

# THAI CAPITAL AFTER THE 1997 CRISIS

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## INTRODUCTION

WHAT is the future for domestic capital in the economies of what we used to call “developing countries”?

The idea of development in the era after the Second World War imagined that any country could repeat the economic transition of the West by accumulating capital, reallocating labor, and developing industry. Development policy and planning was about nurturing entrepreneurial capitalists by creating the institutions that would help them flourish.

Over the last quarter-century, that model has been discarded. Most of the techniques for nurturing local capitalism in that development era are now outlawed under the rules of the world economy. The new orthodoxy is that capital should have the freedom to roam the world. In practice this means that big companies with the resources to develop technology and invest in marketing can generally out-compete their smaller, weaker, and more recent rivals. The production of all kinds of goods and services is under the control of large transnational companies, mostly based in the advanced economies but with some new additions from emerging giant economies of China and India.

For China and India, this issue is not so critical. They have huge internal markets that can incubate corporations of global scale. Their governments have the weight to bargain with the outside world while still protecting these markets in defiance of the new economic order. But for other developing countries, these special conditions do not apply.

What are the consequences of this trend for entrepreneurial capital in the old developing countries? What is the impact on politics (in the broad sense of the word)? What are the implications for state policy?

Major economic crises serve as a kind of reality check. In the short term, economies may be able to resist or disguise the implications of changes in the global environment. For many countries in Asia, the 1997 crisis brought home the realities of the new global economic order.

This book examines what happened to Thai businesses in and after the Asian crisis. The ten studies offer a variety of very different slices of this history. Three look at sectors or sub-sectors. Two focus on business groups. Two delve into provincial regions. Three take a topical approach. Most of these chapters set their analysis of the post-crisis period into a historical context stretching back over prior decades. As background, we present a general sketch of Thai corporate history from the Second World War through the 1997 crisis to the recovery.

### THE POSTWAR ERA

At the close of the Second World War, Thailand was considered among the most backward economies and societies in Southeast Asia. It had a typical colonial-era economy, exporting primary produce of rice, teak, and tin and importing manufactures. Until 1932, this colonial-type economy had coexisted with an absolute monarchy, and the socioeconomic structure still reflected this history. Most of the indigenous population remained in a semi-subsistent agrarian economy. The urban economy was dominated by expatriate enterprise—either colonial trading houses, or sojourning Chinese migrant businessmen. There were only a handful of significant local firms, owned by former nobles or settler Chinese. Thailand lacked much of the basic infrastructure (physical, legal, institutional) needed for an urban economy, which colonial rulers had installed elsewhere in Asia. Fear of provoking a colonial takeover had resulted in very conservative economic policies. Bangkok was a modestly sized city of one million people, still in the old fort-and-port style. No other urban location had a population larger than fifty thousand. The economic surplus was captured by a small elite that included the old nobility, and a tiny new segment of businessmen, professionals, and officials.

After wartime distortions eased, the economy launched on a phase of rapid growth that lasted for half a century. Three main factors made this possible.

First, the US became Thailand's political and economic patron. The fear of colonial takeover evaporated. US advisers helped to install the

legal and institutional infrastructure for a modern economy, and US funds helped to improve the physical infrastructure.

Second, a large Chinese mercantile population, stranded in Thailand by China's communist revolution, resolved to integrate into the local society and to apply their talents to building local businesses.

Third, as a result of prior neglect, Thailand had a prodigious stock of untapped resources, natural and human. The new physical infrastructure, especially a road network, put these resources within the reach of the migrant Chinese entrepreneurs. For the next thirty years, the economy grew largely by chopping down trees, putting more land under crops, damming rivers for hydropower, mining more minerals, exploiting the sea, and pulling people away from a semi-subsistent existence in the villages.

Banking and politics played special roles in shaping the corporate history of this era. Agrarian societies typically have high rates of saving. Beginning in the postwar era, a handful of banks found ways to collect the petty savings of farmers and shopkeepers, and amalgamate them as capital funds deployed in the growing urban economy. These largely family-owned banks grew at breakneck speed, expanding into merchant capital groups with many subsidiary companies, as well as serving as the hubs of networks of related business families.

The military government, which became the successor to the old royalist rule, provided no blanket protection for capital. Indeed, it withheld many rights from the migrant Chinese as a means to defend its own dominance. Business families thus had to negotiate their individual protection by placing themselves under the patronage of political leaders in return for a levy on their profits.

