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**AN EVALUATION OF FINANCIAL  
CRISIS IN THAILAND**

by

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June, 1998

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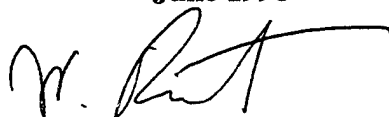
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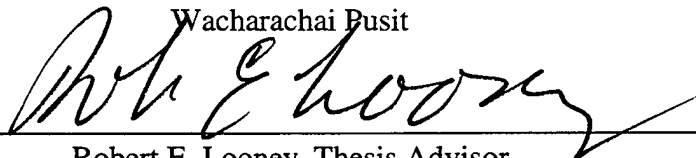
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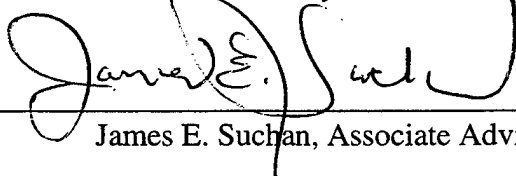


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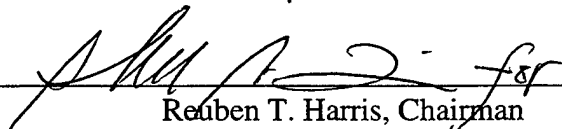
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## ABSTRACT

After implementation of the National Economic and Social Development Plan (1961-1966), Thailand experienced increasing high rates of economic growth. However by mid 1997, Thailand's economy was slipping into the so-called "Thailand financial crisis": falling property prices, slowing exports, rising trade deficits, and the devaluation of the Thai baht. This raises concern about the future. The purpose of this thesis is to examine Thai economic policies leading up to current crisis. Using hypothesis of Williamson and Haggard, the country's economic reforms will be evaluated. From these finding, several conclusions will be drawn concerning the country's economic future.



## TABLE OF CONTENTS

<b>I.</b>	<b>INTRODUCTION.....</b>	<b>1</b>
A.	RESEARCH SCOPE.....	2
B.	METHODOLOGY.....	2
C.	ORGANIZATION OF THE STUDY.....	3
<b>II.</b>	<b>THE GEOGRAPHY AND POPULATION OF THAILAND.....</b>	<b>5</b>
A.	CHARACTERISTICS OF THAI SOCIETY.....	6
B.	AN OVERVIEW OF THAI POLITICAL HISTORY.....	7
<b>III.</b>	<b>THE THAI ECONOMY AND SOCIETY IN THE PAST THREE DECADES.....</b>	<b>13</b>
A.	AN OVERVIEW OF ECONOMIC AND SOCIAL DEVELOPMENT PLANS.....	15
1.	Thailand's Economy Before 1855.....	15
2.	Thailand's Economic Development from 1855 to 1960.....	15
3.	The Use of Thailand's Economic Development Plan from 1961 to the present.....	16
B.	THE EIGHTH NATIONAL ECONOMIC AND SOCIAL DEVELOPMENT PLAN (1997-2001).....	24
1.	The Goals to Achieve.....	26
2.	The Strategy of Economic and Social Development.....	27
C.	THE USE OF THE EIGHTH PLAN.....	29
<b>IV.</b>	<b>THE FINANCIAL CRISIS IN THAILAND.....</b>	<b>33</b>
A.	THE FINANCIAL CRISIS.....	33
B.	THE MAIN REASONS FOR THE CRISIS.....	39
1.	Excessive External Debt.....	39
2.	Huge Deficits in the Current Account.....	40
3.	Exchange Rate Mismanagement.....	40
4.	The Collapse of the Property Sector.....	41
5.	Political Instability, Incompetence and Negligence.....	41
C.	THE WAY TO SURVIVE.....	42
<b>V.</b>	<b>SUMMARY AND CONCLUSION.....</b>	<b>53</b>
A.	SUMMARY OF THE STUDY.....	53
1.	Economic Condition.....	53
2.	Political Condition.....	54
3.	Position of Team.....	56
4.	The Reform Program.....	57
B.	CONCLUSION.....	57
	<b>GLOSSARY.....</b>	<b>61</b>
	<b>BIBLIOGRAPHY.....</b>	<b>63</b>



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## I. INTRODUCTION

In 1950, after a century of zero growth of output per head of population, Thailand was one of the poorest countries in the world<sup>1</sup>. After the National Economic and Social Development Plan was instituted in 1961, the Thai economy was transformed. According to those plans, rapid and sustained growth of output was achieved simultaneously with low inflation and only moderate growth of external debt. The incidence of poverty fell dramatically. Despite the internal turmoil caused by the two oil price shocks of the 1970s, Thailand did not experienced a single year of negative growth, even in per capita terms, an achievement unmatched by any other oil importing, developing country<sup>2</sup>.

In the late 1980s, Thailand's economy was increasingly oriented to the commercial and industrial sectors. From 1986 to 1991, Thai's GDP and per capita income doubled.<sup>3</sup> The Thai economy was still among the fastest growing economies in the world. Manufactured exports surged, and investment from both domestic and foreign sources increased dramatically. However, the Thai financial crisis marked a stunning reversal for the Thai economy, which grew at rates of more than eight percent a year for much of the last decade, before slipping into trouble in 1996 amid falling property prices, slowing exports, and rising trade deficits. Thais enjoyed this economic growth and never thought that their country would face financial problems.

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<sup>1</sup> Peter G. Warr, "The Thai Economic In Transition", 1993, p.1.

<sup>2</sup> Ibid., p.1.

<sup>3</sup> Robinson, David, Byeon, Yangho, and Teja, Ranjit, with Tseng, Wanda, Thailand: Adjusting to Success Current Policy Issues, International Monetary Fund, Washington D.C., August 1991, p. 10.

At the end of 1996, there was still no evidence that would make the Thais believe that Thailand was having any serious financial problems. Up until then, the Thai economy had been strong. On July 2, the financial crisis began with interest and exchange rates swinging wildly from day to day in the fallout from the managed float of the baht.<sup>4</sup>

This research focuses on the current state of the National Economic and Social Development Plan that has been used in Thailand, the current political climate, and the Thai government's current action during this crisis. This thesis will evaluate and predict the future of Thailand's economy using the four general categories of Williamson and Haggard's hypothesis<sup>5</sup>: 1) economic conditions, 2) political conditions, 3) the position of the implementing team, and 4) the nature of the program itself.

#### **A. RESEARCH SCOPE**

This thesis will address the current financial crisis in Thailand up until the end of February 1998 and will examine the four categories mentioned above.

#### **B. METHODOLOGY**

The methodology used in this thesis will consist of archival research, as well as a literature search of books, magazine articles, Internet articles, newspaper articles, and other library information sources. Then, all information will be evaluated in terms of the four categories.

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<sup>4</sup> US \$1 = 40 Baht (mid-May 1998)

<sup>5</sup> Williamson and Haggard (1994) list thirteen conditions ("hypothesis") which may explain the success or failure of various economic reforms. The thirteen conditions are grouped under four general categories: economic conditions, political conditions, the position of the implementing team, and the nature of the

### **C. ORGANIZATION OF THE STUDY**

It is very important for developing countries to persuade investors to invest in their country. Although a country may have a sound banking system, skilled labor, and a strong economy that investors can trust, investors will not invest their money if that country's political system is not stable. Thus, Chapter II details the history of the Thai political system up until the present day. The end of this chapter indicates whether it is stable enough to attract investors.

Chapter III gives an overview of economic development following the inception of the National Economic and Social Development Plan. This chapter also examines whether this plan helped develop Thailand's economy in the past and analyzes the current plan.

Chapter IV identifies the financial crisis in Thailand and also indicates when this crisis occurred, what its impact is, and what actions the Thai government has taken.

Chapter V presents the conclusions, including a summary of how the information in the first four chapters relates to forecasting the future of the Thai economy.



## II. THE GEOGRAPHY AND POPULATION OF THAILAND

Located in Southeast Asia, Thailand has a total area of 514,000 sq. km, including 511,770 sq. km of land and 2,230 sq. km of water, which makes it slightly more than twice the size of Wyoming. Thailand has common borders measuring 1,754 km with Laos on the north and east, 803 km with Cambodia on the east, 506 km with Malaysia on the south, and 1,800 km with Burma on the north and west<sup>6</sup>. Even though it is surrounded by these countries, Thailand still has the southern border, which connects to water--the Gulf of Thailand to the east and the Andaman Sea to the west. Because Thailand is located between the 5<sup>th</sup> and 21<sup>st</sup> north parallels and the 97<sup>th</sup> and 106<sup>th</sup> east meridian<sup>7</sup>, it has a good climate for agriculture and also has many natural resources, such as tin, rubber, natural gas, tungsten, tantalum, timber, lead, fish, gypsum, lignite, fluorite, etc. Thailand is the only territory of Southeast Asia that did not come under Western imperial control<sup>8</sup>.

The country has a population of 59,450,818 (July 1997 est.), including Thai (75 percent), Chinese (14 percent), and other (11 percent). Thai is the main language, while English is the secondary language of the elite. Buddhism is the primary religion in Thailand: Buddhism (95 percent), Muslim (3.8 percent), Christianity (0.5 percent), Hinduism (0.1 percent), other (0.6 percent) (1991)<sup>9</sup>.

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<sup>6</sup> CIA World Factbook, [www.washingtonpost.com/wp-srv/inat/longterm/worldref/country/thailand.htm](http://www.washingtonpost.com/wp-srv/inat/longterm/worldref/country/thailand.htm).

