CHAPTER III

STRUCTURAL CHANGES IN THAILAND:
AN OVERVIEW OF THE ECONOMIC POLICY REGIME

3.1 INTRODUCTION

A country's advance in FDI-led industrial restructuring along the catching-up product cycle (CPC) path depends on a wide range of inter-related factors and conditions, as discussed in the conceptual framework. We also saw that these factors and the interaction between them, which eventually shape the direction and outcome of restructuring, are encompassed within and are shaped by the overall policy environment in the country. Below we undertake an examination of the nature of Thailand's economic policy regime as it evolved over the years, as well as the specific policies related to foreign direct investment and export promotion. Discussion of various external factors such as home country restructuring policies, regional and international trade agreements including AFTA, WTO Agreements, etc. are also taken up wherever applicable. The evolution of Thai economic policies is discussed in the context of the structural changes that occurred in the overall economic structure.

First of all, however, it is important to situate the evolution of Thailand's economic policies within its historical context, as the changes in the Thai economy and polity going back to the period before 1960 have a significant impact on the subsequent evolution of the economy. Below, we provide a brief discussion of these historical circumstances, which were both internal and external.

3.1.1 FDI Inflows and Economic Conditions before 1955: A Historical Overview

Although Thailand's engagement with the international economy can be traced back to the 17th century, this was mainly in terms of trade as the amount of investment was never substantial. The country was unique in the East Asian region in having avoided much close contact with the West until the mid-nineteenth century. Foreign firm involvement in the Thai economy began to any substantial extent only in 1856

---

1 Investments by Chinese and other Asian immigrants before the seventeenth century were not considered as foreign investment.

2 However, Siam (as the country was then known) continued trade during this period with China and her neighbours in Southeast Asia. Prior to 1855, the major proportion of the trade was under royal monopolies and free trade was very much restricted. However, monopolies of specific commodities were sold to the Chinese and the latter had come to dominate Thailand's trade by the time of the Bowring Treaty. See Pasuk Phongpaichit, 1980, Economic and Social Transformation of Thailand, 1957-1976, Chulalongkorn University Social Research Institute (CUSRI), Bangkok, and Ingram, James C., 1971, Economic Change in Thailand 1850-1970, Oxford University Press, London, p. 6, 21 and 27, etc.
following the Bowring Treaty with Britain, which required Thailand to adopt relatively free trade economic policies. Many other European countries as well as the US, Russia, and Japan also signed similar treaties with Thailand between 1856 and 1899 for trading and operating in the country. However, before the end of the Second World War, there were very few foreign affiliates and direct foreign investment in Thailand. According to the first estimate of private foreign investment in Thailand done by H.G. Callis (1942), FDI had accounted for only 38% of the $65 million private foreign investment in Thailand in 1914. All the investments by developed countries came out of Europe dominated by Britain, and the rest was from Hong Kong, Singapore, and India. These firms were concentrated in commerce, agency houses, trading activities, and exploitation and exporting of natural resources such as teak, silk, rice, rubber, and tin.

The low level of foreign capital inflows into Thailand in the late nineteenth and early twentieth centuries had been attributed to the factors that retarded the development of manufacturing industry during this period. Industrial investments had remained unattractive as the domestic market was limited and competition from imports was fierce, especially because the Monarch was unable to impose meaningful tariff protection under the provisions of the Bowring Treaty. Thus, even the expansion of trade that followed the Bowring Treaty saw only major developments in commerce and agriculture, rather than industry. Yet, the expansion of these sectors did have some impact on the development of complementary industries such as rice milling, sugar (until the late 1860s), ice manufacture, and private electricity generation, etc. With the growth of rice exports, milling became an important area of investment for the Europeans as well as for the Chinese merchants.

However, from the late 1920s to the late 1940s, a combination of international and domestic factors led to a decline in European foreign investor activity in Thailand. These included the fallout of the depression, foreign treaty revisions since 1927 that allowed some tariff levels to be raised and encouraged increased local manufacturing.

---

3 But, the predominance of FDI increased further in the post-war period as confirmed by a Bank of Thailand survey, which indicated that by 1954 about 95% of the $40 million (registered capital) private foreign investment in Thailand was direct investment. Quoted in Jeerasak Pongpissanupichit, 1985, Private Direct Investment and Thai Economy, Ph.D. Thesis, Cornell University, p. 163.

4 Japanese and American investments were negligible during this phase. Ibid., p. 170.

5 Prior to 1850, apart from some mining, sugar and rice milling, industrial activities (as opposed to handicrafts) were virtually nonexistent. See Hewison, Kevin, 1986, “Industry Prior to Industrialisation”, Paper Presented at the Conference on ‘Industrialising Elites in Southeast Asia’, 8-12 December, Sukhothai, Thailand, p. 4.

6 See Hewison, 1986, opcit., p. 4-5. According to Kaosa-ard (1988), foreign direct investments in agro-processing and manufacturing in Thailand started in 1858 with the establishment of the American Steamship Rice Mill. However, US investments in Thailand began to be on a particularly remarkable scale only from the Sarit thanarat regime onwards, as we shall see later on.
production, the replacement of the absolute monarchy by a nationalist government in 1932, etc. The latter was the most significant development in that policies of the nationalist government were unsympathetic towards the Western imperialists and antagonistic towards the dominant Chinese business community in the 1930s and 1940s. The new government’s policies were directed towards building up the “Thai economy for the Thai people”, with a program of state enterprises and ‘Thai-ification’ of non-agricultural activities. Apart from taking control of rice trade which was the main source of revenue in the economy and controlling distribution networks which managed the flow of goods between the rural and urban areas, both of which were under Chinese domination, the government began state investment in import-substituting manufacturing. From the mid-1930s to the late 1940s, the government helped start a wide variety of industrial enterprises as either full or partial owner.

Even as the anti-Chinese strategy of the new military-dominated government failed to reduce the economic dominance of the Chinese following their coalescence with the ruling elite, European economic activities and influence in Thailand suffered a

---

7 Until 1926, Thailand’s fiscal autonomy was governed by the Bowring and other like treaties. However, after these treaties were abolished in 1926, import tariffs were slightly raised and inland transit duties were removed. Although these fiscal changes were concerned primarily with revenue rather than protection, they served to encourage local resource-based industries. See Jeerasak, 1985, p. 123-4.

8 Although after being drawn into the international trading system in the mid-nineteenth century Thailand had looked to Great Britain and other Western nations as a source of progress and prosperity, this attitude had begun to change by the end of the century as a result of French and British attempts to infringe on Thailand’s territories. Further, since the Western imperial powers did not offer any assistance towards Thailand’s economic problems following the fall in commodity prices after the depression of the 1930s, this too led to considerable disillusionment. (Thus, when Japan emerged as a major power in the 1930s, Thailand began to ally itself with that country.) See Pasuk, 1980, p. 54.

9 It set up public utilities and also invested in consumer goods industries such as textiles, soap, paper, glass, silk, and cigarettes to replace European imports disorganised by depression and war. In most of these cases, the government took over factories already established by Chinese or European enterprise. It also founded a range of companies involved in the expanding primary product trade. Members of the government and army also were involved in this promotion of state enterprises. See Hewison, 1986, p. 9, Ingram, 1971, p. 229, Pasuk Phongpaichit and Chris Baker, 1995, Thailand: Economy and Politics, Oxford University Press, New York, p. 118-9, and Falkus, Malcolm, 1995, in Medhi Krongkaew ed., 1995, Thailand’s Industrialisation and its Consequences, Macmillan Press Ltd., London, etc.

10 This was because by the time the policy was introduced, the control of Chinese in business had become so entrenched that even those government enterprises that were established to compete with the Chinese had to employ Chinese managers. On the one hand, the insecurity which the anti-Chinese policy had instilled in the minds of the Chinese businessmen led them to seek protection from those able to offer protection and privileges, namely prominent officials in the police and in the army. Chinese businessmen achieved this by reorganising their financial and commercial corporations to include top government officials and other prominent Thais on their boards of directors. On the other hand, as the small group of local bankers and related entrepreneurs who emerged in the mid-1940s from the ranks of successful rice exporters grew in strength, the military found it profitable to align themselves with the rising private enterprise in order to share their benefits. See Pasuk, 1980, p. 41, and also Pasuk and Baker, 1995, p. 287, and Ingram, 1971, p. 231.
sharp decline disrupted by depression, war, and Japanese occupation, as well as due to increasing competition from local Chinese, Japanese\textsuperscript{11} and American firms. The predominance of American and Japanese investments was apparent by the mid-1950s.

Prior to 1950, abundant land, sparse population, relatively high living standards, and very inadequate internal communications had combined to maintain Thailand as an undiversified rural economy. The concern over the consequences of Thailand's over-dependence on a narrow range of primary exports that had arisen in the aftermath of the depression and falling prices of primary commodities was amplified after the end of the 'Korean War boom' by the 1950s.\textsuperscript{12} As mentioned earlier, in the post-1932 period, the realization that development of a local manufacturing sector was crucial to the country's survival had seen the expansion in state's role in industrialization. By the mid-1950s, however, most of the public enterprises were running at a loss.

At the same time, there were drastic changes in the world economic order after the Second World War: the decline of European power and the rise of the hegemonic power of the US; improvement in world trade and thus the economic situation of the country; and the establishment of several international development aid agencies such as the UN, IBRD, IMF, and other agencies which gave opportunities to obtain technical assistance and economic aid, etc. All these led to a shift in the anti-imperialist attitude in Thailand:

Further, since 1950, Thailand became important in the anti-Communist policy of the US in the Southeast Asian region. The military regime under General Sarit Thanarat that came to power through a coup in 1957 became aware of the political and economic gains to be made from a close alliance with the US, which was offering grant aid and official loans as a means to combat communism. The military politicians who had, by the fifties, become substantially involved in many business ventures (industrial, commercial and financial concerns) along with the Chinese and were sharing the profits, had a keen interest in continuing the expansion of private enterprise and obtaining foreign capital for the same. The government perceived that foreign investment was being inhibited by the presence (or threat) of competition from government-owned plants, and that Thailand's prospects for foreign loans and aid would also be enhanced if the government restricted its role.\textsuperscript{13}

\textsuperscript{11} Prior to 1934, Japanese investments in the manufacturing activities in Thailand were absent, although Japanese trading activities had begun in 1924 with investments from Mitsui Bussan Kaisha Ltd. Akira (1985).

\textsuperscript{12} At that time, rice, tin, rubber and teak exports still accounted for some 75 per cent of all Thai exports, as they had for the previous half-century.

This confluence in the interests of the various players and dissatisfaction with the state-led growth by the mid-1950s, eventually led to the economic restructuring plan of Sarit starting in 1957. Most elements of Sarit’s economic plan were influenced by a World Bank report of 1959 recommending a major shift in economic policy orientation away from government ownership and control of industrial enterprises towards economic growth led by private enterprise, in which foreign investment came to play a very important role.

3.2 ECONOMIC POLICY REGIME AND STRUCTURAL CHANGES SINCE THE 1960S

From the early 1960s, Thailand achieved rapid economic growth for almost four decades, until the crisis of 1997-98. This rapid growth, which went hand in hand with a continuous increase in the country’s exposure to the global economy, is well acknowledged to be accompanied by distinct changes in the structure of its output, long-term patterns of which are most explicitly captured by the composition and growth rates of sectoral gross domestic product (GDP) and employment. As we examine the evolution of the Thai economic policymaking process in the ensuing analysis, we discuss these structural changes as and when they occurred.

The central policy making agencies in Thailand have been the National Economic and Social Development Board (NESDB), the Bureau of the Budget, the Bank of Thailand and the Fiscal Policy Office. The Board of Investment (BOI) also played a significant role in the economy, especially in terms of attracting investment. While the five year development plans by the NESDB provide the overall policy guidelines, the Bank of Thailand, the Bureau of the Budget, and the Fiscal Policy Office have traditionally assumed dominant roles in the policy formulation for maintaining macroeconomic stability in the country. Policymakers believed that historically Thailand’s success had depended on trade growth and internal economic stability, for which a stable currency and low domestic inflation had been two major prerequisites. For achieving these objectives, the permanent and professional bureaucracy that evolved out of the political system after the 1932 revolution, therefore, focussed on national economic development based on conservative macroeconomic management. The political independence of the technocratic system traditionally ensured the continuity of economic policy along broadly similar lines despite many military coups and changes in governments over the decades, and helped to maintain this macro-economic stability. Thus, in fact, a stable macro-economic environment has been widely acknowledged to be one of the major achievements of the country, until the late nineties.14 Other

policymaking and implementing institutions such as the NESDB and the ministries have had to operate within this framework of a stable macroeconomic management. It has in fact been pointed out that due to this preoccupation with macroeconomic management, Thailand’s industrial policies have been treated as subsidiary to the macroeconomic stability goal, unlike in countries like South Korea.\textsuperscript{15}

Following the shift in the underlying philosophy of economic planning to a market economy orientation from the late 1950s onwards, the first Five Year Plan (1961-66) echoed the 1959 World Bank proposals for creating a favourable investment climate for local industrial development through private enterprise. Government activities were to be restricted to building infrastructure for facilitating and supporting production activities. Thus, planning has been directed mainly towards securing a smooth functioning of markets, with minimum direct government intervention or controls.\textsuperscript{16} These reforms orienting the economy towards free market enterprise were successful because they had a political constituency, particularly the military officers who were hostile to the group that promoted the post-1932 nationalist policy and the leading Chinese entrepreneurs who favoured a stable macroeconomic environment and less state intervention.\textsuperscript{17} Thus, it is evident from the outset that this policy setting, which was oriented towards market-led growth from the beginning, therefore differed fundamentally from the state-led policy framework in either Japan or in Taiwan and Korea, the so-called ‘leading geese’ in the catching-up-product cycle model that Thailand was supposed to emulate.

Although the First Plan was vague on the role of industry,\textsuperscript{18} Thai government actively promoted foreign investment as part of its ‘internationalised’ foreign policy

\textsuperscript{15} Jomo et al., p. 58-59. For example, while the Ministry of Finance deals with the tax and revenue side of the government budget, the expenditure side is left to the Bureau of the Budget (BOB) which enforces strict rules on keeping the budget as a whole in line. A 1959 law limited the budget deficit to less than 25% of expected revenue; several caps had also been in place for direct foreign borrowing by the Ministry of Finance and for foreign loans obtained by state enterprises. The BOB rejected all proposals from the line ministries that exceeded these budget limits. (They would have to wait for appropriation under the next budget cycle.) This Thai system thus encouraged budget discipline at-large. But, since the line ministries had little say in the allocation of the budget, this system was found to be weak in terms of encouraging efficient and effective use of resources by line agencies. It has been argued that the permanence of the bureaucrats and allegiance to the King as guarantor of the Thai state, rather than to the changing governments, etc. led to the strict enforcement of rules such as budgetary fiscal discipline. See Suthiphand Chirathivat and Vera Erdman-Keefer, 1998, opcit., p. 263-4 and Warr and Nidhiprabha, 1996, opcit.


\textsuperscript{17} See Nipon Poapongsakorn and Belinda Fuller, 1997, Thailand’s Development Experience from the Economic System Perspective: Open Politics and Industrial Activism, Country Report I in Toru Yanagihara and Susumu Sambommatu, eds., p. 466-515, and also Pasuk, 1983, Pasuk and Baker, 1995, etc.

discussed earlier, and the reorientation of the economy for developing a local industrial sector. In 1959, the Board of Investment (BOI) was established with the explicit aim of encouraging private investment from both indigenous and foreign sources, by providing specific incentives to businesses investing in promoted projects, in terms of tax and tariff concessions. Investment incentives were available to both foreign and local firms on a more or less equal basis, though the priority was to attract modern technology through foreign investment. Thus, the Investment Promotion Act of 1960 included specific measures for creating a welcoming environment for foreign investment such as: guarantees against expropriation, nationalisation and government competition; the right to remit investment capital, profits and other payments in foreign currency; modification of the Land Code to make it easier for foreign firms to occupy land, etc. Further, the government also abolished labour unions and outlawed strikes.

During the period of the First Development Plan (1961-66), most government-owned factories that had come into being during the 1940s and early 1950s were closed down or sold off. However, the government invested heavily in basic infrastructure, namely in electricity generation, irrigation, transportation networks, port and air transport facilities, telecommunications and postal services, as well as in social services such as education, so as to facilitate private undertakings. Such large-scale public expenditure was made possible through the massive inflows of foreign grant aid and institutional loans during these years, which greatly improved the infrastructure for investment. The transfers from the US alone, amounting in total to over US$ 3 billion, had an enormous impact on the Thai economy.19

Agriculture, in particular, benefited from this infrastructure build-up, especially, for transport into previously inaccessible cultivable areas in the countryside.20 In the 1950s and 1960s, thus, Thailand’s economic growth was driven by extensive agriculture policies. External factors such as the increasing world demand for commodities during the post-war recovery of the world economy and high international crop prices strongly favoured rapid agricultural expansion. The agricultural sector21 recorded an annual

19 The IBRD was a major source of finance for the infrastructure development programmes, amounting to US$ 440 million between 1950 and 1975, mostly directed to highways, other transport, irrigation, hydroelectricity, and education. At the same time, the alignment of General Sarit’s interests with the strategic concerns of the US in the region led to the channelling of some US$ 2.5 billion during 1951-75 in the form of direct military aid, investment in military installations, and upkeep for troops. Non-military US aid supplied another US$ 627 million over the same period. See Pasuk and Baker, 1995, p. 126 and 128.

20 Pasuk and Samart, 1993, p. 159. See also Pasuk and Baker, 1995, p. 51. From the mid-1950s, the US funded road building in Thailand as infrastructure for its military plans in Indo-China.

21 In the NESDB classification, ‘agriculture’ includes the crops, livestock, fisheries, forestry and agricultural services sub-sectors. Thus, primary sector would mean ‘agriculture’ plus mining and quarrying.
average growth rate of almost 7 per cent during the 1960s. However, this dropped during the seventies and the first half of the eighties (See Table 3.2).

Table 3.1: Sectoral Distribution of Gross Domestic Product at 1988 Prices, 1950-99

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>34.7</td>
<td>29.0</td>
<td>24.1</td>
<td>19.2</td>
<td>15.1</td>
<td>11.5</td>
<td>11.3</td>
<td>10.4</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>1.3</td>
<td>1.7</td>
<td>1.6</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14.9</td>
<td>16.6</td>
<td>21.0</td>
<td>23.2</td>
<td>26.8</td>
<td>30.5</td>
<td>32.0</td>
<td>35.5</td>
</tr>
<tr>
<td>Services</td>
<td>49.3</td>
<td>53.5</td>
<td>54.1</td>
<td>56.2</td>
<td>56.5</td>
<td>56.4</td>
<td>54.7</td>
<td>52.1</td>
</tr>
<tr>
<td>Construction</td>
<td>3.3</td>
<td>5.2</td>
<td>4.5</td>
<td>4.9</td>
<td>5.5</td>
<td>6.2</td>
<td>4.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Electricity and Water Supply</td>
<td>0.1</td>
<td>0.5</td>
<td>1.3</td>
<td>2.1</td>
<td>2.4</td>
<td>2.6</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Transportation and Communication</td>
<td>5.0</td>
<td>7.1</td>
<td>6.6</td>
<td>6.9</td>
<td>7.4</td>
<td>8.0</td>
<td>9.2</td>
<td>9.2</td>
</tr>
<tr>
<td>Wholesale and Retail Trade</td>
<td>17</td>
<td>16.9</td>
<td>17.7</td>
<td>17.2</td>
<td>17.1</td>
<td>16.5</td>
<td>15.2</td>
<td>16.2</td>
</tr>
<tr>
<td>Banking, Insurance and Real Estate</td>
<td>8.2</td>
<td>8.8</td>
<td>8.1</td>
<td>7.4</td>
<td>8.1</td>
<td>10.1</td>
<td>9.3</td>
<td>7.8</td>
</tr>
<tr>
<td>Public Administration and Defence</td>
<td>3.6</td>
<td>3.5</td>
<td>3.7</td>
<td>4.3</td>
<td>3.4</td>
<td>2.7</td>
<td>3.0</td>
<td>3.2</td>
</tr>
<tr>
<td>Other Services</td>
<td>12.2</td>
<td>11.5</td>
<td>12.0</td>
<td>12.5</td>
<td>12.7</td>
<td>10.3</td>
<td>11.0</td>
<td>9.8</td>
</tr>
<tr>
<td>GDP (M.bahth)</td>
<td>159813</td>
<td>310496</td>
<td>669664</td>
<td>1108404</td>
<td>1748767</td>
<td>2699317</td>
<td>2901569</td>
<td>2860291</td>
</tr>
</tbody>
</table>

Note: Banking, insurance and real estate includes 'ownership of dwellings' as in ISIC Div. 3. For 1999, 'Public administration and defence' also includes 'Compulsory social security' and therefore would be a reason for the slight rise seen there. This re-classification could also be responsible for the drop in the 'Other services' category for 1999. Compulsory social security is included in the 'Other services' category for all the other periods.


This rapid decline since the 1970s was partly a result of falling prices and faltering world trade. From the 1970s, the long post-war boom in world trade in primary products was disrupted by the oil crises and the subsequent chaos in currency markets, the rise in protectionism in the EU and US markets, and the emergence of China and Vietnam as competitors in the world rice markets.22 Further, the terms of trade for agricultural goods that had improved in the early 1970s had deteriorated from the late 1970s onwards.23 Correspondingly, the agriculture sector's relative share in GDP decreased rapidly over the seventies and the first half of the eighties (See Tables 3.1). But, while its growth rate declined, agriculture still accounted for nearly 20 per cent of GDP during 1981-86. At the same time, the share of the agricultural sector in total employment fell from 82.3 per cent in 1960 to only about 70 per cent during 1979-84. However, both value addition and employment shares of the agricultural sector showed similar drops in percentage points.

According to Ammar et al. (1993), Chalongphob (1993), Pasuk and Baker (1995), Barker et al. (1985), etc., a major reason for this was the fact that land expansion rather than yield increases explained the greater part of the growth of crop production in Thai agriculture24, which has continued to be the core of Thai agricultural output.25

---

22 Rice being one of the principal export commodities in this phase.
23 During 1980-85, world rice prices had declined by around 50 percent. See Pasuk and Baker, 1995, p. 80.
25 The expansion of land under cultivation meant that the effect of market imperatives on Thai agricultural sector during this phase was not to increase productivity as in countries with land constraints.
Secondly, the onset of multiple cropping in some areas in the central and northern regions between 1960 and 1980 increased demand for short-term labour at peak periods, which was met by increased migration by the north-easterners to these paddy tracts to work as paid labour. Thirdly, while in response to market forces commercial paddy growers had shifted to more intensive production methods from the 1960s, in terms of cropping pattern the importance of paddy had begun declining at least from the mid-1970 onwards, both in its share of agricultural GDP and also in terms of share in total cultivated area. Increasingly, due to favourable international market and price conditions and the new emphasis domestically on export-oriented agro-processing industries, new crops such as cassava, maize, sugar, pineapple, as well as eucalyptus were successfully replacing paddy, urged along by agri-exporters and agri-businesses promoted by the government. This shift away from rice cultivation into cash crops was also prompted by the tax on rice exports, which was dismantled completely only by the mid-1980s. Because these crops had different agricultural calendars to the usual wet season cultivation pattern of paddy, this change in cropping pattern distributed labour demand throughout the year. All these factors together led to a slow rate of decline in agriculture’s share in total employment.