Access to the banks and access to the generals were both limited. The few families that had such access were in a position to dominate the business opportunities that became available. Besides the bankers themselves, there were two main clusters. The first included families that began by exporting primary produce, and then moved into agri-processing and expanded laterally into related businesses such as insurance, shipping, warehousing, and transport. The second included families that took over the import business vacated by colonial firms during the war, and

gradually expanded into manufacturing under government policies of import substitution, often with foreign joint venture partners.

Profits were concentrated among a few tens of families. To strengthen their bargaining power, they networked together through marriage alliances, cross shareholdings, and cooperation in associations providing community welfare.

## TRANSITION

This era came to an end in the mid-1970s and was followed by a decade of uneasy transition. After defeat in the Indochina war, the US patronage of Thailand declined. At the same time, the long phase of postwar growth and stability in the world economy under the Bretton-Woods institutions came to an end, announced by a series of oil shocks and financial crises. Thailand's military rule began to splinter under demands for a transition to parliamentary democracy. Thailand's earlier strategy of growth undermined itself by catastrophic depletion of the stock of natural resources.

At the same time, reserves of natural gas were discovered, offering new possibilities of energy and inputs for industrialization. Because of a decline in infant mortality in the postwar years, the workforce began to grow at 3 percent a year, providing a pool of young labor.

As the economy stumbled through this transition, the World Bank emerged as a new patron. The bank advised Thailand to liberalize its domestic markets in order to loosen the oligopolistic grip of the conglomerates, and liberalize its external markets in order to tap the increased mobility of goods, capital, skills, and technology in the world.

The Thai government accepted this advice, but with some major qualifications. Beginning in the early 1980s, external trade was gradually liberalized by reducing tariffs and abolishing other restrictions. In the mid-1980s, regulations and incentives for investment were reformed to promote export-oriented manufacturing. In the late 1980s and early 1990s, controls on cross-border financial movements were eased, permitting easier inflow of loans and portfolio capital.

But the business conglomerates were able to retain their political influence over the transition from military rule to parliamentary democracy. Liberalization of internal markets was much more limited. Most strikingly, the cartel of sixteen domestic banks defeated reforms that would allow any new bank to be formed, or any foreign bank to expand its business beyond a single branch. Investment rules forced most foreign firms, other than US firms, which were privileged as a result of earlier US patronage, to operate as a minority partner in a joint venture. Foreign firms were excluded from certain sectors, especially agriculture and agriculture-related industries, land ownership, and most service businesses.

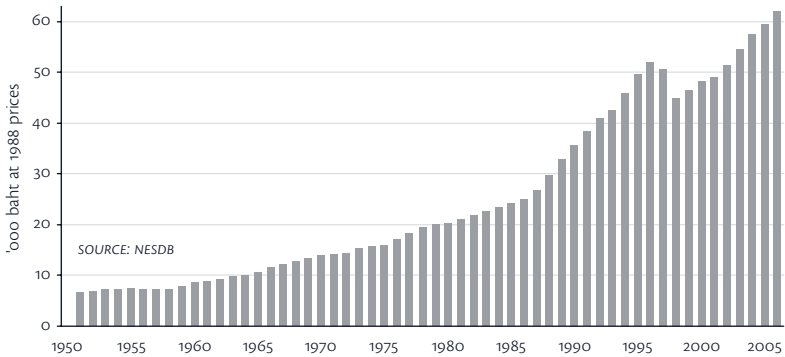
In short, in the transition of the 1980s, many of the external barriers on trade, investment, and finance were removed, but many internal barriers were retained in an attempt to corral some space for domestic capital.

#### THE GREAT BOOM

Initially, this reorientation was a massive success. Thailand became attractive as a site for industrial production and for the expanding world industry of tourism. In 1987, Thailand entered on a decade-long boom based on rising investment in industry, and a transfer of up to a million people a year from agriculture to urban occupations. Over the decade, real per capita income doubled (see figure 1.1), and Thailand was dubbed a newly industrializing economy.

Many Japanese and other East Asian firms transferred manufacturing into Thailand (and other Southeast Asian neighbors pursuing similar strategies) to take advantage of lower costs. Domestic capital participated enthusiastically too, plowing back their own gains from the sudden lift-off, raising funds from the stock market, and tapping international loans under the newly liberalized financial system. The big established families took a leading part. They were attractive as joint venture partners for the incoming firms, and also launched many independent ventures, often acquiring technology by purchase or license.

