malpractice. For example, during March 1996, it was revealed to the public that the BBC had extended a 36,000 million baht loan to a group of politicians for leverage buy-out with grossly undervalued collateral.[62] This group was known as the Group of Sixteen, which was a faction of the main ruling Chat Thai Party, and some of its members held ministerial posts at the time. While the press took note of ineffectiveness of the BOT's supervision and examination duties, it also speculated on the close relationship between Governor Vijit and the BBC's Managing Director.[63] Yet again, this was another case in which the integrity of the Governor was questioned. This revelation further fuelled the criticism concerning the Governor's legitimacy to govern.[64] As a consequence, the opposition politicians called for dismissal of the Governor.[65] In addition, during 8th-10th May 1996 there was a no-confidence debate in Parliament, in which the BBC's problem was singled out by the opposition parties in order to grill the Minister of Finance, which led to a drop in public confidence and hence a deposit run on the bank. It was the first time that the public knew the extent of the BBC's problems. The failure of a commercial bank in Thailand always brought heavy criticism of the BOT because it was thought that there must be something wrong with the BOT's supervision and examination functions. Unlike this time, however, the integrity of the BOT was not usually questioned. By 17th May, the MOF had to take control of the BBC. Ten days later, the Minister of Finance was forced by the PM to resign and after the takeover, the BBC's Managing Director faced several charges of breaking the Commercial Banking Act.

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[61] Rungsan Thanapornpan, "Governor of the Bank of Thailand and [his] borrowing from commercial bank" *Financial Crisis and Financial Sector in Thai Economy*, (Bangkok: Kobfai Publishing Project, 1998), 257-262.
[62] *Matichon*, 14 March 1996.
[63] "Critical Situation of Vijit Supanit: When Principle is Melted into Air," *Nation Weekly*, 22-28 March 1996, 14.
[64] "BBC's Loans for Takeover: [BBC's MD] or BOT Responsibility?," *Econnews*, 18-31 March 1996, 14-26.
[65] *Matichon*, 14 March 1996.

It was later disclosed that the Governor abused his power in this case. An enquiry into the matter by Mr. Suthee Singsaneh's committee, appointed by the MOF on 25 July 1997, confirmed that Governor Vijit abused his power. The committee writes:

> The BOT had issued several warnings to the BBC to fix its problems, however the BOT had not enforced strong and effective means which were under its legal authorities. On the contrary, the BOT, via the Financial Institution Development Fund (FIDF), injected money into the BBC in order to support its financial status before writing off its equities... The committee's view is that there may have been an abuse of power or dishonest law enforcement both in the senses of unenforcement and application of measures that deviate from the laws' objectives.[66]

It was not surprising that by 18th June 1996, when the Cabinet ordered the BOT to adjust the interest rate policy toward a downward trend, the cry of the BOT to regain its independent decision-making powers was falling on deaf ears. All of these scandalous revelations effectively put the BOT's technocrats on a par with the politicians. This contrasted sharply with the same intervention in interest rates in 1990, when the press strongly criticised Finance Minister Pramual Saphavasu while claiming Governor Kamchorn's personality as too weak to stand for the principle of independence. However, neither Governor Kamchorn's nor the BOT's integrity, in the sense of honesty and non-partisanship, was questioned. But this time, the press treated both the BOT's technocrats and politicians as indifferent, reporting that they were as corrupt and unethical as one another.[67] It was then obvious that Governor Vijit had to go. The press was not so concerned with the issue of the interest rate policy in itself; the focus was instead on the fate of Governor Vijit. On 25th June, several Ministers aired their dissatisfaction with

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[66] Fact Considering and Recommendations for Improving the System of Examination and Supervision of Financial Institution Committee, "Report of the Study" 22 September 1997, Executive Summary, no page.

[67] See for example, Rungsan Thanapornpan, "The Politics of Interest Rate Policy," *Manager*, 28 June 1996.

the Governor in the Cabinet meeting. Several issues were mentioned, including the BBC's problems and interest rate policy.[68] While PM Banharn denied a report that the Cabinet proposed to dismiss the Governor, the fact that the new Minister of Finance confirmed to the press that there was indeed a complaint made about the Governor in the meeting is a testimony to the pressure that was on him.[69] The Minister also commented that it was wrong for high-ranking personnel of the BOT and the MOF to hold shares.[70] The boss of the mighty Bangkok Bank also commented that he believed there would be a change in the Governor's post.[71] It was the first time ever that a commercial banker had made a public comment regarding a Governor. This was very strong testimony to how bad the Governor's credibility was. On 2nd July 1996, Governor Vijit resigned.

A week later, Deputy Governor Rerngchai was promoted to the Governor's post. On 25th July, at the first official press conference with the new Governor, he announced his four working principles, three of which were good indicators of the ongoing situation of the BOT. First, he would commit himself to a term of four years. Secondly, he would lead the BOT by teamwork. And thirdly, he would improve the internal regulations of the BOT in order to achieve better codes of conduct and transparency.[72] Since there is no legal limit on the term of the Governor, the first commitment was a way to assure the public that he would not get involved in politics to stay in power. The second and the third commitment both implied and reflected the ongoing perception of the public toward the BOT.

It was, however, bad timing for Governor Rerngchai to take the post, both due to the fact that by this time the BOT was at its lowest point of esteem and credibility historically and was badly divided internally. Moreover, on 29th July

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[68] *Business Cycle*, 28 June 1996.
[69] Ibid.
[70] *Bangkok Business*, 27 June 1996.
[71] *Manager*, 28 June 1996.
[72] *Thai Financial*, 26 July 1996.

1996, the baht value was attacked in Hong Kong and Singapore Markets.[73] This was the first wave of sustained attack that eventually forced the currency to be floated on 2nd July 1997, exactly a year after the resignation of Governor Vijit.

