

Preface

This book reviews the contemporary issues in international monetary and financial economics (such as financial liberalisation, crisis, exchange rate determination, capital control, domestic capital market reform, etc.) in an emerging financial market such as Thailand from a welfare economic perspective, highlighting the social welfare implications of these issues. This book also suggests a normative social approach (as formalised in the new³ welfare economics paradigm) (see Islam 2001a,b; for a discussion of this concept) for analysing and addressing these issues and formulating appropriate policies.

Undertaking the above tasks, the asymmetric information paradigm and other elements of the new³ welfare economics paradigm are adapted in analysing the international financial issues of Thailand, their causes and economic and social welfare consequences.

The last two decades have been a critical period for Thailand's development. From the mid-1980s to the beginning of the 1990s, the Thai economy performed remarkably well and was a showcase for the world economy. Having achieved a double-digit growth rate for a brief period, Thailand in the late 1980s was regarded as the fastest growing economy in the world by the World Bank and the IMF. With prospects of further rapid economic growth, the Thai government accepted Article VIII of the IMF, which required Thailand to liberalise and deregulate its financial system. Accordingly, Thailand removed most regulations on its financial system from 1989 to early 1994. Consequently, the country enjoyed further economic growth and large volumes of capital began to flow into Thailand's financial market. Unfortunately, the story of Thailand's success was short-lived and soon ended, after the financial liberalisation was completed. Finally, economic growth came to a sudden stop and the crisis erupted in July 1997.

This book investigates the recent issues in International Finance in Thailand, focusing on the major issues such as the contribution of financial liberalisation to the crisis in Thailand, the sequence of financial liberalisation, capital controls, and exchange-rate policy, using the asymmetric information paradigm (market, policy and institutional failures). In addition, this study also examines time-series data and other information to explore

the consequences of financial liberalisation for the crisis in Thailand. The book divides the analysis into three parts. Part I reviews the literature on contemporary international financial issues and investigates the financial liberalisation framework that Thailand pursued in opening up its financial system. Part II explores the impact of financial liberalisation on the Thai economy, focusing on the issues of sequencing of financial liberalisation, capital controls and exchange rate policy. Part III reviews financial liberalisation theory and the Thai crisis. In this final part, we present our conclusions about the contribution of financial liberalisation to the financial crisis in Thailand.

The Thai financial crisis was a watershed in Thailand's economic development. The crisis generated considerable analysis, literature and conferences on its cause. However, comparably little work has been undertaken on exploring the development and social welfare implications of the crisis for Thailand's immediate and mid-term future. The most immediate implication of the crisis was the initial drop in income throughout the Kingdom. New numerical estimates that reflect the movements in social welfare resulting from the crisis are developed and presented in this book. It is shown that while the financial crisis had a dramatic negative impact on average income levels, the processes of financial liberalisation and globalisation that preceded the crisis were also having negative impacts on the social welfare levels of Thailand. Conventional measures of social welfare, such as Gross Domestic Product or economic growth provide misleading information on social welfare movements. By adjusting this measure for the net benefits of financial liberalisation, a more intuitively correct measure of social welfare is possible. This study will develop a time series, 1975–1999, which estimates this new adjusted GDP measure of social welfare. It shows that stark differences exist between unadjusted GDP measures of social welfare and financial liberalisation adjusted GDP over this time period. Following this, it is possible to undertake new analyses of the development and social welfare implications. This book explores the opportunities for changes in public policy that can prevent further crises. Various public policy initiatives can now be more fully considered than was possible in the past. This book therefore represents a significant contribution to both development and welfare economic literature.

The study shows that four policy errors in international financial management, especially in the financial liberalisation process, which were caused by the asymmetric information problem, existed in the Thai economy during the study period and contributed significantly to the financial crisis in Thailand. The four errors were inappropriate sequencing of financial liberalisation, too rapid and too extensive liberalisation of capital controls, misalignment of the exchange rate through a basket of currencies

dominated by the US dollar and lack of adequate supervisory systems in the face of large scale capital inflows, giving rise to moral hazard problems. These errors contributed to problems of a high level of current account deficit, speculative behaviour, overinvestment, loss of competitiveness, increased short-term external debt and excessive investment in and lending to the domestic markets. These problems resulted in economic instability and disruption, and made the country vulnerable to financial crisis when the expectations of foreign investors were not met.

In addition, a quantitative empirical analysis (by applying cost benefit analysis) of financial liberalisation and the associated processes shows that the cost of financial liberalisation has been higher than its benefits in Thailand in recent years.

This book, therefore, provides an in-depth analysis of some emerging and enduring issues in international finance from a welfare economics perspective, especially the issues of financial liberalisation, exchange rate determination, capital control and financial crisis, which provides an improved understanding of social welfare implications of international finance in an emerging financial market.

There is probably no book currently available which addresses the financial issues discussed in this book from a welfare economics perspective. The theoretical issues are balanced by the application of welfare economics to an emerging market. This book fills that gap. It can be used as a reference book by researchers, academics, practitioners, policy makers, and postgraduate students in the areas of finance, financial economics, monetary economics, and development economics. It can be used a reference or an additional text for a finance subject at the Masters or Doctoral level.

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