THE 1997 THAI FINANCIAL CRISIS: CAUSES AND CONTENTIONS

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Introduction

While the United States is still feeling the effects of the financial crisis of 2007 and 2008, half way around the world there are economies that are still recovering from their own financial crisis that occurred a decade before. While newspaper stories and news reports continue to focus on the healing American economy and Euro crisis it is important to take another look at what happened in Southeast Asia during the late 1990s. The conditions that allowed the entire region to experience a massive economic downturn have the ability to be repeated, especially if economists, writers, and organizations continue to disagree on its causes.

The Asian financial crisis of the late 1990s involved many nations, public and private organizations, and people, therefore one of the best ways to tackle understanding what occurred is to look at where everything started. The commonly agreed start date of the Asian financial crisis can be pinpointed to July 2, 1997 when the Thai government made the decision to float its currency, the baht, after trying to keep it pegged to the United States dollar. Thailand was the hub of growth in the region and the first to go under financially. While Thailand was not the only East Asian country to experience economic shock and decline, it was the first. This fact combined with Thailand's unprecedented previous rapid growth and economic evolution make it a clear case to study when trying to learn what caused the crisis and how to prevent similar circumstances from arising that would allow a similar situation to happen again. Almost up until the first companies and banks began to go bankrupt in Thailand the crisis was entirely unexpected. A 1995 article in *The Economist* predicted that by 2020 Thailand would be the world's eighth largest economy.[1] As of the latest World Bank Gross Domestic Product rankings in 2014 Thailand now sits in the twenty-ninth spot.[2] At that time Thailand's growth was actually outpacing China, but in just two short years Thailand would go from an Asian miracle economy to the first domino in the chain that brought down much of the success Asia had been experiencing over the previous decade. Throughout the early and mid-1990s Thailand received numerous accolades and was widely praised for the steps the government had taken to open up their agrarian economy and allow it to integrate into the global economic market. In fact the World Bank's 1993 Miracle Report named Thailand as the model for economic development.[3] It was

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1 David Pilling, "Fatal flaws that wrecked Thailand's promise," *Financial Times* (London, England), April 29, 2009.
2 "Gross domestic product 2014," *World Bank Development Indicators Database*, April 11, 2016, http://databank.worldbank.org/data/download/GDP.pdf
3 John Page, "The East Asian Miracle: Economic Growth and Public Policy" (World Bank Report, Oxford University Press, 1993).

quite a shock to not only the world, but the very institutions that monitor economic growth, that Thailand would experience such a dramatic and devastating fall just a few years later.

Despite the fact that Thailand's economic downturn was so unexpected it is essential to reexamine the crisis because little scholarship has been written about the crisis since the early 2000s. It is understandable that the United States and Europe's economic difficulties have occupied the spotlight since then, but to forget what happened in Thailand in the late 1990s makes it more likely that another economic crisis could happen again in another developing region. Reexamining the crisis from a removed perspective will shed light on which players actually created fundamental problems in the Thai economy and which only worsened an already failing system.

This paper will first take a look at the major explanations different scholars offer for the cause of the crisis in Thailand. After establishing the players and which scholars support each story the next step will be to take a step back and examine the evidence. The next chapter will assess the validity of each story based on the facts that were present during and leading up to the Thai financial crisis. The conclusion will consider what has been learned and what steps can be taken to decrease the change of another economic disaster from occurring in developing nations.

CHAPTER ONE
The Possible Causes of the Thai Financial Crisis

Scholars were and still are unable to agree what caused that financial crisis in Thailand, despite the fact that almost two decades have passed since the Thai government devalued the baht and the shockwaves rippled out to impact numerous countries in the East Asian region. No one predicted that that the country named an Asian Miracle would just a few years later find itself in the exact opposite position. There are three main possible groups to blame for the economic crisis in Thailand: the Thai government and domestic business sector, speculators and international investors, and finally the international community. Those who argue Thailand is primarily to blame point out that unprecedented growth masked fundamental problems in Thailand's economy. The second group places the blame on international investors whose speculation caused the value of the baht to half almost overnight. Finally, the remaining scholars claim that the Thai government was coerced into deregulating their economy too quickly and international institutions should accept responsibility. Despite the fact that there are many possible explanations for the economic crisis, most economists and scholars believe that the situation can be an example to learn from to prevent another developing economy from experiencing the same disaster.

The obvious place to start looking when trying to determine what caused Thailand's financial problems is within the Thai government. It was ultimately the government that had to make the changes that resulted in economic liberalization and impressive growth in the first place. During the 1980s the Thai government passed the economic policies that encouraged large amounts of foreign direct investment and easy lending terms. The Thai government removed regulations that promoted import substitution and prevented foreign direct investment.[4] From 1990 to 1995 gross domestic investment was 15.3 percent, comparatively the United States saw a GDI of 4.1 percent over the same period.[5] During the same time period foreign direct investment grew from 3 percent of GDP to 25 percent. Researchers such as Robert Wade of the London School of Economics and economist Frank Veneroso even argue that Thailand should not have liberalized as quickly as it did because it weakened a system that was working well, even if that system had some inefficiencies when compared to the Western world.[6] Thailand was seeing growth before it liberalized, just not at the explosive rate that occurred after the policy changes. Wade and Veneroso point out that Thailand's system included a strong relationship between the government and financial institutions, and while the West might refer to this connection as "crony-capitalism" it was a system that brought stability and productivity to Thailand.[7] It is easy to believe that Thailand's close government and business relationship could have had an impact in corrupting the economic reforms.

The theory that places the blame on the government does not negate the impact of excess credit that was loaned out or the large amount of loans in foreign currencies taken out by financial institutions, but rather it ultimately blames the government's policy changes for causing the most damage. Other parties like the private sector or speculators may have had a role to play, but their role only worsened a bad situation rather than created the situation itself. When the government started making policy changes they removed a lot of the oversight on banking practices. These changes included how much money could be loaned out and what types of groups and individuals could borrow these loans. These adjustments, in addition to the quick economic liberalization, resulted in a loss of a national strategy for development that had been in place in the previous decades.[8] Losing that strategy meant that as long as the economy was growing no one was concerned with combatting corruption or making sure individual policies aligned with the goal of long term growth.

The private financial sector's actions also had a role to play in bringing down the Thai economy. The first half of the 1990s was a lucrative time to invest in Thailand. The Bangkok International Banking Facility (BIBF) was created by the government in 1992 with the purpose of making it easier for banks to borrow from foreign countries and lend that money to those looking for loans in Thailand.[9] From 1990 to 1996 gross domestic investment was 40-44% of total gross domestic product, almost double what it was during the previous decade. In addition, the average real income per capita doubled during the same time period.[10] This financial liberalization ended up doubling Thailand's debt to foreign countries from 1992 to the beginning of the crisis in early to mid-1997. While the economic growth initially masked the impact of the debt, once the growth slowed the debt became too much to pay back. Overall Thailand's debt

[4] Chung H. Lee, "Financial Liberalization and the Economic Crisis in Asia" (London: Routledge Curzon, 2003), 7-8. http://www2.hhs.se/eijswp/103.pdf
[5] Charles W. L. Hill, "The Asian Financial Crisis" (University of Washington). 2.
[6] Robert Wade, "Gestalt Shift: From 'Miracle' to 'Cronyism' in the Asian Crisis," *Cambridge Journal of Economics* 22, no. 6 (1998): 697
[7] *Ibid.*
[8] Lee, "Financial Liberalization and the Economic Crisis" 7-8
[9] Laurids S. Lauridsen, "The Financial Crisis in Thailand: Causes, Conduct and Consequences?," *World Development* 26, no. 8 (1998): 1576.
[10] Pasuk Phongpaichit and Chris Baker, *Thai Capital After the 1997 Crisis* (Chiang Mai: Silkworm Books, 2008).

increased from 34% of GDP to 51% of GDP during that same time period.[11] The new dramatic increase in debt was primarily from the private sector, rather than money borrowed by the Thai government or money being borrowed by individual citizens. With banks borrowing money, there had to be someone taking out loans in Thailand, and consequently an investment bubble was created. One of the main problem industries was the real estate sector that had developers who were building at a pace too rapid for the population to handle. The International Monetary Fund notes that these conditions led to too much optimism, misjudged risk, and credit given to companies and projects that did not warrant it.[12] Financial institutions lending to under qualified borrowers and businesses taking on more debt than they could handle created the classic bubble symptoms that economies have seen time and time again and each time the result is the same: an economic downturn. In the case of Thailand, its newly modernized economy and the large amount of money being lent made it impossible for the economy to absorb the shock.

