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Historical perspectives of the Thai financial crisis

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Abstract

This paper looks at the immediate and longer term origins of the Thai financial and economic crisis. It focuses particularly on the widening trade deficit and the problems in the financial sector before 1997, and argues that (a) the trade problems were largely exogenous, and not related directly to the baht appreciation or uncompetitive wage rates, and (b) the problems of the financial sector were in part the product of excess liquidity and the lack of alternative profitable outlets to the property sector. A root problem was falling real wages, which reduced consumption expenditure and so exacerbated the crisis.

The Thai crisis continues to surprise us. Beyond its second anniversary, neither of two common expectations have been fulfilled. On the one hand, IMF prescriptions, imposed in the wake of the crisis, failed to produce the immediate rebound which was, if only for a short time, widely expected. Second, the crisis, despite its speedy repercussions elsewhere in Asia, and the subsequent crises in Brazil, Russia, and elsewhere in the non-Asia world, has not led (so far) to the world-wide catastrophe which was also the prediction of some.

The passage of time, the length of the crisis, and the possibility that what we are seeing is a long period of stagnation in hitherto booming economies, makes it important to view the crisis in some longer perspective. Certainly we must be cautious in approaching the Thai crisis. The subject is both complex and significant. Indeed, the significance of the subject can scarcely be exaggerated. It seems inevitable that the date of the baht devaluation, July 2 1997, will go down in history alongside others in the history of financial crises. A parallel which springs to mind is the failure of the Credit Anstalt bank, Austria's largest private bank, in May in 1931. From Vienna banking and exchange crises then spread quickly across the world, culminating in the British decision to leave the gold standard in September 1931. Economic historians have been fascinated by the failure of the Credit Anstalt: why did it fail when it did, what were the roots of the failure; and why did it have such a contagious impact on world financial markets?

Similarly, future economic historians will certainly always put Thailand under the spotlight, as the country which started the Asian (and perhaps global) panic. And they will ask similar questions. Why did the Thai crisis occur when it did; why did contagion occur and spread so rapidly; why was the crisis in Thailand so deep and protracted; and what were the roots of the Thai crisis? And just as historians of the Credit Anstalt rightly trace the failure of that bank not just to the economic recession which set in during 1929 but to longer term changes dating back to the breakup of the Austro-Hungarian Empire in 1918, so economic historians will doubtless trace the origins of the Thai crisis back to an earlier period. This will be a principal theme of this paper.

The Thai crisis has great significance for other reasons. For Thai economic history it marks a watershed. Thailand has never experienced any decline in real per capita GDP since the 1950s, and for at least three decades before 1997 The economy has been characterised by strong, steady, growth. This growth, moreover, has taken place against a background of generally sound orthodox budgetary policies, relatively low inflation, and a strong external position. Suddenly, in the space of a single year, the very foundations upon which Thailand's remarkable economic performance was based, have been undermined.

Beyond that, the end of the Thai 'miracle' and the rapid spread of the crisis to other Asian nations, has called into question the very basis of the economic orthodoxy which explained that

growth. On the one hand, export-led growth coupled with 'sound fundamentals' was supposed to ensure continued real growth without drastic setback. This, at any rate, was the message of a well-known World Bank Report (World Bank 1993). Appropriate government fiscal and monetary measures were supposed to keep growth rates both positive and within bounds. And Thailand was a foremost example of a country embracing 'sound' economic policies and opening its economy to globalisation through liberalisation and deregulation in the early 1990s. The unforeseen adverse consequences of these policies will perhaps cause as fundamental a challenge to prevailing economic orthodoxy as did the earlier depression of the 1930s.

On the other hand, the 'model' of export-led growth was supposed to generate not only economic growth but qualitative economic changes which would then ensure further progress. Two developments were expected. Changing factor proportions would push a country's exports up the technological ladder, adding value-added to output, and ensuring a smooth transition from labour-intensive to less-labour intensive and more technologically sophisticated production. With the change would come a better educated and more skilful labour force. Secondly, economic equity inherent in the 'Asian model' would ensure that the while population benefited in the growth process, and growth itself would ensure a healthy expansion of domestic demand.

We now know that these characteristics of the 'Asian model' have not worked, and it is important to ask why.

I

Let me try to express succinctly what I want to argue here. First, the crisis in July 1997 expressed itself as a currency crisis, but the currency was not the major problem. If it was, then the sharp devaluations of the second half of 1997 would have solved the problems.

