Unpopular Guardian

The Politics of Central Banking in Thailand, 1942-1997

by

Supanai Sookmark

**A Thesis Submitted to
the Faculty of Graduate Studies and Research
in Partial Fulfillment of the Requirements for
the Degree of Doctor of Philosophy
in Political Science**

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Abstract

For students of Thai political economy, the financial crisis of 1997 brought the Bank of Thailand (BOT) under the spotlight. The Bank's failure to prevent the crisis damaged its longstanding reputation as the country's staunch defender of financial stability. While many studies rightly point to the decline in the BOT's autonomy, reflected in the political interference with the Bank's financial supervisory role, as a major contributing factor to the crisis, some important questions remain around why the BOT decided to liberalize the financial system in the late 1980s and why it insisted upon pursuing a fixed exchange rate regime?

This thesis explains the path toward financial liberalization and crisis and the constraints on the Bank's policy choices during this period from a historical institutionalist perspective by focusing on the evolution of Thailand's monetary and financial policy and its connection with the BOT's relative autonomy. To begin, the thesis examines the origin of the Bank's commitment to monetary conservatism and international credibility and the formation of its behavioral autonomy from the 1940s to the 1960s to explain the BOT's leading role in monetary and financial management, despite its weak legal status. The institutionalization of the Bank within the context of authoritarianism and the Cold War is key to the making of this relative independence from the government, financial sector, and international financial community. As the BOT emerged as a leading monetary authority by the 1970s, it was able to push for various policy preferences guided by a conservative tradition and the desire to maintain international credibility. At times, the difficulty in balancing between domestic and

external obligations and demands arose to complicate the Bank's policy decisions. The move toward financial liberalization and the persistent pursuit of a fixed exchange regime will be explained based on this background together with other contributing domestic and external factors.

Apart from insight into Thailand's experience with financial liberalization and crisis, this thesis offers understanding of the Thai state's autonomy in monetary and financial policy from the interference of societal and external actors. That this autonomy eroded in the 1990s due to democratization and financial liberalization reflected the challenges to state power posed by political reform and global economic integration. Other contributions include the thesis's application of Selznick's institutionalism to the understanding of central bank 'de facto' independence, as well as a theoretical bridging among the three strands of new institutionalism in their understanding of preferences and actions.

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I became interested in international finance and the influence of the international financial system on developing countries when I began my doctoral program at Carleton University. The financial crisis of 1997, which originated in my home country, Thailand, triggered much curiosity regarding the danger of global financial integration and the role of national governments in managing an open financial system. Professors Jeremy Paltiel and Michael Dolan, in their capacity as advisor and thesis proposal supervisor respectively, helped me hone these interests into a dissertation project and kindly committed themselves to be on my dissertation committee, along with Professor Laura Macdonald.

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Chapter One

Introduction

On September 19, 2006, a group of high-ranking Thai military officers surprised the whole nation and the world by staging a coup to depose the popularly elected Thaksin government. Shortly after, the military-imposed cabinet, led by the former Army Chief, appointed M.R. Pridiyathorn Devakula, who was then Governor of the Bank of Thailand (BOT), to the posts of Deputy Prime Minister and Minister of Finance.¹ This appointment, not to mention his earlier nomination for the premiership, reflected Pridiyathorn's credibility largely derived from his former capacity as the head of the Thai central bank for the previous 5 years. While observers of Thai politics might not find an appointment of this nature so surprising since a number of top-ranking bureaucrats were appointed to various political portfolios under several military and civilian governments, it is important to take note of two developments. First, the assumption by Pridiyathorn of both cabinet roles represented a return of the old alliance between military and civilian bureaucrats and their continued power struggle with elected politicians. Second, his appointment, which raised the political profile of the BOT, put a break on the recent domination of elected officials over the central bank, a phenomenon which, to the concern of many observers, began to be institutionalized during the post-crisis era. Even though it is still too soon to assess the impact of the coup on the long-term character of

¹ He later resigned from both positions in late February 2007 citing media pressure and a rift with the government. See *Bangkok Post*, March 1, 1997, and *The Nation*, March 2, 1997.

the Bank-government relationship, the involvement of a BOT top leader with this struggle for power between the old and new political class was quite indicative of the Bank's important position in Thai politics and political economy.

To grasp the significance of the BOT in the current political context, one has to look back to the Bank's long history as a trusted and reputable institution. Since its inception in 1942, it has played an important role in helping Thailand maintain macroeconomic stability through many periods of economic disturbance. The Bank's firm commitment to, and unyielding pursuit of, its mandate in preserving price and currency stability was perceived as a source of continuity and strength while the country experienced countless waves of political turmoil and instability.² Its role in leading the Thai economy toward structural adjustment and financial liberalization in the 1980s was instrumental to the following rapid economic growth from the mid 1980s to the mid 1990s. This accomplishment earned the Bank not only a significant degree of legitimacy and influence in the areas of macroeconomic and financial policy, but also the recognition of its role as a protector of the public interest against the usurpation of power by certain societal groups.

Only during the period of financial crisis in the late 1990s was the Bank's reputation under serious challenge. Being unable to maintain stability in the financial sector and to defend the value of the baht, the Bank was widely blamed for the loss of confidence among foreign investors in the financial system and the national currency, a phenomenon that triggered a massive exodus of foreign capital. The politicization of the

² Since 1942, there have been 31 Prime Ministers, 52 Ministers of Finance, and 17 constitutions, compared to 21 Bank Governors and 1 Bank of Thailand Act. Dr. Puey Ungphakorn was the longest-reigning Governor. He was in office for 12 years (1959-1971). See Annex II for lists of Prime Ministers, Ministers of Finance, and central bank Governors.

Bank was one of the main reasons causing the decline in its autonomy and capacity to maintain monetary and financial stability. The Bank's loss of credibility was reflected in a number of crisis management measures and the public's reaction to the institution. For instance, the Bank was ordered to revamp its organizational structure by the IMF as part of the latter's conditionality to improve operational efficiency and organizational management. Two Bank Governors were removed from office in the midst of the crisis by the Chavalit and Chuan governments because of their handling of, and involvement in, the events leading to the crisis. A public inquiry was launched by the Chuan government to study the events precipitating the crisis, particularly policy mistakes leading to the loss of international reserves and excessive use of the Financial Institutions Development Fund (FIDF).³ The Nukul Commission, as the inquiry was called, blamed the Bank of Thailand for the launching of the financial liberalization process and named a number of BOT senior officials, including the Bank Governor, as responsible for the misuse of international reserves in the baht's defense. The repercussions from the report led to several resignations of BOT officials, who were either incriminated in the report or felt alienated by the political witch hunt.⁴ Having been a trustworthy and respectable institution for most of its history, these events signaled a severe decline in the Bank's institutional self-image, on which its influence was largely based. Many observers wondered why and how the BOT was brought to a point where it lost its capacity to

³ The FIDF, founded in 1985, was designed to provide primarily financial assistance to distressed financial institutions. Being under the BOT's control, it is considered the Bank's financial arms as it allows the Bank to extend its role as lender of last resort to the financial sector. It was reported that by the end of December 1997, the FIDF spent 700 billion baht in trying to revive illiquid financial institutions. See Sor-Por-Ror [Nukul Commission], *Raingarnphon Garnwikhlor lae Winitchai Khorhetjing Kiewkap Sathanagarn Wikrittagarn thang Settakit* [Analysis and Evaluation on Facts behind Thailand's Economic Crisis] (Bangkok: Thailand Development Research Institute, 1998), pp. 136-142.

⁴ Still in 2005 in a politically-motivated ruling, the Bangkok Civil Court ordered former Bank Governor Rerngchai Makaranond, to pay a fine of 186 billion baht (USD\$4.6 billion) for his negligence and mishandling of the baht defense. See *Bangkok Post*, June 1, 2005.

pursue its mandate and whether it would ever be possible to restore the loss of credibility and integrity. The political developments toward the end of 2006 may have confirmed the resilience and durability of the BOT in maintaining its place at the center of macroeconomic and financial management and the power relations between the bureaucratic and elected political elite.

This thesis is about the institutional history of the Bank of Thailand and its evolving role in the making of monetary and financial policy. My interest in the subject began at the height of the financial crisis of 1997 when the Bank was fighting an unwinnable war with foreign investors and speculators. The nature of this battle first raises questions about the relationship between the international financial system and emerging economies. Developing countries' need for foreign capital led many of them, including Thailand, to open up their capital account and commit to free capital movement in order to attract capital inflows. However, the commitment to free capital movement tended to limit state authorities' ability to maintain financial and monetary stability. The massive exodus of foreign investors from the Thai market in 1997 led to a major devaluation of the Thai baht and a gigantic amount of foreign debt, which inflicted grave damage to the economy. The IMF-approved crisis management measures to regain investors' confidence, such as the maintenance of high interest rates, budget tightening, and the commitment not to introduce capital controls, which instead plunged the domestic market into further recession, revealed a policy bias toward foreign investors at the expense of the whole economy. The unequal burden-sharing of the cost of the crisis between foreign creditors and domestic borrowers not only raised concerns about the

structural power of the international financial system, but also the ability of the Thai authorities to safeguard the economy and their accountability to domestic constituents.

Regardless of the validity of aspects of the ‘outward’ view of the crisis, criticisms of the role of the BOT in managing the exchange rate regime, defending the baht, and overseeing the financial sector inevitably led me to examine an ‘inward’ explanation for the crisis. The branding of Asian economies as ‘crony capitalism’ by many Western policymakers and observers brought to light the widespread corruption and abuse of political and financial power in these economies, including Thailand.⁵ The vast number of insolvent financial institutions that needed to be closed down revealed the mismanagement and unscrupulous lending symptomatic of an unsound financial environment.⁶ The politicization at the BOT and political interference from elected officials added to the central bank’s difficulties in managing the financial sector and the financial system as a whole. However, what seems to be the most damaging action in the eyes of the public was the BOT’s decision to adhere to a fixed exchange rate regime and to spend most of the international reserves in defending the indefensible baht. The failure of the Bank to make a timely change in the exchange rate policy and its blind determination to defend the baht at all costs led the public to project its anger primarily at the institution and the political context that gave rise to corrupt and unsound financial practices.

⁵ For example, see Helen Hughes, “Crony Capitalism and the East Asian Currency and Financial Crises”, *Policy* (Spring 1999): pp. 3-9. Thitinan Pongsuttirak also points to the ‘crisis from within’ in his explanation of the collapse of the financial system and the exchange rate regime. See Thitinan Pongsuttirak, *Crisis from within: the politics of macroeconomic management in Thailand 1947-1997*, (PhD. diss, London School of Economics and Political Science, 2001).

⁶ The authorities suspended 58 out of 91 finance companies by August 1997 and decided to close down 56 in December 1997.

At the center of criticisms and public outcry against the Bank lay the issue of central bank autonomy. The politicization of the Bank and political interference from politicians, which were seen occupying the institution in the mid 1990s, were the main factors negatively affecting its independence. An example can be seen in a controversial dismissal of a Bank Deputy Governor in 1994. Personal rivalry between the then Governor and one of his Deputy Governors was believed to be the main reason behind the collaboration between the Governor and the Finance Minister in removing the Deputy on the grounds of unethical conduct in relation to insider trading in the stock market.⁷ A revision in the BOT's list of financial companies needed to increase their capital in 1996 after it was submitted to the Ministry of Finance and the cabinet also reflected the institution's declining autonomy in financial institution supervision.⁸ The Bank's declining reputation, particularly with regard to its moral authority, added to the loss of autonomy. Governor Vijit's gainful investment in the stock market and his credit line with the Bangkok Bank of Commerce, which was concurrently under BOT scrutiny, raised concerns about conflicts of interest and the impartiality of the Bank's supervision over the financial sector.⁹ What made central bank autonomy a particularly important issue was not only the impact of political intervention on the Bank's performance, but also the contrast of the Bank's former image of a credible, competent, and relatively independent institution with what it had become in the mid 1990s. As many people associated Bank autonomy with its past successful performance in preserving monetary

⁷ To obtain evidence, it was reported that the Governor and the Finance Minister asked the National Security Council to listen to the Deputy Governor's phone conversations. After a legal battle, the dismissed Deputy Governor was exonerated from all charges, but was not reinstated to his former position.

⁸ Nukul Commission, *Analysis and Evaluation on Facts behind Thailand's Economic Crisis*, p. 127. Government interference resulted in the exclusion of certain finance companies which had ties with coalition party member from the original BOT's list. See also Thitinan, "Crisis from Within," pp. 252-253.

⁹ See for example, "Panel to Consider Vijit Supinit Share Acquisition in Siam City," *Bangkok Post*, March 19; and "Various Issues Obscure Reasons Why Vijit Quits", *Bangkok Post*, July 3, 1996.

and financial stability, the loss of autonomy and a decline in the Bank's competence, largely linked to the concurrent political context, were perceived to be detrimental to the country's macroeconomic and financial management. Accordingly, recommendations were made from many quarters in Thai society for the government to grant the BOT more legal autonomy to prevent future political interference. This proposal was strongly supported by the IMF, which also held the view that an independent central bank was largely instrumental to macroeconomic stability.¹⁰

Research Questions and Approaches

This thesis focuses on the issue of central bank autonomy and its implications to the making of monetary and financial policy of Thailand. The objective is to understand better not only the specific question of why the BOT was unable to prevent the financial crisis, but also broader questions of the basis and nature of Bank autonomy and the relationship between this autonomy and the forming and implementation of Thailand's monetary and financial policy. Accordingly, the thesis asks the following questions: what are the nature and sources of the Bank's relative autonomy? what is the relationship between BOT autonomy and the evolution of Thailand's monetary and financial policy? and how did the Bank's relative autonomy (or the lack thereof) shape its contribution to the causes of the 1997 financial crisis?

¹⁰ The IMF was consulted by the BOT in the process of drafting an amendment to the Bank of Thailand Act of 1942. The draft was presented to the Ministry of Finance in 1998. The bill sought to grant the BOT more legal independence from the government particularly by stipulating the Bank's policy objectives clearly and by having Bank Governor appointed by the Senate with a fixed term. Unfortunately, the Ministry of Finance did not approve of the bill. It was then returned to the BOT to be re-written. The Thaksin government further delayed the process of deliberation. It was not until December 2007 that the military-appointed National Legislative Assembly passed the bill. The new Bank of Thailand Act came into effect in March 2008. See a brief discussion of the passage of this law in chapter 7 (conclusion).

Through these questions, the thesis seeks to uncover the ‘making’ of Bank autonomy and its connection with the direction of the country’s macroeconomic and financial policy, as well as the ‘undoing’ or the decline of this independence and its repercussions on the BOT’s ability to maintain monetary stability. The focus on the concept of autonomy also leads the thesis to examine not only the relationship between the Bank and the government, particularly the Ministry of Finance, but also Bank interactions with international and societal actors in the pursuit of macroeconomic and financial sector management. This multi-dimensional aspect of Bank autonomy helps explain the different sources of influence and constraints that shaped Bank actions and the extent of its ability to pursue its mandate. Accordingly, the dynamics of this three-pronged relationship (Bank-government, Bank-societal actors, and Bank-international actors) are essential to, and definitive of, the nature of Bank autonomy at a given time and have direct implications for the development of monetary and financial policy.

By extending the inquiry beyond the scope of domestic politics and economy, the thesis is able to explore opportunities and constraints imposed by external forces, particularly the international financial and monetary systems, on the Thai state and society. As a state agent interacting with international actors and safeguarding the currency to maintain monetary stability and international creditworthiness, the BOT has been placed at the forefront of Thailand’s international economic relations in the interconnected world economy. Being integrated into the international economic system since the mid 19th century, Thailand’s monetary, exchange rate, and financial policy were largely influenced by outward considerations. This ‘international’ aspect of monetary and financial policymaking has direct implications for the country’s monetary autonomy.

It is only by examining the role of external forces in shaping the making of these policies that we will understand the nature of BOT independence and capacity more fully. It will be shown (in chapter 6) that external factors, particularly the structural power of the international financial system, played an important role in influencing the move toward financial liberalization in the late 1980s and in contributing to the vulnerabilities of the Thai financial system.

The interest in the connection between BOT autonomy and the making of Thailand's monetary and financial policy led me to pay special attention to the importance of history and institutions. With regard to the historical orientation, the thesis first presents the view that the relative autonomy of the Bank of Thailand is a product of history and therefore a focus on this historical development is central to the understanding of the subject.¹¹ By looking back into the past, the thesis traces the Bank's institutional history, which shaped its outlook in its formative years. The origin of the BOT, its inherited policy tradition, the struggle to maintain price and currency stability during the period of hyperinflation of the 1940s and 1950s, and the influence of its leaders in defining the Bank's relationship with the government, financial sector and international community, are all essential to the understanding of BOT relative independence.

A historical examination of this relative autonomy also needs to include an emphasis on the development of monetary and financial policy over time. First, the pursuit of these policies according to the Bank's preferences was among the goals behind

¹¹ See John Goodman, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, (Ithaca: Cornell University Press, 1992), p. 2. In examining the history of three European central banks, namely Germany, France and Italy, he argues that historical political struggles play an important role in shaping the varied degree of central bank independence among these countries.

the attainment of BOT independence. As the products of a policymaking process, which involved interactions largely between the central bank and the government and to a certain degree between the Bank and societal groups, the direction of Thailand's macroeconomic and financial policy can be used as indications of the Bank's ability to pursue its policy preferences. The BOT's leading role in launching a sweeping process of financial liberalization in the early 1990s tells us something about its relative autonomy, which was facilitated by the political consensus toward the policy and a brief return of a sympathetic, military-installed, technocratic government. Secondly, as the Bank's autonomy did not derive solely from the law, but also from how it was being perceived by other actors, an investigation into the effectiveness of monetary and financial policy also provides an understanding of the connection between the Bank's capacity, which was a part of its character (or identity), and its influence. As the thesis discusses in chapter 3, the relative macroeconomic and financial stability from the early 1950s to early 1970s played an important role in shaping the Bank's credible and competent image, which in turn enhanced its influential role in the succeeding eras. Third, a focus on the history of monetary and financial policy also reveals the emergence of certain policy preferences, which came to define the Bank's policy orientation and choices of policy instruments. By accounting for the origin of the BOT's policy tradition, namely monetary conservatism with its liberal assumptions, this thesis seeks to uncover the Bank's underlying perception of what constituted effective monetary and financial policy as well as what it viewed as desirable in the macroeconomic conditions and financial landscape. That the origin of the BOT's conservative monetary tradition was linked to the need to maintain international credibility, which at the time of colonialism

was instrumental to the preservation of monetary sovereignty, reflects the long-standing repercussions of the country's integration in the international political economy and its dependence on foreign capital. It is therefore important to keep in mind the power structure of the international monetary and financial system and its impact on the Thai monetary authorities' policy choices, concurrent with reviewing policy traditions and preferences as products of past successes (or failures in case of some preferences) in bringing about macroeconomic and financial stability. By tracing the Bank's policy tradition and preferences, this thesis seeks not only to explain the rationale behind the direction of monetary and financial policy, but also to demonstrate how the Thai authorities managed to keep a good balance between the competing international and domestic responsibilities, i.e., the maintaining of international credibility without compromising the interests of domestic groups too much.

The emphasis on institutions also requires some elaboration. First, the controversy around the issue of central bank autonomy and its implications on Thailand's monetary and financial policy necessitates a focus on the Bank of Thailand as the main actor and subject of this inquiry. This treatment of the Bank as a relatively independent state institution, which is capable of acting autonomously from other state institutions and societal groups, is premised on a theoretical assumption about state autonomy, which will be discussed in more detail shortly. An examination of the interaction and relationship between the Bank and other actors, particularly the government, financial sector, and international financial institutions, in the designing, forming, and implementing of monetary and financial policy, is aimed at shedding light on the evolutionary role of this state institution in the area of macroeconomic and financial sector management.

Second, the focus on the Bank as a relatively autonomous institution leads to its treatment as an actor whose actions, interests and preferences are influenced by both the internal and external environments. Here is where the two aspects of institutional orientations meet in this thesis. The treating of ‘institutions’ as independent and adaptive actors partly allows this thesis to look inward to the internal dynamics of the Bank as sources of its values and character (or identity), which are largely determinative of its actions and preferences. Nevertheless, as the Bank acts and interacts in larger socio-political, economic and international contexts, it is also significantly affected by these ‘institutions’ as they inhibit certain rules and orders that control and shape actors’ actions and perceptions at a particular time and space. The focus on these two aspects of institutional analysis allows the thesis to take into account the BOT’s organizational and external contexts in explaining its role and ability in the making of monetary and financial policy.

Third, an institutional analysis helps address the issue of continuity and change in Thailand’s monetary and financial policy. The long-term commitment of the Thai authorities to conservative monetarism since the post-war period, largely seen in the deflationary bias and fixed exchange rate regime, was facilitated by the political, economic, and international context. The dominant role of economic bureaucrats in economic policymaking under authoritarian governments, the ongoing threat of inflationary pressures, particularly from government deficit spending, and the endorsement from the international financial institutions for this type of macroeconomic policy, all in one way or another played an important role in shaping the political consensus toward these policy traditions. Of equal importance, the emergence of

conservative monetary policy as Thailand's macroeconomic orthodoxy can be understood as part of the institutionalization of the BOT in the 1950s. That this policy paradigm was strengthened by the context of structural adjustment in the late 1970s and early 1980s, in which the BOT played an important role in macroeconomic policymaking with the support of the World Bank and IMF, also reflects the institutional context behind this policy continuity.

The launching of the process of financial liberalization by the Bank of Thailand in late 1980s and early 1990s demonstrates both elements of continuity and change. In the broader scheme of things, financial liberalization fits into the long-standing liberal inclination of the BOT, seen in a number of its policy stances such as its support for a non-interventionist role for government and exchange rate liberalization. However, with regard to financial policy, particularly the openness of the financial system, the Bank showed a significant degree of caution, seen in its long-standing protectionist policies toward domestic financial institutions. An examination into the nature of the financial system, the relationship between the Thai authorities and the financial sector, and the receptivity of the authorities to different types of foreign capital largely influenced by the concurrent international organization of credit and the availability of credit to the public and private sectors, helps explain the gradual change in financial policy, which culminated in a sweeping process of financial liberalization in the early 1990s.

Finally, a focus on the change-resistant aspect of 'institution' allows this thesis to explain why certain changes to the Thai monetary and financial policy did not take place. For example, the idea of path dependence provides a useful conceptual tool for understanding the longevity of conservative monetary policy and the minimal impact

created by the experiment with developmentalism in the early 1970s. Not only was the Bank's experiment in credit allocation short-lived due to economic disturbances and the more immediate commitment to fiscal and monetary restrictions under structural adjustment policy, the nature of the preferential credit allocation schemes themselves was rather piecemeal and arbitrary so that hardly any significant incentive structures were created. To those who seek to understand the financial crisis of 1997, path dependence can also be applied to explaining the complications surrounding the BOT's attempt to maintain a fixed exchange rate regime during the period of financial liberalization and that policy's growing incompatibility with the new financial context. The failure of the Bank to abandon the fixed exchange rate policy and adopt more effective financial institution supervisory measures to prevent the crisis revealed at the same time the difficulties in breaking away from the old policy framework and the institution's lack of political and organizational capacity to overcome such difficulties.

Main Arguments and Contribution

In the following chapters, I argue that the BOT's autonomy is multi-dimensional in nature and that we need to distinguish among its various aspects, i.e., legal, behavioral, and relational, and examine how these different aspects interact to contribute to the Bank's ability to pursue its policy preference at a given time and over time. The thesis will show, through historical examination, that the BOT's legal status, its credibility, and relationship with key actors in monetary and financial policy have been important factors shaping the dynamic of the agency's relative independence, which varies from policy to policy and across time. It will also be demonstrated that the Bank's autonomy is a result

of both its own making and a number of contributing factors. As a political actor, the Bank itself has played an important role in building and maintaining its own autonomy. The ability of BOT leaders to take advantage of available opportunities and to use different strategies to enhance the organization's influence and bargaining power has been central to the pursuit of its policy mandate. Certain factors also contributed to the shaping of the BOT's relative independence. Political consensus among political leaders on a specific policy issue has allowed the Bank to function relatively freely from government interference. Mutual interests of monetary authorities and financial institutions have been an important basis for the latter's cooperation, while the central bank's financial leverage, particularly as lender of last resort, contributed to its authority over the financial sector. International credibility and shared policy preferences helped the BOT maintain its independence from external actors, including the international financial institutions and international financial community.

To the question of the relationship between the BOT's relative autonomy and Thai monetary and financial policy, I argue that central bank autonomy largely accounted for the continuity in the country's conservative monetarism. The connection between Thailand's conservative inclination and monetary sovereignty formed during the colonial period was the beginning of the BOT's longstanding policy preference. The fact that the Bank was able to build and maintain its relative autonomy from the government throughout most of its post-war history contributed to the agency's ability to pursue conservative monetary policy to achieve price and currency stability. Central bank autonomy was also an important factor permitting the Bank to introduce changes to monetary and financial policy. We will see in chapter 5 and 6 that the BOT's credibility,

which served as the main basis for its behavioral independence, largely allowed the organization to experiment with preferential credit allocation schemes in the early 1960s and to launch a sweeping process of financial liberalization in the late 1980s. The Bank's ability to pursue both its policy tradition and other context-specific preferences, facilitated by its relative autonomy, is central to our understanding of the continuity and change in Thailand's monetary and financial policy.

With regard to the causes of the financial crisis, this thesis brings attention to both the context and mechanisms which led to the collapse of the financial sector and the fixed exchange rate regime. It will be argued that changes in the Bank's political, financial, and organizational context in the early 1990s contributed to the decline in the agency's relative autonomy and operational capacity. While parliamentary politics encouraged elected officials to play a more active role in monetary and financial policy, the financial liberalization process compromised the Bank's ability to control capital movement. Organizational changes, which saw increased internal rivalry, politicization, and declining moral authority and technical expertise, further undermined the agency's credibility and capacity to pursue its mandate. In discussing the mechanisms leading to the collapse of the financial sector and the fixed exchange rate regime, I argue for a differentiated view of central bank autonomy. Whereas political interference in the BOT's financial supervisory role indicates a decline in its independence from the government in this area, the Bank's persistent pursuit of the fixed exchange rate policy, regardless of external criticism, reveals the organization's final authority in exchange rate management. It is important that we examine these policies separately to better understand the different implications of the BOT's varying autonomy on its performance.

The major contribution of this thesis is in its institutionalist approach to the understanding of the Thai central bank's independence and the evolution of Thailand's monetary and financial policy. More specifically, the thesis speaks firstly to the issue of state autonomy in the management of monetary and financial affairs. To a large extent, a contextual examination of the BOT's interactions with key actors in the pursuit of its mandate and development goals over the course of history illustrates the insights of the existing literature on the Thai state, particularly Fred Riggs' model of bureaucratic polity (for the period between the 1940s and 1970s) and the challenge to this polity by societal forces seen in the more recent works (since the 1970s).¹² But the institutionalist approach also allows this thesis to reveal other aspects of the Thai state and its autonomy beyond the state-society dichotomy. First, the investigation of the Bank's relationship with the government demonstrates the diverse elements of the Thai state, involving different state institutions and agencies which do not necessarily share the same goals and preferences. While this differentiation is rather conflated in the bureaucratic polity model, the disagreement between the Bank and the military governments, particularly in the 1950s, over monetary and fiscal policy reflects an internal struggle for power and control over these policy areas among state actors.¹³ Second, by tracing the making of the BOT's relative independence, particularly the institutionalization process which gave rise to the agency's credible institutional character, we are able to see the impersonal/organizational

¹² See Fred Riggs, *Thailand: The Modernization of a Bureaucratic Polity*, (Honolulu: East-West Center, 1966). For societal challenge to the bureaucratic polity, see Anek Laothamatas, *Business Associations and the New Political Economy of Thailand*, (Boulder: West View, 1992); Benedict Anderson, "Withdrawal Symptoms: Social and Cultural Aspects of the October 6 Coup," *Bulletin of Concerned Asian Scholars* 9, (1977): 13-30; Sungsidh Piriyarangsarn and Pasuk Phongpaichit, eds. *Chon-chan Klang bon Krasae Prachathipatai Thai* [The Middle Class on the Path of Thai Democracy], (Bangkok: Chulalongkorn University, 1993).

¹³ For criticism of Riggs' s bureaucratic polity model, see, for example, James Ockey, "State, Bureaucracy and Polity in Modern Thai Politics," *Journal of Contemporary Asia* 34, no. 2 (2004): 143-162.

basis of state autonomy, apart from the elitist and personalistic concept of power perceived by Riggs and other scholars.¹⁴ Third, the thesis shows that the construction and maintenance of state autonomy in monetary and financial policy was largely an outcome of the balancing between internal and external interests on the part of the monetary authorities. The BOT's ability to mediate between the demands of domestic and external actors is key to the success of the state in preserving its relative autonomy from both societal and external interference over the years. In chapter 6, the thesis demonstrates that this ability was undermined by the 1990s context of financial liberalization and democratization.

This thesis also speaks to the literature on central bank independence. The main contribution lies in the differentiated view of autonomy and the central role of history and institutions in the studies of central banking politics. While the main literature acknowledge the different types of autonomy, particularly legal and behavioral, most attention has been paid to the legal framework (central bank legislation) as the major indicator of central bank independence.¹⁵ This thesis's focus on the BOT's relative

¹⁴ The elitist view is commonly seen in the Thai state literature. The perception that power lies within the cabinet and high-ranking military and civilian bureaucrats can be seen in various works, such as those of Riggs, Rangsang, Hewison, and Medhi. The personalistic concept is often used to describe the power struggle among political cliques and political parties. See Riggs, *Thailand: The Modernization of a Bureaucratic Polity*, p. 329; Rangsang Thanaphonphan, *Krabuankan Kamnot Nayobai Setthakit nai Prathet Thai: Botwikhro Cheng Prawatsat Setthakitkanmuang phor-sor 2475-2530* [The Decision-Making Process in Economy Policy in Thailand: a Historical/Political Economy Analysis from 1932-1987] (Bangkok: Social Science Association of Thailand, 1989); Kevin Hewison, "Of Regimes, State, and Pluralities: Thai Politics Enters the 1990s," in *Southeast Asia in the 1990s*, eds. Richard Robison, Kevin Hewison, and Garry Rodan. (St. Leonard, NSW: Allen and Unwin, 1993); and Medhi Krongkaew, "An Alternative Interpretation of Economic Policy Determination in Thailand: An Important Interplay of Bureaucracy, Political Power and Private Business," (Tokyo: Foundation for Advanced Studies on International Development) *FASID-IDRI Occasional Paper Series*, no. 12, (1997). For the personalistic view see Thak Chaloemtiarana, *Thailand: the Politics of Despotism Paternalism*, (Bangkok: Social Science Association of Thailand, 1979); and Duncan McCargo, "Thailand's Political Parties: Real, Authentic and Actual," in *Political Change in Thailand: Democracy and Participation*, ed. Kevin Hewison (London: Routledge, 1997). For analysis of the studies of the Thai state see also Ockey, "State, Bureaucracy and Polity in Modern Thai Politics," p. 142.

¹⁵ See, for example, Alex Cukierman, *Central Bank Strategy, Credibility, and Independence: Theory and*

autonomy, regardless of its weak legal status, brings attention to the disparity between legal and behavioral independence, which remains under-theorized in the literature. I argue that Philip Selznick's insights on the institutionalization process of an organization (which will be discussed in more detail in the next section) help us explain the Bank's credibility, based on its technical expertise, moral authority, and guardianship of national interest, that enabled the agency to pursue its policy mandate quite independently in the past.¹⁶ By treating the BOT both as an institution and political actor, this thesis differs from many works in the field that view central bank independence as a result of extraneous factors.¹⁷ As the following chapters will demonstrate, the Bank itself has played an important role in building and preserving its relative autonomy by taking advantage of the political, economic and international context and resorting to various available strategies.

Finally, this thesis seeks to contribute to the understanding of the evolution of Thailand's monetary and financial policy, particularly since the colonial period to the financial crisis of 1997. My main contribution here lies in the focus on the sources of

Evidence, (Cambridge: The MIT Press, 1992); John Goodman, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, (Ithaca: Cornell University Press, 1992); and William Bernhard, *Banking on Reform: Political Parties and Central Bank Independence in the Industrial Democracies*, (Ann Arbor: University of Michigan Press, 2002).

¹⁶ Philip Selznick, *Leadership in Administration: a Sociological Interpretation*, (Berkeley: University of California Press, 1957), introduction.

¹⁷ A large constellation of work on central bank autonomy seeks to uncover the contributing factors behind the institutional design of a central bank. Having central bank independence as the dependent variable, many authors focus on domestic political factors, such as the business cycle model, partisan and ideological preference, and interest group influence, in explaining why politicians, particularly those in advanced industrial democracies, choose to grant independence to their central banks. For examples of these works, see William Nordhaus, "The Political Business Cycle", in *Review of Economic Studies*, Vol. 42, 1975 for the first example. See also Douglas Hibbs, "Political Parties and Macroeconomic Policy", in *American Political Science Review*, Vol. 71, 1977 for the partisan model; Delia Boylan, *Defusing Democracy: Central Bank Autonomy and the Transition from Authoritarian Rule*, (Ann Arbor: University of Michigan Press, 2001) for the 'tie the hand' model; William Bernhard, *Banking on Reform*, for the coalition stability view; and Sylvia Maxfield, "Financial Incentives and Central Bank Authority in Industrializing Nations", *World Politics*, Vol. 46, 4, 1994 for the interest groups approach.

these policies. By establishing that the BOT enjoyed relative autonomy in monetary and financial management, I am able to pay particular attention to the shaping of Bank preferences as an important explanation for the continuity and change in these policy areas. My argument that the BOT's political, ideological, and normative considerations were in one way or another accounted for by its policy preference at a given time offers a multi-faceted understanding of the sources and influence of Thailand's monetary and financial policy. This argument also has a theoretical implication. By demonstrating that political actors do not merely act upon their self-interest, but are also influenced by other factors, such as traditions, beliefs, and normative commitment, I demonstrate the possibility of a theoretical bridging among the three strands of institutionalism, namely Historical, Rational Choice, and Sociological/Organizational Institutionalism, whose differences used to be seen as irreconcilable.¹⁸ This theoretical issue will be discussed in the next section.

Another contribution is in the understanding of the events leading to the financial crisis of 1997. While I join a great number of works that hold views that are critical of the process of financial liberalization,¹⁹ my arguments differ from them at least in at least two respects. First, I place the issue of central bank autonomy at the center of my explanation and demonstrate that the BOT's relationship with the government, financial sector, and international financial community is key to our understanding of not only why

¹⁸ For example, see Kathleen Thelen and Sven Steinmo, "Historical Institutionalism in Comparative Politics," in *Structuring Politics: Historical Institutionalism in Comparative Analysis*, eds. Kathleen Thelen, Sven Steinmo, and Frank Longstreth. (Cambridge: Cambridge University Press, 1992); and Ira Katznelson and Barry Weingast, eds. *Preferences and Situations: Points of Intersection between Historical and Rational Choice Institutionalism*, (New York: Russell Sage Foundation, 2005).

¹⁹ For example, Robert Wade, "The Asian Debt-and-Development Crisis of 1997-199-?: Causes and Consequences," *World Development*, 26, no. 8 (1998): 1535-1553; T. J. Pempel, ed. *The Politics of the Asian Economic Crisis*. (Ithaca: Cornell University Press, 1999); and Joseph Stiglitz, *Globalization and Its Discontents*, (New York: W.W. Norton, 2002).

the Bank failed to manage the financial system properly after the financial liberalization process, but also why it decided to adopt the policy in the first place. In this regard my historical examination of the change in the monetary authorities' receptivity toward foreign capital, largely shaped by their attempt to balance between monetary autonomy and economic gains, offers an original understanding of the process of financial liberalization. Secondly, the institutionalist approach allows me to explain the Bank's persistence in pursuing a fixed exchange rate and financial bail-out policy until the outbreak of the crisis from a path dependence perspective.²⁰ The institutionalization of these policies at the BOT, seen in their legitimacy, organizational resources (e.g. the establishment of the Exchange Equalization Fund to defend the value of the baht and the Financial Institution Development Fund to rescue insolvent banks and finance companies), and policy constituencies, made it difficult for the agency to change the course of their operation toward new and uncharted territories. These 'lock-in' phenomena bring our attention to organizational obstacles facing the monetary authorities apart from the politicization of the BOT and financial policy.²¹

This thesis discusses its main findings and contribution at length in the conclusion.

The next sections deal with the theoretical orientation, methodology, and thesis outline.

²⁰ For a discussion of the concept of path dependence, see Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," *American Political Science Review* 94, no. 2 (2000): 251- 267; and Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis*, (Princeton: Princeton University Press, 2004), chapter 1.

²¹ The politicization of the BOT and financial policy is widely accepted as a major contributing factor to the crisis by works from various orientations. For example, see Nukul Commission Report, 1998; Pasuk Phongpaichit and Chris Baker, *Thailand's Boom and Bust*, (Bangkok: Silkworm Books, 1998); and Stephan Haggard, *The Political Economy of the Financial Crisis*, (Washington, D.C.: Institute for International Economics, 2002). It is also a central issue of two works that particularly examine the role of the Bank of Thailand in contributing to the crisis, including, Thitinan Pongsuttirak, "Crisis From Within", 2001, and Apichat Satitniramai, "The Rise and Fall of the Technocrats: the Unholy Trinity of the Technocrats, Ruling Elites, and Private Bankers and the Genesis of the 1997 Financial Crisis," Ph.D. diss, University of Wales, 2002.

Theoretical Framework

As stated earlier, this thesis draws its theoretical framework from institutionalist theory, which has been gaining much attention in the field of Political Science over the past two decades. The first strand of theoretical influence comes from the ‘new institutionalism’. The emphasis of this diverse group of theorists on the importance of institutions in shaping political interactions among state and societal actors provides useful conceptual tools, particularly the understanding in this approach of state autonomy, preferences and actions, and institutional continuity and change. The thesis also draws from an ‘older’ school of institutionalism. The sociological/organizational branch of institutional studies led by Philip Selznik offers insightful perspectives on the understanding of the Bank of Thailand as an institution. The process of institutionalization of the Bank, which resulted in the formation of BOT institutional characters and value commitment, is key to the understanding of the informal sources of Bank relative autonomy based on its legitimacy. A discussion of these theoretical frameworks is as follows.

State Autonomy

In response to the dominant theoretical paradigm of the 1980s, scholars writing in the new institutionalist approach in North America began to bring attention to the view of states as potentially independent actors. In their seminal work, *Bringing the State Back In*, Evans, Rueschemeyer, Skocpol, and other contributors sought to argue for the relative autonomy of the state and employ a comparative historical method to discover the

determinants for such attributes across countries and over time.²² In doing so, they aimed to contribute to the understanding of “the circumstances under which those who command particular sorts of state apparatuses are likely to pursue autonomous goals and the conditions under which they are likely to be successful in their pursuits.”²³ Their historically-embedded, middle-range theory provided useful and timely insights to the understanding of state-society relations and the implications of state organization on its capacities and actions. Bridging the work of influential pioneers before them and more recent waves of scholars writing on both developed and developing states, this broad movement offers a great contribution to the understanding of the state as an indispensable analytical category in political inquiry.²⁴

This thesis bases its understanding of the Bank of Thailand on this theoretical and methodological tradition. At a broader level, a Weberian view of state autonomy resonates with my perception of the BOT. As a state agency responsible for monetary and financial management, the Bank has had the authority and organizational capacities

²² Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol eds., *Bringing the State Back In*, (Cambridge: Cambridge University Press, 1985).

²³ Ibid., p. 3

²⁴ Pioneer works include those of Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World*, (Boston: Beacon Press, 1966); Reinhard Bendix, *Nation Building and Citizenship: Studies of Our Changing Social Order*, (New York: Anchor Book, 1969); J.P. Nettl, “The State as a Conceptual Variable,” *World Politics* 20 (1968); Peter Katzenstein (ed.), *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States*, (Madison: University of Wisconsin Press, 1978), and Stephen Krasner, *Defending National Interest*, (Princeton: Princeton University Press, 1978). The newer wave includes works by Peter Hall, *Governing the Economy: the Politics of State Intervention in Britain and France*, (Cambridge: Polity Press, 1986); Theda Skocpol, “Bringing the State Back In: Strategies of Analysis in Current Research,” in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, (Cambridge: Cambridge University Press, 1985), and Susan Berger, “Introduction,” in *Organizing Interest in Western Europe*, ed. Susan Berger, (Cambridge: Cambridge University Press, 1981). Also in this tradition are works on the developmental role of the state, such as Chalmers Johnson, *Japan, Who Governs?: the Rise of the Developmental State*, (New York: W. W. Norton, 1995), Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, (Princeton: Princeton University Press, 1990), Stephen Haggard, *Macroeconomic Policy and Adjustment in Korea, 1970-1990*, (Cambridge: Harvard University Press, 1994), and Jung-en Woo, *Race to the Swift: State and Finance in Korean Industrialization*, (New York: Columbia University Press, 1991).

to maintain control over these policy areas. The society-wide and external impact of monetary and financial policy, particularly the fluctuation of prices and the value of the national currency, led Bank officials to view themselves as protectors of the national interest, therefore being more likely to adopt an independent policy stance. As a key government agent in conducting business and negotiations with international financial institutions, the BOT has also enjoyed a significant degree of freedom in shaping the nature of these interactions. The Bank's legal, administrative and organizational advantages over other state and societal actors have also served as an important source of Bank relative autonomy, particularly from outside interference. However, in order to develop a firmer grasp of the nature of BOT autonomy, it is important to examine separately, The Bank's relationship with different sets of key actors central to monetary and financial policy, namely the government, financial sector, and international financial institutions, while trying to account for both contributing and hindering factors toward its autonomy within each relationship. With regard to BOT-government interactions, this thesis is in agreement with most central bank independence literature that the legal basis of this relationship, which has its roots in a particular historical context, has played an important role in defining the degree of Bank relative autonomy from its principal.²⁵

Nevertheless, it is equally important to take into account informal factors, particularly policy consensus and BOT legitimacy, in allowing the Bank to maintain its independence in its operations and in pursuing its policy preferences. The nature of the government regime also has had a role in contributing to the Bank's relative autonomy in various periods. Military governments' reliance on economic bureaucrats in economic

²⁵ For example, see John B. Goodman, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, (Ithaca: Cornell University Press, 1992) and Alex Cukierman, *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*, (Cambridge: The MIT Press, 1992).

policymaking and their concentration of power allowed for technocratic autonomy. Democratically elected governments, on the other hand, have tended to assert their authority over bureaucrats, partly to exercise their electoral mandate, and therefore have been likely to play more active and interventionist role in public policy processes. Regardless of the tendency for technocratic autonomy in authoritarian regimes, both types of government have been no stranger to policy conflicts. By examining the circumstances leading to policy conflicts, which were largely the causes of past government interventions, and those of policy consensus, one would be able to understand better the nature of the Bank's relative autonomy from the government.

Another set of relationships concerns that of the Bank and the domestic financial sector. The 'interdependent' nature of this relationship makes BOT-financial sector interactions differ from the 'principal-agent' relations between the Bank and the government. The ability of the BOT to implement financial policy effectively depends largely on cooperation from financial institutions, while the latter rely on the Bank as their lender of last resort and other services, including protection from foreign competition. Financial institutions' dependence on BOT financial rescue and protection serves as leverage for the Bank to pursue its own policy preferences independent from the financial community.²⁶ In the past, it did not always enjoy this leverage. Its limited financial resources, partly due to its obligations to finance government deficit spending, and the availability of private credit in both domestic and external markets to commercial

²⁶ Generally, the financial sector and the central bank share a preference for conservative monetary policy. As most financial institutions benefit from price and currency stability, they tend to support central bank deflationary bias. Authors, such as Maxfield and Posen, focus on financial sector support of central bank conservative monetary policy to explain the reasons behind central bank independence. See Sylvia Maxfield, "Financial Incentives and Central Bank Authority in Industrializing Nations", *World Politics* 46, No. 4, (1994), and Adam S. Posen, "Why Central Bank Independence Does Not Cause Low Inflation: There is No Institutional Fix for Politics," in R. O'Brien, (ed.), *Finance and the International Economy* 7, (Oxford: Oxford University Press, 1993).

banks, prevented the Bank from establishing control through financial allocation. The close relationship between commercial bankers and military leaders also served as a major obstacle to the BOT's supervisory role over financial institutions. By looking at the contributing factors which allowed the Bank to increase its influence over the financial sector over time, which in turn permitted it to pursue its policy preferences, particularly the launching of the financial liberalization process in the late 1980s, one can comprehend better the evolution of the BOT-financial sector relationship, which constituted an important aspect of the Bank's relative autonomy from societal forces.

It needs to be noted that to a certain degree the relationship between the Bank and the government may be considered as state-society relations. This perspective may be particularly suitable to the period since the late 1980s when party politics became more institutionalized. The change in the composition of cabinet members from predominantly ex-bureaucrats to those who had a business background signaled a shift in the nature of the contemporary political class. The attempts of party politicians to assert more authority in public policymaking, partly to fulfill their electoral mandate and sectoral representation, may invoke the neo-Marxist interpretation of the penetration of societal forces, particularly those of the capitalist class, into state institutions. This thesis takes into account this analytical categorization but seeks not to overstate the dichotomy between state and society and between authoritarian and democratic governments. Its main concern lies in the changes democratically elected regimes brought to the policy consensus in macroeconomic and financial management among political leaders and how that phenomenon affected the Bank's ability to pursue its policy mandate independently.

It will also touch upon the implications of the struggle to maintain state control over monetary and financial policy for the nature of Thailand's development process.

The relationship between the Bank and international financial institutions also provides insight into the idea of state autonomy from external actors. Since the post-WWII era, threats to Thailand's monetary sovereignty have not been as clear as those in the colonial and wartime period. Then the fear of colonization and military takeover by the Europeans and Japanese led the Thai authorities to pursue monetary policy aiming to preserve national sovereignty, while accepting some trade-offs.²⁷ For example, the attempt to maintain a high level of international reserves since the 1920s in order to make the baht stable and convertible occurred at the expense of development spending. In the post-WWII period, external pressures on state autonomy in the areas of monetary and financial policy did not come as direct threats but rather in the form of policy recommendations, such as those posed by IMF and World Bank conditionalities.²⁸ To the extent that Thailand, like many other developing countries, is dependent on foreign investment and credit, and therefore needs to maintain international credibility, it can be argued that the authorities' ability to make policy choices has been significantly constrained by this consideration. It will be shown that in many circumstances, the need to maintain creditworthiness has led to the implementation of monetary and financial

²⁷ During the colonial period, the fear that financial irresponsibility of the state would be used as a pretext for colonial takeover led the Thai leaders to adopt conservative monetary and fiscal policy to maintain macroeconomic stability. Upon the eve of the Pacific War with the absence of a central bank, the Japanese government proposed to the Thai government to establish a central bank staffed with Japanese advisors and personnel. The fear of losing monetary sovereignty prompted the Thai leaders to reject the proposal and urgently establish the Bank of Thailand in 1942. The Japanese also made several requests with regard to monetary policy, including the forced devaluation of the baht.

²⁸ See Tony Killick, *Aid and the Political Economy of Policy Change*, (London: Routledge, 1998); Devesh Kapur and Richard Webb, "Governance-Related Conditionalities of the International Financial Institutions," *G-24 Discussion Papers Series* No. 6, (August 2000), and Ariel Buira, ed. *Challenges to the World Bank and IMF: Developing Country Perspectives*, (London: Anthem Press, 2003).

policy that might be seen as accommodative toward the external sector at the expense of certain domestic groups. Nevertheless, state autonomy was still exercised through certain areas of leeway or in the details of policy implementation. The discussion in chapter 3, 4, and 6 of how the BOT was able to keep the financial sector relatively closed from foreign competition until the 1990s provides an example of this dynamic.

Policy convergence between the BOT and the IFIs adds an interesting dimension to the understanding of state autonomy from external pressures. The BOT's inclination toward macroeconomic conservatism, non-interventionism, and economic liberalization resonates with much of IMF and World Bank policy recommendations over the last two decades. On many occasions, the Bank was seen as using the influence of these international financial institutions to help it convince the government of the need for policy changes. While it may be argued that policy convergence replaced the intrusive and coercive elements of policy recommendations and conditionalities from external actors, it is important to examine the sources of BOT policy preferences to understand the constraints imposed on its policy options.²⁹ What is of particular significance to this thesis is how financial liberalization, another convergence with the global movement of financial deregulation and IFI policy paradigm, affected the Bank's ability to preserve Thailand's macroeconomic and financial stability.

Preferences and Actions

This thesis draws from the theory of new institutionalism with respect to how institutions shape the actions and preferences of political actors. Despite the controversy

²⁹ See a discussion of the various natures of IMF conditionalities in Ariel Buira, *Challenges to the World Bank and IMF*, chapter 3.

between supporters of rational choice and historical institutionalism (RCI and HI), both offer useful and complementary insights as to how preferences and actions are formed. Rational choice institutionalists, basing their perceptions of individual behavior on neoclassical theory in economics, tend to view political interactions as a result of actors' strategic calculation in order to maximize their interests. However, they depart from their neoclassical counterparts in seeing that strategic calculation does not occur in a political vacuum, and that institutions play an important role in shaping actors' understanding and selection of their strategies. RCI scholars like Shepsle, North, and Bates focus their analysis on the role of institutions, defined as both formal and informal rules, norms, procedures, and conventions, in constraining actors' behavior and political outcomes.³⁰ HI's attention on institutions comes from different theoretical perspectives.³¹ Even though they share the idea that institutions constrain actors' preferences and actions, they seek to problematize the motivations behind actors' behavior (i.e., interest maximization) and the process of preference formation. HI theorists, such as March and Olsen, argue that political actors do not always act to maximize their interests but 'associate specific actions with specific situations by rules of appropriateness'.³² In other

³⁰ See Kenneth Shepsle, "Institutional Equilibrium and Equilibrium Institutions," in *Political Science: the Science of Politics*, ed. Herbert Weisberg, (New York: Agathon, 1986); Douglass North, *Institutions, Institutional Change and Economic Performance*, (Cambridge: Cambridge University Press, 1990); and Robert Bates, *Essays on the Political Economy of Rural Africa*, (Berkeley: University of California Press, 1987).

³¹ Contributors to HI bring their insights from various academic disciplines. For example, pioneers such as Katzenstein focuses his work on comparative political economy, while Skocpol draws from historical sociology and March and Olsen from organization theory. See Peter Katzenstein, ed. *Between Power and Plenty*, (Madison: University of Wisconsin Press, 1978); Theda Skocpol, "Bringing the State Back In: Strategies of Analysis in Current Research", in *Bringing the State Back In*, eds. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, (Cambridge: Cambridge University Press, 1985); and James March and Johan P. Olsen, *Rediscovering Institutions: the Organizational Basis of Politics*, (New York: Free Press, 1989).

³² March and Olsen, *Rediscovering Institutions*.

words, they do what they are expected to do through their socialization with existing political and social institutions.³³

Instead of locating itself strictly in one of the two approaches, this thesis finds that both camps have complementary conceptual tools to offer to students of politics and to this thesis project in particular. Attempts of many RCI and HI scholars to compensate for their own theoretical blind spots, which result in their moving closer together, confirm the complementarity of the two strands of new institutionalism. Douglass North, a prominent RCI author, in viewing that actions are not merely decided based on wealth-maximization, but can be driven by ideas and self-imposed restraints, moves closer to HI in the understanding of what motivates actions. His assumption of the limited calculation ability of actors of their environment is linked to the need for rules and procedures, i.e., institutions, to reduce the uncertainty in human interactions. The view of individuals as following everyday routines laid down by these formal and informal rules also puts North closer to March and Olsen's 'rule of appropriateness' in guiding the actions of individual and collective actors.³⁴ Many new institutionalist scholars writing in both streams, such as Hall, Pierson, Katznelson, and Weingast, also advocate a convergence between RCI and HI.³⁵ For example, by bringing attention to the idea of 'fundamental preferences,' which refers to the preferences over courses of actions (as opposed to 'general

³³ Many HI theorists do not reject RCI assumption of self-interested behavior. Hall and Taylor discuss the two approaches within HI, namely the 'calculus' approach which share RCI view of profit maximization and utilitarianism behind individuals' and collective behavior, and the 'cultural' approach, focusing on the role of worldview, norms, and routines in shaping behavior through the process of socialization. See Peter Hall and Rosemary C.R. Taylor, "Political Science and the Three Institutionalisms", *Political Studies* 44, (December 1996): pp. 936-957.

³⁴ See Douglass North, *Institutions, Institutional Change and Economic Performance*, (Cambridge: Cambridge University Press, 1990), chapter 3. See also North, *Understanding the Process of Economic Change*, (Princeton: Princeton University Press, 2005).

³⁵ See Ira Katznelson and Barry Weingast eds. *Preferences and Situations: Points of Intersection between Historical and Rational Choice Institutionalism*, (New York: Russell Sage Foundation, 2005).

preferences' to well-being or survival) and the formation process of these preferences based on actors' 'interpretation of the world and their situation in it,' Hall moves away from HI's taking-for-granted tendencies in assuming that preferences are passively 'caused' by institutions and places himself closer to RCI's focus on a micro theory of actions.³⁶ Pierson's emphasis on the role of time in politics is also meant to bring HI and RCI together. The concept of increasing returns, embedded in the notion of path dependence, was already central to RCI analysis of institutional change seen in North's work and should be compatible with HI's historical-oriented methodology in tracing the evolution of institutions and their impact on political outcomes.³⁷ The issue of path dependence will be addressed in more detail below. The point here is that RCI and HI are closer than they think in claiming that institutions and history (or temporality) matter in the understanding of how institutions shape actors' preferences and actions and vice versa.

Institutional Stability and Change

The new institutionalism brings a lot of attention to the issue of institutional stability and change. Despite the diversity within the approach, there has been a significant degree of agreement among new institutionalist theorists in viewing institutions as stable, change-resistant, and long-lasting. The concepts of path dependence, positive feedback, and increasing returns are adopted by both RCI and HI in explaining the longevity of institutions and how it is difficult, once a 'path' is established,

³⁶ See Peter Hall, "Preference Formation as a Political Process: The Case of Monetary Union in Europe", in Katznelson and Weingast, *Preferences and Situations*, pp. 135-136.

³⁷ Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis*, (Princeton: Princeton University Press, 2004). As for examples of North's work, see North, *Institutions, Institutional Change and Economic Performance*, and *Understanding the Process of Economic Change*.

to break away from institutional 'lock-in'.³⁸ A much lesser degree of consensus, however, is seen on the issue of institutional change. Thelen and Streeck acknowledge that the logic of path dependence, embedded in the idea of institutional stability, tends to encourage new institutionalist theorists to think of change either as minor and continuous or as major and disruptive.³⁹ As a result, small changes tend to be ignored as part of institutional adaptation while major changes are thought of as being caused largely by exogenous factors or a scenario known as 'punctuated equilibrium'. To compensate for these theoretical shortcomings, recent attempts have been made by Thelen and Streeck and other HI scholars to account for various types of changes in institutions and to re-examine the relationship between the process of change and its outcomes based on empirical evidence, particularly in advanced industrial economies.⁴⁰ Even though it is still far from reaching any consensus, a theoretical revisiting like this helps extend the reach of new institutionalism in the theorizing of institutional change.

With regard to institutional change, this thesis is particularly interested in the role of the Bank of Thailand as an agent of change and its ability to initiate changes in the rules regulating the financial system, particularly the launching of the financial liberalization process. The HI view of changes in the external environment that cause actors to change their goals within old institutions can be used to explain how the globalizing trends of international finance shaped the views of Bank officials on the

³⁸ For a good explanation of the concepts, see Pierson, *Politics in Time*.

³⁹ See Wolfgang Streeck and Kathleen Thelen, ed. *Beyond Continuity: Institutional Change in Advanced Political Economies*, (Oxford: Oxford University Press, 2005), Introduction.

⁴⁰ Ibid. Drawing from the essays from their volume, Thelen and Streeck highlight five broad modes of gradual but transformative change, including displacement, layering, drift, conversion, and exhaustion, which they see offer wider explanation of institutional change than the dominant punctuated equilibrium model. Instead of viewing change as largely disruptive and discontinuous, they find that significant institutional transformation can be a result of gradual and incremental change, and that change is often originated endogenously, instead of being introduced from the outside.

potential benefits to be gained from international movement of capital, particularly when Thailand was experiencing an increasing need for investment to fuel its rapid economic growth.⁴¹ However, it will be shown that the Bank's capacities in managing a more liberalized financial system also played an important role in its consideration of whether or not to liberalize. In this regard, the BOT's increased supervisory power over the financial sector and its power and resources to deal with financial institution insolvency through a series of legal amendments and the establishment of the Financial Institutions Development Fund (FIDF) gave the Bank confidence in its ability to manage a more open financial system. Accordingly, it may be said that endogenous institutional change requires not only incentives and opportunities provided by the new external environment, but also the capacities and resources of the agent of change to initiate new rules of the game.⁴²

A focus on changes to the financial system brought about by the process of financial liberalization and the concurrent political changes toward democratization helps explain the path leading to the financial crisis of 1997. In essence, these changes led to increased vulnerabilities and weaknesses of the financial system and a decline in BOT capacity to govern the financial sector and manage the financial system as a whole. Institutionally speaking, the collapse of the fixed exchange rate regime and the financial system revealed the incompatibility of the old and new sets of rules of the game, which opened up a great deal of opportunity for moral hazard activities, leading to the

⁴¹ See Kathleen Thelen, and Sven Steinmo, "Historical Institutionalism in Comparative Politics", in *Structuring Politics: Historical Institutionalism in Comparative Analysis*, eds. Kathleen Thelen, Sven Steinmo, and Frank Longstreth, (Cambridge: Cambridge University Press, 1992).

⁴² See a discussion of elements of theory of institutional change in Siobhan Harty, "Theorizing Institutional Change", in Andre Lecours (ed.), *New Institutionalism: Theory and Analysis*, (Toronto: University of Toronto Press, 2005).

deterioration of financial stability. While this thesis is particularly interested in pointing out the structural power embedded in the international financial system, which constrains the choices of monetary authorities in developing countries, the idea of institutional ‘stickiness’ is helpful in explaining Bank failure to reconsider its priorities and adopt more effective measures to prevent the crisis. The political aspect of this ‘stickiness’, seen in the connection between some financial institutions and political figures and the attempts of the latter to intervene in financial policy to protect their mutual interest, played an important role in limiting the Bank’s ability to manage the financial sector effectively.

Institutionalized Organizations as Political Actors

Finally, the old institutionalism of Philip Selznick lends useful conceptual tools to the understanding of the BOT as an institutionalized political actor. Selznick’s idea of the institutionalization process of an organization, a phenomenon in which an organization is infused with value beyond its technical requirements and develops a distinctive identity or what he calls ‘institutional character’, can be used to understand the evolution of both the BOT self-image and the public perception of the organization as a legitimate authority in macroeconomic and financial management.⁴³ This institutionalization process is essential to the understanding of the Bank’s behavioral autonomy based on its legitimacy. Being recognized for its moral authority, technical expertise, and status as protector of the national interest, these institutional characters served as a source of BOT influence in the making of monetary and financial policy.

⁴³ See Philip Selznick, *Leadership in Administration: a Sociological Interpretation*, (Berkeley: University of California Press, 1957).

During its earlier days, attempts by the Bank's leaders to instill values such as honesty, honor, and duty amid the broader environment of political patronage and corruption and to improve upon the organization's technical expertise, which was closely tied with its commitment to conservative monetarism, by initiating its own human resource development programs, contributed significantly to the formation of the BOT's institutional character. Over the years, these identities played an important role in establishing public trust within Thai society, which in turn positively affected the agency's relative autonomy. By the 1970s the BOT was perceived as a pillar of institutional stability, especially when compared to the ongoing political turmoil inflicted by power struggles among military leaders. The Bank's ability to experiment with a more developmentalist role in financial allocation during the 1970s reflected the influence of this public confidence both with the government and financial sector. The idea of institutionalization also helps one understand how the Bank's legitimacy was closely linked with its value commitment and good performance. Changes in its institutional character over time, as seen in the deterioration of its moral authority and technical excellence in the 1990s, significantly affected public and financial sector confidence in the organization, which in turn had serious implications for the BOT's ability in managing the financial system.

Selznick's views on an organization's adaptive behavior, both with regard to day-to-day functioning and to the changing interplay between internal and external forces, provides valuable insights into the BOT's actions, which are rather complementary to HI and RCI views mentioned above.⁴⁴ The portrayal of organizational actors as strategists, seen in his seminal work, *T.V.A. and the Grass Roots*, in which the leadership of the

⁴⁴ See a discussion of organizational adaptation in *Ibid.*, chapter 2.

Tennessee Valley Authorities collaborated with local constituencies to protect the rural electrification program, at the expense of its official objectives, reflects the adaptive behavior of an organization in pursuit of its own preferences.⁴⁵ This view of strategic behavior is useful to understanding of both sources of organizational actions and institutional change. The idea that the Bank adapted to its environment either strategically or ideologically in order to pursue organizational interests and preferences, allows one to see it as an active political actor and an agent of change. The BOT's employment of various strategies in its attempts to curb government deficit spending in the 1950s and the 1960s, such as promoting World Bank borrowing and constantly reminding the government of Thailand's commitment to the IMF to maintain macroeconomic stability, can be understood in context of the Bank's strategically adaptive behavior to achieve its policy mandate. The BOT's leading roles in initiating the preferential financial allocation schemes in the 1970s, in launching a structural adjustment process in the late 1970s (before the adoption of World Bank Structural Adjustment Programs in the early 1980s), and in pushing for the process of financial liberalization in late 1980s, also reflect the agency's adaptability to the changing socioeconomic and political context and to the unintended consequences of previous policies, which served as sources of institutional change.

It is important to note that over the years the 'new' institutionalism in organizational analysis has departed from Selznick in many significant respects. A number of these differences are of particular relevance here.⁴⁶ First, the new

⁴⁵ Philip Selznick, *T.V.A. and the Grass Roots*, (Berkeley: University of California Press, 1949).

⁴⁶ See more detailed discussion of the differences between the old and new institutionalism in organizational analysis in Walter W. Powell and Paul J. DiMaggio, eds. *The New Institutionalism in Organizational Analysis*, (Chicago: University of Chicago Press, 1991), Introduction.

institutionalism in organizational studies tends to locate the process of institutionalization beyond the locus of organizations to a specific sector or society and view the infused norms and values which shape participants' behavior as myths, classification, and taken-for-granted scripts.⁴⁷ Second, these new institutionalist theorists undermine the intentionality embedded in Selznick's idea of adaptive behavior, seeing actions as having a largely unreflective, routine, and taken-for-granted nature. Therefore, old institutionalism's idea of value commitment in guiding behavior gives way to habits and practical actions.⁴⁸ Third, the new institutionalism focuses on the relationship between stability and legitimacy as a source of institutional continuity, while the old pays particular attention to vested interests within organizations due to certain political tradeoffs or alliances (as seen in the T.V.A. case).⁴⁹ Despite a significant gap between the two approaches, it is the view of this thesis that their differences are not irreconcilable in the study of the Bank of Thailand. While it is not in the scope and ability of the thesis to offer any theoretical insights to bridge this gap, the following arguments seek to defend the relevance of Selznick's approach without rejecting the views of the new institutionalism. First, the idea of the institutionalization of the BOT remains useful even though it can be seen that not only the Bank but the society became institutionalized with the rules and norms governing monetary and financial affairs. The Bank's role as monetary authority and regulator of the financial system, however, made the process of institutionalization of these roles differ qualitatively from those of the regulated and the general public. And while it is plausible that in the later years BOT officials would base their behavior on institutional myth and value-related rules, it can be argued that during

⁴⁷ Ibid.

⁴⁸ Ibid.

⁴⁹ Ibid.

the Bank's earlier years the infusion of values at the Bank, particularly under the twelve-year governorship of Dr. Puey Ungpakorn, was a direct, first-hand experience in which character-defining moments took place. Second, the idea of adaptive behavior, particularly of strategic calculation, explains better the situations whereby the Bank's chosen courses of action were devised to achieve a certain goal, which otherwise would not be met. While cognitive learning and rule-following actions may explain the BOT's more routine activities, actions like the attempts to build and preserve its relative autonomy at different junctures of the Bank history are better captured by the idea of strategic adaptation. Finally, the constraining effects of vested interests and legitimacy can co-exist and reinforce one another in preserving the status quo. In the Thai case the vested interests embedded in the BOT-financial sector relationship (i.e., the Bank allowed for an oligopoly in the financial sector in order to maintain financial stability) was tied to more abstract concepts of national banking competitiveness and financial stability as public interest, which justified the legitimacy of the Bank's role.

Research Methods

Adopting an institutionalist theoretical framework shapes this thesis's methodology. The time frame selection is influenced by the need to understand the evolution of the Bank of Thailand and its role in the history of Thailand's monetary and financial policy. This idea demands an initial investigation into the history behind the establishment of the Bank, which began in the late 17th century. The need to learn about the origin of the Bank's policy preferences also requires a return to the colonial period to find a rationale underlying the Thai authorities' commitment to monetary conservatism,

which can be linked to that of the BOT in the modern period. From there, the thesis continues to examine the making of the Bank's relative autonomy and the relationship between this autonomy and the direction of monetary and financial policy from the pre-war period until the outbreak of the financial crisis in 1997. An examination into this lengthy time span allows the thesis to see patterns of institutional continuity and change in monetary and financial policy with the BOT as an agent of both institutional reproduction and change (or innovation). While the enduring commitment to conservative monetary policy can be witnessed throughout the period under investigation, the process of financial liberalization brought about institutional change to these policy areas. The choice to end the inquiry at the crisis outbreak has been made primarily because the crisis represented the breakdown of both the fixed exchange rate policy, which was a key element of the lengthy pre-liberalization monetary regime, and the BOT's ability to preserve monetary and financial stability through the pre-liberalization policy framework and environment. In other words, it marks an end of an era.

As the thesis stresses the importance of institutions, there is a need to identify them and observe those that have significant impacts on the BOT's behavior. Based on a broad definition, shared by HI and some of RCI writers, i.e., that institution includes both formal and informal constraints such as organizations, rules, norms, procedures, and codes of conduct that shape human interactions⁵⁰, the thesis pays particular attention to a

⁵⁰ While there are some rational choice institutionalists, particularly those who adhere to game theory, who view the existence of certain institutions as a strategic equilibrium, i.e., a situation in which actors would choose not to alter their current behavior and environment, others, such as North, hold quite a similar view of institutions as their HI counterparts. For example, compare Peter Hall's definition of institution, which includes "the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units of the polity and economy", and North's definition, "institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction" and that institutions include both formal and informal constraints, such as

number of ‘institutions’, including the Bank’s legal framework, the political system and nature of political struggle of each period, international monetary and financial regimes, and the Bank itself. The influence of these institutional factors on the Bank is observed by looking at how they offer opportunities or constraint the Bank’s actions. There is also a need to distinguish among the different types of institutions in order to acknowledge the various levels or forms of institutional influence. While the BOT’s legal framework is a set of written rules, the international financial institution’s neoliberal influence comes in the form of idea. The Bank’s commitment to monetary conservatism is not only a normative commitment but a tradition which includes an element of routine. This differentiation helps confirm the different sources of political actions, which will be discussed in the conclusion.

Based on the above methodology, the following methods are employed to obtain information. First, most historical accounts are from existing literature in the studies of Thai politics and political economy and the works by the BOT, particularly its Annual Economic Report and commemorative volumes (every 10 years)⁵¹. These accounts largely include the nature of monetary and financial policy and policy instruments of each time period, Bank interactions with the government, financial sector, and international financial institutions, its organizational arrangement and management, and the contemporary political, economic, organizational, and international context. Contemporary works by the Bank offers not only historical knowledge but also the Bank’s first-hand experience in and view on the issue at hand. The library and archival research for this part of information was conducted mainly at the libraries of the Bank of

“rules that human beings devise...and...conventions and codes of behavior.” See Hall, *Governing the Economy*, p. 19 and North, *Institutions*, pp. 3-4.

⁵¹ The Commemorative volumes include the 10, 20, 30, 50, and 60 years of the Bank of Thailand.

Thailand, Cornell University, and Carleton University. Interviews with Bank officials (see Appendix III for interview questions) also provide background information and insights complementary to that of other sources. The interview process took place during my several trips to Thailand and Washington, D.C (where the IMF is located). I was aware of the tendency of self-justification in official perspectives, therefore trying to use different sources of information to help check against one another.

To understand better the financial liberalization process and the road to the crisis, it is necessary to evaluate the perspectives of relevant actors and policy-makers in order to gain a fuller picture of ‘who acts when and why’. In this regard, in addition to library and archival research, I conducted over twenty interviews with Bank officials, politicians, commercial bank and finance company executives, and financial advisors to learn of their views of financial liberalization and the events leading to the crisis (see Appendix III for interview questions). Similarly, to avoid self-justification or inaccuracy, I tried to check one account against another as well as against other sources of information.

Outline of the Thesis

Chapter 2 addresses the international and domestic politics behind the establishment of the BOT and the origin of the Bank’s policy preferences. It begins by tracing the historical background of the establishment of the BOT in order to show the preoccupation of the Thai authorities with financial independence as the key rationale for the Bank’s establishment. A discussion of the development of monetary conservatism follows, focusing on how the Thai authorities managed the impact of economic integration into the international system in the late 17th century through the maintenance

of international credibility. The central arguments are that the Thai authorities' fear of losing financial independence largely determined the process of central bank establishment and their commitment to conservative monetary policy. This very history of BOT establishment and the legacy of conservatism gave the Bank a distinct identity and awareness of its role and responsibilities in the Thai polity.

Chapter 3 seeks to show how the Bank transformed itself from a small organization to a widely respected and relatively autonomous institution which played a dominant role in the designing of Thailand's monetary and financial policy by the 1960s. It begins with a discussion of these formative years (1940s-1960s), focusing on the making of the Bank's relative autonomy in the context of institutional building and the struggle to pursue policy mandate and preferences. After discussing the Bank's dependent legal status, it will be argued that the agency was in fact relatively autonomous as seen in a number of indicators, including its ability to maintain price and currency stability, to push for exchange rate liberalization, and its freedom to manage its own administrative and budgetary affairs. The last section contrasts the BOT's relative autonomy from the government with its weak authority over the financial sector. However, it will be demonstrated that the Bank was able to increase its leverage over financial institutions through its role as lender of last resort.

Chapter 4 discusses the contextual factors contributing to the making of the Bank's relative autonomy. These factors include the political context of bureaucratic polity, the international political economy of the Pacific War and Cold War, and the institutionalization of the BOT. The chapter argues not only that the institutional context provided certain opportunities which were conducive to Bank relative autonomy, the

BOT's ability to employ different strategies to overcome various constraints and obstacles in its pursuit of policy preferences was also essential to the making of the Bank's de facto autonomy.

Chapter 5 shows how the BOT's relative autonomy allowed it to play a leading role in the continuity and change in Thailand's monetary and financial policy during the 1970s and 1980s and the governing of the Thai financial system. It begins by focusing on a brief emergence of the Bank's developmental role and a return to monetary conservatism through the period of structural adjustment. A continued discussion of the Bank's relative autonomy seeks to highlight the development in the BOT-financial sector relationship as the Bank was able to gradually expand its control over financial institutions. It will be argued that the Bank's relative independence was an important factor allowing the agency to initiate changes to the existing policy framework. On the other hand, the resilience of the conservative policy paradigm, the economic turmoil of the late 1970s, and the adoption of structural adjustment programs contributed to the decline in the Bank's developmental role. The rapid economic growth in the late 1980s and the consolidation of Bank supervision over the financial sector provided the basis for the launching of financial liberalization.

Chapter 6 is about the BOT's difficulties in managing the opened financial system due to the structural power of international finance and the destabilizing domestic and organizational context. It begins with a discussion of the historical/financial basis of financial liberalization with the main focus on the change in the authorities' receptivity to foreign capital in accordance with the change in the nature of international capital movements, the demand from domestic capital, and the Bank's own capacity to manage

the financial system. This analysis is followed by a discussion of the favorable political context to financial liberalization. In explaining the financial crisis of 1997, the chapter focuses on the impact of the changing financial, political, and organizational contexts (financial liberalization, democratization, and politicization of the BOT) on the vulnerabilities of the financial sector and the exchange rate regime and the Bank's credibility. Then the chapter turns its attention to two major mechanisms contributing to the outbreak of the crisis, namely the crisis in the financial sector and the collapse of the fixed exchange rate regime. The main focus is the decline in the Bank's autonomy and capacity in monitoring the financial system on the one hand, and its unchecked independence in exchange rate management on the other.

Chapter 7 concludes by recapturing the understanding of the BOT's relative autonomy and its implications for the evolution of Thailand's monetary and financial policy. The thesis's theoretical contribution to central bank independence and institutionalist literature will also be discussed. The last section discusses how the thesis's institutionalist approach and insights can help us understand the politics of monetary and financial policy in Thailand in the post-crisis era.

Chapter Two

The Birth of the Bank of Thailand and the Origin of Thailand's Monetary Conservatism

This chapter addresses the question of the establishment of the Bank of Thailand and the source of its policy preferences. By examining the relationship between institutional context and political actions, the chapter shows how the fear of losing sovereignty, posed by external threats during the colonial and wartime period, was a leading factor in adopting conservative monetary policy. The establishment of the Bank of Thailand reflected this preoccupation and strategic consideration. The Bank inherited the pre-war role in preserving monetary stability and independence largely through a commitment to conservatism. In viewing itself as the defender of the Thai national interest, the organization developed a distinctive identity that set it apart from other state agencies.

In keeping with Historical Institutional analysis, the chapter is organized to reveal the context for institutionalization and the formation of organizational character in line with the ideas of Philip Selznick. First, it begins by discussing the historical development that led to the creation of the BOT in 1942 and accounting for the significant delay in the establishment process. The following section looks at the development of the conservative monetary traditions and its close connection with the authorities' concern for monetary sovereignty. The nature and forms of this conservative

orientation and its implications for the economy will be subsequently addressed. The chapter ends by discussing how the BOT's policy preferences and institutional character began to emerge from these historical developments.

Historical Background of the Establishment of the Bank of Thailand

The process of central bank formation in Thailand spanned from the period of colonialism to the Pacific War. Even though Thailand, or Siam before 1939, was never colonized, it did not escape the impacts of colonial expansion and rivalry in the region. While some scholars argued that it was the decision between the French and British to keep Siam as a buffer state that ultimately preserved its independence¹, the Thai court's efforts in using diplomacy to ward off colonization, seen in a series of territorial concessions, unequal trade agreements, and the hiring of foreign advisors to help with the Kingdom's modernization projects, should not be underestimated.² To a large extent, these changes helped avoid more serious territorial and trade disputes and improve upon the quality of public administration, which could have otherwise been used as pretexts for colonial interference and take over.

The changes initiated by the Thai court, particularly trade liberalization and bureaucratic reforms, as a response to colonial threats had profound impacts on the development of the Thai state and society. The signing of the Bowring Treaty with Britain in 1855 ended the court's trade monopoly and opened up the Thai economy to

¹ This understanding later led to an Anglo-French Agreement in 1896. See John Girling, *Thailand: Society and Politics*, (Ithaca: Cornell University Press, 1981), pp. 48-49.

² The territorial concession included the loss of the east bank of the Mekong River in 1893, western provinces of Cambodia to the French in 1907, and the southern provinces to the British in 1909. The first trade agreement, the Treaty of Bowring, was signed with the British in 1855. It was followed by more treaties with the US (1856), France (1856), Denmark (1858), Portugal (1858), the Netherlands (1860), and Germany (1861). See a discussion on territorial concessions in David Wyatt, *Thailand: a Short History* (New Haven: Yale University Press, 1984), pp.199-208.

international commerce.³ The rapid increase in the level of trade, as Thailand became integrated in the global capitalist system, monetized the economy and changed the pattern of production to concentrate on a number exports, particularly, rice, tin, teak, and rubber.⁴ The abolition of slavery and the corvée system facilitated the growing commercialization of agricultural production. The same period also saw an influx of Chinese immigrants to fill labor demand and engage in a wide array of economic activities, including rice and saw milling, mining, sugar and rubber plantation, shipping and import-export.⁵ As the Thai population was mostly engaged in agricultural production, the Chinese came to dominate the market-oriented sector of the local economy, while Western enterprises concentrated on international commerce.

The transformation to a trade-oriented economy led to increased demand for financial services and intermediaries. The existing indigenous financial sector was small and undeveloped, consisting of the Court (the Privy Purse), the largest creditor to local enterprises, and small money lenders and pawnshops scattered across the country.⁶ The opening of foreign commercial banks in the late 1880s marked the beginning of the modern era of the financial market in Thailand. However, foreign banks concentrated

³ This treaty ended the court's commodity and trade monopolies, except for opium, and fixed import duties at a flat rate of 3 percent and export taxes around 5 percent. It also allowed British merchants to trade freely, without intermediaries, and to own property and travel throughout the Kingdom. The treaty also granted extra-territorial rights to British and their foreign subjects. See David Wyatt, *Thailand*, pp. 183-187). Also Kevin Hewison, *Bankers and Bureaucrats: Capital and the Role of the State in Thailand*, Monograph series 34, Yale center for Southeast Asia Studies, 1989, p. 40.

⁴ See James Ingram, *Economic Change in Thailand 1850-1970* (Stanford: Stanford University Press, 1971), chapter 3 and chapter 5 for discussion on rice and other major exports.

⁵ Wyatt provides an estimate of the population of Chinese immigrants in 1910 as 792,000, which doubled the size of 300,000 in 1850. A large number of these immigrants worked as wage-laborers, agricultural laborers, clerks, porters, and boatmen. See Wyatt, *Thailand*, pp. 217-218.

⁶ See Bank of Thailand, *50 Years Bank of Thailand* (Bangkok: Bank of Thailand, 1992), p. 11. The Bank notes that the Privy Purse's largest borrowers were Chinese merchants, most of whom engaged in the business of rice milling, saw milling, small-scale manufacturing, and rice export. The second largest group was the royal family and bureaucrats who were involved in business enterprises, and Governors of the various provinces and Siam's foreign territories.

their business within the expatriate community largely to facilitate their own country's international transactions. In this context, Thai authorities not only needed to learn how to regulate the foreign-dominated nascent industry, but also extended their desire to develop a domestic financial sector to serve local customers and businesses.

During the same period, King Chulalongkorn or Rama V (1868-1910) launched political changes with a series of reforms to modernize public administration and consolidate royal power.⁷ Many factors promoted political and administrative change, including the internal struggle between the King and the 'old order' and fiscal constraints from the end of royal trade monopolies. The King gradually reorganized the whole administrative structure largely after Western models to strengthen his power base and to create a more efficient government.⁸ With regard to fiscal reform, a Treasury Department was established and a new centralized tax collection system was put in place. Foreign advisors played an important role in the functioning of the new departments, including the Treasury, where British advisors dominated. By the time Rama V ended his reign in 1910, the administration had become much more functionally differentiated and the government was able to exert its control over all the outlying regions through the help of the newly created bureaucratic machinery.

