which are used to gauge human development to measure communal strength.

5.2.1 Is it possible to decrease the influence of business politics and local dark influences at a quicker pace?

An important problem here is how decentralization specified in the national plan can be implemented in such a way that decision making and financial management power are truly devolved to the local community and its members rather than being held by local influences. The only way to really implement the said ideas would be for the groups of civil society in the local community to come forward to participate in the local administrative bodies. Mechanisms must be created to allow the groups to formally assume the role of managers, at the very least as counsellors to the local administrative bodies. At the same time, it is vital that precautions be taken so that there is no disagreement which could lead to confrontations and which would eventually break the community up.

From what has been discussed so far, if the current political evolution is allowed to proceed at a current pace, business politics and local dark influences will diminish gradually in terms of their importance and their role within the next ten years. This fact results from increasing activities of people's politics and increasing strength of civil society groups, especially if the national economic development is in the direction of sufficiency economy. At the same time, if local influences are exposed more and more by the public and the media, their role will diminish eventually.

The most important reason that allowed local dark influences to fester in the first place can be traced to illegal activities. Problems that still exist today such as illegal narcotics trafficking, interests in underground lotteries, concessions and monopoly in businesses which destroy and deplete the environment for example forest concessions, sawmills and quarrying mills. Among these local dark influences are owners of huge farm areas, a middlem for agricultural products rice millers or a construction contractors who relies on public works projects and the operators of the regional transport business. These types of influential businesses usually provide financial support to both local and national politicians, in return, they received protection from them. Eventually they have become much more powerful. These influential elements will join provincial bureaucrats in a patronage relationship which results in the weakening of the community.

These influences have grown gradually and continuously through the patronage system so much so that they have become rooted in the political and economic power structure, thus difficult to be eliminated in a short time. However, the strength and intensity of these dark influences can only last and connect to national business politics through the establishment of a strong connection with major political parties. At the same time, business politics at the national level can hold on to power partly because of a support base from the local influences; as well as their business connection with multi-national or transnational corporations.

As such, the way to lessen the influence of business politics at the national level and local dark influences at the same time is to discontinue the linkage or connection between the two. This can be done by decreasing the interest from national monopolies, opening the opportunities for private businesses to compete more on equal footing practice for good corporate governance.

Therefore, if the national media cooperate with national civil society groups in exposing information regarding the activities of these groups, together with effective enforcement of anti money laundering laws in the influence of business politics at the national level will be gradually diminished. An important pre requisite here would be a vigilant and strong mass media which seriously takes the stand for the people. This ability to speak for the people depends greatly on their ability to analyze and understand the issues, including the strength of the press and other media associations, who must uphold their responsibility as well as being neutral and putting the public interest above all else.

As the role of civil society organizations become much stronger the role of local dark influences will be diminished. However it will weaken the support for business polities at the national level and dark influences will greatly wane. In this case the effort to rid the area of what remaining influence there might be, depends largely on the empowerment of the community so that it can have a role in checks and balance without direct confrontation especially at a time when the community is still weak. There might be many ways of handling such situation at many different levels. The most delicate and probably the most effective one is recruiting or convincing the local influential figures to join as part of the civil society movement—which can be at the provincial level, district level or the sub-district (tambon) level.

Currently the administrative units in the provincial and sub-district levels are clearly formed. The trend towards promoting a civil society group at the provincial and the sub-district levels seems highly probable if properly promoted. Recruiting or inviting the local influential figures to become part of the civil society movement by pointing out to them the existing problems within the local area and problems at the national level and how these will affect them in the long run, if natural resources of the area are destroyed beyond rehabilitation, or pointing out to them that the poverty of the local community will not be able to support their economic base in the future.

Changing the behavior these local influential figures is a much better approach than through confrontation or outright conflict. At the same time, if the relevant laws are fully enforced in a straightforward manner, these local influential figures will have additional incentive to change. Lessening the power of local influences by convincing them to become a part of the civil society movement is one of the best ways to avoid confrontation while also strengthening the community at the various levels concurrently.

5.2.2 What can be done to help communities which are presently weak?

A weak community is partly affected the local influences. But a community can also be weak without the presence of local dark influences. Such weakness results from the loss of its resources to a point where they can no longer be retrieved or restored if there is no change in the way things are managed. A very good example of this is the loss of resources from their lands being expropriated by state agencies in order to build dams. The loss of land to till because the authorities declared the area as a conserved forest or the loss of coastal mangrove forests because wealthy financiers decided to encroach on the area to start their shrimp farming. Or even examples of villagers having to be relocated because a nearby was being used as a garbage dump site, or those who had to move because of fallout and dust from a rock-blasting site. In many of these instances, the community only has two options: either to give up and relocate themselves elsewhere or fight in every way and using any means they can to win. In the latter option, of course, there is no guarantee that the community would indeed win in the end. However, if it is an issue which can be resolved by a management decision such as when villagers lose their land because of an announcement declaring the part of the area is decreed as conserved forests--then a cooperative effort to solve the problem would be to allocate some part of the land to villagers while at the same time also designating an area as a community forest under the protection of the community in which members of the community can harvest products from the forest so long as they do not cause any negative impact on the environment. In this way, not only will the community be allowed to remain and survive, it will also flourish and become empowered.

Apart from the issue of losing the resources and the right to manage the resources, indebtedness compounded by economic hardships was also the cause of the community weakness. The way the Government currently trying is to resolve the problem by rolling out the carpet, so to speak, with projects such as the Village Fund and the one sub-district one product program. Such attempt can potentially help to alleviate problems in communities with a certain degree of success. However, for communities which are not yet able to manage the resources effectively, whether for lost of their livelihood or wisdom or because of strong tendency for individualism within the community, which is a typical characteristic of a highly-populated poor community in an urban area whose members might have migrated from different localities with diverse indigenous cultures which make it impossible to establish relations as relatives or neighbours. The Government's assistance as mentioned earlier might be able to help these communities as well but they will not solve the real problems and will ultimately resulted in a failure of the projects.

5.2.3 What can be done to allow the strengthening of community to be compatible with economic globalization?

By its own definition, economic globalisation is a state where capital and products can move freely as if there were no boundaries. In this new economic order, the market is highly competitive as long as a country can produce a high-quality product at low cost. However, once these conditions cannot be met, there is no longer any room in the market for that country. Moreover, the flow of capital mostly comes and goes very quickly, and is a form of short-term loan seeking to maximize profit which undeniably destabilises the country economy, especially in terms of physical capital or financial capital. Globalisation is not something that can be avoided. Not being part of it would mean lost opportunities in terms of access to markets for goods and services, technology and capital. This would cause a country to be left behind and become easy prey when it is necessary to open itself to the outside world. Therefore, there is only one possible way of dealing with this and that would be to participate in the globalised world as a knowing player.

The most important capital which will enable us to deal with the trend of globalisation is human capital which emphasises the importance of knowledge and being up to date with the advancement of information technology. Education reform as a means to increase and improve human capital through the development of human Mind cannot be achieved through the current educational system which is a result of the education designed during the of colonial time in the 19th and 20th centuries.The traditional system stresses the transferal of a given body of knowledge from teachers to students rather than stressing the creative ability and development of thinking from learning and solving problems in real situations. Education should be utilised for the benefit of the community and therefore should be organized in the form of community schools as the basis for education management. Education should be viewed as a part of the community development process with the teacher assuming the role of developer and friend who can offer constructive advice which will assist community members to learn by themselves and practise problem-solving. This would be different from the teacher's present role in which the teacher is merely the person who imparts body of knowledge to students. One of the most crucial elements of education reform is the necessity to revolutionize the learning process and not just decentralise administrative power.

Therefore, with regard to education reform with emphasis on encouraging creative thinking, problem solving from actual situation This can be achieved by radically change learning process from the existing one and to shift the management responsibility to the community and community-based schools using the local community and local market as the place of learning, using the benefits of information technology in providing knowledge of interest to the students with the students as the focal point. It is essential that this system of education be established as soon as possible.

At the same time, the community's sufficiency economy or community business do not reject the market system. However, emphasis is placed on the formation of groups to do business so that the businesses will be more secure to better help the groups themselves. Other important issue to be emphasized is that the characteristic of community business must be developed along the SMEs that operate along the concept of sufficiency economy discussed earlier with the emphasis on "down side risk management" and continuous research and development in order to increase the technological capabilities to suit the scale of production with the production cost being the lowest possible. At the same time, emphasis should also be on not being greedy, and honesty to the client, employees and the owners of the raw material --with the ultimate aim to increase employment and welfare of community members.

Doing business in this way will result in much lower cost and without the problem of unemployment which means it is more competitive in the global environment without much difficulty. And while foreign capital may flow into and out of a country relatively quickly, if there is no real need to use such flow of capital, it can do no harm because greed is no longer part of the problem. What is required is being up to date with technology change which will translate into real reductions of cost in order to increase the competitiveness. But it is also be necessary to adapt the in technology so that the condition of employment is not lost. If the operations of the SMEs is done under the principle of sufficiency economy, the national economy will certainly be strengthened in the age of globalisation without much trouble. In addition, it seems there is ever growing popularity for products from natural ingredients that are environmentally friendly, including organically grown fruits and vegetables free of GMOs, alternative herbs and medicines and other natural food supplements. These products are actually becoming more popular the world over and research and development in this field would also be in line with strengthening the community-based economy.

As for large enterprises, namely those which require a capital of more than 200 million baht and the employment of over 200 workers, they can operate very much in the same way as those multinational companies because they are only a small proportion of the overall component of the Thai economy. Even if those businesses have faltered and face serious damage and losses, they will not have direct impact on the national economy. In order to achieve what has been discussed above, a change in the paradigm for the SMEs is required to the development in line with the principle of sufficiency economy. This is the most difficult hurdle because the business sector and policy makers at the national level do not yet completely understand this concept.

6. Conclusion and Suggestions for Further Studies

By exploring the past and current experience of community formation and characteristics of strong communities in Thailand, the paper is optimistic that community-strengthening process in Thailand is going on the right track. It is moving towards development of pluralistic society, with more balanced relationship between the state-market-community, and towards sustainable development particularly with the strengthened human capital and social capital.

Community business with ideology of "sufficiency economy" can be used as an effective means to improve human capital and welfare. Thus, it can lead to sustainable development. Money injection may be useful if it can create a learning process for a newly established or weak group. To empower community, strategies are needed differently at the national level apart from that of the community level. There should also be different strategies for a strong community and a weak community. In any cases, learning process and formation of networks are apparently vital strategies for community strength.

By providing technical and management knowledge, academics should play more important role in capacity building process of apparently strong groups so that they can further improve their own performance as well as being "teachers" to other weaker groups. In fact, learning by doing with the community can be an effective means for academics to acquire new knowledge that can be really applicable to Thai community.

For further studies, it is suggested that any study should focus more on welfare objective, rather than stress on the concept of self-reliance. Self-reliance is actually needed for risk minimization. In this respect, the ideology of "sufficiency economy" is much more relevant than self-reliance since it calls for an attempt to balance the tradeoff between more employment or growth and more risk. Further studies are also needed to understand the relationship between nature of industries and the level of self-reliance, the relationship between self-reliance and welfare, factors determining success and failure of community empowerment, and impacts of various types of community-based business on welfare. The paper suggests sustainability to mean the ability of the community to improve or at least maintain the existing level of local human capital, social capital, man-made capital, and environmental capital. These capitals can also be used as indicators to indicate communal strength.

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An Assessment of Thailand's Health and Education Sector Reforms in Alleviating Social Impacts

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An Abstract

A number of studies have pointed out that a shortage of adequate and appropriate human resources development is one of major causes of economic crisis in Thailand in 1997. Long before the onset of the crisis, reforms in education and health sectors were initiated to deal with these enduring problems in the two sectors. Though the problems addressed by he reformists share common features with the causes rooted in the crisis, the social impacts derived from the latter were much more extensive than those affected by the former. The underestimation of the impact severity could imply insufficiency of the reforms originally designed. The reforms have focused on inputs and structure of the service delivery systems such as the financial support for 12 years of schooling by the government and the universal coverage of health insurance. The reform neither delivers the main result nor resist external social impacts. Its drawbacks are apparent in the issues of incomplete coverage of prime target groups, impractical financing scheme, vague management and poor monitoring system.

There are three suggestions to strengthen the education and health reforms in dealing with social impacts Firstly, the reforms should emphasize on the performance of the education and health output. Priorities go to the strategies with clear and desirable performance. Secondly, the reforms should target disadvantaged groups vulnerable to the crisis. These groups are likely to be people who can supposedly afford education and health services in a normal circumstance and obtain least attention by most health and education schemes. Finally, appropriate indicators should be developed and employed in monitoring uncertainties created by an economic crisis. They can direct the reforms appropriately by modifying and adjusting strategies compatible with the performance and targets set out in the reforms.

1. Introduction

The economic crisis in 1997 has taken a heavy toll on the prosperity and social well-being of many Thai people. Without a state of preparedness for the unexpected economic recession in combination of weak social safety nets, social impact emerged suddenly and spread out rapidly. The government introduced a number of measures and launched immediate programs to alleviate hardships of affected and disadvantaged groups.

A number of studies evaluated the economic and social impacts as well as the policy responses shortly following the onset of the crisis (Siamwalla et al, 1998; Tambunlertchai, 1998; Suksiriserekul, 2000). Due to limited data available as a result of the early phase of the crisis, the social impacts were inconclusive. As it is now five years after the crisis, not only are evidence pertaining the damages done by the social impacts uncovered but also the effectiveness of policies and programs fighting against the impacts are widely assessed.

A reform in the public sector, especially the social sector, has been an ordinary practice in many countries since 1990's. Some countries reform their education and health sectors to avoid the undesirable and foreseeable impacts. Others do it with no choices left after being affected by undesirable and unpredicted impacts. Thailand's education and health sector reforms falls into the latter category. As a result, most people have a high expectation of the reformed sector to resist the next social impacts. The objective of this paper is to assess the capability of the education and health sector reforms in alleviating the social impacts. Also, it points out the improvement needed in the reforms in dealing with the impacts effectively.

The paper consists of seven sections. After the introduction in the first section, the second discusses the problems of the education and health sector leading to Thailand's economic crisis. The third section provides the rationale of reforming the two sectors. The crisis impacts on the two sectors are reviewed in the fourth section. The fifth section elaborates the new directions of the reforms by taking into account the crisis impacts. The sixth section assesses the possibility of the two reformed sectors in reducing the crisis impacts. The conclusion is made in the final section.

2. The problems of the education and health sector contributing to Thailand's economic crisis

Education and health are supposed to be major inputs in developing human resources in Thailand, which in turn contribute to the economic prosperity. Failure to rectify accumulated problems in education and health sector turned a currency crisis to the a national economic crisis. A shortage of adequate and appropriate human resources development is a result of the poor management in both sectors. This section compiles from a number of studies the major problems in the education and health sectors adding to the impacts of the economic crisis.

McLean (2001) argues that poor education in the Thai workforce made the Thai economy incapable of competing in the world economy, unavoidably leading to the economic crisis in 1997. The following six issues reflect the poor performance prevailing in the Thai education sector.

1. A significant proportion of Thai workers are illiterate and lack numeracy skills.
2. Thai workforce lack secondary education.
3. Skilled worker as well as engineers, technicians and managers are in shortage.
4. Education system is fraught with corruption and political unstability.
5. Higher education programs in human resource development are in short supply. The existing programs are inflexible in filling up the needs of students.
6. A domestic research base on human resource development is insufficient to identity relevant problem and suggest solutions in building a skilled and qualified workforce.

A study by the World Bank (1999) on Thailand's secondary education highlights the ineffectiveness of the vocational education system in producing and training skilled labors for the economy. Its main problems can be summarized as follows:

- The public has inadequate and up-to-date information regarding the trends in the labor market. Major pieces of information include employment rates, wages in various occupations, performance of specific training institutions (i.e. completion rates and employment of graduates). Therefore, students cannot make up their mind appropriately which occupations, which schools they should go into, and which skill they should acquire.

- Contents of curriculum do not fully reflect national development goals. They also are not compatible with market condition (i.e. the supply of technicians available and skills demanded by employers). Teaching contents usually are not consistent to skill valued by employers, including the ability to communicate orally and in writing, the attitude of teamwork and the discipline of the workplace. As a result, retraining is needed when they get to work. Employers usually bear the retraining cost.

- Most graduates of vocational schools do not enter the labor market immediately after their study completion but continue on to further study. This results in the waste of additional resources put into vocational education, in comparison with general education. Also, it causes a short supply of skilled labors.

- The structure of vocational education at present is rigid. It is required that formal vocational program take the same study length. For example, to acquire the lower certificate needs 3 years and to obtain the upper certificate needs 2 years. The study length does not indicate students' competencies being taught. Irrelevant teaching contents are incorporated to meet the length required. A longer period of study then necessary deprives both employees and employers of benefit forgone.

The quality of basic education of Thai students is left behind that of other countries at same level of development. Chuachan Chongsatityoo (1998) quotes a test result indicating a poor performance of Thai primary and secondary school students. The test, organized by the International Association for the Evaluation of Education Achievement in 1997, placed Thai students at 20^{th}- 24^{th} ranks and of 41 countries participating in the evaluation. The assessment outcome is in fact lowest in the Asia. The comparison could imply the loss of Thailand's potentialities in the international competitiveness.

The higher education system is considered a.
cannot create a skillful manpower to meet the changing .
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competitiveness.

According to the assessment of Nittayaramphong (1998), the Tha.
care system has long suffered from 10 problems as follows.

1. A transition in the mobility pattern results in an excessive demand for high quality health service.
2. Health services are too expensive.
3. Thai people shoulder higher cost of health services.
4. Accessibility to standard health services is limited and uneven among Thai people.
5. The quality of health services is rated as low.
6. The health care system focuses on treating sickness at the expense of curing patients.
7. The health care system is inefficient.
8. Manpower is in shortage.
9. Legal claims against health personnel's malpractice are on a rise.
10. The cooperation is poor between the private and public health service provides.

A unprecedented rise in demand for health services was obvious before the crisis. The expenditure for the civil servant medical benefit scheme reached 15 billion baht in 1997. The number of beds and doctors in the private hospitals were 29,945 and 3,244; respectively in 1997 (Wibulpolprasert, 1998). Such figures are three times those in 1987. Expenses on drugs and medical equipments, most of which imported from overseas, intensified over the same period.

The education and health sectors share common problems, which undermine the human resource development considerably. Their expenditure, especially the public expenditure, was so high as to be out of control. The quality of education and health services is unsatisfactory. The services are unequitably distributed, fostering deleterious impacts on disadvantage groups. Though the eighth national economic and social development plan addressed these issues, it is too late to rectify them. Furthermore, given the substantial impacts of the crisis or the two sectors, a gradual and general approach to solving the problems is not adequate. It requires a reform, which is advocated by key experts in the sectors long before the onset of the crisis.

3. The rationale of reforming the education and health sectors.

This section discusses underlying reasons for the education and health sectors. Though there are different approaches to the reform, the same problems await the appropriate solution. For example, in 1997 the education reform was proposed by three agencies: Office of the National Education Commission, Commission on Thailand's Education in the Era of Globalization and the Ministry of Education.

Nitungkorn (2001) refers to three principal problems forcing the Thai education system to undergo a radical reform. Firstly, the Thai population has a low education attainment. Most of Thais aged 15 and over spend only 7 years in schools. As a result, three quarters of the Thai workforce have only primary education. A lack of sufficient education turns them to be unskilled labors and make it difficult for their skill enhancement. Secondary, transition rate is low from primary education to secondary education. The problem is most severe in rural areas. Therefore, it causes an inequity in education within the Thai society, inviting other society and economic problems such as poverty and migration. Finally, Thai people must keep up with the trend of globalization and advancement of science and technology. Learning how to deal with the two issues can make Thailand competitive in the world market. Therefore, the education system, in particular the higher education institution, should get ready for developing and transferring technical know-how.

Tagniwalo (1995) stated that health reform in some countries in the Asia focus on the management of health sector expansion to deal with the following five issues.

- the growth of resource allocated in the sector can improve its performance in terms of efficiency, equity and accessibility.
- how to design an appropriate health insurance scheme.
- the participation of the private sector.
- the achievement of desirable health services production, involving costs, quality, availability and scope of health services.
- targeting of priority beneficiary groups such as the poor, women, the elderly, indigenous people, and the displaced population.

It is agreed among Thai experts in the health sector that three factors accelerate a total reform in the sector. Firstly, consumers' demand for higher quality of and better access to health services is kept growing. Secondly, resources are increasingly limited in the delivery of health services. Finally, the public demands the efficiency of the budget spending. In particular, it is required that a contribution of improved health conditions to national development be worthy of the government budget allocated.

Similar problems causing the crisis and stimulating the reform include the loss of international competitiveness, the inefficient uses of resources available and the higher public expenditure burden. However, as opposed to some problems related to the crisis, a number of problems leading to the reform initiatives are less specific, too subjective and full of ambition. As a result, the impacts due to the problems without the reforms are understated. Thereby, the reforms are continuously postponed. For instant, according to the Office of National Education Commission (1997), the previous reform in education occurred in 1974. The current education system has been based on the National Scheme of Education promulgated in 1992. This shows that a significant change in the education sector takes a long time so that many good ideas to deal with the major problems were put off. On the contrary, the impacts stemming from the crisis were immense. The government made every effort to rectify the problems. It should be noted that a new education act intended to reform the education sector was passed in 1999, two years after the crisis.

4. The impacts of the crisis on the education and health sector.

This section evaluates the impacts of the crisis on the education and health sector between 1997 and 2000. The focus is on the size, types and distribution of the impacts. It identifies major public schemes and assistance put into the sectors. Then it assesses whether on not such a remedy can rectify the root causes of the crisis.

The crisis has affected the education system most in terms of lower transition rates. The transition rate of primary-school students to a high school level peaked at 93.2% in 1997. It went down to 88.4% and claimed back to 89.9% in 2000 (see Table 1). The problem is comparatively worst in the South, where the rate was deficit by 6.2 in 2000 from the peak in 1997. Similarly, the transition rate of junior high-school students to the next level was 81.9% in 2000 down from 86.9% in 1997. The greatest difference between the maximum rate in 1997 and the rate in 2000 was found in the North (a deficit of 15.5%). However, it is a surprise for Bangkok and the vicinity to have the higher rate during the period (see Table 2). This can be explained by the fact that most public schools were asked by the government to accept additional students. This leads to a rise in the supply of senior-high school classes. On the contrary, the demand for such a study increases only in Bangkok and the vicinity. The total supply is offset by the total demand and hence the transition rate plummeted. The excess supply of senior high-school education implies that the supply-side management during the economic crisis is inappropriate. Additional budget granted by the government to the senior high schools becomes a waste.

Two surveys of the economic impacts on Thai households in 1999 and 2000 by the National Statistical Office (1999&2000) show a rise in the dropout rate and a substitution of studying in expensive private schools to cheap public schools. The dropout rate rose to 3.4% in 2000 from 1.8% in 1999. Two in every thousand households moved their children from private schools to public ones during the period.

At the household level, it is found that the proportion of households with members studying in school was down from 59.5% in 1999 to 58% in 2000.

Therefore, households receiving scholarship reduced from 2.5% in 1999 to 1.5% in 2000 (see Table 3). The percentage of households making loans for their members' education was unchanged at 2% in the two years. Owing to a huge government deficit, the size of scholarships on average increased from 3,135 baht per household in 1999 to 4,225 in 2000. Similarly, the size of loans went up from 22,465 baht per households in1999 to 23,545 in 2000.

It is obvious that the percentage of the additional scholarship could not help prevent the school drop-outs. On the contrary, the financial support was not distributed well enough to the households vulnerable to school drop-out.

A study by Economic Research and Training Center (2001) analyzes school dropouts in the 1999 academic year. Based on a data survey of more than 1,000 schools in the North, Northeast and South, the dropout rate from schools under the Office of the National Primary Education Committee was 1.03% on average. The rate of the primary school level was 0.89% whereas that for the high-school level reached 2.04%. The dropout rate from high schools under the Department of General Education was 1.63%. Compared with other studies, the findings of this study were significantly lower. The discrepancy could arise from the differences in the dropout definition and the coverage of schools selected. It is most likely that the lower figures are the result of a genuine reduction in the dropout rate as the impact of the economic crisis on the school dropout has diminished over time.

An interview survey of school leavers and their parents highlights that households' low earnings and parents' low education attainment are responsible for the school dropout. The finding is supported by the fact that 35% of the leavers become laborers and 25% help their parents do the family businesses. Other factors explaining the dropout include students' own problems, schools' rigid rule and regulation and teachers' poor teaching method. In fact, most students' problems are derived from poor socio-economic status of their families such as slow learning, poor physical and mental health, drug abuse and having an affair.

Most schools report a tendency of the declining dropout rate. Strategies maintaining the trend include the following.

- an increase in financial assistance to the poor students in terms of grants and loans.
- a possibility of earning while learning
- partially waiving tuition fee.
- encouraging parents to participate in educational activities.
- promoting parents' cooperation in supporting the study of their children.
- raising awareness of parents about the importance of the study, in particular the higher income earning due to a higher education attainment.

According to a recent survey by National Statistic Office quoted by the NESDB (2002), the major reason for students unable to go on a further education involves a lack of financial support. The financial insufficiency problem is severe among primary school students leaving schools (70.3%) whereas it is less serious for the junior high school students (56.9%) and the senior high school students (45.1%). It is likely that children from families working in agricultural sector show the highest proportion of those giving up a further study.

UNICEF (2002) reports that the economic crisis resulted in cutting budget for child and youth development, leading to a slowdown of nutritional development programs such as school launches and milk. A decline in the budget for child education funds was responsible for some children leaving schools.

The Thai government responded to the budget problem by making loan from the World Bank, the Asian Development Bank and the Miyazawa Fund. A relatively small share was given to the education sector, including the following.

1) a 1,000 million baht scholarship fund to students vulnerable to the financial hardship

2) a 7.3 million baht project to support disadvantaged pre-school children in urban areas.

3) a 27.5 million project to provide lunch and milk to disadvantaged children in child development centers.

A comparison of the results of two surveys of the economic impacts on Thai households in 1999 and 2000 indicates a larger proportion of households cut their expenses on medical care. In 2000, 34% of the households reduced their medical expenditure by visiting public hospital in place of private hospitals or by self-treatment compared to 29.9% in 1999.

NESDB (2002) reports that ten percent of Thai households received health services rendered by the Low-Income Medical Care scheme in 1998. However, due to a cut in the government budget, the proportion dropped to 9.9% in 1999. As a result of the economic stimulating package, the proportion soared to 10.6% in 2000. It is also show that 28.4% of the users in the scheme were regarded as poor in 1998. The proportion of beneficiaries went up to 28.7% in 1999 but dropped rapidly to 22% in 2000. As the crisis persists, the poor is likely to lose their share of getting free medical care to the non-poor. NESDB (2002) remarks that it stems from the inappropriateness of criteria of selecting those qualified for free medical care. Some agencies' selection rules are based on need and deprivation rather than poverty per se. A set of unique and cohesive criteria is necessary to establish. Then all agencies involving the free medical care provision can effectively target those in real need of medical care during and after the crisis period.

According to a study by Chayovan et al (2000), health service provision at public facilities was affected by the economic crisis in terms of a decline in medical supplies, a slowdown in employing more staff and cancellation of short-term training programs: This is mostly due to the decrease in the health budget. Although some patients dissatisfied with the poorer quality of health services, a larger number of patients paid visits to public hospital. Eight percent of the sample were reported to turn from private facilities to public ones. It is also found that 11 percent of the surveyed female sample did not seek reproductive health care due to the financial problems during the three years of the economic crisis. Their reproductive health status kept declining after the economic crisis. Poor and worsening health status are found more in Bangkok women than those in other provinces. Nine percent of the sample rated the deterioration of their mental health. Nineteen percent suffered from stress.

However, the crisis encourages the use of family planning. Women most affected by the crisis are likely to have family planning than those least affected by the crisis. This leads to the postponement of having more children for family with financial burden.

The study concludes that the economic impact in the form of lower income level and higher household expense affected the physical and mental health status of Bangkok people than those in provincial areas.

The Office of the National Economic and Social Development Committee (2002) has developed a set of the well-being composite index. Health and education composite indexes are two of the five components of the well-being composite index available at the moment. The health composite index consists of the three dimensions: length of life, good health and fairness in the health sector. Three indicators reflecting these dimensions are life expectancy, the proportion of the population reporting "not sick" during a year and the proportion of the population with health insurance. The education composite index comprises two dimensions: equitable access to education for all Thais and the quality of education. Average years of schooling and enrollment rate of high-school students represent the former dimension while the average test scores of four subjects (Thai language, English language, Mathematics and Science) does the latter. An aggregation of three indicators giving rise to a composite score is based on the geometric weighting. The weighting formula can be expressed as follows:

$$\text{A composite score} = [(1/3)*(P_1^3 + P_2^3 + P_3^3)]^{1/3}$$

$$\text{where } P = \text{score of each indicator}$$

The health and education scores, computed by the NESDB using data in 1996, are 81.5% and 63.9%. This study estimates the scores for the two indexes based on the NESDB method for the period of 1997-2001. The health and education scores become 83.9% and 69.8% (see Table 4). The scores indicate that Thailand made improvements in health and education after the crisis. The findings are to some extent contrast to prevailing feeling of most people. There are two explanations for the difference. One is that the composite indexes focus on the output of health and education. The other is that health and education involve long-term effects of the changing service provision. The true impacts of the crisis on health status and education attainment will occur in the future. On the contrary, the conventional view focuses on the process of health and education production. The priority is given to such indicators as the school dropout and a shift in visiting private health facilities to public ones.

5. The educational and health sector reforms conditional on the crisis impacts

As mentioned earlier, the education and health sector reforms were accepted and implemented in a very short period after the crisis. Not only did the crisis fasten the reforms, but also it determines the ways the reforms should head for, which differ to certain extents from the original ones. This section reviews key principles and strategies of the education and health sector reforms given the availability and perception of the crisis impacts at the present.

The 1999 National Education Act aims at reforming seven major aspects of the Thai education system (Office of Education Reform, 2001)

1. Make the education system appropriate for lifelong learning by coordinating formal, non-formal and informal education.
2. Raise educational quality by altering curriculum and teaching/learning process both in schools and in local communities.
3. Empower decision makers and managers of public and private schools through the decentralization and local communities' participation.
4. Develop teachers' capacity by means of proper production, recruitment, payment and evaluation.
5. Mobilize resources from various sources and make the educational investment achieve the main objective study as equity, efficiency and transparency.
6. Maintain the educational quality via internal and external agencies.
7. Enhance the use media and technology for expanding the coverage of educational services.

As vocational education is fundamental to the development of skilled labors in Thailand, the World Bank (1999) suggest 4 strategies to reform the vocational education system.

- The causes of the rigidity of the vocational education structure stem from the emphasis on skill formation and the bureaucracy. The reform of the structure should focus on intellectual motivation and creating ability.

- As long as the orientation of the vocational education does not change, the reform on the system's finance such as a rise in pupil-teacher ratio, reduction in administrative cost and networking does not matter.

- A national technical and vocational education council should be established. The majority of the council board should come from employers. Its major task will be concerned with actual competencies in workplaces. Employers can assist in shaping teaching contents and setting the number and types of occupation taught.

- The central government's subsidization method to vocational schools should be changed. Instead of using the criterion of "per student attending school", the subsidy should be paid according to "per qualified graduate". This means that the finance targets the output rather than the process of vocational education.

UNICEF (2000) anticipates that the likely improvements due to the implementation of the education reform can be found in the following issues.

- Children can pursue his/her own learning by means of child's learning centered approach.

- Curriculum is designed to serve the needs of local children and communities.

- Teachers acquire updated professional knowledge and skills.

- Family, community and other relevant parties get involved in administering and managing the education system including education planning, resource mobilization, monitoring and evaluation.

- The quality of educational services is accredited and its assessment is made available to the public.

- Information technology and mass media are employed to render educational services to Thai people from all walks of life.

- Students can move from one school to another or from formal to non-formal system smoothly as they wish.

Nittayaramphong (1998) defines a health care reform as substantial changes leading to conceivable improvements in the future, especially changes in the system structure and policy. The ultimate goal of the health care system reform is to build an ideal health care system. It is suggested that the desirable Thai health care system should be based on a mixture of liberal and welfare ideologies, with a modification in responding to the needs of Thai people. Therefore, the health care reform should address appropriately nine issues as follows.

1. The health care systems must provide all Thai with standard health services. Standard health services are referred to a basic and essential set of health services.
2. The health care system is efficient.
3. The health care system must care for patients rather than only treat their illness.
4. The health care system provides an incentive for the competition and cooperation between the health care providers, both in private and public sectors.
5. The health care system allows for a variety of types of health services (e.g. traditional medicine) and ownership of health care providers (e.g. public, private and not-for-profit providers)
6. The health care system must make available more choices of health service provision. Patients should be able to select their own appropriate choices.
7. The health care system must be accountable, in particular regarding the quality of health services, the utilization of resources and the worthwhile of the health care uses.
8. The health care system must promote the participation of people in developing the system.
9. The health care system must evolve on the basis of updated knowledge and information, which are supported by research and development.

Five main strategies are recommended to reform the existing Thai health care system.

a) An introduction of collective financing for the health care system by means of compulsory insurance. As a result, the health care system becomes unique in terms of health care service benefits and standards for all Thais.

b) Health manpower must be increased by means of production and appropriate incentive provision. General practitioners take precedence over specialists.

c) Health services are delivered at family's registered health facilities. The providers must compete and cooperate in such a way that the quality of health services is higher.

d) People are empowered by broadening their rights and promoting civil society. They should have rights in choosing appropriate health services in getting access to information and in strengthening their self-care.

e) The health care system reform must be made sustainable through enacting relevant laws, heightening awareness of the reform and turning to it be a knowledge-based system.

6. An assessment of the education and health sector reforms in alleviating the crisis impacts.

Since the reforms in the education and health sectors have not yet been implemented, this section assesses their likely outcomes on the basis of the reform results expected and tested by the responsible agencies drafting the reform plans. Key conditions and factors vital to support the reform implementation is evaluated, as they might become obstacles in the reform procedure. A comparison between the reform outcomes and the crisis impacts can reveal the chance the reform making a stand against the crisis impacts.

Although the education reform is desirable, UNICEF (2000) is concerned about its management aspect. Firstly, the quality of education is difficult to improve as students are taught to learning by rote rather than by practical skill and creative thinking. Teachers are in shortage of efficiency and supply in core subjects. Secondly, the management lacks coordination and integration between departments. Newly-formed agencies do not solve the duplication and overlapping of some service provisions. Some educational services requiring special attention are still negligent. Finally, the economically disadvantaged and the underprivileged in various sectors of the society such as the handicapped and the rural children get unequitably access to the education opportunities available.

Economic Research and Training Center (2001) concludes that decentralization, curriculum redesign and targeting the vulnerable students for financial subsidy are major approaches to dealing with the dropout issue. The education reform advocates decentralization and flexible curriculum. Local schools and communities can exercise their ideas such as getting students earn supplementary income, making available accommodation to students at schools, offering occupation-related courses, and so on. However, the allocation method of financial subsidy to students is least explicit in the reform. As a result, most schools are likely to give all entitled students an equal share regardless of their needs. Most of the assistance does not go to the intended targets of school dropouts. This means that the reform may be unable to stand out against the economic impacts on the school dropout.

It is skeptical about the ability of local governments in carrying out the education reform as planned. Puntasen et al (2002) found that based on the data during 1997-1999, 39 out of 74 first-class Tambon Authority Organizations (TAOs) were able to provide some educational services to their areas. However, most of these TAOs placed a low priority to educational than to economic activities such as the job generation and the infrastructure improvement. Other 6,000 TAOs across the country lack adequate budget to do a comparable task in the foreseeable future.

Office of Education's Reform (2001) claims that if the present education reform is successful, the Thai society can expect the following five desirable outcome.

1. The capacity of Thai people is raised and conducive to a sustainable development.
2. Education provision is more equitable.
3. The quality of education becomes higher.

4. There will be more participation in the education system.

5. Education administration and provision will be more effective, efficient and accountable.

However, according to the Office's assessment, the reform success depends on six factors such as the political decision making, the urgency of enacting relevant laws, the awareness and participation of every party in the Thai society, the preparedness, the support of administrators of all levels and independent monitoring and evaluation processes.

The health reform emphasizes the financing aspects and methods on major health insurance scheme. By limiting the prescription on local-produced drugs, the length of stay and the reimbursement for the private hospital admission, the civil servant medical benefit scheme could save its expenditure by 2 billions baht in 1998. The per capitation payment method has been initiated to employ in the scheme to further contain the expenses. A new budgeting system so-called block grant, is introduced and tried in a number of public hospitals as a first step in their opting out of the government's control and becoming autonomous hospitals eventually. As a result, the government can loosen its financial tie to these hospital.

Pannarunothai et al (2000) employ "benchmark for fairness" developed by Daniels et al (2000) in evaluating Thailand's health reform proposal and ongoing health reform implementation in two provinces. The health reform proposal was undertaken by Management Science for Health (MSH) and Health System Research Institute (HSRI), with a financial support from the Asian Development Bank. The proposal available in 1999 was used to be a basis for designing the current health reform. Phayao and Yasothon are two provinces participating in field trial pilot project for the health reform for a couple of years.

The benchmarks aim at assessing the following nine aspects of fairness.

1) intersectoral public health
2) financial barriers to equitable access
3) on-financial barriers to access
4) comprehensiveness of benefits and tiering
5) equitable health financing

6) efficacy, efficiency and quality of health care
7) administrative efficiency
8) democratic accountability and empowerment
9) patient and provider autonomy

In-depth interviews and focus-group discussion were used to generate data for the study. A scale of -5 to 5 was given to participants to value their perception on the expected proposal outcome and the provincial reform implementation. It was suggested to assign a score of zero if the outcome and implementation were unchanged. A positive sign implies the improvement, and vice versa. The magnitude represents the size of the changes.

Tables 5 and 6 show the study findings. Equitable health financing; efficacy, efficiency and quality of health care; and administrative efficiency were considered to be strengths of the proposal. On the contrary, its intersectoral public health was the weakness. Participants had greatest concerns over equitable health financing, patient and provider autonomy and administrative efficiency in implementing the health reform at the provincial level.

The study revealed major drawbacks in the health reform proposal. Therefore, if it is used without significant alteration, a number of difficulties and problems could arise. Such a reform may not be able to head off social impacts, as it ignores the following issues raised in the study.

- The unmet needs of the population uncovered by the health insurance and welfare schemes are not identified. Their basic health package is unknown and delivered.
- Health financing is not specific enough to be practical. It lacks evidence-based practices.
- Efforts are insufficient to eliminate the duplication of administration at the central and local levels. As a result, the resource utilization is subject to waste.
- The information systems are not available for health officials to make appropriate decisions and monitor the delivery system.

A study of the Thai bureaucracy reform identifies desirable characteristics of Thai civil servants for the success of the reform (Suksiriserekul, 2002). In order to be compatible with the new bureaucracy system aiming at serving people's need, Thai public employees have to possess at least seven characteristics as follows.

