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).

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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."

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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)

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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).

International Conference on Economic Recovery and Reform

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.

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 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 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 fails 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 20.54, 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, d 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 ich can jeopardize export growth. This is clearly depicted in Figure 12.

cluding 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 ure, 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 ent.

public debt is, therefore, having an implication on the current nomic 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.

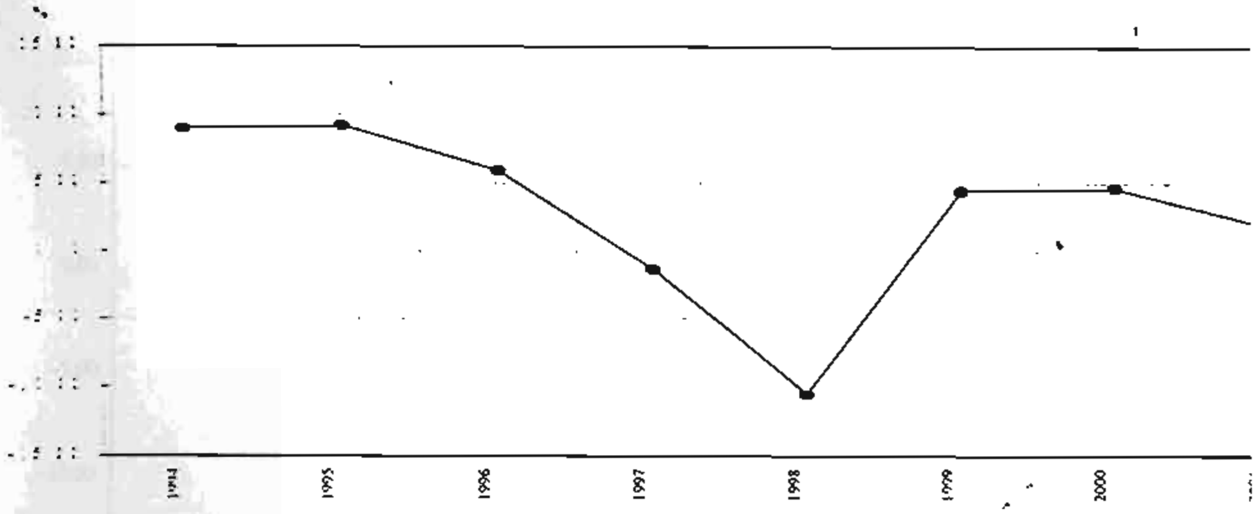
Table 3
Public - Sector Fiscal Balance (GFS Basis), Fiscal Year 2001 -2003