Secondly, the currency crisis was connected to a growing adverse balance of trade, in turn caused by a slowdown in the growth of exports in 1996 and early 1997. Again, this was not the main problem in Thailand for the trade deficit as a proportion of GNP was much higher in 1990, for example, than it was in either 1996 or early 1997.

What the currency crisis and loss of confidence in the Thai baht did was check the inflow of short-term capital. This in turn exposed the insolvency of a number of financial and business institutions (commercial banks, finance companies, property companies). To understand the Thai crisis, therefore, we must ask how large sectors of the financial sector (banks and finance companies) and the real sector (property companies) came to be insolvent.

The answer lies in four forces. First, considerable liquidity in the Thai financial system. This was the product of (a) a high domestic savings rate; (b) large inflows of long term and short-term foreign capital which was not sterilised in the banking sector; and (c) deregulation in the financial sector in the early 1990s. The second force was the desire of the financial sector to increase the returns on their investments. This was, of course, rational economic behaviour, but in the deregulated climate of the 1990s there were two further factors: (a) some first class accounts were withdrawn from the banking system as borrowers were able directly to tap cheaper overseas sources (which was eminently safe as long as exchange stability prevailed); and (b) increased competition in the banking sector encouraged banks to look for higher yielding investments. The third force was the inherited structure of large family-based business groups with close ties to the banking system. The prevailing methods of financing relied heavily on bank lending with as little dilution of ownership through equity as possible. The close personal ties between the banks and the large businesses made the increase of bank lending for expansion a normal path of development. But the risks were thus borne by banks and finance companies rather than by shareholders in the borrowing companies.

Now we come to the fourth force. Why were so many loans, in the climate of excess liquidity and competition for borrowers, badly directed and focused so largely on the property sector? Of course, we can rehearse a cluster of contributory factors: greed, incompetence, lack of transpar-

ency, a concentration on asset value rather than earnings, and so on. But fundamental, in my view, was a lack of alternative profitable outlets in the real sector. This in turn was rooted in low purchasing power among the mass of the population, the failure of the education system to provide a labour force adequate to move to more productive and sophisticated manufacturing occupations as the possibilities of labour intensive manufacture were eroded, and in the failure of the Sino-Thai business groups to adjust systems of management to cope with diversification into the more productive and sophisticated sectors. The lack of alternative investment opportunities was thus rooted in Thailand's economic history.

II

Let us start with the central feature of the crisis, the weakness of the balance of payments. The weakness became increasingly apparent during 1996 and the first months of 1997 and was critical as far as the actual timing of the crisis was concerned. Weak exports brought into question the whole basis of Thailand's economic growth, while an increasing current account deficit to GDP ratio made the Thai currency increasingly vulnerable.

The weakening current account is shown in Table 1. As a proportion of GDP the ratio rose from 5.6 per cent in 1994 to 8.17 per cent in 1996.

Table 1: Current Account Balance ('000 million baht)

1990	-186.2
1994	-203.2
1995	-337.6
1996	-372.2

Source: National Statistical Office, *Thailand Statistical Yearbook*, various years

A key factor in the worsening situation was a sudden and unexpected fall in export growth rates. Indeed, in 1996 there was a small absolute fall in the value of exports for the first time since the 1960s, and the fall came in the wake of several years of healthy export growth (Table 2).

Table 2: Thai Exports, 1996–6 ('000 million baht)

Year	Exports	Percentage change
1994	1180.0	21.3
1995	1381.7	23.6
1996	1378.9	-0.2

Source: National Statistical Office, *Thailand Statistical Yearbook*, 1997

How can we explain the sudden and unexpected fall in exports? Professor Warr (1997; 1998) has recently reviewed the subject and he emphasises two significant factors; the real appreciation of the Thai baht and the rise in real wages which increased the costs of Japan's labour-intensive exports. Indeed, he indicates the latter as the single most important factor.

Undoubtedly there was an appreciation of the baht. In nominal terms the baht depreciated against the US dollar by 2.4 per cent, but rose against the Japanese yen by around 12 per cent in the year 1995–6. Warr adjusts these figures to allow for inflation, yielding a virtually static real exchange rate against the dollar, but against the yen an appreciation of almost 18 per cent.

