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Thailand's Financial and Political Systems: Crisis and Rejuvenation

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# THAILAND'S FINANCIAL AND POLITICAL SYSTEMS

## *Crisis and Rejuvenation*

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William H. Overholt

With Thailand's long history of economic success from the late 1950s through 1996—during which time it had not experienced a single year of negative economic growth, a record unequaled by any other nation—its financial crisis of 1997–98 took Thais and outsiders by surprise. The collapse was brought on by a failure to coordinate policy responses within an economic establishment weakened by corruption; the downfall was further fueled by the broad consensus to focus first on political rather than economic and financial reform. Ironically, Thailand's virtues of diversity and multiple power bases, which promoted competition and free flow of information among segments of society and the economy, and its sensible, gradual openness toward foreign investment in its business community had made it impossible to shift direction rapidly toward reform changes, even at the peak of the financial crisis.

Though as severe as the collapses occurring elsewhere in the world, Thailand's financial crisis avoided the economically destabilizing revolutions its counterparts experienced in the Philippines and Indonesia, and with reference to South Korea and other countries.<sup>1</sup> Currently, a broad reform process is underway and if sustained will substantially enhance Thailand's strengths and reduce its weaknesses, eventually restoring the country to the vanguard of the developing world. If the reform process is truncated by political incoherence

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1. For a detailed account of Thailand's economic virtues and political balance, see William H. Overholt, "Thailand: A Moving Equilibrium," in *Thailand-United States Relations: Political, Strategic and Economic Factors*, eds. Ansil Ramsay and Wiwat Mungkandi (Berkeley: Institute of East Asian Studies, University of California, 1988).

and unresolve, however, Thailand's elitism and educational impoverishment could reduce it to a backwater status among nations.

### Crisis Dimensions

During Thailand's 1997–98 financial crisis, the exchange rate of the Thai baht (THB) plunged from THB 24.53 = US\$1 in April 1997 to a low of THB 53.74 = US\$1 in January 1998. Its stock market declined from 1,415 points on February 14, 1996, to a low of 207 on September 4, 1998. Fifty-six finance companies, more than half of the country's total, had to be closed and the entire capital of the banking system was wiped out. Over half of all bank assets turned into non-performing loans (NPLs). Some 69,000 companies went into debt restructuring and two-thirds of all Thai companies were left with no capital. An economy that had appeared almost recession-proof lost 10% of GDP in a single year. Under modestly optimistic assumptions, the financial crisis looks set to cost the Thai economy the equivalent of five years of growth.

The Thai crisis has been described as a currency crisis, the consequence of speculative attacks, an artifact of premature liberalization of capital flows, a bankers' panic, and even as a crisis of Asian values. While elements of all these aspects were present, the real roots of the crisis were both simpler and more complex. In financial terms, the problem was that a system that for decades had been managed with fiscal conservatism and competence—for instance, it achieved a full decade of government budget surpluses and limited foreign debt—quickly developed a huge domestic real estate bubble and an unsustainable level of short-term foreign debt.

The symptoms of trouble long predated the crisis itself. Even the current account imbalances that first aroused the interest of speculators were a relatively superficial indicator. In the three years prior to the baht devaluation of July 2, 1997, earnings growth had disappeared from an economy that previously, except for rare and isolated years of global economic stress, was exceptional in this respect.<sup>2</sup> By 1996, which started with the usual optimistic estimates of earnings growth, the corporate earnings collapse began to be acknowledged, as indicated by a 35% decline in the stock market. The Thai system had lost its ability to allocate capital efficiently. The emerging financial bubble meant huge but profitless investment. Simultaneously, Thailand developed a current account deficit that eventually ballooned to 8% of GDP. This deficit reflected the same phenomenon as the collapse of corporate earn-

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2. Aggregated historical corporate earnings data are available from Primark Corporation's *Datastream* electronic database (accessed September 1999). Forward-looking earnings estimates are provided by the online database *The Estimates Directory*, published by First Call World Equities, Boston (accessed September 1999) on the World Wide Web at <<http://www.firstcall.com/>>.

ings growth: the inefficient deployment of capital increased imports of non-productive capital goods and consumption but failed to contribute proportionately to production and exports.

The domestic real estate problem had become visible much earlier than 1997. By 1995, Bangkok residential property exhibited a 40% vacancy rate and retail space vacancy rates doubled to 14% in 1996. Demand for office space that year had been only 550,000 square meters and declining, while builders of office space had committed to construct 1,000,000 square meters per year annually through 2001. In 1996, 4,700 condominiums were sold, with 12,500 remaining unsold and 21,900 new ones due to be completed in 1997.<sup>3</sup> Bangkok Land had effectively built whole suburbs of apartments that became literal ghost towns from a lack of demand. In March 1997, 60% of all newly completed office space remained vacant. Despite the huge oversupply, prices had remained relatively flat. Supply and demand would eventually converge, squeezing the real-estate bubble until it popped with a bang that would shatter Thailand's entire economy and financial system. There was general awareness by 1995 that the property sector was overbuilt. While numerous ministerial comments about the risks of the growing property bubble were expressed, nobody actually did anything, and so far as is known nobody actually recommended taking any strong actions. The entire Thai elite was making huge amounts of money; many, perhaps a majority, of the country's leading political figures had direct interests in the finance and property companies.

Preceding the real-estate market's collapse were other problems in related areas. Thailand had a multibillion dollar market for Bills of Exchange, comprising 90-day paper issued by local corporations and guaranteed by local finance companies for purchase by banks. Trouble started in June 1996 when it became clear that Thai Granite would have difficulty servicing its Bills, which were guaranteed by a finance company called Thaimex. With the likelihood of eventual default more certain, a major U.S. bank made preliminary moves to invoke its guarantee. To the bank's chagrin, it became apparent that under Thai law Thaimex would be able to stall payment indefinitely. After the actual default occurred in July 1996, other foreign lenders studied the situation and discovered to their horror that under Thai law all finance companies could avoid payments virtually indefinitely. This writer's research staff at the time published a warning of what was to come in August; by October, when three defaults were underway, savvy members of the banking community were abuzz with concern that the entire Bills market had no

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3. See Jones Lang Wootton International, *Bangkok Property Outlook*, no. 4 (Bangkok: Jones Lang Wootton International, January 1997); and Kim Maire, *Thailand: Financial Services Industries* (Bangkok: U.S. Embassy, [1997]), in U.S. Department of Commerce (DOC), *National Trade Data Bank (NTDB)*, on the World Wide Web at <<http://www.stat-usa.gov/>>.

foundation. A process of slow-motion collapse ensued, creating huge losses for foreign banks and their customers.<sup>4</sup> By autumn, Moody's had downgraded Thailand's short-term sovereign debt rating. The country's problems, however, were not confined to foreign banks and foreign loans. That summer, the percentage of NPLs at Thai banks climbed to a high (for normal times) of 7.7%, and by early 1997 some analysts were expecting that number to double.

These conditions increased foreign lenders' awareness of the much broader reality of risk underlying the position of banks and other creditors in Thailand. Under Thai law, creditors effectively had no way to seize assets that had been placed as collateral for loans to debtors who subsequently defaulted. During February 1997, this writer's research staff held a seminar in Bangkok at which a local lawyer apprised shocked foreign investors of their almost complete inability to recover substantial assets from Thai companies that defaulted on loans or bonds. That May, holders of bonds issued by Alphatec, Thailand's most prestigious high-technology firm, discovered not only that the company could not pay but also that its accounting practices, facilitated by local conventions tolerating a high level of opacity in financial reporting, had enabled it to publish accounts (audited by one of the world's most prestigious accounting firms) that turned a huge loss into a false profit of \$128 million and concealed the transfer of at least THB 3.95 billion to related parties without permission of the board of directors.<sup>5</sup> Foreign banks thus realized how widespread such practices were and their vulnerability to huge losses.

