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CENTRAL BANKING IN THAILAND

by

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INTRODUCTION

In the accounting framework developed by the National Planning Association for open, dualistic economies, central banks influence the real part of the economy by their decisions affecting savings and investment. These decisions are influenced primarily by the central banks' relations with the commercial banks and, to a lesser extent, by the central banks' dealings with the fisc. In Thailand, at least, the decisions of households to save and of business to invest are, as yet, only marginally affected by the central bank's transactions with financial intermediaries other than the commercial banks.

The way in which the financial intermediaries transfer resources from the surplus to the deficit units is influenced by central banks' changes in reserve requirements, rediscount policy, debt management, and by open market operations and selective credit controls, although the last two control instruments play little part in Thailand.

For practical purposes the central bank will be equated with the Bank of Thailand even though, in law, the Ministry of Finance is the supervisory agency and retains the formal overriding power over many

decisions routinely made by the Bank of Thailand.[1]

It is interesting to note that the establishment of a central bank in Thailand followed rather than preceded the development of a lively and fairly sophisticated commercial banking system and that, unlike many

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[1]One reason why the control of commercial banking is nominally vested in the Ministry of Finance and why the Minister is, in principle, the supervisor of the Bank of Thailand operation is that the Bank of Thailand is a relatively recent institution, not established until 1942. Thus, when after some banking failures in the first quarter of the century, the need for some supervisory authority became clear, this task was entrusted to the Minister of Finance under the Commercial Banking Act of 1937. The inflationary pressures during the war and the occupation led to the passage of the Emergency Control Act of 1943, under which powers over all credit institutions were given to the Ministry of Finance rather than to the fledgling Bank of Thailand. Due to circumstances surrounding the establishment of the Bank of Thailand, the Act setting up this institution dealt primarily with the transfer of the note issue from the Treasury, and other functions of the Bank were barely outlined in an accompanying Royal Decree (see Bank of Thailand Act, B.E. 2485, and Royal Decree Regulating the Affairs of the Bank of Thailand, B.E. 2485). There is some difference of opinion regarding the degree of independence that the Bank of Thailand enjoys at present. It would appear that much depends on the Governor and his deputy, who, unlike other members of the Bank's Council, are appointed by the Crown. It would seem that especially since 1962 the effective, operational control of the Bank of Thailand and of commercial credit, in general, has gradually shifted from the Minister of Finance to the Governor of the Bank. This shift was brought about, in part, by the recognition of the integrity and skill of the top management of the Bank of Thailand, partly by the growing complexity of the matters with which it deals and partly by the passage of the Commercial Banking Act of 1962 which gave the Bank of Thailand some instruments of control. Yet, it still remains true that on many significant matters the ultimate decision rests with the Minister of Finance and that he, as a member of the Cabinet, wields political power denied to the Bank of Thailand. See Rak Chareonaksorn, "Control of Commercial Banks in Thailand" (unpublished Master's thesis, Chulalongkorn University, 1966).

countries to whom the formation of a central bank is one of the appurtenances of a newly acquired independence, Thailand has long resisted the setting up of a central bank merely as a status symbol. This resistance was led by three factions which were not necessarily separate and distinct. The British monetary advisors who long held sway over the financial policies of the country opposed the formation of a central bank since 1890. "Conservatives" at the Treasury argued against the "nationalists" of the 1930s that a central bank would be both superfluous and ineffective inasmuch as the commercial banks were dominated by branches of foreign banks not easily amenable to central control. The branch managers of large foreign banks were also lukewarm to the idea of a central bank. Yet the events necessitated the establishment of some institution which could implement the policy of large-scale public works followed in the 1930s, which was one aspect of the anti-Chinese, anti-Western tendencies prevailing in the country under the Pibul Songram regime. In 1939 the Banking Bureau was established. Its primary function was to provide loans to public enterprises, even though, in principle, the Bureau was empowered to perform most central banking functions except that of note issue. In fact, however, beyond performing the fiscal function and beyond some clearing for the existing commercial banks, the Bureau did not attempt to act either as a banker's bank or as the manager of the

country's monetary affairs. The Bureau was a "marriage of political reason and administrative need."[2] It was not until 1942, under the pressure of Japanese occupation authorities and as an alternative to Japanese domination of Thailand's monetary affairs, that the Bank of Thailand at last came into existence.

This sketchy background may help us to understand some aspects of Bank of Thailand policies and operations. From the very outset the Bank was meant to enforce and continue the tradition of financial independence of the country and to safeguard, above all, the integrity of its money at home, if possible, but certainly abroad. The lessons of history as understood by the Thais are clear. A country whose financial affairs are in disorder, whose currency fluctuates wildly in the foreign markets, and one which has difficulty in maintaining payments on its external debt invites the intervention of interested foreign powers and

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[2]The quotation is from the memoirs of H. H. Prince Vivatchai Chaiyan, first Governor of the Bank of Thailand. For events leading to the establishment of the Bank of Thailand, this is one of the primary sources (in Thai). For other sources see James C. Ingram, Economic Change in Thailand Since 1850 (Stanford: Stanford University Press, 1955), especially pp. 17ff; Paul Sithi-Amnuai, Finance and Banking in Thailand (Bangkok, 1964), Chapter 3; Ravi Amatayakul and S. R. A. Pandit, "Financial Institutions in Thailand," IMF Staff Papers (December 1966); and S. Y. Lee, "Currency, Banking and Foreign Exchange of Thailand," Far Eastern Economic Review (October 1960).

risks its very existence as an independent polity.[3] The circumstances which attended the formation of the Bank of Thailand did nothing to lessen the emphasis on the importance of maintaining financial integrity in the foreign markets, but they also brought to the fore the importance of maintaining internal price stability in the face of wartime inflation, the demands of the occupation authorities, and, later on, the needs of the Thai government. The point made here is that by tradition, training, and dictates of the times, the Bank of Thailand had to be primarily concerned with the soundness of its currency, and only incidentally and only in recent times could it devote much thought and energy to the control of credit or the structuring of the financial markets toward developmental needs.[4]

There can be little question that the Bank of Thailand accomplished what it considered to be its primary task. By 1955 the external value of the currency was well-nigh stabilized and the multiple exchange rate system eliminated. By 1959 the era of large budgetary deficits was pretty well brought to an end; and by the onset of the 1960s the internal price level

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[3]"The chief aim of monetary policy has been to safeguard the international position of the baht and the government seems to have put this aim above such national interests as economic development and stability of prices and income." Ingram, op. cit., p. 17.

[4]See T. H. Silcock, "Thai Money: Review Article," Malayan Economic Review (April 1966).

had shown remarkable stability, the baht was firm in world markets, the country possessed a large stock of foreign exchange reserves, budget deficits were either small or easily manageable, the credit standing abroad was first-rate, and the rate of growth of the economy was more than satisfactory. No small measure of credit must go to the managers of the Bank of Thailand for bringing about this state of affairs and for clearing the decks, as it were, for efforts in the areas of developmental finance and the control of credit.

In this paper, oriented as it is towards developmental strategy, no more than a passing tribute can be paid to the excellent performance of the Bank of Thailand in defense of the value of the currency both internally and externally. Inasmuch as the main interest of developmental finance lies in the very areas which were, perforce, somewhat neglected in the past by those at the helm of the Bank of Thailand, the impression of undue criticism may be obtained. It behooves the writer, therefore, to reiterate both his admiration of the way in which the Bank has acquitted itself of its tasks in the past and of his belief that these tasks will have to change their focus in the future.

I. ASSETS AND LIABILITIES OF THE BANK OF THAILAND

One convenient way to look at the operations of the Bank of Thailand is to consider its balance sheets over a period of time which is long enough to register significant changes in the composition of assets and liabilities but short enough to preserve a modicum of accounting comparability. Tables I and II give the baht amounts of the main balance sheet items. Tables III and IV express these values as percentages of a base year, and Tables V and VI give the percentage distribution of assets and liabilities.[5]

During the 12-year period 1955-66, total assets of the Bank of Thailand merely doubled compared with more than a sevenfold increase in the assets of the commercial banks. At the same time, the composition of these assets underwent considerable change. Up to 1959 the bulk of the Bank's assets was divided about equally among gold, foreign exchange, Treasury bills, and government overdrafts. By the end of 1966, over two-thirds of the Bank's assets were in the form of gold and foreign

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[5]All statistical data in this paper were obtained from the Bank of Thailand, either directly from published sources or through the courtesy of responsible officials.

Table I

Assets of the Bank of Thailand
(in million baht)

End of Period	Gold and Foreign Exchange			Claims on Government					Claims on Banks			Contribution to IMF	Other Assets	Total Assets or Liabilities
	Gold	Foreign[1] Exchange	Total	Overdrafts	Balance[2] at Provincial Treasuries	Treasury Bills	Bonds[3]	Total	Loans	Rediscounts	Total			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Dec. 1955	2,246.4	2,452.2	4,698.6	549.8	454.5	3,172.8	1,621.7	5,798.3	3.0	-	3.0	-	5.7	10,506.1
1956	2,246.4	2,799.7	5,046.1	969.7	560.7	3,109.7	1,651.8	6,291.9	-	-	-	-	11.7	11,349.7
1957	2,246.4	3,153.6	5,400.0	1,250.2	413.0	2,966.0	1,925.0	6,554.2	-	-	-	-	15.0	11,969.2
1958	2,246.4	3,056.2	5,302.6	1,412.4	403.7	2,917.7	2,098.0	6,831.8	8.7	-	8.7	-	15.8	12,158.9
1959	2,083.9	3,119.0	5,202.9	1,737.3	614.7	2,944.2	2,037.8	7,334.0	118.1	41.7	159.8	162.5	21.5	12,880.6
1960	2,093.9	3,717.7	5,801.6	-	523.0	2,033.7	2,909.2	5,465.9	130.0	97.2	227.2	162.5	23.1	11,680.3
1961	2,084.1	5,404.5	7,488.6	-	370.0	1,468.8	3,174.7	5,013.5	137.8	86.0	223.8	162.5	21.2	12,909.6
1962	2,084.1	6,791.0	8,875.1	-	403.0	1,348.4	3,299.5	5,050.9	197.0	89.8	286.8	162.5	20.3	14,395.6
1963	2,167.4	8,294.1	10,146.5	-	525.5	180.1	3,267.1	3,972.7	144.8	72.5	217.3	169.0	26.5	14,847.0
1964	2,167.4	9,586.9	11,754.3	-	584.2	356.9	3,237.1	4,178.2	170.5	146.8	317.3	169.0	53.7	16,472.5
1965	2,006.2	11,144.4	13,150.6	-	547.1	482.6	3,201.6	4,231.3	179.4	209.5	388.9	330.2	45.0	18,146.0
1966	1,907.4	14,897.6	16,805.0	-	792.5	451.9	3,075.1	4,319.5	169.6	280.7	450.3	429.0	41.2	22,045.0

[1] Including foreign treasury bills and bonds.

[2] Beginning with June 1963, the series in Column 5 was revised in order to report gross amount of "Balance at Provincial Treasuries" instead of net, and the series in Column 15 was reported as notes in circulation outside the Bank of Thailand.

[3] Including Thai Government bonds floated abroad.

Source: Bank of Thailand.

Table II

Liabilities of the Bank of Thailand
(in million baht)

End of Period	Notes in Circulation[1]	DEPOSITS								Exchange Difference	Other Liabilities	Capital Accounts
		Government & Official Entities		Commercial Banks	Other Banks	Private Sector		Counterpart Funds	Others			
		in national currency	in foreign currency			in national currency	in foreign currency					
-	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
Dec. 1955	5,542.6	311.8	13.5	320.8	28.2	122.2	-	118.6	0.1	3,201.5	1.2	845.6
1956	5,803.5	435.3	1.9	338.8	14.1	98.8	-	351.8	6.0	3,178.4	1.3	1,119.8
1957	5,993.3	336.5	57.0	398.4	32.6	92.7	3.9	452.7	91.9	3,163.0	0.3	1,346.9
1958	5,803.5	453.9	14.1	358.7	16.6	34.8	1.3	375.5	280.5	3,163.0	0.4	1,596.6
1959	6,248.5	462.6	11.0	503.9	19.3	142.6	-	451.1	170.0	3,163.0	7.6	1.701.1
1960	6,661.0	988.5	4.1	554.8	20.7	96.5	1.6	464.9	0.1	1,004.3	7.0	1,876.8
1961	7,267.9	1,202.6	19.5	645.4	30.4	154.5	1.7	544.0	0.2	-	8.2	3,035.2
1962	7,413.7	2,038.3	76.8	788.0	18.5	245.8	1.7	566.6	2.1	-	7.2	3,236.9
1963	7,741.0	1,489.5	113.7	1,016.7	9.8	260.3	1.1	483.9	3.1	-	10.3	3,717.6
1964	8,474.1	2,448.0	169.5	1,000.5	26.3	201.3	0.5	382.8	0.7	-	10.0	3,758.8
1965	9,379.1	3,221.5	109.5	1,061.7	34.2	149.2	0.1	162.4	1.1	-	16.7	4,010.5
1966	10,570.6	5,573.0	38.7	1,183.2	37.3	154.2	-	53.2	-	-	22.8	4,412.0

Source: Bank of Thailand.

[1]See Footnote Number 2, Table I.

