THAILAND
The Institutional and Political Underpinnings of Growth

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A World Bank Publication
THE LESSONS OF EAST ASIA

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The Institutional and Political Underpinnings of Growth

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FOREWORD

Policymakers everywhere are searching for lessons from East Asia’s enormous success in economic development. A number of recent cross-country and thematic studies have sought to identify and analyze the policies behind this success. Among them is The East Asian Miracle, a recent World Bank publication, which draws in part on the Lessons of East Asia project. Study teams, including in-country nationals, examined in some depth the experiences of the highly successful East Asian economies and the public policies underpinning them.

Several clear contributions emerge from this set of country studies. The research:

- Highlights considerable variation in approaches within the group of East Asian economies. For example, some economies chose a substantial degree of government intervention; others did not. The studies dispel the notion that there is a single or uniform East Asian model of success.

- Demonstrates that a core set of good economic policies -- such as macroeconomic discipline, outward orientation, and human resource development -- laid the foundation for East Asia’s success. Pragmatic policymaking -- understood as being nonideological and reversible -- seems to be at the heart of these policies and merits replication.

- Dispels some of the myths about the more idiosyncratic interventions, such as "picking winners" in industry, which sometimes produced the desired result and sometimes did not. Because presence or absence of institutional features seems to have affected the outcomes of these interventions, applications to other regional contexts must be approached cautiously. A dominant finding of the studies is that serious diversions from macroeconomic equilibrium were largely avoided, even by strong interventionists. At the same time, the later generation of industrializers were more successful when they avoided these industrial policies.

A question not easily answered is why East Asian governments adopted fundamentally sound policies and were apparently able to achieve better results from their active policies and to incur lower costs from errors. In this connection, the studies touch on such dimensions of policymaking as the role of the state, leadership, and the bureaucracy. It is one thing to describe the institutional features accompanying a successful episode, however, and quite another to know why and how those features came about. For instance, why did East Asian leaders apparently hold themselves more accountable for economic performance than has been the experience elsewhere? How did the governments manage to gain sufficient national consensus to put difficult policies into effect? These aspects of political economy cannot be ignored. Our analytic tools, however, are severely limited in penetrating these issues, in assessing their impacts, and in assigning credit to them. These country studies are only one step, although a significant one, in deepening our understanding of the experience of East Asia. It is hoped that they will prompt additional work on the institutional foundations of rapid growth.

Gautam Kaji
Vice President
East Asia and Pacific Region
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Danny M. Leipziger
Country Studies Director
EXECUTIVE SUMMARY

Development Strategy and Macroeconomic Performance

Thailand has maintained steady economic growth throughout the post-war period, with GDP growth averaging over 7 percent, and, in recent years, has been among the world’s fastest growing economies. This sustained economic expansion has led to a significant reduction in absolute poverty. On the production side, the economy has been transformed by the rapid growth of manufacturing industry. However, this is not reflected in the employment structure; indicating that industry tends to be capital-intensive. In 1988, nearly 70 percent of the labor force remained in agriculture, producing only 17 percent of GDP, thereby limiting the distribution of benefits from rapid growth.

Thailand’s development is characterized by its macroeconomic stability, but also by a series of poorly managed sectoral interventions. On the positive side, Thai governments have practiced firm fiscal and monetary restraint. There is a strong commitment to maintaining internal and external balance, reflected in laws which restrict the size of budget deficits and foreign debt service. Inflation has remained low and the real effective exchange rate has been remarkably stable. Conservative fiscal and monetary policies have combined to create a macroeconomic environment conducive to the growth of private enterprise. The state has also been successful in managing state-owned enterprises which, for the most part, have recorded a satisfactory operating performance.

Successive Thai governments have tried, largely unsuccessfully, to promote the development of selected industries. Until recently, the government favored the growth of capital-intensive industry; mainly through the trade regime and an industrial policy instituted by the Board of Investment (BOI). In the 1960s and 1970s, Thailand pursued an import substitution strategy. Finished consumer goods and capital-intensive manufactures (including automobiles and pharmaceuticals) enjoyed the highest rates of effective protection, while moderate tariffs were retained for imports of machinery and materials. Under the BOI, industrial policies favored the development of large-scale manufacturing and almost all of the enterprises awarded privileged status (which involved tax and tariff exemptions and import bans) were producing for the home market. The pattern of value-added in manufacturing reflected these policies, with a shift towards heavy industry in the 1970s. Thus, development policy discriminated against agriculture and labor-intensive manufacturers, sectors in which Thailand enjoys a comparative advantage.

Following the second oil-shock, which revealed structural weaknesses in the balance of payments, Thailand adopted a strong adjustment program. The government redesigned its trade and industrial policies to offset the bias against exports. Tariffs were rationalized and their average rates reduced (although effective protection rates for manufacturing remained significantly higher than in other East Asian nations). The BOI adopted the generation of foreign exchange as a criterion for project approval. In the 1980s, approximately half of its programs concerned export activities. The new outward-orientation has been supported by a range of other policies, including a significant exchange rate depreciation, tax exemptions and the establishment of export-processing zones.

Policy liberalization has proved successful, with the economy achieving double-digit growth rates in the late 1980s. The export of labor-intensive manufacturers has expanded rapidly as the pro-trade policies have allowed Thailand to capitalize on its regional location and low labor costs. Foreign investment, notably from Japan and Taiwan (China), has played an important role in the expansion, especially in the electronics and footwear industries. FDI has contributed both to the overall growth of industry and to the diversification and expansion of Thailand’s exports. However, policy continues to discriminate against small producers, largely because of the dominance of the BOI and its preference for large-scale enterprises. Smaller firms still face an incentive to produce for the domestic market, restricting their involvement in exporting and supplying exporters.

Thailand has a well-developed financial system, based upon a strong commercial banking network, which is free of much intervention. It supports the government’s macroeconomic policy in providing a
stable business environment that promotes private investment. Banks have been instrumental in the attempts of the largest Thai firms to organize vertically-integrated groups. In contrast to other East Asian nations, there has been little state direction of credit allocation, except to agriculture, where banks are required to fulfill lending targets to the rural and agribusiness sectors. Leading banks have adopted some of the investment coordination functions performed by the state in other nations. Rather than being an example of the state guiding the market, Thailand may be described, therefore, as a case where the market has compensated for government failures.

In Thailand, the provision of infrastructure was dictated by both security and economic considerations. This proved beneficial in the 1960s and 1970s, as the extension of the road network into rural areas led to a strong expansion in the growth of agriculture. However, as industrial development accelerated in the 1980s, the supply of infrastructure has become a severe bottleneck. The state’s involvement in education presents a similar picture. Thailand established an early commitment to universal primary education, as a means of promoting nationalism. While this policy boosted agricultural productivity in the 1960s, Thailand’s weaker record on secondary school enrollment has led to skills shortages in more recent times.

Institutions and Governance

In the post-war period, Thailand has been governed both by elected politicians and unelected military leaders. For the most part, the legislature has been ineffective, with the consequence that many laws are badly out of date. In this context, coups d’etat played an important function in relieving legislative bottlenecks and getting new statutes on the books. The legal autonomy of the civil service (established in the nineteenth century) has survived these political changes and parliament retains little power to scrutinise the activities of the bureaucracy. While the civil service has become a meritocratic institution, senior officials remain vulnerable to the influence of business interests and patronage remains part of the system. Although its political history has been turbulent, Thailand has managed to maintain social stability, largely because of the strength of the royalty.

The distinction between effective macroeconomic management and ineffective sectoral intervention, which characterizes Thailand’s development strategy, has a strong institutional basis. Of the four agencies which formulate macroeconomic policy, two (the National Economic and Social Development Board and the Bureau of the Budget) are controlled directly by the Prime Minister, who tends to remain above sectional issues, even when he is an elected politician; the other two (the central bank and the Ministry of Finance) are usually headed by technocrats. The macroeconomic agencies share a deflationary bias and a strong financial conservatism. In contrast, the line ministries are headed by politicians who manage sectoral programs to satisfy important political constituents. The independence of the Budget Bureau has prevented the use of macroeconomic policy to promote distributional objectives. As a result, cabinet ministers rely on sectoral interventions to serve this end. While the division between macro and micro agencies has guaranteed the technocrats autonomy to pursue their conservative agenda, there remains little coordination between the different policies. Thus, Thailand is a case where public policy has had only an indirect impact on development progress.
I. INTRODUCTION

Rapid economic growth in East Asia has sparked a great debate. The role of the state is the central issue in that debate. Proponents of a minimalist state argue that East Asian governments have succeeded because they have confined themselves to the maintenance of macroeconomic equilibrium, the provision of basic physical and social infrastructure, and to boosting education. On this view the state has an important role, but one confined largely to establishing the conditions for the efficient operation of markets (Krueger 1979; Kuznets 1977).

Proponents of the activist state, on the other hand, argue that some East Asian countries have succeeded because their governments have intervened extensively in the economy. These interventions, particularly in the credit and foreign exchange markets, have got prices deliberately wrong in order to favor specific industries and firms. The policies are effective because they are supplemented by disciplinary mechanisms. Macroeconomic equilibrium has been maintained in these countries, but growth has always taken precedence. The authorities have sometimes gone against the canons of macroeconomic propriety, and it was growth that eventually rescued them from their problems.

The experience of Thailand may be of some help in this debate. Here is another East Asian economy that has achieved excellent economic growth. Although not as spectacular as in Japan, South Korea and Taiwan (China), Thai growth has been remarkably steady. Even in the worst years in the mid-1980s, per capita incomes continued to grow. But the Thai case is different: neither the minimalist nor the activist analysis accurately describes Thailand’s economic policy and state interventions. This paper deals with the role of the state in fostering growth and considers the issues of the effectiveness of state intervention and of how far the model has been copied (from, say, South Korea or Japan).

The paper advances two main arguments. First, Thai economic policy has been most effective in maintaining a macroeconomic environment conducive to trade, investment, and the growth of private firms. It has been least effective in identifying and implementing sectoral objectives. Thai sectoral policies have not been guided by a strategy of picking-winners, and have often been marked by patronage and rent-seeking. And second, we argue that an activist state may require certain institutional skills that on many measures have eluded Thai economic policy. Macroeconomic stability, combined with the dynamism of private firms (and particularly of bankers), has helped overcome certain weaknesses on the sectoral side. But these mitigating factors may not be enough, if the government wants to guide the economy into industrial deepening or technological upgrading.