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

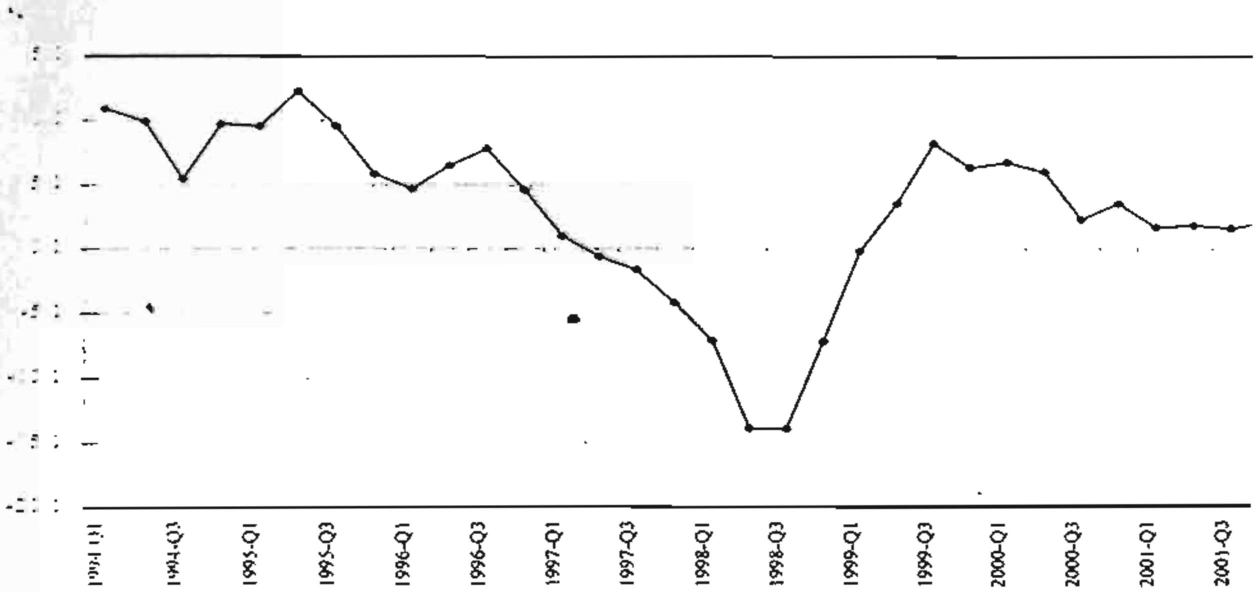


Figure 2
Growth Rate of Consumption Expenditure, 1996 - 2001

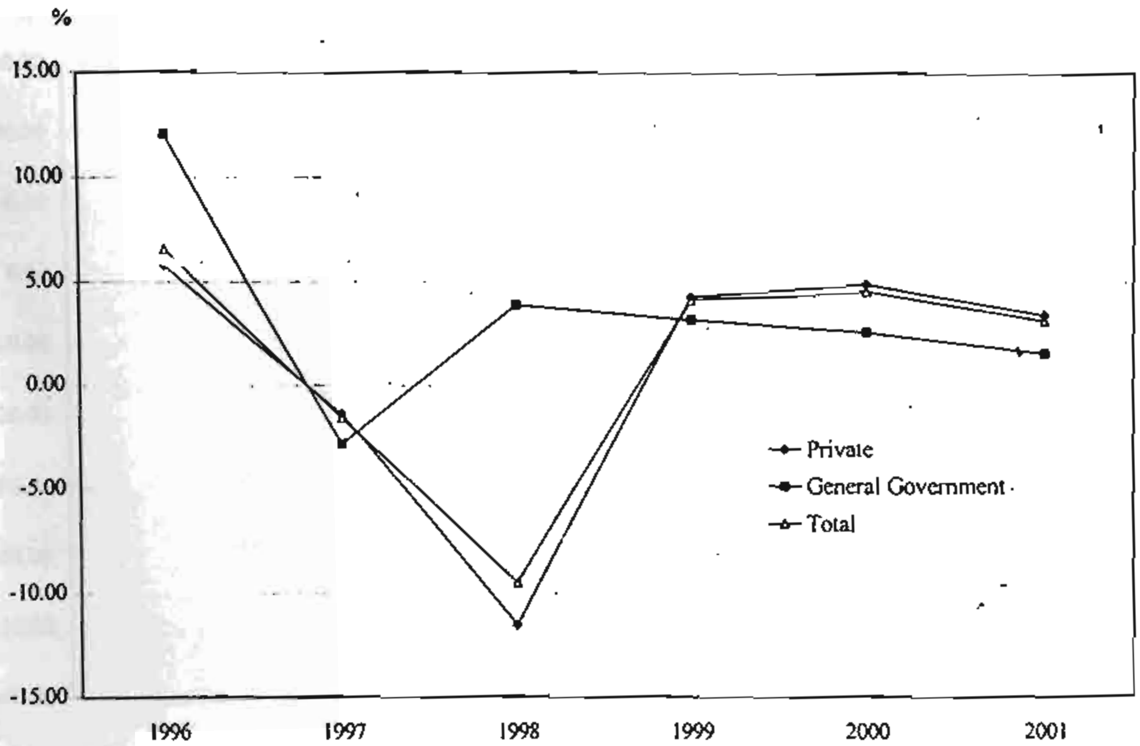


Figure 3