FIGURE I.1 Real GDP per head, 1951–2006



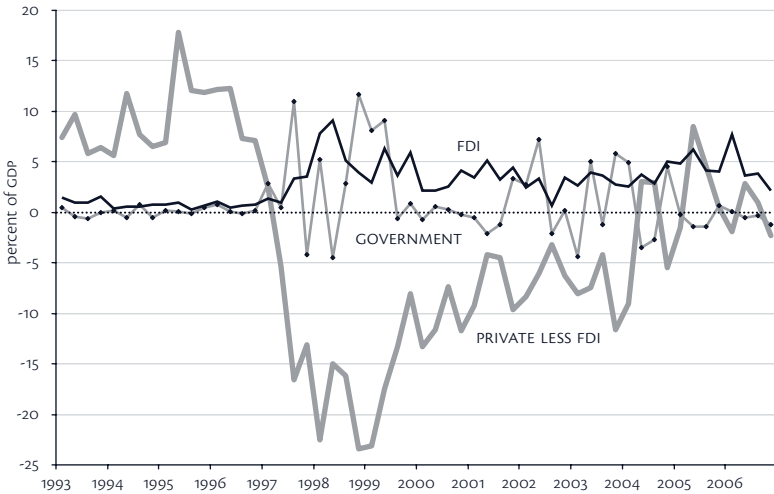
But the boom also threw up a new wave of entrepreneurs. Business success no longer depended on access to the banks and the generals. A new stock market and financial liberalization multiplied the sources of finance. Transition from military rule to parliamentary democracy multiplied the avenues of political influence, as well as providing a generally more secure environment for capital. Some of the new entrepreneurial groups were offshoots from the great families. Some rose from the middling ranks of the capital's business families. Several came from the provinces, and had accumulated their initial capital in the economy of resource exploitation—as loggers, crop traders, or land speculators. They moved into areas of new opportunity opened up by rising incomes and falling borders including telecoms, retailing, hotels, property development, and secondary financial institutions.

#### CRISIS AND RECOVERY

One consequence of the differential liberalization of the 1980s transition was the creation of a two-tier financial market. The cartel of domestic banks still lent at high rates, partially dictated by government monetary policies aimed at controlling the tear-away boom. But firms now also had access to dollar-denominated loans through offshore banks. Local banks

borrowed from this source and lent onwards in baht, profiting from the interest differential. Local firms also borrowed directly from overseas sources. The offshore loans were so attractive that almost every significant business had used this facility to some extent. The private sector's foreign debt ballooned from 8 billion baht in 1988 to 74 billion in 1996.

FIGURE 1.2 Capital account flows, 1993–2006

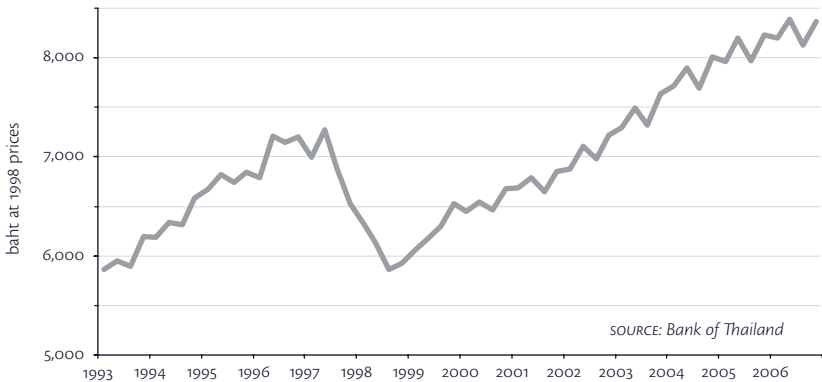


The baht was cut loose from the dollar on July 2, 1997, and sunk to half its former value over the next five months. The baht value of foreign loans doubled, destroying balance sheets. Foreign lenders hastened to collect their loans and withdraw. The drain of short-term capital swelled to the equivalent of almost a quarter of GDP in 1999, and declined only slowly over the next five years (see figure 1.2). Under the shock of the crisis, consumer spending shrank by a fifth in one year (see figure 1.3). The IMF intensified the shrinkage by applying a deflationary package designed for a crisis by excess government borrowing, and totally inappropriate in the case of a private debt overhang. Firms that had been gearing their planning to the pace of the boom decade now found they had enormous unused capacity for the foreseeable future. Many firms



struggled to cut costs by reducing staff and stopped servicing their loans. In the past, default has been rare because it breached the rules of trust between bankers and clients, and placed any hope of future finance at risk. Now default became common practice, and bad loans rose to almost half the total credit advanced.

