

EE463 GLOBALIZATION AND INTERNATIONAL DEVELOPMENT
Semester 2/2020 (20 January – 19 May 2021)

Asian financial crisis impact on Thailand (Tom Yum Kung Crisis)

GROUP 5

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*A solid paper.
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FACULTY OF ECONOMICS

THAMMASAT UNIVERSITY

April 2021

good overview of the financial crisis.

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Overview

The Asian Financial crisis also called "Asian Contagion", was a sequence of currency devaluation. The crisis occurred around the summer of 1997 and spread rapidly all over the Asian markets. The currency markets first failed Thailand which is the effect of the government's decision to no longer hold the local currency to the U.S. dollar. Currency declines spread rapidly throughout East Asia, in turn causing stock market declines, reduced import revenues, and government disturbance (Chappelow 2020). On July 2, 1997, the Thai government ran out of foreign currency and was not able to support its exchange rate any longer; consequently, the government was forced to float the Thai baht and cause the currency exchange rate of baht to collapse immediately (Corporate Finance Institute n.d.). Accordingly, the currency market significantly plays an important role as a cause of the crisis in Thailand and other countries as well.

Since the end of World War II, there have been efforts to improve the economic and social life as we know as the third world countries. The dispersion of this financial development and improvement in the personal quality of life factors is the supposition that general development in the economy will be profitable to everyone. The economic growth that occurred was not evenly distributed and not improving the lives of people in rural areas (Stiglitz, 2002).

Thailand has economic development with GDP growth of more than 7 percent and the GDP per capita has dramatically risen from the last 25 years. This caused a better quality of life of people by decreasing the poverty rate by around 8 percent of half of the population in Thailand. There are more people able to access medical care. Moreover, in the late 19th to 20th century, the process began to slowly rise in terms of development in the technologies. The beginning of agricultural production for the exports cause the reform of slavery and later move to the urban industrial, the agricultural share of GDP dramatically fell (Kelly et al. 2012).

resulted in industrial growth, causing

to feel dramatically

Table 15.1 GDP and Growth of Production by Sectors (in billions of baht and percentages)

Sector	1961-66	1967-71	1972-76	1977-80	1960-80
Agriculture	34.33 (6.26)	45.89 (5.88)	58.22 (6.74)	71.70 (3.53)	(5.1)
Mining	1.36 (16.9)	2.54 (5.35)	2.78 (-0.77)	4.38 (11.66)	(7.76)
Manufacturing	12.21 (11.42)	21.49 (9.17)	34.45 (10.49)	56.90 (8.64)	(10.59)

Source: Calculated from the National Income Accounts.

good use of table to illustrate the key points in the main text

During the economic changes during the 1850s, the cycle of modernization began before in Thailand than other developing countries of the third world. Thailand is one of the most driving world rice exporters. The period 1850s to 1950s remains stable as there is not much difference in income (Ng 1974). From the 1960s to the 1980s the public enterprise and the foreign capital played a significant role and controlled the Thai economy (Bell 1991). During the 1960s to 1970s, Thailand was one of the most successful developing countries and also had the fastest growth rate. The production that rapidly grew along with the progress in reducing poverty during the 1970s was surely impressive (Hays 2008).

At the time, Thailand implements an import substitution industrial policy to allow people to grow speedily because the cheaper goods supply unskilled labor with low wages and also tax-free from the imported machinery. The heavy focus on oil, machinery, and chemicals combined was 69 percent of total imports in 1960. The industrial workers receive the minimum wage as same as unskilled labor. This indicates that the cost of production is so low; hence, this attracts most investors for foreign countries. Thailand is more substantial with labor-intensive techniques (Bradford and Branson 2007).