Growth Rate of Investment, 1996 – 2001

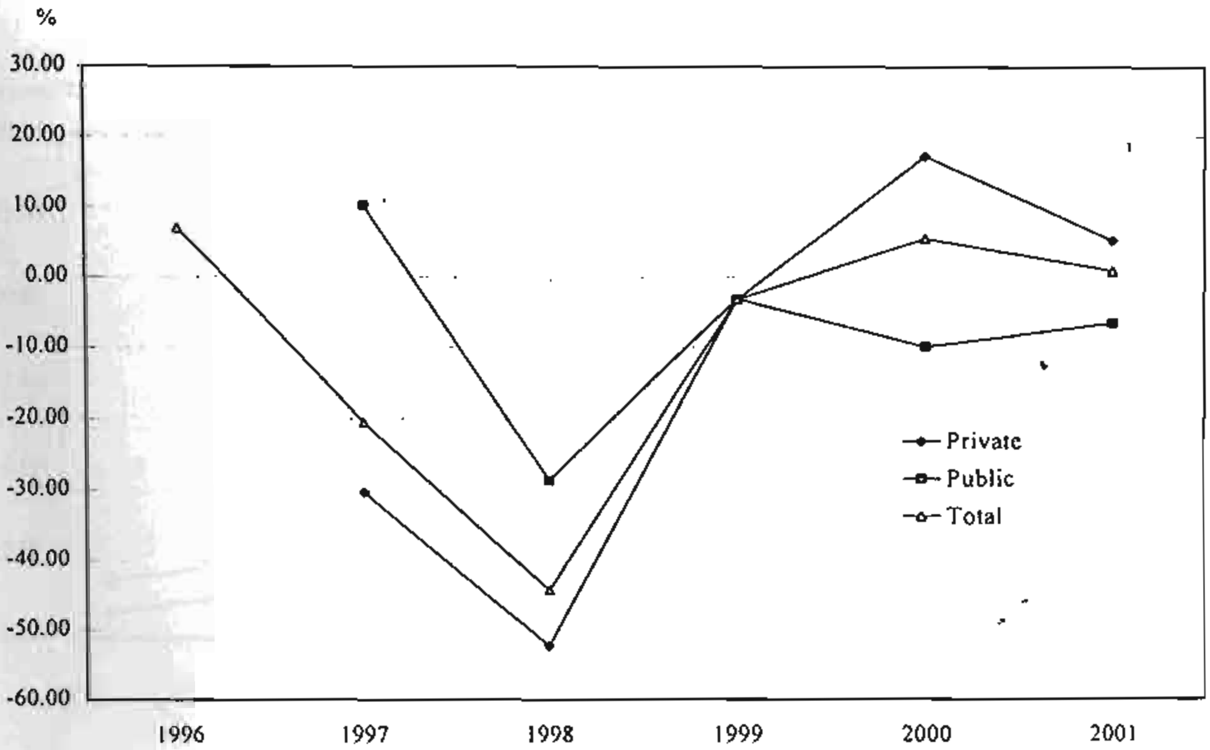


Figure 4
Thailand's Current Account Position as a Percentage of GDP,
1999 - 2001

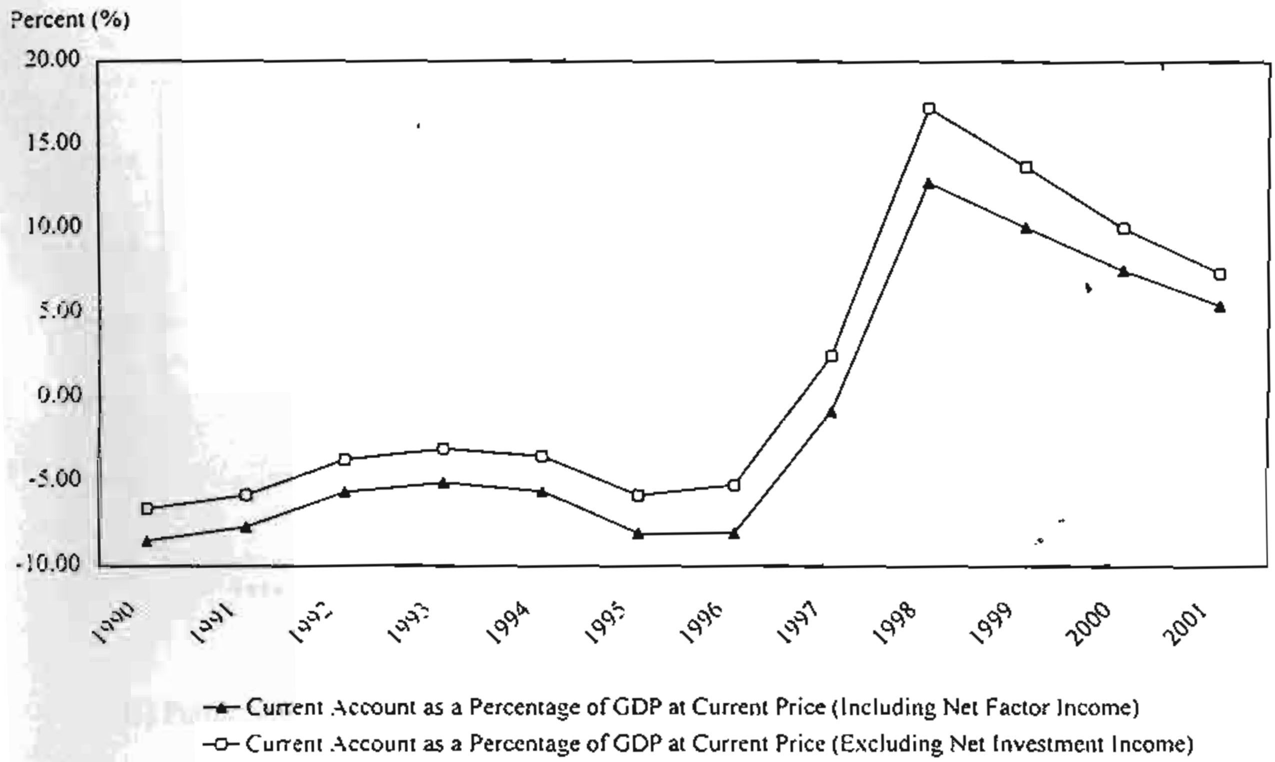
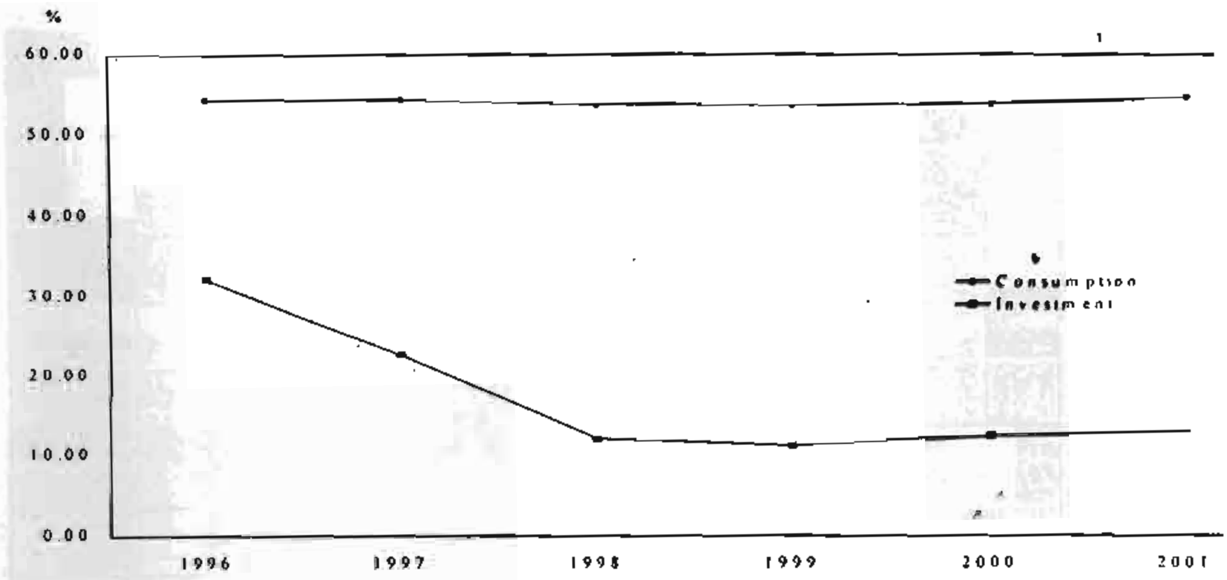


