Keynote Address
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Excellencies
Distinguished Guests
Ladies and Gentlemen

It is a great pleasure to be in Nepal, a kingdom that has so much in common with my own. Not only do we share similarities in our cultural heritage; through the centuries, both our countries have managed to remain free of foreign rule.

But in our own way and in our own time, Nepal and Thailand has each had to open up and adapt to the currents of globalization. And judging from rush-hour traffic in Bangkok and Kathmandu, it seems we also face many of the same challenges on the road to development!

Thailand, of course, had something of a head start. And by most conventional measures, we succeeded spectacularly. In some three decades, we had gone from practically nothing to become a role model for the developing World. Between 1985 and 1995, we achieved the fastest economic growth in the World, were hailed as the latest Asian economic tiger, and made the World Bank's top-ten list of projected biggest economies in the year 2020.

Our crash, when it came in 1997, was equally spectacular, sparking an Asian crisis that has since gone on to engulf much of the developing World. It has also given rise to much soul-searching over whether our development path was the correct one.

The question asked most frequently is: How can Thailand's development experience turn so quickly from blueprint for success into cautionary tale? How can something so right turn out so wrong? Or was it wrong to begin with, only we didn't know it, like someone who only realizes there is a problem with his diet and lifestyle when he gets a heart attack?

There are no simple answers. National development has never been a cut-and-dried proposition. You base your actions on the available knowledge at the time and make corrections as you go along. Certainly, the crisis has severely shaken our confidence. But we must be careful not to throw the baby out with the bath water. Yes, we made mistakes along the way, but there were also some things that we did right. Today, with the 20/20 vision of hindsight, I hope to share with you some insights on how to tell them apart.

First, to give you some idea how far Thailand has come, let me take you back some four decades, before we began to even think of economic development.

In 1956, Thailand was what economists in those politically-incorrect days called a backward economy. The country's population stood at a mere 23.4 million. Bangkok was a tranquil city of placid canals and tree-lined roads, its skyline dominated by temple spires. By far the most important sector of the economy was agriculture, which accounted for 42 percent of the country's GDP, engaged 88 percent of the country's labor force and made up 98 percent of total exports. Industry, which consisted of light manufacturing aimed mainly at the domestic market, made up only 12 percent of GDP and employed just 2 percent of the country's labor force.

Fast forward to 1995, just before the first signs of trouble appeared. Thailand's population had more than doubled to almost 60 million. Most Bangkok canals had been paved over, the trees cut down to make way for more cars, the temples long since eclipsed by high-rises. Bangkok had come to dominate the economy as few cities in the World do, accounting for over 42 percent of Thailand's GDP and almost 15 percent of its population. In the country as a whole, the contribution of agriculture to GDP had fallen to just over 10.4 percent, while that of industry had risen to almost 40 percent.

What had happened in those forty years to bring about his transformation?

The short answer is a combination of laissez-faire capitalism and fortuitous timing. Over the years, a series of shifts in economic policy integrated Thailand ever more closely into the World economy.

Beginning in the late 1950s, upon the advice of the World Bank, Thailand's leadership decided to pursue economic development through private-sector-led, import-substituting industrialization, while reducing the role of State enterprise in the economy.

Another significant shift in policy was the change from industrialization based on labor-intensive, import-substitution to capital-intensive, export-oriented production. Announced in the early 1970s, this policy began in earnest in the early 1980s.

Finally, and most controversially in light of the financial crisis, a process of financial liberalization took place between 1991 and 1994, resulting in huge inflows of capital that, in hindsight, we were unprepared to deal with.

The pace of foreign investment inflows began to quicken at about the same time that Thailand launched its export-oriented industrial promotion drive in the 1980s. When the Plaza Accord of 1985 pressured Japanese companies to move their manufacturing operations offshore, Thailand was a logical choice- thanks to its abundant natural resources, cheap labor, investor-friendly policies and a strong Japanese market presence.

And when Western fund managers began looking for alternatives to the unexciting rates of return offered in the advanced industrial economies, open, dynamic Thailand emerged as a strong favorite. Between 1985 and 1990, foreign direct investment flowing into Thailand shot up from $178 million to $2.5

billion, with Japanese investment rising from $124 million in 1986 to $1.2 billion in 1990. When that flow began to slow down in the early 1990s, foreign portfolio investment took up the slack. Net portfolio investment, which averaged $646 million in 1985-89, rose to $927 million in 1992 and jumped to $5.5 billion in 1993.