<sup>7</sup> David A. Wilson, *Government and Politics of Southeast Asia*, Cornell University Press, 1959, p. 4.

<sup>8</sup> William J. Siffin, *The Thai Bureaucracy*, East-West Center Press, 1966, p. 3.

<sup>9</sup> CIA World Factbook, [www.washingtonpost.com/wp-srv/inat/longterm/worldref/country/thailand.htm](http://www.washingtonpost.com/wp-srv/inat/longterm/worldref/country/thailand.htm).

## A. CHARACTERISTICS OF THAI SOCIETY

Thailand is an agrarian society<sup>10</sup>. Eighty-eight percent of the population either are farmers or conduct agricultural-related activities. Because of its agriculture-oriented background, the Thai society still holds on to old customs as guidelines for living. Some examples are: relying on kindred relationships or association with close friends as indicators of trust and intimacy; believing in superstition because of a dependence on nature, which is beyond their control; placing greater emphasis on status than on capacity; and being sentimentally attached to their place of residence. These values blend with Buddhism, the main religion of most Thais, resulting in characteristics common to most Thais: gentleness, kindness, generosity, and a dislike of being forced or forcing others<sup>11</sup>.

The lifestyles in rural and urban areas differ. The rural life in Thailand, based on brotherhood and equality, is not a complicated life. Old, traditional values, such as believing in things that cannot be proved and respect for elders, are still strong. Thus, rural society tends to ignore what is going on in urban areas, especially if the political and economic situations there do not directly affect what happens in the rural areas. Unlike the harmony of rural society, society in urban areas, where people live in an air toxic environment, a lack of brotherhood, harsh competition, anger, and mental and physical suffering, is much more complicated to live in. However, people in the urban areas have a better education and a better opportunity to find a higher-paying job than those in rural areas. Thus, they are very concerned about information, technology, and the economic

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<sup>10</sup> Armed Forces Information Office, Democracy in Thailand, p. 15.

<sup>11</sup> *Ibid.*, p. 15.

and political situation because all of these affect the Thai economy on which they depend so heavily.

## **B. AN OVERVIEW OF THAI POLITICAL HISTORY**

Thailand was ruled by an absolute monarchy for more than 700 years. During the era of King Rama V, VI, and VII of the Chakri Dynasty (1868-1935), the king tried to initiate democracy in Thailand by giving freedom to all Thai slaves and by creating a toy-model town named "Dusit Thani"<sup>12</sup> as an experimental model of democracy that would lead to the future democratization of the country. However, it was very difficult to establish democracy because the Thai people did not know what democracy was. Indeed, they had no idea about it at all.

On June 24, 1932, the absolute monarchy in Thailand was ended due to a bloodless coup by a group of western-educated military and civilian bureaucrats, the so-called People's Party. In the same year, the People's Party promulgated the first constitution, proclaiming a "constitutional democracy."<sup>13</sup> The King would still be the head of the state, but his power was constrained by the constitution. The first Prime Minister of Thailand was Phaya Manopakorn, a civilian bureaucrat and a leading member of the People's Party.

Until now, there have been 26 military governments and eight military-dominated governments, as well as 17 coups. In 1938, the military's role in Thai politics began to grow after Field Marshal Pibul Pibulsongram, one of the leading members of the People's

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<sup>12</sup> Ibid., p. 6.



Party, became Prime Minister. His cabinet consisted mainly of army officers. During WW II, Pibul's military government allied with the Japanese while Pridi, a civilian bureaucrat and also a leading member of the People's Party, formed an underground movement against the Japanese. Pibul's military government collapsed in 1944. Between August 1945 and November 1947, there were eight cabinets and five Prime Ministers, all civilian. During this era, all governments under civilian control were unstable because they had many economic problems, suffered from corruption, and experienced conflicts among civilian politicians. In April 1948, Pibul came back to power. On September 16, 1957, his military government was ended once again by a military coup led by Field Marshal Sarit Thanarat, the army commander-in-chief.

During his years in power, Sarit believed that the democratic system was not suitable for the Thai people and Thai society. In order to rebuild and refresh the country, he thought the Thai people must be ruled by absolute power and authoritarianism. Nevertheless, during the six years of his military government, he did his job well by encouraging development of the national economy and infrastructure, and by improving the living standard of the Thai people.

After Sarit's death in 1963, Field Marshal Thanom Kittikachorn became Prime Minister. He followed Sarit's policies for ruling the country. In October 1973, hundreds of thousands of students and other people gathered to put pressure on Thanom's military government for political reforms, a new constitution, and an elected parliament. After the fighting between these citizens and the military, Thanom's military government came to an end. Thanom was exiled from the country that year.

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<sup>13</sup> Clark D. Neher and Ross Marlay, Democracy and Development in Southeast Asia, Colorado: View West

In October 1973, the Thai people instituted their democracy by electing civilians to form a new government through elections without military intervention. After three years, in October 1976, military officers overthrew the civilian government again. Thanin Kraivichien, a civilian, was appointed by the coup to be the new Prime Minister. One year later, he was accused of indirectly supporting the Communist Party of Thailand and leading the country to disaster. The same coup that brought Thanin to power staged another coup to throw him out. General Kriangsak, a leading member of that coup, became the new Prime Minister.

In early 1980, General Kriangsak resigned because of a lack of military support and conflict within the government. General Prem Tinsulanonda, a Defense minister and commander-in-chief, was appointed to be the new Prime Minister. Even though General Prem was not an elected Member of Parliament, Thailand was democratized more than it was in the past. For instance, there were two general elections for the Lower House in which all Thai people had absolute freedom to choose their representatives. In another reform, cabinet members were elected members of the Lower House.

General Prem held office from 1980 through 1988 due to his reputation of honesty, and due to support from military, political party leaders, and, above all, "the King." He also achieved cooperation among the military, political parties, and the civilian bureaucracy that helped the rate of economic growth to rise. However, there were two unsuccessful coups in the Prem era. After his second four-year term, in 1988, Prem refused to be prime minister during the next term.

A general election was held in July 1988. General Chatichai Choonhavan, a leader of Chat Thai Party, became prime minister since his political party had won a plurality of votes. He was the first prime minister since 1976 who was elected by members of the House of representatives. At that time, although Thailand enjoyed rapid economic growth, the military did not rely on Chatichai's government because of his reputation for corruption. In 1991, Chatichai's government was overthrown by a military coup.

Anand, a distinguished civilian diplomat and businessman, was appointed by that coup to be the new prime minister. A new election was held on March 22, 1992. General Suchinda, a leading member of the coup, became prime minister due to support from military and pro-military political parties. The people were not satisfied with his premiership because he had declared that he would not accept any position in the new government. The conflict between the people and the military government again occurred in May, 1992, the so-called "Black May Incident." Finally, Suchinda resigned after one-and-a-half months in office. This demonstration affected the military's role in politics. The military became more professional, and there have been no more military coup attempts. Anan was again appointed to be a prime minister in order to take care of the government.

A new election was held on September 13, 1992. Chuan Leekpai, a civilian and leader of the Democrat Party (DP or Prachathipat Party), became prime minister since his political party won a plurality of the votes; a coalition government was formed. In his coalition government, there were many problems among political parties. Some allied parties withdrew from the coalition government and joined opposition parties. In

addition, the government faced two no-confidence votes from opposition parties within four months. As a result, the Prime Minister dissolved the House of Representatives and called for a new election on July 2, 1995.

In 1995, Banharn Silpa Archa, a civilian and leader of the Chat Thai Party, became prime minister and formed a coalition government with six other parties. Because cabinet members lacked knowledge and experience in administration, Banharn's government faced a no-confidence vote by opposition parties in July 1996. Banharn was forced to resign from office and dissolve the House of Representatives.

A new election was held in November 17, 1996. General Chavalit Youngjaiyut, a former army officer and leader of the New Aspiration Party (NAP or Khwamwang Mai), won the election and became the twenty-second prime minister of Thailand.

Only one year after Gen. Chavalit Youngjaiyut became prime minister, the economy in Thailand declined and was in the worst condition it had ever been in before. Chavalit resigned from office on November 7, 1997.

On November 14, 1997, a former prime minister, Mr. Chuan Leekpai, was welcomed back to power again as the twenty-third prime minister. Because of his reputation for honesty, it was believed he could lead Thailand out of its current economic crisis.

Although Thailand was fortunate to be in a good location and have many natural resources, Thai politics looked very unstable to foreign countries. Surprisingly, though, the Thai government, in just three decades, has led the country out of poverty and off of the "poor country" list. Chapter III will examine the ways in which the Thai government

has developed its country into one of the “tigers” of Southeast Asia, starting with The National Economic and Social Development Plan of 1961.

### III. THE THAI ECONOMY AND SOCIETY IN THE PAST THREE DECADES

Thailand has succeeded in developing an average economic growth of 7.8 percent per year. Per capita income increased from 2,100 Baht in 1961 to 68,000 Baht in 1993, a 32-times increase. Poverty was 13.7 percent in 1994, compared with the goal of 20 percent laid out in the seventh National Economic and Social Development Plan.<sup>14</sup>

Thailand is accepted by many countries as a nation with a high rate of economic growth, and, as such, it attracts foreign investment. However, the government has continually invested in developing fundamental services, which have increased the standard of living for Thais<sup>15</sup>.

