CHAPTER – IV

THAILAND

Background :

This chapter examines the experiences of Thailand with the structural adjustment programme, its prevailing economic conditions prior to the programme and its performance on some major macroeconomic indicators after the programme. Thailand is one of the four countries that constitute the South East Asian region. Before 1965, its economic development was not very impressive and it was primarily an agricultural country. Between 1965 and 1980, it could grow at a faster rate of above 6% and followed the import substitution policy for some time which was followed by the export oriented foreign trade policy. In 1980, its agricultural sector contributed 23% of GDP that came down to 15% in 1989 – that is within four years of adopting and implementing the structural adjustment programme. While the share of its manufacturing sector was 21% in the GDP the went upto 25% in 1989, there was a dramatic increase in the share of the manufacturing sector's contribution to its exports – from 49% in 1985 to 74% in 1989.

Thailand's balance of payments situation deteriorated sharply after the second price rise in 1979 and it approached the IMF and the World Bank for the financial assistance. The implementation of the structural adjustment programme between 1981 to 1985 brought about significant improvement and by 1990, Thailand had emerged as an important industrial economy in the region. While Thailand made considerable economic progress between 1991 to 1997, with all its macroeconomic parameters showing healthy positions, its high and unsustainable level of balance of payments position and increasing proportion of short term private capital inflow, with its system of pegged foreign exchange rate were responsible for the unprecedented financial and currency crisis in early July 1997. Its GDP growth rate and all relevant macroeconomic indicators became extremely weak. It was five years in 2002 that Thailand could recover the lost ground.

In Thailand, the period of heavy import substitution alternated with period of open economy. What is significant in case of Thailand is that even when it followed a policy of import substitution, export promotion also remained quite high on policy agenda. In the late 1970s, the government followed a policy of promoting heavy industries in the public sector including a major petro-chemical complex that was based on domestic oil and gas resources. From the 1980s, especially after the Plaza accord, inflow of Japanese capital has been a major factor in promoting rapid industrial growth in Thailand.

The first adjustment loan, a two year standby loan from the IMF was taken in 1981, which was also accompanied by loans under compensatory and contingency financial facility. This was followed by another bigger standby. The World Bank gave a loan covering the period 1982-1984. Thailand needed financial assistance from the Fund and the Bank to tide over balance of payments deficits arising out of the second oil price rise of 1979. Apart from creating large deficit in the balance of payments, the oil price increase adversely affected Thailand's economy by raising inflation, external debt as well as debt service ratio. Another important factor that contributed to Thailand's economic crisis was the sharp reduction in the military expenditure in this area by the USA as a result of the end of the Vietnam War in 1975. The loans given by the IMF and the World Bank, beginning from 1981 marked the adoption of the economic stabilization and structural adjustment programme by Thailand.

In addition to the financial assistance that Thailand received from the IMF and the World Bank, on account of number of favourable factors, it emerged as one of the fastest growing economies of the World during 1986-1990. During these years, the rate of growth of real GDP and of the exports were 10% and 20% respectively per year. As a result of this rapid economic growth, its per capital income almost doubled from \$ 786 in 1986 to \$ 1413 in 1990. Thailand had experienced rapid increase in the rate of growth of GDP and exports also during 1965-1980, when real GDP expanded at the rate of 7.3% per year and the exports increased at the rate of 8% per year. However, it is interesting to appreciate distinct features of growth experience of Thailand during 1986-90 which distinguishes it from its growth experience between 1965-80. In the earlier phase, it was the rapid development of the agricultural sector that contributed to the rapid economic development of Thailand. Its agricultural sector could attain high rate of growth in response to the big increase in the world demand for rice, sugar cane and cassava. Expansion of agriculture was made possible by the opening up of land frontiers. While there was substantial growth of industrial sector during this period, the industries that expanded very rapidly were those which integrated with the agricultural sector of the economy such as food processing, beverages and tobacco. Moreover, the industrial growth was mostly import substituting due to the trade policy that Thailand followed during this period – namely high import duties with the objective of protecting and promoting indigenous industries.

The economic growth that took place in Thailand during 1986-90 – the post structural reform period – was qualitatively different from that which took place during the earlier phase in the following two respects.

(a) A rapid increase in the size of the manufacturing sector.

(b) A clear shift from producing for the domestic market to producing for the world market.

This can be seen from the following table :

Table – IV.1 : Composition of GDP and Exports of Thailand[1]

Sector	Distribution of Nominal GDP (%)		Distribution of Exports (%)	
	1980	1989	1985	1989
Agriculture	23	15	38	18
Manufacturing	21	25	49	74
Other	56	60	12	08
All	100	100	100	100

Source : National Economic and Social Development Board, 1990.

As can be seen from the table, Thailand experienced a significant shift in the GDP during the decade of 1980s. The share of the agricultural sector came down to 15% in 1989 from 23% in 1980, while the share of the

[1] Sen Kunal, "Thailand : Stabilisation with Growth" in Agrawal Pradip et al (ed) Economic Restructuring in East Asia and India, 1996 – P. 135.

industrial sector increased from 21% to 25% during the same decade. In a way, this was a remarkable transformation of the economy within a short period of ten years. The change in the structure of exports within a short period of five years 1985-89 was equally striking. The share of the agricultural commodities in the exports fell sharply from 38% in 1985 to 18% in 1989, while that of the manufacturing goods increased from 49% to 74% during this period of five years. These changes in the sectoral distribution of nominal GDP as well as those in the distribution of exports were accompanied by far more basic changes in the sectoral and the aggregate growth rates in Thailand during 1970-1988. The requisite information is presented in the following table :

Table – IV.2 : Sectoral and Aggregate Growth Rates in Thailand 1970-1988[2]

Sectors	1970-80	1980-86	1986-88
Agriculture	4.2	3.7	1.9
Mining	6.0	4.9	7.9
Manufacturing	9.7	4.1	13.7
Other	7.1	6.4	8.7
GNP	6.9	5.3	8.5

GNP in Thailand increased at the rate of 6.9% and 5.3% during 1970-80 and 1980-86 respectively. In contrast to this, the economy recorded a much higher rate of GNP growth during 1986-88. The contribution of the agricultural sector in the country's GNP growth progressively went on falling from 4.2% per year during 1970-80 to 3.7% in 1980-86 to 1.9% per year during 1986-88. This was more than compensated by far more

[2] Sen Kunal, ibid, P. 136.

impressive growth rate in two sectors namely mining and manufacturing. The mining sector expanded at the rate of 6% per year during 1970-80. This growth rate increased by 25% during 1986-88 when it expanded by 7.9% per year. Similarly while the manufacturing sector's contribution of the economy's GNP increased by 9.7% per year during 1970-80, it increased by 13.7% during 1986-88 marking an increase of 40%. In contrast to two periods – 1970-80 and 1986-88, the intervening phase of 1980-86 is marked by slower growth rates of the constituent sub sectors. The economy could bounce back to higher growth rate after 1986-88.