While some economists blame Thailand and the misguided implementation of too many laissez-faire policies, there are others who still blame the government but uphold that financial liberalization was the right path to take. Those economists, like the IMF's managing director from 1987 to 2000, Michel Camdessus, argue that the policies were implemented incorrectly rather than the economics behind them were flawed. Camdessus wrote in 1998 that the Thai government did not follow the correct steps in capital account liberalization and deregulation. The incorrect implementation was compounded by the fact that the Bank of Thailand promised to back any institution if a run on the bank happed.[13] While this had the positive effect of encouraging lending which led to growth in the short term, it created a moral hazard problem where risky actions taken by one institution would be protected by the Thai government. For example, if a bank experienced a run the Thai government promised to ensure the funds to prevent the bank from going under. Had the impressive growth continued with maybe one or two companies facing financial issues the central bank likely would have been able to cover the losses. However, when everything began to go downhill at once there was too many institutions to bailout. Initially the Thai government did promise a bailout, but as conditions quickly worsened they had to back down on their promise. In the end those who thought they would receive a bailout ended up having to declare bankruptcy.

Those who blame the government for creating a bailout policy also blame the government for not seeing the early signs that something was likely to go wrong. The main proponent of this argument is Jeffrey Sachs, senior United Nations advisor, syndicated columnist, and professor of economics at Columbia University. His narrative points out that while GDP was increasing it was growing primarily in areas that are prone to instability. Furthermore, the ratio of liabilities owed to foreign institutions to assets was growing at an unhealthy rate that pointed out the recklessness of what was taking place. However, the benefits the Thai people were experiencing in the increase in annual household income and quality of life meant that the government had little incentive to make any changes as long as times remained good. Finally, when the government did take steps to ask for assistance and

[11] Lauridsen, "The Financial Crisis in Thailand," 1576.

[12] Charles Collyns and Abdelhak Senhadji, "Lending Booms, Real Estate Bubbles and The Asian Crisis" (Working Paper 02/20, International Monetary Fund, 2002), 3.

[13] Narisa Laplamwanit, "A Good Look at the Thai Financial Crisis in 1997-98" (Columbia University, 1999), 3.

change the economic policies, the damage had already been done and it was too late.

One of the popular and profitable sectors to invest in during the boom was the real estate market. Real estate values skyrocketed first as many Thais were moving from the country to urban cities in search of jobs and prosperity. As Thailand's economy began to succeed international companies moved in to take advantage of an evolving economy. Thailand was quickly changing from a farming society to one with cheap labor willing to build the electronics and other consumer goods the rest of the world wanted. However, in the end supply greatly outpaced demand and companies began to default. The demand for property in Bangkok skyrocketed and buildings were being contracted at a rate never seen before in Asia, let alone in Thailand. With conditions looking so positive, banks were happy to finance these projects no matter who was borrowing. In 1997 the first major signs of a bust began to occur and within a few months the baht's valued halved. Despite the value of the baht decreasing, the amount owed to banks remained the same because most of the loans were first borrowed in U.S. dollars in the form of Eurobonds and then loaned out in baht. At the time of the loan was borrowed this was not problem because the baht was pegged to the U.S. dollar and the interest rate was lower than borrowing in the local currency. With a free floating baht the amount owed on the loans in baht doubled and more institutions defaulted.

The Thai government tried to save the baht at the last minute. The government spent their foreign currency reserve buying up baht to keep the currency stable. In the end the government did not have enough funds and had to let the baht float freely in July 1997. As a result of this move the government was almost bankrupted and 56 of the 91 Thai financial companies closed their doors by the end of the crisis, primarily because they could not afford to pay back their loans.[14] The lack of government oversight and allowing businesses to take advantage of government policies resulted in risky behavior that not only bankrupted individual companies, but brought down the Thai currency, undid the economic progress, and put the government at risk.

The next major story told to explain the Thai financial crisis blames international speculators. This claim centers on the fact that currency speculation forced the devaluation of the baht. The speculators came in at the first signs of a crisis and bought up baht in order to short sell it on the international market. The international community knew that if enough speculators got involved that the Thai government was unlikely to be able to spend enough money to keep the baht pegged to the U.S. dollar. Consequently the speculators came in in full force and did exactly as predicted.

The commonly agreed upon start of the Asian Financial Crisis is July 2, 1997 when the baht was officially unpegged, but it could be changed to a few months earlier to February 1997. This month marked the first companies defaulting on their loans. From then on, the economy only continued to go downhill as the stock market started to fall and more companies were unable to make their loan payments. These defaults caught the attention of the speculators who began buying and selling baht in short order. As the baht continued to fall in value the speculators were able to make money as the debt they paid back was valued less than they originally paid. Eventually enough speculators became involved that the baht could no longer be propped up by the government and in July the peg was abandoned. The speculators created a self-fulfilling prophesy and made money on Thailand's economic crisis. The float caused the debt of businesses and financial institutions

[14] Lauridsen, "The Financial Crisis in Thailand" *1585*.

to double and forced even more into bankruptcy.

One man who engaged in speculation and was called out for playing a key role in bringing down Southeast Asian economies was George Soros. The billionaire had a history of speculation from the time he short-sold billions of British pounds earlier in the decade and helped cause a currency crisis, all while making himself a handsome profit. Five years later in 1997 Soros was called out again, this time by the Malaysian Prime Minister Mahathir bin Mohamad. The Prime Minister publically accused Soros of short-selling the baht and the Malaysian ringgit and called him a "rogue speculator" and blamed him for wanting to profit from Southeast Asia's economic troubles.[15] In 1999 economist Paul Krugman also mentioned Soros in his book, *The Accidental Theorist: And Other Dispatches from the Dismal Science*, as the leader of the speculative industry that creates a self-fulfilling currency crisis.[16] Krugman's argument is less about blaming Soros and others like him directly for creating crises like what happened in Asia or the United Kingdom and more about the moral issue that speculators create when they bet on, and then profit from, economic disasters.

The next major players who might have had a role to play were the IMF and the World Bank. Just a few years earlier the IMF and the United States were involved in bailing out Mexico when the nation ran into a similar situation where speculative attacks combined with too much lending shocked their economy. In that situation the IMF lent Mexico billions of dollars. Here another moral hazard was created because it sent a signal to other developing countries that if your nation gets into economic trouble international organizations and wealthier countries will be there to bail you out.[17] However, Mexico was a different case than Thailand. The debt was primarily domestic rather than owed to international institutions.

One of the main proponents of the argument that blames international economic organizations is Joseph Stiglitz, the World Bank's chief economist during the crisis. Stiglitz later wrote in his book, *Globalization and its Discontents*, that the IMF and the U.S. Treasury pushed unnecessary capital account liberalization onto Thailand.[18] Stiglitz noted that Thailand had a high savings rate and did not need the rapid influx of foreign money to continue on the path of economic development. He concludes his point by writing that the countries that resisted financial liberalization like India and China were the ones most spared from the economic damage in the region.

