

**Thailand 1997 Financial Crisis as the Prologue to the Sept. 06 Coup**



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**Thailand 1997 Financial Crisis as the Prologue to the Sept. 06 Coup**



- I. Thailand Political and Economic Background,**
- II. The 1997 Fin. Economic Crisis,**
- III. The Resolution to the Crisis,**
- IV. The Birth of Populist & PM Thaksin,**
- V. Interim PM Gen Surayud Government,**
- VI. Analysis and Implications and**
- VII. Conclusion and Challenges.**

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### Basic Information on Thailand



- **64 Million People** with average annual income of \$ 8,300 (2005 est., on PPP basis)
- **Total Area** as big as Spain
- **Major Religion** : Buddhism (94.6%), Muslim (4.6%)..
- **Main Export** over \$105 billion worth of product : Food, Rice, Rubber, Tourism, Automobile parts, Jewelry, ICT appliances
- **Political System** : Interim National Assembly, soon to be elected Parliament in 2007 with Constitutional Monarchy
- **Head of State** : King Bhumibol
- **Interim Prime Minister**: Gen. Surayud Chulanont

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### Table 1: Structure of Financial system in East Asia (Bank & Stock based system)

| Economy         | Bank Assets (% of GDP) |              | Equity Market Capitalization (% of GDP) |             | Bonds Outstanding (% of GDP) |             |
|-----------------|------------------------|--------------|---|-------------|------------------------------|-------------|
|                 | 1997                   | 2005         | 1997                                    | 2005        | 1997                         | 2005        |
| China           | 124.4                  | 191.6        | 11.2                                    | 20.9        | 12.9                         | 28.6        |
| Indonesia       | 34.3                   | 68.4         | 36.4                                    | 39.8        | 2.1                          | 27          |
| Korea           | 67.7                   | 91.9         | 14.5                                    | 89.6        | 45                           | 74.9        |
| Malaysia        | 100.6                  | 162.5        | 93                                      | 140.6       | 56.9                         | 89.7        |
| Philippines     | 76.5                   | 61.3         | 51.4                                    | 39.3        | 30.5                         | 35.6        |
| <b>Thailand</b> | <b>79.7</b>            | <b>102.1</b> | <b>15.1</b>                             | <b>69.7</b> | <b>7.1</b>                   | <b>40.2</b> |
| Hong Kong       | 208.2                  | 443.3        | 238                                     | 591.9       | 26.4                         | 46.5        |
| Singapore       | 122.7                  | 185.3        | 111.5                                   | 220.3       | 24.8                         | 68.2        |

Source: Ghosh (2006) "East Asian Finance: The Road to Robust Markets"

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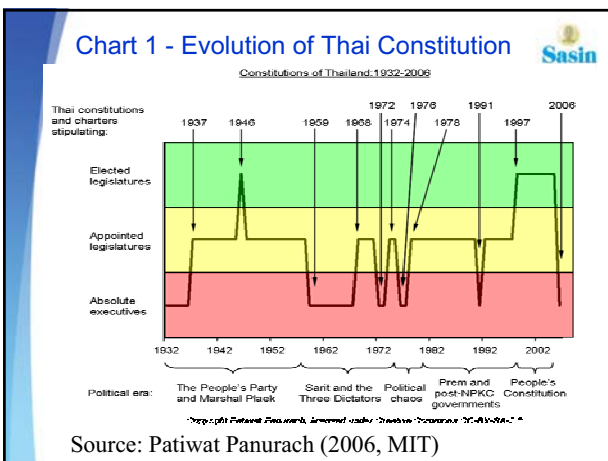
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## The 74 Years of Thailand Democracy Evolution in Brief



**The Democracy Monument** in Bangkok, built in 1940 to commemorate the fall of the absolute monarchy in 1932, was the scene of massive bloody demonstrations in 1973, 1976 and 1992.

- During **1932 to 1973**, history was dominated by the military dictatorship.
- The **history of Thailand since 1973** has seen a difficult and sometimes bloody transition from military to civilian rule, with several reversals along the way..
- 33 Admin. /24 Prime Ministers  
Average Duration = 2.24/3.1 yrs  
**Two Admin. Served full 4 yrs term.**
- 17 Constitutions/Charters..  
Average Duration = 4.35 years  
**People's 1997 Constitution lasted 9 yrs..the most democratic of all.**

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## Thai Financial Crisis: Original Sin



1988-1996 - Thai economic boom periods but with chronic Current Account deficit, weak financial systems and overvalued domestic currency.