Figure 5
Consumption, Investment and Export as a percentage of GDP,
1996 - 2001

A) Private Sector



B) Public Sector

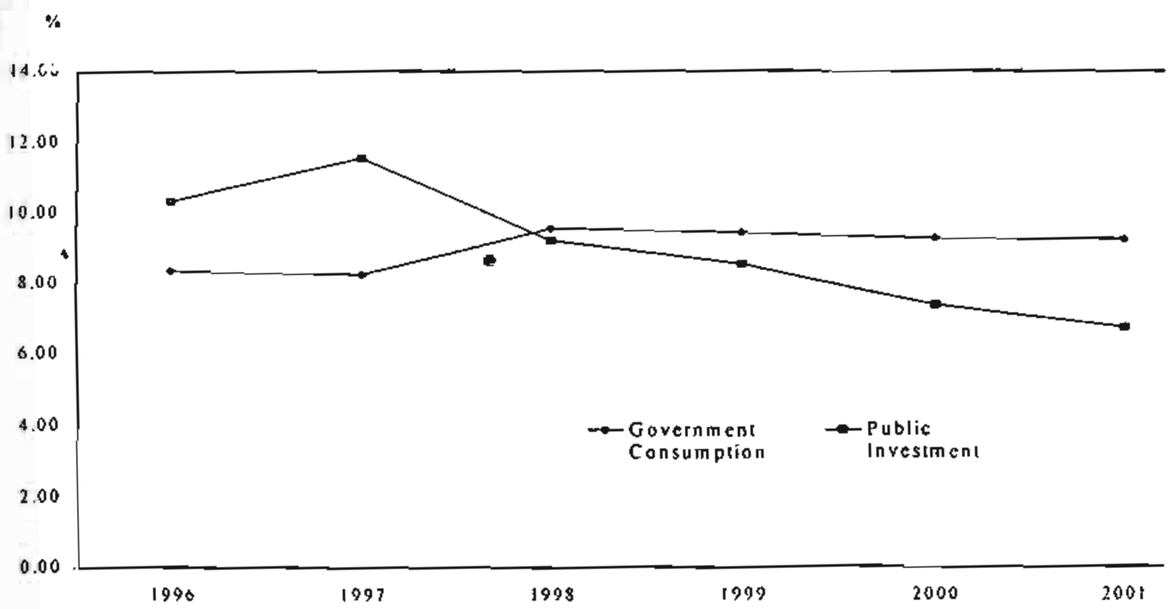


Figure 5 (Continued)

