Chapter 8: Politics of Economic Recovery in Thailand and the Philippines

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1. Introduction

One of the challenges of a volume such as this one is balancing the broad and the narrow. There are commonalities to the pre- and post-crisis experiences of East Asian states—certain themes that we can derive that apply across the region. At the same time we cannot lose sight of the fact that this region-wide crisis played out within the specific political and economic environments of individual states. We cannot focus so much on broad cross-national similarities that we lose sight of how domestic political environments shaped the nature of post-crisis recovery or ignore how the crisis helped reshape some of those domestic political environments. Thailand and Philippines are two interesting case studies in this respect. In Thailand—ground zero for the crisis—the collapse of the economy called into question not just the advisability and sustainability of Thailand’s economic strategy, but it also served as the catalyst for significant political and institutional reform. In the Philippines, by contrast, the comparatively mild economic downturn was viewed in many quarters as a vindication of a set of economic reforms undertaken by the Ramos administration. The economic crisis did not generate a political crisis nor did it lead, in any significant way, to major political and economic reforms. In short, the Thai experience is more like that of Indonesia where a deep economic crisis
quickly became a fundamental political crisis, eventually culminating in political/institutional reform. The Philippines’ experience, on the other hand, looks more like that of Malaysia where the economic crisis did not generate major political reform and needed economic reforms were deferred.

This chapter compares Thailand and the Philippines’ post-crisis economic and political trajectories. I focus on the ways in which the political environment (and changes to that environment) shaped the nature of economic recovery in these two countries. In Thailand the crisis brought to light a whole host of long simmering economic vulnerabilities. After some delay two successive Thai governments undertook a series of reforms to address many of these concerns. However, one cannot understand the timing and content of these reforms without taking Thailand’s political environment into account. On the political front the crisis served to rally public support around constitutional reforms that were already on the table but would otherwise have faced strong opposition from entrenched political interests. It also motivated Thai business interests to take a more active and direct role in politics than they had traditionally done in the past. In total, the crisis and subsequent political reforms combined to produce dramatic changes to Thailand’s political economy. These changes contributed to Thailand’s robust recovery from the depths of the crisis, but also left some pre-crisis vulnerabilities unaddressed while contributing to the emergence of a new set of concerns which ultimately culminated in September 2006 military coup and subsequent attempt to once again remake Thailand’s political environment.
In the Philippines the government’s relatively well-managed response to the Asia Financial Crisis helped the country bounce back quickly from the initial economic setback. Observers hoped that this presaged an end to the country’s perpetual status as the “sick man” of Asia. Indeed, the impressive reform program pushed through by the government of Fidel Ramos prior to the crisis provided grounds for optimism. Ironically though, because the crisis did not engender the depth of political angst in the Philippines it did in Thailand the impetus for further reform—economic or political—was lacking. In the years since the crisis the Philippines economy expanded at a modest pace, but once again at a slower rate than most of its neighbors. At the same time serious economic problems have largely gone unaddressed and threaten even the modest growth rate the Philippines has experienced over the last few years. The lack of reform since the crisis is also attributable to a breakdown in Philippine governance. Since mid-2000, when serious allegations of wrongdoing by President Joseph Estrada first began to emerge, the Philippines political environment has alternated between periods of political crisis and political malaise. Both have been equally inimical to any attempts at serious economic reform. The more time passes, the more the Philippines’ initially impressive response to the crisis looks like an anomaly rather than a sign of better times ahead.

2. Crisis and Recovery

Regardless of the indicator we focus on it is clear the crisis took a much bigger toll on the Thai economy than on the Philippine economy. However, we should note that Thailand’s greater fall came about in part because it had risen to greater heights than the
Philippines. In 1985 Thailand still lagged behind its neighbor in terms of per capita income\(^1\) (see Table 1) but over the subsequent decade the Thai economy was among the fastest growing and best managed (in terms of the macro-economy) in the world. Thailand’s rapid rate of economic growth, lower rate of inflation, and higher level of capital formation reflect the relative strength of the Thai economy vis-à-vis the Philippines during the latter part of the 1980s and first half of the 1990s (Table 1). On the eve of the crisis Thai per capita income had not only caught up with Filipino GDP per capita, but had far surpassed it.

\(^1\)This despite the collapse of the Philippine economy in the waning years of the Marcos dictatorship.
### Table 1: Economic Performance of Thailand and the Philippines

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<tr>
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<th>Thailand</th>
<th>Philippines</th>
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<tbody>
<tr>
<td>GDP/capita¹ 1985</td>
<td>$3,021</td>
<td>$3,572</td>
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<tr>
<td>GDP/capita¹ 1996</td>
<td>$6,816</td>
<td>$3,815</td>
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<tr>
<td>Average GDP growth rate 1986-96</td>
<td>7.6%</td>
<td>1.3%</td>
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<tr>
<td>Average Inflation² 1986-96</td>
<td>4.8%</td>
<td>8.9%</td>
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<tr>
<td>Average Gross capital formation as % of GDP (1986-96)</td>
<td>37.2%</td>
<td>21.2%</td>
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1. PPP, Constant 2000 International dollars. 2. GDP deflator.

Despite its impressive performance by mid 1990s the Thai economy was increasingly vulnerable. Like much of the rest of the region a tidal wave of foreign capital inflows and weak financial sector regulation combined to produce speculative booms in the real estate and stock markets (see the this volume’s Introduction). At the same time capital inflows undermined Thailand’s competitiveness by pushing up inflation and the value of the baht, eventually leading to a decline in investment, a dramatic fall in exports, and an attack on the baht by currency speculators. By the time the Bank of Thailand was finally forced to let the baht float investor confidence had been shaken and money began flowing out of Thailand leading to a collapse of asset prices and of the rate of return on new capital investments.²

² For more information on crisis itself see Pasuk and Baker 2002; Ammar 1997; Bank of International Settlements 1998; and Nakul 1998.
Overall the Thai economy to contracted by nearly 14 percent in both the second and third quarters of 1998. However, we are not interested in this volume with rehashing the details of the crisis itself. Rather, our focus is on pathways out of the crisis and in this context it is significant that economic growth returned fairly quickly in Thailand (Figure 1). Growth began to pick back up in 1999 and for the year Thailand posted a growth rate of 4.45. Growth has been at that level or above in every year since, save one. The sole exception is 2001 when a global slowdown reduced demand for Thailand’s exports and slowed growth to 2.2 percent (Figure 2). Thailand’s growth rate between 1999 and 2005 averaged 4.9 percent.