I have several reservations about Professor Warr's analysis. In the first place, a single year is hardly an appropriate time-period over which to judge the impact of currency changes, while the realities of forward contracts mean that the sort of instant adjustment to exchange rate movements suggested by Warr is inappropriate. Also, a significant proportion of Thai trade (although this applies more to imports than to exports) is denominated in US dollars. In any case the

Japanese market for Thai exports is significant, but not overwhelming. In general over the period 1992–6 Japan, the United States, the ASEAN economies, and the European Community accounted for roughly equal shares, some 20 per cent of the total. It is not clear, too, that a calculation of real yen/baht rates will help us understand the net effect of exchange rate changes on Thai exports to Japan without some consideration of Japanese demand elasticities for Thai goods and the parallel exchange movements in Thailand's competitors. To the extent that Thailand's exports to Japan included partially processed goods shipped to Japan for finishing and other commodities exported by Japanese companies to Japan under contract agreements, the exchange rate would have only a slow effect, if any.

Let us look at exchange movements in a little more detail. Table 3 shows that the sharp appreciation of the baht against the yen in 1995 was short-lived and against the longer-run trend. As the table shows, the years 1992–5 saw a steady depreciation of the baht against the yen, with a sharp appreciation only at the end of the period. In fact, the appreciation resulted in a value for the baht by the fourth quarter of 1996 almost identical the average for 1994.

Table 3: Yen-baht exchange rates, 1992–6

1992	1993	1994	1995	1996
0.2025	0.2270	0.2447	0.2646	0.2314

Source: Bank of Thailand, *Quarterly Bulletin*, various issues.

As far as non-Japanese markets were concerned, the baht remained fairly stable against the US dollar (being largely pegged for the dollar, of course) and against most ASEAN and major European currencies over the years 1993–6. An important exception was the Singapore dollar, where the baht steadily depreciated over the period, by about 15 per cent. Another significant change occurred against the Chinese renminbi when that currency was devalued in 1994. The baht rose by about 54 per cent against the Chinese currency in that year.

The conclusion from the above discussion must cast doubt on Professor Warr's suggestion of the significance of exchange movements (at least the direct baht-yen and baht-US dollar exchanges). It may be that Chinese goods, cheapened by the fall in the renminbi, or goods from the East European countries, made inroads into Thai markets. But the baht exchange rate itself can have played only a minor part. Moreover, when we look in detail at the structure of Thai exports in 1996 we see general falls in all major markets, irrespective of exchange movements. If the fall was rather greater to Japan than to elsewhere, the contraction of the Japanese economy and the general slackening in demand there for imports provides a better explanation.

Table 4: Thailand's Exports by Destination ('000 million baht)

Country	1994	1995	1996
USA	239	251	254
Japan	194	236	238
Singapore	155	197	171

Source: National Statistical Office, *Statistical Yearbook*, 1997

The figures in Table 4 give little support to any obvious impact of Thailand's currency appreciation in 1995–6. To be sure, the rate of decline was greater in Japan than the USA when we compare the yearly changes, but the relative decline was far greater in the case of Singapore, where there was a depreciation of the baht in terms of the local currency.

As mentioned earlier, a more convincing explanation for the slowdown in Thai exports which became apparent in 1996 was the general slowdown of the world economy, and the decline in import consumption among Thailand's major trading partners. We may consider this question

from two angles. First, there was a general decline in the growth rate of exports in 1996 experienced by all major East Asian countries.

Table 5: East Asia, Export Growth Trends (per cent change in \$US)

Country/Region	1994	1995	1996
China	32	23	2
Korea	17	30	4
Taiwan	10	20	4
Malaysia	25	26	6
Thailand	23	25	-1
Indonesia	9	13	10
Developing East Asia	10	12	-5

Source: World Trade Organization, *Annual Report*, Vol. 2, p. 63.

The figures in Table 5 can only suggest that there was a very serious malaise affecting almost all Asian exporting countries during 1996. Interestingly, the sharp slowdown occurred both in NIE economies (Korea and Taiwan) and in the 'tiger' economies (Thailand and Malaysia). While domestic factors doubtless played a part in the slowdown, we should recognise the part played by the general slowdown of demand on the part of the major markets for East Asian exports. Problems for Asian exporters was signalled by a sharp drop in the growth of world trade in 1996 by comparison with previous years. Thus in 1996 world trade grew at 5.6 per cent compared with 9.2 per cent in 1994 and 1995, while imports by advanced economies fell from 8.9 per cent and 8.4 per cent in 1994 and 1995 to 5.3 per cent in 1996. Table 6 shows the sharp fall in import growth in 1996 in a number of Thailand's major markets.

Table 6: Percentage Growth Rates of Imports, Selected Countries

Country	1995	1996
Japan	17.5	3.4
Korea	28.2	7.3
USA	8.5	4.6
Hong Kong	4.0	1.0
China	15.3	-2.2

Source: IMF, *Annual Report*, 1997.