Table 3.2: Sectoral Growth Rates in Gross Domestic Product at 1988 Prices, 1950-99

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>3.0</td>
<td>6.7</td>
<td>4.2</td>
<td>3.6</td>
<td>4.5</td>
<td>3.1</td>
<td>-0.5</td>
<td>0.4</td>
<td>-1.4</td>
<td>-8.6</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>2.8</td>
<td>13.5</td>
<td>5.7</td>
<td>21.9</td>
<td>10.9</td>
<td>7.9</td>
<td>3.4</td>
<td>12.8</td>
<td>-6.0</td>
<td>6.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6.9</td>
<td>10.8</td>
<td>8.9</td>
<td>5.8</td>
<td>15.5</td>
<td>10.0</td>
<td>-4.9</td>
<td>0.9</td>
<td>-10.8</td>
<td>15.7</td>
</tr>
<tr>
<td>Services</td>
<td>6.8</td>
<td>8.5</td>
<td>7.1</td>
<td>5.7</td>
<td>10.8</td>
<td>8.1</td>
<td>-7.8</td>
<td>-4.0</td>
<td>-11.7</td>
<td>0.03</td>
</tr>
<tr>
<td>Construction</td>
<td>14.7</td>
<td>11.3</td>
<td>5.0</td>
<td>6.3</td>
<td>17.3</td>
<td>8.5</td>
<td>-32.8</td>
<td>-26.7</td>
<td>-38.8</td>
<td>-8.5</td>
</tr>
<tr>
<td>Electricity and Water Supply</td>
<td>20.5</td>
<td>23.7</td>
<td>14.4</td>
<td>11.6</td>
<td>11.7</td>
<td>9.9</td>
<td>1.1</td>
<td>5.2</td>
<td>-3.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Transportation and Communication</td>
<td>12.0</td>
<td>9.2</td>
<td>7.4</td>
<td>6.1</td>
<td>11.4</td>
<td>11.2</td>
<td>-2.5</td>
<td>4.4</td>
<td>9.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Wholesale and Retail Trade</td>
<td>6.0</td>
<td>9.3</td>
<td>7.0</td>
<td>4.0</td>
<td>11.9</td>
<td>6.6</td>
<td>-9.4</td>
<td>-4.2</td>
<td>-14.6</td>
<td>13.5</td>
</tr>
<tr>
<td>Banking, Insurance and Real Estate</td>
<td>5.2</td>
<td>6.2</td>
<td>6.4</td>
<td>3.9</td>
<td>14.6</td>
<td>12.5</td>
<td>-11.2</td>
<td>-6.9</td>
<td>-13.5</td>
<td>-10.0</td>
</tr>
<tr>
<td>Public Administration and Defence</td>
<td>3.6</td>
<td>7.3</td>
<td>8.6</td>
<td>5.7</td>
<td>4.5</td>
<td>4.3</td>
<td>-4.9</td>
<td>3.0</td>
<td>6.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Other Services</td>
<td>5.5</td>
<td>8.0</td>
<td>7.5</td>
<td>7.9</td>
<td>6.0</td>
<td>5.1</td>
<td>1.0</td>
<td>2.6</td>
<td>-0.6</td>
<td>-11.8</td>
</tr>
<tr>
<td>Gross Domestic Product, (GDP)</td>
<td>5.4</td>
<td>8.4</td>
<td>6.7</td>
<td>5.5</td>
<td>10.9</td>
<td>8.6</td>
<td>-5.9</td>
<td>-1.7</td>
<td>-10.2</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Note: Banking, insurance and real estate includes 'ownership of dwellings' as in ISIC Div. 3. For 1999, 'Public administration and defence' also includes 'Compulsory social security' and therefore would be a reason for the slight rise seen there. This reclassification could also be responsible for the drop in the 'Other services' category for 1999. Compulsory social security is included in the 'Other services' category for all the other periods.


Meanwhile, with the economy carried forward by the momentum generated by primary sector-led exports, the Second Economic Development Plan (1967-71) had continued to stress the importance of industries producing for the domestic market, especially those using domestic raw materials and labour. The BOI incentives were thus revised to

27 See Chalongphob Sussangkam, 1993, Labour Markets in Warr, ed, opcit., p. 358. The government promoted agribusinesses in order to accelerate the expansion of exports and accelerate the transfer of surplus from the rural sector for building the urban economy. The fact that world rice prices declined by around 50 percent from 1980 to 1985 accelerated this shift in cropping pattern in that phase. See Pasuk and Baker, 1995, p. 59, 80.
reflect these concerns. The Second Plan also identified for the first time certain industries that would be promoted, namely paper, chemical-fertilizer, iron and steel, automobile assembly, cement, gunny bag, and textile industries. However, although import-substitution industrialisation (ISI) policies came to be pursued, for a long time it became subsidiary to the pursuit of agricultural exports-led growth. Thailand’s ISI policies in the 1960s have in fact been considered more as a consequence of the Finance Ministry’s policy to raise additional revenue from import tariffs without imposing further taxes on agriculture.

Even then, an expanding domestic market buoyed up by the income growth from agricultural expansion in the sixties, cheap labour, government assistance, and foreign investment all helped the protected manufacturing sector output to grow at around an annual average of 11 per cent during 1960-69 and around 9 per cent during 1970-79. The large numbers of Sino-Thai businessmen and traders who had consolidated their position in the Thai economy as described earlier, provided both small-scale enterprise and large industrial financial groups upon which much of later industrialisation was built. These large business groups provided a significant part of the domestic corporate investment in modern industry, and have been a principal channel through which joint ventures with overseas firms developed in Thailand. However, many Thai capitalists also grew fast through participation in government projects.

28 A detailed discussion of the changes in BOI policies is carried out in Section 3.4.
29 While this was intended to convey the message that these industries were officially favoured, certain private enterprises also invested in some other industries that later proved to be the leading industries in Thailand. See Kraituydt Dhiratayakinant, 1995, in Medhi Krongkaew, ed.
30 Unlike South Korea, or to a lesser extent, Taiwan, where agricultural land and other natural resources were so limited that they had to pursue manufactured export growth much earlier on, Thailand was able to enjoy prolonged primary export and import substitution growth based on agricultural expansion. As long as policymakers could rely on agricultural exports to meet their policy goals, they paid less attention to policies to promote manufactured exports. See for example, Pasuk, 1980, Pasuk and Baker, 1995, Jomo et al., 1997, etc.
32 During the period of anti-Chinese feeling in the economy, while relations between big Chinese capitalists and state officials evolved into highly cooperative and mutually beneficial, ironically, it was the small Chinese business people who were the victims of discrimination, as mentioned earlier. See Hewison, 1989 and Pasuk, 1983, etc.
33 The Communist victory in China in 1949 was of significance in this context. Chinese remittances from Thailand to China dropped sharply and long-term investment by Thai-Chinese in Thailand was encouraged as links with the former homeland were severed. The accumulated funds were used to establish banks and productive enterprises, which allowed Sino-Thais to establish a hold over most industries. See Falkus, 1995 and Hewison, 1989.
34 In the 1950s, some Thai capitalists had found wealth through participation in government erected public enterprises, namely, paper factories, an army textile factory, sugar mills and distilleries. These businesses were often monopolies and large rents accrued to involved politicians and bureaucrats also. Laothamatas, 1992. Among the major Thai investors has been the Royal Crown, which has numerous business interests including in conglomerates such as the Siam Cement Group and Siam Commercial Bank, and owns a great deal of land.
Further, rapidly increasing population, ‘closing’ of the land frontier and the subsequent pressure on rural incomes produced circumstances in which Thailand could develop on the basis of labour-intensive, urban-based industrial development. Again, taxing agricultural exports, particularly rice, kept the price of staple food low and reduced the domestic terms of trade between agricultural and manufactured products. The price bias against agriculture and the structure of investment incentives directed resources towards manufacturing for the domestic market.

Although manufacturing sector started growing rapidly in the 1960s, service sector’s share far outstripped that of the manufacturing sector in terms of relative contribution to GDP and employment. Service sector has consistently accounted for more than half of total GDP since the late 1950s. It is also the second largest employer following agriculture, which continues to account for almost half of total employment in the country (See Table 3.3).

Throughout the sixties, fiscal and monetary policies had remained conservative. Government deficits during the period averaged below 2% of GDP and annual inflation also averaged only about 5% during the sixties and seventies. Although the country faced trade deficits in the 1960s due to the large imports of intermediate goods and capital goods obtained for the expanding industrial production, the BoP was in surplus due to the large inflows of capital (mainly aid and official loans) and service sector income. Throughout the 1960s and until the late 1970s, agricultural exports also provided the manufacturing sector with the capital needed to obtain imported machinery. However, the potential decline in domestic demand due to the phasing out of US involvement in the Vietnam war in the early 1970s and the rising BoP deficit from 1969 to 1971 after many years of surplus, caused government officials to turn their attention to the promotion of manufactured exports.

3.2.1 The Policy Shift from Import-Substitution Towards Export-Orientation

From the early 1970s, several policymakers began to argue that Thailand should abandon its reliance on agricultural exports-led growth and pursue manufacturing exports-led growth instead. As mentioned in Chapter I, this was also influenced by a change in economic development thinking propagated by developed countries at the time. The success of the Northeast Asian economies in manufactured exports-led growth following Japan came to be construed as the spread of Akamatsu’s “flying geese”

35 See Falkus, 1995, opcit., p. 28-31. See also Pasuk and Baker, 1995, for a detailed discussion of the transformation of Thailand’s agricultural economy since the 1950s.
36 See Jomo et al., 1997, p. 62.
pattern in the Asia-Pacific region through foreign direct investment flows.\textsuperscript{37} The ‘FG’ model became instrumental in creating foreign investment friendly regimes across the region, after the post war economic boom of the sixties and seventies came to an end. Further, contrary to how Yamazawa (1990) emphasised that the CPC development process stressed the continuity of the import substitution regime while pursuing export expansion, developed country economists and the World Bank were recommending developing countries to shift their policies towards export expansion and completely abandon import substitution. The western-trained new generation of Thai technocrats were influenced by these theories at the time, and in turn influenced the policy advices given to the Thai government. In the case of Thailand, however, import substitution policies did continue until the late-1980s (and even later on).\textsuperscript{38}

Thus, although the Third Development Plan (1972-76) recognised the need for export promotion under the influence of these development theories, it also stated that protection could not be abandoned yet.\textsuperscript{39} The investment promotion law was revised in 1972 to include some export promotional measures for firms that exported a significant part of their output and for firms that set up factories outside Bangkok. The Ministry of Finance and the Bank of Thailand also began to offer various forms of assistance to manufacturing exporters. As an important part of the export sector, tourism also began to receive attention during the Third Plan period.

The policies of export promotion and regional dispersion of industrial plants continued to be stressed in the subsequent development plans as well. However, the overall policy regime attracted both foreign and local investment only of the import-substituting variety initially. There were only two industries that ventured into exporting with much success. The first group consisted of agro-business firms which increased processing of products, ranging from tapioca flour mills to fruit canneries. Secondly, there were cheap labour-based industries moving away from rising wage costs in Japan and the West, initially textiles, which was followed by semiconductor assembly. In addition, there were some industries that combined some aspects of both local raw material sourcing and cheap labour utilisation, such as jewellery.

However, overall achievements in the Third Plan were disappointing due to the 1973-74 oil crisis, the resultant world economic slump, and the continued decline in US military spending. Against this background, the immediate objective of the Fourth Plan (1977-81) was recovery from the effects of economic recession and implementation of desired structural adjustments. Along with the existing policies, an industrial

\textsuperscript{37} See Chapter II, Section 2.2.
\textsuperscript{38} The discussion of fiscal and trade policies below will bring this out clearly.
\textsuperscript{39} See Pasuk and Baker, 1995, opcit.
development programme representing a strategy of regional industrialisation and large-scale government investment that covered three provinces along the eastern coast of Thailand was formulated. The Eastern Seaboard Scheme was launched to build new port facilities in Chonburi and Rayong, and to develop a chemical industry complex, supported by the discovery of natural gas from the Gulf of Thailand. To support this program, increased protection was provided to heavy industries producing intermediate and capital goods, which had also become the major users of foreign exchange.

Meanwhile, following a period of sudden decline in foreign investment (in the mid-1970s), the type and range of investment incentives were expanded in the 1977 Investment Promotion Act, and a few more guarantees were added in order to further convince potential foreign investors. These included: guarantees against government monopolisation of sales in products where foreign firms were being granted promotion; against price control; and of freedom from privileged treatment of a government agency or state enterprise. Besides these basic guarantees, foreign investors were also granted the rights of access to all investment and export incentives, to local sources, and awards for government work or supply contracts, unless otherwise specified.40

The performance of the economy during the Fourth Plan was however, again affected by the rapidly changing world economic conditions: particularly the rising price of oil; high interest rates (especially after 1980); declining terms of trade; and declining growth of export volumes due to the recession and growing protectionism in the OECD countries. The situation was aggravated by the way the first oil price crisis was managed without passing on the full price rise to the consumers, and by the withdrawal of the US from Indo-China in 1975 which brought the regular inflow of grant aid and military expenditures to an end. While the first showed up as burgeoning budget deficits, the fallout of the second was managed by the military by resorting to huge external borrowings to the tune of US$ 800 million from foreign commercial banks.

Although the economy did expand satisfactorily in spite of these unfavourable conditions, the current account deficit reached a record high of 8% of GDP in 1977 and 1980. Further, the large infrastructure investments financed partly by aid and low-cost loans from the World Bank, but mostly by funds raised from foreign commercial banks, and the huge military borrowing abroad, created large debt service payments for the economy. Following the second oil crisis of 1979-80, the economy lurched towards a balance of payments crisis, as debt service on the private and public sector foreign loans

40 See Jeerasak, 1985, p. 152.
41 Thailand’s overall terms of trade index declined from 100 in 1970 to 56 by 1982. See Pasuk and Baker, 1995, p. 146.
42 These were mainly the investments in the Eastern Seaboard program and two major hydroelectric projects.
incurred since 1975 soared high. External debt as a percentage of GDP grew from virtually zero in 1973 to 21% in 1980. The deterioration in the BoP during 1979-80 pushed Thailand to turn to the World Bank for financing. The Bank offered loans under its structural adjustment programs, which were in principle, dependent on major institutional and policy reforms designed to reorient the economy towards exports.43

Although manufacturing sector growth declined during the first half of the eighties compared to the seventies, it was still the fastest growing among all the sectors, except for mining. But, the slow growth in its employment absorption meant that although its relative contribution to GDP increased from around 15 per cent during 1950-59 to about 23 per cent in the mid-eighties, its share in employment increased from about 3 per cent in 1960 to only around 9 per cent in 1987, while the service sector’s share in employment almost doubled over the same period to some 27 per cent in 1987.

Even as growth was thought to come from industrial development against the slowdown in impetus from agricultural exports, for the first time it was recognised in the Fifth Plan (1982-86) that the country had no long-term plan for the development of manufacturing industries. Several structural problems arising from past industrialisation were identified such as: the ineffective promotion of manufactured exports; heavy reliance on imported capital equipment and intermediate products; continuing heavy concentration of industrial activity around Bangkok and surrounding provinces; limited labour absorption capacity of the manufacturing sector due to the inadequate promotion of labour-intensive industries, etc. Thus, the aims of the industrial adjustment plan under the Fifth Plan were the promotion of labour-intensive, resource-intensive and export industries, and the gradual phasing out of inefficient industries through the rationalisation of the incentive structure. In 1982, an Industrial Adjustment Committee (Chaired by the Ministry of Industry) was set up for planning and implementing the industrial adjustment program.

However, due to the earlier mentioned problems on the internal and external fronts during the Fifth Plan period, the focus was on restoring macroeconomic stability at all cost, using established means. This included a sharp fiscal contraction through cuts in public investment expenditure, raising tariffs further to improve revenue and reduce imports, and a strict monetary policy to control credit expansion. Whereas such measures had been successful in the past due to the underlying momentum of agricultural export growth, the circumstances in the early 1980s were different. In 1984, when the deflationary measures

43 Thailand had to borrow US$ 542 million from the Bank in 1979-80. In 1981-83, US$ 325 million from the Bank followed this and a further US$ 610 million from linked IMF standby credits. The information for this paragraph is based on Pasuk and Baker, 1995, p. 146-47.
caused a major business crisis and the deteriorating trade balance drained foreign reserves, the government ultimately effected a major devaluation of the baht, subsequent to which the baht was tied to a basket of currencies instead of the US dollar alone.44

Thus, at the end of the Fifth Plan period in 1986, few of the plans for industrial adjustment had been implemented and virtually none of the targets set for the manufacturing sector had been achieved. Despite the enormous pressure from the World Bank, export promotion was limited to some reduction in export taxes, some countervailing measures to offset anti-export biases in the BOI incentive structure, and the removal of energy price subsidies. By the mid-1980s, BOI rules were revised to favour firms which exported all or most of their output. But, the major elements of the export push strategy were not implemented.45 The development of the Eastern Seaboard (ESB) area, including the establishment of fertiliser and chemical plants was also delayed and further scaled down due to the changed economic circumstances (in particular the rapid decline in oil prices and lack of government funds).46 This was a typical manifestation of the trade-off that occurs under explosive external debt servicing burden, between short-run macroeconomic adjustment and the long-term needs for industrial restructuring.

With the export-led growth strategy explicitly retained in the Sixth Plan (1987-91), the main emphasis was on restructuring tax incentives. In addition, agro-based and engineering industries were singled out as the two main industrial groups to be promoted. Of the several objectives, only export-led growth took effect and even so, investment promotion policies or any major changes in industrial policy or macroeconomic management conceived in the Sixth Plan were not perceived to be responsible for this success.47 It was the 1984 devaluation that played the most significant role by removing a major constraint to Thailand serving as a base for manufactured exports. As mentioned earlier, the maintenance of a stable currency through the baht-dollar link had been a key aspect of macroeconomic management for

44 Jomo et al., 1997, p. 64.
45 Jomo et al., 1997, opcit., p. 63.
46 Although construction of some parts of the area began in 1985, the implementation of the ESB development programs accelerated only after the recovery of the Thai economy after 1985. (In mid-1989, the deep-sea ports, industrial estates, and the petrochemical complex (which includes various companies producing intermediate and downstream products of petrochemicals) were under construction. Somsak, 1993, p. 145.
47 First of all, most of the rapidly growing export industries such as canned tuna, artificial flowers and toys were not those initially targeted by the government. These industries had found their own niche in the international market and successfully exploited opportunities arising from a consumer boom in the US (in the case of textiles and toys) and the supply shortfall of alternative suppliers (Philippine canned tuna and so forth). Secondly, the Sixth Plan was drafted before the upsurge of industrial exports in the late 1980s and was shaped by the general pessimism about the economy during the mid-1980s recession. See Warin Wongchanchoo and Yukio Ikemoto, 1988, Economic Development Policy in Thailand: A Historical Review, Institute of Developing Economies (IDE), Tokyo, p. 180.
three decades. Thus, abandoning the link had been perceived as involving a major change in the mind-set of policy makers, opening the way for more far-reaching changes in economic policy oriented towards an export-oriented regime.\textsuperscript{48}

The dramatic improvement in the general economic conditions in Thailand in the latter half of the 1980s was also owing to a combination of several external factors such as the decline in oil prices, reduction in international interest rates, recovery in export commodity prices, and the international currency realignments since 1985. Thus, the fiscal deficit that had reached a peak of 5\% of GDP in 1984, was transformed into a surplus equivalent to 1.3\% of GDP in fiscal year 1988 and 4.9\% in 1990. Simultaneously, due to the combined effects of devaluation, the yen adjustment, and the relocation of investments from Japan and the NICs, Thailand experienced an export boom concentrated in manufactures from 1986. The spurt in labour-intensive manufacture was promoted both by foreign firms escaping from inflating costs at home, and by domestic firms released from the constraints of the import-substitution regime.\textsuperscript{49}

Overall investment as a percentage of GDP, which had averaged around 15\% during 1960-85, climbed steadily since then to reach 28.2\% in 1985 and 43.1\% in 1995.\textsuperscript{50} Thus, from 1986, the manufacturing sector output expanded much faster than service sector output. During 1989-96, manufacturing sector employment growth also exceeded that of the service sector, although not to a very large extent. (See Table 3.4)

Agricultural sector output growth also recovered slightly to an annual average rate of 4.5 per cent during 1987-91, led predominantly by the revival in the fisheries sub-sector since the late eighties, following which the latter became the second major component of agricultural sector output after crops. Agricultural processing products sub-sector was the second fastest growing segment during this phase. Since the early nineties, it has become the third most important sub-sector within the agricultural sector as well. However, from the first half of the nineties, overall agricultural sector growth started declining drastically and it turned negative during 1998-99. In 1999, the agriculture sector constituted just 10.4 per cent of GDP. (See Table 3.1 and 3.2)

This is due to the following reasons. The expansion of the crop sub-sector was made possible by the clearance of forests for cultivation, until almost the mid-1980s. Thus, while crop expansion peaked in the 1960s, the contribution of the forestry sector had steadily declined since 1960 and is currently only about one per cent of agricultural

\textsuperscript{48} See Jomo et al., 1997, p. 64.

\textsuperscript{49} Some of the existing domestic conglomerates diversified into export areas. Many new firms emerged from the ranks of small export-import, service, and retail businesses. Others were founded by members of the expanding ranks of the urban educated. See Pasuk and Baker, 1995, p. 142-170.

\textsuperscript{50} Suthiphand and Erdmann-Keefer, 1998, opcit., p. 262.
GDP.\textsuperscript{51} At the same time, despite an improvement in agriculture terms of trade, increase in crop production through extension of cultivable land, came to an end between the mid-eighties and the early nineties, brought about by a government ban on logging and other regulatory measures related to land use.\textsuperscript{52} Further, expansion of agricultural production, which was previously accompanied by heavy investment in public infrastructure- especially in roads and irrigation projects in the past, was also affected by the cessation in the implementation of large-scale irrigation projects since 1983. Growth rates in all other sub-sectors also dropped drastically during 1992-96, including that of simple agricultural processed products.

Thus, the historically dominant role of the agricultural sector in Thai economy has reduced drastically. This is also irrefutably established by the period-wise correlation coefficients, between GDP and agricultural growth rates, which declined from 0.70 during 1951-86 to just 0.30 during 1986-96. During 1997-98, growth rates in all sub-sectors turned negative except those of fisheries (1.3%) and crops (0.1%), and overall agricultural sector growth was at -0.5 per cent, which declined further by 8.6 per cent in 1999. (See Table 3.2)

Since 1987, agriculture sector’s share in employment has also declined drastically, from about 64 per cent to just over 50 per cent during 1997-98. In fact, the labour force in agriculture has declined in absolute numbers, implying a rapid shift of labour away from the agricultural sector. As mentioned earlier, this labour migration out of the agricultural sector since the mid-1980s catered more to the growing demand from the rapidly growing industry, than service sector. But, in spite of the rapid expansion in manufacturing sector output and its relatively faster growth of employment compared to the service sector, manufacturing sector’s share in total employment has not expanded in correspondence with its growth in GDP share. While the share of manufacturing in GDP increased by about 9 percentage points between 1981-86 and 1997-98, its share in employment rose by only 4 percentage points over the same period. This clearly points towards the continuing capital-intensive nature of the industrial expansion, which has limited the rate of labour absorption by industry even during a period of rapid export-

\textsuperscript{51} Ammar, Suthad and Direk, 1993, p. 95.
\textsuperscript{52} Since the 1960s, the agricultural frontier had progressed mainly through lands classified as “forest” and officially off-limits for agricultural colonisation. However, the interest of the ruling class in agro-processing ventures and the US aid in the sixties during the phase of communist threat enabled rapid clearing of forests and construction of roads to make them easily accessible. By the end of the eighties, though, the consequences of the unprecedented and rapid environmental degradation together with public concern over them compelled the government to impose a ban on logging and brought an end to such extension of cultivable areas. In fact, after stagnating in the early 1980s, paddy acreage had shrunk significantly by the end of the eighties, for the first time in over a century. See Pasuk and Baker, 1995, and Ammar, Suthad and Direk, 1993, p. 80-95.
oriented growth that was premised on a faster rate of employment generation in the economy.