As the growth momentum in Thailand slowed down during 1980-85 under the adverse impact of the oil price rise in 1979 and negative growth rate in the world trade in 1982 – the year in which even the US growth rate became negative for the first time in the post second world war period, the growth rate of exports of manufacturing sector slowed down to 9.9% per year. The economy, however, recovered from this situation and registered a growth rate of 30.2% during 1985-88 – an increase of 200%. There was a spectacular increase in the growth rate of exports of two sub-groups – leather articles and electricity machinery, for which growth rate in exports was 44.5% and 38.5% per year respectively during this period.

Thailand's export led growth during the second half of 1980s was certainly quite impressive especially when we compare it with the difficult years of the first half of 1980s through which the economy passed. The economy was adversely hit not only by the impact of high crude oil prices, but was also affected by the decline in the terms of trade by 22% during this period. Its deficit in the current account of the balance of payments had risen to dangerous level – 6% of its GDP, which was higher than in any year of its recent history. Real GNP increased on an average by 5.3% during 1980-86 and the growth rate of the manufacturing sector was just 4.1% on an average per year, which was less than half of the 10% growth rate of the manufacturing sector during the preceding ten year period.

In view of all these adverse factors, it became clear by the middle of 1980s that Thailand's agricultural sector could not become the leading sector of the economy. This was all the more so as all available cultivable land was brought under cultivation and the land per farm worker had began to decline.

The series of reforms in the macroeconomic policy which were initiated in mid 1980s created a favourable environment for the rapid growth of Thailand's external trade sector. Again the policies to promote export and investment which the government had started in the 1970s began to show its favourable impact on the economy by 1980s.

The remarkable turnaround of the economy of Thailand in the second half of the 1980s could be achieved by a combination of policy mix such as the fiscal policy, the monetary policy, trade policy, foreign exchange rate policy etc. which were adopted by the government due to its acceptance and implementation of stabilization and structural adjustment programme.

Fiscal Policy :

The Thai economy could bring down the high and unsustainable rate of inflation to the moderate rate because of the important changes in the fiscal policy. In 1980 and 1981, the rate of inflation in Thailand was 19.7% and 12.7% respectively and by 1985, it has gone below 1% to go up in the later years in a moderate manner. The rate of inflation was 6% by 1990, approximately one third of what it was in 1980. The rate of inflation could be controlled and brought down due to the adoption of fiscal policy under which the government revenue increased faster than government expenditure, reducing budgeting deficits and generating surplus during the last three years of the decade of 1980s. The requisite information is given in the following table:

Table – IV.3 : Government Finance Performance 1985-90[3]

(Percent of GDP)

Fiscal Measure	1985	1986	1987	1988	1989	1990
Government Revenue	15.84	15.51	16.15	17.13	18.33	20.08
Government Expenditure	19.72	18.63	16.85	14.74	14.68	14.86
Fiscal Deficit	-3.8	-3.1	-0.7	+2.4	+3.7	+5.2

While the Government revenue as a percentage of GDP increased from 15.84% in 1985 to 20.08% in 1990 – a percentage increase of about 5% in a short period of six years, the government expenditure as a percentage of GDP declined during the same period from 19.72% to 14.86% - a percentage decrease of about 5%. The fiscal deficit which was -3.8% in 1985 came down to -0.7% in 1987 and then for the next three years, was

[3] Sen Kunal, ibid.

converted into a fiscal surplus. The government used the fiscal surplus to repay its debt, both domestic and external. However, the reduction in Government expenditure was accompanied by decrease in public investment. The public investment as a percentage of GDP came down from 9.06% in 1985 to 5.18% in 1989. This decline in public investment due to the fiscal policy did not adversely affect the overall investment in the economy due to increase in the private investment. There was a steep increase in the aggregate investment since 1987 when investment to GDP ratio was 23.9% and sharply increased to 31.5% and then 36.8% during 1989 and 1990 respectively. The sharp increase in the investment rate in the economy was made possible by an equally sharp increase in the rate of saving which was 23.7% in 1987 and increased to 30.2% and 30.4% during 1989 and 1990 respectively. By 1990, Thailand could emerge as an economy that could attain rate of saving and rate of investment which was among the highest in the world. Apart from the increasing rate of saving during the 1980s, the flow of foreign capital in different forms also contributed to high rate of investment.

Balance of Payments and Foreign Trade Policy :

During the period 1985 to 1990, Thailand had a deficit in the balance of trade as well as on its current account on account of the 10% depreciation of the currency in real terms from 1985 to 1988 and again there was a 50% increase in exports during 1988 to 1990. However, the imports increased at a faster rate, causing trade deficit during all the years 1985 to 1990, except for the year 1986 when there was a small trade surplus of $ 388 million. The following table provides detailed information on Thailand's balance of payments during 1985 to 1990.

Table – IV.4 : Balance of Payments, Thailand 1985-90

($ Million)[4]

	1985	1986	1987	1988	1989	1990
Merchandise Exports	7059	8803	11595	15781	19834	22811
Merchandise Imports	-8391	-8415	-12019	-17856	-22750	-29539
Trade Balance	-1332	388	-424	-2074	-2916	-6728
Exports of Services	2041	2302	3070	4647	5457	6611
Imports of Services	-1769	-1804	-2342	-3481	-4377	-6089
Net Inflow of IPD	-642	-864	-894	-982	-908	-1053
Net transfers	165	225	225	236	246	207
Balance of Current A/c	-1537	247	-365	-1655	-2498	-7053
Direct Investment	162	261	182	1081	1727	2236
Portfolio Investment	895	-29	346	530	1486	-31
Other Capital	481	-363	534	2228	3408	6964
Balance of Capital A/c	1538	-131	1062	3839	6621	9169
Errors and Omissions	-105	-714	-945	-2596	-5029	-3235

IPD refers to interest, profits and dividend.

An important ingredient of Thailand's macroeconomic policy was the management of its foreign exchange rate. In November 1984, the government devalued its currency Baht by 15%. Since then, its value was fixed to a basket of currencies and it went on depreciating against the currencies of major trading countries. From 1985 to 1988 the rate of depreciation was about 10% per year. It is widely believed that the 1984 devaluation and its depreciation in next three to four years encouraged its exports significantly during 1988 to 1990. In spite of the increase in exports,

[4] IMF, International Financial Statistics.

Thailand had negative trade balance almost for all years during 1985 to 1990 except for the year 1986, when it had a small trade surplus. The surplus in the services account could, to a certain extent, counter balance the negative trade balance. The current account deficit was financed by direct foreign investment, portfolio investment and more importantly by the external borrowing by the private corporations from the world capital markets. While direct foreign investment was small during 1985 to 1987, it increased in a big way from about $1 billion in 1988 to $ 2.2 billion in 1990. The portfolio investment in the stock market of Thailand was fluctuating and was negative during 1986 and again in 1990. It was the borrowing by the private sector corporations of Japan indicated by the term 'other capital', which was around half a billion Dollars per year during 1985 and 1987, increased dramatically to $ 2.2 billion, $ 3.4 billion, and $ 6.9 billion during 1988, 1989 and 1990 respectively that helped Thailand to bridge its growing current account deficits. Thailand had opened its private industrial sector and its stock market to the inflow of foreign capital from the beginning of 1980s and its private sector firms were in a position to resort to external commercial borrowing from the leading international capital markets. Thus, while it needed financial assistance in early 1980s to meet the balance of payments deficits arising out of steep oil price rise in 1979, it began to receive non debt creating capital inflow in the form of direct foreign investment and portfolio investment of which the former was on a substantial scale during the three years period 1988 to 1990.

