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THE IMPACT OF THE ASIAN ECONOMIC CRISIS IN THAILAND

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The Impact of the Asian Economic Crisis in Thailand

By

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Abstract

This paper analyses the downturn in the Thai economy from the onset of the currency crisis to current day. The focus is on the economic crisis in Thailand and its impact on the current account deficit, external debt, collapse of the property sector, political instability, the domestic economy, and exports. Discussion is also provided on how much of the economic crisis in Thailand can be attributed to specific development strategies of previous governments; how much of it to intra-region competition for market share and foreign investment; and how much is related to easy credit policies by relaxing fiscal and strongly interventionist monetary policies.

Introduction

Many economic analysts predict the economic crisis in Asia and Thailand will get worse before it gets better. At the end of November 1997, the Thai Finance Ministry expected the Thai Economy to grow by 0 to 1 percent in 1998, compared with 6.4 percent in 1996 (Far Eastern Economic Review, December 18 1997). However, some observers were even more despairing. For example, the Organisation for Economic Cooperation and Development (OECD) predicted the economy would shrink by 1 percent in 1998, and the Industrial Finance Corporation of Thailand (IFCT) forecasted a contraction of 5.6 percent. However, the actual economic results were even worse than many predicted. According to the Far Eastern Economic Review, July 22 1999, the Thai economy shrank by 1.3 percent in 1997.

Furthermore, they predicted that the Thai economy would shrink by another 8.0 percent in 1998 followed by a further shrinkage of 0.5 percent in 1999. Positive economic growth for the Thai economy was only expected in the year 2000 with 2.2 percent being predicted. Moreover, many companies are expected to fail and close their doors thus increasing unemployment well beyond the 2 million mark (Thammavit, 1998).

I. Literature Review

Thailand's distinction of being the first of the Southeast Asian economies to collapse identifies the tenuous nature of Southeast Asia's capitalist boom. Thailand was praised by the World Bank as being outward looking, receptive to foreign investment and having a market-friendly philosophy. Whilst being receptive to foreign investment did make Thailand a home for Japanese manufacturing, leading to the late-1980's boom, this same receptivity was instrumental in Thailand's recent collapse (Bhatia, 1998).

Following World War II, five main Sino-Thai banking groups emerged to dominate Thai finance and commerce. These Sino-Thai banking groups had their roots in shipping, trading and insurance and they forged alliances with a succession of military governments who required funding for their government projects (Suehiro, 1992). Tariffs were levied on imported manufactures with the aim of generating state revenue. Light manufacturing was controlled by the Sino-Thai financial conglomerates that realised rents from production for a protected domestic market. With the British presence in Southeast Asia being reduced and with the rise of the military as the dominant institution in society, Thailand's key external link was increasingly with the U.S. Army (Bhatia, 1998). The U.S. decision to make Thailand the centre of its broader regional operations, as a result of the Vietnam war, together with Thailand becoming a key destination for mass tourism, proved critical in the terms of Thailand's incorporation into the postwar capitalist order (Anderson, 1977).

U.S. Army investment in related infrastructure and a tourism boom into Bangkok contributed to a development boom in the late 60's, characterised by real estate speculation and the increased concentration of land in the hands of those with access to capital. The chief beneficiaries were the Sino-Thai commercial capitalists, top level bureaucratic and military officials and the rural economic elites. This boom began the process of dispossessing subsistence farmers of their land, developing a class of agricultural tenants and an exodus of rural youth into Bangkok to form the beginnings of a Thai working class. This Thai working class provided the cheap labour for tourism and other service industries and for the industrial boom of the late 1980's and early 1990's. Thailand eventually became a central export platform for Japanese industrial capital, however, during the 1970's Japanese industries sought to overcome their own domestic crisis of over-production by taking advantage of Thailand's protected market and the absence of any domestic industrial capitalists (Bhatia, 1998). This was achieved by developing strategic alliances with Sino-Thai capitalists who had a presence inside Thailand's high tariff walls as distributors of locally-assembled manufactures and suppliers of locally-made inputs for local production (Bernard, 1994).

