

THAILAND ECONOMIC MONITOR

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SECTION 1

Overview

Real GDP is expected to grow by 4.3 percent this year, down from 5 percent in 2006, before rising to 4.6 percent in 2008. Like last year, growth this year has been principally supported by robust net exports, while domestic demand growth has remained weak as political and policy uncertainties, bombings on new year's day in Bangkok, and higher oil prices had led to declining consumer and investor confidence. Lower real wages and farm incomes growth had affected the local purchasing power. *Net* export growth this year is however slower than in 2006 and this is the main reason for the slower pace of GDP growth this year. Exports of goods and services are expected to grow by 6.5 percent in real terms (8.5 percent in 2006), while import growth should pick up to around 2.5 percent (1.6 percent in 2006). This year, the baht appreciation had sharply reduced the growth in export receipts in baht term. This had an additional effect of reducing the local purchasing power. Growth is forecasted to increase modestly to 4.6 next year as domestic uncertainties begin to clear up and domestic demand picks up. However there remain many downside risks related to both the global environment (oil prices and external demand) and the domestic political and policy environment. It is likely that Thailand's growth this year, like last, will be the lowest among emerging East Asian countries.

Exports, though affected mainly by declining growth in key markets, remain the key driver of growth this year and will remain so next year. Growth of merchandise exports this year is projected to decline to 14.5 percent in US dollar value terms (17.4 percent in 2006) mainly due to the sharp slow down in agricultural prices, the deceleration of US demand, and the appreciation of the baht. Export prices of agriculture products have increased slowly at 5.4 percent in the first 9 month of this year in contrast with a 25.5 percent increase last year. As a result, growth of agricultural exports has declined from 26 percent last year to 11 percent this year. Growth of exports to the US has declined by 3.6 percent in the first 9 months, but was offset by stronger growth in all other markets including Japan, EU, ASEAN and China. The baht appreciation had mostly affected exports of goods with high local content such as garments, canned fruits, and furniture, which account for less than 5 percent of total exports. Exports of some high-tech products, such as computers and parts, were negatively affected by the slow down in the demand from final markets for the products. Tourism arrivals and receipts have been affected by the political uncertainty and the bombings in Bangkok on new year's day. Tourist arrivals increased by only 2.8 percent in the first 9 months of this year. Nevertheless, exports remain the largest contributor to growth this year. Looking forward, next year merchandise export growth is expected to slow down to around 10 percent, in line with the continued modest growth in world demand and a strong baht. Tourism receipts should recover as elections take place and political uncertainty declines. Exports of goods and services will remain the key driver of growth next year.

Macroeconomic fundamentals remain strong. Headline inflation has slowed to around 2 percent this year, a 2.7 percentage-point decline from last year, and will likely be around 3 percent next year, reflecting a gradual recovery in domestic demand and oil price increases. Core inflation will be 1 percent or slightly higher this year and next. With both the headline and core inflation remaining low, average policy rate (1-day repurchase rate) for the first 9 months of this year was 0.6 percentage-points lower than that of last year, while minimum loan rate (MLR) is 0.2 percentage-points lower than its level last year. The current account has been in surplus since last year and will reach 4.9 and 2.2 percent of GDP this year and next year, respectively. The current account surplus had helped raise international reserves to US\$80 billion by October, which is 3.5 times short-term external debt, and also led to the baht's appreciation. The baht will likely remain strong at around Bt34 to the US dollar next year as the current account remains in surplus and as less political uncertainty attracts more investment inflows. The government ran a fiscal deficit in FY2007 of Bt68.7 billion, equivalent to 0.8 percent of GDP. However, the deficit next year will be slightly higher than this year's as the total budget disbursement rate should reach 95 percent, compared to 94 percent this year. Public debt has been falling continuously from 46.5 percent of GDP at end-2005 to 40.5 percent by end-2006 to 38.0 at the end of August this year.

The slower growth over the last few years has slowed down the pace of poverty reduction. Real GDP growth in 2002-2004 averaged 6.2 percent per year, but slowed down to 4.75 percent per year in 2005-2006. Head count poverty fell from 14.9 percent in 2002 to 11.2 percent in 2004. With slower growth in 2005-2006, poverty declined only slightly to 9.6 percent in 2006. The projected slower growth of 4.5 percent in 2007-2008 will make additional poverty reduction more difficult. Measures and transfers aimed at poverty reduction are more effective if they are targeted directly to the poor compared to broader programs. Targeted programs would ensure that the benefits reach the poor¹ and will make the most efficient use of public resources.

The need to revive private investment growth is urgent. Private investment growth has been declining since 2004 and will be at its 8-year low this year at around zero growth. Foreign direct investment also contracted this year for the first time since 2003. Weak domestic and foreign demand, policy uncertainties, and less crowding-in from public investment have delayed capacity expansion by firms. High oil prices and greater global uncertainty related to the US sub-prime crisis are not helping either. With its low growth, private investment's share of GDP in 2007 has dropped to its 2004 level of 16.6 percent. This is low compared to even its 1980s average of 22 percent. As a result of the sluggish growth in private investment in the recent years, capacity utilization, which has been rising since 2004, is now approaching pre-1997 crisis levels with many industries running above 80 percent capacity utilization. Should demand pick up next year or the year after, Thailand may face supply constraints if private investment growth does not pick up quickly next year.

Clear policy direction from the new government after the December 2007 elections should help improve investor sentiment and raise private investment growth next year. Even though actual investment has been weak, the Board of Investment (BOI) investment promotion applications and approvals for both local and foreign firms have reached record highs this year. This indicates the improved investor sentiment and a potential investment recovery next year. The signing of the Japan-Thailand Economic Partnership Agreement (JTEPA) earlier this year, which was effective on November 1st, has also helped boost confidence. However, the extent of actual investments will also likely depend on reduced perceptions of policy uncertainty. Relaxation of capital controls and revisions to proposed amendments to the Foreign Business Act (viewed as making foreign investment more restrictive than before) and the liberalization of a few services industries, for example, will greatly help revive investor confidence. With the reduced uncertainty, investments which have been delayed in the last couple of years could be started up next year. The BOI investment approvals since 2004, for example, are largely waiting to be translated into actual investments.

Faster public investment disbursements will also help boost private investor confidence. Public investment this year expanded by 6.8 percent compared to 10 percent last year in nominal terms. The slower growth this year was partly due to the fact that the government's budget increased only marginally (4.5 percent in 2007 compared to 8.7 percent in 2006). In addition, several new measures to make public procurement more transparent and accountable have tended to slow disbursements in the beginning of the year. Disbursement of public investment funds by the government and state-owned enterprises in 2007 will be around 70 percent of its approved budget (compared to 73 percent last year). The carry-overs from this year will be spent next year. In addition, the government's investment budget for FY2008 has been raised by 8 percent. Hence, public investment could rise by around 10 percent in nominal terms. This would provide not only a direct stimulus to growth but also a boost to private investor confidence as well as help slow down the pace of Baht appreciation. However, there is concern that there could be continued delays in disbursements next year, especially for large investment projects, as the new government will assume office only around February next year and may delay decisions.

Many reform measures issued this year have laid a strong foundation for future growth. The current Cabinet has endorsed many acts and regulations that would lead to greater liberalization,

¹ Poverty data from the latest Socio-economic Survey shows that the majority of the poor reside in the agricultural sector in the rural areas of the Northeast. Poverty maps by district, which are being developed by the National Statistics Office, could help identify poor households at the district level.

competition and improved governance. An example is the draft Public Procurement Decree, recently approved by the Cabinet, which would enhance the transparency of the procurement process as well as cancel the privileges of state-owned enterprises which used to have the sole right to sell certain services to the public sector. Another example is the Life Insurance Act and Non-Life Insurance Act, which will allow insurance institutions to increase their foreign equity from the current 25 percent to 49 percent. Moreover, the State Enterprise Corporatization Act and the Deposit Insurance Institution Act have been approved by the Cabinet and will likely be passed by the National Legislative Assembly this year. The National Productivity Master Plan, aimed at raising productivity at both the sectoral and aggregate levels, was approved by the Cabinet. Similarly, the Intellectual Master Plan which aims to promote knowledge creation and dissemination and innovation has been approved by the Cabinet. The Commission of Higher Education has recently approved the 15-year Higher Education Development Plan (2007-2021) which aims to raise the access to and quality of higher education in Thailand. These would help raise the skills levels of future Thai workers, increase innovation and move Thailand towards a knowledge economy.

The challenge ahead for the next government is to implement and build on these reform measures. Implementing and building on the ground work that has been laid by the current government would bring about sustainable growth in the coming years. Further actions to promote greater growth, competitiveness, and equity in Thailand are also needed. Ensuring future growth includes promoting both the quantity and “quality” of public and private investments. Investments of high quality are those that bring about higher productivity, which lead to products and services which are of greater value-added and greater competitiveness in the market. One significant way which helps raise the quality of investments is to promote a more conducive investment climate and greater competition. A better investment climate generally lowers both direct and indirect costs of doing businesses for firms, thus, leaving them with more resources to focus on productivity improvements through, for example, skills development or research and development. Better transportation infrastructure provided through public investments, for example, would help improve the investment climate as they reduce the logistics cost for firms. Cross-country experience has shown that greater competition increases firms’ productivity as they compete with one another. A significant way competition can be promoted is through liberalization.

Improving the investment climate by reducing the regulatory burden can be done quickly and would yield large efficiency gains. A survey of firms in the study of Thailand’s investment climate² revealed that the top constraint to firm’s expansion is regulatory burden. This includes the length and uncertainty in the time taken to obtain approvals and licenses from relevant government agencies, multiple inspections by tax authorities, the delays in tax refunds, as well as price controls. These were largely reported by firms in the garments, food processing, and auto-parts industries. In recent years, the relevant government agencies have made progress in stream-lining some of these processes, resulting in Thailand’s improvement in the World Bank’s Doing Business rankings since 2004³. However, some of the key concerns above as voiced by firms can be further addressed both at the cross cutting level and at the industrial level. These would reduce firms’ costs in dealing with government bureaucracy, thus, allowing firms to focus more on improving their productivity.

Policies to improve the productivity of the services sector would not only help unleash its large potential growth, but also promote growth of the manufacturing sector. A recent sectoral analysis of total factor productivity growth in Thailand over the last 25 years shows that the services sector has lagged behind industry and agriculture⁴. Based on the Thai national accounts data, productivity growth in the wholesale and retail industry and the hotel and restaurant industry were particularly low. This urgently calls for policies to promote productivity improvements in the services sector. Increasing competition in the services sector through liberalization could unleash its productivity growth, which

² *Thailand Investment Climate, Firm Competitiveness and Growth* (2005), a joint study of the NESDB and the World Bank

³ Thailand ranks 15 out of 178 countries in the ease of doing business indicator in 2007, compared to its rank 20 in 2004. See www.doingbusiness.org

⁴ Finding from *Measuring Output and Productivity in Thailand’s Services-Producing Industries*, a joint study of the NESDB and the World Bank (forthcoming)

would also benefit the manufacturing sector which is the users of many of these services such as logistics and engineering. Liberalizing a few of the service industries currently restricted to foreign operators under the List 3 of the Foreign Business Act⁵, for example, would not only promote higher productivity in those industries and the related manufacturing industries, but also help boost investor confidence.

Measures to improve productivity can help to ease the impact of the baht appreciation on sectors and sub-sectors that are most affected. The rapid baht appreciation in the past 12 months has mainly affected the exports of labor intensive and agriculture products such as garments, furniture, and canned fruits⁶. The baht may fluctuate in the coming years but will unlikely return to the 2005 level of Bt40 to the US dollar. It is therefore imperative to target assistance to improve the productivity and competitiveness of the labor intensive and agriculture-based industries, which employ around 40 percent of the workforce. This could be done in a targeted manner through programs aimed at promoting productivity-improvements, technological upgrades, better designs, and training to improve skills of workers in these industries. These would be less costly than a blanket baht support and at the same time help improve the real competitiveness of these industries.

Skill development remains key to Thailand's move towards a knowledge economy and to promote equity. The latest World Bank's Knowledge Economy index (KEI)⁷, which is an aggregate index representing the overall preparedness of a country towards a knowledge economy, showed that Thailand's KEI ranking has fallen from 48 in 1995 to 56 (out of 137 countries) in 2007. The level of education and training is one of the key pillars of a knowledge economy. Moving towards a knowledge economy is the key to maintaining Thailand's competitiveness in the medium term as Thailand tries to move up the value-chain. Thailand's competitiveness in the past relied on cheap resources, particularly, labor. In the near future, its competitiveness will rely on knowledge. Development of knowledge and skills takes time, so Thailand needs to act immediately if it does not want to be left behind in the next few years. The network of higher education institutions, public research institutions, and the private sector must play an increasing role in the creation of new knowledge and its dissemination. Moreover, research shows that there is a strong correlation between education attainment and income equality. Countries which have a higher proportion of population with education attainment tend to have lower income inequality. Income inequality in Thailand has been persistently high for the past 20 years. Developing skills through higher education and training could lead to better pay and job opportunities which would help lower income inequality in Thailand.

⁵ Foreign firms must receive prior approval from the Ministry of Commerce in order to operate in the industries under List 3. These include logistics, engineering, architectural, and retail services.

⁶ The exports of these 3 industries contracted by 9 percent year-on-year in the first 9 months of this year.