Among the most far-reaching impacts of this political transformation was the creation of a new bureaucracy, consisting of a young generation of educated princes and commoners, many of whom received education abroad. This was to become a key

⁷ King Chulalongkorn was the fifth reigning monarch of the Chakkri Dynasty (1782-present). The current monarch is King Bhumibol Adulyadej or Rama XI (1946-present)

⁸ The old order refers largely to powerful aristocrats, particularly the powerful Bunnag family members, who at the beginning of Rama V's reign controlled many influential positions in the government, including the regency and two of the four territorially-divided ministries, i.e. ministries of the South (Kalahom) and the Center (Klang). See Wyatt, *Thailand*, pp.191-192.

political institution in modern Thai politics. While this new bureaucratic elite was the engine of the state-building process under King Chulalongkorn, ironically it became the driving force that brought an end to the system of absolute monarchy in the early 1930s. Resentment of the ways that succeeding Kings, Rama VI and VII, handled a series of political and economic crises triggered by the First World War and the Great Depression and frustration about the concentration of power within the royal family fed by exposure to Western models of parliamentary government led a number of Western-trained military and civilian bureaucrats to join together to form the People's Party (PP) and later stage a bloodless coup to install a system of constitutional monarchy. It was soon clear this was not a move toward democracy but rather a transfer of power from one group of elites to another.⁹ Internal conflicts among the coup promoters caused several changes of governments that marked the political rivalry from the 1930s to 1940s. The process toward the establishment of a central bank reflected the dynamics of this political context.

Finally, the Pacific War, which broke out in December 1941, had great impact on the final decision to establish the Bank of Thailand. On the one hand, Thailand once again escaped the full breadth of Japanese occupation as the Phibun administration decided to ally with Japan and later declare war on the Allied Powers.¹⁰ Phibun's personal admiration of Japan's militaristic discipline and rise to power, the policy-makers' awareness of Thailand's limited military capability, and their belief that Japan would win the war were among the reasons behind this decision. In this regard, Thailand was able to maintain its sovereignty and avoid serious human casualties and other kinds of losses associated with Japanese takeover, unlike other countries in the region. On the

⁹ For example, see Wyatt, *Thailand*, p. 251).

¹⁰ A military alliance with Japan was concluded on December 12, 1941, followed by a declaration of war against the US and Britain on January 25, 1942. See *Ibid.*, pp. 256-258 for more details.

other hand, as a less powerful ally, Thailand was obligated to fulfill several demands by the Japanese government, most importantly to help finance the latter's military spending. It is in this context that the Bank of Thailand was hastily created to carry out this task and to preserve the country's monetary independence.

The Road toward the Establishment of the Bank of Thailand

The idea of establishing a central bank was first proposed in 1888 when foreign banks began to operate in Thailand.¹¹ The initiative came from a group of British businessmen who proposed establishing the Royal Bank of Siam to serve as a government bank for one hundred years.¹² According to the official history of the Bank of Thailand, the proposed bank would have issue bank notes, take deposit of all treasury funds, extend credits to the government, and collect taxes on the government's behalf. The bank was to register as a British bank but would allow for Thai shareholding of up to 50 percent of total equity. Upon consideration, the Thai government of King Chulalongkorn turned down the proposal on the grounds that it did not serve the interest of Siam.

After this first attempt, several other European proposals were submitted to the government for consideration, all of which were rejected.¹³ The rejections were quite

¹¹ The first bank to open for business in Thailand was the Hong Kong and Shanghai Banking Corporation, a Hong Kong-based British commercial bank. It was followed by another British bank, the Chartered Bank of India, Australia, and China in 1894, and the French bank, Banque de l'Indochine in 1897. Before 1888, financial services were conducted by financial representatives of commercial banks registered in Europe, particularly Britain and British colonies whose countries were trading partners to Thailand. See more detail in Bank of Thailand, *50 Years of the Bank of Thailand*, p. 34.

¹² Ibid., pp. 46-47.

¹³ In 1897, Duke de Marignan of France proposed to set up the Royal State Bank of Siam, which would hold the right to issue paper money and raise taxes for the Thai government. As a benefit, the Thai government would receive 40 percent of net profits after a dividend payment of 20 percent per annum. In the following year, Clark, who had submitted the first proposal ten years earlier, made a second attempt by

understandable, in the Bank's view, as the fear was that the national interest would be subordinated to the interests of foreign banks.¹⁴ Given the context of imperialism and colonialism in the region and the experience in dealing with colonial powers, which led to significant territorial, judicial, and economic losses for Thailand, suspicion of Western domination and exploitation was strongly shared among the Thai authorities. Whatever the potential economic gains from these proposals, they were less attractive compared to the possible loss of financial and monetary authority.¹⁵

Apart from various attempts by foreigners, there were also proposals by Thai officials. The Bank of Thailand notes that in 1902, Phraya Suriyanuvatr, the then Thai Ambassador to France, made a recommendation to the government to establish a national bank. Suriyanuvatr, who was asked to raise a one-million-pound loan from overseas to finance a railway project, believed that the loan should be used to set up a national bank and that the government could use profits of the bank to fund railway construction afterwards. His recommendation did not materialize because the government gave priority to its transportation projects.¹⁶ It was also recorded that in the same year, Prince

proposing to establish the Siam Company Ltd., which would have functioned as a central bank with a concession period of fifty years. The company would have retained the right to issue paper money and acted as the government's tax and customs duties collection agent. Also in 1888, a Danish bank submitted a proposal to establish the Bank of Siam through the Ministry of the Royal Treasury. This time a foreign advisor of the Ministry was asked to give an opinion on the matter. The advisor recommended that the proposal be turned down based on the reason that a national bank should not be run by foreigners. Another proposal in the Bank of Thailand's record was that of Colonel Crivenko of Russia. In 1917, Crivenko proposed to establish the State Bank based on funds raised from North America and Europe, which were originally planned to be used in financing commerce in Russia. Due to the outbreak of the Russian Revolution, Crivenko viewed that the money would be better invested in Thailand. See Bank of Thailand, *50 Years*, pp. 46-53.

¹⁴ Ibid., p. 49.

¹⁵ It is interesting to compare this situation with the wide spread practice of tax monopolies or tax farming during the 19th century. The Thai court granted tax collecting rights to the highest bidders, most of whom were wealthy Chinese merchants. While this kind of relationship has been described by many scholars as a partnership or alliance between the Thai elite and Chinese elite, this idea of mutual economic interdependence did not develop well between the Thai elite and Westerners. Colonial experience accounted largely for the combination of fear and suspicion of Western powers among Thai leaders.

¹⁶ Bank of Thailand, *50 Years*, pp. 49-50.

Mahisara, who was the Royal Treasury Minister, mentioned in his report the need for a national bank to monitor the issue of paper money to replace existing coins. However, in his letter to the King in 1905, the Prince acknowledged the difficulties in establishing a central bank, especially due to the lack of support from British foreign advisors, whom he thought might see the establishment of a Thai national bank as adversely affecting British interests in the country.¹⁷ While suggesting that the establishment of a central bank be postponed for the time being, Prince Mahisara encouraged the government to set up a Thai commercial bank to familiarize the public with banking services and to train bank personnel. Accordingly, the attempt to set up the first Thai commercial bank materialized in 1904 with the establishment of the Bank of Siam. In 1907, the bank changed its name to Siam Commercial Bank Co. Ltd., after the business was well received by Thai and Chinese customers.¹⁸

The idea re-emerged in 1913 after a series of banking crises hit local commercial banks. Among the three local banks, only the Siam Commercial Bank remained in operation after a rescue plan by the government. Because of the crisis, the Ministry of the Royal Treasury looked into the possibility of setting up a national bank by consulting with foreign advisors and experts. A recommendation was made to transform the Siam Commercial Bank into a national bank, which would serve as banker to the government and commercial banks.¹⁹ Despite a well laid-out plan, the government did not act upon the recommendation.

¹⁷ Ibid., p. 50. Also in Prasit Na Pattaloong, *The Evolution of the Bank of Thailand*, Bank of Thailand, Bangkok, 1972.

¹⁸ Prasit Na Pattaloong, *Evolution of the Bank of Thailand*, p. 10.

¹⁹ The recommendation was made by W.B. Hunter, a chief manager of the Bank of Madras, which was one of the three banks that served as central bank to India. Hunter's recommendation went into detail the amount of bank's capital fund, managing positions, composition of the executive board, bank's objectives, and how to train bank personnel. More detail can be found in Bank of Thailand, *50 Years*.

Interest in establishing a central bank returned after the People's Party carried out a coup to replace the system of absolute monarchy with a constitutional monarchy in 1932. The People's Party's economic plan was drafted by Pridi Phanomyong, one of the key civilian members of the groups.²⁰ The plan included the establishment of a national bank to serve the country's economic activities, particularly through the granting of credits to the government.²¹ The socialistic tone of the plan, including the nationalization of land, the bureaucratization of the whole society, and an interventionist role for the government in the economy, resulted in a strong rejection from the conservative elements in the government and the National Assembly.²² Controversy over the plan, which reflected the political struggle within the People's Party, led to the dissolution of the Assembly and a setting up of a new cabinet, which excluded Pridi.

Another change of government took place in mid 1933 as Phraya Phahol, a prominent military leader of the People's Party, staged a bloodless coup to form his own government. Once again, Phahol's cabinet discussed the possibility of establishing a national bank. A foreign advisor to the Ministry of Treasury was consulted on the matter. The advisor expressed his reservations over the establishment of a central bank on the grounds that the country still lacked banking expertise, capital funds, and a sound local banking system.²³ During the same year, a Member of Parliament proposed legislation which would have transformed the Siam Commercial Bank into a national bank. The

²⁰ The People's Party was not a political party in an electoral sense. It was a group of the 1932 coup promoters, consisting of senior military officers and civilians who developed resentment against the King's reluctance to liberalize the political system. For more detail of the coup see David Wyatt, *Thailand*, pp. 245-252 and Robert J. Muscat, *The Fifth Tiger: A Study of Thai Development Policy*, (Helsinki: United Nations University Press, 1994), pp. 29-38.

²¹ Bank of Thailand, *50 Years*, pp. 51-52.

²² For more detail of the plan see Robert J. Muscat, *The Fifth Tiger*, pp. 31-38.

²³ Bank of Thailand, *50 Years*, p. 52.

Ministry of Treasury opposed it partly because the bank had never fully recovered from the crisis in the 1910s. As a result, the proposed legislation was dropped.

Not until the administration of Luang Phibunsongkhram, a younger generation military leader of the People's Party who became Prime Minister after Phahol in 1938, was the decision made to establish a central bank. Pridi, who was appointed as Finance Minister (of the former Treasury Ministry), was able to convince the Prime Minister and the cabinet of the necessity of a central bank due to the increasingly unstable political and economic conditions in Europe, and the potential for a major war. He was also able to convince the foreign advisor to the Finance Ministry, who had originally opposed the setting up of a central bank, to support the idea and render his service in the drafting of the legislation.²⁴ Another influential figure in this process was Prince Viwatanajai (Viwat), who was the first Thai advisor to the Finance Ministry.²⁵ Prince Viwat took over the final stage of the drafting and was actively involved throughout the whole process of central bank establishment. When the draft legislation was submitted to the Prime Minister and the cabinet for approval in September 1939, World War II had broken out. In a memorandum included with the draft legislation, Pridi stated the urgency for Thailand to have a national bank on the grounds that Britain and other members of its empire had imposed exchange controls and that there was a tendency toward a possible panic run on local commercial banks.²⁶ Under these circumstances, it seemed a national bank would be needed to assist commercial banks and to manage the exchange regime

²⁴ Ibid., pp. 52-53.

²⁵ The prince's father was Prince Mahisara, former Minister of the Royal Treasury who established the Book Club.

²⁶ Ibid., p. 53.

and government's expenditures. The cabinet endorsed the draft legislation and sent it off to the Parliament. It became law on October 26, 1939.²⁷

The Act on the Establishment of the Thai National Banking Bureau B.E. 2482 (1939), was in fact the first stage in the establishment of a national central bank. The Bureau was intended to be the training ground for future bank staff, while at the same time assuming a much-needed role of banker to the government and commercial banks under unstable circumstances. As will be discussed in greater length later, the decision to establish a transitory organization, instead of a full-fledged central bank, was based not only on the government's limited institutional capability, but also on certain political considerations. The Thai authorities were aware that some foreign advisors, mostly British, were reluctant to support the establishment of a central bank. Due to the concerns that a Thai central bank might affect British financial interests, a National Banking Bureau, which would not compete with commercial banks in offering private banking services nor control the business of foreign banks, was therefore more acceptable in the eyes of foreign banks and their government representatives.²⁸

In keeping with its status as a transitory institution, the decision-making power over the National Banking Bureau remained with the Ministry of Finance. In the Ministerial Regulation defining the activities and authority of the Thai National Banking Bureau,²⁹ the Minister of Finance had directive authority over the Director of the Bureau. Consequently, an advisory committee consisting of banking experts was appointed by the

²⁷ Prasit Na Pattaloong, *Evolution of the Bank of Thailand*, p. 16. See also *Ibid.*, p. 54.

²⁸ According to the Bank of Thailand, the foreign bank community was assured by the authority that the National Banking Bureau would not be in competition with them. It was also mentioned that the manager of the Hong Kong and Shanghai Bank branch voiced his opinion that he believed that the establishment of the new institution would not jeopardize his bank's interests.

²⁹ The Ministerial Regulation was issued on March 30, 1939, five months after the promulgation of the Act on the Establishment of the Thai National Banking Bureau B.E. 2582 (1939).

Minister to consult with the Bureau. The Bureau was assigned to take deposits from, and lend to, the government, public organizations, commercial banks, and credit banks, to manage government borrowing, and to carry out other related banking activities upon the approval of the Ministry of Finance.³⁰ The Ministry of Finance continued to manage the Currency Reserve and make decisions on banknote issuance.³¹ The Ministry's Comptroller-General Department shared its office space with the Bureau, while some of its officials were assigned to the new agency, including the Director-General of the Department, Phraya Songsurarat, who became the first Director of the Bureau.³² A number of tasks previously performed by the Comptroller-General Department, such as deposit taking of public organizations' and government agencies' funds, and fund transfers between Bangkok and other provinces, were transferred to the Bureau. The Bureau was originally divided into six divisions, namely the Research Division, the Bond Division, the Banking Division, the Finance Division, the Accountant Division, and the Secretarial or Central Division. The Exchange Control Division was added to the Bureau in February 1942 when the government decided to impose control on foreign exchange activities after the Pacific War broke out in December 1941.³³

Major responsibilities of the Thai National Banking Bureau reflected the government's financial priorities, particularly the financing of government spending and management of wartime financial affairs. Among the agency's first assignments was the management of four debt offerings used to fund cooperatives, municipalities, industrial

³⁰ Bank of Thailand, *50 Years*, p. 58.

³¹ Bank of Thailand, *10 Years of the Bank of Thailand*, (Bangkok: Bank of Thailand, 1952), p. 1.

³² Ibid.

³³ Bank of Thailand, *50 Years*, p. 58.

development, and the military incursion into French Indochina.³⁴ The Bureau was responsible for the sale of these bonds and the payment of interest.³⁵ It was not recorded whether these bonds were all sold to the public; there is a possibility that the Bureau might have purchased some of them due to its lending obligation to the government.

Wartime financial management was largely dictated by the economic arrangements between Thailand and Japan and the consequences resulting from these arrangements. Shortly before the outbreak of the Pacific War, the Bureau was asked to disburse a syndicated loan to the Yokohama Specie Bank of Japan due to a bilateral agreement to maintain trade. The loan was meant to help alleviate Japan's liquidity problems when its overseas assets were seized by the US, the Netherlands, and the UK and its Dominions, in July 1941.³⁶ The loans to the Japanese were solicited from three Thai commercial banks, one of which was the Siam Commercial Bank. After the Pacific War broke out, the Bureau was assigned to implement exchange control measures in order to centralize foreign currencies in the government's hands for proper disbursement and to prevent capital outflows. At this time, Prince Viwat, the Thai advisor to the Ministry of Finance who was influential in the establishment of the Bureau, was appointed Bureau Director. Prince Viwat was responsible for the drafting of the exchange control legislation and the supporting ministerial regulations, which were

³⁴ The Phibun government ordered a military invasion of Laos and Cambodia in November 1940 in its attempt to reclaim these territories, which used to be under Thai suzerainty before the French took over in 1893. For more detail see Wyatt, *Thailand*, pp. 255-256.

³⁵ They were long-term bonds with 30-year maturity (the Cooperatives, Municipality, and Industrialization bonds), and 7-year and 10-year maturity (the Indochina incursion). The Bank of Thailand took over the responsibility over these bonds once it was established in 1942.

³⁶ Prasit Na Pattaloong notes in *The Evolution of the Bank of Thailand* that due to the freezing of Japanese overseas assets, Japan was in a shortage of liquid funds to finance its international payments. The Phibun government, which developed a sympathetic stand to the Japanese, at first agreed to let the Yokohama Specie Bank sell gold to the Ministry of Finance, so that the Ministry could deposit the gold in the Currency Reserve before more banknotes could be issued. However, it was agreed that such procedures were too much time-consuming and the Thai government then agreed to have the Thai National Banking Bureau lend to the Japanese bank in forms of overdraft services.

enacted in January and July 1942 respectively. As the war progressed, exchange control measures were largely aimed at regulating the yen inflows to curb inflation due to the excessive military spending of the Japanese in Thailand. These inflows were largely encouraged by changes in Thailand's monetary policy in response to the demands made by the Japanese after economic negotiations in Japan in April 1942. The said demands were the devaluation of the baht to the rate of 100 yen to 100 baht (from 155.7 yen to 100 baht) and the use of the yen as the payment currency for bilateral transactions. The Thai government had no choice but to comply with these demands, as due to the alliance between the two countries, Japan had become Thailand's most important trading partner.

By early 1942, there was an agreement within the Thai government that a full-fledged central bank was needed in order to finance wartime spending more effectively. Accordingly, Prince Viwat was asked to draft a bill establishing a national bank of Thailand. With the cabinet's approval, the draft Bank of Thailand Act was submitted to the Parliament and became law in April 1942. As it was agreed that the Act would only be an enabling law to empower the government to establish a central bank, the government needed to issue a royal decree to stipulate the scope of activities and the authority of the Bank of Thailand to complete the establishment process.³⁷ No one knows how long this final process could have taken. However, the Japanese demand that the Thai government establish a central bank with the assistance of Japanese experts and staff during the same time that the Bank of Thailand Act was being enacted helped accelerate the establishment of the Thai central bank. In order to prevent further Japanese encroachment on Thailand's monetary independence, the Thai government convinced the Japanese that the process of establishing a central bank was already in

³⁷ Bank of Thailand, *50 Years*, p. 80.

progress and they tried to have the royal decree regulating the affairs of the Bank of Thailand drafted as soon as possible. Once again, Prince Viwat was given urgent mandate to draft the decree. The decree was finally approved by the cabinet, signed by the Regent, and became law on December 4, 1942. The Bank of Thailand officially opened for operation on December 10, 1942. Prince Viwat, the former Director of the Thai National Banking Bureau and the Thai Advisor to the Ministry of Finance, was appointed the Bank's first governor.

It took fifty-four years from the first proposal to establish a central bank by a group of British businessmen in 1888 to the establishment of the Bank of Thailand in 1942. There are many apparent reasons for repeated rejections of proposals and numerous postponement of the decision to establish a national bank. The first reason is the suspicion at the time by Thai authorities that the proposals by European businessmen and bankers were exploitative and did not serve the interests of Thailand (read the government) as much as those of the foreign owners. For example, the first proposal by a group of British businessmen led by Clark would have registered the bank under British law, therefore giving it extraterritorial status, while retaining the right to be the Thai government's bank for one hundred years.³⁸ The Thai view was stated clearly by the Foreign Minister, Prince Devawongse, in his letter to King Chulalongkorn regarding the proposal. His opinion was that the proposal would not have been beneficial for Thailand and that to agree to it would have resembled giving the country away.³⁹

A second reason concerns the reluctance of foreign advisors to embrace the idea of a central bank and the perception on the Thai side that the establishment of a central

³⁸ Ibid., pp. 46-47.

³⁹ Prasit Na Pattaloong, *Evolution of the Bank of Thailand*, p. 5.

bank might pose a threat to Western interests. Foreign advisors to the government (most of whom were British) frequently voiced some reservations regarding the establishment of a central bank. These reservations, particularly the ones regarding the Thai government's lack of banking expertise, capital funds, and a well-established commercial banking system, were valid and generally agreed to by the Thai authorities. Nevertheless, the Thai leaders could not help but notice that these advisors might have feared that the establishment of a Thai central bank would have affected their own country's interests, particularly the interests of British finances.⁴⁰ This perception was described in a letter of Prince Mahisara, the Minister of the Royal Treasury, to King Chulalongkorn in 1905, and led to a shift in the government's plan from establishing a central bank to setting up the first Thai commercial bank instead. This decision reflected a political desire not to avoid any threat to Western interests that might lead to conflict. The resignation of Prince Mahisara later in 1906 when he decided to register the Bank of Siam as a commercial bank was another example of the attempt to avoid conflicts with Western powers.⁴¹ After learning that the Minister of the Royal Treasury was actively involved with the establishment of a commercial bank, foreign bank managers began to voice their concerns through their consulate offices. It was reported that the British consulate wrote to the Thai Foreign Ministry saying that Prince Mahisara's involvement with a commercial bank was unfair to other financial institutions. In order to avoid further

⁴⁰ After the signing of the Bowring Treaty in 1855, Britain became Thailand's biggest trading partner. The expansion of trade and the need for financial services attracted British trading houses (in the beginning) and commercial banks (later) to open businesses in Thailand. Foreign banks, led by British banks, dominated the banking sector in the country from the late 1880s until WWII despite increasing competition from local banks. According to Samrarn and Charin, in *History of Thai Banking* (Bangkok: Samaphan Press, 1998), pp. 31-32, there were 12 commercial banks in operation before the outbreak of the Pacific War, 7 of which were foreign banks, and 3 of which were British banks.

⁴¹ Samrarn Rodphet and Charin Chamsakorn, *The History of Thai Commercial Banks*, (Bangkok: Samaphan Press, 1998), pp. 21-22.

controversy and any excuse for aggravating foreign powers, Prince Mahisara decided to resign from office. Finally, the establishment of the Thai National Banking Bureau as a transitory agency in 1939 revealed similar political considerations. The assurance the government gave to foreign banks operating in Thailand that the Bureau would not seek competition with commercial banks, nor any control over them, seemed instrumental in gaining approval from the foreign bank community.

A third reason concerns the Thai government's awareness that it lacked the technical expertise and experience to operate a modern central bank, which would have involved a whole range of monetary and financial activities. The idea and practice of modern banking when it was first introduced through the establishment of foreign trading houses and commercial bank branches beginning in the 1860s was a novelty to Thai society. Partly due to a lack of understanding of the business and partly due to the need not to interfere with the interests of Western powers, the Thai authorities did not try to regulate the financial sector until the interwar years. Accordingly, foreign banks grew to dominate the financial sector and were allowed to monopolize certain financial services, such as foreign exchange, and to perform certain functions for the government, such as the issuing of bank notes.⁴² The establishment of the Bank Club may be seen as a learning process for the Thai state in the banking business before any move to exert more control over the financial sector.⁴³ Consequently, in 1939, the Thai government planned the National Banking Bureau as another learning process for an all-Thai central banking operation. Apart from political considerations with regard to foreign interests, this decision reflected the authorities' concern for the need to build up institutional capability

⁴² Bank of Thailand, *50 Years*, p. 37. See also Samraran and Charin, *The History of Thai Banking*, p. 20.

⁴³ The first Thai commercial bank was also able to offer accessible financial services to the Thais and Chinese, whom were largely discriminated against by foreign financial institutions.

before the establishment of a full-fledged central bank, where credibility had an important role.

A fourth reason relates to the utility of a central bank. There had been no pressures or demands for an institution like a central bank to help regulate the financial system until the first banking crisis in the 1910s. From the 1860s until the early 1900s, foreign trading houses and foreign commercial banks were the only financial institutions that offered banking services in Thailand.⁴⁴ These institutions focused mostly on serving Westerners and nobility, while ignoring average Thai and Chinese customers. Their business was primarily based on exchange transactions for international trade. It was not until the establishment of the Siam Commercial Bank in 1904, which later became the Siam Commercial Bank, that local commercial banks started to open for business and by the late 1900s there were three local commercial banks in operation.⁴⁵ When a series of banking crises struck these banks in 1909 and 1913 largely due to a domestic recession, demands started to emerge for a central bank that would serve as lender of last resort for insolvent institutions. As mentioned earlier, there was an attempt to turn the Siam Commercial Bank into a central bank, but the plan was delayed due to the outbreak of World War I. There were also no overwhelmingly pressing demands in terms of monetary management before the Pacific War. Monetary policy had been decided under the advice of foreign advisors and Thailand had been pursuing conservative monetary policy throughout its history of modern government, which helped maintain relative price

⁴⁴ There were also pawnshops but they did not function like commercial banks because they did not take deposits. According to the Bank of Thailand, pawnshops were almost the only choice of source of credits for the Thais and Chinese because foreign commercial banks tended to discriminate against Thai and Chinese customers.

⁴⁵ Bank of Thailand, *50 Years*, p. 35.

stability.⁴⁶ However, it was the particular circumstances on the eve of WWII, i.e., the imposition of exchange controls by Britain and its Dominions that convinced the Thai government to proceed with the establishment of the Thai National Banking Bureau. As the Pacific War progressed, the need for a central bank grew as the government faced the challenge of balancing between the need to finance rising wartime expenses and the need to maintain price stability. Accordingly, the decision to finalize the process of central bank establishment was made.

The skepticism of military and civilian leaders toward Pridi's socialistic economic plan was also another reason that the idea to establish a central bank was postponed during the early 1930s. It is important to recognize the strength of the conservative elements within the Thai state, particularly among the military and bureaucrats. Despite the change to a constitutional monarchy, there was a continuation in ideology and policy preferences in most policy-areas. Monetary and financial policy was no exception. Monetary and financial conservatism remained the policy paradigm of the Thai policymakers after 1932. Therefore, the idea of a central bank serving an interventionist government with economic policies aimed toward redistribution and nationalization of enterprises would not have been compatible with the preferred macroeconomic conservatism. The rejection of the plan, followed by the dissolution of the Parliament and the formation of a new cabinet, reflected the dominant position of the conservatives and their policy paradigm.

⁴⁶ For example, Ingram notes that from 1902-1941 Thailand's foreign exchange reserves were at the level of 100 percent of the money in circulation. Despite the trade-off in development spending, the attempt to maintain a very high level of reserves helped keep the value of the baht relatively stable throughout the period. See more detail in Ingram, *Economic Change in Thailand*, pp. 152-162.

To conclude, the above reasons indicate two underlying concerns that preoccupied the Thai authorities with regard to monetary and financial management. The first concern was the fear of losing monetary and financial independence to foreign powers. The preceding discussion shows that the Thai government chose to make certain concessions to avoid direct conflicts with colonial powers before WWII, or with Japan during WWII, in order to preserve independence. The delay in the establishment of a central bank before 1942 and the rush toward such an establishment at the outbreak of the Pacific War can be understood within this perspective. Closely related to the concern for independence was the concern for credibility. The attempt to experiment with commercial bank business and to set up a transitory agency to train and prepare personnel for future central bank operations can be seen as part of the preparation toward the establishment of a credible agency to manage monetary and financial affairs. The concern for credibility can also be seen in the government's continued commitment to macroeconomic conservatism, the details of which will be discussed in the next section.

Development of Monetary Conservatism

It is important to discuss the development of monetary conservatism prior to the discussion of the autonomy of the Bank of Thailand because the Bank's ability to maintain price stability was largely based on its commitment to monetary conservatism. This policy orthodoxy was deeply rooted in the country's experience in managing monetary and fiscal affairs beginning in the period of colonialism. The experience of colonial conquests in the region pressured the Thai leaders to avoid any policy and

diplomatic initiatives that might risk the country's independence.⁴⁷ Monetary policy was considered a policy area frequently used by colonial powers as an excuse for intervention. For example, Silcock notes that King Chulalongkorn was well aware that insolvent loans could be a source of economic pressure that the colonial powers could use to exert domination.⁴⁸ In citing Thio (1956), Silcock points out the direct experience of the King in surrendering Kedah to the British because the local ruler could not repay a loan he took from British subjects in Penang.⁴⁹ Accordingly, learning from experience, it became a preoccupation of the Thai leaders to maintain sound monetary and fiscal conditions in order to avoid any opportunity for foreign interference based on an excuse of financial irresponsibility.

The adoption of monetary and fiscal conservatism was part of the larger process of bureaucratic reform of King Chulalongkorn during the early 1890s to modernize the Thai bureaucracy to be functionally differentiated and centralized under a Western model of administration.⁵⁰ The Ministry of the Royal Treasury, which was responsible for monetary and fiscal policy, was therefore re-structured to centralize all financial controls within one organization.⁵¹ The government also started to hire foreign advisors to give advice on a whole range of policy areas, including finance.⁵² It was under this

⁴⁷ Ian Brown, "British Financial Advisers in Siam in the Reign of King Chulalongkorn," *Modern Asian Studies*, 12, 2 (1978), p. 211.

⁴⁸ T.H. Silcock (ed.), *Thailand: Social and Economic Studies in Development*, (Durham: Duke University Press, 1967), p. 170.

⁴⁹ *Ibid.*, p. 170.

⁵⁰ Girling, *Thailand: Society and Politics*, pp. 45-46. Girling, citing Vickery, notes that the King chose to follow the model of British colonial administration in Burma and Malaya. See also Michale Vickery, "Thai Regional Elites and the Reform of King Chulalongkorn," *Journal of Asian Studies* 29, no. 4 (August 1970): 873, 875.

⁵¹ An example of a lax in fiscal control is in the area of tax collection. From the beginning of 19th century, tax collection was contracted out to Chinese merchants and provincial leaders.

⁵² The first advisor to the Treasury Ministry was an Englishman by the name Alfred Mitchell-Innes, who had served with the British administration in Egypt, upon the recommendation of Lord Cromer the British proconsul. Mitchell-Innes was appointed to the position in 1896. Ian Brown notes that the idea of

‘Westernized’ institutional structure that conservative monetary and fiscal policies began to take shape and succeed not only in providing the court with more revenue and better financial control, but also in gaining international recognition.⁵³ Interestingly, while some Southeast Asian scholars, like Osborne, credit the process of ‘Westernization’, particularly the reliance on foreign advisors, for helping Thailand evade colonization, other writers, such as Girling, suggest that ‘indirect colonization’ played an important role in affecting the pattern of political development of Thailand.⁵⁴ While it is not the focus of this thesis to answer this question, it is important to acknowledge Western influences in Thailand’s modern government and administration. It is also important to keep an open but critical mind on the implications of the ways these governing and administrative ideas and technologies were introduced to Thai society and how they helped certain groups in the society maintain control. In the case of monetary and financial management, it may be argued that the financial virtues and techniques introduced by foreign advisors contributed significantly to the consolidation of power of the political elite. This power did not merely mean the overall financial control of the state over the kingdom, but also the specific power of the Ministry of the Royal Treasury as the ‘gatekeeper’ of the country’s wealth. Accordingly, it is important to see the relationship between the commitment to monetary and fiscal conservatism and the power of the Thai state in general and of the Treasury Ministry (at this point) in particular.

appointing financial adviser was suggested to King Chulalongkorn by a Belgian general and legal adviser, Rolin-Jacquemyns. See further details in Ian Brown, (1978). See also Walter F. Vella, *The Impact of the West on Government in Thailand*, (Berkeley: University of California Press, 1955), pp. 342-344. Vella also lists the policy-areas, to which foreign advisors were appointed. They included finance, customs, internal revenue, survey, forests and mines, police, education, irrigation, railways, military, judiciary, and foreign affairs.

⁵³ Silcock, *Thailand: Social and Economic Studies in Development*, p. 172. See also Milton Osborne, *Southeast Asia: an Introductory History*, 8th ed., (Crowns Nest: Allen&Unwin, 2000), pp. 71-72.

⁵⁴ Girling, *Thailand: Society and Politics*, p. 47.

The distinct characteristics of monetary and fiscal conservatism recommended by foreign advisors were reflective of European financial virtues of the late 19th century, which gave priority to prudence, austerity, and strict discipline.⁵⁵ Among the most apparent policies following these virtues was the maintenance of a very high level of currency reserves. This policy was pursued consistently by the Thai authorities well into the 1950s, with the exception of the period during and immediately after WWII, to maintain currency stability and convertibility. According to Ingram, from 1902-1941, a foreign exchange reserve was maintained close to 100 percent of notes in circulation.⁵⁶ During the fiscal year of 1930/1931, the Currency Reserve reached 130 percent, and after WWII the reserve rose steadily until it reached 100 percent level in 1951.⁵⁷ Financial prudence also reflected in the setting up of a gold standard reserve in 1907 in addition to the foreign exchange reserve as a stabilization fund to guarantee the convertibility of the baht.⁵⁸ The need to maintain these reserves may be seen as taking priority over many other government projects. For example, Ingram notes that when a loan was raised abroad in 1907 for £2,767,500, £1,432,500 or over 50 percent of the total loan was placed into the gold standard reserve.⁵⁹ The conservative administration of the reserves was also encouraged by the Currency Act of 1928, drafted by a British foreign advisor, Sir Edward Cook. The foreign exchange reserve and the gold standard reserve were transferred to

⁵⁵ Silcock, *Thailand: Social and Economy Studies*, p. 171.

⁵⁶ The exchange reserve was established in 1902 when the government issued its paper money for first time. Prior to 1902, three foreign banks were authorized to issue banknotes, which could be exchange for currency. From 1902 to 1919 according to the Note Act of R.E. 121 (1902), the notes were not technically legal tender because the government stipulated that it would exchange them for precious metal currency. After 1919, the government stopped exchanging currency for notes, and notes became practically legal tender until 1928 when the Currency Act legally changed their status from promisory notes to currency. See for detail in Bank of Thailand, *50 Years*, pp. 24-32.

⁵⁷ Ingram, *Economic Change in Thailand*, p. 171.

⁵⁸ Ibid., p. 171. The gold standard reserve was established according to the Gold Standard Act of R.E. 127 (1907).

⁵⁹ See Ibid., p. 171.

the Currency Reserve, separated from the remainder of treasury funds. The Act stipulated clearly that funds could only be withdrawn from the Reserve under two conditions: first, a withdrawal could be made in exchange for the same amount of notes withdrawn from circulation; second, a withdrawal could be made to reimburse the government if a prior transfer from the Treasury was made to the Reserve to keep it at a required ratio.⁶⁰ By restricting the use of reserve funds strictly to monetary purposes, the Currency Act of 1928 further institutionalized the practice of accumulating a large amount of non-dispensable liquid funds to support currency stability and convertibility. The implications of the pursuit of this type of policy will be discussed shortly.

The attempt to maintain a balanced budget or a budget surplus was also part of the monetary and fiscal conservatism. Silcock notes the connection between financial virtues, presumably austerity and self-discipline, and the management of government revenue and budgets. In referring to the early influence of British financial advisors in the late 1890s, he writes, “The Thais were encouraged to set strict standards in the collection and use of public funds, living within their income, borrowing only for strictly productive purposes.....”⁶¹ This fiscal conservatism continued to be the government’s commitment well into the period of constitutional monarchy.⁶² Ingram notes that despite the economic downturn and upturn of the 1920s and 1930s, the government managed to

⁶⁰ This scenario might occur due to a change in values of the legal assets of the reserve when there were changes in market rates at the time of annual revaluation.

⁶¹ Silcock, *Thailand: Social and Economic Studies*, p. 171.

⁶² This does not mean that the government never experienced budget deficits. In the early 1910s, the Bank of Thailand notes that a large amount of government expenditure was used to finance government administration, defense, and royal expenditure. The fiscal deficits led to the drawing from the Treasury Reserve and borrowing from abroad. For detail, see in Bank of Thailand, *50 Years*, p. 14. However, Wyatt notes that King Rama VI appointed a Committee to Inspect State Revenue and Expenditures, comprising two Treasury officials and three foreign advisors, to implicitly reassure the public and the international financial community of his government’s financial accountability after the 1911-1912 budget deficits. According to Wyatt, by 1913 the government started to experience a substantial budget surplus. For reference see Wyatt, *Thailand*, pp. 227-228.

keep balanced budgets, if not budget surpluses, throughout these periods, with the years from 1932 to 1935 experiencing the largest surpluses.⁶³

Monetary conservatism can also be seen in other forms of government actions and non-actions. Ingram points out that the unwillingness of the Ministry of the Royal Treasury in the 1900s and 1910s to make changes to the weight or fineness of the Thai silver coins was partly due to the fear that such actions would jeopardize public confidence in the metal currency.⁶⁴ As a result, the government experienced problems related to the fluctuation of the price of silver, which finally led to a devaluation of the baht in 1920 when the price of silver rapidly exceeded the face value of the coin.⁶⁵ Ingram also refers to the government's hesitation to drive the rupee and the Straits dollar out of circulation in the northern and southern parts of the country respectively due to the concern that its foreign exchange reserves might not be sufficient to replace them. British foreign advisors also expressed reservations on the issue of pressing the baht into circulation by referring to the limited resources of the government and the vulnerability of the country's monetary conditions to the fluctuation of silver.⁶⁶ It is quite understandable that with the reservations on both sides about the capability of the Thai government to manage the baht in circulation, the idea to establish a central bank was postponed repeatedly.

The extent of the influence of British financial advisors on the Thai monetary and fiscal policies is worth explaining. It is clear that these advisors played an important role in guiding the direction of Thailand's macroeconomic policies through their policy

⁶³ Ingram, *Economic Change in Thailand*, p. 162.

⁶⁴ Ibid., pp. 153-154, 171-172.

⁶⁵ Bank of Thailand, *50 Years*, p. 14.

⁶⁶ Ingram, *Economic Change in Thailand*, p. 172.

recommendations, some of which have been mentioned above. These policy recommendations were modeled on the financial virtues and practices that were valued and exercised by their fellow countrymen both in their homeland and in their various colonial administrations. Accordingly, Silcock is right to a great extent in pointing out these advisors' genuine commitment to promote honesty, efficiency, and rationality in the management of monetary and fiscal affairs.⁶⁷ However, their connection with the British government makes it difficult to disregard the idea that the advisors' recommendations might be influenced by the British government, whose incentives could be linked to the preservation of British interests.⁶⁸ As mentioned above, evidence shows that the Thai leaders had held this belief, particularly as a result of the British advisors' lack of support for the establishment of a central bank. Great Britain developed significant economic interests in Thailand and the possibility of a connection between reservations toward central bank establishment and the preservation of British interests cannot be overlooked. What is more curious is that despite their skepticism, the Thai authorities chose to continue to rely on these foreign advisors for recommendations regarding the country's macroeconomic management, while resorting to other means in balancing out the influence of foreign advisors.⁶⁹ This scenario suggests first that the Thai government

⁶⁷ Silcock, *Thailand: Social and Economic Studies*, p. 172.

⁶⁸ For example, Ingram notes that in 1933, the foreign advisor, James Baxter, asked for advice from the Bank of England regarding the sale of silver from the Currency Reserve. The Bank of England agreed with the sale but did not agree with using the proceeds for capital investment.

⁶⁹ In order to prevent the domination of foreign advisors from one particular country, the government sought to hire advisors from many countries to different policy-areas. In *Economic Change in Thailand* (p. 152), Ingram notes that Americans were employed as general advisors, the French and Belgian as legal advisors, and the British as financial advisors. Dixon offers a longer but complementary list of foreign advisors by various Ministries: the Ministry of Justice hired French lawyers, the Railway Department used German engineers, the Royal Navy employed the Danes, and the Ministry of Foreign Affairs the Americans. See Chris Dixon, *The Thai Economy: Uneven Development and Internationalisation*, (London: Routledge, 1999), p. 32. An example of a balancing act can be seen in the Bank of Thailand's account regarding the drafting of the Thai National Banking Bureau. Besides assigning Prince Viwat to take over the final drafting after the British financial advisor left for a home leave, the government asked an

was aware of the overwhelming need for administrative ideas and techniques to run the modern bureaucracy more effectively (so that it could consolidate power and gain international recognition). Second, being aware of the inevitable inseparability of the interests of foreign advisors and that of their governments, the Thai government came to accept the indirect influence of colonial powers, while building domestic capacity as a means to avoid direct colonization. Accordingly, orthodox monetary conservatism may be the result of British influence in monetary policy that not only preserved financial stability for Thailand, but also served British interests. The need to accommodate British interests reflected the negative incentives underlying this policy preference.⁷⁰

Nevertheless, monetary conservatism contributed significantly to the relative financial stability of Thailand from the beginning of 20th century, which for many Thai leaders was an integral part to the preservation of independence. The maintenance of high reserves, the keeping of balanced budgets or budget surpluses, the limiting of foreign borrowing to a low level, and other conservative monetary and fiscal policies contributed to currency stability and convertibility as well as fiscal discipline, which the leaders took as the basis for international credibility. However, it is important to take note of certain implications of the commitment to monetary conservatism. First, to maintain a large stock of liquid funds without any plan to use them implies that the government did not have available funds for capital investment other than its revenues. The commitment to fiscal discipline and the restrictions on fiscal measures due to treaties

American foreign policy advisor to assist with the process, particularly in convincing the international financial community to approve the law. See Bank of Thailand, 50 Years, pp. 55-56.

⁷⁰ For Brown, among the major factors influencing Siam's economic and financial policies was the need to preserve political independence. See Brown, "British Financial Advisors in Siam," pp. 211-213.

with Western powers further limited the scope of government spending.⁷¹ Were there a need for extra funding, the government had to resort to foreign borrowing, over which it also maintained a tight lid, rather than drawing from the reserves. This situation resulted in several postponements of development projects, such as irrigation, railway, and road construction, which might have benefited the country earlier.⁷² Therefore, it may be said that the pursuit of monetary conservatism created adverse effects on Thailand's early infrastructure development by placing financial limitations on capital expenditures. The prioritizing of monetary stability over development persisted throughout the history of the Bank of Thailand, with the exception of the Bank's rediscount facilities during the 1970s, which could be seen as the closest it has come to developmental lending. The incentives behind this limited developmental role will be discussed in chapter 5.

Second, monetary conservatism reflected the interconnectedness of the Thai and international monetary systems and how such a connection shaped the prioritization by the authorities of maintaining currency stability and convertibility. The adoption of the gold standard in 1902 tied the baht to the price of gold, while the government promised to exchange the baht for sterling (and after 1911 for the US dollar after Britain abandoned the gold standard). The financial advisor recommended the switch to the gold standard

⁷¹ For example, the Bowring Treaty signed in 1855 limited the import tax to no more than 3 percent. Among the implications of these unfair treaties was that the Thai government could not earn from any tariff or other forms of import restrictions.

⁷² Ingram notes that irrigation works were postponed from 1903-1916 through the recommendation of the British financial advisor due to lack of funds and the hesitation to borrow from abroad. Silcock also described a 40-year delay in the construction of the Chainat Dam, which was later funded by a World Bank loan in 1957. He notes that the earlier construction proposal would have resulted in a larger dam and helped alleviated the impact of post-war drought, which had severe effects on the agricultural sector. Brown, while seeking to undermine the influential role of foreign advisers in rejecting irrigation projects suggested by Ingram, endorses the idea of fiscal limitation shared by the Siamese government elite. He sees the financial difficulty of the Siamese government in trying to finance all the public work projects solely from annual revenue as the main reason for the government's limited enthusiasm for irrigation projects. See Ingram, *Economic Change in Thailand*, p. 202; Silcock, *Thailand: Social and Economic Studies*, p. 173; and Brown, "British Financial Advisors", p. 201-204, respectively.

so that Thailand could attract foreign loans and investment. The previous system of the silver standard had caused the baht to depreciate due to the fall in price of silver (from 8 baht per pound sterling to 21 baht per pound sterling), which severely affected business transactions and financial activities.⁷³ After the adoption of the gold standard, the maintenance of a high foreign exchange reserve and gold standard reserve became the priority of the government in order to assure a stable price for the baht and its convertibility. While development projects and other capital investment suffered from this monetary commitment, international creditors benefited the most from a stable and fully convertible baht. The government's commitment to meeting international obligations, which largely originated from the fear of colonization, was now shaped by the more sophisticated form of power of the international financial system in the name of international credibility. It will be seen later in chapters 5 and 6 that Thailand became more and more deeply incorporated into the international financial system by the early 1990s and this time the impact of the structural power was more pronounced and devastating.

Certain perceptions and understandings of monetary and financial management persisted from the late 1890s until the establishment of the Bank of Thailand. These perceptions may be seen as a process of collective learning. A common understanding transcended a period of far reaching constitutional change and was embedded into the bureaucracy. The endurance of this 'conventional wisdom' means that the Bank of Thailand did not start out from scratch ideationally speaking, but with a solid policy tradition (policy paradigm) and specific perceptions about its role in the Thai state and society. This phenomenon demonstrates what Selznick views as the infusion of values

⁷³ Ingram, *Economic Change in Thailand*, p. 152.

within an organization, especially among the top leaders, which enables institutional cultures and characters to take root over time.⁷⁴ Among the most important perceptions held by the monetary authorities was the importance of sound monetary and financial policies to Thailand's independence and international credibility. Such soundness was rooted in the ideas of macroeconomic conservatism, which among other things prioritized high reserves and low inflation over developmental spending. This policy paradigm was institutionalized through the continued commitment to such policies and the enactment of a series of laws, such as the Note Act of 1902, the Gold Standard Act of 1907, and the Currency Act of 1928, which remained in use until the late 1950s.

This policy paradigm and its connection to the country's independence and credibility formed the basis of the institutional power of the Ministry of the Royal Treasury and later the Bank of Thailand. It is important to note that the institutional power resulting from these institutions' management of monetary affairs, particularly the control of the use of all reserves, of the money supply, and of the exchange rate, was restrictive in nature. It will be seen that the Bank of Thailand exercised its restrictive power with the support of its relative autonomy until the late 1980s when the process of financial liberalization was launched.

Second, the success of monetary conservatism, at least in the eyes of its proponents, in projecting Thailand's financial credibility, which was largely instrumental to the country's independence and international recognition, granted the monetary bureaucrats a legitimate role as protectors of national financial interest. This role gave importance to certain qualities in the monetary authorities, such as a commitment to the public interest (as opposed to personal or group interests), honesty, excellence in

⁷⁴ Selznick, *Leadership in Administration*.

expertise, and being guided by principles. These qualities, which continued to be pursued by the leaders and officers of the Bank of Thailand, were essential to the Bank's moral authority. It will be seen later that this moral authority, which was deeply rooted in the country's monetary management tradition, served as a significant source of the Bank's autonomy.

Third, monetary authorities of the pre-BOT period were aware of the mutually reinforcing role of monetary and fiscal conservatism in bringing about financial stability. The fact that the Ministry of the Royal Treasury was responsible for both policies before the establishment of the Bank of Thailand and that there was a general agreement among a small circle of decision makers over conservative policy direction facilitated such the coordination and synchronization. The granting to the Ministry of Finance of supervisory power over the Bank of Thailand by the drafter of the Bank of Thailand Act of 1942 can partly be understood as an intention to maintain policy coordination and control.⁷⁵ However, as political leaders began to take control over policy direction at the Ministry of Finance, divergence in monetary and fiscal policies emerged. While the Bank of Thailand sought to carry on the torch of monetary conservatism, the Ministry of Finance became increasingly instrumental to the military and civilian governments' political aspirations. It will be seen in the following chapter that the success of the Bank of Thailand in preserving price stability, particularly during the first three decades of its

⁷⁵ Prince Viwat who drafted the Bank of Thailand Act had a very close tie with the Ministry of Finance (or the Ministry of the Royal Treasury until 1932) and was very instrumental in the establishment of the Bank of Thailand. Among the many positions he assumed at the Ministry of the Royal Treasury were the Director-General of Revenue Department, and Director-General of Customs Department. He was the first Thai financial advisor, the second Director of the Thai National Banking Bureau, the first Bank of Thailand Governor (1942-1946), the Minister of Finance (1947-1948) and returned to the post of the BOT Governor for a second term (1948). See, in more detail, his biography in Bank of Thailand, *Viwatanajaiyanusorn* (In Memory of Viwatanajaiya), (Bangkok: Bank of Thailand, 1961).

history, largely resulted from the Bank's ability to use various strategies to promote monetary and fiscal coordination.

Chapter Three

The Making of the Relative Autonomy of the Bank of Thailand

This chapter seeks to address the institutionalization of the Bank of Thailand as a state regulatory arm in monetary and financial management and national representative within the international financial regimes. It examines the first three decades (1942-1973) of the BOT, during which the Bank transformed from a small organization established on an urgent basis during World War II to a strong institution widely recognized for its moral authority and technical expertise. The Bank's ability to implement sound monetary and financial policies in leading the economy out of the economic turmoil in the aftermath of WWII toward a relatively stable and constantly growing economy by the 1960s won widespread respect. The BOT's relative autonomy from government interference during this period, particularly during the governorship of Peuy Ungphakorn (1959-1971), played an important role in contributing to the Bank's ability to pursue its policy preferences, which were largely geared toward the maintenance of price stability and a stable financial system. Its increased authority and leverage over the financial sector, achieved over time through various strategies, also helped facilitate the institution's pursuit of these policy mandates.

Explaining the making of the Bank of Thailand's relative autonomy is the main focus of this chapter. To do so, it first discusses the basis of the BOT's relative

autonomy from the government by examining the legal framework, which provided for the Bank's authority and the scope of its responsibilities. Then it moves to discuss the making of the BOT's autonomy from the executive through an examination of a number of indicators to demonstrate that, despite the limited legislative provisions, in practice the Bank enjoyed a significant degree of freedom in performing its role in macroeconomic management and economic development. These indicators include the BOT's ability to maintain relative price and currency stability, the ability to push for exchange liberalization, the twelve-year tenure of Governor Puey, and the BOT's budgetary and administrative independence. The last section discusses the building of the Bank's autonomy from the financial sector. It explores the history of BOT-financial sector relationship and how the Bank was able to increase its authority and leverage over this sector over time, particularly through legal amendments and the BOT's policy to keep the financial sector relatively closed from both foreign and domestic competition. Special attention will be paid to the Bank's adaptive role in taking advantage of the opportunities presented by circumstances and in coping with the constraints imposed by the institutional context. The BOT's ability to adopt various strategies to help it achieve its policy objectives is also central to the understanding of the making of its relative autonomy. Finally, the concept of autonomy will be treated in a broad and differentiated sense, including the formal (legal), informal (behavioral), and relational (with different actors) dimensions.

The Legislative Framework and the Legal Autonomy of the Bank of Thailand

The Bank of Thailand Act was enacted in April 1942 following demands by the Japanese to establish a central bank as well as to devalue the baht and use the yen as a settlement currency. The Thai government agreed to comply with the last two demands, while insisting on establishing its own central bank since such a process was already in progress. When the cabinet approved the Royal Decree Regulating the Affairs of the Bank of Thailand in December 1942, the Bank of Thailand was officially established and opened for operation.

Debates around the issue of central bank establishment from the late 1890s focused largely on the issues of the interests and sovereignty of the Thai state, the actual demands for a central bank, the would-be central bank's proper role and responsibilities, and the right timing for its establishment. The issue of the authority of a Thai central bank was never a point of serious debate or controversy. Even though the issue of central bank autonomy, particularly internal autonomy (its relationships with other government agencies), was not absent from the considerations of the Bank's creators, it was not a major point of political contention. In fact, the government seemed to have a large degree of freedom in establishing the framework of interactions of firstly the Thai National Banking Bureau and later the Bank of Thailand to fit its perception of the proper relationship between the new agencies and the government itself. It is also interesting to note the government's skepticism about the legislative branch, reflected in the selection of legal processes to bypass Parliament's input in specifying the responsibilities of both institutions. Such skepticism and the bias toward the executive, which was at that time dominated by former bureaucrats, may be seen as reinforcing the so-called image of a

‘bureaucratic polity’, in which, despite parliamentary form of government, actual political power rested in the hands of military and civilian bureaucrats.¹

Accordingly, as a transitory agency, the Thai National Banking Bureau was quite naturally placed under the directive of the Ministry of the Royal Treasury, which had been formerly responsible for the management of monetary affairs. The legislative process in establishing the Bureau also reflected the power of the Treasury Ministry over the new agency. While the Act on Establishment of the Thai National Banking Bureau B.E. 2482 (1939) stipulated how the Bureau was to be established, the Ministry of the Royal Treasury was authorized to issue a ministerial regulation to define the activities and authority of the Bureau.²

The legislative process to establish the Bank of Thailand was different but still echoed the influence of the executive more than that of the legislative branch. At the time of drafting, it was agreed by the cabinet that the Bank of Thailand Act should simply be an ‘enabling’ act to empower the government to issue a royal decree establishing the Thai central bank. The Bank of Thailand explains that the rationale for this arrangement was to avoid the lengthy legislation as of other countries’ central bank laws. As the idea of central banking was relatively novel to Thai society, there was a concern within the government that some members of Parliament might attempt to amend the draft legislation in a way that could alter the original intent of the law.³ Tull Traisorat notes the disagreement and reservations in the Parliament when the draft Act was being deliberated. For example, the necessity of a central bank was questioned given that the

¹ See Fred W. Riggs, *Thailand: the Modernization of a Bureaucratic Polity*, (Honolulu: East-West Center Press, 1966).

² The Act stipulated that the Bureau be established as a political bureau with a capital fund as determined by the Treasury Ministry but not exceeding 10 million baht. See Bank of Thailand, *50 Years*, p. 57.

³ *Ibid.*, p. 80.

Treasury Ministry had already been doing a good job in monetary management. Some MPs were also concerned with the possibility of a depreciation of the baht if bank notes were to be issued by the new central bank.⁴ Accordingly, the Bank of Thailand Act only stipulated the BOT's constitution, the required capital funds and reserves, the arrangements for the control and management of the Bank's affairs, the Bank's central banking roles, and the requirements for the audit and examination of the Bank. The elaboration of the scope of the Bank's activities was left to a Royal Decree drafted by the government. As mentioned above, the Royal Decree Regulating the Affairs of the Bank of Thailand was approved by the cabinet in December 1942, leading immediately to the opening of the country's first central bank.

As the formal legislation aimed to provide the government some discretion in the scope of authority and activities of the new national bank, it is important to divine the intention embedded in both the Bank of Thailand Act and the Royal Decree to learn about the Bank's legal autonomy. Even though legal autonomy is only one among several dimensions of actual central bank autonomy⁵, it helps inform us of the formal framework of actions intended for a central bank by lawmakers.⁶ It is against this framework that one must situate actual central bank autonomy by also looking into other informal factors influencing the behavior of the central bank in question, in this case the Bank of Thailand. These informal factors will be discussed in the next section. What is of concern here is the original legal framework that helped determine the autonomy of the

⁴ Tull Traisorat, *Thailand: Financial Sector Reform and the East Asian Crises*, (Cambridge: Kluwer Law International, 1999), p. 13.

⁵ Alex Cukierman, *Central Bank Strategy, Credibility, and Independence: Theory and Evidence*, (Cambridge: The MIT Press, 1992), p. 369.

⁶ *Ibid.*, p. 371.

Bank of Thailand by serving as a structure of incentives and restrictions imposed on the interactions between the Bank and other actors.

Before discussing the legal autonomy of the Bank of Thailand, it is important to first define what is meant by the term ‘autonomy’? As the term suggests the subject’s ability to self-direct and govern, implying the absence of outside interference, the question is then: autonomy from whom? Students of the political economy of central banking usually take such autonomy to be autonomy from the executive branch, which arguably has the inclination to spend money for political purposes that may in turn cause inflation. Accordingly, a central bank, which is usually seen as having a ‘conservative bias’ with regard to monetary policy, needs to be autonomous from the government’s political interference if it is to be able to maintain price stability. But Maxfield has rightly pointed out that central bank autonomy can also importantly mean autonomy from other actors, such as from the legislative branch or societal groups, particularly the financial sector.⁷ The intentions of the Thai military/bureaucratic government to avoid the expansionary impulse of Parliament members supported this view.⁸ The urgent establishment of the Bank of Thailand due to the government’s attempt to forestall Japan’s interference with Thailand’s monetary autonomy shows that interference can also come from external actors. This external dimension of central bank autonomy is much less studied except for colonized or occupied economies. It is also treated less critically due to the assumption that modern central bankers are alike in their conservative bias and thus monetary convergence across countries is voluntary rather than compliant. This

⁷ Sylvia Maxfield, *Gatekeepers of Growth: the International Political Economy of Central Banking in Developing countries*, (Princeton: Princeton University Press, 1997), pp. 19-20.

⁸ Prince Viwat noted the enthusiasm of the young politicians to expand agricultural credits in his memoir, in Bank of Thailand, *Viwatanajayamusorn*, 1961.

issue will be revisited in chapter 5 and 6. The argument here is that there are several dimensions to the question of ‘autonomy from whom’, therefore it is important not to lose sight of the concurrent political context in which a central bank is designed to operate. While acknowledging that the narrow concept of autonomy (from the government) is a major element of the Bank of Thailand’s independence, this thesis seeks to examine the wider concept of autonomy, particularly when discussing the informal sources of the Bank’s independence.

Despite the attention given to the concept of central bank autonomy, particularly in a broader sense, it is quite commonly accepted that a central bank should not be completely autonomous and, based on empirical evidence, none has been so. Stanley Fischer distinguishes between two concepts, ‘goal independence’ and ‘instrument independence’, in his account of modern central banking and argues that a central bank should have the latter, not the former.⁹ Goal independence refers to a central bank that sets its own goals, while instrument independence means a central bank that has the freedom and discretion to use monetary policy to achieve its assigned goals. The principal-agent approach, generally applied by economists to explain a central bank-government relationship, is consistent with the concept of instrument independence.¹⁰ Central to both theoretical and practical preferences in favor of an instrument independent central bank is the issue of accountability.¹¹ In the context of liberal democracies, where most studies of central banks originate, it seems reasonable and

⁹ Stanley Fischer, “Modern Central Banking”, in Forrest Capie, Stanley Fischer, Charles Goodhart, and Norbert Schnadt, *The Future of Central Banking*, (Cambridge: Cambridge University Press, 1994), p. 292.

¹⁰ This is an economic concept, referring to a contractual relationship under which a person or a group of persons (the principal) engage another party (the agent) to carry out certain activities on the former’s behalf, the process of which could include the transferring of some authority to the latter.

¹¹ In “Modern Central Banking”, Fischer discusses why instrument independence is preferred over goal independence.

necessary to compensate for the democratic deficits of non-electoral institutions (such as central banks) by executive or parliamentary oversight. However, when one looks at the political history of a developing country like Thailand, which at the time of central bank establishment was under de facto authoritarian rule dominated by military and civilian bureaucrats, one may find a different rationale behind the seemingly similar preference for an instrument independent central bank. This is to say that the legal intention for a central bank cannot be fully understood outside the political and socio-economic context or without referring to the notion of power.

With regard to the legislative frameworks for the establishment and the functioning of the BOT, it may be said that the laws have sought to define the relationship between the Bank and the government and to grant the Bank the authority to carry out its responsibilities. In other words, the laws have provided for the extent of the Bank's autonomy from the executive branch and the freedom and power to do its jobs. The legal characteristics for this autonomy and authority can be found in certain areas of statutory stipulations. Based on the standard legal indicators used to determine central bank autonomy¹², the chapter now examines the following stipulations of the Bank of Thailand Act of 1942 (the BOT Act) and the Royal Decree Regulating the Affairs of the Bank of Thailand of 1942 (the Royal Decree).

First, it is commonly viewed that when the government has little authority to appoint and dismiss central bank governor and when the governor's term does not

¹² For a comprehensive study of legal central bank independence, see Cukierman, *Central Banking Strategy, Credibility, and Independence*. For discussions of legal indicators see Maxfield, *Gatekeepers of Growth*. See also Delia M. Boylan, *Defusing Democracy: Central Bank Autonomy and the Transition from Authoritarian Rule*, (Ann Arbor: University of Michigan Press, 2001) and William Bernhard, *Banking on Reform: Political Parties and Central Bank Independence in the Industrial Democracies*, (Ann Arbor: University of Michigan Press, 2002). Despite methodological differences, quantitative and qualitative studies of legal central bank independence tend to agree generally on the legal characteristics served as indices for independence.

correspond to that of a government, that particular central bank can be considered quite autonomous. In this respect the BOT does not fare well as the BOT Act empowers the cabinet to recommend the Crown to appoint and dismiss the governor or deputy governors.¹³ There is no stipulation regarding the term in office of the Bank's top executives, therefore giving the cabinet the discretion to make changes to the Bank's top positions. However, the absence of tenure stipulation can work toward the Bank's advantage when there is a political consensus to keep a particular Bank Governor in office. The ability of Dr. Puey to remain in office for twelve years during a period of military rule is a case in point.

Second, the provision for the resolution of conflict regarding policy issues is also regarded as an indicator of central bank autonomy. In this regard, the BOT Act, once again, empowers the Minister of Finance to make the final decision should there be a disagreement between the governor and the majority of Bank directors¹⁴, who form the executive body of the organization of which the governor is the ex officio chairman.

Third, a central bank is believed to be more autonomous if its main objective stipulated in the law is to maintain price stability as opposed to one which has multiple objectives that may or may not include price stability. According to Cukierman, this is due to the central bank's ability to 'elevate the target of price stability above other objectives'.¹⁵ Interestingly, the objective of price stability was clearly mentioned in the preamble of the draft BOT Act.¹⁶ However, the preamble was dropped from the final

¹³ Bank of Thailand Act of 1942, Section 19.

¹⁴ Ibid., Section 17. The directors, who together with the governor and deputy governors form the executive body of the BOT, called the Court of Directors. They are appointed and removed by the cabinet upon the recommendation of the Minister of Finance (Section 19).

¹⁵ Cukierman, *Central Banking Strategy, Credibility, and Independence*, p. 377.

¹⁶ The draft BOT Act as published in Bank of Thailand, *Viwatanajayanusorn*, pp. 20-36.

version of the law passed by the Parliament. Nevertheless, despite the absence of a legislative stipulation, the BOT always upheld as its mandate the task of preserving price and currency stability.

Fourth, the existence and conditions of legal limitations on the ability of the government to borrow from the central bank is another standard indicator of legal independence. The general assumption is that the stricter the limitations, the more autonomous the central bank from the government. In case of the Bank of Thailand, the Royal Decree provides that the government can get unsecured loans and advances from the Bank to finance its budget at the amount of no more than 25 percent of the budget. The government is required to repay such loans within the first three months of the following fiscal year.¹⁷ The pressure to lend to the government, largely in the form of overdraft service and purchases of government bonds, was of great concern to the BOT during the 1940s and 1950s as these types of lending directly affected the amount of money in circulation, therefore potentially aggravating inflation.

Fifth, the government's ability to reprimand the central bank through various measures, such as removal, policy veto, budget cuts, and oversight also indicates the power of the former over the latter. As mentioned above, the power of the Thai cabinet to remove the BOT governor and deputy governors through the Crown can be exercised to keep the Bank in line. The Minister of Finance's general supervision over Bank affairs, which under normal circumstances means a rather loose and passive control, could become a stricter oversight when conflicts on policy issues arise. For example, the Minister of Finance can reject a bill initiated by the Bank and refuse to send it to the Parliament or ask for a revision of the bill. However, with regard to budgetary control,

¹⁷ The Royal Decree Regulating the Affairs of the Bank of Thailand of 1942, Section 12 (8).

the BOT does not rely on the government budget like many other government agencies. Its budgetary autonomy prevents the government from using budget cuts as a reprimanding measure. Instead the Bank's budgetary autonomy has served its many organizational interests such as in human resource development and attractive remuneration for its personnel through scholarship and training programs and higher salary and bonus structures compared to other government agencies.

The legal indicators above portray a rather dependent central bank.¹⁸ Throughout the Bank's history, governments have tried to exert their influence over the Bank's affairs particularly through the removal and appointment of central bank governors.¹⁹ The absence of a statutory stipulation regarding the term in office of the governor seems to give the government more flexibility in exercising such power. The lack of a clear written mandate seems to make the Bank vulnerable to more arbitrary or politically motivated objectives. And despite the limit set at 25 percent of the total budget and a clear repayment schedule, the overdraft service that the Bank has to extend to the government to finance the latter's budget indicates a form of fiscal domination over monetary affairs. Finally, the ability of the government to capitalize on the Minister of Finance's general supervision power to impose a stricter oversight over Bank policy when conflicts between the two institutions arise also affects the ability of the Bank to operate independently.

¹⁸ According to Cukierman's measurement in his quantitative studies, the Bank of Thailand scored 0.26 in its overall legal independence, compared to the Bundesbank of Germany—0.66, the Federal Reserve of the US—0.51, and the Bank of England 0.31. See Cukierman, *Central Bank Strategy*, p. 381.

¹⁹ For example, within the period from July 1997 to May 1998, which was at the height of the financial crisis, there were three governors taking turn at the helm of the Bank. The Chavalit government dismissed Rerngchai, who was the BOT governor when the crisis struck in July 1997 and appointed Chaiyawat as his replacement. Chaiyawat was pressured to resign in May 1998, to be replaced by M.R. Chatu Mongkol by the Chuan government.

Viewed collectively, it may be said that these legal provisions provide opportunities and incentives for the government to exert its influence over the Bank of Thailand. But it will be demonstrated in the following sections that this legal structure also shaped the way the Bank acted strategically to compensate for the loss of autonomy in certain areas and to concentrate on informal sources of autonomy, which are key to the Bank's actual independence.

Before closing, it is important to examine the original intention of the laws viewed by the drafters with regard to central bank autonomy in order to understand its relationship with the political context at the time. In his memorandum on the Bank of Thailand, Prince Viwat wrote explicitly that he wanted the BOT to be an autonomous institution.²⁰ However, this autonomy primarily meant the autonomy to carry out its goals and responsibilities or what Fischer calls 'instrument independence'. He was clear that given the political tradition, wartime situation, and international practices, the Bank of Thailand should not be completely independent from the government. His attempt to accommodate both legal aspirations resulted in the granting of full management power to the governor and the Court of Directors, and the power to keep Bank executives in check through various means including the power of appointment and dismissal to the Minister of Finance. As he saw it, this check and balance relationship would allow the Bank a sufficient degree of freedom to operate its own affairs under the indirect control of the Minister of Finance (instrument independence). On the other hand, the government would be able to control the general lines of policy through the appointment of the governor and the Court of Directors (policy control).

²⁰ Bank of Thailand, *Viwatanajaiyanusorn*, pp. 66-67.

It is important to take note of Prince Viwat's uncritical approach toward the potential conflicts and political interference arising from this relationship, which did occur later on. Without any written evidence, one can only try to understand his position in relation to the political context. Having served with the Ministry of Finance in a number of important positions and then being appointed the Director of the National Banking Bureau (the predecessor of the BOT), Prince Viwat typified how important bureaucratic and political positions changed hands among top bureaucrats. Having worked for both fiscal and monetary authorities whose institutional interests differed, his general outlook illustrates the common understanding and orientations as well as lines of communication among the bureaucratic elite, which seemed to facilitate the cooperation and compromises among them. The Prince's rather optimistic view of the power relations between the Ministry of Finance and the Bank resulted from this assumption of a loose bureaucratic 'bond' despite their different institutional interests. This assumption contrasted with his skepticism toward the legislature, with its more diverse social makeup and whose interests were more locally- or sectorally- oriented. With regard to central banking, politicians were seen as lacking good understanding of central banking business and some, who entertained socialist aspirations, were viewed with distrust.

Accordingly, it may be seen that Prince Viwat's intention for the legal status of Bank of Thailand was premised on a bureaucratic polity, where the bureaucratic elite controlled political power. If the legislative framework for the relationship between the Bank and the government were rather uncritical, the laws were clearer in giving the executive (read the bureaucratic elite) more power than the legislature. The operational autonomy provided by law has largely remained true to the original intention and become

institutionalized as part of the Bank's institutional character. As the Bank's scope of responsibilities expanded due to new demands in the area of public and private finance, its operational autonomy added to the Bank's institutional power.²¹ However, the legal autonomy from the government has not always resulted in the outcomes that Prince Viwat envisioned. While keeping in mind the potential advantage of not having clear statutory stipulations in the areas of the governor's term in office and the Bank's main objective²², these legal aspects, along with the others mentioned above, are seen by today's standards as indicators of a the lack of independence. Many accounts of government intervention, to be discussed in the following chapters, reflect the outgrowth of this legal framework. One of the main explanations for the outgrowth lies in the change in the political context, which in turn changed the structure of incentives and restrictions perceived by actors, including the Bank of Thailand. The following section discusses how the Bank was able to manage and make use of the original legislative framework as well as the political and socio-economic contexts of the first three decades to transform itself from an incipient organization to a strong, credible, and relatively autonomous institution.

²¹ For example, there was an amendment to the Bank of Thailand Act of 1942 in 1985 to include a chapter on the establishment of the Financial Institutions Development Fund (FIDF), which would serve as a deposit insurance institution. Despite being a juristic person, the FIDF was established within the Bank of Thailand. The BOT Governor chairs the Fund's management committee and its manager is appointed from an officer from the BOT.

²² One may argue retrospectively that one of the advantages of not having a fixed term for the BOT governor is the fact that Dr. Puey was able to remain BOT governor for almost 12 years. His long governorship is considered vital to the BOT's character-building process. Having clear written mandates can affect the Bank's autonomy negatively if there were too many or conflicting mandates or objectives for the Bank to follow.

The Making of the Bank of Thailand's Relative Autonomy

Looking over the first thirty years of the Bank's history, the small agency transformed itself significantly into one of the most trusted and competent government institutions by the early 1970s. Starting with a very small staff, the size of the organization grew from 167 personnel in 1942 to 719 in 1962 (both numbers not including top executives). The organizational structure had also evolved from six departments in 1943 to seven departments and three offices by the mid 1950s. The growth in the size of the Bank clearly reflected the increase in the volume of its responsibilities and the growing sophistication in its functional differentiation. The Bank's active track record helped explain its physical expansion. Immediately after its establishment in 1942, the BOT needed to steer the country out of the hyperinflation that plagued the economy throughout the Pacific War and the immediate post-war period, by employing various restrictive measures, including controls on currency, credit, and foreign exchange. These measures contributed to the amelioration of the inflationary pressures and the gradual resumption of the internal and external stability of the baht. Later when the economy started to stabilize, the need for reconstruction required the Bank to be instrumental in laying the groundwork for better macroeconomic management and economic development. This groundwork included the adoption of a more liberalized and stable exchange regime, setting a par value for the baht, and the promotion of exports through rediscount services. Additionally, the Bank extended its role to the realm of fiscal management when it encouraged the government to adopt more fiscal discipline and revamp the budgetary process. By the late 1950s fiscal and monetary coordination increased along with less arbitrary budgetary appropriation, which

contributed positively to the ongoing process of economic development. As with other developing countries, the Bretton Woods institutions played an important role in providing technical and financial assistance to Thailand's development endeavor after the mid 1950s. The BOT was responsible for negotiating and coordinating with these international institutions in various development projects, reform programs, and routine business contacts. Among the pioneer projects was the preparation for the first 5-year National Economic Development Plan launched in 1961, the first national development plan in Thai history. Finally, but equally importantly, the Bank played an active role in promoting a relatively stable financial system, largely by building a good professional relationship with commercial banks and revamping the legal framework overseeing the banking business. Governor Puey, whose governorship lasted for twelve years, was famous for applying moral suasion to promote cooperation between the Bank and commercial banks. The Commercial Banking Act of 1962, a product of this cooperation, provided for more up-to-date rules on reserve requirements, cash reserves, credit extensions, branch opening, and inspection in order to achieve more stability in the financial sector and to allow for better supervision of financial institutions by the authorities.

To understand better the physical transformation and successful track records of the Bank after its first thirty years, it is important to examine the status of the Bank vis-à-vis the government as well as societal and external actors, particularly those in the financial community. In this regard, the Bank's autonomy seems to be central to such an analysis as it helps shed some light to the power relations between the Bank and these key actors in their interactions in the shaping and implementing of Thailand's

macroeconomic policies. The existing legal framework constrained the Bank's autonomy to the scope of operational autonomy or instrument independence rather than policy independence. The statutory stipulation clearly allowed the Bank's top executives to enjoy the freedom to manage BOT affairs while the Ministry of Finance controlled over the general lines of policy through its supervisory role and power over appointment. Keeping this legal structure in mind, the success of the Bank in maintaining relative price stability and currency convertibility and its active and influential role in the process of economic development, particularly in promoting fiscal and monetary coordination and a relatively stable financial system, compels us to look beyond the Bank's legal autonomy. The following discussion demonstrates that despite the limited legal provisions, in practice the Bank enjoyed a relatively large degree of freedom and authority in performing its role in macroeconomic management and economic development. These indicators include the Bank's ability to pursue relative price and currency stability, the ability to push for the liberalization of the exchange rate system, the twelve-year tenure of Dr. Puey, and BOT budgetary and administrative independence.

The ability to pursue relative price and currency stability

Price Stability The BOT's ability to pursue relative price stability during the first three decades of its institutional history was a result of the government's priority of controlling inflation and the Bank's attempt to use different strategies to meet government financial needs without seriously jeopardizing price stability. As mentioned above, the Bank of Thailand Act of 1942 did not stipulate the main objective(s) of the

Bank. Even though there seemed to be a consensus among key economic bureaucrats at the time that the Bank's mandate should be to maintain price stability²³, the lack of clear legal stipulations with regard to the matter made the Bank vulnerable to conflicting priorities of the government. Nevertheless, high inflationary pressure experienced during the Pacific War and the post-war period required immediate attention from the government, therefore giving the BOT a clear mandate in alleviating inflation. Under this mandate, the Bank primarily employed restrictive monetary measures, including controls of currency, credits, and foreign exchange. Even though it was impossible to completely contain the phenomenal inflationary pressures, these measures were able to curb the severe impacts of inflation, particularly by reducing the supply of money in circulation and temporarily halting the price increase of certain essential goods. They also helped enhance the scope of the Bank's authority in managing the financial system during such difficult times.

From the immediate post-war period until the late 1950s, the Bank continued to find itself under pressure to curb inflation and regain currency convertibility while the government ran a long series of budget deficits and the country's terms of trade deteriorated. Among the main problems causing inflation during this period was the government's fiscal condition. The rising financial obligations to fund economic reconstruction and economic development projects were part of the reason why government expenditures rose faster than revenues. Another reason, noted in a number of the Bank's Annual Reports, was the fact that many of these projects were financially

²³ The objective was clearly stated in the preamble of the draft the Bank of Thailand Act of 1942. It was removed from the final version of the legislation when passed.

unsound or ineffectively implemented.²⁴ Flaws in the process of budget appropriation also contributed to the perpetuation of fiscal deficits.²⁵ As deficit financing continued, it added to the inflationary pressures forcing the cost of living to rise continuously.²⁶

In this regard, the Bank of Thailand, on the one hand, became the biggest lender to the government to help finance its budget deficits and development projects. In the beginning government borrowing was in the form of selling government securities to the public, particularly treasury bills (for short-term lending) and government bonds (maturity over 12 months), which due to their unattractive interest rates did not sell well and had to be mostly purchased by the Bank.²⁷ In 1952, the government began to use the overdraft facility that the Bank was legally obligated to provide.²⁸ This borrowing method had severe effects on the economy because it added directly to the money supply, which in turn drove up inflationary pressures. On the other hand, in the effect to bring about price stability, the Bank resorted to various strategies to limit government borrowing and to mitigate the inflationary pressures that ensued. For example, it usually sought to lend to the government less than the requested amount, and thereby was able to slightly mitigate the extent of budget deficit.²⁹ Second, it tried to encourage the government to make government securities more attractive to the public since mobilizing

²⁴ Bank of Thailand, *Annual Report of 1952, 1953, and 1954*.

²⁵ It was customary for the government to first come up with the expenditure and then try to find the revenue to finance it.

²⁶ Consumer Price Index from 1947 to 1955 rose every year from 1,370 to 1,830 (using the year 1938 as a base price of 100). Data from the Bank of Thailand's *Annual Report 1938*.

²⁷ The treasury bills were initiated in 1945. Originally, they were held mostly by commercial banks and the Government Saving Bank. When the long-term government bonds were introduced later, treasury bills lost their popularity due to less competitive interest rates. Therefore the Bank had to purchase most of them. In 1947, the holding of treasury bills and government bonds was 284 million and 3 million respectively. In 1955 the holding of treasury bills and government bonds by the Bank rose to approximately 3.1 billion and 1.6 billion baht respectively. See Bank of Thailand, (1997).

²⁸ The Royal Decree Regulating the Affairs of the Bank of Thailand of 1942 section 12, (7 ter). In 1952, the government drew an overdraft of 300 million baht. The amount rose to 549 million in 1955. See Bank of Thailand, *20 Years of the Bank of Thailand*, (Bangkok: Bank of Thailand, 1962).

²⁹ Bank of Thailand, *50 Years*, p. 202.

public savings would help draw money out of the system. Despite several rejections from the Ministry of Finance of the idea, the government decided to raise interest rates for government bonds and treasury bills in 1956 and 1958 respectively.³⁰ Third, later in the 1960s, the Bank chose to selectively finance some government development projects, which were of high priority and logistically sound, with foreign currencies drawn from international reserves and proceeds from the Exchange Equalization Fund.³¹ This method had little effect on money supply because most of the time the borrowed money was required to pay for imports of capital goods. The government was also required to pay back in foreign currency, therefore helping replenish the international reserves. Fourth, after the relationship with the World Bank was established, the Bank sought to co-finance some government development projects with the World Bank. As the conditions tied to World Bank loans were much more stringent, particularly in terms of repayment and material specification, the government became more disciplined in the disbursement and repayment of these loans.³² The ability of the Bank to employ these various measures and strategies in its attempt to bring about price stability while the government pursued expansionary policies reflected the Bank's ability and relative freedom to use its monetary instruments to mitigate the effects of fiscal deficits on price stability.

The late 1950s and 1960s saw the Bank's ability and scope of operation in pursuing price stability increase, as it became more involved with many other public

³⁰ The Interest rate of government bonds was raised to 8 percent, while that of treasury bills from 2.26 percent to 3 percent. See Bank of Thailand, *20 Years*, p. 95 and Bank of Thailand, *50 Years*, p. 200.

³¹ The Exchange Equalization Fund was a foreign exchange mechanism, founded in 1955, to intervene in the market to protect the value of the baht. It is a juristic body administered by a committee consisting of Minister of Finance (chair), Minister of Foreign Affairs, Minister of Commerce, Deputy Minister of Finance, and the Governor of the Bank of Thailand. The Fund manager, who runs day-to-day operations, is appointed from a high-ranking official from the Bank.

