Weak State and Political Economy of Thailand: Ten Years after the Crisis

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Summary

The main thesis of this study is concerning with strength or weakness of the Thai state. It will argue that degree of state’s weakness/strength is a very important variable to understand the political economy of Thailand, but unfortunately it is often ignored by scholarly Thai studies. This study offers an explanation of the changes of Thai political economy by focusing mainly on this variable. It is of the opinion that low degree of state strength or high level of state weakness is capable of explaining genesis of the 1997 economic crisis, poor performances of crisis resolution and unsuccessful in creating a new mode of capital accumulation for next rounds of growth. For the genesis, the decline or the weakening of technocratic macroeconomic agencies especially the Bank of Thailand—the strongest section of the state—is a very important cause of the crisis as argued by Apichat (2002). This study will further argue that weaknesses of the Thai state can also explain the poor performances of crisis resolution and contribute greatly to the unsuccessful creation of new mode of accumulation.
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I. Introduction

The main thesis of this study concerns the strength or weakness of the Thai state. It will argue that the degree of the state’s weakness/strength is a very important variable to understand the political economy of Thailand, but unfortunately it is often ignored in scholarly Thai studies. This study offers an explanation of changes in Thai political economy by focusing mainly on this variable. The study shows that a low degree of state strength, or high level of state weakness, is capable of explaining the genesis of the 1997 economic crisis, the poor performances of crisis resolution efforts, and the lack of success in creating a new mode of capital accumulation for the next round of growth. The weakening of technocratic macroeconomic agencies, especially the Bank of Thailand – the strongest section of the state – is a very important cause of the crisis as argued by Apichat (2002).

The study will be divided into six main parts. The first is the introduction. The second section will discuss the state’s role in crisis resolution while the third will deal with the state’s efforts to reconfigure the basic rules of the financial game. The fourth part will try to point out new developments in the Thai polity during the controversial Thaksin Government period. The sixth section will briefly single out consequences of the 19th September 2006 coup on the economy, and the final section is the conclusion of this study.

The Asian Crisis and the End of the Bankers’ Capitalism

From 1951 to 1996, the annual growth rate of the Thai economy was 7.8%, an impressive figure by any standard. Relationships between the banking capital and the state were at the center of this growth process. Bankers played pivotal roles as an intermediary between savers and investors, and as coordinators of investments among firms and industries. Banker’s decisions were based mainly on friendship, kinship or ethnic ties, with minimum prudential considerations. They had a strong relationship with the military, providing them with various benefits in exchange for political support; especially for vetoing the (BOT) Bank of Thailand’s efforts to develop an effective policy to create prudential supervision of, and competition within, the banking system. On the other hand, the BOT, with minimum intervention from the military, provided a stable macroeconomic environment conducive for growth. The result of this triadic relation was a high-debt-growth model, led by the bankers. Ammar, a leading economist in Thailand, names the above a period of ‘bankers’ capitalism’ in order to emphasis the central roles the bankers played, – especially in terms of capital allocation and investment coordination with minimum state interventions. This is in contrast to the experiences of South Korea and Taiwan during their catch up industrializations, where the roles of investment allocation and coordination were largely conducted by the state. To
this end, it is generally agree that the Thai state is not a strong or a developmental state. Rather is can be classified as an intermediate state along the continuum of state strength from predatory to developmental state suggested by Evens (1995). Although the strength of the Thai state was very limited compared to a developmental one such as South Korea’s, it was nevertheless ‘adequate’ to jump start the economy by building the bankers’ capitalism mode of accumulation for economic growth.

However, the ‘bankers’ capitalism’ began to decline in the late 1980s, and was brought to an abrupt end by the 1997 crisis. The bankers-industrialists nexus detailed above led to, on the one hand, a very high degree of ownership concentration and a high debt to equity ratio. On the other hand, this high-debt-growth model, although it enabled high rates of capital accumulation and hence high growth, made both the financial and real sector highly vulnerable to negative shocks under the liberalized free flow of international capital regime, which had been imprudently established in the early 1990s. Moreover, the capital account liberalization, especially the ill-fated establishment of the Bangkok International Banking Facilities (BIBFs) led to an influx of foreign funds/credits which undermined the bankers’ traditional roles of credit allocation and investment coordination. In other words, the capital influx liberates the credit-hungry corporate (real) sector from the banker’s captive loan market since they could directly tap on the international capital market and thereby eroded the bankers’ role of investment coordination. This process eventually led to massive overinvestment and asset price bubbles and hence the genesis of the 1997 crisis.

The flotation of the Thai baht on 2nd July 1997, and the huge devaluation that immediately followed, generated massive exchange rate losses to the whole business sector. The extent of the losses were tremendous, to the point that the aggregate banking sector’s equities, as listed on their balance sheets, went negative. At its peak, the non performing loans of the financial sector were 48% of total loans. To get out of this financial messes, a balance sheet adjustment process had to be carried out: a process of loss sharing among three main parties; the corporate sector, financial institutions and the state. This process necessarily implied changes of ownership. In a society which had never experienced this kind of ownership upheavals, and therefore had very weak established rules of loss sharing, this meant that the rules for sharing these bad loans had to be created at the same time as the crises was being resolved. Predictably, the process of creating these new rules became a massive political struggle. To which we now turn.
II. The Politics of Loss Sharing

According to Ammar and Nuttanan (2003, 210, 214-215), the total losses suffered by the private sector from the crisis amounted to 5.34 trillion baht as of May 2002. The total value of equity in the economy was 3.24 trillion baht in 1996, of which 2.42 trillion baht belonged to the real sector and the rest (0.83 trillion baht) was owned by the Financial Institutions (FI) sector. These numbers mean that the private sector as a whole did not have adequate capital to absorb losses. And this implies that depositors and FI creditors had to bear part of the losses. However, since the government had issued a blanket guarantee for both parties, this meant that their burden was instead shifted to tax-payers. The burdens partly transformed into losses, occurring to the Financial Institution Development Fund (FIDF), which amounted to 1.4 trillion baht.

The above figures are partly a result of the politics of loss sharing. This paper is of the view that any reform package to solve the economic crisis, whether it is a state-led or a market-led approach, is ultimately a political decision. Those countries hit by the crises had to reform their rules and laws for two purposes, immediate short term crisis solutions, to facilitate further economic growth in the long run. For example, Korea and Thailand had to amend their legal frameworks, especially the bankruptcy and foreclosure laws, to facilitate a balance sheet adjustment process. Those new rules and laws obviously have distributive consequences which in themselves are a political decision. Since crisis solution is not separable from politics, the following discussion will argue that the state’s strengths and weaknesses can explain the pace and nature of economic crisis solution.

Financial Institution Restructuring: Market-led vs. State-led

In one respect, the crisis was fundamentally caused by overinvestment, therefore the book values of assets and equities needed to be written down, as did the liabilities the firm possessed, in order to enable a viable firm to continue its operation and save the firm from financial insolvency. Until this process of writing down assets and liabilities is unfinished, the firm can not resume its normal business functions since no financial institutions will extend loans to a financially insolvent or fragile firm. The unavailability of credit will prevent the firm from making further investments and/or even from gaining access to working capital. If the majority of firms in the economy are caught up in this process of debt resolution then the macro economy will not recover from the crisis. On the other side of the same coin, as long as the debt work-out process is not finished, this will affect FIs’ ability to lend. This is because a high level of distressed assets, of uncertain value, calls for a high level of reserve provisions and hence affect FIs’ capital adequacy ratios. To this end, the process of writing down the
assets and liabilities of both firms and FIs should be as speedy as possible in order to facilitate the overall economic recovery. In other words, the speed of balance sheet adjustment is a key determinate of the speed of macro recovery (Ammar 2005, 77).

To this end, governments can play pivotal roles in speeding up the balance sheet adjustment process through various means and measures. In general, these measures can be classified as a market-led or a state-led adjustment process. It might be noted that differences between the two approaches are in degrees rather than in kinds. The experiences of the countries hit by the Asian crisis show that they all employed a mixture of the two approaches. None-the-less, it is still possible to classify their measures as a state-led or market-led approach. For example, Malaysia’s and Korea’s packages can be largely classified as state-led, while Thailand’s is largely a market-led approach. The overall differences between the two can be illustrated by briefly comparing measures taken by Thailand and Korea. In the case of Korea, the state aggressively handled FIs’ problems of non performing loans (NPLs) and capital adequacy by setting up the central state owned Korea Asset Management Corporation (KAMCO) to buy out NPLs from FIs and setting up the Korea Deposit Insurance Corporation (KDIC) for recapitalizing viable FIs at the onset of the crisis. In other words, the Korea state firmly committed to, on the one hand managing NPLs, and on the other hand to injecting capital to FIs. In the case of Thailand, a public capital support program for FIs was not set up until one year after the outbreak of the crisis and only after the government was certain that FIs had a very limited opportunity to recapitalize by their own efforts. Moreover, the state did not finally set up Thailand Asset Management Corporation (TAMC) until four years after the crisis, and it mainly ended up dealing with state owned FIs’ NPLs rather than private FIs’ NPL it had anticipated dealing with. The main difference between the two countries approaches is, thus the degree of state intervention in speeding up the balance sheet write-down process. This study will argue that, in the Thai context, a higher degree of state-led approach could have made the adjustment occur more quickly, and hence the economy could have recovered faster.

As argued above, the speed of balance sheet adjustments, both in the financial and corporate sector, are closely linked with the speed of overall economic recovery. The following discussion will focus on two groups of measures adopted by the Thai state for restructuring the FI sector. The first group was intended to tackle the problems of solvency and capital adequacy, a system-wide problem, while the second group aimed to solve the NPLs and distressed assets problem. Those two groups were closely interrelated and, indeed, two sides of the same coins. Recapitalization would increase FIs’ capacity in realizing losses from their NPLs, hence facilitating debt resolution. On the other hand, reductions in NPLs would lower FIs’ capital requirement and enable them to resume their normal functions.
Solvency and Capital Adequacy Problem

The degree to which FIs needed to recapitalize can be illustrated by two numbers. During 1997-1999, the whole banking sector’s losses was 688,452 million baht while at the end of 1996, its total capital stood at 356,954 million. This means that the banks direly needed to increase their capital to absorb the losses and to meet the BIS capital adequacy ratio and also to cushion losses from the rising NPLs.

The first measure in this direction was a liberalization of foreign ownership. Foreigners were allowed to hold a majority stake in FIs for up to 10 years beginning in November 1997. Afterward, the Chuan’s government pinned its hope on private initiatives for capital injections. Some big banks, for example, Bangkok Bank (BBK) and Thai Farmers Bank (TFB or Kasikorn Bank) managed to issue straight equity amounting to 43,000 million baht in the beginning of 1998. However, the worsening of the Asian crisis shook international investors’ confidence in emerging markets and it became clear to the government that the remaining FIs had very limited opportunity to recapitalize on their own. Faced with a worsening situation, the government realized that in order to protect the system-wide solvency it needed to offer public funds for recapitalizations. However, the program was only a voluntary scheme since the government intended it to be only a backstop plan.

The public fund capital support plan became known as the August 14 package. It offered help both for Tier-1 and Tier-2 capital with strings attached. For the Tier-1, the authority exchanged 10-years non-tradable government bonds for FIs’ preferred shares and reserved the right to change the FIs’ management. Furthermore, the participating FIs had to fully provision against their classified assets immediately, rather than phasing in the new requirements gradually during 1988-2000 as allow by the BOT. While the main objective of the Tier-1 support was to help FIs raise new capital which could be used to shoulder losses, the Tier-2 support was intended to stimulate new lending and NPL restructuring. FIs could ask for Tier-2 support of up to 20% of their new lending by exchanging their subordinated debt for 10-years non-tradable government bonds. While the package committed 300,000 million baht for capital support, only 10 FIs participated in the program with total support amounting to 70,628 million baht consisting of 61,304 million baht for Tier-1 capital and 9,324 million baht for Tier-2 capital by the end of 2000. However, only one large bank, one medium-size bank which already had large government holdings, and two financial companies participated in the Tier-1 category program.

The fact that less than one-fourth of the earmarked fund was utilized and only a small number of FIs participated meant that the scheme had little success, especially in terms of expediting NPL solution and facilitating credit expansion. FIs saw the requirements attached to the package as too harsh, especially the right to change management and the complete

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1 Otherwise stated, this part mainly draw from Veerathai (2003, Chapter 4, 25-32)
provisioning. Moreover, they knew too well that opportunity for profitable new lending was very limited due to the massive excess capacity after the crisis. Therefore, the capital injection from the government was of limited utility for FIs, apart from writing down losses (Ammar and Nuttanan 2003, 201-202). A better way out was to engineer a new financial instrument in order to meet the capital adequacy ratio and at the same time preserving control rights. Since there was little opportunity to recapitalize by issuing straight equity, and seeking to protect their control rights, the two largest banks of Thailand—Bangkok Bank (BBL) and Thai Farmer Bank (TFB)—in the first half of 1999 issued hybrid capital by combining preferred shares with perpetual subordinated debts to be counted as their Tier-1 capital, which was compatible well with the BIS’s guidelines. The hybrid instrument could be used to minimize the dilution effect on existing shareholders, for example, the BBL’s Tier-1 component consisted of 3.5 million baht in preferred shares with voting rights and 34,497 million baht in non-voting subordinated bonds. In total, private banks issued hybrid capital to the amount of 82.4 billion baht in 1999 and significantly helped FIs to recapitalize up to the regulatory requirement.

To sum up, the discussion so far points out that one of the government’s main aims of the August 14 package was largely unsuccessful. The aimed was to help FIs to recapitalize to the extent that they could make full provision against their classified assets immediately and also be able to meet the require capital adequacy ratio. With fully provisioned and adequate capitals, the authority further wished that FIs would start lending and hence facilitate economic recovery. Since the scheme was voluntary and FIs wanted to minimize their ownership dilution, they successfully evaded the governments efforts, instead further recalling their loans, at the cost of deeper recession, in order to preserve their capital position. Had the Thai state been stronger and more effective, it might have been in a position to force recapitalization on FIs, and then could have employed them to restructured corporate debt more effectively, as was done in Korea. However, this alternative was not possible under the weak state such as Thailand. As a part of August 14 package, the Chuan Government nationalized two more small banks and 5 more financial companies. By this time the state had already nationalized 6 banks and 13 financial companies, with loans amounting to 22.55% of the total banking system’s loans; and the state was already encountering substantial difficulties in managing those nationalized FIs (Veerathai 2003, Table 3.1, 19, 21-23). Had the government further forced FIs to recapitalize, these would have further complicated the difficulties. More fundamentally, it is doubtfully that a politically weak government such as that of Chuan was powerful enough to intervene into the remaining big banks.

Non Performing Loans Resolution

A fundamental step of FIs restructuring is NPLs and distressed assets resolution. The
recapitalization efforts merely tackled the consequences of the NPLs, but they did not get at the root cause of them. An effective resolution will reduce the need for provision against classified assets, and hence FIs’ capital requirement. In tandem with the above capital support package, but in contrast with Korea’s approach, the NPLs resolution approach taken by the Chuan’s government was again a market-driven method led by FIs. The government saw its roles as supporting the FI-led efforts towards resolution, by providing appropriate incentives. These incentives included such policies as creating a necessary legal infrastructure for debtors and creditors, eliminating tax disincentives and other obstructions to effective NPL resolution, and to facilitate coordination among relevant parties. Chief among these roles was to amend the outdated, and debtor friendly, legal framework and court procedures, especially laws related to bankruptcy and foreclosure. This was a key necessary condition for a market-led approach, for the excessively lenient laws were insufficient to create a credible ‘threat’ for debtors to negotiate with their respective creditors, both in and out of the court process. To this end, the Chuan Government set up a BOT’s supervised out of court debt restructuring process, known as the Corporate Debt restructuring Advisor Committee (CDRAC) framework.

Why did the Chuan Government decide to employ a market-led approach? Certainly the government seriously considered a state-led method, however there were both practical and political difficulties that forced it to settle on a market-led approach. Veerathai, a young technocrat seconded from the IMF to work with the Government, argued for a market-led framework and is worth quoting at length. Due to FIs’ inadequate capital, he argues against establishing a centralized government owned AMC.