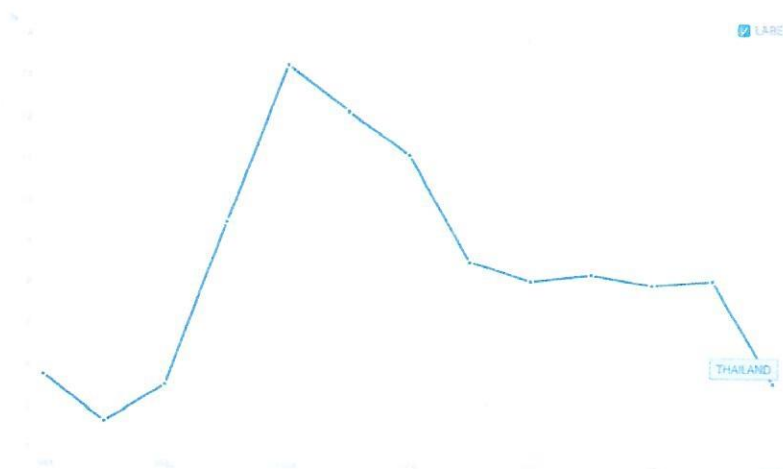
Thai economy started taking off around the 1970s and kept growing steadily, The GDP fourfold between 1970 and 1990; meanwhile, tripled in income per capita (Hays 2008). From the 1972s to 1975s the demand growth rose dramatically over the capacity and the import share. The export orientation was gradually introduced in many sectors such as wood, rubber, and textile products. So during the period 1975s to 1980s demand for export was rising so the import substitution was no longer work for contributing growth. However, in the early 1980s, the performance of the Thai economy had slowed down partly as a consequence of the worldwide recession. At this time when oil prices changed rapidly, Thailand was hit by the condition that one-third of money from export went to pay for crude oil in Thailand and later people switched from using oil to natural energy. Thailand is one of few countries that are not facing liquidity problems unlike other countries did because of the limit of government borrow rate so they find a cheaper source to invest and funds. Besides, the global recession in the early 1980s was partly influenced by several developments including an oil shock in 1979 (Kose, Sugawara, and Terrones 2020).

During the late 1980s after the global recession, Thailand had the fastest growing economy in the world around the late 1980s and early 1990s with the peak at 13.6 percent growth rate in 1988 in term of annual GDP growth (The World Bank 2021); hence, Thailand was on its way to joining the name of tigers like South Korea and also Taiwan; however, the serious flooding in late 1995 significantly slowed down the economy. By the 1990s, the concern of the

efficiency of development by concerns of the poor and the local community were well structured and effective. Some studies found that democratic systems achieved the most development among developing countries because they allowed people to be more efficient and successful (Riviera-Batiz, 2002). In the mid-1990s, the goal was to make local people gain more access to the state resources and be able to sustain their community, ^{Human rights have become more significant in society (McGee, 2002).} *McGee*

For about 10 years before the crisis around 1987 to 1996, the Thai economy ~~had a good~~ ^{OK} performance with an annual GDP growth rate of 9.4 percent on average; meanwhile, the growth rate of real exports was 14.5 percent along with the inflation rate of 4.7 percent. As well as the investment, the investment ratio rose from 27 percent in 1987 to 41 percent in 1996. This ^{confirms} ~~clarifies~~ that the Thai economy is surely in a satisfying situation; however, Thailand still needs a high amount of foreign capital and foreign investment to develop and improve the country's economy.

Thailand's economy expanded rapidly as a result of many big companies moving their production base into Thailand and also exporting domestic goods created income for the country as well. Hence, when the country is richer the government has an idea to push Thailand to be the financial center of the region; meanwhile, because of the good economy, many countries demand Thai ^{ad} baht and ^s ~~make~~ ^{made the} Thai-baht appreciate. And if the currency keeps getting stronger it will cause the price of domestic products to be higher and will reduce the export; as a result, the Thai government fixed the exchange rate at 25 Bahts per 1 U.S. Dollar

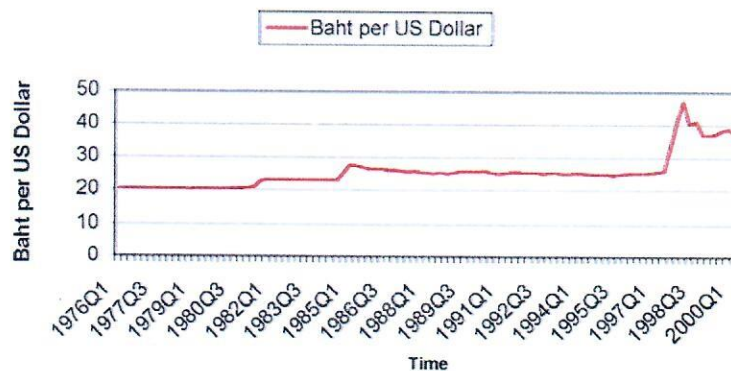


GDP Growth (annual %)