Banks realized simultaneously that (1) an impending bubble burst was endangering a wide range of even the most prestigious Thai companies; (2) a lack of transparency in company accounts under prevailing Thai regulations obscured the real financial status of their customers; and (3) Thai bankruptcy law failed to protect creditors. A massive exodus of foreign bank loans and fixed-income investors from Thailand ensued, triggering the country's historic financial crisis. Although a bubble collapse might have occurred under any circumstances, it happened that the Thai bubble, produced by overpriced real estate and overextended banks, was inflated primarily with foreign currency. However, this fact was secondary. China and Japan had bubbles, too, but these were inflated almost entirely with local currency. The economic consequences of a bubble are similar regardless of whether the inflation is based on domestic or foreign currency: the affected sector (predominantly real estate in Thailand and Japan and industrial conglomerates in China and

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4. See Aaron Henderson, "Thai Bills of Exchange: Storm Warning," *Asia Window* (Bankers Trust Hong Kong) (August 1996), and "The Thai Finance Sector: The Storm Has Begun," *ibid.* (October 1996).

5. "A Decidedly Old-Fashioned Windfall," *Financial Times*, July 24, 1997.

South Korea) implodes, companies in that sector become unable to pay their loans, and this in turn threatens to bankrupt the banks. In Thailand's case, the bubble was inflated largely with dollars; the sudden need to repay those funds created one of the dramatic, brief financial squeezes of modern history and temporarily doubled the price of dollars. This in turn led to the almost universal perception that the core of the financial crisis in Thailand was currency. It wasn't. Rather, the crisis was produced by a simultaneous real-estate bubble collapse and bank panic both domestic and foreign—neither irrational nor hasty—from the realization that customers were not creditworthy. The crunch had begun two years before the banks even exited. What was irrational was the banks' fundamental disregard of applying elementary credit rules to their entrance into the Thai financial market.

The inflation of the bubble with foreign exchange resulted from peculiar financial arrangements, whose political origins are instructive. Thailand maintained relatively high interest rates to contain inflation in a booming economy and controlled the exchange rate in order to stabilize trade prices and limit inflation. This combination worked very well for many years. The economy achieved high growth with modest inflation. Because trade increases much faster when prices are highly predictable, trade price stability is quite valuable as well as inflation control, and trade drove Thailand's rapid growth.

Thai authorities then gradually allowed a freer flow of foreign currency exchange. Arbitrageurs naturally borrowed dollars at low interest rates and turned them into baht to earn high interest rates. Believing that the currency was controlled, they were confident that earnings could be converted back into dollars without fear of loss. Soon banks followed suit on a scale of several hundred million dollars each. This exchange liberalization process was accelerated hugely by a unique Thai institution, the Bangkok International Banking Facility (BIBF). At the beginning of the 1990s, Thai leaders envisioned that Bangkok could become a competitor of Singapore and Hong Kong as an international banking center. Though the dream was far-fetched because of Thailand's poor communications infrastructure and poor financial transparency, it was potent and had some limited feasibility as applied to neighboring Indochina. In order to compete, the government pursued legislation in September 1992 to allow banks licensed by the BIBF to take deposits and lend in foreign currency to overseas customers at highly preferential tax rates.

As initially conceived, permitting such a plan would not have contributed to the creation of a great domestic financial bubble because all deposits were to be taken from foreigners and all the lending would go to the same—so-called “out-out” banking. But Thai banks, one of the most potent political forces in the kingdom, lobbied to be allowed “out-in” banking also. They

succeeded, and in March 1993 all 15 domestic banks plus 32 foreign banks were licensed by the BIBF. The Bank of Thailand (BoT) unofficially encouraged foreign BIBF licensees to maximize their lending by telling them that some license holders would be upgraded to allow opening of local branches, with determinations based at least in part on the growth of their assets. Foreign banks, long denied the opportunity to create new branches in Thailand, seized the BIBF opportunity more as a way to expand their presence in the Thai market rather than to use Bangkok as an international clearinghouse. Thus, political lobbyists transformed the BIBF into something quite different from what its creators had intended.

Foreign money invested heavily in Thailand's finance companies and banks. These companies in turn channeled the cash inflow to property developers—who built frenetically even when the market was exhausted—and into numerous other businesses with little hope of financial return. The consequences were collapses in corporate earnings growth, the current account balance, and the creditworthiness of the entire Thai financial system. The BIBF structure, inaugurated to turn Bangkok into a leading international financial center and enhance the profits of the city's leading banks, combined lethally with high domestic interest rates and the pegged currency. The combination took just four years and four months to produce in Bangkok the financial equivalent of a nuclear blast.<sup>6</sup> In April 1999, according to BoT data, 47% of all loans at banks and finance companies were not being paid.

The deep roots of the crisis in the Thai financial system and property bubble belie the common interpretations of the problem as being primarily the result of a currency contagion, foreign speculation, domestic banking regulatory failures, or a foreign banking panic. Elements of all of these were present, of course, but the central problem was a financial bubble caused by institutions that channeled huge amounts of foreign capital into a limited economic space.

## Crisis Response

The Thai response to the crisis was peculiar. Although they followed the International Monetary Fund's (IMF) programs and dealt with their failed finance companies and collapsed foreign exchange reserves, the Thais basically declared a time-out at the end of 1997 and focused on writing a new constitution instead. The government did engage in financial crisis manage-

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6. The U.S. Embassy reported on September 23, 1992, that bankers regarded the BIBF as a useful first step but inadequate to generate significant activity. They particularly criticized BIBF rules as doing too little to stimulate foreign borrowing for domestic Thai investment. See *Thailand—Offshore Banking Regulations* (Bangkok: U.S. Embassy, 1992), in DOC, *NTDB*. In fact, BIBF generated more than US\$8 billion the last nine months of 1992, US\$17 billion in the following nine months, and continued to grow exponentially.

ment, but economic issues were relegated a lower priority than political reform. There was a surprisingly broad consensus that change in the political arena had to be the foundation of economic reconstruction. This response cannot be properly comprehended without putting it into the context of the far-ranging, impending changes in the country's political economy. But before doing so, it is appropriate to survey first the orthodox financial policies with which the government addressed its problems.

Thai officials were convinced not only that the currency basket peg could be defended but that it must be. They were conscious of the huge load of foreign debt that would become unbearable in the event of a large devaluation—indeed, the minister of finance previously had headed one of Thailand's largest companies that had carried some US\$4 billion of foreign debt. Given this view of the basket peg's importance, the country's financial bureaucracy felt they had to gamble the country's entire foreign exchange reserves on its defense. Their failure left remaining net usable reserves amounting to only US\$1 billion and forced the Thai government into the arms of the IMF, which imposed high interest rates to defend the currency and fiscal austerity to reduce imports and thereby increase reserves. The result was a recession of extraordinary proportions—a growth of -10.0% in 1998.