Financial Liberalisation and the Economic Meltdown

The slippery path toward the 1997 financial meltdown actually started in 1990. The BOT's technocrats began to draft up a financial liberalisation programme which eventually led to the worst ever economic crisis in Thailand. The question as to why the BOT chose to implement such the policy was answered by an enquiry committee, widely known on Thai as the 'Sor Por Ror'. The committee was set up soon after the 1997 crisis to explore the causes of the problem. Below is a part of its findings:

> The BOT could have not chosen to open up the capital market [capital account] in 1990, however it chose to do so. That decision was a consequence of a long running policy which reflected fully preferences of the political actors at the time. Once Mr. Vijit assumed the Governorship, he enthusiastically pursued this policy to the point of establishing the Bangkok International Banking Facilities (BIBFs), which was supported by the Finance Minister Mr.Tarrin Nimmanhaeminda as well as the Cabinet at the time.[74]

The liberalisation and deregulation programme was mainly driven by Governor Vijit, who wanted to secure his position as a Governor. As discussed above, Governor Vijit came to power by allying himself with the personal advisory team of PM Chaitichai, one of whose major policies was to 'transform the battle field [of Indochina] into a market place'. In other words, the Chaitichai government supported the peace process in Indochina, especially for alleviating the Cambodian conflict. Thus represented the first major shift in Thai foreign policy toward Indochina conflicts ever since the late 1970s. The policy anticipated

[73] *Financial Day*, 7 August 1996.

that the newly found market emerging after the peace settlement, would be beneficial economically for Thailand. This policy, therefore, became one of the most important political selling points of the government. Undoubtedly, the overall deregulation and liberalisation programme, incorporating the ultimate aim of establishing Thailand as a funding centre for the region, was pushed by Governor Vijit partly to please his political masters. Within this context, the deregulation and liberalisation programme was also a necessary component of the whole vision. And the most important part of the plan was deregulation of exchange control, both within the current and capital accounts. To be a financial centre, the free flow of capital with a minimum restriction on exchange control is the first necessary condition. Why should a Governor of the BOT want to please the politicians, in spite of the BOT's traditional ethos of *de facto* political independence? This question will be answered in the last section of this paper.

In essence, the initial programme consisted of four parts. First, financial deregulation and liberalisation - all the major financial variables were deregulated. Interest rate ceilings of various types of deposits and loans were gradually lifted between 1989 and June 1992. Relaxation of foreign exchange control was implemented in three stages from May 1990 to February 1994. By this time, the only remaining restriction on the capital account concerned transactions by Thai residents for portfolio and property outward investments, and for outward Foreign Direct Investment in excess of US$ 10 million per individual per year. The scope of commercial banks' and financial companies' activities were expanded. For example[74], both institutions were allowed to operate more investment banking activities such as underwriting, dealing and arranging for debt instruments. Moreover, commercial banks were allowed to undertake businesses of asset management, such as provident fund management, while financial companies were

[74] Enquiry and Recommendation for Increasing the Effectiveness of the Management of the Nation's Financial System (Sor Por Ror) Committee, *Report on Facts of the Economic Crisis Situation*, (Bangkok: TDRI, 1998) 21.

permitted to operate foreign exchange businesses. Concurrently, several restrictions regarding portfolio management of commercial banks were relaxed. For example, the requirement that banks had to hold government bonds in order to open new branches was abolished in 1993: while the requirement that banks had to extend agricultural credit, later renamed as the rural credit requirement, in an amount of no less than 20% of their deposits was expanded.

Secondly, the improvement of supervision and examination of financial institutions were anticipated. However, the only main improvement in supervision criteria was the adaptation of the Bank for International Settlements (BIS) capital fund to risk asset ratio, but this did not redefine the standard of loan classifications, i.e., the definitions of non-performing loans, and turned out to be grossly inadequate.

Thirdly, development of financial instruments and services was also needed by both the financial sector and the BOT since it would help the sector to adjust its liquidity positions more easily and help the BOT to conduct its monetary policy more effectively. The promulgation of the Securities and Exchange Act 1992, followed by the establishment of the Securities and Exchange Commission as an independent agency to supervise the operation of capital markets, were in line of the development.

Lastly, development of a payment system was planned. The aim of this plan was to facilitate the growing volume of transactions more efficiently. The large value electronic fund transfer network – BAHTNET - was opened in May 1995, for example.

The deregulation and liberalisation programme was, in fact, conceptualised since the term of Governor Chavalit, who had been in power for only six months. When he was due to retire, he desired to leave his mark on the financial system. This, in turn, led him to implement the first round of exchange control relaxation by signing up the Article VIII of the IMF Charter in May 1990, upon which the country agrees that it would not resort to exchange control in its current accounts.

This action was, however, rather symbolic than substantial, for Thailand was already under this agreement *de facto* before then. The more concrete turning point of the Thai economy was further liberalisation and institutionalisation of capital inflows by an introduction of the BIBFs. This was implemented under Governor Vijit.

The Impossible Trinity and the Establishment of the BIBFs

By November 1991, the BOT was ready to push for an ever-increasing integration between domestic and international financial markets. A proposal to establish the Bangkok International Banking Facilities (BIBFs) was presented to its Court of Governors at this time.[75] The BIBFs were conceptualised as an initial part of the wider plan to establish Thailand as a regional funding centre in order to exploit the benefits of the newly found peace among Indochina countries. In essence, the participating organisations would only be allowed to conduct their business in foreign currencies, not in the Thai baht. Three types of business within the scope of the BIBFs included the Out-Out, Out-In and Intra-participants transactions. The Out-Out transactions referred to financial business that would only be operated between the non-residents of Thailand. The Out-In transactions referred to those conducted between sources of funds outside Thailand and borrowers within the country.

The single most important intermediate target of any central bank is an ability to control domestic money supply in order to achieve its ultimate objective, namely economic stability. An incorporation of the Out-In business has a very significant implication for the ability of a central bank to control domestic money supply, and hence any proposals to allow such business must be justified.