While Stiglitz argues that the pressure of the IMF and the U.S. Treasury in Thailand was reckless, there are others who argue that it was the really the U.S. Treasury using the IMF as a tool in order to promote the "Washington Consensus".[19] Stiglitz describes it as "a consensus between the IMF, the World Bank, and the U.S. Treasury about the 'right' policies for developing countries."[20] These policies were originally made in response to economic issues in Latin America after World War II and were believed to be applicable to the rest of the world, despite the fact that Thailand's issues looked nothing like the problems Latin America had been facing.

Another claim that places the blame on the U.S. Treasury is less altruistic. In this account the root of the problem is the United

[15] "Timeline of the Panic," *Frontline*, 2014, http://www.pbs.org/wgbh/pages/frontline/shows/crash/etc/cron.html.

[16] Paul Krugman, *The Accidental Theorist* (New York City: W. W. Norton and Company Inc., 1998), 159.

[17] Laplamwanit, "A Good Look at the Thai Financial Crisis" 6.

[18] Joseph Stiglitz, *Globalization and its Discontents* (New York City: W. W. Norton and Company, 2002), 212.

[19] Stiglitz, *Globalization and its Discontents.* 16.

[20] *Ibid.*

States because they wanted a more economically liberal Asia to increase potential trading partners.[21] The IMF pressed Thailand as well as other Asian nations to change their policies citing economic growth as the reason. In fact, the IMF even considered adding "capital account liberalization" to its charter as one of its key responsibilities in advising developing nations.[22] Here the U.S. Treasury is held responsible because they pushed neo-liberal policies either for their own trade benefit or indiscriminately with the belief that liberalization would automatically lead to economic success.

The U.S. Treasury's involvement is rooted in its relationship to the World Bank and the IMF. The U.S. Treasury is the World Bank's primary funder[23] and the IMF's largest shareholder.[24] Since the creation of both institutions at the Bretton Woods conference in 1944 the U.S. has been criticized for controlling the World Bank and IMF and using the organization as an extension of U.S. foreign relations and economic policy. The U.S. does have a considerable amount of influence over the World Bank because voting to approve loans and projects occurs on a scale that is proportional to the amount of funding a member country has contributed.[25] This arrangement means that for a loan to be approved it likely needs the approval of the U.S. In addition, U.S. allies like Japan and Saudi Arabia often vote with the U.S. increasing the countries' influence even further.

A similar situation occurs at the IMF. The U.S.'s large contribution to the fund gives it the largest proportional vote. In the history of the IMF the nations that could come together and outweigh the U.S.'s vote, namely Japan and European countries, have never chosen to do so. With that much say in the IMF and World Bank's decision it is possible that the U.S. could have used the two institutions for their own benefit in the Southeast Asian region.

Just as the Thai government might have been able to step in before it was too late and change their policies to prevent the worst of the crisis, the IMF also had a chance to get involved. Either the international organizations or the U.S. could have suggested a more gradual liberalization process that was tailored to the economic and governmental conditions in Thailand or gotten involved to slow down the crisis when the first signs started appearing. One solution that was suggested was the creation of an Asian Monetary Fund that would have pulled resources from countries like Japan, China, and Taiwan.[26] The purpose of the Fund was to provide emergency assistance with few strings attached to countries in the region that needed quick cash. However the U.S. Treasury did not support the idea and the plan was scrapped. Stiglitz argues that in fact the plan was abandoned because the U.S. Treasury and IMF did not want competition in their own arena.[27] The Fund along with the 100 billion USD that Japan offered to support it would decrease IMF influence in the region and that was something the U.S. and the IMF wanted to avoid, especially if China was given the chance to join. It is possible that this fund would not have made any difference because of the size and scope of the Asian financial crisis, but it was supported by the regional countries. The coercion of the international com-

[21] Mark Weisbrot, "Ten Years After: The Lasting Impact of the Asian Financial Crisis," *Center for Economic and Policy Reserach*, (2007): 5.

[22] *Ibid.*

[23] Gregory Palast, "IMF's four steps to damnation," *The Guardian* (London, England), April. 29, 2001.

[24] "Resource Center," *U.S. Department of the Treasury*, Feb. 3, 2016, https://www.treasury.gov/resource-center/international/int-monetary-fund/Pages/imf.aspx.

[25] "Voting Powers," *The World Bank*, http://www.worldbank.org/en/about/leadership/VotingPowers.

[26] Weisbrot, "Ten Years After," 5.

[27] Stiglitz, *Globalization and its Discontents,* 112.

munity led to Thailand's unsound economic policies and allowed the crisis in the end.

The common theme running through the story that blames outside international involvement is that laissez-fare policies are unsuitable for developing economies. Stiglitz, along with economists Thomas Hellmann and Kevin Murdock of Stanford, came together and proposed that rather than implement risky full financial liberalization the policy that should be pursued in nations like Thailand is one of financial restraint. These economists looked directly at East Asian economies and found that financial liberalization led to "weak institutions, poor deposit mobilization, and negative returns to financial assets."[28] The author's major issue with the way financial liberalization had been done, like in Thailand, was that it did not set up incentives for stable institutions to be created and assumed that what worked in the west automatically works for developing economies.

Even almost 20 years since the devaluation of the baht the world's leading economists still cannot agree on what caused the Thai financial crisis. Each possible cause holds a piece of what truly happened but only by examining the primary evidence without the influence of any other scholars. Most of the literature on the Thai financial crisis was written while Thailand was still recovering or in the early 2000s. The most recent articles discuss the crisis from the perspective of ten years later, but still do not address the primary evidence itself.

[28] Thomas Hellmann, Kevin Murdock and Joseph Stigliz, "Financial Restraint: Towards a New Paradigm," *The Role of Government in East Asian Economic Development Comparative Institutional Analysis*,(1997): 50.

CHAPTER TWO
The Real Story – Why the IMF and World Bank Are to Blame

After establishing the common explanations of the Thai financial crisis the next step is to determine which, if any, of the possible causes truly did lay the foundation that led the nation into economic catastrophe. While each story has a role to play in making the financial situation in Thailand worse, only the involvement of the World Bank and the International Monetary Fund created new conditions that allowed the bad business and economic practices to continue until finally Thai financial institutions and the Thai government ended up bankrupt. Essentially the World Bank and the IMF are primarily to blame for the Thai financial crisis while the other parties only played a secondary role that made the crisis worse, but did not cause it initially.

To determine why the World Bank and IMF are to blame as well as why others are not it is necessary to look at the evidence that surrounds the crisis. For each story to be true certain factors should exist that would support their role as the cause of the crisis. This chapter will look at those factors that refute the accusations that the Thai government, Thai businesses, and private international institutions and speculators caused the crisis while also showing that multiple factors exist that support the involvement of the World Bank and IMF.

For each possible explanation this chapter will look at a specific factor that should support the stories outlined in the previous chapter. First, illustrating that corruption in Thailand remained constant before and after the crisis will show that the Thai government and businessmen did not cause the crisis. Next, taking a look at when the speculation took place on a timeline of the crisis will demonstrate how other financial factors had already placed Thailand on the road to disaster long before the speculators came in looking to make a profit. Finally, looking at reports and loan agreements from the World Bank and IMF will explain why those two institutions are primarily to blame for Thailand's financial crisis.