While the crisis began in Thailand its effects quickly spread. The graph of Philippines’ quarterly growth rates follows Thailand’s general pattern but with a much shallower slope. Initially the government’s response was enough to keep investors happy during last half of 1997—for the year the Philippines posted a growth rate of 5.2 percent. Only in the midst of the Indonesian meltdown did economic growth dip below zero, returning to positive territory in 1999. From 1999 to 2005 the Philippines economy grew at an average annual rate of 4.5 percent, with a temporary slow down in 2001.
Figure 1: Quarterly Growth Rates 1996-2000 (Constant Prices)

Source: Asian Development Bank, Asia Regional Information Center. [http://aric.adb.org](http://aric.adb.org)

Figure 2: Annual Growth Rates 1999-2005 (Constant Prices)

As instructive as the comparison of growth rates may be it paints an incomplete picture of the post-crisis recovery trajectory in each country. Figure 3 charts the GDP/per capita figures for Thailand and the Philippines. Growth in per capita income returned to both countries in 1999, though at a slower rate than prior to the crisis. The relative severity of the crisis in Thailand is reflected in the fact that it took Thailand 6 years of steady growth to regain the income level it reached before the crisis. By contrast, per capita income barely dipped at all in the Philippines and all of the income losses were recovered by 2000.
Figure 3 also communicates another important fact of the post-crisis trajectories in Thailand and the Philippines. The Philippines’ strong performance in the midst and immediate aftermath of the crisis is largely offset by its lack-luster performance since. Indeed, overall per capita income as barely budged from 1996 (or 1990) levels. Other economic indicators tell a similar story including a steady decline of gross capital formation (GCF) in the Philippines since the crisis. GCF was more than 24 percent of GDP in 1996 but fell to 18.8 percent by 1999. Since 1999 GCF has further declined to a
low of 15.8 percent in 2005. By contrast, Thailand’s GCF, while also falling from a pre-crisis high of 42 percent to 20.5 in 1998 and 1999, has steadily increased to reach 31 percent of GDP in 2005 (World Development Indicators). Likewise, while the peso initially retained more of its value than did the baht in the wake of the crisis, since June 2000 the peso has steadily lost ground to other currencies, including the baht. In the next two sections I examine the recovery experience of each country in more detail.

3. Thailand: Institutional Reform and the Changing Political Economy of Policymaking

Thailand had the ignominy of being the first casualty of the Asian financial crisis. The coroner's report has been widely circulated so there is little need for a detailed review of the causes of the crisis. It is important to note that the crisis was as much evidence of a political failing as it was a failure of economic policy or strategy. Many had seen storm clouds on the horizon but little was done to prevent the crisis from coming or to quickly contain it once it broke. Politics got in the way (Pasuk and Baker 1998; MacIntyre 2004). The crisis shone a spotlight both on the weaknesses and vulnerabilities inherent in Thailand’s growth strategy, and also on the shortcomings and failures of Thailand’s political system. The result was greater support for not only economic reforms, but also political reforms in the form of a new constitution.

The crisis, then, generated greater support for constitutional reform than would have been the case otherwise. At the same time the crisis helped bring about a fundamental alteration of Thailand’s political economy. First, under severe stress from
the crisis Thailand’s business elite abandoned their traditional behind-the-scenes involvement in politics and instead moved to play a more direct role in politics and policymaking. Second, Thailand’s existing political elite (including Thailand’s two largest parties) were greatly weakened as a result of the crisis, leaving something of a political vacuum. Third, the crisis heightened the distrust among the Thai public towards globalization and foreign economic interests and the initial decision to implement the austere IMF recovery plan only increased these feelings. In the end, Thaksin and the Thai Rak Thai party were able to exploit these changes to cobble together a political party, secure a rare majority in the 2001 election, and then, most importantly, impose a level of party discipline and party cohesion previously unheard of in Thailand’s democratic history.³

With a secure, disciplined majority in control of government, the Thai “model” of political economy was drastically revised. Gone were the short-lived, indecisive multiparty governments that had been the distinguishing feature of Thailand’s political economy since the 1970s. In its place was a majority party government that immediately demonstrated its ability to take decisive action on the policy front, but which also set about to bring political and economic authority completely under the control of a single party, and more specifically, under the control of the Prime Minister.⁴ In the rest of this section I discuss in more detail the role the crisis played in bringing about these changes to Thailand’s political economy and the consequences of those changes for policy.

³ See Hicken 2006 for more details.
⁴ It was this concentration of authority under Thaksin that alarmed Thaksin’s critics, including, ultimately, the King and the military.
The Crisis and Constitutional Reform

While Thailand’s pre-reform political system was criticized on many fronts a few aspects of the system received a large share of the blame. First, critics pointed to the highly unstable nature of Thai politics as a major weakness and a contributor to the crisis. The Thai political system prior to 1997 generated large-multi-party governments that were notoriously short-lived. This undermined policy planning, continuity, and implementation while encouraging many actors to adopt a short-term and sometimes predatory outlook on government service.

Second, reformers, academics, and politicians themselves complained that Thai political parties were inadequate to the tasks at hand. Parties, as ephemeral alliances of electoral convenience, lacked any sort of coherent policy program. In addition, Thai politicians were chiefly concerned with directing government goods and services towards narrow groups of political supporters as part of an effort to build candidate-specific networks of support. The result of this state of affairs was a decided lack of any actor within the national government with strong incentives to provide national public goods (Hicken 2001). 5

Finally, the Thai system came under criticism for not being sufficiently democratic. An appointed Senate remained as a vestige of an earlier authoritarian era. Political and economic authority remained highly centralized within the Bangkok-based

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5 It is telling that Thailand’s most ambitious reforms during the early-mid 1990s came during the unelected government of Anand Panyarachun.
bureaucracy. In general, the system lacked a sufficient system of checks and balances that
could rein in abuses by those in authority.