The failure of their effort was not expected by the IMF, which had predicted positive growth despite the austerity program. In retrospect, the IMF's insistence on a government budget surplus of 3% of GDP, together with extremely high interest rates, in an economy that had achieved fiscal surpluses every year in the previous decade was quite inappropriate. The IMF later backed off from its restrictive policies, but only after severe damage had been done.

A generic response to a bubble's collapse would be to deflate the affected sector and reorganize the banks, as the U.S. did with its savings and loans crisis in the 1980s, while simultaneously reinflating non-bubble sectors of the economy. This is what China and, less vigorously on the reform side, Malaysia have sought to do with some interim success. Such a prescription is quite different from the IMF's usual one, which was designed to ameliorate crises brought on by chronic fiscal deficits such as those facing many Latin American or African debtor nations. The ability to follow such a prescription in Thailand and South Korea was hampered, however, by the nearly complete exhaustion of those countries' foreign exchange reserves. Even though the IMF demands for a budget surplus were excessive, rebuilding the reserves did require hitting the brakes. In any event, IMF excesses eventually were spectacularly successful at collapsing imports and thereby creating a surplus that restored reserves.



This development in turn caused a spectacular bull market in Thai bonds and stabilized and strengthened the baht. A firm currency, combined with recession and deflation, permitted a radical reduction in interest rates. The yield on a one-year government-guaranteed bond fell from 16.02% in May 1998 to 4.19% in May 1999. The resulting flood of liquidity could not go to loans for corporations because there were almost no creditworthy corporations left after the bust. Therefore, the money sat in the banks and flooded into the stock market, which soared. These conditions did a marvelous job of restoring Thailand's financial markets. However, the problem of restoring the real economy remained. Virtually all the banks and finance companies were dying and needed either to be revived or put quickly to sleep. Most major companies were illiquid or insolvent, and the credit system could not function now that banks were aware that the collateral and guarantees provided by their customers were basically worthless.

Faced with the breakdown of its entire financial system as a result of the property bubble collapse and the inability of companies to repay foreign debt at the new exchange rate, Thailand acted decisively to close ailing finance companies. Almost immediately, 58 failed finance companies were closed, with two later reopening. This was in itself an act of considerable political courage because many of these finance companies were partially owned or controlled by powerful politicians. The government was much less decisive, however, in dealing with more politically potent banks and major corporations.

Selling the assets of the finance companies was also implemented decisively. The Financial Restructuring Authority (FRA) was given the mandate to auction off THB 866 billion of such, which it did quickly and honestly. But the problem was that the FRA was not given authority to service the assets—to manage the companies, collect and restructure the debts, and even reorganize the companies it needed—until a year and a half after the crisis first broke. The result was a major and apparently unnecessary increase in NPLs. Borrowers who were not being pressed to pay made the decision to turn their loans into what came to be called “strategic non-performing” ones. That is to say, it became advantageous not to pay. Moreover, since the FRA had no authority to roll over loans that were paid in good faith, solvent companies faced a strategic choice: pay and go bankrupt, or don't pay and keep the business alive. Such was the origin of the strategic NPLs that became about one-third of the overall systemic problem. Defenders of the FRA's decisions argue that, in the Thai context, if the Authority had been granted the license to service the assets, it would have been impossible to avoid a quagmire of corruption. That argument is uncomfortably powerful. Despite the strategic NPLs, the whole FRA intervention on balance was a major success.

Another action the government took was to recapitalize banks. Only two thus far have been willing to go to the government for capital, thereby diluting their ownership. Families controlling banks have attempted to maintain such control even if it meant severely shrinking the institutions. In fact, Thai banking reform has been noteworthy for the lack of official pressure to replace the management and owners of failed institutions. Much of the bank recapitalization to date has been the raising of prudential capital through special instruments called Stapled Limited Interest Preference Shares (SLIPs) and Capital Augment Preference Shares (CAPs), which fit a loophole in the Basle capital adequacy requirements. Such instruments require payments of 12%–22% annually, so the banks cannot expect to become healthy until the SLIPs and CAPs are retired. Only Siam Commercial Bank has actually raised enough capital to cover its NPLs. For most of the banks, the raising of prudential capital just defers the problem to a later date. Some institutions have developed a novel way of reducing their proportion of NPLs; they go to their best customers and offer loans at 4.5%, against the banks' cost of funds of 5%. This loses money but reassures naïve regulators and helps to raise money from equally naïve investors.

Nonetheless, Thailand's reforms will create a new banking system. There ultimately will be far fewer banks, perhaps as few as six rather than the original 15 (now 13). Foreign banks will play a much larger role and the whole system will become more competitive. The Netherlands's ABN Amro has bought Bank of Asia, Development Bank of Singapore has bought Thai Danu, and the U.K.'s Standard Chartered Bank has bought Nakhornthon Bank. These foreign-dominated institutions will bring higher standards and fiercer competition. Within the banks, practices really are changing. Top bankers almost universally recognize that they must change from lending on the basis of names and collateral to doing so on the basis of balance sheets and cash flow. Already, competition from the foreign banks plus the painful lessons learned in 1997 are producing a rise in credit requirements and accounting standards. On balance, much positive change is occurring, though the cozy relationships among the Thai elite have left Thai banks in worse shape than those of South Korea or Malaysia.

Along with increased restructuring, the credit and investment system is being enhanced. Now that banks have discovered the weaknesses of their position under Thai law, the funds simply will not flow unless collateral and guarantees become more legally binding. The government managed to pass new bankruptcy and foreclosure laws, which putatively improve the position of creditors. Thailand's earlier laws were written for a primitive agrarian society, where one of the great social risks was the potential for the creation of a horribly unequal society based on powerful landlords' oppression and foreclosure of weak neighbors. But laws targeted at avoiding oppression of

poor peasants could not sustain the finances of an emergent industrial society. A creditor could force a debtor into bankruptcy, but the process of trying to seize assets or collateral typically took seven to 10 years, during which time much of both disappeared.

Thailand established a new bankruptcy court that opened June 18, 1999, headed by a judge who is respected as a rising star. Over fierce opposition, new bankruptcy laws were passed in May; these required that personal guarantees, including past financial ones, be honored. The laws were intended to shorten the process of trying to invoke guarantees and seize collateral to a three- to five-year fight.<sup>7</sup> Also changed were the penalties on bankruptcy to make it more socially tolerable; instead of being banned for life from the civil service or the monastic community, a bankrupt individual is now banned for three years.

Yet, the bankruptcy law and system continue to have critical weaknesses. There is no Thai equivalent of U.S. Chapter 11 bankruptcy (protection during reorganization) for individuals or partnerships. The Thai setup allows only bankruptcy based on a balance sheet test, and with Thai accounting practices most businesses can show a balance sheet with more assets than liabilities. A proper test would assess the ability to generate cash flow adequate to repay debts. But leading lawyers argue that a well-designed presentation of a case can usually overcome this defect. There is no regime for secured lending other than property and personal guarantees; cash flow and movable assets effectively cannot be used as collateral. Judges have no experience with cases involving more than one creditor and the police have negligible capability to probe fraud and other complex financial problems. Moreover, a white-collar criminal can usually buy his or her way out of a problem. Furthermore, foreclosure is never automatic. A debtor whose assets are foreclosed remains obliged to pay the debt, so debtors always fight against foreclosure. In September 1999, a leading law firm revealed that loopholes in the law will permit debtors to delay closure for 11 years, even worse than the prior seven to 10 years. Similarly, there still are ways for a guarantor to walk away from obligations.