- This spectacular growth was propelled by **exports** (with a pre-crisis average growth of 23%), **investment** (with an average growth of 22%), **and widespread speculative activities**, especially in the property sector.
- Thailand's **banks** were **massively over-extended** with Loan-to-Deposit ratios of around 130% before the crisis, while NPLs were virtually a non-issue.
- In financing the spectacular growth, Thai **corporations** were often **borrow in USD term and over-extended** with the D/E ratios of the non-tradable sector staying above 2.0.
- All of these events took place while the Thai Baht was still pegged to the U.S. Dollar.

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## Thai Financial Crisis: Genesis



May 1997 - Foreign speculators attack the baht. Bank of Thailand committed "forward swap" notionally equivalent to 90% of foreign reserves to defend the baht against speculative attack.

- The event is triggered by an export contraction in 1996 (-1.9% y-o-y, compared to +24.8% in 1995), the Baht was subjected to speculative attacks.
- It is "commonly misunderstood" that Thailand's international reserves were "wiped out" from a futile defense of the currency.
- **July 2, 1997** - Thailand changes its exchange from fixed to managed floated exchange rate, the de facto massive baht devaluation. Soon Thai government requests "technical assistance" from the IMF.

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## Thai Financial Crisis: Unfolds



Aug. 5, 1997 Thailand received a \$17 billion loan from the IMF with tough economic measures conditions.

- Thailand's GDP contracted 1.4% in 1997, and the contraction worsened to -10.5% in 1998, compared to the double digit growth during the bubble era.

Dec. 8, 1997 – 56 insolvent finance companies and one commercial bank are closed. The remaining financial institutions suffer from financial panic.

- Due to the BOT's intervention into ailing financial institutions, the number of Thailand's finance companies has been cut to 18, from the pre-crisis level of 91, while Thai commercial banks dropped to 13, down from 15 in 1996.
- Banks' NPLs skyrocketed, as a result, is reaching 46% of total loans in March 1999 due to massive balance sheet destruction for all firm.

Dec. 31, 1997 – The SET index declines from 787 in Jan. 1997 to a low of 337 in Dec. of that year. Thai economy turns into recession spreading throughout Asian region.

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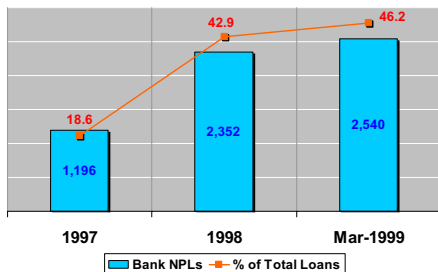
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Chart 2: Bank's NPLs during 1997 to 1999



Recession reins as, Banks as a long life institutions lose their creditability and firms lose their trustworthiness. Thai credit market fails. At the peak, Thailand's bank NPLs rose rapidly to (USD67.8 billion), or 46.2% of total loans, in March 1999.

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### III The 1997 Thailand Post Mortem: Coordination Failure



Political Economic Impact in 1997 were as follows :

- **Currency Instability** : Baht from 25 to 57 /USD causing devaluation in the region. ( Globalization ! )
- **Blanket Guarantee** was issued to protect Bank/ Fin. Depositors/creditors to stop bank run.
- Only 19% of Thai firms had any hedging at all.
- SME and/or family owned firms borrowing in bahts went under because of high interest rate – over 20%! **\*\*\*Crisis of SME/Middle Class Collapse\*\*\***
- Collapse of the financial and banking sectors
- Major Economic Contraction (-10% GDP)
- Fall of the **PM Chavalit Gov't** shortly after in late 97 (later came back as DPM along with his MoF in Thaksin Admin.)

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### Thailand's 1997 Experience Post Mortem



Right after the 1997 Crisis, PM Chuan Govt

Basically followed IMF's advise of 'Free Market', 'Free Democratic' process.