Prior to the boom of the mid to late 1980's Thailand was affected by the rapidly increasing price of oil which it imported and the downturn in commodity prices seriously affected their commodity exports. When interest rates started to increase dramatically, Thailand, like other developing countries, became encumbered with an unsustainable foreign debt burden. As a result, Thailand was forced to enlist the support of the International Monetary Fund (IMF) and was subjected to a structural adjustment program. This restructuring was central to the boom-bust scenario of the last ten years. Two key issues played a major role in this restructuring and were key contributors to the boom-bust scenario. These key issues were identified as the changing role of capital and a more explicit attempt to promote export-oriented manufacturing (Bhatia, 1998).

As far as the changing role of capital is concerned, this involved the privatisation of public enterprises and decisions concerning the allocation of public assets. This also coincided with the increased importance of elections by the late 1980's and these elections were noticeably more democratic. The increase in the importance of these *'so-called'* democratically held elections actually increased the influence of the regional capitalists by increasing the power of capital through enhancing the monetary rewards that induced businessmen to enter politics (Huntington, 1991).

Just as the changing role of capital created the conditions for a domestic economic boom, the explicit attempt to promote export-oriented manufacturing created the path for the influx of Japanese capital. It was the rapid appreciation of the yen and the lowering of Japanese interest rates in the mid-1980's that encouraged the diffusion of labour-intensive Japanese manufacturing throughout Southeast Asia, and especially to Thailand. The influx of Japanese industrial capital created a manufacturing boom that lessened the influence the IMF was able to exert on Thailand, thereby ensuring that structural change in Thailand was short lived and kept to a minimum (Bello, 1997). Infrastructure projects that were requiring structural adjustment as constituted by the IMF were ultimately funded through Japan's development assistance in the early 1980's without any structural adjustment (Shiraishi, 1997).

The greater Bangkok area saw a spate of new factories, a large influx of unskilled workers from the provinces, world class traffic congestion and had become, almost overnight, a major platform for manufactured products for re-export to third countries. From the mid 1980's to the early 1990's Japanese investment poured into Thailand, causing a dramatic rise in exports. Not only was much of the increase in production attributable to Japanese capital but many domestic corporations relied heavily on this Japanese capital.

The Thai boom coincided with the yen appreciation and this meant that assets in other Asian countries appeared ridiculously cheap to Japanese investors. Japanese tourist agencies promoted cheap holidays and more specifically golfing holidays. Developers soon followed the Japanese industrial capital with an influx of investment in golf courses, resorts, hotels, theme parks and retail outlets. By the late 1980's service and real estate related investment had become a quarter of Japan's total investments in Thailand (Reiko, 1991). With restrictions on foreign ownership as a result of the Alien Business Law (1972), Japanese developers and investors formed strategic alliances with Thai capitalists and the higher echelon of the Thai military to control the construction industry.

Finally, Japanese Trading companies formed strategic alliances with the Sino-Thai capitalists whose origins lie in agriculture, buying up large amounts of land, and introducing export-oriented agriculture to meet the increasing demand. The increase in exports of manufactures and agricultural produce; the escalation of asset prices, especially land; the expansion of an urban and professional class; and, the influx of foreign visitors into Thailand created an image among the developers, financial and industrial capitalists, causing many to hold Thailand up as the economic model of the 1990's. However, little attention was given at the time to the movement of the Japanese economy into recession in the early 1990's which led to the collapse of asset prices in Japan, the beginning of a long deflationary spiral, and the gradual drying-up of Japanese investment into Thailand (Bhatia, 1998). The entire Thai power block, including the military, the middle class and the technocrats, were all involved in speculative investment and the zeal of capitalist growth. Lacking the capital to sustain it, they used global finance.