Since the late eighties, apart from the growth in the manufacturing sector, the overall high economic growth of Thailand had also led to the expansion in domestic and foreign demand for infrastructure such as transport, telecommunication, legal services, franchising and insurance, which in turn led to the increased participation of domestic as well as foreign companies in various service sector activities. Foreign demand for such services as industrial estates, hotels, golf courses, and so on have been an important development factor in Bangkok and in several industrial development zones and tourist sites outside Bangkok. In the nineties, impetus also came from the privatisation of service activities previously performed by public enterprises, such as the State Railways of Thailand and the Telephone Authority of Thailand (TOT).53

The unexpected economic boom during the early part of the Sixth Plan period created major infrastructure bottlenecks. This led the government to revise the Plan in early 1989. After some delay, the government also responded to the boom-fed increased tax revenues: 1) it increased the wages and salaries of public employees; 2) it began to expand capital investment expenditure which had been on a decline due to the tight fiscal policy of the early 1980s; 3) it retired public debt; and 4) it allowed more private-sector participation in transport and communication sectors to reduce the bottlenecks in the infrastructure sector.54 Meanwhile, in spite of the economic set back and slower growth during 1991-92, the government policy towards deregulation and privatisation proceeded.

The government declared that it would withdraw from activities that can be carried out better and more effectively by the private sector and will allow more privatisation of some parts of its operations. The Eastern Seaboard Scheme which had represented a major return to direct government intervention in investment in industry in the early eighties was scaled back and several new infrastructure projects were opened up to privatisation. Excessive protection was removed to promote more competition in industries such as automobiles.55 Fast-track financial sector reform and liberalisation was also set in motion since 1991, in order to significantly mobilise domestic and foreign savings for the ambitious fast-track growth plans.

The enthusiastic response of foreign and domestic capital to Thailand’s new emphasis on export-oriented manufacturing had convinced policymakers that they could

54 Direk, 1995, p. 143.
55 In July 1991, Thailand’s interim administration announced a set of reforms designed to liberalise the automotive industry. A long-standing ban on imports was dropped and tariff rates on CKDs and CBUs were reduced. Prices of locally assembled cars and trucks dropped fifteen to 25% overnight and further reductions were anticipated. The underlying justification for the reform was to force the local auto industry to improve efficiency or to close down. The reforms still left a gap of protection for local assemblers, but competition had clearly increased. See Atchaka and Brimble, 1992.
now rely on manufacturing for export growth (and to a growing extent, service sector growth), as they had relied on agriculture in the past. The export-oriented policy was continued in the Seventh Plan (1992-96), with additional reference to the diversification of export markets as well as industrial location. Infrastructure facility improvement expenditure was to increase by 150% over the levels in the Sixth Plan, with particular emphasis on telecommunications and transportation. All these policy measures clearly promoted large capital inflows into two main sectors, namely, export-oriented manufacturing and its support activities in the service sector.

3.2.2 Links Between Service Sector and Overall Structural Changes

While the structural change that has occurred in Thailand in terms of the decline in the share of agriculture in the economy’s output and employment over the last four decades is not unusual, what is exceptional is the dominant position occupied by service sector in its output. Although the manufacturing sector started growing rapidly in the 1960s, the service sector’s share far outstripped that of the manufacturing sector in terms of relative contribution to GDP and employment. Since the late 1950s, the service sector has consistently accounted for more than half of total GDP. It grew steadily for almost four decades until 1997, constituting a high average annual share of about 56 per cent in GDP during 1980-96, until it declined after the crisis. But, with a share of 52.1 per cent of GDP in 1999, the service sector continues to be the most significant sector in Thai economy. With a share of 36 per cent of total employment, the service sector is also the second largest employer following agriculture (See Table 3.3 below).

Table 3.3: Distribution of Employment by Sector, 1960-98

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>82.3</td>
<td>79.3</td>
<td>72.7</td>
<td>70.5</td>
<td>69.7</td>
<td>64.4</td>
<td>63.6</td>
<td>55.1</td>
<td>50.8</td>
<td>51.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3.4</td>
<td>4.1</td>
<td>7.4</td>
<td>8.1</td>
<td>7.6</td>
<td>8.8</td>
<td>10.1</td>
<td>12.5</td>
<td>13.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Tertiary</td>
<td>14.1</td>
<td>16.1</td>
<td>19.5</td>
<td>21</td>
<td>22.1</td>
<td>26.6</td>
<td>26.4</td>
<td>32.4</td>
<td>36.2</td>
<td>35.7</td>
</tr>
<tr>
<td>Construction &amp; Utilities</td>
<td>0.6</td>
<td>1.3</td>
<td>1.3</td>
<td>2.2</td>
<td>2.6</td>
<td>2.7</td>
<td>3.3</td>
<td>5.3</td>
<td>4.7</td>
<td>4.0</td>
</tr>
<tr>
<td>Commerce</td>
<td>5.7</td>
<td>5.3</td>
<td>7.5</td>
<td>8.1</td>
<td>8.5</td>
<td>10.8</td>
<td>10.1</td>
<td>11.9</td>
<td>13.9</td>
<td>13.9</td>
</tr>
<tr>
<td>Transport</td>
<td>1.2</td>
<td>1.6</td>
<td>2</td>
<td>1.9</td>
<td>2</td>
<td>2.6</td>
<td>2.4</td>
<td>2.8</td>
<td>2.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Services</td>
<td>4.7</td>
<td>7.1</td>
<td>8.3</td>
<td>8.5</td>
<td>9.1</td>
<td>10.7</td>
<td>10.0</td>
<td>11.8</td>
<td>13.9</td>
<td>14.3</td>
</tr>
<tr>
<td>Others</td>
<td>1.9</td>
<td>0.8</td>
<td>0.2</td>
<td>0.1</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>99.8</td>
<td>99.5</td>
<td>99.6</td>
<td>99.6</td>
<td>99.4</td>
<td>99.8</td>
<td>100.1</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Pasuk and Samart, 1993, p. 156 in Peter Warr, ed., The Thai Economy in Transition, Cambridge University Press, Australia. (Although this source refers the shares as ratios of total work force, they actually represent ratios to total employment.) Figures for 1988-98 are based on data from NSO, 1999 Labour Force Survey.

The fact that the relative share of service sector in GDP did not really change since the beginning of the 1980s until the crisis (See Table 3.1), is crucial in understanding the

56 Jomo et al., 1997, opcit., p. 66.
57 Atchaka and Brimble, 1992, UNCTC, p. 20.
exact nature of the structural changes that unfolded in Thai economy. It is observed that between 1980 and 1986, agriculture's share in GDP had continued to decline, albeit gradually, while the shares of services and manufacturing increased slightly. However, if we look at the annual percentage shares in the years between 1981 and 1986, it is seen that although there are annual variations, there was no significant change in the relative shares of the various sectors in those years. From 1986 onwards though, the decline in agriculture's share in GDP accelerated as we saw earlier. This was accompanied by a dramatic expansion in manufacturing sector share, while service sector share remained the same until 1997.

This trend comes out even more conspicuously in the growth trends in employment pattern. Two distinct phases can be differentiated in the changes that have occurred in the employment pattern. The commercialisation of agriculture and the shift to intensive production methods starting in the 1960s and intensifying from the mid-1970s onwards made agriculture increasingly investment-intensive and led to a crisis among small-scale rice growers. While the government vigorously promoted entrepreneurial capitalism among agro-businesses, it provided no support or protection for the colonising peasant. Instead, the government denied the colonising peasant access to land rights and independent capital. Growing numbers of cultivators thus turned to wage labour, either as a result of land loss or, more often, through increasing reliance on wage earnings to supplement the inadequate returns from a small plot. This was not very different from a typical agrarian society in transition under the incursion of commercialisation of agriculture. Much of this increase in labour immigration into the urban areas was drawn to man the infrastructure, petty trades and service industries of an expanding commercial city during Bangkok's initial economic expansion of the 1960-1975 period. By the early to mid-1980s, growing numbers from the low average income and high vulnerable smallholder farming families had joined the ranks of these off-season labour migrants. Thus, during 1960-87, service sector employment increased at 5.6 per cent per annum, when manufacturing sector employment grew only by 4.6 per

---

58 This is because of the fact service sector share had increased from 54.8 percent in 1979 to 56 percent in 1980 and then remained around that level, while the manufacturing sector's share which touched 23 per cent in 1977 remained so during 1977-86. These changes fall into the seventies period (1970-80) where the 1970-76 shares obviously outweighed the 1977-80 change and therefore, in terms of average shares it is the 1981-86 period which brings out the increase in their shares while in fact the changes during 1981-86 are insignificant.

59 While farmers with larger holdings gained access to institutional finance and undertook the new capital investments required for land improvement, seeds, chemicals, and machinery, most smaller cultivators were not in a position to avail institutional sources of finance (especially long-term) because they did not possess land titles. See Pasuk and Baker, opcit, p. 33-86.

60 During this first phase of its urban growth, Bangkok acquired hotels, a better airport, new roads, hospitals, massive banks, more administrative offices, more universities, and department stores. The city also developed a huge informal sector of street traders, taxi-drivers, food sellers, construction workers, and service industries of all kinds. See Pasuk and Baker, 1995, p. 186-189.
cent. From 1986 onwards, on the other hand, manufacturing sector employment grew faster than that in the service sector, due to the rapid expansion in manufacturing sector production as discussed earlier. However, as we already saw above, at about 36% of total employment, service sector employment still stood higher than that of industry during 1997-98.

Table 3.4: Growth Trends in Employment Pattern, 1960-98

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>11.5</td>
<td>0.1</td>
<td>3.1</td>
<td>3.8</td>
<td>-0.6</td>
<td>-4.1</td>
<td>-2.9</td>
<td>1.1</td>
<td>-1.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3.8</td>
<td>14.7</td>
<td>6.2</td>
<td>2.9</td>
<td>7</td>
<td>11.9</td>
<td>4.8</td>
<td>-1.7</td>
<td>-2.4</td>
</tr>
<tr>
<td>Tertiary</td>
<td>3.2</td>
<td>5.0</td>
<td>6.0</td>
<td>5.3</td>
<td>8.4</td>
<td>9.3</td>
<td>5.8</td>
<td>-1.1</td>
<td>-5.8</td>
</tr>
<tr>
<td>Construction+utilities</td>
<td>9.9</td>
<td>3.0</td>
<td>18.1</td>
<td>6.1</td>
<td>5.5</td>
<td>31.5</td>
<td>13.0</td>
<td>-21.8</td>
<td>-36.7</td>
</tr>
<tr>
<td>Commerce</td>
<td>1.2</td>
<td>9.4</td>
<td>6.2</td>
<td>4.9</td>
<td>10.5</td>
<td>9.4</td>
<td>4.7</td>
<td>1.5</td>
<td>-3.0</td>
</tr>
<tr>
<td>Transport</td>
<td>4.9</td>
<td>7.3</td>
<td>2.8</td>
<td>4.0</td>
<td>7.1</td>
<td>12.1</td>
<td>3.1</td>
<td>-1.5</td>
<td>-5.9</td>
</tr>
<tr>
<td>Services</td>
<td>6.1</td>
<td>5.2</td>
<td>4.5</td>
<td>5.4</td>
<td>7.7</td>
<td>4.4</td>
<td>4.9</td>
<td>5.8</td>
<td>5.6</td>
</tr>
<tr>
<td>Others</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
<td>75.4</td>
<td>-0.6</td>
<td>3.7</td>
<td>4.3</td>
<td>-3.5</td>
</tr>
<tr>
<td>Total</td>
<td>1.9</td>
<td>1.8</td>
<td>3.9</td>
<td>4.1</td>
<td>2.1</td>
<td>0.9</td>
<td>0.7</td>
<td>-0.1</td>
<td>-3.1</td>
</tr>
</tbody>
</table>


The service sector can thus be seen to be more prominent than the industrial sector in the Thai economy, in terms of both contribution to GDP and employment. This is corroborated by the fact that while the correlation coefficient between growth rates of the service sector and GDP for the entire period 1951-96 was 0.80, it was only 0.69 for the manufacturing sector (and 0.56 for the agricultural sector) (See Appendix Table 1). However, a phase-wise estimation of these correlation coefficients shows that during 1950-86 itself, the correlation coefficient between service sector and GDP growth rates at 0.76 was significantly greater than that between the manufacturing sector and GDP at 0.61. Further, while the correlation coefficient of growth rates between service sector and agriculture was 0.20 during 1950-86, that between service sector and manufacturing sector was also only 0.28. Clearly, until the mid-eighties, service sector expansion was not highly correlated to the performance of either the agriculture or the manufacturing sector. Thus, the expansion of the service sector that substituted agricultural sector’s declining share in GDP during 1951-86 seems to have been rather autonomous.

During 1987-96, on the other hand, the coefficient of correlation with GDP growth rates increased to 0.89 for service sector and 0.91 for manufacturing sector. Thus, there is a clear and radical strengthening in manufacturing sector’s relationship with GDP growth after 1986 (rising from 0.61 to 0.91). But, the relationship of service sector with GDP after 1986 also became stronger and is not revealed to be significantly different from that of the manufacturing sector. Further, while the correlation coefficient of growth rates between service sector and agriculture sector fell to -0.13 during 1986-

---

61 The only service sub-sector with a higher correlation coefficient with manufacturing sector growth than with agricultural growth during this phase was construction. However, construction’s share in GDP was less than 5 per cent during this phase.
96, the correlation coefficient between the growth rates of services and manufacturing increased from just 0.28 during 1950-86 to 0.81 during 1981-96. Thus, after the mid-eighties, service sector expansion has been significantly correlated to the growth of industry. Evidently, this cross-sectoral linkage pattern mirrored the policy shift towards export-oriented manufacturing sector and related service industries.

This does not tell us anything about the direction of this relationship. But, given the fact that service sector share in GDP remained more or less constant during 1987-96 and that its growth was slower than that of the manufacturing sector, its high correlation with GDP and manufacturing during this phase clearly warrants further analysis. Thus, although the focus of our study is the restructuring of manufacturing sector, we examine the structural composition of the service sector and the changes that have taken place within this sector in more detail. During the three decades from the fifties, the average contribution of services to GDP rose from around 50 per cent (1951-59) to 56.2 per cent (1981-86). As we have established earlier, this expansion of the service sector was mostly autonomous. Most of this expansion was contributed by four sub-sectors namely, trade, ‘other services’, banking and finance, as well as transport and communication.

Trade has been the most important component of service sector throughout, reflecting the dominant trade orientation of the Thai economy. It constituted about 17 per cent of GDP and as much as 30 per cent of total service sector output until the early nineties, after which it declined (See Table 3.5). But, trade remained the largest sub-sector within services and became the second single largest sector within the overall economy overtaking agriculture since the late eighties. The increase in the correlation coefficient between the growth rates of trade and GDP from 0.55 during 1951-86 to 0.92 during 1987-96, also clearly points towards the large and increasing dependence of the economy on trade. Another interesting result that comes out of this analysis is the fact that during 1951-86, the correlation between the growth rates of trade and agriculture was 0.17, while it was 0.23 between trade and manufacturing, which are not very different from each other. However, during 1987-96, while the correlation of trade with agriculture declined further to 0.04, that with the manufacturing sector increased sharply to 0.86. Apart from the rapid growth in manufactured exports, this could also

---

62 Although average annual growth rates during 1951-86 was much larger for utilities (electricity and water supply) and construction than these sub-sectors, the former constituted less than 5 per cent of GDP and utilities also had only low correlation coefficient with service sector growth rates during this period.

63 Although not significantly different from each other, the higher correlation for manufacturing in a period when manufactured exports were less significant than agricultural exports could have been due to the increasing imports of manufactured goods under import-substitution industrialisation. Urban Thailand was increasing its imports of capital equipment and consumer goods without coming up against foreign exchange constraints owing to the large share of foreign grant aid flows in total capital flows, almost until the late seventies and the second oil crisis.
point towards high import content of manufactured exports since the mid-eighties. This hypothesis is explored in detail in the Chapter V.

On the other hand, as mentioned earlier, the service sector has been an important employer of rural migrant workers who face economic problems in their locality, most of whom would be drawn into 'other service' activities in the urban areas (apart from petty trading and construction). The 'other services' category, which includes education, health, recreation and entertainment, hotels, restaurants, personal services, domestic services, non-profit institutions and repair works, constituted some 12 per cent of GDP during 1951-86. Evidently, this sub-sector involves service activities related to both tourism and out migration of workers, two areas in which the government had begun paying increasing attention from the Third Plan (1972-76) onwards, which increased further following the balance of payments crisis in the early eighties.

The growth of the finance sub-sector during the sixties and seventies was principally related to the expansion of the banking sector. During 1951-80, the finance and banking sub-sector constituted some 8.4 per cent of GDP. During 1981-86, however, growth in this sub-sector declined sharply due to recurrent problems in the financial sector, and its share in GDP also declined (See Table 3.6).

### Table 3.5: Composition of Service Sector GDP in Thailand, 1980-99p

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>8.6</td>
<td>9.7</td>
<td>11.1</td>
<td>7.3</td>
<td>5.5</td>
</tr>
<tr>
<td>Electricity and Water Supply</td>
<td>3.6</td>
<td>4.2</td>
<td>4.6</td>
<td>5.4</td>
<td>5.8</td>
</tr>
<tr>
<td>Transport and Communication</td>
<td>12.3</td>
<td>13.2</td>
<td>14.2</td>
<td>16.8</td>
<td>17.8</td>
</tr>
<tr>
<td>Wholesale and Retail Trade</td>
<td>30.7</td>
<td>30.2</td>
<td>29.2</td>
<td>27.9</td>
<td>31.1</td>
</tr>
<tr>
<td>Banking, Insurance and Real Estate</td>
<td>13.3</td>
<td>14.3</td>
<td>18.0</td>
<td>17.1</td>
<td>15.0</td>
</tr>
<tr>
<td>Public Administration and Defence</td>
<td>7.6</td>
<td>6.0</td>
<td>4.8</td>
<td>5.4</td>
<td>6.1</td>
</tr>
<tr>
<td>Other Services</td>
<td>23.9</td>
<td>22.4</td>
<td>18.2</td>
<td>20.1</td>
<td>18.8</td>
</tr>
<tr>
<td>Share of Total Services in GDP</td>
<td>56.2</td>
<td>56.5</td>
<td>56.4</td>
<td>54.7</td>
<td>52.1</td>
</tr>
</tbody>
</table>

Note: Banking, insurance and Real estate includes 'ownership of dwellings' as in ISIC Div. 3.

For 1999, 'Public administration and defence' also includes 'Compulsory social security' and therefore would be a reason for the slight rise seen there. This re-classification could also be responsible for the drop in the 'Other services' category for 1999. Compulsory social security is included in the 'Other services' category for all the other periods.


64 See Pasuk and Samart, op. cit., p. 165 and Pasuk and Baker, 1995, p. 43, etc.
65 Following Pasuk and Samart, 1993, p. 170. Business services component which basically refer to the finance, insurance, and real estate sub-sector is not included in the 'other services' category here as in Pasuk and Samart (1993), as the finance and real estate sub-sector data is available separately in the NESDB data now and hence will allow us to analyse the finance & real estate sector growth separately.
66 The government considered especially tourism as one of the major sources of potential foreign exchange earnings and employment generation, ever since other sources (especially US grant aid, loans and other foreign inflows) declined since the mid-seventies. The government offered incentives for the construction of hotels and other tourist facilities and increased the promotional budget of the tourism authority. See Pasuk and Samart, 1993, p. 157.
After 1986, the composition of the service sector underwent a change. After touching its peak at 25 per cent in 1985-86, the share of the 'other services' sub-sector in total service sector output declined. On the other hand, the share of the largest sub-sector, trade, was maintained during 1987-91, during which period it registered one of the fastest growth rates. Apart from the slight improvement in the utilities sub-sector, all the other sub-sectors were also on the decline. Meanwhile, the finance and construction sub-sectors registered the fastest growth rates running at double-digits, and increased their share in total service sector output (See Table 3.6). The share of the transport and communication sub-sector also increased. Therefore, significantly, while 1987-91 was the phase of the fastest growth in service sector over the entire period 1951-96 (10.8 per cent per annum on average), the fact that its share in GDP did not change significantly during this period is clearly attributable to this restructuring that took place within the service sector from 1987 onwards involving the rapid expansion of the finance and construction sub-sectors.

Table 3. 6: Growth Rates in Service Sector GDP at 1988 Prices, 1950-99  
(Period average growth rates in percentage)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Services</td>
<td>6.8</td>
<td>8.5</td>
<td>7.1</td>
<td>5.7</td>
<td>10.8</td>
<td>8.1</td>
<td>-7.8</td>
<td>-4.0</td>
<td>-11.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Construction</td>
<td>14.7</td>
<td>11.3</td>
<td>5.0</td>
<td>6.3</td>
<td>17.3</td>
<td>8.5</td>
<td>-32.8</td>
<td>-26.7</td>
<td>-38.8</td>
<td>-8.5</td>
</tr>
<tr>
<td>Electricity and Water Supply</td>
<td>20.5</td>
<td>23.7</td>
<td>14.4</td>
<td>11.6</td>
<td>11.7</td>
<td>9.9</td>
<td>1.1</td>
<td>5.2</td>
<td>-3</td>
<td>3.1</td>
</tr>
<tr>
<td>Transportation &amp; Comm.</td>
<td>12.0</td>
<td>9.2</td>
<td>7.4</td>
<td>6.1</td>
<td>11.4</td>
<td>11.2</td>
<td>-2.5</td>
<td>4.4</td>
<td>-9.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Wholesale and Retail Trade</td>
<td>6.0</td>
<td>9.3</td>
<td>7.0</td>
<td>4.0</td>
<td>11.9</td>
<td>6.6</td>
<td>-9.4</td>
<td>-4.2</td>
<td>-14.6</td>
<td>13.5</td>
</tr>
<tr>
<td>Banking, Insurance &amp; Real Estate</td>
<td>5.2</td>
<td>6.2</td>
<td>6.4</td>
<td>3.9</td>
<td>14.6</td>
<td>12.5</td>
<td>-11.2</td>
<td>-6.9</td>
<td>-15.5</td>
<td>-10.0</td>
</tr>
<tr>
<td>Public Administration &amp; Defence</td>
<td>13.6</td>
<td>7.3</td>
<td>8.6</td>
<td>5.7</td>
<td>4.5</td>
<td>4.3</td>
<td>4.9</td>
<td>3.0</td>
<td>6.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Other Services</td>
<td>5.5</td>
<td>8.0</td>
<td>7.5</td>
<td>7.9</td>
<td>6.0</td>
<td>5.1</td>
<td>1.0</td>
<td>2.6</td>
<td>-0.6</td>
<td>-11.8</td>
</tr>
<tr>
<td>Gross Domestic Product, (GDP)</td>
<td>5.4</td>
<td>8.4</td>
<td>6.7</td>
<td>5.5</td>
<td>10.9</td>
<td>8.0</td>
<td>-5.9</td>
<td>-1.7</td>
<td>-10.2</td>
<td>4.2</td>
</tr>
</tbody>
</table>

Note: Banking, insurance and real estate includes 'ownership of dwellings' as in ISIC Div. 3. For 1999, 'Public administration and defence' also includes 'Compulsory social security' and therefore would be a reason for the slight rise seen there. This reclassification could also be responsible for the drop in the 'Other services' category for 1999. Compulsory social security is included in the 'Other services' category for all the other periods. Source: NESDB National Income of Thailand, 1996, 1998 and 2000 series.