Although this development has led to economic growth and an increase in the standard of living, its main advantage was to urban areas. The annual per capita income for Thais in Bangkok<sup>16</sup> and in major provinces such as Chon-Buri<sup>17</sup> and Phuket<sup>18</sup> is very high, 16 times<sup>19</sup> more than that in different parts of the country. This difference is especially true in the northeast, where annual per capita income is the lowest, 12 times below the national average. The most obvious difference in standard of living is between the highest 20 percent of income-earners, who increased their income by five percent between 1988 and 1992, and the lowest 20 percent, whose income declined by .7 percent

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<sup>14</sup> Office of the Prime Minister, The Eighth National Economic and Social Development Plan, March 1996, p. 7.

<sup>15</sup> Thais refers to Thai people.

<sup>16</sup> Bangkok is the capital of Thailand.

<sup>17</sup> Chon-Buri is a province located eastern part of Thailand.

<sup>18</sup> Phuket is a province located in the southern part of Thailand.

<sup>19</sup> Maticohen, 25 February 1997, p. 7.

in the same period. The gap between the rich and the poor has negative, long-run effects on development.

Because of increasing competition among the Thais, they have to do everything they can to stabilize or increase their income. This had led some people to engage in negative behavior, such as robbery. It also caused a lack of morals and discipline, for example ignoring the national law. The old way of life has faded with the collapse of society's institutions based on family and tradition. Development also has led to increased population density and pollution in many urban areas. One effect of living in a bad environment has been an increase among Thais of illnesses such as headache, cancer, heart attack, and high blood pressure. The rate of the illness for Thais seems to increase with progress in economic development and with people's income levels.

As economic development began to accelerate, natural resources were used without proper management. Those natural resources and the environment were destroyed without plans for replacing or repairing them. Thus, the soil was stripped of its nutrients and water was polluted. Furthermore, the noise, air pollution, and dust in the urban areas also negatively affected the quality of life.

Along with the negative consequences of development, however, came the positive effects. Most Thais now take advantage of fundamental services they lacked before. For instance, in 1994, 97.7 percent of houses in the rural area had electricity. More than 75 percent in urban areas and 32 percent in rural areas had irrigation systems. A better transportation network is in place; roads connecting provinces, districts, and sub-districts have increased to 210,025 kilometer in total range. The percentage of children in rural areas who receive mandatory education has increased to 97.7 percent.

## **A. AN OVERVIEW OF ECONOMIC AND SOCIAL DEVELOPMENT PLANS**

More than 40 years ago, various development plans for Thailand's economy were established. However, during the First to the Seventh National Economic and Social Development plans, the purpose of the plans mostly came from suggestion of foreign countries, especially the World Bank. After the National Economic and Social Development Plan has been in placed for 40 years, a measurement of the country's development was reported to the World Bank in 1994. In that year, the World Bank announced that, based on its annual per capita income of over \$1,500, Thailand was no longer a poor country.<sup>20</sup> Before Thailand could reach this point, it had to go through three significant eras of economic development:

1. Thailand's economy before 1855
2. Thailand's economic development from 1855 to 1960
3. The use of Thailand's economic development plan from 1961 to the present

### **1. Thailand's Economy Before 1855**

Before 1855, Thailand was ruled by a monarchy. Thailand's society was still a small, so-called "family institute."<sup>21</sup> The country was rich with natural resources, and economic activity was carried out by individuals, not by the system of production or large industry that Thailand has today. Goods were more often exchanged via trading than by using money. Trade with foreign countries was not controlled by law and, thus, communication or trade with foreign countries depended on the individual.

### **2. Thailand's Economic Development from 1855 to 1960**

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<sup>20</sup> Somnuk Nontijan, *The Eighth National Economic and Social Development Plan(1997-2001): The Analysis and Question*, Rongtanaket Offset, 1996, p. 16.

<sup>21</sup> *Ibid.*, p. 17.



Thailand first started trading formally with foreign countries in 1855. Most foreign trade during this time was from the public sector, not the private sector. Thailand still did not have rules by which individuals or the private sector had to deal with foreigners. As for the public sector, most of its trade activities were just responses to the needs of foreign countries. However, it could be said that this was Thailand's first step toward opening its market to the world.

In 1950, Thailand's Economic Parliament was established to develop an economic development plan. Most of the support for Thailand to develop itself came from The World Bank. In 1958, a study of the country's development was completed and sent to the World Bank. The National Economic Development Plan was first used in 1961. Although economic development plans had already been used in many countries--e.g., they had been used in India for ten years, in the Philippines for nine years, in Pakistan for seven years, and in Malaysia for five years--it was not too late for Thailand to have its own economic development plan.

### **3. The Use of Thailand's Economic Development Plan from 1961 to the Present**

For almost 40 years, The royal Thai government has implemented Eight National Economic and Social Development Plans. The office of the National Economic and Social Development Board (NESDB)<sup>22</sup>, serving under the Office of the Prime Minister, prepares, recommends, and revises the plans. From the first of the series to the latest, the plans have increasingly reflected the importance of industrial development in Thailand's overall economic development. Successive governments have consistently held two

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<sup>22</sup> Robert J. Muscat, The Fifth Tiger – A Study of Thai Development Policy, p. 134.

policies since the first plan. First, the private sector should be the leading force in bringing about development; the government should take the supporting role in assisting and providing the private sector with infrastructure, technological resources, and human development. Second, the government should protect the private sector against competition from new state enterprises.

*a. The First Plan: "The Nation Economic Development Plan" (1961-1966)*

The first plan, called "the Nation Economic Development Plan," covered a six-year period from 1961 to 1966. Its primary objective was to raise the country's standard of living. This plan focused only on economic development by emphasizing investments in infrastructure, particularly those involving hydroelectric power, transportation networks and irrigation systems<sup>23</sup>. It also established the Board of Investment (BOI) and encouraged the production of domestic goods to reduce imports.

The results of using this plan were an 8.1 percent growth of GDP, a 6.3-percent increase in income from the agricultural sector, an increase in per capita income of almost 50 percent, from 2,137 Baht in 1961 to 3,063 Baht in 1966, and only a 1.3-percent rise in inflation.<sup>24</sup>

The main problem with the plan was that it focused entirely on economics and neglected social and environmental issues. Even though per capita income increased, this benefited only those in the urban areas.

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<sup>23</sup> National Economic and Social Development Board, From the first to the Sixth Development Plan: Key Issues and Results, Bangkok, 1994, p. 1.

<sup>24</sup> Somnuk Nontijan, The Eighth National Economic and Social Development Plan(1997-2001): The Analysis and Question, Rongtanaket Offset, 1996, p. 19.

*b. The Second National Economic and Social Development Plan (1967-1971)*

Recognizing that an increase in productivity required infrastructure as a major input, the second plan (1967-1971) was created to continue the first plan. This plan was the first five-year plan that continued the high priority on infrastructure projects.<sup>25</sup> To formally recognize the importance of social development, the word “social” was added to this plan. It became the National Economic and Social Development Plan, and is still called that today.

This plan was very much like the first plan, but it did more to encourage the private sector to invest money in the industrial and service sectors. It also established the rural development plan and built more hospitals in rural areas to increase the standard of health care.

The results of the second plan can be measured by looking at the GDP, which increased 7.8 percent; in addition, per capita income went up to 4,104 Baht in 1971, a 100-percent increase from the beginning of the first plan; electrical energy increased to 1,169 thousand kW; and roads expanded from 8,498 km. to 11,761 km.<sup>26</sup>

Some issues that affected this plan were that the world market was becoming more industrialized and that the government had to put money into maintaining military capability due to decreasing support from the U.S. military because of the end of Vietnam War.

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<sup>25</sup> National Economic and Social Development Board, From the first to the Sixth Development Plan: Key Issues and Results, Bangkok, 1994, p.2.

<sup>26</sup> Somnuk Nontijan, The Eighth National Economic and Social Development Plan(1997-2001): The Analysis and Question, Rongtanaket Offset, 1996, p. 19.

As with the previous plan, this plan had some inherent problems. First, the difference in per capita income between urban and rural areas was obviously increasing, creating a bigger separation in society between rich and poor people. Another problem was political instability caused by the withdrawal of U.S. military troops.

c. *The Third National Economic and Social Development Plan (1972-1976)*

A main feature of the third plan, used from 1972 to 1976, was its emphasis on accommodating socially and politically-oriented objectives due to the growing inequity in income distribution. This inequity was perceived as a threat to internal stability from spreading insurgency.

This plan attempted to increase imports by adjusting the customs tax and by providing low-interest loans to import industries. To maintain economic stability, this plan focused on controlling inflation. It also aimed at reducing the difference in the standard of living between the urban and rural areas. And, most important, this plan proposed to give the same services to rural areas that the second National Economic plan did.

This plan led to GDP growth of 6.5 percent, as well as an increase in inflation to 10.8 percent. Imports of goods for industry were reduced. During this plan, Thailand exported cloths more than rice. The population growth rate was reduced by 2.6%. Regional development programs to increase education and health care were greatly expanded, particularly in the northeast.<sup>27</sup>

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<sup>27</sup> Ibid., p. 19.

The major impact on this plan came from internal and external political instability and from the oil crisis, which caused Thailand's economic downturn during the first three years of the third plan.

The negative consequences of this plan were almost the same as the second plan: a failure to address quality of life and the environment. In addition, the income gap between people living in urban and rural areas increased further.

*d. The Fourth National Economic and Social Development Plan (1977-1981)*

The economic downturn from the third plan led policy makers to emphasize economic recovery in the fourth plan (1977-1981). The focus of this plan was to preserve and develop Thailand's natural resources. This plan was also designed both to develop the economy and to build social equality. Increasing the export of agricultural products, keeping prices of goods stable to prevent inflation, and expanding and distributing services to urban and rural areas were additional goals of the plan.

