Has Thailand Learned from the Asian Crisis of 1997?

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ABSTRACT. Many economists have investigated the causes of the Asian crisis of 1997 in order to prevent a repeat of it. There were many issues leading to the crisis, and there is no agreement on what all the causes were. I conclude that for the case of Thailand, there were three main causes: exchange rate policy, weak financial institutions, and actions of the government. The crisis is analyzed, and the results are used to suggest ways to prevent future unnecessary recessions. Finally, the current situation in Thailand is examined to determine whether Thailand has learned from the crisis and made any necessary change to prevent a future collapse in the Thai economy.

I. Introduction

Recession is one of the most frightening words to economists, policy makers, business owners, and the general public. The Asian crisis was an extreme case of a recession. It was the worst recession in Thai history. It spread across many countries in Asia and other countries around the world. Because the crisis started in Thailand, the emphasis for this paper is the situation in Thailand. The crisis is analyzed, and the results are used to suggest ways to prevent future unnecessary recessions.

II. An Outline of the Crisis

A. THE BOOM BEFORE THE CRISIS

Thailand enjoyed remarkable economic development from 1987 to 1996. GDP per capita grew at a rate of 8.17% per year. GDP measured with PPP grew at an average of 12.62 % per year [NYU 2005]. According to Vines and Warr, "during this decade the Thai economy was the fastest growing in the world" [2005, 440]. Economic growth also improved living standards in Thailand. People could afford more goods and services. Life expectancy increased from 58 in 1970 to 69 in 1995; the literacy rate went up from 79% to 94% from 1970 to 1995, and the income of the poorest fifth was $726 in 1990, a 101% increase from 1970 [Radelet et al. 1998, 15 and 20].

B. WHEN DID IT START?

Most people are under the misconception that the crisis occurred without warning. Actually, economic growth started to fall at the end of 1995. Figure 1 shows that growth of GDP per capita dropped from 8.61% to 5.24% that year.

Figure 1. GDP Per Capita Growth

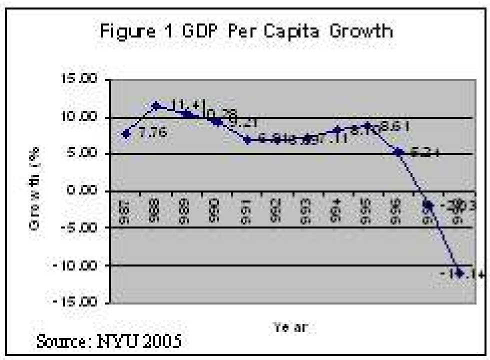

Figure 2 breaks down GDP growth for each quarter from 1994 to 2000. This allows us to see that the fall started in the fourth quarter of 1995. It eventually became clear at the end of the second quarter in 1997 that the recession had begun.

Figure 2. GDP at 1988 price (percentage change)

Year	Q1	Q2	Q3	Q4
1994	11.26	9.17	5.09	10.31
1995	9.10	13.05	10.00	5.54
1996	4.44	6.67	7.78	4.73
1997	1.35	-0.57	-1.85	-4.58
1998	-7.57	-14.20	-13.93	-7.40
1999	-0.20	3.40	8.40	6.40
2000	6.50	6.20	2.40	4.00
Source: TDRI 2007				

Another indicator of the downturn was external short-term debt. According to data from the Bank of International Settlements, short-term debt increased from $27,151 million in June 1994 to $45,567 million in June 1997, while the debt to reserves ratio increased from .992 to 1.453 during the same period [Radelet et al. 1998, 15 and 26]. This indicates illiquidity and vulnerability in the Thai financial sector.

According to Radelet et al, the first significant evidence of the financial problem occurred in the property market. Property prices declined in late 1996. On 5 February 1997, Somprasong Land, a major property developer, failed to make a payment on its foreign debt. The bankruptcy of Somprasong Land was an indicator of trouble in the real estate market. Every real estate company tried to get rid of on hand assets to minimize its loss. At the same time, no investors wanted to buy these assets, which drove down the price of properties even more. This caused people to assume other real estate companies would go out of business. The expectation of widespread business closings combined with the drop in property prices to put financial companies into trouble because they had made loans to companies in the Bangkok property market, [Radelet et al. 1998, 27].

From late 1996 to June 1997, the Bank of Thailand spent about $39 billion in foreign exchange reserves purchasing forward contracts defending the baht (the Thai currency) against currency speculators [Radelet et al. 1998, 28]. Eventually, on 2 July 1997, the government decided to let the baht float. The announcement from the Thai government acknowledged that the Thai economy was in trouble, and it turned out to be the worst recession in Thai history.

C. WHAT HAPPENED AFTER JULY 2, 1997?

After the announcement, people were shocked by the rapid fall of the baht. It fell from 24.52 bahts per US dollar to 30.18 bahts per US dollar the first day. On 12 January 1998, the Thai currency hit rock bottom at 56.10 bahts per US dollar, compared to an average in 1996 of 25.34 bahts per US dollar [The Fed of NY]. The Thai stock market plummeted right away. The Thai government had to borrow money from the IMF to increase liquidity, and standby credit of $3.9 billion was approved on August 20th, 2007 [BIS 1998, 132].

For most laypeople in Thailand, the boom economy seemed to end dramatically. They did not know exactly what happened. Many businesses went bankrupt, and people stopped spending. The news continuously reported on national debt, describing how much each Thai person owed on the IMF loan created by the government without explaining why the loan was taken out in the first place

The floating of the Thai baht initially affected businesses using foreign currency loans. The crisis caused the risk premium to increase and eventually drove up the interest rate. The increase in the interest rate affected everyone, not just the businesses using foreign currency loans. The three-month interest rate in early 1997 was about 13.1%. It hit its peak on December 25th, 2007 at 26% [BIS 1998, 136]. As shown in Figure 3, the real short-term interest rate was more than double what it was the year before at the end of quarter 2, causing the Thai economy to become stagnant.