Another requirement for creating a sound financial system is that company accounts and reports to investors must be reasonably complete and accurate. By tradition, Thai companies kept one set of books for the tax collector and one for themselves; this habit easily evolved into keeping one set for banks and minority investors and one for themselves (and possibly a third for the tax collector). In South Korea, a similar problem has been dealt with by the president's demanding and imposing requirements that local accounting prac-

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7. By comparison, this process typically requires three years in Taiwan, which has one of Asia's better systems.

tices be replaced by international accounting standards and that conglomerates provide consolidated accounts. In Thailand, there has been no such drive. The government has agreed with the IMF to amend the civil code to improve transparency, but to make such changes is seen as complicated and it does not appear that anyone is giving it very high priority. Thai lawyers argue that the regulations are in place but have never been enforced.

The standard of bookkeeping practice is being improved, not through political decrees but at the insistence of the banks, by accountants' new fear of lawsuits, and through a new awareness on the part of the government and the courts that the formerly abstract concept of transparency can be of life or death importance. International accounting firms are taking control of their local partners and telling them to shape up. When Siam Commercial Bank was raising new capital, its extensive disclosure was unique in Thai financial history. That new positive benchmark and the success that it brought will influence future deals.

The financial principle of transparency is also creeping in through the back channel of politics under the name of freedom of information. The new law has led to a wide opening of previously closed doors. There is at present, for instance, something of a fad for parents of children rejected by schools at all levels to exercise their freedom of information rights and get the exam scores of their own offspring to compare with those of the more successful applicants. What these parents have been finding has been making headlines and embarrassing even the country's most prestigious universities. It will be virtually impossible to curtail the trend toward greater openness.

The changes have extended also to affecting how foreign businesses may operate on Thai soil. Thailand has had complex and theoretically severe restrictions on foreigners' ability to own companies in the country. Among other things, the law greatly restricted their ability legally to own property or have controlling interests in banks and finance companies. Much of this law went unenforced. For instance, senior officials were usually willing to work out ways for foreigners to own far larger shares of finance companies than the law technically permits. Practicing law was closed to non-Thai citizens under this regulation but in practice Thailand has been much more open to foreign lawyers than Singapore or Hong Kong, whose laws are less restrictive. Despite such exceptions, the laws were great deterrents to a foreigner's ability and willingness to buy distressed property assets, foreclose on property, and invest in banks and finance companies during the crisis. Under a proposed new Alien Business Law, such restrictions would be greatly loosened; in the meantime, the Ministry of Finance is granting exemptions to those legal restrictions on foreign investment in financial institutions that remain in place.

Progress on restructuring bankrupt firms has been painfully slow. As of May 1999, the BoT had identified 68,983 companies that had gone through debt restructuring (52,681 firms, with THB 430 billion outstanding) or were in process (16,302, with THB 825 billion outstanding).<sup>8</sup> As these numbers suggest, Thailand's problem is much more complex than Korea's. In South Korea, the majority of the debts are held by only a half dozen conglomerates. In Thailand, even the top 600 debtors do not hold half of the NPLs.

Initially, there was no incentive for companies to consider restructuring in earnest. Banks could not foreclose on corporate assets nor effectively invoke guarantees that had been given. Forcing a company into bankruptcy gained the banks only spite, not assets. As noted in the discussion of the FRA, there were even incentives for firms that could pay their bills to stop doing so. The new foreclosure and bankruptcy laws gave the banks tools to force companies to negotiate. But neither side liked the idea of referring disputes to the courts. At first, creditors and debtors simply failed to meet. So the government designed a two-part system to bypass the court process. For financial firm debtors, there is a BoT process, currently in use for about 300 companies. The creditor submits a plan to the BoT and then negotiations ensue according to that bank's rigid deadlines. The BoT is authorized to impose penalties on any debtor that doesn't comply. For non-financial firms, the government formed the Corporate Debt Restructuring Advisory Committee (CDRAC). Funded by the World Bank, the committee created a mediation process for the big companies. Unlike that employed in Indonesia, the process in Thailand treats each company individually and unfolds in a series of 36 steps for each of the 667 companies targeted. Once companies agree to enter the process, they and the banks must meet deadlines for each step under the guidance of a mediator.

The bankruptcy process itself has had mixed results. Srithai Superware, generally regarded as a high-quality small company (and hence a relatively easy case), required two years of discussions with creditors before coming up with a reorganization plan to submit to the bankruptcy court. Submission to the court is necessary because otherwise key benefits are lost; for instance, if the bank takes a haircut, the debtor must pay a 30% tax on it and the creditor cannot deduct the haircut as a business expense.<sup>9</sup> The innumerable smaller troubled companies are given a month of free consulting subsidized by the government in an effort to sort out their problems.

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8. For further details, see Anoma Srisukkasem, "230 Debtors Face Legal Action," *Nation* (Bangkok), Section B, July 3, 1999, p. 1.

9. The term "haircut" refers to the difference between the market value of a security and its collateral value. The haircut is intended to protect a lender of funds or securities from losses owing to declines in collateral values.

Much of the restructuring that has been done is just rescheduling, with overdue interest being capitalized, loan durations stretched out, and interest rates reduced to fit borrowers' cash flows. This solves temporary or cyclical problems. In fact, about half the overdue debt comprises short-term loans (less than one year) that in many cases can be rescheduled without damage to either party. But the majority of troubled loans involves deeper problems, and the lack of more fundamental restructuring (banks taking haircuts, companies selling subsidiaries or bringing in strategic partners, major employee layoffs) just postpones the problem a year or so.

Foreigners play an increasingly vital role in this whole process. Thailand has a major advantage here; although Thai nationalism is very strong, the integration of Thai and foreign companies has not proven to be particularly difficult. As one banker told the writer in June 1999, "We don't have Korean xenophobia here, and we don't have Korean unions." Except, he might have added, among the state enterprises, where privatization is so far going nowhere.

### Are the Reforms Politically Sustainable?

The central lines of policy conflict during the economic crisis have been between the reformers and the foot-draggers. Nobody is trying to reverse existing reforms, but there are those individuals seeking to delay the implementation of old ones and crafting legislation for new reforms. For instance, in mid-1999 the Senate delayed and modified the new bankruptcy and foreclosure laws in apparent efforts to protect the interests of some of that body's wealthier debtors and their friends. Such conflicts of interest are epidemic.

Currently, privatization is the most hotly disputed battlefield. Unions and management alike have hotly opposed privatization of Bangchak Petroleum, EGAT (Electricity Generating Authority of Thailand), Thai Airways, the Telephone Organization of Thailand, and Krung Thai Bank. The rallying cries of opposition have been the same as anywhere else in the world, from contemporary China to Margaret Thatcher's Britain: the loss of jobs is inhumane and selling any part of, for instance, Bangchak Petroleum to foreigners would desecrate the national patrimony. Such views have enough money and political weight behind them that progress in most areas has been grudging and just enough to avoid further catastrophic financial collapses. A series of privatization bills face difficult opposition. They must pass the Senate, and many senators have strong personal interests in opposing privatization. Thus, the prospects for privatization are limited and will be slow to come.