Source : The World Bank

Identification of key issues

In the 1990s, many countries in ASEAN were experiencing both economic and credit boom as GDP greatly rose. In the early 1990s, the interest rate of borrowing from the U.S. in the U.S. dollar term was low. The U.S. was gaining the most compared to other currencies in the world in 1995; meanwhile, the current account in Thailand was in deficit (Charumilind, Kali, and Wiwattanakantang 2006). There were massive amounts of loans for the property sector or real estate market that shifted the credit conditions and consequently interest rate rose exponentially. Thailand was facing a sharp depreciation of the Thai baht making the market collapse as the value of short-term debt rose and hence leading to the collapse of many companies and making things worse (Sufian 2009). This caused a change in the economic activities because when the domestic currency—the Thai baht depreciates the price of goods and services will dramatically increase. Thailand imports less from abroad as domestic products seem to be cheaper from the Thai citizen's perspective. People have high inflation expectations because there was higher inflation from the price rise so this encouraged Thai people to export more goods to foreign countries (Chomsisengphet and Kandil 2007). ^{The foreign creditor is} ~~resisting to~~ ^{began to} lengthen new loans since foreign debt ^{was} ~~is~~ rising. During the same period, many people withdrew the credit because the current account deficit increased. ^{In the meantime,}



The event of the Asian Financial crisis from 1997 to 1998 began in Thailand and consequently spread to neighboring economies rapidly. As mentioned earlier, it began in a form of a currency crisis in Thailand when Bangkok, which is the capital of Thailand, unpegged its currency from the U.S. dollar (Ba 2019). Hence, it triggered a sequence of currency devaluation and massive capital outflow. Besides, the crisis became a global crisis when it started to affect Russia and Brazil economies (PBS 2014).

The reasons for the crisis in 1997 mainly came from the presumptuousness in the power of the Thai economy as they have had successful experiences overtime. The huge mistake of

small caps.

there were

Thailand is using financial liberalization without a proper monetary and exchange rate policy on the financial institutions (SUSSANGKARN and VICHYANOND 2007). During the same period, the three reasons that caused the financial crisis in 1997. Firstly, there was intense competition from China in terms of low-wage labor after China devalued the currency of itself during 1994. Along with the second reason were relationships between banks and politicians and businesses. Lastly, egocentric, aggrandize, and arrogant policies were implied (Hays 2014).

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In 1994, China devalued its currency by 33 percent against the dollar leading to the cost of Chinese laborers less than Southeast Asian labor. Moreover, this consequently made the Chinese products considerably cheaper than the products in Southeast Asia as well. Between 1994 to 1995, the dollar strengthened against countries that had pegged their currencies to the dollar and started to struggle as businesses looking for cheap labor turned to China rather than Southeast Asia. Export in the United States had also fallen as a result of the depreciation of Chinese currency and the rise in the value of the dollar. Import expenses continually exceed the income from export, and the current account deficit grew to unhealthy amounts. As a result, Thailand's overseas debts rose to 43 percent which is almost half of the GDP.

In the five crisis countries including Indonesia, Malaysia, the Philippines, South Korea, and Thailand, the foreign borrowing in 1995-1996 reached an annual rate of 43 billion U.S. dollars, with two-thirds having maturity dates of less than a year. According to the International Monetary Fund (IMF), short-term loans to Thailand soared to an astonishing around 7 to 10 percent of GDP in only three years preceding 1997; meanwhile, foreign direct investment languished at 1 percent of GDP. When the crisis hit, these short-term funds disappeared as rapidly as they had materialized (Devan, The Strait Times 2007).

There were massive loans in dollars before the crisis in Thailand. Asian banks owed more than the amount that they had in deposits. Most of the debt was short-term debt and a spending spree was funded and money has been foolishly invested in speculative property. Also, Thailand was filled with excess phone lines, petrochemical plants, and cement factories.