The first possible cause that can be excluded is corruption. Corruption is not an uncommon issue for economically developing countries and Thailand is no exception and it makes sense how it could play a role in bringing down the economy. In Thailand's case corruption takes the form of improper relationships between government officials and businessmen in Thailand. Instances of businesses paying for special favors or exemptions happen to be business as usual for a portion of the Thai economy. The argument is these relationships allowed the liberalization policies that brought Thailand economic prosperity to be exploited to a large enough level that businesses went bankrupt and the Thai government lost almost all of its money trying to keep the nation afloat.[29]

A quick history of Thailand will show that while corruption is a serious problem for the nation, it did not cause the nation's economic problems. Thailand was an absolute monarchy until the 1930s when a revolution ushered in a new era of constitutional monarchy. During this time the country of Siam evolved from a feudal state where slavery and serfdom where common to the modern Kingdom of Thailand that exists today. On paper a constitutional monarchy seems like a stable form of government with power given to the people but since 1932 Thailand has had seventeen different constitutions and is currently looking toward approving an eighteenth. The people do elect the National Assembly, essentially Thailand's bicameral parliament made up of the Senate and the House of Representatives, but the military regularly controls who holds the office of prime minister. Numerous coup d'états have changed the composition of the legislature and have ousted elected prime ministers.

With this history in mind it would be possible for corruption to flourish and therefore be responsible for the crash of the Thai economy. However, that corruption would have to be widespread enough cause a large shock that rippled outward to multiple countries while keeping those involved still wealthy. One thing to consider is how Thailand operated before the crisis. Corruption has and continues to be an issue in the government. The election system rests on a system that allows corruption to breed. In Thailand political parties are not strongly united groups. Rather, parties are temporary alliances that rarely last more than a few election cycles.[30] Therefore, Thai politicians tend to work with a small but devoted core group to get elected. In many cases these groups are made up of wealthy businessmen who have the power and funds to influence elections. This arraignment means that politicians are incentivized to act in favor of their small support group rather in favor of the nation as a whole. While this arrangement does not necessarily equal corruption, it does create a favorable climate for it.

Different administrations took different approaches to tackle corruption in Thai politics. In 1995 the first Corruption Perceptions Index by Transparency International was released ranking forty-one countries from least to most corrupt. Out of those nations Thailand ranked thirty-forth.[31] The next year Thailand ranked thirty-seventh out of fifty-four nations surveyed, showing an

[29] Laplamwanit, "A Good Look at the Thai Financial Crisis" 3.

[30] Allen Hicken, "The Politics of Economic Reform in Thailand: Crisis and Compromise" (presentation, Politics of Economy Reform Seminar, William Davidson Institute, MI, January, 2003). 14.

[31] "1995 TI Corruption Index," *Transparency International*, July, 15 1995, http://www.transparency.org/files/content/tool/1995_CPI_EN.pdf.

improved score and therefore less corruption.[32] The year of the crisis, 1997, Thailand ranked thirty-ninth out of fifty-two nations studied and a slight increase in corruption. However, over the three years the level of corruption determined by Transparency international was similar.[33] Looking at the data from 1995 to 2015 Thailand's corruption statistics have not made any significant improvement. Their ranking shifts up and down each year but the overall score remains between 3.2 and 3.6 out of a perfect 10. If corruption was the issue it is likely that Thailand's score would have continued to rise as the nation's economy has recovered since the late 1990s but that is not the case.

Transparency International did not release corruption studies prior to 1995 so it is possible that the major corruption occurred before that time and was corrected but the damage was already done. To determine what corruption was taking place it will be necessary to look at the prime ministers and their interactions with businessmen and the economy during their administrations. The major economic changes began in the 1980s as Thailand was trying to recover from the oil shocks it experienced during the 1970s. 1980 saw the election of Prime Minister Prem Tinsulanonda and his main economic goal was to centralize economic policy with common focus to spur economic growth. During his eight years as prime minister four major and largely independent institutions were created: the Budget Bureau, the National Economic and Social Development Board (NESDB), the Ministry of Finance, and the Bank of Thailand.[34] These institutions were headed by technocrats rather than elected officials. The purpose of this organization was to give the institutions independence from the corruption that Thai politics was historically accustomed to.

Prime Minister Prem was installed by the military but in 1988 he was replaced by Chatichai Choonhave in an election rather than a coup. This change also caused a shift in power. Despite the fact that Chatichai was a retired general, he was elected because he built himself a base of prominent businessmen and well-respected local leaders. His close relationship with wealthy businessmen did give him a reputation for corruption and his economic policy changes did allow those businessmen to profit generously. Most of his cabinet was filled with business elite, family members, and those who financed his election.[35] His cabinet was known as the "buffet cabinet" because the ministers were able to take what they wanted during Chatichai's leadership.

From the outside it looked like Chatichai's election would be beneficial for Thailand's economy. He described his economic goal as "turning battlefields into marketplaces."[36] Rather than fighting with the rest of the countries in Southeast Asia, Chatichai sought to supply the other nations with the materials to build up their infrastructure while Thailand made a profit from the exports. Unsurprisingly, this move was highly popular with the Thai business sector but unfavorable with the military. Expanding Thailand's trade, especially to neighbors so close, increased the boom in Thailand and the stock market rose along with prices and profits. The amount of money up for grabs is what made the corruption under Chatichai so pervasive but just because a lot of corruption existed does not mean it was enough to

[32] "TI Corruption Index 1996," *Transparency International*, 1996, http://www.transparency.org/files/content/tool/1996_CPI_EN.pdf.

[33] TI 1997 Corruption Index," *Transparency International*, July, 31 1997, http://www.transparency.org/files/content/tool/1997_CPI_EN.pdf

[34] Hicken, "The Politics of Economic Reform" 5.

[35] Pasuk Phongpaichit and Chris Baker, *Thailand's Boom!* (Chiang Mai: Silkworm, 1996), 179.

[36] Steven Erlanger, "Thailand Seeks to Shape a 'Golden Peninsula', "*The New York Times* (New York City, NY), Aug. 30, 1989.

cause the financial crisis. One of the largest issues of corruption Chatichai's cabinet saw was that businesses were found to have written checks to ministers in order to receive special consideration or money when it came to a new regulation or law.[37] Despite the fact that Chatichai's leadership increased corruption, he was only in power from 1988 until 1991 and he was not in charge during the most profitable and expansive years. The military eventually overthrew Chatichai in a nonviolent coup to fix some of the corruption issues.

The 1990s were the years when Thailand experienced the most growth, international involvement, and foreign and international investment. If Chatichai had governed during the early to mid-1990s then corruption would stand as a variable that caused the financial crisis, but much of Chatichai's policies and improper relationships with businessmen had been undone by the time loans started going bad and financial institutions started going bankrupt. After the 1991 coup, Anand Panyarachun was appointed as the prime minister after being approved by the military. His leadership saw a return to funding the military and making choices that favored technocrats, academics, and experienced civil servants rather than favored businessmen.[38] The changes did not take Thailand back to the entirely independent days of Prime Minister Prem, but they did make progress on the unhealthy relationships between businesses and government.[39] While the highest level of government saw changes the local levels did as well. Overall, businessmen began to get more involved in politics.[40] Not only did they see more political opportunities than ever before, but they were able to make money from Thailand's economic liberalization and pushed for more openness either through funding politicians or gaining public office themselves. Allen Hicken, director of the Center for Southeast Asian Studies writes that while the initial push for liberalization come from the IMF and World Bank, "by the mid-1980s a large group of economists and technocrats had come to support financial liberalization as a way to increase business competition within the Thai economy and as part of an effort to make Thailand the regional financial hub."[41] Thai businessmen and bank officials saw the growing economy and supported policies that continued that growth while also allowed them a chance to profit from deregulation. Despite more businessmen obtaining election, economic policy was still controlled by the top and the more independent institutions created under Prem.

The 1990s still saw a close relationship between business and government, despite the efforts of the military to clean up corruption. During this time Thailand was labeled a "miracle economy" for its impressive gross domestic product growth and ability to switch from an agrarian to industrial economy so quickly. The unhealthy relationship between business and government remains an issue in Thailand today and likely continues to hurt the economy; however, the corruption itself did not cause the financial crisis because it did not create the most harmful economic policies.