Figure 3. Short-term interest rates in real terms: alternative deflators

Deflated by:					year-on-year inflation	
	1990-95	1996			1997	1998
			Q2	Q3	Q4	Q1
Interest (%)	5.1	4.7	10.4	12.3	12.4	14.5
Deflated by:					quarterly inflation	
					1997	1998
			Q2	Q3	Q4	Q1
Interest (%)			10.5	6.5	9.2	14.2
Source: BIS 1998, 138						

A high interest rate made it hard to invest or come up with positive net present value projects because it made investments less profitable (See Figure 4). In addition, many existing businesses went bankrupt due to their inability to pay back loans, and remaining businesses had a hard time staying solvent. Some had to layoff workers and cut spending. This caused unemployment to rise(See Figure 5). Many employees had to take salary cuts and forgo amenities such as bonuses. Despite the decrease in income, employees in general were very happy to remain employed. However, they remained fearful as to how long they would remain employed. As a result, people decreased spending, which ended up affecting every business, regardless of size.

Figure 4. Investment Promotion in Thailand

	1996	1997	1998
Applications Approved			
No. Of Approvals	970	919	483
Total Investment (millions of baht)	531,198	481,292	254,864
Source: TDRI 2007			

Figure 5. Unemployment Rate

	rate	changes
1998	3.4	277.80%
1997	0.9	
1985-1996	2.41%	
Source: EconStats (2004). Acquiring data from IMF-IFS		

D. THE CRISIS SPREADS

The crisis did not stop in Thailand. Shortly after the crisis broke out in Thailand, the effect spilled over to other countries. The Philippines, Malaysia, and Indonesia were affected because foreign investors viewed these economies as similar to Thailand. The Philippines peso floated on July 11th, 1997, and dropped a total of 41.8% from July 1997 to January 1998. The Malaysian Ringgit fell by 46.3% from July 1997 to January 1998. The Indonesian rupiah floated on August 14th, 1997, and dropped a total of 84.3% from July 1997 to January 1998. The crisis moved to East Asian countries such as Taiwan, Hong Kong, and Korea. Taiwan and Hong Kong were affected because they had loaned money to countries in South East Asia. The Korean won floated on December 16th, 1997, and dropped a total of 54.6% from July 1997 to December 1997. The Hong Kong market was also affected. The Hang Seng index, the stock market index in Hong Kong, fell by 23% on October 20th-23rd, 1997. The crisis eventually reached Russia and Latin America [BIS 1998, 132-136]. The country that got hit the hardest by the Asian Crisis was the Philippines [IMF 1997, 18].

In many of the affected countries, governments had pegged the exchange rate prior to the crisis. When their reserves fell below the value of their external debt, they decided to float their currency.

III. Literature Review

Researchers have spent years analyzing the cause of the Asian crisis to determine what exactly caused the crisis to take place. A review of this research may help one understand the crisis from different points of view, and putting many pieces of information together can help one see the big picture.

The IMF concluded that the crisis occurred because of weak financial systems due to insider dealing, corruption, and weak corporate governance, inefficient government spending and an unstable banking system. The situation was made worse by governments defending a pegged exchange rate and protecting failed banking institutions. Consequently, foreign investors started to panic after recognizing that foreign exchange reserves were lower than the level of short-term foreign debts [Radelet et al. 1998, 1-2].

Vines and Warr concluded that "the investment boom and its changing composition generated record growth but also increased macroeconomic vulnerability" [2003, 440]. The combination of vulnerability and the decline in exports due to increased competition from abroad caused the crisis to occur. They explained that overinvestment occurred in domestic private investment. Overinvestment had three main causes. The first is related to government policies, some of which were actually supported by the IMF. The Thai Government created the Bangkok International Banking facility (BIBF) that made it easier to obtain foreign funds. The second cause was poor monetary policy. The policy caused interest rates abroad to be substantially lower than the interest rate in Thailand, which made it more attractive to borrow foreign funds. The last cause was due to non-bank financial institutions. Before the crisis, "banking licenses in Thailand had been highly profitable" [Vine et al. 2003, 457]. The non-bank financial institutions were fighting to get a license, so they competed with one another to be on top in the domestic financial market. They borrowed a large amount of money from abroad and lent at lower interest rates than banks. In turn, overinvestment in domestic private investment created a large current account deficit, which eventually caused reserve vulnerability. [Vine et al. 2003, 440-

466].

Scott MacDonald focused on transparency. He said that a lack of transparency and disclosure were the major catalysts to the crisis. As economist Rudifer Dornbusch noted "With transparency, you get the right prices and you can get the most stability" [MacDonald 1998, 689]. A lack of transparency and disclosure amplified problems with money politics and corruption. During the growth period, a lack of transparency and disclosure did not seem to be a problem. When recession occurred, a lack of transparency aggravated problems, resulting in deep recession. MacDonald also agreed with the three main reasons mentioned by Vines and Warr. However, MacDonald added a fourth reason - poor lending practices by financial institutions. Loans were easily granted without adequate review. He believed that all these problems would not have existed if transparency had existed. There were many factors leading to a lack of transparency in the Thai financial world. First, the Thai tradition of patron-client relationships created informal networking. The networking was generally based on reputation and family or ethnic networks. The informal networking was largely used to make financial decisions without formal procedures. A second problem was a weak legal structure. People found loopholes in laws and got away with illegal actions. This included an abusive use of power, especially by public officers and governors. A lack of transparency played a big role not only during the growth period but also during the crisis. For instance, investors used informal networking to get away from deep losses through informal networking and bribery [MacDonald 1998, 688-702].

Jim Glassman looked at the crisis in a different way. He wrote that the main cause of the crisis was the decline of profitability of manufacturing caused by global export competition and over-capacity. He showed that manufacturing profit rates continually declined since 1990. It was clear that Thailand lost market share in export markets to other countries, especially China. During the boom period, all other Asian countries were expanding at the same time. Unfortunately, exporting seemed to be the only way to expand profit because the domestic market was not growing fast enough. The Asian countries were also focusing on exporting similar products to the same markets such as Japan and the US. Furthermore, Thailand put very little focus on technology advancement. In the mid 1990s, Thailand had only 0.2 research and development scientists and technicians per 1000 Thai population, which was a significantly lower ratio than in South Korea

(2.9), Singapore (2.6), China (0.6), and even Vietnam (0.3). Thus, Thai firms competed with others by focusing on low labor costs, rather than high productivity. Consequently, Thai workers' standard of living increased at a lower rate than others, so the consumption power in the country remained low. So while other countries had no boundary to how much they could expand, Thailand could only lower its labor costs so much [Glassman 2001, 122-147].