Table III

Index of Assets of the Bank of Thailand

End of Period	Gold & Foreign Exc.		Claims on Government				Claims on Banks				
	Gold	Foreign Exchange	Overdrafts	Balance at Provincial Treasuries	Treasury Bills	Bonds	Loans	Rediscounts	Contribution to IMF	Other Assets	Total Assets
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Dec. 1955	100	100	100	100	100	100	100	-	-	100	100
1956	100	114.17	176.37	123.36	98.01	101.86	-	-	-	205.26	108.03
1957	100	128.60	227.39	90.86	93.48	118.70	-	-	-	263.15	113.92
1958	100	124.63	256.89	88.82	91.96	129.37	290.0	-	-	277.19	115.73
1959	92.76	127.19	315.98	135.24	92.79	125.65	3936.66	100	100	377.19	122.60
1960	92.76	151.60	-	115.07	64.09	179.39	4333.33	233.09	100	405.26	111.17
1961	92.77	220.39	-	81.40	46.29	195.76	4593.33	206.24	100	371.92	122.87
1962	92.77	276.93	-	88.66	42.49	203.45	6566.66	215.35	100	356.14	137.02
1963	96.48	338.23	-	115.62	5.67	201.46	4826.66	173.86	104.00	464.91	141.31
1964	96.48	390.95	-	128.53	11.25	199.61	5683.33	352.04	104.00	942.10	156.78
1965	89.30	454.47	-	120.37	15.21	197.42	5980.00	502.39	203.20	789.47	172.72
1966	84.91	607.52	-	174.37	14.24	189.62	5653.33	673.14	264.00	722.81	209.83

Source: See text.

Table IV

Index of Liabilities of the Bank of Thailand

End of Period	Notes In Circulation	DEPOSITS								Exchange Difference	Other Liabilities	Capital Acc'ts.	Total Liabilitie
		Gov. & Official Entities		Commercial Banks	Other Banks	Private Sector		Counterpart Funds	Others				
		in National currency	in foreign currency			in national currency	in foreign currency						
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Dec. 1955	100	100	100	100	100	100	-	100	100	100	100	100	100
1956	104.71	139.60	14.07	105.61	50.00	80.35	-	296.62	6,000	99.27	108.33	152.42	108.03
1957	108.13	107.92	422.22	124.19	115.60	75.86	100	381.70	91,900.-	98.79	25.00	159.29	113.92
1958	105.78	145.57	104.44	111.81	58.86	28.47	33.33	316.61	280,500.-	98.79	33.33	188.81	115.73
1959	112.73	148.36	81.48	157.07	68.43	116.68	-	380.35	170,000.-	98.79	633.33	201.17	122.60
1960	120.17	317.03	30.37	172.94	73.40	78.96	41.03	391.98	100.-	31.36	583.33	221.94	111.17
1961	131.12	385.69	144.44	201.18	107.80	126.43	43.59	458.68	200.-	-	683.33	358.94	122.87
1962	133.75	653.72	568.88	245.63	65.60	201.14	43.59	477.74	2,100.-	-	600.00	382.79	137.02
1963	139.66	477.71	842.22	316.92	34.75	213.01	28.20	408.01	3,100.-	-	858.33	439.64	141.31
1964	152.89	785.11	1,255.55	311.87	93.26	164.72	12.82	322.76	700.-	-	833.33	444.51	156.78
1965	169.22	1,033.19	811.11	330.95	121.28	122.09	2.56	136.93	1,100.-	-	1,391.67	474.28	172.72
1966	189.57	1,787.36	286.66	368.83	132.27	126.19	-	44.86	-	-	1,900.00	621.76	209.83

Source: See text.

Table V
Percentage Distribution of the Assets of the Bank of Thailand*

End of Period	Gold & Foreign Exc.		Claims on Government				Claims on Banks				
	Gold	Foreign Exchange	Over drafts	Balance at Provincial Treasuries	Treasury Bills	Bonds	Loans	Redis-counts	Contri-bution to IMF	Other Assets	Total Assets
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Dec. 1955	21.38	23.34	5.23	4.32	30.20	15.44	0.03	-	-	0.05	100
1956	19.79	24.67	8.54	4.94	27.40	14.55	-	-	-	0.10	100
1957	18.77	26.34	10.45	3.45	24.78	16.08	-	-	-	0.13	100
1958	18.48	25.13	11.61	3.32	24.00	17.26	0.07	-	-	0.13	100
1959	16.17	24.21	13.49	4.77	22.86	15.83	0.92	0.32	1.26	0.17	100
1960	17.84	31.83	-	4.48	17.41	24.91	1.11	0.83	1.39	0.20	100
1961	16.14	41.86	-	2.87	11.38	24.59	1.07	0.67	1.26	0.16	100
1962	14.48	47.17	-	2.80	9.37	22.92	1.37	0.62	1.13	0.14	100
1963	14.60	55.86	-	3.54	1.21	22.00	0.98	0.49	1.14	0.18	100
1964	13.16	58.20	-	3.55	2.17	19.65	1.04	0.89	1.02	0.32	100
1965	11.06	61.42	-	3.01	22.66	17.64	0.99	1.15	1.82	0.25	100
Feb. 1966	10.34	63.83	-	2.68	2.20	16.43	1.35	0.85	1.70	0.62	100
Dec. 1966	8.65	67.58	-	3.59	2.05	13.95	0.77	1.29	1.95	0.19	100

*Details may not add up to total because of rounding.

Source: See text.

Table VI

Percentage Distribution of Liabilities of the Bank of Thailand*

End of Period	Notes in Circulation	DEPOSITS								Exchange difference	Other Liabilities	Capital Acc'ts.	Total Liabilities
		Gov. & Official Entities		Commercial Banks	Other Banks	Private Sector		Counterpart Funds	Others				
		in national currency	in foreign currency			in national currency	in foreign currency						
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Dec. 1955	55.27	2.97	0.13	3.05	0.27	1.16	-	1.13	-	30.47	0.01	8.05	100
1956	51.15	3.83	0.02	2.98	0.12	0.87	-	3.10	0.05	28.00	0.01	9.88	100
1957	50.07	2.81	0.48	3.33	0.27	0.77	0.03	3.78	0.78	26.43	+	11.25	100
1958	48.22	3.73	0.12	2.95	0.14	0.30	0.01	3.09	2.32	26.01	-	13.11	100
1959	48.51	3.60	0.09	3.90	0.15	1.11	-	3.50	1.32	24.56	0.05	13.21	100
1960	57.03	8.46	0.03	4.75	0.18	0.83	0.01	4.00	-	8.60	0.05	16.06	100
1961	53.30	9.32	0.15	5.00	0.24	1.20	0.01	4.21	-	-	0.06	23.51	100
1962	51.50	14.16	0.53	5.47	0.13	1.71	0.01	3.94	0.01	-	0.06	22.49	100
1963	52.14	10.03	0.76	6.85	0.07	1.75	0.01	3.26	0.02	-	0.07	25.04	100
1964	51.44	14.86	1.03	6.07	0.16	1.22	0.03	2.32	-	-	0.06	22.82	100
1965	51.69	17.75	0.60	5.85	0.19	0.82	0.01	0.89	0.01	-	0.09	22.10	100
Feb. 1966	52.45	20.35	0.32	4.18	0.17	0.87	0.01	0.78	-	-	0.09	20.78	100
Dec. 1966	47.95	25.28	0.18	5.37	0.17	0.70	-	0.24	-	-	0.10	20.01	100

*Details may not add up to total because of rounding.

Source: See text.

exchange, and the holdings of government bonds became second in importance. Government overdrafts disappeared from the balance sheet, and claims on banks and contributions to the IMF made their appearance (see Table III).

The gradual reduction in the proportion of gold to total assets represents the desire and the need to obtain a greater return on foreign assets and was made possible by an increase in Thailand's holdings of other foreign securities as well as by its full membership in the International Monetary Fund. It is also possible that that country's growing political and economic ties with the United States have contributed to the policy of reducing holdings of gold and of increasing holdings of securities held in, among other places, the United States.

More important, perhaps, was the elimination of government overdrafts by 1960. These claims on government came into being in 1952, when the government, taking advantage of the provision of the Bank of Thailand Act, began to borrow from the Bank without security at an annual interest rate of 2 1/2 per cent.[6] By November of 1960 this claim was eliminated, parallel to the improvement of the budgetary position of the

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[6]The Act enables the government to borrow up to 25 per cent of ordinary budget expenditures, without collateral, in the form of an overdraft.

country and the determination of the Bank to reduce inflationary forms of finance. The same considerations were operative in the sharp reduction of Treasury bills in the Bank portfolio. In 1955 these amounted to over 30 per cent of total assets, a proportion which fell to some 2 per cent by the end of 1966 (see Table V).

Under the Currency Act of 1958, government bonds designated in local currency could be used as a cover against the note issue, provided that such bonds (and Treasury bills) did not constitute more than 40 per cent of notes issued.[7] However, inasmuch as foreign exchange reserves continued to increase throughout the period, there was little pressure on the Bank to increase significantly its holdings of government bonds. These holdings did increase after 1960, but the increase was temporary; by the end of 1966 the proportion of government bonds to total assets was about the same as it was at the end of 1955.[8]

In terms of the rate of increase over time, loans to commercial banks show the most spectacular growth. This is misleading, however,

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[7]IMF subscription and short-term commercial bills rediscounted by the Bank of Thailand can also form a part of the secondary backing of the currency provided that, together with government securities, they do not exceed 40 per cent of the note issue.

[8]The debt management policy of the Bank of Thailand is discussed more fully later.

as it derives from the fact that, in 1955, the total amount of such loans outstanding was very small. The Bank of Thailand did not actively begin its operations of providing liquidity to the commercial banks until 1959, the same year in which it reduced its role in financing government deficits. Employing 1959 as a base year, it can be seen that bank loans grew less than 50 per cent by the end of 1966. More significant was the rate of growth of rediscounts which increased sixfold from 1959, the year they were initiated, until the end of 1966. Even so, claims against commercial banks totalled less than 2 per cent of total assets at the end of 1966 (see Tables III and V).

The contribution to the IMF did not change to any significant extent until 1965 when it nearly doubled, reflecting the increase in Thai GNP and the Bank's foreign exchange reserves.[9] Other assets include real estate, etc. The sharp increase in 1964 coincides with the construction of branch premises in Haadyai, the only branch of the Bank of Thailand to date.[10]

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[9] Another reason for the increase in the Thai quota in 1965 was to increase the availability of the sound and convertible baht to other members of the Fund.

[10] The Bank plans construction of a branch in Khonkaen in the Northeast and possibly one in the North.

With respect to liabilities, note issue has increased somewhat less than total liabilities. This reflects both the growing importance of deposits in the money supply and the prevailing price stability throughout most of the period.[11] As a percentage of total liabilities, notes in circulation decreased somewhat--from 53 per cent at the beginning of the period to 48 per cent at the end of the 12-year period.

Paralleling the drastic shift in the composition of assets after 1959, the composition of liabilities also shows a significant change around the same year. This was due to the disappearance of the Exchange Equalization Account, the proceeds of which were used to retire the government overdrafts outstanding, as well as to retire a goodly proportion of Treasury bills (see Tables IV and VI).[12]

The elimination of 30 per cent of total liabilities, consequent to the liquidation of the Exchange Equalization Account, created a gap which

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[11] For historical reasons, touched upon in the preceding section, the Bank is organized into two departments, the Issue Department and the Banking Department. For a time the balance sheets of these two departments were published separately. This somewhat archaic procedure has now given way to a joint balance sheet, published monthly by the Bank of Thailand even though the official Government Gazette continues to publish two separate sets of financial statements.

[12] This account, set up in 1955, was used to maintain the unofficial parity of the baht in foreign markets and thus to dispense with the multiple exchange rate system in operation up to that date. See Andre Mousny, The Economy of Thailand (Bangkok: Social Science Council, 1964) for details.

was filled by the growth of deposits and the growth of the Bank's capital account. Deposits of government and other official entities were 3 per cent of all liabilities in 1955 and more than 25 per cent by the end of 1966. This spectacular growth was due mainly to the very considerable increase in Treasury balances. Compared with the eighteen-fold increase in government balances held in local currency, the less than fourfold increase in commercial bank deposits appears modest indeed. The share of commercial bank deposits rose from slightly over 3 per cent of all liabilities in 1955 to some 5 1/2 per cent by the end of 1966.

Over 90 per cent of total liabilities of the Bank of Thailand at the end of 1966 were composed of notes in circulation, government deposits, and capital accounts. Of the remaining, and leaving aside the commercial banks' balances, no liability exceeded 1 per cent of the total. Private sector deposits represent, in the main, the holdings of various quasi-official bodies and monopolies; e.g., the tobacco monopoly, the state sugar enterprises, and so on. Counterpart funds which, in principle, arise out of the sale of commodities imported under U. S. aid programs are, at present, simply a budgetary designation of Thai funds used to support U. S.-funded projects, where the foreign exchange component is imported free by the United States and the Thais provide the local currency.

This rather cursory look at the changing pattern of assets and liabilities of the Bank brings out the crucial significance of the demarkation date which occurred about mid-way through the period when the Bank began to turn to the commercial banking system and away from financing the government. Moreover, an examination of the tables reveals that the Bank's involvement with the private sector of the economy has not yet reached any significant proportions. Commercial bank deposits at the Bank of Thailand are but a fraction of the total liquid resources of the system, prima facie evidence of the inability of the Bank of Thailand to affect the behavior of the commercial banks by economic pressures alone.[13] The volume of accommodation extended to commercial banks via the Bank of Thailand constitutes a small proportion of the Bank's resources and an even smaller proportion of those of the commercial banks themselves. The balance sheets of the Bank are silent on the holdings, if any, of the obligations of other financial intermediaries or of specialized development institutions.[14]

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[13]The issues relating to control of commercial banks will be discussed more fully later.

[14]At the time of writing the Bank did contemplate acquiring obligations of such institutions; namely, those of the Bank for Agriculture and Agricultural Cooperatives and the Industrial Finance Corporation of Thailand. The form of these obligations was not yet settled but the amounts will be token ones, at best.