During 1992-96, while the shares of trade and 'other services' declined further, the three sub-sectors finance (including insurance and real estate), transport and communication, and construction increased their shares in total service sector output further, with the former two now registering the fastest growth rates while the growth in the construction sub-sector slowed down relatively. In fact, during this phase, the finance sub-sector became the second largest sub-sector within service sector, following trade.68 This trend

68 An exception is the correlation of trade with service sector growth rates which increased from 0.70 during 1951-86 to 0.93 during 1987-96, although its share in service sector output was slightly declining between these two periods. This could be attributed to the fact that its share in service sector output was very high and its growth rates also remained high, despite the fall in relative share. The correlation of utilities (with total service sector growth) also increased between the two periods, but its share remained only just about 5 per cent of total service sector output.
was clearly reflective of the financial liberalisation policies adopted by the government since 1991 and also the huge demand created for financial services by the manufactured exports boom. At the same time, the boom in the construction and real estate sub-sectors was reflective of a private capital-driven speculative expansion across the emerging markets in this phase. 

However, after 1996, excluding transport and communication, the shares of both the finance and construction sub-sectors in total service sector output declined rapidly. Both sectors registered negative growth rates during 1997 and 1998 reflecting the serious problems in the financial and real estate sectors, and they continued to deteriorate in 1999. The share of trade in total service sector output also declined further during 1997-98, but picked up strongly in 1999. On the other hand, despite registering a negative growth rate in 1998, the transport and communication sub-sector has steadily increased its share and has come to constitute almost 18 per cent of total service sector output.

The ‘other services’ sub-sector shows an inverse relationship with the trade and construction sub-sectors. Its share seems to surge especially during periods of decline in the prospects of the trade and construction sub-sectors. Meanwhile, the employment share of ‘other services’ sub-sector saw a rise from 7.1 per cent to 10.7 per cent over 1970-87 and further to around 14 per cent by 1997-98. Thus, the ‘other services’ sub-sector alone absorbs as much labour as the total manufacturing sector and has remained an absorber of unemployed and underemployed from the various other sub-sectors within the service sector itself, apart from the labour withdrawn from the manufacturing sector during periods of industrial recession.

Following the economic crisis in 1997, while the manufacturing sector output contracted in 1998 for the first time since 1985, the service sector output also registered negative growth rates in both 1997 and 1998, for the first time ever in Thailand’s modern economic history, principally owing to the drastic decline in output in the

---

69 Dhar and Murali (2000) have shown that an increased role for market-based financing since the early 1990s had led to a movement of capital away from manufacturing to service sectors across the five crisis-hit countries of Indonesia, Malaysia, Thailand, Korea, and Singapore, as well as in other emerging market countries. See Dhar, Biswajit and Murali Kallummal, 2002, “Market Significance in Investment Decisions in East Asia”, RIS Occasional Paper No. 66, RIS, New Delhi.

70 The share of ‘other services’ which had been on a declining trend since 1987 shows a sudden jump during 1997-98, as the shares of trade and construction in service sector output declined considerably. But, even though the share of the construction sub-sector continued to decline in 1999, that of ‘other services’ declined again to its 1992-96 level, because the share of trade had risen strongly again in 1999.

71 Which here also includes the finance sub-sector, due to the classification of data by NSO.
construction, trade, and finance sub-sectors. But, in 1999, even though service sector output growth was stagnant, the manufacturing sector recovered with a massive 15.7 per cent growth rate.

Thus, although a large part of the story of the enormous changes in the Thai economy over the last couple of decades do concern the shift from agriculture to industry as is most commonly pronounced in the literature, the above structural analysis clearly reveals that it is equally important to consider the crucial structural changes that have occurred within the tertiary sector. It has been suggested that the tendency to describe the rapid growth experience of Thailand during 1987-96 as a 'manufacturing boom' rather than as a service sector boom concentrated in construction and financial services is because manufacturing sector growth is viewed as more "autonomous" and "causal". The growth in construction, financial services activities, and transport and communication on the other hand, is seen as being caused, in large part, by the restructuring of the economy away from traditional agriculture and towards more urbanised and more commercialised manufacturing activities. However, there are several weaknesses in this approach. First of all, this view assumes that the restructuring of the economy away from agriculture towards manufacturing and the development of the service sector occur autonomously. Clearly, this is hardly realistic as both depend crucially on government policy framework and changes in it, as well as a large number of various inter-related internal and external factors as we saw above. Secondly, it assumes that service sector development occurs naturally as a consequence of industrial development. We have clearly seen above that historically service sector's contribution to GDP was running ahead of manufacturing sector growth in Thailand, and that rapid industrialisation has not advanced its growth, rather, it has been associated with structural changes within the service sector. This takes us to the third and most important point that it fails to consider the restructuring within the service sector in a period of rapid economic growth, and the dynamism involved in the important sectoral interactions running from service sector growth towards manufacturing sector, which have important implications for restructuring within the manufacturing sector (and elsewhere). The post-1987 changes that have occurred in the service sector structure,

---

72 Further, with employment across all these three major sectors registering negative growth rates in 1998 in the aftermath of the economic crisis and demand recession, service sector employment was the hardest hit declining by almost 6 per cent.
74 See Brummit and Flatters, 1992, opcit., p. 5-6.
therefore, have important implications for the development path and sustainability of export-led industrial growth and restructuring.

3.2.3 Changing Political Economy in the Period of Export-led Growth

The transformation from the protected regime towards export-oriented growth and the rapid liberalisation and privatisation that accompanied it were also synchronous with a fundamental change in the Thai political system, the character of its business class, and a change in the relationship of its business class with bureaucracy and politicians.

During the import substitution period, domestic capital was dominated by the major commercial banks and by twenty or so conglomerates engaged in textiles, agro-business, and some import-substitution industries. The alliance described earlier in terms of the relationship between businessmen and the military generals had continued and grown stronger in the 1960s and 1970s. The dominance of these firms which were mainly Bangkok-based, had relied on their dense network of personal and commercial relationships, their political linkages, their relations with foreign partners, their access to accumulated assets of the big banks, and their ability to dominate the protected home market. Thus, even though the Thai government, especially its planning board, had realised the implicit danger of prolonged industrial protection and attempted to incorporate a switch towards export-oriented industrialisation in the five year plans beginning in the 1970s, these efforts were ineffectual in the face of the vested interests of the conglomerates and their political allies who wished to retain the old regime. As long as the domestic market expanded on the basis of the growing rural surplus and continuing foreign inflows, domestic capital was not keen on exporting. Thus, until the domestic market squeeze occurred during the late 1970s' recession, various industry groups continued to demand tariff protection. This was favoured by the Ministry of Finance, which considered tariff revenue as a major source of government income.

When the import-substitution industries ultimately reached their limits for output expansion following the economic slowdown in the late 1970s, the business leaders finally became interested in exporting. They organised to put pressure on the government for a change of strategy towards supporting exports. The Association of Thai Industries and the Thai Bankers Association along with the Chamber of Commerce had formed a joint standing committee in 1977 and petitioned the government to form a


76 See Pasuk and Baker, 1995, p. 144 and Pasuk and Baker, 2000, Thailand’s Crisis, Silkworm Books, Chiangmai, Thailand, p. 20, etc. Pasuk and Baker (2000) have argued that until the 1980s, technocrats had only a limited role in making policy. They only administered the policy laid down by the military rulers under the influence of the World Bank, which was in turn adjusted by business lobbies.
regular government-business standing committee, to serve as an official channel for
dialogue between leaders of the business community and senior government officials in
the core macroeconomic agencies and sectoral ministries.\footnote{The textile industry, which was the largest manufacturing industry with export potential, led the
ttempts to lobby the government. It persuaded the Bank of Thailand to give preferential credit on
textile exports, and the Ministry of Finance to grant refunds of taxes and tariffs levied on inputs. Other
industries with export potential such as jewellery firms followed the textile example. See Pasuk and
Baker, 1995, p. 140.} Although the government had formed a consultative body in 1978, the formal body Joint Public Private
Consultative Committee (JPPCC) came into existence in 1981 under Prime Minister
Prem Tinsulanond who had come to power in 1980.\footnote{Since the late 1970s, the dissolution of the cold war and the decline of US tutelage had paved the way
for a gradual transition from military dictatorship to parliamentary systems in Thailand, although the
military continued to play a significant role in parliamentary politics, until around the mid-1980s. See
for example Pasuk and Baker, 2000, p.21.} Prem gave high priority to the
management of the economy and wanted to increase government support to the private
sector, by advancing trade and industrial adjustment measures such as adopting an
export-oriented industrialisation strategy. Through the JPPCC, the business community
requested many tax reforms and changes in government regulations to support their
export drives and other business interests.\footnote{See Anek Laothamatas, 1992, “Politics of Structural Adjustment in Thailand”, in Andrew Macintyre
and Kanishka Jayasuriya ed., The Dynamics of Economic Policy Reform in Southeast Asia and the
Southwest Pacific, OUP. However, there were still many pressure groups (such as those businessmen
who profited directly or indirectly from teaming up with the military generals for exploiting the
protected home market) that opposed this transition in the 1980s. They continued to manipulate
political contacts in attempts to protect domestic market privileges and to maintain privileged access to
government expenditure flows. See Pasuk and Baker, 1995, p. 149, 168.} But, while business leaders played an
important role in advocating the promotion of export industries, they could have no role
in the decision to introduce economic stabilisation measures as part of the structural
adjustment program initiated through the World Bank loans in 1980. The core economic
agencies were in charge of this.

Prem had boosted the role of the NESDB and put it in charge of the structural
adjustment programme,\footnote{NESDB was also made the secretariats of both the economic ministers' meetings and the JPPCC.} and also appointed a former high official of the Bank of
Thailand as Finance Minister. While the Ministry of Finance and the Bank of Thailand
were convinced about the absolute need for measures to stabilise the economy reeling
under the second oil crisis, and had no difficulty in trimming the government budget and
tightening money supply in the name of structural reform under the World Bank loans,
they were initially reluctant to alter the exchange rate or reduce tariff levels through fear
that these might exacerbate the country's trade and balance of payment deficits in the
short term.\footnote{The military also maintained its opposition to a change in the strong currency, which facilitated their
large external borrowings and arms purchases.} However, as the economic crisis and recession in trade of the early 1980s

\begin{footnotesize}
\begin{itemize}
\item \footnote{The textile industry, which was the largest manufacturing industry with export potential, led the
ttempts to lobby the government. It persuaded the Bank of Thailand to give preferential credit on
textile exports, and the Ministry of Finance to grant refunds of taxes and tariffs levied on inputs. Other
industries with export potential such as jewellery firms followed the textile example. See Pasuk and
Baker, 1995, p. 140.}
\item \footnote{Since the late 1970s, the dissolution of the cold war and the decline of US tutelage had paved the way
for a gradual transition from military dictatorship to parliamentary systems in Thailand, although the
military continued to play a significant role in parliamentary politics, until around the mid-1980s. See
for example Pasuk and Baker, 2000, p.21.}
\item \footnote{See Anek Laothamatas, 1992, “Politics of Structural Adjustment in Thailand”, in Andrew Macintyre
and Kanishka Jayasuriya ed., The Dynamics of Economic Policy Reform in Southeast Asia and the
Southwest Pacific, OUP. However, there were still many pressure groups (such as those businessmen
who profited directly or indirectly from teaming up with the military generals for exploiting the
protected home market) that opposed this transition in the 1980s. They continued to manipulate
political contacts in attempts to protect domestic market privileges and to maintain privileged access to
government expenditure flows. See Pasuk and Baker, 1995, p. 149, 168.}
\item \footnote{NESDB was also made the secretariats of both the economic ministers' meetings and the JPPCC.}
\item \footnote{The military also maintained its opposition to a change in the strong currency, which facilitated their
large external borrowings and arms purchases.}
\end{itemize}
\end{footnotesize}
deepened and caused business failures and affected government revenue, the
government was finally forced to accept the need to develop new sources of foreign
exchange earnings, by targeting manufactured exports. The Ministry of Finance and the
Bank of Thailand accepted the need for exchange rate and tariff reforms, facilitated by
the second Structural Adjustment Loans from the World Bank and stand-by credit from
the IMF.\footnote{82} Thus, in November 1984, the finance ministry and the Bank of Thailand
persuaded the cabinet to devalue the currency, which had remained the major policy
block in enhancing the competitiveness of Thai exports.

Anek (1992) has argued that by co-opting the coalition political parties which
wished to see the democratisation process proceed, by placing non-partisan people with
a technical background in key positions,\footnote{83} and by granting the business sector an
unprecedented level of institutionalised access and influence in the policy-making
process through the JPPCC and satisfying a number of their immediate demands, Prem
created conditions which facilitated the adoption of a whole package of structural
adjustment measures by the government. These enabled him to reduce the risk of
disaffected members of the business community forging potentially strong alliances
with other forces such as opposition political parties and those sections of the military
opposed to the government’s unpopular economic reform programme. Thus, even
though many business interests (in manufacturing and especially banking and finance)
were adversely affected by the devaluation, the private sector was willing to accept these
blows rather than assist a military-provoked crisis which would result in an enlarged
political role for the military. Thus, they allied with the technocrats in the crucial policy
changes brought about by the latter during 1984-85. In fact, the desire of a large section
of the political elite to support the democratisation process was a decisive element in
Prem’s ability to withstand the pressures from the elements which threatened to derail
the painful economic reform process.\footnote{84}

But, in 1988 when Prem stepped down after presiding over the “semi-
democracy” and was replaced by an elected prime minister, Chatichai Choonchavan, the
government quickly moved to shift power from the bureaucrats back to the politicians.
Meanwhile, although foreign capital became more important during the boom, local

\footnote{82} See Anek Laothamatas, 1992, p. 36-37.

\footnote{83} Most of these European and US educated technocrats were greatly influenced by World Bank
advocacies on free trade and liberalization, and believed that liberalizing markets would abolish rents,
expose inefficient business practices, and maximize welfare. See Pasuk and Baker, 2000, p. 23.

\footnote{84} The businessmen had begun to take a more aggressive role in politics since the early 1970s as a means
to increase their control over policymaking. A number of well-known bankers and businessmen had
obtained ministerial portfolios during the brief period of civilian rule of 1973-76. After the return of
the military rule during 1976-79, business became increasingly pro-democracy because they wanted to
see the role of the military and military budget reduced so that taxes and tariffs could be reduced and
the government could spend more on infrastructure development needed to support the production
expansion in their planned export drive. Thus, when the military attempted to block the devaluation,
capital also expanded and diversified, with a deepening of business especially in the provinces. Along with the rise in party politics, there was a rise in the political power of the provincial business class.\textsuperscript{85} The government of General Chatichai Choonchavan and members of his cabinet were involved in business both at the local and national levels and reflected the increasing involvement of business in Thai politics.\textsuperscript{86}

While the macro-managers maintained a tight grip, in other respects the government's role in managing the economy was thus in retreat in the second half of the 1980s. The role of the planning board as an effective voice in policymaking diminished. In 1988, the NESDB was relieved of its role as supervisor for all major government investment projects. The central bank and the Ministry of Finance remained the most powerful agencies for policymaking, but they came under more influence from business lobbies working through the parliament, cabinet and business associations.\textsuperscript{87} By working through the JPPCC, the business associations succeeded in clearing away some of the apparatus of licenses and controls installed in the Sarit era. By shifting aside technocrats, shuffling the boards of the state enterprises, sidelining NESDB, and placing control over government contracts under individual ministers, the new government significantly shifted control over government funds from the permanent bureaucracy to the elected ministers.\textsuperscript{88} The private sector also had greater participation in the formulation of the Seventh Development Plan (1992–96). Input for the Seventh Plan came not only from leading bureaucrats and academicians, but also from elected and non-elected cabinet members directly involved in the policy formulation process, and from various private groups, business associations and NGOs.\textsuperscript{89} The undermining of military control over the state's affairs and state funds by the politicians led to the castigation of the government with corruption charges emanating from close political-business relations, and eventually led up to the coup of February 1991.

\textsuperscript{85} Some provincial businessmen borne up by the cash crop boom had succeeded dramatically by running semi-legal or criminal businesses. Many of them deployed their super-profits to manage the electoral franchise, to transport themselves from province to capital by politics, and to begin competing in the same national economic frame as the metropolitan conglomerates. See Pasuk and Baker, 1995, p.408.
\textsuperscript{86} In the 1988 general elections, two-thirds of all the elected candidates were businessmen, a higher proportion than in any previous election. With control of the cabinet, business set out to restructure the administration and the economy. See Jomo K.S., ed., 1997, p. 66 and Pasuk and Baker, 1995, p. 348-350, etc.
\textsuperscript{87} The Finance Ministry was controlled by a succession of business politicians. Pasuk and Baker, 2000, p. 23.
\textsuperscript{88} In various state enterprises ministers removed senior bureaucrat appointees and replaced them with business allies or friendly bureaucrats. On the other hand, the allocation of major government contracts was placed under the control of individual ministries with minimal reference even to the cabinet. See Pasuk and Baker, 1995, p. 350, and Kraiuydht, 1995, p. 112.
\textsuperscript{89} Chairman of the NESDB executive board in this period has been a leading banker, and in early 1994 became the deputy prime minister in the Chuan government. Other Board members also came from the private sector. Kraiuydht, 1995, p. 112.
Thus, after a long period of parliamentary democracy, the military seized power again in February 1991. The new government of Anand Panyarachun under the tutelage of a military faction (the so-called National Peace-Keeping Council-NPKC) was private sector-oriented by profession and inclination. He brought back the technocrats, filling his cabinet with many of the technocrats who had been prominent during 1984-88. Anand’s business-technocrat cabinet concentrated on enacting reforms in economic management to meet the demands of Bangkok’s export-oriented business. The bureaucracy, which in the mid-1980s had believed that trade liberalisation offered Thailand the opportunity to make a rapid economic transition, now believed that financial liberalisation would not only spur the economy, but also make Thailand a financial centre for the region. Anand’s cabinet took most of the major decisions on financial liberalisation. Anand also personally advocated the idea of an Asian free trade area to boost the regional economy. His government also accelerated several infrastructural projects, particularly roads, telecommunications, and mass transit projects in the capital.

Initially, the Bangkok businessmen supported the military and tried to win their support like in the periods before the mid-1980s. This was an offshoot of the resentment they had towards the growth of provincial influence under Chatichai which downplayed the JPPCC. Chatichai had elevated the provincial politicians, some of whom had used political patronage and parliamentary power to advance their business enterprises in competition with older established Bangkok concerns. But, the period of economic boom had seen two new groups of capitalists become dominant in the economy. The first was the exporters in electronics and other manufacturing sectors, and the second was a group of new aggressive businessmen in the broader financial sector, media, telecommunications, real estate, tourism, and a range of other service sectors. The realisation by Bangkok business that the instability represented by the word ‘coup’ was damaging for an economy which had become highly reliant on exports, foreign investment and tourism, led them to take a pro-democracy stand later on.

However, the elections since 1992 have instituted parliaments split along nine to twelve party lines, led by fragile coalition governments with representation from about half of these parties. Under these circumstances, the assignment of cabinet portfolios and heads of independent central agencies got muddled up in the political balancing act

---

90 Prime Minister Anand was the head of the Federation of Thai Industries (FTI) before becoming the head of the new government. A number of his cabinet members were also leading executives of big corporations. See Kraiyudht, 1995, p. 111-12.

91 See Pasuk and Baker, 1995, p. 408 and Hewison, 2000, p. 198-200. The most systematic analysis of the Thai business class with a clear distinction between the ways of the older established Bangkok metropolitan business, the provincial businessmen, and the later generation of outward-oriented entrepreneurs was carried out by Pasuk and Baker, 1995. Hewison (2000)'s analysis supports this
of the Prime Minister, to meet the demands of coalition partners as well as the need for personal allies in the government. In this scenario, persons without suitable expertise were likely to be appointed to these agencies, which jeopardized both their efficiency and independence in managing macroeconomic stability.\(^\text{92}\)

Further, no major institutional innovation took place to manage the very high industrial and service sector growth since the late 1980s. The Ministry of Finance continued to define the economic policy framework for the country, and the central bank continued to attempt the traditional conservative macroeconomic management, which became increasingly difficult subsequent to the capital account liberalisation set in motion since 1992. As much as all these political economy changes had crucial implications for macroeconomic stability, they also augured important implications for industrial restructuring, as the reliance on export-led growth increased in the 1990s. In many areas such as labour policy, regional zoning for industrial dispersion, etc. the government reacted to the boom by retreating towards laissez-faire.\(^\text{93}\) And as we shall discuss in various subsequent sections, in other areas such as industrial upgradation and deepening, technological capability development, etc. despite the various government pronouncements, no serious or sustained efforts were taken to effectively bring about the desired changes which were crucial for sustaining momentum in export-led industrial growth.

As we have seen in Chapter I, Taiwan, South Korea, and Singapore had all afforded a central role to an autonomous state in the development of export-oriented, capitalist economies. Thus, strong state capacity to direct industrial policy has been associated with these NICs, which have been able to develop fundamentally strong industrially bases. But, in Thailand, as Jomo et al. (1997) has pointed out, the trend of change in economic strategy- from import substitution to export orientation- coincided with a political trend away from military domination in politics towards greater democracy and increased business influence in policy formulation.\(^\text{94}\) This tended to aggravate the conflicts between the various dominant interest groups and further while emphasizing the changes in the first set of capitalists through the export-oriented boom and financial liberalization.

---

\(^\text{92}\) See Suthiphand and Erdmann-Keefer, 1998, p. 273 and Unger, Danny, 1998, Building Social Capital in Thailand, Cambridge University Press, p. 76. The increased political interference also tampered with the BOT's ability to monitor banks and finance companies in the mid-1990s. For political reasons, the BOT was forced to delay measures to counter-act the development of rising non-performing loans linked to the real estate sector and issue rules for adequate risk coverage, which came too late. The Chavalit government suspended three senior central bank officials, who were connected to the prosecution of former officials from the Bank of Commerce, which had collapsed under a heavy debt burden. All these interfered with the Bank's functioning.


\(^\text{94}\) See Jomo et al., 1997, p. 75. See also Laothamatas, 1992 b, Business Associations and the New Political Economy of Thailand, Institute of Southeast Asian Studies, Singapore and Westview Press.
encouraged short-termism in economic policies. While the momentum generated by financial sector liberalisation and expansion in service sector activities was fundamental to the changes, the fact that the business and bureaucracy grew more confident following the boom years also contributed to the sluggishness in undertaking measures aimed at restructuring the production sector, before the massive export growth slowdown in 1996 brought things to a head by early 1997.

3.3 MACROECONOMIC POLICIES AFFECTING INDUSTRIAL RESTRUCTURING

Having looked at the overall trends in policy formulation, economic circumstances, and structural changes, below we specifically look at trade and fiscal policies, monetary policies, and financial sector development policies.

3.3.1 Fiscal Policy, Trade Policy and Export Promotion

While strict budgetary discipline was one of the cornerstones of traditional Thai macroeconomic management, the role of fiscal policy in industrial promotion has remained relatively low, reflecting the government's orientation towards the free market principle. The focus of the ensuing analysis is thus restricted to the use of tariffs, although other tax measures also come under discussion wherever applicable.

