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The Role of Governance  
in Development Revisited:  
A Proposal of an Alternative View

Yasutami Shimomura  
Hosei University

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# **The Role of Governance in Development Revisited: A Proposal of an Alternative View\***

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\* The responsibility for facts and opinions in this publication rests exclusively with the author and its interpretations do not necessarily reflect the views or the policy of the FASID or other institutions.

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This article attempts to reexamine our basic understanding of the relations between economic development and governance. Its main purpose is to i) cast light on the complicated realities which the mainstream arguments in the international community have failed to take into account, and ii) propose an alternative theoretical framework to overcome such shortcomings<sup>1</sup>.

## 1. Introduction: Governance matters

There is a consensus about the crucial role of good governance in achieving sustainable development.

World leaders have repeatedly asserted in their statements that good governance is an indispensable element for sustainable development, together with democracy and basic human rights. In 2001, the summit leaders of G8 announced in Genoa, “Open, democratic and accountable systems of governance, based on respect for human rights and the rule of law, are preconditions for sustainable development and robust growth”. They declared to help developing countries promote:

- accountability and transparency in the public sector
- legal frameworks and corporate governance regimes to fight corruption
- safeguards against the misappropriation of public funds and their diversion into non-productive uses
- access to legal systems for all citizens, independence of the judiciary, and legal provisions enabling private sector activity
- active involvement of civil society and Non Governmental Organisations (NGOs)
- freedom of economic activities.

Kofi-Annan, United Nations Secretary General also asserted “Good governance is perhaps the single most important factor in eradicating poverty and promoting development” (UNDP2002:51).

Similar assertion has been repeated by the international aid community.

In 1991, the Development Assistance Committee (DAC) of Organization for Economic

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<sup>1</sup> This was drafted based on my articles published in Yasutami Shimomura ed. The Role of Governance in Asia, Singapore, Institute of Southeast Asian Studies, 2003, with various addition and modifications.

Co-operation and Development (OECD) emphasized that the concept of “governance” has assumed a more central focus as an area of key attention by both bilateral and multilateral donors, and participatory development cannot be achieved without good government, which is composed of competence and honesty, public accountability, broader participation in discussion and decision-making on central issues (OECD1991:33 and 44). Lewis Preston, former President of the World Bank stated “good governance is an essential complement to sound economic policies ” (World Bank1992:v). And his successor James Wolfensohn regards “good and clean government” and “an effective legal and justice system ” as elements constituting basic prerequisites for sustainable growth and poverty alleviation in his proposed Comprehensive Development Framework.

While the postulate of strong relation between economic development and good governance is well accepted, it should be admitted that our knowledge of the detailed process of causality link: how good/bad governance leads to good/bad development performance is much limited.

In order to overcome the above-mentioned problem, this article attempts to examine how the mainstream approach has paid insufficient attention to some crucial aspects of the reality, and propose an alternative analytical framework . In our proposal, we will introduce a couple of hypotheses reflecting the reality more effectively, and stress the importance of accumulating large number of in -depth case studies on the relations between governance and development performance under specific country conditions . To illustrate how the proposed idea works, a recent case study will be shown.

## 2. The Mainstream Approach: A Critical Review

### 2-1. Definition of good governance

The definition of good governance is broad and vague. However, as the communiqué of the Genoa Summit suggests, the following issues have been frequently referred by the international community as basic components of good governance:

- a) Accountability, transparency, openness etc. in exercising power of government
- b) Rule of law, competent and credible judiciary, and predictable public conduct
- c) Sufficient institutional capacity of the public sector to ensure effective administrative behavior
- d) Corruption control

e) Control of excessive military spending

In addition to the above agenda, democracy has been repeatedly raised as an important element of good governance by many experts and institutions. OECD has claimed democracy is an indispensable part of good governance. UNDP stresses that good governance should be “democratic governance”, from the viewpoint of human development (UNDP2002:51). This position could be labeled as “broad” definition, in contrast to the position of the Bretton Woods institutions, i.e. the World Bank and IMF (Nelson and Eglinton1993:9). The World Bank and IMF have carefully avoided “explicit” commitment to political regime agenda, taking into account the legal framework of Bretton Woods system, which is based on “nonpolitical vision”. The position of the Bretton Woods institutions could be called as “narrow” one.

## 2-2. Conventional regression analysis

A wide variety of empirical studies have been done on the relations between good governance and development. When we review the huge stock of such empirical studies, we find that most of researches are based on regression analysis. While various valuable findings have been given, these researches have basically failed to show the insight into the specific and detailed process how the difference in governance influences development performance in a real world in which we actually live. Also their outcomes are rather mixed as shown below .

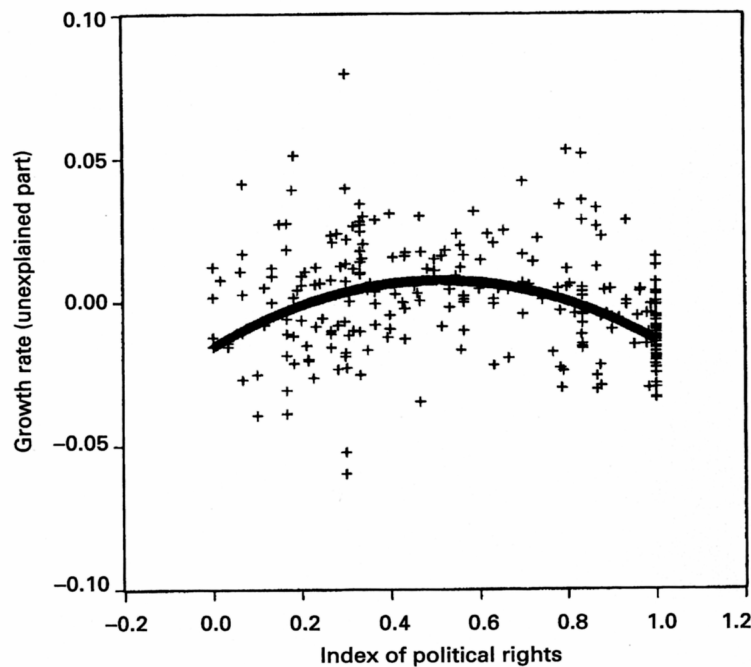
Let us see some examples. Robert Barro explored relations between the growth rate and democracy indicator (Barro1997:60, Figure 1). Kaufmann, Kraay, and Zoido -Lobaton illustrated positive relations between (i) voice and accountability and infant mortality, and (ii)rule of law index and per capita income (Kaufmann, Kraay, and Zoido -Lobaton 2000:12, Figure 2 and 3). In its Human Development Report 2002, UNDP showed there is no automatic link between (i) democracy score and equity, and (ii) democracy score and human development indicator (UNDP2002:60, Figure 4 and 5). According to Beatrice Weder, the proposition “property rights and the rule of law are important for development” were strongly supported econometrically, while there is only weak support of the proposition “high levels of corruption reduce growth”, in spite of widely accepted conviction that corruption damages development, and neither democracies nor autocracies are superior at generating higher growth (Weder1999:61 -62).

Conventional regression analysis of these literatures has basic shortcomings. Let us review two most notable aspects:

First, the adopted analytical tool is not necessarily suitable to the problem with complicated structures. A set of elegant and highly sophisticated econometric tools could be effective in treating “well-structured” problems, where the number of alternatives is limited, the policy goal can be clearly defined and the probabilities of outcomes of the adopted policy measures are predictable. However they often do not work properly when they are applied to highly complicated and “ill-structured” problem, where the abovementioned conditions are not found. The relation between governance and development is a typical ill-structured problem, as there are a wide variety of unknown perspectives. Under the circumstances, we should be cautious about the findings of regression analysis.