Two other aspects of the Bank of Thailand's balance sheets are of interest from the standpoint of their influence, potential if not actual, on the pattern of saving and investment. The first of these is the large stock of foreign exchange held as assets of the Bank. In a real sense, the possession of large foreign balances, which yield a return almost certainly below the alternative return these resources could earn if employed internally, represents a rent exacted from owners of the savings incorporated in large foreign exchange reserves.[15]

The accumulation of "treasure" has been one of the characteristics of the growth pattern of the Thai economy in the past and helps explain, in part, why the country has not reached a higher level of development in spite of a high rate of voluntary saving, relative internal stability, and certainly a positive marginal productivity of capital, all of which Thailand has enjoyed for several decades.[16] It would seem that some of the cogent historical reasons, touched upon previously, are no longer valid and that there is little justification for holding reserves in excess of

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[15] I am indebted to Professor Edward Shaw for bringing this to my attention.

[16] See Robert Muscat, Thailand, A Strategy for Development (New York: Frederick A. Praeger, Inc., 1965), pp. 29ff.

a full year's import requirements. The savings represented by these reserves could, in principle, be used more productively in furthering the sustained growth of the economy.[17]

The other aspect of the balance sheet which deserves attention by those concerned with the impact of the Bank of Thailand's operations on the volume and direction of saving is the changing composition and volume of government securities held among its assets, an outward manifestation of debt management.[18]

Thus, it will be convenient to analyze the role and the impact of the Bank of Thailand's operations under three headings. Under the first of these headings attention will be given to the provision of credit by the Bank of Thailand to the commercial banking system. Under the second heading the implications of debt management policies will be

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[17]It should be noted, however, that the full implementation of the Five-Year Plan (1966-71) would put a severe strain on these balances.

[18]Strictly speaking, debt management is only in part within the purview of the Bank of Thailand. The Treasury (the Ministry of Finance) is the higher authority with respect to the type, character, and frequency of issue. As stated earlier, however, the operations and policies of the Bank of Thailand will be assumed to have the authority and sanction of other parts of the Thai government unless there are good reasons to believe otherwise.

considered. The last heading will contain a discussion of the role of the Central Bank in structuring the financial market in a developing country, its function in the development process, and its contribution to the financial intermediation between savers and investors.

These three headings will receive attention which will be uneven in both scope and depth. The provision of credit to the commercial banks, which now stands at the center of the Bank of Thailand's operations, will be discussed most fully, even at the risk of some duplication with earlier studies.[19] The analysis of debt management policies, although detailed in some respects, will be concentrated on selected aspects of the problem and will deal only incidentally with budgetary policy or overall monetary policy. The paragraphs under the last heading will be to a large extent tentative and intuitive. Moreover, the content of these paragraphs will seldom be rigorously substantiated. This will not necessarily make them less important from the standpoint of development strategy.

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[19]See Alek A. Rozental, "Commercial Banking in Thailand" and "Branch Banking in Thailand" (Field Work Reports #13 and #19, respectively; Washington, D. C.: National Planning Association, Center for Development Planning, 1967), mimeographed.

II. PROVISION OF CREDIT

In general, Bank of Thailand credit is extended in one of two ways. Commercial banks can borrow from the Bank of Thailand, usually against the collateral of government securities, or they may obtain credit against one of the several lines of rediscount made available by the Bank of Thailand. It is the latter form of credit provision which not only shows a more rapid growth but also contains a number of features of special interest. It will, therefore, be discussed first.[20]

A. REDISCOUNT FACILITIES OF THE BANK OF THAILAND

There are, at the time of writing, three types of rediscounting facilities made available to the commercial banks and their customers by the Bank of Thailand. The oldest, and still the most important in terms of the value of paper discounted, is the export rediscounting facility. Begun in November 1958, the rediscounting of exporter's paper is the best established, the most widely used by the commercial banks, and the best

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[20]Inasmuch as direct borrowing from the Bank of Thailand is done mainly against the security of government bonds in the portfolio of the commercial banks, it will be convenient to discuss this form of credit provision under the heading of debt management.

known to the business community. Started in conjunction with the export drive, it was initially confined only to certain kinds of export transactions and only to selected types of paper, but its coverage was gradually extended so that, at the present time, it embraces most of the important agricultural exports and covers letters of credit, purchase contracts, usance bills, bills of exchange, and other documents used in export finance. The duration of this credit facility is limited to 90 days, and the Bank of Thailand rediscount rate is 5 per cent per annum, provided the exporter is not charged more than 7 per cent by the discounting bank.[21]

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[21]When the facility was first offered, the rate charged by the Bank of Thailand for rediscounting purposes was set at 7 per cent. At that rate there was little interest in rediscounting on the part of the commercial banks and the rate was reduced at the end of the year. Initially the rediscounting facility was confined to rice. A year later it was extended to other crops, but certain important exports (e.g., tin) remained excluded. With the development of newer agricultural exports it became necessary to extend the facility to cover documents other than those familiar in the traditional export markets where bills of exchange and, to a lesser extent, irrevocable letters of credit predominated. Even so, the existing regulations tend to favor the more established export documents. Thus, the maximum amount of credit granted against bills of exchange is 90 per cent of the face value of the invoice. Against irrevocable letters of credit it is 70 per cent, and the maximum is only 60 per cent against purchase contracts. In every case the foreign documents must be accompanied by the exporter's promissory notes, supporting documents, and a number of requisite statements from the sponsoring bank. These supporting documents include warehouse and godown receipts, invoices and sales slips, bank and special forms, and pledges required by the Bank of Thailand. The maturity of each promissory note cannot exceed 90 days from the date of rediscounting. When export proceeds have been completed before maturity date, the exporter must repay his promissory note in whole or in part.

In the course of time the requisite procedures have been somewhat simplified and adjusted to the needs of the export trade, but they still remain rather complex and time consuming. There are, in fact, two separate aspects in the process of obtaining the rediscounting credit from the Bank of Thailand. The first of these involves the commercial bank and the second, the exporter. Any commercial bank which wishes to avail itself of the facility must first apply for a line of rediscounting to the Bank of Thailand. The approval is by no means automatic, and the pertinent regulations make it clear that the facility is a privilege rather than a right. In fact, while most banks operating in Thailand, whether foreign or domestically chartered, are now eligible, the power to grant and to revoke the privilege of acting as a discount bank under the export rediscounting facility is a significant power of the Bank of Thailand and one which, in principle at least, may be used to achieve objectives other than those directly related to export trade.[22]

The exporter is also not granted the privilege automatically. He must apply to the Bank of Thailand through his commercial bank and must establish, to the satisfaction of the Bank of Thailand, his bona fide, his

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[22]This point is discussed later.

standing as an exporter, and his overall credit rating. This is so in spite of the fact that the discounting commercial bank assumes contingent liability in the event of nonpayment by the exporter on the date due. Initially, the whole process takes from two to three months. Once the bank and the exporter have assured themselves of the line of credit under the rediscounting facility, the release of the Bank of Thailand funds under a specific transaction is done promptly and quite efficiently.[23]

While there is little question that export rediscounting plays a role in sustaining the remarkable export performance of the Thai economy, its quantitative importance must be kept in perspective. As suggested by Tables VII and VIII, neither from the standpoint of the exporters nor that of the commercial banks is the rediscounting by the Bank of Thailand a determining factor in the situation. Measured as a proportion of total exports, the value of rediscounted paper never exceeded 9 per cent, nor

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[23]While some commercial bankers still complain about cumbersomeness and length of the export discounting procedure, an intensive series of field interviews disclosed that these complaints either refer to the initial establishment of the line of credit or are due to the shortage of competent clerks, at some of the smaller banks, able to prepare the necessary documents promptly and fully. It would appear that once a line of credit is established and all the documents sent to the Bank of Thailand, the transfer of funds to the account of the discounting bank takes no more than a day or two.

Table VII
Bank of Thailand Operations, Export Rediscounting as Proportion of Total Exports
(In Million Baht)

Year	Value of Export Rediscounts	Value of Exports (FOB)	Percent
1959	326	7560	4.31
1960	768	8614	8.92
1961	781	9997	7.81
1962	660	9529	6.93
1963	551	9676	5.69
1964	913	12339	7.40
1965	850	12941	6.57
1966	550	13744	4.00

Source: See text.

Table VIII

Bank of Thailand Operations, Export Rediscounting as Percent of Bank Export Credit
(In million baht)

Outstanding End of Period	Export Rediscounts	Banking Export Credit	Percent
June 1965	40.5	798.7	5.07
December 1965	121.1	1279.1	9.47
June 1966	29.9	974.1	3.07
December 1966	103.2	1308.8	7.89

Source: See text.

was there any discernible upward trend in this proportion (see Table VII).[24] Export rediscounting continues to be but a small part of the total value of bank credit extended to the export sector (which, in turn, is only a fraction of the total value of exports). In 1965 and 1966, for example, the value of rediscounted export paper as a percentage of export credit outstanding at the commercial banks ranged from 3 to 9 per cent (see Table VIII). Moreover, the availability of the export rediscounting credit facility is far in excess of its actual utilization. Exact figures are hard to come by, and they vary considerably from one bank to another; but it would appear that for all commercial banks, and taking the last three or four years as a whole, the ratio of utilization to availability did not exceed 20 per cent.[25]

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[24]The sharp increase in 1960 was due, inter alia, to the extension of the range of eligible exports and to a considerable reduction in documentary stamp duty. The sharp decline in 1966, in spite of an increase in the value of exports, can be explained, in part, by the sharply increased liquidity of the commercial banks in that year.

[25]Each of the discount banks is given a "quota," which is currently 50 per cent of the sum of its cash deposits at the Bank of Thailand and its unencumbered holdings of government bonds. The combined quota for all the commercial banks ranged, in the last four years, between one and one-half billion baht. The annual value of discounted paper averaged three-quarters of a billion baht. Assuming random distribution of this type of credit over time, about one-fourth of this amount (360 divided by 90) should be compared with the total line of credit available.

There are several reasons why the export rediscounting facility still constitutes a small fraction of total export finance. For example, rubber, tin, and a significant fraction of rice exports do not come within the purview of this credit facility.[26] Bankers may not like the procedural aspects of the credit facility and certainly do not like the narrow spread of two basic points between the discount and the rediscount rate. Exporters may have a variety of reasons for financing their exports in ways not open to rediscounting scrutiny. But the main reason for the underutilization of export rediscounting facility is simply the considerable and growing liquidity of the commercial banks in Thailand. So long as their own funds are by and large abundant, the rediscounting facility will be taken advantage of only marginally to tide over a temporary or seasonal tightening of funds or, perhaps more importantly, to enable the commercial banks to engage in other activities in the comfortable knowledge that they have a readily available source of funds at their disposal--a source of funds which not only is costless but also brings in a modest return. Thus, the commercial banks may still be quite anxious to establish themselves as discount banks and to present

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[26]Exports of rubber are traditionally conducted on the basis of sight bills. Tin has special characteristics of trade and financing which make it unsuitable. Some 40 per cent of rice export is on government-to-government basis.

themselves to exporters as providers of cheap credit, but they do not necessarily have to exhaust this line of credit. After all, so long as their own funds are available, a 7 per cent return is better than a 2 per cent return.[27]

All this does not, of course, mean that the export rediscounting facility is of no importance or that it does not need to be further improved and streamlined. It may be marginal, but for some exporters at all times and for other exporters at certain times it may make a difference between profit and loss. For the economy as a whole it may mean that, in the absence of this line of credit, certain exports would not have taken place. Export rediscounting appears to be particularly valuable for newer exports, such as shrimp, and for extension of other exports to new markets.

In line with the growing emphasis on the development of manufacturing capacity in the country, the Bank of Thailand has, since 1963, made available to the commercial banks rediscount facilities to manufacturers. At present these facilities are of two types. The first makes it possible for the domestic manufacturer to obtain cheap funds for

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[27] Another reason for the low rate of utilization of the export rediscount facility is the availability of foreign funds to Thai banks engaged in financing foreign trade. Even though foreign credits are used more extensively in financing imports than exports, the amount borrowed from abroad by export financing Thai banks exceeds considerably the volume of rediscounting.

the purchase of raw materials. The second provides credit facilities, below the market rate of interest, against sales of manufactured goods on credit.[28]

While, in principle, the procedures for obtaining credit under the two manufacturing lines of rediscounting are similar to those under export rediscounting, in practice they appear much more vexing and cumbersome to the banking community and their clients. To a large extent this is because officials at the Bank of Thailand and at the commercial banks are still in the process of evolving standards and practices which will insure compliance with the intent of the regulations, on the one hand, and the needs of industrial community, on the other. It does seem, however, that a manufacturer seeking rediscounting credit must provide a lot of information, and he must undergo a thorough credit examination, not once but twice. Moreover, there are several areas of

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[28]The rediscount rate is 5 per cent provided no more than 7 per cent is charged to the manufacturer. Credit is extended for a maximum of 120 days, and the maximum amount granted may not exceed 90 per cent of the face value of the invoice but is not less than 30,000 baht. The maturity of the promissory note dates from the day of rediscounting.

disagreement as to what constitutes raw material, what is meant by manufacture, and on other matters on which agreement is difficult to come by.[29]

Yet, despite shortcomings in procedure and applications, most of which are expected to be reduced or eliminated in the course of time, the provision of credit to manufacturers constitutes the first deliberate step taken by the Bank of Thailand to channel resources in directions deemed critical by the country's planners. Irrespective of whether manufacturing represents the truly critical direction from the standpoint of optimal development strategy, the rediscounting facilities offered to

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[29]The Bank of Thailand stands ready to rediscount promissory notes issued by the manufacturer and previously discounted by the commercial bank, provided that the commercial bank submits such notes to the Bank of Thailand together with documents which will include, but will not be confined to, the following: balance sheets, operating accounts, profit and loss statements, and a special lengthy statement by the manufacturer. In addition, the commercial bank will certify that the promissory note is bona fide and that the face value is not greater than is customary in trade. Finally, the commercial bank will sign an authorization to debit its account at the Bank of Thailand, and it will also authorize that, in the event the balance in its debit account is insufficient to cover its liability under the promissory note, the Bank of Thailand may dispose of other assets held. Even then the rediscounting facility may be refused to the applicant bank, particularly if the bank has been guilty of contravening the provisions of the Commercial Banking Act. This sounds reasonable. But the regulations go on to say that when under its contingent liability the commercial bank has to dispose of its assets other than cash, held at the Bank of Thailand, it disqualifies itself for the rediscount facility. The latter provision would suggest that a commercial bank which had once made a bad credit appraisal will be debarred from the rediscounting facility in the future. This sounds less than reasonable.

manufacturers are highly significant because they demonstrate that the Bank of Thailand now considers it its responsibility to influence the flow of savings and their utilization. The official rationale for offering facilities to manufacturers is that they will reduce the competitive disadvantage of local producers who face rates of interest higher than those obtaining abroad and who suffer from a shortage of working capital.