1) motivated by the financial incentives.
2) acquiring training and development.
3) having adequate working skill.
4) focusing on general skill.
5) realizing the lucidity of the mission targets.
6) working on a competitive basis.
7) cooperating with other to arrive at the expected result.

Only two characteristics of the majority of Thai public workers at present meet the above criteria: having adequate working skill and realizing the lucidity of the mission targets. The study also notes that the lack of some economic-related characteristics such as financial motivation and training and development acquisition is associated with the unbalance allocation of public workers. Some agencies are able to provide their staff much higher opportunities of financial incentives and on the job training than the averages.

The bureaucracy reform is supposed to be an example for other public sectors to follow the human resource and personnel management. The unsuccessful bureaucracy reform will cause the failure of managing human resource and personnel in the health care and education reform accordingly. The two sectors will be left on their own to tackle the quality and appropriate allocation of their staff. In addition to the pressure put on them due to the reform implementation, such a task adds to the burden. Their efforts could be diversified so much as being unable to keep an eye on the emerging crisis impacts.

7. Conclusion

Based on the facts and evidence shown in the previous sections, it can be concluded that the reform in the health and education sectors is fraught with drawbacks. The expected results are not likely to succeed, let done being a cushion against the social impacts. The shortcomings in the reform plans for the two sectors can be summarized in the following issues.

The reform plan lacks a comprehensive coverage. The education reform plays down the role of the scientist and technologist production as well as the vocational education. As it is crucial for the country's competitiveness, the shortage of S&T personnel is still a threat to the Thai economy. In addition, research and development (R&D) is not address at all in the reforms of the two sectors. This means that both industry and health sectors must rely on foreign countries for their àcquired technology and drugs and medical supplies. The poor coverage for health and education services affects disadvantaged groups most and hence maintain or worsen a mal-distribution of education and health services.

Financing scheme devised in the reform plan is impractical. Capitation payment method applied to the health sector will make loss to large public hospitals since lower-level hospitals are unwilling to refer their patients to them. An underestimated per capita budget allocation will bring down the quality of health services eventually. Similarly, an argument cannot be solved over the appropriate sum of subsidy per student. It is difficult to strike a balance between the adequacy of tuition fee subsidy and the out-of-control education budget. Since the decentralization in the education sector requires the local community's sound financial support and management, almost all local communities are not ready to carry out their own schools.

Though the management issue is a key to the success of the reform cited in most literature of the public sector reform, the health and education sector reforms provide an unclear direction for the management. It seems to leave the management style to vary with and depend on heads of agencies and managers. Such a vague management pattern has stirred up a resistance by teachers and health personnel. Their concern is about the abuse of managers' extensive authority. The implementation of the reform is not likely to reduce duplicate works and promote the cooperation between different agencies. The reform plan does not address human resources development so that the undesirable characteristics of public employees existing in the old bureaucratic system are removed and suitable behavior encouraged. Most teachers and health personnel are confused about the reform procedure.

The monitoring issue is treated as passive in the reform plan. No indicators reflecting the output and outcome of health and education services are available. Also, the reform sectors lack indicators signaling unusual changes possibly leading to major damages. For instance, the school dropout is used to represent a major educational problem. Immediate actions are required to stop it. However, realizing the rising dropouts is too late to rectify the damages done. More sensitive indicators are needed to capture the problem before intensifying to a larger scale. Performance issue is low on the reform's list of priority. A lack of clear performance indicators can guide the health and education sector to go nowhere. The selection of appropriate strategies in the health and education system must be based on the evaluation of performances.

It is suggested that the reform takes into account the following three issues in alleviating social impacts emerging from external sources. Firstly, the reform should be based on a holistic approach. Every part of the sector should aim at contributing to single output that can be measured by key performance indicators. All efforts are consolidated to achieve common goals. Secondly, the reform should focus on targeting potentially disadvantaged groups most vulnerable to the crisis. These groups are easy to be overlooked. For example, some people who can afford education and health services in a normal situation lack the means to do so in the crisis period due to being laid off. Finally, in order to capture abnormal signs of troubles developed in the systems either from an economic crisis or from other causes, it is essential to have a surveillance system by using sensitive health and education indicators. Such indicators can inform of the likely impacts and hence the respective measures to cope with them. To get a maximum result, the indicators can preferably link with performance and targets determined by the system. The linkage can point out the severity of the impacts so that adequate efforts can be mobilized to contain the impact in time.

8. Future research

In response to some criticisms for the health and education sector reforms, several aspects of the reform proposals should be paid serious attention. Emergent investigation is required on the issues of financing and resources mobilization. Therefore, the research findings can contribute to the reform improvements in the near future. The research direction is illustrated as follows.

1. The financing of health and education services should be analysed on how to separate providers from purchasers. The split breaks down the monopolistic power of the providers. Competition among the providers enhance efficiency of resources used. Payment schemes to the providers chosen must motivate the providers to serve the target population affected most by crisis (e.g. potentially drop-out pupils, the disadvantaged groups and the emerging poor).

2. Various possible sources of resources for the two sectors are identified and compared to evaluate in terms of viability, level of fund, sustainability and fluctuation with respect to economic condition. Such a study enables policy makers and planners to substitute between different sources of fund affected by economic crisis to a differing degree.

3. Benchmarking studies should be undertaken of other countries with similar health and education reform procedures to Thailand. The studies keep Thai reformers aware of strengths and pitfalls of each step of the reform implementation. As a result, an anticipation of undesirable impacts can be foreseen and accompanying alleviation measures devised. The reforms will be least disturbed and gain supports needed to achieve its goals.

Table 1 : Transition rate of the primary school level to the junior high school level

Region	Years					
	1992	1996	1997	1998	1999	2000
Bangkok and vicinity	97.1	99.1	101.5	95.3	91.6	97.9
Central	71.7	90.5	93.6	90.6	92.0	93.7
Northeast	55.2	89.9	94	88.4	91.6	93.3
North	68.6	92.6	94.2	90.1	91.8	93.5
South	67.6	79.6	81.8	77.1	74.2	75.6
The Whole Kingdom	67.5	90.2	93.2	88.4	89.6	89.9

Source : The Office of National Economic and Social Development Board (2002)

Table 2 : Transition rate of the junior high school level to the senior high school level

Region	Years					
	1992	1996	1997	1998	1999	2000
Bangkok and vicinity	103.6	109.6	106.9	138.2	144.5	135.4
Central	84.9	88.5	90.5	83.8	85.6	83.1
Northeast	81.4	77.3	74.9	65.1	67.1	66.3
North	90.6	91.4	90.4	77.1	81.2	74.9
South	90.5	90.6	86.4	76.4	75.7	75.4
The Whole Kingdom	90.3	89	86.9	82.1	84.6	81.9

Source : The Office of National Economic and Social Development Board (2002)

Table 3 : Scholarship and loans for education of Thai households from the government in 1999 and 2000

Scholarship and loans	Years	
	1999	2000
Percent of households with members studying	59.5	58.0
Percent of households with scholarship	2.5	1.5
Percent of households with loans	2.0	2.0
The size of scholarship (baht per household)	3,135	4,225
The size of loans (baht per household)	22,465	23,545

Source : National Statistical Offices (1999 and 2000)

Table 4 : Health and education composite indexes of Thailand before and after the economic crisis

Period	Health composite score	Education composite score
before the crisis	81.5%	63.9%
after the crisis	84.2%	69.8%
Change	2.7%	5.9%

Sources : 1. NESDB (2002)

2. Author's own calculation

Table 5 : Average scores of the proposal on health reforms

Benchmarks	Score
1. Intersectoral public health	0
2. Financial barriers to equitable access	3,4
3. Non-financial barriers to access	2,3
4. Comprehensiveness of benefits and tiering	3
5. Equitable health financing	4,5
6. Efficacy, efficiency and quality of health care	4
7. Administrative efficiency	4
8. Democratic accountability and empowerment	3,5
9. Patient and provider autonomy	3

Source : Pannarunothai et al (2000)

Table 6 : Average scores of the health reform implementation in Phayao and Yasothon

Benchmarks	Phayao*	Yasothon
1. Intersectoral public health	1.8	2
2. Financial barriers to equitable access	2.6	2.2
3. Non-financial barriers to access	2.7	2
4. Comprehensiveness of benefits and tiering	1.4	2.1
5. Equitable health financing	1.5	1.5
6. Efficacy, efficiency and quality of health care	2.1	2
7. Administrative efficiency	1.8	1.5
8. Democratic accountability and empowerment	3.8	1.9
9. Patient and provider autonomy	1.6	0.8
Overall score	2.1	1.8

* In Phayao, the score presented are the average amongst 8 district health officers only

Source: Pannarunothai et al (2000)

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Nordic and Asian Crises in Structural Perspective -The case of Sweden

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1. Introduction

The economic crisis in the Nordic countries, Sweden and Finland, at the early 1990s exhibits many striking similarities with the Asian crisis of 1997/98. In both cases a crisis in the financial sector triggered a chain reaction that involved a dramatic fall in exchange rates, a collapse in the real estate market, a dramatic fall in stock market values and a fiscal crisis for the government sector. The question is why countries at seemingly very different levels of economic maturity came to experience such similar developments. Explanations for the Asian crisis have in large degree circled around the issue of inherent structural weaknesses in an Asian development model, notably connoted by the concepts such as crony capitalism and moral hazard. The fact that the Nordic crisis exhibits similar characteristics casts serious doubt on these explanations. In the Nordic case explanations concentrated on the alleged over-size of the public sector. In this paper it is argued that the fundamental similarity between the two cases is made up by the changes in the global financial system that altered the scope for national policy making in the 1980s and 1990s. Financial deregulation led to a movement away from a system characterised by a socialisation of savings to a system where savings were increasingly being circulated in private and international and largely unregulated capital markets. In both the Asian and the Nordic cases there was from the mid 1980s a movement away from a rationing system characterised by capital shortage in which government regulation aimed at influencing resource allocation to a system of capital surplus. In both the Nordic and the Asian cases this surplus capacity coincided with an increasing demand for investment capital.

In Asia, the Plaza Accord of 1985 that gave the ASEAN countries a competitive edge in exports of manufactured goods. In the Nordic countries, notably in the Swedish case, a booming export sector driven by exchange rate depreciation in 1982 triggered an expansion of the demand for credit. When the export sector slowed down in both cases investments relocated towards the domestic sector, to real estate investments and to the public sector. In both cases it was an expansion based on access to cheap credit. The similarity demonstrates that the "developmental state" was not a typical Asian phenomenon since, in fact, the Nordic welfare state was in large degree built on similar characteristics as the Asian model, the foundation of both being the government control over national savings. When this control eroded in the 1980s it led to similar reactions regardless of development levels. Thus, we conclude that both crises were consequences of a structural change in the financial sector that was to lead to structural effects also in the real economy. In the following analysis the case of Sweden shall be taken to represent the Nordic crisis whereas the references made to Asia shall be more general character in character. First we describe the events that made up the Swedish crisis and then the causes of the crisis are traced by means of a comparison with the Asian crisis. Finally, an attempt is made to discuss the differences in terms of crisis management and recovery between Sweden and Asia.

2. The Relevance of the Swedish Crisis for Asia

What is it with the case of Sweden that makes it worthwhile comparing with the Asian experience in terms of crisis, crisis management and policies for reform and recovery? One obvious phenomenon is course that Sweden experienced an economic and financial crisis in 1990-1992 that had many striking similarities with the financial crisis of Asia in 1997-98. First, there was a collapse in the real estate market. By, 1990 real estate prices had risen with few interruptions for a period of about 15 years and a peak was reached in 1989. During the subsequent five years, prices fell by 75 per cent. Three out of four real estate companies listed on the Stockholm Stock Exchange ran into such serious problems that they either went bankrupt or had to be restructured.

Second, the stock market bubble burst. Between 1980 and 1989, market quotations on the Stockholm Stock Exchange had risen by over 1.100 per cent, which may be compared with a world average of a little over 300 per cent. During the following years the general stock market index fell by 50 per cent. Third, the financial market was shaken to the extent that the entire banking system was being threatened. Burdened with huge credit losses from non-performing loans on real estate and for stock market speculation three major banks, *Nordbanken*, *Första Sparbanken* and *Gota Bank*, went bankrupt, while the stock market value of the two largest, *SE Banken* and *Handelsbanken*, fell by 80 percent. In addition, 200 of a total of 300 finance companies disappeared from the market. Total credit losses during the period 1990-1993 are estimated at almost SEK 200 billion, or roughly 10 percent of GDP. Fourth there was the most spectacular of the crises, the currency crisis. Overheating and the financial crisis had weakened the economy and the fixed exchange rate could no longer be maintained and the Central Bank was forced to abandon the fixed rate. The crisis culminated in the fall of 1992, when for a few days repo rates were raised to 500 per cent in the vain hope of stemming currency outflows. Interest rate hikes and other contractive measures for defending the fixed exchange rate in the midst of European *currency turmoil* further exacerbated the economic downturn and added to the banks' loan losses. During the next few months, the floating *Krona* fell by 25 percent against the D-mark, 40 percent against the US dollar, and 60 percent against the yen.

Finally, this all led to a crisis in the real economy and in government finances. The banking crisis led to a tougher credit policy, with higher interest rates and stricter requirements for collateral. At the same time, the collapse in asset values led to a reduction in private consumption and a reduced willingness to invest. One indicator is that industrial investments were halved between 1989 and 1993. The macro effect of the crisis was a fall in total demand on the domestic market, with a consequent reduction in the demand for labour. The stimulus from the export sector, which benefited from the devaluation, was not sufficient to trigger a rise in domestic demand until several years later. Open unemployment rose from 1.1 percent in June 1990, to 9 percent three years later, and real GDP fell by 6 per cent during the period 1991-1993. The rapid growth in unemployment raised public spending, at the same time as tax receipts fell which combined to create a great strain on public fincances. In 1994 the public sector's budget deficit had grown to almost 12 per cent of GDP.

Thus, there are striking similarities with the Asian crisis. This is the narrative of the Swedish crisis, but what is the plot; the underlying mechanisms and causalities? Many other countries have had similar experiences as well during the last decade and a half. In fact more that two thirds of the member states of the IMF have gone through financial crises of some sort and of sizeable magnitude during this period. So, Sweden is by no means a unique case in this respect. There is nothing sensational about a small open and heavily trade dependent economy experiencing external shocks. The interesting thing with the case of Sweden is rather that for some considerable length of time it was taken to represent a model, not only of macro-economic management and performance but also of political economy with specific institutional arrangements under the rubric of the Welfare State. Sweden was in many respects a Weberian "ideal type" of Welfare State. So, when the crisis struck it was more than an imbalance in macro-economic management or in the finical system alone, it was also an attack on a system. One relevant question is then to what extent this system could withstand or survive the threat posed by the crisis. We shall deal with this issue in the discussion about reform and recovery. However, a more interesting question to start with is whether the politico-economic system had in some sense become a factor responsible for weaknesses and vulnerabilities in macro-economic policy-making, i.e. whether structural weaknesses in the institutional system were any way important factors behind the crisis.

What is the relevance of this to the Asian case? We know that there is an abundance of explanations for the Asian crisis and we know equally well that the region is still struggling with the task of recovery some five years after the turmoil started. We also know that, in contrast, the Swedish economy had a seemingly rapid recovery after its crisis years. Being as we are in what happened to be the "eye of the storm" in 1997 it is relevant to ask questions about the significance of these similarities and differences between the Swedish case and the Asian crisis. What is the significance of these obvious similarities? Are they accidental or are they signs of more fundamental and structurally founded similarities? Could the same similarities be found is any other country that has experienced a financial crisis since the mid 1980s? Are the factors behind the crisis to be identified beyond the working of the national economy, i.e. the forces of globalization or is it that there actually were structural similarities between the Swedish Welfare State model and an Asian Developmental State model? And is it that in both cases structural weaknesses contributed strongly to the eruption of the crisis and if so, what are these similarities? What did the Swedish Welfare State have in common with the Asian model, in case there ever was one? And did these similar characteristics contribute to making the crises so deep and far reaching even if they may not have triggered the actual chain reaction in the course of events that make up the crisis? Or was it perhaps a fact that both the Swedish Welfare state and the Asian Developmental State had already been eroded to the extent that neither of them might have had any significant influence over the events that came to constitute the crises?

3. The Asian Developmental State that turned into Crony Capitalism

As said before the Asian crisis is often discussed in terms of Crony Capitalism and moral hazard. The peculiarity of this is that state intervention has been extensive in the success stories of industrialisation of Asia, from South Korea and Taiwan to Malaysia and Indonesia (but perhaps less so in Thailand). It has been argued that their success in building up domestic technological capacities has been mainly due to the assistance provided by the state to the export sector. What was required to achieve this was an efficient bureaucracy, which did not allow itself to become controlled by political "populism", but was "insulated from political pressure". Their bureaucrats were capable, motivated and effectively insulated from short-term political pressure

In this perspective, many Asian governments and, above all, its bureaucracies, were considered unusually enlightened and insulated from influential interest groups. They were taken to represent a national economic interest vis-à-vis the world at large and they were in position to "discipline" their own special interests. It was this argumentation that established the idea of a specific "East Asian model" with the Developmental State as a core ingredient. It was also this that was supposed to be the Asian model. Developmental States were initially identified in Singapore, Taiwan and South Korea, but the concept was later and with surprising frivolity applied in studies of the industrialising ASEAN-countries as well. The application of the concept to explain the ASEAN industrial boom is problematic in itself, but even more troublesome is the fact that the core instruments of the Developmental State were so seldom clearly identified. In fact, many studies are guilty of misinterpretation of the Developmental State since they fail to identify the steering and control mechanisms, i.e. the institutional arrangements needed to control and direct investments. The essence of the Developmental State was its control of savings via the *state-controlled credit system,* basically the banks. It was this command over national savings that made it possible for the state to take a compelling role in the process of industrialisation. Government control over credit institutes and foreign currency allocation were central ingredients in the support to export industries and key actors in export industries were systematically favoured by credit, low interest loans, subsidies, tariff rebates on imported intermediary and capital goods. It was via lending through state-controlled banks that leading export firms were established in a mercantilist partnership with the state.

The fact that the state controlled the banks was one of the most distinguishing features of South Korea and Taiwan. "Korea controlled both the allocation of credit and the interest rate through its state-owned banking system" (ADB p.102). When the military took over the rule of Korea at early1960s banks were nationalized. It was via lending through these state-owned banks that the huge conglomerates were established in a mercantilist partnership with the state. However, in 1983 the banks were privatised. From then onwards state controls began to decline and instead the large conglomerates could take control over the credit flows by influencing the banks and the government. So, in the course of time from early 1980s to 1997 the principal-agent relationship had been reversed in Korea. This is an extraordinary change in economic organisation. When we discuss the Korean "model" it must be recognised that Korea before 1983 was a control system of mercantilist type with the state controlling capital, whereas during the last fifteen years it has moved towards a system where monopolies seems to be running the state. So, the Korean case demonstrates that the Asian model was clearly a model in transition at the time of the financial crisis and it had been so for more than 15 years. Cronyism and moral hazards might have become realities but it should be remembered that the major reason for that was the change in financial architecture.

In 1997 the Asian financial crisis struck the world almost like a bolt from the blue. The story of the crisis is often told and need not be repeated here. Still, the crisis instantaneously gave rise to a lively debate. Many leading analysts now saw the crisis as an inevitable consequence of inherent weaknesses and distortions in the Asian economies. It was even considered a natural outcome of an obsolete politico-economic system. The obituaries of the Asian model became legion. Concepts such as "crony capitalism", "rent seeking-state", "bad governance" and "moral hazard" were oft-repeated expressions, and they all contributed to augmenting the picture of a model of economic development in Pacific-Asia doomed to failure (see N. Routine's Homepage on the Asian Crisis). State involvement was thus taken to have been the main root of the problem. The close ties between the political apparatus and industrial and commercial circles were thought to have distorted the market allocation system. Favouritism rather than competence formed the basis of government intervention and in general transparency was virtually non-existent. Firms had taken extravagant risks in the secure understanding that the government would come to their rescue. This school of thought saw the crisis as marking the end of the Asia-Pacific model of development and in case there ever was one such model it was more likely to have created problems than having contributed to economic growth. The Developmental State paradigm had been turned into Crony Capitalism.

Crony Capitalism is a reality but what did it have to do with the Developmental State? In fact, not much. Taiwan is a case in point, not least since it was the only economy in the region that got through the crisis without relatively lightly. In Taiwan, state ownership was an important element in the mercantilist strategy. Another important factor was the KMT, the ruling party, and its involvement in industry and business. Also in Taiwan the state controlled the banks, but unlike Korea the banks were not privatised during the 1980s. Most commercial banks remained under state control while interest rates, capital flows and currency trade were liberalised. The Taiwanese economy has undergone a dramatic and remarkable transformation since the mid 1980s. Much of the low skilled labour intensive industry is gone and many of the small guerrilla capitalists working outside the legal system have moved out. However, since the mid1980s the pressure towards globalisation has been signified by a process of integration of markets for goods and capital, which has fundamentally altered the scope and content of government-market relations in developing Asia in general. Not only have Korean and Taiwanese Developmental States been transformed; the fact is that such institutional arrangement as those of Korea and Taiwan may have had little importance in the ASEAN region.

The tendency has been to dismantle existing national regulatory frameworks and to open up to free capital movements. In this sense the governments in Asia-Pacific have been forced to play according to new rules of the game, rules set by international markets. This marks a great change for governments that in large degree used to be in a position to set their own rules. The globalisation forces after the mid1980s not only threatened the government-business balance, in the NICs, but also provided latecomers in the region (first the ASEAN-countries and thereafter China and Vietnam) with alternative development paths.

This means that in case there was something called a development model practised by the Asian NICs in the period 1960 to 1980, it was of little relevance in the speeding up of the process of industrialisation in the ASEAN countries in the 1980s and in China in the 1990s. This process was not led by Developmental States but by the deregulation of the financial systems which created a capital surplus. In fact, as a contrast Taiwan was the only net exporter of capital in the period. It was also an economy where the government kept the control system over the financial system by not allowing a privatisation of the banks. In a sense Taiwan remained the last Developmental State.

4. The Swedish Crisis

So, if the Asia political economy structure had been changing in Asia in the midst of a remarkable growth expansion led by a booming export economy, what was it that had changed in the case of Sweden? Like in the case with the Developmental State undergoing a shift, Swedes were told that their institutionally unique economic model was if not dead yet at least overdue. They would have to accept that that their politico-economic model either did not exist any more; or if it did, it was exactly this fact that was the root of all the problems that led up to the crisis. This was of course a message hard to digest, not least since the economy had performed so well in the 1980s, in fact much in the same way as the economic boom in the ASEAN region in the 1990s.

What model were it then that was cracking or, alternatively, constituted a structural weakness that made the crisis inevitable? The Swedish model of Welfare State has often been held up as an interesting model to learn from. It is reputed for its combination of sustained economic growth and structural change on the one hand and social equity and provision of welfare via public sector transfers and services on the other. Sweden was not seldom presented as a third path, between socialism and capitalism, as an ideal type of a mixed economy. It had a well-functioning macro-economic system with on the one hand a highly competitive private-owned export industry and, on the other, a service sector that was largely dominated by political decisions. The economy was divided between one sector exposed to foreign competition and one largely shielded form competition. But the system was hardly dualistic since industries catering for the home market were either subcontractors to export firms or working within the realm of the public sphere as contractors for public sector investments. In fact, the two sectors had a symbiotic relationship.

Public sector involvement centered on provision of free education health care etc and on the extensive public insurance system, but public sector investments dominated many other activities as well and the lion's share of construction of building activities took place within the public sector sphere. One might say that the typical traits of the model were the strong alliance between export industry, i.e. big business, and a strong state in control over the service sector. The presence of this symbiotic relationship gave the government a key role to play as a link between exporting companies and home market industrialists and between private industry and public services.

Industrial policy played an important role in the attempts to speed up and sustain the structural transformation of industry since the 1950s. The so-called solidaric wage policy that aimed at removing cheap labour was one important ingredient, another being the investment funds generated by the public work pension system that was effective from around 1960. Another ingredient was the central wage negotiations between employers and trade unions, which codified the social contract between capital and labour. Strikes were few, largely due to the fact that the trade unions were encompassing in character and largely disciplined by the leading Social Democratic party that had held office for 40 successive years.

In this system, state ownership of industry was marginal, the government did not intervene in wage bargaining, but it did play a leading role in guiding and directing the economy and it did so because the financial architecture was such that it allowed the government to be a leading actor. A fundament of the system was the government control over the national financial system. The board of Central Bank was politically appointed and the bank's activities and actions were assumed to reflect the wishes and aspirations of the government. In fact, this control and rationing of credits can be characterised as a large-scale socialisation of savings. Sweden had an extensive income tax system with the highest tax (inclusive of personal income tax and social insurance tax) on labour income in the world. Tax rates on capital and property was far more modest and so were corporate taxes, which contributed to a development of labour saving technologies and to the rise of capital-intensive big business. In essence it was an arrangement based on transfers of private savings to investments and consumption. Savings were in this way reallocated to investments either in the form of public sector activities or indirectly to private industry via spending that raised consumption.

This system was not without weaknesses. In the longer run the workforce was gradually being transferred to the public sector which put great strain on the public sector wage bill and also, given that the system was financed by income taxes, put increasing pressure on private industry to produce a taxable surplus. Given the concentration and export orientation of industry the economy became increasingly dependent on export revenues and the capacity of the export industry to remain internationally competitive. Tax rates were very high, especially the tax on labour income. This of course made labour costs very high, which on the one hand stimulated investments in new technology and on the other threatened the competitiveness of export industry. In the mid 1970s industry went through a structural crisis as shipbuilding, steel and other basic industries were being challenged by new competitors, in particular from Asia. One receipt that was attempted at several occasions was depreciation of the *krona*. In fact, up to the early 1980s this was the major instrument used to keep up international competitiveness. Furthermore, the devaluations of course spurred inflation and rising labour costs also in the public sector.

Why was there a crisis? The devaluations of 1981 and 1982 are important triggers of a process that led up to the crisis. They created a long-lasting boom and rapid increases in the demand for credits, both from business and the household sector. Profits in export industries remained high almost throughout the 1980s. Several of the leading export companies had problems with "excess liquidity", which was invested in the share and money markets. Investment in commercial property and financial investments both contributed to the high level of asset prices. However, changes in the institutional architecture had a more fundamental effect. The fact is that when the crisis began to build up in 1990 some of the old institutional arrangements had been dissolved or abandoned. In 1985 there was a deregulation of domestic credit in 1985, which led to a mushrooming of new private financial companies and an increase in bank lending due to pent-up credit demand. Both the liberalization of various lending restrictions (interest rates were freed and property could be fully mortgaged) and the fact that the banks were now permitted to compete fully with the finance companies, contributed to the credit expansion. The increased competition meant that the banks and the other financial institutions adopted a strategy, which focused on a gaining of market shares rather than on minimising risk and maximising profit in each individual case. In five years, the indebtedness of the private sector increased from 100 percent to 150 percent of GDP. At the same time, the average lending risk also rose. For example, the first-mortgage loan institutions increased their loan ratio from 75 percent to 85-90 percent.

An increasing share of bank lending was financed on the international market. The financial market was liberalised before the external capital outflows, which meant that overheating of the domestic economy could not be adequately balanced by capital outflows for investment abroad. Later capital accounts were opened and trade in foreign currencies was deregulated. While the government at the same time had decided to follow a strict fixed exchange rate regime the use of monetary policy was blocked. In the interest rate was raised to cool down an overheated economy the effect would be that more capital would be floating in from abroad and, in the reverse case, lowering the interest rate would to stimulate investments would result in capital flight. In addition, at the end of the 1980s a tax reform was launched, basically focusing on a lowering of marginal income tax. This led to a rapid increase in private saving at the same time as it put pressure on government finances. However, using fiscal policies to downsize the public sector spending turned out politically impossible at the end of the 1980s. The results of these changes were: credit expansion, overheating, rising asset prices, business boom and huge lending to the real estate sector.

In the course of five years, private borrowing grew from 85 to 135 % of GDP. A large proportion of the borrowed money was spent on speculation, both in real estate and in financial assets. The real estate speculation culminated in a bubble that burst in 1990-91. Protected by the economic upswing, there were many misdirected and overly optimistic investments in various industrial and building projects. The fixed exchange rate regime led to high levels of foreign borrowing, particularly in the private sector and, as mentioned above, made it difficult to counter the gradual overheating of the economy by applying contractive monetary measures.

The bubble stared bursting already in 1990 when one of the leading finance companies, *Nyckeln* (which literally means 'the key') declared credit losses amounting to 250 million SEK. Soon several other companies went bankrupt and the reason was obvious, falling asset prices in the real estate market. Over the coming two years a crisis was building up until the finally eruption with the attack on the *krona* in September 1992. Thus, an interesting thing is that it took two full years for the crisis to build up and give full effects in the real economy in terms of bankruptcies and lay-offs in the industrial and service sectors. In a way it is remarkable that it took so long before the full extent of the crisis was felt. This was probably due to a lack of knowledge among the public and also among policy makers and actors in the financial markets about what was actually happening and what the implications of disturbances in the financial system would be for the real economy.

5. The Swedish crisis compared to the Asian crisis

So we can conclude that the causes of the growth of the bubble are found in the simultaneous increases in the supply of and the demand for capital and credit during the 1980s. In what way was this experience similar or different from the Asian crisis? Factors that contributed to Sweden's acute crisis and which distinguish this case from Asia were a relatively deep international downturn around 1990 and the high interest rates in the wake of German reunion. In addition, Sweden's fiscal position was vulnerable with a public debt-to-GDP ratio of around 40 per cent. Sweden's external borrowing ratio was also high - some 30 per cent of GDP. But the structural similarities are clear. The characteristics of the Asian crisis may be summarised as follows:

- Free capital flows combined with currencies pegged to the US $; exchange rate risk was not perceived;
- Strong growth and high interest rates attracted private short term capital which was invested in stock markets and real estate; asset prices become inflated;
- Supervision of the banking system poor and corrupt—banks could easily overstretch themselves relying on the govt to rescue them if there are problems; transparency in banking and industry very low.
- Asian currencies became overvalued when the USD appreciated; exports started slowing down in 1993-94.
- Debt-equity ratio of many Asian countries was high, much of the debt was foreign; makes firms sensitive to changing conditions such as exchange rates.
- Return on capital was often low — especially taking lending rates into account.

There is do doubt that to a large extent most of these characteristics apply to the Swedish case as well. Corruption or cronyism would not be a relevant characterisation, but the fact that there were fundamental weaknesses in the financial system is quite clear, weaknesses that came about when the old system of socialised savings and rationed credit was gradually abandoned. The financial system had not adapted to the change from a sheltered environment to a deregulated and much more competitive situation. In the old system banks had little incentive to develop a sophisticated credit culture, involving comprehensive evaluations of debtors, projects and collateral. One obvious similarity between Sweden and Asia was the overoptimistic reliance on collateral and other guarantees, rather than on the viability of the loan project itself. After the deregulation was a fact, bank managers saw a chance to gain market shares and to increase revenues by taking new risks, but they clearly they failed to take into account the risk involved. One of the major faults in credit decisions was that banks lent to customers and projects of which they did not have enough knowledge. Concentration of lending to high-risk projects in the real estate sector was another problem. At the peak of the crisis, bank loans to real estate, or collateralised by real estate, accounted for more than 60 per cent of all loan losses.

Bank borrowers often demanded loans denominated in foreign currencies. Interest rates on these loans were lower than on *krona* loans and as the *krona* was fixed within a fairly narrow band, there was presumed to be no exchange risk. The banks borrowed the foreign currencies abroad and on-lent them to customers, avoiding open exchange risk exposures. However, when the *krona* was attacked and the fixed exchange rate subsequently had to be abandoned, banks were doubly affected. Foreign counterparts, perceiving the banks' weakened position, reduced or withdrew credit lines. This forced the banks to demand either early repayment from customers or loan conversion into domestic currency. This led, in turn, to sharply increased loan losses because, at short notice, borrowers were unable to raise the larger amounts in *krona* that were needed to repay the foreign currency loans, which the depreciation had made much more expensive.

These are apparent similarities between Asia and Sweden in the problems associated with the setting up and living under a new system of financial architecture. In Asia, much the same way as in the 1980s in Sweden, the good supply of capital had pushed up prices for equity and real estate, thereby creating a bubble. In some countries, a current account deficit and the fixed exchange rate had become untenable. Another common denominator was the very short-term profile of external borrowing. But in some ways the Swedish problem more severe since most Asian countries were reputed to be successful in macroeconomic management. Before the financial crisis inflation was low or moderate in most countries; unemployment was low or moderate in most countries; current accounts mostly well balanced (but problems were building up in Thailand and Malaysia); government budgets were balanced and the current account problem was not due to excessive government spending. In sum, standard macroeconomic criteria did not indicate serious trouble in the Asia-Pacific region.

In fact, macro-economic imbalances appear to have been more pronounced in Sweden. Furthermore, the events leading up to the crisis were clear indications of the fact that the old politico-economic system was in a process of transformation. To a large extent the pillars of the Swedish Welfare State had been removed or proven untenable in the new financial environment. In the case of the ASEAN region the boom of the export economy in the late 1980s and early 1990s was made possible through the new financial architecture. Capital resources were being made available from markets that had been non-existent for the early industrialising economies of the region, such as South Korea and Taiwan. In fact, without access to these capital resources it is hard to see how the export boom in the ASEAN region could have come about in the first place. The financial crisis, however, was not a consequence of the presence of an all-encompassing Developmental State. But policy mistakes were indeed made and it is hardly unlikely that the enormous expansion of private capital resources in the Asia-Pacific region might have spurred rent-seeking, DUP-activities or even corruption given the fact that governance practices remained non-transparent.

Policy mistakes were indeed made in Sweden as well, and also in this case the mismatch between old practices and demands and new possibilities and restrictions created imbalances that contributed to the crisis. For instance the devaluation of 1981-82 had led to an inflationary pressure throughout the 1980s, which had led to higher cost of labour. Under similar circumstances in the 1970s and 1980s the currency was depreciated several times. By 1990 a broad political agreement had been established that that the fixed exchange rate should be maintained in order to bring down inflation down. The policy was clearly efficient in achieving exactly that: inflation fell from 8-10 per cent to 2-3 per cent in less than two years. Another effect, however, was that real interest rates rose. Structural reforms were also implemented, particularly in the tax system but also in housing regulation. One aim of these reforms was to create more market-related incentives for savings and to reduce subsidies. While these changes may have been needed and welcome they did came at the worst possible time from a macroeconomic point of view.

To what extent, then, what the Welfare State model responsible for the crisis? The political arena had no direct influence over the events leading up to the crisis. However, in a more general sense both the government and the Central Bank were responsible for not recognising the risks involved in the deregulation of the financial system, in particular the mismatch between deregulation and the ambition to maintain the welfare model. In the Asian case the course of events was much more rapid. Once the crisis had begun the reaction among actors in the financial markets was immediate and swift. This reaction was probably based on experience, i.e. knowledge what would happen unless immediate action was taken. Most likely this tended to speed up the pace of the crisis and perhaps it contributed to its aggravation.

In Sweden the system was also directly responsible for the crisis in the sense that there was underlying structural weakness that could not be resolved with conventional tools of economic policy. In the political arena there was "business as usual" although a budget deficit was building up due to falling revue and constant or increasing spending. The restrictive fiscal policy that would have been appropriate proved impossible for political reasons, especially since there was an election campaign in 1991, i.e. in the midst of the crisis. As compared to Sweden most countries in Asia were better off in terms of macro economic management. Government spending was moderate and there was no big debt building up prior to the crisis. And in fact few people bothered about cronyism until it became the fashion term.

In the case of the ASEAN countries the problem was that much of the previous expansion had been founded on a false image of efficient institutional arrangements and good governance. The export/led industrial boom was driven by an influx of foreign capital and the recipient countries obviously benefited from a reputation that had been built up in East Asia during the 1970s and 1980s for having proper macro economic management or fundamentals right. First these images were based on observations from a period long gone. Second, there was little evidence that the concept of "proper institutions" had any greater relevance to Southeast Asia in the 1990s.

In sum, neither the Swedish crisis nor the Asian crises would have happened without the deregulation financial markets In Southeast Asia this obvious because the export boom was driven by foreign capital and the fixed exchange rate contributed strongly to the influx. The problem was more and more deregulation without proper regulatory measures; liberalisation per se was the top of the agenda. In Sweden the main problem was the mismatch between an increasingly privatised and badly regulated financial seems and a politico/economic system dominating the service sector and founded on the control over savings.

In Sweden the crisis revealed the fact that welfare model based on public spending needed to be reformed. Public spending had to be reduced when the tax reform made savings float into the private capital markets. In Southeast Asia the institutional system or institutions of governance that came under scrutiny. Loss of confidence spread like fire. So, reform programs in Sweden had to focus on the reforming of the public sector model for serves provision whereas the Asian reform focused on issues of governance.

6. The Recovery programme in Sweden

With an economy falling apart and a bankrupt financial sector, it was clear that radical action had to be taken. The reform of the banking sector came to play a central role for the recovery, just as it had been in the core of the crisis. All the large banks were burdened by huge losses and six of the seven largest banks required capital injections from the state or from their shareholders. In 1991 and 1992 the government injected over SEK 16 billion into *Nordbanken*.

In September 1992 the government introduced a bank guarantee that meant that all creditors, but not shareholders, were protected against loss. The motive and intention of the guarantee reads as follows: "The state guarantees that banks and certain other credit institutions can meet their commitment on a timely basis. The purpose is to ensure the stability of the payments system and to safeguard the supply of credit. The guarantee is not directed to a specific creditor". A special Bank Support Authority was established to administer the guarantee. The aim was to avoid a liquidity crisis. The Authority evaluated all banks. Credit portfolios were classified and valued, property collateral was valued and sensitivity analyses were carried. Three solutions were identified: A private solution with owners putting up new equity; a semi-private solution with equity guarantee and a total restructuring of the banks. The core task was to separate bad loans from good ones. The state support consisted of guarantees, loans and share capital. It covered all banks with a Swedish charter. The banks should be able to meet all their obligations. The guarantee did not cover share capital. The Central Bank made it clear that its role was limited to supply liquidity to solvent banks. Direct costs amounted to around SEK 65 bn SEK (4 per cent of GDP); private owners raised SEK 13 bn in new equity. The Central Bank used greater part of its foreign exchange reserves for deposits in the banks and to maintain or restore confidence in the banking system. The payment of bank support was balanced by the government's holdings and income from shares and equity in the three of the banks with an estimated value of more than SEK 60 billion. The guarantees to the rest of the banking system, which amounted to SEK 84 billion, were not utilized. The recovery was surprisingly quick. After 1993, no new commitments were made by the Authority and the banking sector as a whole showed a profit as early as 1994. One reason was that the banks' interest margins rose, another reason being that the tight economic policy caused real interest rates to fall and that an upturn in the international economic situation contributed to an expansion in the export sector. Most important, however, was that the restructuring of the banking system was both rapid and radical. The state guarantee was abolished July 1, 1996.