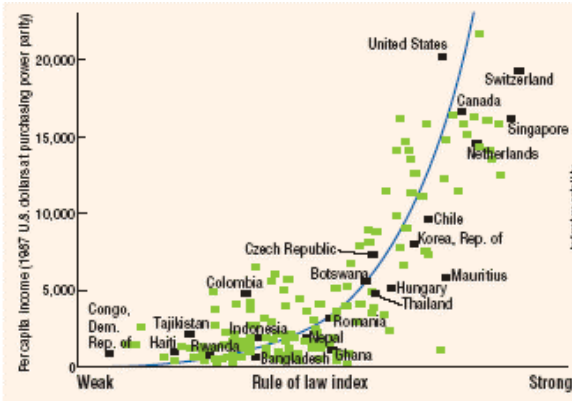
Second, the stage of development is not taken into account properly. In most cases, as is apparent in the analysis made by Kaufmann, Kraay, and Zoido-Lobaton (please refer to Figure 2 and 3), a group of advanced economies such as US, Sweden, and Singapore, are compared with Least Developed Countries (LLDC), such as Afghanistan, Sierra Leone, and Congo. As there are significant differences in socio-economic structures between these two groups, dealing with them in a single dimension is not advisable even though various measures are attempted for controlling the expected problems.

Figure 1



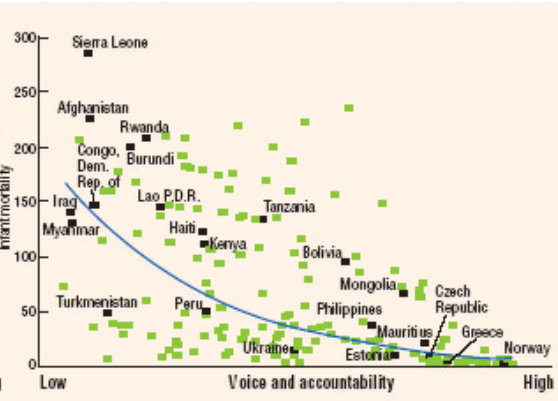
Source: Barro 1997

Figure 2



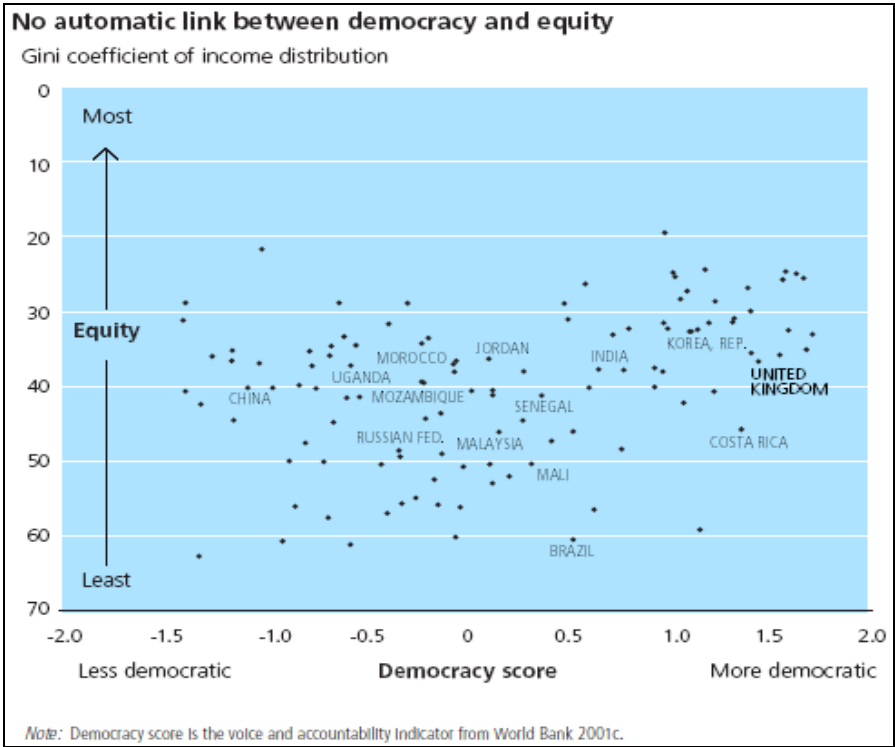
Source: Kaufman, Kraay, and Zoid -Lobaton 2000

Figure 3



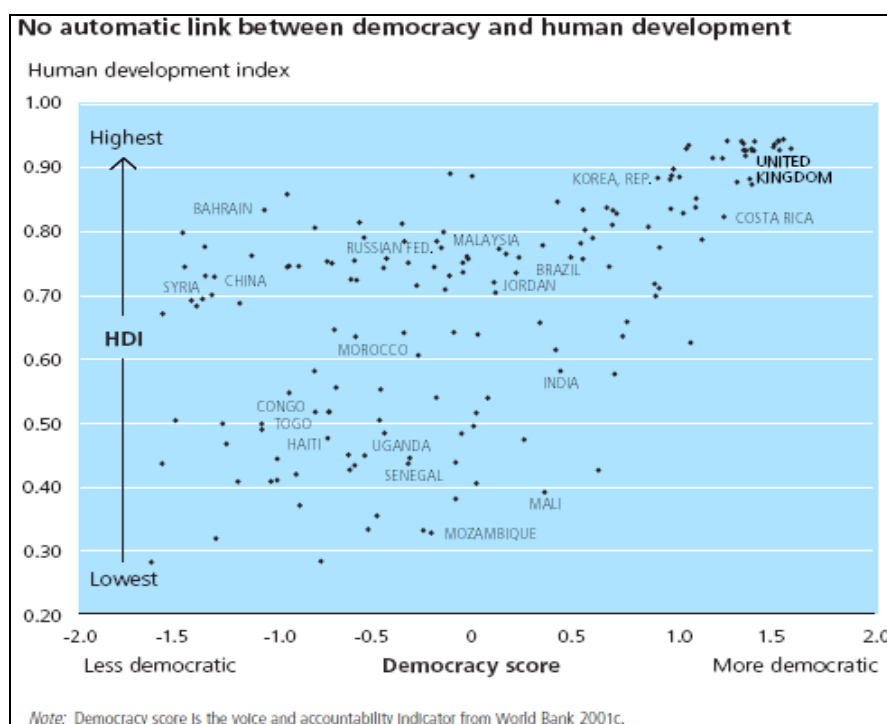
Source: same as Figure 2

Figure 4



Source: UNDP 2002

Figure 5



Source: UNDP 2002

2-3. Exceptional? Yes. Irrelevant? No.

The standard research on governance and development tends to highlight two types of countries: countries of good governance/performance on the one hand and countries with bad governance/performance on the other hand (Figure 6). It is argued that the contrast between them shows the worth of good governance. The clear contrast between Ghana and Zambia is often cited (refer to World Bank 1998 for example). However this is excessively simplistic, as a group of high performing developing economies are excluded. Put it differently, the standard approach does not pay due attention to a group of countries with excellent development performance and disappointing governance indicators (case 1 in Figure 6). This group includes East Asian economies such as Thailand, Indonesia, China, and Vietnam. An OECD report once proposed governance indicators of ASEAN economies in 1980-83. While the figures were lower in comparison with some South Asian and African counterparts (Table 1), it should be noted that in those days ASEAN countries prepared for the high speed export-led growth of the late 1980s.

There is a recent similar case. Indicators of China and Vietnam in 2000-01 are not better than selected South Asian and African countries (Table 2).