Rather than corruption being the major issue in the Thai government, the evidence points to inexperience and lack of guidance. One example is the creation of the Bangkok International Banking Facility (BIBF). In 1993 the BIBF was established to fully open the doors to the capital market

[37] Phongpaichit and Baker, *Thailand's Boom!* 180.
[38] Charles P. Wallace, "Junta Frees Deposed Leader of Thailand: Coup: Former Prime Minister Chatichai Choonhavan is shown on TV with the country's new rulers. 'I have washed my hands of politics,' he says" *Los Angeles Times* (Los Angles, CA), March 10, 1991.
[39] Hicken, "The Politics of Economic Reform in Thailand" 14.
[40] *Ibid.*
[41] *Ibid*.

allowing international lending to come to Thailand in full force. Along with the BIBF came the elimination of interest rate ceilings, and further liberalized foreign exchange transactions. These changes encouraged financial institutions to expand and offshore banking was established under the watch of the BIBF.[42] The BIBF played a key role in promoting Thailand's economic growth, but it was created before sound regulations and rules were established regarding international investment and lending. The BIBF was in charge of regulating commercial banks that wished to start international banking facilities in Thailand. It created rules for offshore and local lending. It was these conditions that allowed too many substandard loans to be allocated and ultimately contributed to businesses going into default.

Corruption was not the cause of these flawed regulations. Neither Thailand nor the international community thought that they would be necessary for Thailand's economy to modernize and prosper. When some became worried that Thailand might need to take steps to control its growth the damage had been done. Along the way there was little incentive for the Thai government to want to install new policies that could have prevented or lessened the impact of the crisis because Thailand's growth was so impressive.

The lack of regulation created an environment that allowed for morally hazardous loans to thrive. Just three years after the creation of the BIBF the amount of money lent through the institution added up to 31.2 billion USD.[43] Bringing in that much money in such a short time period seemed like a blessing for the previously struggling Thai economy, however, the type of loans that the BIBF lent should have raised an alarm. Almost all of the loans that came into Thailand were short term and lent to real estate and property developers. Not only were the loans given to a market that was highly susceptible to speculation, but they were given to institutions that were promised a bailout if they went under.[44] On the surface the economy was growing, and at an impressive rate. Except all growth is not necessarily good growth in the long term. With the growth came unsustainable rates of debt to foreign institutions. When economic growth is occurring, there is little incentive to not make bad loans, and the international community is applauding the transformation it is easy to continue on without oversight and safeguards that could have protected Thailand in the long run.

Finally, in late 1995 members of the Thai government did start to take notice that the economy was headed down an unsustainable path; however, their efforts were too little and too late to stop the crisis from occurring. China was beginning to gain the comparative advantage in the inexpensive and low skilled labor market and Thailand needed to make adjustments that compensated for that shift. The Ministry of Finance and the Bank of Thailand were concerned about possible speculation.[45] The response was to constrict monetary policy with the goal of tightening the reigns on economic growth and curb inflation. The objective of the tight monetary policy was to raise interest rates to make lending more expensive. Ideally fewer people would seek fewer loans with the new higher interest rate and financial institutions would only give out loans to highly qualified borrowers. Tightening monetary policy is meant to control lending, but it is only effective if there is not another lending willing to offer lower inter-

[42] Lauridsen, "The Financial Crisis in Thailand" 1576.

[43] Nussara Sawatsawang, "Thailand's Financial Crisis of 1997: A Survey and Critique of Dominant Explanations" (*Institute of Social Studies* 278, 1998) 5.

[44] Laplamwanit, "A Good Look at the Thai Financial," 3.

[45] Lauridsen, "The Financial Crisis in Thailand," 1579.

est rates. Thailand raised interest rates domestically but at the same time the international financial institutions kept their interest rates comparatively low. Therefore borrowing did not stop, it just continued in the international market.

Looking at the evidence it is hard to make the case that the Thai government is the primary cause of the Thai financial crisis. Corruption was and is still a problem in Thailand, but that corruption existed before the financial liberalization and continued at a steady rate afterward. Corruption and improper relationships between the Thai government and the business sector did have a role to play in escalating the severity of the crisis, but it cannot be said to have created the conditions for so many businesses, financial institutions, and the government to declare bankruptcy.

Just like corruption, the role of international speculators is also a secondary one in causing the Thai financial crisis. The clearest way to determine the role the speculators did play is to look at the timeline of events as well as what financial factors were already in motion once the speculators came to East Asia looking for a the chance to make a quick profit. The Thai government did spend billions of dollars in an attempt to protect the baht from speculators, but that intervention only sped up the timeline of events.

The purpose of currency speculation is to borrow currencies with the anticipation that their value will decrease and therefore paying back the loan will be cheaper in value than initial amount borrowed. George Soros is likely the most famous currency speculator. He was not only involved in speculation against the Thai baht but he was also blamed for short selling pounds and bringing down the Bank of England as he made a profit of over 1 billion dollar pounds in 1992.[46] Speculation does hurt economies. When Soros took advantage of high inflation and an unsustainably high exchange rate in England he cost the U.K. Treasury an estimated 3.4 billion pounds. His actions of borrowing pounds and paying back his loans to take advantage of devalued pound caused a very real problem for the British, but his exploration of a bad currency situation did not cause the situation itself and England was able to recover without entering into a full blown crisis.

A similar situation occurred in Thailand. By 1996 the international community was learning that Thai financial institutions had made numerous risky loans in industries that were underperforming, like the real estate sector. From 1990 to 1995 domestic investment grew by 15.3 percent, comparatively domestic investment only grew by 4.1 percent.[47] The loans were inexpensive and easy to acquire. However, the loans were borrowed in US dollars rather than Thai baht because the interest rate was cheaper and the currencies were pegged at the time. The problem started when industries started to over produce and were unable to pay on their loans. Early 1997 saw an estimated 365,000 unoccupied apartments in Bangkok alone and another 100,000 units still scheduled to be built before the end of the year.[48] With overproduction an issue the international community started to get the sense that Thailand could not continue on the same path.

Thailand was reaching the end of an economic bubble and speculators were watching and waiting to profit from the burst. The first company to default was the Thai property developer Somprasong Land. On February 5, 1997, Somprasong Land was unable to make its scheduled Eurobond loan

[46] David Litterick, "Billionaire who broke the Bank of England," *The Telegraph* (London, England), Sept. 13, 2002.
[47] Hill, "The Asian Financial Crisis," 2.
[48] *Ibid.*

payment. While this default was only the first of many the stock market had already been declining since 1996 and had lost 45 percent of its value. The Stock Exchange of Thailand had reached a high of 1400 points in early 1996 and at the lowest point of the crisis it would reach a low of 200 points, losing about 80 percent of its value. Other property developers started defaulting as well as that placed Finance One, Thailand's largest financial institution in a position where they could not pay back the international institutions they had borrowed from and by the end of February Finance One would have to declare bankruptcy.

The message was clear: Thailand's boom was busting and because of the nature of the loans. By the middle of 1997 Thailand's international debt had reached 50 percent of its GDP.[49] This amount of foreign debt combined with the fact that the baht was pegged to the US dollar made the situation prime for currency speculation. The baht had been pegged since 1984 at the exchange rate of 25 baht for every US dollar. As institutions declared bankruptcy and Thailand's current account deficit grew it became more and more likely that this peg was unsustainable. Speculators began short selling the baht in order to make a profit on the likely future devaluation of the currency. Short selling "involves a currency trader borrowing baht from a financial institution and immediately reselling those baht in the foreign exchange market for dollars".[50] As a result, the speculator is able to make a profit once the baht's value falls in comparison to the dollar and when that speculator buys the baht back to pay off his loan it will cost fewer dollars than he spent originally.