Insofar as the rediscounting of raw material purchases is concerned, there is another alleged comparative disadvantage in that imported raw materials benefit from cheap financing by foreign suppliers. Accordingly, more lenient treatment is given to those who apply for rediscounting credit for the purchase of local raw materials. Here again the Bank of Thailand deliberately tried to influence the direction of funds and the nature of economic activity.[30]

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[30] In addition to more lenient treatment for those purchasing local materials, rediscounting facility for those using imported raw materials was tailored in accordance with their foreign finance arrangements. Thus, if the credit for foreign raw materials was for 180 days, rediscounting was not made available at all. In the event foreign financing ran for 60 days, rediscounting currency did not exceed an additional 60 days. These provisions had some limited effects. The value of rediscounts for purchase of local raw materials rose from 28 million baht in 1965 to 72 million in 1966, much of the increase being due to higher purchases of cotton and kenaf.

In terms of value and as a proportion of total credit extended to manufacturing, rediscounting facilities offered by the Bank of Thailand have yet to play a major role. As shown in Table IX, the joint total of raw materials and credit sales rediscounting did not exceed 11 per cent of the outstanding total bank credit to manufacturing. Even though the value of raw materials' rediscounts rose from 70 million baht in 1965 to 254 million in 1966, much of this increase was due to promissory notes against purchases of tin, which were, in turn, due to the establishment of a major tin smelter on the island of Phuket.[31]

Rediscounting under the credit sales facility shows a more rapid rate of growth though it is difficult to form firm conclusions because of the short experience with this type of credit.[32]

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[31]See Bank of Thailand, Annual Economic Report 1966, pp. 55-56. It will be recalled that tin was ineligible under export rediscounting credit. Total manufacturing rediscounting line of credit (commercial banks' quota) appears to be the sum of deposits and unencumbered government bonds rather than 50 per cent of that sum as in the case of the export rediscount quota.

[32]Raw materials' rediscounting started in 1963, and it was not until 1965 that credit sales' facilities were extended to all manufacturers whether they had previously qualified under the raw materials' rediscounting provisions. The requirements and provisions of this line of credit are analogous to those obtaining under new materials' rediscounting except that the maturity of the promissory note will not exceed 90 days, and the amount discounted does not exceed 90 per cent of the sale's value of the product. The promissory note cannot be issued later than 60 days from the sale's transaction.

Table IX

Bank of Thailand Operations, Manufactures Rediscount as Proportion of Commercial Bank Credit to Manufacturers

(In million baht)

End of Period	Raw Materials	Credit Sales	Total	Bank Credit	Percent
June 1965	20.7	11.3	32.0	1317.0	2.43
December 1965	22.3	67.6	90.0	1482.0	6.07
June 1966	69.4	93.3	162.7	1491.0	10.91
December 1966	90.6	89.1	179.7	1725.0	10.42

Source: See text.

Total value of rediscounting under credit sales rose from 228 million baht in 1965 to 801 million at the end of 1966, several times the value of raw materials' rediscounting.[33] It is reasonable to expect that credit sales will continue to be more popular than raw materials' rediscounting. Much of Thai industry is of the finishing and packaging variety where the raw materials are imported under financial arrangements which compare favorably with those proffered by the Bank of Thailand.[34] The type of industry which is based on local raw materials and which is largely locally financed and managed is not yet well established in Thailand. There is also the problem of finding suitable local materials. For example, the local textile industry finds that only about one-fifth of its needs can be met with local cotton and the rest must be imported.

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[33]See Bank of Thailand, Annual Economic Report, p. 56.

[34]Many established firms can get up to 18 months' credit abroad. Moreover, many of the manufacturing firms are, in reality, subsidiaries of foreign manufacturers, and the import of components presents mainly accounting problems. The Bank of Thailand has, accordingly, devised strict rules regarding the physical change in the imported materials to be effected by the local manufacturer before he can qualify for rediscounting. These rules, while well motivated, create occasional problems.

But more disquieting is the apparent tendency for credit sales' rediscounting to be preempted by larger and more established industrial units. There is a real question whether such units should finance their distribution costs at from two to five basic points below the market rate of interest and whether their operations would indeed be curtailed or slowed down if this subsidy were unavailable to them. Yet the small manufacturer may either be unaware of the facility or be reluctant to provide all the information required for his eligibility. Most likely, he simply lacks the necessary documentation. There are also reasons to suspect that bankers are much less eager to endorse the promissory notes of the small firms than they are of the large industrial units. Yet, as shown elsewhere, it is the small and medium manufacturer who, in Thailand, has the most acute need for an access to finance at reasonable terms.[35]

From the preceding discussion of the Bank of Thailand's rediscounting facilities, three main problem areas seem to emerge. The first of these has to do with methods, techniques, and procedures governing

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[35]See Alek A. Rozental, "Financing Thai Business Enterprise," (Field Work Report #21; Washington, D. C.: National Planning Association, Center for Development Planning, 1967), mimeographed.

the administration of the present facilities. The second area concerns itself with the possibility of extending the range and scope of rediscounting, perhaps by offering similar facilities to other segments of the economy. The last problem area pertains to the allocation of credit by the Bank of Thailand, to insure that such credit flows to those who need it most and that it promotes activities which would not thrive in its absence.[36]

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[36]The listing of these problem areas would seem to call for remedial suggestions in line with the "piecemeal engineering" concept discussed elsewhere. See Alek A. Rozental, "Financial Markets and Development Planning: A Conceptual Framework" (Field Work Report #2; Washington, D. C.: National Planning Association, Center for Development Planning, 1966), reprinted in Thai Economic Review, August 1967. Such suggestions will be made, in some detail, in a later paper. At this point it will be sufficient to indicate the thrust of these suggestions. Thus, much of the procedural complexity and cumbersomeness of the rediscounting procedure could perhaps be avoided were the Bank of Thailand rediscounting truly what such a term connotes; that is, refinancing of paper already certified by the commercial banks. It is the commercial banks who should be responsible for the credit and evaluation phase of the application of the exporter or manufacturer. To extend the scope of rediscounting to other segments of the economy presents greater problems, but one such important segment was already proposed elsewhere. See Alek A. Rozental, "Financing Rural Households in Thailand" (Field Work Report #4; Washington, D. C.: National Planning Association, Center for Development Planning, 1966). One way in which the small manufacturer may obtain a greater share of rediscounting credit may be to offer the commercial banks a greater "spread" for promissory notes with a face value below a certain amount.

III. DEBT MANAGEMENT AND THE BANK OF THAILAND

The ostensible reason advanced by the Bank of Thailand for entering the area of provision of cheap credit to selected kinds of borrowers is that these borrowers face high interest rates in the money market, and this puts them at a competitive disadvantage vis-a-vis their counterparts abroad. There is little question that the interest rates in Thailand are high, both in the organized and the unorganized markets. As shown elsewhere, the modal rate of interest for bona fide small or medium-size businessmen is in excess of 20 per cent per annum, with a range from some 6 per cent to over 30 per cent per annum.[37] These rates are certainly higher than those prevailing in the industrialized countries and almost certainly higher than those available to businessmen in most of the countries of Southeast Asia. Yet the subsidized credit provided by the Bank of Thailand under the various lines of rediscounting goes, in the main, to those who already appear to have better than average access to relatively cheaper credit in the Thai financial markets. As argued above, large exporters and large manufacturers seem to have been the main

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[37]See Alek A. Rozental, "Financing Thai Business Enterprise."

beneficiaries of rediscount provisions and it is these two groups whose credit status within the country is appreciably better than that of many others. Moreover, the experience with rediscounting to date hardly justifies the hope that the provision of limited quantities of cheap credit to narrowly selected groups will tend to depress downward the entire interest rate schedule. While there was some decrease in the rates charged by the banks during 1966, the decrease was a minor one. It seems to have been brought about more by Bank of Thailand suasion than by anything else, and it does not appear to have changed the real cost of bank accommodation to any significant extent.[38]

One reason for the persistence of high interest rates in Thailand in the face of large resources, both actual and potential high interest rates, of the monetary system in general and the commercial banks in particular, must be sought in the debt management policies pursued by the country's monetary authorities.[39] On the one hand, the

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[38]The most important of these reductions was to set the upper limit on the commercial bank rate at 14 per cent instead of 15 per cent. See Rozental, "Commercial Banking in Thailand," Table XXXIV. However, only a fraction of all loans made are at the ceiling and, as shown in "Financing Thai Business Enterprise," there are costs, hidden or explicit, which the borrower must bear in addition to the interest charge.

[39]Another reason must be sought in "underutilization of capacity" of Thai banks. See Rozental, "Commercial Banking in Thailand," pp. 85ff.

availability of government securities provides the commercial banks with attractive outlets for their idle funds and, on the other, it inhibits their willingness to seek other, untried and more risky outlets for these funds.[40]

Table X gives the holdings of government securities, classified by principal category of holder, for the period 1956-66. These securities are of two types, long-term bonds, maturing from 8 to 15 years, and short-term bills, whose currency ranges from 3 to 4 months. At the present time, holdings of bonds far outweigh holdings of bills, the volume outstanding of which has been steadily decreasing since 1959. Moreover, issues, sales, and the amount outstanding of bonds has shown an upward trend, with sales in 1966 almost double those in 1965 (see Table XII). The implications of these large bond holdings will be discussed first.

A. GOVERNMENT BONDS

Table X shows that the composition of bond holders has changed considerably over the years. In 1956, nearly 80 per cent of all bonds outstanding were held by the Bank of Thailand, with other banks

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[40]For a discussion of the circumstances and conditions under which commercial bankers will compete for business by lowering the interest rate charged, see Marshall Freimer and Myron J. Gordon, "Why Bankers Ration Credit," Quarterly Journal of Economics (August 1965), especially p. 416.

Table X

Thai Government Internal Securities Outstanding, Classified by Holder
(in million baht)

End of Period	Government Bonds					Treasury Bills			
	Bank of Thailand	Com. Banks	Government Savings Bank	Other	Total	Bank of Thailand	Com Banks	Other	Total
Dec. 1956	1,636.2	135.3	56.4	230.5	2,058.4	3,132.8	94.1	39.8	3,266.7
1957	1,934.6	149.1	124.5	257.1	2,465.3	2,988.2	79.8	218.7	3,286.7
1958	2,089.8	198.3	168.7	295.0	2,751.8	2,946.6	43.7	276.4	3,266.7
1959	2,041.2	289.5	267.2	374.1	2,972.0	2,973.8	16.1	276.8	3,266.7
1960	2,820.8	394.8	440.2	516.8	4,272.6	2,057.2	23.5	27.0	2,107.7
1961	3,193.8	531.5	646.3	678.3	5,049.9	1,495.9	80.0	31.8	1,607.7
1962	3,328.3	943.8	981.0	816.3	6,029.4	1,377.0	183.6	46.4	1,607.0
1963	3,287.0	1,379.6	1,324.0	978.8	6,969.4	182.2	304.6	163.2	650.0
1964	3,266.5	1,903.8	1,751.6	1,212.3	8,134.2	361.1	262.1	26.8	650.0
1965	3,237.5	2,342.7	2,405.0	1,372.2	9,357.4	452.4	197.0	0.6	650.0
1966	3,063.0	3,728.7	3,456.4	1,583.2	11,831.3	484.2	391.0	4.8	880.0

Source: See text.

Table XI

Government of Thailand, Internal Direct Debt, 1966

(In million baht)

Outstanding End of Year	All Internal	Short & Medium Term	Long Term
Total	12,680	850	11,830
Change during year	(+2,676)	(+200)	(+2,476)
AVK of Thailand	3,517	454	3,063
Change during year	(- 172)	(+2)	(- 174)
Commercial Banks	4,120	391	3,729
Change during year	(+1,580)	(+194)	(+1,386)
Government Savings Bank	3,456	---	3,456
Change during year	(+1,053)	---	(+1,053)
Others	1,587	5	1,582
Change during year	(+ 215)	(+4)	(+ 211)

*Note -- At the end of 1966 total baht equivalent of direct external debt outstanding was 1,796.5 million baht, of which 1,408.3 million was denominated in U. S. dollars. Thai government guaranteed obligations totaled 3,487.8 million baht, of which 3,212.5 million were in U. S. dollars. During the year there was an increase of some 285 million baht in direct debt and less than 9 million in guaranteed obligations.

Source: See text.