The present Chuan government's policy approach has been to do what is necessary to cope with the financial crisis rather than pursue a broad vision of a reformed economy. Even within the context of the immediate crisis, the

government has focused public attention on financial sector reforms. It has been reluctant to lead the public toward recognition of the broader problem of overcapacity and the associated need for bankruptcies and layoffs. Such an approach contrasts sharply with Kim Dae-jung's Korea, where the president eloquently advocates and relentlessly pursues a vision of a much more open, transparent, competitive, and efficient economy that he also expects to enhance the country's democracy. Moreover, Chuan has delegated the economic reform drive to Finance Minister Tarrin Nimmanhaeminda, who takes the heat for painful reform policies.

Chuan's instinct would appear to be to play it safe. More importantly, any Thai prime minister faces severe constraints in how far and fast he or she can lead. The role of the king prevents anyone else from being the country's ultimate moral and political arbiter, and the politics of running a coalition based on a minority party hampers any strong leadership. That the parties and coalitions have no strong base of ideology or principle other than the self-interest of their members deprives the leader of any firm policy platform. Chuan provides the government with an image of relative integrity and maintains the organization of a party that is more cohesive than any Thailand has ever seen. Tarrin provides the substance of reform. As indicated below, the issue of integrity is central and in many ways drives the country more strongly than the economic reform.

The prime minister has offered neither a forceful articulation of the causes of the problem nor a vision of Thailand's future. This has less tangible but nonetheless important consequences for public opinion. There are widespread views of the crisis as an aberration, bad luck, or as having been caused primarily by nasty foreign speculators abetted by some bad decisions at the BoT. (The one excuse that doesn't work in Thailand is the widespread contagion metaphor, since the illness started there.) Such claims leave a substantial part of the population believing that, if they just hold on, life will go back to the way it always was. It won't.

While an opposition government probably would not reverse the principal reforms, it might well gut or delay both political and economic ones. At best, a new government under communications billionaire Thaksin Shinawatra, the opposition Palang Dharma Party leader who served as deputy prime minister under Chavalit, could be expected to move forward but only after a lengthy period of putting its own stamp on programs and making changes to satisfy a new set of interest groups. At worst, a government under General Chavalit and his New Aspiration Party would adamantly oppose privatization and drag its feet on the implementation of many existing reforms. Thus, the staying power of the current coalition is economically significant. Fortunately for the government and the reforms, most of the opposition is in such bad repute with the electorate that there is little chance of the former experiencing a

sudden surge of popularity or credibility with the voters. And Chavalit, who probably has the biggest war chest, still attracts skepticism from potential coalition partners because he chose so many outsiders for his cabinet when he was prime minister. Nonetheless, the government must be cautious, for the fact that the opposition is disliked provides no guarantee that it will not come to power in any early election as a result of complex, multiparty negotiations.

But one also cannot conclude at present that the government is stable. As the American political cartoonist Walt Kelly famously put it, "We have met the enemy and he is us." All three of the ruling Democratic Party's major coalition partners have been engaged in fierce internal struggles over who should become ministers. In none of these struggles do policy issues play a significant role, nor is there much concern for continuity of policy in any of the parties involved. The problem is that implementation of the new Constitution has set off a feeding frenzy with all trying to snatch up ministries before the trough is changed. Under its new provisions, the number of cabinet seats will fall from 49 to 35. Moreover, many current political leaders will be ineligible or unlikely to obtain ministries, as the new Constitution requires among other things that ministers must have a bachelor's degree and must not be elected officials. It will no longer be easy to obtain a ministry by bribing a party elder, and the prime minister will find it more difficult to justify inappropriate appointments by referring to coalition politics. The desperation of legislators, the utter lack of principle with which they pursue their last shot at the prestige of being minister, and in many cases the last good chance to obtain the wealth that comes from having a hand on the public spigot has led to self-destructive conflict that can only be compared with sharks that have found blood in the water but no meat and have taken to biting each other.

The worst of these conflicts has occurred within the Social Action Party (SAP). The SAP, which is split into five factions, was a member of the governing coalition and held 20 seats in Parliament as well as four in the cabinet. In June 1999, a majority of the non-cabinet member SAP legislators attacked the party's leadership in essence to demand a turn at the trough. The fray resulted in the resignation of the party leader and the departure of SAP from the coalition. Although the government still had a comfortable parliamentary majority of 236 seats to the opposition's 149, it also was left with the uncomfortable task of parceling out the ministries anew among the remaining divided and belligerent members of the coalition. Despite such problems, the governing coalition has managed to derive weaknesses from its strengths. Under Prime Minister Chuan, the Democrat Party has become Thailand's first cohesive party and a potent policy instrument. Because of this, the longer the Democrats stay in power, the more they overshadow their fractious, policy-indifferent coalition partners. This creates an unspoken concern



among some of the partners that the Democrats need to be unseated before they become too strong. On the other hand, elections are very expensive and the opposition parties have huge war chests (some of which were allegedly built up from foreknowledge of the devaluation), and so the coalition partners remain wary of following through.

Thailand faces no risk of serious social disruption as a result of the crisis—assuming there is no big surprise forthcoming that will make matters worse. Unlike in South Korea, most Thai unions are weak and docile. Unlike in China, unemployment is not so severe as to create fear of widespread unrest; Thailand's rural areas have absorbed many of those who lost their jobs. Unlike in Indonesia, the experience of the average Thai has been a setback of several years in income growth rather than any real risk to basic livelihood. The poor were mostly not hit hard. The main impact was delivered to wealthy people with large property assets, significant stock market positions, or sizable outstanding loans denominated in foreign exchange. Such people will take retribution on the government that was in charge at the time of the crisis but should not be a source of social unrest.

### Economic Recovery

In addition to imposing painful reforms, the government has attempted to stimulate a recovery. It reduced the value-added tax from 10% to 7% and successfully encouraged a substantial decline of interest rates. The government set a stimulative budget deficit of 6% of GDP and spent Miyazawa funds from Japan, amounting to 2.5% of GDP, to create as many as 500,000 jobs. None of this was done efficiently. As of the end of June 1999, it looked probable that the government would manage to spend only THB 650 billion of its planned THB 800 billion budget. The Miyazawa money is being scattered to the village chiefs—THB 1 million to each village administrator—and used to revive the property sector without any effort being made at economically efficient use, notwithstanding that this money must eventually be repaid. Such problems aside, the economy began to recover in 1999. First quarter 1999 growth was 0.9%, second quarter 3.5%, and growth of over 3% for the year seemed likely.

Longer-term economic prospects are mixed. The labor-intensive industries that have long propelled Thailand's growth are now obsolescent. Textiles, footwear, and toys are failing to recover due to competition from China and other countries. While a depressed exchange rate will reinvigorate some of these industries for a while, following such a path to growth only offers Thailand the opportunity of recovery without development.

Thailand's effort to follow other Asian countries up-market into electronics has largely failed. Although production and exports under this general category have been substantial, Thailand's electronics industry basically is dedi-

cated to assembly and packaging. There is no significant research and development. The country has made an even bigger effort, dating back slightly more than a quarter century, to build steel, refining, and petrochemical industries. These have survived only by virtue of high tariffs and other subsidies; they have been a drag on the national economy since they began, monuments to a generation of Thai planners who were convinced that the only proper future for Thailand was to follow South Korea into those fields.

