

Lessons From Thailand's 1997 Financial Crisis for the Current Global Economy

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Pre-Crisis Thailand: 1985-1996

- One of the fastest growing countries in the world
- Fixed exchange rate below equilibrium, resulting in the accumulation of foreign reserves from \$ 4b to 36b by December 1996
- 5% higher interest rate than most of the world making foreign money want to flow into Thailand
- Capital controls which prevented foreign money from flooding into Thailand

Thailand's Wage Rate was Rising more than
her Neighbor's



Solution: Be Indo-China's Patron

- Encourage Thai companies to invest in neighbors – offer tax cuts, negotiations, credit, etc.
 - From a Western perspective this defeats the purpose
 - From an Eastern perspective this builds a family
- Provide financing, thus set up the Bangkok International Banking Facility (BIBF).

Goal of BIBF

- Attract a large amount of money from the US, Europe, and Japan that would be loaned to Thailand's neighbors.
- The money did flow in, but it did not want to flow out of Thailand due to higher Thai interest rates.
- There was not enough productive use for this money within Thailand

Result: A Speculative Bubble

- Excess supply relative to market demand of
 - 150 % in iron and steel
 - 192 % in automobiles
 - 195 % in petrochemicals
 - 200 % in Bangkok housing
 - 300 % in private hospitals
- When more is built than can be sold, borrowers default on their bank loans.

Events that made a Speculative Attack Possible

- Bangkok Bank of Commerce Case
- Somprasong Land Company defaults on US\$ 3m interest payment on European debentures
- March 3, 1997 suspension of the trading of financial institution stocks and bonds on the Stock Exchange of Thailand with the naming of 10 weak companies and the increase in reserve requirements.



George Soros took out forward contracts to exchange Baht into dollars at the rate of 26 baht per dollar in January 1998. Soros advertised Thailand's problems and sold all of his baht. Thailand defended the baht by buying up the surplus baht. When Thailand started to run out of dollars, the baht was floated on July 2, 1997.

The Baht fell from 1\$ for 25 baht in June 1997 to 1\$ for 54 baht in January 1998. Soros traded 1 billion dollars for 54 billion baht on the spot market; he then used his forward contracts to change the 54 billion baht into 2 billion dollars – doubling his money.

IMF to the Rescue?

- August 19, 1997 Thailand took out a US\$ 17.2b loan from the IMF/World Bank.
- Does the IMF create Moral Hazard?
- IMF and Conditionality:
 - Cut Government Spending
 - Increase Taxes
 - Reduce the Money Supply, increasing interest rates
 - Do not rescue any more financial institutions

IMF, “Why?”

- Note, the fall in Thailand's exchange rate from 1\$/25B to 1\$/54B would double the baht price for all Thai imports and half the dollar price for all Thai exports resulting in a major recession
- IMF conditionality makes this recession much worse
- Why does the IMF do this?

Consequences

- Thailand's prime minister resigns Nov. 3, 1997
- 64% of finance and securities companies shut down
- 27% of Thai banks taken over
 - Management fired
 - Stock written down to 1/1000th of its previous value
- Other financial institutions warned

Consequences, continued

- Banks stop lending (making recession worse)
- Borrowers stop paying on loans (strategic non-performing loans)
- First bankruptcy case under the new bankruptcy laws thrown out of court because the company could pay if it wanted to.



The Rise of Thaksin

- Thai Love Thai Party
- Bought votes
 - Poor farmers no interest for three years
 - \$25,000/village (77,000 villages)
 - All hospital visits cost US 75 cents
- Biggest Land Slide
- Corruption case

Thaksin Undercuts Democracy

- Bought iTV, fired 20 reporters
- Replaced election commissioners
- Replace governor of the Bank of Thailand
- Sued newspapers that said anything critical
- Assimilated other political parties
- Used the threat of dissolving parliament to get his way

Thaksin Undercuts Democracy continued

- Bangkok land deal
- 1700 to 2500 drug dealers killed extra judicially
- 1,000 Muslims died between Jan 2004 and Dec. 2005
- “Provinces that voted wholly for his party would get special attention, others would have to wait in a queue.”