Paul Krugman said that there are several possible causes of the Asian crisis. However, he believed that the two most important reasons were severe moral hazard problems and the overpricing of assets. First, he suggested moral hazard largely occurred in financial institutions. Most foreign creditors of financial institutions believed that the Thai government guaranteed the financial institutions. The assumption led many investors to assume less responsibility toward their actions. Krugman noted that during the boom period, investors received all the profit, but they thought that they could walk away with no personal cost if losses occurred. Thus, moral hazard eventually caused overinvestment and poor investment choices. Asset overpricing also started with moral hazard and overinvestment. Because there was too much money, financial intermediaries tried to gain profits from speculating on assets. Due to the moral hazard problem, investors made bidding decision based on best case scenarios instead of expected values. Hence, assets were overpriced. When the crisis hit, asset prices fell, causing big losses [Krugman 1998].

IV. The Crisis in Thailand

The research above shows that the crisis was multi-faceted. In the case of Thailand, there appears to be three main causes: exchange rate policy, mistakes by financial institutions and businesses, and government actions.

A. EXCHANGE RATE POLICY

1. Exchange Rate and Speculation

Prior to 1990, borrowing from abroad was uncommon, so the gap between the interest rate in Thailand and the US was not important. As foreign borrowing became more common, the decision to peg the exchange rate left room for profit from arbitrage. For instance, the Thai government tried to keep the exchange rate at 25 bahts/US dollar. In 1990, investors could borrow $100 in the US at 10.01%, and lend $100 in Thailand at 14.75% (Figure 6). When the government decided to peg the exchange rate it caused the forward rate to be the same as the spot rate. Investors could make a profit of $4.74 without taking any risk (100*1. 1475-100*1.1001 = $4.74). To currency speculators, this means the expected the future spot rate should be lower, which is shown below by using the uncovered interest parity concept.

$$E(S^{B/\$}) / S^{B/\$} = (1 + i^{B}) / (1 + i^{\$})$$
$$E(S^{B/\$}) = 1.1475 * 25 / 1.1001 = 26.08 \text{bahts} / \$$$

The calculation above suggests that with these interest rates, the exchange rate should change from 25 bahts to 26.08 bahts per dollar, ceteris paribus.

Figure 6. Prime Rate (%)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
THA	16.08	13.38	11.54	11.59	12.27	14.75	15.40	12.23	11.16	11.05	13.17	13.75	13.06	14.51
US	9.93	8.33	8.20	9.32	10.87	10.01	8.46	6.25	6.00	7.14	8.83	8.27	8.44	8.35

Sources: Bank of Thailand and The Fed of St Louis

As the arbitrage occurred, the risk of devaluation of the Thai currency increased. However, the crisis did not occur immediately for many reasons. First, the Thai government still largely remained in control of the financial system. Second, most investors still believed that the Thai government would continue pegging the exchange rate. As a result, no profit could be gained from currency speculation. Third, the economy did well at the beginning. Until 1991, Anand Panyarachun was the Prime Minister of Thailand. He supported capitalism, decreased government control over the market, and allowed funds to be transferred in and out of the country more easily. (In the past, investors had to report to the Bank of Thailand if they took funds in and out of the country) [United Nations]. Though his reforms were good for the Thai economy, it created an opportunity for speculating because these investors did not have to report to the Bank of Thailand. Moreover, Thai officials did not manage the policy effectively, allowing the Thai currency to be easily attacked by speculators.

In 1996, the interest rate gap widened, and the Thai economy began to deteriorate. These two reasons caused speculators to believe that the value of the Thai baht was much lower than its current pegged rate. Both foreign and domestic speculators hedged the exchange rate in large volume. At the same time, the Thai government spent a total of around $39 billion in forward swaps outstanding. Thus, foreign reserves were really low. Because of low reserves, the Thai government was not able to hold the exchange rate any longer. Hence, the Prime Minister, Chavalit Yongjaiyut, decided to float the Thai currency on July 2, 1997.

2. Exchange Rates and Exports

As mentioned earlier, export growth declined due to increased competition from other countries. But the pegged exchange rate policy made the situation worse. Thai exports were a major source of growth as they amounted to 35 to 40 percent of GDP from 1991 to 1996 [NYU 2005]. The high exchange rate made Thai products more expensive. As a result, Thailand was at a disadvantage compared to its competitors such as China.

B. FINANCIAL INSTITUTIONS, BUSINESSES, AND REASONS WHY BANK RUNS OCCURRED

1. Overinvestment

How can we know an overinvestment problem existed? Numbers in Figures 7 and 8 can answer this question. The gross external debt growth rate averaged 20.55% from 1987 to 1996. Growth happened largely in short-term debt from banks and long-term private enterprises (See Figure 8). High growth in external debt occurred once in 1991, corresponding with the beginning of the economic boom, and happened again in 1993 as a result of the Bangkok International Banking Facility (BIBF) being introduced in 1992. BIBF stimulated growth in foreign currency lending [Radelet et al. 1998, 22]. Because external debt in these financial institutions increased dramatically, that meant that there was high demand for external debt from domestic investors. However, average GDP growth was only 15.53% during the same period, indicating that the external debt actually did not create value (Please note we must include a lag when comparing the two variables; the debt should increase before GDP).

Figure 7. Comparison between debt and GDP growth

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	Avg.
External debt growth	9.94%	6.79%	8.20%	19.61%	34.20%	10.82%	25.98%	24.50%	52.65%	12.79%	20.55%
nominal GDP growth	17.26%	22.03%	17.16%	18.12%	15.10%	13.46%	12.16%	15.61%	16.17%	8.22%	15.53%

Sources: [NYU 2005] These growth rates calculated from external debt and nominal GDP in US dollars.