³² Bank of Thailand, *50 Years*, p. 202. Examples of projects that the Bank co-financed with the World Bank were the Phasom Dam electricity-generating and irrigation project and the construction of the Third-Stage State Highway in the late 1960s.

polycymaking processes. For example, in 1959 the Bank began to participate directly in the planning for the government budget through the annual budgetary allocation forum consisting of the Bank Governor, the Minister of Finance, the Director of the Budget Bureau, and the Secretary of the National Economic and Social Development Board (NESDB). The Bank Governor was also an ex officio member of the newly established NESDB, therefore taking part in the planning and deliberating of every 5-year National Economic and Social Development Plan.³³ The increased involvement of the Bank in major public polycymaking allowed it to be proactive in pursuing its monetary objectives. By directly taking part in these budgetary and development planning processes, the Bank had the opportunity to deter or alleviate the impact of inflationary spending before that particular budget became official. One might argue that ‘having an opportunity to do so’ does not mean that the Bank would be ‘able to do so’, particularly under the dictatorial regime of that time. However, when taking into account the network of economic bureaucrats in key economic positions, the military leaders’ reliance on these bureaucrats to lead the development process, the charisma and credibility of Dr. Puey, and his close relationship with international development agencies, it is very plausible that the Bank was able to take advantage of these contexts to fulfill its monetary objectives.

Evidence shows that despite the growing government expenditure due to the emphasis on economic development, the government was seen as trying to avoid deficit-financing methods that would create inflationary pressures. For example, after 1960 the government ceased to use overdraft services from the central bank to finance its budget, which previous governments had done in the 1950s. The government also tried to mobilize private savings to fund its expenditures by employing new incentives, such as

³³ The first plan was launched in 1961.

raising interest rates for government bonds and allowing for the income incurring from these bonds to be tax-free, in order to make these securities more financially attractive to the public. As a result, more people and financial institutions invested in government bonds than in the past. The change in government deficit financing methods contributed positively to the Bank's ability to maintain monetary stability throughout the 1960s.³⁴ The increased influence of the BOT in macroeconomic policy making is a good indicator of the informal source of the Bank's relative autonomy in pursuing its policy mandate beyond the scope of the laws.

Currency Stability Currency stability was a vital government priority in the post-war reconstruction period. When the war ended, Thailand's financial standing was in a frail state. International reserves, which were composed of 70 percent Japanese yen, 13 percent treasury bills, and only 17 percent gold, lost most of their value.³⁵ The baht had depreciated severely due to the wartime inflation. International trade, which was the most important channel to acquire foreign currencies, was almost non-existent. Accordingly, the government faced the challenge of reviving the value of the baht, which was central to the resumption of international trade and investment. Because of foreign currency shortages, the government also saw the need to centralize the allocation of scarce foreign exchange. In this regard, the Bank of Thailand continued to play a vital

³⁴ Technically speaking, the Bank was able to manage the growth in money supply so that it would be compatible with the growth in GDP. Its stability benchmark was that the growth of the former should be higher than the latter about 2 percent. See Bank of Thailand, *30 Years of the Bank of Thailand*, (Bangkok: Bank of Thailand, 1975), p. 39.

³⁵ The Yen severely depreciated after the War. Other kinds of assets, particularly pound sterling and US dollar deposits in Europe and the US, were seized by the Allies when the Pacific War broke out.

role in implementing foreign exchange controls, which had been underway since the war, and in re-establishing and maintaining the external value of the baht.

From 1945 to 1947, a blanket exchange control required all foreign exchange be transacted through the BOT at official rates. These rates, which were set in 1946 at 40 baht per pound sterling and 100 baht per 10.075 US dollars, were considered highly overvalued given the small international reserves and high inflation. As black market activities rose, with the baht being exchanged at around 80 baht per pound, exchange control measures were relaxed to allow free market transactions. Accordingly, after 1947 most exporters, except those of primary commodities (rice, rubber, and tin) were permitted to exchange foreign currencies at market prices. The official rates were applied to exporters of the three primary commodities, private imports of necessary goods, and government development financing to control the cost of living and subsidize reconstruction projects. Selective exchange controls involved multiple exchange rates, consisting of the official rate, market rate, and mixed rate (the three main commodities) until 1955.³⁶ Throughout this period, the BOT was able to replenish international reserves rapidly, particularly when Thailand experienced a rice export boom from 1947 to 1951.³⁷ The Bank also made substantial profits from buying foreign currencies from exporters at low official rates and reselling some of these currencies to commercial banks

³⁶ Exporters of rubber had to surrender 20 percent of their foreign earnings to be exchanged at official rate. For tin exports, at first 50 percent, then later 40 percent, of their proceeds had to be exchanged at the official rate. Rice exports handled by the government (about 95 percent) were converted at the official rate, while private exporters were allowed to exchange their earning at market rate. The mixed rate was a result of these exports being subjected to two different rates. See more details in W.M. Corden, "The Exchange Rate System and the Taxation of Trade", in T.H. Silcock (ed.) *Thailand: Social and Economic Studies in Development*, Duke University Press, Durham, 1967.

³⁷ This was because rice exports were mostly handled by the government's Rice Bureau.

at higher rates.³⁸ These financial gains served to enhance the ability of the Bank to strengthen the value of the baht.

Due to the state of the post-war economy, there seemed to be an agreement among policymakers, particularly the economic bureaucrats, that exchange controls and the use of multiple exchange rates were necessary to rebuild the value of the baht and to control the cost of living. According to Silcock, these restrictive exchange measures reflected the anti-inflationary tradition among these bureaucrats and their attempt to repair the damage of wartime inflation.³⁹ Prince Viwat's, the first Bank Governor, held the post of Finance Minister between 1947 and 1949 and was later in the 1950s appointed as the government's financial advisor providing continuity of the conservative influence in the government at least in the area of currency stability. The Bank was given full authority to pursue selective exchange controls, which contributed to the rapid increase in international reserves and substantial exchange profits that it was able to use to offset government deficits. Interestingly, conflict between the government (Ministry of Finance) and the Bank in this area lay in the former's desire to pursue an even more deflationary policy through the appreciation of the baht in 1952. There were two main reasons behind the move. First, as rice exports boomed (as well as other commodities) during the Korean War causing domestic prices of rice and related foodstuffs to rise, the government wanted to lower the cost of imported essential goods to alleviate the growing cost of living. Second, the rise in the value of the baht from 1949 to 1952 due to increased demand for Thai exports gave the government high confidence in the value of

³⁸ According to Corden, these profits were 430 million in 1951, 670 million in 1952, 510 million in 1953, and 620 million in 1954. See his chapter in Silcock, *Social and Economic Studies*.

³⁹ Ibid., pp. 174-178.

the national currency and the conviction that the baht was undervalued.⁴⁰ The Bank opposed this currency revaluation preferring to let international trade conditions determine the price of the baht. However, the government insisted on the appreciation of the free baht (market rate) from 51 to 45 baht per pound. This conflict resulted in the resignation of the Bank Governor, M.L. Dej Snidvongs. The irony was that M.L. Dej was right in anticipating a rise in imports and its adverse effects on the country's balance of payments. The revaluation quickly led to a fall of the baht after a series of unfavorable turns of events.

A growing balance of payments deficit caused by rising imports after the revaluation in 1952 and the decreasing demands for Thai exports after the Korean War paved the way toward the liberalization of foreign exchange policy in 1955. In the beginning, the government resorted to import restrictions to cushion a fall in international reserves. However, as the value of the free baht fell drastically from 45 to 58 baht per pound in late 1953, restrictive fiscal and monetary policies were deemed ineffective. While these policies had previously been instrumental to the building of international reserves and helped subsidize essential goods and development projects, they also created a lot of distortions that over time were counter-productive to the workings of the economy, particularly under existing circumstances. Among such distortions was the strain these restrictive measures imposed on exports. Exporters of major commodities lost much of their baht earnings as they were obligated to convert part of their foreign currency earnings at the official rates. The revaluation drove export prices in the

⁴⁰ The baht rose steadily from 57.75 baht per pound sterling in September 1949 to 51 baht per pound sterling in February 1952. The growing strength of the baht and its revaluation plan fitted into Phibun's nationalistic agenda as it demonstrated that his economic nationalist policy (i.e. nationalization of rice exports from the Chinese) was doing very well. The confidence in the baht almost led to the abandoning of the holding of foreign currencies as part of the currency reserves. See Bank of Thailand, *20 Years*, p. 68.

international market even higher, thus making Thai exports less competitive. Another example of the distortions was the control of rice exports by the government. As the price offered by the Rice Bureau to rice millers was much lower than the real market price, there were numerous incidents of rice smuggling.⁴¹ When private rice exports were permitted (about 5 percent of total rice exports), the substantial profits to be made from the gap between the international market price and the Rice Bureau price made the granting of rice export licenses a part of the widespread political patronage. A large amount of the Bureau's profits was also siphoned off into the pockets of some political leaders. And as international demand for rice went into decline, the Bureau was less efficient in finding markets for Thai rice compared to private traders.⁴² Not only did exchange controls and multiple exchange rates result in a lot of economic distortions, they also opened up and intensified opportunities for corruption, political clientele, and factional rivalry.

The liberalization of exchange policy in 1955 reflected the ability of the economic bureaucrats to use the opportunities offered by the declining terms of trade, currency fluctuation, and the recommendation from the IMF to the government to abandon the old exchange regime. The preference to liberalize the exchange policy revealed another long time commitment of the economic bureaucrats besides monetary and fiscal conservatism. Its relationship with the Bank of Thailand's autonomy will be discussed separately below. At the moment the focus is on how the liberalization process added to the Bank's autonomy in maintaining currency stability. The liberalization process started in March 1955 with the use of a new but more realistic exchange rate for assessing foreign

⁴¹ See Corden, "The Exchange Rate System".

⁴² Silcock, *Thailand: Social and Economic Studies*.

exchange holdings in the Note Issue Reserves.⁴³ As a result, there was an increase of about 2.5 billion baht in the value of foreign currency holdings. About half of these reserves were used to set up an Exchange Equalization Fund (EEF) to support the value of the baht. Legally, the EEF is a juristic body governed by an EEF committee.⁴⁴ However, the day-to-day operations are largely under the management of the Fund manager who is selected from among high-ranking officers from the Bank of Thailand. Since the Fund's creation, the Bank has enjoyed a large degree of autonomy in the daily interventions to maintain a desirable value of the baht. The next step in the process of liberalization included the abandoning of the multiple exchange rates and the adoption of a single rate set after the market rate at the time, namely 58 baht per pound or 20.7 baht per US dollar. Finally, exchange controls on major exports (rice, tin, and rubber) were removed. Instead, export taxes were imposed on these commodities in the forms of a rice premium, tin royalty, and rubber duty to keep domestic price in check.

From the 1955 liberalization through most of 1960s, the Bank of Thailand was able to maintain relative currency stability through the mechanism of the EEF and the control of high international reserves. While the economy continued to suffer trade deficits throughout the second half of 1950s, particularly in 1958 when the balance of payments deficit peaked at 1.6 billion baht, international reserves were not significantly affected. In fact, international reserves rose steadily from the end of the 1950s well into the early 1970s, from 297.9 million USD in 1959 to 909.8 million USD in 1972. These reserves, which were under the full management of the BOT, played an important role in

⁴³ From the old rate of 35 baht per pound to 56 baht per pound. Market rate at the time was about 58 baht per pound. See Bank of Thailand, *20 Years*, p. 85.

⁴⁴ The EEF committee is comprised of the Minister of Finance (chair), Minister of Foreign Affairs, Minister of Commerce, Deputy Minister of Finance, and the Governor of the Bank of Thailand.

sustaining the value of the baht, which even with the largest balance of payments deficits in 1958-1959, fluctuated only slightly. In fact, according to Corden, from 1955 to 1963, the rate moved around no more than 3 percent.⁴⁵ This stability finally became institutionalized as a par value was set in 1963 after being postponed for the first 14 years since Thailand joined the International Monetary Fund (IMF) in 1949. The fixed value of the baht was at 20.8 baht per US dollar, which was to be defended by the EEF within a 1 percent band required by the IMF. This exchange rate was in effect until 1972. Given the track record, the setting of a par value for Thailand was not just the beginning of the commitment toward currency stability, but to quote a senior Bank official, a “concrete recognition of the fact that exchange rate stability of the Thai currency had long been maintained.”⁴⁶

The ability of the Bank of Thailand to maintain the external value of the baht during the first three decades through its control of international reserves and the EEF is a good indication of the Bank’s autonomy. With the priority given to currency stability by the governments, the Bank was given the authority to implement various measures, ranging from exchange control, multiple exchange rates to a single exchange rate with the EEF, to regain and then maintain the stability of the currency. The Bank’s full control of international reserves stipulated by the Currency Act of 1958⁴⁷ allowed it to accumulate these assets to a high level despite the obvious needs for foreign currencies in all kinds of government projects and obligations (see Table 1 for levels of foreign exchange reserves

⁴⁵ Corden, “The Exchange Rate System”, p. 158.

⁴⁶ Khunying Suparb Yossundara, in her cremation volume, Bank of Thailand, Bangkok, 1974, p. 7, quoted in Bank of Thailand, *50 Years*, p. 216.

⁴⁷ The Currency Act of 1958, section 29 stipulates, “The Currency Reserve may be spent as aforesaid only by an order of the Governor of the Bank of Thailand or of a representative specially appointed by the Governor of the Bank of Thailand for that purpose”.

from 1952 to 1969). It was exactly the high level of reserves that contributed significantly to the stabilization of the external value of the baht during this period. The preference to maintain a large amount of reserves reflected another tenet of monetary conservatism (besides deflationary inclination), which continued to be adhered to by the economic bureaucrats since the colonial period. This orthodoxy was exemplified in Corden's discussion of the percentage of gold or foreign exchange held by the Bank as a currency reserve. Before 1958 the baht had to be covered 100 percent by these assets, while the revised Currency Act of 1958 stipulated the minimum requirement at 60 percent (of notes in circulation).⁴⁸ However, he notes that even then the Bank's holdings remained higher than what was legally required. For example, the foreign exchange and gold were 72 percent and 74.5 percent of the currency reserves in 1960 and 1964 respectively.⁴⁹

Table 3.1

Foreign Exchange Reserves (Million US Dollars)

Year	1952	1954	1956	1958	1960	1962	1964	1966	1968
Reserves	\$354	\$283	\$316	\$302	\$353	\$495	\$609	\$850	\$922

Source: Bank of Thailand, Annual Economic Report

The Bank's control over the management of the EEF also reflected its relative autonomy in maintaining currency stability. As mentioned earlier, the day-to-day operation of the EEF was overseen by a manager who was appointed from among the

⁴⁸ Ibid., section 30.

⁴⁹ Corden, "The Exchange Rate System", pp. 158-159.

Bank's senior officials.⁵⁰ The EEF used its own reserves to buy and sell currencies in the market to defend the value of the baht. These reserves are part of the international reserves, which have been set aside from the currency reserve so that they could be used by the EEF at its discretion. The ability of the Bank to preserve the value of the baht after 1955, even before the setting of the par value in 1963, can be attributed to the autonomy of the Bank in employing this stabilization mechanism in parallel with its management of the international reserves.

It would be inaccurate to account for currency stability only by focusing on the Bank of Thailand's autonomy. Some observers, including the Bank itself, have referred to 'luck' when it comes to the favorable contexts facilitating the pursuit of price and currency stability. These favorable factors, such as the rice export boom between 1947 and 1951 and the huge inflows of foreign assistance and loans from the mid 1950s onward, contributed in a different way to the Bank's ability to build and preserve its holding of international reserves. Some of these factors will be discussed in more detail in the following section. The argument here is that it is important to view the Bank as an active agent whose autonomy was constructed from its ability to take advantage of the opportunities presented and to adjust itself to the restrictions imposed on it by the circumstances.

The liberalization of the exchange rate system

The Bank of Thailand's influence in convincing the government to abandon the multiple exchange rate system in 1955 can be seen in its ability to initiate a new set of

⁵⁰ The first EEF manager was Bisudhi Nimmanhaemin, who later became Bank Governor after Dr. Puey left the office in 1971. Sommai Huntrakul succeeded Bisudhi in 1965. He was appointed Minister of Finance (without being an elected MP) for three terms in the 1970s and 1980s.

macroeconomic policies, which it believed to be more compatible with and beneficial to Thailand's open economy. This type of influence can be distinguished from its operational objectives in maintaining price and currency stability. The Bank's role in leading the move away from the post-war macroeconomic framework of capital controls and multiple exchange rate system and in laying the foundation for the country's future economic development implied that it perceived itself as responsible for the long-term progression of the whole economy, rather than merely being instrumental to the agenda of the day.⁵¹ This role was consistent with the long time self-perception of many economic bureaucrats as being the guardians of the national interest, which in effect led them to disassociate themselves from politicians who were perceived to act upon sectoral, regional, or personal interests.⁵² Bank preferences for a unified, market-led exchange rate system also continued the pre-WWII monetary tradition of minimal state intervention in the maintaining of currency stability. The move away from the highly interventionist wartime and post-war exchange rate regime toward the minimalist tradition had important implications for the role of the state in this area of macroeconomic policy. Accordingly, it may be said that the Bank's ability to guide foreign exchange policy toward the direction of a less interventionist and more accommodative approach to exports reflected its policy influence that was beyond instrumental autonomy stipulated by the legal framework.

⁵¹ Silcock, *Thailand: Social and Economic Studies*, p. 185.

⁵² The term 'national interests' can be highly debatable when it comes to the question of 'winners' and 'losers' of a particular policy. For example, the exchange control imposed on rice exports was partly meant to keep the domestic price of rice low for internal consumption in order to control the cost of living. However, such control, which acted as an export tax, put a heavy toll on rice farmers as paddy prices were also kept low by the buyers in the business chain, namely rice millers and the government who monopolized rice exports from the end of WWII until 1955.

Even though there was no legislative stipulation for the Bank's role in the making of exchange rate policy before the promulgation of the Currency Act of 1958, in practice the BOT played an important role in advising the Minister of Finance on foreign exchange issues. Prince Viwat's former credentials as the first Thai advisor to the Ministry of Finance and the Director of the National Banking Bureau facilitated the Bank's engagement in the forming of exchange rate policy since its inception. Such influence was apparent in the government's adoption of wartime and post-war exchange control policy upon Prince Viwat's recommendation.⁵³ As mentioned earlier, the precariousness of the wartime and post-war economic situations seemed to dictate Prince Viwat's choice of a restricted exchange policy, as well as inducing a policy consensus over the restricted exchange policy of both periods. It can be seen that the credibility of the Bank Governor was an important basis for his advisory role to the government. Prince Viwat's choice of a restrictive exchange regime reflected his pragmatism in coping with the urgency and seriousness of the foreign exchange problems. The policy consensus among the political leaders built around the pressures of foreign exchange crisis on the one hand and the tradition of credibility of economic technocrats on the other allowed the Bank to be relatively autonomous in the design and implementation of this exchange rate policy.

Despite the fact that the system of multiple exchange rates and exchange controls enabled the Bank to replenish international reserves within a short period of time and helped to curb the prices of essential imported goods, among other things, the BOT's support for such an exchange regime was clearly temporary. The idea of lifting the exchange controls and adopting a unified market rate was floating among economic

⁵³ Prince Viwat played a key role in the drafting of the Exchange Control Act of 1942.

bureaucrats well before 1955. A number of reasons accounted for the preference for a liberalized exchange regime. First, it was quite apparent that the restrictive exchange policy was a source of economic distortions, which in the long run could put the economy at a disadvantage. The supplying of foreign currencies to pay for imported essential goods at the official rate, which was much lower than the market rate, was the equivalent of providing import subsidies for these basic goods.⁵⁴ Even though this measure significantly helped control the cost of living, it put a strain on the country's international reserves, especially when exports could not keep up with imports.⁵⁵ Exchange control measures, which required exporters of rice, tin, teak, and rubber to exchange some of their foreign earnings at the official rate, distorted the real income of these exporters. The consequences were not only the decline in export incentives and competitiveness, but also the pushing of the financial burden onto primary producers (farmers) by middlemen and exporters.

Second, there was a preference for a non-interventionist monetary policy among key economic bureaucrats at the Bank. Prince Viwat clearly intended to abandon the multiple exchange rates and exchange controls as soon as the price of the baht stabilized at a satisfactory level at the time when these policies were implemented.⁵⁶ M.L. Dej advised the government against the revaluation in 1952 because he believed that the free

⁵⁴ The official rate in 1951 was 35 baht per pound, compared to 53 baht per pound market rate. See Corden, "The Exchange System", p. 152).

⁵⁵ The heavy strain was felt in late 1952-1953 when a revaluation of the free market baht (from 52 to 45 baht per pound) led to a rise in imports. Declining export competitiveness, affected by the revaluation, and a fall in the demands of rice and other exports in world markets, led to a decline in export earnings. The Bank of Thailand had to sell a large amount of pounds, and later US dollars, to pay for imports at the appreciated rate, which was much higher than the world market rate.

⁵⁶ In his memorandum to the MOF dated January 15, 1952, Prince Viwat referred to the original objectives of exchange rate policies set in 1947, i.e. to stabilize the value of the baht and to eventually lift exchange controls, which would lead automatically to the abandoning of multiple exchange rates. See *Viwattanachayanusorn*, p. 232.

market baht should be determined by international trade conditions. He resigned in protest when the revaluation was imposed. Dr. Puey was also critical of the government's interference with the exchange rate policy. While he was instrumental in helping the government cope with the impact of the 1952 revaluation by imposing import controls and reducing import subsidies⁵⁷, his goal was to see the restrictive exchange policy lifted when the international reserves situation stabilized. The non-interventionist policy tradition dated back to the colonial period (mid 19th century to WWII), when the monetary mechanism was allowed to adjust itself freely to the rise and fall of trade and finance. The rationale behind this approach in the beginning was largely the preoccupation of the Thai elite with avoiding criticism for fiscal and monetary irresponsibility from colonial powers. For almost a century, this liberal system worked quite effectively in preserving the external stability of the baht.⁵⁸ Even though the context which gave rise to this policy orthodoxy had changed, the economic bureaucrats' desire to go back to this tradition revealed their outward-looking preoccupation and pragmatism in believing that the international credibility of the baht was crucial to the long term growth of the economy.

Third, the International Monetary Fund (IMF) also played an important role in shaping the preferences of the economic bureaucrats at the BOT. Upon joining the organization in 1949, Thailand assumed an obligation to maintain orderly exchange arrangements and to promote a stable system of exchange rates, which included in

⁵⁷ Import controls were launched in November 1953 in order to curb the rise in imports. All importers were required to have import licenses from the Ministry of Commerce. The Bank of Thailand also scaled down the list of import subsidies granted to certain essential commodities (by allowing importers of such commodities to buy pounds or US dollars at the newly set market rates, which were much lower than the actual free market rates). By early 1954, the list was reduced to 4 items including fuel, milk, medicine, and cotton. See Bank of Thailand, *20 Years*, p. 72, and *Than Phuwakarn Puey*, pp. 117-127) for more details.

⁵⁸ The exchange rate was maintained at 11 baht per pound from 1923 to 1941. See Ingram, *Economic Change in Thailand*, p. 161.

particular the setting up of a par value and the abandoning of restrictive exchange policies.⁵⁹ Due to the precarious post-war economic conditions, Thailand had received a grace period until 1952 to consider adopting the unified exchange rate and setting the par value. When this deadline was not met, a second grace period was successfully negotiated in 1953, as the economic conditions had not satisfactorily stabilized. Even though it was not until 1955 and 1963 that the exchange liberalization and the par value respectively were finally implemented, the desire to comply with IMF requirements was present among Bank executives and senior officials at the outset. This compliance may be understood as being closely linked to the Bank's pre-existing preference for a liberal exchange regime, based on the outward-looking pragmatism mentioned above. The professional connection between Bank officials and the IMF developed through training programs and annual consultative meetings between the two institutions also played an important role in orienting Bank officials ideologically and technically toward a liberal exchange regime.⁶⁰ However, it may be argued that the obligations to the IMF and the technical and ideological inclination toward IMF exchange policies did not supersede Bank consideration of the national interest. The delay in the lifting of exchange controls, abandoning multiple exchange rates and setting the par value reflected the Thai monetary authorities' autonomy in choosing the appropriate timing in implementing more liberal exchange policies.

Fourth, the fact that interventionist economic policies created opportunities for political patronage, corruption, and fraud had a significant impact on the liberal bias of

⁵⁹ The International Monetary Fund, *Articles of Agreement*, Article IV, "Obligations Regarding Exchange Arrangements".

⁶⁰ One should also note that many Bank senior officials received their university education from Europe and the US. For example, Dr. Puey, who received his doctoral degree from the London School of Economics, participated in a six-month training program at the World Bank in the early 1950s.

many economic bureaucrats. The export monopoly of the Rice Bureau was a good example of the sources of state patronage, corruption, and fraudulent activities. By buying cheap from rice millers and selling to foreign buyers at a much higher price, the Rice Bureau made substantial profits for the government.⁶¹ Unfortunately, some of the profits were likely appropriated by top officials. Because of the attractive profits plus the permission to exchange part of export earnings at the free market rate, there was high demand for government licenses for private rice export (about five percent of total value of rice export).⁶² Accordingly, the granting of some of these licenses was done arbitrarily as part of political patronage to private individuals, who would then sell these licenses to exporters at a high price.⁶³ Fraudulent activities can also be seen emerging from the loopholes opened up by multiple exchange rates. As importers of essential goods were allowed to buy their foreign currencies at the official rate, there were opportunities for fraudulent import contracts. One of the most controversial cases involved a commercial bank, which managed to buy a large amount of pounds from the BOT at the official rate but did not allocate them for import purchases.⁶⁴ These examples were set against the backdrop of state intervention in many areas of economic activities promoted by the Phibun regime, while political rivalry and factionalism were seen as thriving in this economic environment. It is quite understandable to see economic bureaucrats

⁶¹ There was a significant gap between the domestic price of rice that the Bureau paid rice millers and the selling price it received from foreign buyers, even though according to Corden it was slightly below the world market price for rice. See Corden, "The Exchange Rate System", pp. 156-157.

⁶² Ibid., p. 152.

⁶³ Ingram notes that the price of rice-export permits could go up to US\$35 per ton in the market, compared to the official price at US\$3 per ton. Dr. Puey talked about such phenomena openly in 'Looking Back Looking Ahead', while he was offering some precautions to the growing demand from the society, particularly from university students, for the government to take over rice export in the 1970s.

⁶⁴ The pursuance of this case by Dr. Puey cost him his position as Deputy Governor of the Bank of Thailand. When a powerful military figure tried to exert his influence to prevent the BOT from fining the bank that committed fraud, Dr. Puey did not back down to the former's demands, but chose to resign to avoid political fallout.

developing preferences for non-interventionist economic policies so as to limit government power in allocating rents and other kinds of abuses of such power. This aspect of the inclination toward non-interventionism, in this case the liberal exchange regime, reflected these bureaucrats' political pragmatism within the existing domestic political environment.

It would not be accurate to argue that the BOT had full autonomy in the liberalization of the exchange regime. The government's decision to revalue the baht in 1952 to lower the cost of living showed that its policy preferences and that of the Bank departed and that it was willing to go against the Bank's recommendations to let the market determine the value of the (free) baht.⁶⁵ However, three years later the Bank was able to convince the government to abandon the multiple exchange rates and exchange controls in 1955 largely due to the following reasons. First, a series of economic problems arising from the overpriced baht and the declining terms of trade proved the government wrong in its calculations with regard to the impact of the stronger baht and its optimism in the demand for, and prices of, rice in the world market.⁶⁶ Instead of bringing down the cost of living, the decline in export competitiveness and rapid rise in imports (including luxury goods) led to a much larger drop in the international reserves, which started to create concerns among many economic bureaucrats and the government

⁶⁵ The revaluation decision was primarily aimed to create deflationary effects to offset the rising inflationary pressure in the market through the sale of the pounds from the international reserve. Even though it was not in Prince Viwat's recommendation to the government (he recommended the lifting of exchange controls and the abandoning of the multiple exchange rates), he agreed with the idea that overstocking pounds should be released to curb inflation. This action was in principle approved by the IMF, which allowed for a change of the value of the baht to fight inflation (within the 2 percent margin). See Ingram, *Economic Change in Thailand*, pp. 174-178, and Viwattanachayanusorn, pp. 272-273.

⁶⁶ Ingram, *Economic Change in Thailand*, p. 177.

itself.⁶⁷ The slowdown in exports also revealed the vulnerability of the Thai economy resulting from its heavy dependence on exports of a small number of primary products, a condition the Bank had been worried and frequently warned the government about.⁶⁸ As the government was facing compounded economic difficulties, the Bank of Thailand was able to play an important role in advising the government both in coping with the immediate problems and in making long-term changes to the economic structure, including the liberalization of the exchange regime. It may be said that the deteriorating economic conditions, partly caused by the government's miscalculated decisions and partly by uncontrollable world markets, helped the Bank's liberal preference gain more currency against the government's interventionist inclination. The Bank was also able to use this opportunity to enhance its autonomy in managing the exchange rate through the proposal to reassess the value of the international reserve and to establish the Exchange Equalization Fund (EEF), a quasi-autonomous exchange mechanism under Bank supervision. All of these attempts materialized in 1955.

Second, the Bank was also able to use IMF influence to gradually convince the government to abandon the restrictive exchange rate system. After Thailand had joined the Fund in 1949, the Bank started to remind the Ministry of Finance of the obligations to the Fund, including the setting up of the par value and the lifting of the exchange controls, particularly in its annual reports to the MOF.⁶⁹ The five-year grace period

⁶⁷ The heavy demands for pounds and dollars made the newly set free market rate (45 baht per pound) untenable by the end of 1953 as the real exchange rate for the baht dropped to 58 baht per pound.

⁶⁸ The Bank of Thailand warned against the heavy dependence of the economy on a few exports, i.e. rice, tin, teak, and rubber as world markets for agricultural products could become unpredictable and favored consumers over producers. It sought to encourage the government to diversify the country's exports, particularly into the area of manufacturing production. For example, see Bank of Thailand, *Annual Report 1948*.

⁶⁹ The Bank frequently used its annual reports to the Ministry of Finance to offer a critique and recommendation for government economic policies.

agreed upon by both the Thai government (represented by the Bank) and the IMF before the termination of exchange controls and multiple exchange rates meant that a tentative limit had been set on the implementation of these policies. During the grace period, regular consultation between the BOT and the Fund over exchange policy liberalization through annual consultative meetings and technical assistance missions also helped remind the government of its obligation to comply with the IMF at the end of the five years. Even when the grace period was extended in 1953 due to unstable economic conditions, the fact that the IMF continued its consultation with the BOT in preparation for future liberalization implied quite clearly that a change to a unified exchange rate system was in motion. Accordingly, it may be seen the Bank was able to refer to the obligations to the IMF and IMF recommendations to add more weight to its preference for a move toward the liberalization of exchange policy.

However, it needs to be mentioned that the influence of the IMF, particularly in this case, was more determinative of a broader policy direction than of an immediate policy change. As mentioned earlier, the fact that the BOT waited until 1963 to set a par value of the baht revealed its autonomy with regard to the following of IMF policy recommendations. The government's revaluation in 1952 also reflected its autonomy in choosing a policy instrument in dealing with domestic economic problems. Accordingly, it may be said that the Thai state (be it the Bank or the government) enjoyed a significant degree of autonomy in macroeconomic management, despite its dependence on the IMF for financial and technical assistance, as long as it could show plausible justification

within the IMF-approved policy framework.⁷⁰ The ability of the Bank in using IMF influence in supporting its policy preference was most effective in preparing for the longer-term macroeconomic policy trajectory and in adding more legitimacy to its policy advice to the government when the latter was pretty much inclined toward such advice.

It may be said that the liberalization of the exchange rate system in 1955, a result of the Bank's ability to push for its policy preferences, also served as a source of the Bank's autonomy in managing the exchange regime for over four decades until the financial crisis of 1997. Its primary control over the international reserves and the EEF allowed the Bank to maintain the external stability of the baht throughout this period. It will be argued later that the institutionalization of this autonomy has given rise to exchange policy orthodoxy, which proved to be incompatible with for the new financial environment brought about by the process of financial liberalization in the 1990s.

The Twelve-year tenure of Dr. Puey

The fact that the Bank of Thailand Act of 1942 does not specify the term in office of Bank executives is one of the main indicators of central bank dependence by normal standards. However, the lack of a statutory stipulation on a term limit worked to the Bank's advantage when Dr. Puey Ungphakorn took office in 1959 and remained as Bank governor for twelve years until 1971. His unusually long tenure is as much a good indicator of the Bank's relative autonomy as a contributing factor for its making. A number of reasons need to be mentioned. First, the long, uninterrupted term in office implies policy continuity, which can be seen in various areas of the Bank's work. Dr.

⁷⁰ In principle, the revaluation in 1952 was not in conflict with the IMF policy recommendation. The IMF approved of the imposition of deflationary policy, e.g. revaluation, to curb inflation. However, the preferred rate of revaluation was within 2 percent margin.

Puey's influential role in promoting exchange rate stability, beginning when he served the Bank under different capacities in the 1950s, became institutionalized as a par value was finally set in 1963 and remained unchanged until 1972.⁷¹ The Bank's role in preserving price stability, particularly through the promotion of fiscal and monetary coordination, was strengthened and expanded through budgetary reform processes, in which Dr. Puey himself was directly involved as the first Director of the newly established Budget Bureau before being appointed as Bank Governor.⁷² The Bank's involvement in credit allocation also expanded during his tenure. Starting from rediscount services for rice exports at the end of 1950s, the Bank extended the facilities to cover other agricultural products, certain raw material imports, and selected industrial products during the 1960s. These credit allocation schemes, albeit minimal in their effects, continued to symbolize the BOT's limited developmental role until the late 1980s. It may be seen that the institutionalization of these monetary measures during Dr. Puey's term in office facilitated policy continuity and reflects the Bank's ability to pursue these measures over a long period of time.

Second, Dr. Puey's charisma, integrity, and professional caliber indicated that his long tenure was not a result of his being subservient to the government or any interest group. These personal qualities helped reinforce other aspects of behavioral autonomy. By demonstrating moral authority both in his private and professional life, Dr. Puey was well respected and recognized for his integrity and credibility as much as his

⁷¹ Dr. Puey was appointed a member of the Bank's Court of Directors in 1952. In 1953, he assumed the position of Bank Deputy Governor for 7 months. His early departure was due to his conviction not to yield to political influence in the public gold sale scandal. He was immediately appointed by the Court to be the Bank's expert advisor. In 1955, he became the advisor to the newly established Exchange Equalization Fund.

⁷² Dr. Puey, who was also the Assistant Permanent Secretary of the Ministry of Finance in the mid 1950s, was influential in recommending the Phibun government seek technical assistance from the American Public Administration Service in 1955 in reforming the budgetary system.

professionalism. His honesty, courage, and relentless determination in the pursuit of public interest amidst widespread corruption and political patronage won him public and international support, which in turn helped insulate the Bank from political intervention. The military leaders were also aware of and depended on his professional competence and credibility to lead the country's macroeconomic management.⁷³ Dr. Puey's assertion of Bank independence from political influence can also be seen in his opting to resign from his position as Bank governor on many occasions.⁷⁴ This strategy proved to be quite successful in preventing possible political interference or unbecoming practices.

Due to Dr. Puey's personal character and professional capacity, his tenure enhanced the Bank's *de facto* autonomy. Among the prominent contributions were his policy network connection both within Thailand and abroad, which enabled him to create a policy environment conducive to fiscal and monetary coordination and monetary stability. Similar to many of his predecessors, Dr. Puey had a close connection with the Ministry of Finance, where he had served under several important positions beginning in the late 1940s. What was particularly important was his relationship with a network of economic bureaucrats at the Ministry of Finance, the Bank of Thailand, and other strategic economic agencies, with whom he shared a certain outlook on the economy and the commitment to improve the country's economic conditions through their technical

⁷³ Maxfield argues that the need for international support by the Sarit government played an important role in fostering the Bank of Thailand's autonomy. See Maxfield, *Gatekeepers of Growth*.

⁷⁴ Dr. Puey mentioned some of these accounts in his brief autobiography "Looking Back, Looking Ahead" On one occasion, when he found out that the Sarit government was planning to establish a committee on fiscal policy, he strongly disagreed with the plan since it was under the responsibility of the Bank. He then stated that he would resign from the Bank if the committee were to be established. The plan was finally dropped. "Looking Bank, Looking Ahead" was first published in the Bank's journal, *Thor-Por-Thor Parithat*, April, 1976. It was reprinted in numerous publications, including *Puey Ungphakorn: a Siamese for All Seasons*, (Bangkok: Komol Keemthong Foundation, 1981).

expertise.⁷⁵ With the support of this informal network, Dr. Puey was able to promote more coordination in fiscal, monetary, and development planning.⁷⁶

Dr. Puey's direct involvement in a number of key economic agencies himself, even after he was appointed to the post of Governor of the BOT, also enabled him to lay the foundation for fiscal and monetary coordination. For example, due to his influential role in budgetary reform, Dr. Puey was appointed the first Director of the Budget Bureau in 1956, a position which he continued to hold even after he was appointed Bank Governor in 1959. In 1961, while he was holding these two positions, he was appointed to the post of Director of the newly established Fiscal Policy Office. Shortly after this appointment, he resigned from the Budget Bureau and continued to lead the two key economic agencies until 1967 when he resigned from his position at the Fiscal Policy Office. While it seemed to be a concentration of fiscal and monetary power within one man⁷⁷, Dr. Puey's leadership at these three institutions helped institutionalize fiscal and monetary coordination, which in turn facilitated the pursuit of monetary stability throughout the 1960s.

Dr. Puey's international connections were also instrumental in shaping the Bank's relative autonomy. These connections were formed as a result of his service to the Thai government beginning in the late 1940s. Among the most influential connections was his

⁷⁵ In "Looking Back, Looking Ahead", Dr. Puey credited his colleagues at Ministry of Finance and the Bank of Thailand in their collective efforts to revive the post-war economic problems. Some of them included Boonma Wongsawan, Sommai Huntrakul, Bisuthi Nimmanhaeminda, Suparb Yossunthorn, and Krongthong Chutima.

⁷⁶ Stifel argues that the cooperation of these economic bureaucrats, particularly those at the Bank of Thailand, the Ministry of Finance, the Budget Bureau, and the Planning Agency (the National Bureau of Economic and Social Development) challenged Riggs' concept of 'bureaucratic policy', whereby budgetary allocation reflected the power relations among ministries. See Laurence D. Stifel, "Technocrats and Modernization in Thailand", *Asian Survey*, Vol. 16, No. 12 (Dec., 1976), p. 1194

⁷⁷ This idea was also entertained by Dr. Puey, resulting in his resignation from the Budget Bureau and the Fiscal Policy Office later on. See "Looking Back, Looking Ahead".

relationship with the Bretton Woods institutions, which began at the time when Thailand gained membership to the two organizations in 1949. His active involvement with both the IMF- and World Bank-related activities, such as participating in their annual meetings, negotiating development loans and coordinating with technical survey missions and technical assistance projects, earned him their recognition and confidence, which he brought to and continued to maintain at the Bank. During his long tenure, Dr. Puey was influential in promoting regional cooperation among central bankers in Southeast Asia to facilitate regional development and strengthen regional representation and bargaining power at the IMF and World Bank.⁷⁸ This effort led to the establishment of Southeast Asian Central Banks (SEACEN) and the Asian Development Bank (ADB) in the mid 1960s. It may be said that the Bank of Thailand's active international role, through the leadership and reputation of Dr. Puey, helped elevate the Bank's international status, which contributed positively to its autonomy and credibility at home.

While it is important to acknowledge that international support helped foster the Bank's autonomy and credibility domestically, a more active account of the Bank in building this autonomy should be noted. Many authors argue that the Bank was keen to use international support to pressure the government to pursue sound monetary policy.⁷⁹ This phenomenon can be observed during the long tenure of Dr. Puey. For example, in its annual reports the Bank continued to refer to the obligation to and recommendations of the IMF as it tried to maintain a stable and convertible baht in order to pave way for the setting of the par value, which was eventually set in 1963. Dr. Puey was also unequivocal about his preference for using World Bank or Asian Development Bank

⁷⁸ His seniority and good reputation among central bankers in the region helped facilitate such efforts.

⁷⁹ For example, Silcock argues that the BOT used its membership of the IMF and World Bank as a lever to push for sound monetary and financial policy. See Silcock, *Thailand: Social and Economic Studies*, p. 189.

loans to fund some government development projects due to the latter's more stringent lending and disbursement conditions. This active role of the Bank will be discussed at greater length in the following chapter. What is of concern here is how Dr. Puey's international and support and his ability to use this support toward Bank advantage give us some idea about the nature of his twelve-year tenure.

Third, the long governorship also implies a significant continuity in Bank organizational development. During Dr. Puey's term, the Bank continued to grow in size and scope of operations to catch up with rising demands for its services and to improve its functional differentiation. Dr. Puey began to play an influential role in the Bank's organizational restructuring in the mid 1950s when he first served with the BOT in different capacities. Among the important changes in the 1956 organizational restructuring was the establishment of the Bank Examination Office (for commercial bank supervision) and the Economic Research Department to cope with the growing responsibilities in supervising commercial banks and the increasing demands for academic research to guide economic policymaking.⁸⁰ In 1964, the Bank underwent another organizational restructuring, which saw among other changes the Bank Examination Office being elevated to a departmental level. The continuous growth of this office corresponded with the Bank's attempt to modernize and stabilize the financial system, which was expanding rapidly toward the end of 1950s. The promulgation of the Commercial Banking Act of 1962, which provided the Bank more power and responsibilities in supervising commercial banks, triggered the need for a larger Bank Examination Office. Another important organizational expansion during Dr. Puey's term

⁸⁰ The 1956 organizational restructuring took place during the governorship of Kasem Sripayak (1955-1958). Dr. Puey was then serving as the Bank's technical expert and advisor to the Exchange Equalization Fund.

can be seen in the opening of BOT regional branches. In order to serve the rising demands for financial intermediaries in other regions and to centralize this intermediary role under Bank jurisdiction, the first regional (South) office was opened in Hatyai in 1964, followed by the opening of the Khonkhaen (Northeast) and Lampang (North) offices in 1968 and 1969 respectively. The Bank's ability to transform its organizational structure to facilitate the growing authority and responsibilities was partly attributable to its long, uninterrupted, and relatively independent leadership, which allowed for policy continuity and complementarity.

The twelve-year tenure also saw the institutionalization of Dr. Puey's scholarship programs and merit-based recruitment system, which had lasting effects on the character of the Bank and contributed to its technical expertise. The scholarship programs were first launched in 1960 to provide scholarships to selected high school graduates with academic excellence to study abroad in the fields that would be beneficial to the Bank's operations. The programs were later expanded to provide scholarships to wider groups of candidates, such as those who were studying at the university level abroad, or had completed a university degree in Thailand or abroad, or to BOT personnel who wanted to further their education.⁸¹ The objective of these programs was primarily to improve Bank human resources and to maintain professional excellence. Dr. Puey was seen playing an active role in the process, down to strategically choosing the areas of study, countries, and the academic institutions that housed particular schools of thought or technical approaches.⁸² The success of these programs can be seen in the career path of many of

⁸¹ Interview with Bank officials in Fall 2004.

⁸² Bank of Thailand, *Than Phuwakarn Puey* (Governor Puey), (Bangkok: Bank of Thailand, 1999), p. 233-234. An account given by a Bank senior official, who was a former scholarship student to this author in Fall 2005 about how Dr. Puey helped him select his field of study, testified to this statement.

the scholarship students both inside and outside the Bank.⁸³ Another contributing factor to the Bank's integrity and professional competence was the institutionalization of a merit-based recruitment system during Dr. Puey's tenure. Previously, BOT personnel were largely recruited based on a recommendation system as priority had been given to personal integrity (often read as an elite family background). When Dr. Puey became Governor, an examination system was introduced and became institutionalized as part of the Bank's meritocracy. His long tenure facilitated the continued pursuance of these organizational policies, which in the long run fostered the credibility of the Bank.

Finally, some attention should be paid to the 'making' of the twelve-year tenure. Given the unusually long term in office, it is important to understand why Dr. Puey was able to remain in his position for over a decade. Apparently, a combination of factors was at work in keeping him at the Bank's helm. First, the military leaders, Sarit and Thanom, must have been satisfied with him as Bank Governor, probably not for his independence and strong-will, but for his good performance. Under Dr. Puey's leadership, international reserves rose steadily, government spending became more manageable, the baht stabilized, inflation was controlled, and development planning was more synchronized. Accordingly, the political leaders had to accept the Bank's assertion of autonomy while the macroeconomic conditions were in good order. Maxfield's emphasis on the military leaders' concern for international creditworthiness supports this line of thinking. Their need for international financial support, which was largely

⁸³ Among the prominent scholarship recipients are Paibul Wattanasiritham (a nationally prominent figure in rural development), Vijit Supinit (former Governor of the Bank of Thailand 1990-1996), Supachai Panitchpakdi (former WTO Director-General and currently Secretary-General of UNCTAD 2005-?), Chaiyawat Wibulswasdi (former Governor of the Bank of Thailand 1997-1998), and most recently at the time of writing Phaiboon Wattanasiritham (Deputy Prime Minister and Minister of Social Development and Human Security 2006-2007).

dependent on stable macroeconomic conditions, allowed for a more autonomous central bank and the continued tenure of Dr. Puey.

Second, Dr. Puey can also be seen as have played an important role in determining the length of his term. His interest in working with dictatorial regimes, believing that he could contribute to the common good through the military leaders' economic development goals and that there was a network of reputable economic bureaucrats installed to important economic positions, primarily explains his willingness to accept and remain in the job.⁸⁴ This 'alliance', in a way, shows the priority that Thai economic bureaucrats placed on 'economic' rather than 'political' development. The expectation that economic development would eventually lead to conditions conducive to democracy was not uncommon among developing countries' professionals.⁸⁵ Dr. Puey's retirement in 1971 to become the Dean of the Department of Economics and later Rector of Thammasat University and his more vocal support for democracy at this point reflected his belief in the role of education in political development.

As mentioned earlier, in order to assert Bank autonomy, Dr. Puey used his international support, particularly from the Bretton Woods institutions, as leverage to pressure the government into adopting certain economic policies or policy instruments. There is also some indication that he had to compromise with the military leaders' demands in order to deflate certain pressures and to keep them at arms-length. An example of this compromise can be seen in the area of credit allocation. Despite being firm on the principles and regulations of international borrowing, Dr. Puey chose to deal with irregular projects backed by military strongmen by allotting an extra budget (within

⁸⁴ "Looking Back, Looking Ahead" in Komol Keemthong Foundation (1981).

⁸⁵ Muscat, *The Fifth Tiger*, p. 90).

certain limits) specifically for this type of ‘project’.⁸⁶ Another example can be seen in the area of credit control. Silcock observes that besides certain political difficulties in controlling commercial bank credits, the Bank was also prevented from using some of its monetary instruments, particularly the sale and purchase of government securities, more extensively. The main reason was that it could not object too strongly to these sales because it had already put a lot of pressure on the government to avoid borrowing directly from the Bank. Accordingly, Silcock notes that the Bank “can so far do little more than accept a passive role of selling such government securities as the market will take.”⁸⁷ This passive role may be seen as another form of compromise on the Bank’s part to let go of certain issues so that it could be more assertive on other (probably more important) issues, while preventing the military leaders from feeling too pressured.

These factors, which reflected a close connection between good performance, autonomy, and compromise, contributed to the lengthy tenure of Dr. Puey. It is important to examine the making of his tenure not only because it helped institutionalize the Bank’s relative autonomy, but also because it reflects actors’ interactions within a legal framework that does not provide for a fixed term in office for Bank top executives. Without a legislated guarantee of a fixed term in office, the Bank Governor inevitably had to secure his/her position while being concerned with the question of how to preserve the Bank’s autonomy. It seems that the trade-off between autonomy and good performance dovetails with the trade-off between compromise and job security. What is important is whether the governor would let his concern for job security come before Bank autonomy. Despite some small compromises, Dr. Puey’s determination to avoid

⁸⁶ Wanrak Mingmaneeenakin et al, *Paidsibpee Acharn Puey* [Eighty Years of Dr. Puey], (Bangkok: Manager Press, 1996).

⁸⁷ Silcock, *Thailand: Social and Economic Studies*, p. 199.

political interference in Bank affairs was clear. His threat to resign on several occasions was not only a good strategy to deter political intervention, but was also seen as an indication that he was willing to uphold the principle of the Bank's autonomy over extending his term in office. A number of governors before him led the way in this practice. Prince Viwat resigned from his first term because of his and the Court of Directors' disagreement with the government's policy on gold reserve sales.⁸⁸ M.L. Dej also resigned due to his disagreement with the government's revaluation policy in 1952.⁸⁹ In both cases, resigning served as a form of protest, which helped draw attention from the public, especially the media, even though the government might still have been allowed to do what it wanted. Dr. Puey's ability to persuade the military leaders to respect his policy preferences without having to resign may reflect his control of more leverage and a more accommodative environment to the Bank's relative autonomy. Nevertheless, the similarity lies in the willingness of various governors to put their job on the line to uphold their convictions on certain issues. This tradition was the basis of the Bank's integrity, credibility, and moral authority, which for many observers were contributive to the Bank's autonomy during the three formative decades. As this value-based tradition faded, giving way to rule-based and more politicized behavior, there seemed to be a change in the patterns of interaction among implicated actors in responding to the lack of clearly specified term of office. This change will be discussed on in the chapter 6.

⁸⁸ Bank of Thailand, *20 Years*, p. 10.

⁸⁹ *Ibid.*, p. 69.

Budgetary and Administrative Independence and their Impacts

According to the Bank of Thailand Act of 1942, the Bank is granted the authority to manage its own budget and internal administration.⁹⁰ This budgetary and administrative autonomy exempts the Bank from the rules and regulations of the Civil Service Commission and the Ministry of Finance, which govern most state agencies' budgetary appropriation and personnel management.⁹¹ Except for the annual external audit of Bank Reserve accounts, the institution enjoys the freedom to manage its own financial and administrative affairs.⁹² Evidently, this freedom can be seen as another dimension of the Bank's relative autonomy from executive control provided by the constitutive legislative framework. In his quantitative studies of central bank independence, Cukierman also includes a central bank's freedom to determine its own budget and the salaries of high-ranking officials as indices of a particular bank's actual independence.⁹³

During the first three decades of the Bank's history, budgetary and administrative control helped reinforce other sources of behavioral autonomy, particularly its technical expertise and professional competence. As mentioned earlier, the Bank had gone through numerous rounds of organizational restructuring before and during Dr. Puey's term in order to improve the organization's functional differentiation and to cope with the

⁹⁰ Section 7-11 of the Bank of Thailand Act of 1942 implies that the Bank manages its own capital fund without any budgetary support from the government.

⁹¹ This is not to exaggerate the government's budgetary and administrative control over state agencies. There are definitely many areas where controls are more relaxed than others, particularly when proximity from the center is farther. Silcock talks about the relaxed controls in government enterprises and municipalities. Many who are familiar with the operations of Thai embassies abroad may also agree with the relatively large degree of freedom and discretion in budgetary management of the ambassadors. The point of the matter is that the Bank of Thailand is exempted from such control from the government to begin with. See Silcock, *Thailand: Social and Economic Studies*, p. 187.

⁹² Section 35-37 stipulates that Bank Reserve accounts are subject to external audit by the Audit Council.

⁹³ Cukierman, *Central Bank Strategy*, pp. 386-387.

expansion in the scope of BOT responsibilities.⁹⁴ Judging from its good records, these organizational changes, which were largely facilitated by the Bank's control over its own purse and internal management, helped the BOT do its job more efficiently. Another significant impact of budgetary and administrative autonomy was seen in the area of human resource development and management. Dr. Puey's scholarship and recruitment programs mentioned above were also made possible by the Bank's budgetary and administrative control. With its own vast financial resources and recruitment authority, the Bank, through Dr. Puey, was able to establish its recruitment tradition outside the control of the Civil Service Commission, thus engaging the Bank directly in the creation of its own human resource pool. The Bank's financial independence also allowed it to pay its employees handsomely with high salaries, bonuses, and other kinds of employment benefits.⁹⁵ These financial incentives were aimed to attract and maintain high-quality personnel and to sustain employees' loyalty. Some may believe that they could also have helped prevent corruption, which might have been induced by income scarcity. Accordingly, it may be said that the Bank's ability to design (and redesign) its own organizational structure and personnel-related policies to meet its professional commitments and to maintain a high standard in technical expertise was largely facilitated by its budgetary and administrative autonomy.

It is interesting to explore further the connection between budgetary and administrative autonomy and the Bank's moral authority, which is another important

⁹⁴ An example can be seen in the area of financial institution supervision. In 1948, the Bank Supervision Section was first established under the Research Division. In 1956, it was separated from the Research Division and upgraded to the Bank Examination Office. Nine years later, it was elevated to a departmental level, thus becoming the Department of Bank Examination before being transformed to the Department of Financial Institution Supervision and Examination in 1972. See more details in Bank of Thailand, *50 Years*, p. 176.

⁹⁵ Other benefits include retirement benefits, health care services, housing loan facilities, and cremation funds. See more details in Bank of Thailand, *50 Years*.

source of its de facto autonomy. Silcock focuses on this connection as he attempts to describe the Bank's moral influence. As the Bank was free from any financial and administrative controls, he sees that "the opportunities for gain by any dishonest members of the Bank of Thailand's are almost unlimited, yet it maintains a high reputation both in Thailand and abroad for its integrity".⁹⁶ Silcock's insight brings up two issues simultaneously: the temptations of unchecked power and the pressure for self-restraint on the Bank's part not to fall into such temptations. Building upon this thought, it may be argued that the Bank's moral authority is based largely on its members' self-restraint in not taking advantage of the opportunities that come with their power and responsibilities for personal gains. Governor Kasem Sripayak's resignation in 1958 to take responsibility for a money scandal committed by a Bank junior officer shows an attempt by the Bank to uphold such moral authority. The removal of Jote Guna-Kasem from his double posting as Bank Governor and as Minister of Finance in 1959 due to a note-printing scandal even though he was later exonerated, is a reminder of the negative repercussions of the concentration of fiscal and monetary power within one person. Dr. Puey's attempt to avoid any opportunity for misconduct and corruption in bank examination by issuing an internal memorandum demanding Bank inspectors not to accept any favors, gifts, or meal invitations from commercial banks under inspection also serves as an example of the institutionalization of the Bank's moral authority. These examples show the dangers of being relatively autonomous and how throughout the first thirty years the Bank learned through mistakes to maintain self-restraint and take precautions. Further discussion on the institutionalization of moral authority and the implications of value-based institutional character is provided in the following section.

⁹⁶ Silcock, *Thailand: Social and Economic Studies*, p. 187.

At the moment, it may be seen that the Bank's control over its budget and internal administration contributed to its ability to shape its organizational structure and institutional character in ways that has supported and sustained its behavioral autonomy.

The Bank of Thailand and the Governing of the Thai Financial System

As described in chapter 2, the history of commercial banks in Thailand long predated the Thai central bank. To understand the nature of the BOT-financial sector relationship during the first three decades of the Bank, it is necessary to discuss the pre-existing relationship between the Thai authorities and the banking community in order to learn of some of the constraints that the Bank encountered when it took on a supervisory role over this powerful sector. The Bank's ability to use various strategies, including legal amendments, moral suasion, and alternative monetary instruments to increase its authority over and induce cooperation from the financial sector contributed to the relatively sound financial management during this period. The financial institutions' increasing dependence on the BOT to act as lender of last resort and protector from foreign competition is key to understanding of the establishment of the Bank's relative autonomy from this societal group.

The early years of the relationship between the state and banking sector saw the desire of the state to exert its authority over commercial banks constrained by the context of colonial power relations and the state's inexperience in the banking business. As mentioned in chapter 2, the first commercial banks to operate in the country were mostly

European.⁹⁷ Legally, the extra-territorial treatment of British and French subjects until the end of WWI exempted these banks from the Thai government's authority. However, the consolation was that the scope of financial practices of foreign banks at the time (i.e., foreign exchange and international trade facilitation) limited their operations mostly to foreign customers. The attempt of the state to regulate banking business was first geared toward local banks, whose customers were predominantly Thai and Chinese. When the first Thai commercial bank, the Bank of Siam (now the Siam Commercial Bank), was established in 1904⁹⁸, the Charter of the Bank of Siam was the first instrument of state control over banking, reflected in the provisions regulating the bank's liquidity and security, setting limits on foreign shareholding, requiring regular reports to the Minister of Agriculture, and allowing the government unlimited access to the bank's books.⁹⁹ Later, when commercial banks became more popular among the public, the first law to regulate domestic banks was passed in 1928, stipulating the minimum capital requirements, the prohibition of connected lending, and the reservation of directorial positions to Thai nationals.¹⁰⁰ As it turned out, government supervision of domestic banks during this early period proved less than successful. The fact that most domestic banks were established to facilitate particular business groups in international trade business lines, particularly rice exports, made their liquidity vulnerable to the ups and downs of their businesses. Without close financial supervision and a central bank to act

⁹⁷ The first commercial banks in Thailand included the Hong Kong and Shanghai Bank (British), the Chartered Bank (British), the Banque de L'Indochine (French), the Sze Hai Tong Bank (China), and the Mercantile Bank (British). Their branches were opened in 1888, 1894, 1897, and 1909, and 1919 respectively.

⁹⁸ It was renamed the Siam Commercial Bank in 1907 and then the Thai Commercial Bank in 1939.

⁹⁹ As there was no law regulating commercial banking business, an opening of a commercial bank required a Royal Charter to be granted by the Ministry of Agriculture. However, after the Charter was granted, the government did not impose strict supervision. See Bank of Thailand, *50 Years*, p. 39.

¹⁰⁰ The Act Regulating Commercial Activities Affecting the Safety and Welfare of the Public of 2471(1928) gave power to the Ministry of Finance to lay down regulations governing commercial banks.

as lender of last resort, the government could not prevent the collapse of a number of local banks in late 1910s and early 1930s.¹⁰¹

The attempt to regulate foreign banks and later to control national ownership of the banking business was taken up seriously after the People's Party came to power in 1932. The Act Regulating Commercial Banking Business Act of 1937 was the first piece of legislation that sought to regulate both domestic and foreign banks.¹⁰² When this law became effective, a number of banks were shut down as they did not meet the legislative requirements stipulated by the law. It is important to note that the law was aimed particularly at Chinese-controlled banks, both domestic and overseas, due to their increasing economic presence in Thailand and their growing support for the nationalist movement in China. European banks, whose activities had been hampered by the economic and political situations in Europe including the Great Depression and the threat of WWII, had become a lesser threat. In fact, when the Pacific War broke out in 1941, these banks were ordered to shut down and their assets were confiscated.¹⁰³ This was the end of the domination of the Thai banking sector by foreign banks. By the time the war ended, domestic banks, established before and during the war, had taken control of the banking business in Thailand.

¹⁰¹ The Siam Commercial Bank was an exception. Its special status under the Royal patronage ensured it received financial injection from the Treasury Department and the Office of the Privy Purse when it encountered a financial difficulties in 1931. When this law became effective, a number of banks were shut down as they did not meet the legal requirements stipulated by the law.

¹⁰² The law was promulgated in September 1937 and became effective in April 1938. Bank of Thailand, *50 Years*, p. 41. Many financial establishments were shut down when this law became effective as they did not meet the legal requirements of the law. This included small money-exchange businesses, which were quite popular among the Chinese community. These businesses were re-categorized as exchange banks (as opposed to deposit banks) based on their main activities and were subject to heavy taxes due to their role in sending remittances to China.

¹⁰³ The National Banking Bureau was responsible for the compiling of the seized assets, the releasing of deposits and other assets to depositors. See Bank of Thailand, *50 Years*, pp. 61-62.

The attempt of the People's Party (PP) to control Chinese businesses in general and to standardize the banking business in particular initially led to a restructuring of Thailand's financial landscape. It was the first time the government demonstrated clear authority over the banking sector. Besides the closing down and confiscation of most (Chinese-owned) banks, the People's Party was involved in the establishment of a number of new commercial banks as part of its goal to take control of the financial system.¹⁰⁴ These banks later became the economic power base for different PP leaders.¹⁰⁵

As it turned out, the PP was not successful in achieving its goal of eliminating foreign (Chinese) economic influence from the Thai economy, despite its extensive attempts to restructure the economy as seen in the financial sector. The different approaches pursued by military and civilian leaders and the lack of expertise in various business enterprises forced the coup group leaders to cooperate with the Chinese economic elite, thus enabling the latter to use its connections with the state to enhance its economic power base.¹⁰⁶ With regard to the banking sector, political leaders and Chinese business groups cooperated in taking control over the banking business, filling the void left by foreign banks. Contrary to the PP's original intention, Chinese business groups were able to use their financial resources and expertise to extend themselves into the

¹⁰⁴ These banks included the Bank of Asia, The Metropolitan Bank, and Ayudhya Bank, established in 1939, 1941, and 1945 respectively.

¹⁰⁵ During this time, the Siam Commercial Bank was placed under the control of the PP as they took over the Office of the Privy Purse and acted on behalf of the Ministry of Finance (formerly called the Treasury Department), which owned significant shares of the bank. See Pannee, *Analysis of Commercial Banking Capitalists*, p. 67.

¹⁰⁶ Pasuk and Baker, *Thailand: Economy and Society*, pp. 120-125. Such cooperation may be seen in various forms, e.g. joint ventures in government enterprises and in private businesses initiated by PP leaders, the appointment of leading Chinese businessmen to manage government enterprises, and the granting of contracts to Chinese companies. See also Pannee, *Analysis of Commercial Banking Capitalists*, p. 106.

banking sector in order to build a financial base for their blooming business ventures, particularly toward the end of WWII.

The Bank of Thailand was established in 1942 in the context of this state-business relationship. From the early 1940s to the late 1950s, the Bank did not have much control over the banking sector due at least to two major constraints, namely the political connection between bankers and political leaders and the financial independence of commercial banks from the BOT. The existing political connections between bankers and political leaders proved to be a constraint on the Bank's role in the controlling of credit and the supervision of financial institutions at an early stage of its history. Among the first signs of difficulty was the failure of Parliament to pass the Emergency Decree on Credit Control, proposed by the BOT and the MOF in 1943 to curb private credit extension in an attempt to contain wartime hyperinflation. According to the Decree, commercial banks were required to hold minimum cash reserve of 9 percent within a ceiling of 45 percent of total deposits and to hold a minimum of government bonds no less than 40 percent of total deposits.¹⁰⁷ A new law in place of the aborted Decree, the Emergency Credit Control Act of 1943, was less stringent in that cash reserves of commercial banks were set at a minimum of 25 percent and the holding of bonds and cash reserves should not exceed 50 percent of total deposits.¹⁰⁸ Difficulties were also seen in the Bank's attempts to regulate the banking sector through the promulgation of the Commercial Banking Act of 1945 to replace the existing law, which had been enacted during the outbreak of the Pacific War.¹⁰⁹ In this law, drafted by Prince Viwat, the

¹⁰⁷ Bank of Thailand, *50 Years*, p. 95.

¹⁰⁸ Ibid.

¹⁰⁹ The Emergency Act on Supervision of Banking Activities of 1941 was enacted to provide the Minister of Finance to prohibit or limit commercial bank operations to suit government wartime policies.

authorities showed signs of concerns for the soundness of the financial system as more banks and non-bank financial institutions, such as insurance companies, were established toward the end of WWII.¹¹⁰ These concerns focused on excessive competition and risky lending practices, seen in the stipulation on maximum deposit rates and prohibition of lending more than 30 percent of bank paid-up capital to one individual. The Act also granted the BOT supervisory power over commercial banks for the first time. However, political pressures were at play in constraining the authorities' freedom in exercising the power granted by law. For example, the provision on large exposure to a single borrower was opposed by commercial banks and was finally dropped from the Act.¹¹¹ It also seemed that the BOT never resorted to the interest rate ceiling mechanism to control excessive competition and it was not until 1953 that BOT officers were for the first time appointed as bank inspectors.¹¹²

During the 1950s, the political patronage relationships between the military leaders and Chinese-dominated big business groups intensified. Factional rivalries among the political elite pressured each group to expand its economic power base by forming patron-client relationships with big businesses, particularly commercial banks.¹¹³ The control of rents by the state also forced these Chinese-dominated private entrepreneurs to seek political patronage from the military leaders. As a result, many top military officers were invited to serve as advisors and board directors of private companies. In the banking sector, the competition to expand political patronage was

¹¹⁰ Four more banks were established toward the end of WWII, including the Bangkok Bank of Commerce (1944), Bangkok Bank (1944), Bank of Ayudhya (1945), and Thai Farmers' Bank (1945).

¹¹¹ Bank of Thailand, *20 Years*.

¹¹² Silcock, *Thailand: Social and Economic Studies*, p. 194.

¹¹³ See Pannee, *Analysis of Commercial Banking Capitalists*, pp. 113-117.

quite fierce. Out of ten banks operating in the post-war period all but one had developed clear connection with the major military factions.¹¹⁴

A well-known case of political intervention in the BOT's operation, which manifested the degree of political patronage, was the removal of Dr. Puey as BOT Deputy Governor in 1953 due to political pressure. The interference was in response to the BOT's intention to fine a commercial bank that had violated BOT regulations with regard to the purchase of pounds sterling at a discounted rate. According to the regulations, commercial banks were allowed to purchase pounds from the BOT at a discounted rate in order that they be used in the payments of essential imports. When the BOT found that the United Bank (*Saha Thanakarn*) failed to use the purchased pounds as required, it sought to fine the bank accordingly. General Sarit, who would later become the Prime Minister (1958-1963), tried to persuade Dr. Puey to drop the hefty fine as he intended for the government to take over the Bank. When Dr. Puey refused, he was removed from his position after having served for only 7 months. This incident was frequently used to exemplify Dr. Puey's integrity, as he chose not to bend to political pressure.¹¹⁵ However, this incident also illustrates the context of political patronage and the constraints it generated for the BOT in exercising its supervisory power over the financial sector.

Another important restriction on the Bank of Thailand's authority over commercial banks was the latter's financial independence. On the demand side, the

¹¹⁴ The Wang Lee Bank was a family-run bank, which was geared toward facilitating the family's business ventures. In terms of assets, it was the smallest banks compared to other commercial banks operating in the 1950s and 1960s. See *Ibid.*, pp. 194-197.

¹¹⁵ See Dr. Puey's own account of the incident in Puey Ungphakorn, "Liew Lang Lae Naa (Looking Back, Looking Ahead)," in *Puey Ungphakorn: A Siamese for All Seasons*, (Bangkok: Komol Keemthong Foundation, 1981). Also in Bank of Thailand, *Governor Puey*.

continued inflation of the wartime and post-war periods generally allowed commercial banks to operate in an environment of ample liquidity. Their relationship with the military leaders also provided access to state funds, which could go to finance their non-bank family businesses or to recapitalize their banks.¹¹⁶ Some large banks, particularly the Bangkok Bank, had access to external funding from their bank branches overseas. Foreign companies that entered into joint ventures with Thai businesses were another important source of finance besides commercial banks, therefore reducing the demand for bank lending in other economic sectors. Accordingly, the availability of private funds during this period made commercial banks see little need to turn to the Bank of Thailand as their source of funding. The BOT's lack of financial capacity to assume the role of credit allocator due to its obligations to fund government expenditure also explained the low degree of financial allocation to the banking sector in the post-war years. This capacity limitation was acknowledged by the Bank when it initiated the rediscount facilities to act as a credit control instrument and to promote export at the same time in 1953.¹¹⁷ Due to the lack of financial resources to fund such schemes, the idea of rediscount credits did not materialize until 1956. Nevertheless, owing to the availability of private funds mentioned above, rediscount facilities received only little attention from commercial banks until much later as they were limited in scope (for rice exports only

¹¹⁶ For example, due to its connection with political leaders, the Bangkok Bank in 1953 received 30 million baht from the Ministry of Commerce to increase its capital from 20 million baht to 50 million baht. Even though such a transaction allowed the Ministry of Commerce to hold 60 percent of the bank's overall capital, the capital increase helped the Bangkok Bank to improve its competitiveness, particularly with foreign banks and turned it into one of the biggest Thai banks in the system. Later in 1956, the Ministry of Commerce sold its share worth 15 million baht back to the bank's management group, thus reducing its share from 60 to 30 percent of total shares. See more details in Pannee, *Analysis of Commercial Banking Capitalists*.

¹¹⁷ Bank of Thailand, *30 Years*, p. 45.

until 1960) and contained high interest rates compared to credits extended abroad.¹¹⁸

Also, commercial bank borrowing (not including overdraft service) from the BOT, which became available after 1947, was at rather negligible level until mid 1960s. High interest rates might have accounted for the unpopularity of BOT loans among commercial banks; when the Bank reduce the interest rates from 8 percent, as set in 1958, to 7 percent in 1965, commercial bank borrowing increased from 463.6 million in 1964 to 1.6 billion in 1965.¹¹⁹ It can be argued that the low degree of financial dependence by commercial banks on the Bank of Thailand during its first two decades limited the Bank's capacity to use monetary instruments to control private credit extension and allocation, particularly through changes in lending rates.

Despite the two major constraints preventing the BOT from exercising authority over commercial banks more effectively, the Bank employed various strategies to try to exert certain control over the financial sector. Some of these strategies included the introduction of new legislation to help standardize banking practices and to give the BOT more authority in supervising financial institutions, the resorting to alternative monetary instruments to help control private credits, and the use of moral suasion to acquire cooperation from the banking community. These strategies became more institutionalized toward the end of the 1950s and early 1960s, as the Bank also became stronger institutionally due to the long tenure of Dr. Puey. But the most important leverage that the Bank developed against the financial sector was found in the BOT's role as lender of last resort and its policy to limit competition in the sector from both new domestic and

¹¹⁸ For example, in 1959, commercial banks drew upon BOT rediscount credits at the amount of 198.2 million baht, which equaled to only 4.98 percent of commercial banks' own rediscount services. *Ibid.*, p. 47.

¹¹⁹ *Ibid.*, p. 44.

foreign entries. Commercial banks' increased dependence on the BOT's financial assistance and its keeping the banking system relatively closed contributed to the former's cooperation with the authorities as well as the latter's ability to pursue rather independent financial policy objectives in the following periods (to be demonstrated in chapters 5 and 6).

The introduction of new laws regulating commercial banks, which largely reflected the Bank's perceptions of existing problems with regard to banking practices, may be seen as an attempt to exert its control through the standardization of the banking sector and the granting of more power to the BOT. The Commercial Banking Act of 1945, drafted by Prince Viwat, the first BOT Governor, was a first attempt by the Bank to standardize banking businesses through the provisions on capital reserve requirements, liquidity requirements, an interest rate ceiling, and account disclosure and auditing.¹²⁰ As the law drew upon different models of Western financial institutions, some authors criticize the Bank for having introduced banking standards which were biased against local models.¹²¹ While this may be true to an extent, it may be argued that the rationalization of banking practices based on Western standard, served as a basis of authority for the BOT in structuring the banking sector toward a model of sound banking to promote financial stability. As it seemed to the monetary authorities, like Prince Viwat, that full control of the banking sector was neither practical nor desirable, attention was then paid to establishing a sound banking code rather than seeking to exert control

¹²⁰ Bank of Thailand, *50 Years*, pp. 99-100. See also Silcock, *Thailand: Social and Economic Studies*, p. 192.

¹²¹ For example, see Silcock, *Thailand: Social and Economic Studies*, p. 192.

over bank operations.¹²² The BOT's attempt to exert more control over the banking sector was later seen in the promulgation of the Commercial Banking Act of 1962.

Drafted in a different financial context, where banking services had become more popular among the public and there was a country-wide expansion of banking businesses, the Act granted more power to the BOT in promoting stability of the banking sector. For example, the Bank was now to determine the ratio of the capital reserve requirement and the cash reserve requirement with which commercial banks needed to comply.¹²³ It was also empowered to set both lending and deposit rates. To avoid liquidity crises, which a local bank witnessed in 1959, a limit on credit extension to a single individual was also included in this law.

However, what seemed most influential to the relationship between the BOT and commercial banks emerging out of the 1962 Act was the limit the monetary authorities put on the number of commercial banks in the system. After 1962, only one bank was granted a license to operate, keeping the total number of commercial bank to 16 (reduced to 15 in 1987) until the decision to allow more commercial banks was made in 1996.¹²⁴ The Act also allowed for only one foreign bank branch to operate in Thailand and sought

¹²² In his memorandum, the Prince was of the view that it was not practical to control banking activities as most lending decisions involved discretion and risks. Therefore, it was better to set certain banking standards to be supervised by the authorities. It is also interesting to note that the law did not provide the Minister of Finance discretionary power to grant banking licenses. Any bank, which met the legal requirements with regard to its financial status, would be allowed to operate. The intention behind this stipulation was that Thai banks would not get discriminated against as the authority might be inclined to grant banking licenses to foreign banks, while seeking to subject Thai banks to its discretion. See Bank of Thailand, *Vatanajayanusorn*, pp. 141 and 143.

¹²³ The capital requirement was changed from a fixed amount of funds to a ratio of 5-15 percent of bank assets. Cash reserve requirement was set with a wider range, i.e. from 5-50 percent of deposits, to be determined by the Bank of Thailand. See Tull, *Thailand: Financial Sector Reform*, p. 27.

¹²⁴ Bank of Thailand, *50 Years*, pp. 176-177. In 1984 the Asia Trust Bank became insolvent. It was nationalized by the BOT's rescue plan and renamed the Sayam Bank. In 1987 the Sayam Bank merged with another government-owned bank, the Krung Thai Bank. See *Ibid.*, pp. 300-301.

to ascertain that commercial bank ownership concentrated in Thai hands.¹²⁵ To many observers, the limit on new bank entries resembles a government-endorsed cartelization of the Thai financial system, in which existing banks were able to collude among themselves, particularly in setting interest rates.¹²⁶ The cap on foreign bank branches and ownership requirements also reflected the authorities' protectionist tendency to keep out foreign competition. The issue of protectionism will be discussed in a greater extent in chapter 6. Here, it may be said that the BOT was quite willing to tolerate the quasi-monopoly in order to achieve relative financial stability and Thai banking sector competitiveness, and to maintain control over the existing commercial banks through a guarantee of low competition. It was under these policies that commercial bank dependence on the BOT's protection began to develop.

In its attempt to manage private credit allocation, the BOT sought to establish more financial control over commercial banks by expanding its role as credit provider to the banking sector. Even though the Bank's limited financial capacity in the 1940s and 1950s, largely due to its obligation to finance government deficit spending, prevented the institution from assuming this role at that time, the situation improved in the 1960s. As the burden to lend to the government was decreasing, the BOT's financial capacity to provide credit to the financial sector expanded. The demand for credits from other economic sectors as the economy was growing steadily also encouraged commercial

¹²⁵ Ibid. See also The Commercial Banking Act of 1962, sector 5. The Act requires no less than three-quarters Thai shareholders and the same proportion for Thai nationals to serve on a bank's board of directors.

¹²⁶ Pasuk and Baker, *Thailand: Economy and Society*.

banks to turn to the BOT for credit.¹²⁷ Consequently, monetary instruments, such as central bank lending and rediscount facilities, became more popular among financial institutions. As mentioned earlier, commercial bank borrowing increased significantly in the 1960s and so did the rediscount facilities. For example, rediscount services for the export of agricultural products rose steadily from 551.4 million in 1963 to 1.9 billion in 1972, while the same service for industrial products, particularly cement, rose from 141.8 million in 1969 to 1.5 billion in 1972.¹²⁸ Commercial banks were able to profit from the difference in Bank rates and their repurchase rates, which were still lower than market rates. The BOT, on the other hand, was able to use this monetary mechanism to correct short-term adverse market conditions affecting various economic sectors.

However, the most important financial leverage of the BOT against the financial sector with regard to credit provision was its role in bailing out insolvent banks. The Bank's concern for systemic risks arising from public loss of confidence in financial institutions influenced its policy preference to prevent these institutions from collapsing. The handling of the Agricultural Bank case in 1959, which showed signs of insolvency due to excessive expansion and non-performing loans, set a precedent for the BOT's approach toward bank insolvency as it encouraged the Ministry of Finance to purchase a majority of the troubled bank's shares.¹²⁹ The Bank's role in organizing a bail-out package for the Thai Development Bank in 1970, comprising loans from the BOT itself and other commercial banks, confirmed the BOT's preference.¹³⁰ Moral hazard aside, it

¹²⁷ See a discussion of the Thailand's economic performance in the 1960s, which was under the First and Second National Economic Development Plan (1961-1966, 1967-1971), in Muscat, *The Fifth Tiger*, pp. 97, 103.

¹²⁸ Bank of Thailand, *30 Years*, pp. 49 and 51.

¹²⁹ Bank of Thailand, *50 Years*, p. 177.

¹³⁰ *Ibid.*, pp. 177-178.

may be said that the BOT's financial rescue policy deepened the dependence of commercial banks on the Bank's role as lender of last resort, which in turn allowed the Bank to solicit bank cooperation in programs that might not necessarily be profitable or financially attractive, such as the preferential credit allocation schemes for the rural sector launched in the late 1960s. The issue of preferential lending will be discussed in greater length in chapter 5.

The use of moral suasion, which reflected the regulator's hesitation to use formal authority to achieve commercial bank compliance, was nevertheless seen as a relatively effective strategy for the BOT in the 1960s to secure bank cooperation. As discussed in more detail in the preceding section, there were certain conditions that contributed to the effectiveness of moral suasion, particularly that employed during the tenure of Dr. Puey. The personal characteristics of the longest-serving Governor, especially his honesty, integrity, and courage to stand up for what was right, won wide respect from bankers. The institutionalization of the Bank of Thailand under Dr. Puey's leadership in terms of moral authority and technical competence also drew confidence from financial institutions of the Bank's capacity to guarantee financial stability. Benefits to be reaped from a cooperative relationship between commercial banks and the Bank of Thailand and from the nature of the financial system in general were another incentive for bank cooperation. The limitation of new bank entries (and limitation on foreign bank branches), the bail-out policy, the benefits from stable fixed exchange rates, and even the relatively smaller profits from rediscount services tended to make commercial bankers inclined toward cooperation with the BOT. It may also be argued that the unpredictability, albeit attractive payoffs, of political patronage, may have been

responsible for the turning to more professionalism and more formal channels of interest representation by a new generations of bankers. This development can be seen in the establishment of the Thai Bankers Association (TBA) in 1958 to represent all Thai-owned commercial banks. The Association then became a useful channel through which the Bank of Thailand could use moral suasion to solicit collective cooperation, such as in controlling competitive lending. A series of well-known speeches by Dr. Puey at the annual BOT-TBA banquets reflected his tactful use of the occasion to send messages to the TBA, and through the TBA to the banking community as a whole. These messages took different forms, varying from stern direct warning to humorous jabs. For example, on the issue of competitive lending, Dr. Puey warned,

To do good should not depend on other people doing good. Morality has no conditions..... When Field Marshall Thanom (the Prime Minister) said he was against corruption, he did not mean that you can be corrupt, if others are. Certain banks, I hear, use the pretext of rumours about other banks paying interest higher than the legal limits to indulge in a dog fight for deposits. This excuse is invalid in law or morality. So far, the Bank of Thailand has confined itself to mere warning. From now on we intend strictly to enforce the Law and invoke statutory punishment.¹³¹ (February 20, 1964)

On the issue of ‘bouncing’ checks, he remarked,

In a money market, we must expect good paper and creditworthy customers. The report of the Clearing House confirmed what the President (of the TBA) has just said. That is, the number of “bouncing” cheques has indeed decreased. It has not yet however, reached the level that we could call satisfactory. In the “league” table arranged in descending order of cheque-bouncing frequency, some banks ought to be congratulated because they have managed to escape from the top ranks. Others, however, so far hold fast to leading positions. To these “Champions” I pray that they take measures speedily to submerge, for the sake of confidence in their banks.¹³² (February 6, 1963)

¹³¹ Bank of Thailand, *Soonthornrapote, Bote-kwarm, lae Kamkuan doi Dr. Puey Ungpakorn, Phoowakarn*, [Speeches, Articles, and Slogans by Dr. Puey Ungpakorn, the Governor of the Bank of Thailand] (Bangkok: Bank of Thailand, 1964), p. 78.