Global finance represents a regulation of finance capital. The globalisation of finance has seen the demise of fixed exchange rates and the dismantling of domestic regulatory frameworks has given rise to a spiders-web of hierarchical relationships. Each form of finance has a specific agency that has a specific set of interests and relationships. Also each form of finance has cemented itself in the domestic environment in specific ways. A key element of the global finance system is its fragmentation, mirrored in its decentralisation and privatisation and the mechanisms for recycling capital (Bhatia, 1998). This is linked to the location of power at global, regional and national levels. New types of financial intermediaries make the distribution channels of finance that link borrowers and lenders more complex, more decentralised and less accountable.

The Thai boom generated an ever-increasing demand for financing at the time when institutional investors such as merchant banks were emerging as an important source of credit. North America's continued recession in the early 1990's convinced fund managers to look for better investment opportunities in 'emerging markets.' In order to attract foreign capital the Thai Government put regulations in place to attract foreign investors. Between 1990 and 1994 the Thai Government undertook several initiatives to deregulate the financial system in order to be accessible to foreign capital. The first initiative involved the deregulation of domestic finance by expanding the scope of operations of commercial banks and financial institutions. The second initiative involved the dismantling of all significant foreign exchange controls and the establishment of the Bangkok International Banking Facility (BIBF) in 1993 (Thammavit, 1998). Under the BIBF Thai and foreign banks were permitted to engage in offshore borrowing in foreign currencies, to convert those funds to Thai Baht and re-lend them to local borrowers. BIBF Loans were the avenue for most of the foreign capital flowing into Bangkok. The third initiative of financial deregulation involved the pegging of the Thai Baht to the U.S. dollar (Bhatia, 1998; Thammavit, 1998). The final initiative involved maintaining interest rates at higher levels than in the developed countries.

These initiatives encouraged institutional investors to pour money into the domestic Thai financial markets. Mutual funds from developed countries were driven to Thailand because of low interest rates in their domestic markets. The influx of these institutional investors resulted in a significant increase in equity capital in markets throughout Southeast

Asia, especially Thailand. Foreign banks took advantage of the arbitrage opportunities provided by the interest rate differentials. Cheap money in Japan, North America and Western Europe came to play a critical role in the organisation of credit with this money being lent to local Thai financial institutions. Financial deregulation also benefited local Thai capital. Once the Bank of Thailand issued new bank licences finance companies competed with each other to establish themselves as major players in the industry by borrowing large sums of money through the BIBF and re-lending them locally, focusing on short term investments, particularly property development. Easy credit and willing foreign buyers facilitated the emergence of a new sector of would-be financiers.

The first noticeable weakness in the deregulated Thai financial system came in 1994 when China devalued its currency to promote labour-intensive exports. This was followed in 1995 by a depreciation of the Japanese yen against the U.S. dollar. These exchange rate shifts did not upset the baht-dollar peg that provided investors with some form of stability but it did reduce the attractiveness of cheap Thai exports. The ten-year increase in Thai exports peaked in 1995 forcing the Bank of Thailand to use its reserves to defend the baht.

By the end of 1995 it was evident that there were no buyers for the luxury housing and modern office space in Bangkok. The stock of vacant units was estimated at $U.S.20 billion (Bhatia, 1998). In June 1996 the Bank of Thailand began to prop up local banks by taking equity in a prominent local bank that was on the verge of collapse (Far Eastern Economic Review, May 21, 1998, p. 62). By early 1997 non-performing loans to Thai institutions stood at over $U.S.3 billion (Bhatia, 1998). The final blow came to the Thai economy when the Japanese Finance Ministry suggested that they may need to increase interest rates to protect the falling value of the yen whose value had fallen significantly against the U.S. dollar. This possibility together with the economic environment of the day triggered a run on the baht and the collapse of Thai asset prices. Merchant and investment bankers began to call in their loans. This sent local lenders who had borrowed in U.S. dollars and leant in local currency scampering to exchange baht for yen or U.S. dollars. As local Thai investors began to sell their stocks, institutional investors were selling off all of their Thai holdings, triggering a collapse of asset prices. As a result of this wholesale sell-off of Thai equities and currency the Bank of Thailand tried to preserve the baht-U.S. dollar peg by buying up the currency that was being traded. They did this by using official foreign reserves. By July 1997, the Bank of Thailand had no choice but to replace the fixed exchange rate with a managed float, as it could no longer tap the reserves. When the Thai Finance Minister's request for a loan was turned down there was little alternative but to call in the IMF. Fifteen years since its last economic crisis, Thailand was once again subjected to IMF structural adjustment.