Table XII
Sale of Government Bonds
(Jan. to Jan.)
(In million baht)

Type of Holders	1964		1965		1966	
	Amount	Percent	Amount	Percent	Amount	Percent
1. Bank of Thailand	6.289	0.52	6.716	0.52	55.396	2.19
2. Government Savings Bank	428.9	35.22	655.0	51.10	1053.0	41.53
3. Commercial Banks	525.180	43.14	431.265	33.65	1327.608	52.37
4. Organizations & Institutions	75.923	6.24	37.604	2.93	45.305	1.79
5. Societies, Foundations, Hospitals	13.217	1.08	34.697	2.70	2.751	0.11
6. Private Corporations	30.171	2.47	8.146	0.63	2.240	0.08
7. Insurance Cos.	6.713	0.55	4.270	0.33	5.352	0.21
8. Private Individuals	131.131	10.78	104.401	8.14	43.748	1.73
Total	1217.524	100.00	1281.559	100.00	2535.400	100.00

Source: See text.

(commercial and the Government Savings Bank) holding less than 10 per cent of the total. By the end of 1966, 10 billion baht worth of bonds, out of an outstanding total of nearly 12 billion baht, were about equally divided among the portfolios of the Bank of Thailand, the commercial banks, and the Government Savings Bank. The category of holders designated as "other" includes eleemosynary and similar institutions, private corporations, insurance companies, and individuals. Table XII gives a more detailed breakdown of these holdings for the years 1964 through 1966.[41] As seen in this table, while the absolute amount of bonds purchased by non-banking investors shows an uneven trend, their relative share shows a decline, with the sharpest drop occurring in the case of individuals.

Table XIII lists the major characteristics of the indentures of internal bonds of the Thai government, issued since 1956.[42]

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[41] It should be noted that Table XII gives the acquisitions by holder category of securities issued in each of the three years, 1964, 1965, and 1966, while Table X gives totals outstanding at the end of each year for the period 1956-66.

[42] This is not strictly true. There were two bond issues in 1960 and two in 1963, aggregating 2.8 billion baht, which are not included in Table XIII. These four were issued under conditions and terms which were quite special, however, and quite different in intent and purpose from those bonds which form the basis of the discussion in the text and which are given in Table XIII. For example, the 1960 issues resulted from the conversion of government overdrafts from a short- to a long-term obligation. At least one of the 1963 issues, even though internal, was denominated in foreign currency.

Table XIII

Thai Internal Bonds, Selected Characteristics
(In million baht)

Month	Year	Amount Issued	Interest Rate	Years of Currency	Amount Sold	Amount Redeemed	Amount Outstanding
Jan.	1956	500	8	10-15	500	49	451
May	1958	500	8	8-15	500	3	497
June	1959	484	8	10-15	484	20	464
Feb.	1960	500	8	10-15	500	16	484
Feb.	1961	500	8	10-15	240	8	232
Jan.	1962	500	8	10-15	500	8	492
Mar.	1962	500	8	10-15	265	2	263
Jan.	1963	1,000	8	10-15	1,000	12	988
Jan.	1964	1,000	8	13-15	1,000	11	989
Jan.	1965	1,000	8	12-15	1,000	8	992
Feb.	1965	300	7	9-12	300	---	300
Jan.	1966	1,000	7	9-12	1,000	---	1,000
Feb.	1966	500	7	9-12	500	---	500
Mar.	1966*	700	7	9-12	700	---	700
Apr.	1966	500	7	9-12	324	---	324

*Note: There were additional bond issues in 1966. See Table XI

Source: See text.

Until 1965 the coupon rate of these bond issues was 8 per cent per annum.[43] The reduction of the coupon from 8 to 7 per cent was accompanied by some reduction in the maturity dates, but this apparently was not sufficient to compensate for the lower return, at least insofar as individual purchasers were concerned, and there was a sharp reduction in purchases in 1966.

Commercial banks, on the other hand, continued to buy government bonds and actually increased their holdings of bonds as a proportion of total assets during 1966. Although the reduced return on bonds made them less attractive to individuals as contrasted with the return on fixed deposits, the commercial banks continued to find these bonds an attractive outlet for their idle funds, and they found them even more attractive when the Bank of Thailand borrowing rate was reduced at the same time from 8 to 7 per cent.[44]

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[43]The coupon rate was 4.5 per cent before 1954. It was increased to 6 per cent in 1954 and then to 8 per cent in 1956.

[44]The maximum rate of interest payable on fixed deposit accounts held at the commercial banks for 12 months or longer was 8 per cent until 1963, when it was reduced to 7 per cent. Corresponding to the reduced purchases of bonds by individuals during 1965 and 1966, there was a sharp increase in the fixed deposits held at commercial banks. At the end of 1962 time deposits of private residents totalled 3.1 billion baht. They rose to 4.2 billion baht in 1963, 5.4 billion in 1964, and 6.4 billion in 1965. From 1965 to the end of 1966 they rose by 2.4 billion, to 8.8 billion baht.

[44](Continued) The reduction in maturity date apparently meant little to private individuals inasmuch as the minimum holding period required before the bonds could be redeemed without loss of interest remained three years from the date of purchase. The exact terms vary with each bond issue but the following, taken from the prospectus of the First Loan Bond of the B. E. 2509 Budget (1966), are typical. This issue of 1 billion baht was offered either as bearer or as registed bonds at the option of the purchaser. Maturity is 12 years, but they can be redeemed after 9 years. Interest of 7 per cent is payable semi-annually. Bonds are issued in denominations of 100, 1,000, 10,000, and 100,000 baht. Interest on bonds is tax exempt and the bonds are acceptable as security in all transactions. After three years the bonds can be redeemed for cash, but the amount of interest will depend on the length of time held, according to the following schedule:

Period Held	Interest Received on Bonds Sold
3 to 5 years	5.0 per cent per annum
5 to 7 years	5.5 per cent
7 to 8 years	6.0 per cent
8 to 9 years	6.5 per cent
9 years and over	7.0 per cent

In actual fact, even though the bonds have to be held for three years before they can be redeemed at the Bank of Thailand, there is a secondary market for these bonds at the commercial banks. Bonds sold to these banks before three years have elapsed from the date of purchase sell at discount from par. One interesting aspect of this secondary market is that the terms proposed by the participating banks appear to be identical; i.e., all banks will pay 97 per cent of par for bonds held less than one year, 97.5 per cent for those held between one and two years, and 98 per cent for those held between two and three years. The existence of the secondary market is one more indication that the commercial banks are not deterred by the terms to maturity of these bonds. In point of fact, more recent issues of government bonds have extended somewhat the holding period. Thus, an issue of 2 billion baht worth of bonds in 1967 provides that the redemption period will be from 10 to 15 years; that is, the purchaser must hold the bonds at least 10 years before he can resell them to the Bank of Thailand without losing any of the interest return.

The commercial banks find government bonds attractive for a number of reasons. Not only is return on them riskless, but it is also substantial in terms of alternatives. While it is true that commercial banks can charge up to 14 per cent on commercial accommodation, the process of extending loans, assessing the value of the collateral and so on, imposes operating costs which are probably in excess of those associated with the acquisition of government bonds. Bonds are acceptable as collateral against loans from the Bank of Thailand, against promissory notes issued for settlement of rice premiums, against AID-financed imports, and other obligations, direct or contingent, of the banks.[45]

By far the most important attraction of government bonds is that they are now the principal asset against which the commercial banks can borrow from the central bank. The terms on which these loans are extended are quite lenient and insure that the banks may regard their

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[44](Continued) The tax exemption is an important feature of these bonds but hardly an overriding one if only because the interest payable on fixed deposits is similarly exempt from income tax. Thus, the determining consideration for an individual appears to be liquidity when the interest return is the same as that payable on bank deposits and the risk appears to be not significantly different. When money is held as a fixed deposit, full interest is payable after 12 months and the money can be withdrawn virtually at any time without any discount from par, even though the interest return will be adjusted to the length of time the deposit was maintained.

[45]For instance, in rediscounting procedures.

portfolio of government securities as almost equivalent to cash reserves in terms of liquidity and much more rewarding than cash in terms of return. The interest cost of borrowing from the Bank of Thailand is equal to the bond coupon; but while the interest received on the bond is tax exempt, the interest payable on the loan can be deducted from the commercial bank's gross income for income tax purposes. If the commercial banks were allowed to borrow the full face value against the security of the bond, they would actually make money in the process. In fact, however, the banks can not borrow more than from 70 to 90 per cent of the face value of the bond, depending on the length to maturity. Even so, the net cost of borrowing is minimal.[46]

Thus, there is little wonder that commercial banks continue to purchase large quantities of government bonds, despite the reduction in the coupon rate in 1965. What needs explaining, however, is the fact that the amounts borrowed from the Bank of Thailand remain but a minor source of

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[46] A loan from the Bank of Thailand may be obtained either by spot pledging of government securities or by an advance pledge of such securities. On the date due (loans are usually made for 90 days) the commercial bank can, if it wishes, settle its debt by disposing of the bond collateral. This is seldom done, however, inasmuch as few banks either need or are willing to accept a reduction in interest return. Most frequently loans are settled, if need be, by replenishing the bank's account at the Bank of Thailand which is debited on the date the loan is made.

funds to the Thai commercial banking system, averaging less than 1 per cent of its liabilities over the last 10 or 12 years.[47]

As shown in Table XIV, borrowing from the Bank of Thailand, over the period 1957-66, averaged substantially less than 10 per cent of all borrowings of commercial banks even though that total has been rising steadily year after year. At the end of 1966 total loans outstanding of commercial banks, both local and foreign, operating in Thailand, amounted to 3.4 billion baht of which only 337 million was owed to the Bank of Thailand.[48]

There appears to be no discernible trend in borrowing from the Bank of Thailand, with the amounts borrowed from that source varying from year to year. Nor is there any apparent difference between locally chartered and foreign chartered banks. Over the years, and as a proportion of total borrowings, there appears to be a somewhat lesser reliance on interbank loans (see Table XV). The decline in interbank loans

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[47]See Rozental, "Commercial Banking in Thailand," p. 21.

[48]The 200 million carried as owed to other banks in what purports to be a consolidated table of all banks in the country is due to a peculiarity of Thai banking accounts. Ibid., p. 17.

Table XIV

Thai Commercial Banks, Borrowing by Source

(in million baht)

End of Period	All Banks				Banks Incorporated in Thailand				Banks Incorporated Abroad			
	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total
Dec. 1957	-	95.1	543.8	638.9	-	91.5	179.5	271.0	-	3.6	364.3	367.9
1958	8.7	100.9	559.9	669.5	8.7	83.8	202.3	294.8	-	17.1	357.6	374.7
1959	41.9	252.9	738.4	1,033.2	40.1	194.8	353.5	588.4	1.8	58.1	384.9	448.8
1960	109.7	202.2	804.9	1,116.8	104.7	166.5	402.1	673.3	5.0	35.7	402.8	443.5
1961	106.3	243.5	1,065.5	1,415.3	103.0	167.1	549.7	819.8	3.3	76.4	515.8	595.5
1962	103.5	293.1	1,429.8	1,826.4	103.5	141.3	949.6	1,194.4	-	151.9	480.1	632.0
1963	98.0	370.2	1,852.3	2,320.5	91.7	136.4	1,373.1	1,601.2	6.3	233.8	479.2	719.3
1964	164.7	326.4	2,383.9	2,875.0	142.6	96.1	1,665.0	1,903.7	22.1	230.3	718.9	971.3
1965	244.4	241.4	2,727.9	3,213.7	218.6	112.5	1,848.6	2,179.7	25.8	128.9	879.3	1,034.0
1966	336.9	198.5	2,889.4	3,428.8	290.5	92.8	2,053.8	2,437.1	46.4	105.7	835.6	987.7

Source: See text.

Table XV

Thai Commercial Banks, Borrowing by Source*
(Percentage Distribution)

End of Period-	All Banks				Banks Incorporated in Thailand				Banks Incorporated Abroad			
	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total	From Bank of Thailand	From Banks in Thailand	From Banks Abroad	Total
Dec. 1957	-	14.88	85.12	100	-	33.76	66.24	100	-	0.98	99.02	100
1958	1.30	15.07	83.63	100	2.95	28.43	68.62	100	-	4.56	95.44	100
1959	4.06	24.48	71.47	100	6.82	33.11	60.08	100	0.40	13.06	86.53	100
1960	9.82	18.11	72.07	100	15.55	24.73	59.72	100	1.13	8.05	90.82	100
1961	7.51	17.20	75.28	100	12.56	20.38	67.05	100	0.55	12.83	86.62	100
1962	5.67	16.05	78.29	100	8.67	11.83	79.50	100	-	24.03	75.97	100
1963	4.22	15.95	79.82	100	5.73	8.52	85.75	100	0.88	32.50	66.62	100
1964	5.73	11.35	82.92	100	7.49	5.05	87.46	100	2.28	23.71	74.01	100
1965	7.60	7.51	84.88	100	10.03	5.16	84.81	100	2.49	12.44	84.88	100
1966	9.83	5.79	84.27	100	11.92	3.81	84.27	100	4.70	10.70	84.60	100

Source: See text.

*Details may not add up to total because of rounding.

is, surprisingly enough, more pronounced in the case of locally chartered banks.[49] For a number of reasons, of which the desire to avoid paying tax on interest income is perhaps the most important, there has been since 1962 a growth of "interbank deposits" at the expense of "interbank loans."

The acquisition of bonds by commercial banks was given another fillip in 1965 when the proportion of government securities allowed to count as reserves against deposit liabilities was raised from 25 to 50 per cent. Given the attractions of bonds to the commercial banks, there ensued, in 1965 and 1966, a shift in the assets of the commercial banks from cash to securities. Thus, at the end of 1965, the ratio of cash assets to demand deposits stood at 9.74 per cent. By the end of 1966 it fell to

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[49]See Table XV. One would expect that, as the scope of business activity expands, it will be the foreign banks who will tend to rely more heavily on head offices abroad for their seasonal and cyclical needs. Yet, the proportion of total funds obtained from foreign banks has, if anything, declined in the case of banks chartered abroad and increased in the case of those locally incorporated. One reason cited in field interviews with managers of foreign banks is an alleged discrimination in the tax laws which treats funds obtained from headquarters abroad as addition to capital and disallows deduction of interest payable on those funds for income tax purposes. Locally chartered banks do not encounter any difficulty in deducting interest charges on funds obtained from their foreign correspondents from the gross income base.