The proposal to introduce Out-In transactions was justified on three grounds. First, it was claimed that this type of business already existed in practice, but had to be booked for outside Thailand. Secondly, and in connection with the first point, it was argued that the transaction would not complicate the monetary policy of the authorities because Thai non-financial companies had previously borrowed freely from abroad with no ill effects on domestic monetary policy.

[75] BOT. Archives. "Minutes of Meeting of the Court of Governors 11th /91 dated 28th November 1991" *Minutes of Meeting of the Court of Governors.*

Thirdly, the Out-In transaction would attract foreign institutions to participate in the BIBFs, and hence ensure its success.

With the benefit of hindsight, the second argument was not valid since the BOT was already faced with difficulties from the influx of foreign capital. Moreover, on page 25 of the same proposal, it was readily admitted that: "under the present exchange rate system, it is difficult to control money supply due to change in the foreign reserves".[76] It was true that Thai companies had previously been able to borrow from abroad quite freely, but most of them, by and large, had to be bluechip companies. The Out-In business was bound to intensify the speed and pace of inflows since it would enable a smaller, but equally capital hungry, company to tap foreign capital.

One can find the real reason for allowing Out-In transactions on page 35 of the proposal, where it is predicted that it would take at least another five years for the Indochina market to materialise. One can infer that the immediate, short-term objective of the BIBFs was to encourage Out-In business. Furthermore, it was said on page 27 that one of the main objectives of the facilities was to use it as an instrument to mobilise foreign capital to finance the anticipated investment and saving gap of the economy. This leaves a little doubt that, at least for the short-term period, the main objective of introducing the BIBFs was to further encourage capital inflows. In essence, one can argue that the proposal pays too little attention to the potential effects of the Out-In transaction on the money supply, which would, in turn, have major implications for the ability of the BOT to conduct monetary policy. Why would the BOT, which had been famous for its conservative ethos, choose to introduce a mechanism that could potentially undermine its own ability to control the money supply? As argued above, this was a part of the grand vision of the BOT's technocrats who had tried to please their political masters since 1990.

[76] Ibid.

After an establishment of the BIBFs in 1993, the dominant business was indeed the Out-In transaction. It was not surprising that this led to a further increase in the amount of capital inflows, which literally flooded the domestic financial market. The volume of net capital inflows to Thailand rose from an average of about 9% of GDP annually during 1988-1992 to 14% of GDP in 1995. Table 2 shows that the amount of inflow increased significantly from 1993 to 1996.

Table 2: Total Net Capital Inflows to Thailand (Billions of US$)

Year	1989	1990	1991	1992	1993	1994	1995	1996
Inflows	6.6	7.2	10.6	8.1	12.6	15.8	22.8	18.1

Source: Yos and Pakorn 1998, Table 8, 21-22

From this time onward, the economy had reached the point of no return. A grave mistake of the plan was the policy inconsistency between the free flow of capital and the *de facto* fixed exchange rate regime. The baht had long ago been pegged to the US dollar. Even given that the basket pegging system was adopted from 1984 to 1997, the dollar still commanded a predominant weight in the basket. Therefore, the exchange risk of foreign borrowing denominated in US dollars before 1996 was negligible. The exchange rate stability and free flow of capital, together with low interest rates abroad, gave strong incentives for the corporate sector to build up massive unhedged foreign debts. The end of 1996 heralded the first time that the BOT had been urged to seriously consider a more flexible exchange rate regime by a permanent secretary of the MOF since 1993,[77] after capital outflows and speculative attacks to the baht. But the request was too late, even by this time. After nearly a decade of high capital inflows, which were accentuated by the BIBFs, the economy was distorted to the extent that it was beyond minor repair. However, the consequences to the economy still might not have been as bad as they were after the baht was finally forced to float by speculators on 2nd July 1997, and Thailand lost virtually all of its international currency reserve. It is clear that the establishment of the BIBFs was one of the most important causes of downturn in the Thai economy.

When the panic of international financial markets set in after the July 1997 flotation of the baht, the capital outflows brought the whole economy to its knees.

[77] Enquiry and Recommendation for Increasing the Effectiveness of the Management of the Nation's Financial System (Sor Por Ror) Committee, *Report on Facts of the Economic Crisis Situation*, (Bangkok: TDRI, 1998) 81.

This proves that the technocrats had tried but failed to achieve the 'impossible trinity', namely to have a free flow of capital and an independent monetary policy under a fixed exchange rate system.

Did some of the best and the brightest economists of Thailand fail to take this doctrine into consideration? Clearly, the BOT and the MOF had not failed in this aspect. In November 1991, the BOT presented its study on the incorporation of the BIBFs to its Court of Governors, not for approval but merely for acknowledgement. In the document, a working group, which had studied the merit of establishing the BIBFs, listed three main risks associated with the proposed establishment, with the relevant one being:

> 2) The effect on monetary policy conducts
> Under the present setting of the exchange rate system, the authorities have little flexibility in using the exchange rate as an instrument to insulate the effects of foreign inflows from the domestic financial system. A more effective measure that can insulate these effects is the rearrangement of the present exchange rate system to a more flexible exchange rate arrangement. This more flexible arrangement will act as another cushion to insulate the effects on the domestic financial system. The new arrangement will not only help the authorities to avoid uncertainties of determining the appropriate level of the exchange rate which is very difficult to pinpoint in practice, but also be able to let the exchange rate movement be more flexible. **Without taking political constraints into consideration,**[78] a more flexible exchange rate system will be an excellent supportive measure for the ongoing liberalisation efforts of the authorities, especially for the policy of foreign exchange liberalisation. The Economic Research Department, therefore, recommends that the more flexible exchange rate system should be implemented concurrently with the process of establishing facilities such as the BIBFs in order to reduce risks that might be incurred to the stability of the domestic financial system.[79]

It is therefore clear that the top executives of the BOT had known of the doctrine of the 'impossible trinity' at least since 1991. They also realised very well that the