In summary, the main causes of the economic crisis in Thailand are, firstly, large deficits in the current account. Thailand's deficit was 8 percent of GDP in 1995; 7.9 percent in 1996 and 1997 (Far Eastern Economic Review, January 15 1998). Also the export growth rate decreased by 23.5 percent between 1995 and 1996. The deficits caused the country to rely heavily on external borrowing (Thammavit, 1998).

Exhibit 1

Monthly Statistics 1997

External Accounts (in billions of baht)	May	June	July	Aug	Sept
Exports	124.0	119.3	137.6	147.7	171.1
(Percent Change)	0.8	9.3	24.2	25.1	52.0
Imports	140.8	143.8	159.6	170.6	170.0
(Percent Change)	-10.2	-1.9	9.1	9.4	23.7
Trade Balance	-16.7	-24.5	-22.0	-22.9	1.1
Current Account Balance	-22.7	-23.2	-17.7	-18.6	-3.9
Balance of Payments	-112.3	-24.6	-51.5	-146.1	133.0
Official Foreign Reserves (U.S.$bn)	33.3	32.4	30.4	25.9	29.6

Source: Bank of Thailand (cf Thammavit, 1998)

Secondly, excessive external debt, in 1997 the International Monetary Fund (IMF) estimated that Thailand's external debt was about $U.S.99 billion i.e. about 55 percent of GDP. The majority of this debt was privately incurred and this large external debt sharply lifted the country's debt service ratio from 11.4 percent in 1994 to 15.5 percent in 1997 (Thammavit, 1998).

Thirdly, the collapse of the property sector that began to boom in the late 1980's. With the liberalisation of international capital flows in 1993 this sector grew rapidly. By 1995, an oversupply of housing emerged, expanding into a major problem. With loans increasingly becoming more expensive and hard to get under the Bank of Thailand's squeeze on lending, the property sector began to collapse in 1996. The property sector's debts totalled around 1,000 billion baht in 1996. The slump in the property sales market and lending squeeze worsened developers cash flow troubles and defaults on interest payments. As a consequence many finance companies and small banks faced liquidity problems, with 16 finance companies suspended in June 1997, and another 42 in August 1997. By December 1997, 56 finance companies were closed permanently.

Exhibit 2

Monthly Statistics 1997

Monetary Statistics (in billions of baht)	**May**	**June**	**July**	**August**	**September**
M1	430.1	396.4	393.5	428.4	400.5
(Percent Change)	2.7	0.8	-3.6	7.3	-1.9
M2	3,910.6	3,958.1	4,047.5	4,139.4	4,166.3
(Percent Change)	11.3	11.9	14.5	16.7	16.6
Monetary Base	454.4	514.3	468.5	435.6	433.8
(Percent Change)	11.5	29.8	14.6	9.9	7.4
Bank Deposits	3,816.0	3,986.9	4,059.4	4,035.0	4,065.5
(Percent Change)	11.8	15.9	18.2	16.9	16.5
Commercial Bank Credit	5,112.2	5,076.1	5,308.6	5,420.3	5,539.2
(Percent Change)	12.4	10.4	15.3	16.4	17.0
Excluding BIBFs	4,263.5	4,246.2	4,281.3	4,326.0	4,391.8
(Percent Change)	12.8	11.1	11.5	11.3	10.9