The paper is organized as follows: Section 2 reviews Thailand’s macroeconomic policy and performance. Section 3 examines sectoral policies and their results. Section 4 looks at the institutions of economic policy-making in Thailand, and Section 5 analyzes the political economy of macroeconomic

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1 In this paragraph we have followed the most articulate presentation of the activist view in Amsden (1989). The book maintains that the same story applies not only to Korea, but to Japan and Taiwan (China) as well. See also Johnson (1981) and Wade (1990).
decision-making. The final section provides some conclusions about the Thai government’s success in promoting growth and industrialization.

II. OVERVIEW OF THAILAND’S DEVELOPMENT

The Kingdom of Thailand has been one of the most rapidly growing economies in the world in recent years. However, its growth has been striking for much longer. During 1955-88, only four developing economies achieved a higher growth rate of per capita GDP than Thailand’s at 3.9 percent a year: they were Brazil and Malaysia (slightly faster), and Taiwan (China) and Korea (much faster). Thailand’s success is more likely to be relevant to the typical developing economy because Korea and Taiwan (China) had some distinctive features that are not likely to be replicated.

The most notable feature of Thailand’s record is macroeconomic stability. Sound macroeconomic policies, combined with a relatively open regime for foreign trade and investment, have resulted in sustained and rapid growth. Investment in primary education has been helpful, but investment in secondary education has been weak, especially compared with the successful Newly Industrialized Economies (NIEs). This weakness has been the main factor holding the economy back from even faster growth.

Thailand’s growth has brought a rapid decline in absolute poverty. It has also been associated with an increase in inequality. Development has been concentrated sectorally (in industry rather than in agriculture) and geographically (in Bangkok and its environs). Thus, the story of Thailand’s postwar development is largely one of success, though the imbalances show that the benefits of development have not been spread as widely as they might have been.

Sources of Growth

The Thai economy did not do well in the years immediately following the second world war, as the country retained a policy of heavy state involvement that dated from the 1930s. Real per capita GDP declined between 1950 and 1955 (Figure 1). However, beginning in the mid-1950s, Thailand switched to an emphasis on private sector development and an outward orientation. Since that shift in strategy, the economy has grown steadily and rapidly.

Figure 1 compares Thailand with Korea and the Philippines, three economies that were at about the same level of development in 1950. Korea has been one of the stars of recent decades, with per capita GDP growth averaging 5.7 percent during 1955-88. The Philippines, with a 2.1% average growth rate, has been one of the slower growing of the East Asian economies, though it has not done badly compared with many other developing countries. Over time, differences in annual growth rates lead to big contrasts in living standards. By 1988, real income in Korea was 80% higher than in Thailand, which

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2 This comparison ignores small economies and city states such as Hong Kong and Singapore. Growth rates were calculated from real per capita GDP figures derived from the International Comparison of Prices (ICP) project, release five.

3 A long period of Japanese colonialism; extraordinary amounts of U.S. aid; and a Confucian culture that emphasized education are three examples of characteristics that distinguish Korea and Taiwan (China) from other developing economies.
in turn was 50% higher than in the Philippines.

In terms of conventional growth theory, Thailand's rapid development is something of an anomaly. Investment averaged only 14.0 percent of GDP during 1955-88, well below the investment rate in Korea or the Philippines. The new empirical growth literature, on the other hand, sheds considerable light on Thailand's success. It has identified three variables that are highly correlated with per capita growth in developing economies: school enrollment rates, measures of outward orientation, and macroeconomic stability.

Macroeconomic stability is one of Thailand's strongest features. A good summary measure is the price level in Thailand, measured in U.S. dollars (see Figure 2): in essence, the real exchange rate. Certainly some variation in the real exchange rate is necessary and desirable as the external environment allows.

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This investment figure is from the unpublished ICP Release 5; Comparable figures for Philippines and Korea are 18.7% and 22.6%, respectively.

See, for example, Barro (1990) or Dollar (1992a).
changes and as development proceeds. But no country needs a roller-coaster, which is what most developing economies have experienced. The real exchange rate will generally show a lot of short-run variability in a high-inflation economy such as Brazil’s. Overvaluation can also be sustained for some years through exchange controls and/or external borrowing; but such a misaligned exchange rate will eventually collapse (i.e, Brazil or the Philippines in the early 1960s, Egypt in the 1970s). Thailand stands out as an economy whose real exchange rate has been low and stable continuously since 1955.

That stability is also a sign that Thailand is a relatively outward-oriented economy. Other potential measures of openness have been proposed in the literature, and most of them show that Thailand is indeed relatively open. Only "relatively", however, since Thailand has heavily protected a few capital-intensive industries. The pattern of selective protection is not untypical, even among developing countries that are measured empirically to be relatively open. In the case of Korea, for example, agriculture has been largely protected.

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6 On the basis of its low price level, Dollar (1992b) categorizes Thailand as "very outward oriented."

Education is an area where Thailand's performance is more complex. In cross-country studies, the primary school enrollment rate in 1960 is a variable that has been found to be highly correlated with economic growth in subsequent years. Thailand's 1960 rate of 83 percent was high relative to other countries in its income group. On the other hand, Thailand does not have a particularly high enrollment rate in secondary schools, a variable that also has a significant impact on growth. Thailand's rate in 1960 was 13 percent, well behind Korea (27 percent) or the Philippines (26 percent) and at about the same level as Brazil (11 percent). More importantly, Thailand's secondary school enrollment rate has not increased much over time (see Figure 3).

Effects of Growth

Rapid economic growth has transformed Thailand over the past few decades. But even as absolute poverty has declined, some income gaps have widened. Today, the Bangkok region, with 16 percent of the population, produces about one-half of GDP and nearly two-thirds of industrial output. This contrast is linked to another one: between industry and services, on the one hand, and agriculture on the other. Industry's share of GDP increased steadily from about one-quarter in 1970 to more than one-third in 1988. But one of the startling characteristics of Thailand is that this transformation of
production has not been associated with a comparable shift in employment (see Figure 4). The employment share of industry grew by only a few percentage points during this period. In 1988, nearly 70 percent of the labor force was still in agriculture, producing only 17 percent of GDP.

Korea's development, also shown in Figure 4, provides an interesting contrast. Labor shares in Korea in 1964 were similar to those of Thailand in 1970. But, as Korea's industry grew, it absorbed labor much more rapidly than Thai industry did. By the late 1980s, Korean industry produced about the same share of GDP as Thai industry, but employed nearly 30 percent of the labor force, against only 16 percent in Thailand.

The uneven development of different regions and sectors in Thailand has resulted in a
deterioration in the household distribution of income (Table 1). The share of income going to the richest 20 percent of the households rose from 49 percent in the mid-1970s to 56 percent in the mid-1980s. The Gini coefficient of inequality has shown a similar trend.
Table 1: THAILAND: INCOME SHARES BY QUINTILE, SELECTED YEARS
(% of total income)

<table>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1-st</td>
<td>49.26</td>
<td>51.47</td>
<td>55.63</td>
<td>54.98</td>
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<tr>
<td>Highest top 10%</td>
<td>33.40</td>
<td>35.44</td>
<td>39.15</td>
<td>37.85</td>
</tr>
<tr>
<td>Second top 10%</td>
<td>15.86</td>
<td>16.04</td>
<td>16.48</td>
<td>17.12</td>
</tr>
<tr>
<td>2-nd</td>
<td>20.96</td>
<td>20.64</td>
<td>19.86</td>
<td>20.3</td>
</tr>
<tr>
<td>3-rd</td>
<td>14.00</td>
<td>13.38</td>
<td>12.09</td>
<td>12.20</td>
</tr>
<tr>
<td>4-th</td>
<td>9.73</td>
<td>9.10</td>
<td>7.87</td>
<td>7.98</td>
</tr>
<tr>
<td>5-th</td>
<td>6.05</td>
<td>5.41</td>
<td>4.55</td>
<td>4.51</td>
</tr>
<tr>
<td>Second bottom 10%</td>
<td>3.62</td>
<td>3.28</td>
<td>2.75</td>
<td>2.74</td>
</tr>
<tr>
<td>Lowest bottom 10%</td>
<td>2.43</td>
<td>2.13</td>
<td>1.80</td>
<td>1.76</td>
</tr>
<tr>
<td>Total Share</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>Gini Coefficient</td>
<td>0.426</td>
<td>0.453</td>
<td>0.500</td>
<td>0.478</td>
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<tr>
<td>Variance of logarithm of Income</td>
<td>0.530</td>
<td>0.602</td>
<td>0.737</td>
<td>0.689</td>
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</table>


Despite the increase in inequality, the number of households living below the poverty line fell from nearly 60 percent of the total in the early 1960s to 30 percent in the mid-1970s and 24 percent in the mid-1980s. Urban poverty declined particularly sharply, so that poverty in Thailand today is largely a rural phenomenon, concentrated in the North and Northeast of the country.8

III. SECTORAL INTERVENTIONS

The government has pursued a fairly activist policy of intervening to promote particular industries and even firms. The main instruments of industrial policy have been the trade regime and the Board of Investment (BOI), which have combined to favor large industry. In the 1960s and 1970s, they supported capital-intensive, import-substituting activities. In the 1980s, they shifted in favor of exporters, but were still biased towards large-scale producers. But these interventions have not been important in explaining Thailand's economic success. Indeed, there is good reason to believe that social and economic

8 Hutaserani (1990).
development would have been more rapid had industrial policy not focused on particular industries but rather emphasized capital accumulation (especially human capital) more generally.

**Trade**

The trade regime has been one of the main tools of Thai industrial policy. Before the mid-1950s, it was extremely restrictive. Rice exports were controlled by a state monopoly; exporting was discouraged by significant export taxes and there was a system of multiple exchange rates. As part of the policy shift in the mid-1950s, the government liberalized the trade regime. It unified the exchange rate in 1955, and abolished the state-owned rice company.\(^9\)

Even after these reforms, Thailand still had substantial import protection for certain industries. As of the mid-1960s, the country had moderate levels of effective protection for finished consumer goods. Their nominal tariffs were 25-30 percent ad valorem, whereas tariffs on machinery and materials tended to be 15-20 percent. In the 1970s, Thailand increased effective protection for finished consumer goods, raising their nominal tariffs to the 30-55 percent range, while maintaining machinery tariffs at their low levels. The main protected industries were textiles, automobiles, and pharmaceuticals.\(^10\)

The protection for automobile assembly was particularly strong. At times, vehicle imports were banned or subject to domestic content rules. In the late 1980s, even after some easing of protection, the effective protection rate for motor vehicles was still around 70 percent. Textiles also continued to receive high protection.\(^11\)

In general, the most heavily protected industries were capital-intensive manufactures. This policy discriminated against agriculture and labor-intensive manufactures, the sectors in which the country had static comparative advantage in the 1960s and 1970s. There was also discrimination against agriculture in the form of export taxes, notably for rice. It seems very likely that this regime had a significant effect on the pattern of industrialization in Thailand. On the basis of comparative advantage, one would have expected the leading sectors in Thailand to be agriculture, related processing industries, and labor-intensive manufactures.