¹³² *Ibid.*, p. 58.

Another example of Dr. Puey's use of moral suasion can be seen in the first-of-its-kind financial package aimed at rescuing the Thai Development Bank in 1970. The Bank was able to persuade thirteen commercial banks to inject capital into the troubled bank while allowing the former to become shareholders of the latter.¹³³ Despite its effectiveness in helping the BOT control the banking sector during the 1960s, moral suasion did have its limitations. As the Bank's moral authority and competence played an important role in earning commercial bankers' confidence and trust, which formed the basis of voluntary compliance, the failure of the Bank to uphold such qualities would then affect bankers' desire to comply. It will be seen in chapter 6 that the lack of clear encoding of the moral conduct of central bankers, particularly those at the top, contributed to the loss of confidence in the BOT among the banking community in the period leading up to the financial crisis of 1997.

By the 1960s the Bank had established relative autonomy from the government and the financial sector, and therefore was able to pursue its policy preferences in the maintenance of monetary and financial stability. Policy consensus among political leaders, particularly for a stable currency, bankers' reliance on the BOT to limit competition in the financial sector, and the Bank's own credibility all contributed to the building of the institution's relative independence. However, The BOT's adaptive role in employing various strategies and policy instruments to achieve policy objectives and to promote and preserve its independence is central to understanding how independence was achieved. In the 1950s, the Bank's frequent reminders to the government of Thailand's obligations to the IMF to liberalize its exchange rate policy and the promotion of the

¹³³ See more detail in Nopporn Ruengsakul, *Nayobai Kae-panha Wikrit nai Thanakarnpanit Thai* [Resolution of Banking Crises in Thailand] (Bangkok: Thailand's Development Research Institute, 1987).

Bank's involvement in the process of national development and budgetary planning are among many cases in point. Dr. Puey's initiatives in taking advantage of the BOT's budgetary and administrative autonomy to reengineer the organization and to improve upon the Bank's human resources also exemplified the active role of BOT leaders in sustaining the Bank's credibility and capacities. These phenomena fit well with Selznick's insights on an institution's adaptive ability to sustain itself and maintain its core values or mission, in this case the pursuit of monetary and financial stability.¹³⁴ In the next chapter, we will analyze more closely the relationship between the institutional context and the BOT's actions and preferences in order to demonstrate the influence of the contextual factors on the making of the BOT's relative autonomy.

¹³⁴ Selznick, *Leadership in Administration*, Introduction.

Chapter Four

Contextual Factors and the Relative Autonomy of the Bank of Thailand

This chapter addresses the role of contextual factors in contributing to the building of the BOT's relative autonomy. By examining the domestic and external political economic context as well as the Bank's own organizational setting, it will be seen that these institutional environments provided both opportunities and constraints that affected the BOT's interactions with the government, financial sector, and external actors. The Bank's ability to take advantage of favorable opportunities and to adapt itself to institutional constraints was vital to the emergence of central bank autonomy. In its analysis, the thesis will take into account both formal and informal 'rules of the game', such as the bureaucratic polity, the influence of international financial institutions (IFIs), and the BOT's legal framework, which had significant impact on the Bank's ability to build and maintain its independence. The chapter also demonstrates that the BOT's preferences and actions were not always driven by interests but also by ideological commitments and traditions.

This chapter begins by discussing the political context of military authoritarianism, which spanned from the early 1930s to the early 1970s. The main focus is to show how the concentration of power within military and civilian bureaucrats and their need to maintain international support and credibility helped insulate monetary and

financial policies from societal pressures and allowed the BOT a certain degree of freedom to pursue its policy objectives, particularly the maintenance of a stable currency. The international political/economic context, particularly the Pacific War and the Cold War will be examined in the following section to demonstrate its intervening effects on the interactions among key political actors, including the Bank, governments, financial sector, and international financial institutions. Attention will be paid to the impact of the Japanese occupation on the Thai authorities' consensus on fighting inflation and the role of the World Bank and IMF in providing the BOT leverage against the government. The last section discusses the internal or organizational context that facilitated the making of the BOT's relative autonomy. It will be shown that some of the Bank's historical experiences, such as its history in safeguarding Thailand's monetary sovereignty, the BOT leaders' ability to choose relatively effective policy measures to maintain monetary stability, and their attempt to set moral standard in public service, contributed to the formation of the Bank's credibility, the lengthy tenure of Dr. Puey and the BOT's budgetary and administrative independence also provided a context in which this credibility could be institutionalized.

The Political Context

The political context of the first three decades of the Bank of Thailand (1942-1973) was a period of military and bureaucratic dominance, embodied in two lengthy military regimes of Field Marshal Phibun (1938-1944 and 1948-57) and Field Marshal Sarit (1959-63). After the overthrow of the system of absolute monarchy in 1932, the military had been in control of political power, while administrative power lay with the

civilian bureaucracy. The concentration of executive and administrative power within the military and civilian bureaucrats was the basis of Riggs' concept of 'bureaucratic polity'.¹ In this bureaucratic polity, political parties were weak and unorganized, as they were largely undermined by military regimes. If allowed to function, the elected House of Representatives was largely counter-balanced by the appointed Senate dominated by military and civilian bureaucrats. All civilian governments were short-lived, not only due to the weakness embedded in coalition governments, but also due to frequent direct military interventions.

Generally speaking, the concept of a bureaucratic polity, which emphasizes the concentration of political and administrative power within military and civilian bureaucracy, helps explain the continuity in the control of macroeconomic management by economic bureaucrats, which dated back to the absolute monarchy era. This continuity was reflected in the political appointment of top economic bureaucrats to key economic ministries, particularly the Ministry of Finance, and the common cross-posting of top executives between Ministry of Finance and the BOT.² This bureaucratic control over key macroeconomic positions not only helped insulate fiscal and monetary policy-making from extra-bureaucratic pressures, but also ensured the longevity of monetary conservatism, which was rooted in the tradition of macroeconomic management from the colonial days. Even though it became increasingly more difficult for the post-WWII governments to maintain fiscal discipline, the recognition of military leaders of the need

¹ Riggs, *Thailand: Modernization of Bureaucratic Polity*.

² As mentioned earlier, Prince Viwat, who was the first Thai financial adviser to the Ministry of Finance and a former director of the National Banking Bureau, became the first Governor of the BOT. His two terms as Bank Governor was alternated with his position as Minister of Finance. Dr. Puey started his career in the Ministry of Finance before being appointed to the position of Bank Governor in 1959. He also served as Director of the Budget Bureau (under Prime Minister Office) and Director-General of the Fiscal Policy Office (under Ministry of Finance) for a period of two and five years respectively while serving as BOT Governor.

to maintain international credibility facilitated the pursuit of monetary conservatism led by the BOT.³ Accordingly, with the exception of wartime and immediate post-war hyperinflation, there seemed to be a broad consensus among military and civilian authorities that the Bank of Thailand should accumulate and sustain high international reserves in order to guarantee the stability and convertibility of the baht.

The dominant role of the government in the legislative process also helped economic bureaucrats institutionalize their conservative bias and preferences for currency stability in a number of legal frameworks. The ability of the government to initiate laws and to insulate these laws from heavy legislative scrutiny implied that the content of a law was largely determined at ministerial and cabinet levels.⁴ These legislative procedures provided good opportunities for economic bureaucrats, including BOT leaders, who were usually entrusted with drafting laws with regard to macroeconomic management, to institute their conservative tradition and other preferences into the legal framework. Among the key pieces of legislation supporting monetary conservatism was the Currency Act of 1958, drafted by Prince Viwat.⁵ To preserve the conservative spirit of the Currency Act of 1928, which was abandoned during the war, the 1958 Act stipulates the legal requirement for a par value and a separate currency reserve to maintain the stability of the baht.⁶ The Bank of Thailand, empowered as the currency

³ See Riggs, *Thailand: Modernization of Bureaucratic Polity*, and Thak Chaloemtiarana, *Thailand: the Politics of Despotic Paternalism*, (Bangkok: Social Science Association of Thailand, 1979).

⁴ One of the advantages of the government was the legislative tradition that would leave the administrative detail of a piece of legislation to be determined by the government. For example, the Bank of Thailand Act of 1942 was designed to be the enabling act to empower the government to issue a royal decree stipulating the scope of the Bank's activities. The appointment of military and civilian bureaucrats to the Senate also reflected the government's extended control in the legislature.

⁵ The first Currency Act of 1928 was drafted by a British financial adviser, Sir Edward Cook.

⁶ Currency Act of 1958, sections 8 and 26.

authority, becomes the sole keeper and manager of these reserves.⁷ The Act also empowers the Bank and the Exchange Equalization Fund to defend the value of the baht through the purchase or sale of foreign currencies on demand.⁸ These stipulations not only helped re-institutionalize the pre-war monetary tradition, but also significantly supported the Bank's operational autonomy in maintaining the external stability of the baht.

The autonomy under military rule of the economic bureaucrats in general and the Bank of Thailand in particular should not be exaggerated by the idea that the control of macroeconomic management was concentrated in the 'bureaucratic polity'. Evidence suggests that the relationship between the Bank and the government was not always harmonious and the Bank's preferences did not always prevail. The resignation of Prince Viwat and M.L. Dej from the Bank's governorship in 1946 and 1952 respectively in protest of government policy imposition revealed policy differences and the power relations between the two institutions. Accordingly, it may be safer to say that the Bank's autonomy was seen as strongest when there was a convergence in macroeconomic policy preferences among key decision-makers. As mentioned above, while the concentration of power within the bureaucracy insulated public policy from extra-bureaucratic and societal pressures, the need to maintain international legitimacy and credibility to win foreign assistance and diplomatic approval facilitated a general policy agreement to preserve macroeconomic stability, particularly the convertibility of the baht. In this regard, the Bank was thus granted a significant degree of autonomy in protecting the external value of the national currency throughout the period of military rule. While

⁷ Ibid., section 26.

⁸ Ibid., section 23.

it was more challenging for the Bank to achieve domestic price stability due to the ongoing inflation largely caused by government deficit spending, its ability to adjust to these constraints by employing various strategies to alleviate inflationary pressures was also evident. Furthermore, the late 1950s saw the Bank taking advantage of the change in the political environment to promote a framework for more fiscal and monetary coordination, in which it played an important role. Such a strategy may be seen as instrumental toward enhancing and institutionalizing central bank autonomy.

An examination of the nature of power struggle and political rivalry of the two main military regimes under Phibun and Sarit offers some insights into the varying political environments affecting the Bank-government relationship and the various strategies adopted by the Bank to maintain and institutionalize its independence. The rule of Phibun spanned two periods: 1938-1944 and 1948-1957. During his first regime, Phibun was at the peak of his power. He was able to get rid of his political enemies and emerged as the dominant leader of the People's Party.⁹ The precariousness of international politics also helped unite the political elite for the preservation of national security and sovereignty. Phibun was able to garner legitimacy from his nationalistic economic and foreign policies. Viewing Chinese control of major businesses in Thailand as a threat, his government nationalized a number of Chinese-owned enterprises, set up state corporations to compete with the Chinese, such as in rice trade and banking, and

⁹ His main rivalries were largely the royalists and the conservative members of the People's Party (promoters of the coup that brought an end to the system of absolute monarchy), who sought to bring back the status quo of the old regime. Their final collaboration was allegedly an assassination plot against Phibun in 1938. The government moved quickly upon this alleged plan to arrest the conspirators, followed by the capital punishment of 18 of them. Kobkua argues that after 1939, there was no more serious opposition arising from the conservatives and the royalists. See Kobkua Suwannathat-Pian, *Thailand's Durable Premier: Phibun through Three Decades 1932-1957*, (New York: Oxford University Press, 1995).

imposed restrictions on Chinese economic activities.¹⁰ Phibun's aggressive foreign policy took the form of military campaigns against Indo-China in 1941 to reclaim former territories lost to France in 1907.¹¹ Not until the outbreak of the Pacific War did a split between him and Pridi, another key civilian leader of the People's Party, become intensified. Toward the end of the War, Phibun's grip on power was in decline due to his role in collaborating with the Japanese. His government fell in 1944.

The Bank of Thailand was established in 1942 in this political context. Phibun's initial control of power and the absence of major political opposition and internal rivalry facilitated the relative freedom and flexibility of the government in the decision-making process, including in macroeconomic policies.¹² Examples can be seen in the government's ability to finally establish a central bank (starting from the Thai National Banking Bureau in 1939 and the Bank of Thailand in 1942), and to change its monetary policy to accommodate the demands of war.¹³ The government's preference for the continuation of macroeconomic conservatism was reflected in the important role it gave to economic bureaucrats, such as Prince Viwat, in the shaping of monetary policy and the establishment of a monetary institution. Due to the imminence of the Pacific War, the threats to national and financial sovereignty posed by Japanese aggression dictated the policy choices of the Phibun government for the preservation of Thailand's

¹⁰ See Wyatt, *Thailand*, pp. 254-256.

¹¹ He was awarded the rank of Field Marshal by the Council of Regency in July 1941 due to his leadership in the Indo-Chinese War. See Kobkua, *Thailand's Durable Premier*, for more detail about events leading to the territorial conquest. Kobkua argues that, in contrast to the popularly-held view that Phibun was opportunistic in choosing to invade Indo-China when France was in its weakest moment, the military excursion to Indo-China was believed to be the only available option for Thailand to develop a neutral boundary between Thailand and Indo-China.

¹² Andrew MacIntyre, *The Power of Institutions: Political Architecture and Governance*, (Ithaca: Cornell University Press, 2003).

¹³ These demands included the imposition of exchange controls and the floating of government bonds to finance the military incursion in French Indo-China.

independence. The establishment of the Bank of Thailand in 1942 was instrumental to the preservation of the country's financial autonomy. The agreement among the political and bureaucratic elites, including Bank Governor (Prince Viwat) to accommodate the demands of the Japanese government in the hopes of protecting Thailand's sovereignty led to a number of concessionary monetary policies, which put Thailand at a disadvantageous position.¹⁴ The priority of maintaining price and currency stability and accommodating the Japanese demands helped to endorse the Bank of Thailand as the protector of monetary stability and sovereignty. Through such a role, the Bank continued to carry the torch of financial independence passed onto it from the economic bureaucrats of the colonial era, a task that separated the Bank from being merely an administrative and political tool of the government. With its initial missions to uphold national financial integrity and autonomy, the Bank emerged as an organization which stayed relatively aloof from domestic political rivalries and power distribution.

The second Phibun regime (1948-1957) saw a decline in the ability of the Prime Minister to consolidate his power compared to his first administration. Invited to lead the government after a military coup toppled a civilian government in 1947, Phibun was more a figure head who commanded domestic political support and international recognition than one who actually wielded power.¹⁵ Before 1951, a power rivalry among the Coup Group (mostly Army officers), the Navy, and the National Assembly created a scenario quite favorable to Phibun in terms of the balance of power. However, after the

¹⁴ These concessions included a devaluation of the baht, the commitment to provide liquidity to Japanese spending in Thailand, and the adoption of yen as payment currency.

¹⁵ The coup was led by a group of senior military officers who were not satisfied with the rise of what they perceived as the leftist elements in the existing governments and society, particularly labor unions. Their concerns were supported by the conservatives, royalists, and military leaders like Phibun. The Coup Group invited Phibun as its leader due to his popularity among the officers in the Army. Phibun's anti-communism stand also made him an ally of Western powers, particularly the U.S. See Kobkua, *Thailand's Durable Premier*, for more details.

suppression of a Navy-led rebellion in mid 1951, the Coup Group emerged as the most dominant political group, whose power consolidation culminated in another bloodless coup later that year.¹⁶ This period witnessed the political supremacy of the Coup Group at the expense of other political groups and the rise of the formerly suppressed rivalry between the two major cliques within the Group, led by Phao and Sarit respectively. Phibun tried to stay above this internal power struggle, while drawing legitimacy and support from Western powers, particularly the U.S. It is important to note that even though Phibun's economic nationalist policy against the Chinese intensified at the beginning of this period, a number of factors, including declining communist threats in the region, the indifference of the Thai public to new commercial opportunities, and government's lack of expertise and capacity to take over or compete with Chinese businesses, contributed to a re-consideration of the existing discriminatory policies in the mid 1950s.¹⁷ This change of policy allowed Chinese-owned big businesses to reclaim their dominance and to try to sustain their advantage through the alliance formed with military leaders. The Phao-Sarit power struggle became aggravated against this backdrop toward the end of the second Phibun regime, with Phibun leaning toward Phao. His attempt to hang on to power came to an end in 1958 as Sarit staged a coup to topple the newly elected Phibun government and established a military regime in which he ruled with absolute power.

Like the preceding period, the post-war economic conditions, particularly the high inflationary pressures and the low level of international reserves, largely dictated a policy

¹⁶ One of the reasons behind this coup, known as the Silence Coup, was the fear among the Coup Group that a draft new constitution supported by the National Assembly would once again give rise to the monarchy.

¹⁷ See G. William Skinner, *Chinese Society in Thailand: an Analytical History*, (Ithaca: Cornell University Press, 1957), pp. 373, 379-380.

consensus among political and bureaucratic elites toward the re-establishing of price and currency stability. However, it can be argued that the consensus was more pronounced in the building of the external value of the baht, particularly through the re-accumulation of international reserves, a concern which reflected the continuation of the sovereignty and external credibility-conscious mentality of the pre-constitutional monarchy elite. The Bank of Thailand was given the authority to manage the exchange system and it was able to take advantage of the multiple exchange rates to make substantial profits from the sales and purchases of foreign currencies, which went strictly to reserve accounts instead of government revenue. Due to a series of amendments to the Currency Act of 1928, the Bank's autonomy in safeguarding the external value of the baht through the maintenance of international reserves was strengthened and later institutionalized when the new Act was passed in 1958. With regard to domestic price stability, the Bank experienced more difficulties in curbing inflationary pressures largely due to ongoing government deficit spending. Regardless of the demands of post-war reconstruction and rehabilitation, intense internal rivalry among political leaders manifested in competition to allocate as much of the budget as possible toward one's own constituency (i.e., departments, state enterprises, development projects, etc.), and this accounted for the seemingly uncontrollable deficit financing. When combined with ineffective appropriating methods, budget deficits became the norms (See Table 4.1). Under these circumstances, the Bank, which by law had the obligation to lend to the government, resorted to various strategies as mentioned in chapter 3, such as lending less than the original amount, promoting borrowing from international agencies that had strict disbursement criteria, and strongly advising the government against misappropriation in its Annual Reports.¹⁸

¹⁸ For examples, see Bank of Thailand's *Annual Reports* of 1952, 1953, and 1954.

Table 4.1

Government Fiscal Conditions from 1947 to 1955
(Million bath)

Year	Income	Expenditure	Surplus (+) Deficit (-)	Net Borrowing from the BOT (decreasing – increasing +)
1947	996.0	1,217.2	- 221.2	- 11.8
1948	1,692.2	1,685.0	+ 7.2	- 63.6
1949	1,929.8	2,237.3	- 307.5	+ 330.9
1950	2,143.3	2,591.7	- 447.9	+ 333.8
1951	2,532.3	3,418.5	- 888.2	+ 389.8
1952	3,346.9	4,433.9	- 1,087.0	+ 910.7
1953	3,940.9	5,240.6	- 1,299.7	+ 1,844.3
1954	4,265.9	5,493.8	- 1,227.9	+ 1,478.9
1955	4,380.2	5,025.5	- 645.3	+ 552.3

Source: Bank of Thailand, *20 Years*, p. 79.

The factional power rivalry did have some adverse effects on the Bank's ability to supervise the banking sector and to control private credit. As the power struggle between Phao and Sarit cliques included competition to build and enlarge an economic base for wealth generating and patronage expansion, it became common practice among these political leaders to develop personal relationships with major business groups, including commercial bankers. For examples, the Phao clique established close relationships with the Bangkok Bank, Bank of Ayudhya, the Asia Trust Company, Thai Military Bank, and the Thai Farmers' Bank.¹⁹ The Sarit faction, on the other hand, had ties with the Union Bank of Bangkok and the Bangkok Metropolitan Bank.²⁰ As chapter 3 alludes to briefly, this connection, seen in these companies' invitation to prominent military leaders to sit at their board of directors, served as a source of business opportunities, public confidence, and political protection from certain financial regulations.²¹ The hesitation of the Bank of Thailand to change the cash-reserve ratio during the 1950s despite rising inflation can be seen partly as a result of the politics surrounding financial institution supervision. Dr. Puey's resignation from the BOT as Deputy Governor in 1953 also originated from political pressures to exempt a commercial bank from a hefty fine for having violated exchange control regulations with regard to the purchase of pound sterling at a discount rate. The hands-off approach of the Bank of Thailand to private credit controls reflected partly its conscious reaction to the constraints posed by political interference in financial institution supervision. The Bank's longer-term goal was rather the promotion of a sound

¹⁹ See Silcock, *Thailand: Social and Economic Studies*, pp. 202-203, Pasuk and Baker, *Thailand: Economy and Politics*, p. 124, Girling, *Thailand: Society and Politics*, and Skinner, *Chinese Society in Thailand*.

²⁰ Pannee, *Analysis of Commercial Banking Capitalists*, p. 115.

²¹ An example of financial opportunities was seen in the transfer of 30 million baht from the Ministry of Commerce to the Bangkok Bank in 1953, making it the largest local bank in Thailand. See Pasuk and Baker, *Thailand: Economy and Society*, and Pannee, *Analysis of Commercial Banking Capitalists*, for more details.

banking system with standardized practices and prudential requirements through the drafting of a new Commercial Banking Act initiated in 1953 to replace the existing Act of 1945. But the experiences of political interference must have shaped the BOT's preference for a relatively closed banking sector to limit competition and preserve financial stability.²² Accordingly, after the promulgation of the Commercial Banking Act of 1962, only one more bank was granted a license to operate, capping the number of commercial banks at 16 (reduced to 15 in 1987 when two government-owned banks merged together) until the period of financial liberalization in 1990s.²³

The Sarit regime (1958-1963) saw political power concentrated in the hands of the Prime Minister who ruled by absolute power through the Revolutionary Council. The 1952 constitution was abolished along with the National Assembly and political parties.²⁴ Instead, martial law was in effect while Sarit assumed various strategic positions, including the commander-in-chief of the army, supreme commander of the armed forces, director-general of the police department, and later minister of national development.²⁵ The Sarit-led coup in 1957 also brought an end to the former Phao-Sarit power struggle with Sarit emerging as the most dominant political leader. Even more so than during the first Phibun regime, Sarit's dictatorial power allowed for more flexibility and freedom in

²² A fierce competition in the banking sector manifested in a banking crisis in 1959 when the Agricultural Bank encountered insolvency problems due to its rapid branch opening and bad loans. The authority decided to step in to provide financial assistance and eventually took over the bank. See Bank of Thailand, *50 Years*.

²³ For the case of the collapse of the Asia Trust Bank and the merger between the Sayam Bank (the newly nationalized Asia Trust) and the Krung Thai Bank see Bank of Thailand, *50 Years*, pp. 300-301.

²⁴ Trade unions were also banned during this period.

²⁵ The Ministry of Development was formed in 1963.

policy formation and implementation, as there were relatively fewer concerns for balance of power and the allocation of resources domestically.²⁶

Sarit's policy preferences for economic development were influenced by a number of factors, including inspiration from his trips to the U.S. and Europe in 1957.²⁷ His perception of himself as a paternalistic leader, and his desire for international legitimacy and credibility, contributed positively toward these preferences. The Bank of Thailand was given a central role in the restructuring of the economic planning and budgetary procedures so that they were more compatible and supportive of the process of economic development. Sarit's choice of Dr. Puey as the new Bank Governor reflected his willingness to appoint reputable and capable economic bureaucrats to lead the economic development process. During this period the Bank enjoyed a significant degree of autonomy in promoting fiscal and monetary coordination, particularly through the reduction of government deficit spending, which had caused detrimental effects to domestic price stability.²⁸ Fiscal and monetary coordination was also promoted through the revamping of the budgetary processes, particularly the creation of the annual budgetary allocation forum, where the Bank of Thailand Governor joined other key policy makers in a more systematic and effective budgetary planning. The fact that the newly established Budget Bureau, of which Dr. Puey also assumed the directorship from

²⁶ However, it should not be seen that Sarit was completely free in terms of the selection of policy choices or preferences. For example, the Cold War context forced him to be reliant on the U.S. for financial and technical assistance, implying that the U.S. had played an important role in influencing a wide range of policies, particularly national security and development. See Thak, *Thailand: Politics of Despotic Paternalism*.

²⁷ Sarit did not lead the government after the coup. A diplomat, Phote Sarasin was chosen to be Prime Minister. After an election in which the government party won the majority, Phote stepped down. Sarit's deputy, Thanom Kittikajorn took over the Premiership. Political instability caused by increasing popularity of the opposition party (Democrats) led Sarit to stage another coup to put an end to party politics in October 1958. See Wyatt, *Thailand*.

²⁸ For example, the government was encouraged to stop using overdraft services from the Bank of Thailand to finance its budget. It was also encouraged to borrow from the public through the selling of government bonds.

1959-1962, was under the supervision of the Office of the Prime Minister, as opposed to a less powerful Ministry of Finance, helped reduce inter-departmental and ministerial competition over budget allocations. The establishment of the National Economic Development Board and the launching of the first 5-year National Economic Development Plan in 1961 endorsed the Bank of Thailand's proactive role in pursuing its monetary objectives, particularly the maintenance of price stability. By participating directly in the deliberations on national development planning, the Bank, through the influential role of Dr. Puey, had the opportunity to ascertain the compatibility of its monetary objectives with development strategies and financing.

Another important aspect of Sarit's economic development framework was the focus on private investment. The inefficiency and corruption associated with state enterprises and the competition to develop political patronage over key businesses by the previous regime were the main justifications for this market-oriented policy. In 1959, the Board of Investment was created to promote both foreign and domestic investment, particularly in the manufacturing industry. This period saw a significant increase in foreign direct investment, with the U.S. and Japan as the top two investors, and a substantial growth of the manufacturing sector. Even though it was not originally intended, the nature of investment promotion undertaken at this time, which included the setting up of tariff walls for imports of consumer goods while lowering imports of capital goods and raw materials, was clearly import-substitution. The Bank of Thailand initially did not oppose this policy as it was aware of the pressures rising imports put on the country's balance of payments and the need to support domestic capital and its infant industry. This topic will be picked up in chapter 6 to discuss the financial aspects of the

import-substitution regime and the attitude of the authorities toward foreign capital. Here it is suffice to acknowledge the new direction of economic development policy under the Sarit administration and the important role of the BOT in partaking in its planning.

The drive for economic development was closely related to Sarit's quest for domestic and international legitimacy. Domestically, his self-perception as being a benevolent authoritarian ruler based on a traditional concept of paternalistic leadership led to his desire to improve the standard of living of the people, particularly those in the rural areas. Internationally, the concern for national security, as the spread of communism in Indochina intensified,²⁹ drove Sarit closer to the U.S. for the latter's financial, military, and technical assistance. National development projects and economic restructuring under the advice of the World Bank can also be seen as a part of the Cold War policy paradigm promoted by the U.S.³⁰ The role of the Bank of Thailand at the center of the economic development process, as a source of technical expertise and as Thailand's official representative in dealing with the World Bank and the IMF, allowed the institution to operate with a significant degree of authority. It was not merely the desire to establish international credibility on the government's part, as argued by Maxfield, that made it grant the Bank relative autonomy.³¹ Rather, the Bank's ability to capitalize on its role at the center of the regime's domestic legitimacy and as the contact agency of international financial institutions tended to contribute significantly to the Bank's relative autonomy.

²⁹ Communist activities intensified in Laos and Vietnam in early 1960s.

³⁰ The direction and priorities of the administrative restructuring and the first national development plan followed the recommendations of the World Bank report, published in 1959, after a World Bank's Survey Mission to Thailand from mid 1957 to mid 1958. The Bank of Thailand played a key role in recommending that the Phibun government request such a mission from the World Bank in order to improve the state of national development.

³¹ Maxfield, *Gatekeepers of Growth*.

The International Politico-Economic Context

Two major overarching international politico-economic contexts, namely the Pacific War and the Cold War, brought about certain opportunities for the establishment and consolidation of the Bank of Thailand's autonomy during the first three decades of its history. At the outset of the Pacific War, the decision of the Phibun government to form an alliance with Japan manifested in the signing of the Thai-Japanese Pact of Alliance in December 1941, and inevitably led to extensive Japanese involvement in Thai political, military, and economic affairs.³² As mentioned earlier, Japan's wish to establish some monetary control prompted Thai authorities to seek to preserve Thailand's monetary sovereignty through the hasty establishment of the Bank of Thailand in December 1942 and the adoption of a number of initial monetary concessions to appease the Japanese. Throughout the war, the Bank was obligated to supply the baht for Japanese military expenditure and trade settlements, even though such obligations, which required the Bank to issue a large amount of notes, largely caused severe inflationary pressures.³³ Accordingly, one could see the Bank's early operations in a political light as its ability to perform a capable central bank role to accommodate the financial demands of the Japanese troops was linked to the preservation of Thailand's monetary sovereignty. As in the colonial past, this struggle unavoidably included certain concessions and compromises, some of which were quite damaging and had long-lasting effects. The consensus within the political elite that the Bank should try to ease the devastating effects

³² Thailand declared war against Great Britain and the United States on January 25, 1942.

³³ The Bank had the obligation to exchange on demand Japanese yen to be used for military expenditure and trade transactions into Thai baht based on the bilateral agreements between the two governments made on several occasions. Military spending, which increased exponentially during the course of the war, had the most impact on inflationary pressures. For an idea of the increase, the Bank notes that in 1942, Japanese military spending was about 2 million baht per month. The figure leaped to 100 million baht a month during the last six months of the war in 1945. See Bank of Thailand, *20 Years*, p. 34.

of hyperinflation led to the granting to the institution the authority and autonomy to implement various anti-inflationary measures, such as foreign exchange controls and the abandonment of the one-thousand-baht notes. With regard to Bank autonomy, the Bank's dual function as a protector of Thailand's monetary independence and a central banker at a time when price stability was badly needed, enabled the institution to establish its initial autonomy and legitimacy in the Thai state.

The Cold War context also provided opportunities for the institutionalization of Bank autonomy. Some of the most important opportunities emerged from the relationship between the Bank and the international financial institutions, namely the IMF and the World Bank, which from an international political economy perspective can be seen as the core institutions of the post-WWII international economic order under American hegemony. These relationships, particularly that with the IMF, served as sources of financial assistance, technical expertise, ideological influence and political leverage, which the Bank of Thailand was able to use to support its autonomy in the pursuit of its policy preferences. These contributions need to be examined in more detail.

As a major institution for international development, the World Bank was a significant source of development funding for most developing countries, including Thailand. The first World Bank project lending to the Thai government was in 1950, after Thailand became a member in 1949.³⁴ The borrowing negotiation was arranged and carried out by the Bank of Thailand, which acted as the official fiscal and monetary agent

³⁴ The first lending included three loan projects totaling 25.4 million USD, including a 3-million project for railway construction, a 4.4-million port development, and 18-million for irrigation and electricity projects. An investigation team from the World Bank to study each project preceded the granting of the loans in October 1950. The loan agreement was considered the first in Southeast Asia. See Bank of Thailand, *50 Years*. See also Edward Mason and Robert Asher, eds., *The World Bank Since Bretton Woods*, (Washington, D.C.: The Brookings Institute, 1973).

in dealing with the two Bretton Woods institutions.³⁵ From that time until 1971, Thailand received 22 loans from the World Bank, totaling 394 million US dollars.³⁶ The World Bank loans appealed to the Thai government, particularly to the Bank of Thailand, due to a number of reasons. First, World Bank loans entailed attractive financial conditions to sovereign lenders, such as a long maturity period, relatively low interest rates and a reasonable interest payment calculation.³⁷ Second, the loans were often accompanied by related technical assistance, which was deemed valuable to the government in directing the incipient national development process. Third, and most relevant to the Bank of Thailand's desires to control government development spending, World Bank loans' strict disbursement criteria (e.g., that funds had to be used exclusively for World Bank pre-approved projects) helped instill some sort of fiscal discipline on the Thai government. As a result, the Bank of Thailand still encouraged co-financing schemes between itself and the World Bank in the late 1960s, even though the country's favorable financial position could have allowed for self-financing.³⁸ The Bank of Thailand was able to use the World Bank's strict lending conditions to promote more fiscal discipline and more effective use of funds in government development spending, which in turn helped alleviate certain effects of growing budget deficits on domestic price stability.

³⁵ Upon the signing of the membership agreement between Thailand and the two Bretton Woods institutions in May 1949, the Bank of Thailand was authorized to be the government's fiscal and monetary agent in dealing with both institutions. See Bank of Thailand, *50 Years*, p. 119.

³⁶ Mason and Asher, *World Bank since Bretton Woods*, p. 684.

³⁷ The calculation of interest payments was based only on the amount of loans that had been disbursed.

³⁸ Mason and Asher note that the Thai government had gone through great lengths to continue to borrow from the World Bank, due to the highly valued technical assistance and the disciplinary features of the latter's lending. In one example, possibly referring to the Phasom Dam projects, they note that the Thai government went through the whole borrowing procedures "for the sake of the corollary benefits of following Bank-prescribed policies and procedures, but arranged to buy back immediately the bulk of the [World] Bank's lending during the years 1967-68, leaving the [World] Bank as financier of only a fraction of the foreign-exchange costs of agreed projects." See *Ibid.*, p. 683.

Both the World Bank and the IMF are significant sources of a wide range of technical assistance to developing countries. For Thailand, technical assistance from the World Bank from the early 1950s to the early 1970s largely accompanied its loan projects, which were mostly in the area of basic infrastructure, particularly irrigation and flood control, electricity generating, and transportation. In addition, some assistance was aimed at institution-building efforts to encourage better execution and maintenance of World Bank-financed projects. For example, the Yanhee Electricity Authority, which is now the Electricity Generating Authority of Thailand, the Port Authority of Thailand, and the Railway Authority of Thailand were encouraged to establish themselves as separate agencies outside the civil service to promote more organizational independence.³⁹

However, the most influential role that these institutions played, which also placed them in direct contact with the Bank of Thailand, was in the area of macroeconomic policy. As Thailand gained membership to the IMF in 1949, the Fund played an important role in providing policy recommendations and advice with regard to Thailand's monetary policy, particularly the adoption of a par value and the liberalization of exchange policy. The annual consultative meeting between the IMF and the Bank of Thailand, which was part of the membership requirement, served as one of the channels for the passing on of such recommendations and for information gathering for future technical (and financial) assistance.⁴⁰ The BOT frequently reiterated these recommendations in its Annual Reports.⁴¹ The IMF also provided opportunities for human resource development in the area of macroeconomic policy. Regular technical training programs for BOT staff and

³⁹ Ibid.

⁴⁰ For example, a technical assistance mission was sent by the Fund to help the Thai government prepare for the transition toward exchange liberalization. See Bank of Thailand, *50 Years*, pp. 122-123.

⁴¹ See for example the 1948, 1959, 1952, 1953, 1960, and 1961 Annual Reports.

opportunities to temporarily serve in various capacities at the Fund's Executive Board for senior BOT officers contributed not only to the improvement of BOT technical expertise and international experiences, but also to the transmission of ideological biases toward liberalism.

The World Bank also played an important role in providing technical assistance in the area of macroeconomic policy. The most influential macroeconomic policy recommendations were based on its one-year Economic Survey Mission launched in 1958, which called for the Thai government to establish a national economic planning agency. As a result, the National Economic Development Board (now National Economic and Social Development Board or NESDB) was established in 1959 to replace the old National Economic Council.⁴² The NESDB's primary responsibility was to develop a medium-term national development plan and to deal with various economic development matters delegated to it by the government.⁴³ The Governor of the Bank of Thailand is an ex-officio member of the Board of NESDB along with other heads of key economic agencies, such as the Director of the Budget Bureau, the Director-General of the Fiscal Policy Office, and the Secretary of the NESDB. The establishment of the NESDB and its more coordinated decision-making procedures matched the desire of economic bureaucrats like Dr. Peuy not only for a comprehensive economic development planning but also for more fiscal and monetary coordination, which was deemed essential to the maintenance of price stability.

⁴² See the 1959 Bank of Thailand's Annual Report.

⁴³ The First National Economic Development Plan was launched in 1961. It covered a period of six years from 1961-1966. The plan primarily focused on infrastructure development, including transportation, communication systems, public utilities, irrigation, and electricity generating.

The relationship between the Bank of Thailand and the IMF and the World Bank in the area of macroeconomic policy and the role of the Bretton Woods institutions in providing policy recommendations to the Thai government may be seen as that of a knowledge-based network of professionals or 'epistemic community'.⁴⁴ Due to a general perception of macroeconomic policy as being highly technical, Thai governments have come to rely quite significantly on the assistance of 'economic experts' in various stages of public policy process, such as issue clarification, goal and interest identification, and policy formation. Since its inception, the Bank of Thailand has served as an expert agency that provides financial, monetary, and fiscal policy advice to the government. The Bank's technical expertise has become a source of its de facto autonomy that insulates its operations from government interference to a significant degree. As the BOT developed its relationship with the IMF and the World Bank, it became incorporated into a powerful community of macroeconomic and development experts, whose claim to technical authority has been widely accepted, partly due to their political and financial support base. Being a part of this influential community, the BOT has gained access to certain types of shared knowledge and information available to community members, which help foster its technical expertise and allow it to establish more credibility at home. That the Bank continued to present the macroeconomic policy agenda as a technical matter may be seen, on the one hand, as a reflection of the product of its professional expertise, and on the other hand, as the Bank's attempt to demarcate its policy domain, in which it enjoys relative autonomy.

⁴⁴ Peter Haas defines an epistemic community as "a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area". See more detailed discussion in Peter Haas, "Introduction: Epistemic Communities and International Policy Coordination", *International Organization*, 46, no. 1 (Winter 1992): 1-35.

The concept of epistemic community can also help one understand the ideological connection between the Bretton Woods institutions and the Bank of Thailand, which became stronger in the late 1960s and early 1970s. According to Haas' observation, members of an epistemic community tend to share certain 'normative or principled beliefs', which play an important role in guiding their analyses of the practices and problems central to their professional domain and their choice of methods in dealing with those problems.⁴⁵ The shared normative commitment and policy preferences among the BOT and the Bretton Woods institutions, such as the belief in the essential role of the market and a sound macroeconomic framework, can be largely understood as a result of a process of socialization within their epistemic community.⁴⁶ Professional functions, such as the BOT-IMF annual consultative meetings, World Bank loan negotiations, training programs for BOT officials at both the IMF and World Bank, and the World Bank-IMF Annual Joint Meeting of Board of Governors, serve as fora for constant communication and socialization. Generally, there has been a significant degree of policy agreement between the Bank of Thailand and the Bretton Woods institutions in the history of their interactions. Since the late 1960s, the impact of the sharing of policy preferences on Thailand's macroeconomic policy has become more pronounced, seen in the emphasis on the private sector as the engine of growth, fiscal and monetary coordination, and the liberalization of the exchange system. This phenomenon can be attributed to the changing political and economic conditions, which facilitated the adoption of these policies, and the increased autonomy of the Bank in macroeconomic management from the government. It will be argued in chapter 6 that the adoption of a financial

⁴⁵ See more detailed discussion in *Ibid.*, p.3.

⁴⁶ The shared educational background among many BOT officials and the staff of these international financial institutions also plays an important role in establishing shared normative commitments.

liberalization policy in late 1980s can be understood in the context of policy agreement between the BOT (and the Thai government) and the IMF and the relative autonomy of the BOT in pursuing this policy preference.

There are two points to be made with regard to the ideological convergence between the Bretton Woods institutions and the Bank of Thailand and its connection with the BOT's autonomy. First, while it cannot be denied that there has been much evidence supporting a process of ideological socialization through the high degree of contacts and interactions between the IMF and the World Bank and the BOT, the latter's free-market preferences cannot be seen as merely influenced by ideological orthodoxy. Rather, the Bank's suspicion of government intervention in the economy, such as the establishment of state-owned enterprises, was rooted in real material experiences. The failure of numerous government companies, established as a result of economic nationalist policies during the first and second Phibun regimes, culminating in a gigantic government bailout of the National Economic Development Corporation Ltd. in the late 1950s⁴⁷, was a clear proof to many economic bureaucrats of how counter-productive interventionism could be. Not only was the failure attributable largely to a lack of expertise on the government's part but also the use of these enterprises by military leaders as channels in the pursuit of personal and clique interests contributed to widespread corruption and misallocation of resources. Accordingly, the BOT's aversion toward interventionism was grounded in the history of Thailand's political economy and the Bank has found its allies

⁴⁷ National Economic Development Corporation Ltd. (NEDCOL) was created in 1954 as a holding company with five manufacturing subsidiaries, including two sugar mills, a jute mill, a marble factory, and a paper mill. According to Muscat, the enterprises were so severely mismanaged that it went bankrupt in three years, forcing the government to take over the company and bear the burden of loan repayment. Due to the fact that it was 'the largest single industrial venture of the period', the debt repayment burden was financed through the government budget for five years. See Muscat, *The Fifth Tiger*, pp. 60-62.

in the Bretton Woods institutions in the attempt to reshape the economic landscape of the country.

Second, even though there were a significant degree of ideological congruence and policy agreement between the BOT and the Bretton Woods institutions, pragmatism and tradition also played important roles in determining the pace and scope of policy changes. The continued imposition of exchange controls and multiple exchange rates after the end of WWII demonstrated the pragmatic approach of the Bank's leaders, especially Prince Viwat, to exchange policy as they realized the need to continue maximizing foreign exchange usage and to stabilize the value of the baht through those restrictive measures. The Bank's conservative tradition may be seen as partly influencing the postponement of the setting of the par value until 1963. The BOT's desire to make sure that exchange rate stability could be achieved and maintained before a par value was set had a lot to do with its perception of its capability to defend the national currency. Until it was able to accumulate a substantial amount of international reserves and had the financial authority and autonomy to defend the baht, the Bank moved very slowly toward the adoption of a par value.⁴⁸ Even though the exchange rate liberalization and the establishment of the Exchange Equalization Fund in 1955 contributed positively to exchange rate stability, the Bank waited eight more years before finally fixing the value of the baht. Accordingly, within the context of ideological and policy agreement between the Bank and the IMF, the Bank had a significant degree of freedom in deciding the proper timing and the scope of particular policy changes. This freedom may be

⁴⁸ The tradition of monetary conservatism can be seen in the preference to hold unusually large international reserves by Thai monetary authorities, i.e., Ministry of Finance before 1942 and the Bank of Thailand after 1942. See Ingram, *Economic Change in Thailand*, pp. 171, 311. He notes that the pre-WWII conservative tradition returned after the war ended seen in the rise of currency reserve to more than 100 percent of the notes in circulation from 1951.

attributable to a number of factors, including the satisfactory balance of payments position of Thailand⁴⁹, the country's strategic importance to the Cold War rivalry, and the favorable policy implications of the dominant role of Thai economic bureaucrats, including those at the BOT in macroeconomic management. The degree of freedom became much more limited in the early 1980s as Thailand experienced balance of payments problems and had to resort to the IMF's stabilization programs, and in the late 1990s when the financial crisis struck and the government once again turned to the IMF for help.

Finally, besides serving as sources of financial, technical, and ideological influence, the relationship between the Bank of Thailand and the Bretton Woods institutions offered some political leverage which the Bank could use to endorse its autonomy and policy preferences. Such leverage may be seen as being based on the power of the two institutions, which was not only inseparable from their control of financial and technical resources, but also from their strong US support base in the international political economy. To the Thai political elite, who saw the need to depend on US financial and military assistance in the fight against communism, the close US-IMF/World Bank relationship added to the credibility of the two institutions. One distinct example of the influential role of the US can be seen in John F. Kennedy's message to Sarit in 1962 asking the latter to study the report of the World Bank's 1958 economic mission seriously.⁵⁰ Even though, as discussed earlier, Sarit's political

⁴⁹ According to Ingram, Thailand's external debt in late 1960s was about one-third of its holding of gold and short-term dollars. Ibid., p. 311.

⁵⁰ The message was sent in an outgoing telegram no. 1005, dated January 11, 1962. Ukrist Pathamanand, "Saharat amerika kap nayobai settahkit thai 2503-2513." [The USA and Thai Economic Policy 1960-1970] MA thesis, Chulalongkorn University, 1983, p. 91, quoted in Pasuk and Baker, *Thailand: Economy and Politics*, p. 127.

interest in establishing his legitimacy and in centralizing his economic decision-making power accounted for the changes in economic planning in the late 1950s and early 1960s, it is hard to deny the power of persuasion of the US government. The Bank of Thailand may be seen as benefiting from such political leverage as the focus of the report coincided with its policy preferences, particularly with regard to fiscal and monetary coordination and fiscal discipline.

The Bank's frequent references to the IMF (and to a lesser degree, the World Bank) in its Annual Reports may also be seen as its strategy to use the latter's influence to help persuade the government to adopt certain behaviors or policy preferences. For example, with regard to exchange rate liberalization and the setting of the par value, the Bank made references to the IMF in many of its reports, including those of 1948, 1950, 1952, and 1953, particularly by invoking Thailand's membership obligations and the need to follow IMF recommendations.⁵¹ The Bank was also seen as using the IMF to convince the government to combat the on-going budget deficits. In the 1958 Annual Report, the BOT referred to IMF recommendations from the annual consultative meeting that 'every effort should be made to reduce the budget deficit and check against further expansion of credit in the private sector in order to maintain internal stability of the baht'. While it cannot be argued that this strategy resulted in immediate policy compliance, it did help to legitimize the incremental change toward particular policy directions favored by the BOT, particularly exchange liberalization and fiscal discipline.

⁵¹ In the 1948 Annual Report, shortly after Thailand was accepted as members of the IMF and the World Bank, the Bank advised the government to try to stabilize the exchange value of the baht so that a par value could be set within a reasonable period of time. In the 1950 Report, the BOT made reference to IMF report on monetary and economic survey and its recommendations with regard to the exchange rate system. In the 1952 Report, the Bank once again reiterated the importance of the need to stabilize the baht and establishment of its par value in order to fulfill the agreements made with the IMF. In 1953, the Bank referred to the Fund's recommendations that Thailand adopt measures to improve its financial, monetary, and banking administration in order to proceed toward exchange rate liberalization.

The Institutionalization of the Bank of Thailand and the Organizational Context of its Autonomy⁵²

As argued earlier, the Bank of Thailand's de facto autonomy, based on its technical competence, moral authority, and its role as a protector of the country's financial sovereignty, is central to the understanding of central bank independence in Thailand. The sources of this autonomy may be seen as the Bank's institutional identities, which have developed over time as a result of a process of institutionalization. Philip Selznik's insights helps us understand this process better as he points to the infusion of norms and values in organizational behaviors as an organization transforms itself into an institution.⁵³ The BOT may be seen as having gone through such a process as it came to develop its own distinct identities, which were embedded in certain set of norms and values through the course of its operations. According to Selznik, these identities, namely technical competence, moral authority, and guardianship of financial sovereignty, were rooted in the Bank's history and may be seen as products of Bank interactions with and adaptation to its external and internal environment. Accordingly, one may view these identities as a result of the BOT's learning process, in which it came to value certain thinking and behaviors that had proved to help maintain its relevance and integrity. It is important to examine the development of these institutional identities and their contribution to the Bank's relative autonomy in more detail.

⁵² The use of the term 'organizational' is intended to mean the internal social world of the Bank, which is analytically distinct from its external environment mentioned above. While the term 'institution' is more appropriate in explaining the nature of the BOT as the organization had gone through the process of institutionalization, the use of 'institutional context' could be confused with other political and socio-economic institutions, which were considered as the Bank's external environment.

⁵³ Philip Selznik, in explaining the differences between the terms 'organization' and 'institution', argues that an organization refers to "an expendable tool, a rational instrument engineered to do a job." Institutions, on the other hand, are "products of interaction and adaptation; they become receptacles of group idealism; they are less readily expendable. For more details see Philip Selznik, *Leadership in Administration*, pp. 5-22.

The BOT's technical competence may be seen as emerging directly from the Bank's operations. The need for the Bank to perform well was of overwhelming importance at its inception. The challenge of the wartime economy put extra pressure on Bank leaders to try to maintain price and currency stability. The need to preserve financial sovereignty by demonstrating to the Japanese that the newly established central bank could meet the financial demands of the Japanese government also forced the BOT to do its best in financing Japan's war efforts while at the same time trying to curb hyperinflation. The Bank's ability to accommodate Japan's demands and to alleviate the impact of hyperinflation during the war was the beginning of its technical recognition. During the post-war period, the BOT's ability to use different strategies to curb the effects of government deficit spending in order to try to maintain domestic and external price stability was also the basis for its good reputation. The growing strength of the country's international reserves and the value of the baht in late 1950s, compared to their very weak position at the end of WWII, were also attributable to the BOT's capable operations (see Chart 4.1 below). Since the 1960s, the BOT's role in coordinating fiscal and monetary policy to provide a sound macroeconomic framework for the national development process and in the establishment of an exchange mechanism to guarantee the value of the baht added to its reputation for competence. It may be noted that there might be an element of luck contributing to the Bank's relatively good macroeconomic management record. For example, the increasing demands for Thai commodity products in world markets, except for the high fluctuation in the early 1950s due to the Korean War boom and bust, helped maintain steady inflows of foreign exchange, which in turn contributed positively to the balance of payments. However, it can still be argued that the

BOT's ability to maintain relative price stability and a stable baht, regardless of the war and immediate post-war periods, was largely attributable to its technical expertise, which involved its ability to use appropriate monetary and financial tools to achieve particular goals. It needs to be noted also that such expertise was not only based on the professional training of the Bank's leaders and staff, but also on the tradition of monetary conservatism inherited from the colonial period. The BOT's continuing prioritization of a high level of international reserves was a case in point. Such conservatism played an important role in stabilizing the value of the baht, possibly at the expense of development spending. This issue will be discussed in the next chapter.

Chart 4.1

Thailand's Exchange Rates 1947-1970

Source: Ingram (1951, p. 337).

The Bank of Thailand's image as a moral authority can be considered as quite an exceptional honor. The attempt to uphold qualities like honesty, transparency, and fairness in a sea of corruption, patronage, and favoritism that seemed to plague other

government agencies, was a rare quest. However, these qualities were made possible by a series of Bank leaders who believed that it was part of the job requirements for central bankers to be honest and trustworthy and who viewed themselves as protectors of the national interest, rather than personal or group interests. Disillusionment with the prevalence of political patronage, corruption, and favoritism also led many economic bureaucrats, such as Dr. Puey, to seek to go against the tide, not only for moral purposes, but also so that Thailand could gain greater recognition and trust from the international community. The BOT's moral authority gained further strength when it took on a practical role in early 1960s. As mentioned above, due to the close relationship between military leaders and commercial bankers, it was difficult for the BOT to have an effective supervisory role over those banks, particularly in credit control. However, Dr. Puey's use of moral suasion to promote the cooperation of commercial banks was considered very successful in enhancing BOT supervisory power. This informal strategy, which could only be possible when the Bank commands the respect and trust of the banking sector, is considered by many as more effective than legislation-based supervision, that may lack cooperative support of commercial bankers. Last, but not least, the integrity of Bank Governors also contributed to the BOT's moral authority. As mentioned earlier, there are a number of examples of Bank Governors choosing to resign to uphold certain principles. Equally important is an example seen in Dr. Puey's integrity throughout his lengthy service. As mentioned in the last section, his honesty, fairness, and courage to stand up to the military leaders undoubtedly served to enhance the credibility of his office.

The Bank of Thailand was also perceived as a protector of the country's financial sovereignty and national interests. This identity may be seen as emerging from the

Bank's specific experience during the Pacific War, even though one could also trace the connection to the same role held by the Ministry of Treasury during the colonial period. The important responsibility of preserving Thailand's financial sovereignty had provided the Bank with a unique sense of mission, which distinguished it from many other government agencies. The fact that the policy-areas of Bank regular responsibility, i.e., monetary and financial policy, are macroscopic in nature facilitates the imagining of the national interest commitment. Seeing themselves as public servants, Bank officers also view their loyalty as lying with the nation, rather than in individuals or groups. This institutional identity was reflected in the aversion of BOT leaders to the pursuit of group or individual interests, seen in political patronage and corruption, and their attempt to focus largely on the 'economics' of monetary, fiscal, or financial policies to avoid politicization. However, it is interesting to ask what constitutes 'the national interest' for the BOT and who are the winners and losers of the pursuit of these national interests. For example, evidence shows that the bias toward maintaining high level of international reserves benefited foreign investors at the expense of the people who could have benefited from some kind of development spending. The Bank also showed preferences towards promoting the export sector, while support to the non-export agricultural sector was rather insignificant. These issues will be discussed in the following chapters. What is of concern here is that the Bank developed a distinct identity as a protector of financial sovereignty and defender of national interests out of its unique historical experience. Later on, the nature of its responsibilities and the long-time self-image of its loyalty also contributed to its commitment to serve and guard the national interests, primarily based on its perception.

Drawing from Selznick's insights, it may be argued that the BOT's institutional identity, namely technical competence, moral authority, and as a protector of national interests, contributed positively to its relative autonomy, particularly by fostering the institution's image of trustworthy, credibility, and legitimacy. Despite the difficulty to quantify these qualities like legitimacy, an increase in Bank responsibilities during the second half of its first three decades reflected a perception of the Bank's dependability and political clout held by policy-makers. These newly assigned responsibilities included the supervision of the Exchange Equalization Fund since 1955, the joint deliberation of the annual budget since the 1959, the more direct supervision of commercial banks since 1962, and the provision of preferential credits to certain sectors in the economy since 1960s. As most of these responsibilities were facilitative of the BOT's top priority, i.e., maintaining price and currency stability, it may be argued that they contributed quite positively toward the Bank's autonomy in pursuing its ultimate goals.

The last discussion to be considered with regard to Bank *de facto* autonomy concerns the organizational contexts, which contributed to the institutionalization of Bank identities. Among the most important contexts were the lengthy tenure of Dr. Puey and the BOT's budgetary and administrative independence. When combined, these contexts worked together to provide continuity and administrative freedom, which facilitated the process of institutionalization. Examples are as follows. Budgetary and administrative independence allowed the BOT, particularly under Dr. Puey's leadership, to focus on strengthening its Economic Research Department in promoting the BOT's technical competence. Originally established as an Economic Research Division in 1942, it was upgraded to department level in 1956 as part of a major organizational

restructuring to respond to increasing demands for academic research to guide economic policy making. As the key component of monetary and financial policy-making, the Department has been very active in providing in-house research not only for policy-makers but also for the public through its publications, such as the Annual Reports and Quarterly Reports. The Department's use of macroeconomic models to make economic forecasts was also widely known and well received among the media and the concerned public, reflecting a public perception of the Bank as a reliable source of economic information. Many prominent Bank officials, such as Dr. Puey's colleague, Khunying Suparb Yossunthorn, former Minister of Finance Sommai Huntrakul, former Bank Governor Vijit Supinit, former Deputy Prime Minister, WTO Director-General, and now UNCTAD Director, Supachai Panitchpakdi, served under this Department at some point of their Bank career. It may be said that the strength of the BOT's technical expertise was institutionalized through the growth in size and significance of the Economic Research Department thanks to the budgetary and administrative freedom and the lengthy leadership of Dr. Puey.

Another complementary example can be seen in the area of personnel management. The financial and administrative freedom to initiate its own scholarship and recruitment program contributed greatly to the development of the human resources at the BOT. Dr. Puey's introduction of a merit-based selection system and scholarship programs helped increase the quality of Bank staff, which in turn strengthened the institution's technical competence. The merit-based system also helped foster the BOT's moral authority as it was applied to the personnel promotion system. As also mentioned earlier, the BOT's vast financial resources has allowed it to reward its staff quite

generously, thus helping reduce the incentives for corruption. The instruction of Dr. Puey for Bank officials, who were responsible for financial institution supervision, not to open opportunities for any kind of bribery enhanced the BOT's power of moral suasion.

However, it needs to be noted that despite a largely successful track record, the institutionalization of Bank moral authority did not lead to systematic encoding of the BOT's moral code of conduct. Bank leaders and officials were expected to impose their own self-restrictions and moral standards, which could become arbitrary given individuals' differences. This issue will be picked up in the discussion of the deterioration of the Bank's moral authority during the course leading up to the crisis.

The organizational contexts, namely the continuous leadership of Dr. Puey and the budgetary and administrative freedom of the BOT, provided great opportunities for the Bank to shape its own process of institutionalization. The institutional identities, that emerged as products of this process reflected the Bank's conscious design of what kind of an institution it wanted to be. These value-added preferences may be seen as derived from the BOT's own experiences over time in interacting with the external and internal environments. Based on these experiences, its technical competence, moral authority, and commitment to national interests were both instrumental and ideological to its existence as an institution, especially during the first three decades of Bank history. This is the foundation of the making of the Bank's de facto autonomy, which over time seemed to compensate for its relatively weak legal autonomy. It is this 'discreet' or 'soft' power that allowed the BOT to lead Thailand in its development process, particularly the process of financial liberalization in the early 1990s. This part of the Bank's history will be accounted for in the following chapters.

In conclusion, this chapter complements chapter 3 in explaining the making of the BOT's autonomy during the first three decades of its history by focusing on the role of institutional context in this process. Institutional settings, including the bureaucratic polity, the Pacific War and Cold War, and the Bank's own organization, played important roles in helping the Bank establish and maintain its relative autonomy, despite the institutions' weak legal status. The military governments' reliance on economic bureaucrats, the influence of the international financial institutions in Thailand's economic development process, and the institutionalization of the Bank as a credible and competent institution all in one way or another offered structural frameworks that were conducive to central bank independence. Institutional theory, which focuses on the influence of institutions on political behaviors, leads us to draw a connection between the favorable institutional settings and the BOT's choices of strategies and actions in its pursuit of policy preferences and relative autonomy. Selznick's insights on how an organization becomes institutionalized also guide us to examine the 'making' of the Bank's credibility, which was the main basis of its relative autonomy. The institutionalization of the Bank through the infusion of its values, including moral authority, technical competence, and guardianship of the national interests, was central to the understanding how the Bank's credibility was achieved and sustained during this period. We will see in chapter 6 that when this credibility was in decline, its ability to operate independently and effectively was adversely affected. But before then, chapter 5 discusses how in the 1970s and the 1980s the Bank's influential political status, achieved through the agency's trustworthy history, allowed it to play a leading role in guiding

Thailand's monetary and financial policy leading to the adoption of financial liberalization in the 1990s.

Chapter 5

Central Bank Autonomy and the Continuity and Change in Thailand's Monetary and Financial Policy from the 1970s to the 1980s

This chapter examines the development of Thailand's macroeconomic and financial policies from the early 1970s to the late 1980s in order to explore the policy context that set the stage for the financial liberalization process. The political climate of the 1970s was highly unstable as seen in the rise and fall of populist movements, a brief period of an ultra-right regime, and continued military intervention in politics. Representing a source of stability in the times of political turmoil, the Bank of Thailand had an important role in the design of macroeconomic and financial policies, which reflected both continuity and departure from those of the preceding periods. While the conservative tradition can be witnessed in a series of restrictive monetary measures and the exchange policy, a symbolic departure occurred in the mid 1970s as the Bank assumed a more interventionist role in credit allocation to improve the imbalance against the agricultural sector. However, the experiment of 'developmental' credit allocation proved to be short-lived when structural adjustment came to dominate the macroeconomic agenda in the early 1980s. While commonly regarded as externally induced through the conditionality of the World Bank and the IMF, structural adjustment efforts resonated with the Bank's commitment to economic laissez-faire policies,

monetarism, and international credibility. Rapid economic growth resulting from structural adjustment policies provided further political support for the long-contemplated process of financial liberalization.

While the relative autonomy of the Bank of Thailand that was a result of its thirty-year legacy allowed it to play an important role in shaping the patterns of macroeconomic and financial policies based largely on its preferences, it has to be kept in mind that such autonomy was by no means static, but evolved according to the changing dynamic of the Bank's relationship with the government and other societal actors. Accordingly, it will be shown that during this period, changes in institutional contexts, such as the emergence of more democratic regimes and the growing interdependence between the BOT and commercial banks, led to a gradual reshaping of the basis of the Bank's de facto autonomy. The ability of the BOT to adapt itself to the changing environment while maintaining its institutional characters of moral authority, technical competence, and political neutrality during this period was key to its dominant role in macroeconomic management and the liberalization of Thailand's financial system.

This chapter begins with the emergence of a developmental role for the Bank of Thailand by looking at policy measures for credit allocation and the institutional contexts that gave rise to them. The next section seeks to explain the continuity of monetary conservatism and the preoccupation with maintaining price and currency stability on the part of the Bank, which despite the emergence of a developmental tendency, did not cease to assume priority. To do so, political and economic conditions (domestic and external) supporting the Bank's restrictive monetary policy will be discussed. Also in this section, structural adjustment policies aimed at correcting economic distortions will

be seen as part of the broad pattern of macroeconomic conservatism adopted by the Bank. The third section seeks to explain the move toward financial liberalization at the end of the 1980s through an examination of the Bank-financial sector relationship. The increased power of the Bank over financial institutions resulted from a series of legal amendments and the institutionalization of its role as lender of last resort is key to the understanding of the Bank's preference toward financial liberalization and its capacity to deal with changes.

The Bank of Thailand and Developmental Credit Allocation

The Bank of Thailand had always been involved with the national development process. Since the end of World War II, it had played an important role in financing government development projects through various lending instruments, such as direct lending of international reserves, government bond sales and purchases, and co-financing with the World Bank. By the late 1950s, the Bank became directly involved with the annual budgetary allocation process and the deliberation of the five-year National Economic and Social Development Plans, which not only fostered fiscal and monetary coordination, but also increased the Bank's participation in development planning. The BOT's direct mandate in maintaining domestic and external monetary stability and a viable financial structure also had significant implications for the process of economic development as sound macroeconomic conditions contributed to the growth of the economy.¹ (See Table 5.1)

¹ Supachai notes that domestic prices before the first oil shock in 1973 increased in an average of 2 percent annually. See Supachai Panichapakdi, *Financial Development in Thailand and other Developing Countries*, (Bangkok: Marketing Media, 1985), p. 26.

Table 5.1

Some Macroeconomic Indicators of Thailand 1963-1971

Year	GDP Growth (%)	Money Supply Growth (%)*	Consumer Price Index (1962=100)	Exchange Rate (Baht to 1US Dollar)
1963	9.8	7.0	100.9	20.84
1964	6.6	7.2	102.9	20.84
1965	7.8	18.3	103.8	20.83
1966	12.2	13.7	107.7	20.80
1967	7.8	7.1	112.0	20.80
1968	8.5	10.1	114.4	20.85
1969	7.8	4.0	116.8	21.0
1970	6.8	8.0	117.7	21.0
1971	6.4	10.3	N/A	N/A

Source: Bank of Thailand, *30 Years*, Bank of Thailand, *Annual Reports* (several years), and Ingram, *Economic Change in Thailand*.

* The relative monetary stability during this period can be seen in the synchronization of the growth of money supply and the growth in GDP. The Bank notes that as a rule of thumb, it tried to keep the money supply growth rate as close to 2% of GDP as much as possible. See Bank of Thailand, *30 Years*, p. 39.

Despite its close involvement with Thailand's development process, the Bank limited its role in macroeconomic management and planning, the financing of government development projects, and the supervision on a sound financial system. Due to World Bank recommendations and the experience of inefficiency and corruption in state enterprises, government authorities intended to leave sectoral development in the hands of the private sector, with commercial banks playing a key role in the mobilization of saving and credit allocation. Declining emphasis on state enterprise, which was a product of Phibun's nationalist economic agenda, indicated the turn away from the interventionist economic orientation in the post-war period.² However, in the late 1950s, the Bank of Thailand also resorted to preferential credit allocation to channel funds to selected sectors. Direct involvement in micro-level credit allocation was indeed a departure from the Bank's traditional role of non-interventionism and macro-level management. This initiation requires further examination of the types of preferential credit and their objectives, together with the contexts that gave rise to developmental credit allocation. Finally, the surprisingly small effect of preferential credit allocation on the economy's incentive structure will be discussed.

Preferential credit allocation extended by the Bank of Thailand largely took two forms, namely funds extended through a BOT rediscount facility at low interest rates directed to specific sectors, and those extended through certain lending regulations imposed on commercial and development banks. The Bank's first rediscount facility was extended to the export sector, particularly to rice exports in 1956 and to other exports in

² In the 1958 Annual Report, the BOT referred to the Revolutionary Party's Announcement No. 33 that the government sought to guarantee that 'the state will not created new industrial establishment to compete with the authorized industries', and that 'the state will not transfer private industrial establishment to state ownership'. See Bank of Thailand, *1958 Annual Report*, section 32.

1958 at a subsidized rate of 5 percent.³ Commercial banks and development banks were allowed to charge 7 percent for the purchases of promissory notes from exporters. The objective of these export credits was to provide financial assistance to Thai exporters to meet the costs incurred by export businesses.⁴ Regulations regarding rediscount facility to the export sector were frequently modified to fit changing circumstances, such as to allow non-export sugar producers and rice millers to be included in the facility in 1971.⁵ (See Table 5.2) In 1963, in a move to promote manufacturing sector, the Bank of Thailand began to extend rediscount services to promissory notes arising from the purchases of raw materials.⁶ A year later, sales of manufactured products were also included in the rediscount schemes. In 1969, preferential manufactured credits were prioritized based on the types of raw materials. The highest credit line went to agro-business using local agricultural products, while second on the priority list was agro-based manufacturing goods which used both local and imported materials. The rediscount rate for these businesses was the same across the sector (See Table 5.3). The Bank of Thailand's first rediscount facility to the agricultural sector was extended in 1968 to rice and maize growers through the state-owned Bank for Agriculture and Agricultural Cooperative (BAAC), which was founded in 1966. In 1969, credits were extended to cotton growers through both BAAC and commercial banks and later to other agricultural production and activities, including animal husbandry and fishing. The rediscount rate charged by commercial banks for agricultural credits was between 10 to 12 percent, which was higher than export and manufactured credits due the higher

³ Bank of Thailand, *50 Years*, p. 161.

⁴ Bank of Thailand, *30 Years*, p. 45.

⁵ *Ibid.*, p. 48.

⁶ *Ibid.*, p. 49.

Table 5.2

Values of BOT Rediscount Facilities to the Export Sector 1963- 1972

(Million Baht)

Types of Exports	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
Rice	317.8	420.9	478.1	145.5	349.5	127.6	197.4	214.5	694.3	590.4
Maize	100.3	322.1	169.7	210.8	199.6	186.2	185.2	311.6	389.8	141.2
Rubber	10.0	6.5	2.7	11.8	10.6	25.8	27.4	36.2	22.4	81.0
Tapioca Flour	50.9	44.5	32.2	29.1	89.9	99.2	98.2	118.5	142.7	65.2
Jute	9.2	22.9	45.2	47.2	47.3	27.9	17.3	221.4	74.8	55.1
Castor	2.2	6.2	3.4	7.2	15.7	12.4	11.8	26.6	35.2	5.3
Sugar	3.7	47.3	37.2	5.3	18.6	N/A	N/A	49.1	128.6	559.7
Tobacco	1.0	0.7	1.2	8.0	22.3	38.1	13.3	27.7	35.7	23.9
Shrimp	3.6	6.0	26.5	40.6	46.4	9.7	13.5	8.0	36.3	46.0
Minerals	N/A	N/A	N/A	N/A	N/A	N/A	N/A	6.4	68.5	56.0
Cotton	N/A	N/A	N/A	N/A	3.8	15.2	3.4	16.1	4.1	3.2
Canned Fruits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	27.1	14.8
Others	52.7	36.1	54.5	43.9	44.8	29.3	64.6	67.3	82.9	343.5
Total	551.4	913.2	850.7	549.4	848.5	571.4	632.1	903.4	1,742.4	1,984.3

Source: Bank of Thailand, *30 Years*, p. 49.

Table 5.3

Values of BOT Rediscount Facilities to the Manufacturing Sector 1969-1972

(Million Baht)

Types of Industries	1969 (Jul.-Dec.)	1970	1971	1972 (Jan.- Aug.)
Cement	51.3	431.1	630.9	819.5
Tin	N/A	42.0	276.0	170.0
Textile	15.3	119.1	171.0	134.2
Gunny Sacks	25.3	112.2	105.5	29.4
Automobile Tires	N/A	N/A	94.6	108.5
Steel Rods	N/A	49.8	69.5	74.7
Oil Refinery	18.0	44.2	49.7	38.1
Ceramic Tiles	7.0	47.8	45.4	28.5
Monosodium Glutamate	N/A	N/A	15.4	11.6
Others	24.9	17.9	60.4	107.7
Total	141.8	864.1	1,518.4	1,522.2

Source: Bank of Thailand, *30 Years*, p. 51.

overhead costs for agricultural credits.⁷ As with other preferential credits, regulations regarding agricultural credits were modified from time to time to accommodate pressing circumstances, such as 1971 when the BOT extended the rediscount facility to cover agricultural purchases to help farmers who were unable to sell their crops and to facilitate agricultural trading.⁸

In addition to the rediscount facility, in the mid 1970s the Bank of Thailand extended further credit to the rural sector, particularly the agricultural sector, to compensate for the imbalance in credit distribution in the financial system. Through its regulatory role, the BOT began in 1975 to require commercial banks to increase lending to the agricultural sector by 5 percent over the previous year's lending. In 1976 the lending requirement was changed to 7 percent of a bank's total deposits. The lending requirement was then raised to 11 percent and 13 percent in 1978 and 1981. Banks that were unable to meet this requirement were asked to place the rest of their unused required credits at the BAAC, earning 8 percent interest. Branches of commercial banks in the provinces were required to lend at least 60 percent of their total deposits to residents of the areas and one-third of these credits had to go to farmers. The ceiling interest rate for agricultural credits was also fixed at 12 percent per annum when the legal ceiling for all types of lending was at 15 percent. Indirect pressure by the BOT to increase the level of monetization of the rural areas was also seen in the condition for commercial banks to open new branches in the provinces, if they wished to open new branches in the metropolitan areas of Bangkok and its vicinity.

⁷ Ibid., p. 54.

⁸ Bank of Thailand, *50 Years*, p. 162.

To understand why the Bank embarked upon a more interventionist role in credit allocation, we must turn to the context surrounding Bank and government authorities, which influenced the course of policy-making. We also need to understand the linkage between the consequences of former policies and the responses to policy outcomes in the process of policy-making. Peter Hall's analysis of the fall of Keynesianism in Britain in the early 1980s exemplifies this approach. By examining the evolution of the Keynesian regime from the early 1950s to the late 1970s, he demonstrates that some of the key features of British economic policies were policy responses to the outcomes of previous demand management measures and that these 'corrective' policies later generated unexpected political consequences which served to undermine the interventionist regime.⁹ This emphasis on the connection between old and new policies and how a policy environment influences policymakers' decisions is useful in helping us understand the emergence of the BOT's preferential credit allocation policy and its modest results. The Bank's role in interventionist credit allocation can be understood as follows. First, it may be argued that the initial attempt of the BOT to offer rediscount facility to the export sector reflected its desire to promote exports as the main source of foreign exchange and government revenues (export taxes). The rediscount facility extended to rice exporters was initiated in 1956 a year after the end of government monopoly in rice exports. Not only did the Bank seek to respond to the financial needs of rice exporters in meeting the

⁹ Incomes policy is the case in point. Hall explains that in order to contain inflation brought about by the attempt to maintain full employment, incomes policy was designed to control the growth rate of wages. Despite initial cooperation from union leaders and the Trades Union Congress, in the long-run income policies inflicted resentment and division within the labor movement as they interfered with the autonomy of trade unions in wage determination. As a result not only was the policy unsuccessful in curbing inflation as many unions had an incentive to break from the policy line, the labor movement also disintegrated as union leaders lost control over the rank-and-file who could engage in bargaining with the employers. See Peter Hall, *Governing the Economy*, chapter 4.

costs of exporting,¹⁰ but it was likely that the credit extension was also aimed at compensating for the export taxation in the form of the rice premium, imposed by the government since 1955.¹¹ Criticism against rice exporters aside, it seemed that rice premiums significantly reduced the profits of the international rice trade for Thai exporters.¹² According to Corden, the cost of the premium, which was the equivalent of an export tax, ranged from 21 to 29 percent of the total value of rice exports between 1956 and 1964.¹³ Other export commodities, such as tin and other minerals, and teak and other woods, were also subject to similar export taxation. The Bank of Thailand's export credit extension could then be understood as an attempt to create export incentives to compensate for certain disincentives in the export tax structure and other uncertainties arising from international trade.

Second, the rediscount facility provided to the manufacturing sector in the early 1960s may be seen as part of the transition away from the previous period of direct government intervention in the industrial sector. The shift to private sector-led import-substitution policy during the Sarit regime, with the approval of major international financial institutions, required financial assistance from the state to help local companies deal with production costs in order to compete with imported goods. According to the BOT, 'the manufacturing industry of Thailand was in an infantile stage', therefore 'many

¹⁰ Bank of Thailand, *30 Years*, p. 45.

¹¹ The rice premium was paid when an export license was obtained. It took the form of a three-month promissory note. The rates varied based on different grades of rice and tonnage. See more detail in Corden, "Exchange Rate System," p. 159.

¹² The issue of the rice premium has been long debated as a source of urban bias by the government, which led to the exploitation of rice farmers as rice millers and exporters tended to lower the price of rice paddy to compensate for their smaller profit margin caused by rice premium. The bias was linked to the government's desire to keep the price of rice low and to make sure there was enough rice for domestic consumption, whereby it tried to reduce export incentives through imposing a rice premium. Critics, including Corden argue that such a premium may be seen as a regressive tax as it put financial burden on the poorest segment of the society. See more detail in *Ibid.*, p. 169.

¹³ *Ibid.*, p. 160.

companies were in need of liquidity, which they borrowed at high interest rates, resulting in high production cost and low competitiveness against imported goods'.¹⁴ Accordingly, it was initially believed that preferential credit allocation would help these companies with their purchases of raw materials, which not only helped lower production costs, but also promoted domestic trade in raw materials. As mentioned above, the rationale and criteria for such credit extension was expanded over time to include various types of industries and types of raw materials being used.

Third, the Bank's decision to increase credit extension to the rural sector, particularly the agricultural sector, may be understood in a more ideological light. From the early 1960s, the BOT under the governorship of Dr. Puey showed increasing commitment to the idea of 'development', which was defined more broadly than economic growth. This commitment was shared by a number of leading economic bureaucrats at other economic agencies. Their participation in the planning of the first and second National Economic and Social Development Plans allowed ideas such as "social development" and "rural capacity building" to be included among development goals. As a monetary agency, the Bank of Thailand found its role largely in the financing of government social development and rural infrastructure development projects, while trying to maintain monetary stability at the same time.

For example, during 1966-1971 the Bank provided major financing through the purchases of government bonds for educational development targeted in the Second Plan, including a project to establish the Faculty of Medicine of Ramathibodi Hospital, a vocational school development project, and a co-education secondary school

¹⁴ Bank of Thailand, 30 Years, p. 49, my own translation.

development project.¹⁵ Within the BOT, one can find early indications of the commitment to development by looking at the focus of Bank scholarship programs, which started to send students to study Development Economics at leading universities of the field around the world.¹⁶ However, after a decade of a national development process, rising disillusionment emerged among economic bureaucrats, including Dr. Puey, due to the slow progress in social development and the growing income disparity between the urban rich and the rural poor. Dr. Puey's second thoughts about previous development strategies were quite revealing.

Before 1973 I would say that we had progressed fairly well with the orthodox way of development, disregarding perhaps, to our regret, the social problems that accompanied that. We looked, together with many less-developed countries, at the gross national income and the rate of growth; we did not look inside. For this I must blame myself as one of those who had devised this kind of development.¹⁷

In keeping with this reassessment of past policies interventionist credit allocation measures to the rural areas gradually emerged. The change in leadership at the BOT when Dr. Puey left the institution to continue his work in education in 1971 did not drastically affect the development concerns of the institution. Bisudhi Nimmanhaemin, who served as the next Governor, had served as the deputy of Dr. Puey since 1965, and Snoh Unakul, who succeeded Bisudhi in 1975, was former Secretary-General of the National Economic and Social Development Board, who had worked closely with Dr. Puey from the inception of that agency. However, the economic imbalances emerging from external factors, such as the Nixon doctrine and the first oil shock, eventually forced monetary authorities to put greater priority on maintaining price and currency stability.

¹⁵ Bank of Thailand, *50 Years*, p. 201.

¹⁶ Interview with a senior Bank officer, Bangkok, November 2004.

¹⁷ This citation is from Dr. Puey's speech at a seminar at Georgetown University in 1976, quoted in Muscat, *The Fifth Tiger*, p. 136.

Nevertheless, it is important to mention that the Bank's desire to redress the impacts of uneven development found a legitimate target in the imbalances in private credit allocation. The growth of the banking sector since the mid 1950s, seen in the growing number of commercial banks and the expansion of their bank branches concealed an underlying bias against the rural sector.¹⁸ With low levels of credit extending to rural customers compared to the urban sector, bank branches in the rural areas acted as means through which rural savings were channeled to urban, non-agricultural borrowers. The fact that rural lending had higher overhead costs and that the system of collateral-based lending discriminated against poorer customers were among the major factors hindering commercial bank credits to the rural areas. The Bank's desire to address these imbalances was manifested in the extending of rediscount facility to the agricultural sector in late 1960s and the change in commercial bank lending requirements in the mid 1970s.

Finally, the political context of the early 1970s, which saw the rise of democratic and populist sentiments, played an important role in supporting the Bank's 'development' credit allocation schemes. By the late 1960s, dictatorial rule under Thanom, who succeeded Sarit in 1963, began to lose legitimacy in line with rising demands for more political openness and participation. Thanom's responses, the promulgation of a long delayed constitution in 1968 and the holding of a general election in 1969, which his party won, were seen as political strategies to retain power. Faced with opposition in the Parliament over his government's budget proposal, Thanom staged a coup against himself in 1971, dissolved Parliament, banned political parties and restored military rule.

¹⁸ According to the Bank, the number of bank branches rose from 115 in 1955 to 423 in 1962. See Bank of Thailand, *20 Years*, p. 96.

This time the military regime met with widespread resentment from societal groups, particularly the middle-class, students, workers, and farmers. Public outcry and discontent culminated in the October 1973 with a mass demonstration led by student movements. Despite its use of violence to quell the demonstrators, the military junta could not retain power as the King stepped in and demanded that the military leaders leave the country. The triumph of the people with royal support over the dictators gave momentum to a populist-oriented policy agenda in a number of governments that followed until 1976 when the tide turned against 'revolutionary' ideals in favor of reactionary forces in the society.