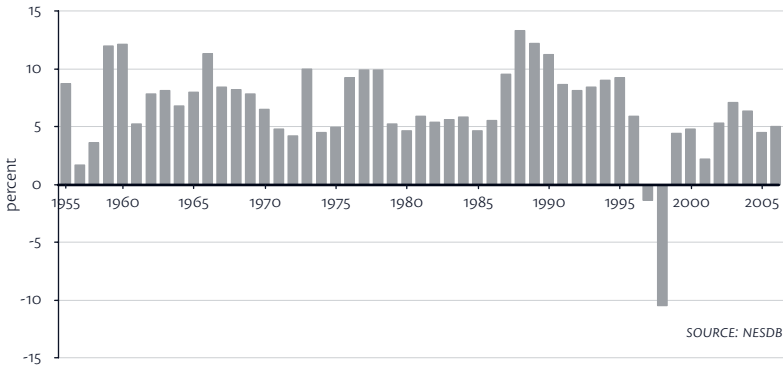
FIGURE 1.3 Per capita private consumption, 1993–2006



The crisis was a massive shock. Over the prior four decades, growth had seemed as natural as the annual arrival of the rains. The only uncertainty was the relative scale. The shrinkage of 1997–1998 was not only unique but also massive in scale (see figure 1.4). While some kind of slump or crisis had seemed inevitable, few had predicted the severity, or the contagious effects on the region.

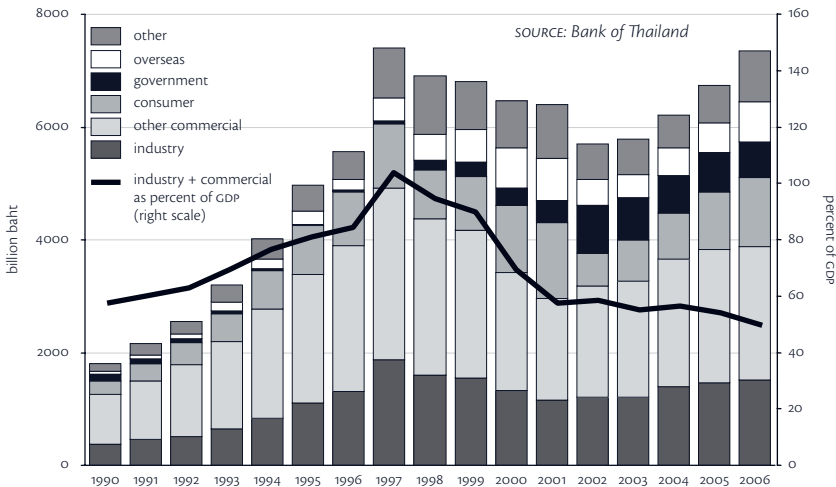
By mid-1998, the IMF admitted that its approach had been wrong. The deflationary policy was abandoned in favor of efforts to stimulate the economy through rising consumption. The government ran a budget deficit; the Japanese threw in some extra funds under the Miyazawa Plan; and the Thaksin government (2001–2006) extended the stimulus by expanding credit. With these measures, consumption regained its pre-crisis peak by 2003, and continued to grow strongly thereafter. This policy approach softened the social impact of the crisis and its potential political consequences. Employment climbed back to its former level.

FIGURE I.4 Real GDP growth, 1955–2006



The two million who slipped below the poverty line were hauled back above. But the consumer stimulus did not quickly translate into investment because of the existence of so much excess capacity and the collapse of the financial market. Banks refused new loans and shrunk the credit extended to business by one-third (see figure I.5).

FIGURE I.5 Distribution of commercial bank lending, 1990–2006



But exports boomed because the depreciation of the baht cut the cost of labor and other local inputs. Between 1996 and 2006, exports multiplied 2.3 times in dollar terms and 3.5 in baht terms, dragging the economy out of the crisis. In the post-crisis years, almost all growth in GDP could be attributed to rising exports (Warr 2005: 37).