“If a central state-owned AMC were set up then to buy NPLs from private FIs, the FIs would not be in position to realize losses from NPL transfer and the authorities would have to buy NPLs at the inflated prices, thereby incurring additional costs for the public. In this context, pricing of NPLs would need to offer a compromise between NPLs’ fair values and each FI’s capital adequacy; it could not be done in a transparent manner and could be detrimental to the authorities’ political support” (Veerathai 2003, 65).

Apart from NPL pricing problem, he also argues that the government was in real fear of the potential political problems associated with interventions both in the process of selecting debts to be transferred to AMC and in making NPL restructuring decisions. These political interventions would be not only magnifying the moral hazard problem, but could be easily transformed into political scandals which could destabilize the government.

2 The details of bankruptcy law amendments will be discussed below. However, it is sufficient to state briefly here that the amendments during the Chuan Government were watered down by debtors to the point that it rendered the NPL solution painfully slow.
Although Veerathai also cites other practical difficulties associated with central AMC approach\(^3\), it can be claimed that political rationales for not setting up central AMC was, indeed, crucial. From the quotation, incurring additional costs for the public is not a strong argument. It can be argued that the increased costs have to be weighted against additional benefits for the economy as the whole, since one can also expect a faster pace of NPLs solution and hence a faster economic recovery, provide that the centralized AMC handled the transferred NPLs efficiently. The main point is thus the ‘political support’.

While the Government was a shaky political alliance of 6 parties with a slim majority in the Parliament from the start, the performance of the Financial Sector Restructuring Authority (FRA) was such a disaster that it used up the Chuan Government’s political capital to the extent that the FRA gave a bad name to the whole reform package. The FRA conducted its first auction of core assents (hire-purchase loans) of the closed-down 56 financial companies in June and first auction of commercial loans in December 1998, with very ‘low’ recovery rates, to a storm of public outcry. Regardless of the ‘true stories’ behind this ‘poor’ performance, the public’s impressions of the ‘stories’ were very negatives. At best, the ‘low’ rate was due to incompetence of the authorities involved and at worst, due to a conspiracy between the Thai authorities and the foreigners who colluded to disposed of the assets at low prices for personal gains. Either way, it was done at the expenses of tax-payers. Effectively, those authorities were accused of being traitors.\(^4\) Timing was crucial here: the August 14 Package--the most importance reform measures of Chuan’s government, which set out the overall market-led framework--was declared just two months after the first auction. There is little doubt that the disastrous performance of the FRA was a major consideration for the Government in choosing a market-led over the state-led approach.

Faced with those political and practical difficulty, the Chuan’s government encouraged private FIs to set up their own AMCs by enacting the AMC Emergency Decree as part of the August 14 Package. This measure can at best be summarized as a limited success. In total, 16 AMCs were established, of which 12 AMCs were owned by private FIs and were small in size; only 4 of them purchased NPLs exceeding 30,000 million baht each. In 2001, the Institution of Certified Accountants and Auditors of Thailand issued a new guideline on the transfer of financial assets which effectively required FIs to maintain capital adequacy both for the NPLs and the bonds issued by their AMC subsidiaries, resulting in double counting (Veerathai 2003, 63). Therefore, this method of employing decentralized AMC for NPLs resolution was mainly used by the state to solve its FIs problem. The private FIs barely

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\(^3\) There are a variety of difficult practicalities, especially in the Thai context. First, there are various methods of calculating a ‘fair price’, which is very much dependent on assumptions made regarding the key macroeconomic variables. Secondly, setting up a new entity and running it are very time consuming both in terms of legal requirement and finding qualified staff, especially in the Thai context. Thirdly, a central AMC could have easily been transformed into a debt warehouse – a very costly solution from the standpoint of tax payer’s. See, details in Veerathai (2003, 57, 74-75).

\(^4\) The accusation, directed toward the Chuan Government in general and its minister of finance, was still being used as a political football as recently as in 2006.
participated.

The Thaksin Government’s approach to solving the problem of NPLs was a clear break from that of Chuan’s government. Thaksin advocated for a state-led solution by proposing to set up a centralized state owned asset management corporation, this subsequently became one of the Thai Rak Thai’s (TRT) key platforms for the January 2001 general election. By the end of 2000, the system-wide distressed assets remained high, although the level of NPLs was sharply reduced from the 1999’s peak due mainly to the transfer of state owned FIs’ NPLs to their AMCs, but the private FIs’ NPLs remained high at around 17-20%. A text of the press advertisement of TRT’s campaign, a month before the election, stated that “I’d [Thaksin] like to see all bad loans cleared from the banks, and loans restructured, to give an opportunity for those Thai...[and] banks to escape from the crisis, increase their capital, and rapidly extend loans” (Pasuk and Baker 2004, 87). After winning a landslide election, the TRT’s government set up the Thailand Asset Management Corporation (TAMC) in October 2001.

Although Veerathai (2003, 73-76) cites several issues that contributed to failures, according to his opinion, of the state-led efforts of NPLs resolution both through individual state owned AMCs and TAMC, there are some issues that particularly relevant to this discussion, to which we now turn.

First and foremost, the ineffectiveness of TAMC was due to the fact that it was established four years after the crisis, by which time most of the NPLs had already achieved some sort of court hearing — thus prohibiting them from being transferred to the TAMC by its emergency decree--or had been restructured. As a result, the TAMC ended up transferring 81% of its assets from the state owned FIs, while the amount of NPLs purchased from private FIs was only 15% of all private FIs’ NPLs outstanding at the end of June 2001. To this end, the TAMC failed to achieve its ultimate aim of relieving private FIs from the burden of NPLs.

Having said that, the TAMC, by the end of 2005, had successfully concluded the resolution of 772 billion baht of assets out of 777 billion baht assets transferred to it with an expected recovery rate of 48% (WB June 2006, 28-29). This ‘good’ performance owning in no small part to the fact that the TAMC had special legal powers and immunities which are denied to others. Only three special powers need be mention here to point out the very fundamental difference between Chuan’s and Thaksin’s government, namely their respective political strength.

1. When a debtor or guarantor attempts to hide assets or does not cooperate with

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5 Qualifications have to be placed on this assessment, especially concerning the associating problems of transparency, of public costs and of credit culture. For example, the problems of costs and credit culture, since the TAMC uses its NPL acquiring price—a book value--as a benchmark for debt restructuring. This benchmark does not only benefits certain debtors, especially cases of clean loans, unfairly at FIs’ expense, but can also incur substantial public costs particularly on NPLs transferred from certain state owned AMCs. The book value is the NPL’s face value minus required provisions for the un-collateralized portion of the loan, hence, in cases of clean loan with fully provisioned, the transfer price is zero. Using this low cost (price) of NPLs as a benchmark for restructuring, the TAMC can make substantial ‘hair cuts’ to debtors at the expense of FIs. The certain state owned AMCs may suffer heavily since they had purchased NPLs from state owned FIs at very inflated prices in order to help the FIs’ recapitalization by accounting methods.
TAMC in NPL restructuring, the TAMC may ask the Bankruptcy Court to put them under permanent receivership without investigation.

2. The TAMC is entitled to liquidate a debtors’ collateral, if a debtors fails to repay the loans within one month after the TAMC issues a notice.

3. For corporate restructuring cases, the Bankruptcy Court may consider TAMC’s rehabilitation plan without the debtors’ participation.

For Chuan’s government to set up an entity with these special legal powers to bypass the normal legal process of the bankruptcy and foreclosure laws would be unthinkable. As argued above, the FRA’s conduct destroyed the government’s political strength to the point that these kinds of special power, especially against debtors, were unlikely to win parliamentary approval. As the discussion of the amendment of the bankruptcy law below will demonstrate, the much weaker version of the law proposed earlier was subjected to strong resistance from debtors in early 1999, and was ultimately watered down significantly.

Secondly, it is clear that Thaksin’s government was biased in favor of the debtors, as in the case of the bankruptcy law amendment, at the expense of FIs. The government wanted the TAMC to restructure as many cases as possible rather than liquidate them. In other words, the TAMC was used to bail out unviable debtors. Viable debtors, in the preceding four years, had already been restructured before TAMC’s establishment, the remaining NPL debtors would have limited business potential. In order to reinvigorate these debtors a deep ‘hair cut’ would have been required (Veerathai 2003, 76).

Lastly, although the political influence of private bankers was reduced by the crisis, it was (and is) still a powerful force to be reckoned with. The TRT’s government, by and large, had no problem imposing costs on the bankers. The second issue above and the pricing benchmark (see the above footnote) were clearly costly to FIs. It was difficult for the weak Chaun Government to impost such disadvantageous terms on the bankers. However, the Thaksin Government could not completely ignored demands made by the bankers. A TRT source explained the stand-off between the two as: “the bankers ignored government requests from them to approve more loans. At the same time they demanded the government to amend the TAMC Act to enable them to mark their collateral value to the market prices, and not to evaluations by the Land Department”. In the end, the government relented (Pasuk and Baker 2004, Chapter 4 footnote 3, 279).

**Bankruptcy Law Amendment**

As mentioned above a key factor necessary for a speedy market-led debt resolution was a proper legal framework that governs debtor and creditor relationships, especially bankruptcy laws, foreclosed laws and court procedures. The existing framework before the crisis was utterly inadequate to deal with the financial turmoil that existed among debtors and creditors...
after the crises hit. The framework was very favorable towards debtors, particularly its lengthy procedures and legal loopholes which could be exploited by debtors. Consequently, it could not be used by creditors as a credible tool to ‘threaten’ debtors into serious negotiations, particularly strategic debtors. Therefore, there was a real need to amend this framework in order to facilitate speedy debt resolution. To this end, during 1999-2000 the Chuan’s government managed to pass 5 new laws: a) Bankruptcy Law, b) establishment of the Central Bankruptcy Court, and c) three amendments to the Code of Civil Procedures. The first two laws were directly aimed at correcting the shortfalls of the existing Bankruptcy Act dating back to 1940, while the last 3 amendments aimed to expedite the foreclosure process; for example, it could take between 40-60 months to obtain a court order just for foreclose debtors’ assets. However, not only was the amended process itself was slow, but it was also heavily watered down to the point that it could not contribute to a speedy resolution as the Chuan Government had intended.

The original bankruptcy law, enacted in 1940, was obsolete and inadequate for the new situation after the crisis. The most basic shortfall was the lack of modern legal basis for business rehabilitation. In other words, it allowed only for liquidation of debtors after being declared bankrupt. The shortfall was first amended in 1998, but this still left weaknesses, and it was again amended in 19996.

The second amendment was subject to a very contentious debate. Politically, it was unhelpful that the law amendment was a part of the conditionalities attached to the IMF financial support programs, and thus was viewed as a critical indicator of Thailand’s commitment to the reform package by foreign investors. Being a part of the conditionalities, it was exploited by debtors to whip up nationalist-anti-foreigner sentiments among the general public. The debtor-led-anti-amendment campaign propagated a doomsday scenario that many of Thai firms would become bankrupt and be taken over by foreigner creditors. Furthermore, those influential debtor-turn-campaigners were themselves members of the Upper House of the Parliament, which had the authority to vet the draft amendment and could further delay the legislation process and hence, weaken the government politically. To this end the Chuan Government had to compromise with the debtors-cum-parliamentarians.

In total, there were 8 issues of contentious between the government and the senators7. Among those issues, there are two points where the debtor-senators won concessions from the government that are worth further comment. First, while the draft amendment empowered the bankruptcy court to quickly convert unsuccessful rehabilitation cases into liquidation, the senators watered down this power. If a rehabilitation plan failed, the amended law required a court’s affirmation of the debtor’s insolvency before the liquidation process can begin. This opened up loopholes for debtors who intended to fail their rehabilitation plans, who then

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6 See more details in Pairoj and Nuttanan (2004, 54-80) and Veerathai (2003, 53-56)
7 Otherwise stated, this part of discussion draw from Apichat (2005, 21-31)
contested their insolvency status. This loophole was associated with another shortfall of the amended law, namely the criterion for commencing bankruptcy cases. The criterion is based on balance sheet test of insolvency, i.e. a negative net worth, rather than debtor’s cash flows. This criterion enables debtors to delay bankruptcy proceedings by using a ‘creative’ accounting method to contest their net worth.

Secondly, and more importantly, was the issue of ‘automatic’ discharging a natural person from the bankruptcy status. Under the original 1940 law, a person legally designated as bankrupt operated under severe disabilities. This status had no set expatriation date, so it became difficult to emerge from bankruptcy. Although a bankrupt person could ask for the discharging at any time, it was very difficult to be legally discharged from the status, especially if the debtors were considered to be ‘unscrupulous’ debtors, e.g. intentionally hiding their assets from their creditors. The 1940 law stipulated that, in the case of unscrupulous debtors, the debtors could not be discharged from the bankruptcy status unless there were special reasons, and they had been under the status for at least 5 years. In practices, the court generally considered whether or not the debtors had paid for more than 50% of their debts as a crucial criterion for discharging a person from bankruptcy status.

The debtor-senators managed to amend the original law to limit the maximum period of bankruptcy to only 3 years, provided that the person was a scrupulous debtor. In other words, the amended law automatically allows a bankrupt person to regain their normal status 3 years after the court’s bankruptcy ruling, and as a result every bankrupt person would be freed of any debt obligations after 3 years and could resume a business life. According to Veerathai (2003, 54) this amendment effectively shortened the bankrupt period by at least 9 years from the 1940 law and greatly impaired the effects of a bankruptcy threat against debtors, especially the strategic ones, and did not contribute to a speedy NPL resolution as the government intended.

Why does such a shortened period have a great impact on the speed of NPL resolution? Threat of a personal bankruptcy had been widely used by Thai FIs to enforce their lending contracts. Unlike lending practices of their counterparts in advance countries, the Thai FIs’s decisions about extending credits was based heavily on physical collateral and personal guarantor of loans rather than an analysis of their customers’ cash flows. The importance of personal guarantors is due to the following:

A) The lacks of transparent financial accounts of firms meant that cash flow analysis was of little value: in practice there was no separation between owners and managers. In effect, it was tricky to separate between firms’ assets and the owners’ personal wealth.

B) Firms had low registered capitals on their books. The owners guaranteed the firms’ loans, thus effectively expanding the firms net worth. These two facts led to a very common practice of Thai FIs to require firms’ owner-cum-managers to plead their personal guarantee on behalf of their firms’ loans. The shortened period of bankruptcy greatly reduced the FIs leverages against the debtors since the FIs would have only 3 years to pursue ‘hidden’ assets.
of owners-personal guarantors. If FIs believed that a debtor had ‘hidden’ assets—the basic practice of most debtors—they would bring the case to the Civil Court, in which case they could pursue the hidden assets for up to 10 years. Given that the Civil Court’s procedure is lengthier than that of the Bankruptcy Court, the amended law could not speedup the NPLs resolution as planned.

Not only did the Chuan Government takes a whole year to pass the amendment, but the amended bankruptcy law was arguably less threatening to debtors than was the original law. This amendment clearly reflects a government that was politically weak to the point that it could not adopt a necessary measure needed to solve a pressing problem. Although the Chuan Government had more political capital for reform than the previous, and discredited, Chavarit Government, its political capital was largely gone by the end of 1998. From the second half of 1998 onward, there were various allegations of corruptions and abuse of powers by ministers. This allegations hit the Democrat Party of Mr.Chuan, and the other parties in his coalition as well. Chief among these allegations was the FRA’s assets auction performance, as discussed above8. Moreover, 1998 was the worst year of the crisis: the economy shrank 10%, and did not show any sign of recovery until the second quarter of 1999, while the bankruptcy law was scheduled to be debated in the Upper House in April. In the end, the Chuan Government had no choice but to compromise with the debtor-cum-senators.

During the heightened period of the public debate concerning the pros and cons of the proposed bankruptcy law amendment, the chairman of the Thai Bankers’ Association (TBA) and others private bankers made several public comments. They effectively threatened that if the amendment was not passed, or was diluted, then the economy would not be recovery. But all these efforts were to no avail. The bankers’ failure to push for a stronger law testifies to their own lack of political weight after the crisis. It can be argued that historically the bankers’ political power had been very influential. They could prevent various banking law amendments from being materialized, if they so wished (Apichat, 2002). Not so after the crises.