1. A Few General Results
  - 'Ideology Clashes' : **Reform Fatigue**
  - **Growing discontent with globalization**
2. A Few Examples of Market Failures
  - **Thai Credit Market Failures.**
  - **Lack of effective Demand Side.**
  - **Discontinuity in Supply Side**

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### III Change everything all at once



IMF & High Hope: **PM Chuan Gov't** (Aug'97 - Feb 01)

1. **Fin. Sector Reforms** (asper IMF's request- Pro free-Market)

- **Increased Foreign Participation** : Bank/NPL sell off, M & A, no foreign ownership limit...
- **Forced Insolvent Institutions to close and FIDF** took over 58 finances and 4 banks; later forced merge Results : Only 12 Banks and about 20 finances left
- **Fin Institution Act** – Modernize the framework
- **Bank of Thailand Act** – Independent & A/C
- Passed **Bankruptcy Act** – Chapter 11 & others.
- Amended the Public Co. Act & SEC.
- **Econ. Dream Team** – Dr. Supachai, Tarrin, etc.

**Speed up Privatization** : Master Plan in 1998

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### III Reform Fatigue, Coordination Failure & Capacity Problem



The Fallouts of Market base Policy : **PM Chuan Gov't**

#### 2. Market must clear itself. Where is the cash/market ?

- **Fired Sale** of NPA by Financial Restructure Agency causing deep discount price benchmark causing a complete collapse in asset based loan lending >>SME
- **Institutions engineered to snap up cheap assets** – NPLs, NPAs & distressed loans.

#### 3. Setting up TAMC (owned by FIDF) to buy the residual NPL : warehouse

#### 4. Cutting down education subsidy...

Are people both public & private be ready for... ?

**No Pain, No Gain !?! >> Not Popular Ideas !!!**

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### III. To Preserve Democracy or Economic Reform ?



High Hope: **PM Chuan Gov't** (Aug'97 - Feb 01)  
with mandate for political economic reform

#### 5. People 1997 Constitution & Election in 2001

- First Election ever for the Senators (as **independent**)
- Establish of '**independent** agencies/watchdog - NCCC, Election Comm., Admin. Court, NGO
- Public Info Disclosure Act
- Decentralization Initiative in admin & tax power

**The aim is for fewer political, stronger parties.**

Reforming both economic and political system, at the same time, **but forget** to assist the social and community burden.

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### III Burden Sharing : Fiscalization of FIDF losses



Projected 1.4 trillion baht losses  
( equivalent to about 30% of GDP where 42 baht = 1 USD)

Losses in closing down  
56 Finance in 1997

Interest & Expense

Loss in NPA, Recap &  
Intervention

FIDF 1 Bond  
500 billion

FIDF 2 Bond  
112 billion

FIDF 3 Bond  
780 billion

Issue in 1998

Issue in 2000

Issue in 2002

**Burden Sharing** : The BOT is responsible for principal repayment while the MOF is responsible for interest payment. Source : Bank of Thailand ; MoF Aug. 02

**Redistribution of Wealth**

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**Thailand Previous PM Pol Col Thaksin Shinwatra**  
Feb 9, 01 to Sept. 06



Tainted with corruption, scandals and power manipulation

According to Prof. Kaewsant Adhipothi (2006) there are five characteristics of **Thaksinocracy**:

1. Hijack the 1997 Constitution
2. Control and distort the Democracy
3. Replace Nationalism with Materialism
4. Extremely Corrupted
5. End peace and justice of the land

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**Behavior Econ. & Micro Econ Concerns (by design)**



**State Bank Lending** as quasi-fiscal spending distorts from Private lead Bank to **Command and Control Bank System**. The **B200 b Vayupak Fund** guaranteed by gov't (to support SET) is being issued to the people in order to recapitalize state banks.

- State Banks are prone with **common agency problems** with multiple objectives. High loan growth with political agenda & little discipline means high NPL.
- **Gov't guarantee mutual fund distorts market** and raise substantial contingency liability burden to the public.
- Mutual fund should be invested according to bank or corp performance and its objective.

Suggestion : Emphasizing more on quality intervention in **market failure segmentation** rather than quantity.