Figure 8. External Debt Outstanding (Millions of US Dollars)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
External Debt												
General Government	5,226	5,536	5,112	3,951	4,177	4,107	4,312	4,819	4,876	5,152	6,051	6,947
Short-term	66	255	172	257	395	290	0	180	85	34	0	0
Long-term	5,160	5,281	4,940	3,694	3,782	3,817	4,312	4,639	4,791	5,118	6,051	6,947
Monetary Authorities	973	672	275	1	0	0	0	0	0	0	7,157	11,204
Long-term	973	672	275	1	0	0	0	0	0	0	7,157	11,204
Banks 7/	1,526	2,484	3,158	4,233	4,477	6,263	13,019	27,976	41,939	41,869	39,221	28,322
Short-term	1,188	2,218	2,832	3,947	4,139	5,532	10,371	21,556	33,697	28,858	24,403	17,437
Long-term	338	266	326	286	338	731	2,648	6,420	8,242	13,011	14,818	10,885
Other Sectors	12,294	12,372	14,305	21,123	29,224	33,251	34,776	32,072	54,017	61,721	56,847	58,589
Short-term	1,706	2,275	2,945	6,213	10,857	13,092	12,263	7,443	18,616	18,851	13,891	10,984
State Enterprises	0	1	0	0	310	260	0	0	0	20	20	150
Private Enterprises	1,706	2,274	2,945	6,213	10,547	12,832	12,263	7,443	18,616	18,831	13,871	10,834
Long-term	10,588	10,097	11,360	14,910	18,367	20,159	22,513	24,629	35,401	42,870	42,956	47,605
State Enterprises	7,751	7,081	6,720	7,563	8,323	,8701	9,859	10,896	11,526	11,629	10,854	13,277
Private Enterprises	2,837	3,016	4,640	7,347	10,044	11,458	12,654	13,733	23,875	31,241	32,102	34,328
Gross External Debt	20,019	21,064	22,850	29,308	37,878	43,621	52,107	64,867	100,832	108,742	109,276	105,062
		5.22%	8.48%	28.26%	29.24%	15.16%	19.45%	24.49%	55.44%	7.84%	0.49%	-3.86%
Short-term	2,960	4,748	5,949	10,417	15,391	18,914	22,634	29,179	52,398	47,743	38,294	28,421
Long-term	17,059	16,316	16,901	18,891	22,487	24,707	29,473	35,688	48,434	60,999	70,982	76,641

Source: TDRI 2007

In other words, the borrowed funds were not used solely for investment purposes or, if they were, were for bad investments.

2. Investment and Financing Decisions

Investors must make capital budgeting decision to evaluate positive net present value projects, including predicting the return on the assets. After finding positive net present value projects, investors move on to financing decisions, and look for the cheapest source of funds. When making capital budgeting decisions, investors have to take overall economic performance into consideration. Because the economy did so well during the period, it is reasonable to believe returns would be high, leading to a high number of new projects being approved. In addition, the reasons for overinvestment mentioned by Vines and Warr in Section III amplified the number of new projects. These led to an increase in needed funds. According to The Thailand Development Research Institution (TDRI), foreign and domestic investment increased dramatically (See Figure 9 and 10). Because interest rates in the US were much lower than interest rates in Thailand (See Figure 6), foreign loans were very attractive. However, investors knew there was an exchange rate risk associated with foreign loans. Therefore, they had two options. They could borrow directly from foreign banks (and thus accept the exchange rate risk), or they could borrow from a Thai financial institution at a higher rate.[1] According to Kumar and Debroy, because the government pegged the exchange rate, most financial institutions did not hedge to prevent exchange rate risk [1999, 5]. To reduce risk and because it was more convenient to borrow money from domestic financial institutions, most investors acquired funds from domestic financial institutions. Because of a good economic outlook, the poor lending practices mentioned by MacDonald, and the moral hazard problem mentioned by Krugman in Section III, financial institutions lent out money easily without adequate screening or assurance. According to Asian Economic News, "the 300 million dollar loan for the financial markets, approved in 1997, underpins [the need for] fundamental reforms for transparency and accountability in the financial sector" [1999]. While banks were controlled by the Bank of Thailand, non-bank financial institutions could make their own decisions without government supervision. Figure 11 shows that gross external debt outstanding increased gradually. In 1991, gross external debt began to rise rapidly. Financial institutions were not able to pay off their debts and the external debt outstanding began to rise.

Figure 9. Investment (millions of baht)[2]

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total Investment requested	59,688	208,949	530,826	461,503	524,751	250,498	213,023	278,745	594,592	901,384	833,818	490,828	224,595
Total Investment approval	34,610	67,748	201,842	290,294	476,610	279,456	284,336	177,456	281,651	584,684	531,198	481,292	254,864
Source: TDRI 2007													

Figure 10. Capital flows in Thailand (millions of baht)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
CAPITAL FLOWS	11,354	21,624	73,158	144,511	247,753	288,160	240,742	265,895	305,851	545,826	493,530	-161,971	-413,435
1. Direct Investment	6,880	4,712	27,883	45,869	61,624	47,110	49,980	39,810	21,935	29,422	35,597	109,737	300,162
2. Portfolio Investment (Equity Securities)	2,517	12,862	11,185	36,658	11,507	928	11,512	67,851	-10,165	56,120	28,437	122,303	14,270
3. Loans	1,957	4,051	34,089	61,984	174,622	240,122	179,250	158,234	294,081	460,284	429,496	-394,011	-727,867
Source: TDRI 2007													

Figure 11. Loans and external debt

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Total Investment-loan approval (millions of dollars)	8123.1	20986	1795	20510	9817	8386.7	11009	23642	36178	32902	1 5649.2
Gross external debt outstanding by financial institutions	13,820	14,856	17,463	25,356	33,701	39,514	47,795	60,048	95,956	103,590	96,068
Ratio	1.70	0.71	0.97	1.24	3.43	4.71	4.34	2.54	2.65	3.15	6.14
Source: TDRI (2007) and NYU (2005)											

3. What Happened After the Thai Currency Floated?

After the currency float, the Thai economy plunged down into deep recession, causing many businesses to go bankrupt. Financial institutions took the burden from both ends. First, businesses could not pay back their debts either because their businesses did not perform well in the recession, or because they were companies that should not have been lent funds in the first place. As a result, non-performing loans (NPLs) skyrocketed. For state-owned banks and financing companies, NPLs made up more than 50% of their total loans (See Figure 12). Second, external debt increased dramatically due to the devaluation of the Thai currency, which made it really hard to pay back. However, instead of letting the inefficient financial companies collapse, the government tried to protect these companies for two reasons. First, the government believed that letting the financial companies go bankrupt would send out the message that Thailand was in big trouble, making Thailand unattractive for investment and causing an even bigger recession. Second, the client-patron relationship came into play. Executive managers of the financial companies had connections to governors. Some actually supported the governors financially. The Thai government spent around $19.3 billion to prop up 91 failed financial institutions in 1996 and early 1997 [Radelet 1998, 28n].