By 2000, it was clear to observers that the Chuan’s government and its IMF-led neoliberal reform package was death politically. The main reason why the government still stayed in power till the scheduled general election January 2001 was that there was no credible alternative opposition parties. Chavarit’s party, already discredited by the outbreak of the crisis, was slowly disintegrated due to internal infighting. Under this context, the newly established Thai Rak Thai Party (TRT) led by Thaksin Shinawatra seized the opportunity by offering alternatives to the electorates. The two main political platforms of the TRT were ‘nationalist’ and ‘populist’ economic policies. The nationalist platform manifested into an election pledge that the TRT would re-amend the controversial 11 economic bills passed by the Chuan Government, including the bankruptcy laws. Armed with these innovative political

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8 See details of political events during this period and the anti-economic laws reform movement in Apichat (2005, 32-40).
platforms, the TRT won the largest majority yet seen in the Thai house of the representatives. Three years later, the TRT Government fulfilled its election promise by putting the re-amended Bankruptcy Act and the Central Bankruptcy Court Act into effect in July and in October 2004 respectively and mainly for benefits of debtors. The government had not, however, kept its other economic election promises. This indicates that the TRT nationalist platform is more rhetoric than substance.

The new legislation further benefited debtors in at least two ways. To begin with, the easing of the criteria for a bankrupt person to leave the status of bankrupt primarily benefited the ‘unscrupulous’ debtors category. As mentioned above, the 1940 law stipulated that in the case of unscrupulous debtors, the debtors could not be discharged from the bankruptcy status unless there were special reasons, and he had been under the status for at least 5 years. The Chuan Government’s amendment did not change this rule, hence bankrupt people who were classified by the court as such, did not benefit from the debtor-cum-senators’ efforts. The TRT’s government changed this stipulation to the effect that the maximum period an unscrupulous debtors could remain under bankruptcy status was capped at ten years. The ‘scrupulous’ debtors also gain from the new amendment, albeit at the lesser degree. The new rule allows them to leave bankruptcy before 3 year, by making an appeal to the court.

Secondly, the new amendment increases the right to appeal in several cases. The main objective of the Chuan Government’s amendment was to expedite NPLs resolution, therefore it focused on cutting short the legal proceedings by limiting the right to appeal court rulings to a necessary minimum. For example, there was no right to appeal a court order concerning a bankruptcy case, though one could appeal in the case of rehabilitation. The TRT Government amended the laws in ways that effectively gave more rights to appeal court’s decisions in 4 categories of court’s orders in the bankruptcy cases, and granted more rights to appeal in one category of rehabilitation cases. Although it is debatable whether more appeal rights are proper and necessary in terms of legal justice, it is certain that these rights strengthened debtors bargaining power vis-à-vis creditors’, through the lengthier court proceedings they allowed.

It is also important to note that the new amendment did not correct any inadequacies in the laws that were still in place since the 1999 amendment. Among other things, the criterion for commencing bankruptcy proceedings was still based on each debtor’s balance sheet insolvency—i.e. a negative net worth—rather than debtor’s cash flows. This criterion enabled debtors to delay bankruptcy proceeding by contesting the true value of their assets and liabilities even though they could not service their loans. Clearly this kind of inappropriate provisions is not conducive to a strong financial sector.

The above discussion points out that the TRT’s government was a debtor friendly government who pushed new laws benefiting debtors at the expenses of creditors. This study will argue below that, indeed, the TRT Government was a government for big businesses in the “real” sector of the economy. It acquired state power in part as a result of the 1997 crisis,
which nearly wiped out the bankers’ fortunes, hence weakened the political prominence of the banking sector.

**Results of Non Performing Loans Resolution**

By 2003-2004, it was very clear to concerned observers that the progress of NPLs resolution had lost momentum. The NPLs climbed quickly and reached its peak in the middle of 1999 at 2.7 trillion Baht or 47.7% of total loans, it slowly reduced afterward till the beginning of 2000. But by the end of 2000, it had sharply dropped to 17.7%, since then it had fluctuated between 10% and 15% of loans during the period between 2001-2004, finally dropping to 8.2% in 2006. The sharp reduction in 2000 was mainly due to the fact that the government allowed FIs to set up AMCs, and FI then transferred their NPLs to these new entities. However, if one adds back the amounts transferred to the existing NPL figure in the middle of 2001, the total FIs’ distressed assets would be nearly 30% of the total loans (Ammar and Nuttanan 2003, 122). Afterward, the increasing figures of 2002 and 2003 reflect inadequate methods of loan restructuring (Table 1).

Why was the pace of NPLs resolution so slow, especially while the Chuan Government was in power? First and foremost, it was due to failures by the government to either amend bankruptcy and foreclosure law, or to rework court proceedings that were overly creditor friendly, both key conditions for a market-driven approach to succeed. The failures were due to political opposition from debtors as discussed above.

Secondly, in contrast to Western business practices, there was rarely a separation between firm ownership and management in Thailand. Debt restructuring also involved equities write-off, and when a firm’s value was reduced to zero, as a general rule the ownership must change hands. However, this change of ownerships also implied change of management, which was also part of the firm’s value. Therefore, the creditors bargaining power, vis-à-vis the owners-debtors in Thailand was less than that of the Western countries (Ammar 2005, 76).

<table>
<thead>
<tr>
<th>Year</th>
<th>1998</th>
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<th>2000</th>
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<td></td>
<td>2,674,533</td>
<td>2,094,425</td>
<td>863,663</td>
<td>477,405</td>
<td>771,126</td>
<td>641,883</td>
<td>592,171</td>
<td>477,071</td>
<td>484,905</td>
</tr>
</tbody>
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Source: BOT

9 Before the set up of TAMC. The transfers of NPLs to TAMC had little effect on the total NPLs figure since it involved mainly the transfers between state owned AMCs which had set up before the TAMC, and the TMC.
Thirdly, the pace of debt restructuring was slow in part due to the poor debt restructuring methods employed by FIs. The most prominent method was to reschedule rather than restructure debt, with a very minimum ‘hair cut’. A WB report (Jan 2006, 16-17) estimates that more than three-quarters of the restructured cases, under the framework of Corporate Debt Restructuring Advisory Committee (CDARC)\textsuperscript{10}, were ‘cosmetic restructures’ since they involved no reduction in the book value of the loans and relied instead on an extension of maturity and grace period, and a reduction in the contractual interest rates. This is was mainly because FIs wanted to “protect their fragile capital positions [and] avoid dilution of control”. This is partly a consequence of the FI decision to not participate in the 14\textsuperscript{th} August of public capital support package as discussed above. Moreover despite of having close connections with their debtors, Thai banks had inadequate knowledge of their customers’ businesses and prospects. Therefore, they tended to reschedule rather than to restructure their loans.

As a result of the difficulties discussed above, especially the poor method of debt resolution, there was a high rate of re-entry NPLs. For example, at the end of March 2003, the figure for re-entry NPLs was 57,568 million, which nearly equaled the value of the FIs’ resolved NPLs; 59,002 million Baht (Ammar and Nuttanan 2003, 123). The IMF also estimates that between Oct 1999 and Oct 2002, the cumulative re-entry NPLs were over 40\% of restructured and reclassified loans. In other words, 4 out of 10 resolved NPLs had in fact not been resolved, they had re-entered the NPL pool. System-wide distressed assets remained high at almost 40\% of GDP in 2002. As a result, the progress of Thailand’s debt resolution lagged behind regional peers. While Korea enjoyed the lowest level of distressed assets at 7\% of total loans, Thailand and Indonesia still had distressed assets totaling 37\% of all loans in 2002. Although Korea had favorable initial conditions, its better performance was due to the work of KAMCO, which purchased a large share of the problem loans early on, while Thailand relied more on a private sector-based resolution (IMF 2004, 40-42).

Due to the above facts, the IMF’s country report (2004, 45-48) \textit{Thailand: Selected Issues} lost patience with Thai’s market-let resolution approach, which it had supported since the crisis began, and implicitly called for a more state-led approach by transferring more private FIs’ NPLs to the TAMC, in spite of the fact that it also implicitly criticizes the TAMC for a lack of transparency. In other words, the IMF sees the TAMC as a necessary second best solution to tackle the NPL problem.

In 2003 six years after the crisis, while economic growth had rebounded since 2001, the BOT’s technocrats were still concerned with medium to long term economic prospects due to the problem of the large debt overhang, and its effects on the real sector of the economy via finance-investment nexuses. They stressed the ongoing problem of large debt overhang in FI

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\textsuperscript{10} It was launched in 1998 as a voluntary, out-of-court framework for restructuring NPLs. As of Dec 2005, the CDARC had resolved 1,198 cases with a value of 17,037 million Baht out of a total of 2,606 cases with a value of 40,220 million, equivalent to a 42\% completion rate by value or 46\% completion rate by cases (WB, June 2006, 28). Comparing the 46\% rate with regional peers, the rate is much slower than Korea, Malaysia and Indonesia, with completion rate 95\%, 77\% and 56\% respectively in the mid 2003 (WB, Jan 2006, Table 3.3, 18).
sector that impaired credit flows and called the economic rebound then occurring as a ‘growth without credit’ (Piti and Don, 2003). While some of the BOT technocrats\textsuperscript{11} were optimistic that investment would soon play its historical role as a main engine of economic growth, they were subsequently proven wrong.

The discussion above argues that the slow process of balance sheet adjustment and hence the slow pace of economic recovery in Thailand was largely a result of state weaknesses. Evidences suggest that Thailand’s performance in dealing with the crisis was lagged behind those of her peers such as South Korea and Malaysia. Weaknesses of the Thai state are plainly shown by the performance of and decisions taken by Chuan’s government. The political weakness of the Chuan Government prevented it from employing a higher degree of state-led measures to speed up the process and compelled it to play a supportive rather than a leading role in resolving the crises, in contrast to the case of Korea. The government contemplated employing a stronger degree of state-led crisis resolution measures, which theoretically could have contributed to a speedier crisis resolution. It was forced to refrain from doing so specifically due to its political weakness, and generally due to the ineffectiveness of state agencies. Furthermore, when it chose to employ a market-led approach, it also failed to amend the necessary legal framework in such a way as to allow that approach to succeed. Again, this failure was due to its political weakness.

The Thaksin Government was elected with strong public support, and a mandate for change, and consequently had the political power to overcome obstacles and set up the TAMC\textsuperscript{12}. The relatively quicker performance of the TAMC was in no small parts due to its special legal powers. It seems almost certain that those special powers – to bypass the weak bankruptcy and foreclosure laws – had no chances to pass parliament under the Chuan government. The relatively limited effectiveness of the TAMC debt solution was due to the fact that it was set up far too late, four years after the crisis. Most likely, the pace of debt resolution would have been far quicker, had it been to set up under the Chuan Government.

However, even though the Thaksin Government overcame political difficulties in setting up the TAMC, it still faced other weaknesses of the state. Ammar and Nuttan (2003, 25, 200-203) argue that a central AMC in Thailand would, in all likelihood, always be far less effective than that of South Korea’s. Their rationale is that the Thai state, unlike the Korean state, did not have the capacity to handle the transferred NPLs efficiently. The Thai state lacks people with extensive knowledge of, and experience in, conducing state directed credit and industrial policies, which are the hallmarks of Korea’s developmental model.

In sum then, the main argument offered by this study from the discussions so far is that the strength or weakness of a state directly influences the effectiveness and speed of economic crisis resolution.

\textsuperscript{11} See, for example, Roong, Yunyong and Daungporn (2003).
\textsuperscript{12} More example of the government state-led approach to the economy will be offered below.
III. Politics of Building New Rules for Financial Sector

While the above discussion is concerned with the solving of the immediate problems of the crisis, namely how to recapitalize the FIs sector and to resolve the NPLs, the discussion of this section will focus on efforts to rebuild the financial sector on a sounder footings in order to prevent a new banking crisis, and to facilitate the next rounds of capital accumulation. In order to do this, there is a need to amend/create at least 3 financial laws, namely the Bank of Thailand Act, the Financial Institutions (FIs) Act and the Deposit Insurance (DI) Act. To achieve those objectives, there is a need to redesign and overhaul the power relationships between the politicians, the technocrats and the private bankers that are determined by the original laws. The most important of these is the power relationship between the Bank of Thailand and the politicians, especially those in the Ministry of Finance. The single most important issue is the degree of the BOT's political independence from politicians. After the crisis a painful lesson was learned: the obsolete governance structure of the BOT – its concentration of decision-making power in the hands of the Governor within the Bank while he in actuality is subject to the pleasure of the Minister of Finance – was a very important cause of the crisis. In other words, the Bank of Thailand Act 1942 has to be amended to give the Governor a higher degree of legal independence from the MOF, while also reducing the Governor’s concentration of power within the Bank.

According to the neoliberalist view, central bank independence is a necessary condition for conducting monetary policy in order to achieve a low inflationary macroeconomy. At the same time an independent FI regulator is also necessary for an efficient and sound FI sector, since it prevent politicians from using FIs as a source of power and/or money for political patronages or for other policy purposes. As far as the experiences of Thailand are concerned, while it is arguable whether the independence necessary for low inflation monetary environment especially in a developing country context such as Thailand, there are various cases of political intervention that led to unsound FI’s practices and FI failures. Apichat (2002, Chapter 6-7) argues that Thai bankers were very successful in influencing the state policy concerning regulation of the FI industry. Their influence was such that it prevented the BOT from managing the industry rationally. Any financial supervision authority has to strike a balance between competition and prudential practices, the BOT failed to do so. The balance was tipped in favour of the bankers, i.e., there was an insufficient degree of competition and an inadequate regulatory framework. In other words, the BOTs’ failures in these two most fundamental FI sector policies were due largely to the immense power of the private bankers. The Bankers were very closely connected with politicians who repeatedly interfered with BOT efforts to regulate banks, which effectively blocked the BOT from rationally managing the sector. Moreover, the failures in these two policy areas reinforced each other to the benefits of the bankers. First, the failure to create mandate prudential practices led the BOT to
close the banking market to new entries since they feared the collapse of banks, and this led to an oligopolistic industrial structure. Secondly, this structure further increased the political power of the sector, leading to its increasing ability to prevent the BOT from instituting a higher degree of prudential supervision, which in turn led to the further reluctance of the BOT to open up the market, due to the fear of bank collapses.

Given both its neoliberal outlook and the above experience, the BOT holds the principle of central bank political independence close to its heart and is determined to fight for it, by amending those laws. There were two major efforts to do so through the legislative process. The first attempt was during the term of the Chuan Government, while the second effort was during the Thaksin Government. Both failed mainly because of the conflicts between the MOF and the BOT concerning the degree of the BOT’s de jure independence. As a result, currently the original acts of the BOT and FIs are still enforced without amendments, in spite of the fact that various drafts of amendment have been written. All the inadequacies created by the existing laws that led to the banking collapses are still in place 10 years after the crisis.

Struggles for Central Bank Independence: Financial Laws Amendments

Chatu Mongol Sonakul\textsuperscript{13} was appointed as the Bank Governor in April 1998 by the Chuan Government. His daunting mandates were to restore the credibility of the almost totally discredited Central Bank, and to tackle the deep economic-cum-banking crisis. The Bank was extensively reorganized: its pyramid-like organizational structure was flattened. Its departmentalization was redesigned according to a central bank’s main lines of responsibilities, e.g. monetary policy, financial institution supervision, etc., this was to assign clearer duty and accountability. Each function was overseen by a Deputy Governor. Moreover, Chatu Mongol established an inflation targeting framework for conducting monetary policies which was run by the Monetary Policy Committee. The second committee, the Financial Institutions Policy Board, was also created to oversee financial institutions’ stability. These committees were composed of members both from inside the Bank, and from outside it as well. The key objective of establishing the committees was to create mechanisms to balance the decision-making power of the Governor, a need to do so was one of the lessons learned from the crisis.

This new organizational structure is not yet legally sanctioned. Additionally, the BOT is still de jure dependent on the MOF: its Governor can be dismissed at anytime for any reason, since the amendment efforts have to date all failed. While the BOT has been organizationally reformed internally, its core power relationship with the MOF has not been changed.

\textsuperscript{13} An ex-permanent-secretary of the MOF with a reputation of feisty independence and direct talks with no less than a hint of arrogant.
following discussions will focus on conflicts between the two organizations which prevented the BOT from having *de jure* independence.