III

I want to turn now to some aspects of the financial crisis. It is now a matter of history that the immediate cause of the crisis in mid-1997 was a financial crisis, and that subsequent problems in the financial sector delayed recovery and deepened the economic recession. It is also a matter of history that the problems of the financial sector had developed over several years, that they were related to the combination of liberalisation and deregulation coupled with an exchange rate which more or less tied the baht to the US dollar, and that they involved over-investment in what turned out to be unproductive sectors, especially the property sector.

Investment in Thailand was a product of high domestic savings rate combined with substantial inflows from abroad (Lauridson 1998). The investment ratio (gross domestic investment as a proportion of GDP) rose steadily from 25 per cent in 1980-4 to 30 per cent in 1985-9, and to over 40 per cent in 1990-6. Savings were encouraged by relatively high interest rates; the minimum loan rate (MLR) fluctuated between 17 per cent and 13.5 per cent, in the first half of the 1990s, and were raised significantly in 1995. These rates were higher than in many overseas financial centres, including Japan and the United States. High interest rates attracted short

term funds from abroad and also encouraged domestic borrowers to seek loans abroad rather than at home to finance their investments. Indeed, it was possible to make a profit simply by borrowing from abroad and depositing the money at high interest in baht. The process of increased short-term borrowing in Thailand was encouraged by a number of financial liberalisation measures undertaken in the first half of the 1990s. Two important measures were the deregulation of foreign exchange in 1992 and the foundation of the Bangkok International Banking Facility in 1993 (see Chart 1). The latter allowed local and foreign commercial banks to take deposits or borrow foreign currencies from abroad, and to lend the money, in Thailand and abroad. The purpose of the measure was to establish Bangkok as a regional financial centre, to rival Singapore, and to provide a source of short-term funds to cover the growing current account deficits.

The result of these liberalisation measures, and other developments in the world economy, was a significant increase in Thailand's foreign borrowing. In 1992 the external debt stood at around US\$40 billion, and this had increased to US\$80 billion by March 1997. This debt, overwhelmingly from the private sector, increased from 34 to 51 per cent of GDP over the period 1990–1996. Much of the debt, around 36 per cent in 1996, was short-term (ie maturing in one year or less). The ratio of short-term debt to foreign reserves rose from 0.6 in 1990 to around 1.0 in 1995 and 1996.

A feature of the inflow of funds into the banking system was that a large proportion found outlets in the property market, and something of a speculative 'bubble' economy developed in the first half of the 1990s. Features of the property bubble were the development of condominium projects, commercial offices, residential developments, golf courses, hotels, and shopping malls. The investments affected not only Bangkok and surrounding districts, but also reached deep into the provinces.

It should be emphasised that most of the foreign currency loans were not hedged against possible currency movements, and that many were financing long-term projects with short-term borrowing. Such investments gave rise to what was known in the 1930s as the 'transfer problem', namely loans which did not give rise directly to the foreign exchange in which the loans had to be serviced and repaid. It should be emphasised, too, that much of the lending to the property sector came not only from the commercial banks but also from finance companies. Bank of Thailand figures show that total loans to the property sector increased from 264 billion baht in 1993 to 767 billion baht in March 1996, with 54 per cent of the latter total coming from commercial banks and 45 per cent from the 90 or so finance companies.

Already during 1995 and clearly in 1996 many property companies were in difficulties. Early in 1997 one of the largest and best-known property companies, Somprasong Land, defaulted on the interest payments of a foreign debt, and pressure on several other property companies, and on a number of finance companies, increased. It became clear that the largest finance company, Finance One, was in difficulties.

I do not want in this paper to trace in detail the breakdown of Thailand's financial sectors. Landmarks include vain attempts by the Bank of Thailand to arrange mergers with banks and troubled finance companies, the suspension of 16 finance companies on June 27, the suspension of a further 42 finance companies on August 5 (following the baht devaluation of July 2 and the call by Thailand for IMF assistance), and the permanent closure of 56 of the 58 finance companies on December 8, 1997 (which accounted for some two-thirds of the total assets of the sector). Meanwhile, various attempts have been made to recapitalise and restructure the Thai commercial banking sector, under IMF guidance.

Rather, I want to consider why Thailand should have experienced a speculative property 'bubble', and why investment by financial institutions was not more soundly based.