⁷ KEI is a simple average of 4 sub-indexes which represents the 4 pillars of the knowledge economy: (1) economic incentive and institutional regime, (2) education and training, (3) innovation and technological adoption, and (4) information and communications technologies (ICT) infrastructure. See www.worldbank.org/kam

SECTION 2

Recovery and Outlook

2.1 Real GDP Growth and Macroeconomic Developments

Real GDP growth in 2007 will decelerate to 4.3 percent, before speeding up slightly to 4.6 percent in 2008. These growth rates are the lowest among those of the emerging East Asian countries (see Table 1). Growth this year, like last year, is mainly driven by net foreign demand as exports grew by 6.5 percent in real terms, while imports remained subdued, growing at only 2.5 percent (see Table 2). On the other hand, domestic demand remained in a slump, growing at only 1.7 percent year on year as a result of the sluggish private consumption growth and a contraction in private investment. Growth next year should benefit from the acceleration of domestic demand as uncertainties are reduced and consumers regain confidence as inflation and interest rates are projected to remain low. Investments by the private and public sectors as well as household consumption should pick up from the low rates this year. Exports of goods next year will likely grow slower at 6.6 percent in real terms (10 percent in nominal terms) as key trading partners' growth rates are projected to slow down and the baht remains strong. Export growth of services will speed up mainly from the revival of tourist receipts which were affected by the bombings on 2007 new year's day and the political issues this year. Imports are expected to speed up as investments pick up. As a result, net foreign demand will no longer contribute to growth next year as much as it did in 2006 and 2007.

Table 1. East Asia Economic Growth

	2005	2006	2007	2008
Emerging East Asia	7.7	8.3	8.4	8.2
Develop. E. Asia	9.2	9.8	10.1	9.7
S.E. Asia	5.1	5.4	5.7	5.8
Indonesia	5.7	5.5	6.3	6.4
Malaysia	5.0	5.9	5.7	5.9
Philippines	4.9	5.4	6.7	6.2
Thailand	4.5	5.0	4.3	4.6
Transition Econ.				
China	10.4	11.1	11.3	10.8
Vietnam	8.4	8.2	8.3	8.2
Small Economies	7.8	7.2	6.4	6.2
Newly Ind. Econ.	4.9	5.5	5.1	5.1
Korea	4.2	5.0	4.8	5.1
3 other NIEs	5.5	5.9	5.4	5.1
Japan	1.9	2.2	2.0	1.8

Source: World Bank East Asia Region; October 2007. Consensus
Forecasts for NIEs. Regional averages are GDP weighted.

Inflation has remained low this year but may increase next year due to the rise in oil prices and some relaxation in price controls. Headline inflation is expected to fall to around 2.2 percent this year from 4.7 percent last year and rise to around 3 percent next year. Core inflation⁸ was only 1 percent in the first 9 months of this year and would likely be just slightly higher for the whole year. Headline inflation in the first 9 months of the year was around 2 percent compared to 5.1 percent in the same period of 2005. This is the result of the sharp slow down in the prices of non-food items, in particular, transport and communications and housing and furnishing, which are in line with the slow down in the domestic demand for them. Moreover, price administration of many food and non-food items has

⁸ Core inflation is headline inflation excluding raw food and energy items.

slowed down their price increase⁹. Prices of energy used by consumers, on the other hand, have fallen this year by 0.9 percent after rising by almost 20 percent last year (see Figure 1). This is partly due to the slower increase in world oil prices and, thus, domestic gasoline prices compared to the previous years. Premium gasoline price in the first 9 months of this year increased by 1.8 percent and is expected to increase by around 5 percent year-on-year, a decline from its 15.5 percent rise last year. Moreover, the switch from premium gasoline to premium gasohol this year by consumers has lowered fuel costs for them, as the price of gasohol is around 10 percent lower than that of gasoline¹⁰. Next year, the movement of oil prices remains uncertain. Current projections show that world oil prices could rise up to 15 percent next year. Domestic petrol prices would rise by a little if the government tries to mitigate the price increase by lowering petrol taxes and fees as it did in November this year¹¹. The Bank of Thailand's estimate shows that the rise in crude oil prices next year could raise headline inflation by 0.75 percentage-point¹². Prices of manufactured products will also likely rise faster than this year as more industries will be allowed by the Ministry of Commerce to slightly raise prices of their products after many of their requests were turned down this year. On the other hand, agricultural and food prices are expected to increase more slowly next year in line with world prices. In addition, the expected deceleration of import prices next year and the continued strength of the baht will lead to a lower increase in import prices in baht terms. Hence, headline inflation would likely rise from 2 percent this year to around 3 percent next year.

Table 2. Thailand's Real GDP Growth by Demand Components

(Percent)

	Share of 2006GDP	2006	2007H1	H2p	2007p	2008p
Total Consumption	62.6	3.2	2.2	3.3	2.7	3.8
Private C	53.6	3.1	1.1	1.8	1.4	4.0
Gov C	9.0	3.4	9.2	12.0	10.6	3.0
Gross fixed capital formation	23.3	4.0	-0.6	2.6	1.0	9.5
Private Investment	17.4	3.9	-1.5	1.2	-0.2	10.0
Public Investment	5.9	4.5	2.2	6.5	4.5	8.0
<i>Change in Inventories</i>	<i>-0.9</i>	<i>-155.1</i>	<i>-64.3</i>	<i>-50.0</i>	<i>-55.0</i>	<i>77.0</i>
Total Domestic Demand	85.0	0.3	0.9	2.4	1.7	6.7
Exports	68.7	8.5	6.8	6.2	6.5	7.2
Goods	56.0	9.0	8.2	6.0	7.0	6.6
Services	12.7	6.7	1.1	7.0	4.0	10.0
Imports	54.3	1.6	2.0	3.1	2.5	10.5
Goods	44.6	-0.8	1.6	3.3	2.4	10.5
Services	9.7	14.3	3.8	2.0	2.9	10.5
Net Foreign Demand	14.4	46.7	28.4	16.4	21.5	-3.3
GDP	100.0	5.0	4.3	4.3	4.3	4.6

Source: NESDB (2006 & 2007H1), World Bank's projections (2007 & 2008)

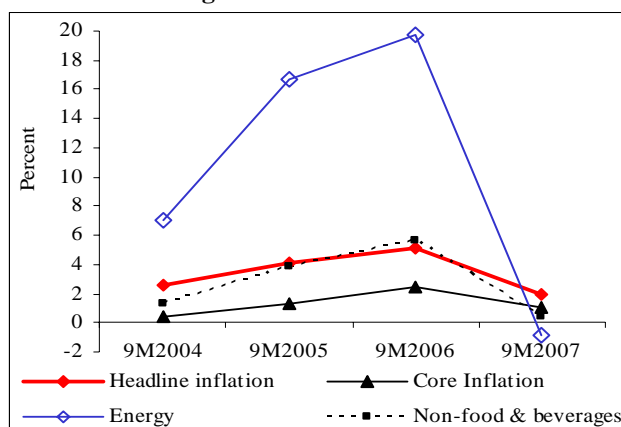
⁹ Prices of around 200 product items are administered by the Ministry of Commerce. In many cases, price increases must seek approval or consent from the Ministry. See a detailed description in the Thailand Economic Monitor, November 2006 issue.

¹⁰ Sales of premium gasohol jumped from 0.06 billion liters in 2004 to 1.19 billion liters in 2006. Sales of premium gasoline fell from 2.97 billion liters in 2004 to 1.47 billion in 2006. In the first 9 months of 2007, premium gasohol consumption was 1.04 billion liters, compared to only 0.89 billion liters of premium gasoline.

¹¹ Contribution to the Oil Fund from gasohol, biodiesel and diesel sales was reduced by Bt 0.30 per liter in November.

¹² According to the Bank of Thailand's Inflation Report (October 2007), a 1 percent increase in crude oil price would lead to a 0.05 percent rise in headline inflation. Hence should crude oil price rise by 15 percent next year, headline inflation would rise by 0.75 percent.

Figure 1. Inflation Rates



Source: Bank of Thailand

Interest rates have fallen this year as inflation declined and are expected to remain at similar levels next year. The policy rate (1-day repurchase rate) has been reduced by 1.7 percentage-points since the beginning of the year and now stands at 3.25 percent in October. Its 10-month average is 0.6 percent lower than that of last year. The minimum loan rate (MLR) has also fallen by 0.2 percent in the first 10 months of this year, averaging at 7.3 percent. The 6-month deposit rate fell by 0.9 percentage-points from that of last year. In the first 10 months of the year, it averaged 2.9 percent. The policy rate would unlikely be changed should inflation remain below 3 percent as projected and the recovery of domestic demand next year is fragile.

The baht will continue to strengthen as the dollar weakens and the balance of payments surplus continues to be strong. The baht averaged Bt34.7 per US dollar in the first 10 months of this year or a 9.3 percent increase from same period last year and would likely average at Bt34.5 per US dollar for the whole year. In the first 10 months of this year, the baht appreciated by 9.3 percent against the US dollar, 11.5 percent against the Yen, 5.0 percent against the Chinese Yuan, and 1.6 percent against the Euro. As a result, the nominal effective exchange rate, which is the weighted average value of the baht against the currencies of Thailand's trading partners¹³, has also appreciated by 7 percent in the first 10 months. Thailand's real effective exchange rate¹⁴ this year and last year has also appreciated by more than those of all the other countries in East Asia, except for Indonesia and the Philippines (see Table 3). The baht began to appreciate quickly after November last year. It averaged Bt 37.9 to the US dollar last year compared to its average of Bt40.2 per dollar in 2005. The rapid appreciation was the result of the weakening of the US dollar as well as the large capital inflows into Thailand, largely in the form of FDI, which has led to an unprecedented balance of payments surplus of US\$12.7 billion. The balance of payments surplus this year could be even higher as a result of the large current account surplus, which more than offsets the decline of the capital account surplus from that of last year. The balance of payments in the first 9 months of this year has reached US\$10.8 billion, of which US\$9.3 billion comes from the current account surplus. The lower capital account surplus this year can be attributed to the lower FDI inflows and greater outflows from commercial banks, which are partly from non-resident baht accounts (see Table 4). Next year, the balance of payments surplus is projected to be similar to this year's as the current account surplus declines, but FDI rises. Other forms of capital inflows are uncertain with the sub-prime problem overhanging. The baht next year is therefore expected to strengthen slightly from this year.

¹³ Thailand's key trading partners are the US, EU, Japan, ASEAN, and China.

¹⁴ Real effective exchange rate (REER) is the nominal effective exchange rate deflated by the countries' inflation.

**Table 3. Change in Annual Real Effective Exchange Rate (REER)
In Selected East Asia Countries**

(Percentage)

	2005 to 2006	2006H1 to 2007H1	2005 to 2007H1
Thailand	8.9	8.6	17.5
Philippines	11.1	8.4	19.5
Indonesia	17.1	2.3	19.4
Malaysia	4	4.5	8.5
China	2.1	3.9	6.0
Singapore	2.4	1.2	3.6
India	-1.3	4.8	3.5
Hong Kong	-0.9	-4.8	-5.7

Source: IFS

Note: Positive numbers indicate appreciation

Table 4. Net Flows of Capital

(Million US\$)

	2005	2006	8M2007
Monetary authorities	225	416	-661
Government	-952	-567	-2,006
Bank	222	-7,409	-6,886
Other sectors	11,591	13,279	6,998
Non-bank	9,340	13,616	7,374
FDI	6,503	10,031	5,433
Portfolio	1,876	1,642	3,072
<i>of which</i>			
Equities	1,614	2,353	3,288
Debt securities	262	-711	-216
Foreign Loans	-1,308	2,867	-91
Others	2,269	-925	-1,039
State enterprises	2,251	-337	-376
Total capital flow	11,085	5,719	-2,554

Source: BOT

Thailand's current account surplus reached a record high this year as a result of slow import growth. The current account surplus this year, reaching almost US\$12 billion is the highest since 2000. This is the result of the sharp increase in the trade account surplus as the imports of goods remain sluggish this year in line with the slumped investment growth (see Table 5). Next year, the trade account is likely to decline as import growth rises with the recovery in investments, while export growth decelerates in line with the slow down in key trading partners' demand. The current account next year should register a smaller surplus of US\$5.8 billion or 2.2 percent of GDP, but remain higher than its 2001-2004 levels. This will raise the international reserves to higher than its current US\$80 billion.

Table 5. Trade and Current Accounts. 2005-2008

(Million US\$)

	2005	2006	2007p	2008p
Exports of Goods	109,193	128,220	146,812	161,493
(% change)	15.0	17.4	14.5	10.0
Imports of Goods	-117,722	-125,975	-136,053	-156,461
(% change)	25.9	7.0	8.0	15.0
Trade Account	-8,530	2,245	10,759	5,032
as % GDP	-4.8	1.1	4.5	2.0
Net services income & transfers	677	996	1,046	676
(% change)	-48.2	47.0	5.0	-35.3
Receipts	26,810	32,073	33,676	37,549
(% change)	9.7	19.6	5.0	11.5
Payments	-26,132	-31,077	-32,631	-36,873
(% change)	13.0	18.9	5.0	13.0
Current Account	-7,852	3,240	11,804	5,708
as % GDP	-4.5	1.6	4.9	2.2

Source: BOT (2005 & 2006), World Bank's projections (2007 & 2008)

Imports have grown this year from a low base last year and will speed up further next year.