**The First Effort to Amend the BOT Act**

Amidst the BOT’s organizational reform during 1998-2000, the first draft of amendment was prepared with two main issues in mind. The first was how to recapitalize the BOT from heavy losses it had incurred defending the baht at the onset of the 1997 crisis. Conceptually, the consolidated balance of the BOT’s accounts was not in red. In point of fact, while the BOT’s balance in its Banking Department showed heavy losses from defending the baht, the balance of its Issuing Department showed massive gains which were more than enough to offset the losses of the Banking Department’s accounts.\(^{14}\) The BOT could not merge the accounts of the two departments in order to show the consolidated balance since it was legally prohibited from doing so by the Bank of Thailand Act 1942 and the Currency Act 1958. Obviously, there is a need to amend those Acts.

The second main point of the amendment was how to restructurizing the BOT, especially the governing relationship between the MOF and the BOT.\(^{15}\) In essence, there were 3 main contentious issues concerning the degree of BOT’s independence from the MOF. First, Article 21 of the draft stipulated that the Minister of Finance was empowered to supervise the overall matters of the Bank. The Bank wanted to delete this Article entirely. Secondly, Article 27 entitled the Minister to dismiss the Governor subjected to 5 conditions, but it also made clear that the Governor could not be dismissed if he or she exercised due policy discretions. The BOT’s position was that the dismissal power should be the prerogative of the Upper House of the Parliament and subjected to no less than 60% of the votes. Thirdly, the government was allowed to borrow from the Bank to financing its deficits, but had to pay the bank back within one year. The BOT countered that the government must pay it back within 3 months.\(^{16}\)

From the above, the issue of accounting consolidation was very controversial publicly. The issue had been initiated by the Bank since 1998. However, when the MOF learned that after the accounting consolidation and hence recapitalized the BOT’s losses, there would be a significant amount of money left. This money could have been used for compensating the

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\(^{14}\) A main function of the Banking Department was an operation arm of the BOT engaging with the money market. The losses were due to its swap option commitments when the baht was devalued heavily after the second of July 1997 whereas a main function of the Issuing Department was currency issuing which required backup of foreign currencies and assets. When the baht devalued, the new value of foreign currencies and assets (in term of Thai baht), recorded in accounts of the Issuing Department, increased massively.

\(^{15}\) The Cabinet approved the amended draft on 14th March 2000, and instructed the Minister to workout the differences with the Governor. On the next day, the meeting between the two was held to solve the 7 remaining issues of controversy. The three issues discussed below were unable to reach consensus, but the MOF determined to push them through.

\(^{16}\) See details in an interview given by the Secretary of the State Council, who were participated in the above meeting, in *Prachachart Turajit* (20th March 2000, 1, 16).
massive losses of the Financial Institutions Development Fund (FIDF),\(^{17}\) which had lost vast sums of money attempting to stabilize financial institutions during the crisis.\(^{18}\) This would have significantly reduced the fiscal constraints of the government, and would have freed up resources to jump-starting the economy, hence the MOF rushed the amendment through the legislative process without consent from the BOT. The Bank saw this as a direct political intervention into its internal affairs, and argued that this action was equivalent to forcing a central bank to monetize the government’s fiscal deficits, and was determined to fight it.

The BOT mobilized political support from an unconventional group of very famous forest monk followers. Since the outbreak of the crisis, this elder monk had campaigned for donations from the public in order to give them to the BOT for topping up the foreign reserves, as an act of patriotism. His charisma attracted supporters from all walk of lives and the donations reached nearly USD 14 millions, which was an enormous sum in the Thai social context. The press reported that the Bank’s leaders lobbied the monk and informed him that the accounting consolidation would contradict the objective of his campaign, namely to use the donations only for backing up the foreign reserves.\(^{19}\) The monk then publicly aired his objection to the consolidation. The Bank’s mobilization pushed the government into a corner and it effectively abandoned its legislative plan by the end of May 2000.

A number of reasons can be singled out to explain why the government aborted its legislative plan. First and foremost, the Chaun Government was a fragile seven-party coalition with a slim majority in parliament. Although it had high political capital at the beginning, by 2000 the capital was used up and the only reason why various attempts within and outside the parliament to dislodged the government were not successful, was the even weaker opposition coalition, which had been politically discredited by the crisis. The government itself was significantly politically weakened after the massive sell-off of the closed down financial companies’ assets. Whatever the truth of the story might be, the government was conceived by the public as, at best, an innocence that was taken advantage of by foreign buyers, and at worst as a traitor who conspired with foreigners to dispose of the assets cheaply. Moreover, throughout 1999 nationalist sentiments were further inflamed by a campaign against 11 economic laws reform such as the Bankruptcy and Foreign ownership Act which were part of the conditionalities attached to the loans from the IMF and WB.

Aside from its political problems, by 2000 the economy still showed negligible signs of strong recovery, a full three years after taking the bitter prescriptions recommended by the IMF. The next general election was due by the end of the year, a great number of the charismatic monk’s followers living in the northeast of Thailand, the most populated region in which the Democrat Party led by Chuan had no solid support. The government had every

\(^{17}\) It is a fund under the BOT supervision and functioning as a war chase for bailing out distressed FIs.

\(^{18}\) A measure in order to stop bank run from FIs was the unlimited guarantee of both depositors and creditors of FIs by the FIDF, consequentially the government also had to guarantee and compensate for losses of the FIDF.

\(^{19}\) See Prachachart Turajit (10th April 2000, 14)
incentive to abandon its effort to amend the Bank of Thailand Act.

The Second Effort to Amend the BOT Act, the Draft of Financial Institutions Act and the Deposit Insurance Act

After the general election was held in January 2001, the Thaksin Government came to power with a landslide victory and later merged with other parties to form a single party led government, the first ever in Thai politics. In May 2001, Chatu Mongol was sacked and the government appointed Pridiyathorn Devakula as the new Governor of the Bank of Thailand.

There were several sources of conflict between the BOT and the MOF that prevented the drafts of the three acts from going through the legislative process during the Thaksin Government.

The first case became public in July 2004. It was a case concerning the bad lending practices of top executives of the Krung Thai Bank (KTB), which is the largest state-owned bank. The BOT was eventually able to force the KTB –overriding the opposition of the Finance Minister-- to reclassify 1.1 US$ billion as bad loans and, at the same time, was able to prevent its top executive from serving for a second term as Managing Director. In essence, it was a story about using political connections to obtain a loan. It was later revealed by the press that the KTB approved 9,900 million baht to a real estate company which kicked back more than 100 million baht to a person very closed to Prime Minister Thaksin, as a reward for his help in obtaining the loan. The press at the time speculated that Governor Pridiyathorn might be sacked since the KTB’s managing director and the Finance Minister were close friends. It was further revealed that the only reason why the Governor escaped the dismissal was he had solid evidence of money transactions which could be linked to a person related to the Prime Minister. This case suggests that the issue of BOT political independence is still at the heart of the conflict.

The second case was a conflict between the BOT and the MOF concerning the FIs Act, the main issue of contentious was again the BOT’s independence. As part of the reform package created after the crisis, a draft of Financial Institutions Act was produced. Essentially, the draft had three main themes. A) It overhauled and redesigned functions, authorities, and responsibility between the BOT and the MOF. In the original laws, most of the supervising authorities are designed in such a way that effectively the BOT has to seek approvals from the

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20 After the coup d'état on 19 September 2006, Pridiyathorn Devakula, the Bank's Governor during 31 May 2001 - 7 Oct. 2006, resigned from the post and was appointed as the Finance Minister. In February 2007, he resigned from the Cabinet since the PM appointed the former Finance Minister to be a Chairman of a working group in charge of strengthening the foreign investors' confidences of the economy which have been damaged by the political instability since 2005. Pridiyathorn claimed that this appointment was equivalent to the lack of confidence in his duty by the PM, hence the resignation.

21 Than Satajit 29th Oct. – 1st Nov. 2006
MOF before implementations, even if large numbers of those authorities are not involved with policy matters.\textsuperscript{22} As a result, the MOF can easily and legally intervene into the BOT’s FI supervision. This structure of power is particularly problematic when the BOT needed to apply tough measures to FIs, such as closing down a FI\textsuperscript{23}, and hence significantly contributing to the pre-crisis weak prudential regulations. Therefore, the draft Act drastically reduced the MOF approval authorities.

Secondly, the draft instituted a well defined rule-based regulatory mechanism; Prompt Corrective Actions (PCA). The PCA clearly stipulates trigger points—a well defined step-by-step criteria that forces the BOT to take corrective actions against weak FIs. For example, if a FI’s capital ratio is less than the minimum requirement of 8.5% but still above 5.5%, then the BOT has to take control of the FI or dissolve its subsidiaries. If a FI capital ratio fails below 3%, the BOT has to confiscate the FI’s license. This is a major improvement from the old laws, which empower the BOT with various means but subjected them to the MOF approvals. Additionally, the lack of clearly defined trigger points enabled the BOT delay taking (perhaps permanently) necessary tough actions due to political considerations. A particularly notorious case was the Bangkok Bank of Commerce (BBC), which became one of the triggers of the financial crisis.

Additionally, the draft increased the BOT’s supervising authority over FIs in a number of areas. For example, it enables the BOT to conduct a consolidated supervision. With this authority, the BOT can supervise and regulate financial conglomerates — parent FIs and their subsidiaries, on a consolidated basis, such as using consolidated capital ratios. The old laws did not authorize the BOT to do so.

In 2000, the above mentioned draft of the new FIs Act, drafted during the Chuan Government, was put through the legislative process and was being vetted by the Upper House in 2002. During this stage, the House Vetting Committee inserted a clause that effectively limited the spread between loan and deposit interest rates to a certain percentage points, claiming that this would protect consumers from FIs. However, this sort of interest rate ceiling would not be practical in the ‘real world’ and the Lower House did not agree with the insertion. Finally after a joint meeting, the two Houses could not reach a compromise (Roong, Don and Pajongjit (2005, 26). In the Thai legal tradition when the two parties can not reach a joint solution, the Lower House has the final say: it has to vote for confirming its position within 180 days. However, the Lower House, which was now dominated by the Thaksin’s party failed to confirm it and this failure effectively killed the draft bill.

It is not surprising that the Lower House failed to confirm the draft Act. By 2002, an important government agenda was restructuring and reorganizing the whole Government bureaucracy. The MOF employed this opportunity to revamp the whole system of financial

\textsuperscript{22} Those authorities were mainly results of the TBA political lobbying especially during 1960s. It wanted to balance the regulatory power of the BOT by the MOF.

\textsuperscript{23} There are a number of cases that this kind of political interferences did occurred. See details in Apichat (2002, Ch 7)
institutions (FIs) supervision, reasoning that the existing system was too fragmented. A new Financial Supervision Authority (FSA), similar to the one used by the UK, was proposed. The new organization would have power to supervise all kinds of FIs which were under the supervision of various authorities. For example, the MOF supervised special financial institutions such as the Government Saving Bank and the Export and Import Bank, while commercial banks are supervised by the BOT. Moreover, the insurance industry which is also a public deposit-taking institution is supervised by the Ministry of Commerce, while security firms are under the supervision of the Security Exchange Committee (SEC). This fragmented supervision is costly both to the public and private players, since some of the institutions are subject to two or more regulatory agencies. More importantly, different regulators have different rules and criterion which creates inconsistencies and non-level playing fields between different types of FIs. Lastly and directly relevant to the BOT, by reducing its role in supervising FIs, it would reduce the chance of any conflict of interest, whereby concerns about the fragility of the banking sector might persuade the BOT to pursue a more accommodating monetary policy than that warranted by the pursuit of price stability alone.

The BOT’s main argument against the FSA is that most of the financial conglomerates in Thailand, unlike the developed countries which first established FSAs, have commercial banks as a flagship rather than other type of FIs. For example, insurance or security companies, thus their exposure to other lines of financial business such as stock dealings via their subsidiaries is low. Moreover, Thai commercial banks still overwhelmingly dominate the deposit-taking market. Therefore, when the commercial banks are subject to the BOT’s supervision, the problems of inconsistency and non-level playing fields are minimal. It should be noted that the BOT did not oppose the establishment of the FSA on principles. Rather it argued that their establishment was not yet urgent. In particular, the BOT argued that the fragmentation of regulatory regime that leads to the problems of inconsistency and non-level playing fields is not severe, given the low degree of market linkages between capital and credit markets.

It is debatable whether the fragmented regulatory system is a serious problem under present conditions. However, it is certain that the fragmentation was a problem, and it would become more severe in the future given the fact that the degree of market linkages was increasing, i.e. the traditional separations of functions or line of businesses between types of financial institution will be increasingly blurred. And in turn, the fragmentation will negatively affect the development of a strong and efficient financial sector as the whole. Two examples should make this point clear. First, if a security firm is a subsidiary of a commercial bank, then its capital position must be counted as a part of its parent bank, and thus subject to the capital adequacy consolidated supervision rules of the BOT. On the other hand, if a

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24 The Deputy Governor asked for a closed discussion with members of the Faculty of Economics, Thammasat University on 7 February 2005 and made a presentation against the idea of setting up the FSA. This is obvious that the Bank was engaging in a public relation batter against the MOF.
security firm is an independent, it is subject only to the SECs supervision rules – which were less restrictive than the consolidated rules – hence the independent firm can invest a larger share of its capital than can its counterpart that is a bank’s subsidiary. This inconsistency leads to a non-level playing field between subsidiaries of Thai and foreign banks. While the Thai banks’ security firms are subjected to the capital consolidated rules, the foreign bank-owned firms are not. This is the case since the foreign banks registered their banking-operation units separately from their security firms in Thailand, i.e. the foreign banking subsidiary unit in Thailand is legally not a parent of its security firm. In sum, this inconsistency puts security firms owned by Thai banks at disadvantage position vis-à-vis a foreign owned ones.

A second example would be the case of hybrid security products--a cross between debt and security instruments--a prime case of inter-linkages between capital and debt markets. A Thai financial conglomerate can not shares expertise and resources across its banking and security entities, due to the BOT’s rules aimed at preventing conflicts of interest between the two entities. But, a foreign conglomerate can do so due for the same reasons as in the first example25. This inconsistency led not only to a non-level playing field problem, but it also led to an inefficient use of resources among Thai conglomerates, and hence negatively affected the whole financial sector development.

Worst of all, the state has no mechanisms to solve or to reconcile problems of fragmentation and inconsistency among the regulators. Each agency just focuses narrowly on its own prerogatives without coordinating with other agencies26. To this end, the move to establish a single and comprehensive regulatory regime can not be dismissed wholesale.

This whole grand scheme of the FSA was in the planning stage for more that two years, and was finally shelved due to opposition from various stakeholders; including the BOT.27 Notably, the scheme lacked credibility. The main question was would the FSA have de facto independence from the government? The MOF declared that it would give the FSA legal independence, a position that many stakeholders found doubtful. One hallmark of the Thaksin Government is that it was a highly market-interventionist government. Its various economic policies have been characterized as a populist policy funded through quasi-fiscal methods. Government owned FIs were ordered to expand lending to a variety of groups. For example, the KTB was ordered to make new loans available to previous NPL businesses in order to stimulate the economy. Furthermore, practical factors which could compromise FSA de facto independence were also raised. Even if FSAs were given legal independence, where would FSA's manpower and resources come from? With this kind of hallmark28, its FSA scheme which necessarily needed political independence lacked credibility, especially among

25Interview, Veerathai Santiprabhob, Vice President of Siam Commercial Bank, BKK, 10th April 2007.
26 Fragmentation among state agencies is not a unique problem of the financial sector, indeed, it is a major problem common to other sectors. See further discussions below.
27 Interview, Dr.Chodechai Suwanaporn, Director of Financial Institutions Dept., Fiscal Policy Office, the MOF, BKK, 9th April 2007.
28 See more details below.
privately owned FIs.\textsuperscript{29}

Given the above conflicting contexts, it is understandable why the Bank did not press for amendments of the BOT, Deposit Insurance and FI Acts during the Thaksin Government’s tenure. The BOT obviously does want to retain its FIs supervising authority, which has been written in the draft amendment of the BOT Act\textsuperscript{30}. This is in total contrast to what Governor Pridiyathorn did after he assumed the Finance Minister post after the coup in September 2006. One of his very first actions was to push hard for amendment of both laws. On 27\textsuperscript{th} February 2007, the Cabinet approved the draft amendments and sent it through the legislative process just one day before his resignation from the ministerial post. Dr. Chodechai revealed that during the whole term of the Thaksin Government the BOT had not submitted the drafts to the MOF. However after October 2006, Dr. Chodechai had to work during weekends in order to prepare the drafts for the Cabinet’s approval.