At the time of writing, the annual interest charge for interbank loans varied from 7 to 8 per cent with loans from abroad available to Thai commercial banks at from 6 to 7 per cent. In addition to lower interest rates the advantage of funds borrowed from abroad was their length which was typically 180 days, compared with 90 days for loans from the Bank of Thailand and only a few days in the case of interbank loans. By borrowing from abroad for 180 days and lending to importers for 90 days, the commercial banks can, even allowing for shipping and other delays, profitably invest funds obtained at relatively low cost from abroad.

8.63 per cent. On the other hand, the ratio of liquid assets (which differ from cash assets mainly by the inclusion of government securities) to deposits rose from 25 per cent at the end of 1965 to 30 per cent at the end of 1966.[50]

With commercial banks liquidity assured by recourse, if need be, to foreign credit and by the rapid growth of deposits, particularly time deposits,[51] the Thai commercial banks increasingly converted their excess reserves into government securities. By the end of 1965, the banks' holdings of government securities were larger than their excess reserves (see Chart II).

Table XVI shows that the policy governing distribution and treatment of government bonds (as well as Treasury bills) was not determined by budgetary needs. Issues of government bonds have been, in recent years, substantially in excess of deficits and have been mainly responsible for the accumulation of large cash balances at the Treasury

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[50]See Bank of Thailand, Monthly Report (June 1965), p. 7. Because of the highly seasonal demand for bank accommodation liquidity ratio tends to vary considerably from month to month. As shown in Chart I, however, liquidity of commercial banks in 1966 was very high throughout the year.

[51]Demand deposits were 6.4 billion baht at the end of 1965 and 7.5 billion at the end of 1966. Time deposits rose in the same period from 6.8 to 9.3 billion baht. As mentioned previously, most of the increase in time deposits was a result of increased holdings by private residents.

Chart I

Thai Commercial Banks, Ratio of Liquid Assets to Deposits, 1962-66

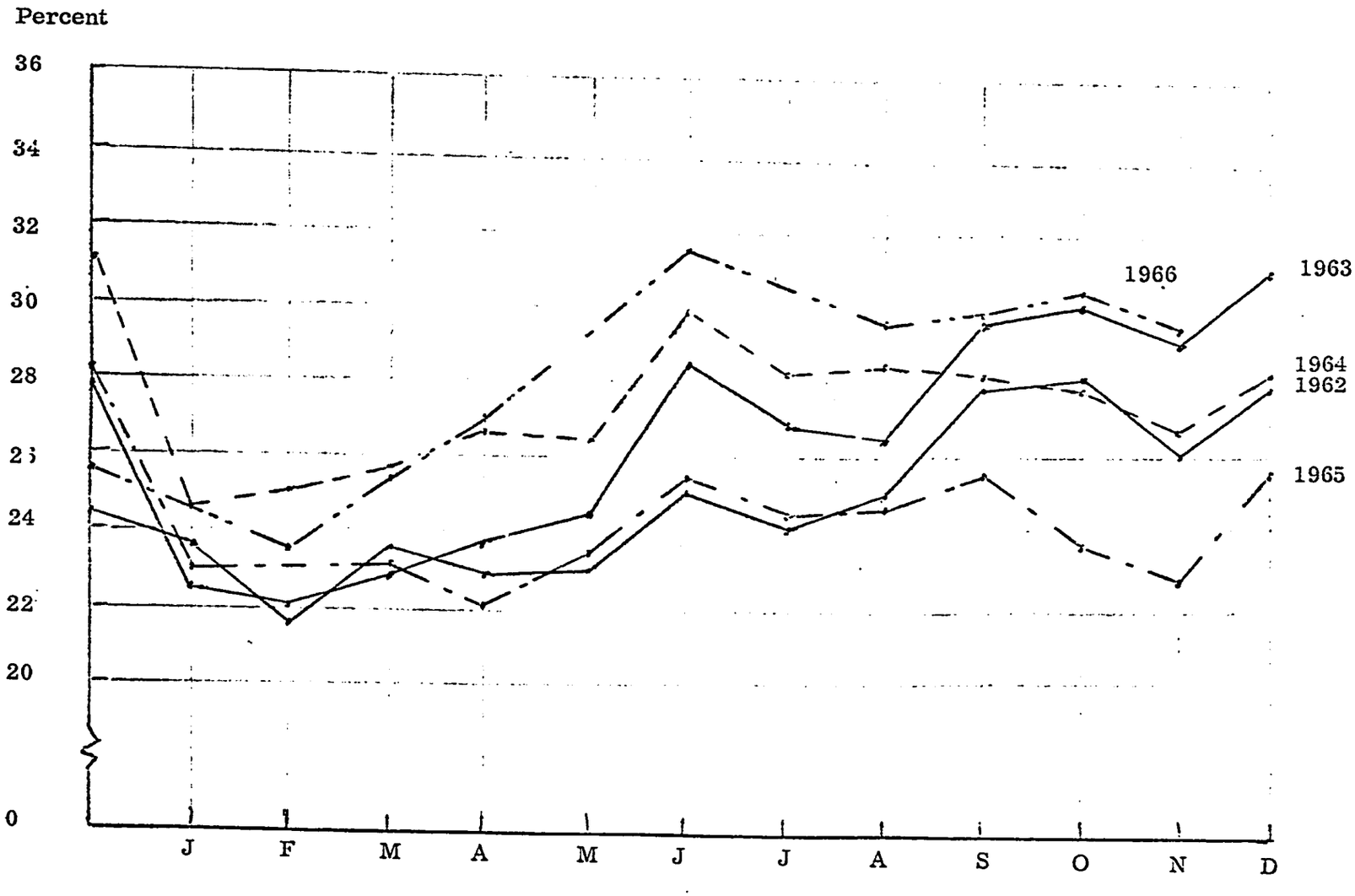

Chart II

Thai Commercial Banks, Holdings of Government Securities and Excess Reserves
1962-1966

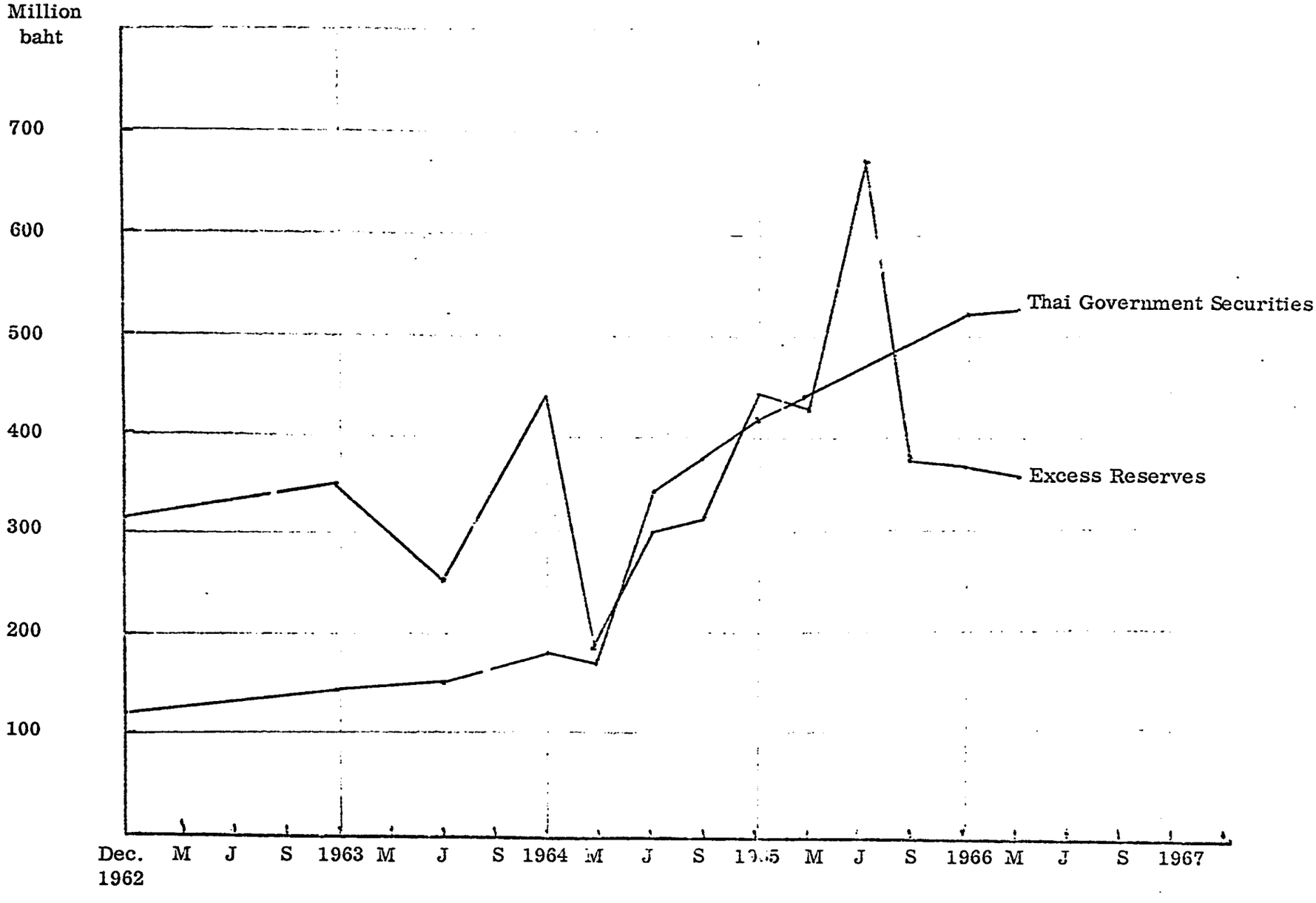

Table XVI

Thai Government Deficits, Borrowing and Treasury Balances
(in million baht)

Fiscal Years	1962	1963	1964	1965	1966
Treasury Cash Deficit	-1	-358	-555	-240	-668
Sale of Bonds	576	900	905	1195	2302
Sale of Bills	-123	277	-699	-51	145
Coin Issues	14	48	67	91	77
Change of Treasury Balance	466	867	-282	995	1856
Treasury Balance, End of Year	1871	2738	2456	3451	5307

Source: See text.

account. Whatever the exact reasons for making available to the commercial banks large blocks of bonds at very favorable terms, the net effect has been to make the commercial banks more liquid, less economically dependent on Bank of Thailand direction, less anxious to compete for customers, less likely to reduce interest charges as a means of securing employment of their idle funds, and more content to continue business as usual instead of seeking new uses for their funds.[52]

B. TREASURY BILLS

As seen in Table X, holdings of Treasury bills among financial institutions are, at the present time, much smaller than those of government bonds. Compared with the nearly 12 billion baht worth of bonds outstanding at the end of 1966, total bills outstanding amounted to only 850 million baht, of which commercial banks held less than 400 million baht. Moreover, as contrasted with bonds, which are held by a great variety of holders, the

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[52] The Bank of Thailand has, of course, to contend with many pressures and many needs of the economy. The policy of accumulating large Treasury balances may have been motivated by a fear of inflation. The Bank of Thailand has been interested, for some time, in creating a money market and feels that issuance of securities in excess of budgetary requirements is a step in the right direction. Also, it may feel that by making available bonds and bills at coupon rates below those obtainable in many parts of the market, it helps to bring about a general reduction in the level of interest rates.

vast bulk of bills are held by banks (central and commercial), with less than 5 million baht held outside.[53]

Under an act passed in 1944 which regulates the issues and terms of Treasury bills, the responsibility for their management is vested in the Ministry of Finance. In practice, however, the management of bills is now in the hands of the Bank of Thailand. In fact, until about 1960, the Bank was almost the sole purchaser of the bills from the Treasury, and the proceeds of these sales were credited to the Treasury account to finance operating needs of the government. The rate of return offered on these bills, together with other terms of issue, were not sufficiently attractive to attract other buyers.[54] It was not until 1960 that the Bank of Thailand succeeded in convincing the Ministry of Finance that it should increase the maximum rate of interest paid on Treasury bills from 3.0 to 4.5 per cent and permit their issue on tap as well as on tender. The Bank of Thailand

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[53]The bulk of this (4.8 million) is held by the Government Savings Bank.

[54]At the outset, when the bills were first issued by the Ministry of Finance, they did attract a number of commercial banks as well as the Government Saving Bank. But the Bank of Thailand, by bidding close to the fixed price, managed to depress the yield below 1 per cent per annum and became, after 1947, the sole buyer of bills. After 1948 the yield on the bills continued to increase but the return on bonds increased even faster, rising to 8 per cent in 1955. Moreover, until about 1960, there were no provisions for reselling the bills before maturity.

stood ready to sell bills from its own portfolio to commercial banks and others with an option to buy them back before maturity at a penalty rate of one-fourth of 1 per cent.

Parallel to the development of a secondary market in Treasury bills, the volume of outstanding bills has gradually been reduced, and the emphasis in Treasury bill policy has shifted from that of financing government to that of developing a money market.