Import values grew by 7.3 percent in the first 9 months of this year, mainly as a result of expanding raw material imports. Raw material imports increased both in terms of value and quantity. On the other hand, import growth of products in all other categories has slowed down (see Table 6). Capital goods imports have slowed down considerably from last year as investments have slowed down significantly. Fuel imports in the first 9 months have contracted, mainly due to the fall in quantity imported. Domestic petroleum prices this year are almost 50 percent higher than that of 2004. Consequently, consumption growth of petroleum products has been declining as consumers and firms switch to other sources of energy such as coal, electricity and natural gas (see Figure 2). Next year, fuel imports will unlikely expand rapidly. Total imports, however, are projected to grow faster than this year at 15 percent as imports of capital goods increase with the recovery in investments.

Exports of goods and services remain the key driver of growth this year and will remain so next year.

Exports in the first 9 months of this year grew by 15.7 percent in US dollar term relative to the same period last year, which is about the same as in the last couple of years. These expansions were entirely supported by increases in export volumes, as export prices decelerated. In term of Baht, exports expanded by only 4.6 percent in the first 9 months of 2007 due to the Baht appreciation, compared to the 12.4 percent growth in the same period of 2006. Exports to the US market contracted this year but were offset by the sharp export growth to other markets, particularly the EU and ASEAN (see Export Performance section for more details). For the whole year, growth in exports of goods is projected to be 7 percent in real terms and 14.5 percent in value, compared to 9 percent and 17.4 percent in 2006, respectively. This slow down is mainly due to the slow increase in agricultural prices and the deceleration of US demand, which is Thailand's largest export market. The appreciation of the baht had mainly affected the exports of industries that have a high local content such as garments, canned fruits, and furniture and furnishing items, which account for less than 5 percent of total exports. Exports of some high-tech products, such as computers and parts, were negatively affected by the slow down in the demand from final markets for the products¹⁵. Political uncertainty and the 2007 new year's day bombings have affected tourism numbers and receipts. Tourist arrivals increased by only

¹⁵ The growth rate of computer exports this year, for example, is only half that of last year. Computer parts exports have contracted year-on-year. These are mainly attributed to the slow down in the demand for computers in the US market.

2.8 percent in the first 9 months of this year. As a result, exports of goods and services in real terms will decelerate to 6.5 percent this year from 8.5 percent last year. Next year, merchandise export growth is expected to slow down slightly to 6.6 percent in real terms and 10 percent in nominal terms, in line with modest growth in world demand and a still strong baht. Tourism receipts should recover as elections take place and political uncertainty declines. Exports of goods and services in real terms could reach a slightly stronger 7.2 percent growth in 2008.

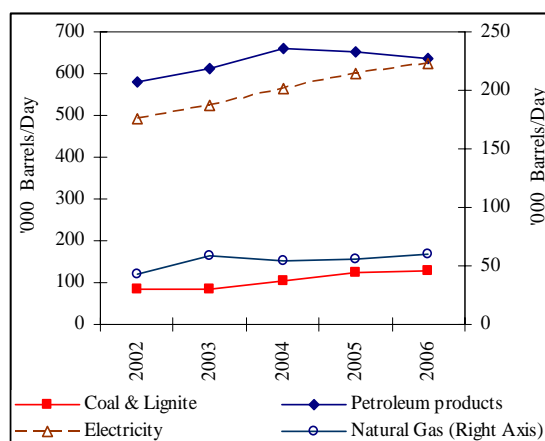
Table 6. Import Value and Valumn Growth, 2005-2007

	2005	2006	2006 9M	2007 9M
(Percent)				
Consumer Goods				
Value (7.5%)	12.4	15.3	15.8	9.1
Volume	10.0	15.2	15.9	5.8
Raw Materials				
Value (41%)	18.1	5.6	3.8	13.6
Volume	16.0	1.7	0.5	7.5
Capital Goods				
Value (28%)	24.5	8.0	5.9	2.7
Volume	21.8	5.8	4.0	0.7
Fuel & Lubricant				
Value (18.1%)	58.4	20.3	21.0	-3.4
Volume	17.2	-1.4	-6.2	-4.2
Total				
Value	25.9	7.8	6.7	7.3
Volume	18.5	1.3	-0.4	3.5

Source: BOT

Note: Figures in () are shares in total import value in 9M2007

Figure 2. Energy Consumption (Crude Oil Equivalent Unit)



Source: EPPO

Household consumption was depressed this year but should recover next year in an environment of accommodative inflation and interest rates, although income uncertainties could constrain consumption growth. Lower economic and income growth have depressed consumer confidence, though inflation and interest rates remain low. Farm income growth this year, though reaching over 15 percent, is lower than that of last year as crop prices decelerated. Monthly *real* wages in the non-agricultural sector for the first half of the year declined by 1.5 percent as did the workers' work hours per week (see Household Consumption section for more details). Consumer confidence, as measured by the Consumer Confidence Index, has been declining every month since November last year and hit a 5-year low in October this year. In the first half of the year, real household consumption grew by only 1.1 percent year-on-year. It has accelerated slightly since the third quarter of this year. For the whole year, household consumption will expand by 14.4 percent year-on-year, lowest rate since 1999. With inflation and interest rates remaining low and output and investment growth expected to be higher next year, consumer confidence should be revived as well as their spending. However, key crop prices are not expected to be as robust as this year in line with their international prices, hence, limiting the growth of rural household income and consumption. Moreover, workers may continue to see their working hours cut down and incomes reduced should exports in labor intensive industries continue to be adversely affected by the appreciated baht. Household consumption is therefore expected to increase by 4 percent next year from its low level this year.

Private investment growth this year will likely be the lowest since 2000 as the investment climate has not been favorable, but is projected to start rebounding next year. Private investment growth this year suffered from high oil prices and global uncertainties as well as domestic policy uncertainties. As a result, real private investment has contracted by 1.5 percent year on year in the first half of this year. Its growth is expected to be zero for the whole year. Foreign direct investment (FDI) has

contracted this year, the first time since 2003. The delay in the large public infrastructure investments has also provided a less crowding-in effect to private investment. With the upcoming elections announced and the Japan-Thailand Economic Partnership Agreement (JTEPA) effective on November 1st, investor confidence has shown signs of recovery. The Bank of Thailand's business sentiment index (BSI) improved year-on-year for the first time in August after declining since December last year. The expected BSI for the upcoming 3 months has started to improve in August, after declining since March this year. The Thailand's Listed Companies Association's quarterly CEO Survey in October showed that more than 60 percent of the 110 firms surveyed plan to increase their investments next year. Investment promotion applications to the Board of Investment (BOI) in the first 9 months of this year are 23 percent higher than that of last year. This is the highest level since 2000 (see Private Investment Section for more details). Moreover, the real lending rate will be slightly lower than this year's 5 percent, thus, not an impediment to private investments by local investors. Thus, should confidence rebound next year, investments which have been delayed in the last couple of years, such as those that received BOI approvals since 2004, could be translated into actual investments next year. Private investment in real term is therefore expected to expand by 10 percent next year.

Public investment expansion slowed down this year but should speed up next year as disbursement rates pick up and the government's investment budget rises more aggressively.

Public investments, in nominal terms, rose by 6.8 percent this year compared to 10 percent last year. However, after adjusting for inflation, public investment rose by 4.5 percent (in real terms) this year, the same rate as last year. This is because inflation was much higher last year compared to this year. The slower growth this year was partly due to the smaller increase in the government's budget of only 4.5 percent year-on-year in FY2007 compared to 8.7 percent in FY2006¹⁶. In addition, several new measures to make public procurement more transparent and accountable have also slowed disbursements at the beginning of this year. Disbursement of public investment funds by the government and state-owned enterprises in 2007 will be around 70 percent of the approved budget, compared to 73 percent last year. The carry-overs from this year will be spent next year. In addition, the government investment budget for FY2008 has been raised by 8 percent (see Public Investment Section for a detailed discussion). Hence, public investment could rise by around 10 percent in nominal terms or 8 percent in real terms.

The government's fiscal stance remains strong. Because of the delays in investment disbursement this year, the actual government deficit is smaller than was budgeted. The government ran a fiscal deficit in FY2007 of Bt68.7 billion, equivalent to 0.8 percent of GDP, which is lower than the Bt146.2 billion budget deficit set for FY2007. The budget for FY2008 assumes Bt165 billion deficit. However, the actual deficit next year should be just slightly higher than this year's as the total budget disbursement rate should reach 95 percent, compared to 94 percent this year. Public debt has been falling continuously from 46.5 percent of GDP at end-2005 to 40.5 percent at end-2006 to 38.0 at the end of August this year. Public debt may rise next year as the proposed amendment to the Public Debt Management Act, which is now in the National Legislative Assembly, allows the central government to issue bonds in excess of its deficit financing needs. This is aimed to help develop the bond market in Thailand. However, public debt level is still required to be below 50 percent of GDP.

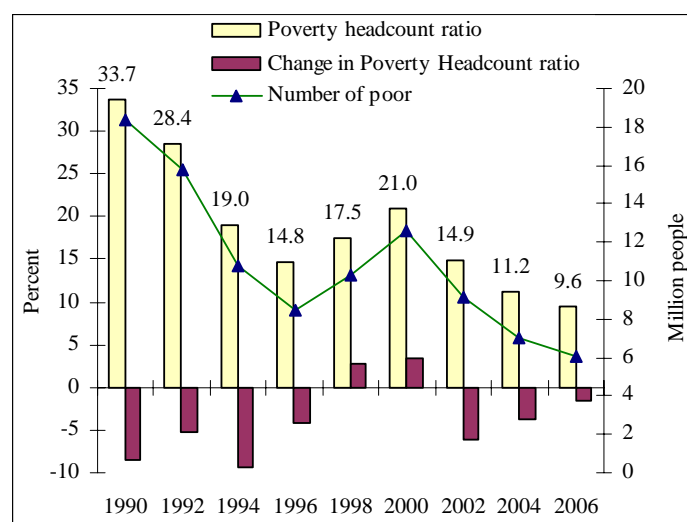
2.2 Poverty

Poverty fell between 2004 and 2006, but at a relatively slow pace. The poverty headcount ratio fell from 11.2 in 2004 to 9.6 in 2006, leaving 6.1 million people living below the national poverty line of 1,386 Baht/person/month. Apart from the increase in poverty during 1997-2000 as a result of the crisis, the recent reduction in the poverty rate of 1.6 percentage point in 2004-06 was the lowest since 1990 (see Figure 3.). Part of the reason was low crop production, especially in main crops such as rice,

¹⁶ The Thai fiscal year runs from October of the previous year to September in the current year. FY2007 runs from October 1st, 2006 to September 30th, 2007.

rubber, sugarcane, maize and cassava (although farm income did rebound in 2006) (see Figure 4. and Figure 5). Higher fuel input prices relative to prices for agricultural outputs also eroded farm incomes. The progress of poverty reduction between 2005 and 2006 has been slower in the Northeast and the South than in the North. The poverty rate in the Northeast and the South reduces by 1.8 and 0.5 percentage-points respectively, compared to a reduction of 3.7 percentage point in the North (see Table 7).

Figure 3. Poverty Headcount Ratio and Number of Poor, 1990-2006



Source: NESDB

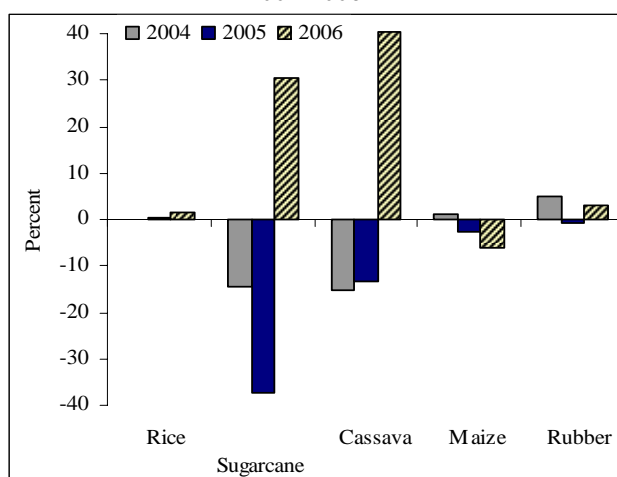
Table 7. Thailand Poverty Headcount ratio classified by region, 1996-2006
(Percent of total population)

	1996	2000	2004	2006
Thailand	14.8	21.0	11.2	9.6
Northeast	24.5	35.3	18.6	16.8
North	17.8	23.1	15.7	12.0
South	10.3	16.6	6.0	5.5
Central	6.1	9.0	4.5	3.3
BKK	1.2	1.7	0.8	0.5
Urban	9.9	8.6	4.6	3.6
Rural	22.9	26.5	14.2	12.0