The weak real estate sector was created through speculation. Businesses were unable to pay the high-interest rates and also the weak banking sector further undermined the system as it could not provide sufficient loans any longer. Investors had been worried about the defaults and started to take their money out of Thailand by 1996 as a consequence of unsold properties in Bangkok began to accumulate. Bangkok reported 350,000 abandoned housing units, as well as many unfinished offices and unfinished hotels, as of August 1997. Many industries became "sunset industries", in which firms managed to turn out the same goods year after year for less profit rather than investing in more modern equipment (Hays 2008).

From the other perspective, for individuals who accumulate debt, people earning \$350 a month were stacking up massive debts by spending several times the number on easy-to-get credit cards and purchasing luxury products. Thailand's interest rates were higher than the United States. When Thai currency was pegged to the dollar, many Thais borrowed as much as they could, then traded it for Baht and profited the difference, but sadly this only worked out well until the Thai baht collapsed.

The Thai government would be of little help. Between 1993 and 1996, there were three separate governments. None of them wanted to be the one to impact negatively on Thailand's celebrations by enacting legislation to contain the country's bubble. Banharn Silpa-archa, the Prime Minister in the mid-1990s, was regarded as the "flying ATM". He depleted the government's budget of \$39 billion to boost up the economy and hold corporations and banks alive, following their huge debts.

During the crisis period, in terms of the domestic economy, the economic objective for the 1997 and 1998 fiscal year, a budget surplus of 1 percent of the GDP was set by the government of Chuan Leekpai to meet the condition set by IMF for its 17.2 billion U.S. dollar bail-out of the economy (Wang and Kim, 1998). The surplus was aimed to cover both of the indisposed finance companies' support costs and also commercial banks' support costs as well. Almost 60 finance companies required help and support which was worth the amount of 440 billion baht from the Financial Institution Development Fund; moreover, there was also an additional 220 billion baht that was extended to both other finance friends and commercial banks (Julian, 2000). With the fiscal budget that was located at 800 billion baht in 1998 which was lower than the amount spent in 1997 by 11 percent; hence, the revenue target was expected to fall to 802 billion baht from 872 baht and forcing the government to increase spending cuts and also increase the taxes, which would hurt the economy further (Terdudomtham, 1998).

Monetary policy before the crisis

Due to the high level of foreign investment, the capital inflows increased to a high level in 1996 ^{whereby} that is the capital inflows exceeded the current account deficit, implying the rapid increase in official reserves. The impact is the inflows affecting the aggregate demand and domestic credit growth. With the fixed exchange rate and the rising domestic price, the real exchange rate will appreciate. When the rising in real exchange rate occurred, that will lead to a decrease in the export section. That is a negative effect on Thailand which is a country where most of the income is from the export section. Secondly, the volatility of international financial markets. The capital inflows in emerging countries are a serious concern too. For example, when the foreign interest rate rises, capital inflow in the emerging markets will be reduced and that is a negative shock to the emerging country like Thailand. Lastly, the concern is about the loan, when capital inflow and the reserve are redundant and the domestic credit is rapidly growing. It can cause a careless loan from the bank. That can cause the loan problem when the economy declines.

Based on According to the reasons mentioned above, ~~they~~ ^{we} explain why Thailand could not handle the Asian financial crisis. The increase in capital inflow and the volatility in financial markets were caused by the monetary policy in Thailand. So, if Thailand has a good ministry and monetary policy, Thailand may ^{have} handle that crisis. (Jansen 1997). *it is not difficult to*

Fiscal policy during crisis

which is the At this particular time, the suggestion was tightening the fiscal policy because of the reduction in government expenditure. In 1985, the government supervised further in the balanced budget and lowered the ceiling of the public sector on external debt (Jansen 1997), *and* Cause GDP ratio from 19 percent in 1985 to 14 percent in late 1989. The budget surplus leads to more stimulus in demand. After the policy, it established the balanced growth between the exports and domestic demands. In 1986, the GDP ratio started to increase with the rise in economic activity. It can say that fiscal policy may not be the intended plan to allocate capital inflows but the outcome is successful to deal with the debt problem.

Since the crisis, the government budget shortage has been below 3 percent of GDP and reached 3.3 percent in the 1990s (IMF 2003a). Thailand deals with long-term debt management discreetly. Total public debt increased from 14.5 percent in 1996 to 57.6 percent of GDP at the end of 2001. *to decrease* The debt ratio started to decline. The economic return ~~return~~ *rebounded* swiftly and the fiscal balance returned in 2004.