[78] My emphasis

implementation of a more flexible exchange rate arrangement might be faced with political obstructions. This is also true for the top executives in the MOF. The Minister of Finance sent a letter to the Cabinet dated 28th August 1992. The letter, which asked the Cabinet to approve the principle of the BIBFs, was essentially a summary of the above study and concluded that:

> [t]o mitigate risks and destabilisation of the domestic monetary system, [due to the effects of excessive foreign capital inflows on the domestic money supply]...the most important consideration is the rearrangement for a more flexible exchange rate system, which will act as another cushion for the effects on the domestic financial system from the foreign inflows.[80]

Technically speaking, there were two main mistakes made by the Bank of Thailand. First, what went wrong was that the sequence of liberalisation was implemented incorrectly by the authorities, i.e., the capital account had been opened before the introduction of a flexible exchange rate system. Secondly, the BOT encouraged more capital inflows through an introduction of the BIBFs before implementing a flexible exchange rate regime, despite acknowledging the doctrine of the 'impossible trinity' and the recommendation of the Research Department, which had made clear that the regime should have been introduced concurrently. Clearly, it was not a matter of inadequate training or technical incompetence *per se* among the BOT's technocrats. So what was a matter? There was a debate among the BOT's technocrats regarding an adjustment of the exchange rate system and policies that could have implications for monetary measures. Those who had advocated a flexible exchange rate system and more vigilant approach toward monetary measures were silenced. One thing is clear from this internal debate: the structure of the BOT did not allow the potentially beneficial idea to be translated

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[79] BOT. Archives. "Minutes of Meeting of the Court of Governors 11th /91 dated 28th November 1991" *Minutes of Meeting of the Court of Governors.*

[80] The attachment - The Development of Thailand into a Regional Funding Centre - to the MOF's letter Ref. 0303/38190 dated 28th August 1992.

into the BOT's policy. Why is this the case, and why was the change of an exchange rate policy so difficult and contentious?

The Bifurcation between Macro and Micro Economic Policies, and The End of The Gang of Four

One of the theses of this paper is that the four agencies (the Gang of Four) responsible for the macroeconomic policy formulation were anything but cohesive, that partly brought about the economic crisis in 1997. The effective policy coordination, especially between fiscal and monetary policies, which had been chiefly responsible for the high economic growth within a stable economy for more than 30 years, was at its lowest point by the 1990s. By 1975 the macroeconomic technocrats, the most cohesive group of all the state's economic personnel, began to split. The first half of the 1980s, amidst the difficult economic restructuring, left the technocrats deeply divided. Within this context, the further deterioration of both cohesiveness and the traditional ethos of integrity, caused by the changing incentive structure of the economy in 1990s, left the macroeconomic agencies nonfunctional.[81] By this time the professional politicians were not prepared to act merely as a rubber stamp as they once had. A deterioration of the technocratic institutions and an increasing assertiveness of the politicians left the state without effective tools to formulate the right policies for the economy. The result was the 1997 crisis.

To substantiate the above claim, it is necessary to look at the macroeconomic policy coordination during 1994-1996. From 1990 to 1995, the average growth rate of the economy was 8.6% per annum, while the inflation rate stayed at a low level until the end of 1993, then climbing. In the same time frame, the current account deficit declined from about 8% of the GDP to the lowest point in 1993, and climbed up again to 8.2% in 1995. However, the deficits were more than offset by capital inflows, which resulted in increasing foreign debt. Higher inflation and accumulating deficit were clear signs that by 1994, the economy was overheated. The Sor Por Ror Committee points out that the authorities could have had five options to follow in order to cut down the aggregated demand.[82] Two of them were the tight monetary and fiscal policies.

The Committee's judgement is that the balanced fiscal policy proposed by the four agencies was not enough to cool down the economy, and that a more appropriate policy would have been a fiscal surplus policy. However, on 18th January 1995, when the agencies met to formulate the 1996 fiscal policy, the meeting had concluded that a balanced budget would be used. Governor Vijit, who represented the BOT in the meeting, neither pushed for the surplus policy nor objected the balanced policy. In a following year, the meeting also reached the same conclusion without any opposition from the BOT.[83] It is important to note that under the fixed foreign exchange rate regime and free flow of capital, the fiscal policy tended to be more effective in aggregate demand management than the monetary policy. Since the BOT chose to use the fixed rate regime, then, it should have pushed for a fiscal surplus policy. Although the fiscal policy was not under the authority of the BOT, the BOT traditionally had a large influence on it.[84] Why didn't the BOT push for the surplus policy? At least two explanations can be offered here. First, the BOT may have seen a balance policy as appropriate. But this is unlikely. As the BOT itself employed a tight monetary policy in both years, [85] this indicated that there was a concern about the overheated economy. Then, why did the BOT choose to employ a less effective measure? The second explanation may be that the BOT had lost its previous influence on fiscal policy setting, it hence did not even try to push for the surplus policy. If this was in fact

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[81] More discussion will follow.

[82] Enquiry and Recommendation for Increasing the Effectiveness of the Management of the Nation's Financial System (Sor Por Ror) Committee, *Report on Facts of the Economic Crisis Situation*, (Bangkok: TDRI, 1998) 12.

[83] Ibid., 13.

[84] For example, during the time of Governor Puey, the BOT virtually had the veto power of determining the upper limit on government spending.

the case, then one can conclude that the degree of policy coordination between the Gang of Four reached a minimum.