The effect of these incentives can be seen in the distribution of value-added among manufacturing industries (Table 2). In 1970, manufacturing value-added was concentrated in food processing and traditional labor-intensive activities, though even at that point Thailand had a surprisingly large share of its value-added in heavy industries. The import-substituting strategy was especially strong during the 1970s, and manufacturing value-added shifted towards heavy industries (with the share rising from 31.9 percent in 1970 to 42.6 percent in 1979). This policy no doubt helps to explain why industry’s share of GDP rose substantially in the 1970s while industry’s share of the labor force showed little increase.

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\(^9\) See Jitsuchon (1991) for a discussion of trade policy in this period.

\(^10\) Sibunruang (1986).

<table>
<thead>
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<th>Industry</th>
<th>1970</th>
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<td>Chemical and chemical products</td>
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<td>3.6</td>
<td>3881</td>
<td>3.3</td>
<td>8787</td>
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<td>petroleum products</td>
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<td>Rubber and plastic products</td>
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<td>2.9</td>
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<td>3.3</td>
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<td>Non-metallic mineral products</td>
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<td>1.3</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>1221</td>
<td>5.2</td>
<td>9884</td>
<td>8.4</td>
<td>12470</td>
<td>4.9</td>
</tr>
<tr>
<td>Textiles</td>
<td>1759</td>
<td>7.5</td>
<td>15390</td>
<td>13.1</td>
<td>27326</td>
<td>10.7</td>
</tr>
<tr>
<td><strong>High-Skill Labor-Intensive Industries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fabricated metal products</td>
<td>756</td>
<td>3.2</td>
<td>3509</td>
<td>3.0</td>
<td>6552</td>
<td>2.6</td>
</tr>
<tr>
<td>Machinery</td>
<td>733</td>
<td>3.1</td>
<td>2978</td>
<td>2.5</td>
<td>6095</td>
<td>2.4</td>
</tr>
<tr>
<td>Electrical machinery &amp; supplies</td>
<td>442</td>
<td>1.9</td>
<td>2869</td>
<td>2.4</td>
<td>7656</td>
<td>3.0</td>
</tr>
<tr>
<td>Other manufacturing industries</td>
<td>554</td>
<td>1.5</td>
<td>3815</td>
<td>3.2</td>
<td>14862</td>
<td>5.8</td>
</tr>
<tr>
<td><strong>Traditional Light Industries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wearing apparel except footwear</td>
<td>2126</td>
<td>9.0</td>
<td>10524</td>
<td>8.9</td>
<td>35513</td>
<td>13.9</td>
</tr>
<tr>
<td>Leather, leather products and</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>footwear</td>
<td>538</td>
<td>2.3</td>
<td>2077</td>
<td>1.8</td>
<td>7288</td>
<td>2.9</td>
</tr>
<tr>
<td>Wood and wood products</td>
<td>654</td>
<td>2.8</td>
<td>5671</td>
<td>4.8</td>
<td>5432</td>
<td>2.1</td>
</tr>
<tr>
<td>Furniture and fixtures</td>
<td>484</td>
<td>2.1</td>
<td>2184</td>
<td>1.9</td>
<td>3744</td>
<td>1.5</td>
</tr>
<tr>
<td>Paper and paper products</td>
<td>367</td>
<td>1.6</td>
<td>1686</td>
<td>1.4</td>
<td>3921</td>
<td>1.5</td>
</tr>
<tr>
<td>Printing, publishing and allied</td>
<td>336</td>
<td>1.4</td>
<td>1508</td>
<td>1.3</td>
<td>3668</td>
<td>1.4</td>
</tr>
<tr>
<td>industries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Food and Related Industries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>4681</td>
<td>19.9</td>
<td>14294</td>
<td>12.2</td>
<td>33258</td>
<td>13.0</td>
</tr>
<tr>
<td>Beverages</td>
<td>2820</td>
<td>12.0</td>
<td>10123</td>
<td>8.6</td>
<td>20981</td>
<td>8.2</td>
</tr>
<tr>
<td>Tobacco</td>
<td>1733</td>
<td>7.4</td>
<td>6353</td>
<td>5.4</td>
<td>12136</td>
<td>4.8</td>
</tr>
<tr>
<td><strong>Total Value-Added</strong></td>
<td>23,503</td>
<td></td>
<td>117,611</td>
<td></td>
<td>255,029</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank of Thailand.
In 1981, Thailand's trade policy began to promote exports more explicitly. The second oil shock exposed underlying weaknesses in the country's balance of payments, resulting from the import-substituting policies of the 1970s. Remaining export taxes were reduced and the exchange rate was devalued by 8.7 percent. The government also made an effort to rationalize tariffs. In 1982, it cut the top rate from 100 percent to 60 percent, and also reduced the average rate. However, budgetary problems soon led to the imposition of an import surcharge, undermining the effort to reduce average protection. By the mid-1980s, effective protection for manufacturing in Thailand (52 percent) was still substantially higher than in other East Asian economies such as Korea (28 percent), Malaysia (23 percent), or the Philippines (23 percent).^{12}

Some of the bias toward heavy industries was corrected in the 1980s, partly because of these modest changes in tariffs and more importantly because of the Board of Investment (discussed in the next section). The value-added shares of heavily protected industries such as transport equipment and textiles declined between 1979 and 1986. Overall, the weight of heavy industries in manufacturing value-added decreased from 42.6 percent to 36.7 percent. The industries whose shares expanded were labor intensive: traditional products such as garments, as well as new, higher skill areas such as electronics and jewelry. Still, as of 1988 this policy shift had done little to raise the low employment share of industry.

Only in the past few years has Thailand done much to liberalize manufactured imports. In 1990, the government cut tariffs on capital goods used in manufacturing, from 20 percent to 5 percent. It followed this in 1991 with large reductions in tariffs on automobiles and computers. In 1992 the government reduced duties on chemicals, textiles, iron, aluminum, and glass.

**Board of Investment**

The other powerful instrument of industrial policy in Thailand has been the Board of Investment (BOI). It was established in 1960 to implement a new investment promotion act. Its activities were initially carefully circumscribed; laws dictated which industrial activities it should promote and each promotion certificate was subject to cabinet approval.^{13} BOI incentives included a holiday on income tax (initially for 2 years). However, the BOI’s most significant power was over imports. It could exempt particular firms or industries from import duties on machinery, components, and raw materials, as well as imposing bans and surcharges on competing imports.

In 1962, the Promotion of Industrial Investment Act gave BOI more flexibility and independence. It allowed BOI itself to issue promotion certificates and to add to the list of eligible activities. The 1962 act also created three basic groups of promoted activities, with different incentives based on their perceived importance to the economy. Full exemption was granted to a range of mostly heavy industries, including basic metals, machinery, and chemicals. A second group, mostly involved in assembly (i.e., of motor vehicles, agricultural machinery, or electrical appliances), received half-exemption, and another (including agricultural processing industries, textiles, and pharmaceuticals) got one-third exemption.

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^{12} Bhattacharya and Linn.

^{13} The description of the evolution of BOI policy here is based on Sibunruang.
There were various adjustments to the investment promotion laws in the 1970s, but the basic thrust remained: to promote capital-intensive industrialization. Capital intensive in two senses of the phrase: first, the industries promoted tended to be ones that employed a lot of capital per worker; and, second, the strong incentive to import machinery favored capital-intensive techniques within each industry.

Almost all promotional certificates awarded in the 1960s went to firms producing for the home market. Apart from that general principle, however, "[n]o really clear and explicit criteria were developed to form the basis for a decision" to promote individual firms (Ingram 1971:289). The BOI never provided a coherent import-substitution philosophy, and its practices were often inconsistent. For instance, it never developed performance criteria to judge whether the firms fulfilled any stated policy objective and rarely evaluated the firms it promoted. There is evidence that the import-substituting policies did not succeed in "picking winners." Wiboonchutikula's study of total factor productivity (TFP) growth in Thai manufacturing found that TFP growth has been low in import-competing sectors and relatively higher in export industries.

When Thailand started to favor export promotion in the early 1980s, the BOI was called upon to play a different role. A major study of its work was carried out under a UNDP/IBRD technical assistance project, and it recommended substantial reforms. In January 1983, the BOI announced Criteria in Approving Investment Promotion and Providing Tax Privileges. This was the first time that clear criteria for the approval of projects were published. In addition, some of the specific characteristics favored — generation of foreign exchange through exporting, employment creation, utilization of local raw materials, and industrial decentralization — represented a shift in the thrust of Thai industrial policy.

**Export Promotion Policies**

Even as it switched to export promotion, the Thai government stressed that its efforts were not intended to distort markets but to reinforce market competition.

The most important change in incentives came through the real exchange rate. Throughout the 1960s and 1970s, the Thai baht had been tied to the U.S. dollar, with only minor adjustments from time to time. This passive policy served Thailand well while the Bretton Woods system of fixed exchange rates was in effect. However, problems arose once the major currencies began to float. Linking the baht to the dollar led to a rise in the real effective exchange rate in the early 1980s, despite the 8.7 percent devaluation against the dollar in 1981. The big change in Thailand's real exchange rate came in 1984, when the Bank of Thailand started tying the currency to a basket of major currencies, not just the U.S. dollar. This led to an immediate 14.8 percent devaluation of the real effective exchange rate. Furthermore, the new policy gave the government more flexibility, as the basket to which the baht was tied was not precisely defined. As the U.S. dollar fell against major East Asian currencies in the second half of the 1980s, the Thai government allowed the dollar weight in the basket to increase, so that the baht was devalued significantly against the Japanese yen and the New Taiwan dollar. The real effective exchange rate depreciated by nearly 30 percent between 1983 and 1991.

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14 Jitsuchon.