The overall thrust of Thailand's foreign trade policy was to rely on import substitution. At the same time, its use of quotas to restrict imports was rather insignificant. In 1989, only 75 import items were subjected to non tariff restrictions and of these, agricultural commodities were by far more important to be protected. Thailand made use of import duties largely to protect its domestic industry. "The tariff structure discriminated considerably between different types of goods and between those that are generally exported and those meant for the domestic market. The highest nominal protection was provided to consumer goods, with the highest in this category being for non-durables. The next highest nominal protection was given to intermediates for consumer goods and to capital goods. The lowest nominal rates were imposed on intermediates used in the production of capital goods. Moreover, in all these categories, there was a general tendency for average nominal protection to increase over the period 1981-1987."[5]

The average level of effective protection against imports increased as a result of increase in tariff rates in 1984 and 1987. Again, throughout this period, export-oriented producers were at a disadvantage in comparison to import substituting sectors. Moreover, the gap between the incentives provided to the exporters and to the import-substituting producers increased during the decade of 1980s.

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[5] Sen Kunal, Ibid.

"All this shows the trade liberalization was not a component of the Thai "Success Story". If anything, tariff rates on most imported goods seem to have increased in the last decade. That this did not result in Thai and foreign firms producing mostly for the domestic market can be explained by a small domestic market and aggressive export promotion by the Thai government."[6]

In contrast to the contractionary fiscal policy, the government pursued an expansionary monetary policy. The growth rate of money supply M_2 during 1986 – 90 was on an average 20% per year. However, such a high rate of growth of money supply did not result into high inflation rates as growth in money supply was caused by credit expansion to meet the increasing credit needs of the trade, commerce and industry. The monetary authorities in Thailand took the view that the rapid expansion of trade and industries should not be unduly constrained by shortage of liquidity. Again, the large inflow of foreign exchange because of foreign direct investment, portfolio investment and external commercial borrowing by the private sector corporations in Thailand during 1980s was bound to contribute towards, monetary expansion, especially under the conditions in which the Bank of Thailand was reluctant to sterilize the increase in bank reserves. The Central Bank of Thailand pursued this policy to avoid sharp increase in the foreign exchange rate of the domestic currency which would have caused an adverse impact on the export performance of the economy.

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[6] Sen, Kunal, Ibid.

Thailand introduced wide ranging financial sector reforms during 1990-91. The ceilings on interest rates were lifted in 1990 so that the banks could mobilises more savings from the depositors. A far reaching financial sector reform was undertaken in 1991 when the government introduced convertibility on the current account transactions of the balance of payments. The commercial banks were authorised to deal in foreign exchange while in earlier years, this function was reserved only for the central bank as in many developing economies of the world. This measure was preceded by 1984 devaluation of the domestic currency Baht and almost 10% depreciation of the currency each year during 1985 – 1986 and 1987. This restored the foreign exchange rate to its equilibricem level at which trade, commerce and industry could buy and sell requisite amount of foreign exchange without creating market for unofficial transactions in foreign exchange or harmful speculation. In earlier years, the commercial banks were required to invest 16% of their deposits in government bonds. Now this was reduced to 8%, leaving larger financial resources with the commercial banks for lending to the productive sectors of the economy and also adding to the profit making capacity of the banks. One major financial measure which had already existed in Thailand, unlike in most developing economies of the world then and even now was that the commercial banks were not owned, controlled and managed by the government. They were privately owned. There was keen competition among these banks to expand their business by ensuring good service to the customers. The interest rates on deposits and advances were free to be determined by the market forces of demand for and supply of lonable funds.

Industrial Policy :

In Thailand, a quasi-government body – The Board of Investment was established since late 1950s. Since early 1970s, the wide ranging incentive scheme was adopted and implemented by the Board of Investment to promote exports. The incentives were made available to the domestic firms as well as foreign firms and covered vast array of benefits like exemption from import duties on imported raw materials as well as components and selective exemption from business taxes and export duties. BOI could also grant income tax holidays to the firms assisted by it for three to eight years. In view of its wide ranging promotional policies the BOI could play a critical role in the development and structural transformation of Thailand's industrial sector and the promotion of exports. During the few decades before 1980, the government of Thailand assisted the traditional industries such as textiles and food processing. The BOI particularly started assisting electrical and non electrical machinery and the chemical industries. Since mid 1980s, the BOI also turned its policy initiatives in the promotion of export oriented industries. What is even of greater significance in the industrial development of Thailand during 1980s was that because of the promotional work undertaken by the BOI, a new indigenous Thai entrepreneurial class dynamic and outward looking – came into existence.

Direct Foreign Investment :

In the second half of 1980s, Thailand experienced a substantial increase in the flow of direct foreign investment. Two factors that contributed to the rapid economic growth of Thailand and its transformation from a predominantly agricultural economy to the predominantly industrial economy in the South East Asian region were the direct foreign investment and its export orientation. Thailand received direct foreign investment of only $ 164 million in 1985. This increased to $ 1106 million in 1988 and $ 1778 million in 1990. In six years, the flow of direct foreign investment to Thailand during 1985 to 1990 increased by 15 times and when the era of rapid economic development began in 1988, the direct foreign investment, within a short span of three years, increased by about two and a half times. The significance of direct foreign investment can be appreciated from the fact that while it constituted 3.4% and 2.2% of gross private investment in Thailand during 1980 and 1987 respectively, it was 8.3% and 9.4% during 1988 and 1989 respectively. Thailand could reach a significantly high rate of investment of about 36% by 1990 because of the substantial flow of direct foreign investment. This factor also played a critical role in providing export orientation to the Thai economy during the years when it was undergoing changes due to implementation of the structural adjustment programme. The following table provides some more useful information on direct foreign investment.

Table – IV.5 : Direct Foreign Investment by Sector, Thailand 1983-1989[7]

(Percent)

Year	DFI in Manufacturing	DFI in rest of the economy
1983	20	80
1985	21	79
1986	27	73
1987	45	55
1988	57	43
1989	47	53

In contrast to 20% and 27% of the total DFI during 1983 and 1986 respectively going to the manufacturing sectors, it was almost twice as large during 1987 and 1989; 1988 being an exceptional year in which it was almost two third of the total DFI going to the manufacturing industries.

An important factor that contributed to the substantial flow of DFI from Japan and Taiwan to Thailand was the appreciation of these two currencies implying depreciation of the Thai currency making it profitable for these two countries to invest in Thailand. At the same time, Thailand welcomed the flow of foreign capital to sustain higher rate of investment in the domestic economy and also to benefit from the technology transfer. Moreover, Japan and Taiwan wanted to avoid adverse impact on their manufacturing cost arising out of increasing labour costs and benefit from transferring their manufacturing base to Thailand, enjoying the advantage of cheap labour during these years. Some useful information is provided on the countries from which the DFI came and the sectors of Thai economy in which this foreign capital came to be invested.

[7] Sen Kunal, ibid.