*2006 National Poverty Line is 1,386 Baht/head/month

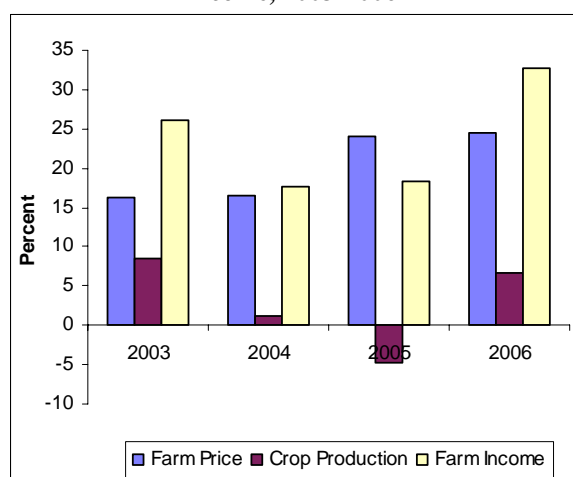
Source: NESDB

Figure 4. Growth of Key Crops Production Index, 2004-2006



Source: NESDB, BOT

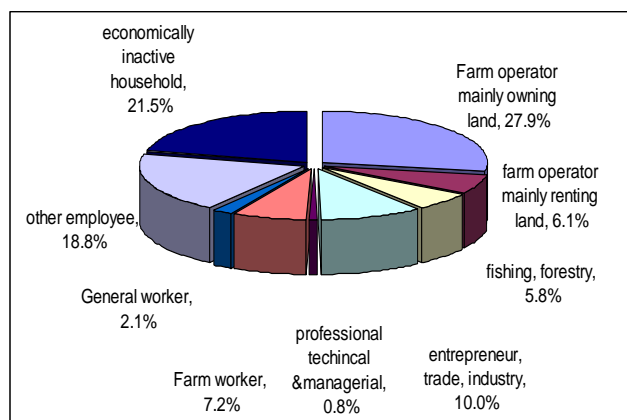
Figure 5. Farm price, Crop Production and Farm Income, 2003-2006



Source: BOT

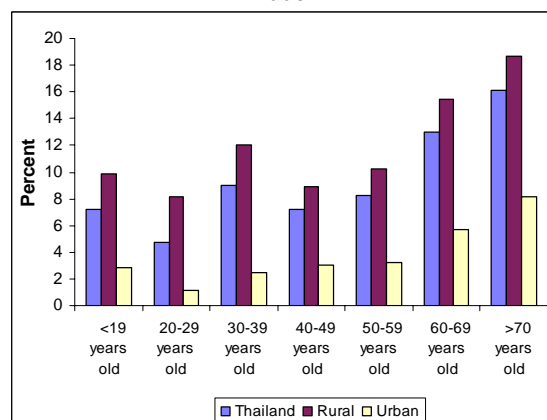
Poverty continues to be concentrated in the households engaged in agricultural activities in the rural areas of the North and Northeastern regions. Poverty remains highest in the North East, with a poverty headcount rate of 16.8 percent, although this is down from 24.5 percent in 2006. Poverty in the rural areas is down to 12 percent of the population – almost half the rate in 1996 – although this is still over 3 times that of the urban areas (3.6 percent). Almost half of poor households derive their incomes from agriculture, fishing and forestry (Figure 6). Another important group among the poor is the elderly – the age of the head of household is highly correlated with poverty, especially in the rural areas (see Figure 7).

Figure 6. Proportion of the Poor Household Classified by Economic Activities, 2006



Source: SES

Figure 7. Poverty Headcount Ratio Classified by Age of Household Head in Urban and Rural Area, 2006

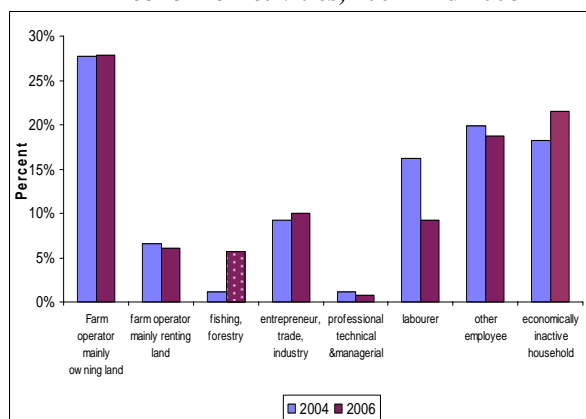


Source: NESDB

Poverty has increased sharply among those in the fishing and forestry industries. Between 2004 and 2006, the proportion of poor households whose main economic activities were fishing and forestry increased from 1.0 to 5.8 percent (see Figure 8). One of the reasons for this was that many Thai fishermen, especially those who live in Andaman coastal area had failed to rebuild their way of life after losing houses, boats, and fishing equipments in the Tsunami of 2004. The sharp rise in oil prices has also hurt the incomes of the fishing industry as diesel accounts for a large share of its operating cost. Figure 9 shows that the rise in the price index of fishery products has been lower than the steep rise in fuel prices, therefore, the farm price index of fishery relative to petroleum prices had been continuously falling since 2002, only leveling off in 2006. Consequently, the poor households working

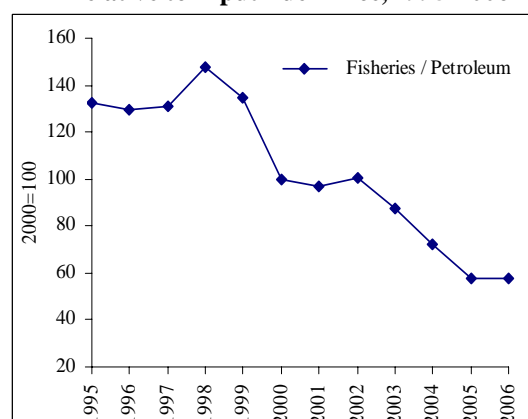
in fishing and forestry have the lowest per capita income growth compared to those engaging in other economic activities.

Figure 8. Proportion of Poor Household Classified by Economic Activities, 2004 And 2006



Source: SES

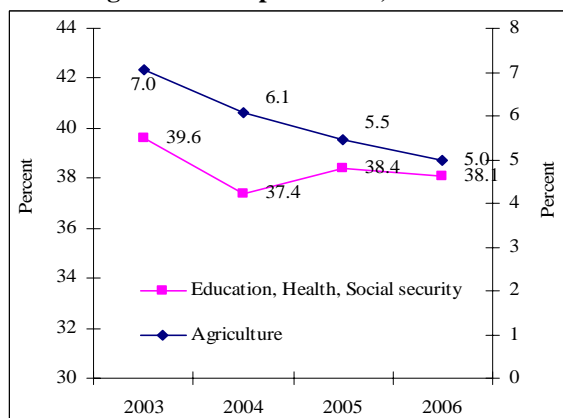
Figure 9. Index of Fishery Product Prices Relative to Input Fuel Price, 1995-2006



Source: BOT

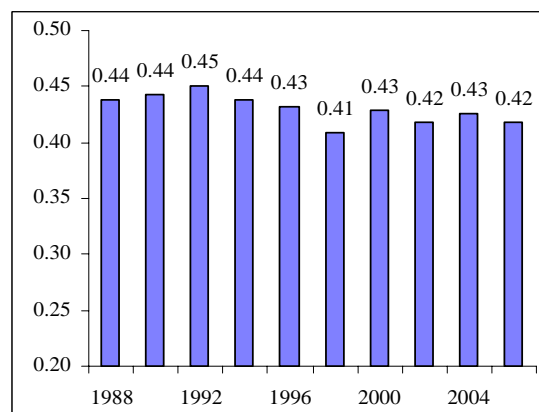
Government transfers have tended not to favor the less well-off. A smaller share of public transfers flow to activities that are more beneficial to the poor. While more than half of the poor are working in the agriculture sector, the share of total government expenditure for this sector has been declining continuously from 7 percent in 2003 to 5 percent in 2006. In addition, the government budget allocated to activities which are most relevant to the poor such as education, health, and social security and welfare has also been declining from 39.6 percent to 38.1 percent over the same period (see Figure 10).

Figure 10. Share of Actual Government Expenditure of Education, Health, Social Security, Agriculture Expenditures, 2003-2006



Source: NESDB

Figure 11. Gini-Coefficient, 1988-2006



Source: NESDB

Income inequality has slightly improved but remains high. The income inequality as measured by the Gini-coefficient fell from 0.43 in 2004 to 0.42 in 2006, but the amount of change is not large enough to be statistically significant. However, if we look at the longer period, the average Gini-coefficient between 2000 and 2006 (0.42) is lower than the average between 1988 and 1996 (0.44) by 4 percent (see Figure 11). Nevertheless, Thailand's income inequality index as measured by the Gini-coefficient has remained moderately high compared to other countries. Thailand ranks 78 out of 127 countries¹⁷.

The gap between the rich and the poor remains large, while income of the upper-middle income group grew faster than others from 2004 to 2006. From the latest Socio-Economic Survey (2006), the per capita expenditure of the richest quintile is 8 times higher than that of the poorest quintile, an

¹⁷ World Development Indicator, World Bank (2006). The higher rank represents higher income inequality.

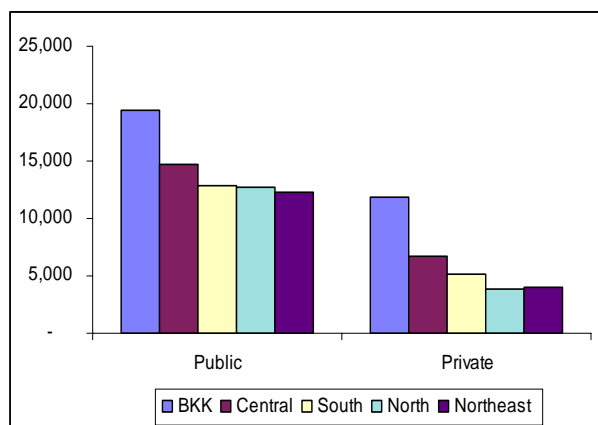
increase from 7.7 times in 2002. The gap between the second poorest quintile and the richest quintile has been unchanged at 5 times since 2002 (see Table 8).

Table 8. Average Per Capita Expenditure, 2002-2006

	(Baht/month/person)		
	2002	2004	2006
1st poorest Quintile	869	983	1,163
2nd Quintile	1,360	1,555	1,874
3rd Quintile	1,930	2,220	2,689
4th Quintile	2,873	3,309	4,012
5th Richest Quintile	6,696	7,868	9,221

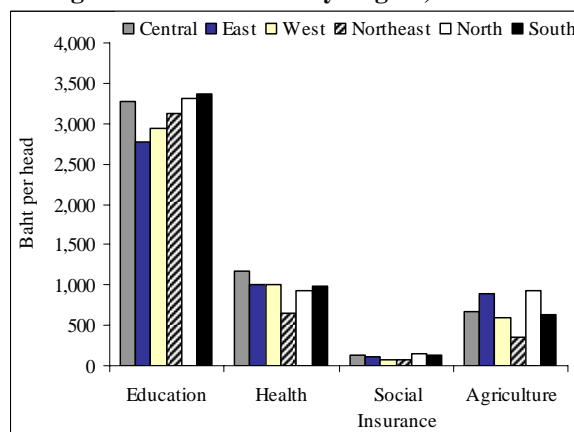
Source: NESDB

Figure 12. Average Wage of Employee in Private and Public Sector Classified by Region, 2006



Source: Labor Force Survey, NSO

Figure 13. Actual Government Expenditure per Capita on Education, Health, Social Welfare, Agriculture Classified by Region, FY2006

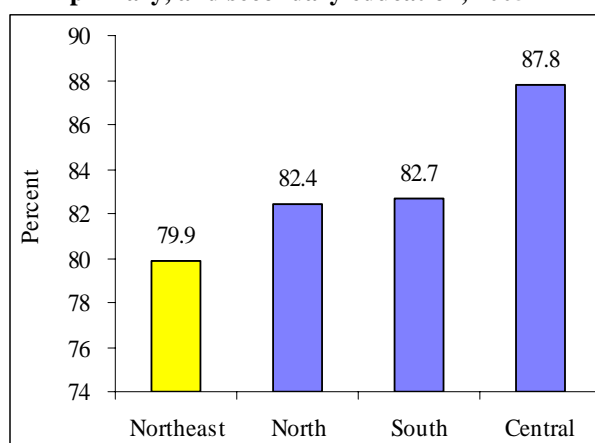


Source: NESDB

Inequality in terms of wages, employment, government transfers, and education and health services between the Northeast and other regions is high. The average wage levels of employees in both private and public sectors in the Northeast are more than 3 times and 2 times lower than those in Bangkok and the Central region, respectively (see Figure 12). Per-capita government expenditure especially for the Northeast on health and agriculture is also lower than other regions and below the Central by almost half (see Figure 13). Consequently, the overall enrollment rate of the Northeast is lower than the Central by 7.9 percentage points and lower than the North and the South by 2.5 and 2.7 percentage points respectively (see Figure 14). In addition, the number of population per physician in the Northeast is also higher than other regions and doubling the figure of the national average, reflecting less opportunity for good health care services (see Figure 15).

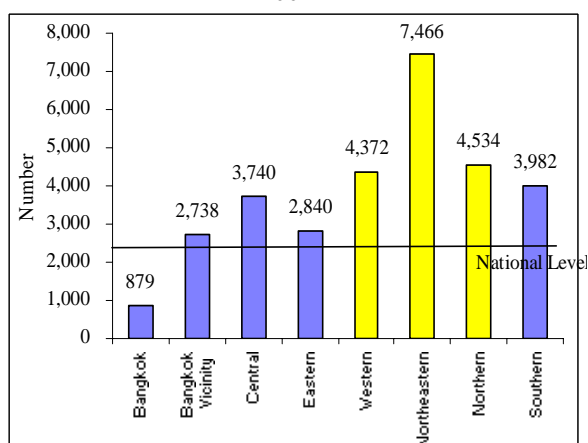
Improving productivity of the agriculture sector, supporting farm incomes and better targeting of government's transfers will help the poor. As the national poverty rate continues to decline but at a slower pace due to a slower economic growth and low crop productions, the poverty continues to be concentrated among those living in the rural areas and especially in the agriculture sector. At the national level, the government can help to reduce poverty through assigning policies that support rural development and increase agricultural productivity. Improving the local investment climate through the use of social transfers and agricultural productivity improvement programs will also promote development in the rural areas, increase agricultural productivity, and improve income distribution. At the sub-national level, the government should better target social assistance to the poorest groups which mostly are agricultural workers and households headed by the elderly.