Figure 6

Mainstream Case High development performance with good governance	Case 1 High development performance with deficiency in governance
Case 2 Disappointing development performance with good governance	Mainstream Case Disappointing development performance with deficiency in governance

Table 1

Governance indices and Freedom Scores in early 1980s:  
East Asia, South Asia, and Africa

	(1)* corruption	(2)* red tape	(3)* legal system	(4)* governance average of (1)-(3)	(5)** freedom scores
East Asia					
Indonesia	1.5	2.75	2.5	2.25	5.5
Malaysia	6	6	9	7	3.4
Philippines	4.5	5	4.75	4.75	5.4
Thailand	1.5	3.25	3.25	2.67	3.4
South Asia					
Bangladesh	4	4	6	4.67	5.5
India	5.25	3.25	8	5.5	2.3
Pakistan	4	4	5	4.33	7.5
Sri Lanka	7	6	7	6.67	2.3
Africa					
Cameroon	7	6	7	6.67	6.6
Ivory Coast	6	7.75	6.5	6.75	5.5
Zimbabwe	8.75	7.75	7.5	8	3.5
Ghana	3.66	2.33	4.66	3.55	6.5
Kenya	4.5	5	5.75	5.08	5.5

\*1980-1983(the higher the better) 、 \*\*1982-83(the lower the freer)

Source: (1)-(4) Bardhan, P. The Role of Governance in Economic Development , Paris, Organisation for Economic Co -operation and Development, 1997, (5) Freedom House, Freedom in the World Country Ratings 1972 -73 to 2001-2002

Table 2  
Governance Indicators in 2000-01:  
East Asia, South Asia, and Africa

	democracy	rule of law	government effectiveness	Corruption
East Asia				
China	-7	-0.19	0.14	3.5
Vietnam	-7	-0.57	-0.3	2.6
South Asia				
Bangladesh	6	-0.76	-0.54	0.4
India	9	0.23	-0.17	2.7
Pakistan	-6	-0.74	-0.48	2.3
Sri Lanka	5	-0.31	-0.44	n.a.
Africa				
Botswana	9	0.68	0.83	6
Ghana	2	-0.08	-0.06	3.4
Kenya	-2	-1.21	-0.76	2
Tanzania	2	0.16	-0.43	2.2

\*the higher the better

Source: UNDP, Human Development Report 2002

While these phenomena may puzzle the people who rely on the standard theory of governance and development, it should be admitted that these constitute the reality. Theoretically there are three possible ways to explain why these economies have achieved sustained development in spite of disappointing governance indices. First, the existing proposition of strong relation between governance and development might not be universal as granted. Second, standard governance indices might be biased. Third, governance elements which are not included in the standard governance indices might contribute to development. Although the first two issues are important, this article focuses the attention on the third aspect.



### 3. Alternative Approach: Proposal of Two Realistic Hypotheses

This paper proposes two hypotheses on the role of governance in development. The purpose is to reflect the reality more effectively.

3-1. First hypothesis: meeting a limited number of “strategic” good governance elements is crucial

Developing economies are strongly urged to improve governance. What is not clear is how far they are to improve governance. Is it vital for them to attain most of the governance requirements? Is it a realistic mission?

According to our observation, the mainstream approach literatures have an implicit assumption that high development performers show better governance in general. The reality is however more complicated. When we compare East Asia and Sub Saharan Africa, the picture is not simple. In Table 1 and 2, East Asian countries do not show any distinct superiority in governance over selected African economies, according to the ratings by the international community, although the development performance between two groups is decisive.

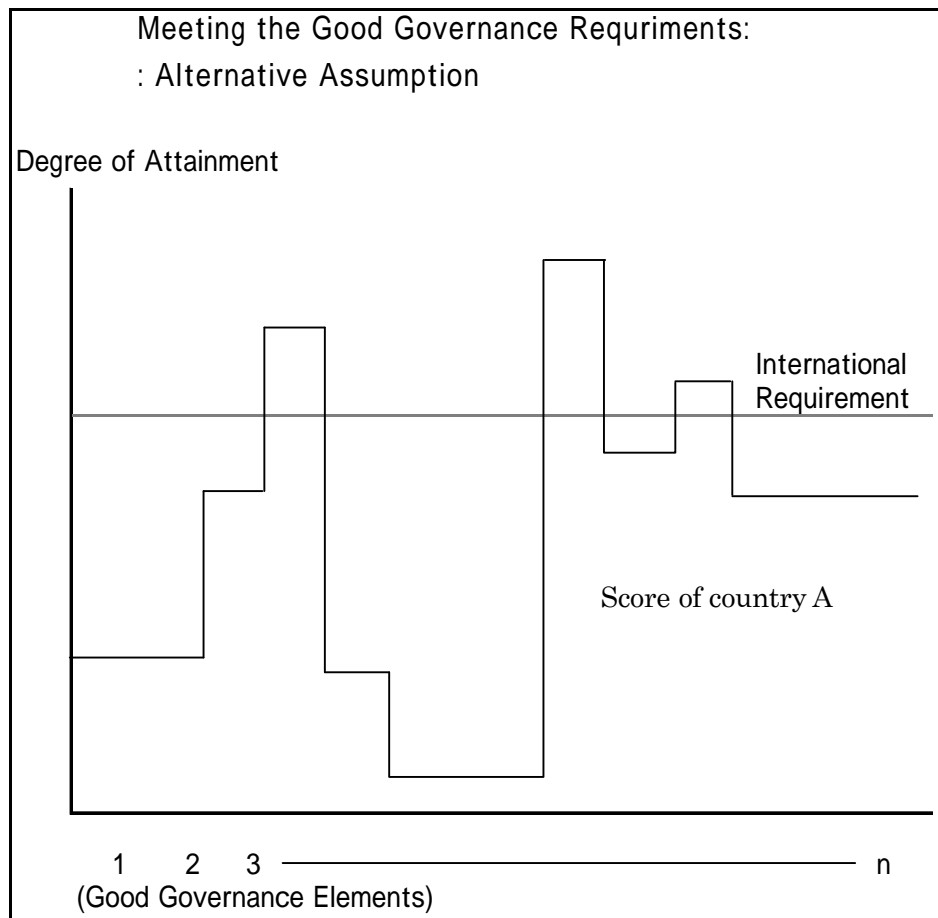
To work out this puzzle, we need more realistic hypothesis. Even without meeting most of governance requirements, meeting limited number of “strategic elements of governance” may ensure sustained development. Figure 7 illustrates this. Suppose there are “n” elements of good governance; regarding each element certain degree of attainment is required by the international community. Suppose a country, which shows high development performance, meets only three requirements. According to our assumption, some of the attained elements ensure high development performance.

Let us review the communiqué of the Genoa summit. It proposed a long list of desirable governance conditions. Apparently, meeting these goals is desirable. However, meeting some crucial or strategic ones may be enough to lead to sustained development.

Under this assumption, we need to identify the strategic elements of governance in individual developing country. The components of strategic elements are supposed to differ from one country to another, and in accordance with development stages. The higher the development stages, the more sophisticated requirements. When Thailand tried to launch sustained growth in the late 1950s, the strategic elements for them could be much simpler than those for the Thai economy to maintain their position of emerging market in the late 1990s.

Understanding strategic elements of good governance is not an easy task. Our proposal is to accumulate case studies of various countries to gain clues to these elements.

Figure 7



3-2. Second hypothesis: endogenous elements of good governance which are embedded in socio-cultural structures of developing societies can play important roles

Investors, aid officials, and NGO staffs share a common view that getting things done in East Asia is much easier than Sub Saharan Africa. However, various governance indices do not necessarily show clear differences in these two regions, as we already saw in Table 1 and 2. This situation suggests that the standard set of good governance does not work effectively, as far as these two regions are concerned.

This situation also hints that governance elements which are not included in the standard list may play important roles in development. Exploring such possibility could cast light on new aspects of relations between governance and development, and lead to better understanding of the role of governance.

In every community, we find various endogenous factors have governed the manner of

decision making explicitly or implicitly. It is necessary therefore to pay due attention to informal institution including social capital, which is embedded in specific historical and cultural background of a society. While such elements do not appear explicitly in the standard list of good governance, they may play critical roles in getting things done effectively.

### 3-3. Accumulation of in depth case studies

How to identify then the abovementioned strategic and embedded/endogenous elements of good governance? Our proposal is to accumulate case studies of specific policy agenda in specific countries of specific period. Such studies would provide vivid and realistic pictures of the role of governance in the improvement or deterioration of development performance. Policy implications drawn from accumulated findings are crucial for supplementing the mainstream approach.