With speculators circling, the Thai government spent their own foreign currency reserves in an attempt to keep the value of the baht up and pegged to the US dollar. By July, 1997 the Thai government had spent 5 billion US dollars buying up baht as well as raised interest rates in order to slow down the eventual burst. Eventually the government ran out of money and on July 2, 1997 the announcement was made that the baht would be unpegged and allowed to float freely. Immediately the baht devalued by 18 percent and did not stop declining until 55 baht equaled one US dollar. Not only was this more than twice the pegged value but it meant that the debt institutions like Finance One owed to international creditors doubled.

Speculators like Soros made a large profit off baht speculation, but that does not mean they caused the crisis. Before the speculators started buying baht, businesses and institutions were already struggling. The speculators made millions off the crash and there is a moral culpability those speculators hold for, in a sense, pushing Thailand over the edge sooner than it might have on its own, but in the end they are not responsible any more than government corruption is for causing the fundamental economic issues that brought down the Thai economy.

After discrediting the variables that would support the idea that the Thai government and local businessmen or private international speculators were responsible, the last option to investigate is the influence of the international community. The IMF and the World Bank were the institutions that pressured Thailand to liberalize their economy through loan requirements, continually commended their economic growth, and assured Thailand and the international community that Thailand was on the path to long-term success. The best way to get a clear picture of the IMFs and World Bank's involvement is to look at the loan agreements between the institutions and Thailand as well as the official visits and reports written about Thailand. These documents esta-

[49] Richard P. Cronin, "Asian Financial Crisis: An Analysis of U.S. Foreign Policy Interests and Options" (CRS Report for Congress, Jan. 28, 1998).

[50] Hill, "The Asian Financial Crisis," 4.

blish that the IMF and World Bank laid the foundation for the crisis and continually encouraged Thailand to continue on a path that allowed corruption to thrive and unhealthy debt to accumulate.

However, before taking a look at the evidence that incriminates the World Bank and IMF the relationship between these two institutions and the U.S. Treasury has to be explained. The U.S. Treasury did and still has a lot of influence over the actions of both these economic organizations. Furthermore, the U.S.'s position was to encourage economic liberalization and free trade at home and abroad. In 1989 the U.S. signed the Asia-Pacific Economic Cooperation with twenty other Pacific Rim countries with the goal of increasing economic relationships and prosperity between the member nations, including Thailand.[51] The U.S. wanted a prosperous Thailand not only for Thailand's benefit but for the region's growth and for the development of another trading partner. However, the purpose of this agreement or support IMF and World Bank policies was never just to create a new market for U.S. companies to expand. FDI from the U.S. did increase when Thailand began its process of liberalization. In the end the U.S. Treasury's role in Thailand is simply wanting the nation to have a healthy economy, there is no evidence to suggest malice, exploitation, or ignorance towards the Thai people and economy.

Finally, Thailand's financial crisis originates with their interactions with the World Bank and the IMF. The tough economic times that Thailand experienced in the 1970s resulted in the Thai government asking for help from international organizations. The oil shocks that caused economic problems across the world hit Thailand especially hard. In an attempt to revitalize the economy Thailand expanded its public sector and invested in public works.[52] As a result Thailand's debt rose. The current accounts deficit, or the amount more Thailand was importing than exporting, increased to over 7 percent of GDP by the end of the decade.[53] In addition, Thailand's debt to international institutions increased from under fifteen percent to over thirty-five percent from the middle to the end of decade.[54] This amount of debt and the inability of the Thai government to bail itself out caused the government to reach out for international loans to get the nation back on the right track.

On June 6, 1980 the World Bank released the *Industrial Development Strategy in Thailand* with the purpose of decreasing the adverse effects of Thailand's economic situation and make recommendations to open up the Thai economy. The recommendations can be summarized as valuing exports over import substitution and discouraging the government from investing in "inefficient capital-intensive investment projects."[55] The report identifies Thailand's comparative advantage, or what Thailand does better than any other nation, as "labor-intensive and natural resource intensive products."[56] The World Bank reports authors predicted that their suggestions, if carried out, would lead to increased employment in the industrial sector and improve the living standards of the poor.

The Development Strategy written in 1980 had the goal of implementing the economic changes rather quickly to get Thailand back on the right economic track. The purpose of the recommendation to increase exports and decrease import substitutions

[51] "What is Asia-Pacific Economic Cooperation," *Asia-Pacific Economic Cooperation*, May 2014, http://www.apec.org/about-us/about-apec.aspx.

[52] Kalpana Kochhar, "Thailand: The Road to Sustained Growth" (International Monetary Fund, 1996), 6.

[53] *Ibid*.

[54] *Ibid*.

[55] "Thailand: Industrial Development Strategy" (PUB2804, World Bank, Washington, D.C., 1980), iv.

[56] *Ibid*.

was to reform the "duty and tax rebate scheme" while at the same time "extend[ing] loans for investment in export activities."[57] The World Bank wanted to immediately implement measures to promote exports but wanted to ease the policy changes regarding import protection over a period of five years so as not to cause any more unnecessary shocks to the Thai economy. In the end, Thailand lowered tariffs and made up the lost revenue by introducing an excise tax on the most highly protected goods.

This report was the first suggestion of liberalizing the Thai economy. The overall tone of the report is to allow more imports and investments to come into the nation, not only from domestic investors but international as well. The report wants the Board of Investment (BOI), Thai government, and Thai financial institutions to be open to the change and be ready and able to accommodate new goods and money entering the country. However, no recommendations were made to change the structure of these institutions and the government to ensure that the new changes would result in success. Thailand was still in the process of modernization and, as previously established, corruption was a major issue. This first report illustrates the disturbing trend of the World Bank and IMF to make policy recommendations without taking the initiative to suggest safeguards that would prevent the changes from being exploited or implemented incorrectly.

The World Bank did not only offer policy suggestions to Thailand, they also offered the nation loan agreements. The government deficits Thailand had along with high inflation levels caused the nation to reach out for loans from the international community and the World Bank was willing to step in to lend a helping hand. Before offering Thailand a specific loan agreement the World Bank visited the nation and published a country study titled *Thailand Toward A Development Strategy of Full Participation*. The visiting economists reported on many aspects of Thai society but the major finding of the economic portion centered on the BOI and the prior agricultural economy transitioning to a growing economy based on industry. The study noted that the BOI, since its establishment in 1959, lacked a "consistent set of policy objectives."[58] The World Bank criticized institutions like the BOI that had essentially autonomous control over policy and willingness to change that policy regularly. As a result, Thailand did not have uniform incentives for industries, let along for different companies within a particular industry. Without clear and uniform policies investors are hesitant to bring their capital into a country and domestic investors are pushed to certain areas and discouraged from investing in potentially profitable and beneficial industries.

Encouraging Thailand to create positive consistent policies based on healthy economic strategy is a necessary and positive function of the World Bank, however, requiring too many changes too quickly without attention to the environment of the Thai economy had and would continue to operate under was reckless and significantly contributed to laying the foundation for the financial crisis. The World Bank was doing what it thought was right in following previously established economic ideas to boost the Thai economy, but nations, their people, and their economies are not just pieces of a formula. On paper lowering interest rates combined with increasing exports seems like an easy fix to stimulate economic growth and in a developed country might be the solution. Except when dealing with a developing nation with an economy in transition it is important to consider how the economy has worked in the past. This consideration includes deter-

[57] *Ibid*.

[58] "Thailand: Toward a Development Strategy of Full Participation" (PUB-2059, World Bank, Washington, D.C., 1980), 13.

mining which groups hold significant power and influence and takes into account how the economy works on a day to day basis, not just how it should work. Economics involves people and therefore has to take into account the spirit of those people. Policies that work effectively in the United States or even other Western nations not always translate into long term successful programs elsewhere.