The second interpretation is more likely because even the politicians and the Fiscal Policy Office (FPO) opposed the tight monetary policy used by the BOT. As discussed above, by June 1996 the tight monetary policy was openly opposed by the politicians, which partly led to the forced resignation of Governor Vijit. The important point to note here is that the FPO, a member of the Gang of Four, gave some very odd reasons for supporting the politicians' opposition to the high interest rate policy. It claimed that a high interest rate would cause higher inflation and also less exports.[86] Rungsan Thanapornpan observed that since 1992, the FPO and the BOT have raced against one another to have a leading role in monetary policy setting. Moreover, their respective influences depended on what political party was in power or who was the Minister of Finance. For example, during 1992-1995, when the Democrat Party was in power, the FPO had the upper hand, while during Finance Minister Dr. Surakiart Sathirathai's term in office (July 1995-May 1996), the BOT had a leading role due to the close personal relation between the Minister and Governor Vijit.[87] Indeed, as Ammar points out, "[t]he fiscal policy side of the technocracy has clearly disintegrated. The degree of cooperation between the four key agencies is now minimal" (Ammar 1997a, 71). He argues that most of the technocrats in the Gang of Four have become highly politicised, in particular the Budget Bureau, whose former Director has always been known as 'Banharn's boy'.[88]

Two points can be drawn from the discussion so far. First, by the first half of the 1990s, the cohesiveness between macroeconomic technocratic organisations, i.e. the Gang of Four, had deteriorated to the extent that it prevented

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[85] Ibid., 13.
[86] Rungsan Thanapornpan, "Politics of Interest Rate Policy", *Financial Crisis and Financial Sector in Thai Economy*, (Bangkok: Kobfai Publishing Project, 1998), 214.
[87] Ibid., 212-213.
[88] Banharn was a former PM (Dr. Ammar Siamwalla, personal correspondence, 16th December 2000).

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[88] Banharn was a former PM (Dr. Ammar Siamwalla, personal correspondence, 16th December 2000).

effective policy coordination. The divisiveness showed itself clearly both within and between organisations. By 1996, the best organisation among them, the BOT, was badly divided and deprived of its long established credibility and reputation of integrity and honesty. This had a profound implication, since the BOT's *de facto* autonomy had previously always been protected by its credibility and good reputation. The case of interest rate policy intervention discussed above is testimony to the importance of the BOT's credibility and reputation.

Secondly, the internal debate within the BOT concerning the measures leading to the introduction of the BIBFs proved that the structure of the BOT did not enable potentially beneficial ideas to be implemented, nor did it prevent potentially dangerous decision-making. A lethal combination of these two related points led to the ill-fated attempt by the BOT to defend the impossible trinity. The BOT finally accepted the inevitable by floating the baht on 2nd July 1997.

Why did the BOT, under the leadership of both Governor Vijit and Governor Remgchai, choose to defend the fixed exchange regime to the extent of sacrificing nearly all of its reserves? This question has to be answered in relation to both Governors. First, under the leadership of Governor Vijit, the crucial point was the decision to establish the BIBFs without concurrently introducing a flexible regime in 1993. As argued previously, an early introduction of a flexible regime might have been able to deter the capital influx in the first place, and enable the BOT to pursue a tight monetary policy more successfully. Since this recommendation of the BOT's Research Department was not implemented, the economy had to suffer from the consequences.

Therefore, it is sufficient and appropriate to question why Governor Vijit ignored the recommendation. First, Deputy Chaiyawat -- the Governor's right hand man -- held strong convictions toward a fixed exchange rate policy. He was not convinced that there was an urgent need for a flexible regime. Therefore, his conviction surely gave rise to doubts in the Governor toward the recommendation to move to a flexible regime. Secondly, the exchange rate policy adjustment had been the single most sensitive of all monetary-side policy issues due to previous political experiences. With the heavy political cost of exchange rate adjustment in 1984, and with the experiences of Governor Kamchorn's dismissal still fresh in his mind, the newly appointed Governor, who had taken the post by politicking, was clearly not prepared to risk his job security unnecessarily since the economy was in very good shape in 1993. Moreover, the establishment of the BIBFs was in itself an act of political pleasing by the Governor toward his political masters. Why raise an unnecessary and potentially politically costly issue?[89]

Why had the BOT resisted changing the exchange rate policy under the leadership of Governor Rerngchai? There are several related answers to this question. By the time Governor Rerngchai took the post, the bubble economy was about to burst. In other words, it was unrealistic to expect the BOT to be able to override the incoming economic crisis. Even if the exchange regime had been adjusted as early as the second half of 1996, the crisis was still unavoidable. Having said that, the BOT should at least have been able to guide the economy to a better landing ground. The fact was that the BOT miserably failed to do this and accentuated the crisis by gambling out the international reserves. This was partly a result of the lack of good leadership on the part of Governor Rerngchai. Faced with both the looming currency and banking crises, he did not dare to bite the bullet by changing the exchange regime. The hesitation to do so was due to several factors. Personally, Governor Rerngchai had been assigned only a second grade job for several years during his time as joint-Deputy Governor. In effect, he was deprived of the relevant experience of running macroeconomic policies.[90] More importantly, the organisation that he inherited from Governor Vijit was deprived of cohesiveness and credibility at a time when they were most needed. Neither was

[89] By law, the initiative to change or adjust the exchange rate system must be recommended by the Governor, to which the Finance Minister has to react.

[90] His career path followed the banking and financial institution supervision, which was responsible for banking sector policy, not for the macroeconomic policy. And traditionally, this career path is not the breeding ground of a Governor.

been the single most sensitive of all monetary-side policy issues due to previous political experiences. With the heavy political cost of exchange rate adjustment in 1984, and with the experiences of Governor Kamchorn's dismissal still fresh in his mind, the newly appointed Governor, who had taken the post by politicking, was clearly not prepared to risk his job security unnecessarily since the economy was in very good shape in 1993. Moreover, the establishment of the BIBFs was in itself an act of political pleasing by the Governor toward his political masters. Why raise an unnecessary and potentially politically costly issue?[89]