The political mood of the early 1970s, which saw the rise of not only the middle-class and students, but also marginalized groups like farmers and workers, reflected public resentment against the concentration of political and economic power within a small elite. This growing disillusionment with political and economic conditions was in line with the Bank's concerns about the consequences of uneven economic development brought about by the first two National Economic and Social Development Plans over the previous decade. The symbolic victory of popular movements after the 1973 mass demonstration, despite its brevity, provided an extra endorsement to the BOT's self-assessment and decision to embark upon a more developmental role in rural credit allocation. The attention of the subsequent governments of Sanya and Kukrit to improving the livelihood of farmers created a policy context sympathetic to and responsive towards popular demands made known during the 1973 uprising.

For example, Sanya's caretaker government saw the establishment of a national committee to address land disputes, the earmarking of 300 million baht from rice

premium revenue to guarantee the price of paddy, and the passing of the Land Rent Control Act to keep a lid on rent. Kukrit's *tambon* (subdistrict) development funds injected 2.5 billion baht into all 5,203 *tambon* in the country to be used in infrastructure building and repair projects.¹⁹ According to Morell and Chai-anan, the amount of money allocated to each *tambon* (around 400,000 baht) was fifty times higher than any previous funds allocated to this level of administration.²⁰ Unfortunately, given the hasty nature of the initiative and the short life of the government, many of the construction and repair projects were not completed as with other reform programs to devolve more power to local administration. Nevertheless, it can be seen that within this brief period from 1973-1976, there existed a clear political will toward redistributive policies to address rising demands for more political, economic, and social equality. The political will provided an opportunity for the BOT to assume a more developmental role within its own capacity. It is important to note that government emphasis on redistribution was largely driven by pragmatic attempts to relieve rural grievances brought to the fore by the 1973 movements, and at the same time to counter communist tendencies, which were seen as encroaching on Thailand through the countryside.

The Bank's more interventionist role attracted attention to changes in the incentive structure and investment pattern within the economy and any institutionalization of group interests depended upon state subsidized finance. It is interesting that the Bank's credit intervention did not have significant impact on sectoral formation and mobility. Authors, including the Bank itself, point to the limitations in the

¹⁹ A somewhat similar policy was adopted by Thaksin when he came to power in 2001. Notwithstanding of many criticisms against the real motive, its redistributive consequences were largely responsible for his being overwhelming re-elected in 2005. See David Morell and Chai-anan Samudavanija, *Political Conflict in Thailand: Reform, Reaction, Revolution*, (Cambridge, Mass.: Oelgeschlager, Gunn & Hain, 1981).

²⁰ Ibid.

scope of operations and the Bank's capacity as the reasons for the minimal effects of the Bank's preferential credit extension schemes. For instance, Muscat argues that given the availability of domestic credit in the hands of commercial banks due to the growth in deposits and the ability of large companies to access foreign loans, the BOT's mandatory lending requirements and rediscount facilities did not particularly limit commercial bank credit to other sectors.²¹ This argument is supported by the fact that commercial bank reliance on borrowing from the BOT was small, thus limiting the latter's ability to use the interest rate (bank rate) mechanism to control private credit. This phenomenon is an interesting contrast to Korea, whereas the banking system relied heavily on state directions for credit and allocation. Unlike its Thai counterpart, the Korean state was able to use the centralized banking system to provide incentives in the form of 'policy loans', interest rates, and other subsidies to specific sectors or industries to protect infant industries or to facilitate sectoral mobility.²²

The short-term, market-correction nature of the BOT's rediscount facilities also limited the Bank's long-term impact on the incentive system. This reactive nature may be seen as corresponding to the Bank's objectives to use these facilities to ease the financial burden encountered by priority sectors due to changing market conditions or lack of competitive edge and experience (in case of nascent manufacturing sector). As a result, the list of eligible sub-sectors and the lending conditions were constantly changing to correspond to short-term market conditions. One implication of these short-term facilities was that funds were largely used to finance immediate transactions and, in case

²¹ Robert J. Muscat, "Thailand," in *Financial Systems and Economic Policy in Developing Countries*, eds. Stephan Haggard and Chung H. Lee (Ithaca: Cornell University Press, 1995).

²² See Jung-en Woo, *Race to the Swift: State and Finance in Korean Industrialization*, (New York: Columbia University Press, 1991), pp. 10-12.

of farmers, personal consumption rather than long-term fixed investment.²³ The reactive nature of the BOT's credit allocation role can also be seen in the extension of credits to the rural areas, even though the Bank had expressed its long-term commitment to rural development. The lending requirements imposed on commercial banks in the mid 1970s were aimed at correcting the imbalances in credit allocation between urban and rural areas, which were the result of the non-interventionist financial structure. The turning of the 'developmental' tide in mid 1980s as structural adjustment came to dominate the policy agenda, undermined any potential impact a more equal distribution of credit might have had if the imbalances were to be significantly corrected. Instead, it seemed that the BOT became more lenient toward commercial banks in meeting the required lending targets before preferential credit allocation was abandoned altogether during the period of financial liberalization in the late 1980s.

It has also been argued that the Bank of Thailand's primary goal in maintaining the stability and convertibility of the baht also limited its capacity to continue to offer low interest rates to priority sectors.²⁴ Concerns for capital outflows, in case the disparity between world interest rates and subsidized domestic interest rates widened, played an important role in influencing the Bank to try to maintain competitive interest rate regime. As there was already a civil code limiting the ceiling on lending rates to 15 percent, the Bank had even less room to maneuver to maintain a profit margins for commercial banks at a time when world interest rates were on the rise. Accordingly, the Bank's willingness to provide for subsidized loans was limited by the priority of currency stability and convertibility.

²³ Muscat, *The Fifth Tiger*.

²⁴ Ibid.

In addition, institutional history helps us understand the limited role of the BOT. The absence of state control over the process of private financial allocation in the history of Thai political economy explains the evolution of a non-interventionist role of the state and constraints on efforts to become more interventionist. The fact that Thai commercial banks were financially independent of the Bank from its inception meant that the BOT did not have control over private credit allocation except through the cash reserve requirement and the type of assets used as reserves. The close relationship between military leaders and commercial bankers particularly in the 1950s after the People's Party's initial attempt to take control over this sector only made bank supervision more complicated for the BOT. This relationship can be seen in the representation of the military leaders on the executive boards of commercial banks. This phenomenon reflected rent-seeking behavior by the military for personal and factional gains rather than the state's attempt to control the financial sector and to direct the process of financial allocation. The BOT had to manage the financial system through its supervisory role and was able to gain cooperation from commercial banks largely through moral suasion, based on trust and mutual benefit. By limiting competition in the banking sector (not granting more banking licenses after 1962) and acting as lender of last resort (always bailing them out), the BOT was able to keep commercial banks in line and maintain overall financial stability. The development path of the BOT-bank relationship did not allow the opportunity for state-directed finance to emerge. The BOT's preferential credit allocation schemes might have come close but their small size and reactive and short-lived characters prevented them from having a significant impact on the existing pattern

of credit allocation. The relationship between the BOT and commercial banks will be discussed in more detail below after the following section.

The Continuity of Monetary Conservatism and the Path toward Structural Adjustment

As discussed in the previous chapter, the conservative tradition in monetary policy was a legacy of the colonial period when the Thai elite tried to maintain macroeconomic credibility, particularly currency convertibility, to avoid a pretext for colonial takeover. Conservatism was embedded in a number of policy preferences including the holding of large international reserves and the maintaining of fiscal discipline and exchange rate stability. The relative currency stability of pre-WWII years, seen in the unchanged value of the baht at 11 baht per pound from 1923-1941, was testimony to the legitimacy of conservative monetary policy in preserving Thailand's international credibility. It is important to note that the capacity of monetary authorities at that time to maintain domestic and external stability depended largely upon their ability to promote fiscal and monetary coordination, which was essential in successful macroeconomic management. The centralized nature of the Court's administration and the King's role as the grantor of political rewards facilitated such coordination while preventing competition in and politicization of the budgetary process as seen in the period after the absolute monarchy ended.

The first thirty years of the Bank's history saw the continuation of monetary conservatism in its operations. At the outset, the urgency in the fight against inflationary pressures brought about by wartime spending during the Pacific War called for restrictive

monetary and exchange policy to control domestic prices and foreign exchange transactions. As inflationary pressures were prolonged after the War, the Bank continued to employ anti-inflationary measures to cope with the problem. However, the difficulty lay largely, although not solely, with growing budgetary deficits incurred by the government in meeting the demands for economic rehabilitation and development under economic nationalist policies, not to mention the rising factional and ministerial rivalry in resource allocation. The lack of fiscal and monetary coordination was reflected in the rather undisciplined fiscal expansion on the government's part and the Bank's attempt to curb inflation largely through monetary means was apparently one of the most challenging obstacles in macroeconomic management facing economic bureaucrats in the 1950s.

Not until the late 1950s did the political consensus started to move toward more systematic macroeconomic management and development planning.²⁵ In 1959, the synchronization of fiscal and monetary policies was promoted at the highest level through the more inclusive development and budgetary planning processes, in which the BOT played an influential role. As a result, government deficit spending became more manageable and less inflationary as direct borrowing from the BOT was abandoned and substituted by borrowing from the public through the issuing of government bonds.²⁶

The Bank's conservative bias also continued to be seen in its seeking to accumulate large international reserves. The system of exchange controls and multiple

²⁵ More coordination started to be seen during the last years of Phibun as he tried to win his legitimacy from the public and the U.S.

²⁶ The rise in Treasury Reserves after 1960 indicated that the government was able to finance itself from other sources of credits instead of borrowing directly from the BOT, which resulted in a direct increase of money in circulation, hence creating inflationary pressures to the economy. According to the Bank of Thailand, government Treasury Reserves went from a deficit of 630.5 million baht in 1959 to a surplus of 58.1 million baht in 1960. In 1961, the Treasury Reserves continued to hold a surplus of 24.8 million baht. See Bank of Thailand, *20 Years*, p. 95.

exchange rates, imposed during the wartime period until 1955, helped the BOT gain a huge amount of exchange profits, which went directly to the international reserve accounts. Later on the surpluses in the balance of payments from early 1960s to 1969 accounted for the constant rise in international reserves. By 1952, the Reserves amounted to \$352 million or 91.47 percent of the money in circulation. The holdings rose to \$922 million in 1968, almost equal to the total money supply in the system. Despite criticism that the accumulation of a large reserve hindered more effective use of capital, the baht became one of the most stable currencies in the region with the support of international reserves. There was little change in the exchange rate after 1955 when the system of multiple exchange rates was abandoned until the first par value adjustment in 1971 (see Table 5.4 and 5.5).

Before moving on to discuss the period of 1970s and 1980s, it should be pointed out again that the Bank's ability to maintain relative price and currency stability through the pursuit of conservative monetary policy reflected its relative autonomy in pursuing its mandate and choosing preferred policy instruments. As we can see, this autonomy was largely encouraged by a broad consensus among key policymakers on the urgency to curb inflation and stabilize the national currency, particularly given the unstable economic conditions during wartime and post-war periods. History also shows that without fiscal and monetary coordination, there were limitations to the capacity of the BOT to maintain price and currency stability. Given the separation of fiscal and monetary responsibilities and the more politicized nature of fiscal policy, the Bank had to employ various strategies to foster fiscal and monetary coordination in order to attain sound macroeconomic conditions. Not until the Sarit regime did better coordination start to develop.

Table 5.4

International Reserves of ASEAN 5 Countries (1955-1970)
(Million US dollars)

Years	Thailand	Indonesia	Malaysia	Philippines	Singapore
1955	192	226	235	139	114
1956	206	210	245	139	88
1957	212	185	251	65	77
1958	197	180	257	82	96
1959	215	267	333	84	117
1960	267	293	356	111	115
1961	350	89	349	26	123
1962	419	63	376	34	165
1963	472	21	386	81	433
1964	556	21	417	100	431
1965	643	17	467	155	430
1966	831	19	493	149	394
1967	916	2	425	120	495
1968	928	82	450	99	712
1969	892	117	556	76	826
1970	823	156	616	195	1012

Source: International Monetary Statistics (Electronic Source), International Monetary Fund.

Table 5.5

Exchange Rates of ASEAN 5 Countries (1955-1970)
(National Currency per 1 US Dollar)

Years	Thailand (Baht)	Indonesia (Rupiah)	Malaysia (Ringgit)	Philippines (Peso)	Singapore (Singapore Dollar)
1955	21.23	n/a	3.06	2.02	3.06
1956	20.66	n/a	30.08	2.02	3.08
1957	20.90	n/a	3.05	2.02	3.05
1958	21.10	n/a	3.06	2.02	3.06
1959	21.19	n/a	3.06	2.02	3.06
1960	21.14	n/a	3.06	2.02	3.06
1961	20.99	n/a	3.05	2.02	3.05
1962	20.84	n/a	3.06	3.92	3.06
1963	20.84	n/a	3.05	3.91	3.06
1964	20.83	n/a	3.07	3.91	3.07
1965	20.83	n/a	3.05	3.91	3.06
1966	20.75	n/a	3.07	3.90	3.08
1967	20.80	235	3.05	3.93	3.07
1968	20.85	326	3.06	3.93	3.08
1969	20.92	326	3.07	3.93	3.09
1970	20.92	378	3.07	6.43	3.08

Source: International Financial Statistics (Electronic Source), International Monetary Fund.

Accordingly, it may be said that a political context that not only encouraged central bank independence but also accommodated fiscal and monetary coordination in the direction of macroeconomic conservatism was essential to the authorities' ability to achieve satisfactory macroeconomic conditions.

Another observation concerns the objectives of monetary conservatism. On the one hand, conservative preferences served as pragmatic, reactive and direct responses to the concurrent economic conditions. Due to the severe inflationary pressures on the economy during the first two decades of the Bank's history, it is not surprising to see that monetary conservatism, closely associated with low inflation and stable currency, took priority on the policy agenda. On the other hand, one also sees a longer-term, more proactive and broad inclination behind monetary and fiscal conservatism. During the colonial period, the fear of losing independence led to the need to maintain fiscal discipline and currency convertibility in order to uphold international credibility and financial responsibility. In the post-WWII period, the need to attract all kinds of foreign capital also influenced monetary authorities to try to sustain the reputation for credibility and creditworthiness through a tradition of conservative macroeconomic management. This longstanding international bias can be seen particularly in the BOT's preferences to hold large international reserves, to commit to baht convertibility and to be responsive to balance of payment deficits.

The Stage for Structural Adjustment and the Return to Macroeconomic Conservatism

The period of 1970s and 1980s also saw a parallel development of macroeconomic conservatism in the form of stabilization and structural adjustment policies, despite the experimentation with developmental credit allocation. During much of the 1970s, the increased inflationary pressures induced by a number of related external and domestic factors, particularly the two oil shocks, the end of the Vietnam War and the growing government budget deficits, required the BOT to employ largely restrictive monetary policy to curb inflation. During the 1980s, Thai authorities' attempts to restructure the economy toward an outward-orientation gained momentum due to a combination of factors, especially the growing influence of monetarist economics, the conditionality of the IFIs, and the pressures from big business groups that had recently developed interests in export production. The reactive character of the BOT's stabilization policy, seen in the 1970s, gradually gave way to more coordinated restrictive monetary and fiscal policy under the period of structural adjustment. By the early 1980s the economic circumstances had led the Bank to once again fully adopt conservative macroeconomic and non-interventionist traditions.

Instability in the international monetary system, which culminated in the abandoning of gold convertibility by the US in 1971 and the end of fixed exchange rate system in 1973, created tremendous pressures on the value of the baht. The BOT had to reduce the par value of the baht in 1971 for the first time since 1963 and a second time in 1972 in order to keep it in line with the US dollar, which was depreciating.²⁷ The first oil shock in 1973 did not have much adverse effect on the Thai economy as the rise in world

²⁷ Bank of Thailand, *50 Years*, p. 241.

commodity prices offset the increase in the cost of crude oil and other imports. However, as foreign investment, particularly from Japan and the U.S., continued to flow into the country, the BOT in 1974 had to employ restrictive monetary policies to curb inflationary pressures, which had reached 24 percent at the end of 1973. The Bank was able to bring inflation down to around 5.7 percent during 1975-1977.²⁸

However, economic instability began to build up again when inflationary pressure increased and the balance of payments worsened. Rising budget deficits were largely responsible for inflationary pressures. From the mid 1970s, government expenditures rose sharply due to increased military spending and other types of government spending to stimulate domestic demand.²⁹ Oil subsidies launched in 1973 to help the public bear the financial burden of the oil shock aggravated the fiscal balance. A drop in world commodity prices toward the end of 1970s also caused a decline in agricultural export revenues, which in turn put pressure on the balance of payments. In the attempt to cope with economic instability, the BOT decided to abandon baht parity in 1978 in favor of a more flexible exchange policy, known as Daily Fixing.³⁰ The baht was then pegged to a basket of currencies of Thailand's major trading partners. The Bank also raised domestic interest rates to be more compatible with world market rates in order to avoid capital outflows and to slow down credit expansion to curb inflation. During the same year, when the balance of payments deficit worsened, the BOT turned to the IMF for the first time for financial assistance. Even though the loan did not entail formal conditionality,

²⁸ Bank of Thailand, *Phim pen Anusorn Ngarn Phraratchtharn Plerngsop Sommai Huntrakul* [Cremation Volume of Sommai Huntrakul], (Bangkok: Bank of Thailand, 1993), p. 105.

²⁹ A large proportion of government spending came from foreign commercial bank loans, which were abundant in the Euro market.

³⁰ The baht parity adjusted in 1971 was responsible for the artificial appreciation of the baht.

the government was requested to draw up a Financial Program, which stated its commitment to controlling public and private credit.

The second oil crisis broke out in 1979 before economic conditions improved. The rise in the price of oil aggravated the existing balance of payments deficit, while agricultural exports continued to face decreasing world demand. Other exports also suffered from worldwide economic depression as industrialized countries adopted a high interest rate policy to curb inflationary pressures. The total value of crude oil and other related imports jumped from 10 percent in 1972 to 31.3 percent in 1980.³¹ Accordingly, the balance of payments deficit worsened, causing international reserves to deplete rapidly. Capital outflows due to high interest rates in industrialized countries also put pressures on the level of international reserves. With regard to domestic prices, the oil price hike drove up inflation to almost 20 percent. In coping with inflation, the BOT resorted to restrictive monetary policy by raising the interest rates of both deposits and loans. As the existing legal framework set the ceiling of lending rates at 15 percent (while world interest rates hovered around 17-18 percent), the BOT had to seek government and Parliamentary approval to abandon the existing interest rate structure set by the Civil and Commercial Code of 1930.³² Despite some opposition in Parliament, the BOT was able to push for the liberalization of the interest rate structure through the passage of the Financial Institutions Lending Rate Act of 1979. As a result, the BOT was able to use interest rate policy to control credit expansion more effectively and to make

³¹ Bank of Thailand, *Sommai Huntrakul*, p. 108.

³² *Ibid.*, p. 109, and Bank of Thailand, *50 Years*, pp. 279-280. See also a personal account by Nukul, who served as BOT Governor at the time, in Nukul Prachuabmoh, *Cheewit thi Khumkha* [A Life Worthwhile] (Bangkok, Dorkya Press, 1996), pp. 109-111.

the domestic interest structure more compatible with world interest rates.³³ The BOT also tried to even out the spread between domestic and world interest rates by raising the withholding tax on international borrowing to make it more expensive.

While high interest rates were aimed to control private credit expansion, it appeared that the soaring government deficits countered the BOT's deflationary attempt. In 1980, the government budget rose 24.5 percent from the previous year, compared to a 13.6 percent increase in 1979, creating a budget deficit amounting to 5 percent of GDP.³⁴ The politicized nature of fiscal policy rendered attempts to reduce government expenditure extremely difficult, particularly the cost of living subsidy. When the Kriangsak government tried to raise gasoline and cooking gas prices by 30 percent in 1980, it was forced to resign.³⁵ Prices of other public utilities, such as electricity and bus fares, were also subsidized, thus adding further pressures to bloated government expenditure. Public sector borrowing to cover rising financial burdens beginning the mid 1970s, such as in military spending, infrastructure building projects, and public enterprise deficits, also added pressure on the level of international debt and government's ability to service its debt. In 1980, the ratio of external foreign debt to GDP was 21 percent, compared to almost zero in 1973.³⁶ Even though the level of debt was much smaller than seen in Latin American countries, for conservative-minded monetary authorities at the BOT it was a cause for concern as international reserves were rapidly depleting. Finally, the Bank of Thailand was authorized to negotiate with the IMF for a Stand-by loan for

³³ According to the Bank, between 1980-1981 the Bank made changes to interest rates 11 times. Bank of Thailand, *Sommai Huntrakul*, pp. 109-110.

³⁴ *Ibid.*, p. 110.

³⁵ See Larry A. Niksch, "Thailand in 1980: Confrontation with Vietnam and the Fall of Kriangsak." *Asian Survey* 21, no. 2 (February 1981): 223-231.

³⁶ Pasuk and Baker, *Thailand: Economy and Society*, p. 147.

the first time. Under IMF conditionality, the government was required to control inflation and current account imbalance by setting targets in the reduction of private credit, the budget deficit and external borrowing.³⁷

Even though the first Stand-by loan helped reduce the pressures on international reserves and reinforce the political will to correct fiscal and current account imbalances, economic conditions deteriorated as budget and balance of payments deficits continued from 1981 to 1985. During this time, the government resorted to more financial assistance from the IMF and the World Bank in a series of Stand-by arrangements (1982, 1983, and 1985) and Structural Adjustment Loans (1982 and 1983).³⁸ Resorting to a series of loans from the IMF and World Bank reflected the difficulties the Thai government experienced in restoring macroeconomic stability and restructuring the economy toward a more outward-looking orientation. These difficulties lay partly in the political sensitivity of stabilization and adjustment policies, particularly tax increases and abolishing oil subsidies and tariff protection. Some difficulties were found in the adverse effects of previous policies. For example, the deflationary policies aimed at reducing imports and curbing domestic demands caused a rapid increase in fiscal deficits in 1982 as revenue collection fell short of targets. A brief expansionary monetary policy to stimulate the economy in 1981 led to the rapid expansion of private credit, which, given the large number of weak and under-supervised financial institutions, resulted in rampant unscrupulous lending and non-productive investment.³⁹ There were also difficulties in bringing about substantive changes to the old import-substitution structure, which was

³⁷ Bank of Thailand, *Sommai*, pp. 145-146.

³⁸ *Ibid.*, pp. 145-61

³⁹ *Ibid.*, p. 118. The Bank notes that private credit extension expanded 34 percent in the second half of 1983.

gradually set up in the late 1950s, as many factors were working against the new measures. For example, the overvalued baht, tied to the increasingly appreciated US dollar, hindered the price competitiveness of Thai exports. Accordingly, the success in bringing macroeconomic instability under control and laying the foundations for monetarist macroeconomic management and export-promotion was not reached until 1986 when these difficulties were tackled with more coordinated and compatible fiscal, monetary, financial, and exchange policies. A brief look into how the Thai authorities, particularly the Bank of Thailand, worked toward achieving such policy coordination is presented below, with the exception of financial policy, which will be dealt with separately in the following section.

Fiscal Policy With regard to the fiscal conditions, the government faced a fiscal crisis in 1982 as previous fiscal restriction measures to reduce the chronic budget deficits resulted in a fall in tax revenue.⁴⁰ As government expenditures continued to grow, a shortage in revenue collection led to more budget deficits. The economic downturn in 1982, induced by previous restrictive monetary and fiscal policy, aggravated fiscal conditions. The Prem government had to resort to more restrictive policies such as tax and tariff increases and budget cuts in order to finance government spending.⁴¹ These unpopular policies created a lot of criticism and public protests, prompting the government to partially freeze

⁴⁰ Examples of fiscal restriction measures, which were part of the government's structural adjustment programs, included a 5 percent budget cuts across the board, changes in methods of income tax collection, and a reduction in export taxes. See Ibid., p. 116. See also Chaipat Sahasakul, "Fiscal Policy," in *The Thai Economy in Transition*, ed. Peter G. Warr (Melbourne: Cambridge University Press, 1993), p. 206.

⁴¹ For example, in 1985, the government set a zero growth budget for the 1986 fiscal year. See Bank of Thailand, *Sommai*, p. 126.

and stabilize domestic oil prices to help relieve the rising cost of living.⁴² It also sought to build private sector support through the public-private joint deliberation bodies.

Another problematic area, which aggravated fiscal and current account conditions, was the bloated government's external debt. The public sector's foreign debt continued to rise even though the government tried to set a lower ceiling for foreign borrowing every year after 1982. Not until 1985 was the government able to contain external borrowing through the passing of new legislation controlling public sector borrowing. Under this legislation, the Ministry of Finance (MOF) was also authorized to refinance some of the existing debts for more secure debt servicing conditions. After this reform, the level of public sector borrowing from abroad was reduced to 11.1 percent in 1985, 10.7 percent in 1986 and 9.4 percent in 1987.⁴³ Another attempt to improve the fiscal conditions occurred by reducing financial losses of state enterprises, largely the result of inefficient resource allocation. Government subsidies for utility prices for water, telephone, and bus fares were reduced, allowing prices to increase in 1984.⁴⁴ In 1986 energy prices were also restructured in line with market prices to reduce government's financial burden. In 1986, further expenditure reduction was also seen in the control of budget disbursement to reduce cash deficits along with more tax increases.⁴⁵ Signs of improvement became visible in 1987 and 1988 when the rate of increase of government expenditures rose only 2.6 percent and 4 percent respectively, while growth of tax

⁴² Bank of Thailand, *50 Years*, p. 270. See also Praipol Koomsup, "Energy Policy," in *The Thai Economy in Transition*, pp. 314-316. Praipol points out the fiscal burden caused by the Oil Fund, which was used to subsidized some oil products, including diesel, kerosene, and LPG. In June 1985, the deficit (the difference from oil revenue and subsidies) amounted to 189 million baht per month.

⁴³ Bank of Thailand, Sommai, p. 128.

⁴⁴ See Phisit Lee-atham, *Jaak Yoong Glaipen Roong* [From Crisis to Double Digit Growth] trans. Veera Theeraphat (Bangkok: Wattachak, 1994), p. 35-36.

⁴⁵ *Ibid.*, pp. 129-130. The control of monthly cash deficits was a part of the IMF conditionality before the disbursing of the 3rd Stand-by loan.

revenue jumped by 18 and 25 percent due to a combination of economic recovery and an improved tax collecting system.⁴⁶ Accordingly, a substantial decline in budget deficits was registered in 1987 and the government experienced a surplus in 1988.⁴⁷

Exchange Rate Policy As the baht was fixed to the US dollar, it began to become overvalued as the US dollar continued to appreciate in the early 1980s, causing increasing loss of confidence in the currency within the financial community. In 1981, capital inflows declined in response to higher interest rates in the world markets. Pressures from international debt repayment and declining exports forced the international reserves to diminish to an unexpectedly low level.⁴⁸ The BOT needed to devalue the baht twice in 1981 (1.07 percent and another 8.7 percent or from 20.775 baht per 1 USD to 21 and 23 baht) in order to restore the confidence in the currency and improve balance of payments conditions.⁴⁹ The system of Daily Fixing, which saw the co-determination of the exchange rates by the Exchange Equalization Fund and commercial banks, was abandoned, returning to the former system in which the EEF solely determined the exchange rates.⁵⁰ The Bank notes that a devaluation was a controversial policy instrument as it had never been done before and there seemed to be a lot of opposition in different quarters of society. The first devaluation turned out to be too little to have any significant impact on the market so the second one was needed. The public outcry

⁴⁶ Chaipat Sahasakul, "Fiscal Policy," p. 208.

⁴⁷ Ibid., p. 223. According to the data from the Bank of Thailand, government budget deficits in 1987 dropped from 35,516 million baht in 1986 to 8,861 million baht in 1987. In 1988, the government experienced a budget surplus of 45,561 million baht.

⁴⁸ Bank of Thailand, Sommai, p. 118. The Bank notes that in 1983 the country's international reserves were reduced to 2.5 billion US dollar or about three months of imports.

⁴⁹ Bank of Thailand, *50 Years*, p. 270.

⁵⁰ Ibid., p. 282.

against the second devaluation led to a resignation of the Deputy Minister of Finance.⁵¹ The devaluation temporarily restored stability to the economy in late 1981. However, as the value of the US dollar continued to rise, the baht appreciated rapidly causing Thai exports to lose price competitiveness. The Prem government, in close consultation with the BOT and the IMF, decided to devalue the baht 14.8 percent (from 23 to 27 baht per USD) in November 1984 and adopted a basket currency system to determine proper exchange rates.⁵² Despite political opposition and wide public resentment, the government was able to withstand the pressures and stand by its decision.⁵³ In 1985, the BOT adjusted the combination of the basket of currencies to give more weight to the US dollar, which was the most popular currency in business settlement. The 1984 devaluation was a milestone in the government's structural adjustment efforts as it was a major break away from the structural constraints, which had been working against exports in favor of the inward-looking import-substitution regime. In 1985 when the yen appreciate significantly against the US dollar as a result of the Plaza Accord concluded at the same year, Japanese investment started to flow into Thailand as the baht, which was tied to the US dollar, became even less expensive.⁵⁴

⁵¹ Bank of Thailand, *Sommai*, p. 116. See also Phisit, *From Crisis to Double Digit Growth*, p. 37.

⁵² Bank of Thailand, *Sommai*, p. 121.

⁵³ Among the most powerful opponents was that of the military. The Army Chief came out in public to denounce the government decision and demanded a reinstallation of the former exchange rates. See Phisit, *From Crisis to Double Digit Growth*, p. 38. See also Juree Vichit-Vadakan, "Thailand in 1984: the Year of Administering Rumors." *Asian Survey*, 25, no. 2 (February 1985): 232-240.

⁵⁴ The Yen had been appreciating since 1970 due to the strength of Japan's exports and its growing trade surpluses but the rise of 1985 was very dramatic. According to Pasuk, between 1970 to 1984, the yen rose 47 per cent against the US dollar, while from 1985 to 1988, the appreciation was 89 per cent. See Pasuk Phongpaichit, *The New Wave of Japanese Investment in ASEAN*, (Singapore: Institute of Southeast Asian Studies, 1990), p. 40.

Monetary Policy In terms of monetary policy, during this period the BOT continued to employ interest rate policy largely to provide counter-cyclical outcomes in order to stabilize the monetary system. For example, in 1982, the BOT reduced the ceiling of deposit and lending rates and reduced bank rates several times to prevent an economic downturn as a result of restrictive fiscal and monetary policy in the late 1970s.⁵⁵ When liquidity rose in 1983, which drove imports and balance of payments deficits to rise, the BOT returned to restrictive policy to curb domestic spending by increasing bank rates from 11.5 to 13 percent at the end of 1983.⁵⁶ However, as fiscal deficits continued and the baht remained overvalued, the burden of adjustment weighed more heavily on the BOT and its monetary instruments. This difficulty can be seen in 1983-1984 when balance of payments deficits amounted to approximately 90 billion baht, a 50 percent increase from 1982. The BOT was not able to convince the government to devalue the baht as the latter was concerned with the political repercussions. As a result, the BOT needed to rely on interest rate policy to control credit expansion (which drove up imports) by asking commercial banks to limit their credit extension to no more than 18 percent of the total of last year's credits.⁵⁷ This policy proved to be short-lived (eight months) as it aggravated the liquidity problem induced earlier by the finance company crisis. Commercial banks were also seen as using this policy as an excuse to reject unwanted loans arbitrarily. Finally at the end of 1984, when it was apparent that the overvalued baht was unsustainable, the government decided to devalue the currency with the support

⁵⁵ Ibid., p. 116. See also Bhanupong Nidhiprabha, "Monetary Policy," in *The Thai Economy in Transition*, ed. Peter G. Warr (Cambridge: Cambridge University Press, 1993).

⁵⁶ Bank of Thailand, *50 Years*, p. 282.

⁵⁷ The government also sought to raise import taxes for luxurious items to curb imports. It also tried to promote exports by providing tax exemption for certain export items. See Bank of Thailand, *Sommai*, pp. 120-121.

of the BOT and the IMF. In 1985-1986, when the macroeconomic conditions started to improve, the BOT largely pursued expansionary policy to stimulate economic growth. Interest rates and interest rates ceiling were reduced and special credit facilities were extended to exporters by the BOT.⁵⁸ As economic growth began to accelerate toward the end of the 1980s, anti-inflationary measures were employed by the BOT, such as the launching of the BOT bonds in 1987 and 1988 to absorb excess liquidity in the financial system and changes in interest rate structures in 1990. The increasing fiscal discipline after 1987 helped reinforce the effectiveness of these monetary measures in maintaining relative domestic price stability.

By 1985, the macroeconomic conditions of Thailand began to stabilize, while the structural framework for export-promotion became increasingly institutionalized.⁵⁹ These economic conditions together with the rise in capital inflows, induced from the appreciation of the yen as a result of the Plaza Accord and the 1984 devaluation, contributed to a rapid surge in exports of manufactures and services.⁶⁰ In order to understand the role and position of the BOT in encouraging these changes, one needs to focus on the compatibility between the emerging macroeconomic and industrial framework and the Bank's policy traditions and preferences. While it is difficult to deny the role of the World Bank and the IMF in pushing for a series of structural changes through their loan conditionality, it may be argued that there was a significant degree of compatibility between the former institutions' and the BOT's policy preferences. The

⁵⁸ Ibid., p. 122.

⁵⁹ The institutionalization of export-orientation may be seen in the gradual abandoning of import tariffs since mid 1980s. A more rapid tariff reduction was achieved later in the early 1990s during the Anand administration. See Suphat Suphachalasai, "Export-Led Industrialization," in *Thailand's Industrialization and its Consequences*, ed. Medhi Krongkaew (London: St. Martin's Press, 1995), pp. 71-76.

⁶⁰ In 1986, exports rose 23.9 percent from the level in 1985. In 1987, exports grew by 31.7 percent, followed by another 37.2 percent in 1988. See Ibid., p. 68.

compatibility can be seen in a number of policy traditions and preferences of the BOT, which were rather congruent with World Bank and IMF recommendations. First, the conservative monetary policy tradition was compatible with monetarist influence on IMF loan conditionality. As shown in the previous chapter, the BOT's preoccupation with controlling credit expansion in order to contain inflation over the years was not very different from the IMF's monetarist approach to demand management. The IMF's conditions for the Thai government to control private and public credit expansion and debt creation to specific levels, seen in the performance criteria for loan disbursement, largely echoed what the BOT had sought to achieve over time as its long-standing mandate.⁶¹ However, as discussed earlier, the BOT's capacity to maintain monetary stability also depended on fiscal coordination on the part of the government. Accordingly, the IMF loan conditionality, which not only emphasized the monetarist approach to macroeconomic management but also fiscal-monetary coordination and fiscal discipline, helped endorse the BOT's policy preferences and its autonomy in pursuing such preferences.

The BOT's inclination toward export-promotion, which can be seen in its credit extension schemes to the export sector beginning in 1960s, was in line with the World Bank's outward-oriented structural adjustment policies. This export-oriented inclination reflected the BOT's long-standing concerns with Thailand's dependence on a small number of agricultural exports when the world market prices of such commodities fluctuated invariably. On many occasions the Bank warned the government of the vulnerability of the country's main source of foreign exchange as the rise of agricultural export values was due to rather favorable, yet uncontrollable, conditions in the world

⁶¹ See economic targets and performance criteria in Bank of Thailand, *Sommai*, pp. 145-150.

markets and proposed for a diversification of the export sector. The Bank's credit allocation schemes extended to other exports besides rice in 1960 reflected its support for export promotion and diversification. It is important to note that the concern for export promotion was not completely absent from the government agenda before the structural adjustment period. The external deficits since the 1950s meant that the government always relied on exports as a major source of foreign exchange. Emphasis had been placed on export promotion ever since the Third National Economic and Social Development Plan (1972-1976).⁶² However, export incentives were largely offset by tariff protection aimed at supporting an import-substitution industry. In the late 1960s and early 1970s, the BOT found support among a new generation of scholars and technocrats, including those at the National Economic and Social Development Board, who began to criticize the incompatibility between import-substitution and export-promotion policies.⁶³ By the mid 1970s, business leaders, particularly those in the textile industry, also began to show an interest in shifting production toward exports as domestic growth slowed down.⁶⁴ They gradually allied with the BOT to support the export industry while sending signals to the government through their business associations such as the Association of Thai Industries the Chamber of Commerce, and the Thai Bankers Association.⁶⁵ Nevertheless, a number of factors, particularly the government's need to increase revenue collection and control domestic demands during the economic instability period from the mid 1970s to the mid 1980s prevented a substantial and

⁶² Suphat, "Export-led Industrialization," p. 71.

⁶³ The National Economic and Social Development Board (NESDB) was among the strongest proponents of export orientation. It criticized the ineffectiveness of export-promotion efforts in the Fourth National Economic and Social Development Plan.

⁶⁴ Pasuk and Baker, *Thailand: Economy and Politics*, p. 150.

⁶⁵ The BOT provided preferential credit to textile exports. See *Ibid.*, pp. 149-151.

systemic reduction of import tariffs and export taxes. The World Bank's conditionality provided both financial and political support for the proponents of export-orientation policies in overcoming the disincentives to exports caused by the existing tariff system.

The BOT's general concern for market distortions and inefficiencies, which had grown over the years as a result of various government intervention measures, also found support in the structural adjustment policies of the World Bank. As mentioned earlier, the Bank's general objection to government intervention in the economy was rooted in the real experience of the Thai political economy. The period of economic nationalism led to the establishment of a number of inefficient state enterprises and enrichment opportunities for the political elite to develop patronage relations with big business groups. Despite the shift toward the promotion of the private sector since the Sarit regime, remnants of old economic practices, such as government subsidies and price controls, persisted, particularly within existing state enterprises. The Bank's concern for economic distortions arising from such practices may be seen in a number of its actions. For instance, Dr. Puey spoke out clearly against the military leaders' sitting on boards of directors of private companies. The Bank also assumed an active role in the curbing of government external borrowing, including that of state enterprises after the 1960s. Its credit allocation schemes, initially for rice exports and then to the other exports, also aimed at compensating for disincentives imposed on exports in general, and rice exports in particular, by the import tariff structure. By late 1970s, economic instability largely brought about by the international monetary system had increasingly convinced Thai authorities of the costs of the 'market distortions' imposed by past interventionist policies. The problem, however, lay with political obstacles to the dismantling of such measures.

In this regard, the IFIs's structural adjustment policies seemed to help reinforce the policy consensus among the Prem government and key economic agencies, including the Bank of Thailand, to tackle ineffective government intervention. In the Bank's own account of the structural adjustment period, it notes that loan conditionality was mostly congruent with and similar to what the Thai authorities had in mind, particularly the control of domestic demand and reduction of market distortions.⁶⁶

Accordingly, there was a significant degree of compatibility between the Bank's policy tradition and preferences and structural adjustment and stabilization policies prescribed by both international financial institutions, which resulted in an endorsement of the Bank's conservative tradition and its legitimacy in this trying period. The technocratic administration of the Prem government also demonstrated a strong inclination toward outward-oriented and restrictive monetary and fiscal policies. However, one must also be aware of the constraints posed by political and economic conditions in the understanding of the rather gradual process of structural adjustment. Political opposition to unpopular policies, such as currency devaluation and the raising of oil and public utility prices, put off government implementation of these policies until the later stage of the process. The economic difficulties in implementing restrictive fiscal policy, particularly a sharp fall in tax collection, also delayed the reduction of import tariffs, as these had always been a major source of government revenue. This gradualist approach reflected the varied capacity of the Thai authorities in implementing change in different policy areas and the autonomy of the government in pacing structural adjustment policies to suit political and economic circumstances. The Bank of Thailand also views itself as taking a cautious approach toward structural adjustment and

⁶⁶ Bank of Thailand, *Sommai*, p. 112.

stabilization policies. In explaining its actions, the Bank makes reference to the principles of appropriateness, flexibility, and caution in maintaining the right balance between restrictive and expansionary policies and between stabilization and growth to minimize the trade-off and to be adaptive to changing circumstances, particularly those influenced by the international monetary conditions.⁶⁷

The Transformed Relationship between the Bank of Thailand and the Financial Sector

During the 1970s and 1980s the Bank of Thailand, through its various strategies, had developed a certain level of control over the banking sector. This was a world different from the relationship between the BOT and commercial banks in the early 1940s and 1950s discussed in chapter 3, in which the BOT had sought to focus primarily on setting sound banking practices. As the Bank was able to extend credit to the financial system and to assume the role of lender of last resort in time of bank insolvency, the relationship became more interdependent and cooperative in the 1960s. In this transformed relationship, the 1970s and 1980s saw the Bank of Thailand seeking to shape the financial system toward certain preferences, particularly based on the ideas of equity, competition and diversification, and stability. These models were not necessarily compatible or accommodative of one another, as the Bank itself was not a monolithic institution and did not operate in a vacuum. In fact, over time some ideas did overshadow others in their importance. The relatively good relationship between the Bank and commercial banks, developed in the 1960s, allowed the former to seek cooperation from the latter in pursuing its goals. A brief examination into the Bank's

⁶⁷ Bank of Thailand, *50 Years*, p. 285.

competing policy objectives and its relationship with financial institutions with regard to each objective is as follows.

As mentioned in the first section, the BOT's concern for a more equitable financial system emerged in the late 1960s. In attempting to redistribute credit to the rural areas and to the agricultural sector, the Bank used its rediscount windows to encourage commercial banks to lend to the agricultural sector at lower-than-market interest rates. It also made the opening of bank branches in the rural areas conditional upon lending to local residents. The populist political context and signs of economic disparity resulting from previous economic development programs reinforced the Bank's equity objectives. Despite their complaints, commercial banks did make profits out of the schemes and had their own incentives to be involved with rural development policies, particularly when a lot of criticism was directed at their concentration of wealth and bias toward urban customers.⁶⁸ Unfortunately, a combination of factors, including the rise of the radical conservatives in mid 1970s, the monetary and fiscal problems of the government at the end of 1970s, and the influence of neo-liberal ideas through structural adjustment policies, hindered the institutionalization of equitable financial policies. Still, the BOT's credit allocation to the rural areas were not abandoned right away, and some authors argue that the Bank paid less attention to whether or not commercial banks met the lending quota to the rural areas as they were required.⁶⁹ Interestingly, during the structural adjustment period, rural credit allocation was justified as part of the attempt to

⁶⁸ Commercial banks were criticized for a number of issues. Public view of banks making easy profits from interest rate spread led to its comparing commercial banks, seen in popular media, to leeches or bloodsucking creatures. For more informed observers, banks' preferences to lend to their business and family circles affected their lending policies, which tended to be biased toward collateral-based over project-based lending, therefore failing to take into account the economic potential of the projects under deliberation. See Supachai Panichpakdi, *Financial Development*, chapter 2.

⁶⁹ Muscat, "Thailand", p. 128. Supachai Panichpakdi, *Financial Development*, chapter 2.

correct economic distortion of previous policies, such as price controls and export taxes.⁷⁰

By the early 1980s the Bank had distanced itself from the commitment to equitable development, while adopting the neo-liberal language of efficiency and non-interventionism.

The Bank's inclination to promote more competition and diversification in the financial system was connected to and conditioned by its desire to preserve stability. As discussed earlier, it intentionally limited competition in the banking sector by capping the number of banks in the system at 16 since 1962 to maintain financial stability.⁷¹ This policy, however, led not only to the oligopoly of the banking business due to a closed system, but also the concentration of wealth among a few banking families as they used their financial fortunes to expand their business empires. Sanctioning finance and securities companies to flourish in the early 1970s may be seen as an attempt by the monetary authorities to compensate for the lack of competition in the banking sector and to encourage the diversification of financial services to serve the growing needs of diverse customers. Nevertheless, due to their financial power, banking families also benefited from these business opportunities and continued to expand their business conglomerates. For example, in the mid 1980s the Sophonpanich family of the Bangkok Bank, which became the largest Thai bank, controlled 14 finance companies, 5 insurance-related companies, 36 trading companies, and 13 manufacturing companies.⁷² The Lamsam family of another large bank, the Thai Farmers Bank, had significant shares in 3 finance companies, 2 insurance-related companies, 27 trading companies, and 11

⁷⁰ See the government's Letter of Intent to the World Bank in 1980 in Bank of Thailand, *Sommai*, p. 153.

⁷¹ This number dropped to 15 in 1984 when the Asia Trust Bank became insolvent and was taken over by the Bank of Thailand. The nationalized bank changed its name to Sayam Bank. In 1987 it merged with another state-owned bank, Krung Thai. See Bank of Thailand, *50 Years*, pp. 300-301.

⁷² Pranee, *Analysis*, pp. 238-252.

manufacturing companies.⁷³ The Techaphaibun family, which controlled three medium-sized commercial banks, namely Srinakorn Bank, Bank of Asia, and Thai Development Bank, had ties with 10 finance companies, 2 insurance-related companies, 20 trading companies, and 3 manufacturing companies.⁷⁴ Not until late 1970s did the BOT begin to dilute the concentration of bank ownership after a crisis in a finance company brought home the danger of collusive lending and fraud permitted by single control of financial institutions.⁷⁵ The Commercial Banking Act of 1979 sought to limit single ownership to no more than 5 percent of the shares in commercial banks. Banks were also required to become public companies, where more than 50 percent of company shares had to be owned by no fewer than 250 shareholders. Also it was not permissible for one individual to own more than 0.5 percent of the bank's total shares.⁷⁶ Interestingly, the law did not have retroactive effects on existing commercial banks, making it quite powerless in tackling the family-controlled nature of bank ownership.⁷⁷ Furthermore, such provisions were exempted in the 1980s to facilitate the rescue package organized by the BOT with cooperation from the banking community.⁷⁸ Based on existing evidence, it is arguable that the Bank of Thailand has never made it a top priority to address family-controlled bank ownership, or even perceived it as a major problem. The Bank's lukewarm position on this issue can be seen in contrast with its clear policy of preventing foreign financial institutions from dominating the Thai financial system, as seen in its policy of allowing foreign banks to open only one branch office in the country. The issue of the BOT's

⁷³ Ibid., pp. 212-222.

⁷⁴ Ibid., pp. 267-275.

⁷⁵ See more details of the Raja Finance Company in Bank of Thailand, *50 Years*, and Tull, *Financial Sector Reform*.

⁷⁶ Commercial Banking Act of 1979, quoted in Tull, *Financial Sector Reform*, p. 30.

⁷⁷ See more criticism of the law in Ibid.

⁷⁸ The Emergency Decree of 1985 Amending the Commercial Banking Act of 1962.

perceptions of foreign capital and its policy toward foreign financial institutions will be discussed in the next chapter. Here, it may be said that the Bank was more concerned with the protection of domestic financial institutions from foreign competition than with the oligopolistic nature of the banking sector deriving from the low level of competition.

Finally, the BOT always made it a priority to promote stability in the banking sector in order to preserve the stability of the financial system. As discussed earlier, the Bank's approaches to foster stability in the banking business were a combination of formal/legal and informal means. In its early years, the Bank tried to promote a sound banking code to set standards in the banking business. In the 1960s when the banking sector flourished, the BOT sought to control excessive competition by limiting the number of banks in the system and by employing moral suasion to solicit banks' voluntary compliance, particularly with regard to interest rate competition. The Bank's role as lender of last resort, particularly when a commercial bank faced liquidity problems, confirmed its commitment to preventing potential systemic shock to the financial system. The 1970s and 1980s saw this role institutionalized as the BOT encountered occasional instability induced by the expanding, yet under-regulated financial sector. The passing of new legislation, including the 1979 Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, and the 1985 Emergency Decree Amending the Commercial Banking Act of 1962, provided the Bank with more preventative and supervisory power and the financial means to deal with liquidity and insolvency crisis. Among the most important developments was the establishment of the Financial Institution Development Fund (FIDF) under the control of the BOT to provide support to distressed financial institutions. Taken after a series of

former rescue operation patterns, particularly the famous ‘lifeboat scheme’ of 1984, the FIDF sought to lend to insolvent financial institutions and in some cases took over the management of distressed institutions temporarily. Its financial resources came partly from the BOT and partly from the financial institutions’ required contribution.⁷⁹ This way, the BOT was able to act more independently in responding to an emerging crisis, as it did not have to depend on the cooperation of the banking community. Through the creation of new legal frameworks, the BOT was granted more authority and autonomy in the handling of financial crises in order to facilitate its commitment in the preservation of financial stability. In other words, the BOT was now more equipped with formal/legal means and authority to manage the financial sector that it had in the 1960s.

On the other hand, it could be argued that the Bank’s approaches to liquidity and insolvency problems tended to promote moral hazard among commercial banks and other non-bank institutions by creating a perception that the BOT would always come to their rescue. This general perception added to the complacency of financial institutions in their operations in the 1990s, ranging from unscrupulous lending to borrowing from offshore facilities without hedging against exchange fluctuation. Nevertheless, from the BOT’s perspective, its ability to restore financial stability to the system after a series of financial crises through the mechanism set forth by the new legal frameworks enhanced its confidence in its capacity to supervise and manage the financial sector. This confidence played an important role in encouraging the BOT to attempt to shape the

⁷⁹ According to the Royal Decree Amending the Bank of Thailand Act of 1942, which was passed in 1985, financial institutions are required to contribute to the Financial Institutions Development Fund (FIDF) annually no more than 0.5 per cent of their total deposits, loans, or money received from the public. In 1986, a rate of 0.1 per cent was set by the Bank of Thailand. See Bank of Thailand, *10 Years of FIDF*, pp. 103 and 108.

nature of the financial system once again in the late 1980s and 1990s to accommodate the rapidly growing economy and the changing nature of the international financial system.

Understanding Central Bank Autonomy in the 1970s-80s

This chapter concludes by looking at both how BOT autonomy played a role in the process of macroeconomic and financial policymaking and how the autonomy itself was affected by the political and economic context of the 1970s and 1980s. A number of points may be made in this regard. First, even though the economic instability triggered largely by external factors might have contributed to the policy consensus between the government and the BOT, the Bank's image of stability and its pragmatic development policy during the 1970s facilitated its leading role in macroeconomic policymaking. The political turbulence witnessed throughout the 1970s in the rise and fall of populist movements, a brief period of ultra-right regime, and the military's continued intervention in politics, by no means provided for a stable policy environment. Several changes of governments (six from 1970 to 1980), which for once in Thai history represented certain ideological struggles in the society, could have easily led to fragmented macroeconomic management. However, the continued relatively sound macroeconomic policy, particularly monetary and exchange rate policy, can largely be attributed to the relative autonomy of the BOT in pursuing policy preferences responding to both external and domestic economic circumstances. Two points can be made about the basis of the Bank's relative autonomy. First, the Bank's institutional character, not only its moral authority and technical expertise as defender of the national interest, but also its institutional representation of continuity and stability, earned the Bank respect from

political leaders and the legitimacy to play a leading role in macroeconomic management. The Bank took note of its role in restoring foreign investors' confidence as Thailand's political situation and that of the region demonstrated a great deal of uncertainty and instability during mid 1970s. This reflected its 'trusted upon' mission to maintain international credibility through sound monetary and exchange rate policy.⁸⁰ Second, the Bank's adoption of a developmental role and its promotion of more equitable development, while seeking to maintain its conservative macroeconomic tradition, appeared to have practical value in addressing the demands of the newly emergent populist elements without overly compromising its conservative commitment. This orientation fit into the government's rural development programs, seeking to appease the populist movements and the rural population in the fight against communism. Accordingly, the Bank was able to experiment with developmentalism through its pursuit of preferential credit allocation and compulsory lending quite independently until the economic circumstances and a shift in the ideological tide led it to gradually abandon this interventionist role.

A second point concerns the extent to which Bank policy responses were influenced by extra-institutional factors and whether or not these responses were compatible with its policy preferences. The question is, if the BOT was allowed a large degree of operational autonomy in macroeconomic policy during periods discussed above, what were the sources of its policy preferences? Was the Bank forced to adopt these policies against its own inclination? One could agree that an affirmative answer to the last question would put the notion of the Bank's relative autonomy into question. However, evidence seems to suggest that the macroeconomic and financial policies

⁸⁰ Bank of Thailand, *50 Years*, p. 243.

pursued during this period were largely in accordance with the Bank's policy preferences. Preferential credit allocation, for example, emerged from the Bank leaders' broader reflections on the failure of past development policies to bring about equitable development, particularly between the urban and rural areas. The rise of the populist movements in the early 1970s did provide some impetus to the development thinking at the Bank about the consequences of previously uneven economic development. On the other hand, in the realm of monetary policy, the structural adjustment programs, obligated under the World Bank's conditionality, were also compatible with the BOT's conservative macroeconomic tradition and its support for an export-orientation and market-led economy. The economic disturbances brought about by the collapse of the international fixed exchange rate regime, the oil shocks, and a sharp decline in financial assistance as the US pulled out of Vietnam had earlier convinced the Bank of the need for structural adjustment to cope with the new economic reality. It may be argued that adjustment attempts took place as early as 1971 (before the resorting to World Bank loans) as the BOT decided to abandon the par value and adjusted the value of the baht to be in line with the value of the US dollar. Other attempts followed suit, e.g. a couple of exchange rate adjustments in 1973 and 1981, and the lifting of the interest rate ceiling in 1979. But it cannot be denied that the World Bank's conditionality gave a big push to structural adjustment efforts as some existing policies, such as import tariffs and price subsidies for basic utilities, were very difficult to abandon, therefore perpetuating the fiscal burden on the government.⁸¹ Accordingly, it may be said that Bank preferences

⁸¹ However, it may be argued that the government's hesitation to abandon some of these subsidies, though politically motivated, could be part of the reasons why structural adjustment programs in Thailand did not inflict so severe an economic disruption to the Thai population. The commitment to reduce market distortions, particularly the improvement in prices of agricultural products received by farmers, as they

were largely embedded in the macroeconomic and financial policy implemented during these periods. The policy convergence of the BOT and the IMF and World Bank raises an interesting point in considering the intrusive and coercive nature of these IFIs' loan conditionalities and perhaps provides a quick answer to the question of the Bank's relative autonomy from external actors. However, it is important not to forget how Bank preferences were formed and the sources of influence and constraints that shaped them as discussed in the previous chapter, particularly the need to maintain international credibility. This issue will be picked up again in chapter 6.

Third, the Bank was seen as developing increased autonomy in its supervisory role of the financial sector and gaining more authority over the financial sector during the 1970s and 1980s. This development was significant, as historically the Bank did not particularly have control over the financial sector. The Bank's strategies to focus on the promotion of sound banking through legal means, the use of moral suasion, the maintenance of a closed financial system, and the attempt to increase commercial banks' financial dependence on the BOT were key to its increasing power over the financial sector. The last strategy was more pronounced in the 1970s and 1980s. The Bank's preferential credit allocation schemes increased commercial bank borrowing from the Bank (with discount rates) in order to lend to priority sectors. The BOT's role as lender of last resort, exercised during a series of finance companies and bank crises in late 1970s and early 1980s, was also finally institutionalized in the establishment of the FIDF in 1985. The fact that the FIDF allowed the Bank more freedom to extend financial assistance to insolvent financial institutions to prevent their collapse increased the

were formerly subject to some forms of price control or export taxes, was also beneficial to the rural population. See more details of the 'conditionality' in the Letter of Intent of the Thai government to the World Bank in 1981, published in Bank of Thailand, *Sommai*.

dependence of local financial institutions on the BOT, which despite its moral hazard implications, contributed to the BOT's confidence in its power to guarantee financial stability. Such confidence in the increased authority and autonomy of financial institution supervision and financial sector management played an important role in encouraging the BOT to adopt the process of financial liberalization at the end of the 1980s.

Fourth, while the Bank gained more authority over the financial sector, some changes began in the relationship between the BOT and the government (through the Ministry of Finance-MOF) in the 1980s. For the first time in Bank history, Bank Governor Nukul Prachuabmoh (Nov. 1979 to Sep. 1984) was removed from office by the government through the recommendation of the Minister of Finance Sommai Huntrakool in 1984.⁸² Six years after, Kamchorn Sathirakul (Sep. 1984 to Mar. 1990) was also dismissed from governorship by Finance Minister Pramual Sabhavas.⁸³ The causes for both dismissals were policy conflicts between the leaders of the two institutions.⁸⁴ These phenomena may be seen as the exertion of the Ministry of Finance's authority over the BOT as the former enjoys supervisory and appointing power over the latter according to the Bank of Thailand Act of 1942. The political context of quasi-democracy, which saw a gradual institutionalization of parliamentary politics since 1980, except for the appointment of General Prem as Prime Minister, played an important role in changing the

⁸² See for example media and BOT officials' reactions to the dismissal in "Central Bank Men Defend Governor," *Bangkok Post*, September 13, 1984, and "A Dangerous Precedent," *Bangkok Post*, September 16, 1984.

⁸³ "Thailand's Central Bank Governor Sacked," *Financial Times*, March 7, 1990 and "Dismissal Shocks Commercial Banks," *Bangkok Post*, March 7, 1990.

⁸⁴ In Nukul's case, the conflicts were the disagreement between him and Sommai over a number of issues, particularly how to handle an insolvent bank, the Bank's proposal on a deposit insurance agency (which Sommai disapproved), and a possibility of baht devaluation. In the case of Kamchorn, the main contention lied in Pramual's hasty financial liberalization policy, including the lifting of bank deposit rates and the allowing for foreign bank entry, with which Kamchorn disagreed.

relationship between bureaucrats and the government. Drawing upon their electoral mandate, cabinet members began to get actively involved in public policymaking in order to satisfy their constituencies, parties, or even personal interests. In this context, the Ministry of Finance, due to its fiscal power, became a rather powerful tool for the government and a sought-after portfolio for individual politicians. This development created a departure from the traditional ‘alliance’ among economic bureaucrats at key economic agencies and ministries, which had previously been a source of policy coordination under past authoritarian regimes.

Of course, there had been government and MOF intervention in BOT affairs in the past. However, under military regimes, power was more concentrated in the Prime Minister, and therefore, conflicts largely emanated from disagreements between the PM and the Bank Governor. Under the Prem quasi-democratic governments, and later democratically-elected governments, the Ministry of Finance sought to exert itself more distinctively, if not completely independently from the PM. The nature of coalition governments, in which key coalition members were granted strategic cabinet portfolios—Finance, Interior, Defense, Communication, etc.—was the main reason for the more prominent role of the MOF. Consequently, the BOT needed to find new strategies to maintain its autonomy under the new political context as it could not longer rely on the long-time ‘alliance’ with the MOF. How the BOT responded to the context of democratization in the 1990s was central to the Bank’s autonomy and its capacity to pursue its preferences effectively. This issue will be discussed in the following chapter. What can be concluded here is that the BOT was able to maintain its operational autonomy during the 1970s and 1980s due to its legitimacy and ability to draw policy

support from the government and influential external actors, particularly international financial institutions. Because of its relative autonomy, the Bank was able to experiment with developmentalism through the launching of preferential credit allocation and compulsory lending schemes. However, economic disturbances at the end of 1970s and early 1980s compelled the Bank to reconsider its priorities, resulting in the prioritizing of conservative macroeconomic policy and non-interventionist role in credit allocation. The success in the structural adjustment programs, initiated by the Bank but more effectively pushed by the IMF and the World Bank, led the Thai economy toward rapid economic growth toward the end of the 1980s. At this juncture the Bank planned to launch the financial liberalization process in order to facilitate the country's long-term growth. The BOT's increased authority and autonomy over the financial sector, through several legislative amendments and a newly established financial arm (FIDF), also rendered the Bank confident of its ability to guarantee financial stability under a more liberalized context.

Chapter 6

Financial Liberalization and Financial Crisis

The resumption of macroeconomic stability, rapid economic growth, and implementation of series of financial reforms mentioned in the last chapter set the stage for the launching of financial liberalization in the late 1980s. But, as the world witnessed, less than a decade later the Thai economy went bust when the financial crisis struck in July 1997, with contagious effects for other economies in the region and across the globe. This chapter seeks to explain why the Thai authorities, particularly the Bank of Thailand, decided to liberalize the financial system in the late 1980s and discuss the context and mechanisms contributing to the crisis in 1997.

Taking a long view to explain the reasons and motives behind the adoption of financial liberalization, this chapter examines the history of the Thai authorities' receptivity toward different types of foreign capital since the 1950s. It argues that the changing receptivity of the Thai authorities toward foreign capital during the late 1980s was central to the political consensus behind the process of financial liberalization. The confidence of authorities in their capacity to manage the open economy and in the competitiveness of domestic sector was among the main reasons why they decided to embark upon the process. The pressure from the international financial community also played an important role in pushing the authorities toward making the decision. To understand the pace and timing of financial liberalization, attention will be brought to the politics between the BOT and the Ministry of Finance and how the former was able to

take advantage of the return of technocratic governments to advance its liberalization project.

In explaining the causes of the crisis, this chapter first focuses on the changing context of financial liberalization and democratization of the 1990s that increased the vulnerability of the financial system as well as hindering the BOT's capacity to maintain monetary and financial stability. The weaknesses of the financial sector, particularly the lack of risk assessment experience, were aggravated by the influx of massive foreign capital flows, while the democratized political climate induced collusion, moral hazard behavior, and intervention in BOT affairs. The changes in the Bank's organizational context, which saw signs of internal rivalry, politicization, declining moral authority and technical expertise, contributed significantly to the agency's receding capacity and autonomy.

In addition to the changing context, this chapter looks at two important mechanisms contributing to the crisis in the financial sector and the collapse of the Thai currency. First, the BOT's failure to apply effective measures to resolve the scandal at the Bangkok Bank of Commerce in 1996 triggered the spread of investor panic with regard to the soundness of the financial system. Political interference in the Bank's decision to close down a number of insolvent finance companies further aggravated the declining confidence and undermined the effectiveness of the agency's measures. Second, the BOT's persistence in pursuing a fixed exchange rate regime led to a host of moral hazard problems, as investors and borrowers became too complacent about exchange rate risks. As the economy slowed down and loss of confidence grew, the fixed

regime proved to be a costly burden for the Bank in defending the baht against market forces.

The different dimensions of central bank autonomy are at the center of these explanations. The receptivity of the Thai monetary authorities toward foreign capital largely reflected the ability of these officials to exercise their discretion to protect domestic capital by restricting access of certain types of foreign capital into the Thai economy. The maintenance of a relatively closed financial system since the 1950s revealed a certain degree of central bank autonomy from the forces of the international financial community. However, this does not mean that the Thai authorities were free from external pressure. The decision to launch a financial liberalization process can be linked to state officials' longstanding desire to maintain international credibility and the ongoing pressure from the international financial community to open up the Thai financial sector. The fact that the Bank came to its own decision to adopt the process of financial liberalization based on the confidence of its officials in their ability to manage the financial system and their calculations of the benefits of foreign capital movement suggests how the agency identified national interest with the international financial system.

To understand the two mechanisms leading to the crisis also requires a differentiated view of central bank autonomy. Political interference in the BOT's supervisory role and increased accessibility by Thai financial institutions to foreign credit indicate a decline in both the Bank's independence from the government in this policy area and its leverage with the financial sector. In contrast, the BOT's continued autonomy in the management of the exchange rate regime held off outside intervention

while allowing the agency to persistently pursue an unsustainable fixed exchange rate regime until July 1997. By distinguishing between the Bank's relative autonomy in these two policy areas, we can see the negative impact of political interference and lack of supervisory power on the one hand and of unchecked authority on the other.

The time dimension and institutional factors are also central to this chapter's analysis. To understand the move toward and the implications of the adoption of the financial liberalization process, it is important to learn about the evolution in the authorities' perception of the national interest and their strategies to balance domestic and external demand. A historical examination also gives us a comparison of the monetary officials' ability to manage capital inflows in the era before and after financial liberalization. With regard to the crisis, a focus on how the institutional environment (i.e., rules, norms, and accepted practices) shaped actors' behavior over time is key to the explanations of the vulnerabilities inherent in the financial system and the decline in the BOT's organizational strength and image. Continuity and change are also recurrent themes in this chapter's discussion of the two mechanisms leading to the crisis. The Bank's persistent pursuit of the fixed exchange rate regime and its indiscriminate bail-out policy shows the resilience of policy tradition, and the coalition of interests that came with it, in guiding the policy choices of state officials even at a time when new policy directions were badly needed. As Bank credibility and organizational cohesiveness was instrumental to the maintenance of the agency's autonomy and capacity, a deterioration of its respectable character contributed to the failure to adapt to the changing environment.

The chapter is organized as follows. The first section deals with the historical development of the Thai authorities' receptivity and interactions with different types of foreign capital from the 1950s to late 1980s, followed by a section on the politics of the financial liberalization process. Section three begins with a discussion of the theoretical approaches to the crisis and the thesis's main arguments. Section four focuses on the context of and mechanisms leading to the financial sector crisis by discussing the vulnerability of the financial system aggravated by the changing financial and political context and how the BOT's ineffective policy responses and declining autonomy led to the loss of investor confidence. The last section deals with the currency crisis, focusing on the constraints the Bank encountered in maintaining a fixed exchange rate policy to attract foreign investors and contain the cost of foreign debts. The BOT's autonomy in this policy area contributed to the prolonged defense of the baht at the expense of international reserves. Organizational factors contributing to the Bank's inability to respond effectively and in a timely manner to the precarious situation on the eve of the crisis will also be addressed.

The Origin and Sources of Political Support for Financial Liberalization

The Nukul Commission, appointed by the Chuan government to investigate the facts behind the financial crisis, states clearly in its report that the first step in a series of policy mistakes leading to the crisis was the Bank of Thailand's decision to launch the financial liberalization process in 1990.¹ The report notes that it was the Bank's choice

¹ Nukul Commission, *Analysis and Evaluation on Facts behind Thailand's Economic Crisis*, (Bangkok: Ministry of Finance, 1998), p. 9. Nukul Prachuabmoh was a BOT Governor from Nov. 1979 to Sept. 1984. His strong reputation was largely based on the Bank's important role during the structural adjustment process and a series of bank and financial company crises.

to open up the capital account, and it could have chosen not to. The report goes on to say that this decision was a result of a long-standing policy orientation that in the late 1980s and early 1990s gained full support from elected officials. After the liberalization process was launched, other policy mistakes ensued, including the Bank's maintenance of fixed interest rates and its failure to pursue conservative macroeconomic policy.

Intrigued by the commission's decisive conclusion, this section tries to understand why the Bank decided to pursue financial liberalization. Having been an icon of macroeconomic conservatism, the Bank's plan to open up the country's capital accounts and to allow capital to flow in and out freely was undoubtedly a bold departure from its earlier stability-oriented and conservative approaches to financial and macroeconomic management. What factors then contributed to the Bank's decision to depart from its policy tradition? This section shows that the answer to this question lies in the power relationship between the state authorities and foreign capital. It will examine how different types of foreign capital have, since the 1950s, influenced the policy responses of the Thai authorities and the effects of such responses on the financial system. In the late 1980s, the trends of financial globalization and the concurrent domestic financial and economic contexts convinced the authorities to open up the financial system to more foreign capital inflows through the financial liberalization process. Despite the potential benefits, it is important to note the declining ability of the Thai authorities to protect the financial system from external disturbances in this new financial context. This observation aside, in the last subsection, it will be shown that the ability of the BOT to muster political support for its control over the substance and sequencing of financial liberalization were key political factors behind the launching of the process.

The historical-financial basis of financial liberalization

The basis of financial liberalization may be seen as rooted in the relationship between the Thai economy and the international financial system, particularly how foreign capital influenced changes in domestic financial system and vice versa. As a small, developing economy, Thailand relied on external sources of credit to fund a significant part of its public and private sectors' expenditure and investment costs. Generally, dependence on foreign credit led the Thai authorities to seek to maintain stable macroeconomic conditions in order to attract the attention and to ensure the confidence of foreign investors. Scholars like Sylvia Maxfield view this dependence as one of the major contributors to central bank independence as governments seeking to attract foreign capital tend to grant more autonomy to their central bank to pursue domestic and external monetary stability.² This line of analysis finds some supporting evidence in the Thai economy. The Sarit and Prem administrations serve as good illustrations of the idea that the need to promote an attractive and reliable investment environment for the corporate sector led the government to pay extra attention to macroeconomic stability.

While the creditworthiness outlook of governments and central bankers allows one to see how the dependence of developing governments on foreign capital inflows can influence their macroeconomic policy orientation, it shows only one side of the story (i.e., the power of the international financial system over recipient countries) and fails to reveal how the host governments seek to maintain their autonomy, especially to protect domestic businesses from foreign competition. With regard to foreign capital, Pasuk offers a more balanced view. In her study of Japanese foreign direct investment in

² Sylvia Maxfield, *The Gatekeepers of Growth*, p. 33.

ASEAN in the 1970s and 1980s, Pasuk argues that the authorities of recipient countries developed different outlooks toward different types of capital depending on whether they posed any threat to state and domestic capital.³ Building on this framework, the thesis examines the connection between the Thai authorities' receptivity toward different types of foreign capital inflows and their ability to provide protection to certain business groups, particularly those in strategically important industries like banking and the infantile manufacturing sector. This investigation looks back to the period of the 1950s up to the 1980s in order to show first the influence of different types of foreign capital on Thai economic policies and second a gradual change in the receptivity of Thai authorities toward private foreign capital and their strategies to protect domestic industries from foreign competition. The main idea is that while the reliance on foreign capital drove Thailand, like other developing countries, to comply with certain demands and pressures from the international financial community, including the need to maintain international credibility, the Thai authorities were able to exercise their autonomy in protecting the economy from foreign competition in different ways, but not without a cost as some protective measures affected the long-term competitiveness of the local industry. However, it is important to note that in the 1980s this autonomy was largely hindered due to the process of financial liberalization. While the context of rapid economic growth and the confidence of the authorities, particularly the BOT, did account for this risky move, the strong pressure from the international financial community for Thailand to open its financial markets should not be ignored.

³ See Pasuk Phongpaichit, *The New Wave of Japanese Investment in ASEAN: Determinants and Prospects*, (Singapore: Institute of Southeast Asian Studies, 1990), pp. 67-69.

The Period of the 1950s to the 1960s

As mentioned in chapter 3, the continuous flows of foreign financial assistance and loans, most significantly from the US and the World Bank in the 1950s and 1960s, played an important role in financing the government's various expenditures, including military spending, economic reconstruction and development projects and essential import purchasing.⁴ To monetary authorities like the Bank of Thailand, financial assistance and loans from the US government and the World Bank not only helped fund public sector expenditure and development projects, but also helped the Bank maintain monetary stability. The use of these grants and credits to pay for the costs of imports and development projects helped reduce pressures on international reserves, which could have occurred had import payments been drawn from the government's coffers. The U.S. import-subsidy loans even helped absorb the baht from the domestic market when the received dollars were sold to importers of certain consumer goods, therefore reducing inflationary pressure. Also, as mentioned in chapter 3, the Bank even encouraged government borrowing from the World Bank to fund its development projects, rather than borrowing from the BOT itself, as the World Bank loans entailed elaborate disbursement procedures that largely helped prevent the misuse of funds.

As seen in chapter 3, to maintain continued support from the United States and international financial institutions, the Sarit government adopted liberal economic policies, seeking to promote private enterprises while attempting to tone down the growth

⁴ See for example, Bank of Thailand, 20 Years, pp. 90-91, and Richard Doner and Daniel Unger, "Thai Economic Development", in *The Politics of Finance in Developing Countries*, eds. Stephen Haggard, Chung H. Lee, and Sylvia Maxfield (Ithaca: Cornell University Press, 1993).

of government-owned companies.⁵ Based on the World Bank's recommendations, Sarit also sought to modernize the budgetary processes and promote better coordination in macroeconomic and development planning.⁶ These changes were seen in the establishment of the Budget Bureau and the National Economic Development Board in 1959, giving the economic bureaucrats a significant degree of autonomy to lead these organizations and the reform process, resulting in better coordination among key economic agencies. It is at this juncture that Thailand started to experience macroeconomic stability and economic growth as a result of the expanding private sector and increasing inflows of foreign investment.⁷

In considering the impact of foreign capital on Thailand, it is important to ask if the economic reorientation and bureaucratic reforms during Sarit's regime were largely a result of US and World Bank pressures as the Thai government was highly dependent on their financial assistance. After all, these policies sought to reduce government intervention in the economy and open up the country to more foreign investment, which meant more competition to local business groups, even though some of those groups had close connections with military leaders. In this regard, a rather complicated picture may be seen, reflecting the different implications of foreign assistance for different groups and the discretion that remained for the Thai authorities in the implementation process to respond to foreign capital. It could be argued first that the Sarit government probably

⁵ For example, the Board of Investment was established in 1959 and the Investment Promotion Act was passed in 1960 to create an attractive business environment and provide incentives for local and foreign investors. Besides the tariff and tax incentives, there was a guarantee against the nationalization of private enterprises and a ban on labor unions and strikes.

⁶ Such recommendations were made after the World Bank's economic survey mission was completed its one-year study (1957-1958) of the Thai economy.

⁷ Pasuk and Baker note that Thailand experienced a high cumulative growth of 6.6 percent while maintaining low inflation from late 1950s to early 1979s. See Pasuk and Baker, *Thailand: Economy and Politics*, pp. 129.

viewed compliance with the policy recommendations of the United States and Bretton Woods institutions as a reasonable trade-off as it seriously needed military and economic assistance to continue. Moreover, scholars have argued that Sarit was using the opportunities of private sector promotion to reduce the economic influence of his political rivals, i.e., the Phin-Phao clique, whose interests were connected to many government enterprises, while attempting to build his financial base in the private sector.⁸ Accordingly, the maintenance of flows of financial assistance and the adoption of U.S.-influenced policies fit into Sarit's desire to consolidate his power and to establish his legitimacy based on economic development and national security.

Second, there was a strong inclination from key economic bureaucrats, such as Dr. Puey and a number of Western-trained officials, to promote more liberal economic policies. Having experienced the ineffectiveness and corrupt tendencies of the previous regimes' economic nationalist policies, these bureaucrats openly welcomed the reduction of government intervention and involvement in the economy. Their receptivity and their active role in economic policy planning and implementation under Sarit facilitated the promotion of the private sector and macroeconomic policy coordination.

Third, despite the inclination to adopt the policy recommendations of major donors and creditors, a combination of factors still allowed the Thai authorities, including the BOT, a great deal of discretion to pursue their own preferences, including protecting local entrepreneurs from foreign competition. The strategic importance of Thailand to the U.S. containment policy in Indochina meant that the U.S. government was very much inclined to supply the Thai government with economic and military assistance to sustain

⁸ Silcock, *Thailand: Social and Economic Studies*, p. 20. See also Hewison, *Bankers and Bureaucrats*, pp. 94-95.

and maintain close cooperation with the regime despite imperfect compliance.⁹ The Thai authorities continued to have a great deal of control over investment and financial policies, in which local business groups were able to find protection from foreign capital. The requirement for majority Thai ownership in promoted enterprises under the Board of Investment's promotion schemes and the one-branch restrictions imposed on foreign banks wanting to operate in Thailand are among examples of discriminatory measures against foreign businesses that were carried out throughout the 1960s and 1970s. Moreover, the difficulties in dismantling the existing regime of government enterprises and the lack of experience and inconsistency in promoting the private sector also prevented the liberal economic policy from advancing in full force.¹⁰ Accordingly, even though the U.S. and the World Bank were able to influence changes in policy direction through their role as major donors and creditors, there remained a great deal of discretion and inconsistency in policy implementation, which in turn diluted the effects of the changes at the policy level.

The Thai authorities' receptivity to private foreign capital inflows was more cautious and selective. The post-war period not only saw the rise of state involvement in economic sectors, but also the unexpected forging of a mutually beneficial relationship between key political leaders and Chinese-origin domestic capitalists. This economic structure led the authorities to be sensitive toward foreign competition. This concern was

⁹ Military and economic assistance grew after Sarit's death in 1963 and Thanom came to power as the U.S. became increasingly involved in Vietnam. According to Thak, US assistance for infrastructure construction, particularly communications, jumped to \$42.9 million in 1963, compared to \$97.5 million from 1954-1962. The same table shows that these funds peaked at \$200 million in 1966. See Thak, *Thailand: Politics of Despotic Paternalism*, pp. 268-270.

¹⁰ For example, due to slow responses from foreign investors, the Investment Promotion Act of 1960 had to be redrawn in 1962 to be more attractive. The new incentives included longer tax holidays (from 2 to 5 years), import tax exemptions for capital goods and raw materials, and more opportunities for profit repatriation. See more details in Kevin Hewison, *Bankers and Bureaucrats*.

reflected in their lukewarm receptivity toward FDI, while allowing domestic capitalists to establish their sources of credit through bank intermediaries and other types of commercial credit.¹¹ The following discusses the pattern of credit mobilization and allocation which emerged in the political economy of this period and which came to mark the receptivity of the authorities and domestic capital toward foreign capital in the later periods.

During the post-war period until late 1950s, the availability of credit from various sources, such as business networks, trade credit, government investment funds and public savings (both domestic and foreign)¹², allowed small groups of domestic capitalists to expand and diversify their trade-based business empires within the context of political patronage. Commercial banks, the core business of these conglomerates, played a dominant role in capital mobilization and credit allocation. Their control of domestic deposits and their ability to borrow from other financial institutions, largely those incorporated abroad, facilitated the channeling of funds to finance their other business ventures. The nature of these sources of funds allowed domestic capitalists to continue to maintain management and ownership control within a small number of families. The international monetary system's commitment to a fixed exchange rate regime and a relatively stable baht also minimized the risk of exchange fluctuation and made the cost of borrowing abroad rather predictable. The business connection and partnership that

¹¹ Even though there were attempts by the Phibun II government to welcome foreign investment in 1950, the state reserved the right to invest in any area it wanted. The uncertainty of being subject to nationalization or in competition with state enterprises was undoubtedly a disincentive for foreign investors. Not until under Sarit regime did foreign direct investment started to flow in more systematically through the Board of Investment's investment promotion programs. See Hewison, *Bankers and Bureaucrats*, p.104, for discussion of Phibun's attempt to improve receptivity toward foreign investment.

¹² Bank deposits were the largest source of credit for corporate investment from mid 1950s to early 1960s, while foreign bank loans were the largest source of banking lending by banks incorporated in Thailand. See Bank of Thailand, *Annual Report*, 1961, p. 27, 89.

domestic capitalists formed with military leaders and other influential groups (e.g., the crown properties) allowed the former to seek and build protection against both domestic and foreign competitors. Among the most protected groups was the banking sector. In an attempt to lower competition, in 1955 the second Phibun government passed banking regulations, which imposed restrictions on new bank openings and foreign banks operation.¹³ As a result, existing domestic commercial banks were able to take advantage of these regulations to grow and dominate the banking sector as they later surpassed foreign banks in terms of overall deposits, capital, and credit extended.¹⁴ The quasi-monopolization of the banking sector also found support among Thai central bankers. The Bank of Thailand's goal of promoting a stable financial system led the institution to accept the relatively low level of competition while aiming to achieve more stability in the banking sector. The closed financial system also served the Bank's desire to prevent the domination of the Thai financial system by foreign financial institutions, a phenomenon of the pre-war period.