15 Calculated from the IMF’s index of real effective exchange rate.
These developments resulted in a large increase in the incentive to export from Thailand, spurring Thai firms to export and also attracting direct foreign investment from the economies whose currencies had appreciated. Other Thai policies supported the export drive:

- Tax privileges and refunds
- Zoning
- Electricity cost reduction
- Refinancing facilities
- Marketing assistance
- International trading firms
- Quality control

The BOI gave priority to export projects in addition to ones using local input, projects employing a large labor force, and those located outside the Bangkok area. It granted numerous tax exemptions to export-oriented projects, including duties and business taxes on imported raw materials or components or re-exported items, business taxes on domestic input, export duties, and certain deductions from taxable corporate income. Roughly half of the projects that the BOI promoted in the 1980s were export-oriented.

Even firms that were not BOI-promoted could claim similar tax refunds on their export activities, and their claims were dealt with by the Customs Department in conjunction with Fiscal Policy Office. Under these schemes, exporters were entitled to receive rebates on customs duties, business taxes, municipal taxes, excise taxes, and other taxes previously collected on particular inputs. However, these rebates were not as effective as the exemptions available through BOI, so that small firms continued to be at a disadvantage.

The government also streamlined customs procedures and abolished unnecessary regulations so that exporters were able to expedite their processing and shipments. It established export processing zones (EPZs) and bonded warehouses. Firms in EPZs enjoyed several privileges, such as exemptions from import duties, export duties, and business taxes. Foreign investors were permitted to own land, to bring in necessary technicians or experts, and to remit much of their foreign exchange. EPZ factories also benefited from good transportation and telecommunications, and could get a 20 percent reduction in their electricity bills as long as they were qualified for the Fiscal Policy Office’s tax rebate scheme. Each EPZ had bonded warehouses for storing duty-free imported inputs destined for export production. These warehouses helped exporters to limit the burden of customs duties and storage expenses. Once again, however, the deregulation within EPZs tended to assist large firms, while leaving the incentive regime for small firms quite distorted.

In addition to tax privileges, exporters received concessionary credits. The central bank has been extending refinancing facilities (RFs) to certain economic sectors (exports, industry, and agriculture) since 1956. Typically, an eligible entrepreneur wishing to obtain a cheap loan can issue a promissory note to be discounted by his bank and rediscounted by the central bank, both at below-market rates. Some 95 percent of RFs were absorbed by exporters.

The Thai government also provided exporters with marketing assistance, by organizing international trade exhibitions, setting up trade missions, establishing commercial and trade offices abroad, and lobbying. Thailand sought to emulate the role that international trading firms have made in the Japanese
export drive. Such firms were given special privileges from the BOI on condition that their performance was satisfactory. This policy, however, did not succeed in creating strong trading firms.

The export drive raised several noteworthy points. First, quite a few of the measures — and particularly the most critical one, the refund of taxes on inputs — corrected an existing distortion. Secondly, these measures, even though technically they were sectoral in nature, were spearheaded by the macroeconomic technocrats, and many of them involved the Ministry of Finance. With the exception of the Ministry of Commerce, the sectoral ministries were bypassed entirely.

As a result of these new policies, Thailand's exports of labor-intensive manufactures increased rapidly. Between 1970 and 1979, light manufactures had increased from 1.4 percent of Thailand's exports to 12.8 percent. By 1986, their share had soared to 30.8 percent of total exports. The main industries involved were clothing, footwear, artificial flowers, jewelry, and integrated circuits.

Although the BOI's new emphasis on export promotion supported the export drive, its importance should not be exaggerated. In general, BOI has been a follower, not a leader. For example, the BOI started to favor electronics in the early 1980s, yet the industry did not make much progress. It was not until the mid-1980s, with the large devaluation in the real exchange rate, that electronics really took off. In 1987, the BOI approved more electronics promotions, with increased investments, than in all its 27 years of existence. There are other sectors that the BOI did little to promote until they were already very successful: canned tuna, canned fruit, and jewelry are good examples. In recent years the importance of BOI has diminished as the tariffs and taxes upon which its incentives were based have been reduced.

While the trend in the 1980s was toward general export promotion, that decade also witnessed the Eastern Seaboard Program. This program was primarily a regional development scheme, but the original conception involved a targeted sectoral policy to develop heavy industry as well. The program was organized around the newly discovered natural gas supply in the Gulf of Thailand. The initial plan was to develop a national fertilizer complex, steel mills, gas and oil processing, and petro-chemicals (all import substituting) as well as export-oriented light manufactures. At the end of the day, many of the heavy projects were abandoned because the technocrats resolved that the projects would overextend the financial resources of the government. In particular, the steel mills and fertilizer complex never materialized. The export-oriented factories built on the industrial estates have done well, so that the Eastern Seaboard Program has been successful as a regional development scheme and has contributed to the 1980s export boom. The abortive attempt to target the development of heavy industrial complexes, on the other hand, was a failure. The facilities that were built, notably in petro-chemicals, survive today because of continuing import protection, but have not been major contributors to the country's industrial development.

In general, it is clear that Thailand's overall incentives for industry in the 1980s have been satisfactory. However, the economy would probably have developed even more successfully with a regime geared to broad-based liberalization of manufactured imports, rather than continued restrictions combined with a super-agency (or EPZs) that could cut through the restrictions. The flaw in the Thai system was that it kept so many small and medium firms out of exporting or of supplying exporters. For a large firm that could get BOI promotional benefits, there was a strong incentive to export in the 1980s.

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16 Chitayarangsan (1990), p. 73.
For smaller firms, on the other hand, the incentive largely remains to produce for the domestic market. This combination resulted in Thailand becoming a significant exporter of manufactures. However, labor-intensive manufacturing has not had the same effect on production and employment that it has had in the NIEs.

Table 3: DISTRIBUTION OF THAILAND’S EXPORTS, 1970, 1979, AND 1986

<table>
<thead>
<tr>
<th></th>
<th>1970</th>
<th>1979</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Heavy Manufactures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iron and Steel</td>
<td>0.3</td>
<td>0.4</td>
<td>0.9</td>
</tr>
<tr>
<td>Non-ferrous Metals</td>
<td>11.8</td>
<td>9.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Chemicals and Plastics</td>
<td>0.2</td>
<td>0.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Transportation Equipment</td>
<td>0.0</td>
<td>0.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Textiles</td>
<td>1.3</td>
<td>6.7</td>
<td>5.9</td>
</tr>
<tr>
<td><strong>High-Skill Light Manufactures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machinery, n.e.c.</td>
<td>0.1</td>
<td>0.3</td>
<td>2.1</td>
</tr>
<tr>
<td>Electrical Machinery</td>
<td>0.1</td>
<td>3.3</td>
<td>8.3</td>
</tr>
<tr>
<td>Metal Products, n.e.c.</td>
<td>0.2</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Other Industries</td>
<td>0.4</td>
<td>2.2</td>
<td>6.0</td>
</tr>
<tr>
<td><strong>Traditional Light Manufactures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wood Products, Paper</td>
<td>0.3</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Rubber Products</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
</tr>
<tr>
<td>Leather &amp; Products</td>
<td>0.1</td>
<td>0.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Clothing, Footwear</td>
<td>0.1</td>
<td>4.3</td>
<td>10.8</td>
</tr>
<tr>
<td><strong>Primary Products</strong></td>
<td>83.3</td>
<td>66.8</td>
<td>54.4</td>
</tr>
</tbody>
</table>

Source: UN Trade System.

Thailand has a different pattern of resources to that of Korea or Taiwan (China), so its pattern of industrialization is unlikely to be the same. Its land-labor ratio is more favorable, creating a weaker incentive to leave agriculture. Indeed, the area of cultivated land actually increased by nearly 50 percent between 1970 and 1980, so that the land-labor ratio was rising, contrary to the experiences in most
developing countries. One would therefore expect to find a larger share of the labor force in agriculture in Thailand than in the NIEs. However, there is no fundamental reason for such a large productivity gap between (a) industry and services and (b) agriculture. The fact that Thailand is rich in natural resources means that agriculture has the potential to be a high-productivity sector.

To the extent that government action altered relative prices from those prevailing in international markets, it discriminated against agriculture and labor-intensive manufacturing and in favor of heavy industry. A neutral policy would have boosted agricultural productivity in two ways: by raising agricultural prices, and by encouraging some labor to move out of agriculture into manufacturing. Stronger development of secondary education in rural areas would also have helped, by increasing the ability of farmers to absorb new information and technologies and equipping other rural dwellers to move off the land and into industry and services. To complement this, the government could have invested more in physical infrastructure in rural areas.

Financial Policies

Thailand has a relatively well-developed financial system. Broad money (M2) is about two-thirds of GDP in Thailand, a ratio typical of a developed country and far higher than the norm for a country at Thailand's level of income. By and large, the government has not relied much on credit control and directions. The exceptions are some credit directed to agriculture and small-scale industry — ironically, the same sectors discriminated against by the combined effect of the trade regime and the BOI's activities. However, the real thrust of financial policies has come via interest rates and the regulation of the financial system. By these methods, the government has helped the development of strong commercial banking.

Commercial banks are the dominant financial institutions, accounting for 59 percent of all financial assets in 1988. Five large private banks are particularly prominent; together, they made 65 percent of all commercial bank loans in 1988. Their growth has been nurtured by the government's policy of setting ceilings on both deposit and lending rates. These ceilings have almost always been well above the rate of inflation, thus avoiding the severe distortions common in many developing countries. On the deposit side, for example, ceilings in the 1980s were in the 10-13 percent range, while inflation was very low. As a result, actual deposit rates bumped up against the ceiling only very rarely.

The ceilings have probably had more effect on the lending side. The prime lending rate of commercial banks was normally well below the lending ceiling. But commercial banks typically make loans to less creditworthy customers at rates well above the prime. Thus, it is likely that some of these customers have been denied a loan by the interest rate ceilings. Even so, the commercial banks increased their dominance of the Thai financial system during the 1970s and 1980s, which suggests that regulation did not hamper their ability to compete. Early in the 1990s the government further liberalized the financial system by fully deregulating interest rates.

Other aspects of regulation worked in favor of the banks. There are, for example, no markets for commercial paper or corporate bonds. One reason for this lacuna was the restrictions on the issuance

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17 Siamwalla (1991) analyzes the impact of this land expansion on Thailand's development path.

18 Data in this section are from the World Bank's Financial Sector Study, 1990.
of debt by companies whose shares are not traded on the stock market. Many Thai industrial firms are closely held, so were unable to issue their own paper. These regulations have contributed to the development of industrial groups of closely held firms clustered around the major commercial banks.