How come the programme was so successful? One important reason is that the rescue action came early, it was comprehensive, fully transparent and implemented without delay. There was a broad political consensus about the support program. There was no nepotism or protection of vested interests and the authorities encouraged the greatest possible openness about the problems and the financial situation of the individual banks. Bad loans and property values were entered in the accounts in an open and transparent way, and the banks and finance companies that were not likely to recover from the credit losses were liquidated. The reform programme acquired immediate credibility among foreign investors and creditors.

Another factor was that all the banks fulfilled or surpassed the 8 per cent Basel requirement for capital. So, although non-performing and other impaired loans amounted to 15 per cent of GDP in Sweden the original cost to the government of rescuing the banking system amounted to only some 4 per cent of GDP;

This was a fundamental measure in order to restore confidence in the Swedish banks both from domestic and from foreign depositors and other counterparties. The results showed themselves rather quickly, e.g., in the form of renewed interbank credit lines with foreign banks. Also the Swedish public remained calm and there were no runs to the banks.

To restore confidence in the financial system was absolutely fundamental and there is no doubt that the recovery programme proved successful. The macro-economic imbalance created by the crisis more difficult to handle, however. It was to take several years before the government managed to reach budget balance and the recovery of the real economy remained slow. Domestic demand was weak due to low consumption (caused by rising unemployment) and low investment (caused by company restructuring, the credit crunch and the halt in public investments); hence the recovery had to be led by exports. The export sector also became more competitive due to the depreciated currency; in fact, the export boom that followed was the strongest ever recorded in Swedish modern economic history. However, it was to take several years before the effects of this boom would begin to have effects on the domestic economy.

In the ten years that have passed since the Swedish economic crisis unemployment has halved, but still it remains almost 5 of the workforce and the low levels of the late 1980s are not likely to be reached in the foreseeable future. This does put continued strain of the government budget and it tends top have a depressive effect on domestic demand. The long-term effect of high unemployment is hard to predict but one should remember that the Swedish model was based on the foundation that o people had work, earned en income and were able to pay taxes that could finance the welfare system. The model was never accustomed to long-term unemployment.

The welfare model has indeed been reformed but on the other hand public spending remains high and the economy has become even more export dependent than before. So, when asked if the Swedish reform and recovery programme has been successful or not I would like to quote prime minister Chou En-lai, who when asked about his opinion on the effects of the French revolution answered: “It is too early to tell”.

Thailand's Emergence from the Crisis: New Paradigm for Sustainable Growth

by

M.R. Pridiyathorn Devakula

Governor, Bank of Thailand

International Conference on "Economic Recovery and Reforms"

at The Imperial Queen's Park Hotel, Bangkok

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Distinguished Guests
Ladies and Gentlemen,

It is my great pleasure to be here with you tonight. I would like to, begin by welcoming you all once again to Bangkok and to this important international conference on Economic Recovery and Reforms. I would also like to express our appreciation to the Faculty of Economics, Thammasat University, the main organizer of the conference, in allowing the Bank of Thailand to co-host the event. Our appreciation also goes to the distinguished scholars who came from all over the world to share with us their perspectives on this important topic.

To many of us here, especially those in the Asian region, the 1997 financial crisis has completely changed our lives. It was, in a way, a sharp reversal of fortune when suddenly things that were thought to be good before the crisis became no longer good enough. And terms like 'restructuring' and 'reforms' have then become something of a norm. This long and tiresome journey has now lasted for more than five years, and naturally begs a question, "when are we going to get out of this abyss?" This question is particularly pertinent to Thailand. After all, the Asian crisis started here.

To provide a starting point in answering this question, I would like to share with you tonight some of our views on the current state of the Thai economy, where we are, where are we heading, and most importantly, what we see as the key ingredients for sustaining Thailand's economic growth.

Ladies and Gentlemen,

At the height of the Thai crisis, Thailand's nominal per capita GDP in dollar term fell by more than 30% according to a World Bank estimate while financial restructuring costs have exceeded 30% of GDP, and capital flows reversals surpassed the 60% of GDP mark. Given such a depth and breadth of the crisis, the current momentum of recovery does suggest that Thailand has indeed come a long way. This view is increasingly shared by the market, including major credit rating agencies, with some analysts concluding that perhaps Thailand has more or less turned the corner. The extent to which Thailand has elevated from the crisis of 1997 is probably best illustrated by the latest macroeconomic performance and data.

Thailand's GDP growth in the first half of this year is a testament to the strength in the current recovery. The economy expanded by 5.1% in the second quarter after a robust 3.9% in the first quarter. In level terms, real GDP has now exceeded its pre-crisis level. And according to the latest incoming data, the economy in the third quarter looks to remain quite robust as well.

Thailand's better performance this year, notwithstanding a lackluster global economy, has been supported by the strong momentum in both domestic demand and exports. Front-loaded fiscal measure sparked up the initial momentum in domestic demand, while private consumption and investment are now adding firmly to the growth process. As the regional economies began to recover in the last five months, export growth has also provided an additional impetus to the recovery.

Along with this recovery, inflation remains subdued, credit growth has turned positive, and business profits are improving, encouraging firms to expand their capacities through new investment. These broad movements are indicative of a positive dynamic linked to the current recovery.

The most significant improvement since the crisis, however, has been the strengthening of external stability. Continued current account surpluses have allowed external debt to run down in concomitant with a build-up of international reserves. The coverage ratio of reserve to short-term debt has risen to 290% in July 2002, four times the ratio at the end of 1997.

Ladies and Gentlemen,

Although I share the view that the worst may now be behind us, I believe Thailand still has some way to go. The key question is how can we make it last, especially now that the global economic recovery may be somewhat slower than earlier anticipated? The answer to this question probably lies in the answers to yet another important question: what have we learnt from the recent crisis?

For Thailand to prosper in the future, we can no longer rely on the old way of doing business or, for policymakers, the old way of running the economy. We need a different and more effective paradigm that will not only sustain the current growth momentum but also helped the country meets future challenges.

Putting the crisis under microscope reveals critical flaws that beg for new approaches and strategies in all of the four major areas: (1) the real sector, (2) the financial sector, (3) the issue of governance, and (4) the macroeconomic framework.

In many respects, these lessons are neither limited to Thailand nor unique to the recent crisis. The challenge is perhaps how to put them into the context of rapidly evolving global and regional economies.

Let me start with the real sector.

For a brief period in the early 1990s, it seemed that everything was going well. Everywhere one turned, businesses were booming. Demand seemed to always outpace supply. And on top of all that, Thailand was just named Asia's fifth economic tiger. Little did everyone know, however, that the spectacular economic performance masked certain structural weaknesses in some part of the real sector. As it now becomes all too clear, parts of Thailand's real sector prior to the crisis were characterized by low productivity and high leverage.

With the benefits of hindsight, Thailand's past rapid growth could be attributed primarily to quantity, that is, the mobilization of capital, labor, and natural resources, rather than quality. During decades of spectacular growth, total factor productivity or TFP rose only modestly. Overtime, Thailand's inability to further move up the quality ladder, after it graduated from a low-labor-cost production- base status, gradually led to the erosion of our export competitiveness.

In relation to the attitude towards risk, Thailand's use of leverage, being among the highest in Asia, put the country in a vulnerable position to potential adverse shocks. When the crisis hit in 1997, many companies thus found themselves in desperate straits to service their debt, eventually leading up to a major collapse of the real economy.

While these weaknesses have been and are being addressed since the crisis, these measures take time to become fully effective. In the meantime, these shortcomings have been accentuated by the recent change in global competitive landscape brought about by China's WTO accession. Thailand, like many other countries, will need to reposition itself quickly to meet this new global challenge.

Stepping beyond the realm of the real sector, another expensive lesson learnt during the crisis is that the world financial markets have become extremely slippery. As today's financial world becomes increasingly interconnected, disturbances in one market can quickly spread to others with devastating results. These merciless and indiscriminating financial storms therefore need to be guarded against around the clock, with an early warning system developed to help protect all those involved.

Looking back over the past ten years, the Thai financial sector has changed considerably. The financial liberalization trend prodded along by the Bank of Thailand not only expanded the size and the scope of the sector, but also made it become more open.

The government's ultimate purpose of the liberalization was to provide domestic investors access to foreign funds so that Thailand could transform itself into a true industrialized economy. Unfortunately, the opening up of the financial sector left the country in an uncharted territory.

Confidence in the Thai economy back then meant easy offshore money for everybody, with foreign market access. Encouraged by the fixed exchange rate, Thai financial institutions, like many other Thai corporates, borrowed freely and imprudently from abroad. And in pursuit of quick profit, many of these foreign borrowings were converted into baht loans without proper currency hedging.

Exacerbating the problem was the fact that many of the domestic loans went into real estate deals, rather than into productive investments. A property price bubble ensued, and the Thai financial institutions, lacking the necessary credit skills, accepted inflated property values as the basis for new loans. These pyramid-like financing schemes placed a serious strain on the system, and their eventual collapse resulted in a flood of non-performing loans for the unwary lenders.

Admittedly, the Bank of Thailand also shares the blame of what went wrong in the financial sector. Although the liberalization policy was probably correct given the circumstances, its potential benefits were undermined by the lack of strong institutional underpinnings. The existing regulatory framework was simply inadequate to detect and prevent the brewing problems. At one level, inadequate follow-up framework made it difficult to track where the funds were going. But the heart of the problem lay in the loose supervision and examination system in place. Regulatory waivers were common. And the culture evolved to one that encouraged or condoned excessive risk-taking behavior.

Compounding the problem were Thailand's underdeveloped capital markets. The absence of what Alan Greenspan termed a "spare tire" of finance made bank lending the dominant source of corporate financing. Consequently, viable businesses were trapped in the breaking down of the banking sector's intermediary role with no way out, and the crisis spiraled into a devastating credit crunch.

The most significant implication drawn from this lesson is thus a strong financial sector is essential for a country to sail through financial storms. It is perhaps not a coincidence that Singapore and Hong Kong fared better than many other Asian countries during the 1997 crisis, for their financial systems were, and still are, relatively deeper than the rest. A strong financial sector serves as an absorber for external shocks while a weak and inefficient financial sector aggravates the depth of the problem and prolongs the recovery process.

Beyond the "hardware" of the physical and financial infrastructure, the "software" of the ethical issues governing the running of the system is also critical. Tales of businesses being endowed with extraordinary treatments from bankers through their cross-holding relationship are probably still fresh in everyone's mind. Like in most other crisis-affected Asian countries, these relationships played a critical role in the evolution of the crisis in Thailand.

The problem of weak governance is not limited to the private sector, however. Regarding monetary policy, a post-crisis survey of stakeholders, consisting of domestic and foreign institutions, government agencies, as well as the general public, revealed that the BOT was also perceived to be plagued with several weaknesses: lack of good leaders, lack of experiences, and lack of transparency.

Finally, in the macroeconomic framework as a whole, it is probably obvious from the experiences leading up to the crisis that high growth cannot be reached and sustained in the absence of consistent government economic policies.

The most striking example here is the combination of the fixed exchange rate and the financial liberalization policy, which inherently led to underestimation of exchange rate risks. In the end, market stability that the fixed exchange rate regime was intended to foster was undermined by market-driven foreign borrowings.

The lesson for Thailand as well as for other emerging economies is that the authorities must regularly review their policy stances in the drive to keep up with changing financial environments. A move towards liberalization, for example, should be examined carefully in the light of the public sector's capability in stabilization and whether there is sufficient infrastructure in place to support the regime shift.

Finally, the crisis reminds us the importance of monetary and fiscal policy coordination. More conservative fiscal policy would have done what monetary policy could not accomplish; namely, to cool down the overheated economy.

Ladies and Gentlemen,

These lessons have been expensive ones. Thailand, as a nation, has spent the last five years dealing with the problem with some severe hardship and grave consequences. Although it is probably safe to say that the height of the problems is now behind us, we still face an enormous uphill battle. A new set of challenges seems to emerge everyday, some with very important repercussions on the Thai economy. Here, what spring to my mind are the delay in the global economic recovery and China's WTO entry already mentioned, as well as the current global equity slump. This is just to name a few.

To prepare Thailand for these future challenges, we need to get the fundamentals right on all of the four areas that I have just discussed. In brief, we need to raise productivity in the real sector, rebuild our financial infrastructure, instill the value of good governance in both the private and public sectors, and develop a comprehensive macroeconomic strategy.

Needless to say, comprehensive real sector reform is at the core of the new paradigm for sustainable growth. And this requires a carefully planned national agenda. In essence, Thailand needs to distinguish itself quickly in the fast-evolving global competitive landscape. As global competition intensifies, Thailand can neither simply keep growing on the back of capital accumulation nor dwell on massive production of low value-added goods. Desirable product features such as high quality and consistency are needed to sustain export competitiveness, and to maintain linkage to the global arena with clear focus on market awareness and adaptability.

Recently, there have been positive signs in some industries such as jewelry, garments, and food, where production technology has been upgraded to increase competitiveness of these industries and to move them up the value chain. Unfortunately, while such developments are encouraging, they have not been adequately spread out to other industries.

By the time these adjustments are completed, it may have been too late, probably rendering losses in a number of industries.

What we need **now** is a national agenda that comprehensively looks at competitiveness of all parts of the real sector. Industries that can no longer compete in the world market will have to be gradually phased out. Other industries that depict competitive edge and growth potential in the global arena will warrant further plans to upgrade technology, increase added values, and develop marketing strategies. These plans will have to be implemented through a concerted national effort so as to ensure better resource allocation along with greater value creation.

Reforming the real sector would however need to be complemented by strengthening of the financial sector. A notable example of such a strategy is the establishment of the Thai Asset Management Corporation or TAMC. The TAMC was set up to reduce distressed assets in the banking system through centralization of NPLs management. TAMC's ultimate goal goes beyond the partial clean up banks' balance sheets. It is hoped that doing so would enable banks to resume their normal lending activity and get the entire economy going strongly again. Nevertheless, as great goals alone do not automatically translate into successful results, the eventual impact of TAMC on the current recovery will depend crucially on the performance of its management.

Still, the effort to nurture our banking system back to its normal health has already started to bear some fruit. Profitability of the banking system is improving and the recent credit upgrade of major banks confirms that we are proceeding on the right track.

This of course does not mean that all is well. There are still weak points in the system. But at least, we know where they are and we are working hard to tackle them.

With respect to financial institution stability, the authorities' strategy was to bring the infrastructures of the Thai financial system up to international standards. Among the measures taken are the introduction of strict provision requirements, the steps to the establishment of the Deposit Insurance Agency, and the tightening of the Bank of Thailand's supervision and examination framework.

To improve oversight, the Bank of Thailand has also adopted a policy in line with the new BIS Capital Accord, emphasizing the importance of systemic stability and efficient risk management.

In an effort to further modernize our financial system, the Bank of Thailand, in cooperation with stakeholders and representatives from the SEC and the Department of Insurance, is in the process of drafting the country's first Financial Sector Master Plan. Scheduled to be implemented in 2003-2012, the Master Plan is intended to increase competition within the Thai financial systems and at the same time to improve the soundness of the system as a whole.

The preliminary vision for the future of commercial banking and financial services in Thailand given by a high-level steering committee comprises three pillars – accessibility and availability of financial services for all potential users nationwide; a competitive and efficient financial system; and finally fairness for all customers.

This preliminary vision of the Master Plan reflects our changing perception of the country's new financial architecture. As there are already two Asian financial centers in Hong Kong and Singapore, there is no point to try to be the third one. Instead, what Thailand needs is probably a more customer-oriented financial sector with efficient operation and minimum systemic risk.

The extent to which Thailand's financial service landscape is going to change from today will depend on the results and recommendations of an ongoing study. What I can tell you now is that whatever the final outcome will be, for Thailand, this is a change to rectify past shortcomings for the better.

As we are drafting our Financial Sector Master Plan, the SET is working tirelessly on its Capital Market Master Plan. The SET plan tackles another important problem, namely the underdevelopment of Thailand's capital markets. If its implementation is successful, Thailand will have a balanced and diversified financial system that is more robust and stable than the one today.

The third area that needs to be addressed is good governance. We need to move fast to ensure that firms follow proper accounting standard and information disclosure, to improve the protection of minority shareholders' right, and especially to assure independence of board of directors from management. For financial institutions in particular, the Bank of Thailand, with the assistance and cooperation from the World Bank and several domestic stakeholders, has assembled a manual entitled the Directors' Handbook, which provides guidelines of practice for directors of financial institutions. Regulations on the required structure of Board of Directors would follow within "November". Most important point was the regulation announced in July 2002 which imposes strict conditions on lending to related companies, which was one of the major cause of NPLs in the past. Moreover, the Government has also set up a National Committee on Good Governance, responsible for campaigning for good corporate governance on various inspects simultaneously, with the SET as the secretariat.

Instilling the value of good governance in the public sector is as important as in the private sector. On this issue, the current government has expressed an intention to tackle the problem that has long plagued the Thai public sector. Among steps already taken are the recent overhaul of the civil service workforce, fiscal decentralization, and privatization of state-owned enterprises. If executed in a proper manner, these efforts will go a long way towards good public sector governance. However, there are still some other areas in public governance that need attention from the government. These areas are of great interest to the public and are therefore currently under public scrutiny.

On transparency, progress has also been made in terms of public data disclosure. Having adopted already the IMF's Special Data Dissemination Standard (SDDS), Thailand is considering moving up one step further to publish the more stringent Reports on the Observance of Standards and Codes (ROSCs), which disclose in more details the country's economic and financial management.

In an attempt to restore the public confidence in the financial system, the Bank of Thailand itself has undergone major reforms in its organization structure, data management, and work processes. Inflation targeting has been adopted as a framework for the conduct of monetary policy. And despite the crisis turmoil, we have been able to maintain and better define our independence.

The final area of the new growth paradigm is the urgent need for a comprehensive macroeconomic strategy. Policies must be conducted under good discipline, with the right policy mix and stance. Here, the keyword is the coordination of monetary and fiscal policies.

The Bank of Thailand's role in promoting sustainable growth is to conduct responsible monetary policy to ensure price stability. But sound fiscal policies are also needed to complement the effectiveness of our policy. It is critical that public debt does not become a problem and threaten to drag the recovery process. Fiscal responsibility and discipline are thus keys, and I am extremely glad to see that the government has taken the first step towards fiscal sustainability by consolidating its budget this fiscal year.

Underlying all these frameworks, however, efforts must also be made to ensure that domestic saving mobilization is adequate to finance our economic development in a sustainable fashion. As the Thai economy regains full strength, our current account is likely to be in deficit again and we need to ascertain that the savings-investment gap is kept at an appropriate level.

Ladies and Gentlemen,

In closing, allow me to reconfirm that Thailand has certainly come a long way since the crisis. To make it last, we do need a bit of luck on the global economic development while ensuring that we get all the fundamentals right.

Some of these reform measures are tough and social support is needed to ensure that we continue to move in the right direction.

If we manage to get all of these real, financial, governance, and macroeconomic frameworks in place, I do believe that Thailand would be well on a sustainable road to development.

With these in mind, allow me to wish this conference every success in its endeavor. As a Thammasat Economics alumnus, it is an honor and a great pleasure to be 'home' addressing the distinguished guests and participants of this prominent conference.

Thank you.

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Ex Ante

Examples of Stabilization View

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Clearly, the Stabilization View is neither wrong nor misguided.

It needs to be supplemented

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Too much stabilization can lead to a form of moral hazard.

It can also be a form of subsidy on risk-avoidance, and thus discourage market development.

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Risk co-management means an approach that attempts to assess the various risks that the economy faces, and try to find out the means whereby the risk burden can be shared in a fair manner.

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Think of pre-1997 Asia as an area with great success in stabilization but has little risk co-management.

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There seem to be three sources of risk facing a macroeconomy:

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- Government Errors
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Each of these require different mixes of stabilization and risk co-management.

Thus, purely external shocks require more risk co-management than stabilization

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Where as co-ordination failures would require more in the way of stabilization policies.

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Conclusion:

Asia badly needs risk co-management mechanisms.

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The speed with which balance sheets are adjusted to reflect "true" values are of the essence.

A thought experiment.

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Crisis has destroyed the old financial mechanism.

New one has to be established

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Four possible systems:

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- Big bank-based (Japan, Thailand)
- Bank-based with mix of banks (Germany)
- State-directed bank-based (pre-crisis Korea)

Developmental

No evidence yet which of the four yields the "best" results

"Best" = Best able to select projects with the highest rate of return

Thailand's Emergence from the Crisis: New Paradigm for Sustainable Growth

by

M.R. Pridiyathorn Devakula
Governor, Bank of Thailand

International Conference on "Economic Recovery and Reforms"
at The Imperial Queen's Park Hotel, Bangkok
28 October 2002

Distinguished Guests
Ladies and Gentlemen,

It is my great pleasure to be here with you tonight. I would like to, begin by welcoming you all once again to Bangkok and to this important international conference on Economic Recovery and Reforms. I would also like to express our appreciation to the Faculty of Economics, Thammasat University, the main organizer of the conference, in allowing the Bank of Thailand to co-host the event. Our appreciation also goes to the distinguished scholars who came from all over the world to share with us their perspectives on this important topic.

To many of us here, especially those in the Asian region, the 1997 financial crisis has completely changed our lives. It was, in a way, a sharp reversal of fortune when suddenly things that were thought to be good before the crisis became no longer good enough. And terms like 'restructuring' and 'reforms' have then become something of a norm. This long and tiresome journey has now lasted for more than five years, and naturally begs a question, "when are we going to get out of this abyss?" This question is particularly pertinent to Thailand. After all, the Asian crisis started here.

To provide a starting point in answering this question, I would like to share with you tonight some of our views on the current state of the Thai economy, where we are, where are we heading, and most importantly, what we see as the key ingredients for sustaining Thailand's economic growth.

Ladies and Gentlemen,

At the height of the Thai crisis, Thailand's nominal per capita GDP in dollar term fell by more than 30% according to a World Bank estimate while financial restructuring costs have exceeded 30% of GDP, and capital flows reversals surpassed the 60% of GDP mark. Given such a depth and breadth of the crisis, the current momentum of recovery does suggest that Thailand has indeed come a long way. This view is increasingly shared by the market, including major credit rating agencies, with some analysts concluding that perhaps Thailand has more or less turned the corner. The extent to which Thailand has elevated from the crisis of 1997 is probably best illustrated by the latest macroeconomic performance and data.

Thailand's GDP growth in the first half of this year is a testament to the strength in the current recovery. The economy expanded by 5.1% in the second quarter after a robust 3.9% in the first quarter. In level terms, real GDP has now exceeded its pre-crisis level. And according to the latest incoming data, the economy in the third quarter looks to remain quite robust as well.

Thailand's better performance this year, notwithstanding a lackluster global economy, has been supported by the strong momentum in both domestic demand and exports. Front-loaded fiscal measure sparked up the initial momentum in domestic demand, while private consumption and investment are now adding firmly to the growth process. As the regional economies began to recover in the last five months, export growth has also provided an additional impetus to the recovery.

Along with this recovery, inflation remains subdued, credit growth has turned positive, and business profits are improving, encouraging firms to expand their capacities through new investment. These broad movements are indicative of a positive dynamic linked to the current recovery.

The most significant improvement since the crisis, however, has been the strengthening of external stability. Continued current account surpluses have allowed external debt to run down in concomitant with a build-up of international reserves. The coverage ratio of reserve to short-term debt has risen to 290% in July 2002, four times the ratio at the end of 1997.

Ladies and Gentlemen,

Although I share the view that the worst may now be behind us, I believe Thailand still has some way to go. The key question is how can we make it last, especially now that the global economic recovery may be somewhat slower than earlier anticipated? The answer to this question probably lies in the answers to yet another important question: what have we learnt from the recent crisis?

For Thailand to prosper in the future, we can no longer rely on the old way of doing business or, for policymakers, the old way of running the economy. We need a different and more effective paradigm that will not only sustain the current growth momentum but also helped the country meets future challenges.

Putting the crisis under microscope reveals critical flaws that beg for new approaches and strategies in all of the four major areas: (1) the real sector, (2) the financial sector, (3) the issue of governance, and (4) the macroeconomic framework.

In many respects, these lessons are neither limited to Thailand nor unique to the recent crisis. The challenge is perhaps how to put them into the context of rapidly evolving global and regional economies.

Let me start with the real sector.

For a brief period in the early 1990s, it seemed that everything was going well. Everywhere one turned, businesses were booming. Demand seemed to always outpace supply. And on top of all that, Thailand was just named Asia's fifth economic tiger. Little did everyone know, however, that the spectacular economic performance masked certain structural weaknesses in some part of the real sector. As it now becomes all too clear, parts of Thailand's real sector prior to the crisis were characterized by low productivity and high leverage.

With the benefits of hindsight, Thailand's past rapid growth could be attributed primarily to quantity, that is, the mobilization of capital, labor, and natural resources, rather than quality. During decades of spectacular growth, total factor productivity or TFP rose only modestly. Overtime, Thailand's inability to further move up the quality ladder, after it graduated from a low-labor-cost production- base status, gradually led to the erosion of our export competitiveness.

In relation to the attitude towards risk, Thailand's use of leverage, being among the highest in Asia, put the country in a vulnerable position to potential adverse shocks. When the crisis hit in 1997, many companies thus found themselves in desperate straits to service their debt, eventually leading up to a major collapse of the real economy.

While these weaknesses have been and are being addressed since the crisis, these measures take time to become fully effective. In the meantime, these shortcomings have been accentuated by the recent change in global competitive landscape brought about by China's WTO accession. Thailand, like many other countries, will need to reposition itself quickly to meet this new global challenge.

Stepping beyond the realm of the real sector, another expensive lesson learnt during the crisis is that the world financial markets have become extremely slippery. As today's financial world becomes increasingly interconnected, disturbances in one market can quickly spread to others with devastating results. These merciless and indiscriminating financial storms therefore need to be guarded against around the clock, with an early warning system developed to help protect all those involved.

Looking back over the past ten years, the Thai financial sector has changed considerably. The financial liberalization trend prodded along by the Bank of Thailand not only expanded the size and the scope of the sector, but also made it become more open.

The government's ultimate purpose of the liberalization was to provide domestic investors access to foreign funds so that Thailand could transform itself into a true industrialized economy. Unfortunately, the opening up of the financial sector left the country in an uncharted territory.

Confidence in the Thai economy back then meant easy offshore money for everybody with foreign market access. Encouraged by the fixed exchange rate, Thai financial institutions, like many other Thai corporates, borrowed freely and imprudently from abroad. And in pursuit of quick profit, many of these foreign borrowings were converted into baht loans without proper currency hedging.

Exacerbating the problem was the fact that many of the domestic loans went into real estate deals, rather than into productive investments. A property price bubble ensued, and the Thai financial institutions, lacking the necessary credit skills, accepted inflated property values as the basis for new loans. These pyramid-like financing schemes placed a serious strain on the system, and their eventual collapse resulted in a flood of non-performing loans for the unwary lenders.

Admittedly, the Bank of Thailand also shares the blame of what went wrong in the financial sector. Although the liberalization policy was probably correct given the circumstances, its potential benefits were undermined by the lack of strong institutional underpinnings. The existing regulatory framework was simply inadequate to detect and prevent the brewing problems. At one level, inadequate follow-up framework made it difficult to track where the funds were going. But the heart of the problem lay in the loose supervision and examination system in place. Regulatory waivers were common. And the culture evolved to one that encouraged or condoned excessive risk-taking behavior.

Compounding the problem were Thailand's underdeveloped capital markets. The absence of what Alan Greenspan termed a "spare tire" of finance made bank lending the dominant source of corporate financing. Consequently, viable businesses were trapped in the breaking down of the banking sector's intermediary role with no way out, and the crisis spiraled into a devastating credit crunch.

The most significant implication drawn from this lesson is thus a strong financial sector is essential for a country to sail through financial storms. It is perhaps not a coincidence that Singapore and Hong Kong fared better than many other Asian countries during the 1997 crisis, for their financial systems were, and still are, relatively deeper than the rest. A strong financial sector serves as an absorber for external shocks while a weak and inefficient financial sector aggravates the depth of the problem and prolongs the recovery process.

Beyond the "hardware" of the physical and financial infrastructure, the "software" of the ethical issues governing the running of the system is also critical. Tales of businesses being endowed with extraordinary treatments from bankers through their cross-holding relationship are probably still fresh in everyone's mind. Like in most other crisis-affected Asian countries, these relationships played a critical role in the evolution of the crisis in Thailand.

The problem of weak governance is not limited to the private sector, however. Regarding monetary policy, a post-crisis survey of stakeholders, consisting of domestic and foreign institutions, government agencies, as well as the general public, revealed that the BOT was also perceived to be plagued with several weaknesses: lack of good leaders, lack of experiences, and lack of transparency.

Finally, in the macroeconomic framework as a whole, it is probably obvious from the experiences leading up to the crisis that high growth cannot be reached and sustained in the absence of consistent government economic policies.

The most striking example here is the combination of the fixed exchange rate and the financial liberalization policy, which inherently led to underestimation of exchange rate risks. In the end, market stability that the fixed exchange rate regime was intended to foster was undermined by market-driven foreign borrowings.

The lesson for Thailand as well as for other emerging economies is that the authorities must regularly review their policy stances in the drive to keep up with changing financial environments. A move towards liberalization, for example, should be examined carefully in the light of the public sector's capability in stabilization and whether there is sufficient infrastructure in place to support the regime shift.

Finally, the crisis reminds us the importance of monetary and fiscal policy coordination. More conservative fiscal policy would have done what monetary policy could not accomplish; namely, to cool down the overheated economy.

Ladies and Gentlemen,

These lessons have been expensive ones. Thailand, as a nation, has spent the last five years dealing with the problem with some severe hardship and grave consequences. Although it is probably safe to say that the height of the problems is now behind us, we still face an enormous uphill battle. A new set of challenges seems to emerge everyday, some with very important repercussions on the Thai economy. Here, what spring to my mind are the delay in the global economic recovery and China's WTO entry already mentioned, as well as the current global equity slump. This is just to name a few.

To prepare Thailand for these future challenges, we need to get the fundamentals right on all of the four areas that I have just discussed. In brief, we need to raise productivity in the real sector, rebuild our financial infrastructure, instill the value of good governance in both the private and public sectors, and develop a comprehensive macroeconomic strategy.

Needless to say, comprehensive real sector reform is at the core of the new paradigm for sustainable growth. And this requires a carefully planned national agenda. In essence, Thailand needs to distinguish itself quickly in the fast-evolving global competitive landscape. As global competition intensifies, Thailand can neither simply keep growing on the back of capital accumulation nor dwell on massive production of low value-added goods. Desirable product features such as high quality and consistency are needed to sustain export competitiveness, and to maintain linkage to the global arena with clear focus on market awareness and adaptability.

Recently, there have been positive signs in some industries such as jewelry, garments, and food, where production technology has been upgraded to increase competitiveness of these industries and to move them up the value chain. Unfortunately, while such developments are encouraging, they have not been adequately spread out to other industries.

By the time these adjustments are completed, it may have been too late, probably rendering losses in a number of industries.

What we need **now** is a national agenda that comprehensively looks at competitiveness of all parts of the real sector. Industries that can no longer compete in the world market will have to be gradually phased out. Other industries that depict competitive edge and growth potential in the global arena will warrant further plans to upgrade technology, increase added values, and develop marketing strategies. These plans will have to be implemented through a concerted national effort so as to ensure better resource allocation along with greater value creation.

Reforming the real sector would however need to be complemented by strengthening of the financial sector. A notable example of such a strategy is the establishment of the Thai Asset Management Corporation or TAMC. The TAMC was set up to reduce distressed assets in the banking system through centralization of NPLs management. TAMC's ultimate goal goes beyond the partial clean up banks' balance sheets. It is hoped that doing so would enable banks to resume their normal lending activity and get the entire economy going strongly again. Nevertheless, as great goals alone do not automatically translate into successful results. the eventual impact of TAMC on the current recovery will depend crucially on the performance of its management.

Still, the effort to nurture our banking system back to its normal health has already started to bear some fruit. Profitability of the banking system is improving and the recent credit upgrade of major banks confirms that we are proceeding on the right track.

This of course does not mean that all is well. There are still weak points in the system. But at least, we know where they are and we are working hard to tackle them.

With respect to financial institution stability, the authorities' strategy was to bring the infrastructures of the Thai financial system up to international standards. Among the measures taken are the introduction of strict provision requirements. the steps to the establishment of the Deposit Insurance Agency, and the tightening of the Bank of Thailand's supervision and examination framework.

To improve oversight, the Bank of Thailand has also adopted a policy in line with the new BIS Capital Accord, emphasizing the importance of systemic stability and efficient risk management.

In an effort to further modernize our financial system, the Bank of Thailand, in cooperation with stakeholders and representatives from the SEC and the Department of Insurance, is in the process of drafting the country's first Financial Sector Master Plan. Scheduled to be implemented in 2003-2012, the Master Plan is intended to increase competition within the Thai financial systems and at the same time to improve the soundness of the system as a whole.

The preliminary vision for the future of commercial banking and financial services in Thailand given by a high-level steering committee comprises three pillars – accessibility and availability of financial services for all potential users nationwide; a competitive and efficient financial system; and finally fairness for all customers.

This preliminary vision of the Master Plan reflects our changing perception of the country's new financial architecture. As there are already two Asian financial centers in Hong Kong and Singapore, there is no point to try to be the third one. Instead, what Thailand needs is probably a more customer-oriented financial sector with efficient operation and minimum systemic risk.

The extent to which Thailand's financial service landscape is going to change from today will depend on the results and recommendations of an ongoing study. What I can tell you now is that whatever the final outcome will be, for Thailand, this is a change to rectify past shortcomings for the better.

As we are drafting our Financial Sector Master Plan, the SET is working tirelessly on its Capital Market Master Plan. The SET plan tackles another important problem, namely the underdevelopment of Thailand's capital markets. If its implementation is successful, Thailand will have a balanced and diversified financial system that is more robust and stable than the one today.

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GLOBALIZATION AND THAI ECONOMIC REFORMS

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A paper presented at
the International Conference on Economic Recovery and Reforms
28-29 October 2002
Faculty of Economics, Thammasat University
Bangkok, Thailand

ABSTRACT

Globalization has been widely discussed and commonly characterized by free international commodity and capital movement and weakening trade barriers. This results in intensified international competition, shorter product life cycles and large and rapid international capital and commodity movements. The Washington Consensus as the free-market economic reform programme is seen in the globalization context as the ideological summary of the neo-liberalist nature of the ongoing globalization.

A study of policy programme followed by the Thai authorities from the late 1980s leading up to the Thai economic crisis in 1997 refutes the claims by some critics that the Washington Consensus was the most important cause of the crisis. The pre-1997 financial and foreign exchange control liberalization was in essence the liberalization of foreign borrowing under government guarantee of zero foreign exchange rate risk and the Bank of Thailand's guarantee of no financial institution failure. All these were undertaken under weak financial supervision and regulation while a large part of the Thai financial system and Thai corporations were still characterized by family connections, patronism, as well as protection and favour from the state, politicians and bureaucrats, thus resulting in high costs, low efficiency, lack of competitiveness and prudent business operations. Such policy programme was a far cry from the free-market reform programme. Thailand must learn from its lessons in the 1997 crisis and implement an overall structural reform programme further to liberalize the economy and its trade regime in order to achieve an economic recovery and sustainable economic growth in the long run.

This article points to future studies on Thailand's post-1997 economic reform programme. There are still other questions for further policy research such as the inadequacy of the market-oriented reform programme adopted by the Democrat-led government during 1998-2000, the political and economic implications of the

various "restructuring measures" implemented by the Thai Rak Thai government since early 2001, and the nature and implications of the village-based development strategy advocated by a number of Thai conservative scholars.

1. Globalization as a New International Economic Order

The term "globalization" has become commonplace in the media and academic circle. However, the meaning of the term is somewhat unfocused, covering a shade of activities, phenomena and stylized facts. In the media, globalization is related to information technology, the Internet, international propagation of Western lifestyles, fashions, consumerism and Americanism. In economics, globalization is seen in the context of increases in international commodity and capital flows, lower trade barriers, intensified international competition, lower transaction costs (that is, lower information and monitoring costs) due to revolution in information technology and increases in computing power, and most importantly, the retreat of the State from economic activity.

In order to develop fruitful study of globalization in economics terms, the defining feature or the key element of globalization must be figured out and used as the basis of discussion and analysis. Among all the elements discussed in the media, newspaper and magazine articles, and academic essays, free international commodity and capital movement is the most important and the most basic of all. This key element implies lower trade and investment barriers, revolution in information technology and lowering transaction costs, and results in intensifying international competition and weakening state intervention. It also implies institutional changes and cultural and political characteristics of globalization, all of which can be considered both consequences and accelerators of free commodity and capital movement.

Moreover, globalization must be seen as an ongoing development process, not as a ready-made regime or an outcome already in existence. It must also be considered a contradictory phenomenon in which quite a large number of governments and social groups around the world still try to resist or to delay its progress. So there are the majority countries of Europe, North America and Oceania which champion and facilitate free-market reforms and also a number of countries in the extreme opposite end such as North Korea, the Taliban's Afghanistan, Iraq and Iran, while the majority of countries in Asia, Africa and South America lie in between with diverse responses, adjustments and even resistances. While globalization has made significant progress in most parts of the world, there are a large number of areas in which globalization has made little progress or has been successfully resisted. Thus, the approach to globalization study is to adopt a realist position which regards a situation in a given economy as moving and fluid. Globalization both on the world scale and in a given country is seen as a contradictory process whose positive effects are welcome and encouraged and whose negative effects must be openly admitted and analysed. On the other hand, normative judgements and recommendations can still be made as regards appropriate strategy to encourage positive aspects of globalization and counter-measures to alleviate its negative aspects.

Thomas L. Friedman was probably the only writer who comprehensively discussed all aspects of globalization, covering economics, sociology, internal and international politics, environment, and corporate management. According to Friedman (2000), the meaning of globalization can be summarized in one word: integration. However, globalization covers comprehensive, both international and domestic, grounds. Friedman (2000) identifies the following characteristics of such integration:

- Free-market capitalism;
- Deregulation and privatization;
- Cultural homogenization, mainly Americanism;
- information and telecommunication revolution;
- Constant innovation and Schumpeterian "creative destruction";
- Uncertainty, upheaval in the markets;
- Rapid urbanization and cosmopolitanism.

Friedman (2000) treats globalization as "a system" in contrast with the "Cold War system". He regards the period of 1917-1989 socialist experiment as the age of trade barriers, protection, lack of competition and the predominant role of the State in the economy. The 1947-1989 period was the Cold War system proper in which all anti-market elements settled down and became ossified on both sides of the political groups. According to Friedman (2000), even capitalist countries during the Cold War period were also characterized by relatively high degrees of trade barriers, protectionism, welfare states, bi-lateral bargaining in employment, etc. A shift occurred when Thatcherism arose in 1979, followed by Reaganomics in the 1980s and the collapses of social democratic governments in most Western European countries, culminating in the fall of the Berlin wall in 1989. However, what happened was actually not the triumph of capitalism over communism but the triumph of the market over state controls.

Although Friedman (2000) comprehensively elucidates all aspects of globalization, his characterization does not focus on particular aspects, and, most of all, on central issues in the globalization system. He correctly specifies free-market competition combined with information and telecommunication revolution as the basis and impetus behind the surge of economic, social and cultural integration. He even identifies both short-term and long-term international capital (or what he calls "the electronic herds") as a primer mover of globalization. However, his discussion of the linkages from international capital and commodity movement to other aspects of globalization is somewhat unfocused.