When the crisis struck the process of amending the constitution had already
begun. In 1996 the Thai parliament approved a bill that organized a Constitutional
Drafting Assembly (CDA). The CDA convened in the early part of 1997 and by August
had produced a draft that surprised many with the breadth and depth of its proposed
reforms.

The crisis hit just as debate over the proposed new constitution was heating up.
Despite parliament’s decision to convene the CDA there was no guarantee that they
would accept the CDA draft. In fact, the draft threatened the interests of many of
Thailand’s political and bureaucratic elite and was greeted with wariness and even
outright opposition. The fact that most politicians ultimately voted to adopt the draft
constitution, despite some very serious misgivings, is a direct consequence of the crisis.
The crisis effectively raised the stakes connected with the draft by shining a spotlight on
some of the shortcomings in the Thai political system. To a large number of voters and
investors the constitutional draft was a symbol of the government’s commitment to
difficult but needed political and economic reforms. In fact, in the weeks before the final
vote expressions of opposition or support for the draft by leading officials generated
corresponding moves down or up in the stock market and currency markets. In the end
the crisis raised the potential economic and political costs of a no vote and as a result the
draft was adopted.
The new constitution aimed to address each of the three weaknesses in the old Thai system described above. First, in a bid to improve government stability and longevity the constitution included provisions designed to reduce the number of political parties (and increase the chance of majority party governments) and increase the power of party leaders over their party members. This was particularly true of the prime minister who received tools that gave him unprecedented leverage over members of the cabinet (Hicken 2006). Second, the constitution provided greater incentives for political parties to differentiate themselves on the basis of programmatic appeals through the creation of a national party list and the elimination of intra-party competition (members of the same party competing against one another in the same district). Finally, the constitution included a number of reforms designed to further “democratize” the Thai system. These included an elected Senate in place of the appointed body, and numerous semi-autonomous watchdog agencies or superintendent institutions. The constitution also called for an unprecedented level of political and economic decentralization, including elections for local offices.

*The Political Economy of Economic Reform under Multiparty Government*

While the constitutional debate was raging the government of Chavalit Yongchaiyudh was struggling to respond to the crisis. Wracked by party and factional divisions the government was unable to muster a strong, coherent policy response—continuing a pattern established before the crisis where early efforts to head-off disaster by reformers within the cabinet were reversed or blocked (MacIntyre 2004). In this
environment the IMF proposed a US$17 billion stabilization package that came with a host of demands for reform and restructuring. Chavalit was quick to agree to the package—signing an agreement in August of 1997—but his government was slow to move on most of the conditions set out in the agreement.

In the end Chavalit was unable to survive the political damage inflicted by his government’s inadequate response to the crisis. Faced with imminent defections by some members of the coalition (including members of his own party) Chavalit resigned as prime minister in November of 1997. A new coalition, led by the former opposition Democrat Party and its leader Chuan Leekpai, replaced him.

Chuan’s government faced two sets of vulnerabilities in addition to the immediate task of stabilizing the economy. First, as was true of most of the region (see the introduction to this volume) Thailand needed to reform and restructure its financial system. This multifaceted task included establishing more stringent regulatory oversight, managing the restructuring or closing of insolvent financial institutions and the distribution of their assets, restoring liquidity and bank lending, and dealing with the massive number of non-performing loans (NPLs) on the books of nearly all financial institutions. The latter was a huge albatross on not only the financial sector, but also the broader economy. Official government statistics placed the percentage of NPLs at nearly 50 percent of total outstanding loans while some outside observers believed the number to be even higher (Asian Development Bank 2000). The large number of NPLs made

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6 See the Introduction and Hamilton-Hart’s chapter for a comparative view of financial reform throughout East Asia.
banks wary of additional lending and as result, credit was hard to come by for the country’s many cash-strapped firms.

The second set of vulnerabilities concerned the decline of Thailand’s competitive position in the world economy. By the time of the crisis there were signs that Thailand’s ability to realize high rates of growth through accumulation and the export of labor-intensive goods was coming to an end (Richter 2006; Bosworth 2005; Jonsson 2001). Competition for investment dollars combined with the crisis meant that Thailand’s access to foreign investment capital was likely going to decline relative to past levels. In addition, Thailand’s export-led growth strategy was becoming less sustainable given the changing international environment and increased competition from other low-wage countries—chiefly China (Doner n.d.).

Thailand was in many ways ill-prepared to compete in this new environment. During the boom years it had “failed to develop the design and innovation capabilities necessary to move toward [a] more sophisticated production [profile].” (Felker 2001, 3) To continue to compete Thailand needed to upgrade (Doner n.d.). This entailed taking steps to boost productivity and the rate of innovation and technological advancement, along with developing better linkages between the foreign-dominated export industry and potential local suppliers. There was also an acute need for new investment in upgrading the country’s infrastructure in order to better utilize existing stocks of capital and labor and to attract new investment.

Upon assuming power the Democrat-led coalition set out to stabilize the economy and address these vulnerabilities. Operating largely within a framework worked out by
the IMF reformers saw the crisis as an opportunity to push through much needed, and
long delayed, economic and regulatory reforms. Perhaps the most controversial element
of the IMF program in retrospect was its requirement of a severe tightening of fiscal and
monetary policy. This prescription misunderstood the nature of the Thai crisis.
Government profligacy was not to blame for the economic problems. In addition, given
the state of paralysis in Thailand’s financial and business sectors the government was the
only reliable source of liquidity and economic stimulus. The fiscal monetary tightening
ended up deepening and prolonging the economic recession. The Chuan government
responded by finally abandoning this portion of the stabilization program and instead
increased government expenditures (mostly in the form of increased spending on the
social-safety net) in a bid to stimulate domestic demand.