Source: Bank of Thailand (cf Thammavit, 1998)

Fourthly, exchange rate mismanagement, with a fixed exchange rate and the liberalisation of international capital flows, foreign money poured into Thailand between 1993 and 1996. As a result the Thai baht became overvalued against other currencies, partly slowing down growth in exports in 1996, however, the Bank of Thailand continued to peg the baht to a basket of currencies in which the U.S. dollar had a significant influence. Speculators attacked the baht in February and May 1997 and in order to defend the currency the Bank of Thailand used official foreign reserves. The net result being that official foreign reserves fell from $U.S.39 billion in January 1997 to $U.S.32.4 billion in June 1997. Additionally, the Bank of Thailand sold $U.S.23.4 billion of the reserves on the forward market. In July 1997, the Bank of Thailand had to replace the fixed exchange rate with a *"managed float",* as it could no longer tap the reserves. The exchange rate for the baht has fallen steadily since then from 25.8 baht to the $U.S. to around 40 Baht to the $U.S. currently, with the Baht reaching 50 Baht to the $U.S. before settling at its current level. The mismanagement of the exchange rate system has been cited as evidence of central bank incompetence (Thammavit, 1998).

Finally, political instability, Chavalit Yongchaiyudh's administration, which lost government in November 1997, performed very poorly in economic management (Far Eastern Economic Review, May 21 1998). Its economic teams lacked unity and common goals, and failed to deal with the mismanagement by the technocrats. Confidence of foreign and domestic investors slipped away, and the economy continued to worsen after the 1996 elections.

II. Results

A. Domestic Economy

The government of Chuan Leekpai set as its economic objective for the 1997/1998 fiscal year a budget surplus of 1 percent of GDP. This objective was set in order to meet an important condition set by the IMF for its $U.S.17.2 billion bail-out of the economy (Far Eastern Economic Review, January 22 1998). This surplus was to cover the cost of the support for the ailing finance companies and commercial banks. In total 58 finance companies required support from the Financial Institutions Development Fund that amounted to 440 billion baht worth of support. An additional 220 billion baht was extended to commercial banks and other finance firms. The 1998 fiscal budget stood at 800 billion baht, which was 11 percent lower than the amount spent in 1997. The revenue target of 872 billion baht was expected to fall to 802 billion baht, forcing the government to make more spending cuts and/or increase taxes, which would hurt the economy further (Thammavit, 1998).

In the 1997 fiscal year, the government had a budget deficit of 44 billion baht – the first deficit after nine consecutive years of surpluses. Its expenditure for 1997 was 888 billion baht. With 844 billion baht in revenue and 13 billion baht in non-budget surplus, the government still had a cash deficit of 31 billion baht (Thammavit, 1998).

Private spending slowed down in 1997 as pay increases were small or non-existent and employee lay-offs commenced. Retail sales decreased nationwide by approximately 4 percent in the first three-quarters of 1997 compared with the same period in 1996. Imports of consumer goods also decreased by 1 percent in the same period. Value-added tax increased from 7 to 10 percent in August 1997. Private investment also shrank considerably in 1997 with the private investment index shrinking from 100.1 in 1996 to 83.5 for the same period in 1997. Imports of machinery and parts also fell by 2 percent with construction falling further with permits issued for 9.6 percent less space in the same period of 1997 as for 1996 (Thammavit, 1998).

Manufacturing production was reduced as a result of a slowing in domestic demand and the financial crisis. The manufacturing production index decreased by 5.1 percent in August 1997 compared with the same period of 1996, and by 6.7 percent in September 1997 compared with the corresponding period in 1996. Vehicle production decreased from 416,617 in the first three quarters of 1996 to 330,440 for the same period in 1997. However, the output of petroleum production increased by 24.5 percent in the first eight months of 1997 due to the opening of two new refineries in 1996 (Thammavit, 1998).