Table – IV.6 : Trends in DFI, Thailand 1980-89[8]

By Sources (% share)

Country	1980	1985	1986	1987	1988	1989
Japan	23	35	44	36	52	50
US	19	54	19	20	11	14
EEC	20	10	7	10	8	9
Taiwan	0	4	2	8	11	11
Other	38	-3	28	26	18	16

Sector **By sector (% Share)**

Sector	1980	1985	1986	1987	1988	1989
Industry	26	31	31	53	58	47
Trade	19	25	26	9	14	18
Services	18	24	12	13	9	13
Construction	20	36	18	15	7	9
Finance	-5	-29	7	5	10	12
Mining	15	12	4	2	2	2
Agriculture	5	2	3	3	1	0
Percent Export Oriented	41	77	63	88	88	n.a.

Notes: 1. 1989 Source and Sector are based on half year data.
2. Export oriented means 40% or more of output is exported

In 1980, while Japan's share in total DFI that Thailand received was 23%, no DFI came from Taiwan. Between 1980 and 1986, Japan's share in the total DFI, received by Thailand was almost doubled and by 1989, Japan's share in Thailand's DFI was 50%. Taiwan's share, though negligible upto 1986, became 11% by 1989 when Japan and Taiwan together contributed three fifth of the total DFI received by Thailand. In contrast to this, US and EEC contributed together about 40% and 60% to the total DFI received by Thailand during 1980 and 1985 respectively. However, their

[8] Sen Kunal, ibid Page 150.

combined share came down to 23% by 1989. From 1981 onwards, the USA began to have deficit in its current account of the balance of payments which went on increasing gradually and stood at $ 110 billion in 1989. its deficit was largely financed by the flow of DFI and portfolio investment from W. Germany and Japan which were having persistent surplus in their balance of payments. In fact, the inflow of Japan's DFI into Thailand was practically as fast as that into the USA. Again, while Japan's DFI in different countries of the world was directed mostly in sectors like finance and real estate, it went into manufacturing industries like chemicals, electric machinery and transport equipment in Thailand. Other factors favouring flow of Japan's DFI into Thailand was more or less the identical cost of labour as well as the political and social stability in Japan and Thailand. With Japan and Taiwan contributing almost 60% of the total DFI received by Thailand, the importance of the USA, the EEC countries went on declining considerably between 1980 and 1989.

While 45% of the DFI that went to Thailand in 1980 was invested in industry and trade, this has become 65% by 1989. While sizable portion of DFI between 1980 to 1985 went into the sectors like services, construction and mining, this came down drastically by 1989. Thailand could change its structure from a predominantly import substitution industrial country to a predominantly manufacturing industrial country. There was a significant shift from import substituting industries to export oriented industries, as

88% of total DFI industries in 1988 and 1989 were export oriented industries.

Thailand's rate of economic growth was 8.5% per year during 1986-88 that was considerably higher than the pre reform period of 1980-86. Thailand could maintain this high rate of economic growth upto 1997 when the serious financial and currency crisis broke out first in Thailand and then spread to other South East Asian countries. The following table provides information on major economic indicators for Thailand during 1991 to 1995.

Table – IV.7 : Major Economic Indicators : Thailand 1991 to 1995[9]

	1991	1992	1993	1994	1995
Gross domestic Product % Change	8.1	7.6	8.3	8.7	8.8
Agriculture % Change	5.0	4.0	-1.9	5.5	3.2
Industry % Change	12.0	9.3	10.6	9.9	11.9
Services % Change	5.9	7.2	9.2	8.5	71
Gross Domestic Investment % of GDP	42.0	40.1	40.4	41.0	41.6
Gross Domestic Savings % of GDP	35.2	34.8	35.0	35.2	33.6
Inflation Rate % changing CPI	5.7	4.1	3.4	5.1	5.8
Money Supply Growth % Change	19.8	15.6	18.4	12.9	17.0
Mercandise Exports $ Billion	28.2	32.1	36.4	44.5	55.4
% change	23.8	13.7	13.4	22.2	24.8
Mercandise Imports $ billion	34.2	36.3	40.6	48.2	61.9
% change	15.8	6.0	12.1	18.5	31.9
Current Account Balance $ Billion	-7.6	-6.7	-7.0	-8.4	12.3
Current Account Balance / GDP	-7.7	-6.0	-5.6	-5.9	-7.9
External Debt Outstanding $ billion	35.8	39.4	45.8	61.0	68.2
Debt Service Ratio	13.1	13.4	18.5	15.6	11.4

Thailand could maintain its growth rate above 8% except for the year 1992. The agricultural sector could also grow at the rate above 3% except for the year 1993 when it became negative. The industrial sector continued

[9] Asian Development Bank, Asian Development Outlook, 1994, 1996 and 1997 (Page 104)

to grow at about 10% per year. The services sector could expand at the rate above 7% for most part of this period. The rate of saving that was 24% of the GDP in 1985 reached the level of almost 35% of the GDP during this period. Similarly gross domestic investment that was 28% of the GDP in 1985, reached the level of about 41% in the first half of 1990. The savings investment gap, as reflected in the current account deficit, moved between 6% to 7% of the GDP. The large difference between the rate of investment and the rate of saving is indicative of the flow of foreign saving into the economy of Thailand. In spite of the large flow of foreign capital, the rate of growth of money supply moved between 13% to 20% and the rate of inflation moved between 3.4% in 1993 and 5.8% during 1995. The volume of external debt almost doubled during these five years, while the debt service ratio having gone upto 18.5% during 1993, came down to a reasonable level of 11.4% in 1995. The structural adjustment programme that was initiated during mid 1980s, and that produced sound impact on the Thailand economy by accelerating growth rate with stability of price level, continued that growth momentum and price level stability and raised the investment and savings rates to a level comparable with other rapidly growing economies. However, there was one major weakness in this otherwise satisfactory picture of rapid economic development namely deficit in the current account of the balance of payments continued to remain at the dangerously high level-above 5.5% of GDP and reached almost 8% during 1991 and again in 1995. The other relevant factor in this connection is that there was a considerable decrease in the net inflow of foreign direct investment from $1.7 billion in 1993 to $ 0.6 billion in 1994 and this level continued in 1995. While the foreign investment in traditional export industries was going down in size, this was to some extent, counter balanced by increasing flow towards technologically advanced industries. Moreover, appreciation of yen also increased the attractiveness of Thailand as a production centre for Japanese car manufacturing firms that wanted to expand production to meet rapidly growing markets of Asia.

There was some concern on this subject expressed by the Asian Development Bank. "The current account deficit reached a historically high level of 7.5 percent of GDP in 1995 compared with 5.9 percent in 1994. Large capital inflows continued to cover the deficit and raised the official foreign exchange reserves from $ 30 billion in 1994 to over $ 36 billion in 1995. However, there was a change in the composition of capital inflows; portfolio and direct investment weakened while short term inflows to the banking system increased. Net external borrowing also increased because of a surge in lending by foreign banks through the Bangkok International Banking Facility (BIBF). This heavy reliance on foreign saving is a source of some concern as a sudden change in international perception about the soundness of the Thai economy could cause serious difficulties for the economy".[10]

[10] Asian Development Bank, ibid, 1999 Page 106.