Why had the BOT resisted changing the exchange rate policy under the leadership of Governor Remgchai? There are several related answers to this question. By the time Governor Remgchai took the post, the bubble economy was about to burst. In other words, it was unrealistic to expect the BOT to be able to override the incoming economic crisis. Even if the exchange regime had been adjusted as early as the second half of 1996, the crisis was still unavoidable. Having said that, the BOT should at least have been able to guide the economy to a better landing ground. The fact was that the BOT miserably failed to do this and accentuated the crisis by gambling out the international reserves. This was partly a result of the lack of good leadership on the part of Governor Remgchai. Faced with both the looming currency and banking crises, he did not dare to bite the bullet by changing the exchange regime. The hesitation to do so was due to several factors. Personally, Governor Remgchai had been assigned only a second grade job for several years during his time as joint-Deputy Governor. In effect, he was deprived of the relevant experience of running macroeconomic policies.[90] More importantly, the organisation that he inherited from Governor Vijit was deprived of cohesiveness and credibility at a time when they were most needed. Neither was

[89] By law, the initiative to change or adjust the exchange rate system must be recommended by the Governor, to which the Finance Minister has to react.
[90] His career path followed the banking and financial institution supervision, which was responsible for banking sector policy, not for the macroeconomic policy. And traditionally, this career path is not the breeding ground of a Governor.

the divisiveness reduced during the term of Governor Rerngchai. Dr. Chaiyawat, the right hand man of the previous Governor, was assigned less responsibility. The Sor Por Ror Committee claims that Dr. Chaiyawat, as a result of being 'pushed to the side', did not fully devote himself to the common good; in other words, he was doing his job only 'out of duty' in spite of the fact that his opinion toward the policy was decisive within the BOT.[91] Moreover, the flow of ideas and information among the BOT's top technocrats were affected by the conflict between Governor Vijit and Deputy Ekamon in 1995. From this time up until 1997, there was less expression of opinions and exchange of ideas among the BOT's top technocrats. In effect, the method of spying used during the conflict had demoralised the technocrats.[92] Therefore, opinions in favour of a flexible exchange rate regime were not effectively communicated.

A further incentive to prolong the *status quo* came from the fact that an adjustment to the exchange rate regime had always been a potential political dynamite. The Governor might have feared that even if he tried to adjust the regime early on it would have faced opposition from the politicians, especially at this time since the effects to the economy would be explosive. This is due to the fact that the business community had accumulated massive unhedged foreign debts. The political repercussions might have then deprived him of the Governor's post, even if he could have done it. All of these evidences provide us with rationales why the Governor did not want to give up his defence of the baht without a fight.

To sum up, the above discussion claims that the decision to defend the exchange rate regime without due regard to the cost of the action was mainly the result of the slowly disintegrating technocratic institution. In other words, the tradition of integrity and the ethos of devotion to public interest among the Gang

[91] Enquiry and Recommendation for Increasing the Effectiveness of the Management of the Nation's Financial System (Sor Por Ror) Committee, *Report on Facts of the Economic Crisis Situation*, (Bangkok: TDRI, 1998), 85-93.

[92] Ibid., 24.

of Four in general and the BOT in particular had gradually deteriorated to the extent that it prevented the technocrats from functioning effectively. We shall explore rationales underlying this phenomenon in the following section.

The Imperative Nature of Institutional Factors

A former Governor agues that it is possible for a Governor to act as a dictator within the BOT.[93] This fact explains, for example, why Governor Vijit as an individual could do so much damage to the BOT as a whole. To understand this fact one must first understand the institutional blueprint of the BOT, which is laid down in the Act of The Bank of Thailand BE 2485 (1942). Secondly, one also has to understand the structure of power relations between the BOT and the MOF. This section will try to explain two related points. First, how is it possible for a Governor to be a dictator within the BOT? Are there, for example, no mechanisms within the BOT to balance the power of a Governor? Secondly, why, since the early 1990s, had the BOT been subjected to 'implicit intervention' by the politicians?

It should be pointed out that since the BOT was established, the fundamental power relations both within the BOT and between the BOT and the MOF remain largely unchanged in terms of law.[94] Indeed, a thesis of this study is that the failure to adjust these fundamental relations to match the changes in the economic and political 'realities' partly accounted for what occurred in 1997.

The fundamental power structure within the BOT was designed in a way that entrusts most, if not all, of the decision-making in the hands of the Governor. The Court of Governors was not designed to balance the power of the Governor in economic policy making. Moreover, in practice the appointment of the members of

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93 Chavalit Thanachanan, interviewed by author, 4 June 1998, Bangkok, Thailand.

94 To be precise, the check and balance of power between the BOT and the MOF, especially regarding the formal power of employing certain monetary measures and banking supervision power, has been changed from time to time, largely due to the changes in the Commercial Banking and the Financial

the Court had been traditionally carried out in such a way that helped facilitate or coordinate the BOT's policy, rather than balancing the power of a Governor in economic policy making. In other words, the Governor is accountable to no one but the Minister of Finance. This can be clearly seen from Section 14 to 20 of the Act, which lays down the basic power structure, both within the BOT and between the BOT and the MOF. Section 15 stipulates that the Court of Governors (COG) is composed of at least 5 members,[95] excluding the Governor and the Deputy Governor who automatically sit as the Chairman and the Deputy Chairman of the COG, respectively. The main responsibility of the COG is to supervise the BOT's activities in general. Specifically, the COG may have a final word on all of the following 6 points, which are determined by Section 5 of the BOT's 1942 Secondary Registration:

1. Founding and extermination of the Bank's branches and representatives;
2. determination of the conditions and scope of business that is allowed by the BOT's Secondary Registration;
3. determination of the BOT's discount and rediscount rates;
4. provision of facilitating mechanism for the flow of credit;
5. approval of the BOT's profit and loss account, balance sheet account and the BOT's annual report;
6. approval of the BOT's internal regulations.

Aside from the above 6 specific authorities, the Governor can make any decision without even informing the COG. Moreover, the COG has no authority to set the meeting agendas. It is clear that the above 6 authorities involve very little macroeconomic and commercial banking policy. Arguably, the third authority might affect the effectiveness of some of the BOT's monetary measures, but this function of the BOT has traditionally been kept at the very minimum and hence

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Company Acts. However, they represent specific changes in an overall framework which remains largely unchanged.