The loans given by the World Bank to Thailand were conditional. These loans were designated structural adjustment loans (SALs). SALs were loans that provided "financial support to governments that agreed to macroeconomic reforms – reforms that were intended to transform their countries' basic economic structures in a fundamental way".[59] The main conditions associated with SALs are currency devaluation, managed balance of payments, reduction of government services through public spending cuts/budget deficit cuts, reducing tax on high earners, reducing inflation, wage suppression, privatization, lower tariffs on imports and tighter monetary policy, increased free trade, cuts in social spending, and business deregulation.[60] The SALs lent to Thailand did not have all of these conditions built into them, but this list gives a basic idea of the program crafted by the World Bank and ultimately supported by the IMF.

SALs are set up to be short-term loans that provide nations in crisis with a boost to set them on the right track to self-sufficiency. A key part of the loans, which are normally lent in groups over a few years, is that they require drastic change quickly in order to meet the strict conditions of the loan. Compounding the effect of the firm conditions of the SALs is the fact that Thailand government and business officials were largely not consulted when the loan agreements were drafted. Professor and senior fellow at Georgetown as well as former country director at the World Bank, Katherine Marshall, wrote that the World Bank had a history with its early SALs of not consulting the countries themselves and not paying particular attention to "the impact of the reforms on societies and their political repercussions" or making "conscious efforts to inform and engage those affected".[61] The chain of events for SAL creation for Thailand were as follows: Thailand requests help from the World Bank, the World Bank sends officials to the country to craft a report the Development Strategy reports previously mentioned, and those officials make recommendations for loans directed to the World Bank directors and loans are offered to Thailand. No part of the process involves Thai officials sitting down with the men and women crafting their loan agreement. Only during the February and March of 1980 economic review visit to Thailand were the Bank of Thailand, Ministry of Finance, the NESDB, and Thai government a part of the process.[62] This puts Thailand at a disadvantage of not being able to negotiate the terms of their own loan, but needing the money badly enough to be willing to accept the conditions.

This situation meant that Thailand had to follow the instructions of the World Bank, no matter the consequences because they were in need of the loan. The World Bank reported on Thailand each year in their annual report and therefore Thailand had to continue to follow the policies outlined in

[59] Katherine Marshall, *The World Bank: From reconstruction to development to equity* (New York City: Routledge, 2008), 40.

[60] "Structural Adjustment Programmes (SAPS)," *World Health Organization*, Feb. 6, 2016, http://www.who.int/trade/glossary/story084/en/

[61] Marshall, *The World Bank,* 40.

[62] Chaipat Sahasakul, Nattapong Thongpakde, & Keokan Kraisoraphong, "Lessons from the World Bank's Experience of Structural Adjustment Loans (SALs): A Case Study of Thailand" (Thailand Development Research Institute Foundation, University of Manchester, 1988), 16.

the SALs. In both 1982 and 1983 Thailand accepted a SAL. The first totaled 150 million U.S. dollars[63] and the second was 175.5 million U.S. dollars.[64] The SAL I included personal and corporate income tax restructuring, restructuring of the agricultural and energy sectors, and developing the industrial sector. The Thai government created the Economic Structural Adjustment in order to make sure the nation was complying with all of the World Bank's conditions. SAL I's reforms were meant to be implements either immediately or over a five-year period. The conditions of SAL were broad based and included massive deregulation.

SAL I was not enough to solve Thailand's economic issues so the World Bank proposed SAL II in order to help Thailand recover more fully. The purpose of SAL II was to reduce government expenditures and raise government revenue with the goal of reducing the deficit and the current account deficit[65] as well as a continuation and expansion of SAL I. Once again the timeline of the conditions was noticeably short for such drastic economic and financial changes. These loans seemed like the solution to Thailand's problem. GDP growth was exploding and GNI per capita grew from $710 to $2970 from 1980 to 1996.[66] Thailand had found its fix and the risks seemed to be worth the rewards.

[63] "Loan Agreement: Structural Adjustment Loan between Kingdom of Thailand and International Bank for Reconstruction and Development" (Loan Agreement, World Bank, March 15, 1982) 2.

[64] "Report and Recommendation of the President of the International Bank for Reconstruction and Development to the Executive Directors on a Second Structural Adjustment Loan in an Amount Equivalent to $175.5 Million to the Kingdom of Thailand" (Document of the World Bank, World Bank, March 10, 1983), 1.

[65] Sahasakul, Thongpakde and Kraisoraphong, "Lessons from the World Bank's Experience," 2.

[66] "GNI per capita, Atlas Method (current US$)" (Data, World Bank, 2016).

The World Bank loans came with conditions, but that does not exclude the Thai government for not taking precautions against their institutions making bad loans. During the time when Thailand was established as a miracle economy the World Bank was continuously telling Thailand the nation was on the right track and the economy was stable. *The East Asian Miracle* published in 1993 by the World Bank is the most famous report regarding Thailand's accomplishments in the region. In it, Thailand is established as a new industrializing economy and is commended for its economic progress.[67] The report specifically praises Thailand's liberalization policies and the positive relationship between business and government.[68] Thailand deserved the praise, the progress was substantial and the economy was on its way to becoming fully modern. However, Thailand's business and government relationship needed work and the lack of oversight is precisely what allowed the risky loans to occur.

The World Bank should have understood its position as the international authority on developing economies and their praises indicate that a nation is doing a good job and is on the right track economically. The mission of the World Bank is to end extreme poverty and "promote shared prosperity and greater equity in the developing world" by promoting "income growth of the bottom 40 percent of the population in each country."[69] The practical method for achieving this mission is through the five organizations that make up the World Bank: The International Bank for Reconstruction and Development, The International Development Association, The International Finance Corporation, The Multilateral Investment

[67] Page, "The East Asian Miracle"

[68] *Ibid*. (10 & 14)

[69] "Ending Extreme Poverty and Promoting Shared Prosperity," *The World Bank*, April 19, 2013,http://www.worldbank.org/en/news/feature/2013/04/17/ending_extreme_poverty_and_promoting_shared_prosperity.

Guarantee Agency, and The International Centre for Settlement of Investment Disputes. These groups promote foreign direct invest, finance investments, advise businesses and governments, and provide loans. With the amount of economic knowledge centered in the World Bank it is understandable why Thailand heard the World Bank's report and continued on the same path.

The World Bank was not the only international organization giving support and assistance to Thailand. While Thailand was considering assistance from the World Bank the government was also discussing policy changes with the IMF. From 1981 to 1983 the IMF allocated over one billion in special drawing rights to Thailand.[70] Special drawing rights (SDRs) are not a currency, but rather a "potential claim on freely usable currencies of IMF members."[71] The purpose of SDRs is to help supplement existing reserves in developing economies, if a nation like Thailand needs more foreign currency they are able to exchange their SDRs for currency with another IMF member on a voluntary basis.

Like the World Bank loans the IMF agreements came with conditions. With the allocation of SDRs Thailand agreed to decrease its public savings-investment gap and foreign debt.[72] These conditions required Thailand to make changes to their monetary, credit, and fiscal policy; however, it was quickly discovered that Thailand was unable to meet the conditions because they were too strict. Eventually the IMF reconsidered its conditions and allowed Thailand to continue the SDR agreement. The purpose of the SDRs was to help Thailand get back on its feet economically by essentially giving Thailand more money to lower its deficits and implement new regulations.