Thailand was no longer a backward economy, but an East Asian miracle, a Newly Industrialized Country. Thailand did everything by the book, and had the numbers to show that neo-classical economics worked.

But there was a darker side to the success story. Even as Thailand was logging record growth rates, the country was showing signs of strain. Rapid industrialization was creating social and environmental externalities that could not be addressed within the existing growth-oriented paradigm. The private sector was extracting resources and polluting the environment faster than they could be replenished or restored, creating ecological devastation on a grand scale. The income gap was widening between rural and urban areas, and between the rich and the poor, resulting in a flow of labor from rural communities to the city. Bangkok became overcrowded and polluted, with the slums, disease, drugs and prostitution that typify so many of today's mega-cities.

Was this a reasonable price to pay for a decade of double-digit growth? The answer would depend on whom one asks. Those paying the price and those enjoying the fruits of rapid growth were not necessarily the same groups of people. Our economic growth, while high, was unbalanced, inequitable and unsustainable.

Does this represent then, as some have suggested, the failure of capitalism?

To be sure, if we had not opened up to global capitalism, there would have been no crisis, or at least the Asian crisis would not have started in Thailand. But that is like saying one would never have fallen if one had not attempted to walk.

Capitalism is not inherently good or evil. As long as man continues to be driven by self-interest, capitalism will remain the least "evil" way of allocating resources. Like it or not, it is more useful for us to learn to manage capitalism, rather than repudiate it.

The financial crash may also be seen as a harsh market correction, or in the words of Joseph Schumpeter, an act of creative destruction, from which hopefully we will draw the right lessons. So if anything, I would say that the crisis is a reaffirmation of the laws of the market-place.

I would further suggest that Thailand's lopsided growth and financial crash occurred not because we were abiding too faithfully by market principles, but because we did not take those principles sufficiently to heart.

This may be a somewhat controversial Statement, so let me explain.

Earlier I stated that Thailand undertook policies to integrate itself with the World economy. But if you look more closely, you will see that while we adopted the outward trappings of capitalism, much of our economy continued to be dominated by practices that were not market-friendly -- in particular traditional social relationship patterns involving personal connections, patronage and paternalism.

Thus it was that instead of allowing the laws of demand and supply to determine prices and the most efficient allocation of resources, the State directed the process. Instead of developing our comparative advantage to the fullest, we inadvertently weakened it. Instead of fostering a competitive domestic environment, we encouraged monopolies and oligopolies as a means of capital accumulation.

One of the clearest examples of this unwitting distortion of the marketplace can be seen in our agricultural policy. Thailand has long had a tremendous natural comparative advantage in agriculture. Every Thai child knows by heart the ancient inscription describing 13th century Siam: "in the water there is fish, in the fields there is rice" - an apt description of Thailand even in the 20th century.

It is therefore rather ironic that farmers have always been the poorest members of society. Ever since Thailand began exporting rice in the mid-19th century, the rice surplus was taxed, enriching the land-owning upper classes while keeping farmers mired in poverty.

When we decided to industrialize the economy, it was again achieved at the expense of agriculture. Industrial enterprise was subsidized through tax breaks and other preferential privileges.

Rice exports, meanwhile, were subject to a tax - the so-called rice premium-, which was, ended only in 1985, in response to US subsidies of its rice exports. What the rice premium did was raise revenue for the State and keep rice prices artificially low for the benefit of urban consumers. Unfortunately, it also reinforced the chronic impoverishment of rural farmers. Allowing the market to determine prices instead would have raised the income of farmers and energized agriculture, but it was feared that the resulting higher cost of living would spark urban unrest.

Agricultural small-holders therefore remained dependent, orphan-like, on the "patronage" of the State. It was the State that farmers relied on to provide infrastructure, to grant loans and subsidies, even to tell farmers what crops o grow, how to grow them and what animals to raise (advice which often turned out to be misguided). The effect of this culture of dependence and the anti-agriculture bias in government policy was to weaken the agricultural sector by discouraging initiative, innovation and improvements in efficiency on the part of farmers.

I raise the issue of agriculture not only because it illustrates how political considerations have pervaded the process of resource allocation, but also

because it is crucial in understanding many other phenomena in Thailand. Many of our social problems can be traced to rapid industrialization and the imbalances it creates or aggravates between agriculture and urban interests. Chronic rural poverty and indebtedness have transformed farmers- the "backbone of the Thai economy" - into unskilled labor feeding the country's industrial expansion. Rural communities are sapped of their vitality, as Bangkok becomes ever more crowded, its infrastructure and services stretched to the limits.