C) Export, Investment and Consumption

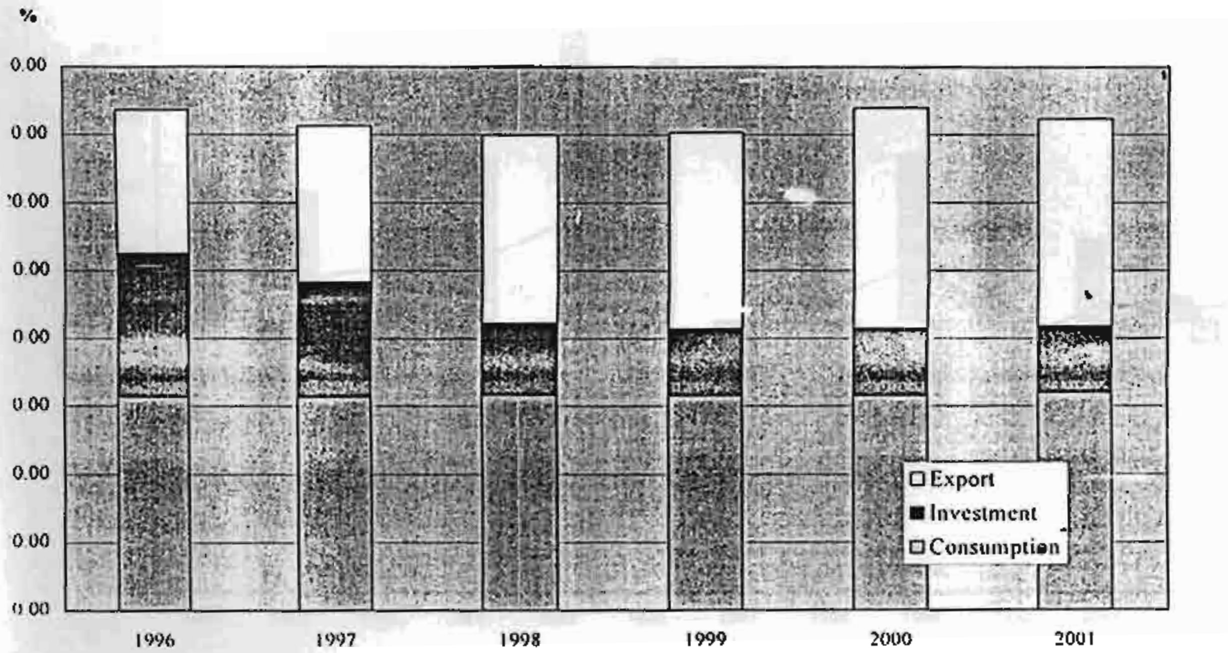


Figure 6
Balance of Payments (US$), 1991 - 2002 Q2

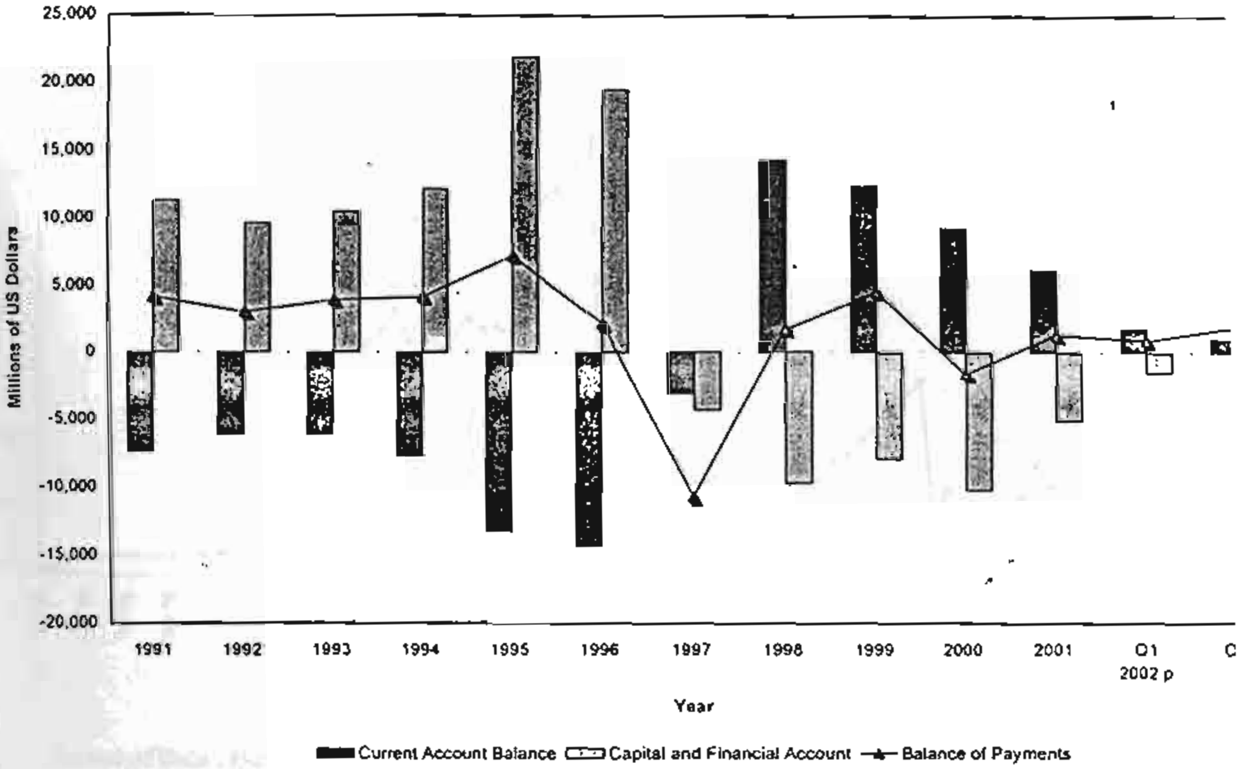
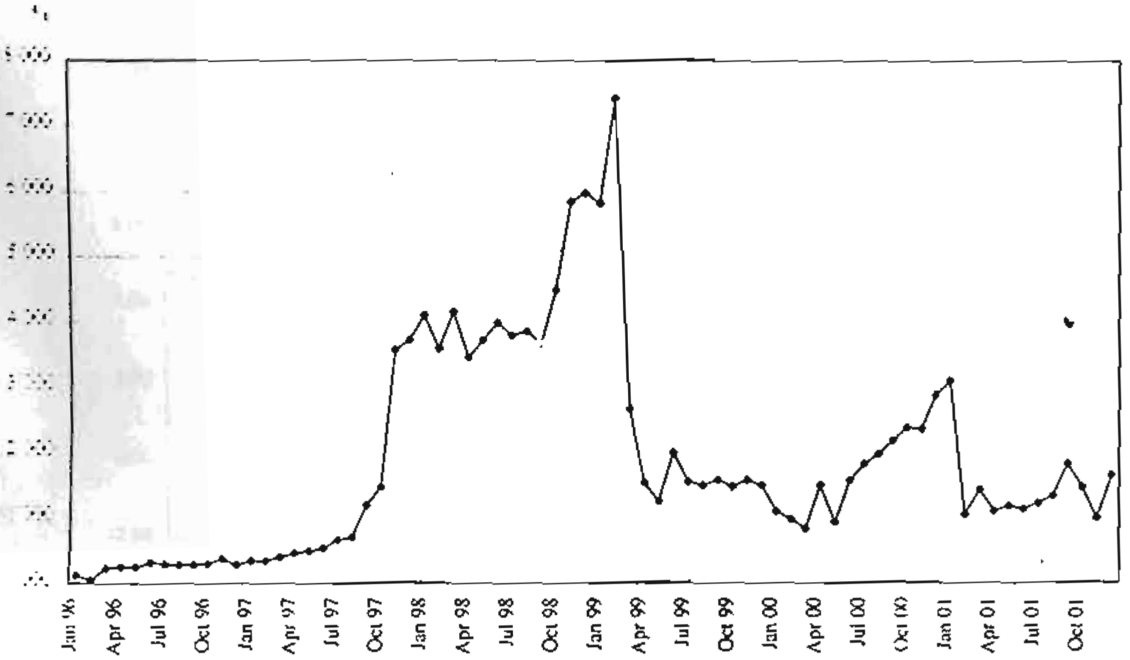
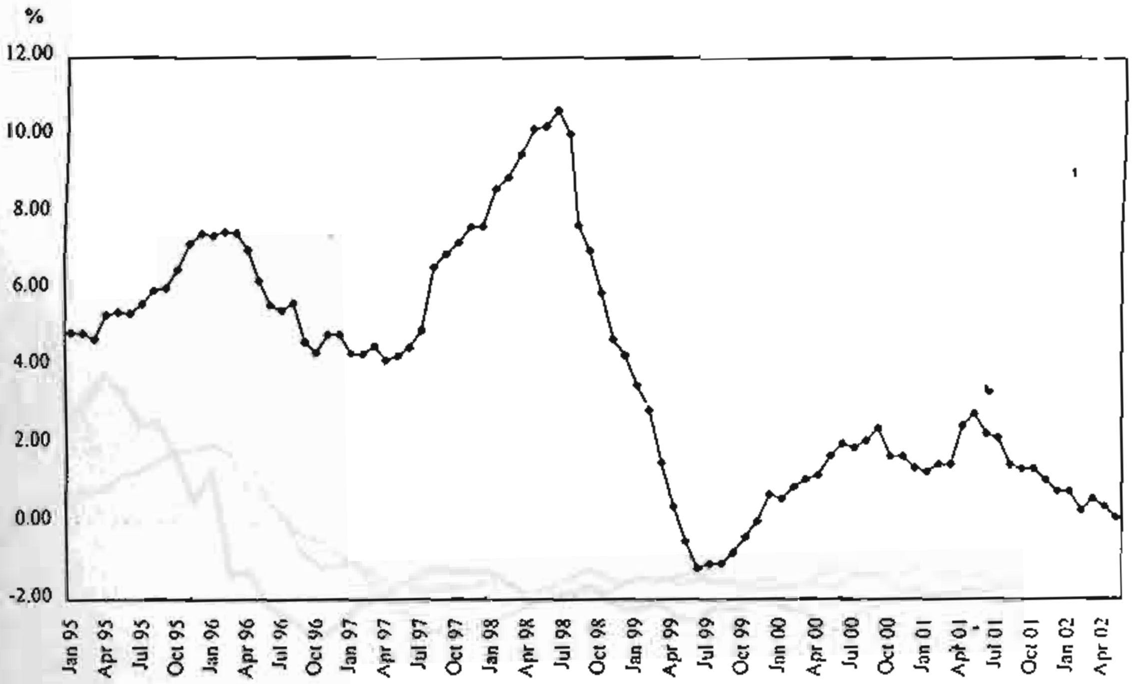