Amoroso (1998) presents more concentrated perspectives on globalization along a Marxian-sociological line. The specific pattern of capital accumulation under globalization and its impact on international capital and trade movements are discussed clearly. Amoroso sees globalization as a new stage of capital accumulation in what he calls "triad capitalism" which is identified as the triangle of the US, EU and Japanese capitalist economies. Thus, " globalization is the means being used to control the market and available resources so as to increment worldwide profit" (Amoroso, 1998, p.52). For Amoroso, globalization is characterized as:

- Concentration of economic power in triad capitalism, of which the core consists of 37,000 transnational corporations (TNCs) that control over 200,000 affiliates throughout the world;
- The decline of national capitalism in which investment, employment, output, demand patterns, technology and industrial relations are determined and de-stabilized by TNCs;
- An upswing in foreign direct investment (FDI) in which both the provenance and recipients of FDI are represented by TNCs in triad capitalism;
- The sharp decline of the share of third world countries in worldwide FDI;
- The destabilization and deligitimization of political system in the third world countries in which governments lose their independent policy-making power and government action becomes a mere function of objectives laid down by TNCs;
- Concentration of world trade in triad capitalist economies;
- The trend towards a divorce between economic growth and employment, i.e., high economic growth is no longer accompanied by high employment of labour;
- The delinkage between nations and national corporations, and widespread transnationalization of TNCs beyond triad capitalist economies (that is, TNCs' link with their mother countries has considerably weakened and has been replaced by joint ventures and partnerships among TNCs themselves;
- Horizontal decentralization of production in which each product is broken down into components, each of which can be manufactured in different geographical areas chosen for the relative advantages each offers;

- The production decentralization made possible by the new system of data transmission and remote production control, the passive subordination of different production units and workers in different sectors, and firm control of government systems through de-stabilization pressure.

Amoroso's discussion of globalization is more focused than Friedman (2000). Amoroso utilizes the Marxian concept of "social formation" which is defined as the totality of the economic-base activity and non-economic structures. So he is able to pinpoint the key feature of globalization as the new stage of capital accumulation within the global capitalist social formation. However, Amoroso seems to have been influenced by the centre-periphery division of the Dependency school. So his discussion is centred around the worsening disparity of capital flow, investment, employments, growth and income distribution between triad capitalism and third-world countries.

Amoroso thus fails to see the overall pattern and impacts of globalization on global capitalism as a whole. He sees triad capitalism and its TNCs as the sole agents who benefit from the new accumulation pattern while third-world countries lose out. He does not see globalization as both a new stage and new constraints on TNCs themselves who also have to adjust their production, distribution and marketing strategies to intensified international competition and world-scale accumulation among themselves. TNCs and governments of triad capitalism must also go through restructuring and reform processes in the late 1980s and early 1990s with large-scale bankruptcy of enterprises, high unemployment, low growth or even severe recession which precipitated changes in government policies to the free-market stance. In such adjustment process, even capitalist groups in developed countries which failed to reform themselves also died out.

Dominique (1999) discusses the linkage from the ideological resurgence of neo-liberalism and free-market doctrinaire in the 1980s to globalization of the 1990s and finally to its economic consequences in growth, employment, and income distribution in both developed and developing countries. Dominique analyses the new stage in economic theory since 1980s and the consequent emergence of the new free-market orthodoxy which has been adopted by governments, international organizations and corporations around the globe. Dominique sees such economic orthodoxy as consisting of globalization, downsizing and restructuring (GD&R) (Dominique, 1999, pp. 92-96). Specifically, globalization is characterized by the following:

- Trade liberalization;
- Deregulation of international capital flows to allow investors to be free to seize on investment prospect on the world scale;
- The time horizon of international capital having been shortened considerably with a stronger focus on short-term profits;
- Rapid capital movements facilitated by developments in financial information and communications technology;
- Borrowers, lenders and speculators' ability to by-pass domestic authorities and local securities houses and to have direct access to diverse, customized financial products and capital markets around the world;
- Pressure on governments to pursue investor-friendly policies with the least state interventions and the most free-trade regimes;
- Transnational corporations' freedom to relocate production and services in any free zone around the world;
- Surges of considerable direct foreign investment, huge capital flows, and tidal world trade volumes;
- Stronger possibility of decision errors in production to reverberate and become a disaster in the financial side of the world economy in the absence of appropriate regulations;
- Downsizing and restructuring (D&R) of government as an adjunct to globalization, i.e., to reduce the size of the government in the macroeconomy and to restructure its functions to strictly legal and

facilitative roles and to the cases of externalities, public goods and increasing returns to scale (EPI).

As in Friedman (2000), Dominique's characterization of globalization is somewhat unfocused. This is because his main attention is to analyse the free-market doctrination and its unproven scientificity rather than the new pattern and central issue of economic growth and capital accumulation itself. Consequently, the weight of discussion is laid on the link to the free-market orthodoxy, to economic reform programmes and finally to their detrimental social and economic consequences. Globalization is thus seen as a linkage rather than the central subject of analysis by itself.

Kim (2000b) discusses the debate between what he labels as the hyper-globalization and globaloney schools on the significance and impacts of globalization. The former consists of neo-liberal proponents who herald "the emergence of truly open and integrated global economy, the rise of a new post-Westphalian global order, and the functional demise of the state system" (Kim, 2000b, p.3) while the latter consists of neo-realist and neo-mercantile opponents who see nothing substantially new in globalization as against the traditional international economic order before the 1990s.

The hyperglobalization school includes, among many others, Ohmae (1990), Reich (1992) and Strange (1995; 1996). They sees the globalization process as encompassing the following:

- Social and economic processes function at a mainly global level, and nation-states are no longer decision-makers but decision-takers;
- World-scale competition has shifted from states competing for control over territory and wealth-creating resources to multi-national corporations (MNCs) competing for control over global markets and investment opportunities;

- Authority has devolved from states to MNCs and other international associations whose power has other sources;
- Economics increasingly takes precedence over and dictates the course of politics;
- National economies are immersed in and perforated by transnational forces and actors that dilute differences between and among nation-states;
- MNCs have become truly global, shifting production sites to anywhere around the globe in response to changes in local conditions.

On the other hand, the globaloney school consists of diverse political, methodological and normative orientations but can be categorized into the neo-realists and the populist-resistance skeptics. This broad globalization opponents includes such writers as Rodrik (1997), Bello (1999), Beinart (1997) and Hirst and Thompson (1996). The neo-realists see no difference between the pre-1990s and the post-1990s international economic order and still contend that the State is as still powerful as before. By contrast, the populist-resistance skeptics accept that globalization is a new and significant world phenomenon. However, they see globalization is a serious threat to social stability, state sovereignty, national and cultural identity and environmental protection. Naturally, this group also includes those writers of the dependency school of thought.

Kim (2000b) criticizes both the hyperglobalization and globaloney schools as adopting extreme conception of globalization. They see globalization as either an ideal structure which has already occurred or a given set of threats against national economies. By contrast, Kim defines globalization as an ongoing process, or a continuum between the autarky on the one hand and the fully-open economy on the other, that is, as:

> a series of complex, independent yet interrelated processes of stretching, intensifying, and accelerating worldwide interconnectedness in all aspects of human relations and

> transactions --- economic, social, cultural, environmental, political, diplomatic, and security --- such that events, decisions, and activities in one part of the world have immediate consequences for individuals, groups, and states in other parts of the world (Kim, 2000b, p.10).

According to Kim (2000b), globalization is a boundary-expanding or boundary-penetrating process, intensifying the levels of interaction and interconnectedness within and among states and societies. The boundary-expanding process has been accompanied by the rapid advances and broader coverage of communications facilities, economic and social interests, and overseas markets, all these of which in turn foster even more intensifying globalization.

Kim is correct in seeing globalization as a process, not an outcome already in existence. If globalization is seen as an existing state of affairs, one is bound to see many elements contradicting the ideal state of globalization, such as widespread state regulation and intervention in the economy and the prevalent trade and non-trade barriers still in existence, hence, the tendency to deny the significance of globalization on the ongoing socio-economic changes.

This view is in accordance with Lindsey (2002) who argues forcefully that the notion of globalization already successfully conquering the world economy is misleading and harmful. When globalization is believed to have successfully dominated the world economy, globalization will also be blamed for all kinds of economic, social and environmental problems in modern days, thus giving undue justifications to anti-globalization activism. Conversely, Lindsey correctly argues that social and economic woes often attributed to globalization and free-market capitalism are actually the results of the "dead hand", i.e., government intervention and state activity in the economic realm. Pervasive government intervention, state enterprises and crony businesses all over the world have resulted in weak private property rights, inadequate or non-existent law enforcement, poor information disclosure, inadequate and ineffective environment protection laws, corrupt politicians and bureaucrats, and never-ending court procedures, have all contributed to most of the social and economic ills, from corruption, frauds, environmental destruction, women and children exploitation and so forth.

As several writers have pointed out, the 1990s is not the first time in which the world economy witnessed the phenomenon of relatively free international trade and capital movements. The period from the mid-nineteenth century up to the First World War was actually the "first era" of globalization in which the world economy developed and expanded in a similar fashion. Although the volume of trade and capital movements and the geographical regions involved in this first-round globalization were incomparably smaller than the modern-day version, the pattern was remarkably similar to what we have had since the 1990s. At that time, international trade and investment was boosted by innovations of steamships and revolution in transportation such as railways expansion, ocean steamships and automobiles, which lowered transport costs and made long-distance trade and investment possible, while newspapers, telegraph and telephones lowered information cost and facilitated both more rapid adjustment to market disturbances and negative repercussions from malfunctions such as speculation in asset prices. The Great Britain was the global power as is by the US nowadays. Government interventions were weak, given the international gold standard and the resulting price stability and low inflation.

The first era of globalization came to an end with the First World War, followed by a long counter-market period during which nations experimented with non-market alternatives such as fascism, socialism, Keynesianism and welfare-states in developed countries, and various versions of "socialism" and state-guiding development strategies in developing world. Finally, upheavals in developed economies during the 1970s-1980s brought down Keynesianism and welfare states while socialism collapsed in the late 1980s and early 1990s, followed by the Asian crisis in 1997. These put an end to the counter-market period of much of the twentieth century whereby the second ear of globalization emerged.

Interestingly, one of the best observations of the first-round globalization which is also very well applicable to the modern-day globalization and free-market capitalism was made by Marx in his *Manifesto of the Communist Party* written in 1847. Marx (1973) was probably the first one who vividly described the first globalization process around the mid-nineteenth century:

> [T]he markets kept ever growing, the demand ever rising. Even manufacture no longer sufficed. Thereupon, steam and machinery revolutionised industrial production. The place of manufacture was taken by the giant, Modern Industry, the place of the industrial middle class, by industrial millionaires, the leaders of whole industrial armies, the modern bourgeois.
>
> Modern industry has established the world-market ... This market has given an immense development to commerce, to navigation, to communication by land. This development has, in turn, reacted on the extension of industry; and in proportion as industry, commerce, navigation, railways extended, in the same proportion the bourgeois developed, increased its capital, and pushed into the background every class handed down from the Middle Ages (Marx, 1973, p.110).

Marx also took notice of the effect of free trade and investment on the homogenization of culture and consumption patterns in every corner of the globe. Thus, the following passages can still be applied to the modern-day capitalism very well:

> The need of a constantly expanding market for its products chases the bourgeoisie over the whole surface of the globe. It must nestle everywhere, settle everywhere, establish connexions everywhere.
>
> The bourgeoisie has through its exploitation of the world-market given a cosmopolitan character to production and consumption in every country. ... All old-established national industries have been destroyed or are daily being destroyed. They are dislodged by new industries, whose introduction becomes a life and death question for all civilised nations, by industries that no longer work up indigenous raw material, but raw material drawn from the remotest zones; industries whose products are consumed, not only at home, but in every quarter of the globe. In place of the old wants, satisfied by the productions of the country, we find new wants, requiring for their satisfaction the products of distant lands, and climes. In place of the old local and national seclusion and self-sufficiency, we have intercourse in every direction, universal inter-dependence of nations. And as in material, so also in intellectual production. The intellectual creations of individual nations become common property. National one-sidedness and narrow-mindedness become more and more impossible, and from the numerous national and local literatures, there arises a world literature (Marx, 1973, p.112).

Marx well understood the pressure of capitalism on backward countries. Free trade and investment coupled with politico-economic and military power of developed countries represented a serious threat which forced developing nations to open up and to modernize their societies and economies:

> The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communication, draws all, even the most barbarian, nations into civilisation. The

> cheap prices of its commodities are the heavy artillery with which it batters down all Chinese walls, with which it forces the barbarians' intensely obstinate hatred of foreigners to capitulate. It compels all nations, on pain of extinction, to adopt the bourgeois mode of production; it compels them to introduce what it calls civilisation into their midst, i.e., to become bourgeois themselves. In one word, it creates a world after its own image.
>
> The bourgeoisie has subjected the country to the rule of the towns. It has created enormous cities, has greatly increased the urban population as compared with the rural, and has thus rescued a considerable part of the population from the idiocy of rural life. Just as it has made the country dependent on the towns, so it has made barbarian and semi-barbarian countries dependent on the civilised ones, nations of peasants on nations of bourgeois, the East on the West (Marx, 1973, p.112).

Finally, Marx clearly saw technical progress and innovation as the hallmark of the capitalist mode of production, thus giving capitalism its unique characteristics unseen before in previous modes of production:

> The bourgeoisie cannot exist without constantly revolutionising the instruments of production, and thereby the relations of production, and with them the whole relations of society. Conservation of the old modes of production in unaltered form, was, on the contrary, the first condition of existence for all earlier industrial classes. Constant revolutionising of production, uninterrupted disturbance of all social conditions, everlasting uncertainty and agitation distinguish the bourgeois epoch from all earlier ones. All fixed, fast-frozen relations, with their train of ancient and venerable prejudices and opinions, are swept away, all new-formed ones become antiquated

> before they can ossify. All that is solid melts into air, all that is holy is profaned, and man is at last compelled to face with sober senses, his real conditions of life, and his relations with his kind (Marx, 1973, p.112).

2. The Washington Consensus in Context

The doctrine of free market capitalism has been discussed and propagated for several hundred years, at least since the Physiocracy before Adam Smith. However, the whole ideological apparatus received full theoretical formulations and "scientific" presentations only after the neoclassical revolution in the late nineteenth century with the synthesis of Marshall and Walras. Despite the dominance of neoclassical theory in economic teachings for much of the twentieth century, the neoclassical recommendations on public policy had not been received systematic formulations as systemic reforms until the 1980s.

It is a general belief that the first known attempt to implement a comprehensive reform along the free-market capitalist agenda was made in Chile and New Zealand in the early 1980s. However, with hindsight, the first real experiment with free-market economic reform was actually made in the late 1970s by the Thatcher government in the UK and in the early 1980s by the Reagan Administration in the US in what is known as "monetarist experiments" and "supply-side economics". This coincided with the period of business administration hypes on "re-engineering" and "downsizing" in the business sector in the US. As already known, the US went through a severe recession with large-scale bankruptcy. A large section of traditional industries in the US died out. These were concomitant with the onset of information revolution, telecommunications advancement, the surge in computing power and, finally, the spread of the Internet to the general public and the business sector and the rise of e-commerce. The structural adjustments in the US lasted until the mid-1990s when the Clinton Administration and the Congress reached agreements to eliminate the fiscal deficit and, thus, significantly to reduce the size and the role of the government in the US economy.

The first known attempt outside the US and the UK to implement a comprehensive reform along the free-market capitalist agenda was made by Pinochet's government of Chile in 1982. The reforms began in price liberalization and the abolishment of subsidies in agriculture, followed by the public sector reform aiming at reducing the size and the roles of the government in distributing transfers to the household sector, along with the privatization of the social security programme. Although Chile experienced high economic growth and low inflation from the mid-1980s to 1994, other negative effects have been identified such as worsening distribution of income, increased pollution.

New Zealand was known to be the next country which followed a similar reform programme in 1984. Agricultural subsidies and supports were abolished while the financial system was liberalized during 1984-1987, followed by a wave of state enterprise privatization during 1987-1990. Social transfer programmes such as unemployment benefits, pensions, health cares, education and family supports were severely curtailed or even abolished. The result has been the decline in the current account deficit, a falling government fiscal deficit, lower net public debt, and relatively low inflation. Again, negative results have been relatively high unemployment, worsening distribution of income and weaker social safety nets.

The reforms carried out in Chile and New Zealand in the 1980s and early 1990s clearly followed a similar set of doctrine advised by their economic advisors and such international financial establishments as the International Monetary Fund (IMF) and the World Bank. The experience from Chile has been extended to Mexico, Latin America and the Caribbean in the late 1980s. Those countries involved in the debt crisis of the 1980s also obligingly followed the reform as parts of the remedy package required by the IMF and their creditor countries. Financial liberalization in the 1980s in these countries was followed by tight fiscal discipline, exchange rate stabilization and waves of privatization in the early 1990s.

Africa saw the arrival of the free-market reform agenda in selected countries in 1987. By the early 1990s, a large number of African countries were following a similar policy prescription aiming at reduction of public debt, cuts on social expenditures and social safety nets, privatization of state enterprises and export promotion. The first half of the 1990s saw the application of a similar prescription in Asia and Eastern Europe.

Such reform agenda began to receive doctrinal systematization in the early 1990s in the form of explicit policy prescriptions for countries with problems of high debt levels, the productivity growth slowdown, unemployment, inflation, inefficient and non-competitive industrial structures, and structural macroeconomic imbalances resulting from over-regulations, rent-seeking and economic intervention by the government (Krueger, 1992; 1993).

The structural adjustment along the free-market line consists of four pillars of reform policy:

- Macroeconomic stabilization;
- Trade liberalization;
- Privatization;
- Deregulation.

Williamson (1994) was probably the first who systematically described a comprehensive set of policy prescriptions he labelled "the Washington Consensus" as follows:

- Fiscal discipline;

- Redistribution of public expenditure priorities towards health, education and infrastructure;
- Tax reform including the broadening of the tax base and cutting marginal tax rates;
- Uniform and competitive exchange rates;
- Secure property rights;
- Deregulation;
- Trade liberalization;
- Privatization;
- Elimination of barriers to direct foreign investment;
- Financial liberalization.

Furthermore, financial liberalization is characterized by six policy measures (Williamson and Mahar, 1998, p.2):

- Elimination of credit controls;
- Deregulation of interest rates;
- Free entry into the banking sector or the financial services industry;
- Bank autonomy;
- Private ownership of banks;
- Liberalization of international capital flows.

Noticeably, the Washington Consensus still requires the role of the State in the economy. The provision of public health, education and infrastructure is still regarded as one necessary involvement by the State. However, the function of the State is clearly geared towards facilitation of market function, such as property rights, the maintenance of the appropriate exchange rate regime, and its ideological commitment to trade, investment and financial liberalization.

Dominique (1999) critically analyses and challenges the overtones of "scientificity" of free-market orthodoxy. He strongly argues that the free-market or neo-liberal policy amounts to beliefs and hype without appropriate theoretical and scientific grounding. According to Dominique (1999, pp. 96-97), globalization, downsizing and restructuring (GD&R) requires a consistent economic reform programmes consisting of three major components:

International integration measures:

- The adoption of competitive exchange rate regimes;
- The opening of national economies to international trade.

Austerity measures:

- Reductions in all government transfers, educational and social protection expenditures;
- Cuts in rights, remuneration and the number of public employees;
- Reductions in public deficits, national debt and inflation.

Market freedom and privatization measures:

- Removal of all market regulations, in particular those affecting the labour and capital markets and capital mobility;
- Reductions of taxes on business incomes, capital gains, and high individual incomes;
- Privatization of public enterprises;
- Privatization of public services, including prisons, post offices, hospitals, among others.

Dominique (1999, pp.99-100) specifies a set of what he calls "tacit proposition" addressed by the new orthodoxy to governments and business enterprises as follows:

Globalization: Propositions to Governments

- Liberate the international financial market.

- Remove all controls and barriers on the international goods and services.

Globalization: Propositions to Multinational Firms and Large Institutional Investors and Speculators

- Lower the costs of production and distribution by any means.
- Minimize tax outlays.
- Be mobile; if a host government does not fully adhere to the new orthodoxy, move.
- Diversity your portfolios and shorten your time horizon.
- Respond quickly to new market developments.

Downsizing and Restructuring: Propositions to Governments

- Liberate the domestic labour market and use the interest rate to control inflation.
- Reduce your debt (domestic and sovereign).
- Disinvest in the domestic economy.
- Remove all regulations, eliminate all transfers, except perhaps to certain big enterprises.

Downsizing and Restructuring: Propositions to Firms

- Depress the wage rate, downsize and replace with part-timers so as to increase short-term profits.
- Become big by mergers and fusions so as to be able to compete internationally.
- Be attentive to shareholders interests at the expenses of employees.

In short, the critical elements in the Washington Consensus consist of free international commodity and capital movement and lowering trade barriers. Other elements, such as secure property rights, fiscal discipline, deregulation and macroeconomic balances, constitute the adjunct to facilitate the realization of free commodity and capital movement.

However, the Washington Consensus is not a simple restatement of the neoclassical free-market orthodoxy. It is a development of such orthodoxy to a highly systematic level when free-market implications of neoclassical theory was transformed into a coherent and comprehensive policy prescription. Such policy programme is regarded a progressive reform agenda suitable to all circumstances of structural inefficiency and low competitiveness, macroeconomic imbalances and widespread moral hazard resulting from monopolies and pervasive government interventions and protection.

The Washington Consensus is different from the textbook implications of neoclassical theory not only in terms of the level of systemization and coherence but also the extent of its acceptance in academic, business and political circles. The free-market reform prescription of the Washington Consensus has become the belief and policy weaponry advocated by organizations and persons of all levels from international agencies, such as the International Monetary Fund, the World Bank and the Asian Development Bank, down to national governments, technocrats in the bureaucracy, research institutes, universities, colleges, schools, multinational corporations, local enterprises, to corporate executives and their employees.

In Thailand, the first scholar who discusses the Washington Consensus and takes to his task to evaluate Thailand's experience and shortfalls in implementing the policy prescription is Somboon Siriprachai (2000). Since then, the Washington Consensus has been discussed in Thailand as a set of policy description, mostly in negative terms ranging from unproven free-market doctrination imported from Western experience to policy conspiracy imposed on Thailand by developed countries (mostly the US).

One damaging accusation against the Washington Consensus is the belief that the crisis in 1997 was a result of Thailand following free-market ideology along the Washington Consensus line. For some, the Washington Consensus has been thus a scapegoat for the blame of the crisis and Thailand's current economic difficulty. Notably, none of the critics, with the exception of Siriprachai (2000), have undertaken serious studies of Thailand's economic policy experience to answer the question of whether Thailand prior to 1997 had followed an adequate and complete set of the Washington Consensus or something different and whether or not the timing and sequencing of reform measures implemented by the authorities were conducive to stabilize the economy in the transition. Therefore, criticism against globalization and the Washington Consensus in Thailand so far must be regarded as severely inadequate and even misinformed at best.

3. Thailand's Pre-1997 Economic Reforms

After a decade of high economic growth and industrialization, Thailand won major international accolades as an emerging Tiger economy during the second half of the 1980s and the first half of the 1990s. However, Thailand's economic fortunes reversed dramatically to the verge of bankruptcy in 1997 and early 1998. The downturn was apparently triggered by a collapse in export growth in 1996, followed in 1997 by capital flights out of the country unseen in the past while the baht had lost over 54% of its value against the US dollar at one point. Thailand has also been blamed for igniting the financial turmoil which escalated to other Southeast and East Asian countries. With many other regional currencies also following the route of the Thai baht, the emergency measures to stabilize the local money and currency markets turned out to be initially ineffective. The hope for a quick economic recovery in Thailand based on stimulation by export growth was also scaled back as other countries in the Asian region also fell into economic recession during 1998-1999.

Although Thailand has always been a relatively open economy since it embarked on modernization in the early 1960s, major restructuring of its economic relations with the international markets only took place after 1986. Prior to the late 1980s, Thailand was not widely known among major international investors and lenders. This was largely due to the lack of any colonial links with the leading developed countries as well as cultural and language barriers. However, with the advent of the globalization era and the sudden discovery of Thailand by the international business and financial community, the Thai economy underwent a highly significant period of transformation through a huge inflow of overseas funds.

First, the openness of the Thai economy increased substantially with external merchandise trade rising from 49.1% of Gross Domestic Product (GDP) during 1980-1989 to as much as 67.8% during 1990-1996. This was much higher than many countries in the region and the world (see Table 1).

Second, the economy has become more industrialized despite the country remaining a net food exporter. Value-added from manufacturing amounted to 35.9% of gross domestic product during 1990-1996 as against 29.2% during 1980-1989 (see Table 2).

Third, net capital inflow into Thailand no longer depended mainly on the need to finance the external merchandise trade deficit. Such inflows were generally above the trade deficit during 1989-1996 as against the levels which were below the deficit before 1989 (see Table 3).

Thailand's ability to attract foreign investors and lenders in the past decade was due in large part to policy measures which were relatively open to foreign participation. The rapid pace of industrialization and openness of the Thai economy also resulted from a deliberate development policy of switching from import substitution to export promotion. Consequently, import tariffs and barriers were gradually reduced during the 1980s and 1990s.

The BOT also undertook to liberalize the financial system during the 1990s. Interest rate ceilings were removed while the exchange controls were eased in the early 1990s (see Table 4). Offshore banking was established under the Bangkok International Banking Facility (BIBF) in September 1992 and the Provincial International Banking Facility (PIBF) in May 1994 while new banking licences were offered to overseas financial institutions in November 1996 and new local players in January 1997.

All of these trade and financial liberalization measures helped promote capital inflows from abroad. However, the missing element in all such liberalization was the necessary safeguards to protect the Thai economy from external shocks and risks. The authorities were in effect promoting external trade and capital inflow without considering their possible negative consequences.

One of the most important mistakes was the BOT's confidence in the currency basket regime which assigned approximately 80% of the weight to the US dollar. Such a exchange regime was actually equivalent to a fixed exchange rate system tying the baht to the US dollar. The mistake became reality when exchange controls were lifted and financial markets liberalized in the early 1990s. In effect, a fixed exchange rate regime coupled with free capital movement was tantamount to the universal guarantee that there would be no foreign exchange risks to traders, investors, lenders and borrowers. However, such foreign exchange risks were actually not eliminated; they were only temporarily hidden and later returned when the guarantee broke down.

Other mistakes included the BOT's commitment to protect local financial institutions from failures, lax supervision of financial institutions, lack of transparency and maintenance of high domestic interest rates, which sometimes were as much as 7%

over those in major international money centres. High interest margins, virtually no exchange rate risk and the BOT's implicit guarantee of local financial institutions encouraged huge short-term fund inflows during 1994-1996 which were used unproductively in large-scale, low-return investment projects, land and stock speculations as well as for consumption.

Net overseas capital inflow, which increased significantly during 1988-1990, continued at an even larger scale in the first half of the 1990s, taking advantage of the high returns to be earned from investing in and lending to Thailand. Domestic interest rates were generally as much as 6-7 percentage points above those of overseas rates. Despite the lifting of domestic interest rate controls, domestic bank deposit rates were maintained at much higher levels than those in overseas markets. This was due to a BOT policy which sought to promote local savings through high bank deposit rates. The BOT also introduced a high interest rate policy in 1995 as a monetary policy measure to slow down the Thai economy from possible overheating. Ironically, such anti-inflationary policy led to the maintenance of high foreign interest rate differentials, which continued to attract short-term fund inflows into the country and further fuelled inflation and overheating of the economy.

Domestic financial institutions also borrowed increasing amounts of short-term funds from overseas as these were cheaper than local deposits while overseas funds also moved into deposit accounts at local commercial banks to gain from the interest rate differentials. The net non-resident baht deposit inflow increased from only US$ 0.4 billion in 1987 to US$ 2.0 billion in 1991, US$ 2.7 billion in 1993 and US$ 3.4 billion or 16.3% of net capital inflow in 1995 while short-term debt shot up substantially from US$ 12.3 billion at the end of 1993 to US$ 41.0 billion at the end of 1995.

Short-term fund inflow stopped abruptly in 1996 when export growth collapsed as a result of the rising strength of the US dollar against the Japanese yen which started in mid-1995. The outflow turned into capital flights in 1997 as the current account deficit worsened and the Thai baht came under attack by international speculators. However, the decline in Thai export growth was actually a long-term phenomenon. Thai exports were already losing their competitiveness from high domestic inflation and rapid increases in wages and salaries. The Thai baht had also depreciated much less than other Asian currencies over the years. The baht lost only 0.1% of its value during January 1990-June 1997 as against 48.9% for China, 26.6% for Indonesia, 24.1% for South Korea, 15.3% for the Philippines and 6.1% for Taiwan (see Table 5).

Thus, Thai exports lost ground against other competitors especially after China's yuan devaluation in January 1994 and Mexico's peso devaluation in December 1994. During August 1995-June 1997, the yen depreciated by 16.5% on average as against the baht. On the other hand, Thai export declined by 0.2% in 1996 as against 23.6% growth in 1995. By contrast, imports surged by 30.5% in 1995 before slowing down to 2.3% in 1996. Consequently, Thailand's current account deficit rose to 8.1% of GDP during 1995-1996 from 7.5% in 1994.

The sharp rise in the current account deficit, the deterioration of export performance and foreign debt of US$ 90.5 billion at the end of 1996 caused alarms among international lenders who immediately called off their loans to Thai businesses and tried to flee Thailand as quickly as possible. The baht also came under international speculative attacks several times during December 1996-May 1997. Mistakenly perceiving the turmoil as a temporary upheaval, the BOT fought against foreign speculators by using foreign exchange reserves built up over many years. It reportedly lost US$ 0.9 billion in official foreign exchange reserves during December 1996. US$ 1.1 billion was lost when the baht again came under attack in February 1997. Finally, US$ 4.0 billion was lost in the May speculative attacks. The BOT also resorted to the currency swap contracts to obtain US dollars in the defence of the baht. US$ 4.75 billion in forward swap contracts had been committed by the BOT by the end of 1996, increasing to US$ 12.2 billion by February 1997 and US$ 25.5 billion by 15 May 1997. With total foreign exchange reserves of US$ 32.4

billion remaining at the end of June 1997 and US$ 400-500 million reportedly flowing out daily, free foreign exchange reserves dropped to no more than US$ 7 billion. The BOT was thus forced to float the Thai baht on 2 July 1997. The baht subsequently went into free fall during the remainder of 1997, dropping from THB 25.84 per US dollar on 30 June 1997 to its historical bottom at THB 55.5 per US dollar on 8 January 1998. High interest rates maintained by the BOT were also ineffective in preventing capital flights and stabilizing the Thai baht as local and overseas confidence evaporated completely.

In addition to exposure to huge foreign debt, the Thai financial system and the economy was also significantly weakened by the financial crisis in 1996-1997. The BOT's failure in handling the Bangkok Bank of Commerce scandal and Finance One Public Co Ltd as well as the suspension of 16 finance companies on 26 June 1997 and another 42 companies on 5 August 1997 led to a complete loss of public confidence in the BOT and the government. A result was deposit runs against Thai financial institutions. Interest rates shot up to excessive levels while liquidity dried up. Finally, Thai financial institutions and corporations with large foreign debt exposure were practically insolvent as a result of the baht floatation on 2 July 1997. The International Monetary Fund's package which required the increase in the value-added tax rate from 7.0% to 10% and a budget surplus also contributed to the worsening of economic conditions. During 1997-1998, Thailand went through its most severe recession in modern history.

- 56 finance companies were closed down in 1997; small banks were taken over by new investors, mostly foreign banking groups, while medium-size banks were taken over the Financial Institutions Development Fund (FIDF) which is the BOT's financial institutions assisting arm. Large banks recapitalized on their own by selling shares to new investors.
- A liquidity crunch in the financial and business sectors followed so that normal business operation became impossible for some time in 1997 and 1998.

- Net capital outflow has continued since 1997 for foreign debt repayment and non-resident baht account withdrawals.
- High domestic interest rates during 1998 in response to capital outflow and the need of the Financial Institutions Development Fund (FIDF) to finance its debt from injecting liquidity into those failed financial institutions during the 1997 crisis.
- Financial institutions were burdened by non-performing loans which rose consistently after the crisis to peak at around 47% in May 1999 before decreasing gradually to the order to 11% by early 2002.
- A current account deficit before 1997 turned into a surplus as a result of export growth and export declines during 1998-2001.
- There was widespread bankruptcy and rising unemployment to over 2 million in 1998 and 1999.
- The Financial Sector Restructuring Authority (FRA) was established in October 1997 to clean up the financial sector by liquidating the assets of the 56 defunct finance companies. The asset auction was held in series during 1998-1999.

4. Policy and Institutional Failures

Major causes of the near collapse of the Thai financial system and the economic crisis during 1997-1998 include the failure of policy formulation and implementation as well as the failure of Thai financial system and corporate management. The key policy mistake was the liberalization of domestic interest rates and exchange controls during the late 1980s and early 1990s, and the creation of offshore banking under the BIBFs in September 1992 and PIPF in May 1994 which allowed broad access to cheap overseas funds, all these undertaken under the currency basket regime which was practically a fixed exchange rate system, thus hiding foreign exchange risks from all foreign-currency denominated transactions. These measures were implemented in order to promote overseas funds inflow without regard to the

BOT's lack of strict financial institution monitoring and the fundamental weakness of the Thai financial system and Thai corporations:

First, monitoring and supervision of financial institutions by the BOT remained lax despite the lessons of the 1980s as clearly exemplified by the cases of Bangkok Bank of Commerce, Finance One Public Co Ltd and the collapses of 56 finance companies.

Second, no attempt was made to increase transparency in the financial system to provide adequate and timely information to investors and lenders. Such transparency will give early warnings to investors and, hence, to facilitate small and rapid adjustment before the trouble develop into a crisis. On the contrary, the financial authorities consistently undertook measures to hide problems from the general public on the pretext of "preventing an unfounded general panic". However, the actual event has proved that such cover-up measure brought about precisely what it wanted to avoid. The lack of information means investors and lenders realized the problem when its magnitude was far too large to handle, and when the chain of events became out of control. Such information surprise will only result in panics and severe, negative adjustment such as uncontrollable huge capital flights, bank runs, sudden collapses of financial institutions, liquidity crunch, etc.

Third, the financial authorities' policy of guaranteeing all financial institutions encouraged moral hazard, imprudent banking, reckless lending and even outright frauds. One these malpractices were discovered, few of the accomplices were ever charged and put on trial, not to mention being penalized.

In other word, the government and the BOT implemented the liberalization measures during the late 1980s and early 1990s without taking into account commercial and financial risks that came with a more open system. Moreover, these measures were undertaken without necessary institutional reforms, by increasing flexibility, transparency, information provision and so on, to enable financial institutions, corporations and even the BOT itself quickly and less painfully to adjust to any possible negative impact of disturbances which are normal to everyday business operation. On the contrary, the fixed exchange rate regime, the implicit guarantee of local financial institutions, lax supervision of financial institutions, and information censors increased the risk of moral hazard.

While trade and foreign exchange control liberalization was being implemented in the early 1990s, the BOT itself was not prepared for the new domestic and international environment. Like central banks in many other countries, the BOT had no public accountability except to the Minister of Finance while there was no fixed term for the BOT governor. However, the BOT had always been held in high esteem because of the efforts and legacy of Dr Puey Ungphakorn who served as BOT Governor during June 1959-August 1971. During Dr Puey's term in office, he instituted a scholarship program to recruit some of the country's best brains to serve the BOT. A large number of bright students were sent to top overseas universities and later returned to work at the BOT. This further increased the BOT's reputation as an organization composed of highly educated and qualified manpower, much more than almost any other institutions in Thailand.

However, a brain drain from the BOT to the private sector during the boom years of 1989-1994 as well as intense competition for power and internal office politics among some of those who remained at the BOT subsequently led to institutional failure. Despite the brain drain, the BOT still possessed more highly qualified people than other organizations in the country. Factions vying for power emerged in the BOT, which eventually led to serious conflicts during the Banharn Silapa-archa government in 1995. Only those trusted by the BOT governor were allowed to have any significant role, thus stifling communications and ideas within the organization. The collegial atmosphere during the Puey administration was replaced by one of subservience to authority and internal politics.

On the other hand, politicians in the government and Parliament were generally wary of being perceived as interfering with the reputable BOT, while they were unable to comprehend monetary policy and the macroeconomy themselves. Thus, the BOT was mostly left independently to conduct its policy without questioning from politicians or even from the prime minister. However, the lack of an effective check and balance system and public accountability made it extremely easy for senior BOT administrators to do whatever they believe were right without much regard to external factors and criticism. The BOT of the 1990os became increasingly closed itself from the outside world, more authoritarian and less tolerant. In the first half of 1990s, internal conflicts led senior BOT administrators to court favour from politicians and, hence, further damaging the image and credibility of the BOT.

A glaring example is the case of a Credit Lyonnais Securities (Asia) Ltd economist in Hong Kong who released a negative report on Thailand on 9 January 1995 in the aftermath of the Mexican crisis, thus triggering a heavy slump on the Thai stock exchange. The author of the report was given a serious warning by the BOT over the report while the report itself was severely criticized and refuted in public. Similar displeasure was expressed over a Moody's Investors Service report released in February 1995 concerning Thailand's over-dependence on short-term overseas capital and questionable bank lending. Such lack of tolerance for different viewpoints was typical of the Thai authorities of the early 1990s and served to reduce its public stature.

With increasing authoritarianism in administration, the BOT lost touch with reality and the outside world. BOT administrators mostly worked as regulators upon their return from overseas studies and thus were not fully exposed to the realities in the private sector and markets. As they were familiar with only exercising authority without accountability, They could not understand or tolerate other points of view, leading to abuse of authority which further eroded the BOT's credibility. It is therefore not surprising to see BOT employees, despite being highly educated, demonstrating to defend their senior administrators against being dismissed in

April 1998 as they were unable to separate their institution and country from their colleagues.

The BOT was also apparently frozen in bureaucracy and red tape because of the fact that the BOT was similar to other state enterprises and had thus adopted typical bureaucratic procedures. No significant attempt had been made to streamline and reorganize its bureaucracy to respond more rapidly to changing events. The BOT thus appeared to act very slowly in responding to the upcoming problems. Measures constantly lagged behind changing circumstances and appeared to be not well thought out in advance. For example, the BOT appeared to be totally unprepared for the floatation of the Thai baht and deposit runs. Another glaring example was the inability of the FIDF officials to rehabilitate troubled financial institutions which failed during the financial troubles of the late 1980s despite the FIDF's mandate to do so. The FIDF's most recent role was simply to provide liquidity to illiquid financial institutions, taking over the BOT's role as a lender of last resort.