The late 1950s and early 1960s saw certain changes in the government's policy toward foreign capital, particularly foreign direct investment (FDI). Besides certain political factors mentioned earlier, new economic rationalization also played a role in the change in perceptions. As the authorities adopted a system of long-term development planning in which economic growth was set as a key development goal, they came to accept the importance of foreign capital in contributing to long-term economic growth. They were also critically aware of the failure of state-led industrial development policy under the economic nationalist regime, which promoted inefficiency, mismanagement,

¹³ See Narit Chaiyasood, "Commercial Banking" in Peter Warr (ed.), *The Thai Economy in Transition*, (Melborne: Cambridge University Press, 1993), p. 230.

¹⁴ Ibid.

and corruption, and came to see the private sector as the new driving force for economic development.¹⁵ FDI was thus seen as an essential element to the promotion of private investment in the manufacturing sector as a source of finance and technological and managerial know-how. Accordingly, the Promotion of Industrial Investment Act of 1960 was passed to provide incentives to private investors both domestic and foreign through a number of privileges such as tax and tariff holidays, profit repatriation, and importing of skilled workers. The Act also provided guarantees that the government would not seek to nationalize any private industrial activity, or to engage in business activity in competition with the private sector.¹⁶ In terms of labor relations, with its dictatorial power the Sarit government also sought to outlaw labor organizations and workers' right to strike to prevent any potential labor disruption and political instability.¹⁷

As a result of the investment promotion policy in general and the promotion of foreign direct investment in particular, the level of FDI began to grow substantially toward the end of the 1960s, particularly within the industries promoted by the Board of Investment (BOI). Despite a slow start, FDI inflows rose from 72 million baht in 1960 to 910 million in 1965 and reached 1 billion in 1970.¹⁸ Much of the funds went to major manufacturing industries such as textiles, electronics and electrical goods, chemicals, machinery, and transport equipment. US investment was the largest source of FDI to Thailand in the 1960s accounting for almost 50 percent of total FDI inflows. Unlike other countries' direct investment, much of US investment went to projects outside the

¹⁵ They were also aware of the pressing need to shift the structure of the economy from agricultural to manufacturing-based as export commodities experienced increasing fluctuation in the world markets. See a discussion on the emergence of development policy and policy technocrats in Muscat, *The Fifth Tiger*, pp. 88-94.

¹⁶ Bank of Thailand, *Annual Report*, 1959.

¹⁷ The Revolutionary Proclamation no. 19 abolished the Labor Act of 1956, which legalized trade unions and their right to strikes.

¹⁸ Different volumes of Bank of Thailand's Annual Reports.

scope of the BOI's promotion, largely in the areas of petroleum products and chemicals. A number of U.S. firms also retained full ownership of their businesses instead of forming joint ventures with Thai counterparts. The size of U.S. investment and the exemption from local equity participation reflected the magnitude of U.S. multinational enterprises that had begun to invest abroad in late 1950s and their ability to take advantage of the U.S.-Thai relationship to build an investment niche in areas that required international specialization. The second largest source of FDI in the 1960s was Japan. Unlike American investment, Japanese investment was largely concentrated in the BOI-promoted industries and took the form of joint ventures with local entrepreneurs.¹⁹ In fact the volume of its registered capital under the BOI's promotion certificates surpassed that of the United States.²⁰ Other top-five contributors of the 1960s were firms from Taiwan, the United Kingdom, and Malaysia.²¹ Together they accounted for approximately 72 percent of the total foreign registered capital with the BOI (2,058 million baht) from 1959 to 1969.²²

The increased receptivity toward foreign direct investment should be taken into consideration along with other parallel policies pursued by Thai authorities. First, with regard to ownership, the government sought to protect domestic capitalists by largely requiring foreign firms to form joint ventures with local entrepreneurs in order to receive

¹⁹ In fact, Japan was the largest source of registered capital under the BOI's promotion certifications. See Ingram, *Economic Change in Thailand*, p. 291. See also Somsak Tambunlertchai, "Manufacturing" in Peter Warr (ed), *The Thai Economy in Transition*, (Melbourne: Cambridge University Press, 1993), chapter 3, for more details on foreign direct investment from the 1960s to 1980s.

²⁰ 658 million baht for Japanese registered capital under the BOI's programs compared to 333 million baht from the US. See Ingram, *Economic Change in Thailand*, Table XXXVI, p. 291.

²¹ Ibid.

²² Calculated from the numbers presented in Ingram's Table XXXVI, in Ingram, *Economic Change in Thailand*, p. 291.

investment privileges.²³ As a result, domestic capital, in some sectors more than others, benefited greatly from entering into partnerships with foreign investors through the transfer of capital and technological and managerial skills. They were also able to apply leverage against their foreign partners through their control of local knowledge and marketing networks.²⁴ Among the most successful groups was one in the textiles sector: a group of domestic entrepreneurs, who formed early joint ventures with Japanese textile firms later emerged as textile magnates in the mid 1970s and was able to gain more control of the sector when Japanese investment started to wane.

Outside the manufacturing sector, commercial banking, as discussed above, was another sector heavily protected from direct foreign competition. The Commercial Banking Act of 1962, which was drafted by the Bank of Thailand in consultation with the Thai Bankers Association, stipulated that commercial banks incorporated in Thailand needed no less than three-quarters Thai shareholders.²⁵ It also required that no less than three-quarters of bank directors be Thai nationals.²⁶ Since 1955 the government also limited the scope of operation of foreign banks to a single bank branch (allowing only one branch operation per bank). And later in the 1970s there was a moratorium on the opening of foreign bank branches in Thailand altogether. The Thai authorities' ownership policy played a crucial role in diluting the competitive impact of foreign capital and allowing domestic capital to gain strength from the context of investment promotion, while largely maintaining controlling interests in specific sectors.

²³ It is plausible that foreign firms might have had more control than the degree of ownership suggested through their role as capital and technology provider. Scholars often refer to examples of how foreign investors, particularly the Japanese, sought to maintain tight control over companies' operations despite their minority shareholding. See Somsak Tambunlertchai, *Japanese and American Investment in Thailand's Manufacturing Industries*, (Tokyo: Institute of Developing Economies, 1977), chapter 3.

²⁴ Pasuk and Baker, *Thailand: Economy and Society*, p. 130.

²⁵ The Commercial Banking Act of 1962, sector 5.

²⁶ *Ibid.*

Second, as mentioned in chapter 3, within the context of investment promotion, the government used tariff policy to promote import substitution, which in effect provided protection to domestic industries. In order to reduce the strains on international reserves and balance of payments while trying to maintain its major source of revenue, the government adjusted the tariff structure to bias it against manufactured products.²⁷ Tariff walls were erected against consumer goods, particularly those being produced domestically, while tariffs on capital goods, components, and raw materials were reduced. This tariff regime and other market incentives not only encouraged foreign investors to engage in production for domestic market as they tried to evade the tariff barriers,²⁸ but also prompted streams of domestic capitalists to invest in industrial sectors in order to take advantage of the sheltered investment environment. As a result, despite the significant increase in the levels of FDI during this period, it constituted only a small percentage of overall capital formation.²⁹ Rather, domestic capital dominated the manufacturing sector and increasingly became the main engine for economic growth after the agricultural sector.³⁰

²⁷ For the government (acting through the Finance Ministry), import (and export) taxes, which were categorized as indirect taxes, had been major sources of revenue. In fact, they, together with excise and sales taxes, accounted for the largest bulk of government income (almost 83 percent in 1960, 81.5 percent in 1965, and almost 81 percent in 1969). The percentages were calculated from Ingram's Table XLI, in Ingram, *Economic Change in Thailand*, p. 300.

²⁸ The Promotion of Industrial Act of 1960 also sought to provide protection to products produced by promotion certificate holders. For example, it stipulated that it would prohibit import of products similar to such products for a reasonable period of time or increase the import duties on products similar to those produced domestically.

²⁹ According to Pasuk and Baker, foreign direct investment constituted 12 percent of total gross capital formation from 1964-1972. See Pasuk and Baker, *Thailand: Economy and Society*, p. 130. This share was even smaller in the 1970s when foreign direct investment was in decline due to domestic politics and international monetary conditions. According to Somsak, FDI was averaging less than 5 percent annually between 1970 and 1987. See Somsak, "Manufacturing", p. 136.

³⁰ While the share of the agricultural sector in GDP was in steady decline (50.1 % in 1951, 39.8% in 1960, and 31.9% in 1969, the manufacturing sector's contribution also rose steadily from 10.3 % in 1951 to 12.6 % in 1960, 14.2 % in 1965, and 15.0 % in 1968. See Ingram, *Economic Change in Thailand*, p. 234.

Commercial banks continued to play an important role in credit allocation for industrial investment. With their control of financial resources and access, they were able to expand into industrial sectors themselves to take advantage of the import substitution regime. Together with emerging industrial capitalists, they formed influential interest groups putting pressure on the government for more protection as time went by. Clearly, it may be seen that the tariff structure of import substitution provided a window of opportunity for domestic manufacturing groups, some with close ties to the banking sector, to start out successfully in this period.

At least two factors contributed positively to this success. First, the availability of credit to commercial banks, largely from domestic saving and foreign bank borrowing, allowed banks to extend their supply of credit to the manufacturing sector. Foreign borrowing was made possible through the foreign bank branches in Thailand and the growing Eurocurrency markets. Second, the relatively stable macroeconomic conditions, particularly the strong balance of payments and rising international reserves,³¹ allowed the authorities to be less concerned with any imbalances that might have caused by import substitution and the existing pattern of credit allocation. As discussed earlier, the Bank of Thailand was not opposed to import substitution in the beginning as it saw the necessity of infant industry protection and the reduction of import dependence, even though it was heard voicing concerns for excessive industrial protection and calling for export promotion at the same time. Only in the mid 1980s were economic reorientation and financial deregulation initiated to tackle some of the problems inherited from this period.

³¹ Macroeconomic stability during this period was partly due to the continuous inflows foreign military and economic assistance and a rise in world demand for Thai exports. Fiscal and monetary coordination also contributed to successful macroeconomic management.

Before moving on to discuss the impact of the changing international monetary and financial landscape in the 1970s, it can be summarized here that in the 1950s and 1960s while the Thai authorities were receptive toward foreign economic and military assistance, they developed only a cautious receptivity toward foreign direct investment. When they decided to open up the economy to more FDI, various measures were implemented to protect domestic capital. Accordingly, FDI did not overwhelm domestic investment or affect the existing pattern of private credit allocation. Commercial banks continued to play a dominant role as suppliers of credit to the growing industrial sector through their access to domestic saving and bank borrowing, particularly banks incorporated abroad. This pattern of capital mobilization, i.e. through debt creation, led to the short-term nature of domestic investment lending, largely through overdrafts and the high debt-equity ratio for domestic firms. It will be discussed later in this chapter that these patterns continued during the period of financial liberalization, making Thai firms particularly susceptible to changes in liquidity and debt servicing arrangements.

The Period of the 1970s to the mid 1980s

The collapse of the Bretton Woods' fixed exchange rate regime and the rise of Eurocurrency markets in the early 1970s had significant impacts on the foreign capital movements to Thailand and the receptivity of the Thai authorities toward them. In response to exchange rate volatility and the surge in the 'petrodollars' from the oil exporting countries after the first oil shock, banks in developed countries diversified their liabilities and assets internationally.³² The 'push' factor from these creditor institutions

³² Ethan Kapstein, *Governing the Global Economy: International Finance and the State*, (Cambridge: Harvard University Press, 1996), chapter 2.

to developing countries was clearly felt in Thailand. A significant indication may be seen in the pressure from foreign financial institutions eager to enter the Thai financial sector. As discussed earlier, the interest of foreign banks in establishing business in Thailand had been evident since the post-war period. The pressure from the domestic banking sector on the government to limit the degree of foreign competition resulted in various measures restricting the scope of operation and the number of foreign financial institutions doing business in Thailand. Accordingly, from the post-war period until the end of 1960s, there were only 13 foreign banks operating in Thailand, each functioning as a single bank branch (compared to 16 Thai banks and their countrywide branch offices). In the mid 1960s foreign banks found another venue of entry as the government began to allow finance and securities companies to operate in its attempt to promote more competition in the financial sector. Many foreign banks formed partnerships with local commercial banks in establishing non-bank financial institutions. The interest of foreign banks in entering the Thai financial market during this period may be viewed as part of the emergence of a global financial system that was underway even before the collapse of the Bretton Woods system.³³ As the internationalization of finance intensified in 1970s, more foreign banks sought to enter into the Thai market. When the authorities suspended the granting of finance company licenses in early 1970s to curb the rapid growth of the non-bank institutions (from 0 in 1966 to 163 in 1972), foreign banks opted to open

³³ Kapstein, *Governing the Global Economy*, pp. 32-37. See also Randall Germain, *The International Organization of Credit: States and Global Finance in the World-Economy*, (Cambridge: Cambridge University Press, 1997). Besides acknowledging the growth of the Eurocurrency markets since 1960s, Germain also argues for the continuity of the Bretton Woods system after the collapse of the gold exchange standard. This is largely due to the idea that existing organization of credit, in which New York served as the financial center, was not significantly affected until much later in the mid 1980s when New York was challenged by Tokyo.

representative offices to establish their presence in the Thai market.³⁴ By 1980, there were 16 representative offices of foreign banks operating in Thailand. They accounted for approximately 24.8 billion baht worth of loans to various institutions in the country, including the government, state enterprises, commercial banks, private corporations, and finance companies.³⁵

The Thai authorities' receptivity to the rapidly growing global financial market reflected their perception of the country's financial needs, the attempt to maintain a balance between protecting domestic financial sector and promoting more competition to increase efficiency, and their ability to maintain financial stability. With regard to Thailand's financial needs, a number of factors contributed to the growing demand for credit by both the public and private sectors. The first oil shock in 1973 placed a large financial burden on the government as it sought to maintain the cost of living through oil subsidies. The decline in US military and economic assistance, particularly after its withdrawal from Indochina in 1975, increased the demand for alternative sources of credit to finance the budget deficit. As the economy expanded, the government also saw the need to invest in large infrastructure projects, such as hydroelectric dams and natural gas processing to accommodate economic growth. State enterprises, particularly those in the energy and transportation sectors, also needed more investment funds to expand their capacity. In terms of the private sector, the slowdown of FDI during the mid 1970s

³⁴ Bank representative offices do not engage in any direct banking business. They may act as a go-between between their principal institutions and Thai customers in arranging for the former's funds to be lent to the latter. The lending can take the form of trade credits for Thai importers and exporters, syndicated loans for the Thai government, or Eurodollar loans for the corporate sector. They could also play a role in helping the Thai government float government bonds in international markets. See more details in Supachai, *Financial Development in Thailand*, chapter 2.

³⁵ Ibid.

increased the demand for bank credit among domestic capitalists.³⁶ A slight shift in government investment promotion policy toward export orientation also provided incentives for industrial groups to invest more in manufacturing production.³⁷ This trend was to gain momentum in the mid 1980s when export orientation moved to the forefront of government industrial policy.

Much of the above demand for public and private credit was met through external borrowing, which began to rise substantially in the mid 1970s. Foreign banks and non-bank institutions played an important role in helping the public and private sectors tap into the global financial markets. For example, the American-based Manufacturers Hanover Trust Company, which held a representative office status since 1968, helped the Thai government take out its first syndicated Eurodollar loan of US\$100 million in 1976. The Export-Import Bank of Japan and the Banque Française de Commerce Extérieur competed to provide export credit combined with soft loans to finance government and state enterprise development projects.³⁸ Representative offices of transnational banks provided part of commercial banks' and finance companies' foreign borrowing (one-third for the former). They also helped Thai firms, particularly large ones, raise investment funds in the Eurocurrency markets. For example, the Toronto Dominion Bank's representative office helped Siam Cement, the largest industrial firm in Thailand, undertake a Euro-syndicated loan in 1979.³⁹ The overall picture of how the availability

³⁶ This was due to a number of factors, including the excess capacity and overproduction associated with import substitution and the rise of nationalist sentiment among the popular movements at the time.

³⁷ Hewison notes that when the BOI began to provide tax incentives and promotional funds for export manufacturers in early 1970s the value of manufactured exports rose sharply from US\$40 million in 1970 to US\$ 270 million in 1973. See Hewison, *Bankers and Bureaucrats*, p. 120.

³⁸ The Electricity Generating Authority of Thailand was the single largest borrower. It was followed by the Highway Department, Telephone Organization of Thailand, and the Petroleum Authority of Thailand. See more detail in Supachai, *Financial Development in Thailand*, p. 135.

³⁹ *Ibid.*, p. 136.

of credit in the global financial market was matched with domestic private and public demand may be seen in the phenomenal increase in external borrowing by commercial banks and the government. The value of private external borrowing rose from 6.8 billion baht in 1973 to 9.2 billion baht in 1976 and to 39.8 billion baht in 1980. For public external borrowing, the number rose from 4.8 billion baht in 1973 to 7.1 billion baht in 1976 and to 29.1 billion in 1980.⁴⁰

Whereas the international availability of and domestic demand for credit had led the government and private sector alike to increasingly rely on external borrowing as a source of credit, monetary authorities, particularly the Bank of Thailand, sought to pursue cautious policies with regard to the openness of the financial sector. Among the key factors influencing the Bank's position in this regard was the structural competitiveness of domestic financial institutions vis-à-vis foreign ones. Even though more efficiency could have been promoted by allowing further entry of foreign banks and non-bank institutions, the Bank was of the opinion that domestic institutions could still be placed at a disadvantage. First, the contemporary interest rate structure, which saw the setting of interest rate ceilings for both deposits and loans, served to limit profit margins for commercial banks when compared to their foreign counterparts. Second, in the 1970s as part of its guided credit allocation, the Bank of Thailand demanded that commercial banks increase lending to the agricultural sector (5 percent increase annually). Such compulsory lending affected the banks' finances as lending to farmers was less profitable and had higher risk of default. Third, transnational banks tended to have a larger capital base, while domestic banks preferred to hold a high leverage ratio, which made them

⁴⁰ Ibid., p. 130.

more vulnerable to financial disturbances. The lack of a secondary market (until 1979) for banks to sell their financial papers for more liquidity also forced banks to borrow more. Aware of these disadvantages, the BOT was rather reluctant to expose Thai banks to too much foreign competition at least until some of the above conditions could be ameliorated.

The Bank's capacity in managing the changing financial landscape brought about by foreign financial institutions and private capital inflows is also an important issue to be considered. As the participation of foreign financial institutions and the inflows of foreign capital had significant implications for the BOT's supervisory and monetary monitoring role, it was deemed important that the Bank have the capacity in terms of resources, authority, and expertise to deal with the changes successfully. These concerns can be seen in the deliberation on the operation of offshore banking in Thailand in the early 1980s. It was seen that among the 'costs' that would accompany the establishment of offshore banking units was the need to expand the Bank's supervisory network to handle offshore banking supervision.⁴¹ The idea of the Bank losing its autonomy in determining and implementing monetary and exchange policy was also raised, as the offshore banking units tended to require special treatment. On top of these concerns, offshore banks would pose a tough competition to domestic banks largely because of their command of sizable capital, making it difficult for smaller domestic banks to thrive. Due to reservations of these sorts on the part of the monetary authorities, the idea of offshore banking did not materialize until 1993 as part of the financial liberalization process.

⁴¹ Ibid., p. 143.

To summarize the development of foreign capital inflows and the receptivity of the Thai authorities toward them from the 1970s to the mid 1980s, one could say that the rapid growth of the global financial markets was an important push factor behind the increase in private capital inflows to Thailand. Foreign banks became increasingly interested in entering into the Thai financial market to diversify their loan portfolio and to earn profits from the interest rate and exchange rate differences. They provided an important means of access to the Eurocurrency markets for the Thai private and public sectors besides the intermediaries by commercial banks. The steady economic growth from the 1960s until interrupted by the second oil shock was an important part of the pull factors. The rising demand in investment credit by both public and private sectors, at a time when foreign financial assistance was in decline and FDI could not step up to the plate, drove these sovereign and corporate borrowers to turn to the overseas money markets as alternative sources of funds.

The Thai authorities' receptivity to private capital inflows through external borrowing can be illustrated to a large extent by the phenomenal increase in external private and public debt during this period. However, they continued to be cautious in opening up the financial sector. Their concerns for the competitiveness of domestic commercial banks, hindered partly by certain structural factors vis-à-vis foreign banks, made the Bank of Thailand reluctant to expose the former to the competition of the latter. However, in its attempt to promote more competition in the financial sector and probably in responding to the push pressures from foreign banks, the Bank continued to allow a limited number of foreign banks to operate in the financial system in different statuses. The Bank's concern for its capacity in handling the changing financial environment

brought about by foreign banks and private capital inflows also played an important role in shaping its cautious response to more innovative and liberal financial activities, such as offshore banking. The issues of supervisory capacity and monetary and exchange policy autonomy were among the main reservations of the Bank concerning the establishment of offshore banking units.

The Mid 1980s to the Early 1990s: the Road to Financial Liberalization

The period between the mid 1980s to the early 1990s saw an even sharper increase in private capital inflows and more enthusiastic receptivity by the Thai authorities. The push factor from the international financial markets intensified during this period as more waves of private capital movements were seen flowing among developed countries and from developed countries to developing countries. Foreign direct investment and international portfolio investment started to claim a significant share of the composition of capital inflows as international bank lending was stunted temporarily by the debt crisis in the early 1980s. Between 1987 and 1993, foreign direct investment originated from a number of countries, most importantly Japan (45 percent), followed by Hong Kong and Taiwan (11 percent), and the United States (10.7 percent).⁴² The net flow of FDI rose from the average of 6 billion baht annually in the first half of 1980s to 28 billion baht in 1988, 45.7 billion baht in 1989, and 64.7 billion baht in 1990. The Plaza Accord in 1985, which resulted in an appreciation of the yen against the US dollar, played an important role in influencing Japanese firms to relocate their operations overseas, where labor and other costs were lower, in order to increase their international

⁴² Bandid Nijathaworn and Thanisorn Dejthamrong, "Capital Flows, Exchange Rate and Monetary Policy: Thailand's Recent Experience", in *Papers on Policy Analysis and Assessment*, (Bangkok: Bank of Thailand, 1994), pp. 1-15.

competitiveness. The need to 'escape the influence of the yen' drove these firms to establish subsidiaries or joint ventures abroad in large number (from around 800 a year from 1978 to 1984 to 1,023 in 1986 and 1,419 in 1987).⁴³ Thailand, like other ASEAN countries, was among the preferred destinations for these firms due to its proximity, past business connections, low labor costs, market openness and relative macroeconomic and political stability. The net flow of Japanese FDI to Thailand rose from around 3 billion baht in 1986 to 27.9 billion baht in 1990. Most of these firms were engaged in export production.⁴⁴

The international diversification of investment portfolio by institutional investors in developed countries such as insurance companies, pension and retirement funds, and mutual funds was responsible for the increase in portfolio investment in 'emerging' markets.⁴⁵ The flows of portfolio investment to developing countries began to pick up in the late 1980s and continued strongly into the early 1990s (from almost zero in 1987 to US\$ 13.2 billion in 1993) due a combination of factors, including a decline in global interest rates, improved domestic policies and growth performance of recipient countries, and the removal of barriers in both developed and developing countries on foreign participation in developing countries' stock markets.⁴⁶

⁴³ Pasuk, *The New Wave of Japanese Investment in ASEAN*, p. 48.

⁴⁴ Pasuk and Baker, *Thailand: Economy and Society*, p. 156

⁴⁵ Rachel McCulloch and Peter A. Petri, "Equity Financing of East Asian Development," in *Capital Flows and Financial Crises*, ed. Miles Kahler (Manchester: Manchester University Press, 1998). See also Linda L. Tesar and Ingrid M. Werner, "U.S. Equity Investment in Emerging Stock Markets," *World Bank Economic Review* 9, no. 1 (1995): 109-129. According to Tesar and Werner, developing countries as a group increase their equity borrowing from almost zero in 1987 to US\$ 5 billion in 1991.

⁴⁶ Barry Eichengreen and Albert Fishlow, "Contending with Capital Flows: What is Different about the 1990s," in *Capital Flows and Finance Crises*, ed. Miles Kahler (Manchester: Manchester University Press, 1998), p. 47. See also Stijn Claessens, "The Emergence of Equity Investment in Developing Countries: Overview," *World Bank Economic Review* 9, no. 1 (1995): 10-17.

In Thailand, the rise of portfolio investment from foreign investors can be detected after 1987. Unlike foreign direct investment, portfolio investment fluctuated more dramatically, reflecting the sensitivity of portfolio investors to various investment environments and the perhaps unavoidable speculative dynamics of such investment. For example, the portfolio balance registered a surge in 1989 to US\$ 1,429 million from US\$ 447 million in 1988, then it dropped to US\$ 457 million in 1990 and US\$ 163 million in 1991.⁴⁷ Despite the relatively small amount of portfolio investment compared to FDI, the interest of foreign investors in the Thai stock exchange was strong following the market opening operation in the mid 1970s, revealing another significant source of external financing for the Thai corporate sector.

Even though international bank lending witnessed a decline as a result of the debt crisis centered in Latin America, it remained a major source of credit for Thai commercial banks and finance companies. The lending networks established in the previous period continued to provide domestic banks and non-bank financial institutions access to international credit. What changed more were the pressures from foreign financial institutions to enter the Thai market. It seemed that the desire to enter intensified during this period as the opportunities to finance FDI, especially for their national companies, and to intermediate other kinds of investment financing, grew significantly. It was reported that between 1984 and 1986 foreign banks submitted more than 20 applications to acquire licenses for branch opening.⁴⁸ The US government also put pressure on the Thai authorities to open up the financial sector to US firms by threatening to revoke the privileges granted under the Generalized Systems of

⁴⁷ Bank of Thailand, *Annual Reports*, several volumes.

⁴⁸ Zhang Xiaoke, *The Changing Politics of Finance in Korea and Thailand: From Deregulation to Debacle*, (London: Routledge, 2003), p. 123.

Preferences (GSP).⁴⁹ At the multilateral level, multilateral agencies such as the General Agreement on Tariffs and Trade (GATT), the Bank for International Settlement (BIS), and the World Bank were other sources of pressure urging the Thai government to open up the Thai financial sector. In an interview with BOT officials in Fall 2003, the author was told that the pressures to open up the Thai financial sector were extended unofficially at the meetings at the BIS, as delegation from developed countries continued to ask BOT officials when Thailand would deregulate its financial sectors.

As many have witnessed, the Thai authorities began to launch the process of financial liberalization in 1989, partly as an attempt to take advantage of the increasing linkages in the international financial system and the opportunities that such linkages had to offer.⁵⁰ But why did the government choose to respond to the trend of globalized finance by adopting such a comprehensive process of financial liberalization, unlike their actions in the past? To answer the question, one needs to take into account the contemporary economic and political contexts and how the authorities weighed both their and the private sector's capacity to manage the changes against the benefits to be received from the process. At this time, the Thai economy had been growing rapidly as a result of the industrial reorientation toward export promotion (even though the process took place in the early 1980s, it never gained momentum until the mid 1980s). (See Table 6.1)

⁴⁹ Ibid.

⁵⁰ Bank of Thailand, *50 Years*, p. 321. The Bank refers to the linkages between globalization, financial institutions, international money markets, and capital markets, and the need to achieve optimal use of resources.

Table 6.1

Economic Indicators 1985-1991

Year	GDP Growth (%)	Inflation (%)	Export Growth (%)	Capital Movement (Billion USD)	Exchange Rate (Baht per 1 USD)
1985	3.5	2.4	10.5	51.4	27.16
1986	4.9	1.9	20.8	11.4	26.3
1987	9.5	2.5	28.8	21.6	25.73
1988	13.2	3.8	33.9	72.7	25.29
1989	12.2	5.4	27.7	152.2	25.7
1990	11.6	6	14.4	206.9	25.59
1991	8.8	5.7	23.5	288.2	25.52

Source: Bank of Thailand

Macroeconomic stability was finally achieved after the painful process of structural adjustment to get rid of fiscal deficits. Exchange rate policy also went through an important adjustment in 1984 when a major devaluation (14.8 percent) was made to put the baht more in tune with the country's international payment position. As discussed in the last chapter, the currency was stabilized as a result and this contributed greatly to the rapid export growth.

Encouraged by these favorable economic contexts, the authorities viewed the developments in the international financial system as a great financial opportunity for developing countries like Thailand to tap into the vast pool of international capital and credit to compensate for the investment-savings gap. The opening up of the financial sector to foreign competition would also improve the efficiency of credit allocation, which was much needed in a mature economy. Financial liberalization would serve as a tool and a pull factor to attract private capital inflows and foreign participation in the financial sector. The authorities could expect that a booming economy should have been able to absorb the adjustment impacts much better than one in economic recession. (See Tables 6.2 and 6.3)

The authorities must have also taken into consideration their capacity as well as the private sector's capacity to cope with the impact of a liberalized financial system. With regard to state capacity, the increase in authority, operational autonomy, and the availability of financial tools might have enhanced financial authorities, particularly the Bank of Thailand's confidence of their ability to manage the financial system. As chapter 5 discusses, the finance company and bank crises in the late 1970s and early

Table 6.2**Foreign Direct Invest Flows in ASEAN 5**

(US\$ Million)

Country	1980	1985	1990
Indonesia	N/A	310	1,093
Malaysia	933.9	694.7	2,332.4
Philippines	N/A	12	530
Singapore	1,235.7	1,046.7	5,574.7
Thailand	189.8	163.2	2,443.5

Source: Nick J. Freeman and Frank L. Bartels, eds., *The Future of Foreign Investment in Southeast Asia*, (London: Routledge, 2004), Table 1.2.

Table 6.3**Regional Foreign Direct Investment Flows Compared**

(US\$ Million)

Region	1980	1985	1990
World	52,197	55,526	202,193
Industrialized Countries	46,479	41,694	172,239
South and East Asia	2,480	4,387	15,984
Southeast Asia	2,253	2,226	12,141

Source: Ibid.

1980s led to a series of changes in the regulation and supervision of financial institutions. The financial authorities, i.e. the Ministry of Finance and the Bank of Thailand, were given more supervisory power through the amendments and passages of laws governing commercial banks and non-bank financial institutions.⁵¹ For example, the 1979 amendment of the Commercial Banking Act gave more power to BOT inspectors to act promptly and authoritatively with regard to the investigation or prosecution of any unauthorized operations. In 1985, another amendment granted the BOT more independence in its supervisory role over commercial banks from the Ministry of Finance, particularly in terms of the maintaining of prudential requirements.⁵² In this regard, the Bank had been imposing conservative prudential regulations to the complaints of financial institutions. Before 1993, the level of capital/risk assets ratio was set at 8 percent, which was higher than the newly adopted 7 percent based on the BIS guideline. Another development, which enhanced the Bank's capacity, was the establishment of the Financial Institutions Development Fund (FIDF) in 1985 to help the BOT extend financial assistance to financial institutions in distress. Through the FIDF, the BOT was able to act as lender of last resort to illiquid or insolvent financial institutions in order to prevent systemic collapse in spite of certain legal limitations prohibiting the Bank to engage in such a task directly.⁵³ The FIDF was designed to help rehabilitate ailing

⁵¹ The Commercial Banking Act of 1962 was amended in 1979, 1985, and 1992. It was to be amended again in 1997 to facilitate mergers among financial institutions, relax foreign ownership prohibitions, and allow for the immediate removal of management at distressed banks by the BOT. As for non-bank financial institutions, the Act on the Undertaking of finance Business, Securities Business and credit Foncier Business was passed in 1979 to regulate their activities.

⁵² Section 22 of the amended Commercial Banking Act of 1962 stipulates that the Bank of Thailand is empowered to require commercial banks with unauthorized or unscrupulous conducts (listed in the law) to rectify or cease their actions without having to consult with the Ministry of Finance first. See more detail in the Commercial Banking Act of 1962.

⁵³ For example, in certain circumstances, it was necessary for financial assistance to take the form of shareholding. However, the BOT was not allowed by law to hold any share in any financial institutions.

financial institutions and to provide a guarantee for depositors in order to preserve confidence in the financial system. The Bank's satisfaction in the stability of the financial system may be seen in the following. Reflecting upon its successful approaches to crisis management during the late 1970s and 1980s, which gave rise to many of the changes mentioned above, the Bank was of the view that ".....all major problems concerning financial institutions have now been resolved. Today, financial institutions as a whole are more secure and ready to support the country's economic growth and prosperity."⁵⁴

The authorities' perception of the private sector's capacity to cope with the changes brought about by financial liberalization, particularly increased competition, also played a role in shaping their confidence in launching the process. In the non-financial sector, domestic industrial groups, benefiting from government protection under the import-substitution regime, had grown to dominate the manufacturing sector despite the existence of foreign competition. In the mid 1980s, they sought to readjust themselves toward export orientation and entered into joint ventures with foreign firms to take advantage of technological and managerial transfers. Their control of domestic market and local connections allowed them to demand a more equitable investment package, which saw better access to technology without completely losing equity control.⁵⁵

Despite the surge in FDI, domestic capital continued to dominate the manufacturing sector. The emerging capital market after its slow start in 1975 served as a new source of

The Bank was also allowed to lend to financial institutions against certain kinds of collateral stipulated by law. See more detail in Bank of Thailand, *Neung Totsawat Korngthoon peua Karn-feunfoo lae Pattana Rabob Sathaban Karn-ngern*, (Ten Years of the Financial Institutions Development Funds), (Bangkok: Bank of Thailand, 1995), p. 36.

⁵⁴ Bank of Thailand, *50 Years*, p. 295.

⁵⁵ Pasuk, *New Wave of Japanese Investment in ASEAN*, p. 93.

investment capital in addition to the existing networks of commercial banks and finance companies, which were the main suppliers of capital and credit to the real sector. The fact that foreign investment only financed around 10 percent (compared to one-third during the late 1960s to early 1970s) of manufactured export growth showed the firm grasp of domestic capital in the sector.⁵⁶

For the financial sector, by the mid 1980s, domestic commercial banks had also developed firm control of local markets through their countrywide branch networks. Benefiting from the limited competition in the relatively closed financial sector, domestic banks grew rapidly. Their share of total financial system assets rose from 40.1 percent in 1980 to 47.3 and 47.7 percent in 1985 and 1988.⁵⁷ In 1987, the Bank of Thailand began to allow commercial banks to expand the scope of their business to engage in loan syndication, feasibility studies (for investment projects), advisory service regarding mergers and acquisitions, custodial services, and intermediation between insurance companies and bank borrowers.⁵⁸ These fee-based businesses helped banks compensate for declining interest-based income, making them more competitive against foreign banks. The Thai banks' growing overseas operations, particularly those of the larger banks, also became important sources of earnings. There were also signs of a transition from family-based to more professional banking as more professional staff was appointed to top managerial positions.⁵⁹ Interestingly, the authorities continued to be very cautious on the issue of foreign bank entry. Despite some inclination on the part of the government to

⁵⁶ Doner and Unger, "Thai Economic Development", p. 114.

⁵⁷ Ibid., p. 107.

⁵⁸ See Bank of Thailand, *50 Years*, p. 315 for changes in the late 1980s. See also Pakorn Vichyanond, *Financial Reforms in Thailand*, (Bangkok: Thailand Development Research Institute, 2000), Annex 1.

⁵⁹ The new breed of bank top managers included Boonchoo Rojanasatian, Umuay Veerawan, Kosit Punpiemrat, and Supachai Panichapak.

welcome more foreign participation at the end of 1980s, foreign entry deregulation did not materialize until the mid 1990s. More discussion about this issue is presented below. Here it may be concluded that the relative strength of domestic firms in both the real and financial sectors seemed to assure the authorities of the private sector's ability to somehow withstand foreign competition (with some assistance from the authorities) while having much to gain from an opened financial system.

The Political Impetus for Financial Liberalization

The previous section argued that the domestic and external economic and financial contexts of the mid to late 1980s played an important role in shaping the perception of the Thai authorities with regard to policy responses to the economic and financial developments at hand. The need to develop the financial system to facilitate long-term economic growth and to reap the benefits offered by the growth of the global financial markets seemed to be central to the authorities' decision to launch the process of financial liberalization. However, a look at the interactions among different actors involved provides a fuller picture of the various political dynamics, that in non-uniform ways not only gave support to liberalization process but also shaped how the process was implemented.

Intervention from the Ministry of Finance at the end of the 1980s, when Pramual Sabhavasul became the finance minister, was a major source of contention in the direction and timing of financial liberalization. Influenced by the economic growth and Thailand's rising business potential in Indochina as Vietnam and Laos started to open their economies, Pramual was among the strong supporters of financial deregulation. His

enthusiasm to transform Thailand into a regional financial center was encouraged by the cabinet's assertive role in economic policy planning, causing key economic agencies to be pushed to the sideline.⁶⁰ With a background in the industrial sector, Pramual sought to liberalize interest rates, particularly for long-term time deposits, and the banking sector to promote cheaper and more accessible investment funds for industrialists. His policy inclination reflected an aspect of the relationship between the financial and industrial groups that saw the attempt of the latter to break down the oligopolistic control of the former. Once in power in 1988, Pramual did not hesitate to launch his financial deregulation policy despite opposition from the Bank of Thailand and commercial bank community.⁶¹ The interest rate ceiling on term deposits over one-year maturity was first lifted in June 1989 to encourage more long-term saving, while he opposed the Bank's proposal to raise the ceiling on lending rates to avoid inflation. The Thai Bankers Association responded with a cartel-like coordinated increase in long-term deposit rates to minimize interest competition and declining interest margins.⁶² It was not until Pramual was removed from office in 1990 that the lending rate ceiling was lifted by the BOT to contain inflation.

Another point of policy divergence was on foreign bank entry. In contrast to the lukewarm position of the Bank of Thailand toward opening up the financial sector, Pramual sought more foreign participation. Unlike his interest rate policy, the move to admit more foreign financial institutions was met with larger opposition, including from

⁶⁰ The Chatichai administration came to power in 1988 when Prem decided to end his semi-authoritarian rule by not leading the next coalition government. As the leader of the Chart Thai Party, which won the majority of the seats, Chatichai Choonhawan became the first elected Prime Minister since 1976.

⁶¹ For the BOT, it was feared that, with the tight monetary situation at the time, the lifting of the interest rate ceiling of long-term deposits would lead to a competitive increase of deposit rates, which would leave small banks at a disadvantage. The BOT governor was removed due to the policy disagreement on interest rate policy. See more details in Zhang, *Changing Politics of Finance in Korea and Thailand*, p. 121.

⁶² Ibid.

the Bank of Thailand, the Thai Bankers Association, the Federation of Bank and Financial Workers Union of Thailand, and leading academics.⁶³ Due to the scale of public opposition, the cabinet decided to drop the issue in early 1990.

Policy conflicts with the Ministry of Finance were an important factor convincing the Bank of Thailand to try to maintain control over the process of financial liberalization. The Bank attempted to do in a series of liberalization measures announced within a short period of time after Chavalit Thanachanan (Mar. 1990 to Sep. 1990) replaced Kamchorn Sathirakul (Sep. 1984 to Mar. 1990) as Bank Governor. The latter was removed by Pramual due to their disagreement on the issue of raising the lending rate ceiling. The Bank's rush to push through a financial liberalization policy package was well captured by Zhang. He writes:

In the first 10 days after his appointment, Chavalit pushed through the long-delayed plan to raise the ceiling on lending rates and floated the interest rates for most deposit accounts. After 1 month in office, he and his associates initiated sweeping changes in Thailand's foreign exchange regime and elevated its position to Article 8 of the IMF charter; a classification for developed economies that lifted foreign exchange restrictions on current transactions. Three months later, the governor mobilised top BOT brains to put forward a comprehensive programme for liberalisation and development of the financial system.⁶⁴

When Chavalit retired after six months in office, Vijit Supinit succeeded him and was able to oversee the completion of the three-year liberalization process in 1992.

A number of factors contributed to the Bank's ability to maintain a leading role in designing the process of liberalization after 1990. First, when Chavalit took office, Pramual was already under tremendous pressure from the financial community due to his positions on interest rate and foreign bank entry policies and his conflicts with the BOT. Moreover, accusations of his receiving huge payoffs from foreign banks made him and

⁶³ Ibid., p. 184.

⁶⁴ Ibid., p. 115.

the Chatichai cabinet susceptible to opposition attack.⁶⁵ Even though he was able to remove Kamchorn from office, with mounting criticism against him he could not afford to pick another fight with the BOT.⁶⁶

Second, the Bank was able to use the pressure of the international financial community, particularly the IMF, to convince the government to agree to exchange control deregulation, which was one of the key elements of financial liberalization. After the encouragement on the part of the IMF for the past decade, the Bank viewed it as an opportune time to officially accept the obligation to make the baht fully convertible. The official acceptance of the IMF Article VIII took place two months before the Joint Annual Meeting of the World Bank and the IMF, which was to be held in Bangkok that year (1990). The choice of Thailand as the venue of that year's meeting largely reflected the recognition of the international financial community of the country's recent economic accomplishments. By announcing the acceptance of Article VIII and the launching of a comprehensive financial liberalization program at the meeting, the government intended to send a message that Thailand was on its way toward a more liberalized and advanced economy and was an even more attractive place for foreign investors.⁶⁷

Third, the political situation in 1991-1992, which saw the unexpected return of the military to politics, brought economic bureaucrats back to the center of economic planning.⁶⁸ The military-appointed interim governments, led by Anand Punyarachun, a former diplomat-turn-businessman, gave endorsement to various political and economic

⁶⁵ *Bangkok Post*, March 16, 1990.

⁶⁶ As reported in the *Bangkok Post*, March 16, 1990, Pramual's softened position toward the raising of lending rate ceiling may be seen in his leaving the matter under the advisement of the newly appointed BOT Governor, despite his previous opposition to the issue.

⁶⁷ Interview with a Bank senior official, Bangkok, Fall 2002.

⁶⁸ The pretext of the coup was reportedly the rampant corruption committed by the Chatichai government. However, a casual political observer would rather say that the Chatichai government's attempt to challenge the power of the military was a more important cause for the coup.

reforms, including those of the financial sector. The acceleration of financial deregulation can once again be seen in the passing of 20 bills into laws on the recommendation of the Bank of Thailand within a period of 13 months.⁶⁹

Fourth, also very important to the Bank's ability to pursue and maintain control of the process of financial liberalization was the coalition of interests and political consensus built around it and the general trust in the capacity of the BOT to carry it out. The fact that financial liberalization offered a host of benefits to a lot of people explained the loose coalition of interest formed around the issue and the political consensus among policymakers. Despite skepticism about their readiness for the opening up of the financial system and their capacity to handle more sophisticated financial operations, the banking community believed in the handsome financial gains to be made and trusted that the Bank of Thailand would always come to their rescue.⁷⁰ Industrial groups saw the opportunity to gain better access to foreign credit without being dependent on commercial banks and finance companies. Small financial institutions and small business owners expected to benefit from more accessible and cheaper credit as more competition was introduced. Having been dominated by larger banks and big businesses respectively, these small-time banks and other business owners hoped that financial liberalization would compensate for their disadvantage when it came to credit mobilization.

Policymakers also saw a lot of opportunities to satisfy personal, party, sectoral, and national interests offered by financial liberalization. Policy conflicts with regard to the issue were on the timing and nature of liberalization rather than disagreement on the

⁶⁹ Doner and Unger, "Thai Economic Development", p. 121.

⁷⁰ Interview with bankers, Fall 2002. The author was informed in a number of interviews that many banks did not feel ready for more competition in the financial sector. One banker admitted that some of the new financial products such as derivatives were difficult to understand.

merits of the policy. The close connection between business groups and government officials made sure that policies benefiting the business community like financial liberalization received close attention from the authorities. As for the Bank of Thailand, its relationship with the international financial institutions, particularly the IMF, the World Bank, and the BIS, brought the BOT into the financial ‘epistemic community’, within which financial liberalization had gained not only technical but political endorsement. Last but not least, public confidence in the Bank of Thailand in leading the economy toward the path of financial liberalization cannot be underestimated as a source of political support. The Bank’s technical expertise, moral authority, and political neutrality witnessed in its past institutional history inspired a great deal of trust among the public in its intentions to lead the country toward financial modernization and its ability to always guarantee financial and macroeconomic stability. Unfortunately, as it turned out, the Bank failed to do so in 1997. The rest of the chapter seeks to explain the constraints on the Bank’s ability to preserve financial and monetary stability.

Approaches to Understanding the Financial Crisis of 1997

Before moving on to discuss the failure of the BOT to maintain monetary and financial stability as a way to understand the 1997 crisis, it is necessary to examine briefly the various approaches to the crisis in the existing literature in order to identify this thesis’s main arguments with certain groups of works and to highlight its contribution to this literature. The task of grouping the numerous contending explanations of the Asian crisis of 1997 is not an easy one but not because they are too diverse or dissimilar. The fact that these works share many common grounds, such as an

emphasis on the institutional weaknesses of the affected countries, government-business connections, and the danger of the free capital movement, they yet disagree on the deciding factors and policy recommendations for the crisis, reflects the politics which underpin the financial liberalization discourse. Nevertheless, this thesis borrows from Wade his categorization of proponents and critics of financial liberalization as a rough dividing criterion because it can incorporate both scholarly and professional views from broad disciplines and ideological orientations.⁷¹

The first group, the proponents of financial liberalization, consists largely of neo-classical accounts, including those made within the institutional financial institutions like the IMF, World Bank, and the Asian Development Bank, and the US government. As supporters of free markets, they tend to be uncritical toward the potential dangers underlying financial liberalization, while laying blame on excessive government intervention, collusion between government and big businesses and other market distorting measures in the affected economies as the main causes of the crisis, leading to the 'crony capitalism' labeling.⁷² The financial and political power of these actors

⁷¹ See Robert Wade, "The Asian Debt-and-Development Crisis of 1997-199-?: Causes and Consequences", *World Development*, 26, No. 8 (1998): 1535-1553. See also reviews of financial crisis literature in Garry Rodan, Kevin Hewison, and Richard Robison, (eds.), *The Political Economy of South-East Asia: Conflicts, Crises, and Change*, (Oxford: Oxford University Press, 2001), chapter 1. Also in Stephan Haggard, *The Political Economy of the Asian Financial Crisis*, (Washington, D.C.: Institute for International Economics, 2000), Introduction.

⁷² See, for example, Alan Greenspan, Statement before the Committee on Banking and Financial Services, January 30, 1998. U.S. House of Representatives. Available at <http://www.federalreserve.gov/boarddocs/testimony/1998/19980130.htm>. Without criticizing certain practices in the global financial system that contributed to financial instability in affected countries, Greenspan outlines a list of domestic factors responsible for the crisis, including unprofitable industries, distortion in government planning, the pegged exchange rate regimes, corporate sector's high leverage (debt-equity-ratio), and weak banking and financial systems. For samples of media coverage that adopted the crony-capital labeling, see *The Globe and Mail*, November 26, 1997, and *The New York Times*, Dec.7, 1997. The labeling was ironic because about less than a decade ago, these crony economies were praised as models of high growth by the institutional financial institutions themselves. See for example World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, (New York: Oxford University Press, 1993).

allowed their view to dominate in policy debates, seen clearly in the nature of loan conditionalities imposed on countries like Thailand and Indonesia that sought IMF financial assistance. Even though many of these supporters, such as Joseph Stiglitz and a number of World Bank officers, became more cautious about financial liberalization and IMF treatment of the crisis at a later time, official support for the process remains, while recommendations on proper deregulation sequencing and adoption of international banking standards were offered to developing governments to minimize the now accepted dangers associated with an open financial market.⁷³

The other group, the critics of financial liberalization, incorporates a diverse group of analysts. Besides voicing skepticism of free capital movement and the loosely regulated financial system generally, many of them pay close attention to the institutional aspects of the problems that led to the crisis. Some refer to the competing models of capitalism and the incompatibility between the Asian model and financial liberalization,⁷⁴ while some focus on the weakened state capacity in directing private investment and maintaining national competitiveness⁷⁵. Other scholars point to the flaws in the political and social structure, seen in the patronage relationship between government and big business and the moral hazard that resulted from such relationship.⁷⁶ A number of analysts look 'outward' for explanations. Sachs and Woo, Redelet, and Wade attribute

⁷³ See World Bank, *World Development Report 1999/2000*, (Oxford: Oxford University Press, 1999), chapter 3.

⁷⁴ Wade, "Asian Debt-and-Development Crisis."

⁷⁵ See Linda Weiss, "State Power and the Asian Crisis," *New Political Economy*, Vol. 4, No. 3, 1999; Linda Weiss, "Developmental States in Transition: Adapting, Dismantling, Innovating, not 'Normalizing'", *The Pacific Review*, Vol. 13, No. 1, 2000; and Linda Weiss and J. M. Hobson, "State Power and Economic Strength Revisited: What's so special about the Asian crisis?," in *Politics and Markets in the Wake of the Asian Crisis*, eds. R. Robinson, M. Beeson, K. Jayasuriya, and H. Kim, (London: Routledge, 2000).

⁷⁶ See Paul Hutchcroft, "Neither Dynamo nor Domino: Reforms and Crises in the Philippine Political Economy," in T. J. Pempel (ed.), *The Politics of the Asian Economic Crisis*, (Ithaca: Cornell University Press, 1999); Stephan Haggard, *Political Economy of the Asian Financial Crisis*; and Pasuk Phongpaichit and Chris Baker, *Thailand's Boom and Bust*, (Bangkok: Silkworm Book, 1998).

the crisis to creditor panic, criticizing the less scrutinized role of foreign investors in creating a self-fulfilling run based on their belief that a run will indeed happen.⁷⁷ Pempel and his collaborators bring our attention to international and regional factors that set the stage for the crisis, such as the size and speed of foreign capital in the late 1980s and 1990s and the greater interconnectedness of the Southeast Asian economies seen in the widespread networks of Japanese FDI.⁷⁸ Many others including IPE scholars like Strange, Pauly, and Eichengreen, emphasize the enduring structural power of the international financial system that perpetuates creditor-debtor power asymmetry, while calling for a reform of the international financial architecture to prevent a repeat of a financial disaster of this magnitude.⁷⁹

Being aware of both the flaws in the Thai financial system and the systemic risks underlying certain international financial practices, the thesis identifies itself with the works in the latter group and seeks to make a contribution to this body of knowledge. While agreeing mostly with the critics' arguments, particularly the weaknesses in the financial system, the moral hazard caused by government-business relations, and the structural power of the international financial system, it attempts to account for the crisis by focusing not only on the 'contexts' but also on the 'mechanisms' which led to an institutional breakdown in Thailand's monetary and financial regimes. Of course, most existing works do not fail to mention the Thai government's commitment to the fixed

⁷⁷ See Sachs and Woo, "Understanding the Asian Financial Crisis", in Wing Thye Woo, Jeffrey D. Sachs, and Klaus Schwab (eds.), *The Asian Financial Crisis: Lessons for a Resilient Asia*, The MIT Press, Cambridge, 2000; Steven Redeleit and Jeffrey Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," *Brooking Papers on Economic Activity*, 1998, and Wade, *Asian Debt-and-Development Crisis*.

⁷⁸ Pempel, *Politics of the Asian Economic Crisis*.

⁷⁹ See Susan Strange, *Mad Money*, (Ann Arbor: Michigan University Press, 1998); Louis Pauly, *Who Elected Bankers: Surveillance and Control in the World Money*, (Ithaca: Cornell University Press, 1997); and Barry Eichengreen, *Toward a New International Financial Architecture: a Practical Post-Asia Agenda*, (Washington, D.C.: Institute for International Economics, 1999).

exchange rate policy and its futile role in defending the baht or the authorities' inability to contain the loss of investor confidence in the financial sector precipitated by banking scandals and mismanagement as the main catalysts for the crisis outbreak. However, the author found that these explanations were insufficient to answer why the monetary authorities, particularly the BOT, failed to adopt more effective policy measures to cope with the problems, especially when history shows that they were quite capable of doing so. For many, political interference seems to be an obvious answer as there was evidence of government intervention in the Bank's affairs, including its handling of insolvent financial institutions.⁸⁰ But lack of independence does not give us the whole story as we can see that the Bank maintained its autonomy in managing the exchange rate right until the end.

To be able to comprehend the circumstances more fully, it is necessary not only to place the issue of central bank independence at the center of the analysis, but also to examine the issue in different policy areas and with regard to different actors, namely the government, financial sector, and international financial community. Moreover, there is a need to go beyond the 'snap shot' understanding of the crisis toward a longer view of Thailand's monetary and financial history. In this perspective, the crisis can be understood in the context of institutional continuity, change, and breakdown of the monetary and financial regime.

Below the thesis offers an explanation of the 1997 crisis that incorporates the above concerns. The main arguments are first that the changing financial context brought about by the process of financial liberalization in the late 1980s and early 1990s and the

⁸⁰ See Pasuk and Baker, *Thailand's Boom and Bust*, and Nukul Commission Report.

political environment of democratization presented destabilizing effects to the maintenance of financial and monetary stability, especially when the monetary authorities sacrificed their control of capital movement. Second, the Bank's concurrently changing organizational context, which saw increased internal rivalry and politicization, and declining moral authority and technical expertise, added to the instability by adversely affecting the agency's credibility and its capacity to adopt effective strategies to achieve policy objectives. Third, central to the mechanisms leading to the crisis was the issue of BOT autonomy from the government, financial sector and international financial community, which largely determined the Bank's varied capacity in different policy areas. The irony is that while the Bank maintained its autonomy in managing the exchange rate regime, its preoccupation with upholding international credibility and investor confidence was among the main obstacles to the abandonment of the fixed exchange rate system. Fourth, the path dependence of how the BOT sought to preserve monetary and financial stability in the past, particularly the maintenance of a stable currency through a fixed exchange rate regime and the provision of financial bailouts to prevent panic runs, helps explain the persisting choices of the Bank's policy measures on the eve of the crisis. These arguments will be elaborated in the following sections, which examine the two major components of the Thai crisis, namely the financial sector and currency crisis.

Financial Liberalization and the Crisis in the Financial Sector

While proponents of financial liberalization largely focus on the weakness of the banking and financial systems of affected countries as a major cause of the crisis, they tend to pay less attention to the danger inherent in certain international financial practices

and the impact of global financial integration on the ability of developing country governments to maintain financial stability and monetary autonomy.⁸¹ In fact, studies on the effects of capital inflows on developing countries show that surges in capital inflows tend to distort domestic prices, put an upward pressure on the currency, and increase the vulnerability of the financial sector, especially when the financial flows are short-term and volatile.⁸² In the Thai case, these problems were amplified by the existing structural weakness of the financial sector, the context of democratization, and the Bank's deteriorating organizational cohesiveness. This section outlines how the financial sector's vulnerability was heightened as a result of the financial liberalization process and how the Bank of Thailand failed to deal with such vulnerability effectively. One of the main emphases will be on the decline in the Bank's operational autonomy and its capacity to employ appropriate strategies to achieve its objective as in the past. But before doing so, we need to look at what kind of changes were brought about by the process of financial liberalization.

The Changing Face of the Liberalized Financial Landscape

Financial liberalization measures introduced in the late 1980s and early 1990s were most pertinent to the operation of the financial sector. The deregulation of interest

⁸¹ For example of this line of analysis, see Pedro Alba, Leonardo Hernandez, and Daniela Klingebiel, "Financial Liberalization and Capital Account: Thailand 1988-1997," *Policy Research Working Paper* 2188, The World Bank, Washington, D.C., 1999; and Alan Greenspan, Statement before the Committee on Banking and Financial Services, January 30, 1998, U.S. House of Representatives, *Federal Reserve Bulletin* 84, no. 3 (1998): 186.

⁸² Carmen M. Reinhart and Vincent Raymond Reinhart, "Some lessons for Policy Makers Who Deal with the Mixed Blessing of Capital Flows," in *Capital Flows and Financial Crises*, ed., Myles Kahler, (Manchester: Manchester University Press, 1998), pp. 93-94. See also Peter J. Montiel, "Managing Economic Policy in the Face of Large Capital Inflows: What Have We Learned?" in *Private Capital Flows to Emerging Markets after the Mexican Crisis*, eds. G. Galvo, M. Goldstein, and E. Hochreiter, (Washington, D.C.: Institute for International Economics, 1996).

rates and financial institutions' portfolio management, relaxation of exchange controls, development of supervision and examination system, development of financial instruments, and improvement of the payment system were among the key features of the liberalization policy package. The Bank of Thailand's sequencing preference was to begin with the issue-areas that were more liberally-inclined than others, such as exchange control and interest rate policies, before moving on to more sensitive issues like foreign bank participation.⁸³ And while some deregulation measures were predetermined, some were launched to compensate for the negative effects produced by previous measures or the unexpected domestic or external contexts. Even though the Bank stressed taking a gradualist approach in pursuing financial deregulation, the magnitude of new measures being launched from 1989 to 1997 presented a momentous change to the Thai financial landscape. A brief look at certain important transformations follows.⁸⁴

With regard to exchange control liberalization, by 1992 foreign exchange markets were liberalized, allowing the public to freely purchase and sell foreign exchange and hold foreign currency accounts. More importantly, nonresidents were allowed to hold Thai baht accounts to facilitate their trade and investment transactions. Also, since 1990 controls on capital account transactions have been lifted to encourage capital transfer from foreign direct investment, except for a few restrictions on capital outflows (acquisition of overseas real estate and stock). An important development was the establishment of the Bangkok International Banking Facilities (BIBF) in 1993 to facilitate international banking and investment services through the intermediaries of

⁸³ Bank of Thailand, *50 Years*, p.332.

⁸⁴ For more detailed information on financial liberalization measures, see Bank of Thailand, *50 Years*, chapters 24-25, and Bank of Thailand, *60 Years of the Bank of Thailand*, (Bangkok: Bank of Thailand, 2002), chapter 1.

licensed institutions.⁸⁵ To promote Thailand as a regional financial center, BIBF aimed primarily to provide financial intermediaries to nonresidents with foreign currency and baht accounts for transactions outside Thailand (out-out transactions). However, what became more popular were its banking and investment services to domestic residents in foreign currency accounts (out-in transactions). Through such services a huge amount of foreign credit was channeled into the Thai economy. In 1995 after two years in operation, international borrowing through BIBF accounted for more than 50 percent of total private capital inflows to Thailand (518.3 billion baht).⁸⁶

Interest rate and other banking (de)-regulations can be considered concurrently. By 1992, interest rate ceilings for all types of deposits and loans were removed, leaving the interest rate structure governed by domestic and external market forces. To help banks adjust to a more competitive environment, the Bank sought to relax a number of constraints on banks' portfolio management and widen their scope of operations. The rural credit policy, which was the remnant of the Bank's interventionist role in credit allocation, was modified to cover a wider scope of activities to give commercial banks greater flexibility. The mandatory requirement for banks to hold government bonds upon opening a new bank branch was reduced several times before being removed in 1993. Banks were allowed to substitute other securities for government securities in meeting the liquidity ratio requirement (7 percent of deposits). They were also permitted to take up a wider scope of operations, ranging from loan syndication, financial counseling service, information service, to securities underwriting and distribution, and trade in debt

⁸⁵ As of the end of 1996, the licensed banks included 15 domestic banks, 11 foreign banks, which already established their branches in Thailand, and 19 new foreign banks, altogether 45 financial institutions. See Bank of Thailand, *60 Years*, p. 49

⁸⁶ Bank of Thailand, *Annual Report 1995*.

instruments. As for prudential regulations, one of the important measures to improve the supervision and examination process was the BOT's adoption in 1993 of the Bank for International Settlements (BIS)'s guideline on capital adequacy to meet international prudential standard. Interestingly, as discussed earlier, the BIS capital-risk-asset ratio of 7 percent was lower than the 8 percent ratio the Bank of Thailand imposed on banks since 1983.

With regard to foreign bank entry, the Thai authorities responded to the heightened pressure for foreign participation by allowing 19 new foreign banks, in addition to the 11 existing foreign bank branches, to operate under the BIBF scheme after 1993. In 1995 the authorities planned to grant more full-banking licenses to qualified foreign institutions. Due to the demanding entry conditions, only 12 foreign BIBF banks without full branch status participated in the bidding.⁸⁷ The decision was finalized in late 1996 and seven new licenses were granted to foreign banks.⁸⁸ Among all the liberalization policy objectives, the opening of the Thai banking market was the least ambitious and cautiously pursued by the authorities. (See Table 6.4)

⁸⁷ Among the disincentives were the requirements for foreign banks to invest US\$ 5 million at the minimum in government securities or to directly deposit the same amount with the Bank of Thailand as part of the prudential regulations, and for the new foreign banks to bring into Thailand at least US\$ 80 million start-up capital. See Zhang, *Changing of Politics of Finance in Korea and Thailand*, p. 132 for a discussion of disincentives and low level of participation.

⁸⁸ Bank of Thailand, *Annual Report 1997*.

Table 6.4

Some key features of financial liberalization process

Exchange Control Liberalization 1990-1992	<ul style="list-style-type: none"> - Residence allowed to purchase, sell, and hold foreign currency accounts (subject to certain conditions). - Non-residents allowed to hold Thai baht and foreign currency accounts. - Most controls on capital account lifted. - Freer outflows of capital for overseas investment allowed.
Interest Rates Liberalization 1989-1992	<ul style="list-style-type: none"> - Interest rate ceiling for all types of deposits and loans lifted.
Banking Deregulation 1990-1993	<ul style="list-style-type: none"> - Requirement for banks to hold government bonds upon opening new branches removed. - Commercial banks allowed to substitute other securities for government securities in meeting the liquidity ratio requirement (7% of deposits). - Financial institutions allowed to expand their scope of operations. - BIS capital adequacy standard adopted. - BIBF established in 1993 to provide 1) banking services to non-residents in foreign currencies and baht (out-out transactions, 2) banking services to domestic residents in foreign currency only (out-in transactions), and 3) international financial and investment banking services.
Foreign Bank Entry	<ul style="list-style-type: none"> - After 1993, 19 new foreign banks allowed to operate under BIBF. - In 1995, planning to grant 10 commercial bank licenses

Source: Bank of Thailand, *50 Years*, and Pakorn, *Financial Reforms in Thailand*.

Financial Liberalization and the Vulnerability of the Thai Financial System

Before 1996 when signs of trouble began to appear, there seemed to be little doubt that financial liberalization had positively contributed to the continued investment boom and rapid economic growth, which was prolonged for almost a decade. Private foreign capital, which flowed into the country at phenomenal rates and scale (from US\$ 10.9 billion in 1990 to US\$ 20.7 billion in 1996) accounted significantly for the rise of gross domestic investment to a level of 40 percent of GDP.⁸⁹ The BIBF was largely responsible for the flows of foreign credit, particularly through the intermediaries of domestic banks. Within one year of operation, loans through the BIBF grew from zero to US\$ 7.7 billion, due to the lower dollar rate, cheaper transaction costs, and tax privileges.⁹⁰ By 1997, BIBF flows for domestic usage (out-in) registered at US\$ 16.9 billion. Though at a much lesser scale, portfolio investment also jumped from US\$ 450 million in 1990 to US\$ 4.8 billion in 1993 and maintained at US\$ 4.5 billion in 1997.⁹¹ Foreign direct investment maintained a steady flow at the average of US\$ 2 billion annually. Non-resident baht accounts, which facilitated foreigners' business transactions in local currency, grew from 1.3 billion in 1990 to 2.6 billion and 3.3 billion in 1993 and 1995 respectively (see Table 6.5).

⁸⁹ Ammar Siamwalla, "Picking Up the Pieces: Bank and Corporate Restructuring in Post-1997 Thailand", paper presented at the 26th Senior Policy Forum on Economic Crisis and Structural Adjustment, Korea, November 5-7, 2001. Domestically-financed investment also accounted for a significant share of total domestic investment.

⁹⁰ Some of these loans were transferred from direct corporate borrowing of Thai businesses and foreign direct investment, particularly from Japan. The tax privileges included lower corporate income tax (from 30% to 10%) and exemption from certain business taxes, interest income withholding tax, and stamp duties.

⁹¹ The jump in portfolio investment was encouraged by the establishment of the Securities and Exchange Commission in 1992, which boosted confidence among foreign investors the security of the Thai stock market. Major portfolio investment was from Singapore and Hong Kong. But the original sources of funds were also from other countries, such as the U.S. and Japan, which diverted part of their funds through Singapore and Hong Kong. See more detail discussion of foreign capital movements to Thailand in Ammar Siamwalla, Yos Vajragupta, and Pakorn Vichyanond, "Foreign Capital Flows to Thailand; Determinants and Impact", Thailand Development Research Institute, 1999, Paper presented at the Institute of Development Studies' Workshop, University of Sussex, UK, November 1999.

Table 6.5

Certain Types of Private Capital Flows to Thailand 1990-1997

(Billions of US Dollars)

Type of Capital Flows	1990	1991	1992	1993	1994	1995	1996	1997
BIBF	0	0	0	7.6	10.1	8.1	4.5	-1.7
Portfolio Investment	0.4	0.1	0.5	4.8	1.1	3.2	3.4	4.5
FDI	2.5	2.0	2.1	1.7	1.3	2.0	2.2	3.6
Non-resident Baht	1.3	2.0	1.7	2.6	2.0	3.3	2.9	-5.8

Source: Bank of Thailand

Together with the domestic capital and credit, which was also growing significantly, the unprecedented amount of investment funds contributed to the continued rapid growth of the economy, averaging 12.2 percent from 1988 to 1990 and 8.6 percent from 1991 to 1995.⁹² At the time of such abundance, the international community praised Thailand as one of the fastest growing economies in the world, with some optimistic projections that it would soon reach the status of a developed country.⁹³

In retrospect, the irony was that while one cannot deny the effects of the investment boom triggered by the huge inflows of foreign capital on the impressive economic expansion, the financial sector, the main instigator of such growth, became increasingly vulnerable because of it. The vulnerability was a marriage of the existing structural weaknesses of the financial system and the changing context in which the financial sector operated. The structural weaknesses have already been alluded to in the previous section. The low level of competition was as much a cause of the weaknesses as their consequence. One can trace the origin of the low level of competition to the protective role of the state since the post-war period. As discussed earlier, such policy was attributable to the symbiotic relationship between the military leaders and Chinese-origin bankers on the one hand, and the desire of the Bank of Thailand to promote financial stability within the relatively nascent financial sector on the other. To a large extent, the oligopoly of the existing commercial banks had led to the institutionalization of certain patterns of ownership, lending practices, and credit allocation biases, the characteristics which tended to reinforce one another.

⁹² Ammar et al, "Foreign Capital Flows to Thailand."

⁹³ For example see *The Economist*, "Who's Nicst?", August 13, 1994.

The concentrated ownership within a single or groups of families, encouraged by business culture, lack of single ownership regulations (at least until 1979), and the nonexistence of capital markets, facilitated the practice of collusive lending as these bankers sought to expand their business base into non-financial sectors. By the 1960s, bank-based conglomerates began to emerge as a result of their advantage in the control of wealth and credit access. Collusive lending was not entirely unproductive to the economy since a large number of funds were channeled to the growing manufacturing sector but it set up a structure of inefficient credit allocation, which encouraged problems such as poor loan quality, lack of loan evaluation skills, and liquidity mismanagement. As connected lending normally required banks to lend rather casually to businesses related to them, they tried to compensate for the moral hazard by requiring high collateral for other 'unconnected' loans. The practice of collateral-based loan requirements prevented the development of project assessment skills, unlike in other East Asian countries.⁹⁴ The preference to avoid giving loans altogether can also be seen in the prevalence of overdraft services, which despite its convenience made banks' loan portfolios rather unpredictable.

The initial financial independence of commercial banks from the authorities and the resulting non-interventionist role of the state allowed the former to have a relative free hand in channeling funds to different sectors. That there was an allocation bias toward the urban, manufacturing sectors over the rural, agricultural sectors revealed the banks' freedom to direct funds to sectors that were more profitable. It may be argued that despite the compulsory lending policy implemented by the BOT in the early 1970s to

⁹⁴ Ibid.

encourage more rural credit, it was carried out rather haphazardly as the Bank's concern for bank competitiveness led it to adopt a lenient approach toward its own policy.

A few words should be said about commercial banks' inexperience in risk assessment and management. The low level of competition in the financial sector well into the 1970s before the rise of finance companies had inevitably made Thai banks generally not keen on taking risks.⁹⁵ The context of relative macroeconomic stability, particularly the stable currency throughout the 1960s, provided banks with extra cushion from exchange rate risks on their foreign liabilities. This environment did not particularly facilitate a development of the risk assessment and management skills which were deemed necessary in a more open and deepening financial system, and on the contrary might have cultivated a sense of complacency in the long-held tradition of exchange rate stability. The difficulties of some financial institutions in coping with the exchange rate adjustments in the early 1980s revealed such complacency as they failed to cover their short foreign exchange positions.⁹⁶

As discussed above, the financial authorities, particularly the Bank of Thailand, were not unaware of the deficiencies and problems embedded in the Thai financial system. The concerns for concentrated ownership, low competitive pressures, and inefficient credit allocation led to a number of financial reform measures being implemented through the years. Allowing for non-bank financial institutions to operate in the late 1960s was partly aimed to promote more competitiveness and efficiency in

⁹⁵ Supachai, *Financial Development in Thailand*, pp. 116-117. Viewing Thai commercial banks as 'risk-aversers', Supachai criticizes them as being weak in risk assessment and failing to take calculated risks. Supporting evidence can be seen in a number of studies on bank borrowing, which conclude that in the 1960s banks tended to borrow to satisfy their needs, not to make profits. See also Narit, "Commercial Banking."

⁹⁶ Supachai, *Financial Development in Thailand*.

credit allocation. The inclusion of single shareholding limitation in the amendment of the 1962 Commercial Banking Act in 1979 was meant to tackle the concentrated ownership problem. The various preferential lending schemes, which peaked in the early 1970s, intended not only to compensate for effects of market imbalances (e.g., declining world market prices or a rise in prices of raw materials, etc.), but also to correct banks' lending biases against the rural and less profitable sectors.

However, it is hard to say that the results were satisfactory. Even though there was more competition in the financial sector, the uncontrollable outcomes of market competition made the system more precarious and did not particularly increased allocation efficiency. Despite being an alternative source of financing, particularly for corporate borrowers, non-bank financial institutions, which were less regulated than their bank counterparts, attracted risky and fraudulent financial activities. A series of finance company crises in the late 1970s and early 1980s testified to the unfortunate precariousness that came with the opportunities to undercut bank quasi-monopoly. The BOT's decision to move away from its interventionist/developmental role in credit allocation, though might help reduce market distortions, permitted commercial banks and other non-bank financial institutions to continue to allocate funds relatively freely at the expense of less profitable sectors. Lastly, the ability of commercial banks to use their competitive edge to adjust to the new environment helped preserve their dominant status in the financial system. The notion of competition became ambiguous when banks began to venture into non-bank financial businesses. With their financial resources, major banks, sometimes with their foreign partners, were seen engaging heavily in various financial businesses. For example, the Bangkok Bank had significant shares in at least 14

non-bank financial institutions in the early 1970s. The Techapaiboon family, who took over three small-to-medium-sized commercial banks in the 1970s, was involved with ten non-bank financial companies. At the same time, the Thai Farmers' Bank, whose interest in non-bank financial business developed a little later than the former two, had one fully-owned finance company and two joint-ventures with foreign banks.⁹⁷ Accordingly, contrary to the authorities' intention, the control over the financial sector by a small number of banking groups did not cease but was well disguised by the participation of non-bank financial institutions.

The launching of the process of financial liberalization may be considered as part of the Bank of Thailand's long-going endeavors to increase competitiveness and efficiency in the financial system. The conviction behind a series of deregulations, influenced by the Bank's historical experience and the neo-liberal thinking within the international financial community, was to allow the market mechanism to function more freely with as little state intervention as possible.⁹⁸ However, the same irony arose. The liberalized financial sector, which played an important role in greasing the rapidly spinning wheel of economic growth, became even weaker and more vulnerable to external disturbances. The new financial and political contexts of the deregulated financial system aggravated existing vulnerabilities in significant ways. Before moving on to discuss the increased vulnerabilities of the financial system, a few words on the changing contexts are needed.

⁹⁷ Pannee, *Analysis of Commercial Banking Capitalists*.

⁹⁸ Bank of Thailand, *50 Years*, chapter 24.

The Changing Financial Context

The intensification of the globalization of finance at the end of 1980s and early 1990s, at the time financial liberalization was launched in Thailand, brought about an unprecedented financial environment. The novelty of the new financial context lay in the magnitude of the private capital and credit available in the international financial system and the financial innovation and arrangement that rendered such funds very mobile. Through the process of financial liberalization, these phenomena were felt in Thailand. The volume of private foreign capital inflows to the Thai economy rose dramatically during the first half of the 1990s, pushing the level of external debt to increase from US\$29.3 billion in 1990 to US\$52 and 90.5 billion in 1993 and 1996 respectively (see Table 6.6).⁹⁹

With the benefits of an opened financial market, foreign capital entered Thailand in various forms, ranging from FDI, direct and bank loans, trade credits, to portfolio investment and non-resident baht account. These funds varied in terms of their movement and volatility. FDI was the most steady as it was intended for long-term investment. Other types of capital and credit were more volatile due to their sensitivity to rather short-term rates of return and opportunity costs.¹⁰⁰ For example, in preferring lower lending costs to long-term loans, most BIBF lending was on a short-term basis. Portfolio investment, though supposed to be a source of long-term capital, was greatly sensitive to market conditions and easy to move around. The most volatile was the non-resident baht account, which fluctuated according to holders' foreign-exchange-related

⁹⁹ Bank of Thailand, *Annual Reports*, various 1990s volumes.

¹⁰⁰ Ammar et al, "Foreign Capital Flows to Thailand."

Table 6.6

Thailand's External Debt 1990-1997

(Billions of US Dollars)

Sector	1990	1991	1992	1993	1994	1995	1996	1997
Public	12.5	12.8	13.1	14.2	15.7	16.4	16.8	24.3
Private	17.8	25.0	30.5	37.9	49.1	66.1	73.7	69.1
Total	29.3	37.8	43.6	52.1	64.8	82.5	90.5	93.4

Source: Bank of Thailand

transactions.¹⁰¹ Its danger was apparent when it became a site for baht speculation in 1997. Through the financial liberalization process, the Thai economy was flooded with huge inflows of various types of private foreign capital, some of which more volatile than others. Even though the inflows partly responded to rising domestic demands, one cannot deny the tremendous, almost fanatic, interest of foreign investors in the Thai market, and other promising emerging markets, as the driving force of the inflows. It was this financial context, in which the Thai economy was exposed to the investing impulse of international creditors that the vulnerabilities of the financial system were aggravated.

The Changing Political Context

The domestic political context of the late 1980s and early 1990s was one of a transition to democracy. Even though the democratization process started in the early 1980s during the Prem administrations, as political parties gradually exerted their central role in politics, the process was interrupted by a military coup in 1991 only to continue when an elected government assumed power in 1992. In this transition, parliamentary politics began to move to the center stage of political struggles, opening up more space for interest representation. The elitist nature of democratization in Thailand, which saw the dominant role of political and economic elites in shaping and participating in democratic processes, determined that business groups found it convenient to take part in politics either directly or indirectly to secure status among the old elite.¹⁰² In the past, the

¹⁰¹ Ibid.

¹⁰² The elitist view reflects in a wide-ranging literature on Thai politics. See for example a discussion of a constant rivalry between state and political elites that shapes the nature of democratic transition in Thailand in Chai-Anan Samudavanija and Parichart Chotiya, "Beyond Transition in Thailand," in *Democracy in East Asia*, eds. Larry Diamond and Marc E. Plattner, (Baltimore: The John Hopkins University Press, 1998). See also discussions on Thai political parties in Duncan McCargo, "Thailand's Political Parties: Real,

involvement of business in politics and vice versa was kept in check, at least in terms of their effects on the economy, if not the scale of involvement, by the relative control of economic bureaucrats over economic (especially macroeconomic) policymaking. However, such control seemed to be waning as elected governments—the Chatichai government as a good example—began to exert their mandate in directing economic policies to serve their own and their constituents' interests. Electoral politics also brought politicians and business people closer through the exchange of financial supports and reciprocal business contracts and other privileges. The interplay of the above changing political dynamics seemed to encourage a policy environment which could be politicized and manipulated to serve certain special interests. It is indeed an irony that democratization, which was believed to encourage broader interest representation, had led to the rise of a new political class, i.e., the business elite, who sought to secure their interests through their control of political and economic power by way of parliamentary politics.

How then did the changing financial and political contexts aggravate the weaknesses and vulnerabilities of the Thai financial system? First, the financial and political environment weakened the financial system's ability to allocate credit efficiently and productively. As mentioned above, the lack of state intervention, except for the rather ad hoc preferential credit schemes for rural and export sectors, had provided the financial sector, particularly commercial banks, a great deal of freedom in the allocation of credit. Such freedom was exercised liberally during the period of financial liberalization. The financial sector played a central role in channeling the available credit

Authentic, and Actual," and Surin Maisirikrod and Duncan McCargo, "Electoral Politics: Commercialization and Exclusion," in *Political Change in Thailand: Democracy and Participation*, ed. Kevin Hewison, (London: Routledge, 1997).

to different sectors across the economy. The influx of foreign capital, together with the sizable domestic saving mobilized through banks and non-bank financial institutions, triggered a significant growth in the loan business.¹⁰³ Much of the credit did go to productive sectors, particularly industry, but a great deal also went into property and the stock market where profits were more lucrative due to the inflated asset values accompanying the economic expansion. The real estate and stock market boom from 1990 to 1994, which saw property prices and the stock index skyrocket unrealistically, reflected how capital and credit were channeled toward speculative as much as, if not more than, productive investments.¹⁰⁴ Finance companies were engaged in such business more than commercial banks. It was reported that about 25 percent of their loans went to the property sector, compared to 8.8 percent for commercial banks, making them vulnerable when a downturn in the property market occurred.¹⁰⁵ The nature of the competition in the financial sector, which encouraged separate specialization among different types of institutions, pushed finance companies to develop their niche in riskier but more profitable types of business to compete with commercial banks. Convenient access to foreign capital such as through BIBF as a result of financial liberalization exacerbated their risky practices.

Commercial banks had their own share of vulnerabilities in credit distribution.

The underlying weaknesses in project evaluation and risk assessment led banks to continue to depend on collateral-based lending, which in many cases was now backed by

¹⁰³ Pasuk and Baker note that loan business rose from 2.7 trillion baht in 1992 to 5.7 trillion baht in 1996, or from 96 to 133 percent of GDP. See more detailed discussion of how funds were allocated in Pasuk and Baker, *Thailand's Boom and Bust*, pp. 98-104.

¹⁰⁴ It was reported that the stock market index jumped from 600 in 1991 to 1750 in 1994, while real estate prices skyrocketed.

¹⁰⁵ Yos Vajaragupta and Pakorn Vichyanond, "Thailand's Financial Evolution and the 1997 Crisis", in *Finance, Governance and Economic Performance in Pacific and South East Asia*, eds. D.G. Dickinson, J.L. Ford, M.J. Fry, A. W. Mullineux and S. Sen, (Cheltenham: Edward Elgar, 2001).

overvalued property. Problems can also be seen in their lending to a large number of ambitious industrial projects, particularly in heavy industry, many of which failed, as they turned out not being able to compete globally.¹⁰⁶ If banks' inexperience in project evaluation led them to overestimate the feasibility of these investments, their willingness to lend, largely due to the abundance of credit and government support, made them even less prudent.