Table XVII shows that the amount of bills outstanding was reduced from over 3 billion baht in 1959 to about half that amount in 1961 and to 650 million in 1965.[55]

The maximum rate payable on 90-day Treasury bills was further increased to 5 per cent in 1961, leading to increasingly large purchases of bills by the commercial banks (see Table XVIII).[56] In 1965, however, the coupon was reduced to 4.5 per cent. The penalty rate for repurchase of bills by the Bank of Thailand was reduced from one-fourth to one-eighth of 1 per cent. In 1966, the coupon was further reduced to 4 per cent, the currency of the bills was limited to 60 days and, as a partial compensation, the penalty rate was cut to one-twelfth of 1 per cent.

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[55]The value of bills outstanding, or the "revolving fund," as it is called, at the time of writing (1968) is limited to 850 million baht.

[56]Table XIX suggests, however, that the more attractive terms at which Treasury bills could be purchased failed to bring in other buyers in any significant amount.

Table XVII

Thai Treasury Bills, Selected Characteristics
(in million baht)

Year	Issued during the year (฿)	Terms	Average Interest (discount) rate	Amount Sold (฿)	Redeemed during the year (฿)	Outstanding at the end of the year (฿)
1956	9,801	4 months	2,260	9,801	9,801	3,267
1957	9,855	4 months	2,279	9,835	9,835	3,287
1958	9,800	4 months	2,923	9,800	9,820	3,267
1959	9,853	4 months	2,990	9,853	9,853	3,267
1960	8,653	3 months	3,077	8,653	9,812	2,107
1961	4,953	3 months	4,647	4,953	5,453	1,608
1962	4,493	3 months	4,978	4,493	4,494	1,607
1963	3,749	3 months	4,980	3,749	4,706	650
1964	2,900	3 months	4,994	2,900	2,706	650
1965	3,150	3 months	4,461	3,150	3,150	650

Source: See text.

Table XVIII

Thai Commercial Banks, Purchases of Treasury Bills

Year	By Tender		From Bank of Thailand		Total	
	Value in million baht	Percent of Total	Value in million baht	Percent of Total	Value in million baht	Percent of Total
1960	13,000	3.8	329,000	96.20	342,200	100
1961	40,000	2.96	1,300,324	97.04	135,324	100
1962	125,000	3.51	3,434,188	96.49	3,559,188	100
1963	310,000	8.26	3,442,231	91.74	3,752,231	100
1964	555,200	18.01	2,527,413	81.99	3,082,613	100
1965	724,000	26.67	1,990,270	73.33	2,714.270	100

Source: See text.

TABLE XIX

Sales of Treasury Bills
(on bid basis)

(calendar years, in million baht)

Type of Holders	1964		1965		1966	
	Amount	Percent	Amount	Percent	Amount	Percent
Bank of Thailand	2344.8	80.85	2426.0	77.01	2498.0	56.56
Commercial Banks	554.0	19.10	724.0	22.99	1918.0	43.43
Insurance Companies	1.2	.05	-	-	-	-
Government Saving Bank	-	-	-	-	.234	.01
TOTAL	2900.0	100.0	3150.0	100.0	4416.234	100.00

Source: See text.

TABLE XX

Bank of Thailand operations, Commercial bank examinations
(frequency in absolute numbers)

	1962	1963	1964	1965	1966
Head office	3	4	23	7	16
Bangkok branches	12	9	35	78	39
Provincial branches	20	130	21	136	98
Total	35	143	79	221	153

Source: See text.

In recent years the monetary authorities have attempted to reduce the proportion of bills bought on tap in favor of direct tender from the Treasury. The schedule of maturity dates, penalty rates, and repurchase prices were so arranged as to provide inducement for holding bills longer and, in consequence, to buy them on tender basis.[57] These attempts met with some measure of success, as shown in Table XVIII.

It would seem that the entire policy regarding Treasury bills has not, as yet, been clarified. There appears to be some confusion regarding objectives, methods, and goals. In particular, three aspects of this policy are, prima facie, inconsistent with the avowed objectives. In the first place, there seems to be little justification for reducing the revolving fund of Treasury bills to the current low level. Treasury bills are a cheaper means of financing government needs than bonds, and, to the extent that borrowing has to be resorted to, reliance on long-term securities increases the budgetary cost of internal debt.

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[57]The schedule, at the time of writing, read as follows:

Length to Maturity	Yield	Repurchasing Rate
1-15 days	2.50 per cent	2.63 per cent
16-30 days	3.05 per cent	3.13 per cent
31-45 days	3.34 per cent	3.25 per cent
46-60 days	3.60 per cent	3.88 per cent

In the second place, to the extent that issuance of bills is motivated by the desire to develop a money market in Thailand, over and above budgetary needs, it is difficult to understand why sales on tender basis should be emphasized and encouraged. The tap market at the Bank of Thailand provides a secondary market which the commercial banks find very useful because it enables them to select the maturities they need on a day-to-day basis.

Finally, the overall reduction of interest yield and reduction of maturities appears inconsistent with specific steps to encourage banks to hold on to the bills for longer periods so as to receive a higher yield. In any event, so long as these banks continue to be very liquid, Treasury bills will play only a marginal role in their portfolios.[58]

IV. CENTRAL BANKING AND THE FINANCIAL NEXUS

The effectiveness of central banking operations in directing the flow of savings and investment into developmental channels depends on the Central Bank's willingness and ability to pursue a growth-oriented policy.

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[58] A much more important issue, and one which will be discussed at some length in a forthcoming paper, is the need to provide a broader spectrum of debt issues. At the present time, there is basically only one type of bond offered to all kinds of purchasers and only one kind of bill, albeit at varying yields to maturity. In particular, there appears to be a need to tailor issues to different markets in terms of yield, maturity, tax status, and other variables.

As mentioned previously, throughout most of its existence the Bank of Thailand has been preoccupied with maintaining the external and internal value of the baht, and only recently has its leadership become concerned with economic growth.[59] While its willingness to channel resources into growth-oriented activities can be said to have increased somewhat, its power to do so effectively is yet to be examined.[60]

In this section, the willingness and the ability of the Central Bank to influence the direction of economic activity will be discussed under two subheadings. In the first of these, Central Bank relations with

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[59]"...there is considerable doubt whether macroeconomic factors related to the money supply as a whole are as important for growth as redirection of the energies of the financial institutions into growth-promoting activities." T. H. Silcock, ed., Thailand--Social and Economic Studies in Development (Durham: Duke University Press, 1967), p. 197.

[60]Willingness and power are, of course, intertwined. The cognizance of the limits of power affects the willingness to undertake certain actions. This, in turn, inhibits the use of power. The reluctance of the Bank of Thailand to use certain powers formally vested in it can be traced not so much to its unwillingness to use them as the recognition that these formal powers are not always tantamount to real power.

commercial banks and other financial institutions will be scrutinized. The second subheading will speculate on the direction which Bank of Thailand activities should take, given certain assumptions regarding the optimal strategy for Thailand's development.

A. RELATIONS WITH FINANCIAL INSTITUTIONS

The commercial banks are by far the predominant financial intermediaries on the Thai scene. Their relations with the Central Bank are manifold and occasionally complex. Some of these relationships arose out of the powers and obligations of the Commercial Banking Act of 1962 and subsequent amendments by the Minister of Finance. Other relationships are those which, although enabled by pertinent legislation, were more fully developed under various administrative notices and provisions of the Bank. Finally, there are those operations of the Bank which affect the activities of the commercial banks but which have already been discussed elsewhere.[61]

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[61] Either under other headings of this paper or in "Commercial Banking in Thailand" (cited previously). Again, it should be noted that many of the activities of the Bank of Thailand which affect the commercial banks stem from the powers and obligations formally vested in the Minister of Finance. Thus, even though examinations of commercial banks and eventual sanctions against them depend to a large extent on the Ministry of Finance, no distinction will be made in the text.

For purposes of this discussion the significant relations with the commercial banks are those which deal with the ability of the Bank of Thailand to control the behavior of these banks, in general, and their lending policies, in particular.

Three types of controls can usefully be distinguished. The first set of control instruments derives from statutory or administrative enactments but is largely useless. Either these controls are not implemented or they are not effective. The formal powers from which these control instruments derive are not invoked for a variety of reasons or, in those rare cases when they are invoked, they are either bypassed or not pressed with sufficient vigor.

The second set of controls over the behavior of commercial banks is also based on formal powers, but these powers are rooted in economic and/or political realities. The Bank of Thailand can exert some influence over commercial banks' portfolios and policies to the extent that it pushes these instruments vigorously.

Finally, there are those instruments of control which are rooted less in formal powers of the Bank of Thailand than in its standing, integrity, and prestige. Up to the present time, it is at least arguable that changes in commercial banking operations were brought about more by "moral suasion" than by the exercise of legal powers by the Bank of Thailand.

The formal powers at the disposal of the Bank of Thailand include the power to set maximum interest rates on various types of accommodation, to vary reserve requirements within rather wide margins, to limit the ratio of risk assets to capital, to prescribe the ratios of specified assets to capital, to regulate the proportion of loans to one name, to examine the books of the banks, and many others.[62] Many of these provisions, however, remain in abeyance. Thus, even though the Bank of Thailand can set the ratio of cash assets to deposits at a rate as high as 50 per cent, it chooses to keep the ratio fixed at 6 per cent. Similarly, the ratio of risk assets to capital, which could by statute reach 15 per cent, remains constant at 6 per cent. There are many reasons for the reluctance to use these rather standard control instruments but some of the more telling ones are quite clear. Given the great liquidity of the commercial banking system as a whole, a very sharp increase in the reserve ratio would be needed to put the commercial institutions "at the Bank." But such a sharp increase would affect the commercial banks quite unevenly, with the smaller banks probably no longer able to operate. Yet, some of the smaller and relatively less liquid banks need to be protected, not only because some of them wield considerable political power but also because it would be both unfair and unwise to press their backs to the wall.

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[62]Some of these powers will be discussed in the succeeding paragraphs. See also, Rozental, "Commercial Banking in Thailand."

Less clear are the reasons for not exercising some of the other statutory powers which, in principle at least, could quite considerably affect commercial bank behavior. Among these are the powers to prescribe the proportion of selected assets to capital and the maximum proportion of capital which can be lent to one name.[63]

Inasmuch as capital resources of Thai commercial banks are more of a constraint on their liquidity than liquid assets, the regulation of commercial bank behavior via selective control of assets would appear feasible. In particular, the Bank of Thailand could, in principle, direct lending activities of the commercial banks into certain directions merely by positing a requisite ratio of a specified asset to total capital resources. But such forcible direction would cause more problems than it would solve. Suppose, for example, that the Bank of Thailand required commercial banks to increase their loans to manufacturers to a much higher proportion of capital than at present. Without proper safeguards on both sides of this particular market for lendable funds, and without

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[63] The Bank of Thailand also has the power of counting unused portions of overdrafts as deposits. The exercise of this power, however, is subject to the limitations mentioned in the preceding paragraph. The power to vary the ratio of assets to capital has been exercised only negatively by excluding certain assets from the definition of risk assets. See Commercial Banking Act of 1962, Sec. 10(2).

rather basic changes in the entire credit structure, such requirements could not be implemented or enforced.[64]

A bank examination, which is routinely performed by the Bank of Thailand, is, even when competently done, a negative instrument of control at best. Certain glaring abuses can be avoided or rectified, but examination of the books, per se, can do little to channel bank lending in desired directions. Moreover, it is very difficult to obtain any information regarding the number of abuses found, their frequency and distribution among banks, remedial action taken, and so on. The Bank of Thailand must protect the confidential relationship it enjoys with the commercial banks, and it would perhaps be improper for it to divulge to an outsider any more than can be gleaned from Table I.[65]

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[64]The language of the 1962 Act is not clear as to whether the various ratios must apply equally to all banks or whether the Bank of Thailand may discriminate among banks. It is understood, however, that these ratios are equally binding on all banks operating in Thailand.

[65]The purpose of a bank examination is twofold. On the one hand, it is to insure that the commercial bank will remain solvent and, on the other, it is to exact compliance with the numerous provisions regarding lending to directors, purchases of certain assets, or engaging in certain transactions. When solvency is in question, the bank, in principle, can be forced into liquidation. Contraventions of existing rules may result in up to one year's imprisonment and fines of up to 20,000 baht.

The Bank of Thailand does have the power to set maximum rates on different types of deposit liabilities and on different kinds of loans of the commercial banks. This is an area where the Bank of Thailand was and is active, but its ability to set effective ceilings on interest rates is, in some instances, bypassed by the devices employed by certain banks to exact higher interest rates on loans and/or pay higher than the official rates on deposits.[66]

It would thus seem that the formidable arsenal of control weapons available to the Bank of Thailand under legislative enactments is seldom used, or used rather haltingly. The reasons for this are both economic and political. The economic reasons have to do with commercial bank liquidity which, however, is unevenly distributed among the individual banks.[67] The political reasons have to do with the

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[66]See Rozental, "Financing Thai Business Enterprise," especially p. 81. The concern with the prevailing level of interest rates is reflected in numerous speeches made by the Bank of Thailand Governor. See Puey Ungphakorn, Speeches, Articles, and Addresses (Bangkok: Bank of Thailand, 1964).

[67]A related economic constraint is the ease with which commercial banks can obtain funds from abroad. This has an effect not only on their liquidity but also on the availability of foreign exchange. In many countries the Central Bank's control of foreign exchange serves as a powerful influence on commercial bank behavior. On the economic limitations of Central Bank power under conditions resembling those of Thailand, see R. S. Sayers, Modern Banking (London: Clarendon Press, 1951), especially pp. 282ff.

considerable political muscle at the disposal of many of the commercial banks incorporated in Thailand. It's a rare bank which does not have on its board a field marshall, a general, or a high police officer. Many Thai banks have close ties with high civil servants, members of the ruling families, or both. No matter how intrepid the leadership of the Bank of Thailand may wish to be, it must reckon with political realities.[68]

But the Bank of Thailand does employ control instruments which enable it to affect the flow of funds through the commercial banks and, hence, the economic behavior of these banks. Perhaps the most important of these are related to rediscounting activities and to granting of permits for new branches. As mentioned earlier, the Bank seems to have a good deal of discretion in allowing rediscount facilities and there is no reason why elements of these discretionary powers should not be employed to achieve certain desired, albeit limited objectives.[69] The objectives must be limited so long as total volume of rediscounting remains low relative to the volume of commercial banks' operations.