Figure 14. Gross enrollment rate of elementary, primary, and secondary education, 2005



Source: MOED

Figure 15. Number of Population per physician, 2004



Source: Thailand Human Development Report, UNDP

2.3 External Environment

Global economic growth this year and next slows down from that of 2006. World real GDP in 2006 grew by 3.9 percent, while it will be around 3.5 percent this year and 3.4 percent next year (see Table 9). The decline this year was mainly the result of the slow down in the US economy, while the economies of Japan and EU slowed down slightly from their 2006 growth. Next year, growth in Japan and EU is expected to further decline, while that of the US slightly increases.

Developing countries real GDP growth this year is similar to last year's but will slow down next year. This year, growth rates in all regions slightly declined, except for those in Sub-Saharan Africa and East Asia which slightly rose. As a result, developing countries growth will be similar to that of last year. Next year, growth will further slow down to 7.1 percent with the largest decline in Latin American economies. Growth in developing East Asia, including China, will also slow down next year to 9.7 percent as oil prices continue to rise, non-oil commodity prices fall, and world trade volume growth falls (see Table 9).

World trade volume growth has slowed down from its 2006 peak. In 2006, world trade volume grew by 10.1 percent, up from 7.8 percent in 2005. It has slowed down slightly to 9.1 percent this year and will slow down further next year to 7.6 percent in line with lower GDP growth in the EU, Japan, and China. As these are key export destinations for Thailand, this would mean slower growth for Thailand's exports next year.

World crude oil prices are expected to rise further next year after rising by another 5.7 percent this year. Oil prices this year averaged around US\$68 per barrel, compared to US\$64.3 in 2006¹⁸. Next year, oil prices are expected to rise by another 6.6 percent to US\$72.4 per barrel. Oil prices have been rising rapidly since 2003 when it was US\$29 per barrel.

Export prices for Thailand this year have not been increasing as robustly as the past few years. Prices of non-oil commodities which have been increasing rapidly over the past few years are projected to decline next year. World prices of Thailand's key crops which have increased by 13 percent in 2005 have increased by only 0.3 percent this year, and are expected to decline by 2.4 percent next year. Moreover, inflation in the G-7 countries, which include Thailand's key export markets, have declined slightly this year and will remain at a similar level of 1.7 percent next year (see Table 9). This means

¹⁸ Simple average of Brent, Dubai, and West Texas Intermediate (WTI's) prices.

that prices of Thai manufactured exports to the G-7 countries will not rise by much more than this year's.

Price of manufactured exports from developed countries is expected to increase only marginally next year. The manufactured unit value (MUV), a measurement of the prices of manufactured goods from major developed countries, has increased by 1.6 percent last year and 2.3 percent this year. It is, however, projected to increase by 0.8 percent next year. This means that the price of capital goods that Thailand imports from the developed countries would increase only slightly next year. Coupled with the appreciated baht, this could benefit investments next year.

Table 9. International Economic Environment
(Percentage change from previous year, except interest rate)

	2005	2006e	2007p	2008p
GDP Growth a/				
World	3.4	3.9	3.5	3.4
World (PPP Weights) b/	4.8	5.3	5.2	5.0
High Income	2.6	2.9	2.4	2.3
OECD countries	2.4	2.8	2.3	2.1
Euro Area	1.5	2.8	2.5	2.1
Japan	1.9	2.2	2.0	1.8
United States	3.1	2.9	1.9	2.0
Non-OECD countries	5.8	5.6	5.1	4.8
Developing countries	6.8	7.5	7.4	7.1
World Trade Volume	7.8	10.1	9.1	7.6
CPI Inflation				
G-7 countries c/ d/	2.0	2.0	1.7	1.7
Non-oil Commodity Prices	13.4	24.7	13.0	-3.1
Oil Price (US\$ per barrel) e/	53.4	64.3	68.0	72.4
- % change	41.5	20.4	5.7	6.6
Manufactures unit export value f/	0.0	1.6	2.3	0.8
Interest Rates				
\$, 6-month (percent)	3.7	5.2	5.3	4.8
€, 6-month (percent)	2.2	3.2	4.3	4.0

Source: World Bank DEC Prospects Group (October 2007)

Note: PPP = purchasing power parity; e = estimate; p= projected

a/ GDP in 2000 constant dollars; 2000 prices and market exchange rates b/ GDP measured at 2000 PPP weights c/ Canada, France, Germany, Italy, Japan, the UK, and the United States d/ In local currency, aggregated using 2000 GDP Weights e/ Simple average of Dubai, Brent and West Texas Intermediate f/ Unit value index of manufactured exports from major economies, expressed in USD

2.4 Export performance

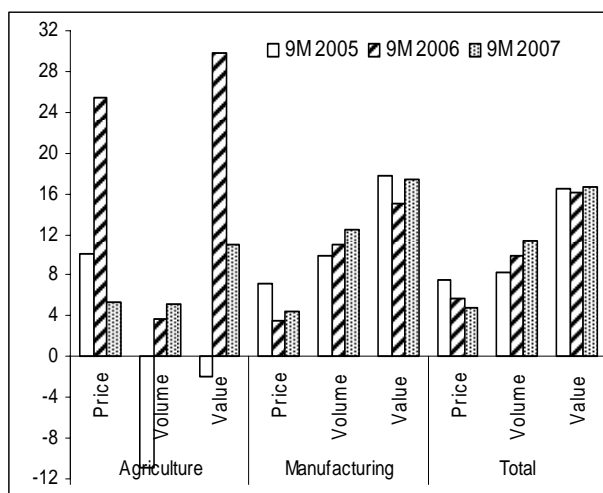
Exports continue to be Thailand's engine of growth this year and would remain so next year. Despite stronger Baht and the slow down in the US economy this year, exports remain resilient. Exports in US dollar term in the first 9 months this year grew by 16.1 percent year-on-year, which is about the same as those in the last two years. Figure 16 shows that these expansions are entirely supported by increases in export volume, as export prices decelerated. In terms of Baht, exports expanded by only 4.6 percent year-on-year in the first 9 months of the year, compared with 12.4 percent last year, due to the Baht appreciation. Total export growth next year is projected to slow down

to 10 percent, compared to 14.5 percent this year. Nevertheless, it will remain a major contributor to GDP growth next year.

However, exports growth next year will be negatively affected by the decline in the global demand and the decline in world prices of Thai key agricultural exports. Growth rates of Thailand's major markets and the world trade volume next year are projected to fall. Output growth of the EU, for example, is projected to fall to 2.1 percent next year compared to 2.5 percent this year. World trade volume which correlates well with Thai exports growth is projected to fall to 7.6 percent next year compared to 9.1 percent in 2006 and 10.1 percent in 2005 (see External Environment section for detailed discussion of the global environment). World prices of agriculture products, including those exported by Thailand such as rubber and rice, are projected to decline next year by 5.3 percent and 3.2 percent, respectively. However, the Japan-Thailand Economic Partnership Agreement (JTEPA) which took effect this November could help increase exports of textiles and garments and agriculture products to Japan next year (see Box 1 on the potential impacts of the JTEPA on Thailand's exports to Japan).

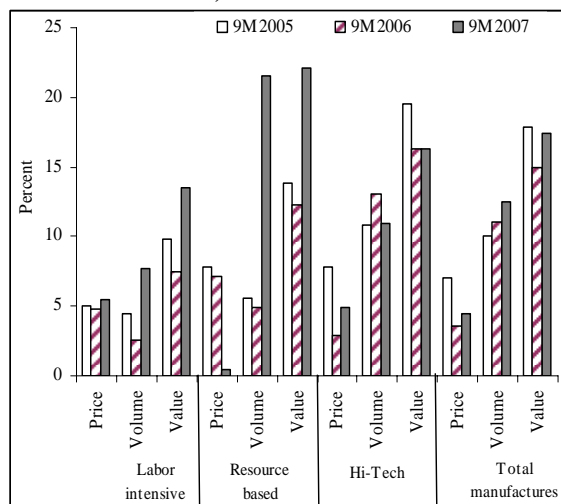
Firms' adjustment next year to the changes in demand and prices for their products could also lower their exports growth. Exports of certain products next year may decelerate as manufacturers switch to the domestic market. With the slow down in domestic demand this year, industries that have certain production processes and technology that do not allow them to easily scale down their outputs¹⁹ have turned to export their products even though the export prices in baht terms are not attractive as the baht had sharply appreciated. When domestic demand picks up next year, firms in these industries would switch to sell domestically. This year many exporting firms have tried to retain their customers by not increasing their export prices in US dollar terms which are usually negotiated 12 months in advance, and bearing the lower baht receipts and margin cuts. However, next year, firms may need to raise their prices in US dollar terms, which could limit their export growth. This is, however, particularly true for products with low import-content, which account for a lower share of Thai exports than those with high-import content. Hence, their impact on total exports may not be large.

Figure 16. Export Growth Price, Volume and Value, 9M 2005 – 9M 2007



Source: BOT

Figure 17. Manufactures Export Growth Price, Volume and Value, 9M 2005 – 9M 2007



Source: BOT

¹⁹ An example is firms in the textile industry whose production is generally large scale and capital intensive. Once started, the machines will produce a large amount and, it is technically difficult to reduce the amount of production.

Box 1. The Potential Impacts of the JTEPA on Thailand's Exports to Japan

The Japan-Thailand Economic Partnership Agreement (JTEPA) was signed on 4 April 2007 and is effective from 1 November 2007. The Agreement covers a wide range of topics such as trade in goods, trade in services, rules of origin, customs procedures, paperless trading, investment, intellectual property, and government procurement. Since Japan is Thailand's largest trading partner and source of foreign investment²⁰, this Agreement tends to have a profound effect on the Thai economy. This box focuses on trade in goods and particularly examines the impacts of lower import tariffs under the JTEPA on Thailand's exports to Japan

Lower import tariffs between the two countries can boost Thailand's exports to Japan. This can be achieved through enlarging exports of products that are currently significantly exported to Japan and by promoting products that are not yet exported substantially to Japan but now have greater potential. The former can be both through cheaper final or consumer goods and through lower costs of Japanese-made intermediate goods that Thailand imports and uses in manufacturing export products.

The JTEPA could help strengthen Thai manufactured exports to Japan and the rest of the world through lower prices of imported intermediate products. Table 10 lists Thailand's top 10 export products to Japan in 2006, at the 6-digit Harmonised Code, with their pre and post-JTEPA tariff rates.²¹ It shows that most of Thailand's top export products to Japan are electronics and electrical (E&E) products (including parts and components) and rubber-related products. Nearly all of these products have already enjoyed zero tariff rates even before the Agreement. Suggesting that the JTEPA is unlikely to increase exports of these products will however be incorrect, given the significance of intra-industry trade between the two countries. Table 11 shows that Thailand, largely through Japanese-owned firms located here, imports a variety of E&E parts and components and irons and steels that are used in assembling many export products. Thailand, for example, imports parts and accessories used in automatic data processing machines (HS847330) (see Table 11) and exports the assembled automatic data processing machines (HS847170) to Japan (see Table 10). Thailand also imports various vehicles parts and components and irons and steels (see Table 11) that are used in assembling Japanese-branded vehicles here and exported to the third markets.²² The JTEPA should therefore strengthen manufactured exports such as E&E products and motor vehicles through lower prices of imported intermediate manufacturing products from Japan.

Under the JTEPA, Thailand's key agriculture products to Japan will benefit from the reduction in Japanese tariffs. Table 12 lists Thailand's top 10 agricultural export products to Japan in 2006. Agricultural products, which despite lower export shares, are labour-intensive and directly affect income generation in the rural sector. All the products listed in Table 12 (except cane sugar) will enjoy lower import tariffs under the JTEPA. This is especially for prawn products whose tariffs are lifted since the first year.

In addition to current major export products discussed above, the JTEPA could also enhance Thailand's overall exports to Japan by encouraging exports of new products or products with currently low export values due to previously high tariff rates. According to the summary report by the Ministry of Foreign Affairs, products that have high potential as they enjoy zero tariff rates since the first year are, among others,

²⁰ In 2006, Japan accounted for about 16.3 percent of Thailand's total international trade value. Approximately 20.0 percent of Thailand's total imports and 12.6 percent of total exports were with Japan. In term of investment, the value of registered capital in FDI projects by Japanese firms accounted for 22.7 percent of all registered capital.

²¹ In this and other tables that will follow, the tariff rates shown for products that have many sub-products may not represent the rates of all sub-products. This should be viewed as suggestive only. The aim here is to give a broad picture of how much tariff measures will be relaxed under the JTEPA.

²² Motor vehicles (not exceeding 5 tonnes, HS 870421) were the fourth most important export product of Thailand in 2006, accounting for about 2.4 percent of total exports.

²³ In thinking about rising products, one could look at products that Thailand exports significantly to the world (which implies its comparative advantage) but not much to Japan. There are not many such products since Thailand's key export products to the world and Japan are quite similar. One exception is semi-milled or wholly milled rice (HS 100630), which accounted for about 1.7 percent of Thailand's total exports in 2006. Rice is however one of the Japanese sensitive items and therefore not part of the Agreement.