Figure 12. NPL Outstanding–Classified by Financial Institution Group

	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
8 Private Banks	994,230	1,053,415	1,094,923	1,165,549	1,221,798	1,276,726	1,239,944
(% to Total Loans)	30.19	32.61	33.91	36.88	39.45	41.73	40.48
State Owned Banks	786,030	813,991	841,371	920,467	966,370	1,006,473	1,036,654
(% to Total Loans)	47.17	48.95	50.25	55.14	58.30	60.94	62.45
Foreign Full Branch Banks	52,258	57,436	59,829	63,142	64,775	69,475	74,244
(% to Total Loans)	5.53	6.32	6.63	7.53	8.05	9.04	9.81
Total Commercial Banks	1,832,518	1,924,842	1,996,123	2,149,158	2,252,943	2,352,674	2,350,842
(% to Total Loans)	31.04	33.17	34.39	37.92	40.53	42.94	42.90
Finance Companies	257,784	268,315	280,803	288,987	299,433	313,907	323,691
(% to Total Loans)	52.63	55.04	57.98	60.36	63.35	66.82	70.16
Total Financial Institutions	2,090,302	2,193,157	2,276,926	2,438,145	2,552,376	2,666,581	2,674,533
(% to Total Loans)	32.69	34.87	36.20	39.67	42.32	44.82	45.02
Source: TDRI 2007							

Because the government used reserves to peg the exchange rate and to support these financial institutions, Thailand's debt to reserves ratio was 1.453 [Radelet 1998, 15]. The low amount of reserves led to another problem. After the investors and lenders realized that the Thai government actually did not have the ability to insure all the short-term debt, panic took place. Foreign investors rushed money out of the country, creating a rapid capital flight. At the same time, lenders tried to collect payments from these financial companies. Eventually, the government could not support these institutions any longer. In December 1997, 56 financial institutions went bankrupt [Siamwalla 2001,21].

C. GOVERNMENT

There are two different points of view regarding government controls, corruption, and macroeconomic mismanagement. While most researchers believe that this was one of the main causes of the crisis, Joseph Stiglitz, a Senior Vice President and Chief Economist at the World Bank, expressed the opposite view. First, he claimed that economic growth had been created by these so call "corrupted governments" in the past decade. Second, macroeconomic policy in Thailand was not poor. Thailand's government surplus represented 2% of GDP in 1995, while the federal surplus in the US made up less than 1% of GDP. The inflation rate was lower in Thailand as well. Third, he thought, "claims about transparency are just a form of blame shifting" [Stiglitz 1998, 1]. He said the lack of transparency was known long before the crisis. He believed that Thailand ranked about average and was considered above average among developing countries [Stiglitz 1998, 1].

However, I strongly believe the Thai government was responsible for the crisis from the beginning. Corruption was a real barrier to economic success. As Robert Lees[3] suggested:

> When the outcomes of business transactions are being determined by bribery, influence-peddling and favoritism, rather than by sound business decisions and market forces, the entire economy pays a price.
>
> Corruption exacts a heavy penalty on every segment of society — laborer and business owner, public official and private citizen. It acts very much like a tax on public projects, adding, according to some estimates, as much as 30 percent to the cost.

> The Asian Development Bank has calculated that corruption can cost governments as much as 50 percent of their tax revenues and can amount to more than a country's total foreign debt. [1998, para. 4-6]

In this section, I present the idea that the Thai government created a too politicized business environment, inefficient macroeconomic and monetary policies, corruption and inefficient laws.

1. Overview and Perception of the Thai Government

Transparency International ranks countries by using the Corruption Perception Index (CPI). The index represented opinions from various business people, especially from those who engage in multinational business. The index is from 1 to 10, with 10 representing a clean country. Thailand's CPI ranking was 1.85 from 1988 to 1992 and increased to 3.33 from 1993 to 1996 [Lambdorff 1996]. Many people believe the difference can be credited in large part to Prime Minister Anand Panyarachun, widely regarded as one of Thailand's cleanest Prime Ministers. He was appointed Prime Minister after a military coup in 1991.[4] He promoted "a more transparent and accountable system of governance in Thailand" [United Nations, para. 16]. However, the country's CPI ranking of 3.33 still put Thailand near the bottom of the list. The CPI ranking showed that business people believed the Thai government was still very corrupt.

As Stiglitz claimed, corruption in Thailand was prevalent before the crisis, but the Thai economy was still growing. Therefore, corruption must not have contributed to the crisis. Occasional corruption probably did not hurt Thailand all that much. During the economic boom, there was enough money to go around. However, when corruption evolved into a collective long-term problem, it may have hurt the country. In 1996, economic growth started to slow down. The total budget available was getting smaller, while the money going out of the door was still the same. The imbalance definitely could have caused problems. Moreover, instead of focusing on solving recessions, politicians were more interested in helping their own businesses or the businesses of friends. Politicians were using money or manipulating policies to protect their businesses instead of protecting the interests of the country. All in all, corruption may have easily turned from normal activities to a main cause of the crisis. [5]

Stiglitz also claimed Thailand's corruption was about average, referencing their rank in the CPI index in 1995. However, most of the countries ranked below Thailand (India, the Philippines, Brazil, Venezuela, Pakistan, China, and Indonesia) underwent a deep recession in the 1990's. The theory of high corruption leading Thailand into recession could be legitimate.

Furthermore, from 1991 to 1997, two out of three prime ministers resigned due to outrageous corruption in the cabinet. Though this corruption was widely known to the Thai people, most of the politicians easily evaded prosecution.

2. Corruption and Bad Policies

First, due to a highly politicized environment, the government had some control over the Bank of Thailand and its decisions. Before 1997, there were crises around the world, such as in Mexico and Argentina (1994-1995) which were caused by pegged exchange rates. Should the examples of Mexico and Argentina have signaled the Thai government to stop pegging the exchange rate? Decisions regarding the exchange rate in Thailand were made by the Prime Minister, the Ministry of Finance, and the President of the Bank of Thailand. However, there were many governors with supporters who owned businesses in Thailand. Letting the baht float would have cost them tremendously. Floating the currency was not a popular policy, which meant it could affect the next election.

Second, as previously discussed, the client-patron relationship helped prop-up troubled financial institutions. There was an investigation regarding this, but there was not enough solid evidence to take governors or officials to trial. Even if no corruption was involved, propping up bad financial institutions was a sign of bad policy. The government was afraid that if one financial institution failed, panic might occur. Instead, the government tried to cover up the truth. Eventually, the naïve policy led to a series of bank runs.