It's re-write this sentence, it is a bit unclear

Lessons learned

The crisis surely brought the economy into a severe recession which required years to recover or heal the pain that came from the recession. Even the impact has been reduced over time but in the end, the effect of the financial crisis still has not disappeared. On the other side, the crisis also gave us a lot of lessons to learn and improve to prepare for the future.

As mentioned above, before the crisis Thailand's economy expanded rapidly; consequently, the good economy ~~made~~ ^{caused} the demand of Thai baht. On the other hand, if the currency keeps getting stronger it will cause the price of domestic products to be higher and will reduce exports. As a result, the Thai Government fixed the exchange rate at 25 Bahts per 1 U.S. Dollar. When it comes to the flexible exchange rate ~~since~~ ^{ed} an enormous capital inflow in Thailand occurs before the crisis. Preventing the exchange rate to rise, ~~They~~ ^{the government} kept the interest rate low to maintain the money supply high most investors lost confidence to invest in Thailand and people are taking money out as soon as possible causing the significant loss leading to macroeconomic instability. The government should be focusing more on the borrowing of foreign currency.

What the government did was not successful, ^{be and} the economy did not expand as they thought. The government did not take action to get rescue from the IMF as quickly as possible so the consequence from this action is large. Once they tightened up the monetary policy, ~~The~~ ^{became} interest rates were extremely high for the borrowers causing many banks to suddenly collapse. Thailand needed to be more reliable to gain trust from others and the reserve money is necessary to face recessions. In the long run, there is no way to achieve the 3 ideal conditions which are stable exchange rate, capital mobility, and monetary stability. Even with the sterilization policy in just a short particular time, to absorb liquidity pouring into the Thai market from the rest of the world is very costly by the foregone interest rate that they should have enjoyed.

^{the lesson} Financial crises in Thailand have been a durable lesson for Thai people. To prevent the risk of crisis, ~~what they~~ learned is that macroeconomics should be mostly balanced all the time. It is better to avoid a massive current account deficit because investors will lose their confidence to invest and better manage the risk more carefully. Well managed during crises, managing time and liquidity. Especially, the appropriate fiscal and monetary policy is necessary to reduce the impact of the crisis. It is mandatory to look over and recover through the banking and non-banking sector. The prudence and determination from the government can help the economy heal faster and ensure people.

Conclusion

All things considered, the Asian Financial Crisis, which occurred first in Thailand in 1997-1998, quickly spread to neighboring countries' economies. When Thailand unpegged its currency from the US dollars, it ignited the currency crisis. The reason for the crisis mainly came from the forwardness in the power of the Thai economy as they have experienced success for a long period. Using financial liberalization without a proper monetary and exchange rate policy on the financial institution was significantly a mistake of the Thai government. As a result, a sequence of currency devaluations and large capital outflows continued. The revenue target was expected to fall to 802 billion baht from 872 baht and force the government to increase spending cuts and also increase the taxes, which would hurt the economy further (Terdudomtham, 1998).

Ten years before the crisis (1987-1996), the Thai economy worked well with an annual GDP growth rate of 9.4 percent on average, while actual export growth was 14.5 percent and inflation was 4.7 percent. As well as, the investments. This indicates that the Thai economy is in a satisfactory state; however, the country's economy still needs a significant amount of foreign capital and investment to expand and grow.

Thailand's economy grew rapidly as a result of several large corporations relocating their manufacturing facilities to Thailand, as well as the export of domestic goods, which generated revenue for the government. Hence, as the country becomes wealthier, the government plans to force Thailand to become the region's financial center; in the meantime, several countries demand Thai-baht, causing the currency to appreciate. If the currency continues to strengthen, the price of domestic goods will grow, lowering exports; as a result, the Thai government fixed the exchange rate at 25 Bahts to 1 US Dollar.

In part of the policy, the paper will provide information about the monetary and fiscal policy before the crisis and during the crisis. The failure of ministry in policy is one of the main problems of the causes of the crisis. The main problem is the fixed exchange rate that had been used in Thailand for a long time. It was not effective in the crisis because it could not handle the effect of the crisis. When the deficit in the current account started but the government and central bank still used the existing policy, the effect is the failure in the economy. So, Thailand has rebuilt the fiscal and monetary policy to solve the problem of the crisis.