Figure 7
Estimates of Country Risk Premiums for Thailand,
January 1996 to December 2001



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

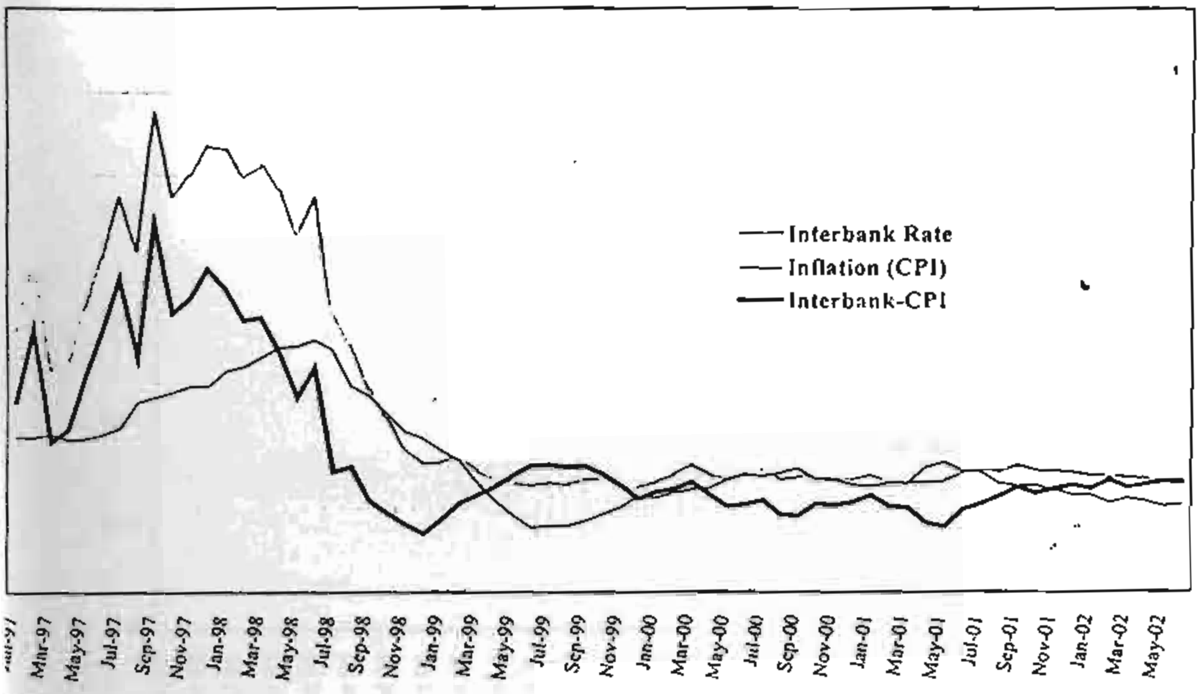


Figure 10
Nominal and Real Effective Exchange Rate of Baht in Terms of Foreign Currencies, January 1995 – May 2002