In accordance with this viewpoint, various case studies on governance in East Asia have been launched. One recent result is a book titled *The Role of Governance in Asia* (Shimomura 2003), which is based on the group works of twelve scholars<sup>2</sup>, five from ASEAN countries and seven from Japan.

Researches have been made on a wide variety of governance issues in ASEAN countries: macroeconomic crisis management, decentralization, aid management of mega project, and corporate governance of local business groups etc. It was reconfirmed that governance issue is really broad and complicated. For example, the attempts of decentralization in pursuit of governance reform lead to a wide variety of outcomes, positive or negative, depending on the local conditions. Another research shows that the fall of an authoritarian regime creates a power vacuum, from where mushrooming governance problems with new rules of the game and different structures evolve.

To illustrate an endeavor of exploring strategic and/or endogenous good governance elements, this article introduces a case of Thailand in the mid 1980s, when the country was struggling to build export capacity. It was presented at a workshop, which was held for the book of *The Role of Governance in Asia*.

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<sup>2</sup> Junichi Inada (Japan), Ikuo Iwasaki (Japan), Kyoko Kuwajima (Japan), Tommy Legowo (Indonesia), Zainal-Abidin Mahini (Malaysia), Pitch Pongsawat (Thailand), Yuri Sato (Japan), Yasutami Shimomura (Japan), Hideaki Shiroyama (Japan), Sudarno Sumarto (Indonesia), Jorge Tigno (Philippines), and Matsuo Watanabe (Japan)

## Case for the Eastern Seaboard Development Plan of Thailand

### 1. Profile of the case

This is the case of a developing country, which tackled two difficult tasks at the same time: macroeconomic crisis management and export capacity building. This country, pursued its own solution, often without conformity to the recommendations made by two influential donors, i.e. the World Bank and the Japanese government. According to our analysis, the country made worthy achievements in this difficult task.

This is the case of a developing country, whose governance rating was relatively low in those days. For strengthening export capacity, this country attempted the construction of gigantic industrial complexes; the task is often accompanied by corruption. They got the task done without any notable scandal.

In this case, a developing country tackled a mission, which required high degree of governance, while the country was given only mediocre governance rating by the international community. They accomplished the mission successfully. We assume this case hints the important roles of a limited number of governance elements, possibly embedded in the specific socio-cultural structure. The exploration of such elements may lead to some new aspects of the link between governance and development.

This is the reason why the case is adopted.

### 2. Thailand in the early 1980s

This is a case of Thailand in the 1980s. This case illustrates how Thailand made remarkable achievements in the attempt of pursuing two policy goals, which were incompatible to a large extent, through its ownership.

The Thai economy was faced with a serious situation throughout the first half of the 1980s. While the Thai economy had shown persistent growth for long time since the late 1950s, it suffered from macroeconomic imbalances under unfavorable international environment (two oil shocks, stagflation in developed economies, sharp rise in international interest rate, and the slump of primary goods prices in international market) in early 1980s.

As Table 3 shows, investment saving gap was between 5 and 6%, fiscal deficit was

around 4-5% of GDP. In 1983, current account deficit reached 7.2% of GDP. The largest concern was rising debt service ratio (from 17% in 1980 to 26% in 1985). It was afraid Thailand could be “another Philippines”.

In the attempt of overcoming the difficulties, the Thai government received the World Bank’s Structural Adjustment Loan in June 1983 and adopted austerity measures. They also introduced currency depreciation in 1981 and 1984. While Thailand was highly evaluated afterwards as one of five “top performers” of structural adjustment by the World Bank (World Bank 1990: 20), pessimistic views were dominant in the mid 1980s. Under the gloomy perspective, the Thai government diminished the size of external borrowing from 1.6 billion dollars in 1984 to 1 billion dollars in 1985.

Table 3  
Macroeconomic indicators of Thailand in early 1980s

(%)

	1 9 8 0	1 9 8 1	1 9 8 2	1 9 8 3	1 9 8 4	1 9 8 5
Economic growth rate	5.8	6.3	4.1	5.8	6.2	4.0
S-I gap	-4.2	-4.1	-2.1	-5.0	-5.8	-4.8
Fiscal deficit/GDP	n.a.	3.2	5.8	4.1	3.8	5.1
Current account deficit/GDP	6.2	7.1	2.7	7.2	5.0	4.0
Export growth rate	23.2	7.0	-1.0	-7.7	16.3	-4.4
Terms of trade	100	87	79	85	84	77
Debt service ratio	17.3	17.4	18.9	22.9	24.8	26.1
Change in Consumer price	19.7	12.7	5.2	3.8	0.9	3.3 (Jan-Sep)

Source: World Bank (1986)

Note: 1985 figures are provisional

### 3. The Eastern Seaboard Development Plan

The case of the Eastern Seaboard Development Plan was adopted in this paper because of its scale, complexity, and the difficulty of execution under the macroeconomic crisis.

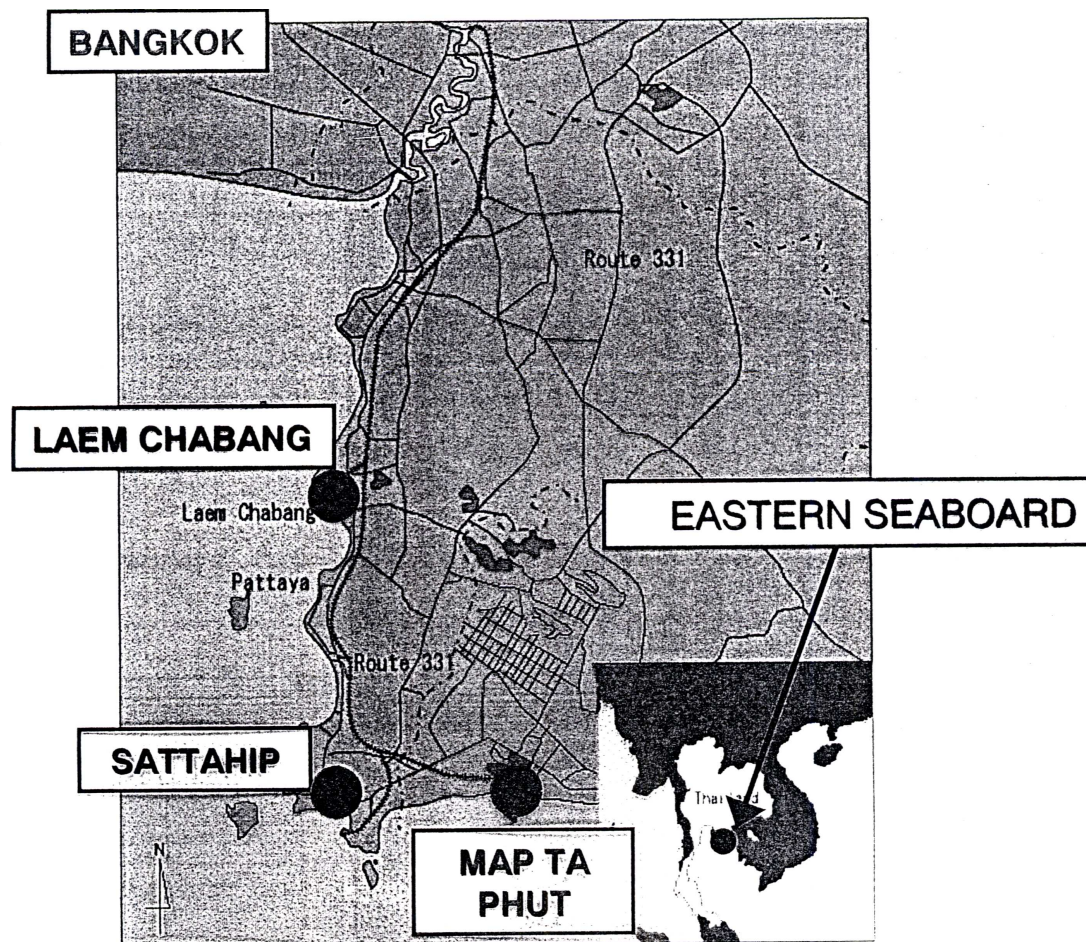
#### 3-1. The mission of the plan

The Eastern Seaboard Development Plan was a regional development plan, being located in the southeast of Bangkok (Figure 8). It was composed of two industrial complexes and a wide variety of infrastructures including two deep seaports. The Laem Chabang was an industrial complex for export oriented and labor intensive industries and the Map Ta Put was basically a heavy and chemical industrial complex based on natural gas reserves in the Gulf of Thailand. The basic idea of the plan was formulated in the late 1970s, and a master plan was completed in 1982.