There is, of course, an element of irrationality in all speculative bubbles, where investments are based upon unsound expectations and where assets are purchased in the expectation of asset inflation rather than justified through a reasonable expectation of earnings. In Thailand, in the

first half of the 1990s, I would focus on three issues. First, the high level of liquidity in the banking system, which encouraged lending. Second the dominance in all major sectors, including banking, of large family-based concerns and whose owners were reluctant to dilute family control. Third, and this is important, a general economic weakness in some sectors of the economy which restricted the lending opportunities of the financial sector and encouraged an unhealthy preponderance of loans to the property sector.

See Chart 1: Structure of Financial Institutions in Thailand

Looking at these points in turn, we have already mentioned how liquidity in the financial sector was encouraged by the inflow of foreign capital and by various measures undertaken after 1992 to deregulate and liberalise the financial system. A high interest rate policy by the authorities had unfortunate side effects: it encouraged domestic savings and certainly caused difficulties for domestic borrowers. But the interest differential with foreign centres meant that first-class borrowers could raise capital abroad. An example was the huge Robinson-Central Department Store group, which borrowed US\$300 million in the period 1994–6 (*The Nation*, 30 June 1998). The creaming off from the domestic banking sector of such major borrowers (and the generally more competitive banking environment) pushed banks and their affiliate finance houses into more risky lending, much of it to the property market.

Moreover the structure of family-centred business groups encouraged bank borrowing rather than equity capital for investment. Even where equity capital was sought, it was often used to maintain close-knit family control of groups. Family links and other close ties between the banks and business groups further encouraged a reliance on bank lending, and family groups were reluctant to dilute ownership through broadly-based equity issues. The result was that during the first half of the 1990s a number of commercial banks and finance companies lent huge sums to Thai business groups often for long-term projects, and often for what turned out to be ill-advised ventures (property, hotels, and so on). We might note in passing the narrowness of the Thai investment market. While the Stock Market is often viewed as a barometer of Thai economic conditions it should be recognised that only a small part of fixed capital investment has been raised through the stock market. Bank of Thailand figures show that, in 1996, only some 440 companies were listed on the stock exchange, and some 40 per cent of total capitalisation was accounted for by the commercial banks. It seems to me that this structure of the investment market was unfortunate: it tended to channel investment funds too narrowly, and encouraged speculative investment in assets as a result of stock market volatility. This was in strong contrast to the far more broadly-based and heavily capitalised Singapore stock market.

Indeed, the combination of bank liquidity, the narrowness of the equity market, the investment policies of family business groups, and the growing weakness of some sectors of the manufacturing and agribusiness sectors in the first half of the 1990s all tended to push the liberalised financial sector towards extensive lending to the property sector.

IV

What evidence is there of general economic weakness and a drying up of investment opportunities (except for property, spurred by asset growth, and a few particular sectors such as telecommunications)? By 1996 there can be no question that many sectors of the Thai economy were weak. We may consider just a few pointers. As mentioned earlier, there was a sharp slowdown of export growth, and the import of this slowdown was felt especially in the labour-intensive sector such as garments, footwear, and so on.

For a longer period, the stock market had signalled economic difficulties. The SET closing index fell from an average of nearly 1700 in 1993 to 1360.1 in 1994 to 1280.8 in 1995 and 831.6 in 1996. Market capitalisation fell sharply in 1996, to 2560 billion baht from 3565 billion baht the previous year. The trends in the price/earnings ratio are suggestive. From 13.87 times (13.87:1) in 1990 the ratio rose steadily to reach 26.1 times in 1993 and remained at more than 19.5 times in 1994 and 1995. In other words, stock values outstripped earnings, resulting in

inflated stock values. Even in 1996, after a sharp fall in stock values, the price/earnings ratio remained above 12 times, and then fell to 6.5 times during the crisis year of 1997.

We may take the falling stock market valuations and high p/e ratios as indicators of growing weakness in some sectors of the economy, especially after 1994. And there were many other indicators. One statistic I particularly want to draw attention to is the fall in the growth of real consumption expenditure from 1994. In 1994 real consumption expenditure had risen by 8.7 per cent; in 1995 the rate was 7.3 per cent, and in 1996 only 6.2 per cent (the lowest since the mid-1980s). The general weakness of domestic consumption was reflected throughout the economy. For example, there was a sharp fall in the growth rate of department store sales in 1996 (at a time when many of these department stores were engaged in large-scale expansion). Imports of key articles such as furniture, furnishings, household equipment, and clothing were virtually static in real terms in 1996 by comparison with 1995, and the sluggishness continued during the first half of 1997. In fact, concentration on slow exports in 1996 has perhaps led commentators to ignore the fall in import growth also, which was nearly as dramatic. Overall imports grew in value in 1996 by only 2.3 per cent, compared with 30.5 per cent and 17.6 per cent the previous two years (and an average growth rate of over 25 per cent, 1990–5). Among imports, there was a sharp fall in the value and numbers of motorcycles from 1995, a sure sign of contracting consumer expenditure. Imports declined by one third in value in 1996, and total domestic sales fell by 20 per cent, in the number of units sold. Another sign of economic contraction was a fall in VAT receipts (2.5 per cent lower in the first quarter of 1997 compared with 1996), while the values of overdue pawns at the country's numerous pawnshops doubled in the four years 1993–6, twice the rate of the previous four years.