95 This was the only change occurring in 1944, which in effect makes no difference to the power structure within the BOT. The same Section in 1942 stipulated that the COG must have three members.

has had little effect on the BOT's policy. Section 20 of the Act also entrusts the COG to determine the pay scale of the BOT's employees, including the authority to approve recruitment and dismissal of the BOT's staff. Again, this authority is not related to the BOT's economic policy responsibilities.

Not only are most of the COG's duties not involved in the economic policy making, but Section 17 also further concentrates the decision making power within the hands of a Governor. It stipulates that, if a BOT policy is outvoted by the majority of the members of the COG, then the Governor still has the right to refer the case to the Minister of Finance to make a final decision. Moreover, Section 18 gives the Governor the right to implement some measures independently which would normally require a prior approval of the COG before being given the green light, although he still has to seek the COG's approval once such measures are in place. Therefore, it is fair to conclude that there is little limitation within the BOT on the Governor making decisions about economic policy. It is not surprising that if one reads through the monthly Minutes of the COG Meetings, during 1959 to 1993 at least, one will find that most of the meetings concentrated on routine agendas, for example, on approval of the BOT's newly recruited staff. The odd economic policy issue showed up occasionally, but only for the COG acknowledgement, not for their approval. Unsurprisingly, there was not even a single agenda item that was subjected to the call for a vote during this period.[96] The COG meeting is clearly not a place to discuss economic policy. For example, during a few months before the baht's flotation in July 1997, a member of the COG had to go public with his opinions concerning the exchange rate policy, as they conflicted with those of the BOT and there was no room for him to express himself in the COG.[97] Therefore, both by the institutional design and in practice, the COG does not function as a check on the Governor's economic policy-making power.

[96] BOT. Archives. *Minutes of Meeting of the Court of Governors 1959-1993.*

[97] Rangsan Thanapornpan, "The Process of Decision making in the Bank of Thailand" *Financial Crisis and Financial Sector in Thai Economy* (Bangkok: Kobfai Publishing Project,1998) 197-203.

These facts explain why an individual who assumes the Governor's post can have tremendous influence on the BOT: the fate of the BOT is very much a function of the leadership and personality of its Governor. The completely different kinds of 'Art of Being a Governor' practiced by Governor Puey and Governor Vijit, which gave rise to very different performances and varying reputations of the BOT, are a confirmation of this statement. In other words, the power structure *within* the BOT allows a Governor to practice tyranny or heroism as he chooses or according to his abilities.

The next factor to be considered is the relationship of power between the BOT and the MOF. Section 14 stipulates that the Finance Minister has both the duty and the authority to supervise the BOT's general conduct. Section 19 determines that the appointment or dismissal of a Governor or his Deputy must be undertaken by the King upon the recommendation of the Cabinet, while members of the COG are appointed or dismissed by the Cabinet upon the recommendation of the Finance Minister. And since the BOT is under the supervision of the MOF, the Finance Minister is the one who traditionally nominates or proposes a dismissal to the Cabinet. However, the Act does not specify the length of the term of a Governor or any conditions under which the Governor might be dismissed.[98] In effect, the Minister has a right to dismiss a Governor at any time and for whatever reasons he sees fit, providing that the Cabinet approves it, *de jure* speaking. Therefore, the Governor is accountable to no one but the Finance Minister.

To sum up, the BOT's decision making process is on the one hand very much concentrated in the hands of the Governor, to the extent that he can be a dictator within the BOT. On the other hand, the Governor is *de jure* subject to the pleasures of the Finance Minister. As argued above, this structure of power was designed during the period in which there was a clear gap of leadership between the BOT's Governor and the BOT's staff, and cohesion of the top technocrats among the BOT and the MOF was high, namely during the post-World War Two period. By 1985, the technocratic cohesiveness had withered away. There were two main factors that accounted for this decline in cohesiveness among the BOT's and the MOF's technocrats. First and foremost, the Second Oil Shock of 1979-1981 and its aftermath for the international economy affected the Thai economy badly, which required necessary remedies. Under pressure to take necessary but contentious and difficult actions, and without the clear leadership of a leading technocrat, various conflicts occurred between the BOT and the MOF. Secondly, the cohesiveness between the two organisations' technocrats was derived partly from the fact that there was a transfer of personnel from the MOF to the BOT. The rise of the third generation of the BOT's technocrats to its core positions from the early 1980s onward stopped this flow. This rise was a result of the BOT's successful human resource development programme initiated by Governor Puey.

Yet this framework of power structures both within the BOT and between the BOT and the MOF has never been changed *de jure*, since 1942. From 1942 to 1997 Thailand changed beyond recognition, both economically and politically. These changes made the basic framework of power relations redundant, which in turn gave rise to a set of changed incentive structures. Some consequences of this redundant institution can be singled out. First, it gave an incentive to the BOT's top technocrats to 'rat race' to power. The rise to power of Governor Vijit and his conflict with Deputy Ekamon were cases in point. Ammar points out that:

> [i]n terms of intrinsic ability, the Governor is now only the first among equals; in terms of legally vested powers, however, he is very much at the top. As a consequence, the prize of governorship and the fight for it among the top management became a very important backdrop that undermined effective teamwork [in the BOT] (Ammar 1997a, 70).

[98]The specified term of a Governor was deleted from the draft of Prince Wiwat.

Secondly, since the Governor is *de jure* subject to pleasures of the Finance Minister, he has only one choice if he wishes to cling to the post; that is, to please the Minister. Ammar defines this pleasing as 'implicit intervention'. Clearly, the introduction of the BIBFs without concurrently adjusting the exchange rate regime is a case of such implicit intervention. This *de jure* dependence on the Minister of Finance had not been a problem in the past, for example during the term of Governor Puey. His unquestionable integrity and the BOT's moral authority had protected him from both implicit and explicit intervention. Perhaps Governor Puey knew all along that, due to the design of the power structure, only the integrity and credibility of the BOT could protect it from interventions. He could afford to behave honestly and with credibility because the power structure within the BOT allowed him to. Secondly, the cohesiveness among the Gang of Four's technocrats also functioned as a second protective shield from intervention by the military-cum-politicians.