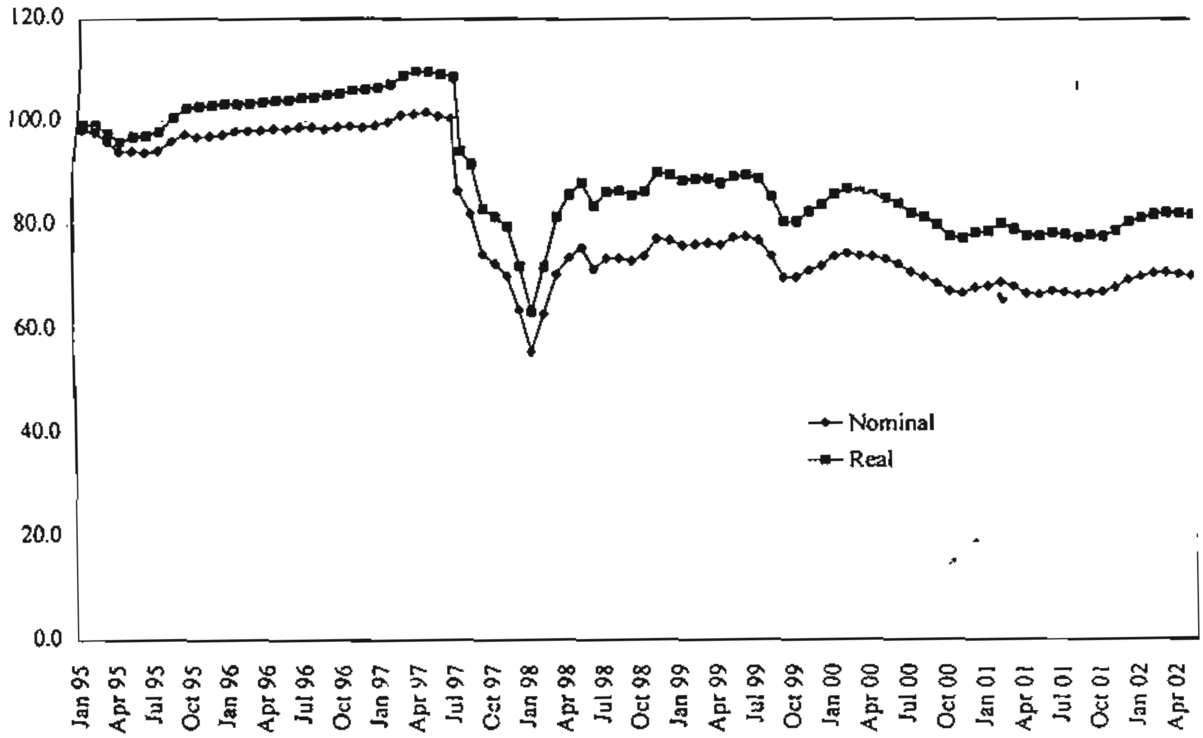
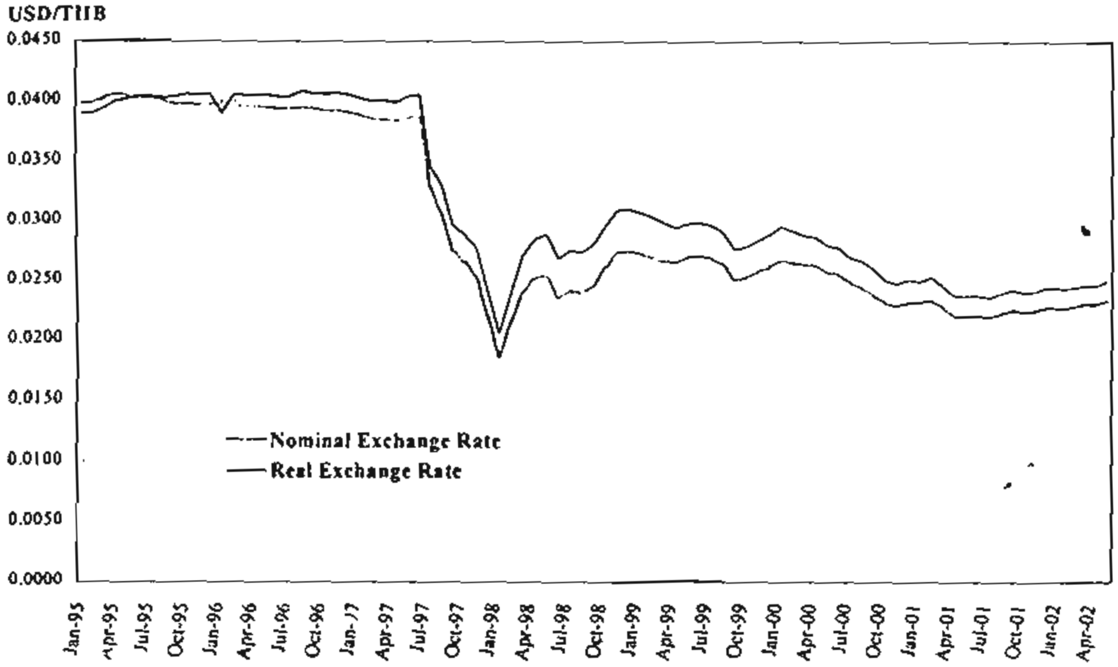