This plan had some positive and negative consequences. For this five years period, GDP grew 7.4 percent, and inflation increased to 11.6 percent.<sup>28</sup> Thailand eliminated its trade deficit. However, the gap between income distribution increased. For instance, the per capita income of the farmer at the end of this plan was 11,464 Baht, but it was five times below the income of people who worked in the industrial sector.

Internal political instability caused trouble during this plan. And, after this plan was completed, Thailand had still lost many more resources and still experienced a gap in income distribution.

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<sup>28</sup> Ibid., p. 19.

e. *The Fifth National Economic and Social Development Plan (1982-1986)*

This plan was the first plan that focused on the tourist sector, and by the end of this plan, Thailand had succeeded in generating high revenues from tourists.

There were two facets to this plan: the Offensive Plan and the Defensive Plan.

The Offensive Plan involved:

1. Developing the East Coast areas and the main province.
2. Reducing the role the government plays in economic development.
3. Giving the private sector the opportunity to help solve the economic problems.

The defensive plan involved:

1. Focusing on and keeping economic growth stable.
2. Focusing on discipline in the treasury.
3. Expanding the infrastructure of production.
4. Focusing on specific areas to develop.
5. Expanding and distributing services to rural areas.
6. Focusing on security of life and property.

The most important aspect of the fifth plan was its emphasis on decentralization. To decentralize, the plan focused on expanding growth and industrial investment in provincial areas. The fifth plan also focused on the issue of income distribution and social instability. The plan established "target areas" for special assistance in 264 districts and subdistricts. Social services were to be greatly expanded in these areas. However, the real focus of the plan was on the Eastern Seaboard Project, a

large government-supported industrial complex designed to become an alternative to Bangkok as an urban-industrial location.<sup>29</sup>

The positive outcomes of this plan were GDP growth of 5.4 percent and a per capita income increase to 20,860 Baht.<sup>30</sup> However, the western culture that began to saturate Thai society caused a change in the Thais's way of life. The plan was thwarted by increasing world economic competition that blocked external trade.

*f. The Sixth National economic and Social development Plan (1987-1991)*

Social inequality was becoming an increasing challenge in the development process. Thus, the aim of this plan was to maintain high economic growth and help low-income populations in both urban and rural areas to gain a larger share of the benefits from development. An "Urban and Specific Zone Development Program" was established to assist people in the urban slums. In rural areas, the target zones were not limited to only areas threatened by insurgency because this threat had subsided. Therefore, the "Rural Development Program" was opened to nationwide eligibility. As for decentralization, the revision recommended expanding industrial investment to regional and rural areas. But, unlike the fifth plan, the government did not map out any industrial complex projects. Instead, it called for the private sector to play a bigger role in the process.<sup>31</sup>

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<sup>29</sup> Robert J. Muscat, The Fifth Tiger – A Study of Thai Development Policy, pp. 180-183.

<sup>30</sup> Somnuk Nontijan, The Eighth National Economic and Social Development Plan(1997-2001): The Analysis and Question, Rongtanaket Offset, 1996, p. 22.

<sup>31</sup> National Economic and Social Development Board, From the first to the Sixth Development Plan: Key Issues and Results, Bangkok, 1994, pp. 8-14.

At the end of this plan, economic growth was still increasing, and the GDP had grown 10.9 percent. Thailand was well advanced in its transition from an agricultural to an industrial and services-based economy, and was on the verge of joining the ranks of Asia's newly industrializing economies (NIEs).<sup>32</sup> Per capita income increased to 41,000 baht, and income from exporting increased to 25.7 percent of GDP.<sup>33</sup> This plan was aided by the increasing number of foreign tourists, increased exports of products from the agricultural and industrial sectors, and, especially, investments from foreign countries due to Thailand's 1991 ranking as first in the world to invest in.

However, political instability once again took its toll on the plan. Conflict between the government and the population, as evidenced by the Black May incident, caused potential investors to hesitate and some investors to withdraw their investments. Another problem for investors was the increasing price of real estate.

*g. The Seventh National Economic and Social Development Plan (1992-1996)*

After experiencing the 1987-1990 breakneck growth, policy makers have added another dimension to the seventh plan. This Plan focused on equality in development distribution. The three main goals of this plan were:

1. Keeping the rate of economic growth stable.
2. Focusing on income and development distribution.
3. Increasing the development of human resources, the standard of living, and the environment.

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<sup>32</sup> Robinson, David, Byeon, Yangho, and Teja, Ranjit, with Tseng, Wanda, Thailand: Adjusting to Success Current Policy Issues, International Monetary Fund, Washington D.C. August, 1991, p. 4.

<sup>33</sup> Somnuk Nontijan, The Eighth National Economic and Social Development Plan(1997-2001): The Analysis and Question, Rongtanaket Offset, 1996, p. 22.



A series of measures to reduce poverty and income inequality were proposed in the plan. These measures included improving production productivity, marketing and price support programs, and decentralizing industrial activities to provincial areas. In addition, human resources would be strengthened through education<sup>34</sup>. Compulsory schooling was to be increased from six to nine years. The government also encouraged the private sector to play a bigger role in providing higher education.

This plan created many advantages for Thailand, including:

1. 8.2 percent growth in the GDP after five years and an increase of per capita income to 71,000 baht.
2. The World Bank declared Thailand off the list of the poor countries due to per capita income increasing to more than \$1,500 or 38,000 baht.
3. The huge investments of 318,000 million baht in the private sector and 700,000 million baht in the public sector.
4. The import value increased to one thousand million baht.

Even with these successes, however, there was still a problem with the inequity in income distribution. The highest 20 percent income group increased their income 16 times more than lowest 20 percent income group.

## **B. THE EIGHTH NATIONAL ECONOMIC AND SOCIAL DEVELOPMENT PLAN (1997-2001)**

After the end of the Seventh Plan, Thailand had a new perception of its future development. Thailand's goals for the future include the following.

1. Every Thai must have equal opportunity to develop himself or herself, including moral, physical, knowledge, and skill development. The main purpose is to

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<sup>34</sup> David Robinson, et al., Thailand: Adjusting to Success Current Policy Issues, p. 6.

increase the Thai people's health, happiness, and morality. The other purpose is to make Thais more knowledgeable and be able to improve their ability to survive in the modern world.

2. The Thai society should be efficient, hard-working, strong, free, equal, merciful, happy, and respectful of humanity.

3. Thailand's economy should have the strength and stability to create equality in income distribution.

4. Natural resources and the environment should be well-managed now and forever.

5. The system for managing development should be decentralized and should create an environment of support for all Thais in the system.

The Eighth plan incorporated the goals mentioned above; and to take the next step toward the development of the country, the plan adopted the following purposes:

The first purpose is to increase and develop the capabilities of the Thai people. These capabilities include health, physicality, knowledge, and talent in their careers in order to survive changes in economics, social issues, and government.

The second purpose is to develop the social environment and to increase society's stability. This purpose focuses on increasing family stability and on supporting the improvement of the standard of living. Furthermore, it creates opportunities for Thais to take part in their country's development.

The third purpose is to develop and to expand Thailand's economy with stability and balance. Along with the increased opportunity to improve their capabilities and take

part in the development system, the Thai people will also have to share equally in the country's economic consequences.

The fourth purpose is to properly manage all resources, especially natural resource and the environment. To support the protection of natural resources, the social environment should also be well-managed.

The fifth purpose is to make the executive management system more open and to allow not only private or public development, but also development at all levels of Thai society.

### **1. The Goals to Achieve**

To achieve all the purposes described above, the current plan contains the following goals:

1. The preparation of efficient support systems for children below five years old.
2. Adequate and efficient education, especially fundamental education for learning-age children lasting nine years to twelve years, and continuing education for all teachers and professors.
3. Making improved labor skills and increased knowledge a priority for workers between the ages of 25 and 45.
4. Fully supporting and increasing the development of disabled people, and also equally distributing fundamental services to all of those people.
5. Reducing accidents in the workplace, as well as all accidents, especially those caused by cars, the transportation of dangerous chemicals, and fires in high-rise buildings.

6. Keeping inflation at a rate that does not cause too much of a negative effect on the Thais purchasing power.
7. Offering adequate and efficient fundamental services to rural areas.
8. Reducing the gap between the rich and the poor by at least ten percent.
9. Retaining and securing at least 25 percent of all of Thailand's forest territory.
10. Increasing crop choices for farmers to choose to cultivate in natural agriculture, mixed agriculture, or forest agriculture.
11. Increasing investments in controlling and improving the environment in order to improve the standard of living at every level of society.

## **2. The Strategy of Economic and Social Development**

To achieve all the purposes and the goals, the strategy of the Eighth Plan should be as follows:

### **1. Human Development**

Human development includes increasing human capability and efficiency in ways that can make Thais morally sound and healthy. Also, it increases the knowledge that will enable Thai citizens' to join in the process of their country's development.

### **2. Social Development**

Social development focuses on strengthening family, community, and culture. Doing so will support a stable society.

### **3. Development in Rural Areas to Improve the Standard of Living**

First, the plan aims to distribute equally development opportunities and social welfare to rural areas in order to increase the efficiency of the rural community. Second, it will support the education system and expand community education. Third, it will

increase available jobs by promoting private business and private development. Fourth, it will distribute economic activity and social services. Finally, it will create ways to solve problems and maintain the environment.

#### 4. Supporting Human Development and Improving Standard of Living

This part of the plan strengthens the economic system to maintain stability in economic growth. Also, it focuses on adjusting the fundamental production process to meet changes in the world market and to improve the standard of living by continually developing scientific technology that goes along with developing rural areas and communities.