Another reason farmers have been so exploited and dependent on the State is lack of education. Thailand's development policy has always rested on the assumption that our biggest strengths lay in natural resources and cheap labor. Successive governments have therefore paid scant attention to upgrading the quality of the workforce, preferring instead to promote our advantage in cheap unskilled labor.

But the entry of new players into the global market after the Cold War has shown that cheap labor is an advantage all developing countries have. Thus it was only relatively recently that human resource development became a new mantra in policy circles, with an emphasis on the upgrading of technical and management skills.

Here I should also add that HRD should not be confined to only the industrial sector. We must make sure that farmers are not excluded, but encouraged to learn how markets work and to develop the skills that will allow them to make independent, informed choices. Education is a public good, like roads and public utilities, without which development is impossible. This may seem obvious, but the short shrift education tends to receive in our development policy suggests that the link between education and development may not be as widely appreciated as it should be.

So far I have argued that the State should let market forces do their work without imposing distorting incentives favoring or punishing a particular sector. I have also pointed out that it is the obligation of the State to provide public goods such as education to allow the economy to achieve its full potential.

That said, I must also note that markets as a rule do not function perfectly. Left to themselves, markets give rise to monopolies, speculative bubbles, insider trading and other assorted distortions.

Hence, the State cannot totally disengage itself from the economy and rely on the invisible hand alone to maintain proper functioning. The State has an obligation to foster competition, prevent market failures, and ensure that private gains are not made at public expense. A minimalist State, or a State that is co-opted by the private sector, will have difficulty performing such duties.

A peculiarity of the Thai State is that it was too hands-on with regard to agriculture, but too hands-off with regard to industry and finance. Even in 1991, a World Bank report noted that Thailand was "a private enterprise system where

few controls are imposed, [and] increased material standards and private gains have been secured at an observable communal expense."

This insight is helpful in explaining how unintended consequences came about. When capital and currency controls were lifted in the early 1990s, it was with the intention of taking Thai industry to a higher plane of development. The policy of financial liberalization, combined with fixed exchange rates and high interest rates, did indeed attract a torrent of foreign capital. The missing part of the equation was the mechanisms and institutions to ensure that this glut of capital was channeled into productive activities, such as agriculture or manufacturing. The situation thus unleashed unprecedented opportunities for the nimble to make quick profits- in stocks, real estate and other speculative areas.

The mood in those years became one that Alan Greenspan aptly describes as irrational exuberance. Flush with cheap money in search of borrowers, banks and finance companies became undisciplined, grossly inflating asset values and over-extending credit. Short-term loans, unhedged thanks to the perceived safety of the baht's peg to the US dollar, were taken to finance long-term activities such as construction projects. Businesses began ploughing their earnings from manufacturing into property speculation. Over-capacity began to build up in sectors such as housing, industrial estates, petrochemicals and steel, many sectors of which had been promoted by the State itself.

By 1996, signs appeared to suggest the party was over. As the US dollar strengthened, so did the pegged baht. Export growth dropped from 24 percent the previous year to zero percent, while the current account deficit stood at a worrying 8 percent. Foreign investment began moving out. Despite reassurances by the government that all was well, it was apparent that the baht was overvalued, a point not lost on speculators. After a series of bruising currency attacks, the government was forced to float the baht on July 2, 1997.

This episode in our economic history demonstrates that if we wish to prosper in the modern market, we cannot afford not to play by its rules.

Here again we have a clash between the traditional and the new. A banking system based on mutual trust and support between lender and borrower, such as that which exists in many Asian countries, is fine for the domestic capital market, but hopelessly out of step in a globalize capital market.

Not only financial institutions but the State as well have to adjust their way of doing things. In an open capital market system, the State, because it usually guarantees bank deposits (with taxpayers' money, no less), must supervise the banks to ensure that the risks taken by the banks are based on project evaluations and kept within certain bounds. This means that a clean, transparent and effective corporate governance system must be in place. Shareholders in a company that misuses other people's money must be punished and not bailed out by the taxpayers. To enforce this, effective supervision by the central bank is required, which in turn presumes that a clean,

transparent and effective government is in place. The problem for most developing countries is how to get such a government -- one free of corruption.

Another area where the State has an important supervisory role to play is in promoting sustainable development. Developing countries, Thailand included, tend to take their natural bounty for granted. Forests are chopped down for timber or farmland, minerals are extracted with little regard for environmental damage, pollution clogs rivers and lungs, all in the name of progress.