While this kind of concern was expressed regarding persistent current account deficit and change in the composition of inflow of foreign capital into Thailand, a rationale for a phenomenon like this was also provided. "The key question is whether the present level of deficit is sustainable. First, it seems that the persistence of the deficit is related to the continuing high level of investment. The failure of domestic saving to match this level must be a cause of concern; however, at the same time, there is scope for effective policies to raise the savings rate, especially in the household sector. Second, the deficit would be more of a concern in sluggish economy, with weak export performance, which is not the case for Thailand. Third, countries with a large current account deficit often have a large budget deficit. However, Thailand has historically maintained budget surpluses, not deficits. Fourth, the financing of the current account deficit does not consist overwhelmingly of short term inflows but a more stable components such as foreign direct investment, portfolio investment, BIBF inflows and public borrowing and trade credits. Finally, Thailand has a relatively strong external financial position. While total external debt at the end of 1995 was relatively high at 68.2 billion, about 41% of GDP, the debt-service, ratio at 11.7% is low by international standards. Also, the country's stock of international reserves stood at $ 36 billion at the end of 1995, equivalent to seven months of imports".[11]

[11] Ibid, Page 107.

The macro economic indicators showed distinct deterioration for the economy of Thailand during the next two years – 1996 and 1997. The relevant information is given in the following table :

Table – IV.8 : Major Economic Indicators : Thailand 1996 – 1997[12]

(Percent)

Item	1996	1997
Gross domestic product growth	5.5	-0.4
Gross domestic investment / GDP	41.7	35.0
Gross domestic saving / GDP	33.7	31.0
Inflation rate (consumer price index)	5.9	5.6
Money supply (M_2) Growth	12.6	16.4
Fiscal balance / GDP	0.9	-0.9
Merchandise exports growth	-1.9	3.2
Merchandise imports growth	0.6	-9.3
Current account balance / GDP	-7.9	-4.0
Debt service / exports	12.2	25.0

There was a sharp decline in the rate of economic growth during 1996 to 5.5% from the high pick it had reached in1995 – 8.8 percent. That the growth rate turned negative -0.4 percent in 1997 the year of unprecedented financial and currency crisis – could be explained in terms of sharp deterioration in indicators like the rate of savings and investment as well as rate of growth of merchandise imports and exports. During 1996, the rate of savings and investment were almost similar to those that prevailed in 1995. The fiscal balance as in previous years was also positive. However, there was a distinct deterioration in the external sector. In contrast with the robust growth in exports and imports during the year 1995 at the rate of 24.8

[12] Ibid, 1998 Page 106.

percent and 31.9 percent respectively, the rate of growth of merchandise exports turned negative -1.9 percent and the rate of growth of merchandise imports was negligible. And yet, the current account deficit in the balance of payments remained at the historically high level of -7.9 percent during 1996 as in the previous year 1995. While the merchandise exports recovered during 1997 from the negative growth rate experienced in the previous year, the merchandise imports decreased by 9.3% as a result of combination of quite a few adverse factors such as steep devaluation of the Thai currency Baht, considerable loss of foreign exchange reserves and the decline in manufacturing activity of the domestic industrial sector. "By the first quarter of 1997, the Thai economy was showing clear signs that it was in trouble. Speculative attacks on the Baht and the closure of several finance companies constituted the prelude to financial termoil of unprecedented magnitude. The currency depreciated form Baht 26 to one US Dollar in July 1997 to more than Baht 50 to one Dollar by January 1998. Negative growth occurred in 1997 and the political consequences included the Prime Minster's resignation in November 1997.

The lack of liquidity caused by the financial crisis had serious repercussions on manufacturing. While production declined only slightly during the first seven months of 1997, with growth running at 5.1% compared with 7.1% during the same period of 1996, the last three months of 1997 saw a decline in production of more than 5% compared with the same period of 1996. Capacity utilization fell to around 70% in such industries as automotive assembly and sales of motor vehicles fell 73% from the previous year's figures. This will undoubtedly adversely affect the future growth of the petrochemicals glass making, rubber and steel sectors".[13]

The Financial and Currency Crisis in Thailand :

In countries that experienced the financial and currency crisis in the 1980s and the mid 1990s, the sequence of events would generally run on the following lines. A country is on a foreign exchange rate system of a fixed or managed exchange rate and government indulges in overspending and as a result, has budget deficits. To live with such budget deficits, it follows an expansionary monetary policy that results into high inflation rate in the domestic economy and leads to an appreciation in the real exchange rate that in turn leads to an increase in the deficit in the balance of trade. If a country continues with such policies for some years, the economy would not be in a position to sustain its current foreign exchange rate with its available foreign exchange reserves. If the economy is on a pegged foreign exchange rate system, it would lead to a speculative attack on the domestic currency.

However, this kind of sequence of events cannot explain the financial and currency crisis of Thailand that broke out in July 1997. The South East Asian crisis was not caused by either fiscal profligacy or excessive monetary expansion by Government. "The affected economies, (of Indonesia, Korea Malaysia, Philippines and Thailand) had a better fiscal record than the non affected economies (of Hong Kong, China, Singapore, and Taipei); all

[13] Ibid, 1998 , Page 105.

posted modest budgetary surpluses during 1994-1996. Before this crisis, the growth of money supply showed no sings of acceleration. No doubt, the growth in broad money was high, averaging about 19% per year, yet given that these economies were also growing at extremely high rates, the growth of monetary aggregates was not excessive. The average inflation rate of less than 7% was relatively moderate, and did not show signs of acceleration. Second, while the affected countries had exhibited a slight slowdown in growth before the crisis, they did not suffer from any substantial unemployment. Indeed, all of them, had full or near full employment, and some even imported foreign labour to mitigate domestic labour shortages. Therefore, these countries did not have the incentives to abandon their pegged foreign exchange rates to pursue more expansionary monetary policies to bring real wages and unemployment down".[14]

Among the factors, that contributed in an important manner, in causing the Asian financial crisis of 1997 and 1998, mention must be made of the private capital inflows from the creditor countries to the net debtor developing countries. The 1990s witnessed a substantial increase in such capital flows over the late 1980s. The following table provides detailed information on this subject.

[14] Asian Development Bank, The Financial Crisis in Asian Development Outlook, 1998 Page 24-25.

Table – IV.9 : Net Transfer of Financial Resources of the Net-Debtor Developing Countries 1986-1996 [15]

(Billions of United States Dollars Per year)

Net Private Resource Transfers	1986-90	1991-96
Private Grants	6.1	9.5
Direct Investment	3.2	30.3
Medium and long term foreign credit	-23.2	11.5
Portfolio and other items	-11.4	22.3
Total	-25.3	73.6
Net official resources transfer		
Official Grants	13.7	13.0
Official credit	1.8	-8.8
Total	15.5	4.2
Total Financial Resource transfers	-9.9	77.8

Source : United Nations, World Economic and Social Survey, 1997 table A27.