²⁴ Countries such as Malaysia, Singapore, and the Philippines have had agreements with Japan, while those with Indonesia and Vietnam are ongoing. The Japan-ASEAN free trade agreement is also expected to be signed in mid-2008. This means that several more countries in the region are about to gain from the freer trade with Japan, although different agreements have different focuses and trade benefits. Note that the signing of the JTEPA was delayed by about a year due to political turmoil in Thailand.

garments and textiles (pre-JTEPA tariffs are 2.7-13.4 percent), jewellery (2.7-10 percent), chemical products such as plastic-based office supplies, bags and tubes (2.5 percent), fresh or frozen tropical fruits such as durians, mangoes and coconuts (10-12 percent), and wooden products (2-7 percent).²³

Overall, the JTEPA should enhance Thailand's exports to Japan. Nearly all key agricultural products gain from lower import tariffs, while manufactured products also benefit from lower prices of imported parts and components. A study by the Thailand Development Research Institute (TDRI) indicates that the value of tariff payment that Thailand could save in the first year after implementing the Agreement amounts to 418 million US dollar or about 1.9 percent of Thailand's total import value from Japan. In the eleventh year, this potentially rises to 1,869 million US dollar or about 8.6 percent of the total import value. Nonetheless, there are other factors that influence the realisation of these benefits. Among others, this includes an ability of Thai exporters to meet Japan's non-tariff trade measures such as rules of origins and quality standards. Another is the fact that several other countries in the region have already implemented or about to sign economic partnership with Japan.²⁴ However, if Thai exporters move fast and take advantage of the JTEPA before other countries sign on to similar agreements, they will be able to enjoy the first mover's advantage.

Table 10. Tariff Rates of Thailand's top 10 Export Products to Japan

	HS6	Product description	Export value in 2006	Share (%)	Tariff in 2006 (%)	JTEPA tariff (%)
1	854229	Other electronic integrated circuits	674.8	4.1	0.0	0.0
2	400121	Smoked natural rubber sheets	552.1	3.3	0.0	0.0
3	400129	Other natural rubber	446.2	2.7	0.0	0.0
4	271011	Non-crude petroleum light oils and preparations	388.6	2.3	Several products, some are 0%	Several products, some are 0%, others have decreasing rates over 5 years and 0% thereafter
5	847170	Automatic data processing machines (storage units)	381.7	2.3	0.0	0.0
6	854221	Digital elec. integrated circuits	347.1	2.1	0.0	0.0
7	160232	Other prepared or preserved meat (species Gallus Domesticus)	337.2	2.0	6-21.3	Several products, one is 0% for all years, others have decreasing rates over 5 years and 3% thereafter
8	847160	Automatic data processing machines (input or output units)	320.9	1.9	0.0	0.0
9	761010	Doors, windows and frames with aluminum structure	236.9	1.4	0.0	0.0
10	852990	Other parts used with transmission/reception apparatus	236.8	1.4	0.0	0.0

Source: World Integrated Trade Solution (WITS) and JTEPA Agreements

Notes: Export value is in millions of US dollar.

Table 11. Tariff Rates of Japan's top 10 Export Products to Thailand

	HS6	Description	Import value in 2006	Share (%)	Tariff in 2005 (%)	JTEPA tariff (%)
1	854290	Parts of electronic integrated circuits	1,311.5	5.1	0-35	0.0
2	870899	Other parts and accessories of motor vehicles	1,298.9	5.0	30-60	20-30% with ASEAN completion rule
3	854229	Other electronic integrated circuits	878.3	3.4	0-35	0.0
4	721049	Other flat-rolled iron or non-alloy steel products (plated or coated)	521.5	2.0	9-20	0%; 7.5% in year 1 to 2.5% in year 9 and thereafter
5	732690	Other articles of iron and steel	460.5	1.8	10-35	15% in years 1-8 to 7.5% in year 9 and 0% thereafter
6	840820	Compression-ignition internal combustion piston vehicle engines	459.0	1.8	10-30	15-20% for all years with ASEAN completion rule
7	392690	Other articles of plastics and other materials for polymers and resins	418.8	1.6	20-60	27.27% in year 1 to 2.73% in year 10 and 0% thereafter
8	840999	Other parts used for compression or spark-ignition piston engines	389.7	1.5	10-30	15% with ASEAN completion rule
9	847989	Other machines and mach. appliances having individual functions	320.0	1.2	10-30	0.0
10	847330	Parts and accessories used in automatic data processing machines	269.1	1.0	0-40	0.0

Source: World Integrated Trade Solution (WITS) and JTEPA Agreements

Notes: Export value is in millions of US dollar.

Table 12. Tariff Rates of Thailand's Top 10 Agricultural Export Products to Japan

	HS6	Description	Export value in 2006	Share (%)	Tariff in 2006 (%)	JTEPA tariff (%)
1	160232	Other prepared or preserved meat (Gallus Domesticus)	337.2	2.0	6-21.3	Several products, one is 0% for all years, others have decreasing rates over 5 years and 3% thereafter
2	160520	Prepared and preserved prawns	214.6	1.3	4.8-5.3	0.0
3	230910	Dog or cat food for retail sale	186.4	1.1	36-59.5 yen/kg	Some are 0%, others are 16-54 yen/kg in year 1 to 1.6-5.4 yen/kg in year 10 and 0% thereafter
4	030613	Live, fresh, frozen or dried prawns	172.4	1.0	1.00	0.0
5	030749	Other Live, frozen or dried molluscs	166.5	1.0	3.5-15	2.9% in year 1 to 0.6% in year 5 and 0% thereafter
6	170111	Cane sugar	152.6	0.9	35.3-103.1 yen/kg	Renegotiate in year 5 or earlier
7	160239	Other prepared and preserved meat	133.8	0.8	0; 6-21.3	0%; 5% in year 1 to 1% in year 5 and 0% thereafter
8	030490	Other fish fillets and other fish meat	96.6	0.6	2-6	Several products, some have 0-2% for all years, others have decreasing rates over 5 or 7 years
9	160414	Prepared or preserved tunas and skipjack	94.9	0.6	9.6	5.3-8% in year 1 to 1.1-1.6% in year 5 and 0% thereafter
10	210690	Other food preparations, not elsewhere classified	71.3	0.4	64 yen/kg, 11-21%	Several products, some is 0% for all years, some to renegotiate, some have decreasing rates over 10 years, while others have tariffs even after year 10

Source: World Integrated Trade Solution (WITS) and JTEPA Agreements

Notes: Export value is in millions of US dollar.

The baht appreciation seemed to have more impact on labor-intensive exports, while the high-tech exports are more severely affected by a slow down in Thailand's key trading partners' economic growth rates. Historical data and the Bank of Thailand's estimations show that Thai exports are more sensitive to the change in key trading partners' real GDP growth rates than to change in the exchange rate²⁵. This is because the baht appreciation mainly affects industries with a high local content as they do not benefit from cheaper imports in baht terms. These are mostly the labor-intensive industries or the agriculture and food-related industries, whose competitiveness mainly relies on having a lower price than their numerous global competitors. They account for less than 20 percent of total Thai exports, but employ around 40 percent of the workforce. This year, for example, the garments, canned fruits, and furniture and furnishing exports have contracted by 9 percent year-on-year in the first 9 months. On the other hand, the impact of exchange rate appreciation on high-tech products, which account for around 65 percent of total Thai exports, are limited as they generally have a large import content. In addition, many firms in these industries are a part of the emerging regional production networks which involve cross-border trades in parts and components. Hence, the impact of an appreciation on the demand for their products is not high. On the other hand, they are more highly affected by lower output growth rates of their key markets. The growth rate of computer exports this year, for example, is only half that of last year. Computer parts exports have also contracted by more than 10 percent year-on-year. These are mainly attributed to the slow down in the US economy, a key market for computer exports²⁶.

With the baht likely to remain appreciated and global economy to slow down, an important way out for Thai exports is to improve their competitiveness. Moving the products up the value chain would reduce the pressure to compete based on low prices with emerging exporters such as Vietnam which have lower wages. These are particularly true for the lower-end labor-intensive industries such as garments and agriculture products. The need to improve productivity is also urgent for the growth of high-tech exports. As global demand slows down and investments are becoming more mobile, Thailand would need to raise the quality of its high-tech exports in order to maintain and perhaps expand its part in the regional production networks as well as maintain its production base for final high-tech goods. The remaining of this section discusses the exports performance this year and next by products and markets and the factors underlying them, including a detailed discussion on the potential impacts of the Japan-Thailand Economic Partnership Agreement (JTEPA) on Thai exports.

This year, agricultural exports slowed down while manufactured exports remain solid. Agricultural export growth eased rather sharply from 25.7 percent in 9M 2006 to 11.3 percent this year (see Table 13). This is mainly due to much less favorable prices. Agricultural export price index in the first 9 months of this year rose by only 5.4 percent year-on-year compared to 25.5 percent last year²⁷ (see Figure 16). In contrast, manufactured exports sped up slightly. High-tech products, which accounted for about 65 percent of Thailand's total exports in 2006, continued to drive overall export growth, although with slightly slower speed. Meanwhile, all other types of manufactured exports improved. Note that both higher export volume and price strengthened the performance of labor-intensive manufacturing products, while higher exports of resource-based manufacturing products are primarily due to larger export volume (+21.5 percent), as export price index rose by only 0.4 percent in the first 9 months of the year compared to 7.2 percent in the same period last year (see Figure 17).

²⁵ The estimation shows that a 1 percent appreciation in the real exchange rate would lower total exports by only 0.1 percent; a 1 percent decline in key trading partners' real GDP growth would lower exports by 1.44 percent.

²⁶ Based on the data from the Customs Department, exports of computers to the United States, which account for about 20 percent of all Thailand's computer exports, grew by only 11.3 percent. Exports of computer *parts* to Singapore, Malaysia, and South Korea in 9M 2007 fell by 29.1, 19.6, and 12.2 percent, respectively. As these countries are part of the production networks in East Asia, this largely reflects lower demand from the final markets, especially the United States.

²⁷ Data from the Office of Agricultural Economics show that average export prices per tonne (in term of Baht) of many key agricultural products declined in 9M 2007 compared to 9M 2006. Among others, these include Para rubber (-8.8 percent), smoked rubber sheet (grade 3) (-9.9 percent), frozen prawns (-10.3 percent), preserved tunas (-0.3 percent), and sugar (-20.7 percent).

**Table 13. Export Value Growth Rates and Shares by Sub-sectors,
January-September, 2005-2007**

	Share (%)	Growth (%)		
	9M 2007	9M 2005	9M 2006	9M 2007
Agriculture 1/	9.2	0.9	25.7	11.3
Manufacturing	88.2	17.8	15.0	17.4
Labor intensive products	8.5	9.8	7.5	13.5
High-tech products	64.2	19.5	16.3	16.3
Resource-based products	10.4	13.9	12.3	22.1
Other manufactured products	5.2	20.8	18.6	30.3
Others 2/	2.6	23.6	16.9	-6.7
Total	100.0	16.5	16.2	16.6

Source: BOT

Notes: 1/ "Agriculture" includes agricultural, fishery and forestry products

2/ "Others" includes mining, samples and other unclassified goods, and re-exports

At the product level, rubber exports dropped while high-tech products generally grew at satisfactory rates. A sharp slowdown in agricultural exports is mainly caused by lower exports of rubber (-0.1 percent in 9M 2007), which is the top agricultural export in term its share in the total export value (see Table 14). This is due a 1.3 percent decline in export volume, as average export price increased slightly. Meanwhile, exports of some agricultural products such as rice and fresh and frozen fishes expanded noticeably. Table 14 also shows that higher contribution to total export growth of resource-based products in 9M 2007 is largely supported by a significant recovery in sugar exports (+96.9 percent)²⁸, while jewellery, leather products, travel goods, and toy products helped to boost the performance of labor-intensive products exports. Within the high-tech products, exports of machinery and mechanical appliances eased rather significantly, underpinned by decelerated export growth of computers (from 27.8 percent in 9M 2006 to 14.8 percent in 9M 2007) and a large fall in computer parts exports (-13.1 percent)²⁹. Sustained export growth in high-tech products was thus supported by expansions in other key products including electrical apparatus for electrical circuits, electrical appliances, and vehicles, parts and accessories. In the bottom part of Table 14, which shows top five products based on export share, we see that, apart from computers and computer parts, export growth of other three products – integrated circuits, air-conditioner, and parts of passenger car – accelerated.

Exports to the US declined, while those to other key markets expanded well. Exports to the US, which accounted for about 15 percent of Thailand's total exports in 2006, registered a 3.2 percent decline in 9M 2007 (+16.0 percent in 9M 2006). This is mainly due to weaker demand following the sub-prime mortgage turmoil. Overall strong export growth is thus supported by other export destinations, which see their contributions to total export growth rising this year (see Figure 18)³⁰. Of particular interest is the EU market, where exports to larger economies such as France, Germany and Italy expanded continuously over the past few years, while growth rates in many of the new EU members have also been impressive. Emerging markets such as China and the Middle East also exhibit increasing market shares. Overall, the weaker demand in the US was offset by stronger demand in other markets.

²⁸ After three years of negative growth (nine-month data), sugar export volume expanded by 126.3 percent in 9M 2007 relative to 9M 2006. During this period, the export price of sugar fell from 329 to 286 US dollar per tonne.

²⁹ Based on the data from the Customs Department, exports of computers to the United States, which account for about 20 percent of all Thailand's computer exports, grew by only 11.3 percent. Exports of computer parts to Singapore, Malaysia, and South Korea in 9M 2007 fell by 29.1, 19.6, and 12.2 percent, respectively. As these countries are part of the production networks in East Asia, this largely reflects lower demand from the final markets, especially the United States.