By 1990, the cohesiveness among the technocrats was a matter of the past. Moreover, the transition of the polity from a 'bureaucratic polity' to an elected regime, which had started in October 1973, was further consolidated by the Chatichai Choonhavan Government. By 1990, the technocrats could easily anticipate that their traditional allies, i.e., the military, would become increasingly irrelevant. Their next political masters would be elected politicians. The *coup d'é tat* in 1991, and its aftermath in May 1992 in which 'people power' denied the military hold on power, were just brief interruptions in the long running trend of consolidation. It was therefore logical for the technocrats who wished to assume or cling to power to begin pleasing their elected political masters. Meanwhile, they failed to reap the benefits in their incomes of the bubble digit growth rate which began in 1987; they were dubbed as a class of 'new poor' by the press.[99] Faced with this double transition, while rules of the game are determined by laws that

[99] This statement is more relevant to the rest of the Gang of Four than the Bank's technocrats.

have remained unchanged, the technocrats had every incentive to practice a new kind of 'Art of Being a Governor'.

Democratisation/politicisation and the technocrats' declined autonomy

It has been argued by some scholars, such as Thitinan (2001), Lauridsen (1998) and Dixon (2001 and 1999), that the Bank of Thailand's technocrats' autonomy decreased from the 1960s onward due to the politicisation of the BOT and other key technocratic agencies. They argue that the democratisation process of Thailand, which gave rise to the growing power of elected politicians who in turn politicised the technocrats, reduced the technocrats' autonomy in economic policy and hence ultimately led to the economic crisis in 1997. Thitinan (2001)--the most recent and comprehensive study—argues that:

> [a]s democratisation made headway in Thailand from 1988, it empowered and emboldened political parties and elected politicians to penetrate and capture macro-policy institutions, shunting aside technocrats and undermining the military-technocracy bargain. Consequently, the MOF's and BOT's political insulation and macro-policy autonomy were eroded, as new coalitions of vested interests assumed electoral power. The MOF and BOT, as well as their related agencies such as the National Economic and Social Development Board (NESDB), became increasingly politicised and susceptible to clientelism. In turn, the growing empowerment of elected politicians and the marginalisation of technocrats led to deleterious macroeconomic policy outcomes, as manifested first in a financial sector distress and later in a full-blown macroeconomic crisis (Thitinan 2001, 14-15).

Although this paper agrees that the democratisation/politicisation argument carries significant explanatory power toward the overall decline of the technocrats' influence in Thailand, especially after 1988, this nevertheless cannot represent the whole story of the decline. There are a few other issues that have to be addressed.

First, the correlation between the degree of technocrats' autonomy and the type of political regime as such is not a straightforward and linear relationship, as suggested by Thitinan. This paper argues that the technocrats' autonomy regarding macroeconomic management was at its height during the military-authoritarian regime of Thanom and Praphat in the 1960s, while their autonomy during the period before 1959 was relatively weak despite the fact that during this period the polity was also ruled by the military-authoritarian regime of Phibun. It is only after 1988 that the overall autonomy of the technocrats began to decline, due to both the regime change and the degradation of the technocrats' internal institutions. Another example of this non-linear relationship is found during the period 1975 - March 1981. While the political regimes during this time oscillated between democracy, extreme military authoritarian and semi-democracy, the technocrats' autonomy was continuously subject to consistent and heavy intervention by both elected and non-elected politicians. The authoritarian governments of Thanin Kraivichien (Oct 1976-Oct 1977) and Kriangsak Chomanand (Nov 1977-March 1980) intervened heavily into fiscal policy and the associated foreign debt deficit financing policy - which had previously been under the tight control of the technocrats - no less but possibly more than the democratically elected Kukrit Pramoj's government (March 1975-April 1975). Even the first Prem government (March 1980-March 1981) enjoyed its fair share of fiscal policy interventions. All of these interventions contributed greatly to the macroeconomic imbalance, which finally led to the structural adjustment programmes during the 1980s. It was not until Prem II that the degree of insulation enjoyed by the technocrats began to increase, and this continued until 1988, enabling the technocrats to conduct the structural adjustment programmes successfully.

Secondly, this paper argues that the deterioration of the technocrats' internal institutions - i.e., their strategic position as connectors between the Thai ruling elites and the international organisations; their incentive structure; their ethos, and their cohesiveness - upon which their influence rested is also very important when trying to understand the rise and fall of their influence itself. For example, this study argues that the technocrats' economic expertise was not only the leverage they had vis-à-vis the ruling elites (as argued by Thitinan (2001)), but also their access to international organisations, especially the IMF and the WB. In other words, it can be argued that the rise of their influence from 1947 to the 1960s, when foreign financial aids and loans were very significant to the economy, was significantly derived from this strategic position. From the late 1980s to 1997, however, the double-digit growth of the economy not only eroded this power base of the technocrats, but also substantially reduced the leverage of the IMF itself. In this aspect, this paper argues that Thailand's developmental capacity was weakened from within.

Conclusion

To sum up, this paper reveals that a new and deeper aspect to the causes of the Thai banking-cum-currency crisis in 1997, which kicked off the Asian economic crisis, by paying close attention to the weakening of institutions upon which the technocrats' power rested. These factors are often neglected by various scholarly fields of study, especially that of mainstream economics. An implication of the lack of concentration on institutional factors in prior is that it is not always sufficient to point out what the best policy options available for policy-makers are: rather, the most important point is whether they are always able to choose them. In other words, this study shows that having effective institutions in place is a much more important factor in providing an ability to choose a set of sound policies than has previously been argued, in the sense that they determine the likelihood of policy-makers choosing and implementing this policy set. The agony of the Thai experience in not choosing the right set of sound policies available to the policy-makers is a result of the imperative of poor institutions.

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