The Thai government therefore decided it was right to introduce some distance between commercial banks and industrial firms and to diversify the ownership of banks. It introduced complex requirements on bank ownership, bank holdings of equities, and bank lending to related firms. For example: (1) no one person can own more than 5 percent of a bank's outstanding shares; (2) a commercial bank must not have fewer than 250 shareholders, each of whom holds not more than one-half of 1 percent of outstanding shares, but who together hold more than 50 percent; and (3) three-quarters of shareholders must be Thai nationals.

It is generally agreed that these regulatory efforts have failed. The big banks are typically family-controlled and closely linked to industrial firms owned by the same families. The unfortunate result of this regulation is that it becomes difficult to sort out who owns what, which complicates the efforts of the Bank of Thailand to assess the quality and riskiness of bank portfolios.

The Bank of Thailand has also supported the banks by providing soft loans in times of trouble. There is no explicit deposit insurance in Thailand, nor a formal mechanism for taking over insolvent institutions. But the government has provided implicit guarantees by not allowing big banks to fail. This policy was tested in the early 1980s, during a time of slow growth following the second oil shock. Several non-bank financial institutions were closed. Some commercial banks had serious financial difficulties. The Bank of Thailand's options were limited by features of Thai law, which made it hard to transfer claims once legal action was commenced. Therefore, troubled financial institutions had to remain in existence in order to foreclose on debtors or to collect overdue debts. In addition, the Bank of Thailand's legal authority to intervene was weak, so its only realistic option for preventing the failure of major banks was to provide low-interest loans. Many such loans are still on the Bank's books.

In practice, therefore, the Thai banking system has been loosely regulated. Restrictions on banks tend to be minor, both concerning interest rates and their lending to related parties. At the same time, regulation has protected the banks, by limiting activities of foreign competitors and by hampering the growth of markets for corporate debt that would compete with bank lending. By bailing out troubled banks with soft loans, the Bank of Thailand has limited the downside risk, not just for depositors but for bank shareholders as well.

Direction of Lending. Beginning in 1975, the government stipulated that a certain share of credit must go to agriculture. It claimed that the commercial banks, based in Bangkok, were ignoring the farmers. The original target was for commercial banks to allocate 5 percent of their previous year's deposit base to agricultural lending. By 1987, the target had reached 14 percent for direct lending to the rural sector plus 6 percent for agribusiness. Shortfalls had to be deposited in the Bank for Agriculture and Agricultural Cooperatives (BAAC), a development bank for agriculture.

In practice, commercial banks have anyway exceeded the 6 percent target for lending to agribusiness. But their lending to agriculture has usually fallen short of the 14 percent target, so they have had to make deposits into the BAAC. They are comfortable lending to large farmers with clear title to their land, but only about one-half of agricultural land is covered by land titles they regard as acceptable. As a result, many small farmers do not benefit from the government's policy of directed credit. They have to rely on informal moneylenders, who charge interest at 5 percent a month.
The BAAC has done something to fill the gap. It generally lends to medium-scale farmers at interest rates far below informal market rates, but above deposit rates. It accounts for about 25 percent of agricultural lending, compared with 55 percent for commercial banks and an estimated 20 percent for the moneylenders. The BAAC has some privileged access to funds, notably low-interest loans from the Bank of Thailand and the deposits from commercial banks. These subsidies, however, are not large. More important, the BAAC is quite efficient, with a recovery rate on loans of 82 percent in the late 1980s. That compares with rates as low as 10 percent for development banks in many developing countries.

The government's effort to build up a similar development bank for industry has been less successful. The Industrial Finance Corporation of Thailand (IFCT) was established in 1960 to provide long-term project finance for private industry. As a development bank it was unusual, in that initially it was fully private. Later, the government became a minority shareholder. Thai commercial banks have been the dominant shareholders, with foreign banks holding significant shares as well. The IFCT is successful in the sense that it is financially sound. However, it has never played much of a role in financing investment in Thailand. Its loans outstanding amount to about 1 percent of the total in the financial system, and even in manufacturing its share of lending is only 3 percent. The reason for its relative failure is that there was no real niche for the IFCT to fill.

It should also be noted that equity rather than debt has been the main source of long-term finance for most manufacturers. The ratio of long-term debt to equity in 1988 was .09 in textiles, .12 in electronics, and .06 in the motor industry. These figures are a bit misleading, as firms in these industries have large amounts of short-term debt to commercial banks that is routinely rolled over and has some of the character of medium- and long-term debt. Their overall debt-to-equity ratio is therefore around 1.0. Thailand has an active and growing stock market, but many large industrial firms remain closely held. Retained earnings are the main source of the growth in equity in Thai industry.

**Direct Foreign Investment**

The Thai government has traditionally had a liberal attitude to foreign direct investment (FDI). Beginning with the first one in the early 1960s, every plan has had a clear policy of promoting FDI. Thai law makes no major distinctions between domestic investment and foreign investment. This is true for tax laws and most regulations. An important exception is that foreigners are generally not allowed to own land in Thailand, so they rely on long-term leases. The Alien Business Law also identifies some industries which are closed to foreigners, particularly various types of farming. There are some restrictions on the number of foreign technicians and managers who can work in Thailand.

These regulations are minor compared with those imposed by many developing countries. Furthermore, they can all be circumvented if a foreign firm receives BOI promotion. A promoted foreign firm is allowed to own land, produce in the prohibited sectors, and normally bring in the expatriate staff it requires. As with domestic firms, BOI promotion also enables a company to get access to imported machinery, parts, and materials without paying significant tariffs. Thus, BOI policy strongly affects the choice of industries in which foreign firms will invest.

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19 Sibunruang and Tambunlertchai (1986).
Changes in BOI policy on FDI have mirrored the board's general policy shifts. In the 1960s and 1970s, it favored import-substituting projects; in the case of foreign investment it preferred joint ventures with Thai nationals over 100 percent foreign ownership. This policy gradually changed to promoting export-oriented activities. The 1983 Criteria in Approving Investment Promotions indicated that companies aiming at the domestic market should be at least 50 percent Thai-owned (and 60 percent in agriculture and services). Where more than 50 percent of the output is exported, foreigners can hold a majority share in promoted investments. And, plants that export all their output can be owned 100 percent by foreigners.

In combination with the large real devaluation of the exchange rate in the mid-1980s, this policy led to a surge of manufacturing FDI into Thailand. The inflow averaged $270 million per year during 1980-85, but by 1990 it had reached $2.4 billion. Firms from neighboring economies whose currencies have appreciated, notably Japan and Taiwan (China), have moved some production to Thailand. Investment has been particularly strong in electronics and footwear. FDI has made a large contribution, both to the overall growth of industry and to diversifying and expanding Thailand’s exports.

**Provision of Infrastructure**

Where and how a government spends money on infrastructure has a large impact on industrial development. The Thai government has a good record in the provision of basic infrastructure; notably railroads, electricity, irrigation, roads, and (extending the concept of infrastructure somewhat) primary education. Its weaknesses have been in urban water supply and the telephone network, but even here it has been under pressure to perform.

In the cases of railroads at the turn of the century and roads in the 1960s and 1970s, the Thai government did not merely respond to demand; it anticipated it. However, its decisions have often been driven by military rather than economic considerations. The transport network has made it possible for the Thai state to increase its presence in the countryside. It is no accident that the decision to spend heavily on roads was made in the 1960s, when the military dominated the government, and the state was increasingly challenged by a communist insurgency. The road network eventually had a major economic impact in promoting agricultural growth, but this was quite incidental.

Some of the same factors were also at work in the development of universal primary education. In the aftermath of the coup d'etat in 1932, the government undertook immediately to expand education as a means to promote nationalism and support for the new regime. The government also wanted to equip ethnic Thais to compete with the Chinese, anti-Chinese sentiments then being quite strong. Within a few decades, primary education became universally available. In the 1960s, the period of compulsory primary education was raised from four years to six. The consequent rise in the quality of the labor force played a big role in boosting agricultural productivity.

As economic growth and industrialization accelerated in the 1980s, the supply of infrastructure became a severe bottleneck. The problem was largely caused by the slowdown in infrastructural investments during the austerity program of the early 1980s. Government investment, mostly for infrastructure, declined from 5.4 percent of GDP in 1970 to 4.0 percent in 1980 and 2.7 percent in 1990 (Bank of Thailand).

With the need to speed up investments in transport and communications, conflicts between the economic technocrats and the elected politicians came to a head. The technocrats wanted to privatize
some of the projects. But in many areas state enterprises had monopoly powers under the law, so the only way private firms could enter the fray was by obtaining concessions from them. The awarding of these concessions then became the battleground; the technocrats lost, particularly during the government of General Chatichai Choonhavan. The country also lost. Not only was corruption rife in the negotiation of many of these contracts, but the negotiation also took a damagingly long time.

IV. INSTITUTIONS OF ECONOMIC POLICY-MAKING

So far, this paper has argued that Thailand’s development has been a strange mix of strong macroeconomic management and poorly coordinated sectoral interventions. The second half of the paper examines the institutional and political bases for this combination.

The institutional origins of economic policy in Thailand lie in the politics of national state formation in the 19th century. Three political features have moulded state institutions and economic policy instruments: the bureaucracy, the system of administrative law, and patronage.

**Bureaucratic Autonomy, Administrative Law, and Patronage**

Under challenges from the British and the French, the monarchy established a functional bureaucracy in 1892. It thereby warded off the threat of colonial intervention while also centralizing political power and bringing the regions under its legal domain. A code of civil law was imported from France, empowering the functionally organized ministries of government with administrative autonomy. To this day, the bureaucracy retains a considerable part of its legal discretion.

In 1932, a coup d’etat did away with the absolutist powers of the monarch and introduced a parliamentary form of government. Since then, although there have been many changes of constitutions, all governments have been at least nominally accountable to the legislature. But the autonomy of the civil service has endured.

Thailand’s code of administrative law has three main features. First, it gives great authority to subordinate laws, which are controlled by permanent officials and by ministers. Acts of parliament typically have very little policy content. Rather, they give discretion to the relevant agencies and affect the relative bargaining power among them. Armed with this authority, officials then introduce whatever regulations and notifications they see fit. This leads on to the second feature of the Thai system: that parliament has little power to scrutinize the activities of the bureaucracy. Rather, the politicians’ source of power lies in ministerial appointments. And the third feature of the legal code is that, as a matter of principle, *the rights of the individual are not protected uniformly from the state*. This gives officials considerable autonomy to decide who wins and loses in the regulation and allocation of resources.