As far as the total amount of financial resource transfer to the net-debtor developing countries is concerned, there was a considerable increase between late 1980s and first six years of 1990s. The net debtor developing countries of the world received negative net transfer of financial resources of the order of about $ 10 billion per year between 1986-1990. In sharp contrast to this, these countries received net transfers of about $ 78 billion every year during 1991-1996. While this factor is quite important in itself, what is even of greater significance is the composition of these financial resource transfers. The composition shows a distinct shift in favour of net private resource transfer as against net official resource transfer. Thus the increase in the total financial resource transfers was not the result of new official flows from the multinational financial institutions like the IMF, the World

[15] Herman Barry and Sharma Krishnan (Ed), International Finance and Developing Countries in a year of Crisis, 1998 Page 11.

Bank and others, as the official grants were practically unchanged at about $ 13 billion and the official credit became negative in a big way from $ 1.8 billion during 1986 – 1990 to $ -8.8 billion during 1991-1996.

In contrast to the net official resources transfer, the net private resources transfer shows a significant increase from negative $ 25.3 billion per year during 1986-1990 to positive $ 73.6 billion. Even private unrequited grants extended by non governmental organizations and other private sources has been considerably higher – about 50 percent more – per year during the first half of 1990s than during the second half of the 1980s. However, it is the profit – driven foreign direct investment that really expanded in the first half of 1990s – from $ 3.2 billion to $ 30.3 billion – almost a ten fold increase in a short span of ten years. The developing countries increasingly adopted under the structural adjustment programme with its emphasis on globalization and privatization, the export promotion or the outward looking development strategies that would not only accommodate but would inevitably require such investments.

Other capital flows to the developing countries, grouped together under the category of portfolio and other items also showed substantial increase. These capital flows represent the most volatile portions of the international financial flows including investment in bonds and equity shares by the foreign financial entities. The net debtor developing countries experienced negative transfer of about $ 11 billion under the category of portfolio and other items during 1986-1990 reflecting capital flight and withdrawals of such funds by the foreigners from these countries. In contrast to this, such capital transfers became positive $ 22.3 billion each year – during 1991 to 1996 reflecting in some sense return of confidence in the economic development process of these economies. Another factor that contributed to these capital transfers was the falling interest rates in the developed creditor countries and the high interest rates among the capital receiving debtor countries which followed such policy as their anti-inflation drive.

The Asian financial crisis of 1997 showed that these portfolio and other short term flows could be highly volatile in the wake of an economic factor reflecting lack of confidence. The prices of financial assets could undergo sharp and sudden changes and the investors could decide to withdraw large amounts of funds from a country or group of countries on short notice, causing tremendous pressure on local currency / currencies.

The Asian Financial and Currency Crisis and Thailand :

Writing on the causes of the financial crisis in the South East Asian countries, the United Nations sponsored study stated , "The Asian currency crisis came to embrace fully Thailand, Indonesia and the Republic of Korea, and to a lesser degree Malaysia and the Philippines, but the precipilating events took place in Thailand. Thailand's crisis can be traced to the large deficit in the current account of the balance of payments, the unyielding exchange rate peg, the manner in which the deficit was financed and how capital flows into the country were intermediated by the Thai financial system."[16]

Current Account Deficit and Appreciation of Real Exchange Rates :

Thailand, having most of the macroeconomic indicators favourable, had two distinctly unfavourable elements in its economics growth episode since 1986 namely high and persistent deficit in the balance of payments and its relatively high inflation. In 1991 and 1995, the deficit in the current account of the balance of payments was 7.7% of GDP and 7.9% of GDP respectively. During 1992, 1993 and 1994, it was almost 6% of GDP which was also on the higher side. In 1996 also, this deficit persisted at 8% of GDP. This has resulted from the weakening competitiveness, strong growth of domestic demand and the slowdown of exports due to slowing down of global trade growth in 1996. Thailand's competitiveness in its traditional labour intensive exports deteriorated due to growth of real wages relative to its competing countries especially China which has emerged as a major competitor to South East Asian countries. An additional factor that adversely affected Thailand and other South East Asian countries was China's devaluation of its currency Yuan in 1994.

The current account deficit was also to a certain extent contributed by increase in imports of both consumption as well as investment goods because of the appreciation of the real exchange rate in Thailand. Thailand's real exchange rate appreciated because of its higher domestic inflation rate

[16] Ibid, Page 15.

in relation to the world average. Moreover, Thailand had pegged its currency Baht to the US Dollar, and as the US Dollar appreciated, Baht also appreciated, contributing to the high and unsustainable current account deficits. Thailand's real exchange rate also appreciated because of the depreciation of Japanese Yen and many European currencies. During June 1995 to June 1997, the real exchange rate of Thailand appreciated by 14 percent. The contribution of these two factors in Thailand – high and persistent deficit in the current account of its balance of payments and the appreciation of the real exchange rate provided vital elements for the financial crisis that broke out in July 1997.

Private Capital Inflow :

Thailand could continue with its persistent current account deficit and rising real exchange rates because of private capital flows from abroad. The substantial flow of private foreign capital helped Thailand in financing its current account deficits, and in addition, contributed to increase in its foreign exchange reserves for several years. In spite of large inflow of capital, Thailand could follow a policy of having high interest rates, through sterilization, and high interest rates helped it receive further inflow of capital.

Since the late 1980s, many Asian developing economies have experienced substantial capital inflows. From 1987 upto end of 1996, Thailand received $ 75 billion. These inflows on an average were 7.4 percent of GDP for Thailand. Again, only a small proportion of this large capital inflow came in the form of portfolio investment and through the banking sector. Once the surge of private capital inflows started, partly driven by the sound fundamentals of the Thai economy and partly by herd mentalities of the investing countries, especially Japan and Europe that experienced serious slow down of their economies leading to drying up of profitable investment opportunities at home, an unrealistic increase in domestic asset prices followed. Such an increase in asset prices, which increases returns to capital through capital appreciation provided requisite inducement for further capital inflows and by middle of 1996, the private capital inflows to Thailand and other South East Asian economies reached an all time high. It is interesting to note that the progress towards implementation of the structural adjustment programme, Thailand had not opened all its sectors for the investment of such private capital inflows and the few sectors like real estate and equities which were opened up for the foreign investors experienced sharp but unwarranted increase in these asset prices. This had started happening in Thailand gradually from the later half of 1980s, but it gathered momentum from the beginning of 1990s.

Financial Sector Imbalances and Weaknesses :

The dramatic increase in private foreign capital brought in its wake three kinds of imbalances in Thailand's banking sector. Firstly, between 1993 and 1996, while the foreign liabilities of its commercial banks increased by almost 12 percent per year, the foreign assets increased by only about 7 percent per year creating a serious mismatch in the external sector.

Second, large portion of the collateral that the commercial banks accepted for advancing loans was obviously real estate and equities. However, these were precisely the assets whose unrealistically high values contained a dangerous element of bubble that eventually burst and threw Thailand into an unprecedented financial and currency crisis. And third, there was another serious mismatch that had gradually crept into the banking sector of Thailand namely the imbalance in the maturity structure of the assets and the liabilities of the commercial banks. While large part of the private capital inflow in the form of portfolio investment was short run, the advances made were for a much longer period. In other words, the banks were borrowing short and lending long.