Despite the fact that import-substituting industrialisation (ISI) was not an explicit or major policy goal for a long time owing to the dependence on agricultural exports, the tariff structure became one of the major factors affecting Thai industrial structure after 1960. In 1960, the new tax rates imposed on all trade had begun to provide a certain degree of protection. Further, there was a major change in 1964 aimed at raising the 1960 tariff rates on products with low tariff rates. The ad valorem rates for most industries, except processed foods, alcoholic beverages and tobacco, were in the range of 20-30 percent. Further, before the late 1960s, there was little escalation in the tariff structure in the sense that finished goods were not subject to much higher rates than inputs.

After analysing the pattern of tariff policy changes in the sixties and seventies, Suphat (1995) has shown that during the period 1961-81, import tariffs were typically used as a means to raise government revenue, to correct balance-of-payments problems,

---

95 The state has been relatively passive in the economy: throughout the 1970s and 1980s budget expenditure as proportion of GDP was rarely above 17% (much of it involving military and administrative expenditure), while public investment as a proportion of gross domestic fixed capital formation averaged only a little over 6% during the 1960s and 1970s. See Falkus, Malcolm, 1995, in Medhi Krongkaew, ed., p. 23.

96 Jeerasak, 1985, p. 127.
and to fight inflation. A major consequence of this policy pattern was an increase in the intensity of industrial protection over the years. Agricultural products faced a negative rate of protection not only because they had to pay export taxes, but also due to the fact that imports necessary for agricultural production, such as fertilisers and farm machinery, were subject to import tariffs. On the other hand, domestic manufacturing industries benefited from industrial protection, whether for import substituting or not. In the 1970s and 1980s, the effective rates of protection within the manufacturing sector were found to be favourable towards consumer goods such as beverages, tobacco and processed food, followed by transport equipment and other durable consumer goods. In general, it was found that over the period 1960-87, export industries received the lowest effective protection, followed by import-competing industries, while non-import competing industries received the greatest protection.

However, over time, the tariff structure had become more sophisticated by grading tariff levels to facilitate imports of intermediate and capital goods. This differentiated tariff structure that levied progressively higher tax rates on finished products encouraged the setting up of several assembly-type industries to supply domestic market demand, especially in the consumer durable and automobile industries. In many instances, local import firms joined with their overseas supplier to form joint ventures and began manufacturing the previously imported products inside the tariff wall.

Later on, even as the NESDB promoted a shift towards export orientation from the Third Plan, estimates of effective rate of protection for 1984 still confirmed this bias in the tariff structure in favour of import-competing industries and against export industries. Specifically, in 1974 and 1978, when the government ostensibly promoted manufactured exports, tariff protection for domestic industries was increased. In fact, the protection of intermediate and capital goods that was brought into effect in conjunction with the

---

98 As Jomo et al. (1997:60) has argued, the rise in tariff protection was also linked to the baht-dollar peg. From around the mid-1970s, the value of the US dollar had risen compared to the currencies of Thailand’s other major trading partners. Therefore, the tariffs on consumer goods had to be steadily raised during the 1970s and early 1980s, to prevent the overvalued baht from generating excessive imports.
99 See Suphat, 1995, p. 72-73. Empirical studies of effective rate of protection (ERPs) in Thailand since the 1960s have used different sets of data, different product definitions, as well as different methodologies. For example, some studies use the official tariff rates, while others use tariff rates estimated from customs duty collections or price comparisons. Nevertheless, summarizing the results of these different studies, Warr (1993: 40-43) has also shown that these studies show the same pattern from the sixties until the nineties.
100 See Jomo et al., 1997, p. 60-61.
101 Examples of products which received high effective tariff protection during the sixties and seventies were textiles, leather products, cooking oils, bakery and wheat products, cosmetics, rubber products, ceramics and earthenware, household electrical goods, motor vehicles, jewellery and cigarettes. See Suphat, 1995, p. 73. Also see Pasuk and Baker, 1995, p. 136.
102 Somsak, 1993, p. 141.
development of the Eastern Seaboard in the Fourth Plan period (1977-81) have prompted some economists to view this period as the second import-substitution period in Thailand.

Where export incentives have been provided to enhance manufactured exports, these were partly offset by the negative effects of high tariff protection or the overall inward orientation of the bureaucracy. The tax rebate scheme is an example of the latter, where the process of claiming export-tax rebates took a long time, until the system was improved with the introduction of bonded warehouses in the mid-1980s. Again, although the BOI also provided investment promotion for exporting firms, only those firms that exported 80% or above of their total production could avail these promotional privileges. The impact of export promotion measures since the early 1970s was also blunted by the strong baht. As we saw in the earlier section, this situation changed only as the worsening revenue condition following the second oil crisis, ultimately brought pressures on the government to devalue the baht.

The 1981 devaluation effectively reduced the protection to domestic manufacturing industries and simultaneously reduced the bias against export industries. In 1982, the government had also announced a reduction in protection on finished consumer goods and increased the protection on intermediate goods and capital goods. However, when the traditional method of restoring macroeconomic stability through tightened credit and restraining imports did not work, the government finally undertook another major devaluation of the baht by 14.8% in 1984. This resulted in a further reduction of the effective rate of protection from 28% to 26% (See Suphat 1995, Table 3.4).

But, persistent budget deficits throughout the early 1980s made it necessary for the government to increase import tariffs. In 1985, there was an across-the-board increase of tariffs. This caused the effective rate of protection to increase again from 26% in 1984 to 30% in 1985. Thus, the government’s efforts to reduce tariff protection during the first half of the 1980s were unsuccessful due to the recurring problems of fiscal and balance-of-payments deficits. Measures taken to reduce protection levels and rationalise the tariff structure as part of the industrial restructuring plan were compromised, some of which was also motivated by lobbying from interest groups. The introduction of the value-added tax (VAT) was also postponed on several occasions. Ultimately, overall protection in the 1980s remained similar to that in the 1970s. Thus, in the late 1970s and early 1980s, while Thailand was an open economy in

---

some aspects, the policy regime retained some aspects of ISI, with compensatory promotion for exporters.\textsuperscript{105}

However, as mentioned earlier, the 1984 change in exchange rate management reflected a landmark shift in attitude among Thai policymakers. It signalled that the government had committed itself to a strategy of exporting its way out of the payments crisis.\textsuperscript{106} After the mid-1980s, the tariff policy became intensely focussed on facilitating export expansion, rather than being driven by government revenue-generation and BOP stabilisation pressures. In 1985, the government reduced import taxes for materials used in exports, and abolished several export taxes. In the following year, business tax was revised to reduce its adverse impact on labour-intensive manufacturing. These tax reforms were facilitated by the unexpected upturn in the economy since 1986, which enabled the government to collect much larger tax and non-tax revenues without having to increase tax rates.\textsuperscript{107} This in turn was made possible because of the increased economic activity and the broadening of the tax base owing to an increase in the share of formal-sector employment in total employment.\textsuperscript{108} Meanwhile, the Department of Export Promotion (DEP) in the Ministry of Commerce was created to deal with export promotion specifically.

Beginning in 1988, the government began to reduce the high tariff rates as the Bank of Thailand also pressed for rationalisation of tariffs to facilitate export growth. The finance ministry did not oppose such cuts to its major revenue source, since the economic boom had increased the overall government revenue, as mentioned above. After a first round of tariff cuts in 1988, the government continued to liberalise the trade regime. In late 1991, tariff protection on capital goods, which was as high as 35% was reduced to 5% on average.\textsuperscript{109} The finance ministry also cut corporate taxes and personal income taxes. After a long delay, VAT was also speedily introduced in 1992 at the

\textsuperscript{105} See Nippon and Fuller, opcit.
\textsuperscript{106} See Pasuk and Baker, 1995, p. 150-151 and Jomo et al., 1997, p. 64.
\textsuperscript{107} Following the economic recovery since mid-1986, the growth rate in government revenue jumped to 15% in 1987 and to approximately 25% in 1988. Meanwhile, the fiscal restraint measures put in place since the structural adjustment period (limits on the rate of increase of public employment to not more than 2% per year and a $1 billion ceiling on annual public borrowing from abroad, which was raised to $1.2 billion in 1989) kept the growth rates in expenditures to 2.6% in 1987 and about 4% in 1988. Thus, government budget turned into a surplus in 1988. See Chaipat Sahasakul, 1993, in Warr, ed., 1993, opcit., p. 207-208.
\textsuperscript{108} It has been pointed out that the boom in land market over the late eighties too led to substantial tax increases through adjusted property values. Inflationary tax, through the income-tax-bracket creep, also provided an additional source of revenue. See Direk, 1995, "Impact of Industrialization on Government Finance", in Medhi Krongkaew, ed., opcit., p. 149.
\textsuperscript{109} In 1991, import tariffs on computer and computer products were reduced from 10-40% to 1-5%, and on machines, equipment, and chemicals for the preservation of energy and protection of environment from 10-40% to 0-5%. Based on Jomo et al., 1997, p. 65 and Suphat 1995, in Medhi Krongkaew, ed., p. 75.
standard rate of 7%.\textsuperscript{110} The beginning of the 1990s thus saw major changes in the structure of tariff protection and tax support for the cause of export promotion.

These were supported by other major policy changes as mentioned below. The government also gradually removed quantitative controls and selective bans on imports.\textsuperscript{111} Earlier attempts to enforce local content requirements were abandoned.\textsuperscript{112} In 1991, the Anand government abolished the limit on the number and model of automobiles that could be assembled or produced in the country. Bans on new ventures in industries such as glass and steel were also removed in the early 1990s. Throughout 1992, the Thai government reduced the tariff on more than 1000 items within 24 major commodity groups. This included the reduction of import tariffs on non-electrical and electrical machinery products from 20\% to 5\%.\textsuperscript{113,114}

While these tariff reform measures were carried out for enabling rationalisation and restructuring of industrial production, by the early 1990s, before much restructuring could take place, Thailand had also come under the pressures of regional and international trade agreements such as, the ASEAN Free Trade Area (AFTA), Asia-Pacific Economic Cooperation (APEC), as well as GATT (tariff reduction round). During Prime Minister Anand's time, there was a drastic shift in the regional trade

\textsuperscript{110} VAT had been planned for about ten years before it was finally put into effect in January 1992. Earlier, the main argument against the introduction of this tax was that business enterprises in Thailand generally did not keep adequate business records and accounts. Eventually, however, its speedy introduction took place in 1992, which was attributed to its eventual acceptance by the JPPCC. See Direk Patmasiriwat, 1995, in Medhi Krongkaew, ed., p. 151 and Somchai, 1995, p. 110.

\textsuperscript{111} In 1986, 65 products required import licenses. Of these, 42 were restricted to protect the producers of such products as automobiles, motorcycles, diesel engines, iron bars and rods. Except for drugs and guns, however, import licenses were granted readily. As part of trade liberalisation, however, the Anand government lifted the ban on the import of motor vehicles with engine size smaller than 2300 cc in 1991, a ban that had been in force since 1978. In 1993, there was still an import ban on 18 commodities, and special permission was required to import another 30. See Suphat, 1995, p. 75.

\textsuperscript{112} More details on local content policy are discussed in Chapter VI on technology policies.

\textsuperscript{113} See Jomo et al., 1997, p. 65 and Suphat 1995, in Medhi Krongkaew, ed., p. 75.

\textsuperscript{114} It has been pointed out that the government tended to follow the tax reforms adopted by high-income and neighbouring countries, due to increasing concerns about international competitiveness. Thus, the trend has been towards lowering of tax rates, simplification of the tax-collection process, and the adjustment of existing tax rates to more uniform rates. In fact, with the adoption of ASEAN Free Trade Area (AFTA) in 1992, the importance of tax revenue from international trade was expected to reduce following the lowering of import and export taxes. Meanwhile, the tax base, particularly, direct tax, was expected to be enhanced further, as formal employment increased. On the whole, while government revenue may not deviate from its historic growth rate, its composition was anticipated to change considerably. On the other hand, as political parties came to play an increasing role in the determination of national economic policy with increased democratisation, and as the influence of bureaucrats declined, fiscal policy was expected to move in the direction of higher expenditure and therefore, overall budget deficits. See Direk, 1995, p. 143-57, Warr and Nidhiprabha, 1996, p. 138-167, etc.
policy, towards rapid liberalisation of trade among ASEAN member countries. AFTA proposition was to make tariffs on intra-ASEAN trade in manufactured goods to the range of 5% or less and to remove quantitative restrictions (QRs) and non-tariff barriers (NTBs), over a 15-year period beginning 1 January 1993, according to the Common Effective Preferential Tariff (CEPT) Agreement. The main objective was increasing ASEAN competitive edge so that ASEAN would become a larger market to support economies of scale, which would in turn make the region more attractive to foreign direct investment and lead to a higher level of industrialisation for the region as a whole.\(^{116}\)

However, in September 1994, ASEAN members decided to shorten the time frame for the realisation of AFTA from 15 to 10 years, finishing by 1 January 2003, instead of 2008, and to include unprocessed agricultural products as well into the CEPT scheme. Subsequently, while the tariff reform since 1990 had been implemented on an industry-by-industry basis, the reform package for the remaining products was completed on December 27, 1994, with the range narrowed to 0-80% compared to the range between 0-100% before. The highest rate was set for passenger cars (80%), followed by luxury goods (40-60%). While finished products attracted a tariff rate of 20%,\(^{117}\) tariffs rates for intermediate products were set at 10%, primary products and capital goods at 5%, and raw materials not produced locally at 1%. Products requiring extra protection were to be taxed at 30%. This tariff structure has been put in place except for agricultural primary products. The tariff rates for the latter are expected to be reformed according to the obligations under WTO by 2008.\(^{118}\)

---


116 ASEAN countries were to reduce tariff levels at varying speeds and the traded commodities were categorized into various categories subject to different rates of liberalization, namely, inclusion list, fast track, normal track, temporary exclusion and sensitive list, etc. The fast track program was to: (1) reduce tariffs above 20% to 0-5% within 7 years (by 1 January 2000); and (2) reduce tariffs at 20% and below to 0-5% within 5 years (by 1 January 1998). Industries included in the fast track list were, for example, vegetable oils, chemicals, fertilisers, rubber products, paper, ceramics and glass products, cement, wooden furniture, pharmaceutical products, plastics, leather products, textiles, gems and jewellery products, copper cathodes, and electronics. The normal track program was to: a) reduce tariffs above 20% in two stages- first to 20% by 1 January 1998, and then to reduce them to 0-5% by 1 January 2000; and b) reduce tariffs at 20% and below to 0-5% by 1 January 2000. Sensitive products not ready to be included in the CEPT could be excluded temporarily, but they were required to be transferred into the Inclusion list 20% annually. By 1 January 2003, all these products should be in the 0-5% range, with QRs and NTBs removed. This includes unprocessed agricultural products as well, except for those in the Sensitive list.

117 Products required for special treatment such as medical or surgical instrument, however, are levied zero percent duty.

The immediate effect of the reform was that the maximum tariff was reduced from 100% to 30% in most cases. Approximately 4000 items have lower tariff rates, which cut the average applied tariff from 30% in 1994 to 17% by 1997. While tariffs on intra-ASEAN trade were being lowered, multilateral tariffs were also falling due to the WTO. However, significantly, because of the conflicts of interests among different industries, a large number of products were classified in the higher tariff categories so that their tariffs remain unchanged. This came about because intermediate producers have not been willing to give up their protection.\textsuperscript{119} Thus, the new tariff structure still exhibits tariff escalation in favour of domestic finished products, unlike in the other ASEAN member countries, which have worked unilaterally to abolish such tariff escalation.\textsuperscript{120}

Thus, in the so-called import-substitution phase, Thailand's industrialisation efforts were accompanied by inadequately formulated and poorly coordinated fiscal policies. Despite the fact that tariff policy was not considered an integral part of the IS regime and for the most part was used to raise government revenue or correct balance-of-payments problems (i.e. for addressing macroeconomic stability concerns), tariff structure came to play a major role in influencing the structure and nature of industrial expansion. Although until the 1980s, effective rate of protection was found to be favourable to import-substituting industries and unfavourable to export industries, this state of affairs did not originate from any strategic planning. In the interim period, the differentiated tariff structure which levied high rates on finished products and low on parts and components encouraged the setting up of assembly type industries to supply domestic market demand. Once the shift in the orientation of trade policy from import-substitution to export promotion occurred, this was also not supported adequately by the tariff structure, as the anti-export bias continued at least until the late-1980s. Whatever efforts were taken to reduce protection levels and rationalise tariff structure were compromised in most instances, either due to short-run macroeconomic adjustment concerns, or due to the pressure from various interest groups. It is only from 1988 onwards after the sharp turnaround in economic growth and capital inflows following the devaluation of the baht and highly favourable external conditions, that the shift to export promotion was supported by sustained efforts for rationalisation in the tariff structure.

\textsuperscript{119} An example would be the lobbying power of the upstream petrochemical industry, as a result of which many local downstream petrochemical industries have been suffering from loss of competitiveness vis-à-vis imports, following trade liberalisation.

\textsuperscript{120} Nipon and Fuller, 1997, opcit., p. 481-9.
However, before the indigenous production base could make the required transition from the high-cost production patterns under the prolonged period of protection (and constant tariff changes with a lack of direction), rapid trade and investment liberalisation was undertaken at the regional and international levels. This has been accelerated subsequent to the 1997 crisis. However, continuous production restructuring and upgradation through indigenous technological capability development is a necessary pre-condition for a sustainable shift to export-led growth, as discussed in the conceptual framework in Chapter II. However, in retrospect, it is clear that this commitment was not forthcoming among Thai policy makers and a large section of the Thai entrepreneurs.

Continuing from this discussion of overall trade policy, we analyse the general and certain specific export promotion policies in the following section.

3.3.2 Other Export Promotion Policies
The general tax incentives provided to exporting firms, operated by the Fiscal Policy Office (FPO) of the Ministry of Finance, include exemption from export duties, exemption or drawback or reduction of excise tax, and entitlement to a zero percent rate for value-added tax (VAT). Apart from these, there is a comprehensive tax refund system for all import duties incurred in the production of goods for export, offsetting the tariff protection for exporters. Imported inputs for manufactured exports are also exempt from taxes such as business and municipal taxes. While refund of duties and taxes on imported inputs are granted by the Customs Department, the refund of taxes on domestic inputs are granted by the FPO. Under the Customs Duty Drawback Scheme, manufacturers who export their products will have the import duties already paid on imported raw materials and components, refunded in full as drawback.

Other export incentives are provided in the form of bonded warehouses and export processing zones (EPZs). Bonded manufacturing warehouses enable firms manufacturing for exports to bypass customs procedures when they import inputs to be used for producing, mixing, or assembling for export. On the other hand, EPZs have

---

121 By 1998, Thailand had as many as 9046 tariff lines in the Inclusion list of CEPT scheme and only around 73 and 7 products respectively in the temporary exclusion and sensitive lists. No product in the Inclusion List could have CEPT tariff rates higher than 20%. More details of the post-crisis changes are discussed in Chapter X.

been established as special areas within industrial estates,\textsuperscript{123} for the specific purpose of encouraging manufactured exports. While all firms locating in industrial estates receive benefits such as physical infrastructural support, permission for foreign firms to own land in the estates, to hire and maintain foreign technicians and experts in the country, and the permission to remit foreign exchange abroad; firms in the EPZs additionally enjoy complete exemption from import duties, import surcharges, export duties, as well as exemption from VAT and excise duties on all items brought into the EPZ for export production.\textsuperscript{124} There were some nine EPZs operating as of 1997. Most of the industrial estates also received promotion from the BOI, which brought an additional exemption from corporate income tax for the firms, for a period of three to eight years from the date income is first derived from the promoted production.

Other trade policy measures include quantitative restrictions, credit assistance to importers and exporters, and tax rebates for exports. Apart from the quantitative restrictions on imports mentioned earlier, the Ministry of Commerce also administers export controls through the export licensing system.\textsuperscript{125} In the early nineties, export controls were placed on 38 commodities, 16 of which were outright bans. The most well known of export quotas are those imposed in accordance with bilateral or multilateral agreements. In 1992, they were imposed on tapioca products exported to the EU, textiles and garments exported to some countries like the US, and on sugar.\textsuperscript{126} Exports of items such as paper, pesticide, flat iron sheets, poly fibre and cement were also regulated.\textsuperscript{127} Export duties have been generally imposed on only seven groups of commodities, namely, rice, scrap iron, rawhide, rubber, wood, raw silk and powdered fish. In addition, export duties could be levied on certain items to prevent the imposition of countervailing duties or anti-dumping duties by some importing countries.\textsuperscript{128}

\textsuperscript{123} The Industrial Estate Authority of Thailand has been established as a state enterprise under the Ministry of Industry to implement the government’s industrial development policy by attracting foreign investment and promoting industrial decentralisation. Since 1972, more than 40 industrial estates have been established, with many more under construction. As of end-1996, there were about 45 industrial estates. Of these, about 21 estates have been run by the IEAT itself or by the IEAT in joint venture with private firms. The others are run independently by private firms. The Thai Factory Development Co. Ltd., founded in 1979 as a subsidiary of the quasi-governmental Industrial Finance Corporation of Thailand (IFCT) has played a key role in industrial estate development.

\textsuperscript{124} Nevertheless, import and export entries are processed for all goods entering and leaving the EPZs, and duties and taxes are collected on any goods that are sold in the domestic market. Lawan Puwan, FPO.

\textsuperscript{125} These aim at preventing or relieving critical shortages of certain food items and raw materials, regulating exports, conserving wild life, environment and energy, maintaining standardised exports and minimum price controls, and honouring bilateral agreements. There are also controls by other ministries for health and safety reasons.

\textsuperscript{126} Atchaka and Brimble, 1992, p. 19.

\textsuperscript{127} Warr, 1993, p. 39.

\textsuperscript{128} Currently, rice, scrap iron, rubber, raw silk, and powdered fish are exempted from export duties. FPO, 1998, p. 32.
In addition to the above incentives, the Department of Export Promotion (DEP) under the Ministry of Commerce is responsible for developing and promoting Thai exports by providing information on potential customers and markets to promote Thai exports overseas. DEP tends to concentrate on promoting traditional exports of small and medium Thai firms such as garments, jewellery, and leather products rather than higher-technology products. The Ministry of Commerce also provides technical assistance through its Export Service Centre. During the Seventh Plan period (1992-96), several services provided by the government were improved to better support the fast-growing export sector.

Some home country government policies, which influenced exports from Thailand (and also influenced FDI inflows during particular phases) include the provisions under the Generalised System of Preferences (GSP), which unilaterally exempts or lowers imports duties on exports from developing countries. Thailand enjoys GSP privileges from most developed countries such as the US, EC countries, Australia, and New Zealand. In addition, some home countries encourage Thai exports to their countries by organising trade missions to Thailand, providing information on buyers and exporters, and assisting Thai firms to improve product quality. For instance, through its Japan External Trade Organisation (JETRO), the Japanese government has actively helped Thai firms to export to Japan, by sending experts to advise Thai firms to improve their quality of their products to meet Japanese tastes and standards in such areas as garment, food, ceramics, etc.\(^{129}\)

Within the country, a number of private organisations such as the Board of Trade, the Federation of Thai Industries, various foreign chambers of commerce and industrial associations also assist their members, by providing information on export opportunities, organising trade missions abroad to participate in trade fairs and arranging interactions with foreign trade missions or foreign buyers. However, in general, the focus of such associations has been to act as lobbying groups to further the interests of their members, and as such have not been found to be very effective in serving as vehicles for information dissemination, technology transfer, or other related activities.\(^{130}\)

### 3.3.3 Monetary Policy and Exchange Rate Management

The maintenance of monetary and financial stability, as discussed in the beginning of the Chapter, has been a central component of Thai macroeconomic management designed to foster trade growth and attract foreign capital. Thus, historically, Thai financial system was highly regulated and was shielded from both domestic and foreign

\(^{129}\) See Atchaka and Brimble, 1992, UNCTC, p. 23.