The implementation of the stabilization program won the government few
supporters. Initial enthusiasm for the government’s strong commitment to economic
reform (a marked change from the inept Chavalit regime) faded away as the economy
continued to decline. Moreover, as the government continued to push its reform program
it began to encounter strong opposition from both business and political circles. Recall
that while the new constitution was adopted in October of 1997 many of its provisions
where not fully in place until the first post reform election in 2001. As a result Chuan’s
government operated under many of the constraints of the previous system. The
exigencies of the crisis bought the government some time and political capital but

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7 The framework called for restructuring the financial sector (including allowing more foreign
participation), privatizing state owned enterprises, reforming the civil service, greater participation by the
private sector in infrastructure projects, and regulatory reforms for both the financial and corporate sectors.
8 This was done with the approval of the IMF (IMF, 3rd LoI, 24 February 1998; 4th LoI,
reforms were often blocked, delayed, or watered-down by members of the government coalition or the Senate. The government did move swiftly to completely close down the failed financial companies and got the Financial Sector Restructuring Agency (to organize the workout of failed finance companies) and Asset Management Company (to purchase and dispose of non-performing assets) up and running as part of the financial restructuring effort. It also significantly improved the supervisory and regulatory framework surrounding the financial sector (Asian Development Bank 2000). However, the government’s efforts to reduce NPLs, encourage corporate restructuring, and induce banks to restructure and resume lending, moved much more slowly as a result of disagreements within the government about how to proceed (Pattnapong 1999). As the delay wore on the number of NPLs continued to grow with more and more firms succumbing to the deepening recession and liquidity crunch (Figure 4). After the government’s eventual restructuring program was shunned by most banks, the number of NPLs continued to grow for more than a year, peaking at nearly 48 percent of all bank loans before beginning a slow decline.

Figure 4: Non-Performing Loans as a Percent of All Loans
By the end of the Chuan administration the economy had stabilized and economic growth had resumed. However, only limited progress had been made in financial sector restructuring—NPLs were still more than 20 percent of bank loans. In addition, almost nothing had been done to address the longer-term question of Thailand’s competitiveness. Efforts to promote technological upgrading received some lip service but little else. The government had also steadily cut public investment in infrastructure development while efforts to promote more private participation in infrastructure projects had fallen flat (Richter 2006).

The government’s dogged implementation of the IMF’s neoliberal reform program meanwhile led to growing opposition across the political, economic, and social spectra. Consistent with the ideational shift that occurred in other East Asian states hostility toward globalization and foreign capital began to grow (see the Introduction to this volume). A loose alliance of NGOS, domestic businesses, intellectuals, politicians, workers, and even the Thai king came together to oppose what they saw as external
interference in Thailand’s sovereign affairs and a fire sale of local assets to foreign
investors (Hewison 2006, 98). Thailand’s domestic businesses were especially concerned.
The crisis had greatly weakened domestic businesses and they struggled to survive in the
face of greater foreign competition. The combination of lower barriers to foreign
investment and good deals on distressed Thai assets led to a sharp increase in foreign
direct investment. Businesses responded by appealing to the government for protection of
their interests, but without success.

As Kevin Hewison describes it, this unprecedented threat to domestic business
interests led Thailand’s business groups to abandon their traditional behind the scenes
support of a variety of political parties and politicians and enter politics directly in a bid
to win protection for their interests (2004; 2005). Their means of entering politics was the
newly formed Thai Rak Thai party. Thai Rak Thai was organized by Thai business
tycoon Thaksin Shinawatra in preparation for the 2001 House election, the first to be held
under the new constitution. Thaksin actively recruited domestic capitalists to the party by
promising them a seat at the policymaking table and a shift in government priorities
towards protecting and promoting the interests of Thai companies.

Thaksin and the Thai Rak Thai party seized on the prevailing anti-IMF, nationalist
sentiment and harnessed it to the benefit of Thai Rak Thai’s electoral fortunes. In his
rhetoric Thaksin talked of protecting Thailand from foreigners out to swallow the country
and its assets. Even the name of the party (Thais love Thailand) evoked this nationalist
sentiment. However, Thaksin did more than campaign on a nationalist platform. He also
struck an explicit bargain with Thai voters. In exchange for domestic business interests
controlling the economy and politics (which he promised they were uniquely qualified to do) Thaksin promised to devote increased attention and resources to social welfare/social protection. In effect, he pledged that the government would take an active role in reducing poverty and raising rural incomes.\(^9\) In line with this pledge Thai Rak Thai campaigned on a platform that included a million baht grant for all Thai villages, a 30 baht health care scheme, a debt moratorium for farmers, and a tamboon development plan dubbed OTOP (one Tamboon, one product).\(^10\)

When the election was held in January of 2001, Thai Rak Thai fell one seat short of a majority in parliament, a fact soon remedied when a smaller party merged with Thai Rak Thai after the election. Thaksin thus became the first elected prime minister to enjoy the support of an absolute majority of House members. He later invited to other parties to partner with Thai Rak Thai further bolstering his majority. After serving a full term (a first for an elected prime minister) Thaksin and Thai Rak Thai were reelected in a landslide in 2005.

What explains the electoral success of Thai Rak Thai? Undoubtedly, Thaksin’s personal assets (financial and otherwise) were important tools in attracting candidates and voters to the party. Thai Rak Thai also benefited from the crisis-induced weakness of the Democrat and New Aspiration Parties. Finally, the constitutional reforms also played a role by establishing electoral rewards for national programmatic appeals, reducing the

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\(^10\) Thaksin also accelerated Thailand’s repayment of its debt to the IMF and succeeded in paying off the loan in July of 2003, two years ahead of schedule. Thailand’s final Standby Agreement with the IMF, with its attendant conditions, expired in June of 2000.
number of parties, and giving Thaksin added leverage over factions within his party (Hicken 2006).