The points I wish to draw from the above discussion is that there was a very general downturn in the Thai economy, at least by 1996 and in some instances earlier, and that the difficulties were by no means confined to the export sector. There is considerable evidence of faltering consumer expenditure and of lower profits by Thai companies. In the next section we will explore this phenomenon more closely.

V

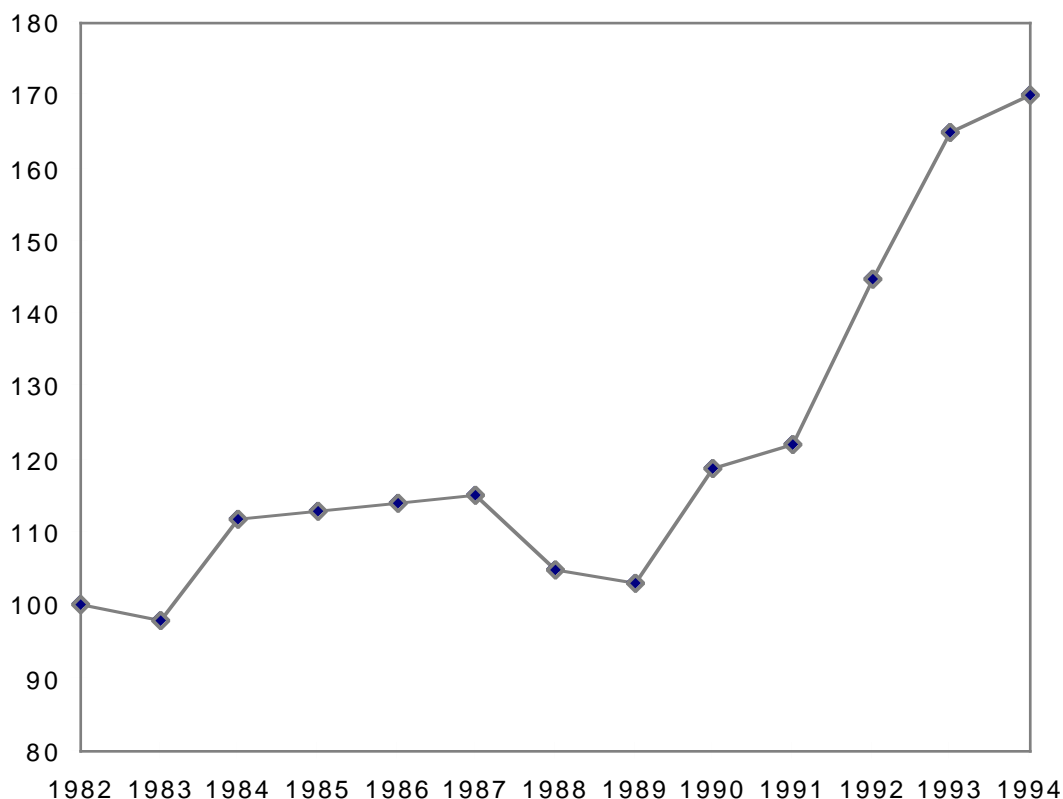
In discussing the Thai domestic economy in the years prior to the collapse of mid-1997, I want first to return to Professor Warr's analysis. He suggests that the single most important factor explaining the slowdown of the economy was a rise in real wages, averaging nearly 19 per cent a year in the period 1991–4 (see Figure 1). As a result, he says, Thai exports became uncompetitive, and this was shown in the sharp fall in exports in 1996 at the first half of 1997 which affected particularly the labour-intensive sector.