Last but not least, the stock market, which had just begun to attract investors' attention in the late 1980s, became another source of vulnerability. Having been a site for siphoning funds more than a place to raise long-term investment, the stock market, which by the early 1990s had attracted large inflows of portfolio investment as a result of capital account liberalization, continued to encourage investors' expectations of short-term gains. In looking for good returns, much of the funds went to already established companies, such as major banks and large industrial corporations, and rising sectors such as finance, infrastructure (especially telecommunication), and real estate. Speculative impulses were evident in the surge of portfolio investment, which rose from US\$ 386 million from 1990-1992 to US\$ 3.1 billion between 1993 and 1996. Their crowding-in behavior added to the artificial demand in the targeted sectors, particularly real estate and finance. It was reported that by 1996, about 57 percent of all transactions in the stock market were in the financial sector and another 22 percent in property and telecommunication.¹⁰⁷ The concentration of equity investment in the non-industrial sectors added to the allocation bias at the expense of the growth of the real sector. The decline of export growth since the early 1990s to almost a complete halt in 1996, though

¹⁰⁶ Pasuk and Baker, *Thailand's Boom and Bust*, p. 100.

¹⁰⁷ Ibid., p. 101.

attributable to many factors, particularly the stronger baht, was closely linked to the issue of underinvestment in the area of technological upgrading and in manufacturing industries with strong export potential such as automobile and parts, electrical appliances, and computer and parts.¹⁰⁸

Second, the financial system's stability was also adversely affected within the context of financial liberalization. The easy access to foreign credit allowed banks and finance companies to borrow extensively abroad as they engaged in lending competition. The high domestic interest structure had always made it more attractive for banks to turn to foreign credit. Their familiarity with borrowing rather than expanding their equity base through the stock market, which would then dilute the concentration of ownership, made debt accumulation, if not too excessive, rather tolerable and not so imprudent. The skyrocketing of private external debt incurred by bank and non-bank borrowers (from US\$17.7 billion in 1990 to US\$ 73.7 billion in 1996) may confirm this outlook.¹⁰⁹ With regard to macro-instability, the growing external debt, much of which was short-term, posed a threat to the country's international reserves and balance of payments position, which in turn affecting investors and creditors' confidence in Thailand's economic fundamentals and its ability in debt servicing.¹¹⁰ At the micro level, the sizable foreign

¹⁰⁸ The Bank of Thailand attributed the slowdown of export growth in 1996 to a number of factors, including the slowdown of world trade, Asian economies, and import demand of major trading partners. For fishery and processed fishery products, shortages of raw materials and trade barriers from some trading partners were responsible for the decline. In some labor-intensive manufacturing exports, such as textile products, toys and plastic products, competitiveness seemed to be the main reason accounting for the downturn. This contrasts with the higher-technology and higher-value-added exports, such as computers and parts, electrical appliances, electronic equipments, and vehicles and parts, which continued to expand at satisfactory rates. See Bank of Thailand, *Annual Report 1996*. It is interesting to see that the Bank did not mention the increasing value of the baht, particularly against the yen, as one of the factors. See a discussion on the currency impact and other factors in Pasuk and Baker, *Thailand's Boom and Bust*, pp. 95-98.

¹⁰⁹ Bank of Thailand, quoted in Ammar et al, "Foreign Capital Flows to Thailand."

¹¹⁰ Due to the sizable amount of short-term external debt, i.e. 51.97 percent of total external debt in 1995, the Moody's creditworthiness index for short-term loans for Thailand was dropped from Prime 1 to Prime 2.

debt of the corporate sector, including banks and finance companies, made these firms highly vulnerable to any changes to the terms and contracts of their liabilities.

Financial stability was also affected by certain financial practices, which despite being rational in their own terms, heightened the risks of volatile capital movement. While banks and finance companies borrowed extensively through BIBF in the form of short-term loans due to the relatively low cost, they increasingly lent out the funds as long-term loans to meet market demand for longer-term investment financing. The maturity mismatch aggravated the liquidity problem when these financial institutions were denied loan roll-ups and were called to pay up their foreign debts at the outbreak of the crisis. Another example was seen in the freedom of entry and exit of stock market investors. While the ‘crowding-in’ behavior led to the artificial rise of certain stock prices, the ‘crowding-out’ decision to collectively exit the market precipitated the fall in those prices.¹¹¹ The rapid capital outflows experienced in 1997 and 1998 attested to the disastrous effects of the freedom of movement accorded to foreign investors in the era of globalized finance. And while the non-resident baht account was aimed at facilitating foreigners’ baht-foreign exchange transactions and the utilization of baht in regional trade, it encouraged the growth of the offshore baht market, which was to become a source of vulnerability to speculative attacks on the eve of the crisis in 1997.

The political context of financial liberalization also presented destabilizing effects on the financial system. The policy dynamics described above, particularly the relationship between politicians and business groups, including those in the financial sector, encouraged certain sets of behaviors, which contributed to the decline of financial

The change by the rating had significant impact on investors’ confidence in the Thai market, leading to the ‘crowding out’ exit which instigated the financial crisis in 1997.

¹¹¹ Pasuk and Baker, *Thailand’s Boom and Bust*.

stability. At least three sets of behaviors require mentioning. The first set involved the use of office or the control of credit to engage in unbecoming conducts and illegal actions, seen in forms of abuse of power, corruption, and fraud. The weakness of law enforcement and now the political contest of democratization allowed politicians and business people, to use their positions and connections to create opportunities for financial and political gain. While it is difficult to know the real extent of this conduct due to its discrete nature, evidence may be seen in some of the cases brought to light by the financial crisis. For example, the Bangkok Bank of Commerce (BBC) case, which triggered the investors' alarm before the crisis, saw politicians and bankers involving in a series of crimes, including share manipulation, loan frauds, suspicious land deals, pyramid money-making schemes, and accounting frauds.¹¹² Having escaped detection for a number of years, these illegal actions caused the BBC non-performing loans to skyrocket from 9 billion baht in 1992 to 19 billion baht in 1994.¹¹³ It was discovered later that most of the bank's bad loans either did not have any collateral or were backed by overvalued property and assets.¹¹⁴ The damage to the financial system as a whole was tremendous, particularly considering the huge amount of funds the Bank of Thailand tried to inject into the BBC to prevent systemic bank runs and the massive loss of investor confidence once the case was made public in early 1996. Devastating and wrong as they were, these corrupt practices were conveniently referred to by critics of the Asian

¹¹² Ibid., pp. 105-110.

¹¹³ Ibid., p. 109.

¹¹⁴ Ibid., p. 109.

development model, not only as one of the important factors contributing to the outbreak of the crisis, but as the structural flaws of 'crony capitalism'.¹¹⁵

The second set of behaviors concerned political interference. Although not a new phenomenon, political interference in public policy became more prevalent after the late 1980s as parliamentary politics allowed for more penetration of special interests, while increasing the mandate and motives of elected politicians in the policy making process. Under this environment, bureaucrats found their autonomy being challenged by elected politicians' more engaging and interest-driven involvement in various policy processes. Moreover, the fragmented power of a coalition government, which encouraged political bargaining and compromises among coalition parties, seemed to block the use of more decisive forms of decision making that used to take place under an authoritarian regime.¹¹⁶

Such effects of the porous and fragmented political arrangements can be found in the area of financial policy and may be seen as having damaging impacts on financial stability during the period preceded the crisis. For example, the controlling interesting of

¹¹⁵ For example of the branding of crony capitalism in the media, see *Economist* Nov. 15, 1997, *Financial Times* Dec. 4, 1997. See also Wade, "Asian Debt-and-Development Crisis," p 1540, for his comments on the unfair use of the term. According to Wade, the nature of the financial system in many Asian economies led firms to hold a high level of equity-debt ratio, therefore providing incentives for bank-firm-government alliance to minimize systemic shocks. While there is an economic rationale for such an alliance, he argues that it is usually understood in political terms, such as corruption and the survival strategies of rulers. I also think the labeling was inappropriate in a number of respects. First, by attacking the 'Asian model' of capitalism as rife with excessive government intervention, the critics simply ignored the variations among Asian economies (e.g. between the Korean and Thai models), therefore being empirically inaccurate. Second, critics also fail to distinguish between the developmental role of the government, seen in the East Asian NICs, which contributed to their economic success, and the corruption and abuse of power by state actors to advance their own gains. While the latter actions deserve strong condemnation, the former's merits should not be ignored or brushed aside carelessly. Third, as the term crony capitalism points to the structural flaws (i.e. internal problems) of the affected countries, we are being led to ignore the effects of financial liberalization on these economies. The fact that financial liberalization introduces new incentive structures to both public and private actors should be taken into account when analyzing the vulnerabilities of the financial system in the mid 1990s and the factors contributing to the crisis.

¹¹⁶ Stephen Haggard, *Political Economy of the Asian Financial Crisis*. See also Andrew MacIntyre, *Power of Institution*.

the Chart Pattana Party, a coalition party in the Chavalit government, in a number of distressed finance companies initially targeted to be closed down by the BOT led the party to veto such a proposal in early 1996. The fragile position of the Chavalit coalition government prevented the PM and the Finance Minister from overruling their veto, therefore settling for a milder solution of capital increase. The indecisive move of the government created doubts within the financial community on the lack of transparency and cost the FIDF a tremendous sum of money in lending to these insolvent institutions. More discussion on the impact of political interference and the politicization of financial policy on the autonomy of the Bank of Thailand and its ability to achieve its policy objectives will be provided below as the chapter moves to discuss the Bank's declining autonomy and capability. It suffices to note here that political interference in financial policy, encouraged by the political context of financial liberalization, was particularly damaging to financial stability during the time before the crisis, when attempts to protect certain interests or groups were made at the expense of systemic stability.

The third set of behaviors, less mentioned than the first two, involved actions and measures by the authorities that instigated moral hazard problems within the financial sector. The relationship between government and bankers, formed over the post-war period, played an important role in influencing the nature of financial policy. The political position of bankers, as a source of financial support and business alliance to military leaders and a main component of financial stability and national financial competitiveness to the BOT, seemed to be taken into consideration upon the making of past financial policy. The influence of this position may be seen in the inclination of the authorities to be protective and accommodative toward the financial sector that created

moral hazard problems to the financial system. Restricted entry of new domestic and foreign banks may be seen as among the key protective measures against too much domestic and foreign competition. Despite achieving relative stability by limiting competition, domestic banks were largely not competitive and sought to perpetuate government protection, particularly against foreign competitors. The success of domestic banks in pressuring for the postponement of new bank entries in late 1980s largely through their influence as a major business lobby (Thai Bankers Association) prevented appropriate system-wide adjustment to take place in light of more competition. As a result, they delved into collateral-based lending and sought to compete by lending more, regardless of loan quality.

Another example may be seen in the authorities' approach to insolvency. The general conviction of the authorities in the necessity to prevent a collapse of a financial institution, despite the justification of bank runs, should be understood within the context of the special relationship between the state and the financial sector. The establishment of the FIDF in 1985 to assist and cope with distressed financial institutions may be seen as the institutionalization of the BOT's past treatment of insolvency problem. The BOT's preference for collective rescue efforts over bank exit and the sharing of losses among owners and depositors reflected a common agreement within the financial community of the BOT's role as lender of last resort and the community's compliance with systemic loss distribution.¹¹⁷ The expectation of bank bail-outs inevitably generated moral hazard

¹¹⁷ This relationship may be applied to explain the preference of the Ministry of Finance to establish the FIDF over a simple deposit insurance institution proposed by the Bank of Thailand. While it may be seen as another matter of BOT-MOF conflict, the fact that Sommai was a former BOT senior official for almost 30 years seemed to make his preference of the FIDF reflective of the BOT's relationship with the financial sector. The conflict between him and the then BOT Governor, Nukul Prachuabmoh, over other issues may have also played a role in his rejecting Nukul's proposal for a deposit insurance institution. However, one

problems not only among owners of financial institutions but also among depositors, many of whom were oblivious of the risky business undertakings of their preferred institutions. The period of financial liberalization saw the aggravation of this moral hazard. With the FIDF in place, the BOT was pressured, if indirectly, by circumstances to inject gigantic amount of funds into distressed institutions without discrimination. The Bank spent about 28 billion baht through the FIDF buying the Bangkok Bank of Commerce (BBC) shares to help the latter increase its capital between 1995 to 1996 and took over its 60 billion-baht non-performing loans afterwards. The FIDF also injected liquidity into many other finance companies in distress due to the property market bust, which amounted to 702 billion baht by the end of 1997.¹¹⁸ At this point the insolvency and liquidity problems, if not caused then encouraged by moral hazard, had weakened the FIDF's ability to coming to the rescue of financial institutions. The authorities eventually had to close down 58 finance companies despite prior massive injection of liquidity. Loss of confidence in the financial system became uncontrollable when systemic liabilities showed the inability of the authorities to contain the problem.

The Bank of Thailand's Declining Capacity and Financial Sector Crisis

The failure of the Thai authorities, particularly the Bank of Thailand, to prevent and resolve the insolvency and liquidity problems in the financial sector which emerged in 1996 was among the main contributing factors to the outbreak of the financial crisis in 1997. For the public, the BBC scandal and the order for 10 finance companies to increase capital in early 1997 followed by the suspension of 16 and then 42 finance

could see that there was a great deal of continuity in the FIDF's operations from the BOT's tradition of bank rescues.

¹¹⁸ Nukul Commission Report, p. 141.

companies due to their weak balance sheet were signs of the severe systemic insolvency of the financial sector. The failure of the authorities, particularly the Bank of Thailand which was directly responsible for financial institution regulation and supervision, to deal with the problems effectively after the BBC case aggravated the loss of confidence among investors and the general public in the financial sector. A combination of deposit runs, foreign loan callback, capital flight, and the baht devaluation inevitably drove the precarious financial system into a deep insolvency and liquidity crisis with the FIDF plunging over 700 billion baht into futile financial rescues by the end of 1997.

The declining capacity of the Bank of Thailand to resolve insolvency and liquidity problems in the financial sector was attributable to the interplay of various institutional factors. The changing contexts of financial liberalization and selective democratization mentioned above had a great impact on the Bank's role in financial regulation and supervision, particularly by rendering such roles more difficult and complicated. But these factors were not solely to blame. Internal changes to the Bank's institutional character that were not completely independent from the political and socioeconomic contexts also played an important role in determining the Bank's ability (or lack thereof) to adapt to the new environment and to maintain its operational autonomy and capacity. The changes affecting the Bank's institutional character and their impact should be examined before discussing their interplay with the financial liberalization and democratization contexts.

As chapter 3, 4 and 5 discuss, the institutionalization of the Bank of Thailand's organizational character took place in the 1960s, particularly during the governorship of Dr. Puey, and was generally reinforced through the Bank's experiences in the 1970s and

most of the 1980s. This institutional character, particularly moral authority, technical competence, and guardianship of the national interest, served as the basis of the Bank's de facto autonomy, which allowed it to pursue its functions according to its preferences. As a result, from the 1960s the BOT was able to maintain relative price and currency stability while attempting to transform the country's macroeconomic and financial policy in a more liberal orientation. The consistency of the Bank's institutional character provided the Bank with the legitimacy to assume an active role in shaping the development of the Thai economy. However, such consistency began to wane in the 1990s. The Bank's moral authority, largely based on the sense of responsibility, fairness, and honesty, was in decline as the public observed practices that revealed improper conduct such as conflicts of interest and self-serving tendencies. The participation of BOT senior officials in the stock market, regardless of the informational privileges of their positions, was inevitably a source of conflicts of interest and impropriety. By 1996, the BOT's reputation sank further with the accusation of the Bank Governor's loan connection with the BBC and his benefiting from the stock market, that although completely legal, brought criticism to his partiality as top financial regulator. His role leading to the dismissal of one of the Bank's Deputy Governors by the Finance Minister without due process also spoke against the principles of fairness and transparency. With regard to technical competence, many observed that there emerged a brain drain problem that increasingly drew capable bank officials into the private sector.¹¹⁹ A number of

¹¹⁹ Interview with Bank officials, Bangkok, Fall 2002. See also Apichat Satitniramai, "The Rise and Fall of the Technocrats: the Unholy Trinity of the Technocrats, Ruling Elites, and Private Bankers and the Genesis of the 1997 Economic Crises" (Ph.D. diss., University of Wales, 2002), pp. 177-181.

senior bank officials left the BOT for top management positions at various commercial banks.¹²⁰

In addition to the loss of essential personnel, there seemed to be a lot of catching up for the Bank to do in terms of new financial technology and instruments.¹²¹ The process of financial liberalization allowed for many more banking and financial businesses that were not only new to financial institutions but also to their regulators. The Bank was increasingly in need of more expertise in new financial innovations, such as derivatives, to be able to supervise and regulate these businesses effectively. The Bank's organizational structure was also criticized. Compartmentalization prevented cooperation among different departments, resulting in poor information and knowledge sharing within the growing organization. The most devastating change to the BOT's institutional character was the politicization of the Bank's affairs. Growing rivalry among senior bank officials, a number of whom were scholarship students during Dr. Puey's tenure, for career advancement had driven some of these officials to establish personal connections with the government and elected politicians for political support. Consequently, such connections opened up more opportunities for political interference by politicians in the Bank's policy process and internal affairs.¹²² The image of the

¹²⁰ For example, Olarn Chaiprawat, former director of the BOT's Department of Financial Institutions Supervision and Examination, left the Bank in the early 1980s to assume a number of important positions in the private sectors afterwards, including President of Siam Commercial Bank and Chairman of Shin Corporation. Supachai Panitchpakdi, also former director of the Financial Institutions Supervision and Examination Department, left the BOT in the mid 1980s to run for public office. He became a Deputy Minister of Finance in 1986 and later left politics to become President of the Thai Military Bank. His recent positions include Director-General of the WTO (2002-2005) and Secretary-General of the United Nations Conference on Trade and Development (2005-present (2008)).

¹²¹ Interview with BOT officials, Bangkok, Fall 2002.

¹²² Apichat Satitniramai, "The Rise and Fall of the Technocrats," pp. 142-152. See also Rangsan Thanapornpun, *Wikrit-ti-karn Karn-ngern Thai lae Setthakit Karn-ngern Thai* [The Financial Crisis and Financial Economics of Thailand], (Bangkok: Kobfai Press, 1998), pp. 213, 236-245.

politicization of the Bank, instigated by a number of incidents, significantly eroded public trust invested in the institution. The dismissal of Bank Deputy Governor by the Finance Minister in 1996 with assistance from the BOT Governor was a controversial case leading the public to question the political neutrality of the Bank.

A number of internal factors contributed to the changes in the Bank's institutional character. First, while there had been a strong expectation of moral superiority from the Bank's leaders by both the public and the Bank itself, the BOT seemed to leave it to chance when it came to regulating the conduct of top Bank officials. Being administratively autonomous, the Bank laid down its own rules with regard to its personnel management and other administrative matters. However, there was little attempt to regulate the conduct of Bank top executives through legal codes to uphold the moral standard of the organization. In earlier years, Dr. Puey was seen as trying to exert the tradition of self-restraint by demanding Bank employees, particularly those who had direct contact with financial institutions in their line of work, not to receive gifts or any kinds of favors from the private sector. The continuation of this type of internal regulation, but in more ambiguous form was seen in the BOT circular 27/2533 issued in 1990 prohibiting Bank officers, who had access to information that might be useful toward the purchases and sales of shares in the stock market, from speculative activities. However, the regulation did not prevent these officers from participating in the stock market for investment purposes. It only required them to report all transactions on a regular basis to their supervisors, who would then send the records to the Internal Audit Department for further supervision. Besides the ambiguity with regard to the practical difference between speculative and investment purposes, this regulation only applied to

permanent staff, not to appointed executive staff. Without a clear guideline or code of conduct, Bank executives were left with a tremendous degree of discretion and a non-legally binding expectation of their moral superiority. As an institution that largely depended on public trust and confidence throughout its history, signs of inconsistency and abuse of discretionary power inevitably affected the Bank's image of moral authority. Knowledge of Bank Governor Vijit's gainful interest in the stock market and his overdraft credit line with the BBC, all of which were perfectly legal, somehow put the Bank's reputation for incorruptibility and impartiality into question, particularly when the BBC scandal was brought to light.

Second, internal rivalry among the Bank's senior officials for top executive positions added to the tendencies for politicization. The growing likelihood of having a BOT senior official appointed as Bank Governor opened up the career advancement opportunity for these top officials.¹²³ For a number of them, their parallel career paths, beginning as returning scholarship students followed by a steady rise to the top thanks to their academic training and expertise, encouraged personal rivalry among these officials as they vied for the limited top positions. The merit-based recruitment programs that the Bank had been known for could not have prevented the intensification of competition for upward mobility when the appointment of top executives was not routinized but instead left to cabinet discretion. Personal rivalry could soon expand into factional rivalry when power struggle involved factionalization at lower levels. The impulse to find political patrons to tip the scales toward one's advantage rendered the organization susceptible to politicization and interference. The removal of two Bank Governors by two different

¹²³ Phisut Nimmanhaemin (Aug. 1971 to May 1975) was the first BOT permanent staff who was appointed as Bank Governor after Dr. Puey (Jun. 1959 to Aug. 1971). The second one was Chavalit Thanachanan (Mar. 1990 to Sep. 1990), followed by Vijit Supinit (Oct. 1990 to Jul. 1996).

Finance Ministers in the mid and late 1980s, a phenomenon that had rarely occurred in the past, demonstrated to Bank officers the growing influence of political power.¹²⁴

Third, with regard to its operations, like other mature organizations, the Bank had increasingly become set in its own ways over time. The tradition of macroeconomic conservatism, the Bank's evolving role as financial institutions' lender of last resort, and its commitment to maintain a stable currency may be seen as coming close to becoming policy orthodoxy. The inclination to hold high interest rates to control inflation, to prevent a financial institution from collapsing, and to maintain fixed exchange rates were among the policy preferences strictly pursued by the Bank over time. The BOT's relative autonomy in these policy areas, some more than others, facilitated the preservation of its policy traditions. For example, the Bank's control over the Exchange Equalization Fund and the international reserves continued to allow it to pursue the fixed exchange rate policy independently. The BOT's authority over the FIDF also helped it exercise the role of lender of last resort and rehabilitate distressed financial institutions. However, one adverse effect of policy rigidity was the Bank's declining ability to adapt to a new environment and experiment with unfamiliar strategies. Such inflexibility greatly affected Bank operational capacity, which used to rest on its ability to use proper strategies and policy instruments to achieve its objectives. Besides the above mentioned example of the Bank's lagging behind in terms of the knowledge of the latest financial technology and innovations, other signs of Bank declining operational expertise were revealed in the BOT's role in regulating and monitoring the liberalized financial system. That the Bank was unable to solve the financial problems at the BBC after the first signs

¹²⁴ See, for example, the reactions of Bank officials with regard to the dismissal of Nukul Prachuabmoh in 1984 in "Central Bank Men Defend Governor," *Bangkok Post*, September 13, 1984. The outgoing Governor viewed the dismissal as a bad precedent that could bring the BOT under political influence.

of serious troubles in 1992 but let the problems intensify until 1996 was quite indicative of the ineffectiveness of the institutions' approaches to dealing with bank insolvency.

The BOT's failure to adopt new approaches that were more suitable to the circumstances and to set new priorities in its policy objectives had a significant impact on its technical expertise and operational capacity, the qualities that hitherto had been the defining characteristics of the institution and the basis of public confidence.

The interplay among the changes in the Bank's institutional character and the new contexts of financial liberalization and democratization resulted in the BOT's further declining capacity to prevent the crisis in the financial sector. The process of financial liberalization not only led to a reduction of the Bank's control of the functioning of the financial system but also rendered its monitoring role more complicated due to the various financial activities and participants associated with the influx of foreign credit. Before financial liberalization, capital controls allowed the BOT to limit the movement of capital across border to a certain extent and the interest rate ceiling helped curb the cost of credit. The much simpler domestic organization of credit largely through bank intermediation of private saving and international borrowing seemed to make the BOT's role in monitoring and regulating the financial system quite manageable. The Bank's relatively high prudential requirements limited the lending power of financial institutions, therefore indirectly serving as a credit control mechanism. Financial liberalization changed the nature of financial regulation that had been adopted by the BOT for half a century. With capital controls lifted, the Bank had to allow capital movement to flow freely across the border save for a few types of transactions. The Bank also had to rely on market-based mechanisms to control credit, particularly open market operations and

interest rate adjustment. While it continued to rely on the prudential requirements to ensure sound banking operations, the fact that there were many other types of financial activities not affected by such requirements, as they were only applicable to bank lending, diluted the effectiveness of this mechanism. And while the fixed exchange rate policy remained, the Bank now gambled baht stability to ensure investor confidence and to minimize borrowers' risks based on its own ability to defend the currency through the use of international reserves.

This new framework of financial regulation and monitoring required the BOT to assume a number of new roles, which by their market-oriented nature (market-based operations and market-pleasing objectives) rendered monetary and policy implementation relatively less decisive or effective. The Bank's confidence in its capacity at the time it embarked upon the process of financial liberalization, even though well grounded in its past success in macroeconomic and financial management, reflected excessive optimism and trust in the role of the free market to guarantee everyone's benefits. Unfortunately, the danger embedded in the integration of domestic financial market to the international financial system manifested itself in ways which were unexpected, if not unimagined, by the Bank at the time when its ability to intervene in the market was much weaker than in the past.

This danger was largely associated with the great influx of foreign capital. There was no doubt that the BOT's liberalization measures played an important role in attracting foreign capital on an unprecedented scale. However, the Bank had much less control over the size, make-up, and distribution of these inflows. The freedom granted to foreign and domestic market participants to engage in cross-border financial activities

allowed these actors to act upon market forces which were not necessarily compatible with the long-term interests of the Thai economy. By 1994, the Bank witnessed the skyrocketing of external debt, a real estate boom and bust, rising inflationary pressure due to increases in the domestic money supply, and signs of reckless financial activities. It tried to alleviate these problems through a series of monetary and financial measures. To achieve credit control and money supply reduction, the Bank raised interest rates in 1994 and tried to maintain high interest rates throughout the pre-crisis period. It also tried to curb the BIBF borrowing by increasing the minimum amount of withdrawal transactions by domestic residents (out-in activities) from US\$ 500,000 to US\$ 2 million in 1995.¹²⁵ The Bank also issued short-term and long-term bonds worth 10 million baht and 1.5 billion baht respectively to absorb excess liquidity in the system between 1995 and 1996. With regard to prudential concerns for short-term capital movement, the Bank began to demand that commercial banks, finance and securities companies and the BIBF maintain a separate cash reserve (7 percent) for short-term borrowing and deposits from abroad in 1996. As many have observed, these measures did not work very well in curbing external debt, or inflationary pressures, or the risks associated with short-term capital movement. The advantage of foreign investors in substituting one form of investment over another (particularly non-FDI capital) kept foreign capital flowing into the country. As a result, capital inflows in the forms of direct corporate loans, portfolio investment, and non-resident baht accounts rose substantially between 1995 and 1996 as BIBF lending decreased. The high interest rate policy, even though aimed at curbing domestic credit extension, was attractive to foreign creditors as long as they had

¹²⁵ Pakorn Vichyanond, *Financial Reforms in Thailand*, p. 42.

confidence in the baht. The ability of the Bank of Thailand to control the influx of foreign capital was quite restricted by the various alternatives available to foreign creditors and investors and by the ineffectiveness of monetary and financial policy within the context of financial liberalization.

Another important aspect of the danger embedded in the liberalized financial system for which the BOT was unequipped was the situation of capital flight. The process of financial liberalization led to the abandonment of exchange control measures, including those used to control capital outflows. Freedom of capital movement, both inward and outward, became one of the main characteristics of a liberalized financial system and a basis of investor confidence. Without the option of capital controls, the BOT had to focus largely on preserving investor interest and confidence in the Thai economy in order to retain the flows of foreign investment. Its role in maintaining macroeconomic stability and a sound financial system was therefore directly related to efforts to maintain confidence.

However, the BOT's shortcomings in this regard can be demonstrated. First, the attempt to control capital outflows by guaranteeing investor confidence was rather precarious. Investor confidence was not always based on perfect information or rational calculation.¹²⁶ Collective market behavior may occur irrationally when people try to 'jump on the band wagon' or 'follow the money'. Once the herd mentality is underway, it is difficult to stop. The absence of any direct mechanism to deal with massive capital flight, the devastating result of which manifested during the crisis, put the BOT at a

¹²⁶ When signs of troubles are discovered, investors may become too sensitive to various factors that were not problematic to them before. Scholars of IPE, such as Susan Strange and Robert Wade, write about investor behavior in less-than-perfect market situations. See Strange, *Mad Money*, and Wade, "Asian Debt-and-Development Crisis."

disadvantage in maintaining financial stability. Second, due to the interconnectedness of world financial markets, capital outflows may be influenced by external factors beyond the host country's control. A good example can be seen in the 'pull' effects of the US economy around the same time of the 1997 crisis due to the revival of its economy and stock markets, causing the return of a large amount of investment funds from emerging markets including Thailand.¹²⁷ This aggravated the impact of capital flight from the Thai market, which was triggered by the devaluation of the baht and problems in the financial sectors. The reluctance of the BOT to impose sterilization measures to contain the outflows for fear of further ruining investor confidence confirmed the structural disadvantage faced by public authorities of developing countries in safeguarding their national economy from the adverse effects of free capital movement.

The context of democratization also played an important role in affecting the BOT's ability to prevent the financial sector crisis. Besides causing some changes to the Bank's institutional character as discussed above, the institutionalization of party politics that was the main aspect of the democratization process in Thailand brought about an important change to the relationship between the Bank and the Ministry of Finance. The former BOT-MOF relationship, based on an informal alliance among senior economic bureaucrats, had given way to a new relationship, which saw the MOF attempting to claim more authority over the Bank and the Bank trying to preserve its autonomy. Among the first signs of a power struggle in the removal of Bank Governor Nukul

¹²⁷ In his discussion of the contributing factors to capital flows to emerging markets, particularly in the 1990s, Kahler refers to low level of interest rates in industrialized countries as a less flattering explanation for the inflows to developing countries. He also points to the slow-down of portfolio capital flows in 1994 as the Federal Reserve raised US interest rates. See Miles Kahler, "Introduction: Capital Flows and Financial Crises in the 1990s," in *Capital Flows and Financial Crises*, ed. Miles Kahler, (Manchester: Manchester University Press, 1998), p. 4.

Prachuabmoh by Finance Minister Sommai Hoontrakul after the former had been in office for four years. Despite Sommai's refusal to view his dismissal as politically motivated, many observers referred to their policy conflicts, particularly with regard to the treatment of a commercial bank in distress and a baht devaluation, as the cause of Nukul's unprecedented removal in 1984. In the past, the public was familiar with seeing a Bank Governor resign in protest against government/MOF intervention, but never in BOT history had a Finance Minister initiated a removal of a Bank Governor.¹²⁸ The irony lay in the fact that Sommai was a former BOT senior officer, who probably knew better than many people how the Bank had struggled to preserve its operational autonomy from government interference. Clashes between the Bank Governor and Minister of Finance also took place between Kamchorn, Nukul's successor, and Pramual as mentioned earlier. Pramual's liberalization policy, i.e., lifting the deposit rate ceiling and permitting new foreign bank entry, did not gain full support from the BOT. His conflict with Kamchorn over interest rate reduction led to the dismissal of the latter in 1990.¹²⁹

The willingness of the MOF to use its power to appoint or dismiss the BOT top executives and to assume a more hands-on role in policymaking created an environment that was not facilitative of the Bank's operational freedom. That Bank leaders chose to adapt to the new political environment by 'playing politics' had important yet various consequences. The wholesale launching of the liberalization process in 1990 under Chavalit, Kamchorn's successor, may be seen as an attempt to take advantage of the political climate that saw Pramual's popularity declining in order to push for the Bank's own version of financial liberalization. The military-installed technocrat-filled Anand

¹²⁸ From 1942 to 1984, four Bank Governors resigned. See Table 7.1 in chapter 7.

¹²⁹ See detailed account of the conflict and media reactions in Apichat Satitniramai, "The Rise and Fall of the Technocrats," pp. 134-142.

government, which came to power shortly after the 1991 coup, helped the BOT carry on the task of introducing sweeping changes to the financial system.¹³⁰ The result was a hasty top-down transformation of the financial landscape. Vijit, Chavalit's successor, was seen playing a different kind of politics when he chose to establish relationships with elected politicians. His connection with the Chatichai government (led by the Chat Thai party) as an economic adviser when he was Deputy Governor in the late 1980s and his accommodative relationship with Surakiat, the Finance Minister under another Chat Thai-led government led by Banharn, showed a different approach to the Bank-government relationship. However, Vijit's inclination to accommodate elected politicians did not help boost the BOT's autonomy or its ability to influence policy. For example, Vijit failed to convince the Banharn government in 1994 to maintain the fiscal surplus that was necessary to counter the expansion of credit due to the influx of foreign capital.¹³¹ The multi-layer connection between the BBC, the Bank and the Chat Thai party induced leniency and delay in the FIDF's measures in dealing with the insolvent institution. In 1997, the Bank and the FIDF had to exclude a number of financial institutions, in which some coalition members had financial stakes, from the list of firms to be asked to increase capital as their financial position deteriorated. The BOT's operational autonomy, particularly with regard to fiscal-monetary coordination and financial institution supervision, was in decline as the Bank was pressured to compromise its objectives and the quality of its operations to satisfy political demands.

¹³⁰ See Doner and Unger, "Thai Economic Development," p. 121.

¹³¹ Apichat argues that by this time (Vijit's tenure) the BOT had lost its influence in the making of macroeconomic policy, particularly fiscal policy, due to the politics among key economic agencies and the politicization of these policy processes. See Apichat, "The Rise and Fall of Technocrats," pp. 168-171.

The interplay between the decline of the BOT's institutional character and the changing financial and political contexts of the late 1980s and 1990s had an adverse effect on the Bank's capacity to regulate and monitor the financial system. This weakness, reflected as early as 1992 in the institution's inability to effectively resolve the insolvency problem at the BBC, was central to the fomenting of the financial sector crisis that culminated in the closure of 58 finance companies in August 1997.¹³² The delay and ineffectiveness of the Bank's financial rescue measures and its tarnished reputation allowed the problems to expand to an unmanageable scale. The rigidity of the FIDF's approach to insolvency and liquidity problems saw the agency inject indiscriminately more than 700 billion baht into distressed financial institutions, gradually reducing the institution's capacity to remain the lender of last resort.¹³³ By 1996, loss of confidence among the public and foreign investors loomed large as they witnessed the various signs of weakness of the financial sector and its main regulator. The downgrading of Thailand's creditworthiness by Moody's Investors Service in September 1996 made such loss of confidence official.¹³⁴ After that, waves of capital flight and its self-fulfilling power began to take momentum, which not only drove even solvent financial institutions to the brink of insolvency, but also made the declining baht no longer defensible.

¹³² In 1992, the Bank discovered through the regular bank investigation the unusually high level of classified loans (26.78 percent) than the whole banking system's average (7.41 percent), meaning the BBC possessed substandard loans 3.6 times more than the whole system. Despite a demand for immediate capital increase, the BBC continued to maintain a dangerously high level of substandard loans throughout 1993-1994 (rose to 39.57 percent in 1994). See more detail in Nukul Commission Report, chapter 4.

¹³³ Nukul Commission Report, p. 139.

¹³⁴ Ibid., p. 135.

Financial Liberalization and the Currency Crisis

The Path toward Currency Instability

Following the baht devaluation in 1984, the Thai currency played an important role in stimulating the growth in manufactured exports, which caused the economy to expand rapidly for almost a decade. The Bank of Thailand's 14.8 percent devaluation and its adoption of the basket-pegged exchange rate system, in which the US dollar was dominant, facilitated the inflows of foreign direct investment, particularly from Japan whose firms began to relocate their production to SEA to lower their production costs since mid 1970s.¹³⁵ The appreciation of the yen against the US dollar after 1985 made the baht, which was essentially tied to the greenback, even less expensive to the Japanese currency.¹³⁶ Foreign exchange incentives, together with other factors, such as cheaper labor costs and macroeconomic stability, therefore attracted more Japanese investors, and to a lesser degree those of East Asian NICs and Western countries, to relocate their production to Thailand. The rapid economic expansion (12.2 percent between 1988 and 1990 and 8.6 percent from 1991-1995) gave endorsement to the export-led growth strategies, which saw the maintenance of a low and stable currency as one of the priorities.¹³⁷ For the BOT, the growth-induced monetary strategies confirmed the merit of its long-time tradition of macroeconomic conservatism, which included the maintaining of fiscal discipline, low inflation, and a stable exchange rate.

¹³⁵ See discussion on the evolution of Japanese investment patterns in SEA in Pasuk, *New Wave of Japanese Investment in ASEAN*.

¹³⁶ Pasuk and Baker note that the yen had continued to appreciate from 1180 yen per 100 baht in 1982 to 508 yen and 388 yen in 1988 and 1995. See Pasuk and Baker, *Thailand's Boom and Bust*, pp. 70-71.

¹³⁷ Bank of Thailand, *Annual Report*, various issues.

In the late 1980s, as the Bank of Thailand embarked upon the process of financial liberalization, it sought to maintain a stable and competitive baht through a fixed exchange rate policy. The main justification, in addition to export stimulation, was to attract foreign capital and to help reduce exchange rate risks associated with currency fluctuation for Thai borrowers. The Bank's confidence in its ability to defend the baht, rooted in its relatively successful history and the relatively high international reserves (around 6 months of imports) under its control, also encouraged the pursuit of the fixed exchange rate system to achieve other intended monetary objectives. To sustain the value of the baht, the Bank continued to pursue conservative macroeconomic policies, including high interest rates and fiscal discipline to limit inflationary pressure, particularly from credit expansion. It cannot be denied that, through these macroeconomic policies, the Thai authorities were able to build confidence among foreign investors, which manifested in huge capital inflows throughout much of the early 1990s. It is important to note that, at least up until 1992, the Bank expressed reservations about the adoption of a market-determined exchange rate regime as it was concerned with the maturity of the country's money and foreign exchange markets and its capacity to maintain a stable currency through the currently available monetary instruments (i.e., the Bank rate, repurchase market, and government securities).¹³⁸

However, as history shows, the maintenance of the old macroeconomic framework in a new context was not without complications. Changes brought about by the financial liberalization process rendered macroeconomic management more difficult and unpredictable than in the pre-liberalization period. For instance, from a practical

¹³⁸ See Bank of Thailand, *50 Years*, pp. 398-400.

perspective, the pursuit of fixed exchange rate policy in an age of accessible foreign funds created a false sense of security among Thai borrowers. With a fixed exchange rate regime, borrowers did not care to hedge against future exchange rate risks and tended to borrow freely due to the lower costs of foreign borrowing. Such moral hazard problems led to excessive and unscrupulous borrowing, which increased the economy's exposure to foreign debt. The BOT's reliance on a high interest rate policy to control credit expansion was also ineffective as high interest rates continued to attract foreign capital.¹³⁹ Moreover, local borrowers, who found domestic borrowing too costly as a result of high interest rates, could easily resort to less expensive foreign loans. Consequently, inflationary pressures created by uncontrollable credit expansion, combined with the appreciation of the baht triggered by external demand and the currency's link to the US dollar, caused a decline in export competitiveness as costs of production were driven higher.¹⁴⁰ Another example of macroeconomic complication was the unintended growth of the foreign exchange markets of the baht. The stability of the baht backed by fixed exchange policy encouraged foreign investors to increasingly invest in the Thai currency through Thai-denominated debt instruments issued by Thai financial institutions and firms. The BOT reported that in 1994 the selling and purchasing of the baht in domestic market alone accounted for US\$ 2 billion a day.¹⁴¹ The trading rates were higher in

¹³⁹ To a large extent, the ineffectiveness of the BOT's monetary policy supports the theoretical proposition of the famous Mundell-Fleming model which stipulates that states could not simultaneously enjoy an independent monetary policy (i.e. the control of money supply and interest rates), fixed exchange rates, and free capital movement. However, as mentioned earlier, from a policy standpoint, the decision to continue to maintain the fixed exchange rate policy was about the Bank's caution about the its capabilities to preserve a stable currency within a flexible regime rather than its ignorance of the risks in the pursuit of a fixed exchange rate regime in an open financial market.

¹⁴⁰ It is interesting to note that the Thai authorities sought to remedy the competitiveness problem by granting import tariff and value added tax rebates and a reduction of tariffs on raw materials to exporters in order to help lower production costs. See Bank of Thailand, *Annual Report 1996*, p. 3.

¹⁴¹ Nukul Commission Report, pp. 3-4.

offshore markets, particularly during Asian trading hours and within the London and New York markets.¹⁴² The major implication of this phenomenon was that the BOT could no longer control the trading of the Thai currency and that it had to stand against these currency traders in defense of the baht.

As already mentioned in the previous section, signs of systemic vulnerability began to emerge toward the mid 1990s. For example, in 1995, the current account deficit rose to an unprecedented 8.2 percent of GDP.¹⁴³ In 1996, external debt accounted for 50.14 percent of GDP, exceeding the 40 percent prudential level.¹⁴⁴ The weaknesses of the financial sector were revealed through the disclosure of the BBC scandal in early 1996 and the rising number of financial institutions in need of FIDF liquidity injection toward the end of 1996 and early 1997. Among the most alarming indicators was a sudden drop in export growth to a negative level in the last quarter of 1996 after having been expanding more than 10 percent annually for the past decade.¹⁴⁵

That foreign investors began to panic and pull their investment from the Thai economy has already been mentioned. What is of concern here is particularly how currency speculators reacted to these signs of trouble and the impact of their actions on the stability of the baht. The economic conditions during 1996-1997 gave speculators reason to believe that the Thai authorities would no longer be able to sustain the baht due to the rising current account deficits, aggravated by the decline in exports, and the huge accumulation of external debt. Taking a gamble on the idea that the BOT would have to

¹⁴² Ibid.

¹⁴³ Ibid., p. 6.

¹⁴⁴ Ibid., p. 7.

¹⁴⁵ The growth rates of exports of the last four months of 1996 were -9 in September, -2 in October, -5.8 in November, and -1.7 in December. See Nukul Commission Report, pp. 26-29, for BOT's view of export slowdown.

devalue the currency eventually, speculators began to sell the baht in the foreign exchange markets. Their actions set a baht devaluation in motion. A series of speculative attacks, which began in January 1997 but became increasingly intense during the month of May, significantly weakened the BOT's ability to defend the currency as international reserves became rapidly depleted. The most severe attack, which occurred on May 14, 1997, required the Bank to spend over US\$ 10 billion to intervene in the markets.¹⁴⁶ Despite a temporary victory against speculators, the weakness of the BOT's international reserve position forced it to abandon the fixed exchange rate policy in July 2, 1997. Unfortunately, when it was revealed to the public that the international reserves had declined to the level of US\$ 2.8 billion after the baht was floated, capital flight intensified as investors lost confidence in Thailand's ability to service its debts. The baht continued to fall sharply from around 27.38 baht to 1 US dollar on July 2, 1997 to 56.06 baht in January 1998, before stabilizing around 40 baht during the aftermath of the crisis.¹⁴⁷

The Bank of Thailand's Autonomy and the Fixed Exchange Rate Policy

To understand why the Bank of Thailand failed to prevent the currency crisis, particularly by abandoning the fixed exchange rate policy before it was too late, one needs to begin by examining the issue of the BOT's autonomy. Here the differentiated view of central bank autonomy is instrumental in helping us understand how the Bank's relative independence varies from one policy area to the next due to each policy's specific context. It can be argued that unlike its role in financial institution supervision,

¹⁴⁶ Ibid, p. 64.

¹⁴⁷ Bank of Thailand, *60 Years*, p. 32.

which was affected by political interference, the Bank enjoyed a high degree of operational and policy autonomy in the area of exchange rate policy. Such autonomy derived from several sources. First, according to the law, a change in the exchange rate system is to be introduced by the Minister of Finance upon the recommendation of the Bank of Thailand.¹⁴⁸ In the past, conflicts did arise from disagreements between the Bank Governor and the Minister of Finance over exchange rate policy, mostly resulting in the resignation of the former.¹⁴⁹ After the baht devaluation in 1984, however, there seemed to be a political consensus on the merit of the basket-pegged exchange rate system in contributing to the growth of export sector and the economy as a whole. This consensus was compatible with the BOT's own preference for a fixed exchange rate regime as it helped the Bank maintain a stable currency. For over a decade, as there was no significant opposition to the fixed exchange rate policy, the Ministry of Finance seemed to allow the BOT to have a final say with regard to any changes to the system. Even on the eve of the crisis, despite several warnings from the IMF, the MOF still chose not to pressure the Bank to make any changes to the exchange rate policy.¹⁵⁰ No matter what the MOF's motives were, the BOT clearly enjoyed the operational and policy autonomy in exchange rate policy until the eve of the crisis.

Second, the control over international reserves allowed the Bank to defend the baht independently. Since 1955 the Exchange Equalization Fund (EEF), which was technically one of the three international reserves accounts, was created specifically for the BOT to use in intervening in the market to maintain a desired value of the baht. From

¹⁴⁸ Currency Act of 1958, section 8.

¹⁴⁹ Dej Snidvongs in 1952 and Nukul Prachuabmoh in 1984. See Table 7.1 in the following chapter.

¹⁵⁰ Based on the Nukul Commission Report, the IMF had tried to persuade the Thai government to adopt a more flexible exchange rate regime at least 7 times before July 2, 1997. See Nukul Commission Report, pp. 31-33, 71-73.

that time, the BOT, through the EEF staff, had played an important role in determining and defending the value of the baht in accordance with the concurrent exchange rate regime. Under the basket-pegged system, the EEF determined the value of the baht daily based on the movement of the currencies in the basket and intervened in the market to achieve the desired value, which fluctuated slightly within a narrow band. In addition to the EEF, the BOT was able to use another account of the international reserves called the General Account to intervene directly in the currency markets independently from the EEF.¹⁵¹ Between 1996 and 1997, this account was used to make swap arrangements with the market in order to maintain the liquidity of the baht in the system. The freedom of the BOT to use these international reserves to defend the baht under its own discretion confirmed its operational autonomy in this regard.

Third, the BOT had the discretion to reveal or conceal essential information even in its communications with the MOF. Sensitive information, such as the level of international reserves, was never revealed liberally even to the Finance Minister. The fact that the Finance Minister was not directly informed of the level of international reserves until very close to the outbreak of the crisis reflected another important aspect of the Bank's autonomy in the pursuit of exchange rate policy.¹⁵²

As the BOT enjoyed a large degree of exchange rate autonomy, one needs to ask a question: why then did the Bank choose to adhere to fixed exchange rate policy? An answer can be drawn from historical, institutional, and organizational perspectives. It may be firstly argued that tradition played an important role in shaping the Bank's preference for a fixed exchange rate system. Throughout its history, the pursuit of a

¹⁵¹ Nukul Commission Report, p. 37. This account was separately managed by the Banking Department.

¹⁵² Ibid., p. 66-70.

stable currency, along with low inflation and fiscal discipline, was part of the BOT conservative tradition. The need to remain creditworthy in the eyes of the international financial community in order to maintain financial sovereignty (colonial period) and attract foreign investment (post-war period) was the key motivation beyond simply achieving macroeconomic stability. The fixing of the value of the baht at a certain level, be it tied to a precious metal or major currency, was the BOT's main policy instrument to achieve its objectives.

Secondly, despite the movement toward a flexible exchange rate regime since the 1970s, developing countries like Thailand were guided by the demand for international credit to continue to maintain a stable currency in order to gain the confidence of foreign creditors and investors. The influx of Japanese investment during the late 1980s was not merely a response to a cheaper baht, but also to the baht's stability as it was technically pegged to the US dollar. In the 1990s, the competition among emerging markets to attract foreign capital also influenced host countries to maintain a stable currency as part of the 'pull' effects. The fact that other ASEAN countries, such as Indonesia, pegged their currency to the US dollar reflected the importance of a fixed exchange rate.

Thirdly, from a capacity perspective, the Bank's lack of experience and lack of a mechanism to deal with a flexible exchange rate regime made the choice of a fixed exchange rate more feasible.¹⁵³ On the other hand, the Bank's control of the international reserves mentioned above showed that it had the capacity to defend the baht to the extent allowed by the level international reserves.

¹⁵³ Ibid.

Fourthly, toward the end of the fixed exchange rate regime, the Bank was still reluctant to change the value of the baht because of the damage it would cause to the economy, which was deemed to be potentially phenomenal due to the amount of external debt. The BOT was also convinced by its own interpretation of the adverse economic conditions, such as the export slump and currency account deficits, that these events were rather temporary or cyclical.¹⁵⁴ One can never know if such an interpretation was justified as investor panic precipitated what the Bank thought to be only a worst case scenario. Clearly, the tendency to see more clearly the damage of a change in exchange rates than the damage from not changing influenced the BOT to remain committed to the fixed exchange rate until the end.

Finally, a number of organizational factors played an important role in weakening the Bank's capacity to use more proper strategies to defend the baht during the eve of the crisis.¹⁵⁵ First, the lack of departmental coordination both at operational and management levels, particularly between the EEF and the Banking Department, led to the uncoordinated use of international reserves. While the EEF sought to defend the baht mainly through the sale and purchase of baht and dollars from commercial banks, the Banking Department, between 1996 and 1997 was responsible for direct market intervention and making swap arrangements. The use of international reserves from two separate accounts without coordination caused the total reserves to be depleted unknowingly. That the EEF manager was not informed of the details of the Banking Department's intervening operations during the speculative attacks, particularly the amount of international reserves used, until mid May 1997 reflected the lack of

¹⁵⁴ Ibid.

¹⁵⁵ Most the information on this issue was drawn from the Nukul Commission Report, chapter 3.

coordination and the questionable secrecy in handling international reserves even among key decision makers. Second, even though faced with a critical situation, BOT leaders did not treat the baht problem with sufficient urgency. An internal recommendation for a more flexible exchange rate policy was not responded to promptly by Bank top decision-makers (over a month's delay), while the baht defense operations were allowed to continue depleting international reserves. The delay in decision-making certainly contributed to the prolonged deterioration of the international reserves. Third, the rigidity of the Bank's priority in its currency defense operation, i.e., to defend the baht at all costs, exacerbated the misuse of the international reserves. The desire to overcome speculative attacks led the Bank to stretch its use of international reserves without considering the damage done to the international reserve position. During the severest attack in mid May 1997, the decision to use unlimited amounts of reserves to win the speculative 'war' cost the BOT US\$ 10 billion, while the reserve position was reduced to US\$ 2.5 billion. The 'victory' only proved to be hollow considering the weak international reserve position Thailand was left with.

Looking closely, these organizational factors were symptoms of broader organizational problems the BOT was experiencing due to changes in its organizational character and the financial and political contexts. Personal rivalry may be a deeper cause of the lack of coordination and decision-making delay mentioned above. The distanced relationship between Bank Governor Rerngchai and Deputy Governor Chaiyawat may be seen as a product of the dissatisfaction of the latter with the former's appointment as Governor after the resignation of Vijit. The latter's brief appointment as Deputy Finance Minister may have created awkwardness in the chain of command to the former.

Rerngchai's decision to not have Chaipayat, who was the EEF manager, oversee the operations of the Banking Department, which was responsible for direct market intervention, seemed to leave the latter out of key decisions despite his expertise and capacity.¹⁵⁶ It was quite likely that these factors created an organizational environment conducive to a lack of coordination, misplaced expertise, and a lack of sense of ownership in overall organizational performance. The need to win the speculative wars could be traced to a larger contradictory role developing countries were demanded to play in the era of globalized finance. The dilemma facing monetary authorities, between the need to maintain a stable currency and the cost of such defense was magnified in a crisis situation. On the eve of the crisis, both the costs to defend and not to defend the baht were already too high, crippling the Bank's ability to come up with any solution that could be satisfactory and expedient. The danger in the freedom of capital movement in the international financial system, in this case reflected in the action of currency speculators, structurally undermined the Bank's capacity to defend the stability of the baht as in the past.

In conclusion, this chapter joins critics of financial liberalization in arguing for the danger embedded in certain practices in the international financial system and the difficulties faced by developing country governments in managing an open financial system. The Thai case demonstrates clearly that financial liberalization made both financial institutions and their regulator, the BOT, highly vulnerable to changes in the pace and volume of capital movement. However, this is not the only explanation for the crisis. The chapter shows that the context of democratization and the change in the

¹⁵⁶ Ibid., p. 86.

Bank's institutional cohesiveness and credibility contributed significantly to the decline in its capacity to maintain financial stability. The structural weaknesses of domestic financial institutions, due to their history of low competition, made them even more susceptible to the risks and danger of free capital movement. In addition to the contextual factors, the chapter focuses on two major mechanisms that triggered the outbreak of the crisis, namely the collapse of both the financial sector and the fixed exchange rate regime. Here, the explanation centers round the issues of the Bank's relative autonomy and the path dependence in the Bank's operation. The decline in its credibility and independence in financial institution supervision, on the one hand, and its unchecked authority in the maintenance of exchange rate policy, on the other, not only are key to our understanding of these mechanisms, but also tell us about the varied extent of the Bank's autonomy in different policy areas and the impact of such variation on its performance. The path dependence concept helps us see the limit in the BOT's policy choices with regard to insolvency in the financial sector and exchange rates. The familiarity of old practices, e.g., the provision of financial bail-outs and the maintenance of a fixed exchange rate regime, and the existing organizational resources and expertise, e.g., the presence of the FIDF and the EEF, made the continued pursuit of these policies more attractive than adopting new but untested solutions.

Finally, understanding both the context and mechanisms that led to the crisis speaks to developing countries' choices in choosing their development path. As the first section of this paper demonstrates, that the BOT identified the national interest with the upholding of international credibility led it to adopt policy preferences incongruent with the trends in the international financial system. Unfortunately, in the period of financial

liberalization, by allowing for free capital movement, the Thai financial system was exposed to the dangers in the ebbs and flows of international finance while the central bank's ability and policy instruments to cope with capital volatility became limited. The difficulties in preserving both international credibility and domestic national interest reflect an important conundrum facing developing countries as they seek to integrate into the global financial system.

Conclusion

The BOT's Relative Autonomy and the Evolution of Thailand's Monetary and Financial Policy

This chapter concludes our quest to understand more fully the relative autonomy of the Bank of Thailand and its implications for the making of Thailand's monetary and financial policy from the 1940s to 1997 by drawing together the main ideas presented in the preceding chapters. The questions on the nature and sources of the Bank's autonomy will be answered in the first section through a dissection of the different dimensions of central bank independence as examined throughout the work. The main findings point to the importance of BOT credibility in maintaining autonomy and gaining compliance, cooperation, and trust from the government, financial sector, and international financial community. This credibility was predicated upon the institution's character, namely its technical expertise, moral authority, and guardianship of the national interest. A decline in these values had significant implications for its ability to operate independently and effectively. The second section seeks to build a case for the differentiated understanding of central bank autonomy in order to relate this work and its contributions to the broader literature. The third section recaptures the connection between the BOT and the evolution in the Thai monetary and financial policy from the 1940s to the financial crisis. Based on an institutionalist framework, the section offers a bird's eye view of the development of these policy regimes in forms of institutional continuity, change, and

breakdown, in which the BOT served as a key agent. The road to the crisis not only signified the incompatibility of certain elements of the old and new rules of the game, but also the failure of the Thai authorities, particularly the Bank, in reproducing the conditions necessary for regime maintenance. The last section looks into the post-crisis era based on the perspective developed in this thesis

The Relative Autonomy of the Bank of Thailand

This study of central banking stresses the importance of a differentiated view of central bank autonomy with regard to the legal, behavioral, and relational aspects of autonomy. By extending our focus from legal independence, as mainly highlighted in existing central banking literature¹, to incorporate a behavioral dimension, we are able to understand better how the BOT was able to maintain a leading role in the making of the country's monetary and financial policy. Distinguishing among the different relationships the Bank maintained with the government, domestic financial sector, and external actors allows us to pay attention to each relationship's dynamic and how each affects the Bank's ability to pursue policy preferences in different areas at a particular time. This gives us a clearer idea of the Thai central bank's role in mediating among the various domestic and external pressures in the pursuit of monetary and financial stability. Below, the chapter assesses the nature of legal, behavioral, and relational autonomy and their determinants.

¹ For example, see William Bernhard, *Banking on Reform: Political Parties and Central Bank Independence in Industrial Democracies*, (Ann Arbor: University of Michigan Press, 2002); and John Goodman, *Monetary Sovereignty: The Politics of Central Banking in Western Europe*, (Ithaca: Cornell University Press, 1992).

De Jure and De Facto Autonomy

Like many other central banks, the legal framework establishing and stipulating the scope of operations and the role of the Bank of Thailand is the primary and formal basis of its relative autonomy.² The 1942 Bank of Thailand Act and Royal Decree Regulating the Affairs of the Bank of Thailand define the Bank's roles and responsibilities, its relationship with the government, and grant the Bank the authority to carry out its responsibilities. Under these laws, the BOT cannot be considered as autonomous in many respects. For example, the government (through the Minister of Finance) has the power to appoint and dismiss Bank top executives, whose term in office is not fixed. The MOF holds supervisory power over Bank operations and acts as a final arbiter in the conflict between Bank Governor and the majority of Bank Court of Directors. Bank policy objective in maintaining price stability is not clearly stipulated in any of the legislation and as the government's fiscal agent, it has the obligation to lend to the government.

Nevertheless, in granting the BOT the authority to undertake its responsibilities, the laws provide a high degree of operational autonomy, which has expanded over time in line with the growing scope of operations. For example, a series of laws, including the Commercial Banking Act of 1962, its 1979 amendment, and the Act on the Undertaking of Finance, Securities, and Credit Foncier Businesses of 1979 granted the BOT an increasing role and power in financial institution supervision. The 1985 amendment of the Bank of Thailand Act of 1942 established the Financial Institutions Development

² Due to the more permanent nature of the legal framework than other sources of central bank independence, there is a general inclination among scholars to focus on central bank law as key indicator of the autonomy of the central bank in question. See Goodman, *Monetary Sovereignty*, Cukierman, *Central Bank Strategy*, and Bernhard, *Banking on Reform*.

Fund as a financial arm of the BOT, allowing it to have more financial and managerial capabilities in dealing with illiquid or insolvent institutions. The Currency Act of 1958 granted the Bank sole authority to preserve the value of the baht through the control of the Exchange Equalization Fund and the Currency Reserve. The same law also stipulated that the MOF can only make changes to the exchange rates upon the Bank's recommendation. Not only does this operational authority allow the Bank the freedom to choose its policy instruments to achieve certain objectives, but the experience and technical expertise related to this authority is an important source of the Bank's influence.

The founding legal framework also provides the BOT with budgetary and administrative independence, enabling it to be free from government threats of budget cuts or administrative interference. This organizational autonomy allowed the Bank, particularly under the leadership of Dr. Puey, to design its own human resource and other organizational development programs, which were instrumental to the building up and sustaining of Bank capacity.

The ability of the Bank of Thailand to draw on other non-formal/legal sources to secure its freedom of operation and to facilitate the pursuit of its policy preferences reveals another aspect of the Bank's autonomy. The discussion in chapter 3 of the formative years of the Bank points to a number of non-formal sources of the Bank's independence. The ability to maintain relative price and currency stability despite government deficit spending reflected BOT operational autonomy in pursuing its unwritten policy mandate. The Bank's success in pushing for exchange liberalization in the mid 1950s indicates its influence in monetary policy direction. Dr. Puey's twelve-year tenure clearly defied government flexible appointment and dismissal power. And

the BOT's ability to reengineer its organization to support its perceived roles and functions revealed how organizational autonomy was used to support operational and policy independence.

Unlike legal autonomy, whose basis rests on the permanence of the laws, behavioral autonomy is largely based on a more fluid and 'softer' kind of compliance, manifested in policy consensus or convergence. The discussion in chapter 3 shows that a consensus between the government and the Bank to fight inflation and maintain exchange controls and multiple exchange rates during the war and immediate post-war period allowed the Bank a significant degree of freedom to pursue price and currency stability. Contextual factors played a role in contributing to government-Bank policy agreement. The hyperinflationary pressures and the depletion of international reserves during these periods convinced the authorities of the urgency of pursuing restrictive monetary and exchange rate policies. The bureaucratic-bias of military regimes, seen in the appointment of like-minded economic bureaucrats holding similar policy orientations to key economic agencies and ministries contributed to policy convergence. The BOT itself played an important role in inducing government compliance toward its policy preferences. The use of international financial institution influence to pressure the government toward a certain policy direction is a good example. In mid 1950s, the Bank was seen repeatedly referring to Thailand's obligation to the IMF to set a par value of the baht in its Annual Reports in order to convince the government to agree with exchange liberalization. In the late 1950s, the Bank also took advantage of World Bank recommendations on institution building to promote fiscal-monetary coordination through the inclusion of key economic agencies, including the Bank, in budgetary

appropriation and national development planning. The Bank's direct involvement in both processes accounted for increased fiscal discipline throughout the 1960s.

The BOT's ability to induce policy consensus or compliance from the government, which is largely the basis of its de facto autonomy, was institutionalized over time as the society came to acknowledge its good performance and significance. Here Selznick's insights on the institutionalization process help explain the connection between the Bank's credibility and its relative autonomy. The institutionalization of the Bank, a process which saw the Bank's distinctive characters—based in its moral authority, technical expertise, and guardianship of national interest—instituted as the organization's self and public image, contributed to Bank credibility and legitimacy in macroeconomic and financial sector management and therefore added to its influential role in these policy areas. This process can be observed during the Bank's formative years, particularly during the lengthy tenure of Dr. Puey, in which systematic attempts were made to promote the above institutional traits. By the mid 1960s, the Bank was widely known for its competence and trustworthiness and as a source of stability in times of political turmoil. This credibility was largely reflected in the institution's leading role in the process of structural adjustment and financial liberalization in the late 1970s and late 1980s respectively. The connection between Bank legitimacy and the process of institutionalization can be a potential theoretical bridge to Selznick's old institutionalism and the new institutionalism in organizational studies. As the BOT's role in preserving monetary and financial stability, through the pursuit of conservative monetary tradition and protectionist financial policy, became socially expected over time, the utilitarian and political nature of this role (e.g. its mutually beneficial relationship with the financial

sector), which Selznick views in terms of vested interest and political alliance, can also be perceived in a more idealistic and non-materialist basis. While material or political gains may be found underlying the Bank's relationship with its constituents, its role has been linked to what Hall calls 'the narratives of national interest', which serves to justify Bank legitimacy and the institution's sense of mission.³ The co-existence of both material and cognitive bases of the institutional status-quo seen in the case of the BOT demonstrates that there is still a significant theoretical connection between Selznick's old institutionalism and its newer counterpart.

As de facto autonomy rests largely upon consensus and credibility, it tends to vary in accordance with the institutional context and the Bank's institutional character. As we see in chapter 5 and 6, the period of democratization in the 1980s saw more frequent policy conflicts between the BOT and the government, ending with several departures of Bank Governor due to dismissal or forced resignation (see Table 7.1). Negative changes in the Bank institutional character had a significant impact on its ability to maintain public trust and to undertake its responsibilities independently and effectively. As the organizational and broader political environment of the 1990s encouraged internal rivalry and factionalism, the BOT was susceptible to political interference, hence losing its relative autonomy. To a large extent, the precipitating events leading to the financial crisis of 1997 were triggered by the loss of Bank independence and credibility particularly in financial institution supervision. The fluid nature of de facto autonomy makes it vulnerable to changes in the BOT's external and internal environment.

³ Hall, "Preference Formation as a Political Process", p. 136-137.

Table 7.1

The termination of BOT Governors' term in office from 1942 to 2001

Year	Governor	Cause for Departure
1946	H.H. Prince Vivadhanajaya	Resigned due to disagreement with the Phibun government over gold sale policy.
1952	M.L. Dej Snidvongs	Resigned due to disagreement with the Phibun government over baht revaluation (appreciation) policy.
1958	Kasem Sriphayak	Resigned to take responsibility of the checking scandal committed by junior Bank officers.
1952	Jote Guna-Kasem	Dismissed due to note-printing machine scandal.
1975	Bisudhi Nimmanhaemin	Resigned in protest of government intervention in BOT Headquarters construction contract.
1984	Nukul Prachuabmoh	Replaced by Kamchorn Sathirakul due to conflicts over bath devaluation and the handling of an insolvent bank with MOF Sommai Huntrakul.
1990	Kamchorn Sathirakul	Replaced by Chavalit Thanachanan due to conflicts with MOF Pramual Sabhavasud over interest rate policy.
1996	Vijit Supinit	Forced to resign due to his handling of the Bangkok Bank of Commerce case. Replaced by Rerngchai.
1997	Rerngchai Marakanond	Dismissed after BOT depleted the international reserves to fight speculative attacks causing massive loss of confidence leading to the financial crisis. Replaced by Chaiyawat.
1998	Chaiyawat Wibulsawasdi	Dismissed due to political pressure against his role in the events leading up to the crisis. Replaced by M.R. Chatu Mongol.
2001	M.R. Chatu Mongol Sonakul	Dismissed due to conflicts with PM Thaksin over interest rates. Replaced by M.R. Pridiyathorn.

Source: Bank of Thailand, *50 Years*, and Rangsan Thanapornpan, *Wikrittikarn Karn ngeru lae Setthakit Karn-ngern Thai* (Financial Crisis and Monetary Economics of Thailand), (Bangkok: Khobfai Press, 1998), pp. 280-281.

Three-Pronged Relational Autonomy

A more comprehensive understanding of the Bank's relative autonomy must include a separate examination of Bank relationship with different sets of key actors central to monetary and financial policy, namely the government, financial sector, and external actors. It is important also to try to elicit the key factors that determine Bank relative autonomy from these actors.

Bank-government Relations

As the above section touches largely upon the Bank-government relationship, there is no need to go into the same details. In essence, the legal framework provides a formal basis for this principal-agent relationship, in which the MOF maintains indirect policy control whereas the Bank enjoys operational and organizational autonomy. That the legal framework places a formal limit on the Bank's independence from the government is clear. However, over the course of its history, the BOT's ability to draw from non-formal/legal sources, particularly from the credibility of its institutional character, to induce policy consensus from the government, and to employ various strategies to achieve certain policy objectives, helped compensate significantly for its weak policy independence. In this regard, it cannot be denied that despite the existing legal limitations, the BOT tended to enjoy a significant degree of independence from the government in the pursuit of its policy mandate and preferences throughout much of its history.

As mentioned above, policy consensus is an important determinant of Bank relative independence from the government. A turbulent economic context, the prominent role of technocrats in economic policy-making during authoritarian regimes,

the Bank's political strategies and its own credibility all contributed to building a policy consensus and compliance that allow the Bank to operate rather independently. The conservative inclination of Thai elites to maintain international credibility and acknowledge their obligation to respond to IFI policy recommendations also helped in one way or another to restrict government expansionary tendencies, therefore helping the BOT pursue a conservative monetary agenda. On the other hand, we can see that policy conflicts did tend to lead to government intervention. While Bank-government conflicts can arise from various reasons, the likelihood that they would warrant government intervention was facilitated by the legal framework and later in the 1980s and 1990s by a more open political context. As already stressed, the Bank of Thailand Act of 1942 poses a formal limit to the Bank's independence from the government, a 'trump card' which can be played by the executive when necessary. The process of democratization in the 1980s, which saw growing business representation in politics, also provided more structural incentives for politicians to intervene in monetary and financial policy, therefore allowing them to take advantage of the legal framework to exert their control. Various institutional factors played an important role in providing opportunities and constraints for both the BOT and the government in their interactions with each other. Interestingly, while the government seems to have the legal control over the Bank, for many reasons history shows that it has not always sought to intervene with the latter unless it had political support (more so for elected governments) and that policy convergence, particularly the maintaining of the external stability of the baht, was often achieved. The BOT's organizational strength, especially its credibility (including strong Bank leadership, as with Dr. Puey), and the ability to adopt different strategies to achieve

its objectives have been instrumental in restraining government interfering tendency and in evading direct conflicts which could have led to political intervention.

A few words need to be said about the implications of BOT-government interactions for the concept of state autonomy. The principal-agent model, though useful in capturing the contractual nature of this relationship and in explaining the problematic that may have arisen from the delegation of authority (i.e., the agent's relative autonomy and the principal's need to maintain control) tends to be context-insensitive, thus diverting us from observing these interactions in their larger political setting. That the architects of the BOT-government partnership, such as Prince Viwat, were more concerned with insulating executive power from the legislature reflects the bureaucratic elite's intention to preserve state autonomy in these policy areas. As argued in chapter 4, the 'bond' between economic bureaucrats who sat on key economic agencies, including the BOT and the Ministry of Finance, may have convinced these elites that potential policy conflicts would rather emanate from members of parliament whom they viewed as representing specific interests. The allowing for the government to determine the scope of BOT activities and to have appointing, dismissal, and supervisory power over the Bank therefore helped preserve executive control over monetary and financial policy. In this respect, it can be seen that the delegation and exercise of authority was done within the sphere of the state. The challenge to this autonomy arose when party politics began to be institutionalized in the 1980s and elected politicians gradually took control of the executive branch. It is in this context that we see more resemblance in the application of the principal-agent model to what is largely understood in advanced industrial democracies, i.e. that the rationale for political control lies in the principal's electoral

mandate. It is important to know that concerns about democratic deficit is not what originally shaped the Bank-government relationship and that the new framing of the contract rationale to honor democratic ideals reveals a change in the nature of governance in the area of monetary and financial policy in the Thai polity, which resulted in more checks and balance between elected and bureaucratic officials.

However, the placing of the BOT-government relationship, at least from the 1940s to 1970s, largely in the context of state autonomy, should not prevent us from seeing the struggles between the Bank and the government over control in the making of monetary and financial policy. Institutional differences, particularly their roles and functions in the Thai polity, played an important part in shaping both Bank and government preferences with regard to these policy areas. The blurring of public and private interest as witnessed in military leaders' involvement in the patronage system is another important factor contributing to Bank-government struggle, which saw the former attempting to protect public finance and the financial system from the plunder of the latter.⁴ The BOT's ability to maintain its relative autonomy and to expand its influence in macroeconomic policy-making through the institution's credibility and proactive strategies as seen during Dr. Puey's governorship was instrumental to the continuation of the conservative macroeconomic tradition pursued by the Thai court since the colonial era.

Bank-Financial Sector Relations The Bank's relationship with the financial sector is another important element of relative autonomy that determined the Bank's ability to

⁴ The capture of parts of the state (or state apparatus) by these bureaucratic groups, whose political struggle led to the pursuit of their own interests, reflects the society-embedded nature of the Thai state during the so-called 'bureaucratic polity' era.

pursue its interests and preferences independently from those of financial institutions. Looking back in history, it can be seen that at the outset, the BOT did not have much authority over the financial sector. The history of foreign bank domination of the financial system and the late establishment of the Thai central bank contributed to the independence of financial institutions from the control of the Thai state. The close alliance between military leaders and commercial bankers and the latter's access to different sources of private credit also added difficulties for the BOT in managing the financial sector in the 1940s and 1950s. However, over time, the Bank was able to increase its leverage against commercial banks through its evolving role as lender of last resort (culminating in the establishment of FIDF) and protector against foreign competition, and to expand its supervisory role through a series of law amendments and passages. Its credibility, particularly during the reign of Dr. Puey, made it possible to solicit voluntary cooperation from the banking community through moral suasion. That the BOT was able to launch a number of financial policies like the preferential credit extension schemes in the 1960s, a series of financial reforms in the late 1970s, and the financial liberalization process in the late 1980s, which were not necessarily in the direct interest of the financial sector, was to a large degree indicative of its relative autonomy from these influential societal groups.

Nevertheless, BOT authority over the financial sector should not be overstated. After all, commercial bankers are among the most influential groups in the Thai society due to their wealth and political connections. To understand more fully the Bank's relative autonomy from these groups and increased interdependence between the two parties, one needs to take into account the shared interests and the benefits to be gained

by commercial banks from the BOT's monetary and financial policy. In general, like financiers in most countries, Thai bankers were largely inclined toward the BOT's conservative bias as their businesses thrived in an environment of financial stability.⁵ As most Thai banks borrowed from abroad, their costs of borrowing were largely contained by a fixed exchange rate regime. Bankers' aversion to high inflation, as their profits rested upon the real interest spread, also led them to support the BOT's conservative monetary tradition. But more particular to the Thai case, a common preference, which proved to be most beneficial to the Thai banking sector, was the authorities' intention to limit the scope of competition in the financial sector and to keep it relatively closed. The quasi-monopoly of the banking sector resulting from the authorities' decision not to grant new banking licenses or to limit the scope of operation of foreign banks helped existing commercial banks to solidify their financial power and expand into other industries while the BOT continued to maintain relative financial stability. Collective financial bailouts, which provided safety insurance against systemic collapse and distributed losses within the community, also served the need of financial institutions for a lender of last resort and deposit insurance.⁶ These 'vested interests' that Selznick sees as underlying an institution, in this case, the rules governing financial sector and the financial system, played an important role in sustaining the relationship between the Bank and its key constituents. However, as discussed in chapter 6, changes in the political and financial context in the 1990s led to increased divergence of interests on the part of the regulator and the regulated, with more opportunities for the latter to gain from credit extension

⁵ See Posen, "Why Central Bank Independence Does not Cause Inflation.," for this line of discussion.

⁶ BOT financial rescue measures were quite successful in maintaining financial stability by preventing the aggravation of bank runs in the system during the finance company and bank crises in the 1970s and 1980s. However, they were ineffective when the insolvency problem became systemic in the eve of the 1997 crisis.

through international borrowing. Financial sector management, particularly prudential regulation, became increasingly challenging, which when added with other factors produced devastating results as seen in the events leading to the 1997 crisis.

The interdependent nature of the relationship between the BOT and the financial sector also meant that authority was exercised rather half-heartedly in some circumstances. The non-interventionist tradition of the Thai authorities in credit allocation entailed primary reliance on private financial institutions to perform this function. As a major channel through which the BOT sought to manage the financial system, the financial sector's capacities, limitations, and sometimes its preferences and interests became the concerns of the Bank in the design and implementation of monetary and financial policy. For instance, as mentioned in chapter 5, in implementing the compulsory rural lending requirement, the BOT was quite flexible and lenient toward commercial banks by giving the latter lending options and sometimes choosing to overlook the missing quota.⁷ Commercial banks' low level of competitiveness, particularly their size of assets and ability to mobilize credits compared to foreign banks, played an important role in deterring the BOT from adopting off-shore banking facilities in the 1980s, let alone opening up the financial sector to more foreign competition. And despite the BOT's intention to limit ownership concentration in the banking sector, seen in the 1979 amendment of the Commercial Banking Act, the effectiveness of the law was compromised by a number of factors, including the non-retrospective nature of the provisions and the later exemption of ownership limit to facilitate commercial banks' participation in financial rescue operations in the 1980s. It can be seen that the

⁷ The BOT gave commercial banks a choice either to lend the required quota directly to the rural areas or to deposit the funds with the state-owned Bank for Agriculture and Agricultural Cooperatives (while gaining some interest).

interdependence (which has grown over the years) between the BOT and the financial sector did occasionally account for policy compromises and reciprocal treatment, which served to qualify the ability of the BOT to pursue its policy preferences.

When taking the many determinants of Bank-financial sector relationship into consideration, we can see that Bank authority over financial institutions and its freedom to pursue preferred policy objectives are largely conditioned by its leverage, credibility, and their shared interests. To a large extent, Bank authority and autonomy over the financial sector improved over time as the latter's dependence on the BOT and the existing financial arrangement institutionalized and more legal power was granted to the Bank in the area of financial institution supervision. As earlier stated, the BOT's more active role in introducing series of financial reforms since the 1980s and its confidence in launching the process of financial liberalization are quite indicative of the expanded scope of authority and policy autonomy. However, effective governing of the financial sector does not merely mean more legal power and freedom to pursue the authorities' policy preferences. Bank capacity to ensure a sound financial system also depends on effective financial institution supervision, which requires a great deal of monitoring power and cooperation from the financial sector. From what we see in previous chapters, while the BOT was able to use various strategies to preserve price and currency stability, its ability to do the same in financial sector management was limited by the Bank's lack of real effective control over financial institutions. Even though Bank supervisory power was later expanded, the co-dependent relationship posed a great deal of constraint on the BOT's ability to manage and regulate the financial sector effectively. As chapter 6 discusses, certain financial arrangements over time produced unexpected consequences,

which contributed to the vulnerability and weaknesses of the financial sector, particularly low competitiveness, concentration of ownership, and collateral-based lending, making the whole financial system susceptible to various kinds of risk. Accordingly, it is important to take note of the two separate issues with regard to Bank-financial sector relationship, i.e., the relative autonomy of the BOT from this societal group, which was supported by the common interests between them concerning monetary and financial policy, and the Bank's ability to effectively regulate the financial sector, which on the other hand was constrained by their very interest-based, co-dependent relationship, especially when their perceived interests came to part under changed institutional contexts.

Bank-External Actor Relations The relationship between the BOT and external actors, particularly the international financial institutions, is another important dimension of the Thai central bank's relative autonomy, which can serve as a proxy for an understanding of the external aspect of state autonomy in the area of monetary and financial policy. In the context of colonialism and the Pacific War, the imminent threats of foreign takeover prompted the Thai authorities to try to safeguard their sovereignty, in our case monetary sovereignty, by adopting policies which aimed to deter further interference and to appease the demands of external powers.⁸ The adoption of conservative monetary and fiscal policy at the expense of development needs by the Thai court was instrumental in avoiding any financial irresponsibility, which could be used as a pretext for intervention by the colonial powers. Later, the hasty establishment of the

⁸ A parallel can be drawn with series of territorial concessions Siam made with Britain and France in order to avoid aggravated conflicts.

BOT and the acquiescence to disadvantageous currency alignment was deemed necessary to protect the country's monetary independence from Japanese occupation. The severe impact of these compromises notwithstanding, the fact that the Thai authorities were able to maintain relative autonomy in macroeconomic policy-making, which enabled them to employ other policy measures to mitigate the impact of hyperinflation, was essential in safeguarding the economy.

During the post-WWII period, external pressures on state autonomy in monetary and financial policy appeared in more subtle forms. The Cold War context and its related development discourse and practices led to the increasingly influential role of the World Bank and the IMF in developing countries' economic planning. For Thailand, the convergence of the Bank's preferences, particularly macroeconomic conservatism, non-interventionism, and economic liberalization, with IFI recommendations helped cushion the intrusive nature of the latter's policy influence. That this Bank-IFI alliance was used to help the BOT preserve the national interest against the penetration of certain powerful groups demonstrates also the contributing role of this relationship to the strengthening of state autonomy from societal capture. However, as we see that the BOT's policy commitments were largely linked to the structurally-imposed desire to maintain international credibility, we have to accept the constraint posed on the Bank's ability to form and pursue its preferences in an autonomous manner by this long-standing credibility concern. Having so argued, it is important to note that such a constraint did not necessarily have entirely negative effects on the Thai economy and its financial system. Regardless of criticisms of the Thai state's developmental role, many students of Thai economic history agree that conservative monetary and exchange rate policies were

instrumental to the relatively steady economic growth in the 1960s and 1980s.⁹ And as chapter 6 discusses, much autonomy remained with the Thai authorities in implementing IFI policy recommendations, as seen in the requirement for joint-ventures between Thai and foreign investors and the BOT's decision to continue limiting foreign bank presence in the financial sector. These experiences help us understand the institutionalization of monetary conservatism and its external bias as Bank policy orthodoxy and serve as evidence of state relative autonomy in using different strategies to protect domestic interest from foreign penetration.¹⁰ It is also important to keep in mind the Cold War political and economic context and the relatively closed financial system in facilitating these phenomena.