## AFTERMATH

Over 2003–2004, the economy seemed to gain a new equilibrium (see figure 1.6). The leakage of short-term funds eased to a more moderate level (see figure 1.2). Most surviving firms had cleared their debts, straightened their balance sheets, and begun to show a profit. The stock market staged a dramatic revival over 2003, and then stabilized (see figure 1.7). After bad loans fell to reasonable levels, banks ceased shrinking their commercial loan portfolios and began to increase their lending to business (see figure 1.5). The overall level of investment in the economy edged upwards.

But some things had changed since the pre-crisis era, perhaps forever.

First, the overall level of domestic savings and investment, which had underwritten the high rate of capital accumulation in the pre-crisis era, had dropped down a step (see figures 1.8, 1.9). In particular, household

FIGURE 1.6 Quarterly GDP growth, 1994–2007



FIGURE I.7 Stock Exchange of Thailand index, 1997–2007



savings had fallen, and household debt had risen, as credit had become cheaper and more accessible. In addition, the banks no longer played such a prominent role in aggregating capital, and the stock market was only a partial replacement.

Second, the economy's integration with the outside world had risen a step. The simplest indicator was the ratio of foreign trade to GDP, which had risen from around 80 percent before the crisis to 150 percent in the

FIGURE I.8 Gross national savings, 1994–2005

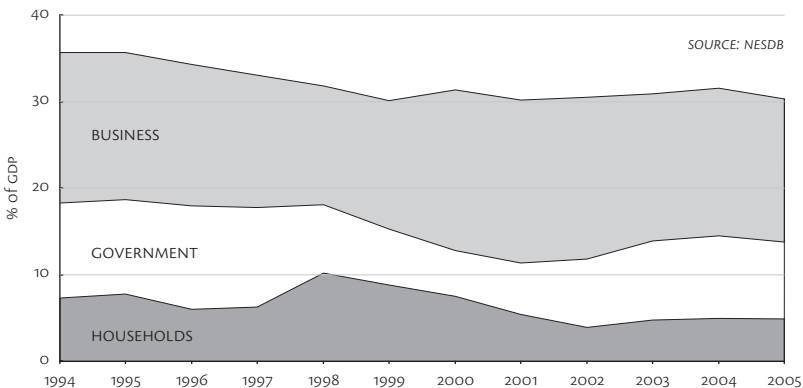
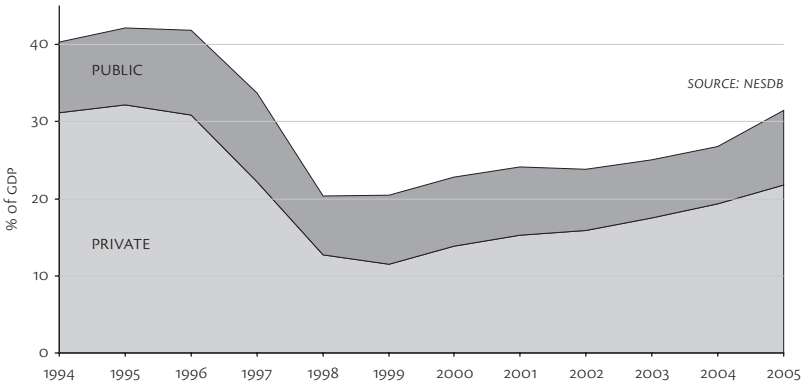


FIGURE I.9 Gross domestic investment, 1994–2005

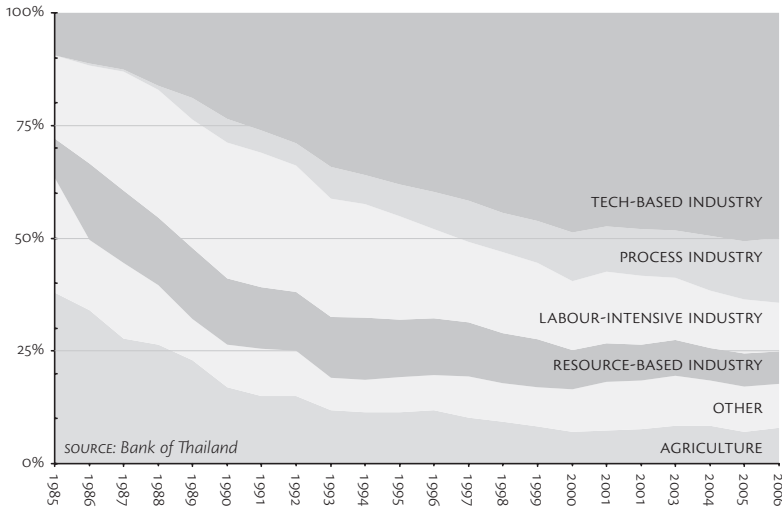


mid-2000s—a very high level for a country of Thailand’s size by world standards (see figure 1.10). The involvement of foreign capital in the economy had also risen by a steep step (see chapter 1). The sectors that were driving the export growth underlying overall economic growth were technology-based manufactures, especially automotive, electrical, and electronic goods, which were almost all produced by transnational firms (see figure 1.11). The contribution of agriculture, resource-based