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**Regenerating Process - Effects of Thai Government Policy**



| Fiscal Year  | 2002 Mil. | Effects on GDP Growth (%) |
|--|-----------|---------------------------|
| <b>Fiscal Policy</b>                                     |           |                           |
| Expansionary Fiscal Spending                             | 22,812    | 0.21                      |
| <b>Quasi-fiscal Policy</b>                               |           |                           |
| People Bank  | 7,596     | 0.1                       |
| Local Business Credit Assistance (BAAC)                  | 3,873     | 0.1                       |
| Cheap Housing Loan Project (GHB-Government Pension Fund) | 21,792    | 0.4                       |
| Government Housing Loan Project for SOEs                 | 2,864     | 0.0                       |
| <b>Total (Source: FPRI, MoF June 03)</b>                 |           | <b>0.6</b>                |

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**Think Old, Act Old (1) : Command Econ. ?** 

- One Strong Man Leadership
- Rigid Structure with Centralized Command n Control Economy
- Dual Tracks: Globalization & Trilemma
  1. Social Welfare Plan : Liberal Populist ?
  2. Big Gov't. : For Selective Giant Private Corp.
- **Analyzed this !** The key questions are :
  1. Who participates in this decision?
  2. How much freedom is allowed in this decision making ?...Freedom of Expression, Press and Association ?

**\* More Participation, More Contestation !**

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**Think Old, Act Old (1) : Command Econ. ?** 

**Analyzed that ! Econ. vs. Political Decision** or Pricing vs. Voting (+Freedom of Expression)

1. Development Stage of Nat'l Econ.
2. Relative share of Public vs. (Which) Private Sec.
3. Institutional frameworks changed within reasonable time horizon –What's about People ?
4. (Cocktails) Objectives of The Policy n Admin.

**US Style :** 'Prosperity through Consumption, and Productivity/Innovation growth' or

**Japanese Style :** 'Prosperity through Export, Stability through Econ. Restructure, Assset Ref.,

**Singaporean Style :** 'Rich Nation, Big Gov't

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**Thailand political crisis 2005– 6** 

- **Original Sin** – State bank KTB CEO Mr. Viroj Nualkhair controversy, CTX/Airport Link deal Corruption, Nepotism, Scandals..The conflict of interests escalates..
- **Triggering Points:** \$1.88 b Tax Free Sale ( & foreign nominee) issues of **Shin-Temasek deal** lead to the house resolution.
- Anti-Thaksin and pro-Thaksin rallies
- The **"Finland Plot '99"** by "leftist October'70"
- The **"Charismatic Figures"**
- August 2006 – **"Faked" Car Bomb Attempt**
- **Sept, 2006 Coup D'etat (or Coup De Grace ?)**

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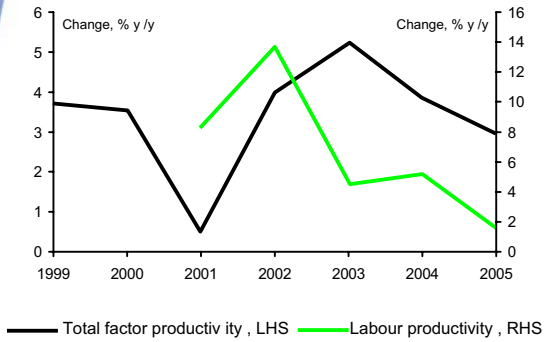
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Chart 6: Measures of productivity



Source: CEIC, UBS estimates

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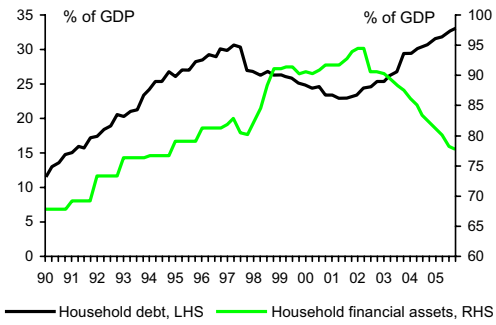
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Chart 4: Household debt & savings



Source: CEIC, UBS estimates

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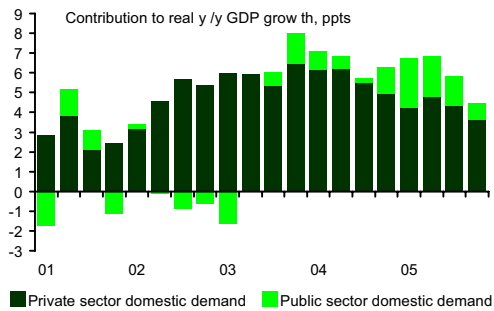
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Chart 5: Private versus public sector domestic demand



Source: CEIC, UBS estimates

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**Thailand Interim PM Surayud Chulanont, Oct 06 - Present** 



Maiden Speech focused on

- 1. **Justice to All:** Tackling Peace to the (Muslim dominated) Southern Unrest.
- 2. **National Harmony:** Bringing Unity to a country divided by previous Admin.
- 3. **National Gross Happiness,** not GDP,
- 4. **HM the King** suggestion to emphasize more "Self-Sufficient Economy"