This second draft of the BOT Act amendment increased the degree of the BOT independence significantly, compared to the first draft. Most important of all, it revised the process of appointing and dismissing the Governor. The new draft stipulates a novel mechanism for the process. A ten-member selection committee would be appointed by the Upper House only from the pool of ex-technocrats, who had previously occupied the posts of the Permanent Secretary of the MOF, NESDB, MOC, Secretary of the Stock Exchange Commission (SEC), and the BOT Governor. This selection committee in turn would nominate a governor candidate to the Chairman of the Upper House, who would recommend him or her to the King for formal appointment. This selection committee would also nominate the Chairman of the Court of the Governor, which would be composed of 12 members. The 12 members of the Court would be composed of 4 insiders; the Governor and 3 Deputies Governor and 8 outsiders; the Secretary of the Fiscal Policy Office, the Secretary of the NESDB and 6 other experts including the Chairman. The 5 experts (excluding the Chairman) would be nominated jointly by the Governor and the Chairman and must be approved by the selection committee. In order to dismiss the Governor, the two-third of the votes from the members of the Court would be needed.

It is clear then that the above mentioned processes eliminated the Finance Minister’s authority, and was designed to minimizing the political influence on the process. The draft intends to keep, as much as possible, the post of the Governor in hands of the technocrats, and tries to maximize his job security. It is nearly impossible for a politically motivated government to dismiss the Governor since the two-third majority votes mean that 8 out of 12 members of the Court must vote for a dismissal, while the ratio of the insiders to the outsiders is 4:8. At least half of the outsiders would need to vote yes on the motion, in addition to all of

\textsuperscript{29} Interview, Thanyalak Wacharasurapon, manager of money and banking research division, Kasikorn Research Center, BKK, 9\textsuperscript{th} April 2007.

\textsuperscript{30} The same reason is applied to the case of the deposit insurance draft, i.e. all three drafts have to be consistent, especially the designs of authority relations between those organizations, hence conflicts in these issues in the BOT and FI acts also preventing the deposit insurance draft to be passed.
the insiders and the chairman. Note this analysis assumes that the 5 outsiders who are jointly nominated by the Governor and the Chairman are in fact independent of the Government.

With this high degree of independence from the government stipulated in the draft and the above mentioned two cases of serious conflict between the BOT and the MOF, Pridiyathorn had every incentive not to submit the draft to the MOF during the Thaksin Government.

The above discussions points out that ten years after the crises began, the three most fundamental financial reforms necessary to rebuild a banking system that is more efficient, more prudent and less susceptible to crisis, have not yet been adopted. This failure of the polity to implement institutional changes that can facilitate next round of capital accumulation is a strong testimony to a very basic weakness of the Thai state: an inability to adjust or change institutions to suite new environments. The consequences of the failure and some observations can be spelled out in more details as follows.

First, the BOT is not more insulated or independent from the MOF. Its attempts to press for *de jure* independence failed. The failed efforts mean that the Governor still legally wields vast decision-making power within the Bank. If he wishes, he can overrule decisions made by the Monetary Policy Committee or the Financial Institution Board, which were designed for counterbalance the power of the Governor, therefore enhancing the Bank’s policy credibility. While all powerful within the bank, the Governor is still subject to the mercy of the Finance Minister. The Governor lacks job security, but at the same time has vast power to run the central bank, these two facts have created incentives for the Governor to be a docile central banker. In other words, the perverse incentive structure governing relationships between the Bank and the MOF, which is one of the factors that led to the 1997 crisis, is still in place. A major reform objective—to create a new legal framework to prevent a reoccurring FI crisis—has not been achieved.

Secondly and logically following from the first, the perverse incentive structure implies that the degree of the Bank’s *de facto* independence is very dependent on the personality of an individual governor and the political strength and/or credibility of a government. The case of the BOT’s accounting consolidation bears out this point. The politically discredited and weak government of Chuan could not impose its demands on the Bank. On the other hand, under a strong government such as that of Mr. Thaksin, the Bank dared not submit its amendment drafts to the MOF for fear of clashing with its existing boss, rather than attempting to gain a higher degree of legal autonomy from it. It should be noted, however, that the fact that the Bank managed to resist policy directives from both governments shows it to be a stronger entity than other state organizations such as the NESDB and the FPO. Both of these organizations’ saw their power and influence, in terms of economic policy formulation, significantly reduced by both governments, particularly during the Thaksin Government. For example, the NESDB was effectively degraded into a management tool dealing only with planning details after receiving directives from the
government. It had all of its policy initiative roles removed. None-the-less, while the BOT is institutionally and politically stronger than other parts of the Thai bureaucracy, by no means is it as strong and effective as it was during its peak years of the 1960s and 1970s.

Thirdly, the political conflicts that prevent the FI laws from being amended is conflicts among state actors (technocrats vs. politicians or the Bank vs. the MOF) rather than between the state actors and private bankers as has historically been the case. The fact that the draft of FIs Act was submitted to the parliament signifies that it was agreed upon (or a workable compromise was reached) between the state and the private bankers, because the bankers had participated in and been consulted in the process that drafted the FI Act. The draft gave more power to the Bank in supervising FIs, indicates the reducing bargaining power of the bankers after the crisis. It ultimately failed because of conflicts within the government, not because of the power of the banking lobby.

Fourthly, the failures to amend the FIs Act and the Deposit Insurance Act means that all the old financial rules that had contributed significantly to the banking crisis 10 years ago are still intact. For example, a lack of well define prompt corrective actions still delays the BOT in taking timely tough actions against weak FIs. This is especially true in ‘normal situations’, due to political considerations by the BOT or direct interventions by the politicians, as in the past.

Fifthly, the failures have denied the sector basic infrastructure and hence has delayed it development. For example, the failure to pass the deposit insurance act means at least two things.

A) The FI sector is still lacks an orderly exit mechanism for a failed FI to leave the market. Due to the inter-connections between FIs through their balance sheets, and the large number of stakeholders involve in a failure, a normal bankruptcy framework is not an adequate mechanism to facilitate an orderly exit of a failed FI. There is a need to set up special procedures, which is also stipulated as a part of the deposit insurance act. The lack of this special mechanism also reinforces the incentives of the BOT to delay or not to take tough actions against weak FIs, since a failed FI would harm lots of depositors. Furthermore without a proper tool to deal with failed FIs, the BOT lacks incentives to promote higher degree of healthy competitions among FIs, due to fears of FI failures. This causes a lack of dynamism in the development of the sector.

B) The present regime of blanket deposits guarantee not only promotes moral hazard behaviors among depositors and FIs, and exposes the government to unwarranted contingency liabilities, it also undermines development of bond and security markets. The blanket regime means deposits are a risk-free asset, and hence it discourages savers from diversifying their assets into bonds and security instruments. It is an impediment to the development of a more

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31 See more details below.
32 Most of the FI law amendments were failed by oppositions from the private bankers (Apichat 2002, Ch.7).
balanced financial system based on both a bank based and a capital market, an important agenda of financial sector reforms after the crisis.

Sixthly, it can be argued that the unsuccessful reform efforts are, in one respect, a result of the emerging of a new powerful political faction of derived from the real sector of the economy, as represented by the Thaksin government.\textsuperscript{33} Unlike the ‘good old days’ during the 1960s – 1997, the Bank’ political masters no longer come from the bureaucratic elite or the ‘professional politicians’, such as the Chat Thai Party or the Democrat Party. The new political classes’ main interests, both politically and economically, were solidly based on the real sector of the economy. For political popularity, a docile central banker is ideals for a party with ‘populist’ and interventionist economic platforms via expansionary monetary policy, soft-loans and ‘selective’ credits. For their factional interests, derived from their businesses based in real sector, an independent central banker with orthodoxy monetary outlooks leads to a creditor friendly, rather then a debtor friendly, monetary regime. Hence, the Thaksin government had incentives to curtail the central banker’s independence and pushed to reduce the central bank’s authority by proposing the FSA scheme. To this end, it can be asserted that the Thaksin Government as an anti-neoliberal reform government.

\textsuperscript{33} Thaksin himself is a telecommunication tycoon and significant number of his Cabinets’ members came from big businesses in real sector, such as automobile and entertainment industry. See this line of argument in, for examples, Wingfield (2002, 286) Kasian Tejapira (2002, 339), Hewison (2003, 5-9.)
IV. Political Institutions and Government Effectiveness

There is general agreement that the Thai state is not a strong or a developmental state, rather it can be classified as an intermediate state along the continuum of state strength from predatory to developmental state, as suggested by Evens (1995). In this aspect, the Thai state is weaker than those in East Asia such as South Korea or Taiwan, but stronger than say, the Philippine during the President Marcos period. Although the effectiveness of the Thai state is more limited than the developmental ones, it was nevertheless ‘adequate’ to jump start the economy during the bankers’ capitalism period under military dictatorships using the technocrats’ policy guidance. The double transitions of an economic boom and democratization that occurred during the 1980s and 1990s undermined the state’s effectiveness. It also contributed to a decline in the power and role of the technocrats, leading to the 1997 crisis (Apichat 2002). In other words, it is argued that the double transitions contributed to a decline of the state’s strength, especially the best segment of its bureaucracy.

This study will further argue that the democratization during the 1980s set up the political institutions that not only became factors contributing to the crisis, but also impeded an effective and speedy crisis resolution, via an ineffective government as in the case of Chaun’s as argued above. As pointed out by MacIntyre (2003, 69) the Chaun’s government ineffectiveness followed closely with the pattern of its predecessors, e.g. Chavalit Government, due to the institutional set up. In other words, the Chuan Government political weakness was not primarily due to any particular characteristic of the government such as its leadership style. Rather, the weakness was the result of the political institutions. The importance of political institutions to government effectiveness can be clearly seen after the 1997 constitution was adopted. In other words, this study is of the view that the strong government of Thaksin was, to a significant degree, a product of the changed political institutions brought by the 1997 constitution.

A fundamental pre-1997 political institution, established up by various constitutions and related laws, that produced ineffective governments was the electoral system: a multiple-seat constituency combined with first past the post voting rules. This system created strong incentives for candidates to utilize an electoral winning strategy that was based on the candidates’ personal reputation, such as the ability to deliver benefits to constituents at the expenses of a party’s collective reputation or platform. As Hicken (2006, 394) points out, “[electoral system] allowed for intraparty competition—pitting candidates from the same party against one another in the same constituency.”

34 Here, institution is defined as ‘rule of the game’. In this aspect, the author certainly not holding the view that democratization in general is necessarily detrimental to government effectiveness. He just argues that the particular political institutions set up in a specific society and period such as that of Thailand during 1980s are unfavorable to state effectiveness.
The candidate-centered electoral campaigns produced at least two unfavorable consequences. Firstly, it partly led to vote buying; a very expensive political campaign expense on the top of other regular expenditures outside the election period. The vote buying practice also discredited the whole political system in the eyes of economically better off urban based voters. Furthermore, the expensive campaign requirement led to a patronage relation between the candidates and their political bosses, a party leader or a faction leader who had the necessary resources to expend. This led to a loose party system which was really a weak coalition of political bosses, and it could easily disintegrate. In other words, it was a factionalized political party system.

Secondly, since the winning strategy was a candidate-centered campaign, it offered few incentives for parties or candidates to develop national platforms. The candidate-centered strategy encouraged candidates to provide local public goods or particularistic goods such as vote buying to their targeted constituencies. As a consequence, the political party system in Thailand was an ‘electoral party’ and could be characterized as a weak, incoherent, undisciplined and loosely bound together by political bosses. In short, it was not a mass party system based on strong organizational structure, with support from the masses and party activists, and adhering to an ideology or a clear policy line. Moreover, it was a system that had high numbers of small parties. An important point here is that the multiple-seats constituency led to a party system that was composed of many small parties. A large number of parties—10 to 12 on the average--together with a candidate-centered campaign meant that it was difficult for any party to gain a majority in the parliament. The crucial consequence was that a general election on the average resulted in a coalitional government with a large number of parties; usually 6 or more (MacIntrye 2003, 43).

Hicken (2006 and 2001) further argues that the existence of a large number of small parties pre-1997 was not totally explainable by the electoral system, i.e. Thailand still had too many parties than was warranted by her multiple-seats constituency. He argues that a crucial factor that encourages politicians to build a few big national level parties, as opposed to large numbers of small parties, is the degree of concentration of power within the government. The higher the concentration is, the stronger the incentive for politicians to build big national parties. He argues that although Thailand is a unitary state and with highly centralizes power in the national government in Bangkok, the highly concentration of power this implication was not present.

During pre-1997 the government’s power was diluted by two factors. First and foremost, the leader of a party was just a first among equals, because of the factionalized nature of Thai parties. The leader’s power was checked by rival factions within his own party, and this discouraged politicians from forming big parties. In other words, a larger party tended to have

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35 Electoral theory predicts that the more seats there are in a constituency, the more parties are viable in that constituency (Hicken 2006, 389).
more factions than a small party and hence more ‘veto players’ in the party. Secondly, until the late 1980s the unelected Upper House, which represented the interests of bureaucrats and military officials, while it did not constitutionally have the power to block decisions by the Lower House, it none-the-less effectively checked power of the government.

MacIntyre (2003) points out that the above political institutions produced a decision-making framework that was fragmented, i.e. the decision making system was characterized by a high numbers of ‘veto players’. He suggests that this type of decision framework tends to generate a status-quo bias since there are many veto players that have to reach an agreement before policy changes can be made. For example, when applying the veto-player concept to the case of the Chuan government: it may be said that the government had at least 6 to 7 veto players within it since it was composed of a coalitional of 6 to 7 parties. Conversely Thaksin Government was a single party government, and thus only had one veto player. This helps to explain why the Thanksin’s government was more decisive and more effective at—‘getting things done’—than the Chuan government was. As MacIntyre (2003, 43) himself is well aware, the numbers of veto players in Thailand pre-1997 could be much higher than the numbers of coalition parties within a single government since most parties were composed of several factions and some factions in large parties were even bigger than other small parties within the government. When these factions defected or threatened to defected, they could easily destabilize the government, or even cause it to collapse. The factionalized nature of Thai parties is a major reason why the pre-1997 governments were slow and ineffective in policy changes.

Very well aware of the linkages between political institutions and government effectiveness, the 1997 constitutional drafters deliberately reconfigured those institutions to produce an effective government. Among other key elements of the constitution, it established political rules specifically designed to produce more stable and more effective government, and to strengthen political parties and reduce their numbers.

The electoral system was greatly reformed. The multiple-seats district was replaced by 400 single-seat constituencies retaining the first past the post voting rule. An addition 100 seats nationwide constituency was proportionately elected from party-list candidates. For these seats, each party needed to gain at least 5% of the national vote in order to qualify for any seats. Although, the single-seat constituency did not eliminate the candidate-centered campaign—the practice of vote buying is still widespread—it helped to reduce numbers of parties since numbers of parties tends to grow with numbers of constituency seats. On the other hand, the party-listed election rules clearly encouraged politicians to campaign on national platforms since the constituency was nationwide and plainly biased toward bigger parties due to the 5% cut-off rule36.

36 Ammar tentatively calculated that the TRT party gained 42 more seats under the 1997 rules in 2001 election than it would have gain under the pre-1997 rules (personal correspondence with the author).
There were also new rules that aimed towards strengthening the government by increasing the power of prime minister relative to factions within his own party and his coalition party leaders, i.e. these rules aimed for increasing power concentration. Firstly, cabinet members had to relinquish their seats in the parliament. This rule was aimed at discouraging coalition defections, but it also reduced the power of faction bosses over the PM, since these bosses were normally awarded cabinet posts. Relinquishing their seats in parliament meant that when cabinet members were expelled by the PM, they could not return to the parliament, thereby had to end their parliamentarian’s role for the rest of the parliament term. Secondly, a vote of no-confidence against the PM required at least 40% of the Lower House which was higher than a vote against ministers. Thirdly, possibly most effectively, candidates must be members of a party for at least 90 days before running in an election, while elections must be held within 45 to 60 days after the House had been dissolved. These rules were meant to prevent party switching which caused many previous governments to collapse. The PM with power to dissolve the House could threaten to call a new election and thereby could prevent those party dissenters from participating in the coming election.