These legal points should be seen against the political background of Thailand’s tradition. Laws in Thailand are very long-lived, but not because of any foresight of the legislators. The real explanation is that the legislature is not very productive in making laws, especially when members of parliament are elected — as they have been for most of the past two decades. Although a coalition government is normally appointed with the consent of the parliament and is nominally accountable to it, as soon as the government is in office it directs its majority to vote for as brief a session of parliament as possible, to prevent members from becoming too obstreperous. Parliament is then usually in session for three months, but it convenes for only about 12 days. Its main tasks are to pass the annual budget and, for
opposition MPs, to debate no-confidence motions against the coalition. These ensure that there is little
time left for legislative business. Again, this is symptomatic of a parliament that is used primarily as a
device for winning seats in the Cabinet.20

The low productivity of the legislature has various consequences. First and most obviously,
Thai laws are sometimes badly out of date. For example, the current legislation guiding the allocation
of the electromagnetic spectrum was passed in 1934. And other key pieces of legislation — like the
Import and Export Commodity Act of 1979 or the National Forestry Act of 1964 — are almost identical
versions of documents enacted much earlier. Secondly, it reinforces the bureaucracy's penchant for
proposing laws that give it all-encompassing powers, to cover as many future contingencies as possible.
Thirdly, since the laws give the bureaucracy such broad powers, it is difficult to liberalize particular
sectors of the economy. Even if the bureaucrats and the ministers agree on a liberalization program, it
cannot be fully credible because the next change of government may lead to a policy reversal.

In this context, coups d'état perform an important function. In the first flush of a coup, the
junta usually assumes broad legislative powers, and its decrees remain on the books on par with acts of
parliament. It also appoints members to sit in a legislature, and this body will then break the legislative
logjam developed in previous elected parliaments. Thais are now living under laws the vast majority of
which were passed by unelected legislatures.

Despite their wide-ranging legal powers, however, officials are not impervious to extra-burea-
ocratic demands. They are vulnerable to intervention both from above (the military and political elites)
and below (lobbying and other forms of influence from interest groups and firms) (Crouch 1984). A
Cabinet position enables a minister to influence how state agencies use their discretion. Moreover, Thai
officials, like most regulators, are vulnerable to "capture" by industry interests that seek benefits from
regulation or protection (Stigler 1971). These opportunities for patronage make the bureaucracy a key
mediator and participant in rent-seeking. But officials remain independent and powerful, because of the
mandates of the legal code.

As for cabinet ministers, they exert patronage depending on which portfolios they hold. Table
4 shows the distribution of Cabinet portfolios among the main coalition parties for all elected coalition
governments between 1975 and 1991. Prior to the coup of February 1991, Agriculture was evenly
rotated among the top parties; Industry was dominated by the Chart Thai Party; Commerce was
controlled by the Social Action Party; technocrats were usually assigned to the Finance Ministry; and
the military, in addition to the Defense portfolio, often laid claim to the Transport and Communications
posts. After 1975, the Agriculture, Commerce, and Industry posts were favored by the leading parties.
In the late 1980s, the Communications post became lucrative with the privatization of numerous mass
transit and telecommunications projects. Many were allegedly used as sources for graft by ministers in
the governments of Generals Prem Tinsulanond and Chatichai Choonhavan.

The typical style of the parties is to manage sectoral policy in an activist fashion, geared to
satisfying particular groups of supporters. With rice prices, for example, politicians have favored

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20 It bears consideration that elected parliaments are often under pressure from the military, both from
the appointed Senate, which also votes on bills, and from individual officers who have been known
to threaten coups to keep the elected lower House in line. This, however, does not in itself account
for the aspiration of elected MPs to the Cabinet. For more discussion see Christensen (1991).
government procurement at above-market prices for some farmers; but they have not introduced programs that would raise prices for all farmers (Siamwalla and Setboonsarng 1989). Trade quotas and factory permits also create opportunities for political parties and individual politicians. In the case of textiles, efforts to liberalize these regulations were often obstructed by elected ministers, who preferred to use controls on factory capacity for allocating largesse to client firms (Doner and Laothamatas 1992: Appendix on Textiles and Apparel).

These general features of state intervention — autonomy, discretion, and patronage — do not in themselves produce "good" or "bad" policy management. Rather they are formal and informal rules of the game that act as incentives and shape competition among political and bureaucratic elites. Between 1932 and 1957, the results were generally negative, because officials used the offices and legal discretion of the state to create and diversify their revenue bases (Riggs 1966; Skinner 1957; Golay et al. 1969). Initially they and the military intervened in the country’s thriving rice industry. Later, military elites used the ministries to create state enterprises in manufacturing.

Throughout this period, the state was very activist. Its interventions were not guided by an industrial development philosophy as such, but were made in the name of economic nationalism, or "rescuing capital from the aliens," the overseas Chinese. In practice, military elites started to collaborate with immigrant Chinese traders, bankers, and nascent industrialists, who exchanged payoffs or shares in their firms for assurance against harassment. Ruling military officials also created franchises for themselves, usually to support their factional struggles for control of the government. Nearly 100 state enterprises were created before 1957, and most of them were poorly managed.

The Division of Management: Macro and Micro Policies

After a coup in 1958, policy reforms curbed state intervention and altered the economy’s course. The management of macroeconomic policies was reorganized, producing an organizational and political split between macro and microeconomic policies (Christensen, 1993: chapter 3; Christensen 1992; Doner and Laothamatas 1992).

In consultation with the World Bank, the new government created new agencies and put them in the Office of the Prime Minister. The most critical ones were the National Economic and Social Development Board (NESDB) and the Bureau of the Budget (BOB). These, along with the Ministry of Finance and the Bank of Thailand, formed the core macroeconomic agencies. Officials from these four agencies are referred to frequently as "the technocrats." In addition, the BOI was created. The government cut back on subsidies for state enterprises, reformed the accounting systems in the line ministries, and empowered the budget bureau to scrutinize their spending. The provision of infrastructure was inscribed in the five-year development plans, launched in 1961. The reforms cut losses, stabilized fiscal management, and ensured more centralized planning and monitoring of public investments.

Credit policies were revised as well, again in an effort to curb patronage. After several quasi-state enterprises went bankrupt and foreign loans were squandered, the government stopped guaranteeing private sector debts. The Bank of Thailand provided selective credit only on a very limited basis, almost entirely in the form of rediscounted promissory notes or "packing credits" for exporters.
TABLE 4
ALLOCATION OF ECONOMIC PORTFOLIOS AMONG LEADING COALITION PARTNERS, 1975-1991
(total posts in elected coalitions)

<table>
<thead>
<tr>
<th>MINISTRY/PORTFOLIO</th>
<th>CHART</th>
<th>THAI</th>
<th>SAP</th>
<th>DEMOCRAT</th>
<th>TECHNOCRAT</th>
<th>MIL/POLICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINANCE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minister</td>
<td>9</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Deputy</td>
<td>13</td>
<td>4</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>INDUSTRY</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minister</td>
<td>9</td>
<td>7</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Deputy</td>
<td>15</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>COMMERCE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minister</td>
<td>9</td>
<td>1</td>
<td>6</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Deputy</td>
<td>15</td>
<td>2</td>
<td>8</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>COMMUN/TRANS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minister</td>
<td>9</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Deputy</td>
<td>21</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>AGRIC/COOPS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minister</td>
<td>9</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Deputy</td>
<td>25</td>
<td>4</td>
<td>7</td>
<td>4</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>


The reforms were successful in part because they had a political constituency which made them feasible and legitimate. The new government had the support of entrepreneurs and military officers hostile to the group that had promoted the nationalist policy. Leading Chinese firms favored a more stable macroeconomic environment and had lobbied, before the coup, for less state intervention (Hewison 1985:266-67). As for the armed forces, they were discovering that technocratic management formed the basis for a lucrative defense budget. Military initiatives began to intrude on debt management only in the late 1970s.\(^{21}\)

The fact that many Thai technocrats had the same views and training was also important for the success of the reforms. Although the reforms were supported by the World Bank, they were formulated and carried out by a group of Thai economists. These people shared an *esprit de corps* inspired by a long tradition of financial conservatism, a tradition inherited from British advisors and from the monarchy's fear that debt would lead to loss of sovereignty.

This "Gladsonian orthodoxy" had a deflationary bias and emphasized financial conservatism (Silcock 1967). Transmitted primarily through the Ministry of Finance and the Bank of Thailand, the orthodoxy shaped the outlook of the first generation of post-war technocrats and influenced officials in

\(^{21}\) It was not until 1984 that an officer, the army commander-in-chief, took a position on a macroeconomic issue, in this case the 14 percent devaluation of the baht because it thwarted the planned purchase of F-16s from the United States (Phongpaichit 1991). Six months later that officer was dismissed from his post.
the other macroeconomic agencies. Moreover, it had a political bias that despised patronage and the corruption that went with it. Evers and Silcock wrote that the liberal exchange and trade regime was "partly the result of opposition [by technocrats] to the opportunities for private gain which a protective system would bring…" (Evers and Silcock 1967:97). The technocrat who did most to institutionalize this philosophy was Dr. Puey Ungphakorn, the former Governor of the Bank of Thailand. We stress that this specific philosophy — which has favored a relatively open trade regime, only minimal central bank discretion over credit and foreign exchange allocations, and fiscal conservatism — was initially made possible and then was sustained for two decades by a growing surplus of exportable agricultural produce.

In contrast, sectoral policies were changed only slightly. The five-year development plans launched in 1960 helped to ensure the development of infrastructure such as irrigation, roads, and electric power. But in the area of industrial policies, there was virtually no coherent or coordinated strategy, in part because the institutional framework was not conducive to it. Moreover, patronage still influenced some of the important decisions by the line ministries.

Beginning in the late 1950s, the civil service gradually changed. It had been an office-holding class, which once owed its allegiance to the King. It became a more meritocratic institution that was involved in policy-based discussions with the private sector. This change owed much to foreign scholarships and training, which had previously been confined to nobles and top officials. For example, in 1987, 61 percent of ranks C9 - C11 officials had achieved a Master’s degree or higher, mostly from abroad. And over one-quarter of serving permanent secretaries at the ministries held Ph.D.s in their fields of service (Xuto 1987). Education and skill have made officials more inclined to involve the private sector in policy issues, and to recognize the value of what private firms bring to bear. In addition, technical training expanded the pool of "engineering technocrats," especially infrastructure specialists. Many of these officials, writes Muscat, were "socialized in a work ethic of professionalism and national interest," a departure from previous practice (Muscat, forthcoming). Yet the organization of sectoral policies and public services remained fragmented. Agencies whose officials received professional training often became dominated by "organizational cultures" that operated without reference to the work of other agencies.