#### 5. Natural Resource and Environment Management

Good management of natural resources can create a balance in the environment. Securing and maintaining natural resources is fundamental for long-term development because it will increase the standard of living in every community. However, the advantages of a well-managed environment, including the prevention and reduction of natural disasters, have to be equally distributed to society.

To increase Thailand development, both the private and public sector need to share resources. This strategy requires cooperation between them. If the private sector and public sector has a conflict with each other, the way to manage and solve the conflict is to use compromise. Furthermore, private sector organizations should know and understand what the public sector do is, and cooperate with each other to achieve national goals.

## 6. The Implementation of Development Plan

This strategy is to implement the plan by setting up different appropriate plans for specific areas. Then, the effectiveness of those plans will be evaluated by a proper measurement index specific to each area.

### **C. THE USE OF THE EIGHTH PLAN**

The Eight National Economic and Social Development Plan is the plan chosen to be used from 1997 to 2001 and to be the fundamental plan for the next century. The plan's strategy is based on the new development system, which transforms the separate development systems into one system. Each aspect of development will have to be efficiently connected so that the country's overall development will move forward, and all Thais will benefit more than they have in the past.

The strategy and the way to develop the country using in the Eighth Plan are reflect a modern plan for the future. By not providing a detailed implementation plan for the public sector, this plan allows every branch to create ideas of how to work within their organizations by themselves. The purpose of doing so came from the increasing responsibility of those branches to its duty. Another strategy is that this plan must directly provide advantages to all Thais, not specific for one group, and also that all Thais must have the right to make their own decisions, to express their opinions, and to ask for support from the government.

A development plan comes from the cooperative efforts of every organization in both the private and public sectors. Every person has a clear duty and a clear responsibility for the plan's success. Using money and resources created by both private

and public sector to implement the strategic plan might be used as a tool to ask for more funding and supporting from the government. However, yearly measurements for those organizations have to be created and then be used to control and to evaluate the plan's effectiveness.

To evaluate the success or failure of the strategic plan, five levels of measurement were created. The first level is to collect data in all areas, including periodic surveys of people's opinions of the development plan. The second-level evaluation is based on all performances of people who take responsibility for the project and all benefits of people who feel the effect of the outcomes. The third level measures the efficiency of the production process in every branch. The fourth measures the efficiency and quality of all institutions inside and outside the public sector. The last level measures the overall effect of the economic, social, and natural resource plans in order to continually develop the next strategy and plan.

As a consequence of adopting the National Economic and Social Development Plan, Thailand has succeeded in economic development. Since 1986, growth in real per capita income averaged 5 percent each year and real Gross Domestic Product (GDP) grew at about 9 percent a year since 1986, but slowed down in 1996. Poverty has been reduced from over 57 percent in the late 1960s to about 13 percent today. Thailand has enjoyed dramatic improvements in other indicators of social welfare, such as food security, education, infant mortality, and life expectancy. By following a development strategy of outward orientation and receptivity to foreign investment, Thailand has evolved from an agrarian-based economy to an industrialized export-intensive one, with diversified economic activity and employment. Although Thailand has been one of the

fastest growing economies in the world, it has experienced periods of instability during the last decade.

During the early 1980s, fiscal imbalances and external oil shocks prompted a period of adjustment and structural reform involving fiscal retrenchment, improved exchange rate management, and export promotion. The stabilization program was a success. Terms of trade improved, and the economy flourished, recording a GDP growth rate of 12 percent a year between 1987 and 1990, and 8 percent growth between 1991 and 1995. Thailand's exports from the manufacturing sector rose from 35 to 80 percent of total merchandise exports, the largest percentage of any Association of Southeast Asian Nations (ASEAN) country, but experienced a slowdown in 1996.<sup>35</sup>

Although Thailand has succeeded in economic development during the past three decades, it now faces economic problems, the so-called "Thailand Financial crisis." The crisis, which started on July 2, 1997, has caused a serious economic downturn. The next chapter will describe this crisis and identify its causes.

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<sup>35</sup> Internet, <http://www.bkkpost.samart.co.th>.





## IV. THE FINANCIAL CRISIS IN THAILAND

### A. THE FINANCIAL CRISIS

After three decades of impressive economic development, Thailand is in the middle of an economic crisis. In the summer of 1997, the Thai baht came under strong pressure and experienced a large depreciation as financial markets considered its pegged exchange rate as unsustainable in view of its large current account deficit. Short-term external debt has risen substantially over the past few years, fueling unsustainable domestic consumption, a real estate boom and raising concerns over the soundness of the financial system.

To support the necessary balance of payments adjustment, a stand-by program with the International Monetary Fund (IMF) was agreed to in August 1997, which provided the basis for a \$17 billion emergency international financing package, of which the World Bank will contribute \$1.5 billion in structural adjustment lending and technical assistance.<sup>36</sup>

Until July 2, 1997, the interest and exchange rates were swinging wildly from day to day in the fallout from the managed float of the baht. Despite liberalized capital flow, a fixed exchange rate proved to be the undoing of the Thai economy. Foreign funds poured into the market to profit from interest rate spreads, fuelling asset price inflation that eventually undermined the financial sector.

The Bank of Thailand, wary of an increasing current account deficit, learned from Mexico's crisis in 1995 the dangers of relying on short-term inflows. It took several steps

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<sup>36</sup> Internet, <http://www.bkkpost.samart.co.th>.

to cool the overheating economy. International banking facilities were ordered to set aside 7% provision for short-term loans. The practical effect of the measure was a surge in loans with maturities of one year plus one day.

Finance companies were ordered to reduce their exposure to the property sector. Margin requirements were raised for securities purchases. Commercial banks were ordered to reduce foreign exchange exposure, and regulators pondered new rules to limit the inherent risks of derivative products on the finance system. But deficits in the current and trade accounts worsened for 1996 over the year before. A series of customs and excise tax hikes on luxury imports did little to stem rampant consumer spending.

In June 1996, the International Monetary Fund, following its annual consultations with Thailand, warned that the increase in the current account deficit had increased the country's vulnerability to economic shocks and shifts in sentiment.

While the tight monetary stance was praised by the IMF, more fundamental policy changes were needed to counter the large and volatile capital inflows entering as a result of capital account liberalization. One IMF paper stated:

"The stability of the baht had served the Thai economy well in the past, but directors recommended a greater degree of exchange rate flexibility to improve monetary autonomy and to reduce the incentive for short-term capital inflows,"<sup>37</sup>

But political turmoil caused continuous reshuffling among the top ranks of economic policy makers, hindering any consideration of policy shifts at the Bank of Thailand and the Finance Ministry. Meanwhile, the US dollar continued to gain ground

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<sup>37</sup> Internet, <http://www.bkkpost.samart.co.th>.

against other currencies. From the spring of 1995 to mid-1997, the dollar strengthened by more than 50% against the yen and 25% against the German mark.

The dollar's strength stemmed from large capital inflow into US markets, as foreign investors rushed to invest in fixed-income securities. Foreign net purchases of long-term US government and corporate bonds in 1996 jumped by 70% over 1995 levels.

As the dollar gained ground, so did the baht. Analysts had calculated that Thailand's 13-year basket system gave an 80% weight to the dollar, 12% to the yen and 8% to the mark. The appreciation of the baht caused Thai exporters to lose market share steadily against regional trading competitors. Labor-intensive industries such as textiles, footwear and clothing gradually gave ground to new competitors in China and Vietnam. Agricultural exports were still dampened by the effects of the flood of 1995. And higher-end industries such as computer components and automobiles were hampered by global overcapacity and local human resource deficiencies.

Rising labor costs, domestic interest rates and other expenses also helped erode Thailand's price edge in global markets, culminating in exports shrinking by 1.3% in 1996, versus growth of 24% posted the year before.

Currency speculators and hedge funds had begun exploring the willingness of the central bank to defend the basket as early as late 1996. On paper, Thailand's official foreign reserves of \$39.2 billion last January, equivalent to 6.6 months of imports, appeared sufficient to deal with any speculative attacks.

Before the beginning of the crisis, the Bank of Thailand was forced to maintain tight monetary policies throughout 1995 and 1996 to fund the current account deficit, support the baht and constrain inflation. High domestic interest rates depressed the

property and equity markets, affecting the loan quality of bank and finance company portfolios. The high spread between foreign and domestic interest rates also provided an incentive for local corporations to seek offshore financing.

The public determination voiced by the authorities to maintain the basket system also caused many corporations to pass up hedging their currency risks. While local commercial banks were required to net their foreign exchange positions, they nevertheless experienced higher credit risk because of the largely open positions of their clients' borrowings.

The high external indebtedness of the corporate sector, mostly open to currency volatility, is believed to be the main reason policy makers did not seek to adjust the basket mechanism. Various proposals expanding the trading bandwidth from four satang<sup>38</sup> around the official mid-rate to eight satang had been floated in 1996, but none was implemented.

Regardless, the central bank was caught in a policy dilemma: propping up the baht with high interest rates was depressing the local economy and leading to a deterioration of asset quality held by the financial sector. In May 1997, adverse economic news and fears of an interest rate hike in the Japanese market caused a massive speculative attack on the baht. Reports had international hedge funds betting as much as \$10 billion on devaluation, taking short positions in spot, forward and options markets against the baht.

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<sup>38</sup> 100 Satang = 1 baht

The Bank of Thailand responded with strong intervention in the spot market, committing about \$4 billion in reserves in defense of the baht. Selective capital controls were employed to cut off offshore speculators from access to the baht.