5. The Washington Consensus and Thai Crony Capitalism

The policy reform measures implemented by the Thai authorities before 1997 are clearly one most important factor leading up to the crisis. However, some critics equate these pre-1997 reform policy with "free-market" reform and thus blame "free-market capitalism" (and, by implication, the Washington Consensus) as the sole source of all current economic woes in Thailand (see, for example, Worapol Promigabutra, 2001; Sucheela Tanchayanant, 2001; and Pravase Vasee, et al, 2001). Such scholars as Pravase Vasee and Saneh Chamarig even go as far as accusing "conspiracy" among foreign capitalist groups and multinational corporation in "conquering" Thailand.

These critics often claimed that the policy reform during 1989-1996 was that of "free-market capitalism". However, such accusation is based on either misunderstanding and misinformation on reform policy of the early 1990s or prejudices against "foreigners".

What actually happened in policy formulation and implementation in Thailand during the late 1980s and the first half of 1990s was rather different. The so-called economic reform for Thailand during the period was very partial and limited. Policy detail was anything but free-market reform. The fact is that the Washington Consensus had never been construed, let alone formulated and implemented, by Thai policy-makers before the 1997 crisis. What really happened was simply lopsided financial and foreign exchange liberalization without necessary structural reform and market liberalization to improve competitiveness and efficiency of the Thai economy.

As seen in Section 3 above, The Bank of Thailand (BOT) began financial liberalization in 1989 by gradually floating domestic interest rates, followed by relaxing foreign exchange control, and finally by liberalization of foreign borrowing in 1992 with the establishment of the Bangkok International Banking Facilities (BIBFs) and the Provincial International Banking Facilities (FIPFs). The most serious policy mistake mentioned in all studies of the Thai crisis was the BOT's decision to maintain a fixed exchange rate system when domestic interest rates were much higher than overseas rates, sometimes with a margin as large as 5-6%, thus encouraging Thai financial institutions and corporations to borrow cheap funds from abroad and invest them in low-return projects or asset-price speculation. The process broke down when the country's foreign debt outstanding rose above US$ 100 billion and foreign currency earnings dried up as a result of stagnant exports in 1996.

However, another equally serious mistake has rarely been mentioned: the failure on the part of the government and the BOT to open up the market and increase competition. Thus, financial and foreign exchange liberalization prior to 1997 was carried out when a large part of Thai financial institutions and corporations were still patronized business with high costs, low efficiency, making profits under protection from the State and corruption by politicians and bureaucrats with habitual practice of information cover-up, "creative" accounting and tax evasion.

Even commercial banks which were the "vanguard" of financial liberalization were financial cartels owned by business families with closed-knitted connections with politics and bureaucracy, all the more so with strong protection from the BOT who had maintained the anti-competitive financial system policy for decades. For example, the BOT had not allowed new banks to be established for several decades (i.e., "birth control" policy on commercial banks), not to mention foreign banks which were (and still are) limited to only one bank branch in Thailand. The restriction led other business groups, which were eager to tap public money for their business expansion, to set up more than 90 finance companies which turned out to be full of financial malpractices and even downright frauds. It is no surprise that these finance companies became the trigger of the Thai financial system collapse in 1997. The BOT began to allow new applications for banking business licences only in 1996, which was far too late.

These banks and finance companies were fully confident that the authorities will step in to rescue if they stumble upon any difficulties as the BOT had done so many times throughout the 1970s and the 1980s. Consequently, they borrowed foreign funds at lower interest rates and lent them to businesses in Thailand without restraints. As had been done throughout their banking experience, all the lending was made without considering how the borrowers would spend the money. What was required was only collateral (mostly, land titles) or, sometimes worse, "personal guarantees" by politicians or prominent businesspeople. It is thus no surprise that these borrowers became non-performing loans (NPLs) as soon as the economy headed downwards as those borrowed funds were invested in land and stock speculation and mega-projects which lacked domestic and international bases and yielded low even negative returns.

Thailand's economic policy before 1997 was weak on trade liberalization. The World Trade Organization was established in 1995 and most WTO trade liberalization obligations had not been implemented. The ASEAN Free Trade Agreements (AFTA) had just started and was very partial, affecting only insignificant commodity groups. Thai businesses were still full of state-granted concessions, state enterprise monopolies, collusions with politicians and bureaucrats, industrial and trade protection by the government. Tariffs and barriers on imports of consumer and intermediate goods remained high.

The country's infrastructure continued to be the realm of state enterprise monopolies which, by the late 1980s and the early 1990s, came to realize that they could make huge income from their monopolies by granting concessions to private-sector operators. These included fixed-line telephones, mobile phones, pagers, satellite communication, Internet services, express ways, etc. On the other hand, the private operators were able to obtain concessions by promising to remit huge amounts of revenues to the patron state enterprises. Thus, these private operators in turn had to use their monopoly power in their crass exploitation of consumers with high prices and low quality of the service, as exemplified by mobile phone services and exorbitant mobile phone sets in the early 1990s.

State enterprise privatization was still a whisper in the air before 1997 and only became slightly louder after 1997.

These banks, finance companies, corporations, state enterprises and their concessionaires revelled in their "heavens" for decades in confidence that the government, the BOT, politicians and bureaucrats would provide protection for them forever. When cheap foreign funds were abundantly available, they borrowed without restraints, leading to huge foreign debt and insolvency when the baht was floated on 2 July 1997.

The economic reform policy in Thailand before 1997 was in essence the liberalization of foreign borrowing while the government guaranteed zero foreign exchange rate risk and the BOT guaranteed all financial institutions. What transpired was the injection of huge amounts of short-term foreign loans into the Thai financial and business sectors which were still full of monopolies, state-granted concessions, patronism, speculation, corruption and information cover-up. Such reform policy is very different from free-market reform policy envisaged in the Washington Consensus.

In Thailand, the first scholar who discusses the Washington Consensus and takes to his task to evaluate Thailand's experience and shortfalls in implementing the policy prescription is Somboon Siriprachai (2000). He evaluates Thailand's structural reform prior to the crisis in 1997 on two fronts: the adequacy of the reform measures in question and the sequence of policy implementation (or "the policy sequencing problem"). The success and cost of reform depend on not only the correct detail of policy measures but also the correct sequence of those measures. It is possible that, although the implemented set of measures is correct, the wrong sequence could produce a different outcomes with different degrees of success and costs.

Siriprachai (2000) clearly demonstrates that the Thai government and the Bank of Thailand (BOT) failed to implement a consistent and comprehensive reform programme prior to the crisis in 1997. As against the ten policy propositions listed by Williamson (1994), Thailand managed to adopt only a few of them but in an incomplete and limited manner at that:

- The Thai government had not been able to maintain an adequate level of fiscal discipline.

- Government expenditures on health, education and infrastructure had been insufficient, resulting in Thailand's current problems of low education standard, inadequate public health insurance and shortages of infrastructures.
- The tax reform was almost non-existent (except the change from the outmoded business tax to the value-added tax).
- Thailand had always subscribed to the fixed exchange rate regime for much of its modern history. Although the system was a kind of adjustable peg, the baht had often been overvalued while the authorities were extremely slow to adjust by a timely devaluation policy. Moreover, the exchange rate had been biased towards imports and against exports.
- Property right definition and enforcement was still a major problem everywhere as signified by the state of weak law and order, public land encroachment, pollution and environmental destruction, and lack of impartial law enforcement.
- There had been deregulation in a number of sectors such as telecommunications, transportation and oil price liberalization while price controls in public utilities were still widespread.
- Trade liberalization through lower tariffs was a partial achievement. Exports of several agricultural products were still closely restricted. The switch from policy of import-substitution to that of export promotion in the late 1970s resulted in a high growth period and lower protection of domestic "infant" industries.
- The elimination of foreign investment barriers had been highly successful although it can be argued that the inflow of foreign capital was actually a result of the changes in economic structures in the US, Japan and the EU after the Plaza Accord rather than the success of the Thai government and bureaucrats.
- Privatization of state enterprises had been a failure for much Thailand's recent history.

- Financial liberalization was the most important, and most controversial, reform measure before 1997.

Siriprachai correctly points out that the authorities made two serious mistakes before 1997: one was a wrong sequence of policy implementation; and the other, the BOT's failure to reform the existing financial system structure and financial regulation and supervision.

Policy reform sequencing has been widely discussed among development economists and, despite disagreement on details, there is a broad consensus that macroeconomic stabilization, trade liberalization, state enterprise privatization and improvement in financial supervision and regulation should be implemented first or in concomitant with financial liberalization while the liberalization of the capital account should come last (Williamson and Mahar, 1998). According to Siriprachai, the correct sequence of liberalization measures was to liberalize domestic markets and to reform legal and financial institution infrastructures, followed by financial liberalization and, lastly, the abolishment of capital control. However, in reality, the BOT implemented measures to liberalize the financial institution system and to relax capital control at the same time, all with a fixed exchange rate system still in place. Thus, in Siripachai's words: "Financial liberalization without a proper immune system or prudential regulation and supervision of financial institutions was the main cause of the economic crisis in 1997, leading to a currency crisis and finally the financial institution crisis."

Siripachai (2000) was ambivalent as to the question of whether the 1997 economic crisis was a result of the incomplete and incorrect implementation of the Washington Consensus or the inadequacy of the basic tenet of the Washington Consensus itself. However, the answer to this question is crucial because different answers will lead to diametrically opposed policy implications. If the cause is the incomplete and incorrect implementation of the policy reform programme, then the implication is that a correct and comprehensive reform along the line of the

Washington Consensus is needed. On the contrary, if the cause is the Washington Consensus itself, then we must abandon free-market reforms look elsewhere for the remedy of the current economic ills. Siriprachai seems to imply that the cause of the Thai economic crisis was a combination of Thailand's institutional failures and the inadequacy of the Washington Consensus programme

As earlier discussed, what happened in Thailand prior to 1997 was not the implementation of a free-market reform programmes, not a line similar to the Washington Consensus. The point is that the crisis in 1997 was caused by the combination of the lopsided financial and foreign exchange control liberalization and institutional failures, which together explain the incorrect policy sequencing argued by Siriprachai (2000). In short, the essence of the crisis is that the Thai economy which was full of moral hazards, free-riding and corruption was allowed to go on a spending spree using cheap short-term foreign funds.

6. Conclusions

Far from generally claimed in public, the Thai economy had not gone through a comprehensive free-market reform prior to 1997. The pre-1997 economic programme was simply the liberalization of foreign borrowing which finally led to excessive borrowing and moral hazard encouraged by protection and implicit guarantees by the government and the Bank of Thailand against foreign exchange rate risk and financial institution failure.

It is true that the post-1997 economic reform programme during the Democrat-led coalition government (November 1997-December 2000) was more free market-oriented. Some reform measures were highly significant, such as the adoption of the new constitution, the amendment of the alien business law, the establishment of specialized bankruptcy court. What was accomplished was important. However, the reform programme was still far from being comprehensive and systemic although the subject requires a separate and detailed study. What is disappointing is the apparent stagnation of market reforms since early 2001 when public policy has clearly reverted to pervasive interventionism and direct control. The economic recovery fuelled by surging consumption and the government deficit since the beginning of 2002 further augments the belief that the Thai economy can recover and grow strongly without necessary and painful market reforms.

However, growth driven by consumption and the government deficit cannot be sustained over the long run. Critical long-term growth factors are exports, which provide foreign exchange earnings, and investment spending, which increases the country's capital stock and, hence, the capacity to generate more output and income over the long period. Thus, market reforms are necessary to improve international competitiveness of Thai enterprises and to induce capital inflow (and the much-needed technology transfer). Thailand must learn from its lessons in the 1997 crisis and implement a comprehensive structural reform programme further to liberalize the economy and its trade regime in order to achieve a long-term recovery and sustainable economic growth.

This study will lead to further investigation of Thailand's economic reform programme after the 1997 crisis. Specifically, there are still questions concerning the inadequacy of the reform programme adopted by the Democrat-led government during 1998-2000, the stagnation and reversal of reform since 2001, the political nature and economic implications of the "restructuring measures" implemented by the Thai Rak Thai government, and the implications of the communal development strategy aggressively advocated by a large number of Thai conservative scholars and social activists.

TABLE 1

EXTERNAL TRADE TO GROSS DOMESTIC PRODUCT BY COUNTRY 1980-1996

	1980-1989	1990-1996
Singapore	297.3	276.5
Malaysia	96.3	163.7
Taiwan	83.4	76.8
Thailand	49.1	67.8
Philippines	37.6	54.4
South Korea	58.5	52.1
European Union	51.3	48.1
Indonesia	36.2	43.1
China	15.9	33.7
United States	15.0	16.7
Australia	18.3	16.4
Japan	18.5	14.8

Source: Bank of Thailand; International Monetary Fund

TABLE 2

GROSS DOMESTIC PRODUCT BY SECTOR 1980-1996

	1980-1989	1990-1996
Manufacturing	29.2	35.9
Agriculture	19.5	13.8
Services	51.3	50.3

Source: National Economic and Social Development Board

TABLE 3

NET CAPITAL INFLOW TO MERCHANDISE TRADE DEFICIT

1980-1997

Year	Percentage
1980	44
1984	61
1988	74
1989	114
1992	115
1995	138

Source: Bank of Thailand

TABLE 4

THE FINANCIAL SYSTEM LIBERALIZATION

1. Lifting of Interest Rate Ceilings	
- fixed deposits (over 1 year)	1 June 1989
- fixed deposits (1 year and under)	16 March 1990
- savings deposits	8 January 1992
2. Lifting of Exchange Controls	
- first round	22 May 1990
- second round	1 April 1991
- third round	1 May 1992
3. Establishment of Offshore Banking Facilities	
- BIBF (first round)	16 September 1992
- PIBF (first round)	4 May 1994
- BIBF (second round)	25 March 1996
4. New Banking Licences Granted	
- Overseas	6 November 1996
- Local	3 January 1997 [1/]
5. Floating of the Thai baht	2 July 1997

Notes: [1/] Approvals were granted by the Minister of Finance for three groups to set up commercial banks in compliance with stipulated conditions by 3 January 1998. However, none of them were able to meet the conditions within the deadline.

TABLE 5

DEPRECIATION OF ASIAN CURRENCIES
AGAINST US DOLLAR
(January 1990 - June 1997)

Country	Percentage
Mexico	66.9
China	48.9
Indonesia	26.6
South Korea	24.1
Philippines	15.3
Taiwan	6.1
Thailand	0.1
Malaysia	-7.5
Japan	-25.8
Singapore	-34.4

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Community Values and Conservation: A Case Study in Ayudhya Province

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Community Values and Conservation: A Case Study in Ayudhya Province

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Abstract

The temporary prosperity during the economic boom of the late 1980s and early 1990s in Thailand along with other East Asian countries had eventually disclosed its fragile reality. In retrospect, the late 1990's economic downfall is looked upon as the collapse of the misleading "bubble economy". The tragic experience somehow suggests a more humble approach towards maintaining and firming our basic economic bases. The cause-effect rationale, then, follows that true growth is the consequence, though not strictly the outcome, of an economy with solid foundation and on-going productive activities. Observations, thus, show that post-crisis priorities have increasingly shifted from constructing growth model to creating sustainability model.

The concept of sustainability in discussion extends beyond those of impressive numerical economic indicators. What must come into serious consideration is a wider range of factors nourishing the most important component that keeps the economy alive- the workforce, which constitutes the nation's human resource. This simply relates to anything affecting the welfare of the population. In this respect, environment, the core issue of this paper, should receive no less attention than other issues. The quality of the environment not only determines the present well-being of the nation's human resource but also the long-term availability and usability of other significant non-human resources. Congruently, the other side of the equation says that the activities carried out by the workforce can, in turn, have tremendous impacts on the environment. This two-way causality now sets up the vital groundwork of this paper.

The formation of the above-mentioned rationale leads to the following systematic structure of the paper. First, a scene of discussion opens with a large non-specific paradigm, portraying the generality of the model of sustainability via social capital activities. Second, a more specific linkage between social capital and the environment is deduced and established from the general model. The main focus is on the local community level. In its application, the paper investigates the degree of influences and externalities imposed by the local-level social capital on conservation in a selected district in Ayudhya province. The paper goes on to the assessment of the case studies and policy implications that might help promote further success and alleviate any existing difficulties or problems encountered by the local –level social capital.

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2 The view expressed does not necessarily represent that of the institutions. Any mistake which may arise in the paper are solely the author's.

I: The Rationale

The force of globalisation, or global integration, constitutes the leading urge towards hastening the past few decades' structural development policies world-wide. However, it remains to be seen whether all individuals have access to the gains from the process of global rule-making. The recent World Bank (2002) study indicates that approximately two billion people, the majority from Asia and Africa, are excluded from enjoying the fruits of such progress. For some countries, this may be the result of the disparity in sectoral maturity[i], the width of which foretells the strength of a nation's overall structural foundation. As experience has revealed, it follows that wide disparity could shorten and obstruct the longevity of the mainstream prosperity period of a country. On the brighter aspect, nevertheless, the phenomenon has contributed to the strengthening of collective actions amongst individuals sharing common goals and beliefs. Such initiatives are increasingly receiving encouragement and support from international development communities and various NGOs. This is particularly visible in the fields such as human rights, feminism and environment.

The temporary prosperity during the economic boom of the late 1980s and early 1990s in Thailand along with other East Asian countries had eventually disclosed its fragile reality. In retrospect, the late 1990s economic downfall is looked upon as the collapse of the misleading "bubble economy". The fragility may be explained by the disparity in sectoral maturity. The tragic experience somehow suggests a more humble approach towards maintaining and firming our basic economic bases, also taking into consideration socio-economic aspects. Indeed, the crisis would have been worse had it not been the "togetherness" of traditional Thai values of family and community that cushioned the loss of income and employment (*Development News* 2002). For instance, Thai families helped each other financially during the crisis and many better-off families offered support to their poorer friends and relatives. Although not having been highly visible at the national level, this scenery portrays a significant role played by the Thai local communities. The cause-effects rationale follows that true growth is the consequence, though not strictly the outcome, of an economy with solid foundation[ii] and on-going productive activities[iii]. Observations, thus, show that post-crisis priorities have increasingly shifted from constructing growth model to creating *sustainability* model.

The concept of sustainability in discussion extends beyond those of impressive numerical mainstream economic indicators. What must come into serious consideration is a wider range of factors nourishing the most important component that keeps the economy alive- the workforce, which constitutes the nation's human resource. This simply relates to anything affecting the welfare of the population. In this respect, environment, the core issue of this paper, should receive no less attention than other issues. The quality of the environment not only determines the present well-being of the nation's human resource but also the long-term availability and usability of other significant non-human resources. Congruently, the other side of the equation says that the activities carried out by the workforce through social capital can, in turn, have tremendous impacts on the environment. This two-way causality now sets up the vital groundwork of the paper.

The formation of the above-mentioned rationale leads to the following systematic structure of the paper. Section II initially presents a large non-specific paradigm, portraying the generality of the model of sustainability via social capital activities. Then, a more specific linkage between social capital and the environment is deduced and established from the general model. The main focus is on the local community level. In its application, Section III investigates the degree of influences and externalities imposed by the local-level social capital on conservation in Baan[iv] Sa-Klee, Sena district, a selected district in Ayudhya province. In Section IV, the paper goes on to the assessment of the case study and policy implications that might help promote further success and alleviate any existing difficulties or problems encountered by the local–level social capital. Section V concludes and suggests some prospects for future research.

II: Framework and Paradigms

II.1: Conceptualising Social Capital

Following the increasing trend towards the concept of sustainability, several models have been constructed and studied under various approaches. Amongst these models, there is a group of research that relates social capital to sustainability. The concept of 'social capital', according to Putnam (1993a), has undergone a revitalisation of its own over the past two decades. The term originally appears in the work of Pierre Bourdieu in the 1970s, being used in conjunction with "cultural capital" to refer to stocks of knowledge an individual acquires through informal social networks. Together with the work of James Coleman, it is later referred to the resources and advantages individuals acquire from participating in social or community setting. Further extensions to include not only individuals, but also groups, communities and even nations have been carried out in Putnam (1993b, 1995) and Fukuyama (1995). To quote Cortes (1993), "Social capital implies a richness and robustness of relationships among people, that the members of a community are willing and eager to invest in one another."

Based on the World Bank's definition, social capital comprises a combination of norms, relationships, institutions and networks influencing the quality and quantity of a society's social interactions that lead to collective actions. Narrowly viewing, it is a horizontal association between associated several networks affecting community productivity and well-being. Viewing as such, Portes and Landholt (1996) show some possibilities of social capital having an important "downside" effect. That is, if the networks aim at cross-purposes to society's collective interests (eg., drug cartels and corruption), it would hinder economic and social development. Hence, a broader perception looks at social capital both horizontally (between people) and vertically (within and amongst organisations such as firms) to account for both the positive and negative aspects. In fact, in her article in *Bangkok Post*, 23 April 2002, Barbara Parr of Price Waterhouse Coopers

(Thailand), one of the main emphases on good corporate governance in major firms relates to commitment to social and environmental issues.

Overall, there is an increasing number of studies showing that social cohesion play a significant role in poverty alleviation as well as sustainable and economic development. Knack and Keefer (1997) work on indicators of trust and civic norms from World Values Survey amongst samples of different market economies. Inglehart (1997) carry out extensive work on World Values Survey's results for general theories of modemisation and development. Narayan and Prichett (1999) find that village-level social capital raises household incomes. Adelman and Morris (1967) and Temple and Johnson (1998) explore the significant relationship between ethnic diversity and social mobility and the variation in national economic growth rates. Abeyskera et al (2000) use indicators such as suicide, orphans, divorce, crime and family structure to see whether social capital cushioned crisis impacts in Thailand.

II.2: Workforce-Driven Sustainability Model

In setting up the initial non-specific paradigm in this section, the paper takes into consideration aspects of Thai social landscape used in Abeysekera et al (2000) that may be unaccustomed to foreign researchers. These aspects have their emphasis on family and community dynamics having been developed in a traditional rural setting and continued to modem and industrialised era. They include: (i) the norms that nature and people are inter-related and, hence, they are part of the forces protecting themselves, (ii) the passing-on of local knowledge such as handicrafts and traditional medicine from one generation to the next, (iii) a horizontal association of reciprocity amongst communities and groups, (iv) management of resources by the community and (v) sharing of diversified knowledge amongst communities.

The paradigm in Figure 1 in the Appendix presents a general model of sustainability driven by workforce. The relationship in the model can be explained by starting at the Workforce box and moving through the diagram clockwise. Via social mobilisation, the workforce, or simply the people, form a kind of social capital from various sources. These sources include institutions such as families, communities, firms, civil society, public sector, ethnicity and gender. Through the process of mobilisation, the changes in social capital requires indices to indicate the level of changes in its dynamic process as shown by the doted line in the middle of the diagram. There had been various innovative ways to measure the "stock" of social capital. However, obtaining a single "true" measure is very unlikely due to the fact that the concept is abstract and multidimensional. Therefore, it can only measure indirectly by methods such as trust in government, voting trend, membership, hours spent volunteering, meeting frequency, household participation level, etc.

Once social capital is instituted with sufficiently strong force, collective actions are carried out with common goals to achieve the desire level of sustainability. The result of these collective actions is measurable by indicators classified under social, economic, cultural and environmental criteria as well as those that are exogenously determined. This, in turn, produces a reciprocal relationship within the process of social mobilisation. For example, if the result of their action shows positive signs amongst these indicators, it is likely that there will be more participation. Hence, social capital stock would literally "rise". Eventually, at some point, the results of their action form a more concrete outcome that could be summed up to become a social well-being (community level), which undeniably affect the workforce directly. In the longer term, this would show at a national level. Whether the benefit goes to the workforce would depend on the national policy on the redistribution system.

III.3: Social Capital- Environment Sustainability Model

The deterioration in the quality of life, environment-wise, that comes along with what is called "modern" development poses the challenge to balance economic growth with resource sustainability and environmental quality from a global perspective. Having set up a non-specific paradigm in Section II.2, a more specific linkage between social capital and the environment is now deduced from the general model. The so-called social capital- environment sustainability model, illustrated in Figure 2 in the Appendix, looks at how social capital at a local-community level exert their role on environment conservation and the reciprocity of the result of their effort affecting their well-being. Such reciprocity further indicates the drive to the formation (or the destruction) of its social capital stock. Local community level refers to the social interactions amongst neighbours, friends, groups, civic society and non-government organisation living in the same rurality. It provides opportunities for participation and gives voice to those who may be locked out of more formal avenues to affect changes. This is particularly important for the deprived and the poor as social capital can be used as a substitute for human and physical capital.

Evidence shows that including those directly affected in the projects ensures that the targeted needs are met, and loyalty and success are more likely. (Narayan, 1995 and Uphoff, 1992). To quote Maurice Strong, Secretary General of UN Conference on Environment and Development, 1992, "Local level actions such as resource management are the very foundation of successful sustainability policy... Experience increasingly shows that the imperative transition to sustainable development cannot be made without the full support of the community and the participation of ordinary people at the local level." The sense of sharing common responsibility to the benefits of all community members for the present and the future on resource management encourages co-operation (Tobisson and Rudqvist, 1992). The strength of the binding of the community to push for actions to mobilise political power is critical to addressing their concerns, for example, on environment degradation (Egan, 1996).

This model shares the common path of mechanism as that represented in Figure 1 but with a more focus on the local community and the environment. Here, social capital at a local community level takes actions to achieve the desired environmental quality and eventually shows at a social community level which directly affects the workforce. Similarly to the first model, there is a simultaneous dynamic component of inter-relationship between environmental quality and capital mobilisation. That is, the two-way causality implies that if their actions show positive outcome, the local inhabitants would be more willing to participate in the activities. Generally, if success avails, it would show at a national level and everyone theoretically benefits in the sense that environment is naturally a public good to everyone without any need of government assistance. This completes the setting up of the major framework to set out for the case study of the paper.

III: Case Study: The Revival of Baan Sa-Klee Local Community

III.1: The Setting

Baan Sa-Klee is a small local community within Bangnomkhoe sub-district of Sena district, Ayudhya province, the former capital of Thailand for as long as 417 years. Ayudhya province is located in the Upper Central Region of Thailand, expanding over a total area of 1,597,900 rai. The province is divided into 16 districts comprising of 209 tambons (sub-districts) and 1,449 moo-baans (villages). Sena district has the population of 50,562, being the fourth most populated district after Muang, Bang Pa-in and Wang-noi[v]. Most part of the province is situated on flood plain where the four major rivers, Chao Phraya, Noi, Pasak and Lopburi pass through. This makes the land suitable for agricultural activities which utilise approximately 94% of the total land area[vi].

The major economic sectors of Ayudhya are agriculture, industry, wholesale and retail trade. In the past, the agricultural sector has been the single most important economic sector. At present, the industrial sector had superseded contributing a ratio of 55.6 percent to GPP (Gross Provincial Product). The second and third largest sectors are wholesale (10.4%), and retail trade and services (7.65%). The remaining 20.47% are made by other economic sectors[vii]. The shift in structural economy of Ayudhya has been catalysed by several supporting factors. First, due to the strategic proximity, being the gateway to other regions of the country, it is an ideal location to expand economy and situate as a distribution centre to other regions. Second, the availability of basic structures, eg., transport, electricity, water supply and telephone networks facilitates the progress. Third, it is located near the source of production and management know-how. Forth, the attraction of long unique history and cultural richness of the ancient kingdom, recognised as one of the World's Heritage by UNESCO on 13 December 1991, contributed to the city's tourism promotion.

III.2: The Transitions

The portrayal to follow is based on observations gathered from several visits to Baan Sa-Klee and from informal interviews[viii] with the individuals involved in initiating the force to revive the local community for survival. Some of the major information contributors are Khun Preecha Dusdul, vice president of the Bangnomkhoe Sub-District Council; Khun Boonchoo Punpeng, head of the sustainable agriculture sub-group of the community; Ajarn Udom Gleepmalai, a retired school teacher very much respected by the villagers; and Khun Kemachart Kanapooses and Khun Monchai Noisorn, volunteers and researchers, who assist the community in terms of technicalities and documentation.

Upon having realised the burden accrued to agricultural workforce after the implementation of the first until the seventh National Economic and Social Development Plan, the eighth plan and onwards to the present-day ninth plan had switched to more concerns on sustainability (NESDB, 2000)[ix]. In spite of the modern mainstream macro-view of perceiving the economy for the "good of the whole nation" at the national policy-makers level, it may, perhaps, enhance more understanding of the rural sentiments to put oneself, for a little while, in the position of the villagers. Viewing as such would make it possible to analyse the maturity or the readiness of the local economic units, that sum up to form the country's groundwork economic structure, to accommodate the growth of the other fast-moving sectors. Any existing disparity in sectoral maturity would, then, imply an inappropriateness of the timing of any policy implementation, particularly in terms of structural changes.

The past four decades, along the process of transition towards modernisation has seen vast material development through capitalism. Unavoidably, such development persistently affects the ways of living of the local inhabitants. This consequently pushes the community economy, which is the basis (physical) solidity of the whole economy, to be severely dependent on the upper-level price-represented mainstream economy (ie., the retail and wholesale market conditions and prices set according to policies accommodating national and global-based interests). Eventually, this causes disruption in the community economic system, which may not yet be properly facilitated for the change. Finally, local unity became discarded and the community's traditional bondage heads towards a demise. Farmers and grass-root level workers (at the ground-level part of the economy) are fatally affected and deprived. Situations forced them to sell their land, the only asset they have which generates income, in order to pay their endless debts. As the paper goes on, one can see that farmers' debts is one of the major accrued obstacles towards development projects and this does not exclude environmental issue.

The debt problem amongst farmers had accumulated from the past and further been exacerbated throughout modernisation. Even before modernisation processes appear in the scene, farmers inescapably incur debt due to the nature of their major income, which depends on annual climate and unpredictable natural conditions. Their only wealth are land (usually rice field) and the land-generated produce (ie., rice). When they need to buy money value-dominated goods in the market, they would need to borrow. Following modernisation, with strong forces of consumerism through advertisement and other forms of media, the locals' *needs* and *wants* become synonymous. Yet, they are not to be blamed for as this tends to be the natural inclination of human beings. These locals are the recipients of external forces and their involuntary response is what has been happening.

Moreover, following the NESDB earlier plans aiming at increasing export to boost GDP growth, the growing of off-season paddy rice (or the double-crop field paddy rice) has been promoted. Originally, seasonal paddy rice (or the single-crop paddy rice) is grown by the majority of the farmers. Seasonal paddy rice, such as the authentic Thai Jasmine, is softer and is the main basic staple for the Thai people from the past. Off-season paddy rice, on the other hand, is hard in texture and cannot be cooked in Thai style cuisine. The purpose of growing off-season paddy rice is mainly for exports as it is widely used to feed animals in foreign countries. There are important observations to note here. First, the local community has lost its self-sufficiency of the basic staples. It does not have enough seasonal paddy rice to feed the inhabitants and, hence, needs to sell their off-season rice and buy single-crop rice from the market. This may hint some inefficiencies within the market mechanism characterised by a disparity in maturity. As noted by Ajarn Udom Gleebmalai, in the past, thirty kilograms of seasonal paddy rice would suffice to feed the community; at present, however, to buy the same thirty kilograms of rice from the market, sixty kilograms of the off-seasonal paddy rice must be produced and sold in exchange for money-value needed. Second, the nature of growing off-season rice requires the use of pesticides and chemicals, meaning that farmers incur more debts in buying such items (the factors of production). Worse, the environment now becomes degraded by such chemical usage. Having no way out, the younger workforce migrates to the already populated urban life and industrial factory, leaving elders and children living hopelessly in the rural.

The above-mentioned phenomenon has led to the drastic deterioration of energy sources and environmental condition due to the promotion of higher production, which relies on toxic chemicals. Poor soil quality, polluted water, poisoned marine animals, destructed forest, less and unpredictable rainfall, dry climate and excessive heat due to greenhouse effect each year are the obvious outcomes. What becomes more tragic and unfortunate is that natural resources are further being deprived, through counter-social interest purposes, to generate money values to satisfy excessive consumerism. In terms of socio-condition of the local community, there arises turmoil, or the state of anarchy. There is a breakage of family relation and social capital becomes discarded. That is, this results in a negative change in the social capital stock in that community. The bond of social capital has lost its strong ties.

Due to this material-dominated trend in which an individual is value-determined by the amount of physical wealth, human value has also depreciated along with the environment quality, leading to low moral standard and increasing crime. Every part of the society now relies upon the structure of the borderless world. The happy community life of yesterday in which everything is so inter-mingled and accommodative to one another has been forgone. One of the elderly gentlemen of the community recalled during the interview: in the past, when rice field is harvested, the remaining grains at the four corners of the rice fields are left for the poor to come and collect freely. The remaining would also be left to feed the other living beings in the natural eco-system, such as birds, which, in turn, eat worms and other insects to protect the rice field. This portrays a reciprocal relationship between human value and the environment. The other elderly, Ajarn Udom Gleebmalai, also enthusiastically recalled how Thai culture is related to agriculture and the environment. The symbolic role of Thai women in the past has been renown for a man who has observed many generations of transition to say that 'women are the best collectors of the best seeds'. That is, after the harvest, it would be the women who return to the field and collect the best seed for the next cultivation. By doing so, the crème de la crème of the rice breed is always ensured for the community without the need for inorganic chemical usage. The beauty of the inter-relationship has literally been engraved even in the present usage of the Thai terminology context of land, or the rice field, as "Phra Mae Thoranee" (meaning 'mother nature' in Thai). The term meant so much for the elders because the land, the rice field, the survival, the life, the culture or even the romance of the typical Thai villagers in the past all circled around one other.

III.3: The Revival of Baan Sa-Klee Local Community

Baan Sa-Klee Community, officially called "Chumchon Wattanatam Klong KanomChine (Kanomchine River Basin Cultural Community), like other communities, is drastically affected by the forces of modernisation. From being agricultural community, literally described as "Nai nam mee pla- nai naa mee kao," (in water there is fish, in field, there is rice), it has turned into "Nai naam mai mee plaa, naa pen kong kao" (in water there is no fish, the field belongs to others). Hence, the community now loses its self-sufficiency and depends on external influences. Consequences follow that there is insufficient household food supply, the population and children lack proper nutrition, local health and sanitation becomes poor. Overall, Baan Sa-Klee cannot avoid being another recipient of the urban negative externalities. The vicious circle that the local community is facing can be visualised in Figure 3 in the Appendix.

Baan Sa-Klee community commented that there is a need for revival, to build community "army". This would be for the locals to come together, become institutionalised, discuss problems, analyse the causes and try to solve problems. The aim is to promote sustainability in the community in terms of social, economic and environmental aspects. It is to build self-sufficiency of basic needs so as to reduce unnecessary spendings and debts. Moreover, the learning and passing on of knowledge in order to reach common goals would be promoted. During leisure time, the community promotes activities, which preserves morality and attempts to 'revive' the once flourished civilisation of Ayudhya and the beautiful relationship of the unexploited land and the people. With the supports and co-operations of various institutions, private and public, NGOs, academics and journalists, the local community has become stronger and reached certain achievements, which induce more efforts.

Sa-Klee community has a number of concrete projects and achievements, some of which are listed as follows:

☆ Savings group: started in 1990 with 34 people and total savings of 4,000 Baht; currently it comprises of 100 people, and total savings of 500,000 Baht.

☆ Sustainable agriculture: started in 1989 with 5 households to promote environmentally friendly organic produces as well as self-sufficiency within the community, currently it comprises of 60 households occupying the area of 300 rai.

☆ Alternative business promotion: started in 1993 to accommodate NESDB plans; supports local handicrafts, non-preservative desserts, herbal drinks and other environmentally friendly products; mostly consists of the young locals.

☆ Environment and natural resources conservation group: initiated in 1989 particularly to campaign heavy industrial waste reduction during 1989-1992; the group has later been supported by the sub-district council along with the projects of plantations of mixed produces, organic rice and vegetables.

☆ Religion and culture group: aims at encouraging young people to appreciate and preserve traditional values and cultural heritage; organises special events in temples, schools and common village meeting places.

☆ Thai medicine group: initiated in 1995; employs the concept of self-healing medications such as traditional massage, herbs, exercises and meditations.

☆ Eco-friendly tourism: promotes understanding of the sustainability of the natural environment and how the environment quality affect the well-being of the locals.

The working of Baan Sa-Klee follows the illustration in Figure 4 in the Appendix. Starting at the top-left corner of the diagram and going through clockwise, the villagers meet at different houses every week to discuss their problems and sort out the solutions. Each household takes turn to be the host. They called such routine activities "Sapha Satoe"[x]. The outcome of the meetings promotes what turns out to be the projects listed above and also illustrated in Figure 4. There has been an increasing number of organic produces which are chemical-free and environmentally friendly and accomodative of the other inhabitants in the eco-system. The major theme of the working of the community is to build awareness and revive the original relationship between the local people, the other living beings sharing the same habitat and the environment. That is, the locals began realising their basic needs, knowing what is good and what is harmful for them and their family and, thus, feel more appreciation to the fruits of nature. At the same time, they must also be concerned about how to keep (ie., sustain) the environment and the natural eco-system to be as good as it has been as long as possible for them and their children to enjoy.

Figure 5 in the Appendix systematically compiles the working of the social capital in Baan Sa-Klee local community. This can be considered as the applied version of the Social capital-environment sustainability model in Figure 2. The transition catalysed by the forces of globalisation along with the proximity advantages of the province of Ayudhya has led to various consequences on the affected local recipients as discussed earlier. This sums up to become the degradation of social well-beings within the local community, which motivates the drive towards social mobilisation. That is, it leads to an accumulation of the stock of human social capital. Despite a number of concrete achievements, at present stage, Baan Sa-Klee is still undergoing the formation cycle of social capital. This sub-circle revolves around the steps of forming social capital followed by collective actions, resulting environmental quality and returns to the effects on social mobilisation, which, again, affects the formation of the social capital. There is the element of dynamism within this sub-circle (denoted by the doted line) happening simultaneously to the process of the bigger circle (the whole model). This shows that Baan Sa-Klee is still struggling to sustain itself for survival against all the obstacles (some of which listed in the box in the diagram). However, there are also positive prospects (the strengths are also listed in the box) such as the experience of failure of some projects and the ability to re-build the group through unity, strong urge, believes and common goals contributing to increasing motivation. Furthermore, improved results tend to make it possible for social capital to continue to persist and, eventually, lead to social and national well-being.

IV: Indicative Observations

Observations reveal several aspects that stress the importance of understanding the economic and socio-cultural sentiments within the local community before any assistance or development projects are planned and implemented. First is the realisation that is compulsory to define the appropriate timing at which the local-level community reaches its maturity to accommodate the mainstream economic policies. Basically, such stage of maturity is attainable when the whole community is so excessively endowed with its own produced goods that it reaches a kind of "saturation" of happiness in consuming its local goods. Reaching that stage, there would, then, be excess supply to maintain the community's own self-sufficiency and also to contribute to the nation's GDP-boosting exports. On the contrary, if that stage of maturity has yet to be reached whilst there is a strong urge to follow the global liberalisation trend at the mainstream-level economy, then there exists what has been earlier discussed in the paper as the disparity in maturity between sectors.