FIGURE I.10 Trade as percent of GDP, 1995–2006



FIGURE I.II Export shares by sector, 1985–2006



industries, and labor-intensive industries, where domestic capital still had a prominent role, had declined steeply.

Domestic capital had been at the center of Thailand's rapid growth in the postwar period. Government policy had provided stability rather than stimulus. Foreign capital had played only a subsidiary role. But over the crisis and aftermath, domestic capital had become of peripheral importance in the key activity driving growth in the national economy. Domestic capital had been moved from the center to the sidelines. How that happened, and what it may mean, is the subject of this book.

#### OUTLINE OF CHAPTERS

The first chapter examines what happened to Thailand's largely family-based firms in the crisis. It starts by calibrating the size of capital inflow in the post-crisis decade, and showing which sectors were chiefly affected. Next it sketches the nature of Thai family firms, and the dynamics of

their growth. Finally it shows how their fate in the crisis depended on how far they had modernized their internal structure.

The next three chapters trace the fate of some key sectors of the economy. Liberalization of investment in the eye of the crisis opened up most manufacturing for full foreign ownership. Much of the capital inflow in the first post-crisis years was for acquisition of export-oriented manufacturing firms. A prime example was the automotive industry. After two decades of government policy nurturing a domestic automotive industry, the bulk of the sub-sector was transferred into foreign ownership. Automotive became one of the largest single industries in the Thai economy. Thailand became a minor hub in the transnational automotive industry. But only a handful of domestic firms remained as serious participants.

In theory, government still proposed to protect much of the service sector for domestic capital. In practice, it had neither the will nor the ability to enforce this protection. Big European retail chains entered promptly to take advantage of cheap land and limited regulation. Government, consumers, and local entrepreneurs generally facilitated their rapid expansion. The mobile phone market was carved up by concessions into a highly profitable oligopoly. Business groups invested heavily in politics to defend this arrangement against both local and transnational competition. The crisis probably worked in favor of the oligopoly. But after the crisis eased, this sub-sector came face to face with the logic of concentration on a global scale. The two major local firms sold out rather than taking the risky leap into global competition.

The next two chapters examine two business groups that not only survived the crisis but also prospered spectacularly. On first sight, the two cases could not seem more different. The first is Khun Charoen, the poorly educated son of a street vendor who emerged over the crisis as Thailand's richest entrepreneur. The second is the Crown Property Bureau, Thailand's oldest and most prestigious business group. Yet in fact, the reasons for their success over the crisis have a key similarity. Both had exceptionally deep pockets for reasons that were more about politics than business. Both were able to recover and restructure faster than their rivals, and hence reap the opportunities of the aftermath.

The next two chapters trace the interplay of business and politics in two upcountry regions. The first is a rural area where the local economy was in transition from an era of primitive accumulation on a resource frontier to a new era of urban growth on the fringes of the global economy. The second area is Chiang Mai where growth was founded on urban functions as a centre of administration, culture, education, and tourism. In both cases, the impact of the crisis was less severe than at the national level, yet it intensified local competition for business opportunities. In both cases, this intensification made local political influence even more important than before as an element of business strategy, especially following the expansion of elective local government in the late 1990s.

Two major themes run through all these case studies. First, the involvement of transnational capital in the economy has risen by a step, and in the long term the survival of domestic firms depends on their ability to compete in a global arena. Second, for the short term politics has *increased* in importance as a strategy for domestic capital's survival. The final two chapters address these two themes. The first looks at the readiness of Thai firms to venture overseas and compete in the global environment. The second analyzes the relations of business and politics within a framework of rent-seeking, focusing on Thaksin Shinawatra's failed attempt to create a new pattern of rent distribution.

The conclusion summarizes the key findings of these studies and attempts a partial answer to the question of what future there is for Thailand's domestic enterprise.