It is clearly of the utmost importance to establish whether the decline in exports was the result of growing uncompetitiveness in world markets. In an earlier section I pointed out that general world economic conditions in 1996 (especially a sharp fall in the growth of imports which affected all Thailand's major trading partners) were acting to check exports. Moreover, while it is certainly true that labour-intensive exports suffered, the problems for exporters were felt across nearly every sector. In general, if we compare the first quarter of 1997 with the first quarter of 1996, we find that overall the exports of labour-intensive manufactures declined by 9.9 per cent in value, while the decline for domestic resource-based exports (ie with a low labour content) was 11.2 per cent. For all non-oil Thai exports the fall was 8.7 per cent. Clearly the problems for exporters were far wider than those stemming from rising real wages and thence uncompetitive prices.

We may, at this point, look a little further at the question of real wages. It is well known, of course, that the process of industrialisation brings an 'aristocracy of labour' whose very high wages may co-exist with low wages for the majority. It is obvious that the growing variety and complexity of wage-earning occupations as industrialisation proceeds will tend to increase the spread of wages from bottom to top. It is also obvious that a process of averaging wages may well indicate rising money (and real wages), even if money wages for those at the bottom of the

scale remain unchanged. Critically, if we are to understand the impact of wage costs on labour-intensive manufacturing industry, it is surely to those at the bottom of the scale that we must look.

Figure 1: Thailand: Index of Real Wages, 1982–1994



Source: Warr (1997)

In general, unskilled wages are set by government minimum wage legislation. A daily wage is set, with usually annual adjustments, and employees are theoretically obliged to pay these amounts as a minimum. No distinction is made between male, female, and child employees, but the amounts are set in three categories covering the Bangkok area, certain other more urbanised areas, and the provinces. In the negotiations which normally take place each year between employees, employers, and government, a key part is always played by the cost of living index, and the amounts set as minimum wages have generally kept somewhat ahead of the inflation rate. This gives us a generally rising real wage. It must be added that in practice there are many expedients by which employers avoid paying the minimum wage, and a recent survey shows that some half of all employers admit to paying less than the minimum. It is well known that the use of immigrant labour (often illegal) and the employment of women and children are ways in which employers reduce wage costs. At the same time other elements of labour legislation (hours and conditions of work, for example) are also avoided.

Turning to the figure reproduced from Professor Warr's article, I want to make two initial points. First, his data stop at 1994. Thus the critical years of 1995 and 1996 are not covered. Secondly, the data are based on the kind of averaging process described above, and thus illustrate the trend of all wage earners rather than those of the labour-force of labour-intensive manufacturers.

The data for 1995 and 1996 are interesting. On April 1, 1994, minimum wages were set at 132 baht a day in Bangkok (and 116 and 108 baht a day in the other categories). After another small rise in October, rates were again increased to 145 baht (and 126 and 118 baht) on July 1, 1995. The rate was not increased again until October 1996. Thus, for anyone paid the minimum wage,

they would have received a money wage rise of around 9 per cent between April 1994 and the end of September, 1996 (a range of 9.8 per cent to 8.6 per cent). Meanwhile, the basic consumer price index rose no less than 12 per cent, while the cost of food alone rose 17.7 per cent. So, even on the most favourable assumptions (that the minimum wage was paid and the basic cost of living index is the appropriate deflator) we find an unequivocal decline in real wages for 1995 and most of 1996.

But this is not all. If we adjust the minimum real wage with the consumer price index for low income consumers we get an even sharper, and longer, decline in real wages. While the minimum wage had risen by only about 9 per cent between April 1994 and September 1996, the low income consumer price index rose some 15 per cent. Over the longer period April 1993 to the onset of the crisis in July 1997, money wages (the minimum wage) rose about 24 per cent while the low income consumer price index rose 30 per cent. Again, there was not a rise in real wages, but a fall.

We may add to the above the widening income disparities which have become evident in Thailand since the great economic upsurge of the 1980s. Mehdi Krongkaew estimates that the Gini coefficient rose from 0.453 in 1981 to 0.525 in 1994, and other studies confirm sharply rising regional and income inequalities over these years (Krongkaew, 1996; Warr, 1997; Falkus 1997).

VI

If the above analysis is correct, we cannot ascribe the weakness of the Thai economy in 1996 and the early months of 1997 to rising real wages, in turn producing non-competitive exports. This is not to deny the importance of wage costs, of course, or to deny that certain Thai exports may have become uncompetitive during 1996. One can think of the increasing burdens of an inadequate infrastructure, rising interest rates, and high land and rent charges as just a few of the cost pressures on Thai firms, as well as wage costs and the effects of exchange movements.