Second, it is, indeed, crucial to note the psycho characteristic of local villagers that once the system become too "structured", they tend to feel constrained to obligate themselves in any particular activity. As a result, this discourages voluntary participation amongst the members and, in severe cases, the social capital may cease to exist. This is also true when agricultural experts from external institutions formally provide guidelines and instructions to the villagers. An example is the failure of the alternative business group of the community, which through stronger effort, was able to be rebuilt later by the villagers themselves. From the interview, the vicious circle works this way: when the tasks are very well allocated to individuals acting as the head or the leader, others tend to feel that it is no longer their responsibility to carry on the work. Moreover, they may feel unhappy to have to follow what may seem like being "dictated". Hence, this lowers the number of participants as time goes by and eventually the social capital breaks down. In fact, this is understandable when considering the way of life of the farmers. They are accustomed of working in the field freely without any superior, being their own boss and, thus, need not be constrained by any rules or regulation. Once they are placed in any structured institution, they could naturally feel uncomfortable.

The resistance to the formalised structure of the institution reflects the movement towards relying on outside assistance, which creates what Dorfman and Lance ([illegible]) called a "therapeutic" state. Such state of the society is characterised by the loss of responsibility or ownership that the society should have for itself. The two techniques that would induce greater potential for success and sustainability of social capital suggested by Dorfman and Lance are: (1) integration and (2) employment of dialogue to facilitate understanding within the community and collective action. Through the two techniques, passive and active relationships amongst the locals need to be differentiated. The passive relationship is the relationship that an individual is born with and the surrounding. It arises passively, without the need of any effort. On the other hand, an active relationship requires much effort as it provides a sense of identity, recognition, belonging, empowerment and trust that defines the dynamic community. The sustainability of the social capital would, therefore, depend on how passive relationship could be turned into active relationship.

Theoretically, the question of how to turn passive relationship into active relationship is almost equivalent to the question of determining how social capital should be structured so that social mobilisation would not be adversely affected. What can be provided by the authority are in terms of technicalities, formalities, documentation, external resources and funding. The informal structure of the community mentioned earlier causes difficulties in making request proposal for fundings or donations from external sources and formal institutions. These institutions usually require formalities in their funding provisions. Hence, it may help if policymakers understand the unavoidability (inevitability) of having such an 'unstructured' structure in the village when considering budget allocation. Perhaps, some flexibility might be given. More importantly, the sensitive point to note is that any innovative action should originate from the local community itself since the major theme of social capital is that the community members, not the authority, work in unity to achieve their common goals. The role of the authority should mainly be to assist passively.

V: Conclusions and Future Research Implications

The economic crisis of the late 1990s in Thailand suggests a more humble approach towards maintaining and firming our basic economic bases. Hence, it is widely observed that post-crisis priorities have increasingly aimed at creating sustainability. The concept of sustainability should extend beyond those of impressive mainstream-level economic indicators. What must come into serious consideration is a wider range of factors nourishing the most important component that keeps the economy alive- the workforce, which constitutes the nation's human resource. This simply relates to anything affecting the welfare of the population. The core issue of this paper is the environment.

The paper constructs both a general non-specific paradigm showing how social capital can exert positive or negative influences on its own well-being through collective actions; and a specific paradigm establishing a more focal relationship between the local-level social capital and environmental quality. A case study is conducted in a small village, Baan Sa-Klee, in Sena district, Ayudhya province. The transitional process of the change in the local economic structure to accommodate the national policy had been portrayed. One of the major observations in the case study suggests there exists a disparity in sectoral maturity which points out to the question of an appropriate timing for policy implementations. Like other communities, Baan Sa-Klee is unavoidably affected by forces of modernisation. The end-result, which is the current state of the community, is the deterioration of environmental quality and other general well-beings. The phenomenon motivates the local community to form a social capital through social mobilisation.

Through the struggling for survival of the social capital, the community at the same time faces various problems, some of which are cumulative from the past. However, observations also show positive prospects such as unity and strong determination that enable the social capital to reform in case of failure. In terms of support from the authority, technicalities, formalities, documentation, external resources and funding may be assisted. However, it is important to note that any plan for community action should be innovated by the local community themselves. This must be so because the concept of social capital is that the community members, not the authority, work in unity to achieve their common goals. The role of the authority should mainly be to assist passively so as to avoid possible resistance from the community.

The concept of social capital requires delicateness in understanding because it is a complex combination of not only economic elements but also cultural, psychological and social sentiments. The observations that there tends to be resistance towards being a structured social capital within the local community may suggest a negative correlation between the degree of formalisation of the social capital and members' participation. Implications for future theoretical research would, therefore, be to define the optimal effort that public sector can provide in terms of structuring in order not to offset or exert any negative impacts on the local's effort. In line with other issues concerning social capital, denoting the "true" direct value of efforts requires appropriate indicators. This poses further challenge for the future research to find or construct such indicators so that the concept of social capital could be investigated more quantitatively. Further, there are various local communities with unique characteristics other than that of the Ayudhya province where more case studies on social capital could be conducted. Performing various case studies as such would create better understanding of the country's diversified local economic structure which sum up to form what can be seen at the macro-level.

Endnotes

i "Sectoral maturity" refers to the readiness of a certain sector to accommodate the progress of the other sectors in the economy and, at the same time, able to self-maintain or upgrade its initial well-being in all aspects that constitutes the basic needs of its components (ie., workforce and other factors of production). In this case, the focal sectors are agriculture, the core basis of the Thai economy, and the emerging manufacture, the higher income-creating alternative.

ii That is, by means of 'solid foundation', all components in all the sectors of the economy must be sufficiently robust. In terms of workforce, the social capital both at the urban and rural level must be tightly bonded, strongly established and institution supported.

iii On-going productive activities imply that production level is consistently maintained and/or expandable through having an appropriate level of factors of production sustained for future usage and ensuring that the negative externalities are minimised.

iv "Baan" or "Moo Baan" literally means village in Thai. Thus, "Baan Sa-klee" represents Sa-klee Village.

v National Statistical Office, March 2001 population survey.

vi Ministry of Interior, 1998 data.

vii http://www.ayutthya.go.th as of 25 April 2002

viii Informal talks and interviews, rather than those of formal ones, are usually more preferable to the villagers.

ix Indeed, the concept of self-sufficient economy, designed by H.M. the King's theory on integrated agriculture had been introduced earlier in 1994 and re-expressed on 4th December 1997 a few months after the renown Asian crisis.

x "Sapha" literally means parliament in Thai, in this case, it refers to a place for meeting and discussion of various issues (in some sense similar to the English Hyde Park tradition). "Satoe" is a kind of homemade undistilled white liquor but the term does not imply that villages meet for the drink. Ironically, Sapha Satoe, a casually lively term, is understood as a rather serious meeting so as to attract more participants and co-operations from the community members.

Appendix

Figure 1: Workforce-Driven Sustainability Model

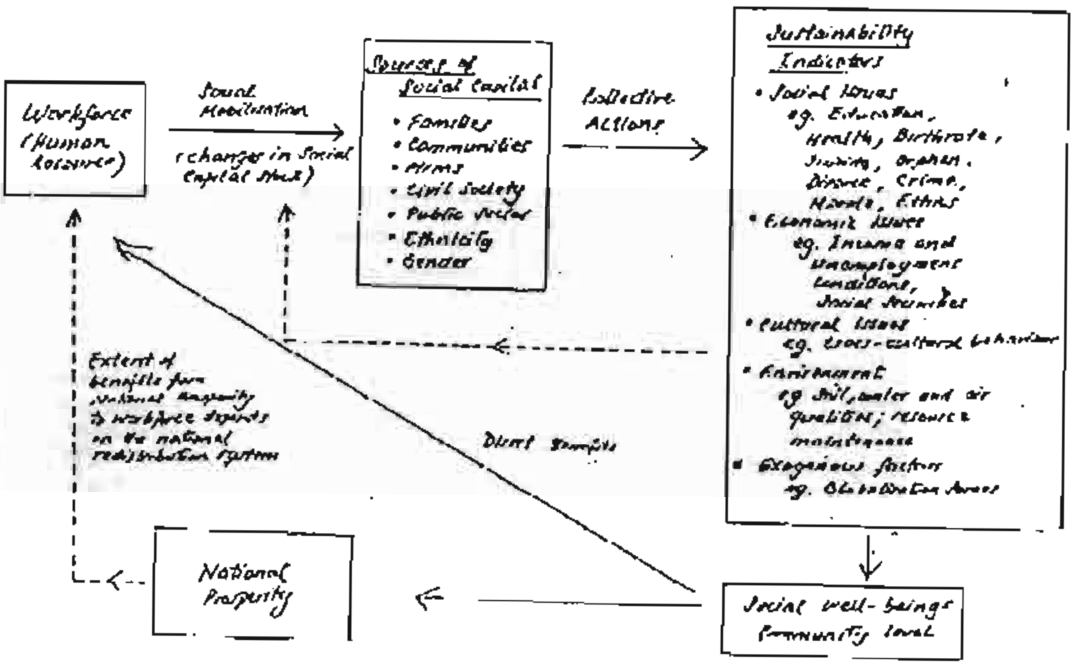


Figure 2: Social Capital- Environment Sustainability Model

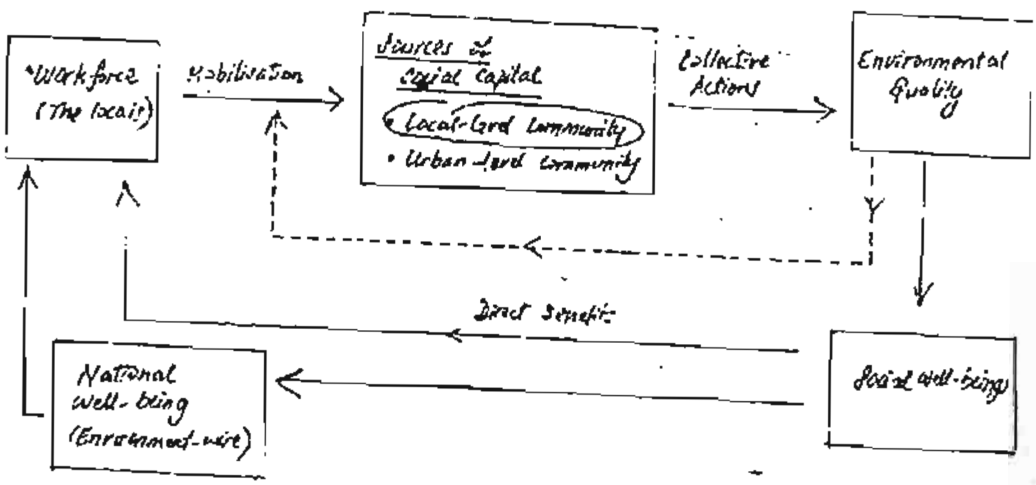
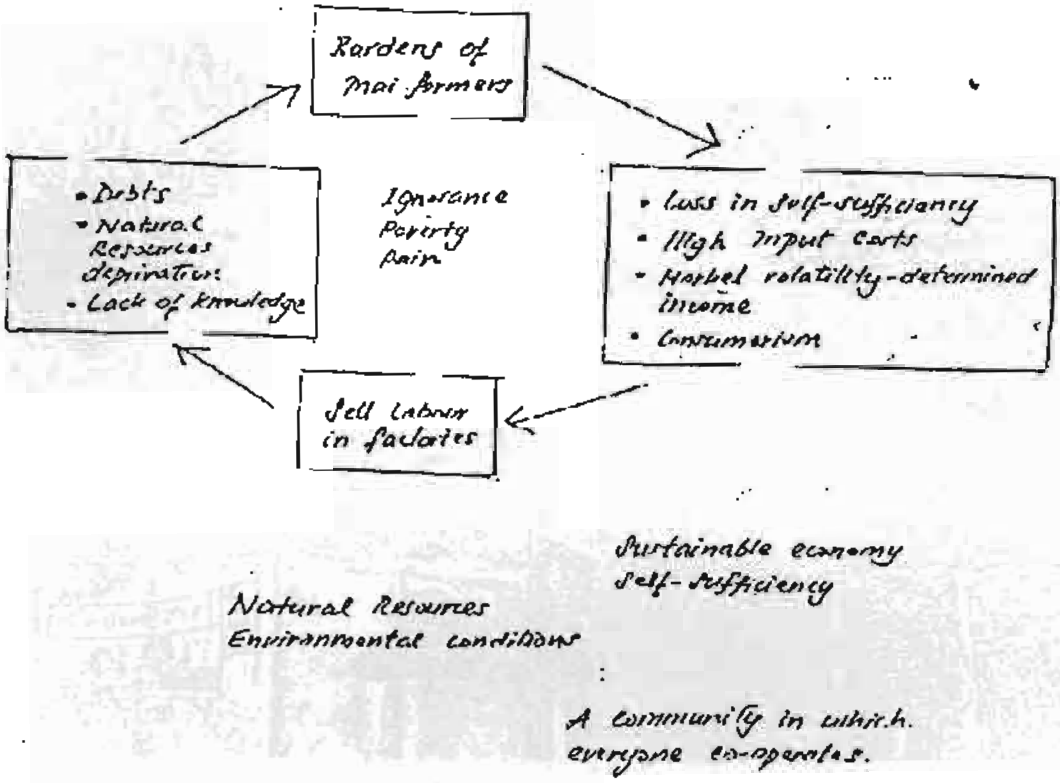
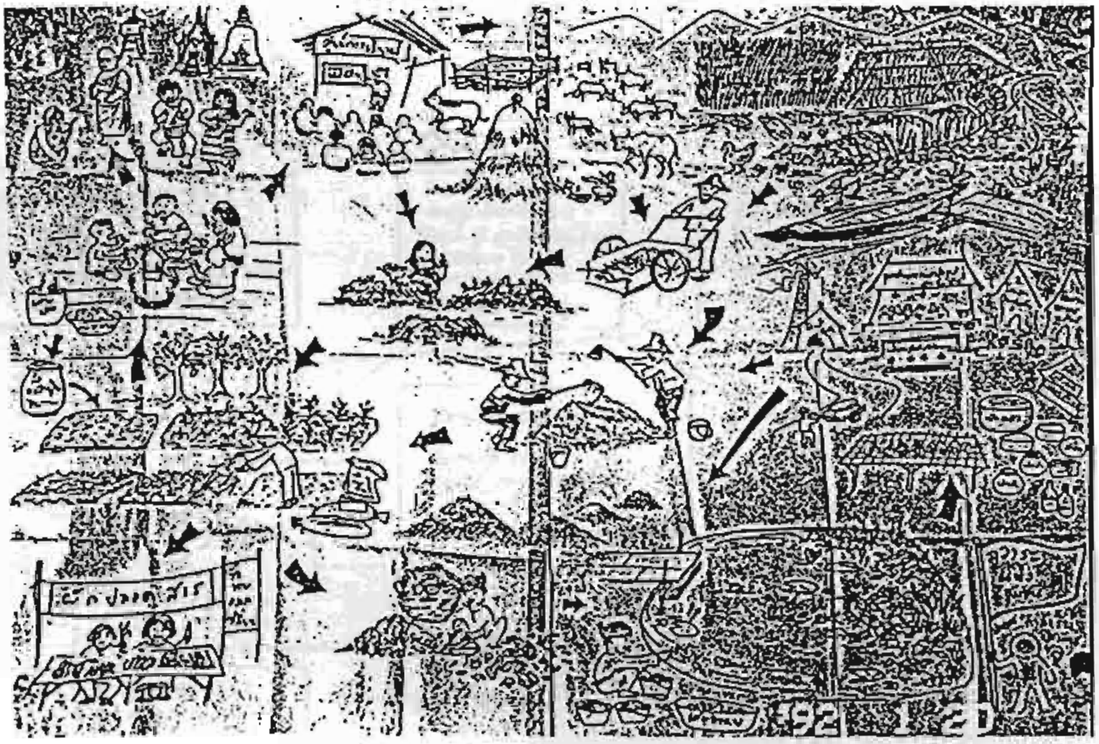


Figure 3: Frame of Thoughts by Baan Sa-Klee Local Community*



* Summary of the seminar organised by Rajabhat Institute Ayudhya, April 2002

Figure 4: The Working of the Baan Sa-Klee Community*

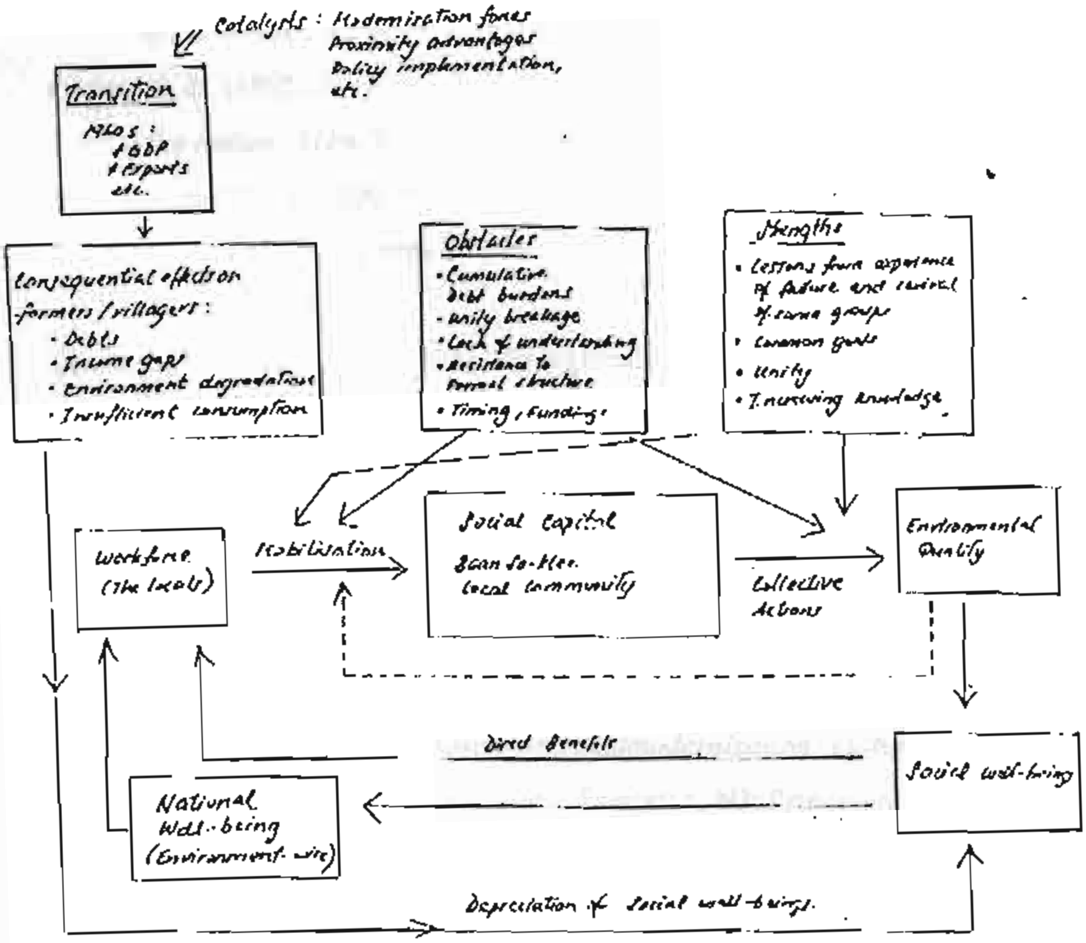


* Illustrated by Khun Boonchoo Punpeng

Courtesy of Alternative Business Group, Baan-Saklee Local Community

Figure 5: Extension of Social Capital-Environment Sustainability Model:

The Case of Baan Sa-Klee Local Community



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Globalization Strategies of Automobile Assemblers in Thailand and Adaptation of Local Parts Suppliers

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Globalization Strategies of Automobile Assemblers in Thailand and Adaptation of Local Parts Suppliers

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Abstract

This paper discusses the adaptation process of assemblers and local parts suppliers in the Thai automobile industry after the economic crisis in 1997. Several changes in assemblers' investment strategies in Thailand brought about significant challenges to local parts suppliers. Structural changes in the industry, brought about by the assemblers' global purchasing and production policy of using Thailand as an export base, unquestionably imposed difficulties upon local parts makers. Survey results indicate that local firms were found lacking in 'process engineering' and 'design' capabilities, which are crucial for them to maintain orders from their customers. This study suggests that, in order to survive and sustain their growth, local firms have had to improve their technological capabilities. In the short run, they have needed to promote 'continuous improvement' in three basic areas: quality, cost, and delivery (QCD) performance, while over the longer term, they have to improve their engineering capabilities and acquire design and testing technologies. There is a great need for technological and financial alliances with foreign partners, public support in forms such as training and parts-testing centers, and the local firms' own efforts. Close collaboration between the private and public sectors is necessary for the whole industry to sustain its growth.

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1. Introduction

Since the late 1990s, the Thai automotive industry has been changing significantly. The industry has undergone a process of structural change, which can be considered as a transition period from a mere import substitution industry to one more export-oriented. In addition to the adaptation process since the economic crisis, changes in globalization strategies undertaken by major vehicle assemblers, which dominate the Thai automotive industry, have produced substantial impacts on the industry as a whole. Significant strategic changes include the global sourcing strategy, the trend to use Thailand as an export base for some specific models of automobiles, and the pressure of partially transferring product development to Thailand. The industry is now exposed to global competition. Parts makers as well as assemblers face higher competition. Their technological capability will inevitably be tested, and they will have to adapt their supply capacity to meet higher demand in the near future.

However, many parts makers still have significant financial and technological limitations because they have just recovered from the crisis. Previous studies such as Nipon and Chayanit (2000), and Thamavit et al. (2002), have pointed out that many local part firms have already gone bankrupt, some have been taken over by foreign firms, and others have quit the industry because of the crisis. It has been argued that local parts suppliers seem to have more serious difficulties with the technological issues than with the financial ones, because many financial institutions have already provided emergency support (Kriengkrai 2002b). A reason for this is that local firms have had little opportunity to accumulate manufacturing experience.[3] Nevertheless, since they are unable to resist the trend of globalization, they need to upgrade their technology capabilities; otherwise, they will be forced to go out of business. The new trend of transferring higher technology by assemblers, to be discussed in this paper, will make it necessary for local suppliers to understand their opportunities and weaknesses in order to adapt

[3] Kriengkrai (2002a, b) notes that the technical problem arises because of the separation of the product development activity (performed in Japan) and the production process (in Thailand).

and sustain their businesses, and for the Thai government to know how to provide support to local firms.

This paper aims to describe the current situation in the Thai automobile industry. It discusses the process of recovery from the crisis that broke out in mid-1997 and the subsequent adaptation processes of automakers and parts makers, and it examines the effects on local parts makers of the changes brought about by the globalization strategies of assemblers. Based on these findings, it seems apparent that suppliers need to improve themselves even if they still have some limitations in meeting the increasing performance demands on the three basic areas of quality, cost, and delivery. In the long run, suppliers need to find strategic technological partners, that is, they must make contractual technical agreements, or make joint ventures, to improve their technological capabilities and competitiveness.

2. Structure of the Thai Automobile Industry and the Pre-crisis Environment

The historical development of the automotive industry in Thailand can be divided into four major phases: 1) early promotion and industry protection through import substitution policy (1960 – 1970), 2) rationalization through Local Content Requirement (LCR) policy (1971 – 1986), 3) the early stage of the export era and a semi-liberalization period (1987 – 1996), and 4) the period leading from the crisis toward liberalization (1997 onwards). Because many studies[4] have provided fairly complete documentation of the historical development of both automobile assembly and the supporting industries, this paper will limit its discussion to the last two stages, i.e., from the semi-liberalization (pre-crisis) to the liberalization period (post-crisis); it will, however, pay greater attention to the post-crisis period. It will focus particularly on the period after the crisis, which can be regarded as the turning point of the Thai automobile industry, which in turn has had considerable impacts on the industry overall. This point will be examined in detail in section 3. This section discusses the structure of the industry and the historical background of the pre-crisis period, in terms of government policies and the reaction of business firms that set the stage for liberalization.

2.1 Structure of the Automotive Industry in Thailand

2.1.1 Automobile Industry

The Thai automobile industry was promoted in line with an import substitution policy. It was among the first industries to receive an investment promotion from the Board of Investment (BOI) and was targeted to promote other industries through its potential of creating linkages. During the early stage, 1961-1971, there were 13 assemblers, the following five of which were Japanese-related enterprises: Siam Motor & Nissan, Toyota Motor Thailand, MMC Sittipol (Mitsubishi), Isuzu Motor Thailand, and Thai Hino Industry (see Table 1). From the beginning to the present, 24 assembly plants have been built (see Table 1). But, according to a report by the Ministry of Industry (MOI 2001), there were 17 automobile assemblers in 2001, with an annual production capacity of 996,800 units (see Table 2). Since the ban on new assembly plants was lifted in 1993, four new projects, namely, Honda, General Motors (GM), Auto Alliance Thailand (AAT), and BMW, have been established. The appearance of these new firms has led to higher competition in the domestic market and paved the way for Thailand to become an export base. Incumbents such as Toyota and Mitsubishi have also adopted export strategies and have already implemented plans to use Thailand as their export base. After only 40 years of development, the Thai automobile industry is now becoming more externally oriented.

2.1.2 Auto Parts Industry

Since a series of rationalization policies was implemented in 1972, the auto parts industry in Thailand has developed significantly. From that time until 1999, the Thai government has implemented a series of major policies – including a local-content requirement (LCR) policy, the mandatory and selective items for localization, high import tariffs, a ban on imported CBU, a ban on new assembly plants, and the localization of the diesel engine – to promote the growth of ancillary local parts and components firms in the automobile industry; boosting the interplay among foreign automobile manufacturers, the state and local firms has

[4] See for example, Doner (1991), Noppadol (1995), Thamavit (1997), Abdulsomad (1999), and Kriengkrai (2002b).

been important for the industrial and technological development of the auto industry.[5]

Most local components firms in Thailand began business by producing replacement equipment under the import-substitution industrial policy; later, they were eager to produce Original Equipment Manufacturing (OEM) parts. According to BOI (1999), Thailand's automotive parts industry consists of about 700 parts makers and can be divided into two major types according to the two respective characteristics of parts production: OEM [6] and Replacement Equipment Manufacturing (REM). There are about 200 OEM parts manufacturers, almost all of them Japanese-owned or Japanese joint venture firms, and some 500 REM makers.[7]

2.2 Pre-crisis: Early Stage of Export Era and Semi-liberalization Period (1986-1996)

Since 1987 the Thai automotive industry has been characterized by a transition from domestic-oriented production toward greater liberalization, and the overall industry has developed a more outward-looking strategy. Exports from Thailand became viable by the end of 1987, when Siam Motors & Nissan and MMC Sittipol (Mitsubishi) exported their first lot from Thailand (Bangkok Post, December 30, 1987).

Beginning on January 1, 1987, a new revised "mandatory and selective items list" was imposed, and the minimum local content requirement was set at 54

[5] See also, Abdulsomad (1999) and Kriengkrai (2002b), for detailed discussions of the (Japanese) assemblers' response to government policies, which has resulted in the development of supporting industries in Thailand. Regarding the development of the technology levels of supporting industries in Thailand, a recent survey by Kriengkrai (2002b) has compared the availability of six automotive-related industries (casting, forging, presswork, press die-making, plastic processing, and plastic mold-making) between 1995 and 2001, using the UNICO (1995) as a reference point. The study has found that all of these industries have been significantly developed.

[6] According to Hobday (1995; 37), OEM is a specific form of sub-contracting, in which a supplier produces a finished product (or part) to the precise specifications of a customer. The customer then markets the product under its own brand name, through its own distribution channels. However, in Thailand, policy makers and industrialists adopt the term 'OEM' with a slightly different meaning. In Thailand, OEM parts are defined as parts produced by a supplier to the customer's specifications and delivered directly to the assembly plant. (Automotive 1997; 105).

[7] Since the economic crisis, there has been no further update on the number of local parts makers; however, Nipon (2001: p.3) notes that the total number of suppliers is less than 700 firms. A reason for this reduction is that some of Thai firms, particularly SMEs, went bankrupt.

percent. The objective of this policy was to transform the industry from pure assembly to semi-manufacture through the compulsory use of the LCR policy (Busser 1999, p. 178). In 1991, this LCR was finally frozen at a maximum of 54 percent for passenger cars and 70 percent for one-ton pickup trucks. That LCR policy was imposed until the end of 1999.

With the high demand for pickup trucks and the localization policy, the government paid particular attention to the promotion of diesel engines for one-ton pickups. The Automotive Industry Development Committee (AIDC)[8] required the assemblers of pickups with engine capacities up to 2,500 cc. to use locally manufactured engines. Imports of engines were banned, and a progressive local content requirement program began. A summary of major automobile industry policies is shown in Table 3. As a result, four automobile assemblers began manufacturing their engines in Thailand. Three Japanese joint ventures – including Toyota, Thai automotive (a subsidiary of Nissan), and Isuzu – were promoted by the BOI, while Mitsubishi was promoted by the MOI for the assembly of diesel and gasoline engines (Supawan 2000, p. 25-26).[9]

In addition to the LCR policies, other liberalization policies were implemented by the government during the 1990s. The first was in July 1991, when the Government lifted the import ban on CBU cars and completely restructured the tariff system on automobiles and auto parts (BOI 1995). These decisions forced the Thai assembly and auto parts industries to improve their efficiency and produce higher-quality cars to meet international standards for export. Then, in 1993, the ban on new assembly plants was lifted. The effect of this policy shift was strong; it significantly transformed the Thai automobile industry from a highly protected industry to a more liberalized one. Moreover, because of the commitment of the Thai government to the General Agreement on Tariffs and Trade (GATT) in 1993, the Thai government had to reassess the import duty

[8] The Automotive Industry Development Committee (AIDC) was established by the Ministry of Industry (MOI) in 1969 in order to impose policies and measures for the automobile assembly industry (MOI 2001).

[9] As a specific result of BOI promotion, five engine parts, namely, the cylinder-block, the cylinder head, the crank shaft, the cam shaft, and the connecting rod, had to be produced locally. At present,

structure for finished vehicles, kits, and components, as well as raw materials, and to plan for the gradual phasing out of local content regulations. This action accelerated the liberalization process of the industry and made it more outwardly orientated.

Combinations of these policy changes are important factors attracting many assemblers to set up operations in Thailand and to use the country as their production hub in this region. Many Japanese and U.S. automobile assemblers and auto parts manufacturers are turning Thailand into a major assembly and components-manufacturing export base for their global operations.[10] For incumbent Japanese firms, a main reason to use Thailand as their export base was that Thailand had no 'national car' project. As evidence, the president of Toyota Motor Thailand commented, "Thailand is the best candidate for hub status because it has no "national-car" policy and offers a level playing field" (Bangkok Post Economic Review 1999).

For the newcomers, including GM, AAT (Ford and Mazda), and BMW Manufacturing, the liberalization policy was a main motivation.[11] The entry of these globally competitive assemblers undoubtedly led to an intensification of competition among automobile manufacturers in Thailand.[12] In the late 1990s, many large, world-class parts suppliers, such as Delphi Automotive system (GM supplier), Visteon and Hella Climate Control (Ford Suppleirs), Sekurit Saint Gobain, and DANA Spicer, established factories in Thailand, following their customers' relocation. Hence, not only did the liberalization policy bring about

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these five compulsory items are produced locally, and the local content of diesel engines produced in Thailand is higher than 70 percent.

[10] Many automakers have implemented export programs. In 1996, Mitsubishi established a clear policy to use Thailand as its center for worldwide production of pickup trucks. Other firms, such as Toyota, Ford, Mazda, Isuzu, and GM (a newcomer), followed the same strategy by establishing Thailand's plants as their regional export bases in Asia.

[11] It was reported that the Ministry of Industry had assured GM several times that Thailand would stick to its liberalization plan, namely, lifting the LCR and cutting import tariffs on raw materials, because of fears that GM might scrap the project (The Nation, October 27, 1997). This statement shows the strong influence of the liberalization policy and the investment decision by this American firm. For BMW, the strategic decision to invest in Thailand was the potential market and its potential as an export base (www.auto-asia.com/interview/interview.2000.05.30.01.shtml).

[12] An unarguable phenomenon is the decline of market share of Japanese assemblers. It has been reported that in 1992, Japanese dominance was about 95 percent but that it has gradually decreased,

higher competition in automobile market, it had a similar effect on the auto-parts manufacturing sector.

3. Major Environmental Changes in the Thai Automobile Industry after the Crisis

3.1 The Reduction of Production and the Plan to Export Overstock

Due to the economic crisis, the domestic sale of new vehicles dropped sharply, by 38.36 percent in 1997 and 60.33 percent in 1998 (Table 4). The decline in domestic demand made assemblers adjust their production plans. According to BOT (1999), Nipon and Chayanit (2000) and Thamavit et al. (2002), the assemblers made their adjustments by reducing their production, temporarily stopping production, and reducing the number of workers as well as operating and working time. Accordingly, the domestic production of automobiles decreased by 35.59 and 56.11 percent in 1997 and 1998, respectively (Table 4).

From 1997 to 1999, there was a huge excess capacity of automobile assembly. The capacity utilization rate was lowest in 1998, when it was only about 17 percent (Thamavit 2001). The excess capacity was due to over investment during the boom period, undertaken to meet the expected growing demand, which was thought to be likely to increase to about 800,000 to 1,000,000 vehicles by 2000 (UNICO, 1995). Many assemblers, such as Toyota and Honda, which had previously concentrated only on the domestic market, then focused on exporting some specific models from Thailand by utilizing the excess capacity (Nation, October 29, 1997, and November 23, 1998).

For instance, Toyota began to export Thai-made pickup trucks to Australia and New Zealand in October 1998. Nissan exported pickup trucks from Thailand in 1999. Honda began to export small passenger cars (Honda City) to Singapore and Brunei in July 1997 and to export the Honda Accord to Australia and New Zealand in 1998. In 1999, Honda exported about 7,000 to 8,000 units (Thamavit

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to 91 percent in 1999, 88.8 percent in 2000, and to 87.2 percent in the first four months of 2001 (Bangkok Post Mid-year Economic Review 2001).

2001). This strategy was adopted in order to circumvent the insufficient domestic demand brought about by the economic slump.

As can be seen in Table 5, from 1997, automobile exports increased sharply during 1996, from 14,020 to 42,218 units, and grew continually to 67,857 and 125,702 units in 1998 and 1999, respectively. In addition to automobile exports, a number of parts and components firms succeeded in breaking into the export markets, especially those for safety glass, ignition coils, wiring harnesses, air and oil filters, and related products.

The industry has been recovering since 1999, as can be seen in Table 4. Domestic production has grown from 158,130 units in 1998 and stood at 459,418 units in 2001, almost equivalent to the figure in 1995. Domestic sales increased from 144,065 in 1998 to 196,985 units in 2001, and they are expected to increase to 380,000 units in 2002 (Manager, July 31, 2002). Although the surge in domestic demand in 2002 may result in the reduction of exports by these firms (The Nation, August 1, 2002), it is reported that many Japanese auto assemblers have decided to use Thailand as their export base, and their projects will commence in the next few years, as will be discussed in the next section.

3.2 Thailand as a Production Hub and Export Base

Based on the automobile assemblers' globalization strategy for production efficiency, Thailand was selected to be a production hub in the region and in some cases the export base for beyond the region as well. This is because the country has considerable growth potential in its domestic market. The recent crisis accelerated this move. Many firms have decided to make Thailand their export base and production hub in Asia, resulting in Thailand's being dubbed the "Detroit of Asia" by Asiaweek.[13]

Among assemblers, Mitsubishi Motors Corporation in Thailand is the largest exporter of CBU cars, with an export amount higher than 60,000 units for many years. It exports pickup trucks to Europe and passenger cars to New Zealand. In the first half of 2002, it exported 30,993 CBUs. The second and third largest

[13] From http://www.asiaweek.com/asiaweek/magazine/99/1001/biz_intvu.html

exporters are Auto Alliance Thailand and GM, newcomers that commenced their operation only in 1998 and 2000. Both companies chose Thailand as their export base from the beginning, and their exports grew rapidly after the launch of mass production, in May 1998 for AAT and in 2000 for GM. In 2001, both companies exported more than 40,000 units (see Table 6). In the first half of 2002, AAT and GM had already exported 20,949 and 14,416 units, respectively (Prachachart Thurakit, 5-7 August, 2002).

Because Thailand is the world's second largest market of one-ton pickup trucks, many Japanese assemblers are restructuring their operation strategies to shift their production of one-ton pickup trucks to Thailand. For instance, in 2003, Isuzu will transfer all of its pickup production in Japan to the Samut Prakan plant in Thailand and plans to produce 160,000 units in 2004. Isuzu's Samut Prakan plant will then produce vehicles for Thailand and Australia while GM's Rayong plant exports 145,000 units (50,000 CBUs and 95,000 CKDs) to other markets (www.auto-asia.com, March 3, 2001, The Nation, May 17, 2002). Similarly, Toyota reportedly plans to shift all pickup production from Japan to Thailand. As a result, Toyota Motor Thailand's (TMT) annual output will rise from 77,000 units in 2001 to 300,000 by the end of 2004 (Auto-Asia, July 3, 2002). It currently exports 12,000 units annually but has plans to increase that figure to 100,000 units in the next three to four years (The Nation, December 20, 2001). Most of the pickups will be exported. This is a part of global strategy of the Toyota headquarters.

In addition, Honda has a definite plan to use Thailand as its export and production hub in Asia. Exports of CBUs are expected to surge in 2003 when it commences production of a new locally made subcompact car (which will be based on Fit's platform) to Japan. Although the production volume for the new model has not been finalized, the export target is 1,000 cars per month to Japan (The Nation, December 20, 2001).

3.3 Globalization Policy and More Deliberate Launching of New Models from Thailand

Globalization and the resulting intense competition in the world market are forcing automobile assemblers to improve their efficiency and competitiveness. As discussed above, Thailand has been selected as production hub in Asia by major automobile assemblers, which is a part of their global strategy to build regional divisions of labor. In order to compete successfully in the world market, every assembler needs to produce at the highest efficiency level. Products manufactured in and exported from Thailand have to meet international standards of quality, price, and timely delivery (QCD). Mori (2002, pp. 32) notes that automobile assemblers aim to reduce the costs of parts and raw materials in Thailand by 15 to 30 percent in the next three years. This means that local suppliers can expect pressure in cost reduction. In addition, as a part of their global strategy, many assemblers plan to launch new models of cars on the worldwide market simultaneously (Mori 2002, pp. 33).[14] As regards the projects in Thailand in particular, details are provided in Table 7.

As Thailand becomes the production hub of some of new models, technological requirements would be heightened along with production volume. It can reasonably be expected that there will be 'intra-firm' technology transfer by assemblers to accomplish this plan. Japanese automobile assemblers, in particular, have plans to increase the localization of engineering functions to raise the ratio of localization (in the region). They aim to strengthen not only the procurement capabilities of their affiliates in Thailand, but also to transfer portions of the production development technology (Mori 2002).

Information in Table 8 sheds some light on the areas of technology that will be transferred at the "intra-firm" level. Apart from simple technology such as assembly, automakers need to transfer production management, supply-chain management, process engineering, engineering change to local condition, and,

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[14] In fact, since 1996, automobile assemblers have been more conscious about introducing the production of new models in other countries, outside Japan; this pattern is especially prevalent in Thailand (Mori 1999, 2002).

surprisingly, the product engineering as well.[15] These functions are crucial to assure the success of the launch of new models in Thailand, since they will make possible the modification of blueprints prepared by parent companies in order to use local parts (Mori 2002; pp. 32).