The Political Economy of Economic Reform Under Thaksin

Thai Rak Thai’s electoral victory dramatically altered Thailand’s political economy in two ways. First, it represented a fundamental shift in business-government relations. Gone was the competitive clientelism described by Doner and Ramsey (2000) replaced by a ship of state directly helmed by business interests. Second, the election brought a majority party to power—something unprecedented in Thailand’s democratic history. The advent of majority government meant that Thaksin and Thai Rak Thai were able to act more decisively than any of their elected predecessors to implement their preferred policies.

The various accounts of the evolution of the policymaking environment under Thaksin all tell a similar story. Thaksin, through a variety of reforms, worked to centralize power and authority within Thai Rak Thai, and specifically within the office of the prime minister. Measures such as bureaucratic restructuring, budgetary reform, reform of the armed forces, new duties for provincial governors, and the marginalization of semi-autonomous supervisory agencies reduced political fragmentation while strengthening the position of the TRT vis-à-vis bureaucratic and partisan rivals (Painter 2005; Hicken 2005).

There were both costs and benefits to this new state of affairs. To begin with, the Thaksin government was much more decisive than its elected predecessors. It was able to
pursue its preferred initiatives, which included a multitude of programs targeted to poor and rural areas. In addition, there were efficiency gains to be had from single party control of the bureaucracy as the party coordinated the government’s various programs. On the other hand, under Thaksin government policy and institutions became the instruments of the ruling party and its leader—there to serve their interests and goals. In the past bureaucratic and partisan rivalries combined to prevent any one party or faction from seizing control of the machinery and resources of government. This was no longer the case. The government under Thaksin was, in many respects, an extension of Thai Rak Thai and Thaksin (Hicken 2006).

The combination of new interests in power and new power for those interests had significant consequences for Thailand’s political economy and its recovery from the crisis. Upon taking power Thaksin immediately put the breaks on privatization and liberalization. When the privatization effort was finally revived in 2003, shares were generally offered only to domestic share holders, and where foreign investors were allowed to participate, their shares did not carry voting rights (Hewison 2005). In the area of telecommunications the setting up of an independent regulatory agency, mandated by law, slowed to a crawl. At the same time the government worked to keep the sector closed to foreign participation—all to the potential benefit of Thaksin’s companies (Pasuk and Baker 2002).

The government also moved quickly to address the vulnerabilities in the financial sector. To tackle the dual problems of NPLs and an enduring shortage of domestic credit Thaksin established a new agency, the Thailand Asset Management Corporation
(TAMC). As the state banks transferred their bad loans to TAMC and then complied with the government’s direction to increase lending the number of NPLs declined and the credit crunch began to ease in 2002 (Pasuk and Baker 2004).\footnote{In total state banks were responsible for 112 percent of the net increases in credit in 2002, and 96 percent in 2003 (Pasuk and Baker 2004).}

Thaksin also began plans to improve Thailand’s competitiveness and stimulate economic growth through a program of mega-projects designed to upgrade the country’s infrastructure. The government committed to raising public investment in infrastructure by 70 percent over a five-year period. The Asian Development Bank estimated that meaga-project investments could have contributed 0.5-0.7 of a percentage point of GDP growth per year beginning in 2007 (2006, p. 225).

Thaksin’s government also broke from past practice by aggressively pursuing bilateral preferential trading agreements. Consistent with the trends outlined in the introduction to this volume the government shifted its focus away from regional and multi-lateral trade arrangements towards agreements with key economic allies.\footnote{The government did, however, participate in regional efforts to reduce vulnerability to future shocks, such as the new currency swap arrangements and regional bond initiative.} Thaksin signed (controversial) PTAs with China, Australia, and Japan and was in the process of negotiating a PTA with the US when he was ousted.

In short, the changes to Thailand’s political environment helped the country consolidate its recovery from the crisis and address some of the economy’s chief vulnerabilities. However, significant challenges remained. Beyond infrastructure investment the government did little to upgrade Thailand’s competitiveness. In fact, to the extent domestic business interests were shielded from competitive pressures it did just
the opposite. Observers were also concerned about the true status of Thailand’s financial system. After capturing the premiership Thaksin replaced the head of the central bank with a political ally. Thaksin’s government was not shy about using the state banks and the TAMC to reward its supporters and there were concerns that political priorities have trumped prudence and economic efficiency (Crispin 2003; Pasuk Baker 2004, 112).

The Fall of Thaksin and the New (Old) Political Environment

The power amassed by Thaksin, and his willingness to wield it in pursuit of his interests, left the government vulnerable to charges of manipulation, favoritism, and corruption. Exhibit A is the political crisis that engulfed Thaksin and Thai Rak Thai in 2006, culminating in a military coup in September. The catalyst for this crisis was the sale of shares in Shin Corp, a telecommunications company built by Thaksin and still owned by his family, to Singapore’s Temasek Holdings. The deal went ahead only after the government reversed its earlier restrictions on foreign ownership in the telecommunications sector. The sale brought a nearly US$2 billion tax-free profit for Thaksin’s family, emboldening Thaksin’s critics while at the same time undermining his support among some allies. After the January 2006 sale the ongoing but previously low-level anti-Thaksin protests within Bangkok grew in both size and strength.

To try to diffuse the protests Thaksin dissolved the parliament, called new elections, and stepped down as prime minister. The major opposition parties chose to boycott the elections and the elections results, which had Thai Rak Thai winning handily, were later thrown out by the courts. Despite this setback Thai Rak Thai was poised to win
the new election scheduled for October or November of 2006. At the same time the anti-Thaksin protests showed no signs of abating. The stalemate was finally resolved via a military coup in September 2006 which ousted Thaksin and his government.