The task of the plan was to tackle two basic problems for the Thai economy. First, one of the central agenda for the Fourth and Fifth Five Year Plan, 1977 -81 and 1982-86 respectively, was to transform the industrial structure and the composition of leading export goods from agriculture to manufacturing. This had been a long standing issue, but became acute under the collapse of primary goods prices in international commodity market after two oil crises. Being faced with a sharp decline in terms of trade, the Thai government accelerated export oriented industries promotion and utilization of domestic energy resources, in the attempt of saving foreign reserves and improving international balance of payment. Owing to the evolution of labor intensive light industries (garment, apparel, accessories, sport shoes, travel kit etc.), the share of industry in GDP surpassed that of agriculture, and the share of primary goods (rice, maize, tapioca, rubber, tin etc.) in the whole export persistently declined from two third in 1970 to half in 1980 and further to one third in 1985. The Thai government was keen to further accelerate this tendency.

Second, improving the living standard in rural areas was a central issue, since the Third Five Year Plan (1972-76). In this regard, the Thai government was concerned in the concentration of business activities into the Bangkok Metropolitan area, as it caused widening regional discrepancy and environmental eradication such as traffic jam, air and water pollution. The discovery of natural gas reserves in the Gulf of Thailand in 1973 led to the idea to construct industrial complexes in the Eastern Seaboard for achieving decentralization of industrial production and improvement of living standard in rural area.

Figure 8



### 3-2. The evolution of the plan

In December 1980, a committee was established under the chairmanship of General Prem Tinsulanonda, who became the prime minister in March 1980 ; this committee was reorganized to the Eastern Seaboard Development Committee, ESDC) in June 1981. In March 1981, a report outlining the industrialization strategy in the region (Anat Report) was submitted to the committee. The Eastern Seaboard Development Plan was adopted in the Fifth Five Year Plan (1982 -86) in October 1981.

Before the launch of the Eastern Seaboard Development Plan, in the late 1970s, the Thai government requested the World Bank to finance the plan. The World Bank financed the master plan of Coopers & Lybrand Associates jointly with the British government. However, when the result was submitted to the Thai government in July 1982, the World Bank recommended utilization of existing Sattahip Port (Figure 8), which is a naval port near the proposed location of Map Ta Phut deep sea port, taking into consideration the heavy fiscal burden. According to the master plan, the estimated

total investment amount was 4.5 billion dollars (1981 year price).

On the other hand, the Japanese government, the largest donor in Thailand, was very active in their support to the plan. At his visit to Thailand, Prime Minister Zenko Suzuki expressed his willingness to support the plan in January 1981, and in May of that year, Dr. Saburo Okita, former foreign minister, who visited as the leader of a government mission, initiated the discussion on technical and financial assistance to the Eastern Seaboard Development Plan. Based on the Okita's recommendation, JICA (Japan International Cooperation Agency) of Japanese Government started the feasibility study of Map Ta Pud deep sea port, which was faced with various technical problems, such as strong wave and silting up.

In November 1982, the National Fertilizer Corporation Limited (NFC) was established, with the equity investment by the International Finance Corporation (IFC) of the World Bank group. The purpose was to construct an integrated fertilizer complex, located near Rayong on the eastern Seaboard, based on the natural gas supplies from the Gulf of Thailand. The Japanese government assured financial assistance to the NFC. In October 1985, the Thai government signed loan agreements with the Overseas Economic Cooperation Fund of Japan (OECF) on the construction of major projects, such as Laem Chabang Industrial Complex, Map Ta Put Port, and Map Ta Put Industrial Complex.

#### 4. The crossroads

##### 4-1. Setback of the plan

On November 13, 1985, the cabinet approved a surprise resolution to freeze all the Eastern Seaboard Development Plan for 45 days, and assigned three ministers to review the whole program. According to the Nation, a Thai newspaper, this was strongly recommended by Dr. Snoh Unakl, who was Secretary General of the National Economic and Social Development Board, and one of the most prominent economists in those days, in his note to Prime Minister dated November 1, 1985 (The Nation, November 21, 1985). It was reported that he wrote this letter having been shocked by a Ministry of Finance report on the serious prospects of external debt, and stressed the urgent need for regaining fiscal and monetary stability through tight belt policy (The Nation, November 22, 1985).

This movement was called "coup by conservative group", who had tried hard to slow down the implementation of big projects from the viewpoint of fiscal discipline. In order



to understand further the background, we already analyzed the macroeconomic situation in those days.

The committee in charge of reviewing the Eastern Seaboard Development Plan was composed of three ministers. Suli Mahasandana, Minister attached to the Prime Minister's Office, was Prime Minister Prem's right hand man and main trouble shooter. He was a classmate of Prem around fifty years ago at a middle school for the sons of lower ranking public servants (Warren 1997:25 -38); Prem's father was a junior prison officer in Songkla, southern Thailand. Meechai Ruchupan, another Minister attached to the Prime Minister's Office, was a lawyer and Suthee Singhasaneh, Deputy Finance Minister was an economic technocrat, who had been the head of the Budget Department of the Prime Minister's Office.

#### 4-2. World Bank factor

While the committee was beginning the works, it was revealed by Bangkok based newspapers that the World Bank Bangkok Office had been behind Dr. Snoh, when he took initiatives of reviewing. According to the Nation, Mr. Quill Hermans, Chief of the World Bank Regional Mission in Bangkok, sent a letter dated November 6, 1985 to Dr. Snoh. In that letter, Mr. Hermans suggested the Thai government to eliminate two deep sea port projects (Map Ta Put and Laem Chabang) from the sixth development plan (1986-90), and use Sattahip and Klong Toey (Bangkok) ports as alternatives, in the attempt of saving fiscal expenditures (The Nation, November 28 and December 2, 1985). The essential features of this proposal was repeated in a more moderate manner in Chapter 6 of World Bank's Country Economic Report, which was published around 7 months later (World Bank 1986: 132 -138).

The World Bank report of 1986 claimed "the combined economic rate of return of the (NFC) fertilizer plant and the port (as presently envisaged) is expected to be very low". As the World Bank took the position that the feasibility of NFC fertilizer plant was acceptable (World Bank 1986:136), it meant that the return of two port projects were regarded very low.

## 5. Aftermath of the review

### 5-1. The Christmas eve cabinet decision

The Thai cabinet approved the report of the three minister committee on December 24, 1985. According the press release, the main points were as follows:

a) The implementation of National Fertilizer Project and Map Ta Put Port were approved. While there was no specific condition for NFC, it was stipulated that the implementation of Map Ta Put should be committed only after the signing of loan agreement on NFC with the Japanese government (NFC was to be constructed in Map Ta Put Industrial Complex).

b) The implementation of other projects including Laem Chabang Port was postponed on the reason “conducting the implementation at this moment is not appropriate”.

It was made clear that the basic structure of the Eastern Seaboard Development Plan was to be maintained. In other words, the World Bank’s proposal to substitute the two deep sea port by existing ports was turned down. However, when we study the press release carefully, it was clear that the implementation of the whole plan was completely postponed. To recognize the intention of the cabinet, we should analyze the following points: “Why NFC, which was the most controversial project in the whole plan, was approved without any condition, while the implementation of Laem Chabang Port, which was quite promising because of its export oriented feature, was postponed?”