³⁰ In 2006, the market shares of the export markets shown in Figure 3 were Japan (12.6 percent), EU (13.9 percent), ASEAN (20.8 percent), Middle East (4.4 percent), China (9.0 percent), and other markets (24.3 percent). Important "other markets" are, among others, Australia, Hong Kong, India, South Korea, and Taiwan.

Table 14. Export Value Growth Rates and Shares by Products, January-September, 2005-2007

	Share (%) 9M 2007	Growth (%)		
		9M 2005	9M 2006	9M 2007
Agriculture				
Rubber	3.6	8.1	53.0	-0.1
Rice	2.0	-9.9	3.2	23.3
Tapioca products	0.9	-6.3	26.9	27.7
Fresh and frozen prawns	0.8	25.0	18.5	13.6
Resource-based products				
Rubber products	2.2	21.8	23.5	21.9
Canned food	1.6	17.4	15.4	19.3
Sugar	1.0	-11.0	-10.0	96.9
Furniture & furnishing items	0.8	5.6	-2.0	-7.9
Labor-intensive products				
Precious stones & jewellery	3.2	19.7	16.9	29.8
Garments	2.0	2.7	2.4	-6.5
Other textile products	1.0	10.0	8.5	12.4
Wood products	0.8	8.6	14.0	12.1
High-tech products				
Machinery & mechanical appliances	15.0	27.0	24.7	13.5
Electrical apparatus for circuits	10.6	3.1	7.5	14.3
Vehicles, parts & accessories	8.5	44.1	20.9	29.6
Electrical appliances	7.7	8.2	6.2	17.4
Top 5 sub-products				
Computers	7.9	60.9	27.8	14.8
Integrated circuits	5.0	10.3	19.7	20.4
Air-conditioner	2.3	15.3	0.7	40.3
Parts of passenger car	2.2	56.5	13.0	34.6
Computer parts	2.1	-11.6	21.5	-13.1

Source: BOT

Note: Products in each category are the four products with the highest market shares in 9M 2007

Thai exports growth are middle among its Asian neighbors. Exports growth of the Philippines, China, Korea and India are higher than that of Thailand at least in the first half of this year (see Figure 19). Export growth of the Philippines was the highest in the region despite the fact that the peso's real exchange rates have appreciated by more than the baht over the past 18 months. Those from Indonesia, Singapore, Malaysia, and Hong Kong are lower than that of Thailand. It is interesting to note that the deceleration of Malaysian exports was primarily due to the lower export growth rates of electrical and electronics products, which are its major export products. On the other hand, exports growth of similar products from Thailand have sped up this year (see Table 14), suggesting that there could be a substitute of imports from Malaysia by those from Thailand in the final markets.

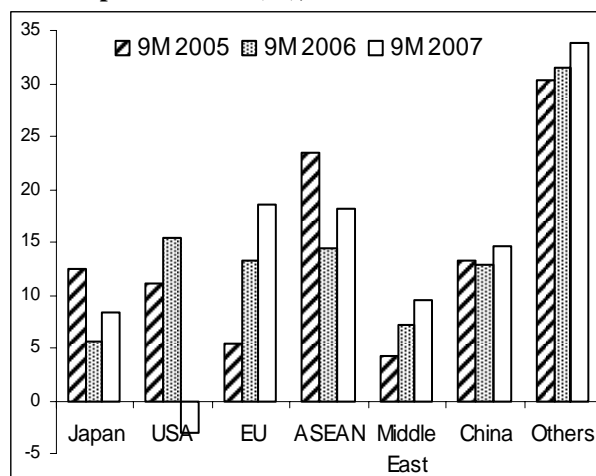
Looking forward, Thailand's export performance would likely decline next year. The World Bank estimates that world real GDP growth rates in 2007 and 2008 would be around 3.4-3.5 percent, easing slightly from 3.9 percent in 2006. The weighted average real GDP growth of Thailand's top ten export markets is also likely to fall from 5.1 percent in 2006 to 4.5 percent in both 2007 and 2008.³¹ World trade volume growth will also slow down next year to 7.6 percent from 9.1 percent this year. Another downside risk is escalating world oil prices, which could weaken the global demand further. In terms of price, agricultural prices should continue the decreasing trend.³² This implies that manufactured exports will continue to drive export value growth. Garments and agricultural exports to Japan could,

³¹ These top ten economies are the United States, Japan, China, Singapore, Hong Kong, Malaysia, Australia, the United Kingdom, Taiwan (China), and Indonesia.

³² This is attributed to lower prices of beverages, food (especially grains), and raw materials. For example, it is estimated that the prices of rice, sugar, and rubber in US dollar terms, which are Thailand's key agricultural export products, would drop by about 3.2, 16.7, and 5.3 percent in 2008 relative to 2007, respectively.

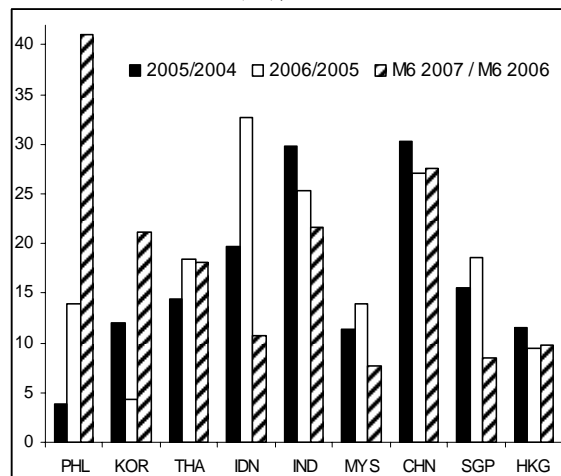
however, benefit from lower tariff rates under the Japan-Thailand Economic Partnership Agreement (JTEPA) (See Box 1 on the potential impacts of the JTEPA on Thailand's exports to Japan).

Figure 18. Contribution to total export growth by export markets (%), 9M 2005 – 9M 2007



Source: BOT

Figure 19. Export growth rates of Selected Asian Countries (%), 2004 – 6M 2007



Source: IMF

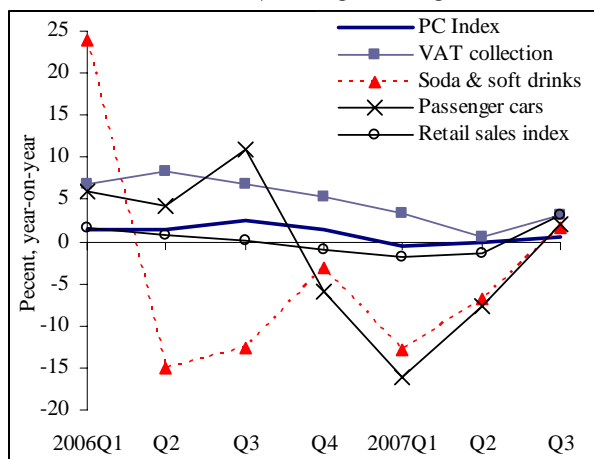
2.5 Household Consumption

Household consumption should recover next year after being depressed this year as consumer's confidence fell with lower economic and income growth. Although inflation and interest rates remain low, real household consumption grew by only 1.1 percent year-on-year in the first half of the year, which is its lowest growth rate since 2000. Consumer's confidence, as measured by the Consumer Confidence Index, has been declining every month since November last year and hit its 5-year low in October this year. Household consumption was particularly depressed for durable goods and hotel and restaurant services. In the first half of this year, purchases of cars and motorcycles and electrical appliances fell from last years levels by 10 percent and 5 percent, respectively. Purchases of hotel and restaurant services grew by only 5 percent, a sharp decline from its 14.5 percent growth in the first half of last year. The Private Consumption Index release by the Bank of Thailand has sped up slightly in the third quarter of the year. Sales of passenger cars and soft drinks and retail sales have started to expand in the third quarter compared to their contraction in the first half of the year (see Figure 20). Household consumption will probably register a 1.4 percent growth for the whole year, its lowest annual growth since 1999. With inflation and interest rates remaining low and output and investment growths expected to be higher next year, consumer's confidence should be revived as well as their spending. However, key crop prices are not expected to be as robust as this year in line with their international prices, hence, limiting the growth of rural household income and consumption. Moreover, workers in labor intensive industries may continue to see their working hours cut down should exports continue to be adversely affected by the appreciated baht. Household consumption is expected to increase by 4 percent next year from its low level this year.

Lower farm income growth and real wages have stalled household consumption growth this year. Farm income growth has slowed down considerably this year while non-farm wages have declined. Farm income expanded by 23 percent year-on-year in the first 9 months of this year compared with more than 30 percent growth last year as a result of both lower growth in farm production and prices. This has affected the purchasing power of rural households which accounts for roughly 10 percent of total household consumption in Thailand. On the other hand, data from the Labor Force Survey suggests that monthly *real* wages in the non-agricultural sector in the first half of the year had declined by 1.5 percent. This is in line with the decrease in work hour per worker as firms tried to adjust to

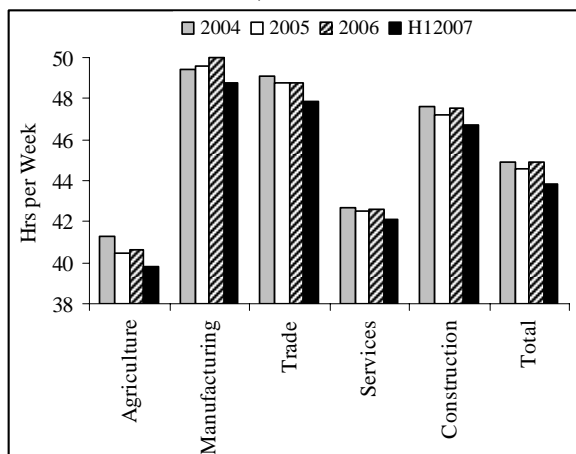
higher costs. In the manufacturing sector this year, for example, a worker works 1.2 hours per week less than that of last year. In the trade and construction sectors, work hours per week declined by 1 hour this year (see Figure 21). This has affected both the purchasing power and the confidence of the workers.

Figure 20. Change in Private Consumption Indicators, 2006Q1-2007Q3



Source: BOT

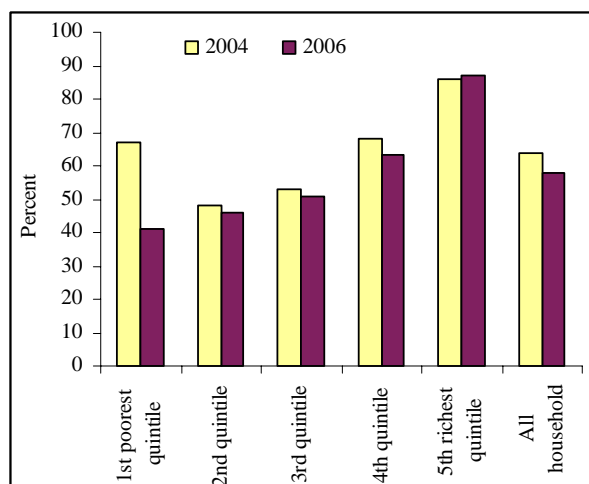
Figure 21. Number of Hours worked per Week per Worker, 2004-H12007



Source: BOT

Next year, household consumption growth should recover with interest and inflation rates remaining low, while household debt to income levels have fallen. Interest rates are expected to remain similar to that of this year with the minimum loan rate (MLR) at 7.3 percent. Inflation is also expected to rise to 3 percent from this year's 2.2 percent. Hence, real loan rates will likely be slightly lower than those of this year (see Real GDP growth section for a discussion on next year's inflation). The recently released Thailand Socio-Economic Survey results for 2006 showed that household debt to income ratio in 2006 stood at 0.58, a decline from 0.64 in 2004. This is the result of the decline in the debt to income ratio of households in all income quintiles except for the richest quintile which remains more or less stable (see Figure 22). This suggests that there is room for additional household borrowing this year.

Figure 22. Household Debt to Annual Income, 2004 and 2006



Source: SES 2004 and 2006

However, the recovery in household consumption will be a cautious one as uncertainties on income growth remain. Farm income growth is expected to decelerate further next year as key crop prices will not increase as much as they did this year. Forecasts suggest that world prices of Thailand's key crops may decline next year after increasing robustly for the past few years (see Table 15). This would hamper the increase of local crop prices. On the other hand, incomes in the non-agricultural sector would depend largely on the strength of Thai exports, a rebound in tourism and continued strong growth in tourism, construction, and real estate businesses.