Shortly after the coup the country’s new leadership formed an interim government announced that one its top priorities was constitutional reform with the goal of correcting some of the perceived shortcomings (and unintended consequences) of the 1997 constitution. Since January of 2007 an unelected drafting assembly has been at work on a new constitution, which will be voted on in a referendum in August of 2007. Elections are expected by the end of 2007. The new draft constitution, if passed, should once again bring about a significant shift in Thailand’s political economy—returning Thailand to a pre-Thaksin state of affairs. This is by design. Thaksin’s popularity and his centralization of political power ultimately threatened the authority of the traditional centers of power in Thailand. These actors are using constitutional reform try to return Thailand to an era when parties were weak, governments were large and unstable, and prime ministers lacked the tools to bring other actors in the political system to heel (Hicken forthcoming).13

If the draft constitution is adopted we would expect policy making to look very much like pre-Thaksin Thailand. Weak, short-lived multi-party governments will tend to undermined policy planning, continuity, and implementation and encourage actors to adopt a short-term outlook. Needed national policies and reforms will be undersupplied

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13 Changes include replacing the elected Senate with a partially appointed body, re-adopting multi-seat districts, allowing party switching, banning party mergers, and reducing the power of the prime minister (Hicken forthcoming).
while politicians spend their time and resources in pursuit of electorally-rewarding pork and particularism.

While awaiting the new constitution and new elections Thailand has been in limbo—headed by a caretaker government whose top priority has not been economic reform and economic growth. This is different from the military’s last stint in power in 1991. Then the military appointed a respected civilian businessman as interim prime minister who then proceeded to push through a series of ambitious economic and regulatory reforms. This time around the coup leaders appointed as prime minister a respected military figure who lacked economic credentials. Under the interim government economic policy/reform has taken a back seat to political reform and dealing with unrest in the South. In fact, the government has regularly mis-stepped in its handling of economy while domestic and international confidence in the Thai economy continue to erode (Nation 2007).

To summarize, in the past dispersed political authority often made it difficult for Thai governments to act. This changed with the 1997 constitution and the election of Thai Rak Thai. However, this new concentration of political authority also carried with it new risks. When power is concentrated, as it was in Thailand, economic actors become highly sensitive to perceptions of the strength and competence of those who wield that power (MacIntyre 2004). Thailand is currently experiencing some of the effects of that sensitivity. The recent uncertainty has delayed spending on the mega-projects, driven away foreign investors, who were already showing some reluctance to invest in Thaksin’s Thailand, eroded consumer confidence (consumer spending had been a major growth
engine under Thaksin), and ultimately threatens to derail the economy. The centralization of power set in motion a political effort to undo some of the consequences of the 1997 constitution and restore a less effective, but for some less threatening, political environment.

4. The Philippines: The More Things Change…

As the Asian Financial crisis broke the Philippines emerged in comparatively good shape. Of the crisis economies the Philippine economy took the smallest dip and quickly recovered its strength. The financial and corporate sectors in the Philippines also survived the crisis in much better condition than their counterparts in Thailand and Indonesia. How did the Philippines, with its reputation as a chronic underperformer, manage to fare better than its highflying neighbors? Three factors played a role. First, the Philippines financial system was in much better shape than others in the region (Noland 2000). After an earlier financial crisis the government of Fidel Ramos undertook a series of reforms designed to strengthen the financial system. The level of non-performing loans and bank capitalization had improved prior to the crisis and the financial sector was much less exposed in the real estate sector than financial institutions elsewhere in the region (ibid.). The greater health of the Philippines finance sector vis-à-vis Thailand can be seen in its much lower percentage of NPLs (Figure 5). Second, because liberalization and economic rehabilitation were slow to arrive in the Philippines, due to the disaster of the Marcos era and the uncertainty surrounding the Aquino administration, the Philippines was a belated participant in the speculative investment and private debt booms (Nolan
Finally, the Philippines benefited from relatively consistent and coherent crisis management and a political system that enabled the government to respond in a timely, credible manner (MacIntyre 2004).

Figure 5: Non-Performing Loans as a Percent of All Loans
Thailand and Philippines Compared

Sources: Bank of Thailand; Bangko Sentral ng Pilipinas.

Ironically, the period of the crisis arguably represents the apex of economic and political performance in the Philippines over the last 20 years. Since the financial crisis, while maintaining a modest growth rate, the Philippines economy has once again descended into dangerous territory. In many respects, the economic situation is worse today than it was immediately after the crisis. The debt and budget deficit levels are unsustainable, government spending in needed investments and services is declining, and there are new worries about the health of the financial system.

In part this economic malaise can be traced back to the fact that the crisis was relatively mild and thus did not generate the momentum for economic and political reform we saw elsewhere after the crisis. Once the Ramos administration stepped down
in 1998 the progress towards needed reforms stalled. As I will discuss in more detail below successive Philippine governments have failed to address three related vulnerabilities since the crisis—debt, tax revenues, and money losing State Owned Enterprises (called Government Owned and Controlled Corporations (GOCCs) in the Philippines). In order to understand how and why this failure has occurred one must first understand the political economy of policymaking in the Philippines—specifically, the crucial role of the president. I argue that the recent Philippine economic deterioration is in large part a function of a series of political crises that have paralyzed two successive presidents.

*The Political Economy of Policymaking*

As in pre-reform Thailand the Philippine political system is one that discourages the development of strong, programmatic political parties (Hicken 2002). Filipino parties are characterized by factionalism, frequent party switching (called ‘turncoatism’ in the Philippines), and party labels that generally mean little to voters or candidates. As a result, parties in the House and Senate are not cohesive, unitary actors pursuing unique policy agendas. Rather, they are temporary alliances of narrowly-oriented politicians primarily concerned with distributing the spoils of government (pork) to themselves and their supporters (Cruz and Chua 2004).

Given the incentives of members of Congress to raid the public purse in pursuit of narrow interests, what exists to prevent legislators from overgrazing on the budgetary commons to the detriment of fiscal health and the pursuit of needed national policies?
One potential antidote is the presidency with its national constituency. However, in order for presidents to successfully fulfill the roll as national policy provider and check against legislative parochialism at least two conditions must hold. First, the president must have some leverage over the other actors in the policy process in order to push through her policy agenda. Second the president must have incentives to provide national public policies/goods.