- Born Aug. 29, 19 43
- Married, Buddhist
- A Former Army Chief, Supreme Commander and Privy Councilor
- Nature conservationist
- both a skilful soldier and a tactful leader.
- Son of Communist, Lt. Colonel Phayom
- Grandson of failed rebel Phraya (Lord) Sri Sitthi

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**PM Surayud's Political Priority** 

- 1. **Political Stability: First and Foremost..**
  - Series of visits to North & North-East to meet and chat with grass root people..
  - Visits to Neighboring nations (except Burma)
  - Active the Internal Security Operation Command
- 2. **Southern Unrest:** > 1,700 casualties since '04
  - Revived the Southern Border Provinces Admin. Center (SBPAC) for Open communication and "self-rule" (Abolished by Previous Admin in '02)
- 3. **Cracks down on Corruptions:**
  - AEC (Asset Exam. Com), NCCC (Nat'l Counter Corruption Com), OAG (Office of Auditor-General)..

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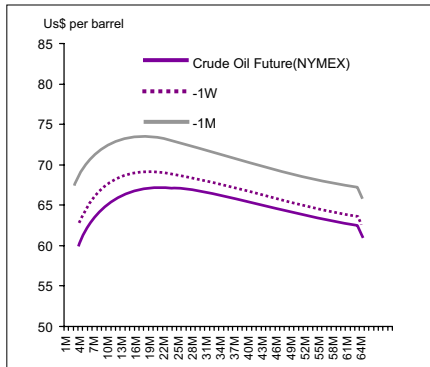
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## Oil Future Yield Curve (Oct 06)




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## Globalization & Trilemma



1. **Capitalism** – is a belief in 'In-equality', is a 'free' market oriented system and based on rational self-interest individuals.
2. **Democracy** – is a belief in 'Equality', is a political process based on one man/woman, one vote with guaranteed 'Freedom of Speech'.
3. **Social Welfare** - maximization should be a government t main objective. State Social Welfare System is invented to make Capitalism and Democracy ideals Compatible.

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**Capitalism : The Invisible Hand** 

**1. Capitalism is a system by itself based on**

- rational, self interested individual,
- 'free' Walrasian exchange market orientation,
- An 'invisible hand' always at works for self correction at the society's best interest.
- Ideally yield 'Pareto' Optimal Allocation.

**2. The main drawbacks of the Capitalism :**

- Based on Ideal Perfect and Complete Market
- **Market Failures** are plain and plentiful.
- Game theory is applicable in impaired market
  - Monopsony, Monopoly, Oligapoly Mkt Power
  - Sequential Nash strategic payoff perturbation...)
- Any set of price in a game is the equalbria outcomes in which each individual rational self -interest player select strategically after learning the rules of game (e.g. player, action & outcome..)

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**Democracy: The Grabbing Hand** 

**1. Democracy in both value and virtue is**

- A Political Process to achieve all means & ends
- Based on 'Equality' Belief at heart
- One-man, One-Vote (+ 'Freedom of Speech')

**2. The first lesson for economist from political science is the government is NOT single, rational decision maker as suggested by Krueger [1994]**

**3. Shleifer & Vishny [1999] - 'The Grabbing Hand'**

- Politicians are rational and self interested.
- Politicians concerned about re-election, exercise of power and prestige.
- Political Campaigns needs a lot of money.
  - 'Money Politics', 'Patronage System'
- Democratic purity is sadly and inevitably distorted by the big, rich and powerful in domestic and now frequently across nations.

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**Democracy: The Grabbing Hand** 

**4. Parenti [1980, pp. 262- 269] – 'The Bureaucratic system'**

- The political process continues beyond legislative bills and executive orders.
- The bureaucratic civil officials are undependable administrative process.
- Most Officials are also rational, self interested for their career and economic gains. [Except: Benevolent Social Guardians]
- Most Officials are neither **neutral** or **nonpartisan**.
- Most Officials are neither **elected** by the people nor **responsible** to the legislature.
- Many Officials' first line of defense is to **selectively** present information and mis-information to the minister and/or public.
- Many officials overtime learn to play 'Game or Timing' or duel for information disclosure as deemed by Shubik [1991]

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## Welfare : The Helping Hand



### 1. Max. Social Welfare as a primary objective.

- Ex : Medical Care, Public School, Unemployment benefits,...
- Market oriented capitalism may be efficient economically for society as the whole (to whom), but inequitable (to many).
- Public-choice theory is the helping hand to correct the market failures and to closer realign public and private interest.