Figure 11
Nominal and Real Exchange Rate of Baht in Terms of U.S. Dollar,
January 1995 - May 2002

A) CPI Base



B) PPI Base

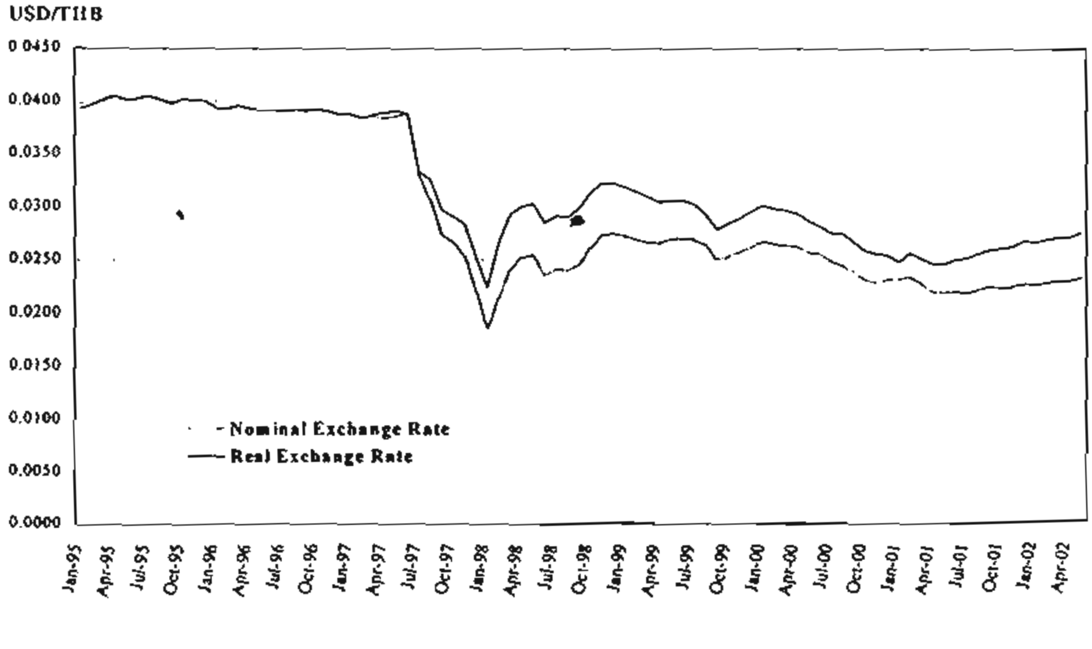
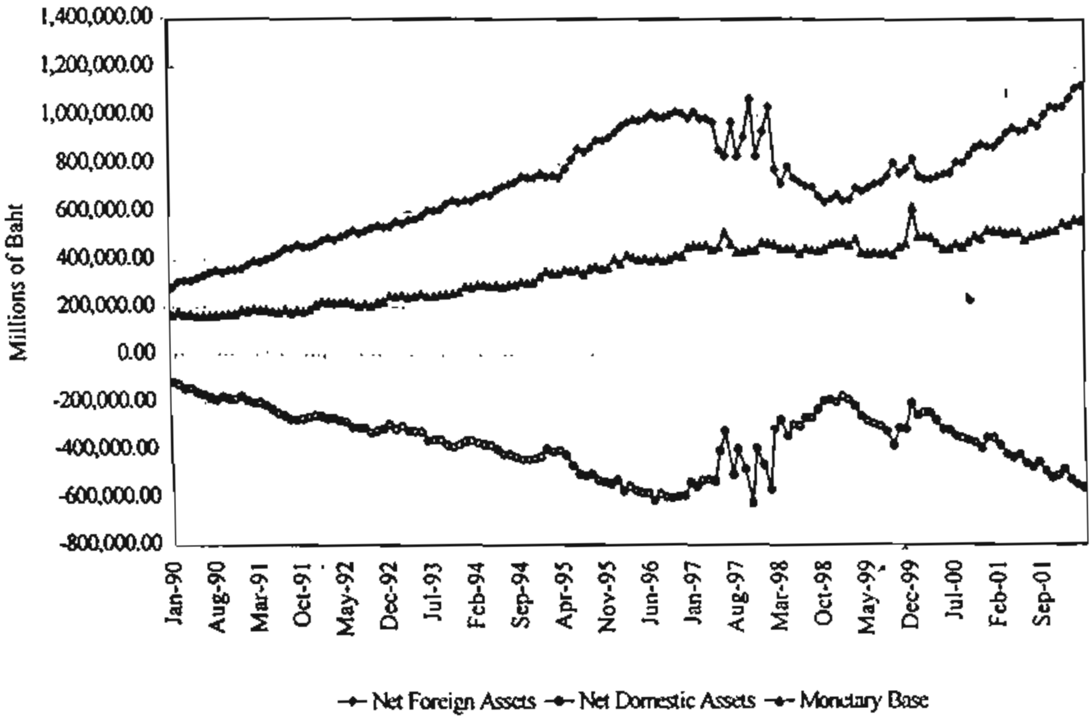


Figure 12
Net Foreign Assets, Net Domestic Assets and Monetary Base,
January 1990 – March 2002



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.

The Master Plan [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.

Progress and Dissent

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