Increased international financial integration, the end of the Cold War, and the rapid economic growth that the Thai economy experienced in the late 1980s created new institutional contexts for the Thai authorities. A surge in the demand for foreign investment and credit and the new international norms of free capital movement significantly changed the BOT's receptivity to foreign capital and led to the decision to launch a process of financial liberalization.¹¹ By opening up the financial system and voluntarily relinquishing most of its control of capital flows, autonomy in resorting to restrictive means to preserve financial stability was largely constrained, and the commitment to international credibility became more vital to the health of the financial system and the economy at large. While the adoption of financial liberalization was the

⁹ For example, see Muscat, *Fifth Tiger*, pp. 77-79, Pasuk and Baker, *Thailand: Economy and Society*, p. 29, and Dixon, *Thai Economy*, p.93.

¹⁰ The Thai experience can broaden the understanding of the impacts and effectiveness of IFI policy prescriptions in developing countries, particularly during the Cold War context.

¹¹ The Bank's confidence in its capacity to manage the financial sector after a series of law amendments to grant it more supervisory power and the establishment of the FIDF as its financial arm in dealing with insolvency and liquidity problems in the system also played an important role in this decision. See Bank of Thailand, *50 Years*.

Bank's own policy initiative and had the support of the government, convergence with the global movement of financial deregulation had important implications for state autonomy from external forces. First, the convergence continued to reflect the structural power of the international financial system, which influenced the choices of developing countries like Thailand that relied on foreign capital inflows. The encouragement of the international 'epistemic community', like the IMF and the Bank for International Settlements (BIS), which added technical and ideational justification for the convergence, showed a more subtle form of this structural power as well as the importance of the role of ideas and knowledge in promoting voluntary compliance. Second, the process of financial liberalization put the BOT at a disadvantage in its relationship with the external sector. Abandoning capital control measures left the Bank with little leverage against volatile short-term capital flows, particularly those aimed at speculative purposes. The increased burden on the Bank to ensure international credibility, which could be arbitrarily and subjectively (or irrationally) interpreted by investors, also made the institution more vulnerable to the mood of the external financial sector. This commitment turned detrimental when it compromised the Bank's ability to preserve macroeconomic stability and to protect the financial system from massive capital outflows during the course leading to the 1997 financial crisis.

Toward A More Differentiated, Historically- and Institution- Oriented Understanding of Central Bank Autonomy: A Contribution of the Thai Case

An investigation into the multi-dimensional aspects of the autonomy of the Bank of Thailand shows us that the concept has many facets and therefore warrants a more

accessible and differentiated understanding.¹² By distinguishing the various sources of the Bank's relative autonomy and its relationship with different key actors in the domain of monetary and financial policy as well as emphasizing the importance of history and institutions, this thesis hopes to offer better understanding of the opaque nature of BOT autonomy, through which a contribution could be made to the studies of the politics of central bank independence.

At least two clusters of insights can be drawn from the approach applied to the Thai case and the thesis's findings. The first one concerns the differentiated but interconnected view of BOT relative autonomy. Among the strongest cases in this thesis for the non-monolithic understanding of central bank independence is the importance of the BOT's de facto power. As we have seen, the dominant role of the Bank in macroeconomic management and its ability to preserve relative price and currency stability over the years cannot be accounted for merely by the Bank's legal status. The BOT's credibility, resting on its reputation for moral authority, technical expertise, and guardianship of national interests, served as an important source of its influence in the making and implementing of monetary and financial policy. Selznick's institutionalist approach particularly helps us explain the making of this institutional character by bringing our attention to the organization's adaptive ability and the infusion of value within the agency, which were manifested in the process of institutionalization. This 'old' institutionalist approach to central bank independence has the potential to expand

¹² The author thanks Dr. Jeremy Paltiel for suggesting the idea.

the understanding of what the existing literature views as ‘behavioral’ autonomy, which is much less theorized and tends to be studied from quantitative perspectives.¹³

By exploring separately the different dimensions of the Bank’s autonomy, the thesis finds that each dimension has its own evolutionary path, which might or might not correspond with others, and is conditioned (although not exclusively) by a set of determinants, which help us understand and predict the nature and development of the said autonomy. For example, in chapter 5 we learn that toward the late 1970s and 1980s, while the BOT was able to gain more authority and leverage over the financial sector through its evolving role as lender of last resort and protector of the domestic banking industry, a change in the political context toward democratization subjected the Bank to more intervention from the government. This is quite opposite from the 1950s and 1960s when the BOT had less authority and fewer financial means to bring the financial sector into line (with little recourse except to depend on moral suasion) but enjoyed quite a significant degree of autonomy (especially during the governorship of Dr. Puey) from authoritarian governments. A corresponding picture can be seen during the pre-crisis era. We observe that BOT’s autonomy from the government and the financial sector was in serious decline and that this phenomenon had a significant impact on the Bank’s ability to maintain stability in the financial system.

¹³ The movement toward granting more legal independence to central banks around the world in the past two decades triggered a widespread academic interest in explaining this movement, particularly in advanced industrial democracies, such as New Zealand, Italy, Britain, France, and the European Central Bank (ECB). To see an example of works which allude to the behavioral autonomy of central banks, see William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country*, (New York: Simon and Schuster, 1987). In examining the rationale behind tight monetary policy in the late 1970s and early 1980s, Greider explains how the Fed was able to use its technical expertise and the complexity of monetary policy to build its relative independence, despite the existing legal framework of congressional oversight. See also John T. Woolley, *Monetary Politics: The Federal Reserve and the Politics of Monetary Policy*, (Cambridge: Cambridge University Press, 1984).

Determinants of the Bank's relational autonomy can add to our understanding of the nature of its relationship with the government, financial sector, and the IFIs and international financial community. Apart from its institutional strength and credibility, the BOT is seen to have enjoyed relative autonomy from these key actors when there appeared to be a convergence of views or interests between them. Policy consensus among government and Bank leaders allowed the BOT to pursue its policy preferences, such as exchange liberalization, structural adjustment, and financial liberalization in the 1950s, 80s, and 90s respectively, while common interests and the building of leverage commanded financial sector cooperation. The BOT's conservative bias and inclination toward economic liberalism are shared by the IFIs and benefit the international financial community, therefore earning the Bank international credibility, while leaving some room for domestic-oriented (protectionist) measures. As these relationships are compliance- and interest-based, the absence of agreement and common interests tends to have a constraining impact on the Bank's ability to pursue its policy objectives. These constraints reflect the underlying advantage of these different actors over the BOT, i.e. the legal authority of the government, the political and economic power of the financial sector and its dominant role as credit allocator, and the country's dependence on foreign credit and investment, all of which put a premium on the Bank's institutional strength to bring about compliance, cooperation, and trust from these actors to ensure its relative independence. One of the implications of this knowledge beyond the Thai case is the varied ability and capacity of central banks to pursue policy objectives in different policy areas, as a result of the different power relations of the central banks vis-à-vis the main actors in a particular policy network at a given period. This scenario is very likely for

those of developing countries as they tend to take on more functions than only to maintain price and currency stability.¹⁴

Another insight derived from the differentiated view of BOT relative autonomy concerns the interconnectedness among these different dimensions. Quantitative measurements of central bank independence largely give us a snap-shot impression of a central bank's legal status or its actual capability beyond the dictate of the law. What is less discussed is how legal independence (or lack thereof) affects behavioral independence, or how, for example, the Bank's relationship with the IFIs helps enhance its stance vis-à-vis the government. This thesis finds that BOT legal status, while serving to limit its independence from the government, offers certain opportunities to the central bank to strengthen its de facto autonomy. The absence of term limits allowed Dr. Puey to remain as Bank Governor for 12 years, which proved to be beneficial to the Bank's institutionalization process. The budgetary and administrative autonomy provided by law also contributed to organizational development, which was essential to the Bank's institutional credibility. The thesis also finds that the Bank's relationship with the financial sector and the IFIs contributed to its influence on the government. The BOT often referred to Thailand's commitment to the IMF in convincing the government to liberalize the exchange rate regime in the 1950s. Dr. Puey's credibility and good relationships within the financial community allowed him to push for the passage of the Commercial Banking Act of 1962 and allowed him to openly discourage seating military

¹⁴ Hutchcroft's discussion of the Philippines case corresponds with this finding. In explaining how the state was captured by the landed oligarchs through a study of the banking system, he points to the difficulties of the Central Bank of the Philippines in regulating the oligarchic controlled banking sector. This is in contrast with the Bank's ability to maintain relatively low inflation and a stable peso since the 1950s, largely due to the support of the same family conglomerates that dominated the economy. See Paul D. Hutchcroft, *Booty Capitalism: The Politics of Banking in the Philippines*, (Ithaca: Cornell University Press, 1998).

leaders on commercial banks' executive boards. These phenomena confirm Bank agency in taking advantage of the institutional context and using different strategies to help it pursue policy preferences. It is this ability and the facilitating context that largely account for cross-country variations in central banks' actual autonomy. But the examples also reflect how Bank legal status and its relationship with key actors were not merely 'indicators' of Bank relative autonomy but became a part of the BOT's 'institutional environment', on which its adaptation and strategies were based. As these adaptive and strategic behaviors showed how different dimensions of autonomy were used to counterbalance or encourage one another, there is a strong case for examining them separately to understand the continuous process of the making of the Bank's relative independence.

An examination of the interplay among different dimensions of the Bank's autonomy also offers interesting comparisons of the nature of the different types of autonomy and their impact on actors' behaviors. The more permanent and tangible nature of the BOT's legal status means that there is a standing incentive and jurisdiction for the government to intervene in monetary and financial policy. On the other hand, credibility-based autonomy largely depends on the ability of the Bank to continually maintain its reputation. Due to the more fluid and subjective nature of this latter type of autonomy, the BOT was compelled to be proactive in seeking government approval or compliance in order to avoid any policy conflict that could lead to government intervention. With regard to the autonomy from external actors, we can see that international financial institutions do have a great deal of influence in the direction of Thailand's monetary and financial policy. However, as seen in chapter 3 and 6, state

autonomy was exercised in the determination of policy timing and the implementation process. The convergence of policy preferences between the BOT and the IFIs and the country's relatively sound macroeconomic conditions seemed to allow more room for the Thai authorities to exercise their discretion (as discussed in chapter 6). But we see that when international credibility was in question and external financial assistance was needed such as during the early 1980s and the 1997 crisis, the authorities found themselves more obligated to follow IFI policy prescriptions rather strictly.

A focus on the interplay between the different dimensions of the Bank's autonomy has the potential to expand the dialogue between the studies of central bank politics with other areas of political inquiry. An important prospect is development studies. First of all, the two subjects are closer than many may think owing to their common interests around the issue of macroeconomic policy and the normative commitment in monetarism (and central bank independence) which underlies both mainstream discourses.¹⁵ This proximity is enhanced when the scope of central bank inquiry extends beyond advanced industrial democracies. As we may know, much of IFI and major donor countries' conditionalities have important bearing on central bank policy choices, responsibilities, and sometimes institutional design. Accordingly, the power relations between state and international actors in the making of these policies are as

¹⁵ The IFIs' widely known Structural Adjustment and Stabilization Programs, which became the core of development assistance since late 1970s, have sought to promote macroeconomic stability largely through restrictive monetary and fiscal policy among other things. These policy preferences are shared by most central banks. Increased attention on the concept of good governance at the IFIs since the 1990s also saw the attempts to promote checks and balances among political institutions as well as accountability, transparency, and efficiency in public services. Part of the policies to achieve these objectives are the establishment of independent agencies, such as the courts and central banks, which are to be free from political interference while being accountable to the public. See Paul Mosley, Jane Harrigan, and John Toye, *Aid and Power: the World Bank & Policy-Based Lending*, 2nd edition, (London: Routledge, 1995), chapter 1 and 2, for a good discussion of ideological and practical background of structural adjustment policies. For the rationale and policy measures for good governance, see World Bank, *World Development Report 1997*, (Oxford: Oxford University Press, 1997), chapter 6.

much relevant to the studies of central bank independence as those of development. As argued earlier, the differentiated view of central bank autonomy allows us to pay attention more closely to these power relations. Another interesting point of exchange concerns the impact of IFI policy recommendations on domestic politics. While the development literature touches rather indiscriminately on how IFI conditionalities can enhance the reformers' political stance, students of central bank independence can bring their insights to help expand this understanding.¹⁶ As we see in the Thai case, the locus of the policy contention was not necessarily in electoral politics, but lay within the principal-agent relationship between the government and the central bank. As a potential ally for much of IFI policy prescriptions, an understanding of the role of developing countries' central banks in the making of macroeconomic and other development policies through an examination of their relative strength vis-à-vis the government and their ability to use different strategies to pursue policy preferences will help students of development expand their perspectives on the politics of IFI conditionalities and the related impact of this politics on the nature and outcomes of economic policy in developing countries.

A second cluster of insights can be drawn from the emphasis in the thesis on the importance of institutions and history, which underlies its institutionalist approach. The first one concerns the view of the BOT as an institution. As discussed earlier, Selznick's view of an institutionalization process that takes place while an organization interacts

¹⁶ Development literature on the issue of international financial institutions' policy conditionality often discusses the extent to which conditionality helps reformers in a particular government push for their policy agenda or helps provide a 'lock-in' mechanism for the reform programs. See for example, Paul Collier et al, "Reconditioning Conditionality", *World Development*, Vol. 25, No. 9 (1997), pp. 1399-1407, and Devesh Kapur and Richard Webb, "Governance-Related Conditionalities of the International Financial Institutions", *G-24 Discussion Paper Series*, No. 6, (August 2000).

with and adapts to its environment and becomes embedded with certain values and interests, helps us understand the basis of the Bank's credibility and its special ties with monetary conservatism. This approach, which highlights the agency of the BOT and the evolving nature of its organization, helps us understand better the political struggle for independence and the control of monetary and financial policy in Thailand. But it also has a wider application for the study of the politics of central banking in a number of ways. First, the focus on central bank agency will add more balance to such inquiries, which normally pay attention to the interactions among domestic and to a lesser extent external actors in shaping the institutional design of a central bank and the making of monetary policy.¹⁷ This thesis provides evidence which shows that a central bank is not necessarily a passive actor but can take an active part in this political struggle.

Methodologically, despite being a dependent variable in the studies of central bank independence, there is a strong case for treating this state agency and its political role as an independent variable along with others.

¹⁷ A large constellation of work on central bank autonomy focuses its attention on the impact of domestic politics on monetary policy to explain the choice of central bank's institutional design. For example, the 'political business cycle' model, referring to a phenomenon in which incumbent politicians seek to manipulate the country's economic conditions in order to win re-election, supports the need to limit government ability to manipulate monetary policy through the establishment of an independent central bank. Some scholars focus on partisan and ideological preferences of a winning political party as a determinant for the nature of monetary policy and the degree of autonomy which a central bank is given. Others see central bank independence as a political strategy to 'tie the hand' of new comers or to minimize conflicts within a coalition government. There are also scholars that focus on the role of interest groups, particularly the financial sector, as the source of pressure behind conservative monetary policy and central bank independence. See William Nordhaus, "The Political Business Cycle", *Review of Economic Studies*, Vol. 42, No. 2 (1975): 169-190 for the first example. See also Douglas Hibbs, "Political Parties and Macroeconomic Policy", *American Political Science Review*, Vol. 71, No. 4 (1977): 1467-1487 for the partisan model; Delia Boylan, *Defusing Democracy: Central Bank Autonomy and the Transition from Authoritarian Rule*, (Ann Arbor: University of Michigan Press, 2001) for 'tie the hand' model; William Bernhard, *Banking on Reform* for coalition stability view; and Sylvia Maxfield, "Financial Incentives and Central Bank Authority in Industrializing Nations", *World Politics*, Vol. 46, 4, (1994): 556-588 for the interest groups approach.

Second, an institutionalist view of a central bank will contribute to the understanding of the agency's actions and preferences in a way that takes into account the importance of internal institutional factors. As shown in the Thai case, institutional character and value commitments have a role to play in shaping bank actions no less than external environment. A focus on these organizational norms, routines and expectation will add an organizational perspective to the sources of bank actions, particularly to those that reflect conformity and continuity over time.

Third, a process of institutionalization also brings our attention to the notion of bank capacity, which in many respects is essential to the attainment and maintenance of bank autonomy. We find that the Bank of Thailand's technical expertise, which has been a vital component of its credibility, was largely achieved through the quality of the organization's personnel and the effective use of policy measures. During Dr. Puey's tenure, systematic attempt for human resource development was established seen in the merit-based recruitment processes and scholarship programs to sustain the organization's technical excellence. An inquiry into the organizational make up of bank credibility is likely to bring the issues of central bank capacity and autonomy closer together as they tend to be treated separately. Recent studies of central bank capacity, like that of Hamilton-Hart, have introduced organizational dimension into the understanding of monetary and financial policy.¹⁸ This thesis wants to contribute to these insightful efforts and seeks to argue further for a place for organizational capacity in the studies of central bank independence.

¹⁸ Natasha Hamilton-Hart, *Asian States, Asian Bankers: Central Banking in Southeast Asia*, (Ithaca: Cornell University Press, 2002), Introduction.

Another cluster of insights from the focus on institutions and history concerns the importance of time and context. The difficulties in applying what we learn from much of central bank independence literature to cases outside advanced industrial societies, like Thailand, often lie in the institutional differences. Political institutions are one area of divergence. Scholars writing on Western democracies often refer to the political business cycle, partisanship, party ideological preferences, coalition politics, and monetary integration (in the case of European central banks) as significant factors shaping the likelihood of central bank independence and the inclination of monetary policy.¹⁹ However, this thesis finds that these democratic institutions have much less prominent role in influencing the politics of central banking in Thailand. Instead, the long period of authoritarian rule, the power of the bureaucracy, and the military-business alliance significantly laid the basis of BOT relationship with the government and the financial sector. That Thailand's democratic institutions are at this late date still in the process of institutionalization, means that the patterns of political struggle for the control of monetary and financial policy under a democratic context have yet to be routinized, therefore explaining part of the discrepancies with advanced democracies cases. The same can be said for Thailand's experience of regionalism.

Another area of divergence concerns the position of developing countries in the international political economy. The dependence on credit, trade, and technological transfer from external sources subject developing economies to international pressures in different ways and to different degrees from what advanced industrial countries have

¹⁹ For examples of works dealing with the issue of political business cycle, see Nordhaus, "Political Business Cycle" and Nathaniel Beck, "Politics and Monetary Policy," in *Political Business Cycles: the Political Economy of Money, Inflation, and Unemployment*, ed. Thomas D. Willet (Durham: Duke University Press, 1988). The variations seem to lie in the author's view of the characteristic of the political business cycle.

experienced.²⁰ We see in the Thai case that the need to maintain international credibility was linked to the preservation of sovereignty during the colonial era and later on to the desire to attract foreign assistance, investment, and credit. We also see that by seeking financial assistance from the IFIs in the 1980s, Thailand was obligated to restructure macroeconomic policy according to IFI conditionalities. During the 1990s the need to attract foreign capital was primarily behind the Thai authorities' decision to launch financial liberalization process as well as being a justification for the maintaining of the fixed exchange rate regime. While much of the central bank independence literature focuses on domestic politics as the main site of political contention (with the exception of the studies of the European Central Bank), it is important to take into account the influence of external pressures, obligations, and expectation posed by international actors and regimes on developing countries' monetary authorities as we seek to understand central banking politics in these economies.

Incorporating the institutional approach in the studies of central bank independence will help expand the breadth of the inquiry to countries with diverse institutional settings. As shown above, by taking into account the Thai political institutions and the country's position in the international political economy, we can understand better the nature of politics of central banking in Thailand. This thesis finds

²⁰ There are various sources of international pressures on developing countries. Among the most studied are the pressures from the international financial institutions through their conditionalities attached to financial assistance. As developed countries have not sought financial assistance from the IMF or World Bank since 1970s, they do not subject to these forms of external pressures. See Buira, *Challenges to World Bank and IMF*, for a discussion along this line. Another widely recognized source of international pressures is from the international financial community. See Layna Mosley, *Global Capital and National Governments*, (Cambridge: Cambridge University Press, 2003) for an innovative work that shows a differentiation between the effects of financial market pressures on developed and developing countries. She argues that while developed countries may be constrained by financial market pressures to maintain low inflation and budget deficits, their governments still enjoy the autonomy and discretion in choosing policy measures to achieve these goals. On the other hand, the international financial community pays closer scrutiny to a wider set of economic (and political) indicators of developing countries, therefore leaving developing governments with more limited policy options.

that such an evolutionary path plays an important role in shaping the nature of central bank relationship with the government, financial sector, and international financial community. That the BOT was established much earlier than democratic institutions explains the dominant role of the bureaucracy in the making of monetary policy in Thailand at least until the 1980s. The earlier rise of the financial sector before the establishment of a governing structure in the financial system also gives a clue to the difficulties the BOT encountered in supervising financial institutions. It can be said that the relative strength of these actors in their vying for policy control and independence depends significantly on how they come to gain their influence from the institutional context and how they evolve over time against one another. The thesis also finds that while an institutional approach takes us to examine the effects of institutions on political behavior and patterns of politics and allows us to compare the different political outcomes deriving from different institutional context over time (and space), at the end there are certain common determinants to be discovered in this case about the nature of the politics of central bank independence. We see that policy consensus is a key determinant to BOT-government relationship and mutual interest is to Bank ability to maintain financial sector's cooperation. These determinants can be helpful for cross-country comparisons, particularly beyond the limit of advanced industrial economies. The idea of a political consensus behind central bank policy preferences, which could be derived from factors such as the government's political motivation and the legitimacy of the said policy, is one of the potential topics for these extended comparisons.²¹ Wider

²¹ See Alan Blinder, *The Quiet Revolution: Central Banking Goes Modern*, (New Haven: Yale University Press, 2004), Bernhard, *Banking on Reform*, and Matthew Watson, "Institutional Paradoxes of Monetary Orthodoxy: Reflection on the Political Economy of Central Bank Independence," *Review of International Political Economy* 9:1(March 2001): 183-196 for arguments along this line. Watson shares Blinder's view

exchanges on the political underpinning of central bank independence and the institutions of monetary and financial policy by scholars working on an array of cases is likely to help reinforce a claim for the studies of central banking in the realm of politics and a place for institutionalism in such inquiries.

The BOT and the Continuity and Change in Thailand's Monetary and Financial Policy: an Institutional View

The BOT's relative autonomy has had direct implications for the nature and evolution of the country's monetary and financial policy and had in turn been affected by these developments. This thesis shows that due to the Bank's relative autonomy, its policy preferences have been largely reflected in the direction of Thailand's monetary and financial policy. In describing and accounting for the evolution of the Thai monetary and financial policy, the thesis highlights traits of institutional continuity and change with the BOT as the main agent of both processes. Through an examination of the Bank's role in preserving monetary and financial policy tradition and orthodoxy on the one hand, and in introducing policy changes on the other, in the context of the struggle for central bank autonomy, the thesis offers an institutionalist view of the evolution of Thailand's monetary and financial policy and the road toward the financial crisis of 1997. This section summarizes the sources of policy preferences, continuity and change in monetary

that the politics of central bank independence should be seen as a struggle to legitimize certain macroeconomic models of monetary policy. Watson also joins Bernhard in arguing for a certain political logic behind the granting of central bank independence. In his study of the impact of party politics on central bank independence in industrialized economies, Bernhard argues that coalition parties are likely to come to an agreement not to interfere in monetary policy in order to avoid inter-party conflict. Watson, on the other hand, focuses on the role of central banks as a political guarantor that would allow governments to avoid responsibilities arising from the asymmetric distribution as a result of existing monetary orthodoxy.

and financial policy, and the events of the 1997 crisis, to be followed by the theoretical implications of the thesis's institutionalist approach.

Sources of Policy Preferences and Decisions

As we have seen, the Bank of Thailand's main preferences, including conservative monetarism, price and currency stability, and economic liberalization, were formed over the course of history and largely influenced by the concurrent institutional context and the Bank's perception of the national interest, bound to two related concepts - monetary independence and international credibility. The interplay of pragmatism, ideology, and other normative and political considerations played an important role in shaping Bank policy preferences within the confine of different sets of institutions. As discussed in chapter 2, the BOT's commitment to conservative monetary tradition and the preservation of price and currency stability can be traced back to the colonial period. Amidst colonial rivalry, the Thai authorities sought to adopt conservative monetary and fiscal policy as one way to preserve national sovereignty. International credibility, particularly through the maintenance of baht convertibility, also became their main preoccupation as Thailand was increasingly integrated into the international economic system and began to seek foreign capital to meet its financial needs.

In the context of post-war economic development and Cold War rivalry, the Bank's conservative macroeconomic tradition was encouraged by major creditors including the IFIs and the US government. Domestic economic conditions and practices, which saw high inflationary pressures and rising budget deficits, also reinforced the Bank's pragmatic and political commitment to price and currency stability. Despite a

brief experimentation with developmentalism, the period of structural adjustment in the 1980s helped to institutionalize macroeconomic conservatism as IFI conditionalities sought to ensure restrictive monetary and fiscal policy and fiscal-monetary coordination. The maintenance of a fixed exchange rate regime since its inception until 1997 attested to the Bank's lengthy commitment to monetary conservatism.

The BOT's inclination toward economic liberalism was exemplified by the Bank's leading role in exchange rate liberalization in the mid 1950s and financial liberalization in late 1980s. The concurrent institutional context offered both opportunities and constraints, which significantly shaped the Bank's policy decisions. Demands from the international monetary regime (for baht convertibility and stability) and the increasingly unsustainable exchange control system at home had a great impact on the BOT's decision to liberalize its exchange rate policy. In the late 1980s, global changes toward free movement of capital, the rapidly expanding export-led economy, and the process of democratization which saw business groups entering into politics affected the Bank's perception of Thailand's new financial landscape. As emphasized above, the BOT's policy decision has various dimensions. It can be argued that Bank support for exchange rate liberalization was a combination of pragmatic consideration of national interest (that the exchange controls should be lifted only after the Bank was able to accumulate a high enough level of international reserves), ideological orientation (influence of Western education of bank leaders and their socialization with the international epistemic community), and political calculation (that liberalization would lessen the opportunities for corruption). In the case of financial liberalization in the late 1980s, practical concerns about attracting foreign capital without compromising the

competitiveness of the domestic financial sector were reflected in a delay in opening up the banking sector to foreign competition. Political considerations can be seen in the Bank's decision to launch a series of swift reforms during the military-appointed Anand government (1992-1993) to avoid the possibility of political intervention. Nevertheless, we do not deny the influence of neoliberal ideas widely shared among Bank officials and their international epistemic community behind the gradual move toward this direction.

The theoretical convergence in the new institutionalism provides a useful analytical framework for this thesis in accounting for BOT preferences and its policy actions. These explanations about the relationship between Bank preferences and the institutional context and the various factors motivating Bank policy actions in turn confirm the validity of this theoretical bridging among different strands of institutionalism mentioned in the first chapter. As we have seen, institutional context, both domestic and external, strategic calculation, ideas, and traditions all play a role in shaping the BOT's policy preferences, goals, and actions. Pragmatism, ideology, and political consideration can also be seen as having a part in guiding Bank policy decisions. In other words, we can argue that political actors do not merely act upon their self-interests, but do follow existing traditions, beliefs, and normal routines, depending on circumstances. Moreover, instead of being passively influenced by institutions (as HI tends to portray), actors respond and adapt to their environment based on what Hall calls their 'interpretation of the world and their situation in it'.²² The expanding of a theory of actions to incorporate these different factors and levels of analysis (macro, micro, and organizational), which used to be rather singly (separately) focused by the different strands of institutionalism, is likely to better account for the multiple sources and various

²² Hall, "Preference Formation as a Political Process," p. 136.

natures of political actions. The thesis also finds that the time dimension has a special role to play in facilitating this theoretical convergence. We can see that over time the Bank's policy preferences became policy tradition and its actions became its character. Therefore, what might have been formed from a practical/strategic calculation at the time of origin could become norms and taken-for-granted routines in a later period. The process of institutionalization then becomes central to this transformation, as it is the locus where interests and ideas transform into norms and routines. Accordingly, despite certain disagreement particularly among the old and new organization/sociological institutionalists on the objects of institutionalization (i.e. what is being institutionalized), this thesis argues that the concept, with its inherent temporality, has the potential to help bridge the theoretical gap among the three strands of new institutionalism.

Evolution in Thailand's Monetary and Financial Policy and the 1997 Financial Crisis: Continuity, Change, and Breakdown

Along with our inquiry into the relative autonomy of the BOT, this thesis examines the evolution of Thailand's monetary and financial policy since the colonial era until the financial crisis of 1997. As we have seen, the Thai monetary and financial policy displayed a large degree of continuity, which saw the concerns for monetary and financial stability and conservative outlook assuming a priority in the authorities' policy considerations. That the Bank of Thailand has been relatively autonomous significantly facilitated the continuation of these policy traditions. But the reproduction of these policy frameworks was not a static process. On many occasions, policy adjustments, such as currency devaluation in the 1970s and 1980s, were introduced by the Bank in

order to address unintended consequences and a changing environment while maintaining the pre-existing structures. On rarer occasions, policy changes represented a clear departure from the previous policy direction. The late 1980s financial liberalization process demonstrates this kind of change. Unlike preceding changes, the impact of this transformative process led to a breakdown in the pre-crisis monetary and financial institutions. The following paragraphs summarize the thesis's arguments on the nature and contributing factors of continuity and change in the Thai monetary and financial policy and the road to the 1997 crisis.

As argued, monetary and financial policy continuity, which characterized much of these policy areas from the post-war period until the 1980s, should not be seen as a static development. Even though we can see that there was little change in the nature of the fixed exchange rate regime, interest rate policy, or how the financial sector was kept relatively closed, we also see that the BOT made several policy adjustments to deal with the changing environment and unforeseen circumstances. A series of exchange rate adjustments in the 1970s and 1980s as a response to external imbalances help illustrate this point (chapter 5). That the BOT decided to abandon the baht parity for the daily fixing and later the currency basket system shows how the preferred exchange rate mechanisms changed over time. The BOT also made numerous changes to the interest rate ceilings to make them compatible with the fluctuating world market rates. Financial policy with regard to financial distress and insolvency changed from ad hoc rescue operations to institutionalized measures embodied in the establishment of the FIDF in 1985. These examples speak for the dynamic and adaptive nature of what we broadly see as continuity in Thailand's monetary and financial policy.

A number of factors contributed to this relative stability. The BOT's track record in controlling inflation and in maintaining a stable currency and a sound financial system gave significant endorsement to the existing policy framework. This good performance factor was facilitated by the Bank's organizational capacity, as reflected in the technical expertise (from years of experience) and resources (tools and mechanisms created over the years to ensure effective policy implementation) to get the job done. The establishment of the Exchange Equalization Fund to defend the value of the baht from 1955 to 1997 and the FIDF to provide assistance to illiquid and insolvent financial institutions since 1985 exemplifies the latter point. But efficiency is never the only explanation. The thesis shows that the BOT's relationships with the government, financial sector, and external actors, which define the politics of central bank independence, is essential to the understanding of monetary and financial policy continuity. The policy consensus among political leaders, vested interest of the financial sector, and the intervening role of the IFIs in supporting Bank preferences all played out to support the legitimacy of the BOT and its role in managing monetary and financial affairs throughout these periods.

The evolution of Thailand's monetary and financial policy also incorporates elements of institutional change. As chapter 5 and 6 discuss, there were changes in monetary and financial policy that presented a departure from the pre-existing policy direction and framework. The developmental role initiated in the 1970s and the launching of the financial liberalization process by the Bank in the late 1980s are cases in

point.²³ But while the former process did not result in institutional change in the pattern of credit allocation, the latter brought about a transformation of the financial system. And while the former was being introduced incrementally and cautiously, the latter was undertaken in a rather swift and sweeping manner. Accordingly, varying types of change and outcomes can be observed from these two processes, the reasons for which will be dealt with below. That the Bank was the initiator of these policies reveals that it was capable of inducing not only adaptive but transformative change and therefore, unlike the conventional view in institutionalism, shows that institutional change can be internally generated.²⁴

As we have seen, one of the contributing factors to institutional change is a change in the environment, which in turn affected a change in the perception of the change agent, in this case the Thai authorities, particularly the BOT. In chapter 5, we see that the spread of communism in the region, the growing inequality between urban and rural areas, and the rise of populist sentiments among certain societal groups coincided with and reinforced the desire of the Bank's leaders to address social problems and tensions through credit allocation schemes in the 1960s and 70s. On the other hand, the globalization of finance, the rise in capital inflows, and the rapidly growing economy were shown in chapter 6 as the late 1980s context that re-shaped monetary authorities' receptivity toward foreign capital leading them to launch the process of financial liberalization. Domestic and external actors did have a role to play, more so for the

²³ The authorities' decision to liberalize exchange rate policy in the mid 1950s, which included the abandoning of exchange controls and multiple exchange rate policy, is considered as a return to the pre-war policy framework.

²⁴ For reviews of perspectives of institutional change see Thelen, "Timing and Temporality in the Analysis of Institutional Evolution." *Studies in American Political Development* 14 (Spring 2000), pp. 101-108 and Streeck and Thelen, *Beyond Continuity: Institutional Change in Advanced Political Economies*, (Oxford: Oxford University Press, 2005)

financial liberalization than for the preferential credit allocation, in pushing for changes in the existing policy framework. But what needs to be emphasized is that the BOT's relative autonomy and its confidence in the capacity to undertake these policy innovations were important factors behind the materialization of the plans. Dr. Puey's strong leadership and the Bank's improved financial status allowed the institutions to experiment with a developmental role in credit allocation. In the late 1980s, increased BOT authority and resources in monitoring financial institutions and in dealing with insolvency problems provided great assurance to the Bank to liberalize the financial system. As for the outcomes, it can be argued that political consensus, cooperation from the stakeholders, particularly the financial sector, and the Bank's own institutional arrangements and traditions largely determined whether the process of change would come to fruition. While these factors were favorable toward financial liberalization, they were seen lacking for the preferential credit allocation. Not only did the political tide soon turn against redistributive measures, but the BOT's co-dependence with the financial sector and its own general inclination toward non-interventionism prevented it from launching more comprehensive and farther-reaching credit re-allocation schemes.

The 1997 financial crisis reflected a breakdown in Thailand's monetary and financial management regimes. The failure of the authorities, particularly the BOT, to maintain a stable currency and a sound financial system was brought about by a complex set of factors, which can be traced to the changes in the financial, political, and organizational context in the 1990s. The financial liberalization process, democratization, and organizational changes within the BOT toward more internal rivalry and politicization unfolded and interacted in a mutually reinforcing manner during this period.

The thesis shows that the interplay of these changes aggravated the existing (or structural) weaknesses of the financial system and seriously affected the Bank's capacity and autonomy in managing the financial sector. For example, convenient access to foreign capital exacerbated weakness in loan risk assessment at most financial institutions, leading to a surge in unscrupulous and unproductive lending. The politicization at the BOT and political interference from politicians hampered the Bank's ability to supervise the financial sector effectively. The increasing incompatibility between the fixed exchange rate policy and the open financial system added more strains to the BOT in defending the value of the Thai currency. But the imperative to continue to maintain a stable baht (to assure investor confidence and contain corporate sector's external debts) and the Bank's autonomy in this policy area (having the sole authority to use international reserves to defend the baht) prolonged the functioning of the fixed exchange rate regime at the risk of speculative attacks and major devaluation until it was too late.

The above arguments on institutional continuity, change, and breakdown have a number of theoretical implications to the understanding of institutional evolution in institutionalism. First, evidence from this thesis supports the recent trend in historical institutionalism that questions the rather sharp distinction placed on institutional stability and change. This perception has largely derived from existing models of change that view institutional change as abrupt, sharp and exogenously induced.²⁵ The evolution of Thailand's monetary and financial regimes sees both continuity and change overlapping and generated endogenously (but not independently from external environment), and not necessarily with major disruption. In this case, the autonomy of the BOT (and its

²⁵ See further discussion of institutional change in Campbell, *Institutional Change and Globalization*, pp. 33-35, Thelen, "Timing and Temporality," pp. 104, and Streeck and Thelen, *Beyond Continuity*, pp. 4-9.

capacities), which made possible its role as reproductive and change agent, is central to the blurring of the continuity-change dichotomy. This implies that power is an important ingredient in the mechanisms that serve either institutional reproduction or innovation and that an examination of power relations among relevant key actors is central to the understanding of how institutions evolve.²⁶

Second, there is a need not only to differentiate between the ‘processes’ and ‘results’ of change, but also among the different change outcomes.²⁷ The Thai case shows the marginal outcome of the BOT’s preferential credit allocation schemes in the 70s and the far-reaching impact of the process of financial liberalization, which turned disruptive in 1997. Without a differentiation, (even though we may not fail to examine why change was possible), we tend to overlook the mechanisms that stabilize and then reproduce the *new* rules of the game that usually includes stabilization and legitimization. While the BOT was able to initiate the process of financial liberalization, the institutional breakdown that followed in 1997 signified the failure of these mechanisms. In this regard, the gist of the understanding of the post-crisis era is to a large extent how the reproductive mechanisms of financial liberalization were instituted and which actors were involved and played a dominant role in shaping this process. This view of the relationship between institutional reproduction and change outcomes supports recent

²⁶ See more discussion of the concept of power and institutional continuity and change in Pierson, *Politics in Time* and Kathleen Thelen, “Historical Institutionalism and Comparative Politics.” *Annual Review of Political Science*, Vol. 2, 1, pp 369-404.

²⁷ Streeck and Thelen discuss the need to distinguish between the processes and results of change in order to be able to account for other types of change that conventional models of change overlook, particularly incremental processes of change that lead to institutional transformation. See Streeck and Thelen, *Beyond Continuity*, pp. 8-9.

movement among historical institutionalists, like Thelen and Streeck and their collaborators to bridge the studies of institutional continuity and change.²⁸

A Look toward the Politics of Central Bank Independence in the Post-Crisis Era

How can we take what we learn here to try to understand the politics of central bank independence in Thailand in the post-crisis era? This last section applies the perspectives put forth in this thesis to explain the role of the BOT after the crisis as a way to conclude this chapter and the thesis. The objective is to point out the linkages between the pre- and post-crisis era and the impact of the former on the development of the latter, as well as to address two important issues underlying the politics of central bank independence during this period, namely the institutional design of the BOT and the legitimacy of the Thai state in monetary and financial management in the context of democratic governance.

As BOT credibility played an important role in defining its relative autonomy, the loss of this credibility, culminating in the mismanagement of the country's international reserves and inability to contain the crisis in the financial sector, inevitably compromised the Bank's independence, particularly during the crisis management period. The Chavalit (1996 to 1997) and Chuan (1997 to 2001) governments assumed a leading role in devising policy measures to cope with the crumbling economy, including negotiating

²⁸ Thelen rightly argues in her response to Pierson's view on the unpredictable nature of historical conjunctures, which see different processes unfold and interact in ways that disrupt the development path of particular institutions, that in these circumstances a connection can be made between institutional continuity and change through a focus on how institutional reproduction fails or being interfered by the processes in question. See Thelen, "Timing and Temporality," pp. 104 and Pierson, "Not Just What, but When," pp. 87-91.

with the IMF for financial assistance.²⁹ As alluded to in the introduction (chapter 1), the removal of two BOT Governors (Rerngchai and Chaipayawat—see Table 7.1), the setting up of an investigative mission (Nukul Commission), and the political witch hunt that followed the Commission's findings all pointed to the decay of the Bank's relative autonomy and the government's role in 'house cleaning'. Another major blow was seen in the IMF's recommendation for the restructuring of the BOT's organizational structure to promote more efficiency and transparency. Notwithstanding the merits of this process (which lasted from 1998 to 2001),³⁰ the externally imposed reorganization heavily undermined the Bank's erstwhile budgetary and administrative independence.

Can we, then, assume an end of BOT relative autonomy and a new era of government-dominated monetary and financial policymaking? Accumulating evidence shows that it is premature to judge accordingly. First, even though the organizational restructuring was imposed upon the Bank from the outside, the fact that the process, particularly the consultancy and design of its blue print, was concentrated among international experts and the Bank itself, allowed the agency a lot of breathing room to reshape its organization. IMF and public support for central bank independence, in response to the political interference before the crisis, also facilitated the BOT's move to amend the Bank of Thailand Act of 1942 to grant it more autonomy in tandem with the organizational restructuring and reengineering.³¹ It can be argued that despite being externally imposed, the reorganization, which saw the BOT become more efficient,

²⁹ See Haggard, *Political Economic of Asian Financial Crisis*, and Pasuk and Baker, *Thailand's Crisis*, (Bangkok: Silkworm Books, 2000) for more details.

³⁰ See Bank of Thailand, *60 Years*, chapter 2, for more details.

³¹ This support should be understood in a political context which saw increasing public demand for good governance. As the crisis unleashed societal-wide resentment against collusive political practices, the idea of a more autonomous central bank fitted very well with one of the reform agenda to promote independent state agencies to create checks and balances within the government.

transparent, and accountable, was instrumental to the agency's regaining its long-term credibility.³² The issue of legal amendments, which were delayed until the time of writing, will be picked up below.

Second, despite its declining credibility and legitimacy, circumstances required that the BOT be authorized to carry out more responsibilities, particularly with regard to the restructuring of the financial sector. For example, during the crisis aftermath the Bank assumed a leading role in tackling non-performing loan problems through the newly established Corporate Debt Restructuring Advisory Committee (CDRAC) to facilitate negotiations between companies and financial institutions.³³ In 1998, the Bank was also given more authority to intervene in remaining financial institutions that showed signs of financial distress as part of a more comprehensive restructuring plan for the financial system.³⁴ It can be argued that these increased responsibilities served as a basis for the BOT's operational autonomy during this period. That the financial sector, as a result of the crisis, became weak and dependent on the BOT for financial assistance and protection from foreign competition facilitated the implementation of the Bank's many reform initiatives.

Third, if the concern for government domination in monetary and financial policy lies in the tendency that governments may seek to manipulate these policies for electoral

³² At least in principle, the BOT became a less hierarchical organization, allowing for more policy input and creativity while reducing bureaucratic red-tape. The Bank also sought to reaffirm its mission and core values to instill commitment and sense of purpose among its employees as a way to re-identify itself. The reorganization increased the Bank's capacities to pursue its responsibilities (e.g. by introducing new approaches to financial institution supervision) and made it more accountable to the public (e.g. making public most of its operations). See more details in Bank of Thailand, *60 Years*, chapter 2-3.

³³ Ibid.

³⁴ The amendment of the Commercial Banking Act and the Finance Company Act empowers the BOT to order capital write-downs, capital increases, or change the management of troubled commercial banks and financial companies. Another amendment of the Bank of Thailand Act also allows the FIDF (Financial Institution Development Fund) to lend to financial institutions in distress with or without collateral. See Bank of Thailand, *60 Years*, p. 51 and 61.

purposes or to serve their other interests, the immediate post-crisis context, which saw the IMF played an important role in guiding macroeconomic policy direction, did not encourage such a manipulation. In fact, the restrictive monetary and fiscal policies pursued in the beginning of the Chuan administration according to the IMF conditionalities was not dissimilar from the conservative macroeconomic traditions that the BOT adhered to during most of its history. Accordingly, it can be seen that the nature of monetary and financial policy during this period was not determined as much by the relationship between the government and the BOT as by the influence of the IMF over the Thai authorities. But as it became clearer in mid 1998 that IMF policy prescriptions were driving the economy into severe recession, a consensus seemed to be reached between the Chuan government and the Bank to abandon the restrictive macroeconomic policies for more expansionary ones.³⁵ It was after these expansionary policies, such as the allowing budget deficits and the lowering of interest rates, that the economic free-fall began to stabilize. It can be said that the IMF's wrong diagnosis of the Thai crisis gave grounds for the Thai authorities to concentrate more on domestic problems and resort to counter-cyclical economic policies to cope with the situation. Growing public and private sector resentment of harsh IMF policy measures also provided the political legitimacy for this change of policy direction.

The coming to power of the Thaksin administration provided an interesting context for Bank-government relationship and the making of monetary and financial policy. That the Thai Rak Thai (TRT) party, under Thaksin's leadership, received vast popular support largely through its nationalist and populist policy platform gave the new

³⁵ Pasuk and Baker, *Thailand's Crisis*. See also Wade, "Asian Debt-and-Development Crisis"; Paul Blustein, *The Chastening*, (New York: Public Affairs, 2001), chapter 3; and Joseph Stiglitz, *Globalization and Its Discontents*, (New York: W.W. Norton, 2002), chapter 4, for criticisms of IMF policy prescriptions.

government a strong mandate to fulfill its electoral promises. The fact that this election was contested under a new constitutional framework, promulgated at the height of the crisis to enhance the quality of democratic governance, also heightens the significance of democratic institutions. Therefore, it was to be expected that the government, particularly the PM and the Minister of Finance, played a dominant and active role in the process of economic policymaking. Thaksin's removal, soon after he took office, of BOT Governor Chatumongol (appointed by the Chuan administration), due to a disagreement on interest rate policy, sent a clear message on government-Bank power relations.³⁶ TRT control of the majority of seats in the Parliament also facilitated the implementation of Thaksin's many economic stimulus and social programs, while the BOT adopted a more 'passive' stance in the process. As most of these programs and policies, such as credit extension to local businesses through state financial institutions, a one-million baht village fund, a thirty-baht healthcare scheme, and a rural credit injection through the 'One Village One Product' program, were largely interventionist and expansionary, they marked a departure from the conservative monetary and fiscal traditions pursued by governments and economic technocrats in the preceding periods.³⁷

History can help us understand the role of the BOT and the basis of its authority in monetary and financial management in this context. First, like the experience during the post-war periods when the Bank had little control over government fiscal spending, it had to rely on monetary policy instruments and other strategies to maintain price stability. From mid 2001 to 2006, the BOT moved its Bank rates upward and downward by 5

³⁶ *Bangkok Post*, June 11, 2001.

³⁷ See detailed discussion of Thaksin policies in Pasuk Phongpaichit and Chris Baker, *Thaksin: The Business of Politics in Thailand*, (Bangkok: Silkworm Books, 2004).

percent to contain inflationary pressures.³⁸ The BOT also sought to control credit excesses and inflation through its prudential policies extended to financial institutions. That the Bank was able to contain inflation to an average of 2 percent from 2000 to 2006 implies that so far its policy instruments and strategies have been quite effective.³⁹ Second, as discussed earlier, the BOT's increased responsibilities over time is an important source of the agency's authority and influence. Since the crisis, among the Bank's essential tasks was the rehabilitation and development of the financial sector. This responsibility gained more momentum in the Thaksin era, seen in the launching of the Financial Sector Master Plan in 2004. The BOT, as the initiator of the project, played a central role in the restructuring of the financial sector, particularly in streamlining the industry by encouraging mergers, recapitalization, and acquisition among existing financial institutions.⁴⁰ That the Bank was able to convince the government and financial community to agree with the plan and to carry out the rather painstaking restructuring process (so far Phase I of the Plan was completed) reflected its continued influence and authority in this policy area.⁴¹ Third, as in the past, international obligations and professional standards help shield the BOT from political pressure. For example, Thailand's adoption of the Basel II Capital Accord in order to ensure confidence among the international financial community forced local banks to revamp their accounting and risk management practices to meet international standards by 2008. It also allowed the

³⁸ Robert Neil McCauley, "Understanding Monetary Policy in Malaysia and Thailand: objectives, instruments and independence." *BIS Papers* no. 31, (December 2006): pp. 172-198. The fact that the deliberation of interest rate policy was routinized and carried out by a group of experts reduced the opportunities for political interference.

³⁹ *Ibid.*, p. 174.

⁴⁰ Bank of Thailand, *Supervision Report 2004*, chapter 4.

⁴¹ The Plan was divided into three phases: Phase I (year 1-3) to improve efficiency and operational flexibility, Phase II (year 4-6) to include new players and capital market development, and Phase III (year 7-10) to build upon the development results from Phase II. *Ibid.*

BOT to push for a passage of a new Financial Institutions Businesses Act, which would provide the agency a necessary legal basis to implement Basel II.⁴²

While acknowledging that the BOT was able to maintain influence and ability to preserve monetary stability during the Thaksin regime, we cannot deny the impact of this administration on the nature of monetary and financial policy and government-Bank relationship in this period. First, with its electoral mandate, control of Parliament, and a strong policy platform and party organization, the Thaksin government showed, for the first time, how elected officials could systematically dominate the process of public policymaking, including that of monetary and financial policy which used to be in the domain of economic bureaucrats. Second, we also see a ‘popularization’ tendency in monetary and financial management. Widespread support for a nationalist and populist economic agenda and the fresh memory of the crisis influenced monetary authorities to look more ‘inward’ and try to respond to domestic demands, including those of marginalized groups, such as small businesses and rural population. That one of the main objectives of the BOT’s Financial Sector Master Plan was to extend greater financial services to the rural areas and small- and medium-size businesses fitted well in this political context. Here again, Selznick’s and new institutionalist insights can help us understand the adaptive role of the Bank in maintaining its legitimacy in its policy jurisdiction and how its preferences were shaped by the changing environment.

Even though the coup in September 2006 put an end to the Thaksin regime, it is likely that the post-coup central banking politics and the making of monetary and financial policy will continue to be defined by the dynamic of democratization. In this

⁴² Speech by Deputy Governor Tarisa Watanagase, July 8, 2004. The Act was passed by National Legislative Assembly in November 2007. It is to become effective in August, 2008.

regard, two issues are of particular importance to the future role of the BOT, namely the Bank's institutional design and the legitimacy of the Thai state in the context of today's democratic governance. The issue of BOT institutional design was brought to our attention at the height of the crisis. The IMF's demand for a reorganization of the Bank and the amendment of the Bank of Thailand Act (1942) was meant to enhance Bank capacity and independence which seemed to be in decline in the 1990s and were believed to be responsible for the economic disaster. Interestingly, while Bank organizational restructuring was completed in 2001, the process of legal reform has been delayed for over a decade. The BOT's attempt to improve upon its legal status, such as by giving Bank Governor a fixed term, transferring appointing and dismissal power from the Minister of Finance to the Parliament, and having its policy objectives clearly stipulated, was met with hesitation from a series of governments (the Chuan, Thaksin, and even the military-installed Surayuth administration). Among the main concerns behind this delay was the potential limitation on governments' ability to respond to voters' demand.⁴³ The new Bank of Thailand Act of 2008 was finally passed in December 2007 and came into effect in March 2008. Even though granting more operational autonomy to the Bank, such as by stipulating clearly the BOT's mandate, providing the agency more legal power to implement monetary and financial policy, and preventing discretionary dismissal of Bank Governors, the Act also grants the government the power to appoint selection committees, which would choose a number of key decision-making positions, including the Chairman of the BOT Board and BOT Governor. The check and balance can also be seen in the stipulation demanding the BOT to set monetary target annually with the approval of the Minister of Finance and the cabinet and to report to the latter with regard

⁴³ *The Nation*, May 14, 2007.

to its performance every six months. It remains to be seen if the new legal framework would be successful in ‘tying the hands’ of post-coup governments or rather allowing the executives new incentives and opportunities to control monetary and financial policy. Only with an uninterrupted process of democratic consolidation could Bank-government relationship play out and institutionalize in a constructive manner, which sees elected officials realize the potential political benefits deriving from having an independent but accountable central bank. In a shaky process of democratic development as Thailand witnessed at the time of writing (June 2008), it is easy for Bank-government interactions to become a proxy for the power struggle among the political class, regardless of the more-balanced new legal framework.

There are two concerns with regard to the legitimacy of the Thai state in monetary and financial management in an era of democratic governance. The first one involves the potential tension between domestic and external legitimacy. The success of the BOT in sustaining the legitimacy of the Thai state in these policy areas largely depends on its ability to preserve monetary and financial stability and maintain international credibility. Up until the 1990s, the Bank was able to rely on a set of conservative macroeconomic policies to maintain both domestic and external legitimacy. But it can be seen that in many circumstances, preference was given toward the maintenance of international credibility at the expense of domestic objectives such as development and redistribution. The Bank’s relative autonomy and most government’s conservative orientation contributed to the pursuit of this policy bias. The post-crisis era saw increased public awareness for domestic accountability in macroeconomic policies, which gave elected officials incentives to adopt an ‘inward-looking’ orientation. The challenge for the BOT

lies in the need to balance between its conservative monetary tradition and expansionary tendencies, such as seen in Thaksin's rural development policies, in order to maintain both domestic and international legitimacy.

Another concern is with regard to the autonomy of the Thai state in monetary and financial policy. The BOT's ability to remain relatively independent through most of its history helped shield monetary and financial policy from being captured or dominated by certain societal (or external) groups, which might manipulate these policies to their own advantage. The dominant role of the Thaksin government in almost every domain of economic policy and its strong representation of domestic capital may be seen as the capture of the state by this political class, a result of which led to certain changes in the nature of monetary policy discussed above. A return to power of the military and authoritarian government in 2006 reflected the attempt of the old political class to regain control of state apparatus and lay new ground rules to keep the power of the new class in check. The fact that the 2006 coup leaders appointed the BOT Governor Deputy Prime Minister and Minister of Finance not only signified the agency's recovered credibility, but also demonstrated its role in legitimizing the old political elite. However, the surge in the 2007/2008 budget deficit, particularly from a leap in military spending, seemed to pose a familiar problem to the BOT in maintaining macroeconomic stability.⁴⁴ Much as the Bank was uneasy with the policy encroachment of the Thaksin government (and the political class it represents), it is necessary for the Bank to avoid being captured by the bureaucratic class or being drawn into the ongoing political struggle. Even with the new

⁴⁴ The military budget increased 33 and 24 percent in the 2007 and 2008 government budgets. The budget deficit for 2007 was 146 billion baht, equaling to 2 percent of GDP, while the deficit for 2008 was expected to be 120 billion baht, or 1.3 percent of GDP. *The Nation*, May 23, and June 28, 2007.

legal framework, the BOT's organizational cohesion, strong leadership, and ability to draw support from the public, financial sector, and international actors are likely to serve as important sources of state autonomy in monetary and financial policy in this era as in the past.

Final Thought

This thesis tries to explain the nature and determinants of the BOT's autonomy and the relationship between this autonomy and the evolution of Thailand's monetary and financial policy. It suggests that a differentiated view of central bank independence is necessary to capture the different interplays between the BOT and the government, financial sector, and international financial community and the difference between legal and behavioral independence. The old and new institutionalism provide useful conceptual tools in this regard. The fact that the BOT enjoyed a substantial degree of de facto autonomy at least from the 1940s to the 1980s suggests that the direction of monetary and financial policy was largely shaped by the Bank's policy preferences. Based on this framework, the thesis goes on to explain why the BOT decided to launch financial liberalization process and how the organization itself helped contribute to the crisis of 1997.

While the thesis shows us that a relatively independent BOT was instrumental in maintaining Thailand's financial stability and that a weak BOT was partly accounted for the crisis, it is still difficult to draw a clear conclusion that central bank autonomy is always desirable. Our discussion of the BOT's unchecked authority in managing the exchange rate regime demonstrates the harm too much independence can cause. The

Bank's commitment to uphold international credibility can leave the economy vulnerable to the changing priorities and interests of the international community. The thesis also touches upon the missing developmental opportunities in the past due to the Thai authorities' commitment to maintain high international reserves. While there is a risk in conducting counter-factual inquiries, more studies on the impact of central bank autonomy and its related monetary conservatism on other sectors in the economy, particularly the non-financial and non-export ones, are still very much needed. The organizational restructuring of the BOT after the crisis, to a large extent, captured the concerns for more accountability and decentralization of decision-making power, while the attempt to amend the Bank of Thailand Act of 1942 was meant to contain political interference. The BOT's plan to extend greater financial services to the rural sector and small- and medium-sized businesses, seen in its Financial Master Plan, was also a move toward a more balanced role of the Bank in integrating these erstwhile neglected groups.

Recent political developments (since the 2006 coup) raise concerns about the BOT's future role in the Thai society and the politicization of central bank independence. The granting of more operational autonomy to the Bank by the military-installed legislature, the conflict between the Bank and Ministry of Finance over expansionary (read populist) fiscal policy, and the power struggle between the old and new political class, which aggravated the existing rural-urban divide, were signs of difficult challenges facing the BOT on fundamental issues of distributive justice and selective accountability. While maintaining financial stability through conservative monetarism serves to uphold international credibility and domestic legitimacy, particularly in the eyes of financial and outward-oriented sectors, as a monetary authority of a developing country, the Bank also

has the responsibility to provide marginalized groups greater access to credit and to support policies that would contribute to more even development. Therefore, it is extremely important for the BOT not to be caught up in current political struggles, which could lead to the exploitation of its newly granted independence to deepen the divide between the have and have-not in the society. As a longstanding guardian of the national interest, it is high time for the Bank to seriously consider what constitutes this interest and whose interest it should really serve.

Appendix I

List of Governors of the Bank of Thailand

	Name	Period in Office
1.	H.H. Prince Vivadhanajaya	Nov. 1942 – Oct. 1946
2.	Serm Vinicchayakul	Oct. 1946 – Nov. 1947
3.	Leng Srisomwongse	Nov. 1947 – Sep. 1948
4.	H.H. Prince Vivadhanajaya	Sep. 1948 – Dec. 1948
5.	Leng Srisomwongse	Dec. 1948 – Aug. 1949
6.	M.L. Dej Snidvongs	Aug. 1949 – Feb. 1952
7.	Serm Vinicchayakul	Mar. 1952 – Jul. 1955
8.	Kasem Sripayak	Jul. 1955 – Jul. 1958
9.	Jote Guna-kasem	Jul. 1958 – May 1959
10.	Puey Ungphakorn	Jun. 1959 – Aug. 1971
11.	Bisudhi Nimmanhaemin	Aug. 1971 – May 1975
12.	Snoh Unakul	May 1975 – Oct. 1979
13.	Nukul Prachuabmoh	Nov. 1979 – Sep. 1984
14.	Kamchorn Sathirakul	Sep. 1984 – Mar. 1990
15.	Chavalit Thanachanan	Mar. 1990 – Sep. 1990
16.	Vijit Supinit	Oct. 1990 – Jul. 1996
17.	Rerngchai Marakanond	Jul. 1996 – Jul. 1997
18.	Chaiyawat Wibulsawasdi	Jul. 1997 – May 1998
19.	M.R. Chatu-mongol Sonakul	May 1998 – May 2001

20.	M.R. Pridiyathorn Devakula	May 2001 – Oct. 2006
21.	Tarisa Watanagase	Nov. 2006 - ?

Source: Bank of Thailand

Appendix II

List of Thailand's Prime Ministers and Ministers of Finance

Prime Ministers	Ministers of Finance
1. Pharaya Manopakorn-nitithada (Jun. 1932 – Jun. 1933)	Phraya Manopakorn-nitithada (Jun. 1932 – Jun. 1933)
2. General Phraya Phahol Pholphayuhasena (Jun. 1933 – Sep. 1938)	Chaophraya Srithammthibes (Jun. 1933 – Sep. 1934) Phraya Manaworachaseewee (Sep. 1934 – Aug. 1935) Phraya Phahol Pholphayahasena (Aug. 1935 – Feb. 1936) Phraya Chaiyossombat (Feb. 1936 – Dec. 1938)
3. Field Marshal Pleak Phibunsongkram (Dec. 1938 – Aug. 1944)	Luang Praditmanootham (Dec. 1938 – Dec. 1941) General Phao Phienlert – Boriphanyudthakit (Dec. 1941 – Aug. 1944)
4. Major Khuang Abhaiwongse (Aug. 1944 – Aug. 1945)	Major Khuang Abhaiwongse (Aug. 1944 – Jan. 1945) Leng Srisomwongse (Jan. 1945 – Sep. 1945)
5. Thawee Boonyaket (Aug. 1945 – Sep. 1945)	Direk Chaiyanam (Sep. 1945 – Sep. 1945)
6. M.R. Seni Pramoj (Sep. 1945 – Jan. 1946)	Direk Chaiyanam (Sep. 1945 – Feb. 1946)
7. Major Khuang Abhaiwongse (Jan. 1946 – Mar. 1946)	Phraya Sriwisarnwaja (Feb. 1946 – Mar. 1946)
8. Pridi Banomyong (Mar. 1946 – Aug. 1946)	Pridi Banomyong (Mar. 1946 – Aug. 1946)

9.	Rear Admiral Thawal Thamrong-Navasawadhi
(Aug. 1946 – Nov. 1947)	Vijit Lulitanond
(Aug. 1946 – Nov. 1947)
10.	Major Khuang Abhaiwongse
(Nov. 1947 – Aug. 1948)	Prince Viwattanachai
(Nov. 1947 – Aug. 1948)
11.	Field Marshal Pleak Phibunsongkram
(Apr. 1948 – Sep. 1957)	Phraya Toha-wenik-montri
(Apr. 1948 – Nov. 1948)
Prince Viwattanachai
(Nov. 1948 – Oct. 1949)
Field Marshal P. Phibunsongkram
(Oct. 1949 – Jul. 1950)
Phra Manuparn-wimonsart
(Jul. 1950 – Nov. 1951)
Maj. General Luang Vijit Vathakarn
(Nov. 1951 – Dec. 1951)
General Phao Pienlert
(Dec. 1951 – Mar. 1957)
Nai Worakarn-bancha
(Mar. 1957 – Sep. 1957)
12.	Pote Sarasin
(Sep. 1957 – Dec. 1957)	Pote Sarasin
(Sep. 1957 – Sep. 1957)
Serm Vinich-chaikul
(Sep. 1957 – Jan. 1958)
13.	Field Marshal Thanom Kittikachorn
(Jan. 1958 – Oct. 1958)	Serm Vinich-chaikul
(Jan. 1958 – Oct. 1958)
14.	Field Marshal Sarit Thanarat
(Feb. 1959 – Dec. 1963)	Chote Guna-kasem
(Feb. 1959 – May 1959)
Sunthorn Hongladarom
(May 1959 – Dec. 1963)
15.	Field Marshal Thanom Kittikachorn
(Dec. 1963 – Oct. 1973)	Sunthorn Hongladarom
(Dec. 1963 – Jul. 1965)
Serm Vinich-chaikul
(Jul. 1965 – Nov. 1971)
Boonma Wongsawan
(Nov. 1971 – Dec. 1972)
Serm Vinich-chaikul
(Dec. 1972 – Oct. 1973)
16.	Sanya Thammasak
(Oct. 1973 – Jan. 1975)	Boonma Wongsawan
(Oct. 1973 – May 1974)

	Sommaï Huntrakul
(May 1974 – Feb. 1975)
17. M.R. Seni Pramoj
(Feb. 1975 – Mar. 1975)	Sawet Piamphongsarn
(Feb. 1975 – Mar. 1975)
18. M.R. Keukrit Pramoj
(Mar. 1976 – Jan. 1976)	Boonchu Rojanasathien
(Mar. 1975 – Apr. 1976)
19. M.R. Seni Pramoj
(Apr. 1976 – Oct. 1976)	Sawet Piamphongsarn
(Apr. 1976 – Oct. 1976)
20. Thanin Kraivichien
(Oct. 1976 – Oct. 1977)	Supat Suthatham
(Oct. 1976 – Oct. 1977)
21. General Kriangsak Chamanan
(Nov. 1977 – Feb. 1980)	Supat Suthatham
(Nov. 1977 – May 1979)
General Kriangsak Chamanan
(May. 1979 – Feb. 1980)
22. General Prem Tinsulanonda
(Mar. 1980 – Apr. 1988)	Sommaï Huntrakul
(Feb. 1980 – Mar. 1980)
Amnuay Weerawan
(Mar. 1980 – Mar. 1981)
Sommai Huntrakul
(Mar. 1981 – Aug. 1986)
Suthee Singsanay
(Aug. 1986 – Aug. 1988)
23. General Chatichai Choonhavan
(Aug. 1988 – Feb. 1991)	Pramual Sabhavasul
(Aug. 1988 – Aug. 1990)
Veerapong Ramangkoon
(Aug. 1990 – Dec. 1990)
Bancharn Silpa-a-cha
(Dec. 1990 – Feb. 1991)
24. Anand Panyarachun
(Mar. 1991 – Apr. 1992)	Suthee Singsanay
(Mar. 1991 – Mar. 1992)
25. General Suchinda Kraprayoon
(Apr. 1992 – May 1992)	
26. Anand Panyarachun	Panas Simasathien
(Jun. 1992 – Sep. 1992)

27.	Chuan Leekpai
(Sep. 1992 – Jul. 1995)	Tharin Nimmanhaemin
(Sep. 1992 – Jul. 1995)
28.	Banharn Silpa-a-cha
(Jul. 1995 – Nov. 1996)	Surakiat Sathienthai
(Jul. 1995 – May 1996)
Bordi Junnanon
(May 1996 – Oct. 1996)
29.	General Chavalit Yongchaiyudh
(Nov. 1996 – Nov. 1997)	Chaiyawat Wibulsawat
(Oct. 1996 – Nov. 1996)
Amnuay Weerawan
(Nov. 1996 – Jun. 1997)
Thanong Bidaya
(Jun. 1997 – Oct. 1997)
Kosit Punpiamrat
(Oct. 1997 – Nov. 1997)
30.	Chuan Leekpai
(Nov. 1997 – Feb. 2001)	Tharin Nimmanhaemin
(Nov. 1997 – Feb. 2001)
31.	Thaksin Shinawatra
(Feb. 2001 – Sep. 2006)	Somkit Jatusripitak
(Feb. 2001 – Feb. 2003)
Suchart Chaowisit
(Feb. 2003 – Mar. 2004)
Somkit Jatusripitak
(Mar. 2004 – Aug. 2005)
Thanong Bidaya
(Aug. 2005 – Sep. 2006)
32.	General Surayudh Chulanont
(Oct. 2006 – Feb. 2008)	M.R. Pridiyathorn Devakula
(Oct. 2006 – Feb. 2007)
Chalongphob Sussangkarn
(Mar. 2007 – Feb. 2008)
33.	Samak Sundaravej
(Feb. 2008 – Sep. 2008)	Surapong Suebwonglee
(Feb. 2008 – Sep. 2008)
34.	Somchai Wongsawat
(Sep. 2008 - ?)	Suchart Thadathamrongvej
(Sep. 2008 - ?)

Source: Office of Prime Minister, Government of Thailand, and Ministry of Finance of Thailand

Appendix III

Questions for Bank of Thailand Officials, Fall 2003

1. How would you describe the role of the BOT in managing the Thai financial system?
2. Is there a common outlook among BOT officials with respect to the Bank's role in the management of the financial system? Has it changed over time?
3. When did the idea of financial liberalization begin to be discussed?
4. Who would you say were the forces behind the idea?
5. Was Thailand being pressured to accept the ideas from the IMF and the World Bank or the international financial community?
6. Was there any opposition against financial liberalization?
7. How were these different ideas received at the BOT?
8. What were the views of other state institutions on the idea of financial liberalization?
9. Could you describe the nature of the financial system before financial liberalization and after?
10. When did the process begin?
11. Who were involved in the making of these policies?
12. What are the benefits of financial liberalization?
13. What were the impacts of financial liberalization on the Bank's capacity to manage the financial system?
14. In retrospect, do you think there was insufficient regulation?

15. What kind of regulations or legal framework was needed?
16. Could you tell me about the decision to resort to the IMF rescue package?
17. Did the BOT participate in the drafting of the Letters of Intent? If yes, how would you describe the role of the Bank in this process?
18. What are the changes in the role of the BOT as a result of the conditionalities?
19. Was the IMF's policy recommendations widely received within the Bank?
20. Who was behind the idea of fiscal stimulation? When did it come into practice?
21. Were there any pressures from other countries concerning how to manage the crisis?
22. What is the role of the BOT in debt restructuring? Could you help explain the process and its latest development?
23. Who were the key decision-makers for the Financial Restructuring Authority and Asset Management Corporation? How would you describe the authority or influence of the Bank with these agencies?
24. How would you describe the relationship between the Bank and other debt restructuring agencies?
25. How would you compare debt restructuring programs of Chuan and Thaksin administration?
26. Could you describe the relationship between the BOT and the MOF?
27. Were there any changes in the relationship before and after the crisis?
28. Has there been a change in the way that the cabinet and the parliament have looked at and treated the BOT over the past 10 years? Do you see any changes in Bank-government relationship under democratic regimes?

Questions for Financial Institutions, Fall 2003

1. When did the idea of financial liberalization begin to be discussed among financial institutions? Was there any pressure from the international financial community?
2. How was the idea received at your institution and the financial sector at large?
3. Was there any opposition?
4. Did you and your institutions have a role in pushing for financial liberalization? If yes, what was this role?
5. Did financial institutions voice any concerns against financial liberalization? If yes, what were they?
6. After the process was launched, how did financial liberalization benefit your institution?
7. Were there any changes or adjustment your institution needed to make in the context of financial liberalization?
8. Were you aware of the problems in the financial sector? Was the crisis unexpected?
9. In your opinion, what were the causes of the crisis?
10. How was your institution affected by the crisis?
11. How did your institution deal with the crisis?
12. What do you think of the government's role in crisis management?
13. What is your opinion on the fiscal restriction policy?
14. Did your institution ask for financial assistance from the FIDF?

15. Can you describe the process of requesting for FIDF assistance?
16. What do you think of the role of the BOT in monitoring the financial sector before and after the crisis?
17. How do you describe the relationship between your institution and the BOT?
18. Did this relationship change after the crisis?
19. How do you compare macroeconomic policy between the Chuan and Thaksin administration?
20. What was your institution affected from the changes in the financial sector brought about by the crisis (and crisis management measures)?

Questions for Thai Bankers' Association, Fall 2003

1. Can you describe the relationship between the Thai Bankers' Association (TBA) and the BOT? How has this relationship developed over the years?
2. What about the relationship between the BOT and financial institutions?
3. When did the idea of financial liberalization begin to be discussed within the financial sector? What was the general opinion of financial institutions?
4. Did the TBA play a role in supporting financial liberalization?
5. How did financial liberalization affect the relationship between the TBA and the BOT and between financial institutions and the BOT?
6. Did you crisis catch you by surprise?
7. What do you think caused the crisis?
8. In retrospect, what should have been done to prevent the crisis?
9. What role did the TBA play in crisis management?
10. Were you satisfied with the role of the BOT in solving the crisis?
11. What is your opinion on how the government handled the crisis?
12. Can you compare the crisis management strategies between the Chuan and Thaksin administration?
13. Can you compare the financial system before and after the crisis? What do you think would be the effects of more foreign bank entries?

Questions for the Corporate Sector, Fall 2003

1. Could you describe the nature of your company's business?
2. Was your company established before financial liberalization (1990)? If yes, how would you compare your business then and after the process?
3. How would you describe the nature of the Thai financial system before financial liberalization?
4. Did your company have any role in supporting financial liberalization?
5. Did you consider financial liberalization beneficial to your business? How?
6. What do you think of the manner in which the process was launched?
7. Was this process affected your company's relationship/business with financial institution?
8. Was the crisis expected?
9. What were the effects of the crisis on your company?
10. How did you protect your company from the crisis?
11. In your opinion, what caused the crisis?
12. What do you think of the way the government handled the crisis? Did you agree with IMF recommendation of fiscal and monetary restriction?
13. How would you compare the financial system before and after the crisis?
14. Is your company a member of any trade association? If yes, can you describe how the association represents your business?

Questions for Politicians, Fall 2003

1. What was your and your party's role in the process of financial liberalization?
2. What was your party position on financial liberalization?
3. In your opinion, who initiated the idea? Was there any pressure from abroad?
4. How did the idea of financial liberalization affect party politics and vice versa?
5. What do you think of the role of the BOT in launching the process?
6. In your opinion, what caused the crisis? Was the party aware of the imminent danger?
7. Can you describe the nature of the decision-making process of during the crisis management period? Did the Prime Minister and Minister of Finance directly involved?
8. When was the decision to resort to IMF assistance made?
9. Before turning the IMF, did the government consider other alternatives for crisis management?
10. How would you describe the role of the BOT and the Ministry of Finance in solving the crisis? What about the cabinet?
11. What do you think of the fiscal stimulation policy?
12. Can you comment of the independence of the BOT?
13. Can you comment on the controversy involving the amendment of the Bank of Thailand Act?

Questions for Bank representatives at the IMF, Summer 2004

Routine Activities between IMF and the BOT

1. How often does the IMF meet with the BOT and what is the objective of these meetings?
2. Are there any exchange, training, or internship programs for the BOT personnel at the IMF? Does the IMF fund any training or scholarship program for the BOT?
3. What BOT departments are in regular contact with the IMF? What is the channel of communication?
4. How many officers at the Fund are responsible for Thailand? How do you divide responsibilities?
5. Are you in constant contact with BOT officials?

The IMF and the Thai Economy

1. What role does the IMF play in safeguarding the international financial system?
2. How does the IMF help Thailand when the economy is in trouble?
3. How does the IMF monitor the Thai economy?
4. Does the IMF have any role or make any comment on the financial system, e.g. the nature of the financial sector, or try to convince the BOT to make any changes to the financial system? If yes, what model of financial system does the IMF have in mind? And does the BOT usually follow IMF suggestions?

5. What does the IMF think about the developmental role of central bank in general and of the BOT's in particular, e.g. encouraging banks to open branches in rural areas, discount facilities?
6. What was the IMF's view of exchange control policy in the 40s and 50s? Did the IMF try to persuade the government to abandon the policy?

Roles during Critical Times

1. What role did the IMF and the BOT play in the drafting of the letters of intents during the financial crisis of 1997?
2. How did the content of the letters of intent come about? How were the policy details, e.g. financial restructuring being worked out?
3. How did the process of drafting go about? Who were involved?
4. Did the IMF officials have to deal with other government agencies, e.g. the Ministry of Finance? Was there any difference in terms of policy preference between the IMF and the BOT, and among the Thai government agencies, e.g. BOT vs. MOF?
5. What role did the IMF play in the BOT's organizational restructuring?
6. What role did the IMF play to help Thailand during the economic crisis in late 1970s?
7. How many Stand-by loans did the government ask from the IMF? (1981, 1982, 1985, and 1997?) What are the procedures of requesting for these loans?

Description of Relationship

1. How would you describe the relationship between the IMF and the BOT? Does the personality of the BOT Governor affect the nature of this relationship?
2. Do you find that the monetary positions of the IMF and BOT quite?
3. How does the BOT usually respond to IMF policy recommendations?
4. How do conflicts of opinion get solved? Who usually has the final say?

IMF and Financial Liberalization in Thailand

1. How did the IMF convince Thailand to liberalize the Thai financial system?
2. Did the BOT share the same commitment to financial liberalization?
3. Did the conditionalities set in the 3 Stand-by Loans from IMF in the early 1980s (1981, 1982, and 1985) set the liberalization process in motion? How?

Opinion on the Autonomy of the BOT

1. What is the latest status on the draft BOT law to grant BOT more independence?
2. Did the IMF play any role in shaping the content of the law?
3. Does the IMF agree with the content of the law and the idea of central bank independence in general?
4. Has the IMF made any recommendation relating to the independence of the BOT?
5. What kind of policy decisions does the BOT need to consult with the IMF, e.g. adjustment to exchange rate?
6. Has IMF ever helped put pressure on the Thai government in supporting the BOT's policy?

7. Has the IMF voiced any concern over the replacement of a BOT Governor?
8. Are there any BOT operations that still being done confidentially or discretely?

Influence on BOT Policy

1. Role in persuading Thailand to liberalize its exchange regime in the late 50s and early 60s.
2. Has the IMF made any recommendation regarding to the BOT organizational structure?

Questions for Bank officials, Fall 2004

Financial Restructuring

1. What was the rationale behind the Financial Master Plan?
2. How would you describe the conditions of the financial system at the time of the policy formation?
3. How would you describe the role of the BOT in the forming of the Plan?
4. What was the role of the Ministry of Finance?
5. Does the Plan reflect policy preferences of the BOT?
6. If yes, what was the reason behind such preferences?
If no, what were the Bank's preferences and how much the Bank had to compromise?
7. Was the private sector being consulted? Could you describe the process of public consultation? Was the Plan well received by the domestic and foreign financial institutions?
8. What was the role of the 'stakeholders' in the designing of the Plan?
9. Could you describe the process of implementation of the Master Plan? (Phases)
10. Could you describe changes to the types of financial institutions?
11. Could you describe the nature of ownership of financial institutions under the Plan, especially foreign ownership?
12. Who initiated the idea of grass-roots financial services?
13. How would you describe the role of the BOT in promoting financial services to underprivileged groups?

14. To what extent did the MOF play a role in supporting this idea?
15. How will the expanding role of the Bank for Agriculture and Agricultural Cooperatives affect the role of the BOT in financial supervision?
16. Have the objectives of the Plan been met so far?
17. Could you describe the current deposit insurance scheme?
18. Why do we need to change to a limited deposit insurance system?
19. What was the role of the IMF in supporting the new deposit insurance scheme?
20. Have the idea of deposit insurance of the BOT and the IMF compatible or similar?
21. Could you describe the development of the BOT's preferences regarding to deposit insurance system?
22. How did the blanket guarantee help the BOT and the government cope with the financial crisis?
23. What would be the status of the new deposit insurance agency?
24. What would happen to the Financial Institution Development Fund?
25. How would the new deposit insurance system contribute to the Financial Master Plan?

Amendment of the Legal Framework

1. Could you describe the legal framework in support of the Financial Master Plan?
Have they all been enacted?
-e.g. the Financial Institutions Business Act
-policy allowing foreigners to hold 100% shares in the subsidiaries (foreign bank branch).

-Decree eliminating special tax privilege for out-in transaction (IBF).

-Deposit Insurance Act

2. To what extent would these laws contribute to the role of the BOT in financial supervision?
3. How would you compare the role of the BOT before and after the new legal framework underlying the Master Plan?
4. Were these laws drafted by the BOT?
5. What is the process of passing these laws?
6. To what extent did the MOF involve with the drafting, approving, and passing of these legislations?
7. Was there a lot of consultation between the BOT and MOF?
8. Do the BOT and the MOF have similar preferences for the new legal frameworks?
9. What is the latest development of the BOT Act?
10. Was the current draft different from the one submitted during the Chuan Administration?
11. Were there any objections from the MOF regarding the current draft? If yes, what were they?
12. Were there any objections from the House and the Senate? If yes, what were they?
13. Could you explain the rationale behind the draft BOT Act? What does the BOT intend to change and why?
14. How did the idea of the new legal framework come about?
15. Why do the BOT need a new legal framework?

16. What are the changes being made to the relationship between the BOT and the MOF and the scope of responsibilities of the BOT under the new Act?
17. Were there any models (other countries' central bank laws) that the new Act takes after?

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