In those days, there was a broad consensus in Bangkok that the economic and political feasibility of NFC was the lowest among the whole projects; we will go back to this point afterwards. To introduce a linkage between NFC and Map Ta Put Port was to halt the implementation of the latter. On the other hand, the cabinet did not claim any major shortcomings of Laem Chabang Port, and simply declared the postponement without specific reason. Obviously, postponing the whole plan was the central message of the cabinet decision.

### 5-2. Aftermath of the decision

Here we will review the fate of three major components of the Eastern Seaboard Development Plan after the cabinet decision of December 1985.

#### 5-2-1. Laem Chabang port and industrial complex

The Plaza Accord of September 1985 caused dramatic appreciation of yen and fundamental changes in the fate of Laem Chabang.

As shown in Table 4, the value of yen versus US dollar, which was 249 yen per dollar at

the end of June 1985, rose to 154 yen at the end of September 1986. Under the circumstance, Japanese manufacturers began to look for alternative plant sites in abroad, and they found Thailand and Malaysia were most suitable among developing countries. The tidal wave of direct investment from Japan became visible toward the end of 1986, when The Board of Investment of Thailand announced that the direct investment from Japan in the first half increased by around 50% ( JETRO Daily, February 7, 1989). Being stimulated by this movement, the investors of Taiwan, Hong Kong, and Korea also began to sharply increase their direct investment to Thailand. Most of direct investment from East Asia was export oriented and basically labor intensive.

As a result of big wave of direct investment, a lot of new factories were constructed, and inevitably caused serious bottlenecks in infrastructure, such as port facilities, road, power, telecommunication, and industrial estate. The shortage of port facilities at Klong Toey (Bangkok) was particularly apparent. The volume of containers handled at Klong Toey increased by 20% annually in 1986 and after, and exceeded the port capacity in 1988 (JETRO Daily, July 23, 1988).

Being faced with serious bottlenecks, the cabinet instructed the Eastern Seaboard Development Committee to resume Laem Chabang Port project on the 15<sup>th</sup> of October, 1986 (The Nation, October 16, 1986).

Table 4  
Exchange rate changes after the plaza Accord

		Yen per US dollar	Baht per US dollar	Yen per baht
1985	June	249.0	25.6	9.1
	September	217.0	27.4	8.3
	December	200.5	26.3	7.5
1986	March	179.6	26.7	6.8
	June	165.0	26.5	5.9
	September	153.6	26.3	5.9
	December	159.1	26.1	6.1
1987	March	145.8	26.1	5.6
	June	147.0	25.9	5.7
	September	146.4	25.8	5.7
	December	123.5	25.1	4.9

Source: IMF International Financial Statistics, various issues

### 5-2-2. Map Ta Put port and industrial complex

In comparison with Laem Chabang, the progress at Map Ta Put was not remarkable, mainly because Thai leaders linked this port with NFC, while NFC suffered from various difficulties. In September 1986, Dr. Snoh of NESDB told Dr. Okita, leader of Japanese government delegation that the necessity of Map Ta Put fully depended on the progress of NFC (The Nation, September 19, 1986).

However, in February 1987, Dr. Savit Phothivihok, who was the Secretary General of the Eastern Seaboard Development Committee and architect of implementation, announced the resumption of international bidding of Map Ta Put Industrial Estate on the reason that the construction of National Petrochemical Corporation (NPC) was in progress (The Nation, February 28, 1987).

This announcement could be a symptom of evolving changes. Finally in January 1988, after three years of the cabinet decision, the government officially cancelled the freezing of Map Ta Put Port and Industrial Complex; these projects completely revived.

### 5-2-3. National Fertilizer Corporation (NFC)

In the meantime, the NFC fertilizer project had been the subject of much controversy. While its background was highly complicated and sensitive, the following two elements were particularly crucial.

First, most of leading figures of Thai private sector were reluctant to cooperate, although Thai private sector was expected to own more than 30% of total share amount. It is to be noted that the Bangkok Bank group, the largest business conglomerate in Thailand in those days, had a subsidiary company dominating the business of imported fertilizer distribution. In other words, the NFC could threaten the rent of Bangkok Bank group<sup>3</sup>.

Second and more importantly, the prospect of the return on equity (ROE) or investment (ROI) was quite uncertain. From the beginning, it was recognized that the profitability was highly sensitive to volatile fertilizer prices (IFC1986:11-12). In addition, the sharp yen appreciation after the Plaza Accord damaged the project, because an international bidding had been already made in July 1984, and the bid amounts of two successful Japanese bidders, were stated in yen. It is to be noted that baht remarkably depreciated against yen (Table 4), because of de facto pegging to US dollars; baht was officially pegged to currency basket in those days.

The retirement of Finance Minister Sommai Hoontarakool, who had tried hard to

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<sup>3</sup> Interview with Dr. Ammar Siamwalla of Thai Development Research Institute of November 10, 1998. Also Nihon Keizai Shinbun, September 8, 1987

realize the NFC project, turned the tide<sup>4</sup>. The Eastern Seaboard Development Committee announced that the NFC is not the issue of the government but the private sector (The Nation, October 16, 1986). In other words, the government washed their hands of the NFC business.

In spite of persistent support by the World Bank and the Japanese government, the NFC project was postponed for long time, and faded away.

## 6. Assessment of the position of three major players: Thai government, World Bank, and Japanese government

In this section, we will assess the decision made by the Thai government, in comparison with the position of the World Bank and the Japanese government. The purpose is to cast light on the institutional capacity of the Thai government in those days.

### 6-1. The structure of the problem

Figure 9 illustrates the essential features of the problem the Thai government was faced with in the mid 1980s. The government had to make decision whether (i) to drastically cut the budget for the plan or (ii) to implement the plan in accordance with the original schedule.

We should pay due attention to the fact that the prospects of the external environment were highly uncertain in those days. Like other developing countries, Thailand was severely hit by deteriorating terms of trade, declining export volume due to stagflation in developed economies, and rising interest rates in international capital market. In 1985 particularly, Thailand experienced a huge balance of payment deficit equivalent to 17% of GDP. In view of this disappointment, it was understandable that most of Thai policymakers and businessmen were pessimistic, and the World Bank was also very cautious (World Bank 1986: Chapter 2).

Theoretically there were two possibilities regarding external environment. In the case of adverse environment, huge fiscal expenditure could lead to unsustainable fiscal and external conditions. Drastic postponement of the Eastern Seaboard Development Plan could be the answer to cope with such risk. On the other hand, in the scenario of improving external environment, the conservative fiscal policy could worsen the infrastructure bottlenecks and undermine investors' confidence. Constructing modern

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<sup>4</sup> Interview with Mr. Manas Leevirapan, former Director, Fiscal Policy Office, Finance Ministry, of November 10, 1998

industrial complexes with deep sea ports and strengthening the competitiveness of Thai economy could be the answer to overcome such problems.

Reflecting its cautious view on the prospects of Thai economy, the World Bank recommended eliminating two ports from the budget. On the other hand, the Japanese government stressed the importance of enhancing competitiveness from long term viewpoint, and recommended the implementation of the Eastern Seaboard Development Plan. There were a lot of disputes in Thailand too.

Figure 9  
CHOICES THE THAI GOVERNMENT FACED IN 1985

	Economic stagnation (Probability?)	Recovery of growth (Probability?)
Execute ESDP as planned (Alternative 1)	Increase in fiscal burden and external borrowings (the second Philippines)	Realization of internationally competitive industrial area Increase in FDI Modernization of economic structure
Postponed the implementation of ESDP (Alternative 2)	Reduction in fiscal burden and external borrowings	Deteriorating bottleneck of infrastructure Deterioration of living, and environmental conditions in Bangkok Deterioration of investment environment

## 6-2. National Fertilizer Corporation

There was a distinction between the Thai government and main donors, i.e. the World Bank and the Japanese government on the NFC issue. As we saw, the project was never realized despite the commitment of equity investment (12% of total share capital) by the International Finance Corporation (IFC) of the World Bank group, and Japanese government's financial assistance through Yen Loan by the Overseas Economic Cooperation Fund (OECF).