Fortunately, the Philippines president is equipped with a variety of formal and informal powers that gives her leverage over legislators, including large amounts of pork that she can distribute to congressional supporters or withhold from opponents. Philippines presidents can and do use the control over the pork barrel to build legislative coalitions in support of presidential initiatives.

However, an ability to push through national policies means little without some incentive to pursue those policies in the first place. Typically we assume that presidents have stronger incentives to pursue national public goods than do legislators (Shugart and Haggard 2001). This certainly tracks with the experience of the Philippines where historically the provision of national public goods has been the domain of the president (Hicken 2002). Yet it is important to note that a great deal of variation can exist between different presidents regarding their policy preferences and their incentives to forge legislative coalitions in favor of national policies. In part these preferences reflect individual core beliefs—Ramos for example was deeply committed to economic reform while his successor, Joseph Estrada, by most accounts was not. However, politicians also respond to incentives generated by the political environment. In the years since the crisis
the presidential incentives for policy reform have decreased dramatically along with a similar decline in the capacity for pushing those reforms through a recalcitrant Congress.

President Fidel Ramos skillfully used the tools of his office to cobble together legislative coalitions in support of a package of liberalizing reforms during his six years in office. However, since the exit of Ramos in 1998 the Philippines political system, never the most efficient and effective to begin with, has broken down. The crisis played an indirect role in this. The comparative shallowness of the Philippine crisis meant that there was not the pressure or support for the kind of political reform that occurred elsewhere in the region. In fact, attempts by Ramos supporters to pursue “cha-cha” (charter change) were quickly derailed by opponents who saw it as primarily a move to keep Ramos in power.

Initially attitudes towards Ramos’ successor, Joseph Estrada were cautiously optimistic. While Estrada had close ties to both former Marcos-era cronies and a group of cronies all his own, the administration appointed highly qualified and well-regarded individuals to its economic team and made no moves to reverse the liberalizing reforms enacted under Ramos. In addition, during the first two years in office the economy began to reap some of the rewards of the earlier reforms—rebounding quickly from the crisis-induced slump to grow at 3.4 percent and 6 percent in 1999 and 2000 respectively. By mid-2000, however, a growing wave of corruption scandals involving the president and his associates had begun to undermine this picture of policy continuity and economic

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14 See Pepinsky’s chapter in this volume for a similar argument about reform in Malaysia.
15 I am not suggesting that a severe crisis is sufficient to generate political reform, merely that such crises make political reform more likely.
health (De Dios and Hutchcroft 2003). The scandals eventually led to Estrada’s removal from office paving the way for the swearing in of Vice-President Macapagal-Arroyo.

From the outset President Macapagal-Arroyo’s administration was plagued by instability. The manner under which Macapagal-Arroyo had come to power undermined the president’s legitimacy and from the outset she faced regular challenges to her authority. Throughout the remainder of her term her first priority was building and solidifying a power base and preparing for an electoral mandate of her own in 2004.16

The 2004 election was a chance for Macapagal-Arroyo to put to rest questions about her legitimacy. After trailing in the polls the president won the election by the narrow margin of a million votes over challenger Fernando Poe, Jr. But she enjoyed only a brief honeymoon. A year into her term the president had to deal with new questions about her legitimacy which surfaced in the form of a tape of wiretapped conversations between the president and an official in the Commission on Elections. The tapes allegedly captured the president directing the election officer to rig the 2004 election to ensure she won by at least a million votes. This news triggered renewed political instability and a failed attempt to impeach the president. In response to the growing instability and out of fear of large-scale street protests the president issued an executive order forbidding demonstrations without a permit, followed by an executive order forbidding executive branch officials from testifying in congressional inquiries without Macapagal-Arroyo’s prior consent.17 On February 24, 2006 the president declared a State

16 In 2002, her popularity and an all time low, Macapagal-Arroyo pledged not to run for election but reversed her decision in 2003.
17 The Supreme Court eventually declared both orders unconstitutional.
of Emergency after uncovering an alleged coup plot. The decree was lifted a week later but in the interim the government used it as justification for dispersing anti-government demonstrators, arresting government opponents, cracking down on leftist political leaders, and conducting raids on media outlets critical of the president.

In short, the years since the Asian Financial Crisis swept over the Philippines have been marked by instability and political turmoil broken up by brief periods of political malaise. This kind of environment has not been conducive to difficult but needed economic reforms. The regular legitimacy crises have deprived presidents of the political capital necessary to push through costly reform programs and raised the cost of building legislative coalitions. More fundamentally, the focus on economic reforms that have high short-term political and economic costs but long-term benefits has been eclipsed by the more immediate need to survive each successive political crisis. To successfully deal with the mounting economic problems would have “require[d] unprecedented cooperation and open-mindedness among the country’s political elite as well as a great deal of forbearance and capacity for sacrifice among the people.” (de Dios et. al. 2004) Unfortunately, these qualities of cooperation, forbearance, and sacrifice are likely to be in short supply during periods of political turmoil and uncertainty such as the Philippines has experienced since 2000.

It is possible that such cooperation behind reform will not occur until the Philippines once again finds itself in the midst of an economic collapse. Such a collapse has become much more likely since the Asian Financial Crisis. In the remainder of this section I will focus on three inter-related vulnerabilities that have largely gone
unaddressed—first, the crippling debt burden, second, inadequate government revenues, and third, money-losing Government Owned and Operated Corporations (GOCCs).

Economic Vulnerabilities

In 1998, the year after the crisis, the national government’s debt was more than 56 percent of GDP. Since then government debt has steadily grown, reaching a peak of 79 percent of GDP in 2004 before declining slightly in 2005. The total outstanding debt of the public sector as a whole was even larger and followed the same increasing trend, reaching levels as high as 118 percent of GDP (Figure 6).  

![Figure 6: Total national-government and public-sector debt](Figure 6)

Source: Bangko Sentral ng Pilipinas.