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[68]For a discussion of the political powers of Thai commercial banks and of the political constraints within which the Bank of Thailand operates, see T. H. Silcock, "Money and Banking," in Thailand: Social and Economic Studies in Development, especially pp. 182-185.

[69]Specific suggestions will, as stated before, be the subject of a separate paper. One possibility along lines suggested in the text could be the allocation of a quota, not on the basis of total liquid assets, but related to the composition of the bank's portfolio.

The possibility of utilizing the right to grant permission to commercial banks to open new branches as a control instrument has been discussed elsewhere.[70] Again, its scope can only be a limited one.

It may be a truism to say that among the controls available to the Bank of Thailand the ones that have the best chance of influencing the policies of commercial banks are those which promise them direct or indirect benefits. Whenever the aims of the economy, as interpreted by the Bank of Thailand, coincide with or can be made compatible with those of the commercial banks, the control instruments can be made to work. When there is little overlap of economic benefit or a direct conflict emerges, the implementation of legal powers of the Bank of Thailand will have to contend with the political realities. Thus, the commercial banks are anxious to have new branches, and they might be willing to abide to a limited extent by Bank of Thailand direction in order to get these branches. On the other hand, they will resist a straight

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[70]See Rozental, "Branch Banking in Thailand," pp. 25-28. Perhaps the best way to achieve desired changes in commercial banks' policy would be to combine potentially effective but politically awkward control instruments with economic benefits which would accrue to the banks once they adhere to the policy change.

increase in the cash-deposit ratio or the substitution of other assets for government securities in their legal reserves.[71] The Bank of Thailand, hemmed in as it is by economic and political limitations which restrict its ability to direct the policies of the commercial banks, is not entirely without resources. To date, its greatest success in influencing the behavior of the commercial banks has derived from "moral suasion"; i.e., in utilizing its great prestige in the community to bring about certain changes in commercial banks' policy. Moral suasion takes time to make itself felt and it is not always easy to relate the cause and the effect; but there is little question that the general improvement in banking practices and the reduction in frequency of grosser abuses owes a good deal to the persistent prodding and cajoling of the Bank of Thailand.[72]

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[71] As an example of this approach may be cited the proposal to combine an increase in the cash ratio with generous rediscounting provisions as a means of inducing commercial banks to discount agricultural credit paper of supervised, productive, group type. (See Rozental, "Financing Rural Households in Thailand," pp. 116ff.) The juxtaposition of the carrot and the stick as a means of channelling the flow of funds into developmental ends will be further explored in a forthcoming paper which will concern itself with "piecemeal engineering" suggestions for the improvement of the Thai financial structure.

[72] In at least one case, the reduction of maximum lending rates in 1966, the tie-in between moral suasion and acceptance by the banking community was a direct one. The Bank of Thailand supplements its moral suasion effort by a range of services to the banking community which tend to make commercial banking more professional and more responsible. Among these should be listed the central clearing of checks, the central register of credit information (confidential information on individuals who owe in excess of 500,000 baht to more than one bank), statistical and analytical services, and so on.

The prestige of the Bank of Thailand is based, first of all, on the skills and integrity of its Governors. The Bank has been fortunate in that the persons chosen to lead its affairs have been men of unquestioned probity, whose financial acumen and experience have been widely respected. The Bank has also been able to retain a measure of independence, both political and administrative, which has stood it in good stead.[73]

The moral suasion is exerted in a variety of ways. One of the most popular ones is through the speeches of the Governor and other high Bank officials given at formal occasions. These speeches are widely reported in the press and frequently reprinted and published.[74]

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[73]The Minister of Finance cannot issue orders to the Governor, and his supervisory sanction can, ultimately, take only the form of removal of the Bank of Thailand's directors, a very drastic step indeed. Unlike most civil servants, directors of the Bank are personally liable for any losses of the Bank's funds which can be traced back to willful negligence on their part. This unusual provision gives the directors some measure of political status. The fact that the Bank of Thailand is outside civil service rules enables it to recruit and retain superior staff.

[74]The membership in the IMF and in the World Bank is said to give a good deal of weight to the pronouncements of the high officers of the Bank of Thailand. The Bank is the primary point of contact for the missions of the IMF and its regular annual consultations.

Apart from its close cooperation with the Treasury, the Bank of Thailand has very few transactions with other financial intermediaries operating in the Thai financial nexus.[75] This itself is symptomatic of the past preoccupation of the Bank of Thailand with the control of money supply and with financing government. Only very recently did the Bank begin to concern itself with provision of credit to institutions other than the commercial banks. Its proposed assistance to the newly created Bank for Agriculture and Agricultural Cooperatives and to the Industrial Finance Corporation of Thailand has already been mentioned. There are, as yet, no direct financial dealings between the Bank of Thailand and life insurance companies, provident and pension funds, mutual funds, and other institutions of the fledgling capital market.[76]

The discussion of the relationships, actual and contemplated, between the Bank of Thailand and financial institutions other than the commercial banks is best referred to another paper, now in preparation, which deals with the capital market.

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[75] Relations with the Treasury have been discussed only tangentially throughout this study which concentrates on the nongovernmental segments of the financial nexus.

[76] As suggested above, the absence of direct financial dealings does not preclude the Bank from being involved in discussions, debates, and deliberations affecting a number of financial institutions. In fact, the officers and staff of the Bank play an important part on many official and unofficial committees concerned with development.

V. CENTRAL BANKING IN THE DEVELOPMENT PROCESS

The preceding section described in some detail the means at the disposal of the Bank of Thailand for influencing the direction of economic activity, primarily via the commercial banks.[77] But in order for the Bank of Thailand to channel resources into developmental needs intelligently, it must know what these needs are, what is their ordering relation, and what kind of policy can be expected to bring the desired directional change. Unfortunately, there is no rigorously defined, universally agreed upon, optimal path of economic development for Thailand. There are, at best, certain hunches whose quantitative expression lacks precision but whose direction is clear enough. These directional hunches suggest that Thailand's former reliance on exports and trade as the primary vehicles of growth will have to be decreased in favor of greater emphasis on manufacturing capacity if the country is to continue to grow in the future.

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[77] The Bank of Thailand operations do affect households' decisions to save, both directly and indirectly. The direct effects flow from the offerings of government bonds and the indirect effects from the terms at which the commercial banks accept deposits. As yet, there are no sufficient data available to permit any conclusions, let alone suggestions, with respect to the impact of the Bank of Thailand on household savings, their level, composition, and form. It is hoped that some of this information may be developed later on.

During the past several years, the ratio of total investment to GNP approximated 20 per cent annually, but less than one-fourth of capital formation can be attributed to "manufacturing."[78] While the rate of growth of value added in manufacturing has, in recent years, been in excess of the growth rate of the GNP, much of this growth appears to have been either of the "packaging" variety--imported manufacturing components are assembled and labelled in Thailand--or else devoted to the production of building materials and components which fed the construction boom in urban areas. Both types of manufacturing activity add relatively little to the expansion of the productive base of the economy and do little to enhance its ability to increase the production of goods and services over time.

It is, of course, arguable whether increased emphasis on manufacturing, which relies more on local entrepreneurship and on local resources and less on imported skills and equipment, describes the best path for Thailand's development to follow. Those concerned with the country's development strategy think so. Thus, the Minister of National Development said in 1966:

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[78] In 1965, for example, of the Gross Domestic Product of 81 billion baht, capital formation accounted for 18.5 billion. Of this amount, only 4.2 billion can conceivably be attributed to manufacturing, and even this figure is grossly inflated by the inclusion of construction equipment in the subtotal for "machinery imports" and of automobile assembly in that of "value added to transportation equipment."

"First, while the proportion of total investment to Gross National Product has reached a highly respectable level of 21 per cent, only a small portion of this investment is being channeled into the manufacturing industries. During the past five years, real manufacturing output increased at the annual rate of only 7.6 per cent. If we are to fulfill the annual target of a 10 per cent increase in manufacturing products in our next Five-Year Plan, and if we are to reach the industrial take-off stage in the foreseeable future, inducement must be provided to shift the emphasis from investment for short-term commercial gain to the so-called growth investment. That is to say, the government will encourage only the type of capital outlay which is based on long-term profits involving the establishment of permanent undertaking with an eye toward future expansion."[79]

In the second five-year plan (1967-71) the target for the manufacturing sector is an annual growth rate of about 11 per cent (compared with the GNP target of some 9 per cent). In the words of the authors of the plan:

"Accelerated industrial development is an objective of the Second Plan which has been adopted in order to realize a structural change in the economy, with the manufacturing sector growing, creating employment opportunities and utilizing greater supplies of indigeneous raw materials."[80]

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[79]Speech delivered at the Seminar on Economic Development and Investment Opportunities sponsored by the Thailand Council of the Asia Society at the Plaza Hotel, New York City, October 5, 1966.

[80]National Economic Development Board, The Second National Economic and Social Development Plan (Bangkok: National Economic Development Board, 1967), p. 165.

In the absence of a rigorously defined and universally accepted strategy of economic growth for Thailand, such statements are little more than value judgments. Even so, they do not appear unreasonable. So long as agriculture remains a rather limited market, manufacturing growth which concentrates on import substitution of consumption goods must slow down eventually. By contrast, manufacturing based on local raw materials shows possibilities of reaching potentially very large export markets. Yet, so far, little has been done to stimulate export-promotion type of manufacturing which, in Thailand, appears to possess comparative cost advantage (i.e., seafood processing and packaging, fruit canning, teak manufacture, etc.).

A part of the "blame" for this state of affairs must be put on the existing financial structure which has mirrored the country's economic development and which has helped Thailand achieve its remarkable growth record to date. If it is true, however, that the continuing growth of the Thai economy will hinge on its ability to develop export-promotion manufacturing capacity, then it behooves the Bank of Thailand to redirect the activities of the financial markets away from their emphasis on foreign trade toward the financing of nascent processing industry, which is based on local resources.

While the emphasis on exports and imports is primarily responsible for the dearth of institutions and instruments for financing locally based manufacture, the heavy reliance on unorganized financial markets for the provision of capital to medium and small manufacturers must also bear a part of the responsibility.[81] Hence, it would seem that the operating framework in which the Bank of Thailand should adopt would be one which encourages the development of capital market institutions and instruments capable of providing finance to fledgling Thai industrialists rather than one which further enhances the ease and convenience of foreign trade financing.[82] In operational terms, and ones which have been defined elsewhere, the Bank of Thailand should provide competitive alternatives to the unorganized markets with the aim of diverting resources from trade, speculative construction, and a higher consumption to "productive" industrial undertakings.[83]

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[81]For evidence, see Rozental, "Financing Thai Business Enterprise."

[82]According to Muscat, among obstacles to industrialization are "no commercial bank interest in financing industrial investment, absence of capital market or the suitable instruments for mobilizing savings and channelling them into the hands of entrepreneurs looking for capital availability of industrial credit (where it can be obtained) only at very onerous interest rates and for short periods." Op. cit., p. 208.

[83]See Rozental, "Financial Markets and Development Planning."

What this means in concrete terms and how this can be done in practice will be spelled out in a separate paper. Only a few suggestions and hints may usefully be dropped here. For example, the current policy of providing encouragement to manufacturers using local raw materials is consistent with the operational framework as outlined above.[84]

On the other hand, the exclusion of much foreign trade paper from the definition of risk assets tends to make that form of activity even more attractive to the commercial banks.[85]

In 1966, over 40 per cent of commercial bank loans went to finance exports and imports, 19 per cent to domestic trade, and only 12 per cent to manufacturing, much of it to rice milling, which accounts for about a third of value added in manufacturing.

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[84] See provisions regarding raw materials' rediscounting, p. 32.

[85] Even though the commercial banks charge lower interest rates to exporters and importers than to manufacturers, especially small and medium manufacturers, foreign trade financing is very profitable. In addition to the interest charges, the banks collect fees for a variety of documents, commissions on exchange transactions, and other charges. Moreover, foreign financing resorted to by domestic banks, principally in connection with their export and import activities, is very lucrative, mainly because the funds from abroad are available for a period of time which is longer than the period at which they are re-lent locally.

As should be clear from the preceding discussion, the ability of the Central Bank to channel economic activities in directions conducive to economic growth will remain limited by the extent of its economic and political sway over financial institutions. Yet, within this constraint set a number of things can and should be done. The Bank is, of course, aware of some of these possibilities. Witness its interest in some of the capital market institutions, its participation in official committees on financial institutions, its advisory functions in the preparation of the five-year plan, and its cooperation with other bodies concerned with Thai economic growth.[86]

One specific possibility which has received a good deal of attention lately and which, although promoted by the commercial banks themselves, has been incorporated in the five-year plan may be briefly mentioned here. This is the suggestion that in order to promote saving and perhaps also to facilitate term lending by commercial banks, maximum interest rates on deposits should be increased for balances held

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[86]See Puey Ungphakorn, op. cit., pp. 82-84.

in excess of one year. While this suggestion merits further study, it raises the question of whether such a step will not delay the formation of capital market institutions able to finance more properly medium- and long-term industrial needs. Also, there may be some doubt as to what extent an increase in fixed deposits will be a net addition to voluntary savings rather than a change in their disposition, given the flexibility of at least some commercial banks with respect to the treatment of time versus checking accounts.