On May 15, 1997, the central bank coerced local banks to restrain from extending baht to offshore banks. The next day, local commercial banks were restricted from conducting foreign exchange swaps of baht for dollars with offshore firms. Spot market transactions to identified offshore speculators were also prohibited. The measures had the effect of splitting the market into onshore and offshore tiers. Annual interest rates for baht borrowings offshore roared to as much as 1,300%, squeezing speculators to close positions.

Some market participants turned to dumping their equity investments to raise the baht necessary to complete their offshore transactions. In response, the authorities ordered that sale proceeds of foreign stock holdings in the Stock Exchange of Thailand must be delivered in dollars. No such limitations were applied for debt instruments in the money market, with the central bank recognizing the continued need by local corporations for offshore financing and debt rollover. While the central bank successfully fended off the pressures on the baht in mid-May, the actions taken did not alter the fundamental weaknesses in the economy.

On July 2, treasury executives from foreign and local commercial banks were called into an emergency meeting with officials at the Bank of Thailand. There they received a bombshell: the central bank would announce later that day that the basket mechanism would be eliminated in favor of a managed float. The baht promptly dropped by 15-20% in value against the dollar.

Many economists had predicted earlier that the central bank would inevitably be forced to expand the bandwidth or devalue the baht. Few predicted the authorities would take an even more aggressive step and implement a float, where market forces would be left to determine the baht's exchange rate. But it had become clear that the resources of the authorities to defend the baht had steadily eroded. Foreign reserves at the end of June totaled just \$32.4 billion.

Capital controls imposed in May had also showed signs of reduced effectiveness, with offshore participants gaining access to baht needed to settle their swap obligations with the central bank. Further downward pressure on the baht came from a rush by corporations to hedge their foreign currency loans.

In August 1997, the central bank revealed why it was necessary to float the baht and eventually turn to assistance from the International Monetary Fund. Regulators had not only spent billions in hard currency to intervene in the market, but had also committed up \$23.4 billion in forward obligations to August 1998 to swap dollars for baht. The numbers were alarming. In this month, Thailand's total foreign debt of \$89 billion, with some \$71 billion to the private sector and \$20 billion coming due by the end of 1997.<sup>39</sup>

Investor confidence in the central bank's external position continued to fall. Reserves at the end of August totaled just \$25.9 billion, sufficient to cover only three months of exports. The majority of reserves cannot be accessed for intervention in the market, being required by law to be held to back up the local money supply.

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<sup>39</sup> Internet, <http://www.bkkpost.samart.co.th>.

Following the float, the Bank of Thailand hiked the bank lending rate 200 basis points to 12.5%. Interest rates stayed high throughout July and August on tight liquidity in the market. Nevertheless, the baht continued to fall and capital inflow trickled to a halt, as investor confidence failed amid widespread rumors of the precariousness of several finance companies and small banks.

## **B. THE MAIN REASONS FOR THE CRISIS**

There are five reasons to be concerned the cause of this financial crisis as follows:

1. Excessive external debt
2. Huge deficits in the current account
3. Exchange rate mismanagement
4. The collapse of the property sector
5. Political instability, incompetence and negligence

### **1. Excessive External Debt**

In 1997, the IMF estimated that the country's external debt was about \$99 billion, or about 55.5% of GDP. The majority of this debt, privately incurred, is \$71.7 billion. On the other hand, the external debt of the public sector was \$27.3 billion, which made Thailand one of the least publicly-indebted countries.

The huge external debt sharply lifted the country's debt service ratio (the ratio of principal and interest payments to exports) from 11.4% in 1994 to 15.5% in 1997. Phatra Research Institute reported:



“The average debt/equity ratio of listed non-finance sector companies increased from 1.58 in 1994 to 1.98 in 1996, and their ratio of earnings. Before tax and interest payments to liabilities decreased from 14.2% in 1994 to 10.7% in 1996.”<sup>40</sup>

As a consequence, these companies are highly vulnerable.

## **2. Huge Deficits in the Current Account**

Thailand's deficit was 8% of GDP in 1995 and 7.9% in 1996. In addition, the export growth rate decreased from 23.6% in 1995 to zero in 1996. The deficits caused the country to rely heavily on external borrowing.

## **3. Exchange Rate Mismanagement**

With a fixed exchange rate and the liberalization of international capital flows, foreign money poured in between 1993 and 1996 attracted by high interest rates. The baht became overvalued against other currencies, partly slowing down growth in exports for 1996. But the central bank persisted in pegging the baht to a basket of currencies in which the dollar had 80% influence.

Speculators attacked the baht in February and May 1997. To defend the currency, official foreign reserves were used, falling from \$39.2 billion in January to \$32.4 billion in June. In addition, the central bank sold \$23.4 billion of the reserves on the forward market - a sale hidden from the public until August.

On July 2, the central bank had to replace the fixed exchange rate regime with a "managed float," as it could no longer tap the reserves. The baht has since fallen steadily from 25.8 to the dollar on July 1 to a trading range of 45-49 baht to the dollar. The mismanagement of the exchange rate system and the rehabilitation of the Bangkok Bank of Commerce have been cited as evidence of the incompetence of the central bank.

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<sup>40</sup> Internet, <http://www.bkkpost.samart.co.th>.

#### **4. The Collapse of the Property Sector**

This sector began to boom in the late 1980s. With the liberalization of international capital flow after the introduction of the Bangkok International Banking Facilities in March 1993, the sector grew rapidly. By 1995, an oversupply of housing emerged, expanding into a major problem. With loans increasingly expensive and hard to get under the central bank's squeeze on lending, the sector began to collapse in 1996.

The sector's debts totaled around 800 billion baht in 1996. Debts of the 26 share market-listed developers were put at 200 billion baht the year before. The slump in property sales market and the restrictions on lending worsened developers' cashflow troubles and defaults on interest payments. For example, in February 1997, Somprasong Land and Place defaulted on interest payments on Euro-convertible debentures worth \$80 million.

Many finance companies and some small banks faced liquidity problems, with 16 finance companies suspended in June 1997 and another 42 in August. In December, 56 of them were closed permanently.

#### **5. Political Instability, Incompetence and Negligence**

Chavalit Yongchaiyudh's administration, which lost power in November, performed poorly in economic management. Its economic teams lacked common goals, and failed to deal with mismanagement by the technocrats. Confidence of foreign and domestic investors slipped away, and the economy continued to worsen after the 1996 November elections.

### C. THE WAY TO SURVIVE

Although Thailand was in the middle of the financial trouble, it still has some positive signs as follows:

1. In 1997, parliament passed a new constitution in which an election was proposed for the middle of 1998. Under the constitution, the new parliament and government were expected to be more concerned about the national interest above all others.

2. The new government's economic team has done a good job, especially in respecting the government's policy of restructuring the finance sector and gaining supporting loans from other countries. For example, the World Bank Country Director in Thailand, J. Shivakumar said:

"The World Bank strongly welcomes the decision announced today by the Finance Ministry on the rehabilitation plans submitted by the 58 suspended finance companies. The criteria which have led to the approval of only two plans are clear signs that the Government is committed to restoring confidence in its financial system. We applaud the FRA for the courage shown in this difficult task and the professionalism demonstrated. The World Bank anticipates that the international community will view this effort favorably,"<sup>41</sup>

In Washington, on January 23, 1998, Thailand's Finance Minister, Tarrin Nimmanahaeminda, held extensive discussions with World Bank Acting President Sven Sandstrom. The Minister thanked the World Bank for its support and timely financing, noting that the renewal of dialogue on structural reform issues had helped Thailand weather the crisis.

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<sup>41</sup> Internet, <http://www.bkkpost.samart.co.th>.

Minister Tarrin re-affirmed that Thailand's macro-economic stabilization program would agree with the multilateral development organizations and reforms in the financial sector. Mr. Sandstrom congratulated the Minister on Thailand's steady progress and on implementing the stabilization program and the structural adjustment program. The World Bank, for its part, would continue to support Thailand with a program that included restoring confidence in the financial sector, supporting the privatization program, and strengthening Thailand's corporate governance framework to promote greater availability and disclosure. The Bank also assisted the Government in designing social safety nets to protect the poor and other vulnerable groups during the crisis. The program supported the most efficient social sector programs and assisted new organizations to facilitate access to the poor by working closely with non-governmental organizations at the local and grass-roots level.

After meeting with the Thai Minister, World Bank President, James D. Wolfensohn visited the Asia region a week later. Thailand was his first stop. Mr. Wolfensohn was welcomed by minister Tarrin and assured of the continued financial partnership of Thailand. Another investment in Thailand's industry came from Germany when that country agreed to provide financial assistance worth 150 million marks (3.6 billion baht). This event was consummated when, German Finance Minister, Theo Waigel, arrived in Thailand with a 50-member delegation. Dr Waigel met Finance Minister Tarrin Nimmanhaeminda for one hour and discussed the state of the Thai economy.

“Dr. Waigel praised Thailand for moving in the right direction to tackle its economic problems and the German government would also help in negotiating with German banks the provision of their loans to Thai corporations”, <sup>42</sup>Mr. Tarrin said.

Germany also made a commitment in a memorandum to extend 100 million marks in guarantees through the Industrial Finance Corporation of Thailand and commercial banks for financing purchases of German goods and funding projects supported by German firms. Another 50 million marks would be used to support small and medium-sized enterprises. Germany also pledged to lend technical assistance in Thailand's efforts to upgrade banking supervision systems and privatization of state enterprises.