Thailand's difficulties in moving up-market derive heavily from weaknesses of infrastructure and education. The more serious of the two has been in offering a basic education. The quality of the schooling provided to Thailand's people has been dramatically poorer than that given in the country's Asian competitors. Moreover, its instruction often is based on obsolete textbooks. It is an inexplicable contradiction in the development strategy followed that those planners of the 1970s and 1980s who insisted on emulating South Korea's industrial strategy failed to take into account the foundation that supported it: universal, high-quality education. This failure derives first of all from the elitism of Thai society, as compared with the egalitarianism of South Korea's. Secondly, it is a by-product of the incentive structure of Thai politics: traditionally, the job of minister of education has been considered second-rate because big bribes are more difficult to get for it than at the Commerce or Telecommunications Ministries. In comparison, education has great prestige in Korea while in Malaysia the Education Ministry is a stepping stone to the top.

Thailand spends about as high a proportion of its GDP on education as other Asian countries, but much of the money is wasted. The new Constitution requires that every child be given 12 years of schooling but does not explain how to do it; the current law requires nine years, but the reality is six for a large proportion of the population. Educational failure has doomed Thailand to having a very backward social structure compared with the other fast-developing countries of Asia. The majority of the populace still works in the rural areas and the weaknesses of the educational system have limited the development of the sector where Thailand has its greatest and most obvious competitive advantage, namely, agriculture. For example, Thailand has long been the world's greatest rice exporter but its rice yields are lower than major competitors' production because Thai farmers lack the education to comprehend and implement more productive techniques.

As for the weakness of Thailand's infrastructure, it derives not from a lack of investment or competent planners but rather from faults in the political decision-making process. Ministries do not communicate with each other. Projects are endlessly delayed by political quarrelling and when pursued frequently are done so not on the basis of national economic benefit but rather of how much they can be milked for personal gain. One need only reflect on

the national airline, with its odd combination of different aircraft and engines that is widely believed to reflect the varying availability of bribes, to understand why an economy that has grown so fast for so long has failed to build an effective road network or telephone system.

The success of Thailand's automotive industry deserves special attention as a template for potential successes in the future. Thailand has succeeded primarily because it is less protectionist than its neighbors and provides a level playing field for foreign direct investors. Unlike Indonesia, the rules are clear. Unlike South Korea, foreigners are not deliberately driven out. Unlike Vietnam, there is no necessity to spend years building a consensus among government and party officials. Unlike Malaysia, Thailand does not insist that all key parts of the car be made at home. This latter difference saves Thai auto producers from the huge inefficiencies of, say, having to make axles (which normally require a production run of at least 500,000 to be efficient) for a limited market. Since Thailand is not protecting a national car like Malaysia with its Proton or Indonesia with its Timor, the country has attracted most of the key global auto manufacturers (Ford/Mazda, Isuzu, Toyota, General Motors, Mitsubishi, and others) and developed a large industry of Thai companies supplying parts and providing services. Thailand's large, partially educated workforce can compete successfully against Malaysia's smaller one, Indonesia's largely uneducated one, and the highly skilled but very expensive one in South Korea. Having a large domestic market helps, as does having a long history in the industry (assembly started in 1962), but the principal keys to success have been openness and fairness.

Air conditioning and white goods could enjoy the same kinds of success that vehicles have. High-quality consumer goods are also a promising product range for Thailand's future. But rather than manufacturing industries, the foundation of future growth must be agriculture. The pitifully low yields of Thai farmlands at present, together with the country's prominence in global food production despite such output, underline a great opportunity. Education, consolidation of agricultural plots (facilitated by demographic changes), and the addition of value-added production can provide enormous growth.

Ironically, given its current weakened state, Thailand's financial services industry could become a great source of competitive advantages in the future. Unlike South Korea, Thailand has had real banks for a very long time. Whereas those of South Korea mostly just handed over money to a small number of conglomerates according to government instructions supplemented by bribes, Thai banks have been making real credit decisions about a multitude of fragmented customers for decades. Bangkok Bank, along with Hong Kong and Shanghai Banking Corp., is the financial reactor core of the overseas Chinese business network in Asia. Thai banks should be much better positioned than those of Hong Kong and Singapore to finance much of Viet-

nam, Cambodia, Laos, and Burma, and the future likely will bring vast opportunities for expansion into southern China. Although Thai banks currently are shrinking, debt-equity swaps should eventually give them far greater influence over the Thai economy. If foreign banks are allowed to team up with and fully control some Thai banks, the country's banking industry could become vastly more competitive and influential—after all, Hong Kong dominates the region precisely because it is so open and competitive. But Thailand may limit the number of steps it is willing to take in this direction. As of now, foreign banks can enter and hold positions for a decade but not participate in any future capital increases; that constraint will vastly reduce the attractiveness and price of Thai financial firms to foreign companies and limit Thailand's ability to develop as a regional financial powerhouse. If Thailand takes its financial medicine, the recovery and reform process could create a vast modern industry much more valuable than petrochemicals or steel.

In sum, Thailand is recovering and has enormous opportunities. But one cannot expect a return to sustained 8% growth any time soon. Thailand will succeed to the extent it follows through on financial and legal reform; focuses on educating its people; makes its industries more competitive by eliminating excessive protection for petrochemicals, refining, and steel; and cleans up its corruption.

### The Thai Crisis in Larger Perspective

In 1997, at the height of the economic crisis, Thailand effectively declared a time-out and focused on passing its new Constitution. This document was designed to replace an existing system of governance by businesspeople trying to use political office to make money with a new one comprising real politicians and real parties. To understand why political reform preoccupied Thailand's attention when the financial emergency was peaking, one has to view the country in the 1990s as a comprehensive system that gradually broke down and is in the process of being rebuilt. In the broadest terms, the financial crisis is but a single aspect of a broader problem facing the Thai regime in that decade.

#### *The Thai Cold War System*

Any attempt to characterize the Thai system represents a still photograph of a moving target, but the way Thailand worked from the 1950s through much of the 1980s involved relatively coherent patterns and stable institutions.

Cold war Thailand was ruled, competitively and in alternation, by a military elite and a growing cluster of democratic political parties. Both sides in this competition employed what was by Third-World standards of the time an exceptionally competent and prestigious civil service. The military would

rule until its excesses of repression and corruption alienated the public. Then the democratic parties would rule until socialist rhetoric, public disorder, inflationary economic mismanagement, and their own corruption alienated the public. As competition between these alternate forms of government heated up in the early 1970s, the king stepped forward as a moral arbiter and the most sensitive barometer of national opinion. The reemergence of a revered and influential ruler 40 years after the military overthrow of the monarchy in 1932 swam against the tide of global history but was decisive in stabilizing and unifying contemporary Thailand. The Buddhist hierarchy, structured as an adjunct of the civil service, not only set the moral tone but also organized a critical margin of Thai life; every boy was supposed to do his time as a monk, and even senior figures who had fallen from grace withdrew to the temples to restore their personal equilibrium and cleanse their public images. The banks, owned mainly by Chinese-Thai businessmen and dominated much of the time by Bangkok Bank's Chin Sophonpanich, disciplined and directed business to a degree that has never been adequately recounted. The military leaders were drawn into a business alliance with the Sino-Thai bankers and greatly enriched by them, but at the same time they deeply resented the latter's power; the coups of the 1980s frequently were accompanied by anti-Chinese banker manifestoes. Private enterprise was identified with the ethnic Chinese and therefore was perceived negatively, while state enterprise was seen as being in the public or native Thai interest. Most of society was rural, operating outside the elite games just described.