\(^{130}\) See for example, Atchaka and Brimble, 1992, UNCTC, p. 19.
competition. Until 1986, the Bank of Thailand’s lending rate was the most frequently used monetary instrument. Historically, since 1924, general interest rates had been restricted to remain within 15%. Maximum interest rates on lending and borrowing were kept constant at 14 and 7 per cent respectively during 1966-1973. As a result, throughout the period 1950-70, annual inflation averaged only about 5% per annum.\textsuperscript{131} The two oil shocks significantly disrupted this regulatory system by raising the rate of inflation and driving domestic interest rates to negative levels.\textsuperscript{132} Overall, except for these two brief periods of external price shocks, the record of inflation in Thailand had been moderate. This was essentially owing to the fact that its discretionary monetary policy operated effectively in the short run in a stabilising manner until 1990. This occurred even though Thailand simultaneously pursued a fixed exchange rate, because during the earlier decades, Thailand had only a limited degree of capital account convertibility.

From 1986 to 1989, there were no changes in the bank rate. This was basically due to the fact that the authorities gave priority to restoring economic and financial stability in the domestic financial system, which was brought to a crisis by ailing finance companies, problematic banks and the failures of various chit funds. The approach adopted to overcome these difficulties was through a coordinated monetary and fiscal policy.

This coordination of monetary and fiscal policies has also been pointed out to be significant in Thailand’s macroeconomic management until the early 1990s. Following the export boom in the late 1980s, despite the large surplus in the balance of payments there was only a moderate increase in the monetary base, due to a budget surplus. Instead of spending the increased revenue resulting from the boom (as discussed in the earlier section), the government had used it to retire external government debt, thus mitigating the expansion of the monetary base that would have been induced by the rising level of international reserves.\textsuperscript{133}

However, from a relative stable interest rate regime, in June 1989, the ceiling on the interest rate on long-term fixed deposits of over one year was abolished. Further, the


\textsuperscript{132} In 1974, both lending and borrowing rates were raised by one percentage point each. But, as inflation rose to 15.4% and 24.3% in 1973 and 1974 respectively, the real deposit rate was negative. In 1980, after the second oil price shock, interest ceilings were each raised by three percentage points. However, the real deposit rate was still negative, as inflation had risen to 19%. The interest rates were restructured in 1980 and 1981 to re-establish positive real interest rates. See Warr and Nidhiprabha, ed., 1996.

\textsuperscript{133} See Warr and Nidhiprabha, 1996, p. 204.
interest rate on fixed deposits of less than 200,000 baht was exempted from tax.\textsuperscript{134} But, it was the liberalisation of capital controls in the early 1990s that removed much of the basis for Bank of Thailand's monetary autonomy. With near-perfect capital mobility, the central bank could not sterilise the effects of capital inflows, as long as the exchange rate remained fixed. A detailed discussion of the implications of the financial liberalisation process set in motion in this phase is carried out in Section 3.3.4.4.

As mentioned already, in order to create a favourable investment climate and to achieve the key economic goal of currency stability, Thailand had also pegged the baht to the dollar from the 1950s onwards. Since devaluation had been considered as a capitulation to inflation, Thailand's long-term commitment to low inflation was accompanied by a great reluctance to use the exchange rate as an instrument of discretionary macroeconomic management. Thus, devaluation occurred infrequently in response to serious problems of external balance, and only when other corrective measures had all been tried and failed.\textsuperscript{135} From 1961 to 1980, the exchange rate between the baht and the US dollar remained at around 20 baht per US dollar. This long history of stable exchange rate achieved the goal of ensuring that Thailand's trading partners and foreign investors were confident about stability.

Initially, this pegging to the US dollar improved the competitiveness of Thailand's exports. This came about as the baht depreciated substantially against the non-dollar currencies, subsequent to the realignment of the major currencies in 1971. From around the mid-1970s, however, the value of the US dollar rose compared to the currencies of Thailand's major trading partners (mainly Japan and Europe), and the baht was pulled along by the strong dollar. As long as world demand for agricultural products remained strong and prices were rising, the rise in the baht's value presented no serious problem. It helped maximise returns to agricultural exports and reduced the costs of necessary imports such as fuel and capital goods. But, when import-substitution industries reached their limits and more significantly, due to the balance of payments crisis,\textsuperscript{136} the technocrats at the Bank of Thailand were convinced of the need to correct the overvalued currency.

Thus, in May 1981, the government devalued the baht by 1.1\%, immediately followed by 8.7\% in July 1981. There was a further 14.9 per cent devaluation of the baht.

\textsuperscript{134} See Bhanupong Nidhiprabha, 1993, in Peter Warr, ed., p. 188-6.
\textsuperscript{135} These other means included an increase in import tariffs as we have seen earlier, contractionary fiscal and monetary policies, and credit controls. See Warr and Nidhiprabha, 1996, p. 205, 210.
\textsuperscript{136} The level of Thailand's international reserves declined from 1979 to 1985. In particular, the adequacy of reserves taken into account in terms of the number of months of imports covered were at historical low levels in early 1981 and late 1984, just before the two devaluations were effected.
against the US dollar in November 1984 and another 1.9% in December 1985.\textsuperscript{137} These devaluations raised the exchange rate to 27 baht per US dollar by the end of 1985. The government was able to contain the inflationary effects of devaluation, by keeping the increase in real minimum wage rate low, freezing electricity tariffs, reducing import duties and income taxes, and setting maximum prices for vital commodities.\textsuperscript{138} 

After the 1984 devaluation, Thailand pegged the baht pegged to a basket of currencies. The basket regime was adopted until June 1997. However, since the US dollar was presumed to carry a large weight in this basket, the baht had remained closely linked to the dollar.\textsuperscript{139} However, the dollar itself declined sharply against yen and major European currencies. Thus, since 1985 the baht depreciated by roughly 100 per cent, not only against the yen, but also against the Swiss franc and German mark, and by 50 per cent against the British pound.\textsuperscript{140} This large exchange rate advantage was a major factor behind Thailand's success in attracting export-oriented FDI during this phase.

The fact that the yen and other currencies had begun depreciating against the dollar again since the mid-1990s meant that baht would have appreciated in real terms, and that would have influenced the competitiveness of Thai exports. However, Warr (1998) has shown that most of the real appreciation of baht from 1990 to mid-1997 was already evident by mid-1994, well before the appreciation of the US dollar began. The principal factors behind this appreciation were the demand effects of the large foreign capital inflows following financial liberalisation, which were only partially sterilised under the fixed rate regime.\textsuperscript{141} This real appreciation had undermined the competitiveness of Thailand's tradable goods sectors, at the same time when the government was believed to be promoting exports and export-oriented FDI aggressively. We shall explore the consequences of this in the analyses in the following chapters.

Thus, as we saw from the discussion above, historically, the changes in Thai monetary policies were directed to favour the development of the domestic financial sector and to ensure monetary and financial stability. Both of these were traditionally

\textsuperscript{137} Since inflation was high in 1980 and 1981 at 19.7 and 12.7% respectively, the authorities were reluctant to devalue at a high rate initially. In contrast, the inflation rates in 1983 and 1984 were only 3.8 and 0.9% respectively. The decision to devalue by 14.9%, the largest in Thai history, thus became acceptable, especially with support under the IMF and World Bank loans to offset the impact. See Warr and Nidhiprabha, 1996, p. 211 and Pasuk and Baker, 1995, etc.

\textsuperscript{138} See Warr and Nidhiprabha, 1996, p. 213.

\textsuperscript{139} In fact, during this period, the Exchange Equalization Fund (EEF) would announce and defend the baht value against the U.S. dollar daily, while monetary and financial measures were mainly designed to be in line with the pegged exchange rate regime. See Bank of Thailand, Monetary Policy at www.bot.go.th

\textsuperscript{140} Falkus, 1995.

considered necessary for achieving sustainable economic growth over the long run. However, the liberalisation policies since the late eighties were largely directed towards increasing overall foreign participation in the evolution of the Thai financial sector. This was to have crucial implications for macroeconomic stability and the sustainability of FDI-led industrial development and restructuring.

3.3.4 The role of Financial Sector Evolution

Despite the limits on deposit and lending rates as part of the conservative monetary policy, real interest rates usually remained positive as discussed above and were high enough to attract financial savings, and enabled considerable financial deepening in Thailand. By the mid-1960s, the Bank of Thailand had succeeded in making the public feel confident about putting their money in commercial banks, and since then, bank deposits had increased rapidly.\textsuperscript{142} The ratio of financial assets to GDP increased from 40\% in 1960 to 120\% in 1990.\textsuperscript{143} By the 1990s, Thailand's organised financial markets consisted of commercial banks, finance, securities and credit companies, specialised banks, development finance corporations, insurance companies, savings cooperatives, the stock exchange, and a variety of mortgage institutions. Among these, commercial banks have been the central players, representing the largest components of total assets, total deposits, and credit extended.\textsuperscript{144} The second largest group is the finance companies, which began operating in 1969. The three specialised banks- the Government Savings Bank, the Bank of Agriculture and Agricultural Cooperatives, and the Government Housing Bank; and the two development finance corporations; and the stock exchange have also played varying roles over the years.

3.3.4.1 The Role of Commercial Banks and Finance Companies in Credit Assistance

Since the 1950s, a handful of local banks established by Sino-Thai merchant/industrial families to support financing of trade and to ensure availability of capital have dominated Thailand's commercial finance sector.\textsuperscript{145} The most successful of such operations found patron-client ties with government officials to be highly

\textsuperscript{142} Kunio, Yoshihara, 1994, The Nation and Economic Growth, The Philippines and Thailand, Oxford University Press, Kuala Lumpur, p. 76
\textsuperscript{143} Warr and Nidhiprabha, 1996, p. 38.
\textsuperscript{144} In 1990, they accounted for 71\% of total financial assets in the country. Warr and Nidhiprabha, 1996, p. 39.
\textsuperscript{145} Prior to that, foreign banks, beginning with the establishment of an HSBC branch in 1888, dominated the history of commercial banking in Thailand. They were primarily engaged in financing European trade. Prince Chaiyanantamongkol established the first indigenous bank, the Siam Commercial Bank, in 1906. Others, mostly Chinese local banks, were established later, mainly to support Chinese rice milling and exporting businesses and to transmit remittances back to Mainland China. However, all foreign banks were forced to suspend operations following World War II, and this provided the opportunity to five local banks to replace them successfully. See Naris Chaiyasoot, 1993, in Warr, ed., The Thai Economy in Transition, p. 226.
instrumental.\textsuperscript{146} Thus, the domination and expansion of these commercial banks had been sustained by the government’s financial policy. Although interest rates were controlled, these tended to be minor. On the other hand, Thai commercial banks benefited from various protective regulations such as prohibition of new entry—both domestic and foreign,\textsuperscript{147} limiting activities of finance companies, hampering the market for corporate debt,\textsuperscript{148} and bailing out troubled banks with soft loans. The huge economic rent generated for the banking business by these regulations, led to the development of strong commercial banks with a high degree of ownership concentration. By the 1970s, the Thai banking industry had come to be dominated by 16 families of Chinese origin.

From the early 1970s, though, growing concern about the power of the major banks had prompted the central bank to encourage the entry of finance companies as an alternative source of capital intermediation.\textsuperscript{149} It established separate rules for finance companies, which gave them some competitive advantage against banks in corporate financing. But, this policy failed to dilute the control of the major banks, because many of the finance companies themselves had Thai banks as the major shareholders. Nine of Thailand’s ten largest finance companies were affiliated to the five major banking groups.\textsuperscript{150} Until 1979, finance and securities companies grew rapidly, but the quality of their performance was questionable. Subsequent to the failures during 1979-86, the number of finance companies dropped from 112 in 1982 to 94 in 1987.\textsuperscript{151} On the other hand, the banking industry still consisted of only 15 local banks by 1990—dominated by the Bangkok Bank and three other banks namely, the Thai Farmers’ Bank, the Krong...
Thai Bank, and the Siam Commercial Bank. 153,154 Fourteen foreign bank branches also existed, but they accounted for only 5% of the total bank assets in the country. 155 Meanwhile, bank credits as a percentage of GDP had grown considerably, following the rapid rise in bank deposits. But, the concentration of banking finance in a few large banking families gave them the opportunity to decide which industries will develop, and they would brook no interference or serious competition. 156 Further, since there was no separate market for corporate bonds, and firms not listed in the stock market could not issue bonds, this concentration of capital in a few large commercial banks necessitated the organization of businesses into large vertically-integrated groups clustered around the banks and/or finance companies, to secure financial flows. 157 The possibility of a biased loan portfolio was thus significant, more because the five major banking groups also engaged in non-banking activities. 158 The absence of a coordinated industrial policy or specific sectoral policies on the part of the government implied that this would not have been countered by any strategic intervention from the government’s side.

Thus, although Thailand has used neither a credit instrument nor a foreign exchange allocation instrument as part of its industrial policy, the clients of the dominant commercial banks grew the fastest because of their privileged access to scarce funds. Thus, while the government might not have officially given special favours to individual firms, it was different informally. 159 The Thai banking industry’s cartel-like structure with its sixteen banks organised loosely under the Thai Bankers Association, possessed substantial power in dictating the cost and allocation of domestic credit and in

153 The Bangkok Bank dominated approximately one-third of the Thai banking system. Together, these four banks accounted for three-fifths of the total assets and 56% of the deposits in the banking industry in 1988, reflecting the very high degree of concentration in the Thai commercial banking system. The share of the four major banks in total deposits and credit increased further to 70% in 1990. See Naris, 1993, in Warr, ed., p. 236 and Warr and Nidhiprabha, 1996, p. 40.

154 Of the 16 commercial banks, Krung Thai Bank had majority government ownership, Siam Commercial Bank was majority owned by the royal family’s Crown Property Bureau, Sayam Bank was partly owned by the government, and the Thai Military Bank was owned by military organizations. All the rest were privately owned.

155 Foreign banks operated at a competitive disadvantage in relation to local banks. They had to pay a withholding tax on dividends transferred abroad; they could not be quoted on the stock exchange since they are subsidiaries of overseas parent companies, and thus could not apply for the 30% concessional corporate tax rate; and most importantly, they were prohibited from opening new branches. See Warr and Nidhiprabha, 1996, p. 39.

156 See Hewison, Kevin, 1989, p. 113. Although lesser than that in the commercial banks industry, concentration in the finance companies’ industry was also high, with the top five companies’ assets accounting for 29% of the whole industry’s assets in 1990. See Pakorn, 1994, p. 40.


158 In 1979, the five major banking groups were already investing in 225 non-financial firms. See Naris, 1993, p. 237.

159 See Jomo et al., 1997, p. 77 and also Pasuk and Baker, 1995.
influencing the effectiveness of Thai monetary policies. Leading clients of the major banks together with the Thai Bankers’ Association have also functioned as powerful lobbies for all forms of government assistance. The four largest banks dominated the inter-bank loan market as well, since they were the main suppliers of liquidity for smaller and foreign banks. In addition, they were the leading players in foreign exchange transactions and thus could exert a degree of control on the supply of foreign exchange too.

Government regulation of credit allocation happened mainly during the period of agricultural exports-led growth, when steps were taken to direct credit towards agricultural output expansion. This was attributable to the fact that from the mid-1960s, the returns from uplands cash crops had played a major role in the balance of payments and the government had an interest in promoting their expansion. From 1966, the government had promoted the Bank of Agriculture and Agricultural Cooperatives (BAAC) under the Ministry of Finance, to provide farmers and cooperatives with concessional credits. From 1975, the government also required that the commercial banks should lend at least 5% of their deposits to the ‘priority sector’, namely agriculture. This ratio was raised to 13 per cent in 1979, of which 2 per cent was demarked as loans to agro-businesses. In 1987, the aggregate ceiling was raised further to 20 per cent, with the coverage widened to include rural and small-scale industrial enterprises. As most commercial banks found it difficult to administer loans to small and medium peasants and administered loans to those with enough collateral, they preferred to lend to big agro-businesses or to make deposit with the BAAC, which in turn lent mainly to large agro-businesses or big cultivators. It has in fact been shown that despite government efforts to direct funds to that sector, agriculture’s share in commercial banks credit had reached only 6.6% in 1988.

The majority of commercial bank funds have historically flown into the export-import and domestic trade sectors. In 1988, the manufacturing’s share was low at about 26%. Although the latter was an increase when compared to the 1970s, this was insufficient for a sector that had come to play an increasing part in the national output and export growth. Further, it was mainly the large business customers who appeared to

160 Under the Association’s auspices, the banks collectively set the standard rates for service charges and loan rates. Because of this oligopolistic structure, it took time for all the banks to agree on the same adjustment, particularly in the downward direction, with the result that interest rates (on loans and deposits) adjusted rather slowly to market conditions. On the other hand, the decisions of the large banks to adjust interest rates used to be followed, to some extent, by small and medium-sized banks. See Warr and Nidhiprabha, 1996, p. 40, and Pakorn Vichyanond, 1994, Thailand’s Financial System: Structure and Liberalization, TDRI, p. 33-34.

161 See Section 3.2 for a more detailed discussion of the role of agro-processing industries.
benefit from such loans. Meanwhile, commercial bank funds going to real estate business also increased from 1987 onwards. Thus, there were initially no moves for financing industrial expansion similar to that observed for agricultural expansion during the period of primary sector-driven growth, except for boosting the capital available for agro-based enterprises to develop their input sources, as they were the backbone of industrial growth during the earlier decades.

Of course, since the late 1950s, the Bank of Thailand (BOT) has offered short-term credit to industrial enterprises in the form of re-discounts of promissory notes through commercial banks. The re-discount facility has been offered to assist high-priority sectors by providing low-cost funds, to finance purchase of raw materials, and sales of production. Here again, until the late sixties, preference was given to agricultural raw materials and agro-industries; it was extended to any industry only in 1974. Since it is the commercial banks that act as the BOT agents in selecting clients, it was predominantly large firms who were initially able to meet the collateral requirement of the banks and benefit from the system. In 1979, this issue was addressed by creating a re-discount window specifically to assist small enterprises with capital investment or fixed assets with less than 10 million baht. These concessional rates were much lower than the commercial banks' average prime rate.

The amount of promissory notes rediscounted by the BOT for industrial undertakings did increase between 1963 and 1980. However, during 1981-85, the share of industrial enterprises in BOT’s total credit declined steadily due to the economic recession, and dropped from 13.9% in 1980 to only 2.1% in 1985. The major industries that utilized the BOT’s re-discount facility were textiles, non-metallic mineral products, basic metal products, and food and beverages, which together accounted for about 90% of the total amount. From 1986, the BOT’s long-standing programme of subsidies for working capital needs of agricultural exporters was also redirected to meet the needs of manufacturing exporters. By 1988, exporters of manufactures were receiving more than half (53%) of the BOT’s subsidized loans.

However, while there was continuous support for exporting industries, there was no “pick-the-winner” type of credit policy as in the case of Japan, Korea or Taiwan. This

164 In the mid-1980s, the BOT provided re-discount facilities at the rate of 5% per annum to commercial banks, which in turn lent to large enterprises at a rate of 7% per annum and to small enterprises at 8% per annum, with a maturity period of 120 days.
166 Jomo et al., 1997, p. 79.
was essentially the outcome of the fact that the government had no coherent policy to promote specific industrial sectors. Although the Board of Investment (BOI) published lists of priority sectors for investment promotion, these were not linked to any preferential credit allocation scheme. They also did not result in any concerted efforts to nurture particular industries deemed to be especially important for long-term growth. The existing credit schemes incorporating all exporting industries reflected this. Nevertheless, minor policies that favoured specific industries emerged, due to a combination of successful lobbying by industrial groups and the preferences or biases of bureaucratic factions within line ministries.  

With the acceleration of the urban economy and the export boom from the mid-1980s, the central bank put priority on liberalising and extending the financial market in order to mobilise funds for the increased levels of investment. While these liberalisation measures indeed resulted in massive fund availability, there were significant changes in the resource distribution pattern. This was to have a major impact on the requirements of the manufacturing sector in the export expansion phase, as we shall see in a following section (See Section 3.3.4.4). Before that, we examine the role played by other financial institutions and the stock exchange in the overall resource intermediation process, in the following two sections.

3.3.4.2 Other Financial Institutions and Credit Assistance

The major financial institutions that administer assistance to investors have traditionally been the Bank of Thailand (BOT), the Industrial Finance Corporation of Thailand (IFCT), and the Small Industry Finance Office (SIFO). Having already discussed the rediscount facility offered by the Bank of Thailand, below we focus on the IFCT and SIFO.

The IFCT, established in 1959 as a private corporation, specialises in providing medium-term and long-term loans in both domestic and foreign currency to industrial enterprises. The IFCT usually charges its clients a fixed interest rate, which is 1-2% below that of commercial banks. While IFCT is prohibited from accepting deposits as commercial banks do; it gets privileges from the government including, access to cheap long-term funds from the government, the BOT and foreign borrowings, and exemption from various tax obligations. The IFCT borrows a large amount of foreign currency loans from foreign money markets, enabling it to allocate foreign currency loans to projects that generate foreign currency income. However, IFCT's lending to private

\[167\] Ibid., p. 75.
enterprises had reached only 1.2% of the total credit released by all financial institutions to the private sector, even in 1992.168

Small Industry Finance Corporation (SIFC), established in 1991 is a special financial institution aiming to provide financial support to small industries, defined for manufacturing as companies with a total fixed asset (including land) not exceeding 50 million baht. Apart from production, SIFC also lends to trade (wholesale and retail) and services. The business of the Small Industry Finance Office (SIFO) under the Department of Industrial Promotion, Ministry of Industry was transferred to SIFC. SIFC provides loans differently from general financial institutions through loan analysis in terms of project financing which is based on possibility of debt repayment rather than the sufficiency of collateral.

Apart from these special financial institutions, an Export Credit Guarantee Fund provides guarantees against post-shipment risks. An Export-Import Bank was also set up to provide manufacturers and exporters with financial services to bring about more operational flexibility and enhanced international competitiveness through low-interest loans and commercial loan guarantees.169 Besides the credit-based financial intermediaries, Thailand also has capital market-based financial intermediaries.

3.3.4.3 Capital Market Development

Although the Stock Exchange of Thailand (SET) was founded in 1975, it had languished since a crash in 1979. Further, the Securities Exchange of Thailand Act of 1974 was primarily designed to regulate securities trading in the secondary, not the primary market. No agency was responsible for primary market development and thus, the mobilisation of funds through the primary market was also not significant during this period.170 Confidence in the market was revived after the Securities Act was reformed in 1984 to prohibit insider-training activities and to improve the supervisory and regulatory framework for listed companies. Following the economic recovery in

---

168 In addition to its financial services, the IFCT has established several subsidiaries to provide various support activities to industrial investors. They include: the IFCT Advisory Company which provides investment and banking services, Thai Orix Leasing Company which leases machinery and equipment; Thai Factory Development Company, which constructs modern, high standard factories fully equipped with utilities for sale on a deferred payment basis; as well as several others. IFCT also invested in a number of financial institutions and venture capital companies, apart from a few manufacturing ventures such as National Fertiliser Public Company Ltd., Strongpack Public Company Ltd., and Y.K.K.Zipper (Thailand) Company Ltd. See Pakorn, 1994, p. 51 and various IFCT Annual Reports.