### 2. The end of purely equity oriented society in state socialism signifies the need to face the challenge of difficult balancing act of the trilemma.

### 3. Tax and Social Welfare

- All social welfare are prohibitively expensive.
- Tax system used to be basically a social accept-able approach to redistribute income and goods from the 'have' and the 'have not'.

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## Behavior Econ. & Micro Econ Concerns (by design)



**Populist Policy** with a strong leadership may give '**a false sense of Entitlement**' and un-funded social welfare commitment which may not be sustainable.

This is a **path dependence (QWERTY) process** !

1<sup>st</sup> Degree : Durability : Initial Condition/ Assertion

2<sup>nd</sup> --- : Past Conditions: Imperfect Foresight

3<sup>rd</sup> --- : Remedial Inefficiency : Propagate Any Errors

Suggestion : Changing attitude of ruling party and recipients from entitlement to **enable-ment policy** for asset accumulation in **market based economy** would be a better **inter-temporal** solution.

Same implications may be applied to banking resolution!

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## Joseph Schumpeter (1883–1950)



- Contrary to Marxist theory, and other theories that place faith in the 'will of the people', Schumpeter claimed that **the masses are capable of little, other than stampeding. Democracy should be limited to elitist, representative forms**, in which the masses have the power only to vote at regular intervals for representatives who compete for popular support.

- In *Capitalism, Socialism and Democracy* (1942, PP. 82 to 85), Schumpeter characterizes **capitalism** with the famous phrase "**creative destruction**" in which old ways of doing things are endogenously destroyed and replaced by the new.

This view seems far more current than Smith's Newtonian notion of an "invisible hand" generating stability in the marketplace.

- **Schumpeter concluded capitalism will be replaced by socialism for non-Marxist reasons.**

People and their Culture,  
Education level Matter.

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## VII. Conclusion (1)



1. Central to banking and crisis resolution in Thailand is to **tradeoff** between **private** lead economy/ efficiency and people equity using mainly **public** coordination / means.
  - The reversal of policy from pro-free market to big government causes delay in bank reform.
  - Banking is increasingly dominant by state banks.
  - If market based and private, the specially SME and investment, lead growth for higher productivity can not be restructured and regain its dominant sector again as in the pre 1997 crisis, sustainable recovery by government remain doubtful.

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## VII. Conclusion (2)



2. The main concerns are the mass behavioral economic fallouts and micro economic concerns.  
Bounded rational & willpower, 'a false sense' of entitlement, over-confidence and 'borrowed' endowment effect are among fine examples apart from typical micro-economic moral hazard, free rider and agency problem.

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## Lessons to be learned from the Financial Economic Crisis:



1. At Household and Firm Level, we need 'a beautiful mind' (Game Theory) to understand :
  - how market can fail and
  - how to adapt and to learn constantly from our experience and any 'outside of the box' thinking.
2. At national level, one should learn that
  - Sequential prioritized Development in capitalism, democracy and welfare does not work.
  - >> Need a balance approach
  - Solution or Illusion : Capacity Building or Hand-out
  - Symptoms or Issues : of the problem
  - Virtuous vs Viscous [Political Economic] Cycle

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### Lessons to be learned from the Financial Economic Crisis:



3. At the international level, we need to understand

Each country is different in

- political economic development, culture ...
- needs in different adjustment speed to globality.
- **Incentive** : ‘Growth’ – More Market, More Demand  
>> Implications for WTO, FTA, etc.
- **Classes** : Three Leagues of Nations
  - Division 1** – (Developed nations /G 7) Free Mkt, Flexible FX in **Friedman way**, Small Gov’t
  - Division 3** – (Nation Building /African) Partially closed economy in **Keynesian way**, Fixed FX, Strong Gov’t.
  - Division 2** – (Emerging nation) Semi-Free Mkt in **Schumpeterian way**, Managed FX, Creative Destruction through “managing openness” in trade, investment, communication...

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### Reference - for further reading



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\*Available for free download (or forthcoming) at [www.Pongsak.Hoontrakul.com](http://www.Pongsak.Hoontrakul.com)

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