In order to assess the decision by the Thai government, a counterfactual analysis of the rate of return on this controversial project was made in accordance with the assumption of the feasibility study: green light in October 1986, starting construction in 1987, commercial production in 1991. The profitability of this fertilizer plant depended on two external factors i.e. exchange rate and world fertilizer prices. Table 5 shows the results of simulation using the actual figures of the exchange rate, and international price of

urea fertilizer (see Table 5).

If the government had given green light in October 1986, the NFC would suffer negative rate of return on investment (ROI), due to yen appreciation and volatile fertilizer price. Although it is to be admitted that this simulation is based on various conditions, what this result suggests is low profitability of the NFC project. In other words, the position of the Thai government was more advisable than that of the World Bank and the Japanese government.

Table 5  
Simulation on the profitability of NFC

(million US dollars)

	Revenue	Profit before tax	New investment	Investment after depreciation
1987			15.8	
1988			202.3	
1989			410.0	
1990			154.8	
1991	170.6	-33.2	42.5	787.9
1992	183.6	-33.4		750.4
1993	162.7	-676.6		712.9
1994	263.6	36.0		675.4
1995	316.3	91.4		637.9
1996	265.9	43.6		600.4
1997	149.0	-70.6		675.4

Profit before tax (average): -4.8

Investment after depreciation (average): 675.4

POI =  $(-4.8/675.4) \times 100 = -0.71\%$

Note: start of construction: 1987

start of commercial production: 1991

based on all the assumption of F/S except exchange rate and fertilizer price

### 6-3. Construction of two ports

#### 6-3-1. Laem Chabang

It was already confirmed that Thailand heavily suffered from shortage of port facilities in the late 1980s, especially in the Bangkok Metropolitan area. It is apparent, therefore, that if the World Bank's suggestion to utilize Klong Toey instead of Laem Chabang had been adopted, the results could be far more disastrous. However one could argue that this was simply due to the Plaza Accord and following high wave of foreign investment, which was unpredictable and occurred by chance. As a matter of fact, necessity of a new port was recognized that even before the effects of the Plaza Accord became visible.

The volume of containers handling at the Klong Toey increased persistently with the rate of 16-17% annually during the first half of the 1980s, in spite of stagnant economic situation. A think tank report forecasted that even under conservative assumption of 12% growth rate, the Klong Toey port could suffer from shortage of container yard capacity (Far Eastern Economic Review, October 30, 1986). It is to be stressed that this forecasting was made in 1985, under the highly pessimistic prospect of the Thai economy. Taking into account the structural deficiency of the Klong Toey as a river port (lack of space and limit of depth due to siltation) the Laem Chabang port was indispensable even without Plaza Accord effects.

#### 6-3-2. Map Ta Put

The central issue of dispute between the World Bank and the Thai government was whether the Sattahip port could take over the function of the Map Ta Put. Utilizing Sattahip as an alternative does not seem a feasible idea, when we consider the fundamental feature of Sattahip. As it is a naval base, the access is limited and there was not enough space for widening the route connecting it with petrochemical plants to be located around the Map Ta Put area, such as National Petrochemical Corporation (NPC) and Thai Petrochemical Industry (TPE). Accordingly there was a broad consensus in Bangkok that Sattahip could not be a realistic alternative from technical viewpoint<sup>5</sup>.

Due to acceleration of economic growth (in 1986:9.5%, in 1987:13.3%) and sharp increase in foreign direct investment, the number of plants operating at the Map Ta Put industrial estate increased from 14 in 1991 to 48 in 1998; most of them were petrochemical plants. In addition, many companies have constructed plants in private

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<sup>5</sup> Interview with Mr. Paisal Sricharatchanya, editor of the Bangkok Post of November 4, 1998, and also Paisal Sricharatchaya "At last beginning, Bangkok finally commits to ESB Projects", Far Eastern Economic Review, October 30, 1986



industrial estates in Map Ta Put area. While the World Bank claimed “the needs of the fertilizer plant are the major justification for the port ” (World Bank 1986:137), there have been much wider needs for industrial estate in this region. This implies the concept of “general cargo port” envisaged by the Thai government was more realistic than the World Bank’s “port for the NFC fertilizer plant ” concept. Our conclusion is that the position taken by the Thai government was more supportable than that of the World Bank.

### 6-3-3. Balance sheet of postponement

Advocates of postponement of the Eastern Seaboard Development Plan emphasized the merit of diminishing fiscal deficit and external debt. However, the scale of these effects was exaggerated.

The World Bank (World Bank 1986:135) claimed that the planned budget appropriation for Laem Chabang and Map Ta Put was 15.1 billion baht in total, in the fiscal years of 1987 and 1988, equal to 7-8% of whole public investment and 20% of external borrowing. Eliminating this fiscal expenditure could contribute to fiscal reconstruction, according to the World Bank. However, this argument did not reflect properly the actual magnitude of public expenditure.

As most of this amount was financed through ODA loans, actual expenditure by the Thai government could be minimized. Also, the effect on the capital account was to emerge ten years later only when principal repayment would begin after grace period. The arguments in those days were not made on the real budget expenditures. As a matter of fact, fiscal deficit turned into big surplus and the debt service ratio dramatically declined during the late 1980s (Table 6).

Table 6  
Trends of fiscal balance and debt indicator

		(%)
	fiscal balance/GDP	debt service/export
1986	- 4.2	25.4
1987	- 2.2	17.1
1988	0.7	13.7
1989	2.9	1.4
1990	4.6	9.8

Source: Economic Planning Agency of Japan, Warr, P. and Bhanupong N. (1996) Thailand’s Macroeconomic Miracle Stable Adjustment and Sustained Growth, Kuala Lumpur, Oxford University Press

On the other hand, the postponement was accompanied by huge costs of infrastructure bottlenecks, which could be reduced if Laem Cahabang port had been completed in 1990 according to the original schedule; the actual completion was at the end of 1991. Overloaded Klong Toey together with serious road congestion in the Bangkok Metropolitan area, and sky-rocketing real estate prices could be reduced by the introduction of Laem Chabang facilities in time.

When this balance sheet is reviewed, the costs of postponement apparently exceeded its benefit. From this viewpoint it is difficult to support the position of the Thai government.

However, we should take into consideration that the economic prospect in the mid 1980s was very uncertain, as was already reviewed. In other words, the decision maker, Prime Minister Prem, was not able to have sufficient information of probability distribution between two cases: adverse or improving. This was also a highly sensitive political issue, because of bitter disputes among policy makers, economists, businessmen, and major donors. Under the circumstances, it was advisable as well as realistic for him to adopt minimax regret criteria: minimizing the cost of the worst case. The result was (i) maintaining the fundamental structure of the whole blue print, (ii) postponing the implementation, and (iii) flexible change of course in response to the change in environment. This was a course between the positions of the World Bank and the Japanese government.

## 7. Conclusion and policy implication

In the mid 1980s, the Thai government was faced with two central policy agenda: coping with macroeconomic imbalance and acquiring sufficient export capacity. They tried to construct two modern deep seaports with industrial estates as the core elements of export capacity building, under the severe fiscal constraint. We found that the Thai government showed good performance in tackling these twin policy agenda simultaneously in a flexible and realistic manner. At least, the path they chose appears better than the recommendations by two influential donors, i.e. the World Bank and the Japanese government. It is to be noted that this was achieved by a developing country with poor scores of governance (see Table 1). If we claim that good governance is a prerequisite of sustained development, we have to answer to a basic question. What kind of governance elements contributed to their achievements?

In our opinion, two factors played important roles in securing advisable decision.

First, Thailand took advantage of “the checks and balances mechanism, which is embedded in their own society”. This mechanism is different, to a certain extent, from orthodox idea of checks and balances, i.e. the separation of three powers: administration, legislation, and judiciary. It was composed of (i) multi-polar system among the political elite, (ii) experienced “balancer”, and (iii) free press. Second, technocrats with certain competence played important role. It should be stressed that they were effectively “insulated” from the pressure groups.