B. Exports

Exports increased by 26 percent in baht terms in 1997 mainly because of the heavy depreciation of the baht. It was expected that this rapid increase in exports because of the depreciation of the baht would help ease the impact of the economic downturn and act as a trigger for an economic recovery. Among the principal exports, exports of electrical and electronic products expanded well. Computers and components accounted for 11.4 percent of total exports, increasing by 12.4 percent in the first three-quarters. Exports of integrated circuits increased by 20.5 percent; radios and televisions and their parts by 11.8 percent, and transformers by 39.1 percent for the period. The baht's collapse helped exports of labour-intensive manufactured goods. For example, during the first 10 months of 1997, while exports of industrial products grew by 18 percent the exports of agricultural products grew by only 4 percent (Thammavit, 1998).

In terms of destination, exports to ASEAN Countries in 1997 accounted for 21.3 percent of total exports. The second-largest buyer of Thai products, the U.S., saw exports increase by 24 percent in the first three-quarters of 1997. Exports to Australia, Belgium, Hong Kong and Taiwan also increased significantly.

Thai imports also dropped by 10 percent in the first 10 months of 1997 to $U.S.54 billion. This caused the trade balance to improve to a deficit of 174 billion baht which is 54 percent lower than for the same period in 1996. A good sign for the future is that the country is continually improving its current account balance as a result of its continued increase of exports over imports (Thammavit, 1998).

C. The World Economy

Asian economies, especially those of ASEAN and South Korea have become embroiled in the financial crisis that first hit Thailand. Apart from Thailand, South Korea, Indonesia and The Philippines had to ask for stand-by-credit from the IMF. Several floated their currencies which all sank fairly fast. Economic growth of all Asian nations has slowed quite dramatically with the OECD predicting that the Asian financial crisis could cut the economic growth of major developed nations quite significantly.

Exhibit 3

World Economy and Inflation

Economic Growth	**1995**	**1996**	**1997**	**1998 (Forecast Only)**
World Economy	3.7	4.1	4.2	4.3
U.S.A.	2.0	2.8	3.7	2.6
Japan	1.4	3.5	1.1	2.1
Germany	1.9	1.4	2.3	2.8
European Union	2.5	1.7	2.5	2.8
Major Industrial Countries	2.0	2.4	2.8	2.5
Developing Countries	6.0	6.5	6.2	6.2
Inflation				
U.S.A.	2.8	2.9	2.4	2.8
Japan	-0.1	0.1	1.6	0.7
Germany	1.8	1.5	1.9	2.3
European Union	2.9	2.5	1.9	2.2
Major Industrial Countries	2.3	2.2	2.1	2.1
Developing Countries	22.7	13.2	10.0	8.9
World Trade Volume	9.5	6.3	7.7	6.8

Source: IMF, World Economic Outlook, October 1997 (cf Thammavit, 1998)

The IMF expected world economic growth for 1998 to be similar to that of 1997 i.e. approximately 4 percent. However, economic growth for the U.S. is expected to decline from 3.5 percent in 1997 to 2.5 percent in 1998, a decline of 1 percentage point. Whilst economic growth for the European Union is expected to increase marginally from 2.5 percent in 1997 to 2.8 percent in 1998 (Far Eastern Economic Review, January 22 1998).

Meanwhile ASEAN has expanded to include Vietnam and Burma (Myanmar). ASEAN member countries have cooperated well during the crisis expanding inter-ASEAN trade.

III. Conclusions

The Thai economy is generally expected to worsen in 1998 and 1999 because of the financial crisis. However, there are some positive signs:

- In 1997, parliament passed a new constitution. Under the new constitution, the government and politicians alike are expected to be more concerned about the national interest than their own.
- The government of Chuan Leekpai has done a good job, economically, especially as far as restructuring the finance sector.
- Thai exports have increased with the depreciation of the baht. The trade balance and current account has improved with this trend expected to continue in 1998 and beyond.

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