According to Table 8, the majority of product-development processes of vehicles produced in Thailand have so far been carried out by parent companies in Japan, while plants in Thailand have played only a limited role, such as the provision of information about local conditions and tastes that will allow conditions in Thailand to be reflected more accurately in the designs. This is also true for models that are currently produced mainly in Thailand, such as 'City', 'Soluna', or 'Hilux' pickups. In the future, it is likely that product engineering and engineering changes to local specifications will be transferred. Transferring the engineering function to Thailand would facilitate in-depth information-sharing between production processes and engineering processes that allow some modifications by Thai plants. This reflects the view of Japanese automobile assemblers that they want to make their operation in Thailand more self-sufficient, both so that they can increase the localization ratio and so they can reduce lead time (Mori 2002, pp. 33). Nevertheless, the transfer of product development and design will not be in the very near future because the choice of location of product development will depend on corporate strategies, and the centralization of product development in Japan seems to be most economical in the current globalization trend.[16]

[15] Product engineering refers to a series of cycles that proceed from the development of detailed blueprints for each component and major systems; then prototypes of components and vehicles are built based on those preliminary drawings; prototypes are tested against established targets; then tests are evaluated and designs modified as necessary. The cycle is repeated until an acceptable level of performance is achieved (Clark and Fujimoto 1991: 116-117).

[16] According to an interview with the Japanese staff members of an automobile assembler, product development and design will remain at headquarters. Although this company has a decided intention to transfer the development function, including drawing, to Thailand, the plan is on hold because the situation has changed. A new model, which previously was a regional model, has become a world-wide strategic model. It will also be produced in other countries. The practice in which Thai engineers participated in the design activity has been abandoned. However, in the future, if plans resume to transfer some areas of the design and product development technology, those functions of the one-ton pickup truck will be the first model to do so.

This change has serious effect on local parts suppliers, especially those without foreign partners, as will be discussed below. There are at least two reasons for this. First, local firms normally lack 'process engineering'[17] capability, while new models normally feature better or improved technological requirements; not only the specifications but also the design and production methods are more sophisticated and require higher manufacturing capabilities (Kriengkrai 2002a, b). These factors impose greater pressure on the industry, but the effect is expected to be particularly high for local parts makers. To maintain their businesses, local parts makers must improve quality and offer competitive prices to the buyers.

Second, assemblers may need to deal with suppliers that have design capability. This is due to the fact that once product engineering processes are transferred to Thailand, it is possible that suppliers in Thailand will have to participate in the assemblers' product-development processes and that parts will be developed jointly, as is now the case in Japan. If local suppliers cannot provide this service, they might invite their home-based suppliers to locate in Thailand. That would result in downgrading of local Tier-1 suppliers to Tier-2 or Tier-3 suppliers. We will return to this point in the next section.

4. Major Changes in and Impacts upon Local Parts Suppliers

During the last five years, the Thai automobile industry has undergone significant structural changes. As discussed above, several factors account for these changes; namely, the economic and financial crisis in 1997, the abolishment of the local content requirement regulations, the entrance of newcomers (American and European firms) who brought with them global parts-sourcing strategies, and the decision of many of incumbents and newcomers to use Thailand as their export

[17] 'Process engineering' activity is defined by Clark and Fujimoto (1991, p. 122) as "a series of [preparation] cycles [in which the] usual progression is to develop a plan for the entire production system; develop plans for individual processes...; and conduct detailed design of tools and equipment; procure or construct and install tools and equipment; try out and test tools and equipment; and conduct a pilot run." The cycles of modification and improvement in product-process design then proceed, and the conditions need to be approved by the customer before commercial production begins. Hence, it can be argued that in order to be successful in launching mass production of new models, the 'process engineering' capability of every supplier is a precondition. Carefully considered, the 'process engineering' is similar to the process during which suppliers make preparation for production..

base for some specific new models. Under the current circumstances, impacts from such changes on local parts makers are particular strong because these manufacturers lack both the financial resources and the technology necessary to meet the price-competitive and quality-enhanced requirements for export products. Local parts makers will inevitably face difficulties unless they improve quality and offer buyers competitive prices. Their status has been sufficiently fragile to make it necessary for policy makers to consider how to assist them. This section will present the adaptation process to the economic crisis and the effects of those changes on local parts firms and will discuss the ways local firms could adapt in response to such changes both to survive and to sustain their growth despite the severe competition.

4.1 Adaptation Process of Local Parts Suppliers after the Economic Crisis

4.1.1 Effects from the financial crisis in 1997

The crisis in 1997 added to the difficulties of local parts firms. Those difficulties went beyond technological capacity to include financial solvency. The economic crisis had two major effects on local auto-parts makers. First, due to the decrease in domestic sales and production of cars, the demand for auto parts decreased sharply; see also the discussion in section 3.1 and Table 4. Jeopardized by the economic crisis, local firms' restructuring plans were focused on downsizing, searching for foreign partners to be sources of financial and technological assistance, and trying to export their products. Second, their foreign debts in terms of Baht increased drastically after the depreciation of the Baht, and there was a liquidity crunch in the Thai economy. As a result, many Thai companies faced severe liquidity shortages and losses of revenue, and many became insolvent. It was very difficult for local parts makers to survive without outside financial aid. Most global suppliers, especially Japanese firms, increased their capital in local joint ventures after the crisis. However, the majority of Thai partners could not increase their capital investment in joint ventures. Thus, foreign investors increased their ownership and control in those joint ventures.

Because of widespread financial insolvency, in August 1997 auto parts makers asked the BOI to increase the limit on foreign equity holdings, so that they could achieve greater liquidity (The Nation, August 30, 1997). The BOI has relaxed the equity condition, allowing foreign investors to own 100 percent of any industrial project in any zone without being required to export the products. Its main objectives were to increase the liquidity of local small and medium scale enterprises and, at the same time, to raise quality standards.[18] Brimble (2000: 12) reported that 19 out of 130 merger and acquisition deals during the period from July 1997 to May 1999 were in the automotive sector. Seventeen out of these 19 deals were with Japanese firms. The net foreign direct investment in machinery and transport equipment has increased substantially, from 109 million US dollars in 1996, to 667 million US dollars in 2000 (Thamavit 2001).

According to the Bangkok Post (April 15, 2000), more than 600 auto parts firms have been closed or taken over by foreign firms since the beginning of the crisis. Large companies as well as small firms have faced difficulty. For example, the Siam Cement Group sold its equity in Thai Engineering Products Co., Ltd. (machining and aluminum casting), Nowaloha Industry Co., Ltd. (iron casting), and Siam AT Industry Co. Ltd. (machining), to Aishin Takaoka (Toyota Group) in 1999. In addition, the Siam Cement Group announced that its auto parts business was not its core business any longer (Thamavit et al 2002).

The Somboon group, one of Thailand's largest auto parts manufacturers, also needed to restructure its business from 16 subsidiaries to focus on only three core businesses. A vice president of the Somboon group disclosed that a "lack of investment capital prevented many firms completing needed machinery upgrades to comply with tougher sourcing standards" (Bangkok Post, May 2, 2000). Another example is that of a local medium-sized company, Taveechai Brakeshoe (Thailand). The company sold of 49 percent of its equity to acquire 500 million baht to reduce its debt burden. But the managing director also pointed out that his company also received technology transfer from its strategic partner (The Nation, July 24, 1999).

In addition, some firms have diversified their businesses. For example, the Sammitr Motor Group, a major local producer of auto parts, announced that it was

[18] There is a promotional condition that the new projects need to be accredited with an ISO quality certificate within two years of being granted the privilege.

switching from being purely an auto parts producer to entering the agricultural machinery business, and that it planned to have 50 percent of its total revenues from the new business within the next five years. The Group president explained that it was unable to become an international player because its costs were higher than those of its competitors (The Nation November 5, 1999). Thai Summit Group and Thai Rung Union Car also diversified their production to include electrical appliances, both products and parts, and agricultural machinery.

Because of a decline in domestic demand, auto parts makers also tried to increase their direct exports the same way automobile assemblers had. Auto parts can be exported either through 1) indirect export (in the export of CBU cars), or 2) direct export, such as OEM parts and REM parts. In terms of the direct export of auto parts, the majority is through global suppliers such as Thai Arrow Product Co. Ltd. (which exports wiring sets) and Denso. Some Thai-Japanese joint ventures that once supplied seat belts for domestic market only have begun exports to their parent companies in Japan and have begun to export to other countries (Nipon 2001). It is expected that the export of after-sales parts or REM parts will also increase.

In this new environment, some of local auto parts makers who have not been able improve have had to go out of business. However, some of them have adjusted themselves and joined the network of global suppliers. Therefore, the new environment provides both threats and opportunities for local auto parts makers.

4.1.2 Abolishment of Local Content Requirements (LCR) policy

Because of the projected date for abolishing the LCR of January 1, 2000, the Thai government decided that the most important matter was to help local part makers reduce costs and acquire technology. The Ministry of Finance revised the import tariff structure, especially regarding raw materials, to lower the production costs of local parts production. By January 1, 2000, the Thai government had terminated the LCR, but it had also increased the import tariff on CKD for all types of vehicles from 20 to 33 percent while simultaneously reducing the excise tax by 2 to 3 percent. These steps were undertaken to keep prices from going up, to protect the customer, and at the same time to protect the local parts makers from the abolishment of LCR; see Table 9.[19]

Nevertheless, automobile assemblers have been free to import parts that offer the best quality at competitive prices from anywhere in the world. Although major carmakers affirm that they are committed to Thailand as their production base, and their purchasing decisions will focus first on local parts, the final decisions depend on quality and price competitiveness (Bangkok Post, May 2, 2000). Local parts makers will certainly face difficulties unless they improve quality and offer competitive prices to the buyers.

4.2 Effects from the Changes of Assemblers' Globalization Strategies

Local suppliers will have to downgrade their status with assemblers. According to Thamavit et al (2002), auto part makers in Thailand may be divided into four groups: (1) Tier-1 global suppliers who are subsidiaries of transnational companies or joint ventures and work closely with assemblers to develop products and supply directly to assemblers; (2) Tier-1 local suppliers; (3) Tier-2 suppliers; and (4) Tier-3 suppliers. The globalization of production and procurement will create substantial threats to the auto parts industry in Thailand. The changes in the auto parts industry in Thailand are as described below.

Along with the investments of the US big three in Thailand, several Tier-1 global suppliers from the US and Europe have established their own subsidiary companies in Thailand or purchased the majority share of Thai companies, as discussed in 4.1.1. They regard their operations in Thailand as part of their global network. These global suppliers have formed their networks including Tier-2 and Tier-3 suppliers in Thailand. For example, Delphi has formed its network with about 20 suppliers in Thailand. All of the suppliers are joint ventures, and none is a purely Thai-owned company (Thamavit et al 2002, pp. 219). One reason is that in accordance with their plans to transfer production of new models to Thailand, they prefer to deal with suppliers that have design capability; see also discussion in 3.3.

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[19] In July 2000, the cabinet approved further tariff reductions on 542 product lines, most of them primary raw material unavailable locally, to reduce production costs and improve export competitiveness (Bangkok Post, July 5, 2000).

It is expected that local suppliers cannot be of the bona fide global Tier-1 category. According to a criterion set by GM and Isuzu, a global Tier-1 supplier must have the ability to supply parts to all of their global strategic production locations where the vehicles will be produced (Mori 2002, pp. 38). This is because the trend of procurement is moving toward "modular" or "system" parts.[20] There are three major reasons. First, local firms have limited capabilities to be Tier-1 suppliers.[21] More specifically, while automobile assemblers have plans to shift the responsibility of design to suppliers, local firms usually lack design capabilities. Second, global suppliers – Japanese, US and European firms – came to Thailand to supply parts to their customers, and these suppliers – far superior to local firms in terms of technology, management, and financial – assumed Tier-1 positions that often moved local firms to Tier-2 status. Third, many local Tier-1 suppliers have been taken over by global suppliers or foreign firms after the recent economic crisis, as discussed above. As a result, most of the local auto parts makers will have to downgrade themselves from Tier-1 to Tier-2 suppliers, or from Tier-2 to Tier-3 suppliers.

In fact, the trend of launching new models from Thailand is not completely new. Several interviews with some major vehicle assemblers as well as some Thai suppliers indicate that intrinsic technological requirements of the ordered parts placed by carmakers have changed rapidly since the 1990s. Until the early 1990s, car models assembled locally were those produced elsewhere, such as in Japan or Europe. Since the latter half of the 1990s, many assemblers have changed their strategies to launch new models in Thailand. Clear examples are the "strategic Asia car" of Toyota (Soluna) and Honda (City). This trend will become increasingly important, since many new models of pickup trucks have been recently launched by Toyota (Tiger), Mitsubishi (Strada), Isuzu (D-Max), Ford (New Ranger) and Mazda (New Fighter), and will be more numerous in the future; see also Table 7. Undoubtedly, there will be greater pressure on local parts firms because they need

[20] 'Modular' is the word used by American assemblers, whereas 'system' is the term used by Toyota.
[21] Suppliers that supply 'modular' parts to assemblers will need to possess abilities to coordinate their suppliers of 'sub-modules' and to manage and ensure the overall quality of 'modular' parts.

sufficient "process engineering" capability, which they have had less opportunity to accumulate because of the characteristics of the technical requirements of the ordered parts in the past.[22]

Why have local suppliers accumulated little experience? The reasons are two-fold. On the one hand, it is mainly because of the production of 'old' or 'copy' models in Thailand. Kriengkrai (2002b) explains that 'copy' models offer little chance for parts makers to accumulate production experience because Thai suppliers prepared their parts by copying the production process and tooling of the parts already developed and used in production elsewhere, in Europe or Japan. In other words, 'information assets' regarding the production process, tooling and equipment were developed by other makers, in some cases by the assemblers themselves, and then were transferred to Thailand. Owing to the fact that master models of many parts in production were prepared by other firms, suppliers in Thailand did not need to perform engineering tasks such as designing, tooling, or production processes themselves. As a result, they did not have the opportunity to accumulate experience regarding these basic engineering tasks for production.

On the other hand, prior to 2000 the LCR policy was still in effect. This policy forced assemblers to purchase parts from domestic suppliers. Hence, even though suppliers had insufficient capability, they had to render some kinds of assistance, such as providing technical advice or even direct training, if assemblers had the capability to do so; if they did not, they could induce suppliers to make 'technical assistance agreement' with their home-based suppliers.

From what we have seen, it can be concluded that local suppliers in Thailand typically have the necessary capability in production operations but have less clearly demonstrated capabilities in preparing for production. A possible explanation is found in the observation that Thai suppliers have been given full assistance by the auto manufacturers, their parent companies, or their partners (through technical assistance agreements). When the production trend moves

[22] See discussion in Kriengkrai (2002a, b).

toward launching new models, where no master model is available, some companies may have difficulties meeting the requirements.[23]

4.3 How would Local Suppliers Adapt to Survive and Sustain Their Growth?

Up to this point, we have discussed the effects of the adaptations of automobile assemblers in response to the economic crisis and their aggressive globalization strategies regarding investment in this region. All these changes make it necessary for local firms to make adaptations in the way they do business and perform operations to survive. Based on the evidence in this study, in many cases, local firms will inevitably be downgraded from Tier-1 to Tier-2, and from Tier-2 to Tier-3, due mainly to the assemblers' global sourcing and 'modularization' strategies, and their plans to transfer engineering functions to Thailand.[24] In this harsh environment, local firms need to improve their technological capabilities regarding three basic elements, i.e., quality, cost and delivery, plus engineering (QCD+E).[25] One school of thought holds that local firms should try to develop their 'design' capability because of the changes within the industry (Manager, August 14, 2002). We think most local parts firms should focus first on improving QCD and later on E, after first attaining some good results in QCD, while some prominent firms which have already achieved a certain QCD level should start acquiring E as well as further improving QCD as soon as possible.

Aiming to improve QCD is cost-effective to suppliers since it requires no large investment, and the ability to improve QCD continuously is a prerequisite for 'process engineering' activity, which will be increasingly important in winning

[23] Difficulties are likely to arise; some suppliers should be prepared to make the tooling, and to prepare both the equipment and the production lines by themselves, based only on the drawing supplied by assemblers.

[24] This situation is particularly true for suppliers that produce parts in conjunction with a 'design' capability requirement. Those that provide services such as stamping, casting, or machining may be able to keep their status as Tier-1 suppliers. However, the requirement regarding quality and technology is certain to be higher than that for previous orders.

[25] Although the trend of assemblers' production is moving toward a 'new model', in which suppliers possess a high capability to perform activities such as design function, testing, and development functions, our interview with assemblers as well as Japanese experts in Thailand Automotive Institute (TAI) suggest that QCD is rather important in the short run. Local firms will

orders from assemblers in the near future. Moreover, if companies can improve their QCD performance, i.e., achieve continuous improvement, then automobile assemblers, their customers, would perceive that they have potential to rise to the higher requirements. Hence, suppliers would be more likely to maintain their businesses with assemblers, in which they can also benefit technologically, through spillover effects, from participating as a supplier.[26]

In the short run, local firms should remain focus on and attempt to keep their business they have, i.e., to maintain the orders from assemblers or global Tier-1 suppliers. Since they lack both financial resources and technology, they probably need to adjust their business perspectives. They should not be over-concerned about being Tier-1 or Tier-2, or attempting to maintain their majority ownership if their financial and technology status are fragile. However, local firms may be able to keep their majority share if they explore ways to make joint-venture agreements with new partners.[27] Local firms need to remain aware that they cannot resist the globalization trend of purchasing and production because there is no legal regulation that compels assemblers to use local parts.

In the longer run, local firms should exert efforts to acquire higher technological levels, such as design and product development, in order to maintain their businesses. Suppliers should search for appropriate technology that would enable them to produce parts higher technological requirements. As Mr. Pornthep Phornprapha, the president of Siam Nissan Motors, correctly suggested, in order to survive in the intense competition, the company must have good management and technology. However, because many Thai firms still do not have their own

have very little chance to win new orders from assemblers unless they prove that they are strong enough in QCD.

[26] A recent work on the Thai automobile industry by Kriengkrai (2002b) reported the existence of technology transfer through this 'inter-firm' channel. Many studies in technology transfer through 'buyer-supplier' or 'subcontracting' relationship found that local suppliers can benefit in several forms of technology improvement, such as improvement in quality control, problem-solving practices, learning new technology from customer specification, learning new production technique, and being able to apply knowledge accumulated from a customer for other customers (e.g., Wong 1991, Capannelli 1997).

[27] This method has been adopted by big conglomerates, and we believe that they can expect spillover from such deals. It has been our observation that local companies can benefit from adopting the skills-formation methods within their own companies and by transferring some engineers from another company within the joint-venture group.

indigenous production technology, they inevitably must search for a good and appropriate technology partner, even if that entails entering into types of acquisition such as striking deals regarding technical assistance or entering joint-venture agreements (Manager, July 10, 2002). Although in the first stage local firms still have to rely on foreign technology, they should try to learn the imported technology in the interest of becoming independent. In other words, local firms should be aware of the importance of creating indigenous technology.[28]

To become independent, they need to make efforts by themselves to pursue technical improvement activities such as quality control circles (QCC), Kaizen or continuous improvement, value analysis and value engineering (VA/VE). In the process, they have to take all the possible training measures including OJT and off-JT. In other words, human resource development is of crucial. Note that these activities cannot be sustained in the absence of the top management's commitment.

To benefit from such activity, the authors suggest that local firms evaluate employees' skill after training and to encourage line supervisors/managers and staff members to revise work instructions or other documents, such as training manuals, quality-control or problem-solving records, regularly, used in combination with a 'codification strategy'[29]. These means could provide an effective way of ensuring training results and subsequent improvement in QCD+E. Moreover, these approaches are believed to be the means of improving the way companies reuse knowledge internally. For instance, a document relating to troubleshooting a specific quality problem, developed as a counter-measure, could be consulted quickly when similar problems arise. Hence, the company could save the time to track down the people who created the document. Moreover, even if those people had already left the company, the problem could be quickly solved

[28] There is also a view that Japanese automobile assemblers want local firms to have their own technology. If local firms possess the capabilities of design and testing, they will be able to reduce costs, which previously had been technical fees, typically by 3 to 5 percent of the sales value.

[29] 'Codification strategy' is a process in which knowledge is codified using the so-called "people-to-documents" approach (Hansen, Nohria, and Tierney 1999, p. 106-108). Examples of these documents are technical specifications, training materials and programming documents. This approach improves the way of reusing knowledge within a company, saving time in tracking down the people who developed it, and, more importantly, enhancing the possibility of developing and improving the documents for further deployment.

without having to research the source of problems and find the solution a second time. Continually updating the documents would also improve the possibility of further improvements. These practices would be particularly useful in situations in which job-hopping or the turnover rate are high.

Alternatively, ISO & QS9000 can be used to enhance the establishment of "codification" in the company. This codification method was introduced by some local parts firms in the process of getting ISO standards or QS9000. Although these certifications per se do not always guarantee success in introducing the codification for better QCD, it has been noted that the practices have a positive impact on productivity (Nipon 2001, pp. 23). Some firms have stated that the detailed documentation of work instruction can reduce the accident rate in production, reduce time spent on trouble-shooting, and, hence, improve productivity. It can work well as the first step to success in codification.[30]

5. The Role of Public Sector as Concluding Remarks

The discussion in the previous sections can be summarized as follows. After Thailand's financial crisis, the automobile industry was forced to become more export-oriented. Apart from this change, assemblers have accelerated globalization strategies, including global sourcing, modularization, and the integration of models and production sites. As a result, Thailand has become the production hub in the region and the export base even outside region in the case of one-ton pickup trucks. Most local suppliers have not been able to deal well with this change, at least in the short term. They are stepping down to a lower tier, or may lose orders in the future if they remain at the same QCD+E level as they currently maintain They have to upgrade QCD to survive and grow, and possibly E to be more profitable and finally become global suppliers. Alliances with foreign partners can be a good way to attain these targets, along with the suppliers' own efforts in human resources development.

However, the problem is that private sector's efforts are not sufficient. Hence, it is recommended that the achieve of this goal requires not only the awareness of the private sector to exert effort; in addition, the public sector should provide support in the areas which are costly and unaffordable by local firms, such as creating training centers and testing centers. We deem that this should be a national policy.[31]

With respect to technical support[32], the Ministry of Industry (MOI) and the "Bureau of Supporting Industries Development" (BSID) of the MOI and Department of skill development of the Ministry of Labor and Social Welfare are expected to increase their roles in the provision of training in manufacturing skills to SMEs, including local parts firms, especially regarding the engineering aspects. Necessary aspects of production for which training is currently required include mold and die, casting, tooling, and design technology, such as CAD/CAM/CAE. Capability in all of these areas is still lacking, and SMEs need these skills to be viable for automakers. Recently, new, independent institutes such as "Thailand Automotive Institute (TAI)"[33], the "Thai German Institute" and the "SME Development Institute" have been established to promote the growth of supporting industries; they provide a testing service for parts and raw materials[34], serve as information consultants and provide training courses, especially in the areas mentioned above, to local SMEs. In addition, according to a report, they are supposed to play a role in coordinating the SMEs with related agencies, both in the

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[30] Another advantage of being accredited quality standard is that they will receive reputation from their customers.

[31] Thailand needs to improve its education system to produce a quality supply of human resources to match the increasing demand anticipated in the near future. However, in this paper, we deal only with the problem that persists in the industry.

[32] As mentioned earlier, local firms need assistance in two major areas; financial and technical assistance. However, it has been noted that emergency loans to SMEs have already been made; hence, it is reasonable to expect that some of the SMEs with sound business plans would already have received assistance. Hence this problem may be less critical than the former, technological capability issue (Kriengkrai 2002b).

[33] Regarding TAI's activities, especially Automotive Technology Buildup Program with Japanese ODA, refer to Takahashi and Kriengkrai forthcoming.

[34] Local parts firms should consider the possibility of exporting parts for the replacement market, or RE parts, after amassing a certain period of production experience. According to a report (Manager, June 19, 2002), the Thai Auto-Parts Manufacturers Association (TAPMA) comments that despite the fact that Thailand is the production base of many assemblers, production and export of RE parts are not so successful. One persisting problem is that Thailand has no testing center to approve the quality of parts, and this inhibits the export opportunities of local part firms. However, testing equipment is very costly, and local firms may not be able to afford this. Thus, TAPMA urges the government to support this strategy by establishing testing centers.

government and in the private sectors, both local and international agencies, to achieve industrial development (UNICO 1999). All of these institutions are expected to exert greater effort in helping local firms improve their technological capabilities. Building upon the work in this paper, in the near future we plan to investigate in detail the particular threats to local suppliers posed by the pressure of higher competition described in this paper, as well as ways government institutions should, accordingly, assist them.

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Table 1 The Establishment of Automobile Assemblers

Year	Assembler Company	Share Holder
1961	1. Anglo Thai Motor	NA
	2. Thonburi panich	Thai 100 %
1962	3. Kanasutra General Assembly	NA
	4.Siam Motor & Nissan	Nissan 25% Thai 75%
1964	5. Toyota Motor Thailand	Toyota 70% Thai 30.4%
1965	6. Prince Motor Thailand	NA
1966	7. Sahapattana Motor	NA
	8. MMC Sittipol	MMC 46.23%, Thai 52.77%*
	9. Isuzu Motor Thailand	Isuzu 49%, Thai51%
	10. Thai Hino Industry	Thai-Hino 30%, Hino 35%, Mitsui 35%
1968	11. Amulkamared Engineering	NA
	12. Thai Pradith Motor Assembly	NA
	13. Nai Lert	NA
1972	14. Bangchan General Assembly	Honda 34%, Thai 66%
1973	15. Thai Rung Union Cars	Australia & Singapore 15% Thai 85%
1975	16. Y.M.C Assembly	Thai 100%
	17. Sukosol &Mazda Motor Industry	Mazda 64.4%, Thai 35..6%
1976	18. Thai Swedish Assembly	Sweden 56% Thai 44%
1977	19. Siam Motor Industry	Thai 75 % Japan 25%
1995	20. Auto Alliance (Thailand)	Ford 48% Mazda 45% Thai 7%
1996	21. Honda Car Manuf. Assembly	Thai 51 Japan 49%
	22. Siam V.M.C.	NA
	23. General Motor	GM 100 %
1997	24. BMW	NA

Note: *Mitsubishi Motors Corporation plan to increase share holding(?) to 90% (from www.auto-asia.com , August 7, 2001)

Source: The Office of Industrial Economics, Ministry of Industry

Department of Industrial Works, Automotive Industry Directory 2000, p. 111

Table 2 List of Automobile Assemblers and Production Capacity in 2001

(number of vehicles)

No.	Assemblers	Passenger cars	Pickups	Trucks and Buses	Total
1	Toyota Motor Thailand	100,000	100,000	-	200,000
2	MMC. Sittiphol	42,000	118,000	14,400	174,400
3	Isuzu Motor Thailand	-	110,000	20,000	130,000
4	Siam Nissan Automobile	-	78,000	3,900	81,900
5	Honda Cars Manufacturing Thailand	50,000	-	-	50,000
6	Siam Motors and Nissan	31,200	-	-	31,200
7	Bangchan General Assembly	20,000	-	-	20,000
8	Thonburi Assembly	13,500	-	1,400	14,900
9	Y.M.C. Assembly	12,000	-	-	12,000
10	Thai Rung Union Car	9,600	-	-	9,600
11	Hino Motor Thailand	-	-	9,600	9,600
12	Thai Swedish Assembly	6,000	-	-	6,000
13	Siam VMC Automobile	-	6,000	-	6,000
14	Motor & Leasing (Thailand)	-	-	200	200
15	Auto Alliance Thailand	-	201,000	-	201,000
16	General Motor Thailand	40,000	-	-	40,000
17	BMW Manufacturing (Thailand)	10,000	-	-	10,000
	Total	334,300	613,000	49,500	996,800

Note: General Motor Thailand and BMW Manufacturing (Thailand) have operated assembly lines since 2000.

Source: Automotive Industry Directory 2000, Office of Industrial Economics, Ministry of Industry

Table 3 Thailand's Major Automotive Industrial Policies (1961-2000)

Year	*Policy*
1961	1960 Industrial Investment Promotion Act provides incentives for the automobile assembly plants. Assembly operations established using CKD kits.
1962	BOI, established under the 1962 Industrial Investment Promotion Act granted privileges, especially a 50 percent reduction in tariffs and trade taxes on CKD kits. Tariffs on imported CKD kits for passenger cars (PCs), pick-ups (Ps) and trucks (Ts) were 30 per cent, 20 per cent and 10 per cent, respectively.
1969	The MOI established the Automotive Industry Development Committee (AIDC) to impose policies and measures with an aim for auto-assembly establishment. 20 per cent increase in tariffs for imported CKD kits for PCs, Ps, and Ts (new rates: 50 per cent, 40 per cent and 30 per cent, respectively).
1971	MOI restricts the number of locally assembled PCs, Ps and Ts. AIDC announced a minimum local content requirements(LCRs) to be effective in 1974.
1975	LCR became effective (25 per cent for PCs from January).
1976	Number of locally assembled PC models limited to twenty-four;this limit was subsequently lifted by the MOI.
1978	The Government banned CBU imports and increases import duty on CKD kits to 80 per cent. The MOI annouced new regulations for LCR for car assembly to increase from 25 to 50 percent within 5 years. The Government banned new assembly plants due to over-capacity. Tariffs on CBU PCs increased to 150 per cent and on CKD PCs to 80 per cent.
1980	The AIDC announced seven required parts for truck assembly, including radiator, exhaust pipe set, battery, leaf spring, tires and inner tube, safety glass, and drum brake.
1982	LCRs for all vehicles frozen at 45 per cent.
1985	Mandatory local-content list imposed. Ban on imported CBU vehicles (with engine over 2,300cc) lifted.
1986	LCRs for passenger cars raised to 54 percent and 61 - 70 percent for commercial vehicles* List for compulsory (List A) and non-compulsory parts (List B) imposed. The BOI promoted domestic production of diesel engine for one-ton pickup
1989	Ceiling on production capacities at existing assembly plants lifted. Localization of diesel engine under BOI promotion should be at least 20% and increase 10% every year until 80%**
1991	Ban on imported CBU cars lifted. Tariffs reduced for all imported CBUs and CKD kits.
1993	Ban on new assembly plants lifted.
1994	New excise tax category for off-road vehicles.
1995	BOI plan to promote new engine assembly operations. New exhaust emissions schedule annouced.
1996	MOF new vehicle financing regulations.
1997	Mandatory inspection of 5-year-old cars. Stricter emission standards enforced on diesel fuel vehicles.
1998	Projected date of LCR termination
2000	LCR terminated Imported tariff for CKD increased from 20 to 33 percent Excise tax reduced

Note: * 61 percent for commercial cars with gasoline engine and 70 percent for those with diesel engine to be effective in 1987

** The regulation for BOI promotion for domestic production of diesel engine for pickup was revised in 1993 and 1995, in order to extend the period until June 1998 and the maximum local content requirement to be 70%

Souce: Board of Investment (BOI), Bank of Thailand (BOT), Ministry of Industry (MOI) and Abdulsomad (1999) Table 11.1, page 283

Table 4 Production and Sales of Automobile in Thailand (1961-2002)

unit of cars

Year	Production				Sale			
	Passenger car	Commercial car	Total	% growth	Passenger car	Commercial car	Total	% growth
1961	310	215	525	n.a.	3,542	3,318	6,860	n.a.
1962	908	276	1,184	125.52	4,658	3,680	8,338	21.55
1963	1,817	1,628	3,445	190.96	9,096	6,303	15,399	84.68
1964	3,978	3,289	7,267	110.94	11,178	9,891	21,069	36.82
1965	4,408	5,687	10,095	38.92	10,974	13,724	24,698	17.22
1966	4,898	5,749	10,647	5.47	14,984	15,835	30,819	24.78
1967	6,211	6,607	12,818	20.39	23,316	26,115	49,431	60.39
1968	7,209	6,779	13,988	9.13	27,898	36,188	64,086	29.65
1969	6,110	6,030	12,140	(13.21)	24,376	41,069	65,445	2.12
1970	6,604	4,063	10,667	(12.13)	21,828	27,438	49,266	(24.72)
1971	9,017	5,997	15,014	40.75	18,008	26,595	44,603	(9.46)
1972	11,630	7,755	19,385	29.11	18,027	26,156	44,183	(0.94)
1973	17,935	9,499	27,434	41.52	30,175	39,843	70,018	58.47
1974	17,572	14,891	32,463	18.33	29,211	44,644	73,855	5.48
1975	15,524	15,467	30,991	(4.53)	23,388	54,729	78,117	5.77
1976	15,333	25,729	41,062	32.50	20,699	57,642	78,341	0.29
1977	18,564	47,310	65,874	60.43	25,480	75,843	101,323	29.34
1978	21,869	45,200	67,069	1.81	23,233	66,034	89,267	(11.90)
1979	21,602	45,137	66,739	(0.49)	22,043	66,816	88,859	(0.46)
1980	23,441	50,544	73,985	10.86	26,840	62,361	89,201	0.38
1981	26,650	60,509	87,159	17.81	27,672	62,372	90,044	0.95
1982	24,629	52,655	77,284	(11.33)	27,356	63,830	91,186	1.27
1983	33,945	75,314	109,259	41.37	32,779	85,732	118,511	29.97
1984	36,127	74,910	111,037	1.63	31,500	82,049	113,549	(4.19)
1985	24,861	58,244	83,105	(25.16)	22,097	63,125	85,222	(24.95)
1986	21,046	53,116	74,162	(10.76)	22,481	55,973	78,454	(7.94)
1987	29,333	68,815	98,148	32.34	27,116	74,508	101,624	29.53
1988	54,459	99,724	154,183	57.09	38,768	107,712	146,480	44.14
1989	58,761	154,787	213,548	38.50	47,705	160,538	208,243	42.16
1990	73,766	231,077	304,843	42.75	65,864	238,198	304,062	46.01
1991	76,938	206,177	283,115	(7.13)	66,779	201,781	268,560	(11.68)
1992	104,565	223,393	327,958	15.84	121,441	241,546	362,987	35.16
1993	144,449	275,582	420,031	28.07	174,169	282,299	456,468	25.75
1994	109,830	325,231	435,061	3.58	155,670	330,008	485,678	6.40
1995	127,640	398,040	525,680	20.83	163,371	408,209	571,580	17.69
1996	138,579	420,849	559,428	6.42	172,730	416,396	589,126	3.07
1997	112,041	248,262	360,303	(35.59)	132,060	231,096	363,156	(38.36)
1998	32,008	126,122	158,130	(56.11)	46,300	97,765	144,065	(60.33)
1999	78,538	248,695	327,233	106.94	66,858	151,472	218,330	51.55
2000	103,089	308,632	411,721	25.82	83,106	179,083	262,189	20.09
2001	156,066	303,352	459,418	11.58	104,502	192,483	296,985	13.27
2002 (Jan-Jun)	74,600	167,164	241,764	11.69	57,731	123,898	181,629	n.a.

Source: Federation of Thai Industries
The Thai Automotive Industry Association

Table 5 Vehicles and Parts Export (1996-2002)

Year	Total	CBU		Engine	Spare Parts	Jig & Die		O.E.M. Part		Others
	Amount	Unit	Amount	Amount	Amount	Unit	Amount	Body Part	Compo. Part	Amount
1996	6,295.55	14,020	4,253.36	801.98	215.44	-	43.66	373.62	602.16	5.33
1997	20,722.84	42,218	16,226.99	2,023.89	505.28	17	56.34	1,037.60	845.16	27.58
1998	34,110.33	67,857	28,125.55	1,536.77	722.79	6,013	63.7	1,347.27	2,288.36	25,89
1999	60,105.53	125,702	50,187.21	3,731.81	883.42	177	141.35	1,424.40	3,678.86	58.48
2000	83,245.46	152,835	63,349.15	7,106.22	1,245.65	-	119.96	1,556.45	9,531.17	336 86
2001	104,000.20	175,299	83,894.70	7,481.38	1758.56	5	141.19	1989 49	11,748.57	96.71
2002 (Jan-Jun)	46,451.44	77,124	34,983.62	2,960.39	873.58	0	0	1343.64	6,221.57	68.64

Note: Amount million Baht
Source: The Thai Automotive Industry Association

Table 6 Thailand's Automobile Exports (1997-2002)

	1997	1998	1999	2000	2001*	2002 (Jan-Jun)**		
							Y on Y change	Share
Mitsubishi Motor	40,072	63,797	60,986	63,541	60,027	30,993	11.41%	40.19%
GM	-	-	-	6,283	48,987	14,416	-30.58%	18.69%
AAT	-	1,213	42,785	49,977	42,077	20,949	4.17%	27.16%
Toyota	1,563	1,819	12,151	16,031	n.a.	n.a.	n.a.	n.a.
Honda	570	2,910	6,361	6,183	n.a.	n.a.	n.a.	n.a.
Isuzu	-	20	516	5,689	n.a.	n.a.	n.a.	n.a.
Nissan	-	-	1,912	4,590	n.a.	n.a.	n.a.	n.a.
Others	-	48	380	541	n.a.	n.a.	n.a.	n.a.
Total	42,205	69,807	125,091	152,835	175,299	77,124	-4.64%	100%

Note: * Export in 2001 is from The Nation (January 29, 2002)
** Export in 2002 is from Prachachart Thurakit (August 5-7, 2002)
Source: Mori (2002, Table 3, pp. 32); The Nation (January 29, 2002); Prachachart Thurakit (August 5-7, 2002); and Thailand Automotive Institute

Table 7 New Model Launches Plans in Thailand (Since 2001)

Toyota	April 01 ~ New Corolla
	2002 ~ New Camry
	2003 ~ NBCS (Compact)
	2004 ~ 1tPU/IMV (vehicle for developing countries)
Honda	2003 ~ Fit derivative vehicle (compact)
	2002 ~ CR-V (multipurpose vehicle)
GM	Aug 2001~ Subaru (minivan, OEM supply)
	2002 ~ Alfa Romeo (passenger car)
	2003 ~ Isuzu 1tPU (for export to makets other than Australia)
Isuzu	2003 ~ new 1tPU
Ford, Mazda	2002 ~ Escape/Tribute (SUV)
Mitsubishi Motors	**Oct. 01 ~ New Lancer (passenger car)**

Note: Models in bold squares will be supplied within ASEAN 4 region (Thailand, Malaysia, Indonesia, and the Phillipines). Shading indicates the models that are planned to export to outside ASEAN 4 region. "1tPU" stands for one-ton pickup truck

Source: Modified from Mori (2002, pp. 30)

Table ๘ Processes that are Likely to be Transferred to Thailand

Process Stages	Individual processes	Present	Future
Product Development	Concept generation	J	J
	Product Planning	J	J
	Product Engineering	J	T
	Engineering change for local specification	J	T
Process engineering		J/T	J/T
Production stage	In-house production management	T	T
	Supplier management	T	T

Note: Product engineering is a process consisting of repeated engineering, prototype making, testing cycles that lead to the completion of formal drawings for products and parts. J = Japan; T = Thailand.
Source: Mori (2002); Fig. 2, pp. 33

Table 9 Thailand Vehicle Taxation (Before and after the termination of LCR)

Unit: percent

Type of Vehicle	Import duty				Excise Tax		Municipal Tax	Value Added Tax (VAT)
	Until Dec 31, 1999		Since Jan. 1, 2000		Until Dec 31, 1999	Since Jan. 1, 2000		
	CBU	OEM	CBU	OEM				
1. Passenger Car								
< 2400 cc.	80	20	80	33	37.5	35	10	7
2400-3000 cc.	80	20	80	33	43	41	10	7
> 3000 cc. or 220HP	80	20	80	33	50	48	10	7
2. OPV	80	20	80	33	32	29	10	7
3. Pickup	60	20	60	33	5	3	10	7
4. Medium and heavy truck without Body	30	10	30	10	-	-	-	7
5. Medium and heavy truck with Body	40	20	40	20	-	-	-	7
6. Pickup passenger vehicle(PPV)	60*	20	80	33	41	18*	10	7
7. Double Cab	60*	20	80	33	41	12*	10	7

Note: CBU = Complete Built up; OEM = Component and parts supply to assembly factory; PPV and Double Cab vehicles are modified pickups which are normally made in Thailand. CBU as of December 31, 1999, was equal to import of pickup in CBU.

