Pairat Momvitaya 2009: The Effect of Financial Liberalization on Economic Growth. Master of Economics, Major Field: Economics, Department of Economics. Thesis Advisor: Assistant Professor Arunee Punyasavatsut, Ph.D. 153 pages.

Financial liberalization had impacts on the economy in many countries since they adopted the financial liberalization in 1970s. In case of Thailand, it started to implement financial liberalization policy informally since 1985. The formal financial liberalization policy was implemented when the country committed to the Article VIII of the IMF Agreement in 1990. According to the agreement, financial system was reformed and some financial restraints were relaxed. However, some researches found that financial liberalization did not only lead to economic growth, but also financial crisis.

The objective of this research is: to assess the level of financial liberalization in Thailand using Edward and Khan's model (1985). The model measured the level of financial liberalization from the relationship between internal interest rate and external interest rate. The model was estimated by Ordinary Least Squares method (OLS). Moreover, this research aims to study the effects of financial liberalization on economic growth and banking crisis using system of equations model which were estimated by Two-Stage Least Squares (2SLS) technique. The path and direction of the effects were analysized by path analysis technique.

The quantitative analysis of this research was divided into two sections. In the first section, the empirical result found that the level of financial liberalization has increased after the official financial-liberalization policy was implemented. But the annual level of financial liberalization fluctuated during the period of study. In the latter section, which is the analysis of the effect financial liberalization on economic growth and banking crisis, the empirical result show that financial liberalization and its higher level led to higher economic growth. The financial liberalization induced economic growth via physical-capital stock accumulation, but not technology change. However, financial liberalization did not only affect economic growth, but also increased probability of banking crisis. Moreover, higher level of financial liberalization induced higher probability of banking crisis.

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