The segmentation and ad hoc nature of sectoral policies continued into the "democratic" period when the main economic ministries — Agriculture, Commerce, Communications, and Industry — became the main sources of largesse for elected politicians. The advent of democracy in Thailand did not encourage a popular coalition to take power and reform the established structures of power (Chantornvong 1988). Rather it saw the rise of political elites whose ambition was to seize control of the state apparatus, in particular the sectoral ministries (Christensen 1991). In every elected coalition government since 1975, Cabinet jobs at these ministries have nearly always been held by the top coalition parties. An added dimension to this is that, in an elected government, many Cabinet ministers represent provincial constituencies, and are thus keen to transfer resources to the countryside.

Unlike in much of Latin America, however, the rigidity and insulation of the budget process make it virtually impossible for politicians "to use macro-economic policies to raise the incomes of lower-income groups" (Sachs 1990:10). Moreover, as parliament has only a minimal say on public spending, appropriations are free of "electoral cycling" (Doner and Laothamatas 1992). As a result, elected Cabinet

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22 We note, however, that distributive pressures come primarily from political elites and the provincial elites that form the parties' support networks, rather than from the rural public at large.
ministers rely on sectoral policies to satisfy the demands of party supporters and voters (Christensen 1992).

The division of macro and micro policies has given technocrats the autonomy to pursue their conservative macro agenda, one that has assisted rapid growth. But it has also meant there has been very little connection between macro and sectoral policies. The macroeconomic technocrats tend to distrust the line ministries, believing they are dominated by narrow bureaucratic interests. In their view, any promotion of private firms generates rent-seeking rather than socially optimal objectives. The relationship between the two policies, in other words, is marked by tension and constraint rather than coordination and complementarity.\(^3\)

In planning, for example, until the mid-1980s the NESDB had no real involvement with the line ministries. In trade policy, there has been a sharp distinction between tariffs as a source of revenue and as an instrument of trade strategy. The Finance Ministry has applied tariffs, still a valuable source of government revenue. But its officials usually have "few institutional linkages to and little real knowledge about particular industries" (Doner and Laothamatas 1992:49), and tariffs are seldom coordinated with the implementation of non-tariff barriers by the Ministry of Commerce and the Board of Investment.

As for fiscal policy, the Budget Bureau tends to perceive itself as a "policeman" of the ministries (Dhiravegin 1987). Although the budget process entails close collaboration between it and the various Departments, they concentrate on the allocation of funds rather than project-based evaluation. Program budgeting has been tried, but it never took hold: it was too big a departure from the Budget Bureau's standard operating procedures.

These adversarial arrangements, and the lack of formal links between macro and sectoral officials, often hamper the effectiveness of overall development strategy. Structural adjustment efforts in the mid-1980s are a good example. They produced successful macroeconomic stabilization, but did little to restructure key industries, including automobiles and textiles (Doner and Laothamatas 1992). Similarly, not enough has been done in areas where sectoral regulation is sometimes necessary, such as implementation of rural property rights, agricultural research and dissemination, and technological research (Doner and Siroros 1992; Doner and Laothamatas 1992).

**The Private Sector and the State**

Government-business relations have changed a lot since 1960. They are now less a matter of ministries and their clients, more a matter of equal partners involved in policy-based consultation. Much of this change has occurred because of the way the private sector has organized itself. It has formed business associations — initially the Board of Trade, the Thai Bankers Association, and the Federation of Thai Industries — which, by the late 1960s, were consulted regularly by ministry officials and macroeconomic technocrats. This was almost unthinkable only a decade earlier, when the Sino-Thai business elite were deemed (or officially scorned as) the "pariahs" of society. Sectoral trade associations have also proliferated, from 48 in 1967 to 233 in 1987 (Thanapornpan 1990:Appendix 5-3). In the

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\(^3\) An important exception to the generalization that macroeconomic technocrats tend to ignore microeconomic problems is their entry into energy sector planning in the early 1980s. But that followed a period when patchwork policies and corruption in this very large sector in the aftermath of the second oil crisis threatened to upset the macroeconomic equilibrium.
context of favorable macroeconomic policies and inconsistent sectoral policies, Doner notes that firms "found associations to be increasingly useful in their responses to changing market conditions" (Doner 1991). All these consultative exercises reach their peak in the Joint Public-Private Consultative Committee, or JPPCC, created by the NESDB in 1980. The JPPCC gathers heads of the leading business associations to talk to leading technocrats and economic ministers. It deals mainly with issues involving overall development strategy.

Another private sector change was the formation of large, vertically-integrated business groups.24 Initially they came from the largest Sino-Thai firms, and were supported by the top commercial banks. The banks were also instrumental in increasing private sector flexibility, by financing exports and attracting savings.25 They helped ensure that the private sector was not entrenched in import substitution industries (Christensen, 1993: Chapter 3; Doner and Laothamatas 1992).

A third influence on the private sector, and its links with the public sector, has been Japanese foreign direct investment (FDI), which is concentrated in the textile, metals, electrical machinery, and automobile industries. By the late 1980s Thailand was one of the chief recipients of Japanese FDI; indeed in 1988 it attracted more than the four Asian NICs combined (Doner 1992: 8-9).

In general, the effects of Japanese investments and joint-ventures on growth and the transfer of technology have been specific to individual industries. For example, in textiles, bureaucratic fragmentation has frustrated the efforts of Japanese and Thai firms to negotiate the development of a textile technology institute with the Ministry of Industry. In other industries, Japanese organizations have been more successful at promoting coordination in industrial upgrading. For example, as Doner has shown, the Japanese International Cooperation Agency (JICA) has been the major supporter of the Metalworking and Machinery Industries Development Institute, which provides technical support for small and medium-sized firms (Ibid.: 35).

Despite these differences among individual industries, the cumulative sectoral effects of Japanese FDI have been to facilitate institutional development in the private sector, and to expand cooperation between Thai business associations and the government (Ibid.; Doner 1991; and Unger 1990). Market linkages between Thai and Japanese firms have encouraged the emergence of inter-firm cooperation and sub-contracting networks. Japanese FDI has also promoted "cooperation clubs" in the automobile industry, which facilitate sharing of information among Japanese and Thai makers of components (Donor 1992: 40). Lastly, Japanese FDI and related institutions have helped lend strategic direction to the Thai private sector, a change that has been valued by officials (Laothamatas 1992).

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24 We follow Leff’s definition of a business group as "a large-scale firm that invests and produces in several production lines that involve vertical integration or other economic and technological complementarities... The Groups mobilize capital from wealthy people linked by family or other personal ties; in addition they often possess their own banks and other financial intermediaries" (Leff 1979:52).

25 It is true that overtly the banks’ traditional role has been to finance short-term trade credits, but it would be simplistic to conclude that this is all, or even primarily, what they do. The commercial banks have backed many entrepreneurs through their good times and bad, and even rolled over their debts until some of the entrepreneurs have become heads of large conglomerates.
A comparison with other countries in Southeast Asia suggests that, on its own, Japanese FDI does not explain the emergence of these forms of public-private cooperation. But it is clear that the impact of Japanese investment in Thailand has been to strengthen the resources and capabilities of Thai firms and to boost their bargaining power with the bureaucracy. More research is required to determine precisely why that leverage has encouraged less rent-seeking than elsewhere in the region (e.g. the Philippines). But private sector efficiency and public-private consultations have not always been enough to correct critical market failures with regard to FDI. Sectoral policies have not ensured the right levels of education and training among the workforce now required by foreign firms, Japanese or otherwise. And the sectoral machinery has been sluggish in providing the institutional framework needed to ensure more transfers of technology and spill-overs of knowledge, the textile institute being a prime example.26

V. MACROECONOMIC POLICY-MAKING

The symbol of the success of Thai macroeconomic management is the nominal exchange rate. But its relative stability has come about because of firm fiscal and monetary restraint, the subjects considered in this section of the paper.

Fiscal Management

In each fiscal year, four agencies cooperate with one another in planning government spending, taxing and borrowing. By the time these agencies first meet, the Budget Bureau has already negotiated the outlines of the following year’s departmental budgets. Strictly speaking, the relevant line ministers are responsible for the expenditure requests to the Budget Bureau, but in practice they leave it to their officials. The normal way for the Bureau to fend off ministerial requests is to say that there is no money.

Meanwhile, the National Economic and Social Development Board proposes the public investment projects envisioned in the ongoing five-year development program. The Ministry of Finance is mainly in charge of estimating revenues from different sources, and the Bank of Thailand decides on the right approach to public borrowing.

The Budget Bureau then submits the following year’s budget, for the Cabinet to approve and submit to the Parliament. The Cabinet seldom tampers with the budget. Within the Parliament, most of the work of considering the budget is done by the Budget Scrutiny Committee. In this Committee, Cabinet members can propose amendments to increase or reduce spending, whereas ordinary members of parliament can propose only expenditure cuts. Thus, both the overall budget and its composition are largely immune to political considerations.

The Budget Bureau is legally in charge only of the expenditure side of the budget, yet it dominates the whole fiscal process. Its practice is essentially that of a housekeeper, indeed a Victorian housekeeper. It estimates the revenues, accepts the Bank of Thailand’s opinion on how much deficit financing the economy can tolerate, then decides how much spending to allow. Most Thai governments, particularly those involving elected politicians, have sought to avoid raising tax rates (with the exception

26 The authors are grateful to Richard Doner for insight regarding this point.
of customs tariff rates. In most parliamentary systems, the budget is a centerpiece of policy-making, with opportunities for politicians to control both taxes and spending. Not so in Thailand. The rigidity of the budget process effectively prevents elected representatives from developing programs or responding to voter demands through public spending. Again, we believe this is a main reason why ministers rely on sectoral interventions to boost their popularity.

It is interesting to speculate why Thai politicians, particularly elected ones, avoid changing tax rates. Of course, most politicians would like to avoid discussing, let alone raising, taxes. For a society riven by the income gap between rural and urban areas, however, the wealth of Bangkok might have made it a convenient milch-cow. The fact that this has not happened is as much a testimony to the political clout of the private sector in Bangkok (plus its undoubted ability to evade taxes) as to the guile of the macroeconomic technocrats.

As if these various devices were not enough, the technocrats’ instincts have been reinforced by the 1959 budgetary law. It limits the deficits to no more than 20 per cent of government expenditures. In 1974 the law was amended to exclude refinancing payments from the calculation: in each fiscal year the government can borrow up to 20 per cent of that year’s total appropriations plus 80 per cent of the part allocated to principal repayments.