Excise tax for both types became effective from February 2000.

Source: The ministry of Finance, Thailand, the Thai Automotive Institute

Fiscal Vulnerability: An Assessment to Thailand after 1997 Economic Crisis

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ABSTRACT

Title: "Fiscal Vulnerability: An Assessment to Thailand after 1997 Economic Crisis"

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After the economic crisis in 1997, Thai economy faced the slowdown in consumption and also investment from private sector. These situations had push government to adopt for a stimulated policy through public spendings. To meet the increasing in expenditures, the ability to raise revenues by government in current situation could not generate enough income from taxes and had to rely on borrowing from public either in form of national domestic debt or central bank's money creation. As a matter of fact, second option seems to be unlikely chosen. Hence, debt financing for government budget deficit is chosen to fight against economic slowdown problem.

However, Thailand seems to follow Japan's experiences in using debt to finance budget deficit, particularly in Mr. Thaksin populist projects such as debt moratorium for farmers, providing health care vouchers for all, pouring 70 billion baht as a loan into villages level, and etc. Common issues of interest is "Is the government's budget deficit too large?" or "Does the government has a fiscal sustainability or not?". Such a kind of these questions are directed to ask whether government is subject to an analogous constraint that when it runs deficit, is it making an implicit promise to creditors to run offsetting surpluses in future or not?

The research reported in this paper is presented at the International Conference on Economic Recovery and Reforms on October 29, 2002 at the Imperial Queen's Park Hotel, Bangkok, Thailand.

The conference is organized by the Faculty of Economics, Thammasat University and the Bank of Thailand. While the paper focuses on issues that have been recognized by this International Conference, the author(s) is(are) responsible for the views expressed in the paper.

Fiscal Vulnerability: An Assessment to Thailand After 1997 Economic Crisis

Chawin Leenabanchong[1]

Introduction

The future vulnerabilities of fiscal policy are in part determined by the public sector, which includes government and state owned enterprises (SOEs), increasing in debt burden. In the pre-crisis period, government's balance was in surplus due to the increase in revenues and low public debt. However, that situation will not re-occur in the near future. After the crisis, the public debt has been increased substantially as a result of the cost of financial sector rescue packages and losses incurred by the Financial Institution Development Fund (FIDF).

In 2001, the Thaksin government has introduced an aggressive fiscal stimulus program in order to fulfill its election campaign promises and manage the economic downturn. It started to finance the budget deficit by borrowing THB 200,000 million, which was 88.8% of total limitation by law in FY 2001 and reduced to THB 174,900 million in FY 2002. On the outside of the budgetary framework, there were other stimuli programs such as the Village Revolving Fund, Debt Suspension for Farmers Program or People's bank which focussed on retail lending. Therefore, if all quasi-fiscal activities are included-central government and SOE's the size of the comprehensive public sector deficit will increase more than the released figures from mass media or government announcement.

To date, little works have been done to consolidate the new level of public sector debt, and analyze the effects, which might come from fiscal burdens that the government will face. This study will focus on the assessment of fiscal vulnerability in 2 areas. If the government forces with an intertemporal constraint, the current real value of its net liabilities equals the present discounted value of future primary surpluses, does the government cut its primary deficit when liabilities rise? If so, there should be a response relationship between the primary deficit and liabilities. Otherwise, the government will deliberately set fiscal balance independent to the level of debt. Therefore, primary deficit/surplus will follow an arbitrary process and does not assure fiscal solvency, which will eventually cause a vulnerability to economy.

Another area is to assess the fiscal sustainability through the conventional indicator such as primary gap or medium term tax gap. Even these Fiscal Sustainability Indicators (FSI) are subjected too much of criticism, but they still provide a good indicator under the limitation of information. Since sustainability concept is basically about good housekeeping. It is essentially about whether a government is headed towards excessive debt accumulation based on the currently public policy announcement and/or declaration implicitly or explicitly. Thus, a good indicator of sustainability is one, which sends clear and easily interpretable signs

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when current policy appears to be misleading to a rapid growing debt to GDP ratio. Hence, fiscal vulnerability will be assessed through FSI.

This paper concerns the period after the crisis in 1997 had been occurred. However, the information before that time might be included to show some changes. Data form 1996:01 to 2002:04 are in our scope.

Public Debt Definition

The issue of public debt usually concerns with two related issues. What the public debt is? And how much of it? Since the exact level of public debt has been an issue in dispute especially for the definition in used which could increase or decrease the amount of debt in consideration. Therefore, the level of public debt can not be measured without an appropriate definition which directly depends on the particular questions to be answered.

For example, if the question is to ask for the debt burden currently borne by taxpayers. Then it makes sense to focus only on the components of public debt which have to be borne by the government budget. These would include direct government debts which at present includes the fiscalized FIDF debt . However, the question of public debt is not so simple. Under the Government Statistic Finance (GFS) Manual of the International Monetary Fund, which intended to separate monetary and financial activities from fiscal activities, places the debt of financial SOEs and the central bank outside the definition of public debt. Excluding financial SOEs debt may avoid some problems which arise from data such as double counting problems due to their financial intermediary role or from conceptual problem of the distinguish between borrowings and deposits which are liabilities of financial SOE. Why should one type of liability –borrowings- of financial SOE be counted while the other type – deposits- are not?

However, using GFS standard does not solve all problems. Ruling political parties in developing countries these days tend to avoid increasing in taxes, but encourage people to enjoy spending more public money through various transfer programs. According to Ammar (2001), Thai government has been running a deficit fiscal policy, but its management tactics are ingenious so some deficits do not appear in the fiscal budget layout. For example, to run the THB. 77 billion Village Revolving Fund or the Debt Suspension for Farmer program, the government used the tactic of borrowing from financial SOE such as Government Savings Bank (GSB) or Bank of Agriculture and Agricultural Cooperative (BAAC) in the first stage and reimburse to these SOEs later. As a result, the government has been less prudent than public think and it has covertly incurred more public debt beyond the amount that either the public or GFS standard have been aware off. To run these programs off-budget, there is no check and balance such as the assessment the true cost of those policies, and easily lead to inefficiency in using capital.

Therefore, the scope of public debt according to government in using GFS standard will include 3 main parts (1) direct government debts, (2) non-financial SOEs debts and (3) FIDF debts. Table 1 below shows public debt figures under GFS standard which government intends to use as a basis for calculating public debt outstandings.

Table 1 Public Debt According to GFS Manual

Unit: billion baht

	Dec 1996	Dec 1997	Dec 1998	Dec 1999	Apr 2000	Dec 2001
Central Government	169.02	328.13	695.22	988.87	1,006.95	1,265.60
External	124.85	296.46	268.49	346.59	345.75	419.91
(million US$)	(4,869)	(6,234)	(7,278)	(9,191)	(9,057)	(9,466)
Domestic	44.16	31.67	426.73	642.28	661.20	845.69
Non-Financial SOE	459.01	680.11	645.90	787.15	827.10	972.29
Guaranteed	391.12	575.07	559.13	688.60	687.05	802.36
Non-Guaranteed	67.88	105.04	86.77	98.56	140.05	169.93
FIDF	57.21	893.11	986.72	777.43	779.29	662.43
Total	685.23	1,901.36	2,327.84	2,553.45	2,613.34	2,900.32
Total (%GDP)	14.86	40.18	50.32	55.13	53.28	

However, in this paper, the question here is to assess the contigent liabilities which need to be borne by the government. It is no use to focus simply on the above components of public debt, which might give bias estimated amount of public debt. The government's contingent liabilities are both in form of explicit and implicit. Explicit contigent liabilities are commitments that are based on law and contracts and primarily include guarantee debt and other liabilities of SOEs as well as financing needs resulting from price support programs. On the other hand, implicit contigent liabilities are commitments that are based on political annoucements, public expectations and interest-group pressures. Most of these explicit and implicit liabilities usually end up with the need for direct/indirect government financing and increasing the size of the government's on and/or off-budget obligations. To absorb losses from these contigent liabilities, state banks, specialized financial institutions or funds are among the first line of government agencies to take care the off-budget obligations. As a result, new non-performing loan in their portfolio will increase a chance to increase their capital sooner or later. With various liabilities of off-budget obligations are underway, unless policy priorities change, the government will eventually be forced to pay for.

In practice, one way to compute how large is country's stock of debt according to above aspect may start from the consolidated balance sheet of public sector. Contingent liabilities from central government, SOEs and central bank may add up while the value of assets held by public sector are substract. This approach tries to build a measure of the public debt net of its (liquid) assets. However, some of these liquid assets are in doubtful such as the claims of FIDF on TAMC or claims on assets of financial SOEs or special proposed financial institutes/funds. This doubt may come from past experiences that most of the assets were not valued as much as the book shown. Moreover, once the add up and substract have been started, it is hard to decide where to stop. For example, during a bank restructuring operation, the value of credits to private sector acquired by the government or by the central bank should be valued at par or market price? In case of existed market price, why not substract the value of privatized and/or traded of SOEs' shares?

The another measure is to use the sum of the value of all public sector bonds and bills held in the market. This approach is more market friendly and does not need to value assets and liabilities' price even when government assets are traded, so that their valuation is not an issue.

First line of table 2 shows the outstanding amount of government bonds while treasury bills are sum up in the second line. However, government debts may not all finance by selling bonds/bills to public, but by selling government debts to central bank. The claims on government in monetary base are also included the picture of public debt. L_1 may reflect the government budget deficit financing either through public or central bank channel. If all SOEs debt are included together with L_1, a more widely definition of public debt has been illustrated by L_2. However, if the double counting and/or type of debt problem may cause some worries, the L_3 definition which substracts all financial SOEs debt out of L_2 may recognize as a substitute definition of public debt.

Table 2 Extended Public Domestic Debts

Unit: billion baht

	1996	1997	1998	1999	2000	2001
1. Government Bonds	18.1	13.8	411.9	587.4	658.9	706.7
2. Promissory Notes and Treasury Bills	26.2	18.0	15.0	55.0	82.0	130.0
3. Government Debts (L_0) (1)+(2)	44.3	31.8	426.9	642.4	740.9	836.7
4. Central Bank Claims on Government	33.5	31.8	170.7	139.7	109.0	146.6
5. L1 (3)+(4)	77.8	63.6	597.6	782.1	849.9	983.3
6. SOEs debt	278.4	294.3	301.1	433.1	481.1	517.9
7. L2 (5)+(6)	356.2	357.9	898.7	1,215.2	1,331.0	1,501.2
8. Financial SOEs Debt	93.8	103.8	103.3	121.4	97.2	98.0
9. L3 (7)-(8)	262.4	254.1	795.4	1,093.8	1,233.9	1,403.2

Source: Bank of Thailand

The Government Budget Constraint

In any countries, the government budget constraint in one period is defined as

(1) $$b_t = (1 + r_{t-1})b_{t-1} - s_t$$

Where b is real government liabilities which include interest bearing debt held by public and central bank claims on government, s is real primary surplus (government revenues less non-interest expenditures), r is real interest rate.

Let q_t be the real discount factor from period t back to zero

$$q_t = \prod_{j=0}^{t-1}(1 + r_j)^{-1} \quad ; \quad q_0 = 1$$

then multiply q_t into (1)

(2) $$q_t b_t = q_t(1 + r_{t-1})b_{t-1} - q_t s_t$$

or $$= q_{t-1}b_{t-1} - q_t s_t$$

Let *db* be the discounted value of public sector liabilities and also *ds* be the discounted value of primary surplus, then (2) can be rewritten as

(3) $$db_t = db_{t-1} + ds_t$$

By substituting (3) forward over infinite horizon will yield

(4) $$db_t = db_{t+n} + \sum_{j=1}^{n} ds_{t+j} \quad ; \quad n > j$$

Sustainability Condition

From (4), if expectation operator is applied on both side and taking the limit of first term in RHS as n goes to infinity, (5) will yield the proposed definition of sustainability.

(5) $$db_t = E\left(\lim_{n\to\infty} db_{t+n} + \sum_{j=1}^{n} ds_{t+j}\right)$$

As n goes large, the discounted value of debt goes to zero as

(6) $$\lim_{n\to\infty} db_{t+n} = 0$$

Therefore, (5) will reduce to

(7) $$db_t = E\sum_{j=1}^{n} ds_{t+j}$$

In words, (7) implies a fiscal policy is sustainable if the present discounted value of primary surplus is equal to the current government liabilities. To make fiscal policy sustainable, if db_t>0, then government must anticipate sooner or later to run primary budget surpluses that large enough to cover the debt outstanding.

There are a number of literatures that try to test one or the other of these constraints empirically and interpret the results as a test of government solvency. However, there are literatures that in contrast, suggest (5) and (6) should be interpreted as equilibrium conditions. The fundamental questions here are: how does (6) get satisfied and how to solve the model?

There are a number of possibilities. For example, there may be an endogenous fiscal policy what makes the sequences of ds_{t+j} satisfy (5) regardless of value of discount factor (q) or initial liabilities (db_t) take in equilibrium. In contrast, if ds_{t+j} is an arbitrary consequence and determined by a political process that takes no account for the level of the debt. Then, the discount factor and/or initial liabilities have to adjust in order to satisfy (5).

The first possibility above can now be defined formally in terms of sustainability condition here (5) as fiscal rule (non Ricardian regime) if primary surpluses are determined by an arbitrary process which unrelated to the level of debt. Then, other factors such as discount factors must be adjusted instead. On the other hand, the monetary rule (Ricardian regime) is the situation where primary surpluses are determined or responded to the level of debt no matter what the discount factors are fed into (5).

Fiscal versus Monetary Rule

Since all governments face the intertemporal constraint as the current liabilities in real term must equals to present discounted value of the future primary surpluses as shown by sustainability conditions in (5) and (6). If the government adjusts the primary surplus to limit debt accumulation, either through the changes in expenditures and/or revenues, the central bank is not forced to increase money and inflate away the debt as suggested by the Ricardian (R) regime. In contrast, if the primary surpluses (or deficits) are set independently of real current liabilities or interest payments, in this case, monetary policy is determined by fiscal needs or non-Ricardian (NR) regime. In the latter case, the fiscal policy becomes a "leadership" or "dominant" and serves as the nominal anchor[2]. The fiscal theory of price determination also suggests that if primary surpluses evolve independently of government debt, the equilibrium price level will adjust to assure fiscal solvency. In those economies, an increase in current debt has no implications of future surpluses and governments are in dynamically inefficient. On the opposite, in Ricardian regime where monetary policy plays a "leadership" or "dominant" role, if primary surpluses

[2] See Canzoneri et.al.,(2001) for the derivation of these names

move automatically to assure fiscal solvency for any path the price level might take, prices are determined in the conventional demand and supply of money.

The evidences from 1997 to 2001 either from table 1 or 2 in Thailand showed the rapid increasing in debt accumulation when compared to historical standard. Therefore, is the government in that time operates under fiscal rule or react the current fiscal behavior on past debt or not? The fiscal rule can be defined as

(8) $$s_t = k + \beta b_{t-1}$$

where k is the exogenous component of primary surplus while β summarizes the government adjustment of the primary surplus to the past liabilities*. The value of β, regardless of the value of k, is important to maintain intertemporal constraint as suggested in (6). To see this with undiscounted liabilities, (6) will be modified to (9) as $db_t = b_t / (1+r)^{t-1}$:

(9) $$\lim_{t \to \infty} b_t = b_0 Z^t + k\{1 + Z + Z^2 + Z^3 + \ldots\}$$

where $Z = (1 + r + \beta)$
Thus, if β<0, Z< (1+r), then (9) holds as fiscal rule.

Empirical Estimation

In the aftermath of Asia crisis in mid of 1997, there were evidences of the rapid rise in public sector liabilities when compared to Thailand's historical standard. There are several questions arose from (8) that does the Thailand's government primary deficits respond to the level of debt or not? Is monetary policy determined by fiscal needs under fiscal rule (non Ricardian regime)?

As figure 1 and 2 show the government liabilities (b) and primary surplus (s) data from 1996 to 2002, which covers period before and after the crisis in mid 1997, b must be expressed in first differences since s is stationary but b is nonstationary. Hence (8) will be modified to

(10) $$\Delta s_t = k^* + \beta^* \Delta b_{t-1}$$

Data in table 2 in monthly basis have been used since the government might choose to sell debt instruments through either public or central in order to finance the deficit in budget. External debts by central government were excluded since in practice, it is easier to borrow domestic. Results of the estimation of (10) are reported in table 1. Most of β^* values are near to zero and statistically indifferent from zero. These may imply that primary surpluses are determined by an arbitrary process which unrelated/unresponded to the level of debt since null hypothesis of $\beta^* = 0$ can not be

* see Taner & Ramos (2002) for the proposition to test monetary or fiscal rule.

rejected at conventional 90 percent level for either the entire period of our sample (1996:01-2002:04) or 3 sub-periods: 1997:07-2002:04 (after crisis); 1997:11-2001:01 (under Mr.Chuan's regime); and 2001:02-2002:04 (under Mr.Thaksin's regime). Even k* values are non-zero, but they are not significant different from zero in all periods either.

Figure 1 Real Government Liabilities

Unit: million baht

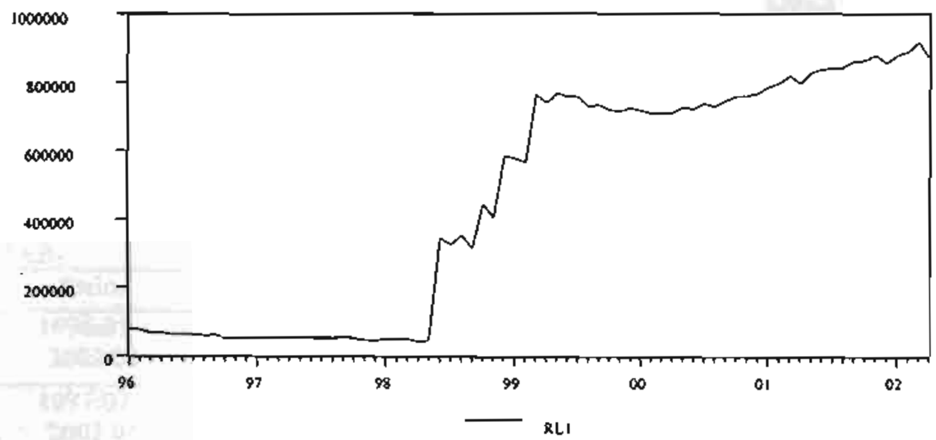
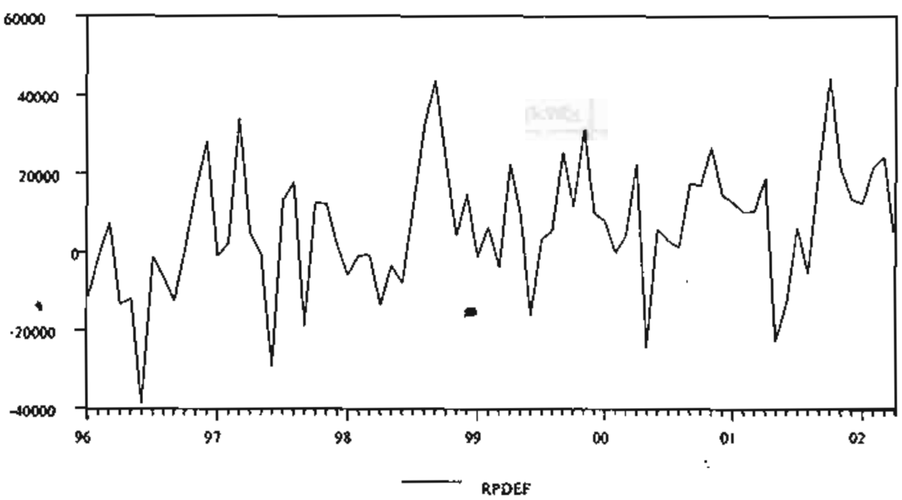


Figure 2 Real Primary Surpluses

Unit: million baht



$$\Delta s_t = k^* + \beta^* \Delta b_{t-1}$$

$LIAB_0$

Period	k^*	β^*	R^2	df
1996:01 – 2002:04	-63.296 (-0.027)	0.022 (0.269)	0.000993	73
1997:07 – 2002:04	305.784 (0.112)	0.015 (0.188)	0.000628	56
1997:11 – 2001:01	-104.291 (-0.035)	0.006 (0.077)	0.000159	37
2001:02 – 2002:04	-3,840.617 (-0.634)	0.278 (0.863)	0.054162	13

$LIAB_1$

Period	k^*	β^*	R^2	df
1996:01 – 2002:04	-220.733 (-0.098)	0.036 (0.798)	0.008652	73
1997:07 – 2002:04	45.610 (0.018)	0.033 (0.750)	0.009939	56
1997:11 – 2001:01	-522.937 (-0.190)	0.029 (0.722)	0.013898	37
2001:02 – 2002:04	-4,700.188 (-0.833)	0.391 (1.286)	0.112828	13

$LIAB_2$

Period	k^*	β^*	R^2	df
1996:01 – 2002:04	-251.441 (-0.112)	0.016 (0.850)	0.009796	73
1997:07 – 2002:04	31.098 (0.012)	0.015 (0.795)	0.011151	56
1997:11 – 2001:01	-715.958 (-0.255)	0.031 (0.780)	0.016182	37
2001:02 – 2002:04	-1,767.647 (-0.341)	0.014 (0.652)	0.031680	13

Fiscal Sustainability Indicators

From government's liabilities to output ratio as in

(11) $$b = \frac{B}{P.y}$$

where B is the nominal value of government's liabilities, P is price level and y is real GDP. The changes in b overtime can be calculated from

$$\frac{d\ln b}{dt} = \frac{d\ln B}{dt} - \left(\frac{d\ln P}{dt} + \frac{d\ln y}{dt}\right)$$

or
$$\frac{1}{b}\frac{db}{dt} = \frac{1}{B}\frac{dB}{dt} - \left(\frac{1}{P}\frac{dP}{dt} + \frac{1}{y}\frac{dy}{dt}\right)$$

$$\frac{db}{dt} = \frac{b}{B}\frac{dB}{dt} - b(\pi+\theta)$$

$$= \frac{1}{P.y}\frac{dB}{dt} - b(\pi+\theta)$$

$$\Delta b = \frac{\Delta B}{Py} - b(\pi+\theta) \qquad (12)$$

If nominal value of government's liabilities is defined as

$$\Delta B = iB - S$$

and substitutes into (12), then

$$\Delta b = \frac{iB-S}{Py} - b(\pi+\theta)$$

$$= ib - s - b(\pi+\theta)$$

$$= (r+\pi)b - s - b(\pi+\theta)$$

$$\Delta b = (r-\theta)b - s \qquad (13)$$

Therefore, the changes in government's liabilities to GDP ratio equal to the initial liabilities multiplied by the difference in real interest rate and output growth, and the primary surplus ratio. If $r-\theta$ is positive while $b>0$, then in order to stabilize or not to increase in liabilities $(\Delta b = 0)$ the government has to pursue a primary (non-interest) fiscal surplus policy. Otherwise, it will violate ex-ante intertemporal budget constraint. On an ex-post basis, to meet the constraint the government will have to switch to a policy of fiscal retrendment, monetization or debt repudiation, eventually. The above equation is quite sensitive to the level of initial liabilities ratio (b) if b is rather high, then the different between rate of interest to growth rate has large impact to primary fiscal position than the low level of b. that means the increasing in real interest rates or slowdowns in growth rate of output are more threatening to countries with high level of public sector liabilities.

Table 3 Historical FSI

Unit: %GDP

	1996	1997	1998	1999	2000	2001
Primary surplus (+)/deficit (-)	0.8	-3.2	-5.3	-5.9	-5.6	-6.5
Public Sector Liabilities (L)						
L_0	1.4	1.0	14.4	22.3	24.3	26.9
L_1	2.4	2.0	20.1	27.2	27.8	31.6
L_2	10.9	11.1	30.2	42.2	43.6	48.3
L_3	8.0	7.9	26.8	38.0	40.4	45.1
Growth (θ)	5.9	-1.4	-10.5	4.4	4.6	1.8
$(r-\theta)$						
0.035	22.9	-91.4	-151.4	-168.6	-160.0	-185.7
0.050	16.0	-64.0	-106.0	-118.0	-112.0	-130.0

According to table 3 above, public sector liabilities are calculated by using (13). Under the sustainability condition, $\Delta b = 0$ public sector liabilities are sensitively to the changes in $(r-\theta)$. Since the interest rates in developing countries usually under some influences from government, especially on government interest bearing debt instruments, interest rates on this debt are far from market force determination. Therefore, the real interest rate over the growth rate of output $(r-\theta)$ is assumed to be 3.5% and 5% in order to generate the public sector liabilities under sustainability conditions. The results show the unsustainability in fiscal policy form 1997-2001 since the deficits in budget increase with liabilities. That is when $(r-\theta)$ is positive and $b > 0$, government has to pursue a primary fiscal surplus policy in order to keep an initial liability constant. However, under the assumption on $(r-\theta)$, the simulated liabilities show a direction of fiscal stance in opposite to the ex-post liabilities.

Debt Ratios and FSI

The main usefulness of FSI is to demonstrate that naïve debt ratios are likely to be misleading indicators of either government solvency or fiscal sustainability. Public debt ratios and FSI are not conceptually equivalent. Since the former refer to the actual or ex-post ratio of the outstanding stock of public liabilities to GDP while the latter is the ex-ante measure of the required permanent fiscal adjustment needed to stabilize the initial (base year) public debt ratio. A country with public sector liabilities 120% to its own GDP and a constant liability does not mean it has more in fiscal sustainability than a country with an increased in liability but lower level of debt ratio.

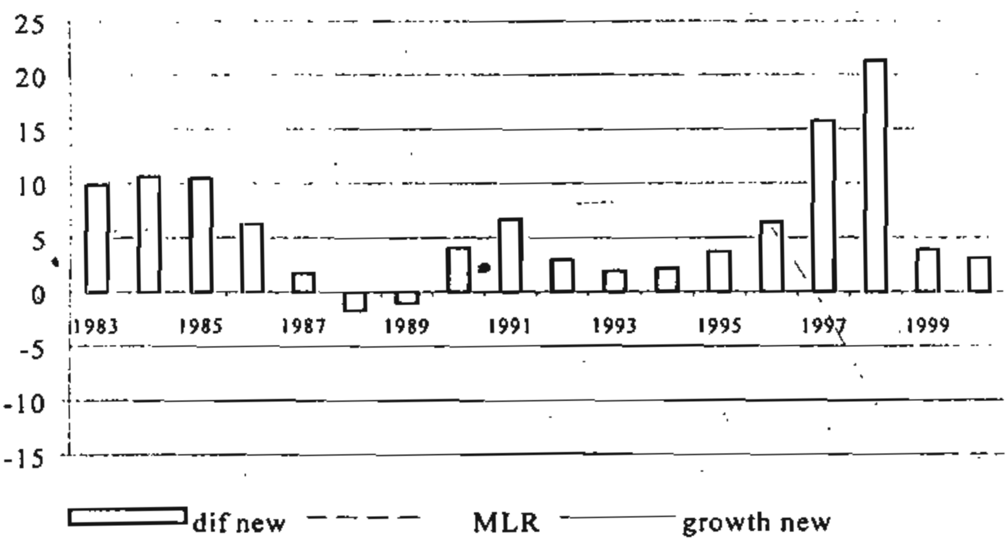
Evidences from table 3 show that the ratio of outstanding stock of public sector liabilities to GDP either in L_0, L_1, L_2 or L_3 definitions, does not guarantee or in contrast misleads the picture of fiscal sustainability. The efforts or claims on hold debt ratio, constant to any figure does not guarantee the fiscal sustainability will be met. If (r-θ) are as in table 3.

Long Term Outlook

The assessment of sustainability of fiscal policy can not limit to historical or backward looking, but must be a forward-looking especially for government's contingent liabilities explicitly and/or implicitly. According to (13), if b is assumed to be equal to 65% of GDP as government tries to keep as a limit, then in order to stabilize or not to increase that figure, $\Delta\ b$ must equal to zero. Therefore, the sources of unsustainability will come from two sources, $(r-\theta)$ and s, which have interdependence, each other. For example, if $(r-\theta)$ were negative, the government would no longer need to generate primary surpluses to achieve sustainability condition. That means the government could run permanent primary deficits of any size, and lead to a positive but constant (no change) level of debt. Moreover, with primary balance in surplus, the debt to GDP ratio would steady decline over time at rate (θ - r). However, does this condition of an excess of the growth rate over the interest rate holds in medium and long run?

Evidence form Thailand past experiences in figure 3 showed that there still have a chance, if not always, but occurred in period of extraordinary such as in high growth period during 1988-9 rather than ordinary period. Growth rates in that period were easily outpaced interest rate in period of recovery to prosperity. In such a case, the theory suggests that a government should issue more debt until the pressure on interest ratios made them at least equal to the growth rate. In general, developing country as Thailand normally had demand for funds exceed the savings. The high interest rates in real term were ordinary situation and usually higher than growth rate in reflecting scare of resources. Therefore, a positive in difference between interest rate and growth rate is (r-θ) assumed in forward looking long term condition as a normal situation.

Figure 3



Considered the recently government bond issuing for FIDF's short term debt replacement, 10-year bond carries 6 % per annum of coupon rate while the growth rate for 2002 was expected to be 3-4 %. The assumption of $(r-\theta)$ in long term around 2 % may be considered a conservative one. In such a case, primary balance (s) must be positive in long term outlook. Otherwise, government is running risk for fiscal policy unsustainable.

However, in contrast, the primary balance for the forward looking in medium or long term may not consistent with sustainability condition as positive on difference between interest ratio and growth rate suggested. Polackova (1998) introduced four types of fiscal risks that the government might face according to four characteristics: explicit versus implicit and direct versus contingent liabilities. Table 4 summarizes these types of fiscal risk. The controversies in assessing fiscal vulnerability are on the contingent liabilities of government or public sector either in explicit or implicit. Since they are obligations triggered by a discrete event that occurred by chance. The probability of the contingency occurring and the magnitude of the government outlay required to settle the ensuring obligation is difficult to forecast. State insurance and/or guarantee schemes for exchange rate, gain-loss sharing in jointed private investments, deposits or crops are examples of either explicit or implicit type. Moreover, direct but implicit liability is also a type of hidden risk to fiscal sustainability, for example: future health care financing or unfunded pubic pension. In long term explicit and/or implicit contingent liabilities and implicit direct liabilities are sources of fiscal risks that hard to assess and detect because the nature of them which can run off-budget and the claim on these liabilities to be a burden to tax-payer are on ex-post situation only. The latter means the government which initiate these contingent liabilities can take risk to run high risk program in expected for high political and/or economic return without discipline in either politics or economics aspects.

Table 4 the Fiscal Risk Matrix

Liabilities	Direct	Contingent
	Obligation in any event	Obligation if a particular even occurs
Explicit	Specific obligations by law or contract	
Implicit	A moral obligation or expected responsibility that reflects public expectations, political pressures, and overall role of the state as society understands it.	

Source: Polackova (1998)

Table 5 illustrates recently in Thai government major liabilities either as direct or as a contingent. The followings are some explanation for the assessment in medium term (< 5 years) or long term (> 5 years).

- The universal health care plan may suffer from the exclusion of social insurance scheme, and public and SOEs employee health care from its own budget. If both of these health care schemes are excluded, this plan is inevitable need more from initial budget THB. 142 billion lay out. Moreover, according to the forecast of population structure in Thailand in Table 6, the older age population (60+) ratio will increase significantly in the future and put pressure on this universal health care costs.

- The local administration revenue sharing from central government budget according to the law is in process to increase its share to full maximum of

35% of central government budget in 2006. In 2002, the size of budget is around THB. 1,000 billion. The schedule of transfer between works and money from central to local government should be synchronized as much as possible to avoid the unnecessary costs that might occur. Otherwise, it may leave the central government with unexpected/unattended local government works that need more budgets to cope with. This may result as an obstruction in downsizing and/or delay in decentralized of central government in the future.

- Reform of central government administration by expanding ministry form 15 to 20 and departments under ministry from 65 to 140 or more are the main worry since it is hard to believe that fixed costs and variable costs after reform will be reduced.

- From the fact that government had fiscalized some FIDF's debt and may does so in the future, TAMC, which is the main agent for FIDF's assets management, is not underpressured and may has incentive not to recover the transferred assets as best as it can. Losses may be in doubt for either period. The estimated transfer price at 32% of book value (THB. 698 billion) will result in maximum cost to TAMC around 23% of book value or THB. 161 billion in medium term[4].

- There are reasons to believe that SOEs' debt will increase in the future. For example:
    - Privatization programs to release SOEs to private are in delay or in doubt. The more in number and time the government holds the ownership of these SOEs, the larger the burden that government has a chance to bore.
    - The need to finance from-operating loss is not reduced as expected. Financial SOEs such as KTB, GSB, SIFC or SICGC, which are running so many government pet projects, can cause some burdens in the future if these projects fail. In case of non-financial SOEs, there are so many longtime-poor operated SOEs, which lack of government decisive policy to cope with.

- Even the government took responsibility to issue bond in exchange for the FIDF debts, but the principal payment belonged to the central bank which most of benefits from international reserves were used to pay for. In detail, the first stage FIDF's fiscalization in THB. 500 billion was earmarked on 90% of net profit from BoT's General Account while the second stage THB. 305 billion was repaid in principal from 100% of net benefits from Annual Yield Account. Therefore, there was an earmarked for these two accounts to generate benefits for principal repayment. In long term, there are risks that may arise form conflict of interest in central bank its own multiple objectives. Moreover, since the interest payments on these bonds are bored by government. With heavy interest costs already bored by

[4] see table 4.5 and 4.6 in Chawin(2002) for more in detail

government in the annual budget[5], another conflict of interest between BoT and government may unavoidable. Because the longer is in principal repayment by central bank, the higher cost of interest the government has to take.

Table 6 Thailand Population Projection

Population age as % of total	2006	2011	2016
(1) 1-24	36.8	34.5	32.6
(2) 25-59	52.5	53.1	52.4
(3) 60+	10.7	12.4	15.0
Total population (million)	65.82	68.09	69.90
Dependency ratio [(1)+(3)]/(2)	0.90	0.88	0.91

Source: National Education Committee, Office of Prime Minister, Dec.1999

Table 7 International Reserves as of May 31, 2002

	General A/C	Currency Reserve			EEF	Total
		Currency Reserve A/C	Special Reserve A/C	Annual yields A/C		
Foreign Assets (man US$)	6,935	9,744	15,871	396	909	
Gold (man US$)		645	41	5		
Total (man US$)	6935	10,389	15,912	401	909	34,546

Source: Government Resolutions to Finance FIDF Losses Stage 2 Mimeo, Bank of Thailand, 2002

[5] from 2001 and 2002 fiscal year, the interest expenses were set around 8% of total budget lay out

Table 5

Unit: billion baht

1. Implicit Direct Liabilities	Med.	Long.
1.1 universal health care plan	142[1]	↑
1.2 unfunded public employee pension	13[1]	↑
1.3 student's fee subsidy	103[1]	?
1.4 local administration budget transfer (up to 35% of budget in 2006)	↑	↑
1.5 reform of government administration	↑	?
2. Explicit Contingent Liabilities		
2.1 TAMC	161	?
2.2 SOEs' guaranteed debt	443[2]	↑
2.3 Deposit insurance	↑	?
2.4 FIDF unfiscalized debt	277[1]	?
2.5 FIDF P/N aval	633[3]	?
3. Implicit Contingent Liabilities		
3.1 SOEs' non-guaranteed debt	74[2]	?
3.2 Off-budget state-owned-fund	↑	?
3.3 Principal payment of central bank (496+305)[4]	801	?

[1] form Voraphat (2002)
[2] all SOEs domestic debt at the end of 2001, BOT
[3] FIDF balance sheets at 31-03-02
[4] THB. 496 bn. (from THB. 500 bn.) from first tranche of government bonds issued in 1999 and THB. 305 bn. in second tranche in 2002

Net Assessment

In sum, from recently past experiences, there are tendencies to believe that under Thaksin's regime; the primary surplus is a rare situation to occur. Even the revenues may increase form growth of the country, but the expenditures that in some part were committed and some in risk of default due to either internal or external factors can easily out pace revenues. Thus, sustainability condition can not reach. As a result, major adjustment in fiscal position such as a sharp increase in tax and/or a sudden stop in some projects may be outcomes eventually in order to avoid repudiation in public debt.

Most of items in table 5 are the evidences to support the above believe. They are not direct liabilities that government has to take care at once, but they are the contingent ones, which can be a cause of hidden fiscal risks if the unfavorable situations occurred. Therefore, the more in numbers and the large in their size in these contingent liabilities either in explicit or implicit, the more in fiscal vulnerability will be. This may lead to the further questions. Do the benefits from economic recovery exceed the costs from fiscal unsustainability? Or do the politicians used the risk taking processes in short term and push Thai economy into the vulnerability path, which may lead to unsusutainability in the long run or not?

With the evidences from the preceded sections show that after the crisis in 1997, primary surplus is determined by an arbitrary process that unrelated and/or unresponded to the level of existed debts. Political reward, even it has a slim chance to achieve, seems to outweight high chance of economic costs that Thai economy will face. Above all, politicians do use other people money to bet against their own benefits instead of their own.

Further Recommended Studies

This paper generally focuses on the fiscal vulnerability issue, which may come from the excessive of public debt. Definition of debt is the area of interest since the scope of debt is directly related to its definition. Since the exact level of public debt has been an issue in dispute, which could increase or decrease the amount of debt in consideration, the study on this definition issue is recommended. The used of GFS basis in calculation of public debt may not solve all problems because of the fiscal vulnerability may arise from the contingent liabilities either implicit or explicit. The chance of default and the size of liabilities are two factors that cause the fiscal risks.

From the results suggested that in the studied period, the fiscal position according to the primary surpluses/deficits are determined by an arbitrary process. The effect of fiscal position through price level as the fiscal theory of price determination suggested or crowding in or out effect is also the interested issues to further studies.

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