The danger this level of debt represents is obvious. Such exposure leaves the Philippines extremely vulnerable to external shocks such as a rise in global interest rates, a sustained increase in world oil prices, a sudden rise in imports, or a sharp drop in

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18 These figures are conservative estimates of the debt burden. Other estimates place the public sector debt as high as 130 percent of GDP (de Dios et. al. 2004).
remittances from overseas workers. In addition, debt service payments are an ever-growthung burden on the country’s development and investment plans. Around 30 percent of government spending currently goes to service the debt (Asian Development Bank 2005). Once we add in non-discretionary spending on things like government salaries and operating expenditures that leaves only around 10 to 20 percent of the government’s budget to cover all of the country’s investment and developmental needs. Since 1998 this share of discretionary spending has fallen steadily (Figure 7). This explains the regular cuts in infrastructure spending, gross domestic investment, and other spending programs since the crisis, as well as the yawning gap between the government’s promises and what it actually delivers by way of goods and services (ibid.).

Figure 7: Discretionary Expenditures
(Percent of Total Expenditures)

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19 The foreign exchange from these remittances has been a key to avoiding some of the dire consequences of such a high level of debt to this point.
The two biggest causes of the growth in the Philippines debt burden since 1997 have been the chronic government budget deficits (which account for 43 percent of the increase) and government commitments to cover the liabilities of GOCCs (which account for 37 percent of the increase) (de Dios et. al. 2004, 3). Looking first at budget deficits, Figure 8 shows that after beginning the crisis with a nearly balanced budget the budget deficit steadily grew from 1998 onwards, surpassing 5 percent of GDP by 2002. Rising
debt service payments are only partially to blame for the growing deficit.\textsuperscript{20} Nor are the changes to the budget deficit due to large increases in government spending. Total spending has held steady since the crisis while primary spending (net of debt service) has actually declined (de Dios et. al. 2004, 4). Instead, the primary cause of the greater budget deficit is a declining tax and revenue effort. From their peak in 1997 both the taxes the government collects and the revenue it takes in have fallen by more than 20 percent (Figure 9).\textsuperscript{21} Adding insult to injury is the fact that this has occurred in the midst of continuous, moderate economic growth. The blame for this state of affairs, then, lies squarely with the government. For at least 10 years policymakers have recognized the need to drastically overhaul the country’s tax codes and tax administration to improve revenue collection. However tax increases and stricter collection have been anathema to already weak presidents and legislators worried about reelection. Only recently have significant steps been taken to increase tax revenue (Hedman 2006).

\textsuperscript{20} The primary surplus (excluding debt payments) also declined, going from a surplus of around 4 percent in 1996 to 0.6 percent of GDP by 2003 (ibid.).
\textsuperscript{21} Revenue measures the taxes a government collects plus receipts from social contributions (e.g. social security) and other revenues (such as fines, fees, rents, and income from property or sales. (WDI)
Figure 8: Budget Deficit as Percentage of GDP

![Graph showing budget deficit as a percentage of GDP from 1996 to 2004.](image)

Source: Philippine Institute for Development Studies.

Figure 9: Revenue and Taxes (Percent of GDP)

![Graph showing revenue and tax effort from 1996 to 2005.](image)

Source: World Development Indicators, World Bank.
The other major cause of the ballooning debt is the debts and liabilities the government has assumed from or on behalf of public sector corporations/GOCCs such as the National Power Company and the Public Estates Authority. In principle these organizations are expected to sink or swim on their own without government subsidies or bailouts. In practice the government has frequently stepped in and assumed the debts of these corporations when they have run into trouble or acted to implicitly or explicitly guarantee further borrowing (de Dios et. al. 2004). While precise estimates are hard to come by the government could ultimately end up responsible for as much as P4.13 trillion in assumed liabilities (approximately forty-eight times annual GDP). The means to prevent future liabilities of this sort lie within the government’s control: namely privatization and restraint.

Under presidents Aquino and Ramos the government began to divest itself of corporations and assets—many of which had been accumulated under Marcos. However, many of the big-ticket items, the National Power Corporation for example, remained in government hands. Plans and commitments to sell or partially privatize many of these entities fell by the wayside as successive presidents have struggled with more pressing political problems. Presidents have also been unwilling to exercise much restraint in assuming new liabilities. Philippines presidents have the unilateral power to decide whether and to what extent to assume the liabilities of GOCCs without the approval of Congress. Every president in the last four decades has used this power and Estrada and Macapagal-Arroyo are no exception (ibid.). Faced with a choice between 1. Forcing a
GOCC to be responsible for its debts, which carries the real risk of price hikes or disruptions in the services, or 2. assuming the debts knowing that most of the costs will fall to future administrations, presidents have invariably chosen the latter.

5. Conclusion

The case of the Philippines illustrates an irony of crisis and recovery. Those countries which escaped the crisis in relatively good shape (Philippines and Malaysia), also avoid launching costly reforms and may, as result, be more vulnerable in the long run, The momentum for reform is always difficult to sustain (as discussed in the Thai case) but the solid performance by the Philippines in response to the crisis had the perverse effect of undermining any sense urgency for addressing the country’s rising debt level, inadequate revenues, and burdensome GOCCs. The political instability since the crisis has prevented the two post-crisis presidents from acting as champions and coalition-builders for needed reforms—a role no other actor is equipped to fulfill in the Philippines political system. While economic growth has been steady since the crisis these unaddressed vulnerabilities threaten to send the economy into another crisis that might prove more difficult to escape.

By contrast, the crisis not only damaged Thailand’s economy, it also shook Thailand’s political foundations. The crisis became a catalyst for far reaching political reforms that eventually brought about a shift from indecisive multiparty coalitions to a very powerful majority government and an accompanying shift in the political economy of economic reform. The government of Thaksin Shinawatra quickly implemented
reforms that reduced NPLs and jump-started bank lending. However, Thaksin’s government also used the power and resources of the state to further the interests of its members and supporters. The recent instability brought about by the excesses of the Thai Rak Thai government, subsequent military coup, and new constitution now threaten to undermine some of the gains Thailand has made since the crisis while delaying the reforms and investments necessary for future growth.
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