170 In the ten years following the enactment of the Public Company Act in 1973, only 33 companies became public companies and only public companies could make IPOs of their shares and debentures. See Pakorn, 1994, p. 27. (It is not clear how many of them actually issued public offerings.)
1986, the SET became active again from 1987 onwards. The ratio of market capitalisation to GDP increased from less than 4% in 1980 to 29% in 1990.

In 1992, the government passed a new Securities and Exchange (SEC) Act imposing tighter regulation, setting up a supervisory commission, and prosecuting some of the more manipulative speculators. Public offering of securities was brought under the purview of the Securities and Exchange Commission (SEC). While issuance of shares and equity-related securities is still restricted to public limited companies, debt instruments could be issued by both public limited and limited companies. From 1992, commercial banks and finance companies also became eligible for carrying out the securities business. These changes represented a major overhaul of the capital markets in Thailand, since the previous regulations that were either too stringent or too complicated were relaxed. 171 Following these moves, more domestic and foreign funds flowed into the Thai stock exchange and the trading volume increased, elevating the SET index to a record high level. Further liberalisation of stock brokerage was undertaken following the reversal of international capital flows when US interest rates increased rapidly in the first quarter of 1994 and there was a drastic drop in the SET index. 172

Since 1987, the capital market recorded a large increase in the capitalisation as it increased spectacularly. However, banking and finance were the two largest sectors on the exchange, followed by various service sectors oriented to the domestic market such as property, telecommunications, and media. 173 On the whole, manufacturing sector was limited by the representation in stock market. Thus, a large part of the increase in market capitalisation in the 1990s only facilitated speculative activities and hence, it had very little effect on the mobilisation of funds for the exporting and other manufacturing sectors.

3.3.4.4 The Overall Impact of Financial Sector Liberalisation

The serious infrastructure bottlenecks created by the unexpected economic boom of the late eighties had got rapidly aggravated, as the private sector (both domestic and foreign) got into an expansive mood with Thailand’s new emphasis on export-oriented manufacturing. This generated immense pressures for financial liberalisation, as savings were expected to fall far short of the huge investment needs for both infrastructural projects as well as for the manufacturing sector capacity build-up (new and expansion) planned by the private sector.

172 Ibid.
There was a recognition among policymakers and top technocrats that Thailand’s future industries would need to be more capital- and technology-intensive, in line with the growing scarcity of labour in the country and the loss of comparative advantage in labour-intensive industries to competitors from China, Indonesia and the South Asian countries by the early nineties. While there was realisation that Thailand’s future prosperity lay in its ability to cope successfully with an increasingly competitive world economy, they believed this was to be achieved through continued commitment to liberalisation and deregulation to access more external capital and imported technology, rather than through internal resource generation or technology capability build-up. The high growth and stable macroeconomic conditions in the late 1980s gave enough confidence to the Bank of Thailand to go ahead with a financial liberalisation package, from 1989 to 1993. The push from the export lobby was also significant, following a slow down in FDI inflows in 1991.\(^{174}\)

An open and efficient financial sector created by liberalisation was considered to contribute substantially to the mobilisation of domestic savings and attract increasingly ‘scarce’ foreign capital. By expanding foreign competition in the local financial sector, financial market liberalisation was also believed to improve the competitiveness of local financial services. At the same time, it was also advocated by Thai policymakers that the financial sector should be developed for its own sake, because Thailand can fill a niche as a sub-regional financial centre, particularly as a provider of financial services for the reconstruction of Indo-China.\(^{175}\) As we saw above, since the economic boom of the late eighties, the political power of the service sector neo-capitalists had also grown tremendously.\(^{176}\) The government’s ultimate desire was to develop Thailand as an international financial centre, to eventually overtake the role of Singapore as the financial centre of the region.

In May 1990, the government announced the official acceptance of the obligations under IMF’s Article VII (capital account convertibility), and along with it the first phase of exchange control deregulations came into effect. The overall financial liberalisation measures included the following: (1) Interest rate ceiling on deposits and lending of commercial banks and financial institutions were abolished. (2) Foreign exchange controls were removed by allowing foreign exchange earners to open their accounts in foreign currencies and non-residents to open their Baht accounts in Thailand. (3) The capacity of commercial banks to engage in foreign exchange

\(^{174}\) A detailed discussion on FDI inflows and structural changes in its pattern is carried out in Chapter IV.

\(^{175}\) See for example, Naris Chaiyasoot, 1995, in Medhi Krongkaew, ed., p. 164-65 and Somchai, 1995, p. 96, etc.

\(^{176}\) See Section 3.2.3 above.
transactions without prior approval from the BOT had also been extended. (4) From April 1991, BOT approval was also no longer required for the repatriation of investment funds, dividends, and loan repayments. (5) Commercial banks and finance companies were allowed to increase the variety and scope of their activities. (6) Lastly, in 1993, capital flows were liberalised under the Bangkok International Banking Facilities (BIBF) scheme, which was set up to facilitate foreign borrowing. Qualified local banks and branches of foreign banks were granted licenses to borrow in the international financial market. The incentive was that investors in Thailand could borrow abroad at reduced cost. Foreign exchange liberalisation encouraged commercial banks to rely more on foreign borrowing, which became a major source of funds in addition to domestic deposits. These liberalisation measures, especially the establishment of the BIBF with issuing of licences to both domestic and foreign banks to borrow foreign funds, and the increase in corporate lending by foreign banks with the liberalisation of 1992, led to an erosion in the oligopolistic powers of Thai commercial banks,177 and led to a massive increase in liquidity across the financial sector.

In 1995, the government prepared to issue several new banking licences to foreign banks, while encouraging the leading finance companies to upgrade themselves into banks. After financial liberalisation, competition between banks and finance companies intensified with respect to both prices and services offered, as the demarcation between their operations no longer existed. However, such competition still benefited only large customers. On the lending front, the large borrowers had now two options; they could borrow from abroad, or they could raise funds directly from the local equity market. As a result, the prime lending rates, i.e., the minimum lending rate, were steadily reduced, while those to general customers hardly changed.178

Under this liberalised regime, international capital flows into Thailand increased three folds between 1990 and 1995. But, there was a change in the composition of capital flows into Thailand during this period, with portfolio flows becoming the single largest component of capital flows. This changed again, as private borrowing in both the banking and non-banking sectors became the most prominent component later on. This got expressed in a dramatic jump in private credit lending from 73.6% of GDP during

---

177 However, foreign banks were not allowed to establish more than one office, to establish ATMs or join ATM pools, or to access the discount window of the BOT. This discrimination had in fact led to the call for further free competition in the banking business, to give more benefits to consumers and investors. Somchai Ratanakomut, 1995, in Medhi Krongkaew, ed., p. 89.

178 This led to the situation where new borrowers with high credit risks have inadequate access to commercial bank credits and where commercial banks may exercise oligopolistic power over small borrowers. See Pakorn, 1994, p. 34.
1987-91 to 124.8% during 1992-96. While capital account liberalisation was the reason behind both, the introduction of the Bangkok International Banking Facility (BIBF) in March 1993 was one of the factors behind the later trend. Meanwhile, as mentioned already, FDI inflows had started showing a declining trend from 1991 onwards.

Foreign portfolio investment had increased significantly during the economic boom in the late 1980s, accounting for 13 percent of total net capital inflows. After Thailand opened up the capital account in the early 1990s, portfolio investment grew even more, and came to constitute over 17 percent of the total net capital flows. From the late 1980s to the early 1990s, most portfolio investment came from Hong Kong, Singapore, the UK and the US. After 1993, accounting for over 60 percent of the total, investment from Singapore dominated total portfolio inflows, followed by Hong Kong and the UK.

Following the debt crisis of the early 1980s, foreign borrowing in the public sector, which was the largest component of Thailand’s net capital flows in the first half of the 1980s, had been contained by putting fiscal discipline in place. However, in the late 1980s, foreign borrowing by the private sector increased. After the country adopted the BIBF scheme, borrowing in the banking and non-banking sectors increased to account for over 70 percent of total capital flows in 1993. Most loans also came from Singapore and Hong Kong. However, it is likely that majority of these loans originally came from Japan since Japanese banks play a major role in the international bank lending operations in these two financial city countries. While much of these loans were disbursed through commercial banks and financial institutions, it has been estimated that large majority of these loans through the BIBF had gone into the real estate sector during 1993-97. At the same time, the focus of FDI also shifted massively into the real estate sector.

Thus, following liberalisation, only a small proportion of commercial bank and other lending went into manufacturing, agriculture, mining and other productive activities; the pattern was similar with foreign borrowings, most of which were collateralised with assets such as real property and stocks. Much of the inflow of foreign savings therefore contributed to an asset price inflation mainly involving real estate and

---

179 The ratio of bank credit to private sector as percentage of GDP was 13.4% during 1960-69, 30.6% during 1970-80 and 52.3% during 1981-86. Following the crisis, this ratio increased further to 161% during 1997-98, but dropped to 130% in 1999. Source: World Development Indicators CD-Rom, 2001.
180 Pairot et. al., 1998.
181 See Section 4.2.2.4 in Chapter IV for a detailed discussion of the sectoral allocation of BIBF funds and FDI.
share prices, leading to the same financial-property ‘bubble’ phenomena,\textsuperscript{182} which characterised financial sector problems in the other fast-growing countries in the region during this phase. In so far as such investments did not contribute to increased production of ‘tradable’ goods, they led to a deterioration of the current account deficit, as we shall see in Section 4.2.2.4 in Chapter IV and Section 5.6.2 in Chapter V.

There exists a large body of theoretical as well as empirical literature on the prerequisites and cautions to be addressed regarding the sequencing of liberalisation. There is a broad consensus that current account liberalisation should precede capital account liberalisation, and that the former itself should be phased out over a sufficient period of time so as to enable the domestic production structure to make the necessary restructuring and upgradation required under liberalised trade. In Thailand, the fact that protection of the domestic market has been restricted by moderate tariff rates, was considered sufficient to argue that the tradable goods sector has become free of price distortions. This was believed to have led to a ‘efficient’ and ‘competitive’ industrial structure, by the policymakers. Thus, complete liberalisation of the capital account was carried out barely one year after the current account transactions were liberalised.

The drop in FDI inflows after 1990 was a major factor which generated the pressure to look for other sources of swift financing, which was required to meet the huge capital needs of the rapidly growing export-oriented and infrastructural sectors. This drove the initiative for the establishment of the BIBF, which ensured the supply of huge amounts of foreign funds. However, as we shall establish in the following chapter, Thailand’s production structure had failed to undergo the restructuring and upgradation necessary to compete in an open regime, both under the euphoria created out of the late eighties’ export success and owing to the fact that the priority of investors (both domestically and internationally) shifted in favour of the booming service sector. The latter also included a number of long-gestation period infrastructural projects. Further, funds through the BIBF were largely short-term in nature, which created severe mismatches when several of the manufacturing industries that used this channel of funding faced severe export slow down by the mid-1990s.\textsuperscript{183} All these culminated in the currency speculation and crisis in early 1997.

Again, there is strong evidence suggesting that both macroeconomic management and supervision of the banking system had become fluid and relaxed rather than stronger and stricter,\textsuperscript{184} which would have been necessary for ensuring that the

\textsuperscript{183} Detailed analysis of Thailand’s trade performance is taken up in Chapter V.
\textsuperscript{184} See for example, conflicts between the minister of finance and the central bank governor, the case of the real estate company, etc. during 1994-97 in Pasuk and Baker, 2000, Hewison, 2000, etc.
adverse repercussions of the liberalisation program did not undermine policy objectives or derail the restructuring in the real sector. Although financial sector supervision and regulations were strengthened subsequent to the financial and banking crisis of the early-mid 1980s, as liberalisation became the all-encompassing objective of the policy makers since 1990, the autonomy of the central bank in macroeconomic management and supervision became seriously undermined, especially due to unwieldy political interference. This was further aggravated by the difficulties in sterilising the effects of the large inflows of foreign funds subsequent to capital account liberalisation, while sustaining the exchange rate that was fixed for all practical purposes.

Having analysed some of the major macroeconomic policies that have influenced the nature of the industrialisation process in Thailand and the political economy of the overall policy framework, we now move onto an examination of the specific policies relating to FDI in the following section. We attempt to highlight how the FDI policies became increasingly liberal after the shift towards export-promotion in the early eighties, and later on, following the slow down in FDI in the early nineties. Throughout the period under consideration, Thailand’s FDI policy regime is never observed to exhibit the kind of state activism that went into the FDI policies of Korea, Taiwan or Singapore.

3.4 PROMOTIONAL POLICIES ON FOREIGN DIRECT INVESTMENT

Reflecting the liberal attitude of the governments under successive Plan periods, Thailand has had no formal screening for FDI except for projects seeking promotional privileges from the Board of Investment (BOI). In the BOI’s screening process too, there was no major distinction between domestic and foreign projects. Although a moderate amount of FDI does not go through the BOI and a foreign investor can get the necessary industrial and commercial licences independent of BOI approval, the BOI is the principal government agency responsible in the case of foreign investment in promoted industries. However, as the nodal agency set up to promote private investment, the BOI’s focus has been on administering incentives to encourage industrial investment. In a more purposeful sense, there has been no single agency in Thailand responsible for monitoring FDI inflows or for ensuring that the FDI thus encouraged complied with the country’s stated development plan objectives regarding effective technological transfer, foreign exchange savings, employment generation, etc.

---

185 On the other hand, technology contracts were not controlled at all. See Atchaka Sibunruang and Somsak Tambunlertchai, 1986, Foreign Direct Investment in Thailand, Background Paper for the Seminar on Transnational Corporations in Thailand Organized by NESDB, UNCTC and UNDP, Pattaya, Thailand, p. 26-27.

3.4.1 Operational Restrictions on Foreign-owned firms

In general, the major laws and regulations that directly affect foreign investment have been the ones governing the ownership and operations of foreign-owned firms, and those specifying the investment guarantees and incentives provided to the firms. These included the Alien Business Law, the Investment Promotion Acts, and the Exchange Control Act of the Bank of Thailand. Other restrictive measures that affect the operations of foreign firms have been the Immigration Act and the Land Code, which concern the employment of foreign nationals and the use of land by foreign interests respectively.

3.4.1.1 Foreign Ownership Restrictions

Although like most host countries in the 1960s, Thailand also preferred joint ventures of Thai and foreign capital to 100 percent foreign ownership in order to better assimilate and absorb new technologies and management know-how, such a preference was not enforced until 1972. Following public resentment and fear against foreign economic domination, especially that of the Japanese since the late 1960s, however, the government was forced to recognise that there was a great deal of foreign investment or so-called ‘alien’ business\(^\text{187}\) in the country, and an Alien Business Law was announced by the government in 1972. The law defined the type of activities in which “aliens” may or may not enter, in order to limit the legal ownership and control of foreigners in certain fields of business in Thailand. It was subsequently amended in 1978. Under the Alien Business Law, business activities were divided into 3 categories: A, B, and C. Businesses in categories A and B were completely closed to aliens\(^\text{188}\). Existing alien businesses in these categories were permitted to continue operations after 1972, but were required either to transfer a major shareholding to Thai partners within a specified period, or to restrict annual expansion to no more than 30 percent of their 1972 production level. However, this condition was waived from 1977 to 1982, with further

\(^\text{187}\) Foreign or ‘alien’ business was defined as a natural person or a juristic person whose nationality is not Thai, including: a juristic person whose capital is 50% or more alien- or foreign-dominated; a juristic person in which an alien holds shares, is a partner or member, or holds membership of more than half of the total in terms of shareholders, partners or members, regardless of the size of the investment shared by the alien; and limited partnership or registered ordinary partnership whose managing partner or manager is alien. The definition also includes juristic persons or firms incorporated in a foreign country. Jeerasak, 1985, p. 137.

\(^\text{188}\) List A included rice and salt farming, trade in native agricultural products and real estate, certain professional services such as accounting, law and architecture, and building construction; and List B included agricultural production, processing of agricultural products, handicraft industries, retail trade, certain types of contractual services, and transportation. Businesses included in List C were wholesale and export trade, retail trade of certain products, industrial and handicraft production of certain commodities, mining, services other than those mentioned in Lists A and B, and construction other than that mentioned in List A. Jeerasak, 1985, p. 138-9.
extension of the waiver to 1986, except for retail activities. New alien businesses in category C were also conditionally permitted.

Nevertheless in practice, this law was clearly not effective in restricting FDI. The most obvious reason behind this was that BOI promoted firms were not subject to the conditions of the law, and industries in which FDI tends to concentrate such as machinery, electrical appliances, vehicles, and chemicals were not included in the list of restricted activities. Thus, foreign investors who owned businesses in List B and C under BOI promotion could still have 100% or majority ownership and control. Secondly, it has been pointed out that the definition of ‘alien’ in this law was very flexible, which allowed the foreigners to legally manipulate ownership structure to yield them the possession of effective control over the operation of the firm. 189 Further, this law was not applicable to activities within the scope of an agreement between the Thai government and a foreign government. Thus, many American firms were exempted from these ownership restrictions, under the provisions of the Treaty of Amity and Economic Relations between Thailand and the US, which granted national treatment to the US firms. 190 In addition, petroleum operations were also exempted from this law.

Later in 1983, the ownership conditions became more liberal. The BOI’s joint venture criteria laid out in 1983 were as follows: Thai nationals must hold at least 60% of registered capital in investment projects in agriculture, husbandry, fishery, mineral exploration and mining, and services, and at least 51% in the production for domestic sales; while foreign investors may hold majority ownership when at least 50% of the output was to be exported and hold 100% when all the output was to be exported. However, in April 1992, the BOI relaxed the criteria by requiring at least 51% Thai ownership of projects in resource-based activities and services and allowing firms that export at least 80% of total sales to have 100% foreign ownership. 191

With further liberalisations later on, foreign ownership requirements were as follows by 1997: For resource-based investment projects and in the service sector, Thai nationals still had to hold more than 51% of the registered capital. However, for projects with investment capital over 1000 million baht, foreign investors could hold a majority of all the shares, with the stipulation that Thai nationals must acquire shares totalling not less than 51% of the registered capital with five years of starting operations. In the

189 For example, foreign investors may hire Thais to hold a certain amount of stock for them as ‘straw men’, which allowed them to enjoy a larger share of ownership than appeared on official papers. The same held true for BOI firms also, where ownership restrictions existed. See Jeerasak, 1985, p. 183-4.

190 As a result, a relatively large proportion of US firms appear to invest directly, rather than through the BOI. Ramstetter, 1997, opcit.

191 Atchaka and Brimble, 1992, Export-Oriented Industrial collaboration: A Case Study of Thailand, UNCTC, Bangkok, Thailand, p. 16.
manufacturing sector, for domestic market-oriented projects, Thai nationals were required to own shares totalling not less than 51% of the registered capital. However, projects in Zone 3 were permitted to have majority or 100% foreign ownership. Ownership requirement for export projects had also become further liberalised: If at least 50% of production was for exports, foreign investors may hold the majority of the shares, and where at least 80% of the total sales was to be exported, 100% foreign ownership was allowed (in any Zone).

3.4.1.2 Other Operational Restrictions

The Alien Occupation Law (1972), replaced by the Alien Employment Act of 1978, required all foreigners working in the country to obtain a work permit prior to commencing their employment, and reserved certain occupations for Thai citizens, mostly in services, handicrafts and agriculture, and professional occupations for which Thai manpower was available.\(^{192}\) The quota specified in the Immigration Law restricted foreign-owned firms, which wished to bring in foreign personnel. However, firms under BOI promotion or those located in IEAT industrial estates generally faced few restrictions in bringing in foreign experts and technicians. By 1997, non-promoted manufacturing activities which: (a) either brought in modern technology to Thailand; or (b) use not less than 50% local materials; or (c) employed more than 20 workers; were eligible to bring in foreign personnel.\(^{193}\) Clearly, this is broad enough to be considered very liberal. On the other hand, there were generally no explicit requirements on labour training, but the BOI could consider any specific requirements for promoted firms, when evaluating the applications for promotional privileges.

Among other general restrictions on foreign-owned firms was land ownership, which was governed by the Land Code of 1954. Foreign-owned firms were generally not allowed to own land under the Land Code, which left leasing as their only option. However, for BOI promoted foreign firms and those in IEAT industrial estates, ownership of land in excess of the limit specified in the Land Code was allowed.

Concerning foreign-owned firms’ financing, Thailand had placed restrictions on areas such as debt-equity ratios and on investment capital remitted from abroad.\(^{194}\) The total debt of a foreign-owned firm was not allowed to exceed seven times its equity. On

\(^{192}\) All occupations in this reserved list were those included in the business activities in the Alien Business Law.

\(^{193}\) Other non-promoted businesses that could bring in foreign personnel were international trade, tourist business and financial institutions. The latter had to have more than 20% Thai equity participation, and bring in not less than 100 million baht in foreign currency. See A Guide to the BOI, September 1998, p. 16.

\(^{194}\) Both applied to newly established businesses in List C annexed to the Alien Business Law.
the other hand, any firm applying for promotion was required to have a debt-equity ratio not exceeding 5 to 1. For investment capital, all declared foreign capital had to be remitted from abroad. This implies that access to local financial sources for investment capital was not allowed for newly established foreign-owned businesses in List C. Another important area concerning a foreign firm’s financing was foreign exchange repatriation control. Generally, since 1959, repatriation of investment capital, profits or dividends, interest and principal of foreign loans, or royalties and payments on other obligations, has been unrestricted by the Bank of Thailand. However, the BOT did reserve the right to stop or limit repatriations during periods of adverse BoP. Although the BOT maintains a register for foreign investors regarding the amount of foreign capital brought into the country and the funds remitted back, registration at the BOT was not compulsory.195

Thus, while there were certain areas in which the extent of foreign ownership and control were restricted, in general, all businesses in Thailand have been open for foreign investment, except in the areas of basic infrastructure, public utilities, savings banks, rural banking, insurance, and production of certain military goods.196 Among the open areas, government set certain industrial priorities both in the form of broad categories set by the NESDB, and in a specified list of promoted industries set by the BOI.

3.4.2 BOI Investment Promotion Policies Under Different Plan Periods
In line with the overall economic policy objective of the early 1960s, the aim of investment promotion as stated in the initial Investment Promotion Acts of 1960 and 1962 was largely import-substitution. BOI’s promotional privileges included fiscal incentives in terms of income-tax holidays of up to five years, exemption or a reduction of import duties on raw materials, machinery and components, exemption from or reduction of export duties, exemption from business taxes on machinery imports, etc. Although the inducement effects of these incentive measures were not large,197 they did serve as an additional positive force in conjunction with other favourable factors to generate increased investment by local entrepreneurs and foreigners in import-substitution industries.

195 According to Atchaka and Somsak (1986), even foreign investors who had not registered, usually transferred capital and associated incomes abroad freely. See p. 33. This then also implies that estimates of the level of remittances abroad would be underestimates of the true extent of outgoing funds.
During the period of the 1960 and 1962 Investment Promotion Acts, three categories of promoted activities were defined: Group A included mainly capital-intensive industries such as chemicals, electrical appliances, automobile and shipbuilding industries. Group B industries were assembly industries like transportation equipment assembly, electrical appliances assembly, agricultural machinery assembly, and the like. Group C industries were mainly labour-intensive and service industries including food processing, textiles and clothing, and hotels and international shipping. That is, the promoted areas were largely in the manufacturing sector.