What Happened Next?

- Election of Feb. 2005: opposition parties do not win enough seats to even initiate a censure debate
- Thaksin's children "buy" Shin Corp stock for 1B/share on Jan. 20, 2006; Thai legislature increases foreign ownership limit on Jan. 22; Thaksin's children sell Shin Corp shares for 49.25 B/share on Jan. 23, 2006 to Singapore making the sale tax free.
- Prem (president of King's Privy Council) said, "Being smart and intelligent is a good thing, but if there is no morality and ethics it is not so good."
- The Yellow Shirts hold massive anti-Thaksin protests.

Fast Forward

- Snap elections of April 2, 2006 annulled
- Military Coup of Sept 19, 2006
- Thai Love Thai (TRT) party dissolved for fraud
- TRT reincarnation won Dec 2007 election
- Yellow Shirts take over airport Dec 2008
- Democrats take over government
- Red Shirts disrupt ASEAN meetings Spring 09





Fast Forward Continued

- Red Shirts take over Central Bangkok April – May 2010
- Army breaks up protest
- Yingluck, Thaksin's Sister, wins summer 2011 election
- When Yingluck tries to slide an amnesty bill through in Nov 2013, massive protest result which are continuing to today.

What does Thailand's Crisis have to do with the current world situation?

- If “Golden Child” Thailand can fall, then who is safe? Fear of speculative attacks led to other countries accumulating massive foreign reserves.
- Total Reserves in the world grew 3.23 fold from 1265 billion SDRS to 4080 billion SDRs between 1997 and 2007. The majority of these reserves are held in US dollars.

US Gain

The Chinese clearly undervalue their exchange rate. This means American consumers are able to buy goods at an artificially low price, making them winners. In order to maintain this arrangement, the People's Bank of China must buy excess dollars, and has accumulated nearly \$ 1 trillion of reserves [this is now over \$ 3.8 trillion]. Since it has no domestic use for them, it turns around and lends them back to America in our Treasury, corporate and housing loan markets. This means that both Treasury borrowing costs and mortgage interest rates are lower than they otherwise would be. American homeowners and taxpayers are winners as a result.

Lindsey 2006

US Losses

- * The world's excess savings funded the speculative bubble that lead to the current crisis in the USA (some deceptive US corporate practices played a crucial role).
- * If the world used the trillions of dollars that they have accumulated, then the value of the dollar would plummet.
- * Countries, like China, with large holdings of US dollars now have significant leverage against the US.

What Devastated Thailand is Plaguing the World Today: A Surplus of Savings

- Above I document government savings via the accumulation of foreign reserves. As of January 2014, these were over 12 trillion US dollars.
- Corporations in the USA, Euro zone, UK, and Japan held 7.75 trillion dollars in cash in January 2012, an “unprecedented sum”.
- Banks are also accumulating cash. US bank deposits hit US\$ 10.6 trillion by the end of 2012 while loan to deposit ratio has fall from 95% (in 2007) to 72%. In Japan, the loan to deposit ratio was only 69% (in Oct 2013)

Why is there a Surplus of Savings?

Production expanding investment requires two things

- Savings to invest
- The hope that what the investment produces will sell

Thus sufficient consumption is needed to justify production expanding investment.

Income distribution has become so unequal around the world that the rich keep saving, but that saving is funding speculative bubbles, seeking a return from rent or deception, or sitting idle. It is not expanding production.

The Solution

- Increase consumption so that the surplus of savings can be invested in expanding production.
- The Thai case demonstrates that too much saving can devastate an economy and set off political strife that can last 17+ years. The Thai case also shows that good intentions do not guarantee good results.

Do you want more info?

- For more details about the Thai case, read Leightner, Jonathan E. (2007), “Thailand’s Financial Crisis: its Causes, Consequences, and Implications,” *Journal of Economic Issues* 41(1) 61-76. Note the Addendum.
- For more details about the current state of the world’s economy read Leightner, Jonathan E. (forthcoming) *The Limits of Fiscal, Monetary, and Trade Policies: International Comparisons and Solutions* (Singapore; World Scientific).