Dr. Waigel said he would report his findings about the Thai economy to attendees at the G7 Finance Ministers/Central Bank meetings in London. Dr Waigel and Mr. Tarrin also presided over the signing of a loan agreement between Kreditanstalt für Wiederaufbau (KfW), Germany's state development bank, and the IFCT. The IFCT will borrow \$30 million, half as a subordinated loan and half as senior debt, over 10-years to support projects between Thailand and Germany. The \$30 million loan was the ninth made by KfW to the corporation. The loan would help encourage investment in Thailand and bolster confidence of foreign investors in the country's long-term economic prospects.

Most importantly for Thailand at this moment is the securing trust from the IMF (International Monetary Fund) to heal its financial crisis. In early August 1997, as it became more apparent that Thailand's balance of payments structure was becoming

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<sup>42</sup> Internet, <http://www.bkkpost.samart.co.th>.

shakier, then finance minister, Thanong Bidaya traveled to Japan to seek financial assistance from its government and commercial banks.

Japanese officials declined to provide unilateral assistance, saying any package should be made under a broad-based economic restructuring program arranged by the IMF. On August 19, 1997, the government announced it would formally enter a 34-month IMF program, receiving a standby credit line of \$14.5 billion to supplement reserves and alleviate pressures on the balance of payments. The IMF and Japan would provide \$4 billion each; China, Hong Kong, Malaysia, Australia and Singapore \$1 billion each; Indonesia, Korea and Brunei another \$500 million each.

Another \$2.7 billion in structural adjustment loans from the World Bank and Asian Development Bank were granted to help restructure the financial and industrial sectors and deal with the social disruption expected over the lifespan of the program. A key element of the program highlighted the need for an immediate tightening in fiscal and monetary policy. A 1998 fiscal surplus target of 1% of gross domestic product, or about 69 billion baht, was set to finance the restructuring of the financial sector. Expectations were high that the acceptance of the IMF package would quickly lead to a restoration of investor confidence, and thus, to a rebound in the value of the baht. This did not occur, however, primarily because of continued concerns about the stability of the banking and finance sector and confusing policy signals from the political leadership.

During March 1998, after the great success of Mr. Chuan Leekpai's three day official visit to Washington, he announced President Bill Clinton's pledges to support Thai exports, provide technical assistance to some state agencies and ease the financial

woes of Thai students in the US caused by the baht depreciation. The US assistance is worth \$1.7 billion, of which \$1 billion would be provided by the US Export-Import Bank (Ex-Im) to ease the credit crunch in Thailand's export sector.

Also, the US Overseas Private Investment Corporation (OPIC) would also provide \$400 million in support of two Thai electric projects and would make available \$45 million in OPIC guarantee investment funds for equity investment in Thai companies. The US Trade Development Agency (USTDA) would finance feasibility studies on the privatization of locomotive and rolling stock maintenance facilities for the state railway of Thailand. It would provide technical assistance to upgrade a communications network for the Provincial Electricity Authority of Thailand.

The technical assistance would also go to the National Electronics and Computer Technology Center for the development of a nationwide, high capacity information network for government services. Furthermore, Mr. Chuan said 165 scholarships worth \$3 million would be granted to Thai students in America to mark 165 years of bilateral relations.

3. Thai exports have increased with the depreciation of the baht. The trade balance and current account have improved. The trend is expected to continue in 1998. To increase the export, the benefits of a weak baht will be used for gaining some advantage. Amid all the gloom, everyone in Thailand accepts that the depreciation of the baht will help the economy to some extent.

Among whom were the following:

Boontipa Simaskul, inspector-general at the Commerce Ministry, said

“The weaker baht would enable Thai products to compete with those from China, its major competitor. In 1996 Thailand began losing ground to China, particularly in labor-intensive sectors such as garments, footwear and parts.”<sup>43</sup>

But with weak currencies the rule rather than the exception in the region now, it is not certain that Thailand will maintain an advantage for long.

However, Mrs. Boontipa said that

“If the baht had not plunged in value, the outlook for exporters would have been far worse by now.”<sup>44</sup>

Charin Hansuebsai, deputy director-general of the Business Economics

Department, said

“One bright spot would be exports of agricultural products. The El Nino weather phenomenon had affected food production in many countries, and Thailand was well positioned to meet demand.”<sup>45</sup>

Indonesia ordered 120,000 tons of tapioca flour from Thailand, and the figure had been expected to rise to 200,000 tons by the end of 1997. Mrs. Boontipa gave credit to Dr Narongchai Akrasanee, who served as Commerce minister throughout most of 1997, for removing many export obstacles. For example, the Revenue Department was ordered to speed up value-added tax refunds to exporters with good records, cutting the waiting time to 45 days, and to 90 days for other exporters.

Dr. Narongchai also cut tariffs on textile- and garment-related machinery to only 5%, established a one-stop Customs office, and deregulated automobile exports.

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<sup>43</sup> Internet, <http://www.bkkpost.samart.co.th>.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.



However, Viroj Amatakulchai, chairman of the Federation of Thai Textile Industries, said efforts to relax customs-related regulations and cut other red tape were just a start.

He said, for example, that promises of speedier VAT refunds from the Revenue Department had not materialized for small and medium-sized exporters.

According to the depreciation of baht, The Commerce Ministry expected exports for 1997 would increase by 26% in baht terms to 1.7 trillion baht, and by 3.5% in dollars to \$57.87 billion. This would ease the impact of the economic downturn and, it hoped, be one of the engines for a recovery.

During the January-October period of 1997, exports increased by 19.8% in baht to 1.3 trillion baht, and by 4.4% in dollars to \$48 billion. Among principal exports, automobiles and autoparts showed the most rapid growth, partly due to the slowdown of domestic demand. Exports from this sector grew by 109% in the period. Also, exports of electrical and electronic products expanded well. Computers and parts accounted for 11.4% of total exports, increasing by 12.4% in the first three-quarters. Further more, exports of integrated circuits increased by 20.5%; radios and televisions and their parts by 11.8%, and transformers by 39.1% for the period.

The baht's collapse helped exports of labor-intensive manufactured goods. For example, shipments of garments increased by 8% in the first three quarters. During the first 10 months, while exports of industrial products grew by 18.4%, those of agricultural products grew by 4.1%. Rice shipments rose by 17.3% and those of frozen shrimps by 4.4%.

Exports to ASEAN members accounted for 21.3% of total exports. Sales to Malaysia increased by 45.1% in the first three quarters, and those to Indonesia by 39.2%.

The second-largest buyer of Thai products is the United States. Exports to the US grew by 24% in the first three quarters. Those to Belgium, Australia, Hong Kong and Taiwan also increased significantly.

During the first 10 months, Thai imports increased by 1.9% to 1.5 trillion baht, but dropped by 10.1% in terms of dollars to \$54 billion. The trade balance improved to a deficit of 174 billion baht, 53.6% lower than for the same period of 1996.

Exports are being counted on as the prime mover to save Thailand's ailing economy, and signs began to emerge in late 1997 that the weakening of the baht was creating new opportunities.

After zero growth in 1996, the country's exports in 1997 were projected to grow by 10% to 1.5 trillion baht. The result, coupled with a slowing of imports, would be a narrowing of the worrisome current account deficit. The forecast appears likely to come true, as exports showed signs of gradual recovery every month in 1997 except February, when there was a decline of 5.1% compared with the same month in 1996.

In the first quarter of 1997, exports rose by 1.7% to 360 billion baht on the same period of the year earlier, while imports fell by 3.4% to 452 billion baht. The trade deficit for the period declined by 19.2% to 91 billion baht.

In the second quarter, the trade deficit dropped sharply by 27.3% to 173 billion baht, as a result of a 3.6% rise in exports and a 4.3% decline in imports. For the first nine months, the value of exports were up by 14.9% to 1.2 trillion baht, due in no small part to the appreciation of the US dollar after the baht was floated on July 2.

The weaker currency has made Thailand's exports more competitive against those of rivals such as China, India and Latin America. But at the same time, other trade

competitors such as Malaysia, Indonesia and the Philippines have experienced sharp currency declines, so competition in global markets is stiff. However, doubts still remain whether exports in 1998 will be as healthy as in the previous year. The preliminary forecast is for 10% growth over 1997.

Many negative factors still beset the country, said Nattapong Thongpakdee, an economist with the Thailand Development Research Institute (TDRI) and author of a TDRI study on international trade and national competitiveness.

“The World Bank and the International Monetary Fund (IMF) appears to be more optimistic. They have been forecasting since early last year that the world's economic outlook for 1998 would be better than in 1997.”<sup>46</sup>

However, many economists question the optimism of the World Bank and IMF, given the spread of Asian economic turmoil. If the Asian financial crisis is left unsolved for too long, the contagion could spread to Hong Kong, China, the United States and throughout the world. Mr. Nattapong warned that the consequences for Thailand's exports, if demand slows in traditional markets, could be heavy.

“Washington is now closely monitoring its 1998 inflation,” he continued. “The US Federal Reserve may be forced to raise interest rates next year to cap inflation. This will affect the world's cashflow.”<sup>47</sup>

The extent to which Korea and Japan suffer will also affect Thailand. Investments in Thailand from these two major sources may be reduced, and Thai exports to Japan and Korea would ultimately suffer, Mr. Nattapong predicted, adding that although the baht is

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<sup>46</sup> Internet, <http://www.bkkpost.samart.co.th>.

likely to recover some strength in 1998, the effect on the prospect for Thai exports is uncertain.

A good sign is that the country has recorded a trade surplus in three consecutive months - September, October and November 1997 – as a consequence improving the current account balance

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<sup>47</sup> Ibid.