Armed with all those rules, Hicken (2006, 397) argues that “Thaksin enjoyed a degree of leverage over his coalition and factional rivals that none of his elected predecessors ever possessed”. The power of Thaksin vis-à-vis his factional rivals can be illustrated clearly in the case of Sanoh Thienthong, leader of Wang Nam Yen faction. He has a reputation of being a ‘king maker’ since his supports enabled 3 party leaders to be the PM, including Thaksin. In other words, whenever he switched parties, his new party leaders became PMs. However, he could not do so again in the 2005 election in spite of his growing conflicts with Thaksin, and he was finally marginalized in the election. Under the pre-1997 rules, there is little doubt that he would have switched parties. During the Thaksin era, although the TRT party was composted of several factions, there was only one veto player; that was Thaksin himself. Certainly relative to the Chuan’s government, the number of veto-players in the Thaksin government was much less than in the Chuan government, even if one want to argue that there was more than one veto-player.

To sum up, the 1997 constitution set up new rules of the political game that reduced the numbers of parties and encouraged them to be larger and more coherent and to focus on national policy level by changing the electoral system and increasing the level of power concentration. The results were impressive: the effective number of parties at the national level was reduced from 7.2 during 1986-1996 to 3.8 in the 2001 election and further reduced to 2.6 in the 2005 election (Hicken 2006, 393). In this aspect, the 1997 constitution was very successful in achieving its aims of building a strong executive and effective government, and the Thaksin government showed no hesitation in making the most out of these new founded powers, to the point of abusing them.
As the previous section points out, the 1997 constitution deliberately reconfigured political rules to create strong executive and effective government. As a consequence, the Thaksin Government, the first elected government under those new rules, had its power greatly enhanced. This section will point out that the government successfully using the enhanced power to concentrate and centralize power in the hands of the Prime Minister. The discussion will also focus on aspects of the Thaksin Government’s projects/programs in order to point out some implications concerning the recent developments of the Thai political economy. It will argue that the Thaksin Government may be characterized as an anti-IMF led reform and market-interventionist government. This does not mean it was either a nationalist-populist or an anti-market government such as one sees in some regimes in Latin America, as some scholars tried to categorized his regime especially during the early days of the government (Warr 2005). Rather, it is a government representing a new faction of the Thai capitalist class, one that comes from the real sector of the economy, and that it has attempted to capture power in the state and does not refrain from using it to advance either their factional interests, or the interests of their cronies. In other words, the rise of the TRT Government signifies a new episode in Thai politics and economics, the eclipse of banking capital—the dominate force in the political economy for four decades--by real sector capital.

Concentration of Powers

During the Thaksin regime, concentration/centralization of powers into the hands of the executives was given a high priority by the government. In effect, there were three channels in which the government executed the concentration, namely bureaucratic reform and reorganization, fiscal concentration and centralization of policy decision-making.

The Bureaucratic Reform

The reform was, indeed, part of the TRT’s electoral campaign in 2001. Talks of bureaucratic reform had been going on for a longtime: previous governments had set up no less than 23 bureaucratic reform committees, but they produced no tangible results. Unlike it predecessors, a reform agency—the Office of the Public Sector Commission (OPSC)—was established by the Thaksin Government as an separate body outside the Office of the Civil service Commission, which was traditionally responsible for bureaucratic reform and

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37 Otherwise stated, the following discussion is mainly taken from Nakarin (2007).
development. Instead, it was put directly under the control of the Prime Minister’s Office. The board of the reform agency was composed of only experts and politicians, the bureaucracy was not represented. These facts testify to how much the bureaucracy’s power vis-à-vis the TRT Government had been reduced. On 3rd October 2002, the government implemented a comprehensive reorganization of the whole bureaucracy: changing it from 14 to 20 ministries, regrouping departments into new clusters based on their main agendas, with each cluster led by a deputy permanent secretary. By 2003, the Cabinet approved an action plan submitted by the OPSC, which aimed for a reduction of 30% - 50% in terms of steps or time needed for an agency to serve the public (Suehiro 2007, 27). The government also proposed to allow the appointment of non-officials to senior posts like permanent secretaries, and to downsize the bureaucracy through forced early retirement for poor performance. Furthermore, the government introduced the so-called CEO ambassadors and CEO provincial governors management style, i.e. an adoption of private business management concept of Chief Executive Officers (CEO) to public affairs. The public CEOs were given more mandates, focused on economic growth, larger budgets and greater power, such as new authority over the line ministry bureaucrats in their province. Also, there was a proposal that would make the CEOs accountable directly to the PM, they would act like a PM’s assistant in the provinces. All these changes were aimed at removing functional duplications and fragmentated bureaucracies that had raised the costs, delaying decisions and created unclear lines of accountability.

However, the most controversial issue concerned the large number of senior appointments, promotions and transfers in both the civil and military services, to Thaksin’s relatives and classmates. By August 2004, 38 officials who were connected to Thaksin or the Minister of Defense’s families, or who were Thaksin’s friends from the Class 10 of the Armed Forces Academies Preparatory School, were appointed to various important military posts. This included the commander in chief of the army, who was the PM’s cousin (Ukist 2005, 142-146). In the civil service, top executives of the technocratic organizations such as the BOT Governor and the NESDB’s chairman were replaced by new appointments from the government. For the NESDB, the new chairman was appointed from the PM’s Chief Economic Adviser while the other committee’s members were also close to the TRT party. After several cases of conflict with the government, the NESDB’s Secretary General resigned from the post. “The main result of all these moves was to make the bureaucracy more responsive to political command. Several senior officials retired…Others attached themselves to the TRT in order to secure favor. The party drew up plans to extend this politicization down the bureaucratic pyramid…” (Pasuk and Baker 2004, 186).

The above appointments were in contrast with the past practices, especially since the mid of 1980s. Traditionally, bureaucratic appointments of senior officials had been based on seniority and a clear career path within each line ministries: a senior official was rarely transferred from one ministry to the others. And these practices of personal management
produced a bureaucracy that was stable, but also inward-looking, with a conservative culture against criticism from outsiders. Thaksin’s appointments bypassed all those established rules. The PM empowered Ministers to directly appoint director generals\(^{38}\) from both within and outside the ministries, or to appoint younger officials without adhering to the seniority and career path criterion. For example, Jakramon Pasukwanich, the former secretary general of the NESDB, was transferred to the post of permanent secretary of the Ministry of Industry, while Ampol Kitiampol, a director general in the Ministry of Agriculture was appointed as the NESDB’s secretary (Suehiro 2007, 22-27).

There is no doubt among observers that the Thai bureaucracy is part of the nation’s problems rather than part of the solutions. To this end, the need for bureaucratic reform is undeniable. However, there is a disagreement between Pasuk and Baker (2004) and Suehiro (2007, 26-27) concerning the TRT Government’s bureaucratic reform. While the former largely sees the appointments as a politicization of the bureaucracy, the latter by and large viewed those appointments as merit based. While it is too early to have a comprehensive evaluation of the reform in terms of the official objectives, namely more efficient and effective bureaucratic performance, both studies certainly agree that an outcome of the reform was that they increased the political control of the bureaucracy by the Thaksin’s government.

**The Centralization of Policy-Making and Budgeting**

Although the economic policy influence of the four-core macro-agencies under the guidance of ‘the technocrats’ had been declining, and had partly contributed to the outbreak of the 1997 crisis, their influence was further sidelined afterwards. It was reduced to the point of their being ‘back-room boys’, whose responsibility was mainly to craft policy details after they had received their policy directives from their political masters.

Among the four core agencies, the FPO and the NESDB suffered most. The roles of the two organizations had been reduced under the Chuan’s government. For example, the Public External Debt Section was taken out of the FPO authority and by 1999 its staff had been cut from 250 to 150, its decision making in fiscal policy was taken over by the Economic Ministers Meetings (Suehiro 2005, 43-44). The FPO and NESDB’s policy roles were further reduced by the Thaksin’s government. The most important development was that the TRT had its own policy formulating mechanism; the TRT Economic Formulating Committee. Suehiro (2005, 46-47) argues that the Thaksin regime was the first government which had a party-based policy team. Apart from the party’s team, Thaksin also formed advisory groups of outsider. These groups were composed mainly of ex-technocrats, capital market experts and big business leaders such as Dhanin Chearavanont, the chairman of the mighty CP Group and

\(^{38}\) Previously, there was a law prohibiting such practices. A Minister was empowered to appointing his permanent secretary only while the secretary was entitled to appoint director generals.
Boonsithi Chokwatana from the Saha (SPI) group. The prominence of these new players meant that policy roles of the core agencies were reduced. For example, when the NESDB and MOF jointly submitted a mid-term economic plan to the Cabinet in July 2001, its content strongly echoed the TRT economic team’s plan, that was part of the policy campaign during the 2001 election. The NESBD was frequently ordered by Thaksin to formulate new policy in strictly adherent to the government’s directives (Suehiro 2007, 12). Furthermore after the bureaucratic reorganization in 2002, the Prime Minister’s Office became the center of policy formulation and monitoring, thereby reducing the roles of the MOF and the NESDB. As Suehiro (2007, 14) argues “Thaksin apparently aimed to replace bureaucratic polity by prime minister-led politics”.

The centralization was also applied to the budgeting process. The most important change was the centralization of budget allocation decision into the hands of the PM. Previously most of the government’s budget was allocated to line ministries, while less than 15% was allocated under the heading of Central and Revolving Funds. The Thaksin Government significantly increased the budget share of the Central Fund. It jumped from 9.6% of the budget in 2001 to 18% in 2002 and peaked at 22.8% in 2004, while the line ministries’ share was reduced from 77.4% to 67.6%, and then to 62.8%, respectively. The Revolving Fund slightly increased from 3.9% in 2001 to 5.3 in 2002 and peaked at 5.9% in 2003. And most of the increases in Central Funds were allocated to programs that the government was electorally pledged to support, projects such as the village funds, community development, national competitiveness and provincial cluster strategy (Suehiro 2007, Table 8-9, 31-32).

The essence of this shifted allocation was that it gave the PM more power in the budget allocation process, power which came at the expenses of the parliament and the line ministers. The purpose of establishing the Central Fund under the 1959 Act of the Budget was to provide flexibility for a government to meet contingency spending needs, such as responding to natural disasters. To this end, when the executive submitted the annual budget proposal to the parliament, there were no detailed expenditures under the Central Fund heading for members of parliament to scrutinize apart from the total amount allocated. This deprived the parliament of its ability to check the budget and balance power. Furthermore, the Fund’s expenditures were subjected only to cabinet approval, and under the 1997 constitution the PM had strong bargaining power vis-à-vis other cabinet members. Therefore, the significant increasing in Central Fund budget meant a centralization of budget allocation into the hands of the PM.

To summarize, Thaksin further consolidated his power through centralization in three areas, bureaucratic reform, policy decision-making and the budget allocation process. And these centralizations were in addition to the greater power granted to the PM by the 1997-constitution. The next section will focus on how the Thaksin Government executed these powers, to which we now turn.
It can be claimed that a prominent feature which set the Thaksin regime apart from previous governments—whether elected or non-elected ones—is its approach to economic management and policy orientation. There are a number of studies that already deal with the Thaksin Government’s economic policy, sometimes called ‘Thaksinomics’, in detail\(^39\). The purpose of this section is just to highlight the state-led approach and interventionist feature of the government. It may be pointed out that there were three arenas which typified the approach, namely industrial policy, aggregate demand stimulation and state directed credits. This high level of state interventions was not conceivable before the 1997 constitution. Previous governments, such as Chuan’s, were not in a position to intervene in the economy to these extents due to state weaknesses. In other words, this section argues that the political rules of the game set up by the 1997 constitution together with the process of concentration of powers discussed above enabled the government to much more strongly intervene in the economy. In other words, the state itself was strengthened during the Thaksin period.

The government clearly intended to stimulate the economy out of the lingering effects of the crisis. Apart from setting up the TAMC, the government stimulated the economy mainly through two channels: state directed credit and so-called ‘populist’ projects such as village revolving funds, a cheap medical care program, agrarian debt moratoriums, etc. Although the populist projects were, in one respect, a continuation of the Chuan government’s Keynesian style fiscal stimulus, the Thaksin administration intensified the stimulation by better targeting groups who had a higher propensity to consume (the poor) and hence a higher multiplier effect on the overall economy. This stimulation was done largely through a quasi-fiscal policy—a novelty in the Thai context—credit expansion by state owned FIs (whose new loans were not part of the Government’s budget, though it would certainly be called in to bail the FIs out in the case of large default rates) in order to circumvent the already high level of public debt (57.6% of GDP in 2001). By 2003, the quasi-fiscal financing was in the range of 2-3% of GDP or 10-17% of the government’s regular budget (Pasuk and Baker 2004, 104-107, 119)\(^40\). As a result of this stimulating package, the 1999-2002 economic upturn could be characterized as a consumption-led recovery. When compared to previous phases of expansion, consumption typically contributed only 54% of aggregate growth, it contributed 65% in the 1999-2002 upturn (Roong, Youyong and Daungporn 2003, 8).

Furthermore, it is possible to claim that another feature which set the Thaksin government apart from previous governments is its employment of state directed credit policy. According to Pasuk and Baker (2004, 109) after trying unsuccessfully to push private bankers

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\(^39\) For example, Pasuk and Baker (2004) and Apichat (2005).

\(^40\) The use of quasi-fiscal measure was critiqued as nontransparent and circumventing rules of prudent budgeting process, which is true. However, an estimate by the IMF (2004, 21-22) points out that even in worse case scenarios, the risk to fiscal position was low. The IMF figure of all special financial institutions’ contingent liabilities that might turn bad due to carry out the government policy loans, is in the range of 0.5% to 3.5% of GDP.
to extends more loans the government then chose to bypass the private banks. The state owned special financial institutions’s (SFIs) share of credit allocation increased significantly from 15% in 2000 to 19% of the total FIs’ sector in 2003. The share of Krung Thai Bank (KTB)--a commercial bank fully owned by the state--also jumped from 12% to 16%. Together, their role in credit allocations jumped from 27% to 35% within 3 years (Pasuk and Baker 2004, 110-111). The total share of all state owned FIs finally reached 40% in 2006. Among them, the KTB played a prominent role due to its size and aggressive approach. It expanded its new loans by 15% in 2002, hence accounting for nearly 80% of that years total credit growth of 4%. Its loan expansion had accelerated to 20% or 92% of total lending growth in the first quarter of 2003 (IMF 2004, 29).

In the name of enhancing national competitiveness, the interventionist and state-led approach was also widely used by the government in the area of industrial policy. The government kicked off the policy platform by employing Michael Porter, an international consultant, to formulate national competitive niches. By 2002, five industries were targeted: tourism; fashion; food; computer graphics and automobiles for promotion. The list was later expanded to include agriculture-product-processing, more computer based segments, medical care and logistics. Pasuk and Baker (2004, 114) suggests that the longer list was a result of political lobbying by businesses who had close relations with the government’s cabinet.

To implement or facilitate this industrial policy, a number of organizations were set up; a textile institute; the Thailand Elite Card Company with 1,000 million baht register capital; the Bangkok Fashion City Company, etc. During the fiscal years of 2004-2005, 98,900 million baht was allocated to the national competitiveness program (Suehiro 2007, Table 9, 32)41, the Government also set up a National Committee on Competition.

Given the above, the Thaksin’s government certainly cannot be described as an ideal hands-off neoliberal state, playing a very minimal role in the economy. The discussions of NPLs resolution and financial law amendments also point out that the government was an anti-IMF reform administration. It did not want to institute a higher degree of central bank independence, or to pass creditor friendly bankruptcy and foreclosure laws. In other words, the government was not interested in building economic rules of the game that facilitated the working of credit market mechanisms, rather it saw the state as a pivotal mechanism in managing the economy.