Checks and balances in Thai style seems an example of “endogenous” element of good governance, which is embedded in specific socio-cultural structure. It might be possible to regard the abovementioned two factors as parts of “structural elements”, as Thailand’s standard governance indices in general were relatively low.

These are the lessons we can draw from the saga of the Eastern Seaboard Development Plan.

7-1. Checks and balances à la Thai: multipolar system, experienced balancer, and free press

7-1-1. Multipolar system among the power elite

In the mid 1980s, there were five influential groups in Thailand: the army, political parties, technocrats, business community, and the mass media. It is worthwhile to point out that it was a multi-polar system and checks and balances among the participants functioned well.

There was no doubt that the army was most powerful, but unlike in previous decades, its power was not overwhelming, particularly when other actors made up their mind to work together in a coalition. For example, in 1984, the Bank of Thailand depreciated baht in spite of strong objection by General Arthit Kamlang-ek, Commander-in-Chief of the army, who was concerned about exchange losses with regard to arms import contracts, owing to strong support from Prime Minister Prem, technocrats, and leading business figures.

Although Prime Minister Prem was a former Commander-in-chief of the army, he did not necessarily behave in line with army’s interest. As a result, the relationship between Prem and General Arthit, his successor, was strained. This was an important background factor of the abortive coup d’état in September 1985 by the army, and perhaps abovementioned currency depreciation in 1984. After the retirement of General Arthit, the political pressure by the army appeared to decline. But Prem had to watch

carefully the movements of the army, as he had already retired and could not directly control the military machine.

In Thailand, no single political party acquired a majority in congress, until very recently. In those days too, many small parties were in rivalry with each other, and it was not possible to choose their party leaders as Prime Minister. Under such circumstances, a coalition of five parties had to agree to choose Prem, who did not have a seat in the congress. While political parties were not so influential, it was recognized that any party could threaten the coalition, hinting at the end of cooperation. In order to secure the stability of his administration, Prem had to be careful about the relationship with the bosses of political parties to prevent their veto. Moreover, complicated rivalry relations were found among technocrats, economists, and business leaders. There was a multi-polar system among the power elites.

It was argued that such delicate checks and balances à la Thai could be a serious handicap for strong leadership to drastically modernize the socio-economic system. Perhaps it was a correct observation. However, the case of the Eastern Seaboard Development Plan shows checks and balances à la Thai enabled a thorough scrutiny of crucial policy agenda.

The function of checks and balances in their own ways prevented notable scandals, as far as the Eastern Seaboard Development Plan is concerned. It is quite exceptional that such a gigantic plan consuming huge amount of budget was executed without serious incidents of corruption.

Many developed countries have introduced the separation of the three powers, i.e. administration, legislation, and judicature, for the purpose of functional checks and balances. While Thailand in the mid 1980s had not fully established such separation, they had an alternative and endogenous system, which led to advisable responses to the challenges of the Eastern Seaboard Development Plan.

#### 7-1-2. Role of experienced “balancer”

Prime Minister Prem Tinsulanonda was born in 1920. He was one year older than Suharto, three years older than Lee Kuan Yew, and five years older than Mahathir bin Mohamad. Like these Southeast Asian leaders who belong to the same generation, he was a leader of a developmental state.

As he stated in his farewell address of August 1988, Prem attempted to claim the legitimacy of his contribution not through political or diplomatic achievements but through economic development, more specifically poverty reduction among the rural people (Warren 1997:18-20). In order to attain this goal, he delegated the power of

macroeconomic management to experienced technocrats, and protected them from pressure groups. These are typical characteristics of developmental state leaders. However, unlike other three Southeast Asian leaders in the same generation, and unlike Sarit, his great mentor, Prem was not a man of charisma, but an experienced “balancer” particularly in the multi-polar system in the 1980s. According to Richard Doner and Anek Laothamatas, Prem skillfully played the army and political parties against each other, and allowed free election and a free press while he was outside congress (Doner and Laothamatas 1994:411 -413, 427-429).

Prem functioned effectively as a balancer throughout the Eastern Seaboard Development Plan disputes. One former high ranking official of NESDB recalled that, Prime Minister’s patience in listening into the voices of different opinions. In his view, such patience finally led to a well balanced judgment and reasonable solution in the end<sup>5</sup>.

### 7-1-3. Transparency and openness in the policy making process through the role of the mass media

This article refers to a lot of newspaper articles of those days. Needless to say, it is very unique to see detailed inside information on public expenditure issues in developing countries. Apparently, most of these newspaper articles were based on the “leaks” from high ranking officials. A typical case was the Hermans Note submitted to Dr. Snoh and triggered the movement to revise the Eastern Seaboard Development Plan.

It is to be admitted that many newspaper articles were not correct (certainly this is not unique to Thailand) and were used as tools of manipulation by each camp. For example, the contents of Hermans Note were leaked to the press in the attempt to prevent the campaign of tight belt policy camp. Nevertheless, many articles contributed to transparency and openness, as details of the policy making process were made known to the public. It is to be pointed out leaks were usual in Thailand in those days. Despite a wide variety of negative effects, at least leaks effectively prevented “back door decision making” by political bosses and barons, which are common in developing (as well as developed) countries. Doner and Anek argue that one of the uniqueness of the Prem administration was it allowed free press (Doner and Laothamatas 1994:412). We would like to emphasize this characteristic as an element of good governance under the Prem regime.

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<sup>5</sup> Interview with Dr. Bunyaraks Ninsananda, Former Director, Overall Planning Division, NESDB, of November 3, 1998

## 7-2. Technocrats with certain competence were insulated from pressure groups

World Bank report of *The East Asian Miracle* stressed the importance of “technocratic insulation” in East Asia (World Bank 1993:167 -174). Perhaps Thailand in mid 1980s was a representative case of “economic technocrats with a minimum of lobbying for special favors from political and interest group ”.

The tradition of independent bureaucracy has a source in the pre- modern Siam court. This tradition was strengthened by Field Marshal Sarit Thanarat when he became Prime Minister through a coup d’etat in 1958 and delegated power over macroeconomic management to a group of young elites trained in abroad; the leader of that group was Puey Ungphakorn, governor of the central bank (Siamwalla 1997:6 -9). A lot of young technocrats were appointed to posts in four organizations - the Ministry of Finance, the National Economic and Social Development Board, the Bank of Thailand, and the Budget Department of the Prime Minister ’s Office - which have formed the core of Thai technocracy since then. Dr. Sino Unakle and Mr. Sommai Hoontrakool, who played important roles in the policy making on the Eastern Seaboard Development Plan, were among them. They had been promoted to leading technocrats, and were regarded as experienced and well-balanced policy makers.

As shown in the case of currency depreciation in 1984, Thai technocrats were effectively insulated from pressure groups, such as the army and political parties, under Prem ’s “umbrella”. Reflecting such insulation, the disputes on the Eastern Seaboard Development Plan were basically made among technocrats, and the roles of politicians and generals were limited. This implies that disputes were made with certain degree of rationality. This is considered to have been an important factor leading to well balanced policy making process.

In this concluding section, we touched upon several governance elements, which contributed to the achievements. Some of them are found in the standard theory of governance. According to our analysis, however, they ensured achievements even though many other standard conditions of good governance were absent in Thailand in those days. This suggests the crucial roles of limited number of governance elements. Meanwhile, we found several governance elements , which are quite unique to the Thai society, contributed a lot. This suggests the importance of endogenous social -cultural conditions in attaining good development performance.

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Foundation for Advanced Studies on International Development  
International Development Research Institute (IDRI)

1-6-17 Kudan-minami, Chiyoda-ku Tokyo 102-0074, Japan

Tel. (+81 3) 5226 0305 / Fax. (+81 3) 5226 0023

E-mail: [op@fasid.or.jp](mailto:op@fasid.or.jp)

URL: <http://www.fasid.or.jp>

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