Such serious imbalances made Thailand's banking sector extremely vulnerable which implied that anything going wrong somewhere would make many other things look wrong. Thus, if for some reason confidence in the economy is shattered and the withdrawals of foreign capital starts, it could cause serious damage to the working of the commercial banks. If, once the sudden withdrawal of foreign capital starts taking place, it would become extremely difficult to protect the pegged foreign exchange rate and would lead to the inevitable depreciation of the domestic currency. This, in turn, would increase the value of commercial banks' foreign liability as well as the economy's external debt. At the same time the withdrawal of foreign capital would lead to the sharp decline in the price of real estate and equity that could carry a serious adverse impact on the value of the collateral against which they made huge advances.

In addition to such imbalances, the financial system of Thailand, like that of other South East Asian countries and Korea, suffered from two crucial weaknesses of adverse selection and of moral hazard both arising due to asymmetric information problem. These problems coupled with a currency crisis are sufficient to bring about a sharp contraction in economic activity and precipitate a financial crisis. The first moral hazard relates to the borrowers. The financial system in Thailand suffered from asymmetric information in the matter of allocation credit. As is very common in the banking transactions, the lenders or the banks have inadequate information than the borrowers regarding the intended use of credit. Thus, the problem of adverse selection exists when those parties who are most likely to produce an undesirable or adverse outcome are those most likely to be selected to receive loans. However, the implication of adverse selection is that the banks might decide not to make any loans, inspite of the fact that good credit risks or investment projects exist in the market. The second moral hazard is with reference to the lenders or the banks. The Thai finance companies implicitly believed that their government guaranteed their financial liabilities. Such an implicit guarantee was assumed due to the strong connection between the owners of these institutions on the one hand and the politicians on the other. Moreover, the supervisory and the regulatory authorities did not have requisite authority to enforce prudential standards.

All these conditions created an environment which induced the banks and other financial institutions to undertake high risk lending activities. Globalization coupled with large flow of foreign capital excerbated the moral hazard problem created by an environment of implicit guarantee.

Reiterating this view, the United Nations' sponsored study stated "Thailand's current account deficit was increasingly financed by large short-term capital inflows which had the potential to become volatile. Compounding the problem, the substantial portion of these funds were channeled by Thai financial institutions into the real estate sector and fed a bubble in property prices. In addition, in many instances the quality of analysis of loan applications appears to have been inadequate. Then slowing economic growth in 1996 and 1997 burst the real estate bubble and a number of financial institutions were left with large amounts of non-performing loans. Many of the financial institutions became insolvent.

While Thailand had been very favourably perceived in the international financial markets in earlier years, its problems became increasingly apparent to investors in 1997. They also became concerned about the emergence of a small budget deficit as a consequence of slowing economic growth. As a result, there was massive speculative selling of the Baht in the spring and summer of 1997. The authorities initially tried to counter this with moderate policy changes and substantial currency market intervention to defend the exchange rate peg. In the process they almost depleted their ample foreign currency reserves. By the beginning of July, they were forced to allow the Baht to float, it quickly began to depreciate sharply.[17]

Measures to Tackle the Crisis :

On 11th February, 1997 the Thai government approved a budget cut of $2 billion over the next two years with an objective to reduce domestic spending and to reduce its deficit in the current account of the balance of payments that had touched an unsustainable level of 8% of GDP in 1996. On 3rd March, 1997, the Thai government suspended trading in the shares of banking companies and the finance companies. The announcement of various measures was made after the insolvency of the country's largest finance company became known towards the end of February 1997. The financial institutions were required to make larger provision for the non-performing loans and to expand their capital base. On 14th July 1997, the government of Thailand and Singapore announced that the central banks of these two countries had jointly intervened in the foreign exchange market of Singapore to support the Thai currency and to prevent the financial and currency instability from spreading to other South East Asian and East Asian countries.

However, the Thai government, finally accepting its inability to protest its currency's pegged foreign exchange rate with Dollar, announced on 2nd July 1997 that it had decided to abandon the Baht's peg to Dollar and that Baht was allowed to float. The country had lost almost 10% of its

[17] Ibid, Page 15, 16, 17.

foreign exchange reserves in May and June in a futile attempt to maintain the peg. Immediately, the Baht fell sharply from \$1 = 24.5 Baht to \$ 1 = 29 Baht, a devaluation of about 20%. Meanwhile, on 29th July 1997, the International Monetary Fund and the government of Thailand announced that they had undertaken discussion on a comprehensive rehabilitation plan. The Thai government in close consultation with the International Monetary Fund announced a comprehensive economic reform package on 5th August, 1997. The package included some important measures to contain balance of payments deficit as well as domestic budgetary deficit – to suspend immediately the financial operations of 42 seriously ailing finance companies, a promise to maintain a minimum amount of foreign exchange reserves at \$ 23 billion, to increase the value added tax from 7% to 10% and also to increase the price of various public utilities in the next year. It was also agreed with the IMF to reduce the current account deficit from8% of GDP in 1996 to 5% in 1997 and to 3% in 1998. In quick succession to this, on 11th August, 1997, a group of countries led by Japan including Indonesia, Malaysia and Singapore as well as the Asian Development Bank and the World Bank agreed on a loan package to Thailand whose total amount came to \$ 17.2 billion. In addition to this, the IMF agreed for the bailout and sanctioned a loan under the Emergency Financial Mechanism of \$ 3.9 billion to Thailand as a part of the financial assistance package to accompany the adjustment programme announced by the government of Thailand on 5th August, 1997. In addition to the financial assistance from multilateral financial institutions and the friendly countries in the Asia Pacific region, the Japanese commercial banks agreed to roll over 80% of their short term loans to Thai industrial units. This was quite important and meant considerable relief to Thailand as the Japanese banks held 50% of its $ 89 billion external debt in addition to a substantial portion of its short term debt. The government of Thailand, on 8th September, 1997 announced some measures to meet the problem of liquidity shortage in the country's financial system – Thailand's Central Bank reduced the cash reserve requirement form 7% to 6% and decided to borrow form the domestic banks and Thailand – based foreign commercial banks to pay debts owned by 58 finance companies whose operations were suspended by the Central Bank in the wake of the eruption of the financial and currency crisis in early July 1997.

The government of Thailand, on 14th October, 1997 approved a comprehensive economic reform package, which was backed by the IMF, under which it agreed to undertake massive restructuring of the financial companies to reduce budget deficit and to introduce higher excise taxes and import duties. The government of Thailand, in October 1997, established two new financial institutions – the Financial Restructuring Agency and the Asset Management Company. The financial restructuring agency would supervise the overall rehabilitation of the financial sector and would decide how many of the 58 finance companies whose operations were suspended would be shut down permanently. Wherever possible, the agency would also facilitate mergers among these companies. The Asset Management

Company would buy bad loans of permanently closed companies and manage, restructure and sell them within a period of less than three years. To obtain the requisite financial resources, the foreign companies were permitted to invest resources without any upper limit for at least next ten years. On 8th December, the Thai government announced that out of 58 finance companies whose operations were suspended in the wake of the financial and currency crisis, 56 finance companies would be closed down permanently. With this decision, a little over 50% of the country's 91 finance companies would be shut down for good. While the deposits of all the depositors would be protected, the equity share holders and the creditors would have to bear heavy losses. Meanwhile, the leading international rating agency – the Moody's Investor Services – sharply downgraded the long term sovereign debt rating of Thailand, together with Indonesia and the Republic of Korea. The new rating was equivalent to "junk bonds", making long term investment in these countries very risky.