Politicians made a profit from every financial decision that was made. Allowing the baht to float may have created a profit of more than one billion bahts for Deputy Prime Minister, Thaksin Shinawatra. According to unsettled civil case 3269/47, Rerngchai Malaganon, the President of the Bank of Thailand at the time, testified that PM Chavalit Yongjaiyut let Pokin Polakul, Minister of the Prime Minister's office, illegally remained present at the exchange rate meeting.[6]

3. Inefficient Laws

Thailand has a law regarding basic corruption cases. For instance, Section 13 of the Corruption Act states that the Commission of Counter Corruption (CCC), founded in 1974, can order "any governmental office, state agency or state enterprise be required to instruct any state official attached there to, who has been suspected of corruption, to declare his assets and liabilities in accordance with such particulars, procedure and within such time as the Council thinks fit [Damrongchai, 1-2]." However, many politicians transferred corrupt money to others' accounts. As a result, it was hard to prove which politicians were corrupt.

The worst part of constitutional law is in the area of business. Most of the cases were examined using criminal law. Thailand does not have any specific law regarding corporate governance, and it is impossible to have everything written down Thai law seems to play catch up with creative unethical behaviors of business people in order to create more profits. This makes it really hard to prevent unethical business activities. Moreover, most judges in Thailand lack understanding of business practice.[7] Those who are knowledgeable in business law are usually hired by businesses to help find loopholes in the law in order to get away with unethical practices. Moreover, according to Simon et al., corporate governance problems such as looting of firms by controlling shareholders, the transferring out of assets to avoid paying creditors, and the propping up using loan guarantees by other listed group members, were part of the Asian Crisis. Statue law did not prevent these activities as well as common law, and countries whose legal system prevented such activities faced milder crises in 1997 [2000, 22].

All in all, inefficient laws cost Thailand tremendously. Politicians could easily get away with corruption and business people operated their businesses the way they wanted. Both led to problems such as inefficient markets, overinvestment, and money laundering, all of which contributed to the crisis in 1997.

V. Changes After the Crisis

A. EXCHANGE RATE POLICY

The floatation of the Thai currency on July 2nd, 1997 was not only the starting point of the Asian crisis, but also eventually led to more efficient markets in Thailand. First, it helped correct the prices of export goods, which helped the real value of exports increase by 21% in 1997 in comparison to a 5% decrease the year before[8] [TDRI 2007]. Second, it supported businesses in Thailand. When the currency was pegged, products from abroad were cheaper than what they were supposed to be, so Thai people bought more foreign products. After the floatation, products manufactured in Thailand were cheaper in comparison to foreign products. Consequently, Thai people bought more domestic products, which helped support Thai businesses and decrease the trade deficit.

Moreover, the Thai government could use the budget in a way that benefitted Thailand more. As mentioned before, Thailand used a total of $39 billion from late 1996 to early 1997 to peg the exchange rate. If the currency had floated, it not only would have helped increase the credibility of the financial system, but the money could have been used to help the Thai economy through investments, improved infrastructure, and research and development.

B. LEGAL REFORM

There were two significant changes in the law. First, Thailand implemented a new constitution on October 11th, 1997, known as the "people's constitution". The gist of the constitution was to reduce the power of politicians and shift power to the Thai people, which represented a new level of democracy in Thailand. With the new constitution, 200 senators and 500 members of the House of Representatives were elected. Voting became mandatory for Thai citizens [Punyaratabandhu 1998]. One more interesting change can be found in chapter 10 of the Thai constitution. This chapter concerns government officials. The chapter has four sections:

(1) Declaration of Accounts showing Particulars of Assets and Liabilities: This section requires high level government and political officials to present their net assets to the National Counter Corruption Commission whenever taking or vacating an office.

(2) The National Counter Corruption Commission: This section states the responsibilities and defines membership of the National Counter Corruption Commission.

(3) Removal from Office: This section elaborates procedures of

investigation and removal of both politicians and high level government officials in the case of corruption and malfeasance in office.

(4) Criminal Proceedings Against Persons Holding Political Positions: This section includes procedures and the responsibilities of the Supreme Court of Justice's Criminal Division for Persons Holding Political Positions, which holds trials for political officials who are accused of corruption or malfeasance. [Thai Constitution 1997, Chapter 10 Section 291 to 311]

There were also three new courts and commissions founded by the new constitution: the Constitution Court, the National Human Rights Commission, and the office of the Ombudsman [Punyaratabandhu 1998]. All in all, the new constitution put an emphasis on preventing corruption from all officers in various shapes and forms. The constitution gave more freedom to the media to do its job in hopes the media would help monitor activities in the Thai government [Friedman 1999, para. 6].

A second major legal reform occurred in Thailand. Major changes in bankruptcy and foreclosure laws helped to promote efficiency. This led to the establishment of a Central Bankruptcy Court, the introduction of a rehabilitative procedure, and the change in foreclosure procedures in order to prevent delay [Siamwalla 2001, 36].[10]

C. THE BANK OF THAILAND

The Bank of Thailand founded the Corporate Debt Restructuring Advisory Committee (CDRAC) in June 1998. "Corporate Debt Restructuring aims to support continuing economic recovery by enabling viable debtors to continue business operations and promoting fair and equitable debt repayment to creditors" [BOT 2000]. CDRAC helped debtors restructure their debts and acted like an arbitrator between debtors and creditors during negotiations. Not only did restructuring help save many businesses from failure, but the CDRAC also coordinated with the Revenue Department and the Land Department to help creditors receive tax deductions to compensate them from losses that might have occurred from debt restructuring. CDRAC helped a total of 702 companies with total credit outstanding of 1.5 trillion bahts [BOT 2000].

One big improvement in the Bank of Thailand, which actually came from an IMF program, was an increase in transparency in releasing key data [Sussangkarn 1999, 9]. The increase in transparency helped investors act more reasonably to current economic situations.

D. GOVERNMENT ACTIONS

After the resignation of PM Chavalit Yongjaiyut, Chuan Leekpai was elected Prime Minister of Thailand in Nov 1997. The PM and the Minister of Finance, Tarrin Nimmanhaemmind, believed the quality of the balance sheets for both financial institutions and corporations were parts of the problems. Cleaning up the balance sheets became part of his policies, leading to reform in the accounting profession. The Thai General Accepted Accounting Practice Standards (GAAP) was founded to prevent bad accounting practices in businesses [Siamwalla 2001, 37].