## V. SUMMARY AND CONCLUSION

### A. SUMMARY OF THE STUDY

As the result of this research, the hypothesis of Williamson and Haggard may explain the success or failure of economic reform used to evaluate Thailand's economic policies. A summary of their hypothesis follows:

#### 1. Economic Condition

The economic condition in Williamson and Haggard focuses on the crisis and the external help that may support change through both intellectual and financial aid. As discussed in the chapter IV, Thailand has gained much external support from both private and government sectors of many countries. For example, after the beginning of the financial crisis, the IMF and the World Bank provided \$ 17.2 billion in aid, while Japan provided \$ 4 billion. Also China, Hong Kong, Malaysia, Australia, and Singapore provided \$ 1 billion each; Indonesia, Korea, and Brunei another \$ 500 million each. On September 11, 1997, the World Bank also provided another \$ 15 million and another \$ 350 million on December 23, 1997.<sup>48</sup> In addition, after the prime minister Chuan Leekpai's three day official visit to Washington, President Bill Clinton announced his support for Thai exports and the provision of technical assistance to some state agencies. On March 1998, Thailand was further supported by \$ 500 million from the Asian Development Bank and \$ 430 million from the World Bank on June 1998, another \$1.7 billion from the US Export-Import Bank, the US Oversea Private Investment Corporation, and Japan's Oversea Economic Corporation Fund.

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<sup>48</sup> Internet, <http://www.bkkpost.samart.co.th>

## 2. Political Condition

This research focused only on the military intervention which was due to the lack of investors' confidence in a government overthrown by a military coup. Previous Thai political history would indicate that there would be a long period of Thai civil-military relations in the government of the country. Although well educated civilians and military personnel had formed a coalition to develop their own country by changing to a political system of democratic government, it was not as advanced as those of the western democracies like the U.S.. Most military governments were too authoritarian for a real democratic country to accept. After the "Black May Incident" in 1992, Thailand had evolved into a stable democracy without military intervention or support.

The Army Commander-in-Chief Chettha Thanajaro said the government could rest assured that the army will not take sides or interfere in politics. And he also said "Don't be afraid or become paranoid about the army interfering in politics. We fully support the government for we are part of it. But we will not get involved in politics. Politics is not for us. Finally, the army had other more important duties to attend to."<sup>49</sup>

From his speech, it can be assured that the army could guarantee no more military interventions in politics at least until the end of the financial crisis because the military knew what it would be like if there was another coup.

This last coup did not necessarily set Thailand back in its slow march to democracy, but was presented as a result of misbehavior by the politicians. Furthermore, the leader of the coup did not break the rule of the National Economic and Development Plan; he still kept running on the same track, developing economic growth as General

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<sup>49</sup> Internet, <http://www.bangkokpost.com>.

Suchinda coolly explained after the investors asked about the fall of share prices. He told a public audience, tongue in cheek,

“We soldiers also invest in stocks. I’m thinking of scooping up some stocks at a bargain price myself on Monday.”<sup>50</sup>

There was indeed a decline on Monday, but only of 7.3 % and that was largely recovered by a 5.7 percent gain on Tuesday. It quickly became clear that the General did not oppose the basic tenets of the last economic policy. Economic growth through private enterprise and market forces would still be the recipe.<sup>51</sup>

Now, Thailand is governed by civilians. The general election for the House of Representative is held every four years. Thai people select their government leader by means of the general elections. Military promotion to high rank, purchases of armed equipment, and military budget have to be passed and signed by the prime minister, civilian or former military, before being presented to the King. It indicates that the military is under civilian control, as it should be in democratic politics. If a member of the armed forces becomes a politician, he has to resign from the force first. Coming from a military background, they learn how difficult it is to play the political game as a civilian because they were not trained in this way. As professional soldiers, they kept politics at a distance.

Thai political history, as discussed in the chapter II, demonstrates the development of Thai politics. There are three factors for success in reforming civil-military relations according to Huntington. First, the norms of military professionalism

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<sup>50</sup> The Nation (Bangkok), 25 February 1991.

<sup>51</sup> Elliott Kulick and Dick Wilson, Thailand's Turn: Profile of a New Dragon, St. Martin's Press New York, 1992.



and civilian control are increasingly being accepted around the world. Second, political and military' elites have come to recognize that the institutionalization of what Huntington calls "objective civilian control" serves the interests of both. Finally, civil-military reform has yielded widespread benefits including reductions in military budget and man power requirements, the curtailment of human right abuses, and the transfer of military-run enterprises into civilian hands that are popular with society as a whole. These successes in reforming civil-military relations in politics will give more confidence to investors putting their money and resources into Thailand.

### 3. Position of Team

According to the ideas of Williamson and Haggard in the meaning of the position of team:

"Coherent economic team: must be united on economic strategy. Presence of a technopol: economists should be in a position of political responsibility as opposed to merely technical advisers."

Thailand has the new Thai Constitution, first used at the end of 1997, that states the need for an economic advisory council. The details in chapter 5 article 76 and article 89 of new constitution state:

Article 76: The state must promote public participation in regulating its policies and decision making on political issues, on formulating economic, social and political development plans and in checking on the use of state power of all levels.<sup>52</sup>

Article 89: The state must have an economic and social advisory council to advise the Cabinet on relevant problem. Economic and Social

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<sup>52</sup> Internet, <http://www.nationalmultimedia.com>

Development Plans adopted according to other laws must be approved by the council.<sup>53</sup>

These two articles in the Thailand's new constitution are related to Williamson and Haggard's hypothesis. They also indicate that Thailand might have developed a plan for economic and political reform whether or not a crisis had occurred.

#### 4. The Reform Program

At the beginning of Thailand's economic development, it has used the National Economic and Social Development Plans. The consequences after using those plans were the growth of the economy and the increase in GDP. All plans were designed in advance before using them. Thus, after the financial crisis occurred, the Eighth Plan, designed before this situation, had to be amended to help solve current problems. After the last amendment of the Eighth Plan on November 12, 1997, the Eighth Plan did not change its main purpose. The consequences of the debate were to fit the Eighth Plan into the current situation. The most important issue was that the plan was required to pay more attention to the development of both human and natural resources. Thus, The government would increase its support for human resources by giving more education to all Thais. Furthermore, natural resources would be secured and preserved for following generations of Thais: these reforms will help Thailand prosper in the long run.

## **B. CONCLUSION**

Although the conditions of Thailand fit into the hypothesis of Williamson and Haggard, it is too early to predict the future of Thailand's economy accurately. It is also soon after the crisis of 1997-1998 for all the data to have been collected. Thailand's

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<sup>53</sup> *Ibid.*,

current recovery plan seems to be on the right track, and its economic problems may diminish soon. However, there are some important factors, not provided by this study, such as the effect of other country's economies on Thailand. Thus, the consequence of this thesis could not guarantee or predict that Thailand would solve its economic problems. It would be better to evaluate Thailand's present state until further research is done and information gathered which would provide a more detailed information assessment of the country's political and economic development.

As a consequence of this evaluation of the effects of the financial crisis on Thailand, it should be recognized that the country is nevertheless in a very improved economic and democratic state ready to take its place with the other developing countries of the Pacific Rim. Thailand's improved condition today is demonstrated by the following facts:

Government: In December 1991, a new Constitution was proposed, which provided for a National Assembly ( an elected House of Representatives and a Cabinet headed by a Prime Minister). In January 1997, a Constitution Drafting Assembly was established to research and draft a new constitution. At the end of this year, the new constitution was promulgated.

Defense: The Thai armed force has an estimated total strength of 254,000: 150,000 in the army, 64,000 in the navy, and 40,000 in the air force.<sup>54</sup> Military service is compulsory for two years between the ages of 21 to 30. The defence budget for 1997 was projected to total 109,000 millian baht.

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<sup>54</sup> Maticohen, 28 January 1997, p. 33.

Economic Affairs: Thailand's rapid economic growth since the late 1980s has encountered certain problems: inadequate infrastructure development including a transport crisis in Bangkok, a shortage of highly trained technical personal, a widening deficit on the current balance of payments, an inequality of income distribution owing to excessive centralization. Inflation began to rise in 1993 and has remained excessively high despite the imposition of strict monetary controls. In February 1997, the Government approved sufficient reductions in budgetary expenditure in an attempt to narrow current deficits. They included government pension schemes introducing compulsory saving for government employees, and increased funds for state enterprises and commerce. In the long term, it is hoped that Thailand will make the transition from an economy based on labor-intensive to one based on manufacturing higher value-added goods without the need for increased imports.

Social Services: Along with this economic development are the social services undertaken by the Ministry of Labor: child welfare, family assistance, welfare for the aged and destitute, disaster relief welfare, and development programs for the hill tribes and land settlements.

Education: Compulsory education for six years was officially undertaken in 1995 between the ages of 6 to 11. In 1996, the government extended the period of compulsory education to 9 years. There are now 20 state universities (12 of which are in Bangkok) and 26 private universities and colleges providing education for the training of young Thai men and women for the new industries, electronic and computer technologies, banking and commercial services, providing the professional careers necessary for an Asian country to compete in a global world.



## GLOSSARY

ASEAN	Association of Southeast Asian Nations
BOI	Board of Investment
DP	Democrat Party ( Prachathipat Party in Thai name)
Ex-Im	US. Export-Import Bank
GDP	gross domestic product
GNP	gross national product
IFCT	Industrial Finance Corporation of Thailand
IMF	International Monetary Fund
KfW	Kreditanstalt fur Wiederaufbau
NAP	New Aspiration Party (Khwanwang Mai in Thai name)
NESDB	the National Economic and Social Development Board
OPIC	Overseas Private Investment Corporation
TDRI	Thailand development Research Institute
USTDA	Trade Development Agency
VAT	value added tax



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