Roughly 80 percent of government spending consists of current expenditures, and within that the bulk consists of salaries and other inflexible items. This means that, when revenues are squeezed, the cuts fall on capital items. Also, government has had little leeway to introduce programs involving recurrent expenditures, such as subsidies or the introduction of new tasks like environmental regulations. Only when there is a spurt of economic growth, as in the late 1980s, could new tasks be undertaken. From a politician’s point of view, the budget constraint implies that very little patronage can be financed by central government. The pressure (indeed the requirement) to provide patronage has to be met by other means: hence the use of tax expenditures by the Board of Investment, or of extra-budgetary funds to shore up commodity prices (selectively) or to keep down petroleum prices. Another major leakage has been the deficits of the state enterprises, particularly in the late 1970s and the early 1980s.

In addition to aggregate control over debts, the budget process pays special attention to foreign debts. In 1976, after a military coup and amidst growing concern about the communist threat, the armed forces proposed a major arms purchase totalling 20 billion baht (US$1 billion at the prevailing exchange rate). To put some controls on the raising of public debt, an Act Authorizing the Ministry of Finance to Raise Loans from Abroad was issued in November 1976. This Act limited the government’s annual foreign borrowing to no more than 10 percent of the budgetary appropriations with the same ceiling being applied to government guarantees for borrowing by public agencies and state enterprises. These measures

27 Listed tariffs have been on an upward surge throughout most of the post-1958 period, so that if listed tariffs were actually collected, Thailand’s would be one of the most protected economies in the world. But the listed tariffs are what the parliament allowed the government to collect. The standard practice of the Customs Department is to adjust the rates that are to be actually collected well below listed tariff ceilings.

28 "Tax expenditures" is a term used in public-finance literature to indicate special reductions from the levels specified in the relevant tax codes. They have some of the characteristics of the expenditure side of the government budget, hence the term.
were reinforced by an emphasis on monitoring and curbing the growth of foreign debt. For example, in December 1961, the Council of Ministers stipulated 5 percent as the ceiling for the ratio of external public debt service to the country's export earnings. In July 1964 this was increased to 7 per cent, and was applied throughout the 1970s. In addition, the debt service drawn out of the fiscal budget each year was not allowed to exceed 13 percent of the government revenues in that year.

Whatever the regulations say, however, the principle of budgetary restraint will not survive a determined onslaught by a government trying to spend its way out of its problems. Unlike many other countries, Thailand has generally avoided this fate. Perhaps it is because macroeconomic imprudence almost immediately leads to external complications and assigns responsibility to the decision-makers involved. Because of the fear of being "caught", Thai politicians (whether they are elected or from the military) have not tampered as much with macroeconomic policy as with sectoral policies. Of the four agencies chiefly involved in formulating Thailand's macroeconomic policies, three are controlled directly by the Prime Minister, who tends to take a less sectional position on any given issue (even if he is an elected member of parliament). The fourth agency is the Ministry of Finance, which has normally been headed by a technocrat. Even General Chatichai Choonhavan, an elected politician, at one point found it prudent to appoint a technocrat as Minister of Finance.

**Macroeconomic Policies at Work**

Even a conservative macroeconomic policy, managed by technocrats who are immune to distributional pressures, cannot insulate the economy against external shocks. The proper test of policy and institutions is how much damage is inflicted, the speed and nature of the response and how well the stresses are managed. This section looks at the events of the late 1970s and the early 1980s, following the second oil shock. Unlike the first oil shock in 1973, when commodity prices rose and thus lessened the impact on Thailand's external position, the second shock reduced Thailand's terms of trade considerably. The effect of these adverse developments was magnified by the decision to keep the baht tied to the dollar.

Between 1980 and 1985 Thailand found itself under severe financial strains, particularly on its external account. To try to contain inflation, the government prevented state enterprises from increasing their prices. This led to an increase in the public sector deficit, which contributed to the rise in the trade deficit; from roughly 6 percent of GDP in the 1970s to a record 9.8 percent in 1983. The external current account deficit also rose as a proportion of GDP.

Thailand's increased reliance on foreign capital coincided with two peaks of interest rates in the global money markets, one in 1981 and again in 1984. The country's external debt service ratio rose beyond the critical benchmark of 20 percent. The baht came under pressure, partly because of the external deficits and also because the U.S. dollar, to which the baht was pegged, rose significantly between 1981 and 1984. Thailand's overall balance-of-payments position plunged into deficit in 1983, and an uncomfortably large portion of its relatively small foreign reserves (about three months' worth of imports) was earmarked for obligations such as IMF commitments.

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29 When debt service payments on loans for national defense were included, the public debt service ratio was not to exceed 9 percent each year.
To cope with these problems, the Bank of Thailand devalued the baht twice in 1981 and 1984. It then opted for a managed float, specifying daily exchange rates in accordance with the fluctuations of prominent currencies. The purpose of this exercise was to maintain the baht/dollar parity within a somewhat wider band. The commercial banks’ credit expansion was capped, in order to curb import demand. Specific sectors — such as exports and low-income housing — were exempted from austerity measures or were given special assistance, a rare instance of the use of selective credit controls. Public foreign borrowing in each year was restricted to an exact ceiling — US$1.6 billion in FY 1985 and US$1 billion in FY 1986-88 — which was far more restrictive than the level allowed by the debt-service-ratio rule. Moreover, the Bank of Thailand began financial deregulation, in an attempt to strengthen the competitiveness of exporters.

These restructuring efforts produced excellent results. Economic growth accelerated from 3.5 per cent in 1985 to 4.9 per cent (1986), 9.5 per cent (1987), 13.2 per cent (1988), and 12.0 per cent (1989). Some of this success was due to external good luck — oil price decreases, the revaluation of the yen and other Asian NIEs’ currencies, low overseas inflation and interest rates — but the reforms contributed to the upswing. More than that, they helped the economy to diversify. New types of exports, and a significant rise in the export share of GDP, contributed to a fall in the current account deficit, from 5.5 per cent of GDP in 1980-85 to only 1.6 per cent in 1986-89. Gross domestic investment also grew strongly mostly due to the revaluation of the yen and other Asian currencies.

This long period of economic slowdown and recovery was spanned by the premiership of General Prem Tinsulanond (1979-88). For part of that period, economic policy was under the control of a populist banker turned politician, Boonchu Rojanasathien. He is unique among Thai politicians in having a macroeconomic program which he was allowed by the prime minister to implement. He obtained this freedom partly because he had some expertise — he was once at the Bangkok Bank — and, more importantly, because he was respected by foreign bankers.

However, Boonchu’s program was strongly expansionist, and in the early 1980s that was not prudent. When it became clear that he was leaving the economy dangerously exposed, he was replaced by a new group of technocrats. The new Minister of Finance, Sommai Hoontrakul, negotiated a loan with the International Monetary Fund, which he used as the pretext for an austerity program.

This whole episode illustrates that Thailand is not immune to populist pressures. Once the rules of financial conservation were broken, however, it did not take long for the technocrats to reestablish control. In our view the discipline of a de facto fixed exchange rate has been the chief instrument in keeping the "books balanced." An additional benefit is that the exchange rate regime has stabilized expectations in the private sector. The last domestically generated inflation in Thailand was as far back as 1942-46. Otherwise Thai inflation has been broadly similar to that of the United States.

VI. CONCLUSION

A simple description of Thai economic policy-making in the postwar period would give the impression that the Thai state has been highly active in promoting growth. On closer examination, much of the action was full of sound and fury that in fact signified very little. This is particularly true of sectoral policies, where any attempt to establish a well-conceived and systematic policy has been defeated, either by corruption or by frequent shifts in personnel and direction. The government never tried to discipline firms and industries to "deliver"; it would not or could not control the allocation of credit and foreign exchange, as some other East Asian governments did.
The Thai government has done well in the one area which, in our view, has been essential for the growth of the economy; macroeconomic management. The stable monetary environment has made it possible for the private sector to grow, and to concentrate on productive rather than speculative investments. The growth of the private sector has, in turn, been fed by strong banks, which in Thailand perform some of the functions of investment coordination that are undertaken by the state in other countries. Certainly one vital lesson from Thailand is that a developing country can do very well by sticking to the fundamentals: macroeconomic stability, outward orientation, and sustained investment in physical infrastructure and primary education.

It is also clear that the key to an even better performance for Thailand is not a more activist state, in the sense of one that intervenes more at the industry and firm level. As this paper has shown, the Thai state has intervened a lot at these levels; but its actions have not been very effective, well coordinated, or carried out with a clear developmental purpose in mind. No doubt some will argue that better sectoral interventions could have assisted the economy to grow more rapidly. However, that is to wish for Thailand a state apparatus that it—and most other developing countries—simply do not possess.

In drawing lessons from Thailand's development, we choose to find a middle ground between the two extreme models laid out in the introduction: the "minimalist state" and the "interventionist state." We do not think that Thailand would have done better with more promotion of specific industries and firms. There was enough of such promotion, and it brought very few benefits. What Thailand could have used—and could have achieved—is more of a sectoral vision when making decisions about infrastructure. "Infrastructure" tends to get lumped together with general or functional incentives. The specific choices about infrastructure, however, almost inevitably affect sectoral development. For example, spending on primary education and roads in the 1960s paved the way for agricultural expansion. Spending on power and ports also helped in the earlier stages of industrialization. One shortcoming, even in this successful period, was the inadequate regional spread of infrastructural investments, so that most industrial plants ended up concentrated in and around Bangkok.

Even though Thailand may have been successful so far, it is less well prepared for the next stage of industrialization. In particular, its investments in secondary education and its output of technicians and engineers fall seriously short of what is necessary to sustain the pace of industrialization.

The relevance of Thailand's experience to other countries is not clear cut. Countries that still depend substantially on agricultural exports and that have a weak state apparatus may benefit by adopting Thailand's strong emphasis on macroeconomic stability. For them, good macroeconomic performance can partially compensate for poor sectoral policies, by allowing the build up of a strong private sector, including a financial system capable of coordinating investments.

The sectoral policies that worked well in Thailand were those that involved the choice of infrastructure investments. Good choices speed up development, whereas bad choices result in serious enough bottlenecks to throttle growth. To make such choices intelligently involves some vision of the changing industrial structure during various phases of economic growth, and also some investment coordination between the private and public sectors. Thailand's experience in this respect has been variable.

As for the government intervening to fix prices, Thailand's experience does not support the view that deliberate distortions can play a positive role in development. The Thai government has deliberately distorted prices, but that has not contributed to growth. Whether a different way of intervening would have done any better remains unanswered.
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