The Thai system had noteworthy balance and discipline in comparison with other Third-World societies. The military-banking-civil service alliance, for example, kept Thai society more docile and conservatively financed, which accounted for Thailand's avoidance of the Latin America syndrome of interest group dominance, inflationary budgeting, and periodic financial crises. The Thai system was more inclusive than its counterparts in the Philippines, Argentina, or South Korea and therefore was less prone to revolutionary upheaval. Even Thailand's rural society had more widespread land ownership and was therefore less susceptible to class-based tumult than China, Cuba, or the Philippines. Despite the residual Sino-Thai frictions, relations between the indigenous Thai and the Sino-Thai were most notable for intermarriage, Sino-Thai adoption of Thai names, and interlocking interests. The civil-military competition, mediated by the king, was smoother than that seen elsewhere, and Thai Buddhist tolerance permeated everything. Firm limits were set by the institutional skeleton of the system: the king, the Buddhist hierarchy, the bureaucracies, the military, and the bankers. It was a very elitist, hierarchical society.

*Breakdown of the Cold War System*

As Thai society developed, each element in the cold war structure gradually was transformed until the old system was obsolete. Economic progress brought the rise of a Thai middle class and an ethnically Thai entrepreneurial business elite. The expanding middle class gave more and more clout to the democratic political parties at the expense of the military and the bureaucracies.

Development also brought with it a complex economy. Increasingly, there appeared a group of civilian technocrats with roots in the middle class who could manage the economy competently without the periodic discipline of military intervention. The economy grew too complex for the military to be able to intervene and quickly sort out any civilian mismanagement that might arise. To the extent that there was a clear breaking point, it came in 1984 when the civilian technocrats and the prime minister knew the country needed a currency devaluation but the army, led by General Arthit as point man for a group of vested interests, demanded that the baht be held stable. Arthit went on national television to denounce the prime minister's plan and the crisis faded only when the king invited Prime Minister Prem to the palace and allowed pictures to be taken showing them conversing in their pajamas. From this point onward, the roles of civilians and the military reversed: the technocrats became the advocates of sound policy and the military became a collection of vested business interests. This reached its peak in the late 1980s under General Chavalit when the army generals controlled and milked all business relations with neighboring Cambodia, Laos, Vietnam, and Burma; directed economic development funding in much of the country; and sat astride the vast flow of funds earmarked for the purchase of weapons as well as aircraft for the national airline, among other things. The vast private fortunes accumulated by generals in that era still undergird some of today's political parties. Symbolic of the era was the fact that the Burmese Army, historically Thailand's greatest enemy, was allowed to cross the Thai border (killing some Thais in the process) in order to outflank the Karen tribal army in Burma to gain access to Karen teak to close a vast deal for the wood between Thai and Burmese generals.

At the same time, development began to break down the rationale for the bureaucracy and the army to control so much of the national economy. The economic crisis of 1984 was one of import substitution industrialization; the inward-looking economy simply could not grow any more. The regime switched to a more open, export-oriented, foreign investment-friendly policy and enjoyed a great boom for the next dozen years. Simultaneously, the rise of an indigenous Thai business elite and middle class took much of the heat out of ethnic Thai resentment of Sino-Thai business pre-eminence; this easing deprived the army and bureaucracy of much of the rationale for state

control of the economy. Today's residual defense of state enterprises is the last reactionary gasp of that elite trying to defend its privileges against the tide of history. Socialist ideology faded in the universities and the democratic parties and this, too, deprived the army and bureaucracy of some of the rationale for state/elite control of vast sectors of the economy. The end of the cold war and anything but nominal socialism in China removed the last piece of the old anti-communist, anti-Chinese rationale for the military's role in the economy.

The bureaucracies' role also weakened. Whether under the control of a dictator or an elected parliament with a military figure chosen as prime minister, the powerful civil service had functioned in a reasonably coordinated fashion. In contrast, under a structurally weak prime minister with the ministries controlled by competing parties determined to keep their deals and bribes secret, coordination and communication often broke down completely. The best of the elite had joined the government under the threat of the cold war and in an economy where most businesses were relatively small and struggling; in the late 1980s and the 1990s, the trend has been for the best to abandon government and seek their fortunes in the private sector. The cold war sense of crisis had given the senior bureaucrats the prestige of saving the nation from the communists; now, prestige came from economic growth and personal wealth. The formerly advanced bureaucracies started to have trouble keeping up with the times. The BoT gets 247 pieces of paper from each bank each week and lacks adequate systems to manage the document flow. The police have no training or system for dealing with complex commercial crimes, so culprits have walked free for years without being tried. The bureaucrats' alliance with the military faded and multiple alliances emerged with powerful business groups.

Gradual financial liberalization slowly deprived the Sino-Thai banking elite of its control over the flow of funds. This trend came later, primarily in the 1990s, and was symbolized by but by no means confined to the BIBF. As one leading scholar said to this writer in June 1997, "Until the 1980s there was corruption but under bankers' rules. With liberalization, the influx of foreign money destroyed the banks' control over their clients." For the first time in Thailand's modern history, widespread financial mismanagement became a core problem. The great financial debacle of 1997 made clear that the formerly cozy interests of businesspeople and bankers were diverging; instead of regarding one another as part of one big family and being treated as such, the bankers and businesspeople henceforth would introduce more and more arms-length procedures into their relationships.

Even the beloved Buddhist hierarchy and monarchy found themselves in changed times. Throughout the 1990s, the monastic community suffered a series of debilitating scandals. The religious reverence for Buddhism contin-

ues to pervade Thai life, but the emergence of a secular society has eroded the institutional standing of the hierarchy. As for the king, he has played an absolutely decisive and uniformly positive role in maintaining Thailand's political stability and economic progress for the past generation. In 1973, he intervened to expel an unpopular military dictatorship and validate student demonstrations demanding democracy. In 1976, after that democracy lost control, he backed a military intervention. In both cases, he sensed the mood of his people and the needs of his country correctly. In 1984, he backed the prime minister against a self-interested army chief in the vitally needed currency devaluation. He helped in 1992 to oust a selfish military clique that had shot many student protesters, and in 1997 he helped pass the new Constitution over the opposition of General Chavalit and his supporters. But the king has begun warning that the country cannot rely on him forever. He has suffered from heart problems, bleeding that required a transfusion, and a fall that damaged his spine. His successors necessarily will play a diminished role. While many of the controversies that once surrounded the succession of the crown prince have been resolved, Thailand's present situation is not conducive to the reemergence of a preeminent monarchy after the present king departs.

In the 1970s and the 1980s, the only position the democratic parties had to take was to be in favor of democracy. This held true through the government of Prime Minister Prem Tinsulanonda (1980–88). Prem, a retired general who held no elected office but was ratified by the legislature, ran the country with both proper deference to the expressed feelings of the electorate and a technocrat's concern for sound management. His regime marked the golden age of cold war Thailand. But now, while there is full democracy, increasingly people have been questioning a system in which almost all campaign funds are raised through bribes to ministers. The problem has never been that there was a margin of corrupt funding; rather, it's that, aside from personal money that candidates spend on themselves, virtually all of the funding has been corrupt. Moreover, candidates frequently join or change parties because they are paid to do so. Unlike in the U.S., where interest groups donate money to pay for a candidate's media campaign, in Thailand the common practice is to make a direct payment to entice the budding politician and pay the market price for the required number of votes to get that candidate elected in some available district.