After Chuan was defeated in the election of Jan 2001, Thaksin Shinawatra became Prime Minister. Thaksin took a different approach to solve NPL problems. He formed the Thai Asset Management Corporation (TAMC). Thaksin noticed old regulations followed in Chuan's government were not fast enough given the amount of debts banks had. TAMC's policy was to maximize value of the assets, minimize the state's and taxpayers' loss, and help revive high-NPL companies. TAMC took over all NPL portfolios for both state and private banks, restructured all the debts, and paid back debtors in the form of non-transferable, ten-year, FIDF-guaranteed (Financial Institutions Development Fund) bonds [Siamwalla 2001, 39-40], [TAMC].

VI. Has Thailand Learned from the Asian Crisis?

Thailand has made various attempts to recover from the crisis, create long-term economic growth, and prevent future crises. However, there are many problems that have not been solved. Additionally, the government could have done many things to enhance the Thai economy. In this Section, current situations are used to illustrate Thailand's problems. Then, suggestions of what Thailand could have done differently to achieve its goals are included.

A. CURRENT PROBLEMS

Since the crisis, Thailand has seen four prime ministers and one military coup. Political instability made it hard for Thailand to move forward.

Corruption and policy inconsistency among the various governments had negative effects on the Thai economy. Corruption also led to political pressures in policies created by the Bank of Thailand, which does not have full independence to make decisions. In the following paragraphs, various problems with each government since 1997 are demonstrated, including direct corruption, indirect corruption, political instability, and problematic policies.

There were corruption scandals in each of the Thai administrations. During PM Chuan Leekpai's tenure (1997 - 2001), most forms of corruption occurred directly in the form of bribery. Two of his cabinet members, Rakkiat Sukthana and Sanan Kajornprasart, were accused of corruption.[11] These two cases illustrate some of the success the new constitution of 1997 has had on corruption.

During PM Thaksin Shinawatra's reign, corruption was more indirect. PM Thaksin is a businessman and is considered one of the richest people in the country.[12] According to the study by Phasuk Pongphaichit, a lecturer at Chulalongkorn University (the most well known university in Thailand), both the Prime Minister and his cabinet members indirectly incorporated corruption through policies that supported their businesses by granting business privileges, reducing taxes and concession fees, and getting rid of business rivals. Phasuk mentioned 13 different cases showing corrupt policies that helped Thaksin's own businesses. Moreover, Phasuk mentioned more than 20 cases related to businesses owned by his cabinet members [The Nation 2006].[13] Though many of these cases were known by the Thai people, only one of the thirteen cases related to Thaksin's businesses reached the Supreme Court.[14] As a result, questions have been raised asking why the National Counter Corruption Commission, which has the responsibility to monitor corruption, did not investigate these cases and send them through the judicial process. To summarize, from 2001 to 2006, the Prime Minister and his cabinet members enjoyed great benefits from corruption by manipulating economic policies to favor their businesses at the expense of other businesses in the same industries and the country as a whole.

Individual leaders have their own thoughts and ideas. Therefore, it is normal to expect policies to differ from administration to administration. However, within an 11 year period, Thailand has changed government administrations four times. The largest policy change occurred between the Thaksin Shinawatra and Surayud Chulanont administrations. Surayud, who was the PM after the coup, had a more conservative administration than Thaksin. Therefore, many policies created during Thaksin's government were reversed. For example, in Surayud's regime, foreign investors were required to deposit 30% of all money invested in Thailand with the Bank of Thailand in no interest accounts. This restricted foreign ownership policy reflected the belief that businesses in specific industries should be controlled by Thai owners[15] [Lopez 2007]. As a result, political and policy instability caused investors to perceive Thailand as a risky market, which may have caused a decrease in long term investment.

The current Prime Minister, Samak Sundaravej, was sworn into the office on 7 February 2008. Samak is the Prime Minister only in name while Thaksin is the power behind him. Samak has already started to reverse some policies created by the prior administration. On 3 March 2008, he reduced the 30% required reserves from foreign investors to 0% [The Government Public Relations Department 2008]. On 10 February 2008, the Minister of Commerce, Mingkwan Sangsuwan, introduced the first popular policy to reduce the prices of 33 "necessary" products, including cars and cell phone service [Thairath 2008]. To reduce prices, the government will either force businesses to reduce the price or intervene in the market with government subsidies. Subsidies cause market distortions and may create a higher government deficit. Dr. Surapong Suebwonglee, M.D., was chosen to be the new Minister of Finance. It is hard to say how good he will be in this position. While certainly educated, Dr Surapong has little or no experience in macroeconomics, and there are a lot of alternate experts with macroeconomic experience. These experts would be reluctant to take the job because of the Thai law. The law says that a minister shall not engage in any private businesses that are under the control of the minister. This will remain in effect until 2 years after one is out of the position[16] [Thai Government Gazette 2001, 147-148]. As a result, no one who is knowledgeable in this field wants to hold the position.

While there have been various attempts to prevent corruption, there is still significant corruption in Thailand. Policies have been made that are beneficial to a group of people instead of to the country as a whole. Moreover, a lack of stability in policies and politics has exacerbated the problems. This instability may also be decreasing confidence among investors wishing to invest their money in Thailand. If the problems are not solved, it will not be a surprise if the crisis happens again in Thailand.

B. SUGGESTIONS FOR CHANGE

Thailand has been trying to respond to problems rather than trying to prevent future crises. Both the Corporate Debt Restructuring Advisory Committee (CDRAC) and the Thai Asset Management Corporation (TAMC) are examples of the problem. Ten years after the crisis, CDRAC and TAMC still help bad businesses and financial institutions clean up their mess. It is time for the government to let go of these companies and let them face the consequences associated with bad judgment. This will encourage businesses to be more cautious and make better decisions, which should help decrease the number of poor investments.

In terms of government, Thailand should be the first priority of politicians, not their own businesses or reputations. Policies that are created to win popularity for a particular party have to stop, and the government should put more emphasis on macroeconomics. It is impossible to get rid of all corruption; however, it should be minimized, especially in obvious cases. Thai politicians can too easily avoid taking responsibility for their actions. Thai law has improved, and it should be used more effectively to counteract unethical actions. Moreover, the law should not discourage qualified individuals from accepting positions.