While the Thai government adopted wide ranging fiscal and monetary measures during the course of the next one year with an objective of improving the economy's balance of payments situation and of regaining the lost confidence of the international financial markets, the foreign exchange market and the share market remained highly volatile making access to international financial markets even more difficult. Compared with the foreign exchange rate of the Baht at the beginning of the year 1997, it has sharply depreciated by 45% against the Dollar like all the currencies in the region.

Thailand after Financial Crisis :

The financial and currency crisis left substantial impact on the Thai economy in terms of reduction in growth rate, reduction in per capita income, considerable reduction in the rates of savings and investment, though it brought about some improvement in the deficit in the current account of the balance of payments, largely through large import compression in 1998. The following table provides requisite information on important economic indicators.

Table –IV.10 : Major Economic Indicators, Thailand : 1998 – 2001[18]

(Percent)

Item	1998	1999	2000	2001
Gross domestic product growth	-3.0	1.0	4.6	1.9
Gross domestic investment/GDP	26.0	29.0	22.7	23.9
Gross domestic savings / GDP	31.4	32.0	31.0	30.0
Inflation rate (consumer price index)	15.4	9.0	1.6	1.6
Money Supply (M_2) Growth	6.8	7.5	2.2	4.6
Fiscal balance / GDP	-2.0	-1.0	-2.4	-2.1
Merchandise exports growth	5.0	8.0	19.5	-6.9
Merchandise imports growth	-15.0	3.0	31.3	-2.8
Current account balance / GDP	3.4	2.0	7.6	5.3
Debt service / exports	15.0	15.0	15.4	20.7

Thailand witnessed an extremely high rate of investment – above 40% during 1991 to 1996.It had a saving rate of above 30% during this period. Again, its rate of investment was far in excess of its savings rate by a

[18] Asian Development Bank, Asian Development Outlook, 1998, Page 106 and 2003, page 95.

margin of 5% and even higher for some of these years indicating the huge inflow of foreign capital. In contrast to all these favourable developments upto 1996, the rate of GDP growth that was around 8% during 1991 to 1995, became negative in a big way, -3.0% during 1998, continuing the negative growth rate of 1997. It hardly recovered from this negative growth phenomenon in 1999. While the economy looked up during 2000, the growth momentum was again slackened during 2001. It was only during 2002 that the economy could finally recover to 5% rate of GDP growth and continued with it during the next two years 2003 and 2004. It was with the substantial and also sustained rate of growth during 2002 that Thailand was able to finally make up for almost all the losses in per capita income that it had to sustain after the beginning of the financial crisis in 1997. The rate of investment steeply came down from 40% upto 1996 to 26% in 1998 and then to less than 25% during 2000 and 2001. There was a decline in the rate of saving too but not as steep as witnessed by the rate of investment. Inflation rate, quite moderate in Thailand from 1991 upto 1997, was exceptionally high only in 1998 and then came down to 1.6% in 2000. Money Supply growth had considerably slowed down after Thailand was hit by the financial crisis. This had to be achieved by the government to bring monetary stability, an important part of the reform to promote export growth and also help the Baht to stabilize its external value after substantial depreciation. Thailand in the past could maintain positive fiscal balance. Indiscriminate expansion of money supply and consequent unsustainable high rates of inflation were quite absent during its period of rapid economic growth after 1986. A small fiscal imbalance had arisen during 1997 and this had continued during 1998 to 2000. The large deficit in its balance of payments of above 7% of GDP was one of the chief contributory causes of the financial and currency crisis. As a part of the reform package as well with the considerable reduction in the inflow of foreign capital, Thailand showed small surplus during 1999 and then showed quite large surplus during 2000. Even with the increase in the volume of external debt that accompanied drastic depreciation of the Baht, the debt-service ratio remained stable at 15% during 1998 to 2000, having scaled upto 25% during the year of crisis – 1997.

Different economies were adversely affected in varying degrees from the sharp slowing down of the growth momentum and Thailand was no exception. The incidence of unemployment and poverty increased, more so because Thailand, like other economies in the region had not developed any mechanism of social safety net. It depended on rapid economic development and increasing employment opportunities for the provision of social security to its people. In spite of considerably reduction in poverty in Thailand during its years of rapid economic growth, a large segment of its population was located below the poverty line. This group of poor and near poor were particularly vulnerable to the impact of the sharp economic slow down.

Moreover, Thailand had a weak human capital base. It lagged behind other South East Asian and East Asian economies in terms of the enrollment at the secondary school stage. While enrollment at the primary level was comparable with that prevailing in neighbouring economies, more than 50% of those children who completed primary school level, could not go far secondary education. This is partly explained by the fact that a large portion of the population in Thailand was still engaged in agriculture. Around the time the financial crisis hit Thailand, 80% of Thailand's labour force of 33 million had no formal education or only primary education. They could not hope for better jobs.

Conclusion :

Thailand achieved a rapid rate of economic growth – GDP growth rate of 6% on an average – during 1965 to 1980. During this period, it followed the foreign trade policy centering around import substitution for some years, while for sometime, it followed the export oriented foreign trade policy. In late 1970s, it also established a major petro-chemical complex in the public sector.

However, the second oil price rise of 1979 created serious balance of payments situation for Thailand coupled with rising rate of inflation, increasing volume of external debt and increase in the debt – service ratio.

To meet its difficult balance of payments situation, Thailand approached the International Monetary Fund in 1981 and was granted a two years standby loan by the Fund. The Fund also sanctioned loans under compensation and contingency financing facility. In addition, the World Bank granted a loan covering the period 1982-1984.

With the requisite financial assistance coming from these two multilateral financial institutions, Thailand adopted and implemented the economic stabilization and the structural adjustment programme. The Thai economy picked up momentum of rapid growth from 1986 and upto 1997, it could maintain GDP growth rate of 7% and above, the saving and investment rate of around 35%, moderate rate of inflation of around 5%, and very low fiscal deficits. Thailand's critical weakness centered around high and unsustainable deficit in its balance of payment – about 6% of GDP and for some years in 1990s, going upto 8%. Again, the share of short term capital flows in financing these deficits went on increasing in 1990s in contrast to the pattern of capital flows during the 1980s. It also had a system of foreign exchange rate under which the value of its currency – Baht – was pegged to the Dollar. And with the rise in the value of Dollar, the Baht's value also increased, making it heavily overvalued.

From the early months of 1997, the pressure on its currency went on increasing and it went on losing its foreign exchange reserves very fast and was not in a position to protect the value of its currency. On 2nd July 1997, Thailand was in the grip of a full scale financial and currency crisis and in next six months, Baht's devaluation took place which was of the order of about 50%. The IMF, The World Bank, other financial institutions extended sizeable financial assistance to Thailand and its economy was again stabilized at higher level of economic growth by 2002. The Thai currency crisis brought to the fore the vulnerability of its financial structure as about 50% of its finance companies had to be closed down.