Thailand is beginning to realize, hopefully not too late, the importance of sustainable development, which the Brundtland Commission's 1987 report defined as development which meets the needs of the present without sacrificing the ability of the future to meet its needs.

From the beginning, the Thai development model has focused single-mindedly on rapid growth. In recent year, as our economy grew while our environment deteriorated, more and more people are wondering if growth is really the panacea it is often made out to be.

Given time, nature replenishes its resources, such as trees, and breaks down most waste products. But rapid industrialization and rampant commercialism tends to create social and environmental externalities that outstrip the carrying capacity of nature: prawn farms that destroy mangrove forests, logging that destroys human and wildlife habitats, vehicle engines that emit noxious exhaust fumes, factories that release toxic substances into the underground water table and waterways. It is by no means certain if our runaway growth has not already compromised future generations' ability to enjoy a reasonably good quality of life.

Here then is clearly a case where unfettered market forces cannot be counted on to work for the greater good, particularly in the context of a global economy, which by its very nature encourages large-scale resource extraction. The pervasiveness of patronage and graft in Thailand aggravates the situation even further. Export-oriented exploitation of resources is therefore simply not sustainable without some degree of government regulation.

What the State should do is to inject greater rationality into the balance between economic and environmental priorities. It can pass and strictly enforce environmental legislation. It can require that prices reflect the internalization of such externalities, rather than allow the socialization of environmental costs. But too often, the State's agents are beholden to well-connected private interests and not particularly keen to protect public resources.

So overall, Thailand's growth has been a mixed blessing. We have tried to compress centuries of industrialization into a few decades, and in the process have discovered how detrimental some of our most entrenched traditions and social institutions are to our country as it tries to fit into the global market.

If those old ways were to disappear, I for one would not be nostalgic. In many cases, they hark back to an unjust social hierarchy that perpetuated poverty for

the masses and enriched a wealthy few. I am not saying that we should dispense with our cultural identity and blindly embrace the monoculture of the global market. What I am saying is that, as in any culture, there is much that should be retained and much that needs to be changed. If we are wise enough, we will know the difference.

Indeed, some wisdom seems to be emerging from the ashes of the financial crisis. Thai society has become more introspective, asking itself where its strengths and weaknesses really lie, and what are the things that really matter in life.

A reform process has begun towards an open society and more effective rule of law. In the aftermath of the crisis, this movement has gathered momentum and is enjoying wide public support. The shortcomings of the State are being redressed through political reform as well as good public and corporate governance. The State is trying to reduce its role in directing the economy, while strengthening its supervisory and regulatory capacities. Transparency, full and timely disclosure of information, and accountability have become watchwords in both the corporate and government sectors.

At the same time, the State and the market are also being monitored by a society that is more aware than ever of the potential for excess and inefficiency. Civil society -- and NGOs in particular -- is playing a more active role in strengthening communities and empowering ordinary citizens. The media have also been a powerful force for change, especially by exposing wrongdoing in high places. Citizens now have the right to access official information, a right that is being vigorously exercised and receiving the backing of our independent judiciary.

The financial collapse therefore marked the beginning of a new chapter in Thailand's development. We are under no illusions as to when we can achieve our goal of development that is just, equitable and sustainable. We recognize that our efforts towards an open society must proceed in tandem, at roughly the same pace, in both political and economic areas.

What we have learned is that when you take steps towards greater economic openness, and especially financial openness, there are a few rules of thumb to bear in mind: Do let the market do its work of determining prices; do provide public goods such as education and infrastructure; do intervene to correct market failures; and do intervene to prevent private self-interest from damaging the common interest. There are also a few don't 's: Don't second-guess the market; don’t favor certain sectors or groups over others; and don't use public funds to bail out private mistakes.

Even when we know the rules, it is not always easy to live by them. South East Asia has the advantage of being able to learn from the successes and mistakes of others. You also have much experience in the way of appropriate technology, which is usually more environment-and community-friendly. We should use the various regional fora-- such as the Bangladesh-India-Myanmar-Sri Lanka-Thailand Economic Cooperation forum, or BIMSTEC--not only to

promote trade and economic cooperation, but also to exchange ideas on development strategies.

Globalization, like capitalism, is a powerful force that should be harnessed for the greater good of mankind. We need to change and grow and become wiser if we are to survive it with our identity intact, so that future generations may look back at us with approval for bequeathing them a World that is not chaotic and bursting at the seams, but a World that is just, equitable and sustainable.

Thank you.