It is also fully understandable why the Thaksin Government was in favor of policies that were beneficial to the real sector at the expenses of the financial institutions. The government can be characterized as a representative of a new faction of Thai capitalists, whose fortunes had been rapidly amassed during the boom years, and who had emerged from the 1997 crisis relatively un-scared. It was a government “of big businesses and for big businesses”

41 By late 2003, Thaksin Government shifted gear from stimulating consumption and private investment through credit expansion to public investment mainly in ‘mega-project’ infrastructures to the cost of 2.4 trillion baht (Pasuk and Baker 2004, 125), but later trimmed down to 1.8 trillion baht in January 2006 (Suehiro 2007, 3).
(Wingfield 2002, 286). Most of the Thaksin’s big business supporters had their business interests in the real sector of the economy: telecoms; real estate; steel; and entertainment media; they “represented the greatest concentration of economic and political power seen in Thailand since the end of the absolute monarchy in 1932” (Ukrit 2005b, 219).

It is fair to characterize the style and contents of ‘Thaksinomics’ as Keynesian; it encompassed a highly interventionist and activist approach. It was not only ‘classically’ Keynesian in terms of aggregate demand stimulation, it also involved supply side management; the state directed credits and a ‘picking winners’ industrial policy. This supply side feature led Pasuk and Baker (2004, 100) to write: “Thaksinomics is a shift towards the ‘developmentalist’ view that in catch-up economies, government has to play a positive role in protecting and promoting firms and sectors”. It is debatable whether the Thaksin Government was indeed a developmentalist government committed to protecting firms and sectors from international competition or how successful were the developmentalist policies and implementations it did adopt. However, it seems fair to say that the government of Thaksin has been the first government since 1957 which seriously tried to use the state’s power to allocate capital through industrial policy and directed credits. It was also in a stronger position both politically and economically to implement the ‘developmentalist’ projects than any previously elected government. The Thaksin government was able to influence FIs’ credit allocation to such degree was partly a result of how the 1999 banking crisis was resolved, namely the nationalization of a few private banks during the Chuan’s government period. In other words, the nationalization gave the state a potent instrument to intervene in the economy through credit allocation—a hallmark of East Asian developmental states—which Thaksin keenly employed. Politically, it was a very strong government empowered by the 1997 constitutional rules and the centralization of powers that resulted.

The military coup on the 19th of September 2006, brought the Thaksin Government and its experiments in ‘picking winner’ industrial policy to an abrupt end. This makes rendering a comprehensive evaluation of the approach impossible, but some conjectures may be offered here as follows.

The experiences of East Asian developmental state such as Korea suggest that there are at least two necessary conditions for a successful ‘picking winner’ industrial policy: a state’s autonomy from vested interest groups and a state’s capacity to implement the policy. Briefly, the first condition refers to a state’s ability to pick a ‘right’ winner, i.e. the ability to correctly

42 This line of argument is also supported by Kasian (2002, 339), Hewison (2003, 5-9), and Pasuk and Baker (2004, 69-72).
44 Another feature of the government was a free-trade-agreement enthusiast.
45 Furthermore, the FI sector was awash with liquidities with historically low interest rates, partly due to the nonfunctioning of the private FIs. This ‘easy’ credit environment enhanced debt accumulation especially among households and hence helped to stimulate demands. This credit environment also minimized a potential conflict between the government and the private bankers since the easy condition meant less competition for credits. It would be a real test of government strength, if the government would have forced the private bankers to extend credits under a tight credit condition.
identify ‘sunrise’ industries or firms. This ability must not be influenced by vested industrial groups or firms, i.e. the state is assumed to make decision based on objective criteria such as potential gains from dynamic comparative advantages rather than, say, a political lobby. There is plenty of evidence that point to the contrary in case of the Thaksin Government’s choices. As Pasuk and Baker point out, the longer list of target industries was due to political lobbying, especially the inclusion of agriculture-product-processing. This is because the CP Group--the biggest agri-business group in Thailand--was part of the inner circle of the TRT’s government. The group’s chairman was an advisor to the PM while his son-in-law was a cabinet member.

The second necessary condition is a strong and effective bureaucracy, especially those in the micro (sectoral) agencies who are responsible for ‘guiding’ industries or sectors. In the Thai context, this condition may be even harder to meet than the first one. Traditionally, the line agencies have been anything but effective, their weakness and ineffectiveness was arguably a factor that influenced the 1960s generation of the technocrats to refrain from employing strong state-led industrialization. The famous weaknesses among the line agencies included fragmentation and non-coordination both in terms of policy formation and implementation. This led to unclear lines of authority, non-accountability and a lack of responsibility, and hence ineffectiveness. These weaknesses lead Christensen, Ammar and Pakorn (1997, 44) to conclude that “sectoral [industrial] policy has therefore approximated laissez-faire largely by default”. In other words, the agencies are so weak that they could not, even if they wanted to, impose their measures on the private sector. They are weak to the extent that their policies and related measures existed only on paper. The laissez-faire industry hence operated by default, this being the flip side of the previous Thai’s industrial policy.

To this end, the bureaucratic reforms, which also emphasized an agenda based reorganization, carried out by the Thaksin Government might help to remedy those weaknesses especially the fragmentation. This could be more conducive towards a successful industrial policy. It is out of the scope of this study to review the degree of success the bureaucratic reforms have achieved. However, there is evidence suggesting that the reforms have not been very effective in addressing those traditional weaknesses of the micro agencies. An example would be the sugar industry, which had been a successful industry, but increasingly faced stronger competition in the world market since 1990s. It needed to be upgraded, and one component of the upgrade package was a better capacity for R&D, such as improving the cane varieties. As of 2003, Doner and Ramsay (2003, 42) pointed out that “[g]overnment agencies are ill-equipped to do relevant research and/or stimulate the activities of growers and millers. Research efforts are fragmented among three separate programs in the ministers of Agriculture, Commerce and Industry…And the agencies face a shortage of researchers”. For an overall assessment of Thaksin Government’s industrial policy, it is worthwhile to quote them at length.

46 And again, the 19th September coup renders a comprehensive evaluation impossible.
“TRT’s strategy is an explicit focus on upgrading with specific, targeted industries …Asia’s tourism capital, and agro-business, such as sugar. Institutionally, Thailand is supposed to be moving toward greater bureaucratic coherence and public-private sector consultation...In addition to bureaucratic reforms, the government has established a National Committee on Competitiveness…initiated efforts to improve vocational training, and supported the development of clusters...But these institutional initiatives may be little more than sophisticated hand waving” (Doner and Ramsay 2003, 44-45).

Furthermore, another hallmark of East Asian developmentalist drive is state directed credit to target industries together with performance criteria. The state is firmly committed to cut credits when the target firms or sectors do not meet the criteria. In case of Thaksin Government, there are no evidences to show that this is being the case. On the contrary, there is evidence to suggest that some credits were directed based on political connections such as the case of KTB lending to the real estate group discussed above. Furthermore, there is also evidence that the TAMC was used to dispense favors to politically connected businesses. For example, Prayuth Mahakisiri, an industrialist who was 27th on TRT’s party list slate at the 2001 election received a 15 billion baht ‘hair cut’ from the TAMC. A few months later he brought a golf course for 1 billion baht cash (Pasuk and Baker 2004, 112).

In sum, although the Thai state gained strength, both politically and administratively, during the TRT Government, all the available evidences indicates that the government’s drive toward a developmentalist direction was not yet successful. This interpretation is not intended to demean the importance of state reform. The weaknesses of the Thai state are a very real and pressing problem, and need to be fixed regardless of whether it pursues a market-led or a state-led form of capitalism. Even a neoliberal form of capitalism requires a considerable degree of state competence; the ‘orthodox paradox’. In other words, there is a need to strengthen the state even when it is to pursue the neoliberal reforms. The failures of the governments to amend the financial laws were just examples of weaknesses that needed to be corrected. The two recent themes of state reform adopted by Thailand: the empowerment of the executives by the 1997 constitution and the concentration of powers into the hands of the executive, are both moves in the right direction.

47 Even neoliberalists do not deny that state competence is needed for public goods productions such as providing education, environmental protection and infrastructures. To this end, the extent of the Thai state’s failures in providing these basic goods are well know. Failures to solve the traffic problem of Bangkok and high rate of mortality in road accident are just a few examples from everyday life of state incompetence.
VI. The 19th September 2006 Military Coup: A Renaissance of Bureaucratic Polity?

There are already a number of studies arguing the causes of the 19th September military coup against the Thaksin Government. Pasuk and Baker (2007, 2), for example, stress the importance of the middle class in supporting the coup. As they wrote: “the 2006 coup in Thailand could not have succeeded…had it not been because major elements of the middle class went along with the royalists and the palace to support the coup”... On the other hand, Suehiro (2007, 2) stresses the importance of state reforms: “[t]he real cause behind the military coup is a conflict between Thaksin who has forcibly conducted reforms of state and royalist-military groups who have believed that his reforms would produce a serious menace to the monarchy system”. For Kasian (2007, 21-22), the coup “was essentially a royalist coup…to reform Thai democracy in such a way as to make it safe again for the monarchy from the challenge of big business political hegemony”48. Read between the lines of Thongchai (2006) the Kingmakers, the coup was a response to the question of monarchical succession49.

The above mentioned authors may emphasize different factors behind the coup, but all of them agree that this coup is a result of the conflict between the Thaksin Government and a royalist-led alliance of the elite and middle classes. While this paper largely agrees with the above interpretations, it wants to stress the importance of state reforms in line with Suehiro. In other words, this paper is of the view that the strengthening of the state, and the corresponding increase in the centralization and concentration of power under Thaksin, “seriously disrupted the pre-existing order of elite pluralism under royal patronage and made many enemies among various elite groups outside the government circles” (Kasian 2007a, 12). In other words, the coup is a reaction by forces opposed to the state reforms carried out by the Thaksin Government. This line of interpretation can be deduced from the contents of the 2007 Constitution, which have been drafted by the military appointed assembly and was approved by a referendum on 19th August 2007. Clearly the objectives of this constitution are just the opposite of the 1997 Constitution’s: they are designed to produce weak governments, less powerful political parties and politicians, therefore giving enormous room for the royalist-led elites to manipulate political outcomes behind the scenes. An analysis of how it does so follows50.

Firstly, it sets up an electoral system which is most likely to bring back the pre-1997 style of parliamentary politics: weak and unstable coalitional governments with large number

50 The discussion below is not intended to be a comprehensive study of the new political institutions set up by the new constitution, it just wants to point out the implications of new rules of the political game on the Thai political economy.
of parties, i.e. it recreates the previous factionalized, undisciplined and short-lived party system. Section 93-95 of the document retain the two tier electoral system, but greatly changes its configurations. The first tier is still composed of 400 constituent seats, but brings back the pre-1997 multiple-seats districts with the first past the post voting rule, i.e. a complete turn back to the pre-1997 rules. These multiple-seats constituencies give strong incentives to politicians to compete on an individual basis, rather than to form large political parties. Partly as a result of this multiple-seats district, the polity would be composed of large number of small parties rather than few big parties, elections would thus tend to produce a coalitional government. In August, 2007, Banharn Silpa-archa, a former PM, already guesstimated that the new government after the coming election on 23rd December 2007 would be composed of 5 parties. The second tier—the previous nationwide party’s listed candidates—is divided up into 8 regional constituencies. This will reduce the PM’s claim of legitimacy as an elected representative of the whole nation and hence will reduce a strong popular mandate, it will also decease politicians’ incentive to build nationwide policy platforms. Clearly, a coalitional government with large number of small and fractionalized parties, and weak mandates, is not conducive for an effective government.

Furthermore, the new Upper House will be composed of 76 (49.7%) provincially elected and 74 (49.3%) appointed senators by a panel of judges and bureaucrats (Section 111-113). Although nearly half of the House is unelected, it still retains the power to impeach the elected top executives and other positions including the PM, the Cabinet Members, MPs, and others, and it is not difficult for them to do so (Section 270-274). For example, Section 271 stipulates that no less than 25% of the House members can initiate the impeachment process. This means that only 38 out of 74 unelected senators can initiate an effort to impeach an elected PM and his members of the cabinet. Apart from being checked by unelected senators, the elected politicians’ powers are further constrained by other unelected independent bodies such as the Constitutional Court, which are largely selected again by panels of judges and bureaucrats. In effect, these mechanisms can be read as a means that the royalist-led elites--significantly composed of bureaucrats and military men--can employ to control political outcomes and politicians.

Secondly and largely as a respond to Thaksin Government’s bureaucratic reforms and bureaucratic appointments, the 2007 constitution explicitly bars all elected officers—the PM, Ministers, MPs and elected local governments’ administers—from recruiting, transferring, appointing, promoting and dismissing all bureaucrats and state owned organizations’ employees at either the national or the local level (Section, 266, 268, 284). The main agenda of the 2007-constitution appears to be to reduce the power of elected politicians vis-à-vis other players, especially the judges and bureaucrats. Among the elected

\[\text{\textsuperscript{51}} \text{The PM and Ministers have authority to intervene in bureaucratic personnel management only if the interventions are needed for implementing government’s policies that have been approved by the parliament or as required by other laws (Section 268).}\]
politicians, the power is shifted back from the PM and party’s leaders to Ministers and factional leaders. The balance of power is also shifted from the executives to the parliamentarians. In other words, the royalist-led elites reacted to Thaksin’s state reforms by staging the coup in order to bring back the essentially outmoded bureaucratic polity in which they can dominate the state. However, the society has been transformed beyond recognition since the period of ‘semi-democracy’ led by the Prem’s governments in 1980s. The implications on the economy of all these regressive attempts will be spelled out in the next section.

The Coup and Its Implications for the Economy

In terms of MacIntyre’s (2003) analysis, the implications of the new rules of the political game on the policy making framework is a return to the highly fragmented decision making of the pre-1997 constitution period, i.e. the period characterized by a high number of veto players which tended to produce a policy rigidity rather than flexibility. Arguably, the number of veto player under the 2007 constitution is potentially higher than that of the immediate years before 1997. The bureaucracy itself will become a very important veto player against other players, in addition to the usual factional leaders and coalition party leaders. Moreover, the new rules limiting elected politicians’ ability to manage bureaucrats will be a significant obstruction to further bureaucratic reforms and other policy implementations. In other words, the bureaucracy under the 2007-constitution gains higher autonomy, both directly through explicit constitutional requirements and indirectly through power of appointing senators and independent bodies.

However, the bureaucracy is a part of the problem rather than a part of the solution. The Thai state’s incompetencies are often caused by bureaucratic ineffectiveness, especially due to its fragmentation and unaccountability. With a higher degree of autonomy from the elected politicians, it is likely that bureaucratic incompetence will increase further. It is quite unlikely that, after the coming election in December 2007, the new government will be an effective government in terms of ‘getting things done’.

This is very unfortunate, given the enormous challenges that are waiting for the new government. The economy is still suffering from the lingering effects of the 1997 crisis: a private investment slump combined with a financial sector awash with liquidity, to which we now turn.

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52 Other rules in the 1997-constitution that strengthening the PM’s power vis-à-vis the Ministers and factional leaders such as the 90 days party membership or the relinquish of parliamentary seat before joining the Cabinet, were dropped from the new constitution.
**Investment slump**

Historically, private investment accounted for the bulk of total investment. It collapsed spectacularly during 1997-1998, registering a 41 percent negative growth rate, which played a major role in the output reduction. Table 2 reveals that private investment as a share of GDP has not fully recovered since the financial crisis. Its share of GDP remained around 15 percent between 1999-2006, which was lower than the average level during the 1959-1986 pre-boom period, and was much lower than the boom period (21.5%). Although its average growth rate is higher than the pre-boom period, it is still lower than the boom period\(^5\).

Moreover, most of the private investment since the crisis has been for replacement investment rather than new investment as shows in Table 3, which has raised concerns over output growth sustainability.