In the 1972 and 1977 Acts, more emphasis was given to the promotion of export-oriented industries and investment in rural areas, reflecting the policy changes outlined in the Third and Fourth Plans. Thus, many extra tax incentives were offered to producers of exports and to producers who established their plants in the Investment Promotion Zones designated by the BOI. For example, import tax was removed from imported inputs used in export activities and business tax was lifted from exported products. The 1972 Act also gave all promoted firms business tax reductions on raw materials of up to 90%, as compared to no exemptions in the previous law. Besides, the BOI offered additional protection, with import bans or import surcharges on competing imports of promoted products, at a rate not exceeding 50% of their c.i.f. prices for a period of one year at a time, in certain cases. The A and B categories described earlier were merged, and service activities such as hospitals, tourism promotion, industrial estates, and export trading, as well as agriculture were added to the list of promoted activities in the 1972 Act. In the 1977 Act, while special incentives for export promotion and industrial decentralisation were similar to those under the 1972 Law, new items such as the exemption of withholding tax on dividends and royalties and other obligatory fees, were added to the incentives for promoted firms.198

Following the economic downturn in the early 1980s, the 1983 Investment Promotion Act undertook a revision of the incentive structure consistent with the goals of the Fifth Plan such as, foreign exchange earning, employment generation, utilisation of local raw materials, and industrial decentralisation. Thus, export-oriented, labour-intensive projects and projects located in the promoted investment zones continued to receive large tax and tariff exemptions. As mentioned above, non-US overseas firms were encouraged to have 100 percent foreign ownership in promoted ventures for the first time, on the condition that they export 100 percent of their output. Major

198 In the 1977 Act, textiles, the largest industry in Thailand at the time, was excluded from the list temporarily because total supply was more than enough for domestic use and to meet the export demand. Earlier in 1962 also, some important industries such as sugar and pharmaceutical products had been dropped from the list due to oversupply conditions. See Jeerasak, 1983, p. 135-6.
improvements were also made in the administration of investment incentives in terms of reduced time taken to approve a project, which came down to two months for a project oriented towards the domestic market and one month for an export-oriented project. The objective of cutting bureaucratic delays also began to be better achieved with the establishment in 1982 of a One-Stop Service Centre, which was required to issue factory permits and licences needed by promoted activities within 90 days. Thus, from the 1983 Act onwards, the BOI promotion policies came to reflect the clear shift in favour of export-oriented projects both in intention and in implementation, and FDI began to be solicited with the explicit aim of creating Thailand into an export base.

This period also saw the beginning of aggressive investment promotion programmes by the BOI, many of which were financed under the World Bank's second structural adjustment loan. These included preparation of investment opportunity studies and project profiles to assist the BOI in preparing plans to promote investment in export-oriented, agro-businesses and regional activities; overseas investment promotion missions; the setting up of an investment data and information centre; setting up of a technology transfer centre; etc. By 1986, all of these except the last had been undertaken.199

In 1986, the eligibility for promotion in terms of separate categories was abolished, but the promotional privileges remained similar to the earlier one. Three more types of firms qualified for promotional assistance since 1986: (1) firms located outside Bangkok; (2) export-oriented firms, which export at least 80% of their output; and (3) firms located in Investment Promotion Zones, which now existed in all regions. According to the argument that prevailed amid anticipation of high economic growth rate in the late eighties, since foreign investors were keen to invest in Thailand, it was believed that it was an opportune time to modify the investment promotion.

The criteria for granting investment incentives were revised three times during the Sixth Plan period (1987-91). The investment promotion policies in 1989 and 1990 focussed on promoting the following: export-oriented industries, industries which use local raw materials; industries which expand the local industrial base through the development of supporting industries; industries which contribute towards enhancing local technological capabilities, and industries located in provinces. In order to promote regionalisation,200 the attractiveness of promotion privileges varied with location, which

---

199 Policy discussion related to technology development is taken up in a later chapter.

200 In 1987, the number of manufacturing establishments in Bangkok and its surrounding provinces still accounted for some 60% of total manufacturing establishments in the whole kingdom. More importantly, the value added from these activities in Bangkok and its vicinities often constituted more than three-quarters of the total value added from manufacturing activities for the whole country. However, since 1987, there has been some dispersion of manufacturing activity towards the outer regions, especially the northeast and the north.
was classified into three Zones for the purpose of decentralisation. The selection of industries for promotion included electronics parts, automobile parts, chemical products, and agro-industries. Other measures aimed at supporting foreign investors were as follows: granting approval for foreigners to purchase residential units in condominiums equal to 40% of its total working space; granting of residence permits; approval to purchase land near their factory for the construction of residential units for their staff members; promotion of development projects in which foreigners can rent space to set up factories inside industrial estates. After the drive to attract investment from Japan in 1987 achieved great success, the BOI also began aggressive investment promotion campaigns for investors from the NICs, apart from the US and Europe.

At the same time, many governments such as Japan, Taiwan, Australia, Belgium, France, and the US became active in assisting their SMEs to invest in Thailand, by providing information on Thailand, arranging investment promotion seminars and financing feasibility studies, and organising missions to visit Thailand. Many of these governments also sent experts from their counties to work closely with the BOI to help facilitate their companies' investment in Thailand. Singapore's Jurong Town Corporation has invested in an industrial estate in Ayuthaya to assist investors from Singapore. Many governments such as those of Germany, Belgium, and Japan also provide long-term loans to investment projects from their countries. Such credit is channelled through IFCT or commercial banks.

In 1990, the emphasis on automobile parts and electronics continued, while telecommunication equipment parts were also added to the list of target industries. The prevailing mentality among policymakers was that electronics, automobile parts, and petrochemical industries were to be regarded as important industries, if the country was to develop and gain the status of a NIC. It was necessary to introduce foreign capital into these sectors in order to enhance the nation's technological capability, as well as to foster Thai firms. The aggressive investment campaigns targeting specific investor countries that began in earnest during 1987-88 were continued, focussing on the EU and the US, as well as on Japan and China. During this period, the BOI also began to promote Thai investment abroad, targeting Indochina.

The tariff reforms since 1991 significantly reduced the BOI's scope to offer incentives in terms of import duty reduction. The introduction of the value-added tax in

---

201 IDE, 1990, Thai Economy in the Changing Decade and Industrial Promotion Policy, p. 57.
202 The information in this paragraph is based on Atchaka and Brimble, 1992, UNCTC, p. 22-23.
203 Special emphasis was placed on EC countries to enable Thailand to cope with the unification of the EC in 1992 and to attract EC investors to Thailand before the political and economic situation in Eastern Europe settled. US Investment was stressed following the declining trend in US Investment in 1989. Japan was targeted again to attract investors aiming to re-export to Japan, and China was expected to launch joint ventures with Thailand in food processing and automobile parts. Source: Ibid.
1992 in the place of the business tax further reduced the advantages of promoted firms over non-promoted firms. All these compelled the BOI to begin providing comprehensive business-related services to investors and potential investors. The role of the Office of the BOI was shifted towards an investment service orientation, placing more emphasis on programs to promote investment matchmaking and the strengthening of backward linkages in the Thai economy.

In the nineties, the Investment Promotion Act 1977 as amended by the Investment Promotion Act 1991 was the one being followed. The BOI's special privileges for export activities now included permission to deduct from taxable corporate incomes an amount equal to 5 per cent of any increase in income derived from exports over the previous years. In addition, a new category eligible for promotion (5.49) was created to cover all export-oriented activities, which refer to those projects generating at least 80% of their sales revenues from exports from the third year of operations.

A further re-orientation of the promotional privileges of the BOI was prompted as a reaction to the GATT's rule on Trade-Related Investment Measures (TRIMs) in 1994. As industrial promotion policy could no longer be based on export promotion, the overall incentive structure was to be based on government support for the development of backward areas (i.e., Zone 3). This policy was then used to assist many expansion projects. Accordingly, while projects in Zone 1 (involving the most industrialised regions of Bangkok and five surrounding provinces) received no import duty and corporate income tax exemption except for projects which export more than 80% of sales or 30% of sales in the case of exemption of import duty on raw or essential materials, Zone 3 involving the least developed provinces received the largest

---

204 In the early 1990s, one of the much debated policy issues in the country was whether the granting of tax privileges to investors should be continued and indeed it was questioned whether the benefit from tax privileges was worth the cost in terms of tax expenditure. In 1989, there had already arisen a proposal to abolish the BOI or to reorganise it as the Board of Export. The argument was that Thailand had reached a stage of development where it was able to attract foreign investment without having to offer tax and duty concessions and that foreign investors would still be attracted by economic stability and all the prerequisites for production (including infrastructure) which Thailand had to offer. The BOI, however, counter argued that it was necessary to have a system of investment promotion because Thailand still possessed the ability to attract foreign investment from neighbouring countries. However, high-ranking officials in the BOI admitted the need to change the role of their organisation and concentrate more on promoting large-scale projects or Thai investment abroad. See Direk, 1995, p. 148-9.


206 Such export projects and those in industrial estates or promoted industrial zones received 50% import duty reduction on machinery (subject to import duty greater than or equal to 10%), and corporate income tax exemption for three years.

207 These received a one-year exemption of import duty on raw or essential materials used in export production. See A Guide to the Board of Investment, September 1998.
incentives. The latter involved: (1) complete import duty reduction on machinery; (2) corporate income tax exemption for eight years; (3) exemption of import duty on raw or essential materials used in export products for five years, for projects exporting at least 30% of total sales; and (4) 75% import duty reduction on raw or essential materials used in production for domestic sales, for five years.

During the Seventh Plan Period (1992-96), the following investment activities were considered to be priority areas: Basic transportation systems; public utilities; environmental protection and/or restoration; direct involvement in technological development; and basic industries. Such projects received: (a) Corporate income tax exemption for eight years, regardless of location; (b) a 50% import duty reduction on machinery for projects in Zone 1 and Zone 2; and (c) complete import duty exemption on machinery for projects in Zone 3. The BOI was also not to impose foreign ownership restrictions in promoted projects in these areas.

Since 1991, in determining the suitability of a project for investment promotion, the BOI has followed different criteria depending on the level of investment capital:

- For a project with investment capital (excluding the cost of land and working capital) not exceeding 200 million baht, the value-added has to be greater than 20% of sales revenue. However, projects which: (a) export at least 80% of total sales; or (b) use domestic agricultural products as raw materials; or (c) involve conserving, restoring or developing natural resources and the environment; were exempted from this minimum value added requirement.
- For a project with investment capital over 200 million baht, the following additional considerations were to be considered: (a) the impact of the project on its own industry and related industries; (b) the impact on government revenue and any additional burden on the government in relation to the project; (c) the effect on consumers; (d) the contribution to technological development.
- For a project with investment capital above 500 million baht, a feasibility study must be submitted.

However, it is important to note that across all categories of projects, the Board has had the leverage to consider special factors while granting incentives. Meanwhile, investment promotion policy continued to encourage the private sector to invest overseas, especially in Indochina and ASEAN countries, to expand export markets, and to gain access to new sources of raw materials and technology.

3.4.3 BOI Policy Liberalisation Since 1997

Following the financial crisis of early 1997, the Office of the BOI declared new measures effective from October 1997, in order to improve Thailand's investment
situation and to increase local industry’s export competitiveness in the face of domestic demand depression. The important features of these measures were as follows.

(1) Projects located in Zone 1 and 2 can expand their investment activities and obtain additional income tax exemption (according to the zone in which they are located). Projects in Zone 1 and 2 in some 61 activities have become eligible for import duty exemption on machinery as well.

(2) The minimum export requirement for promoted firms in Zone 1 and 2 is no longer imposed, so that they can expand their production for exports and can benefit from import duty exemption on raw materials or essential materials used to produce for exports.

(3) In allowing promoted firms to increase production to reflect the real capacity of machinery, import duty exemption or reduction for the machinery used in this additional production is also granted.

(4) Most importantly, to enable promoted firms to increase capital, the BOI, on a case by case basis, relaxed the foreign equity limits on joint-venture projects in Zone 1 and 2, by allowing foreign shareholders to hold up to 100% of equity, if they received the consent of Thai shareholders.\textsuperscript{208} From November 24, 1998, new investment projects in Zone 1 or Zone 2 were also permitted to have majority or total foreign ownership, without any export requirement.

(5) In order to generate more export-oriented activities, projects on the BOI List of Activities Eligible for Promotion (No. 2/1993), that were previously required to be located in Zone 2 or 3, could now be located in Zone 1 or Zone 2, provided that at least 80 percent of all sales each year are from exports. BOI incentives will be provided based on the location of the projects. (This exemption was to expire on December 31, 1999).

(6) In order to improve the efficiency of production, all BOI-promoted projects are allowed duty-free import of replacement machinery, provided that: the applicant was an existing BOI-promoted project; at least 80 percent of all sales each year were from exports; the value of imported replacement machinery was not less than one million baht; and machinery could be imported duty-free one time only, and it must take place prior to December 31, 1999.

Thus, zonal differences in the levels of foreign ownership in promoted companies no longer exist. More significantly, 100% foreign ownership is now allowed in any project, whether domestic market-oriented or export-oriented. However, the range of incentives still varies according to whether products are mainly exported or domestically sold, and depending on the zone in which the project is located. Furthermore, investment projects in agriculture and agricultural products industries, which export at least 80% of sales have also become eligible for import duty exemption on machinery, regardless of location.

Further, a list of 14 supporting industries identified by the BOI to be priority activities in February 1997, were extended in October 1997 to include a total of 19

\textsuperscript{208} Source: Measures to Support Investment in the Current Situation- Announcement of the Office of the Board of Investment No. POR.10/2540.
supporting industries. These are eligible for: (1) exemption of corporate income tax for 8 years, regardless of location; (2) exemption of import duty for machinery, regardless of location; (3) foreign investors may hold majority or all the shares, with no minimum requirement for export.

On December 25, 1998, in a measure designed to protect against increased levels of unemployment and the impact of tight liquidity, the BOI also announced that foreign investors would be able to acquire up to 100% of joint venture retail projects that were in operation prior to January 1, 1999. Projects will be eligible to receive non-tax incentives only, and all capital utilized by the foreign shareholders must be directly transferred from abroad. Existing projects would be permitted to expand branches in Bangkok and the vicinity, only if the branches have at least 1,000 square meters of sales floors. Expansion of businesses in the provinces would not be permitted, as the BOI is concerned about the impact on local retailers.

Further, as it became evident by early 1998 that the deepening recession in the domestic and global economy made prospects for all firms increasingly gloomy, the BOI also announced some criteria on March 27, 1998, for promoting existing non-BOI-promoted companies in order to facilitate them to strengthen their global competitiveness. Non-promoted manufacturers whose activities were already in operation and are eligible for promotion under any category specified in the BOI promotion list became eligible for promotional benefits. While projects meeting these criteria may be located in any zone, only non-tax incentives were to be granted. However, since October 1998, the Board granted non-BOI-promoted companies import duty exemption on raw materials also. Later on, in order to help accelerate exports, non-BOI-promoted companies in the following 11 industries received a one-year extension of their exemption from import duties on raw materials, from October 4, 1999. The industries affected by this announcement were: textile products, garments, leather, shoes, furniture and decorated items, toys, sporting goods, automobile components, plastic or plastic-coated products, and electronic products and components.

From August 1999, the category of International Procurement Office (IPO) was added to the list of activities eligible for BOI promotion, in order to facilitate trading activities, reduce marketing costs, ensure product quality, and build up business linkages. IPOs, which are involved in procuring and sourcing raw materials and semi-finished products from both domestic and overseas suppliers, are believed to encourage export for small and medium size businesses, and also provide substantial benefit to both import-export businesses and the transportation industry. Thus, approved projects became eligible to receive: (1) Exemption of import duty on machinery; and (2) exemption of import duties on raw materials used in production for export. Majority or total foreign ownership of projects in this category will be permitted.

Thus, since the economic slow down in 1997, BOI's investment promotion

---

209 These could have foreign ownership only up to 49% until then.
210 At the time, while there are only four IPOs operating in Thailand, there were many companies engaged in these activities in Singapore and even in Malaysia, both of which offer investment incentives to IPOs.
policies have become the most liberal in terms of foreign ownership levels, while export-oriented investments still receive the maximum benefits, and a lot more activities (particularly in agriculture-related activities, and in services such as software industries, software parks, retail trade, logistics, trade and investment support offices, IPOs) have been added to the list of activities eligible for promotion. Meanwhile, the BOI also set up a matchmaking centre to facilitate the preliminary procedures of mergers and acquisitions (M&As). This centre was to provide information about companies that are looking for either joint venture partners or financial assistance.

In 2000, the BOI, on behalf of ASEAN member countries, also began to organize a series of Joint ASEAN Investment Promotion Events in the major developed countries (Japan, the US and Europe) in order to draw back investments to the region. The objective has been to showcase the increased business opportunities in this region, which have been enhanced by various economic cooperation schemes such as ASEAN Investment Area (AIA), ASEAN Free Trade Area (AFTA), and the ASEAN Industrial Cooperation Scheme (AICO). The ASEAN Industrial Cooperation (AICO) was adopted in 1996 and the ASEAN Investment Area (AIA) was adopted in 1998. The AIA calls for opening up all industries in the region to ASEAN investors and granting national treatment to them (exempting those on temporary exemption lists). The ASEAN Investment Area (AIA) will come into force in 2003. By 2010, full national treatment has to be extended to ASEAN investors, which has to be extended to all investors by 2020, subject to the exceptions provided for under the agreement. It has allowance for safeguard measures, a dispute settlement mechanism and contains the most-favoured-nation (MFN) treatment principle.

3.4.4 Other Liberalisation Measures

Since October 1997, the Bank of Thailand has allowed foreign financial institutions to hold up to 100% in local finance companies or banks for up to 10 years, which was previously limited to no more than 25% stake. A clause provided for stipulates that foreigners can still hold onto their stakes beyond that period, with the condition that they will not participate in further re-capitalisation, which will automatically dilute their holding until their stake falls down to 49%. This liberalisation came much earlier than the schedule of commitments pledged under the General Agreement on Trade in Services (GATS) under the WTO, to open up the banking, insurance, and fund management industries. In an attempt to stimulate demand for the debt-ridden real estate sector, the Condominium Act was also amended to allow foreigners to purchase 100% of condominium buildings of 5 rai (2 acres) or less during the next 5 years, up from the 40% foreign ownership permitted until then.211 The Land Code was also amended to allow individual foreign investors investing specified amounts in activities of productive interest for Thailand, to own up to one rai (0.4 acre) of residential land. The Act on Leasing of Property for Commerce and Industry was modified since May 1999, which extended the leasing period from 30 years to 50 years, renewable for another 50 years. This modification was carried out with a view to attract long-term commercial and

211 However, foreign ownership was still limited to 49% for condominiums situated outside the specified areas of Bangkok, municipal areas, or local administration. See Ministry of Finance, November 1999, p. 46.
industrial investors that have large capital investment and long gestation period. Further, leasing rights have been made into a transferable asset right. The government was also proposing to amend the Alien Business Law in 1998 to increase liquidity in key sectors and to comply with international commitments. Further, the government had also announced an ambitious privatisation programme of state enterprises in September 1998.\footnote{This included state enterprises such as the Electricity Generating Authority of Thailand (EGAT), Telephone Organisation of Thailand (TOT), Thai Airway International (THAI), Petroleum Authority of Thailand (PTT), Provincial Electricity Authority (PEA), Metropolitan Electricity Authority (MEA), Communication Authority of Thailand (CAT), etc. See IDE, 1998, p. 116-126 and Ministry of Finance, Thailand’s Economic Reform, January 1999.}

3.5 CONCLUSION

Thailand had indeed embarked on a state-led import substitution industrialisation path during 1930-60. However, as we saw in the beginning of the chapter, a confluence in the interests of the various players in the political economy and dissatisfaction with the state-led growth by the mid-1950s, led to a major shift in economic policy orientation away from government participation towards economic growth led by private enterprise, in which foreign investment came to play a very important role.

Since this regime change, Thailand has maintained an open and liberal attitude towards foreign direct investment inflows. Initially, foreign investment promotion was a part of the overall import substitution policy regime, even when the tariff protection for import-substitution strategy mostly followed macro economic stability concerns, rather than industrial policy issues. Foreign direct investment was considered crucial for obtaining the capital inflows, technology, skills and managerial know-how required for advancing this industrial development strategy. It was also believed that FDI would help create employment and save foreign exchange. By the 1970s, while still continuing with import substitution, the emphasis of the economic policy had shifted slightly to export promotion and the policies on foreign investment came to reflect this. Thus, in spite of the operational restrictions imposed on foreign investors, the demand for FDI was quite high among Thai policymakers and domestic capital even before the 1980s. Such demand multiplied through the eighties and nineties, as the emphasis of economic policy shifted completely to manufactured export-led rapid growth from the mid-1980s. The latter in turn had come about with the 1984 baht devaluation. From the mid-1980s, the tariff policy became intensely focussed on facilitating export expansion, rather than being driven by government revenue-generation and BOP stabilisation pressures. Thus, FDI promotion policies also became totally enveloped in an aggressive promotion of exports.

From 1987 onwards, there was a sharp turnaround in the economic growth and capital inflows following the devaluation of the baht and highly favourable external conditions. The enthusiastic response of foreign and domestic capital to Thailand’s new emphasis on export-oriented manufacturing convinced policymakers that they could now rely on manufacturing-led export growth. However, along with the transformation from the protected regime towards export-oriented growth and the favourable conjunction of domestic and external factors, there was a boom in the service sector.
This led to a fundamental change in the character of Thai business class, and in its relationship with bureaucracy and politicians.

With the relative boom and structural changes within the service sector since the late eighties, the political influence of the service sector businessmen outweighed that of the manufacturing sector exporters, aggravating the conflicts between the various dominant interest groups. At the same time, similar to the growth path of the manufacturing sector entrepreneurs who shifted from import-substitution to export promotion in alliance with foreign capital, the service sector also witnessed an outward-oriented transformation, which hastened the opening up of the financial sector. Thus, before the indigenous production base could make the required transition from the 'high-cost' production patterns under the prolonged period of protection (and constant tariff changes with a lack of direction), rapid trade and financial liberalisation was undertaken at the regional and international levels. While the export manufacturers also believed this to increase their access to external capital, Thailand’s production structure failed to undergo the restructuring and upgradation necessary to compete in an open regime, as the priority of investors (both domestically and internationally) shifted in favour of the booming and liberalised service sector and towards other non-tradable sectors. This was to have crucial implications for the sustainability of FDI-led industrial development and restructuring.

While many scholars have linked the economic achievements of East Asian NIEs to the institutional attributes of capitalist developmental states, Thailand’s industrialisation is considered to have proceeded without an autonomous state playing a vanguard role in identifying, and allocating resources to, priority industrial sectors. In particular, Thai policymaking has been considered less strong in non-financial industrial policymaking that targeted particular sectors. In nearly all the policy changes, an important aspect to note was that the government was preoccupied with macroeconomic management. Thus, the fundamental issues related to industrial policies have been treated as subsidiary to the macroeconomic stability goal, unlike in countries like South Korea.

Further, we have also seen that throughout the period under consideration, Thailand’s FDI policy regime never exhibited the kind of state activism that went into the FDI policies of Korea, Taiwan or Singapore. Policy directions in Thailand may be said to have remained at the level of functional, rather than selective interventions. The development of the promoted industries, their supporting industries, technology capability, human resources, etc. were not planned adequately or coordinated sufficiently strongly, to enable a well-founded and deeper industrial structure to emerge. Further, the overall trend was in the direction of complete liberalisation of foreign ownership restrictions, reflecting the continuously increasing demand for additional capital and advanced technology generated by the rapid export-led growth paradigm embraced by Thai policymakers and domestic capital, attempting to emulate the leaders in the catching-up product cycle. Against this backdrop of policy discussion, the focus in the following chapter is to examine the extent and nature of the involvement of FDI in Thailand’s industrial restructuring.