By 1988, the country wanted real democracy and it elected another former general, Chatichai Choonhavan, to inaugurate such. The result blew the lid off what limited, self-imposed checks there had been on corruption. All the excesses of an electoral system financed by vote-buying and ministerial payoffs came to the fore and many of the elitist constraints vanished. This was the era of the billion-dollar bribe. In order to hold together a six-party



coalition, each major interest group was allowed to feast. The army was no longer even required to inform the prime minister's office about its major operations and policies; it became a business conglomerate. Chatichai also inaugurated toward Thailand's neighbors a policy of turning the battlefield into a marketplace, which under the cover of a fine post-cold war slogan gave the army *carte blanche* to become a business conglomerate with monopoly positions and a license to squeeze nearby countries mercilessly.

The scale of corruption so appalled the Thai public that there was near-universal support for an army coup in March 1991 that installed a non-elected prime minister, Anand Panyarachun, a career civil servant and businessman with an aristocrat's air and a focus on the good of the nation. Anand's personal probity and his attack on corruption made him a national hero. The former characteristic also led him to step aside as quickly as possible in favor of an elected prime minister. But the ensuing 1992 election was manipulated by a military clique based on Class 5 of the military academy that was determined to retain real power. This act led to violent, public protests that the army brutally suppressed in a Thai counterpart to Beijing's Tiananmen Square debacle. Public revulsion forced out General Suchinda Krapayoon, and Prime Minister Anand came back for three months to clean up the mess.

The developments of the early 1990s left the Thai public disgusted with the excesses of both the military and democratic parties, but this distaste did not lead to a broad system change. The military was totally discredited as a political player and it would take total national collapse or a major international war to gain public acceptance of a military return to power. There was equal public disgust at corruption in the democratic government, but no one put forth a theory of how to fix it. Chuan Leekpai's first government (from September 1992 to May 1995) was a reaction against the corruption and militarism; however, the government came across as being naïve and impotent, unfavorably reminiscent of the Jimmy Carter administration in the U.S. There followed a return to the mold of the past: an interest group-ridden civilian government under businessman Banharn Silpa-Archa that lasted barely more than a year (July 1995 to September 1996) and then the democratic election of General Chavalit, who had presided over the army during the period of the military's greatest military excesses in acting as though it were a business conglomerate during the corrupt Chatichai years. Chavalit came to power in November 1996; his government presided over the total depletion of Thailand's previously well-endowed foreign exchange reserves and the collapse of the baht and banking system of mid-1997. The property bubble, the business and banking excesses, the political party system that treated government power as an avenue to business enrichment, and the role of a military that had become a private business and purchaser of political power—all of the Thai state's problems came together at the same time.

The politically active Thai public looked at this spectacle and decided it needed a new system. Thailand effectively decided that the economy could not be fixed until the political system was at least partially repaired, and that what needed to be repaired in the political system was mostly corruption.

### An Emergent New System

Each element of the Thai system is being recast as a new, more modern (but by no means fully so) replacement. First, there is the Constitution. A commission chaired by former Prime Minister Anand—second only to the king among Thai symbols of probity—proposed constitutional amendments in autumn 1997. Chavalit's government opposed them bitterly and the interior minister at one point accused supporters of the new Constitution of being communists. The Chavalit government was displaced by a new Chuan government in November 1997, and the lower house passed the amendments the following May. The king played a vital, although as usual quiet, role in getting the new Constitution passed. To the extent the new structure is implemented, he will have fulfilled his role in bringing his child to maturity and setting it on its own adult feet.

The new Constitution replaced an appointed Senate dominated by military officers and plutocrats with a purely elected body, but the senators may not campaign or join political parties. Elected politicians are banned from holding cabinet posts, a move intended to curtail the habit of funding campaigns through bribery. Ministers are required to have at least a bachelor's degree, thereby excluding many current ministerial candidates. The Constitution now forces politicians and parties to make their finances public. It provides for broad freedom of information and gives the Senate the right to remove elected politicians, a potentially lethal combination for graft-ridden political leaders. Finally, elections will be organized by an Election Commission rather than by the corruption-ridden Interior Ministry. This should make it difficult for officials to check whether voters actually cast ballots for the candidate who paid for their votes.

The parties have taken on new features, particularly the dominant Democrats. Under Chuan Leekpai, this organization is a new kind of political party: more disciplined and focused on the task of governing as opposed to engaging in self-serving behavior. In his new incarnation, Chuan himself is no longer a weak and naïve figure but rather a disciplined, determined leader managing a relatively effective political organization. As with the army, the Democratic Party is far from having fully escaped the habits of the old system, but the group's organizing principles are sufficiently different that its coalition partners and opposition are right to be terrified that, if this party stays in power too long, the old ways may change forever.

Since Thailand's 1992 bloodletting, the military—always important in the country's political landscape—has withdrawn into a much more limited political role. In 1997, big demonstrations occurred and General Chavalit effectively invited the army in, but the invitation was ignored. The new commander-in-chief under Chuan has emphasized withdrawal from politics. He pointedly resigned his Senate seat. He has refused to handle relations with Burma, Laos, and Cambodia—an authority that allowed General Chavalit to accumulate much of the political war chest that funded his later election to prime minister. The military has accepted drastically reduced military budgets and dilution of its ownership of Thai Military Bank. This does not mean that nirvana has been achieved; the military remains heavily engaged in a wide range of businesses from Thai Airways to illegal logging. But the direction of change is clear. The Thai army is being changed from a business conglomerate into a modern professional force.

Other important segments of society are also seeing change. The Buddhist clergy will continue to set the moral tone of one of the world's most religiously influenced societies, but its role will be more moral and less organizational, and monks' practices will be subjected to a far higher degree of public scrutiny than ever before. The new banking system will be much more competitive, open to foreigners, and arms-length from outside interference than previously was the case. Of course, long-time business associates will still get favored treatment, but the balance sheets will be looked at, often by a committee rather than a single autocratic individual. This will open the economy and create opportunities for more rapid emergence of new groups and businesses. Finally, while the civil service and state enterprises will never regain their former prestige, they will gradually be streamlined and modernized in ways that are parallel to what is happening in the army. The universities, now part of the civil service, will become autonomous and this will lead to a further opening of intellectual life and a weakening of the government's hold on society. Furthermore, the freedom of information laws are causing a gradual revolution in the way all parts of society function.

Considering all that has been outlined above, plainly the universities, nursery schools, ministries, political parties, and banks and businesses all are changing. While the clearest transition to modernity has come in the military, none of the changes in other parts of society will happen quickly. As the explanation of the progress of Thai restructuring outlined above shows, everything is going to be done the Thai way, which means gradually, piecemeal, and with what one can only describe as shenanigans on the side. Moreover, there are risks. The reactionary elements in Thai society have enormous amounts of money and still occupy important positions in politics, the bureaucracy, business, and banking.

Nonetheless, the social and political changes now underway address the greatest weaknesses of Thai society, particularly corruption and elitism. These changes also strengthen all the country's old virtues; it has had many advantages over its neighbors—freedom of information; the inclusiveness of its politics; the diversity and competitiveness of its economy; the ease with which Thais have dealt with foreigners as compared to Koreans, Indonesians, or Malaysians—and all these will be enhanced. Furthermore, the Thai people in general have handled social and political change more smoothly than most of their neighbors. When one compares the gradual and mostly civilized change occurring in Thailand with the upheaval in Indonesia, the jailing of Anwar in Malaysia, and the jailing of two earlier presidents in South Korea, one can see that the Thais again are displaying their superior balance. But despite recent changes, one must also caution that the interim balance remains aristocratic, based on an elitism that is slow both to discipline errant bankers and educate the Thai people.