The IMF also released annual reports that praised the newly prosperous nation. Thailand is consistently mentioned in the IMF's annual reports from 1990 to 1997 in a positive manner. The reports note Thailand's impressive growth, but do offer some suggestions to maintain the progress. However, the overall tone remains positive and is quick to assure Thailand that the nation is on the path to success. The reports have a similar tone to the World Bank's 1993 Miracle Economy Report. In the Annual Report from 1990 the IMF recognizes Thailand as a new member to the IMF after it accepted the Article VIII obligations which essentially make Thailand an active member of the international economic community.[73] It also comments that Thailand has made beneficial changes to open their economy. The 1991 report remarks on Thailand's successful market based economic policies and stable macroeconomic policies.[74] The report specifically calls Thailand's macroeconomic environment "relatively stable" which sends the message that Thailand should continue on the same path without the need for fundamental reforms. 1993 is the first time an IMF report mentions the "sharp increase in external borrowing in Asia, notably by Thailand and Korea" but makes no other comments or suggestions about the situation.[75] Finally in the 1994 report the IMF references a July 1993 seminar where sugges-

[70] Sahasakul, Thongpakde, and Kraisoraphong, "Lessons from the World Bank's Experience," 25.

[71] "Factsheet: Special Drawing Right (SDR)," *International Monetary Fund*, Nov. 30, 2015, http://www.imf.org/external/np/exr/facts/sdr.htm.

[72] Sahasakul, Thongpakde, & Kraisoraphong, "Lessons from the World Bank's Experience," 25.

[73] "1990 International Monetary Fund Annual Report" (IMF Report, 1990) 45. https://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1990.pdf

[74] "1991 International Monetary Fund Annual Report" (IMF Report, 1991) 8. https://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1991.pdf

[75] "1993 International Monetary Fund Annual Report" (IMF Report, 1993). https://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1993.pdf

tions for rapidly growing countries were discussed. The seminar had concerns that economies like Thailand could experience too much capital inflow and overheat. Their suggestions for Thailand and the other countries studied were "tightening of domestic credit policies… with the objective of reducing persistent inflation; and changes in conditions in external markets."[76] Thailand did implement some of these measures. The Bank of Thailand did raise interest rates and did engage in sterilization numerous times in the late 1980s and early 1990s. However the amount of money coming in to the country was too much to be fixed with sterilization.[77] The Thai government was proactive in following the suggestions of the IMF; however the recommendations were not tailored to Thailand enough to make a significant impact.

The 1995 report takes a deeper look into Thailand and does have a warning for the nation. The IMF cautions Thailand to watch rising inflation caused by unchecked demand but immediately follows its warning with, "the Board commended the remarkable performance of the Thai economy, which it attributed to the authorities' commitment to macroeconomic stability, a prudent fiscal policy, an increasingly open trading system, and flexible labor market."[78] It goes on further to support the moderate Thai government's moderate tightening of financial policies. The IMF still fully backed the liberalization of the Thai economy and the structural changes that were associated with it.

While the 1996 report does not mention Thailand the 1997 annual report has a similar message to the reports before it. The IMF recommends "a greater degree of exchange rate flexibility to improve monetary autonomy and to reduce incentive for short-term capital inflows."[79] Yet again the IMF follows up with the statement "the Directors strongly praised Thailand's remarkable economic performance and authorities' consistent record of sound macroeconomic policies."[80] This report was released just a few months before the July baht devaluation and the majority of Thai financial institutions going under. The portion discussing Thailand concludes that Thailand's strong economic fundamentals and manageable debt will keep Thailand strong. Looking back it is hard to understand how the IMF could have released this report in April already knowing that companies had begun defaulting in February and the stock market was rapidly losing value.

The 1997 IMF report illustrates that the international community did not anticipate a crisis in Thailand until it was undeniable. The IMF even predicted growth for Thailand to be 3.5 percent for the next year.[81] The IMF and World Bank honestly believed that their policies requirements and recommendations would lead to long-term sustainable growth for Thailand. Unfortunately their continual praise led to a false sense of stability and allowed a crisis to form underneath the notable numbers and compliments.

The evidence is clear; Thailand followed the recommendations and policy requirements given by the IMF and World

[76] "1994 International Monetary Fund Annual Report" (IMF Report, 1994,26). http://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1994.pdf

[77] Karel Jansen, "Thailand, Financial Crisis and Monetary Policy," *Journal of the Asia Pacific Economy* 6, no. 1 (2001): 131.

[78] "IMF Committee on Balance of Payments Statistics: Annual Report," *International Monetary Fund*, March 1996, https://www.imf.org/external/pubs/ft/bop/bopcmt95.htm.

[79] "Annual Report of the Executive Board of the Financial Year Ended April 30, 1997," *International Monetary Fund*, April 1997,https://www.imf.org/external/pubs/ft/ar/97/97imf.htm

[80] *Ibid*.

[81] Jeffrey Sachs, "The IMF and the Asian Flu," *The American Prospect*, March-April 1998, http://prospect.org/article/imf-and-asian-flu.

Bank. The Thai government had little say in the SAL agreement process and had every reason to default to the economic knowledge of the World Bank, an institution that was created to help developing countries become more economically prosperous. The IMF is also an international organization with a mission to promote stability. The IMF's mission is to "ensure the stability of the international monetary system – the system of exchange rates and international payments that enables countries to transact with each other."[82] Just like the World Bank it is understandable why Thailand would respect the IMF's opinion and follow their suggestions as well as take their praises seriously.

The IMF and World Bank have almost unparalleled international economic authority. But along with that much influence comes responsibility. When making loans it means that the World Bank has to be involved in understanding a developing country before they offer a loan program and give the nation's government a seat at the negotiating table. Thailand's economy quickly evolved from an agrarian economy to a newly modern industrial economy and a switch that drastic requires oversight and planning. The IMF and World Bank should have understood Thailand's political and economic history and how a drastic economic liberalization over a short time period was a risky change.

[82] "About the IMF," *International Monetary Fund*. https://www.imf.org/external/about.htm

CONCLUSION

All of the stories told by economists and scholars had an element of truth to them. The Thai government had a history of instability and numerous coups that made a united economic strategy difficult to establish. Corruption was and remains a constant issue in the Thai government and businesses and it did lead to polices that favored the few over the many. International investors waded into immoral territory when they created a self-fulfilling prophecy by speculating against the baht to seek out their own profit. But ultimately the IMF and World Bank hold the responsibility for laying the fundamental groundwork that allowed all of these other situations to take place.

The Thai financial crisis was not a completely unique occurrence or statistical anomaly. Its lesson are that impressive growth does not always indicate a healthy economy, financial liberalization is not an economic quick fix, and development in all sectors is not equal. The final lesson is one that even the United States struggles with after learning the same hard message that loans should not be lent to underperforming borrowers otherwise the result is the real estate bubble in Thailand or the housing bubble in America. Both the World Bank and the IMF had numerous chances to take a deeper look at Thailand and make important changes but instead decided to see Thailand's GDP growth as a signal of success and a fundamentally healthy economy.

Thailand needed to liberalize. By opening its doors to the rest of the world the residents of Thailand saw their income and quality of life increase in a way that could not have been duplicated without allowing foreign companies to invest within the Thai borders. However, the liberalization needed more oversight that could have prevented fewer risky loans from being lent. In addition further sterilization could have made the amount of borrowing in foreign currency more manageable. This change would have made Thailand's debt primarily domestic and if the baht did still have to float freely it could have prevented companies and financial institutions from going under because of the loans would not have been in U.S. dollars. On the other hand, it is possible that no amount of oversight from the World Bank or IMF could have saved Thailand from a financial crisis. It is impossible to speculate precisely what changes could have prevented the crisis, it is likely that less coercion from the World Bank and more serious recommendations from the IMF could have lessened the severity.

While each story had an element of truth in it, no story had outlined exactly what happened. I conclude that this explanation likely has missed a few pieces of evidence and details. However, overall the responsibility of the IMF and World Bank is clear. The economists who agree that international organizations are primarily to blame point out recklessness or selfishness as the justification for the economic organizations' actions. It is more likely that they truly believed that financial liberalization would lead to long-term success for Thailand. The greatest takeaway should be to continue to assist developing economies but in a way that pays closer attention to the specific conditions on the ground and also includes numerous serious reviews to make sure that any economic growth is not masking fundamental problems.

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