But for an understanding of the Thai crisis, the movement of real wages (and income distribution) is, in my view, critical. Thailand's tragedy was that the benefits of high growth were not shared deeply enough. The absence of sound domestic market growth (based on rising incomes rather than hire purchase debt) helped direct the abundant investment funds of pre-crisis Thailand into unproductive channels. When the crisis hit the financial markets, there was no underbelly of rising consumer expenditure to lessen the effects. Indeed, the policies advocated by the IMF and pursued by the Thai government have depressed real incomes still further, have dramatically increased unemployment, and have undermined further hope of a domestic-led recovery.

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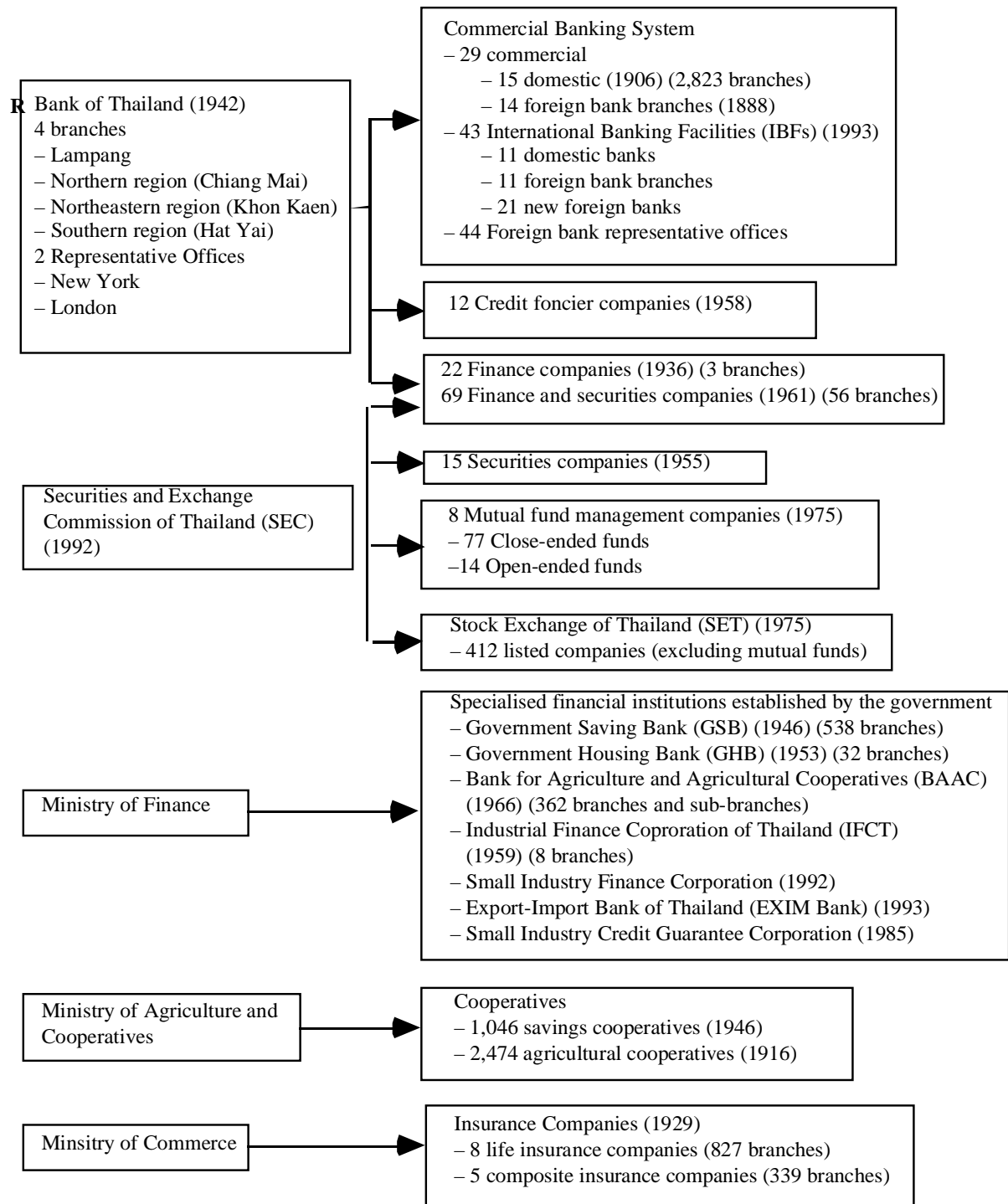
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* The year in parenthesis is when each type of financial institution began operation
 ** Statistics are as of December 1994

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