**Table 2: Investment Indicators**

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<td><strong>Average growth (%)</strong></td>
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<tr>
<td>Output</td>
<td>8.3</td>
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<td>15.9</td>
<td>-41.4</td>
<td>11.9</td>
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<tr>
<td>Government</td>
<td>17.4</td>
<td>14.1</td>
<td>-9.3</td>
<td>9.6</td>
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<tr>
<td><strong>Share in GDP (%)</strong></td>
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<tr>
<td>Investment</td>
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Sources: Adapted and updated from Roong, Youyong, Daungporn (2003, Table 1, 5)

\(^5\) The phenomenon of investment slump is not only confining to Thailand, but it is a part of a wider regional pattern. A recent study done by IMF points out that “the post-crisis Asian investment slump is unusually prolonged and deep compared with other crisis episodes” IMF (2007, 2). Comparing 1990–96 with 2000–04, investment declined by between 4 and 17 percentage points of GDP in the Asian-crisis countries, which compos of Indonesia, Korea, Malaysia, Philippines and Thailand. With the relatively stable saving rates of the region, the collapse of investment and subsequent sluggish investment recovery led to a sustained external surplus in the crisis countries (IMF 2007, 5). By identifying 106 currency and banking crisis events in 85 countries over the period of 1975-2004, the study claims that the investment slump after the Asian crisis is exceptionally prolonged and deep. It found that, on average, a crisis results in 2% fall in investment ratio and the ratio pickups quickly; it takes only 2.2 years on average to recover. However, the investment ratios fall between 10-20% after the Asian crisis. For example, Thailand and Malaysia experiences a nearly 20% drop and have not yet recovered to even their pre-crisis level, 10 years after the crisis. Moreover, the study points out that the slump is worse than that of the Latin America’s experience during the 1980s debt crisis. And only 9 other than Asian-crisis countries out of more than 100 crisis episodes could be categorized as investment slump like the Asian crisis (IMF 2007, 9-12).
The importance of private investment to the Thai economy in terms of its relative contribution to output growth can be clearly seen in Table 4. It has been the second most important factor after consumption both during the economic upturn and downturn. While private consumption and investment accounted for 90 percent of output growth during a typical expansion period, the contribution of investment drops significantly when compared to consumption. Previously investment accounted for two-fifths of the combination as opposed to one quarter now. In other words, the recent expansion is unusually reliant on increased consumption, which also has longer-term implication for output growth since the relative lack of investment implies a future decline in the level of capital stock (Roong, Youyoung and Daungporn 2003, 9-10).

On the other hand, another important point of concern is bank lending. After four years of lending contraction, bank loans began to expand in 2001. The share of bank credit in the economy remains well below the pre-crisis period. Bank credit has declined to 80% of GDP in 2005, below the level of 128% in 1997. In terms of lending-deposit ratio 54, it declined from 134.5 in 1996 to only 85.7 in May 2007, reflecting a slow expansion of credit and indicating excess liquidity in the sector. Moreover, banks are refocused their lending towards consumer loans which increased to 20% up from 10% 10 years ago, and banks are less inclined to lend to the corporate sector (IMF, 2007, 43).

To sum up, in spite of all the efforts and resources devoted to the financial reform program over the last decade, there remains issues that are crucial to Thailand’s long run growth prospects. Investment is still well below the pre-boom level. Although the financial

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54 Calculated from the BOT data by the author.
sector is more resilient to shocks, the financial sector in general and the banking sector in particular are not yet able to perform their most fundamental role, namely the intermediation between saving and investment. The sector is still awash with excess liquidity while some businesses, especially the SMEs, cry out for financing\(^{55}\).

How can one reconcile the above? Is the excess liquidity a result of the reduced capacity of financial institutions to lend, due mainly to their unfinished balance sheets adjustments. If so, the low level of investment is explainable by lack of credits (supply side)? Or is the liquidity a result of an investment slump in the first place, and hence reflective of a low demand for loans (demand side)?

There is no conclusive study on this issue at the moment, the BOT’s technocrats and private bankers are of the opinion that the current situation is due primarily to demand side rather than the supply side problems. While they are not too confident of the causes of the low investment demand, they are of the opinion that the banking sector is in a position to lend. They point out that the sector has more than enough capital and loan loss provisions to facilitate further lending. They also point out the high degree of competition in the industry is such that there are no market segments left unexploited, for example, the SMEs sector which was largely ignored before the crisis, is now better served by banks\(^{56}\). If those bankers’ assessment is reliable then this points to another hypothesis explaining the low level of investment, namely a loss of competitiveness in the real sector, to which we now turn.

The hypothesis is that the real sector is rapidly losing competitiveness and therefore firms lack the confidence to invest. The figure below shows that labor productivity growth of Thailand is slower than some selected East and Southeast Asia countries. In 1996 Thailand and South Korea shared the same level of productivity which was higher than the rest of the group, by 2005, China, Korea, Taiwan and Vietnam overtook Thailand.

One may not agree with the above hypothesis by pointing to the reverse causality, i.e. the lack of investment is the cause of slow productivity growth. But, this paper argues that no matter what are the causes or effects of the slow growth, theoretically, the state can contribute positively to revitalized private investment by improving productivity growth. There are a number of ways that the state can help to improve productivity such as a ‘crowding in’ public infrastructure investment or a ‘new industrial policy’.

The first approach is based on the fact that infrastructure investment has not kept pace with economic recovery, for example, public investment in 2003 was only 60% of the 1996 level (WB May 2006, 33). By investing in infrastructures, it will enhance productivity of private firms and hence induce further rounds of private investment.

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\(^{55}\) Recently, the Baht has been appreciated strongly and the private sector pressures the government to do ‘something’. One of the measures agreed upon between the government and the sector is to create a 5,000 million Baht revolving fund for the SMEs sector (Matichon, 30/7/2007).

\(^{56}\) Interviews by author, BKK, April 2007.
The second approach is the ‘new industrial policy’ suggested by Stiglitz (2002, 15-23). Two principles—board gauged interventions and market-like mechanisms—distinguish the ‘new’ from the ‘old-picking-a-winner’ industrial policy. Unlike the picking winner policy, the state intervention is board based and not trying to pick winners. The intervention is board based in the sense that it should aim to solve market failures; incompleteness, externalities or spill-overs. For example, the state might focus its interventions to produce more public goods such as new innovations and new knowledge. Furthermore, the interventions should be market-like mechanisms as much as possible. For example, a government credit support program for SMEs should be conducted jointly with commercial finance institutions both in terms of operations and capital participation, in order to minimize moral hazard problems.

Arguably the new industrial policy is more appropriate to a ‘soft’ state such as Thailand, since it eliminates the task of correctly identifying ‘the winners’ and reduces the possibility of rent-seeking activities and state capture by vested industrial groups or firms. To conduct this new industrial policy or to invest heavily in infrastructure, the state is still required to have a certain degree of state competence in order to provide those necessary public goods. The renaissance of the Thai bureaucratic polity, in which the state is heavily influenced by unaccountable, anti-reform bureaucrats, does not seem overly promising for future economic growth.
VII. Conclusion

From the above discussions, there are numbers of observations and conclusions regarding the political economy of Thailand that, ten years after the worst financial in its history, can be made.

The main thesis of this study concerns the strength or weakness of the Thai state. It argues that a state’s weakness/strength is a very important variable to understanding its political economy, one unfortunately often ignored by scholarly Thai studies. This study offers an explanation of the changes in Thailand by focusing mainly on this variable. A strong state is a state that exhibits high degree of state autonomy and high degree of bureaucratic capacity. A high degree of state autonomy means that a state must be able to impose its policies, directions or demands on societal actors if it so wishes. To put it another way, the state’s policies/directions are not ‘captured’ or unduly influenced by societal actors, especially by powerful vested interest groups. A strong state is a state that can impose its policy preferences on other actors, i.e. it exhibits a high degree of autonomy in terms of policy formulations. Likewise, a high capacity state means that a state has a reasonably effective apparatuses/means to implement its direction/policy preferences. To a large extent, the level of a state’s capacity is often determined by effectiveness of its bureaucracy.

This study is of the opinion that weakness of the Thai state is capable of explaining the origin of the 1997 crisis, the state’s poor performances in resolving the crisis, and its lack of success in creating a new mode of capital accumulation for next rounds of growth\(^{57}\). The decline or the weakening of technocratic macroeconomic agencies, especially the Bank of Thailand—the strongest section of the state—was a very important cause of the crisis.

This study argues that the slow pace of economic recovery after the crises was a result of weaknesses in the state, especially in dealing with banking recapitalization and NPLs resolution. The weaknesses made the restructuring of financial institutions painfully slow, significantly lagging behind those of South Korea and Malaysia. The weaknesses are clearly shown by the performance of and decisions taken by the Chuan government. The political weakness of the Chuan Government prevented it from employing a higher degree of state-led measures to speedup the process of restructuring, and compelled it to play a supportive role rather than a leading one as in the case of the Korean Government. The government considered employing more state-led crisis resolution mechanisms, which could have contributed to a speedier resolution of the crisis. It was largely forced to refrain from doing so due specifically due to its political weaknesses, and generally because of the ineffectiveness of state agencies. Even when it chose to employ a market-led approach, it failed to amend the

\(^{57}\) It will be unwise to insist that everything can be explained by only a single variable. However, this study strongly believes that the variable is very significant in understanding the Thai political economy.
necessary bankruptcy and foreclosure frameworks which are keys to success in this approach. The resistance of debtors-cum-senators was too great for the state under Chuan to overcome. This failure is strong evidence of the Chuan Government’s political weakness.

The Thaksin Government overcame its predecessor’s political weakness and was able to set up a state-led centralized asset management corporation; the TAMC. The relatively limited effectiveness of the TAMC debt solution was due to the fact that it was set up far too late, four years after the crisis. However, even if the Thaksin Government could have overcome political difficulties in setting up the TAMC, and had it been in a position to do so in a timely fashion, it still faced the other aspect of state weakness; low state capacity. The Thai state, unlike Korea, lacked the capacity to handle the transferred NPLs efficiently. The Thai state lacked the extensive knowledge and experience conducting state directed credit and industrial policies, which were the hallmarks of Korea’s developmental model. The Thai state did not have relevant experience in dealing with the private sector as a basis for a successful state-led debts workout.

It can also be argue that after 10 years of the crisis, Thailand has failed to rebuild a new mode of capital accumulation, which is necessary for the next rounds of economic growth. This failure is a strong testimony to the continuing weakness of the Thai state. The inability to adjust or change institutions to suit new environments is a fundamental consequence of the state’s weakness. The most vivid example of the inability to adjust institutions is the legislative failures of the three new financial laws; the BOT Act, the FIs Act and the DI Act. These failures mean that the crisis destroyed the ‘bankers’ capitalism’—the mode of capital accumulation that served Thailand for 40 years—especially the bankers’ pivotal roles of credits allocation and private investments coordination. But no new mode has been successfully constructed. The financial institution sector has been disintermediated, but the bond market and security market have not been able to replace the sector’s fundamental functions: allocation of financial resources and coordination of investments. Symptoms of the failures are excess deposits in financial institution sector, low investments and low productivity growth, hence a rapid loss of international competitiveness. Moreover, the failures also mean that the old incentive structure —a cause of the crisis, is still in place. After committing enormous amounts of time and resources to financial and capital market reforms, the efforts have largely failed due mostly to the state’s weakness.

The legislative failures resulted mainly from various conflicts among the state actors, mostly between the BOT’s technocrats and the elected politicians. The conflicts between the two actors during the Chuan Government were largely due to stresses and fatigues of difficult crisis management, such as the case of BOT’s accounting consolidation, rather than a conflict due to differences in the direction of crisis resolution and management. Both the technocrats and the government shared the same neoliberal policies, during the Chuan government. Conversely, the conflicts between the technocrats and the Thaksin’s government were essentially due to different policy preferences. It is fair to characterize the administration as an
anti-neoliberal government, especially its financial sector reform program. On the whole, it did not believe in the neoliberal small government doctrine. The government tried to use the state’s powers and apparatuses as a mechanism to jump start and rebuild the economy via direct demand stimulation, directed credits by state owned FIs and industrial policy. It attempted to construct a new mode of capital accumulation by using the state as a means to allocate financial resources and to coordinate investments, replacing the private bankers’ functions that had existed during the bankers’ capitalism era. Under this overall direction, the government tried to remove FI supervising authority from the technocrats, giving the government further leverage over the FI sector. The plan was failed due to strong resistance from the technocrats, with tacit support from private bankers.

It is understandably why the government did not subscribe to the neoliberal doctrine. Primarily, it can be understood as a new development in the Thai political economy: the emergence of a new powerful faction of the capitalist class originating in the real sector of the economy, who took control of the state. Historically, it was the financial capitalists (private bankers) who were the most influential in the polity among the non-state players, hence the designation of ‘bankers’ capitalism’ to reflect their prominence. The 1997 crisis shattered their fortunes and their powers both structurally and instrumentally. Structurally, their influences derived mainly from their prominent role in credit allocations in the economy. The process of financial liberalization begun in 1990, especially the capital account deregulation and the ill-fated set up of the Bangkok International Banking Facilities (BIBFs), led to an influx of foreign funds/credits to the economy. This had liberated the credit-hungry real sector capitalists from the bankers’ captive market, increasingly eroding their traditional roles of credit allocation and investment coordination which in the end led to overinvestment and hence the genesis of the crisis. Instrumentally, the Thai Bankers’ Association (TBA)—the representation of their interests—has been declining in power since the crisis. The TBA members’ interests are more diversified due to the fact that some of its members were nationalized or sold off to foreign banks, becoming hybrid banks. Furthermore, the TBA’s big-banks members such as the Bangkok Bank and the Kasikorn Bank, where the original families still retain management control, now have foreign share holders who own nearly half of their shares. Even in the case of bankruptcy law amendments to benefits the creditors, the TBA was not effective in resisting the watered down law by debtors from real sector.

As the influence of the bankers declined, a new faction of the capitalist class, one coming from the real sector and represented by the TRT party, captured the state in the 2001 election. Because the TRT government answered to the real sector, its overall policy direction tended to benefit its real-sector-businesses constituency at the expense of the financial sector. The state directed credits and targeted industrial policy, the failed plan to set up the Financial Services Authority, and the TRT Government’s bankruptcy law amendments to further benefits debtors, are examples of such policy directions. Viewed from this angle, the lengthy conflicts between the BOT’s technocrats and bankers on the one hand, and the Thaksin’s government on the
other, was a trench war between a declining but still significant power block of bankers and bureaucrats and the rising real sector capitalists. In other words, the alliance of technocrats and bankers managed to block the FSA proposal. This conflict led to an inability of the state to build a new mode of capital accumulation based on the neoliberal direction, since the conflicts prevented the new laws from being adopted.

Though the Thai state was strengthened during TRT Government, both politically and administratively, all the available evidence point out that the government’s drive toward a new mode based on the developmentalist direction is not yet successful. The state still lacks capacity and autonomy: its bureaucracy is still plagued by fragmentation while its industrial targeting and credits directing efforts were ‘captured’ by government cronies and insiders. It should be noted here that the 19th September coup, which abruptly ended the state-led mode of accumulation, render this assessment biased against the state-led affords.

The royalist-led coup can be partly understood as a reactionary response to the state-strengthening movement. The movement eventually gave birth to the 1997 constitution which deliberately reconfigured political rules to create strong executives and effective government. As a consequence, the Thaksin Government’s power, the first elected government under those new rules, was greatly enhanced. The government eagerly employed this enhanced power to concentrate and centralize power in the hands of the Prime Minister through three main channels: bureaucratic reform/reorganization, fiscal concentration, and the centralization of policy decision-making. The centralizations were necessary to the government in order to implement its state-led approach to the economy, i.e. it was necessary to strengthen the state apparatus before using it to direct the economy, even if it was primarily to benefit the government’s real sector constituency, its cronies and its inner circles. These centralizations seriously disrupted the pre-existing equilibrium of power sharing among various elites outside the government circles, who ultimately responded through the coup. In this view, the coup was directed against a centralizing state under the control of a new faction (the “real sector of the economy”) of the capitalist class who made alliance with the poor through ‘populist’ policies.

Recently, a new constitution sponsored by the military was adopted. Clearly the single most important goal of the 2007 constitution is just the opposite of the 1997 Constitution’s. It is designed to produce weak and ineffective governments, less powerful political parties and politicians, and more autonomy for the bureaucracy. This would therefore give enormous room for the royalist-led elites to manipulate the state’s direction behind the scenes. Unfortunately, the bureaucracy is a part of the problem rather than a part of the solution. As argued above, the Thai state’s incompetence is significantly derived from bureaucratic ineffectiveness, especially its fragmentation and unaccountability. With greater autonomy from the elected politicians, it is likely that the bureaucratic incompetence will increase. To this end, it is very unlikely that the new government after the coming election will be an effective government in terms of ‘getting things done’. The challenges that wait for the new
government are enormous. The economy is still suffering from the persistent effects of the 1997 crisis: a private investment slump and a financial sector is awash with liquidity. In other words, a new mode of capital accumulation for further rounds of economic growth have not yet successfully formed, and the government is incapable of assisting in the process.
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