It would be best if Thailand could separate macroeconomic policies from politics. The Thai government currently has too much control over the central bank. For instance, the Minister of Finance can make changes in policies created by the Bank of Thailand, and he can hire or fire the president of the Bank of Thailand. Independence will not only create consistency, but it will also create policies that appeal to the interest of the Thai people, and not the interests of select groups. According to Barro, "studies of the major developed countries show that a less independent central bank tends to deliver higher and more variable inflation" [Barro 1996, 56]. While a less independent central bank tends to inflate the economy during a recession due to political pressure, an independent central bank commits to price stability and keeps inflation under control. High inflation may lead to better economic performance during a recession, but it can be very dangerous to the economy in the long run. Hence, "a move to a more independent central bank appears to be all gain and no pain" [Barro 1996, 57]. Independence for the Bank of Thailand to make decisions in terms of monetary and macroeconomic policies will be very beneficial to the Thai economy in the long run. It will help create stability in the Thai economy. Moreover, individuals who work for the central bank have to commit to price stability and control inflation. Without these individuals, independence given to the central bank will be less meaningful [Barro 1996, 58].

VII. Conclusion

The paper started by introducing the economic situation in Thailand before and after the crisis. Then, causes were discussed. Studies done by various researchers were used to guide my analysis. In my analysis, I conclude that the three main components of the Asian crisis were exchange rate policy, mismanaged financial institutions, and the government. After the crisis, the Thai government spent lots of time cleaning up the mess that caused the crises. There were legal reforms and new government organizations created in order to help solve the problems and prevent them from reoccurring in the future. Some of the changes, such as increasing transparency in releasing key data from the Bank of Thailand, were very helpful to the Thai economy. However, many of them were neither successful nor effective enough to solve a problem as big as corruption. The ineffectiveness of the reform is evident, as corruption remains a major problem in Thailand today. Many policies served temporary purposes and merely postponed the real problems for future administrations to solve. In a sense, Thailand is back to where it is started.

All in all, Thailand seems to move around in a circle it can never break out of. In order for Thailand to experience long run economic growth, it is necessary to encourage better corporate governance in financial institutions and businesses, reduce corruption, enhance macroeconomic policies, and give independence to the Bank of Thailand. If all these goals are reached, Thailand can be an economic leader in Asia.

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Endnotes

1. Note that many non-bank financial institutions lent at a lower rate than the normal interest rate in Thailand because they borrowed money from abroad and competed with other companies in order to be the top financial institutions.
2. Low investment in 1991 was due to political instability.
3. Robert Lees is a secretary-general of the Pacific Basin Economic Council, an association of senior business leaders representing more than 1,100 companies in 20 nations.
4. From 1980 to 1991, all the Prime Ministers were from the military. There were many military coups during that period. Thailand was nominally a democracy, but military coups showed the weaknesses of Thai democracy.
5. During the early 1990s, economic growth was largely in industrial and service sectors, which mainly include high and middle income people. At the same time, income inequality in the agricultural sector, with 51% of the total labor force, increased [Motonishi 2003, 2]. Thus, economic growth does not always bring good

fortune to everybody. Without corruption, more money is available to spend for the poor during the high growth period (It can be in terms of better infrastructure or creating more opportunity for the poor to get education and proper health care). When corruption occurred either directly or through policy, it mainly hurts poor people the most. It transfers money that can be used to help the majority of people to a specific group of people. Thus, it worsens income inequality, which can have a negative effect on Thailand in the long run.

6. Pokin Polakun also held the position from 2001 to 2006 when Thaksin Shinawatra was the Prime Minister.
7. In Thailand, law school can be attended by undergraduates, so most judges have no background in business, which makes it hard to understand malpractice in business world.
8. Using 1986 as a base year for calculation, 21% was the highest growth since 1990.
9. In the past, 270 senators were appointed. The new constitution also increased the number in the House of Representatives from 360 to 500, 400 of which were elected as district representatives and 100 of which were from party lists.
10. Before the reform, the law favored corporate debtors. A plaintiff had to prove that the company ha a negative balance before the court can declare bankruptcy. Many companies can easily get away without paying back loans on time. However, declaring bankruptcy as a person was more threatening since creditors could claim the debtor's belongings. The biggest drawback of the old law was the speed of the procedure. For example, a foreclosure procure could take three to five years. [Siamwala 2001, 36]
11. Rakkiat Sukthana, the Health Minister, was accused of accepting bribes from a pharmaceutical firm and letting the firm win a bid arranged by the Health Ministry. He ended up serving time in jail and some of his assets were confiscated. Also, Sanan Kajornprasart, the Interior Minister, was found guilty of failing to declare all of his assets. He was barred by the Constitution Court from politics for 5 years; however, no further investigation was conducted to find out why the assets were hidden.
12. Statistically, Thaksin was not ranked the richest. However, before he became the PM, he transferred most of his assets to his children, his wife, his relatives, and even servants at his house holding Shin Corp stocks, Thaksin's company. According to a Money & Banking Magazine survey, one of his daughters, who was still in school, was the richest person in Thailand in 2004 and 2005 with assets of 19 billion bahts. His brother-in-law took second place, and his son took fourth place. Not to mention that there were more relatives who were on the list [The Nation 2005]. Moreover, his cabinet members' families also ranked among the richest families in Thailand, which include the Mahakijsiri family, the Jungrungreangkit family, the Maleenon family, the Chearavanon familiy, and the Asavabhokin family [The Nation 2006].
13. One example of these cases mentioned by Phasuk was "the exemption of Shin Satellite (Thaksin's business) from paying taxes on its revenue worth Bt16.349 billion generated from its foreign customers of its IP Star satellite was unjustifiable. This is because the exemption did not lead to any investment in Thailand and Thai people did not receive any benefit. Only the foreign customers and share holders of Shin Satellite received the benefits" [The Nation 2006]. The other popular case was selling 49.6% shares (He changed the policy that foreign investors can own less than 50% instead of less than 35%) of Shin Corp to Temasek, a Singaporean state-owned

company, at $1.9 billion without having to pay tax. This could also affect national secuirty since Shin Corp is a telecommunication company. However, this deal was not successful because a riot broke out, and Temasek eventually decided to sell those shares back to Thaksin [Straits Times 2006].

14. These cases are judged in the Criminal Division for Persons Holding Political Positions of the Supreme Court.
15. This was likely created because of the Shin Corp and Temasek scandals referenced in footnote 13.
16. This law is stated in the Thai Government Gazette by the National Counter Corruption Commission.