Table 15. Change in World Prices of Thailand's Key Crops

(Percent)

	Weight	2005	2006	2007p	2008p
Rice	24.8	20.5	6.5	1.0	0.0
Rubber	11.5	15.2	40.3	1.1	-4.4
Sugar	4.5	37.9	49.5	0.7	4.5
Maize	3.0	-11.7	23.5	1.4	0.0
Palm Oil	2.0	-10.4	13.3	1.5	-4.3
Coconut Oil	1.2	-6.6	-1.6	1.4	-4.3
Soybean Oil	0.8	-11.5	9.8	1.3	-4.0
Coffee, Robusta	0.7	40.5	33.6	1.2	-5.4
Tobacco	0.6	1.8	6.4	1.1	-1.5
Cotton	0.2	-10.9	4.1	1.0	0.9
Sorghum	0.1	-12.4	27.8	1.4	0.0
Weighted average	49.4	8.1	9.8	0.5	-0.5

Source: BOT and World Bank

2.6. Investment

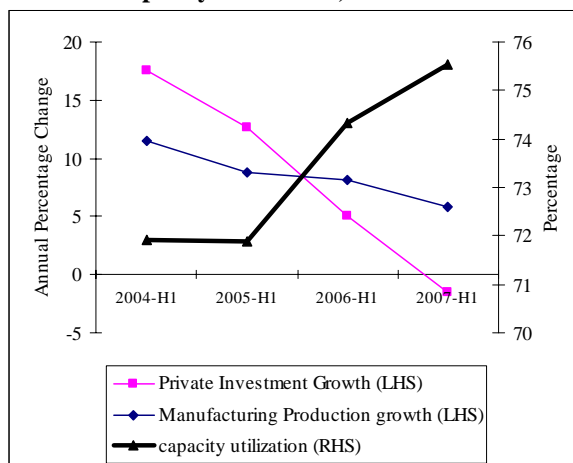
Investment this year slowed down significantly as a result of the lack of growth in private investment, but should speed up next year as private investment recovers. This year, private investment, which accounts for three-quarters of total investments in Thailand, was severely affected by the policy uncertainties and the slow down in domestic demand. It therefore remained at the same level as that of last year, or in other words, no growth. This has lowered the growth of total investment to only 1 percent, which is the lowest rate since 2002. Public investment in real terms, on the other hand, grew by the same rate as its last year's 4.5 percent. However, in nominal terms, its growth has declined from 10 percent last year to 6.8 percent this year as disbursement rate of public investment funds was slow this year. Public investment should speed up next year as the undisbursed funds from this year are carried over. In addition, the government's budget for next year has increased, and the disbursement rates are expected to be higher than this year's. Private investment growth is also expected to speed up next year with investors regaining confidence as the political and policy uncertainties decline. Given so, private investments that have been delayed in the past couple of years could start to be translated into actual investments next year. With both the private and public investments expected to grow faster, total investment is projected to rise by 9.5 percent in real terms next year. However, the downside risk to this growth is that the new government delays its investment decisions next year or may not manage to resolve the political and policy uncertainties. If so, they would affect not only the magnitude of the government's investment but also the sentiments of private investors and, thus, private investment

2.6.1 Private Investment

Private investment growth will likely be the lowest this year since the crisis as the investment climate has not been favorable. Private investment growth this year suffered from the high oil prices, global uncertainties as well as domestic policy uncertainties. As a result, real private investment has contracted by 1.5 percent year on year in the first half of this year. Investment in both equipments and construction contracted³³. Private investment growth for the whole year is expected to be around zero. Oil prices which are now doubling their 2003 levels have led to increases in both the production and the transportation costs for firms, leaving smaller funds for their investments. Moreover, uncertainties around export growth amidst global uncertainties as well as the slow down in household consumption growth have led firms to delay their investment plans. But the most critical factor that delayed private investment this year has been the policy uncertainties within Thailand, especially those that signaled barriers to foreign investments such as the announcement of the capital controls as well as the proposed amendments of the Foreign Business Act. These have severely affected sentiments, particularly those of foreign investors and Thai firms that are affiliated with them. This is reflected in the contraction of foreign direct investment (FDI) this year, the first time since 2003. The delay in the large public infrastructure investments had also provided a less crowding-in effect to private investment.

With the slowing growth of private investment in the past 6 years, capacity utilization has reached the highest level since the crisis. Capacity utilization in the first 9 months of this year stood at 74 percent, just slightly below the pre-crisis level of 77 percent. This is a 10 percentage-points increase from the same period in 2002. This reflects the rapid decline in private investment growth since 2003, while manufacturing production growth continued during those years (see Figure 23). In the first 9 months of this year, 17 percent of industries are operating above 80 percent capacity utilization, of which 10 percent are above 90 percent capacity utilization³⁴. Without a rapid turnaround in private investment growth, a supply constraint may likely emerge when demand growth picks up.

Figure 23. Private Investment Growth, Manufacturing Production Growth and Capacity Utilization, 2004H1-2007H1



Source: NESDB and BOT

Private investment should rebound next year as investor's confidence resumes amidst a more favorable investment climate. With the upcoming elections announced and the Japan-Thailand Economic Partnership Agreement (JTEPA) effective on the November 1st, investor's confidence has shown signs of recovery. The Bank of Thailand's business sentiment index (BSI) improved year-on-

³³ Investment in equipment (accounts for 77 percent of private investment) and construction (accounts for 23 percent of private investment) fell by 1.7 percent and 1.0 percent year-on-year, respectively.

³⁴ Based on the value-added of the industries in 2000. Source: BOT

year for the first time in August after declining since December last year. The expected BSI for the upcoming 3 months has started to improve in August, after declining since March this year. The Thailand's Listed Companies Association's quarterly CEO survey in October has also shown improvements in the business sentiments of listed firms for the next year. More than 60 percent of the 110 listed companies surveyed plan to expand their investments next year. Moreover, investment promotion applications to the Board of Investment (BOI) in the first 9 months of this year are 23 percent higher than that of last year and are higher than the levels since 2000 (see Table 16). Applications are particularly high in the services and infrastructure industries. Real interest rates will also remain low at slightly lower than this year's 5 percent³⁵, thus, not an impediment to private investments. Private investment is expected to expand by 10 percent next year after slowing down in the past 4 years.

**Table 16. Investment Promotion Applications to the Board of Investment (BOI),
January-September of 2004-2007**

(Billion Baht)

	9M2004	9M2005	9M2006	9M2007
Total	373.6	453.6	362.3	446.1
Agriculture	41.1	30.0	29.8	40.3
Mining, ceramics and base metal	9.3	14.0	3.7	33.2
Light industry	8.1	12.0	12.8	8.8
Metal products, machinery and transport equipment	46.1	125.4	43.9	60.5
Electronics and electrical appliance	74.1	69.8	54.8	68.1
Chemical, paper and plastic	73.3	46.3	140.5	97.6
Services and infrastructure	121.4	156.1	76.9	137.5
Applications by foreign firms and joint ventures	212.6	314.1	212.7	345.6

Source: BOI

BOI approvals in the past few years could be translated into actual investments starting next year. The rapid decline in private investment growth in the past few years did not reflect the high amounts of BOI approvals in 2004 and 2005 (see Table 17). This suggests that investors who had received the approvals have been delaying their investments³⁶. As the investment climate improves next year, these approvals will start to be translated into actual investments. Industries that have received large BOI approvals in 2004 and 2005 are in the services and infrastructure, and the metal products, machinery and transport equipment.

Foreign direct investment which had contracted this year will likely rebound next year. Gross inflows of foreign direct investment (FDI) have been increasing since 2000 and reached record high of US\$32 billion last year (see Figure 24). FDI in the first 8 months of this year has contracted by 40 percent to US\$12.5 billion, compared to US\$21.3 billion in the same period last year. FDI contraction was largely in the financial, trade, machinery and transport, food and sugar, and petroleum products industries. Net FDI from the United Kingdom and Singapore declined sharply this year from last year by US\$3.4 billion and US\$1.4 billion, respectively. However, with the JTEPA being effective in November and policy uncertainties starting to clear up in the last quarter of this year, FDI particularly from Japan, which has the largest share of FDI in Thailand, should continue to rise after increasing by US\$0.4 billion in the first 8 months of this year.

³⁵ Based on the Minimum loan rate (MLR) deflated by the change in producer price index

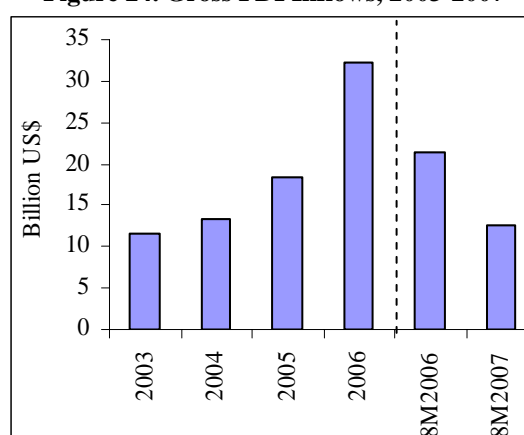
³⁶ In the past, BOI approvals growth and private investments growth are correlated with a 2-year lag, that is, the actual investments usually start 2 years after obtaining BOI approval.

Table 17. Investment Applications Approved by the Board of Investment (BOI), 2003-2006

(Billion Baht)

	2003	2004	2005	2006
Total	283.8	600.8	571.1	373.2
Agriculture	30	57.1	36.5	30.8
Mining, ceramics and base metal	17.1	64.1	104.9	3.3
Light industry	12.8	18.4	12.6	13.4
Metal products, machinery and transport equipment	69.5	74.9	144.3	57.2
Electronics and electrical appliance	44.3	94.3	90.6	61.9
Chemical, paper and plastic	49.3	121.7	55.1	145.2
Services and infrastructure	60.8	170.3	127.1	61.5
Applications approved for foreign firms and joint ventures	218.3	362.4	342.9	282

Source: BOI

Figure 24. Gross FDI Inflows, 2003-2007

Source: BOT

However, the magnitude of the rebound in private investment next year would depend on the extent to which investor's confidence is rebuilt. Policy measures that would help further improve investor's confidence and assist the rebound of private investment are ones that have a clear direction, signal an investment friendly environment, and reduce the cost of doing businesses. The relaxation of the capital controls (or the 30 percent unremunerated reserve requirement on capital inflows), for example, would be a positive signal to investors. However, this should be timed accordingly so that any adverse impact of large capital inflows could manage. The modification of the Foreign Business Act amendment such that the Act will not be applied retroactively and further liberalization of some key services sub-sectors such as the financial, logistics, and telecoms would be welcomed by investors.

Policies and reforms to help reduce the cost of doing businesses for firms will have a long-term impact in stimulating private investment. Policies that would help reduce the regulatory burden and inadequate infrastructure and skills, for example, would promote greater investments by firms. In the NESDB-World Bank's *Thailand Investment Climate, Firm Competitiveness and Growth Study*, firms have expressed concerns of regulatory burden as the top impediment to their business and thus further investments. An example of a regulatory burden is the price controls that are currently in effect for around 200 products in Thailand³⁷. In the monthly Bank of Thailand's *Business Sentiment survey*,

³⁷ See detailed discussion in Box 2 of Thailand Economic Monitor, November 2006. Past issues of the Monitor can be downloaded at www.worldbank.or.th

firms expressed that difficulty in price adjustment and high cost of production are the two key constraints in doing business. The difficulty in the price adjustment despite the rising cost of production is due to the price controls on over 200 products. As a result, the squeeze in firm's profit margins would delay their production expansion, productivity improvements, and investments. Hence, a relaxation of the price controls could help to promote not only firms investments but also improvements to their productivity. Other policies that would promote firm's investment in the upcoming years are in the areas of public investments in infrastructure and skills development and acquisition. Firms in the *Thailand Investment Climate, Firm Competitiveness and Growth Study*³⁸ have cited "inadequate infrastructure" and "skills mismatch" as two of the 3 top constraints to doing business and further investments in Thailand. Increasing public investments in infrastructure would therefore not only provide direct injection into the economy but would also facilitate business operations and their future investments. Similarly, policies to acquire, produce and develop people with skills that meet firm's demands would help build a strong skills base for future production and investment.

2.6.2 Public Investment

Public investment expansion slowed down this year but should speed up next year as disbursement rates and the government's investment budget rise. Public investment this year expanded by 6.8 percent compared to 10 percent last year in nominal terms. In real terms, it expanded by 4.5 percent, the same as that of last year as inflation declines. The slower nominal growth this year was partly due to the fact that the government's budget was increased only marginally in fiscal year (FY) 2007 (4.6 percent in FY2007 compared to 8.7 percent in FY2006)³⁹. In addition, several new measures to make public procurement more transparent and accountable have also slowed disbursements in the beginning of the year. Disbursement of public investment funds by the government and state-owned enterprises in 2007 will be around 70 percent of its approved budget (compared to 73 percent last year). The carry-overs from this year will be spent next year. In addition, the government investment budget for FY2008 has been raised by 8 percent. Hence, public investment next year could rise by around 10 percent in nominal terms or around 8 percent in real terms. These would provide not only a direct stimulus to growth but also a boost to private investor's confidence as well as help slow down the pace of Baht appreciation. However, there is concern that there could be continued delays in disbursements next year, as the new government will assume office only around February next year and may delay decisions on large investment projects.

Public investment expansion this year comes mainly from investments by the state-owned enterprises, while next year's will be mainly from that of the government. In FY2007, state-owned enterprises' investment increased by 16.8 percent in nominal terms (see Table 18). On the other hand, investments by the government did not increase from that of the last fiscal year. This is due to the fact that the government's investment budget was only slightly increased this year, and disbursement rate also fell. The government's investment budget was increased by only 4.6 percent in FY2007 compared 8.7 percent in FY2006. The disbursement rate of the investment budget this fiscal year was 70 percent as compared to 73.4 percent in FY2006.

Disbursements were slow earlier in the year and sped up towards the end of the year. During the earlier months of the calendar year, the disbursement of the investment funds by both the government and the state-owned enterprises were slow as several new measures to make public procurement more transparent and accountable, including a closer scrutiny on public procurement, were put into place by the current government. The disbursement rate for the whole FY2007 is around 70 percent compared to 73 percent last year.

³⁸ A joint study by the NESDB and World Bank released in 2006. The survey data used for the study was collected in 2005 and reflects information from 2004. The report can be downloaded at www.worldbank.org

³⁹ The Thai fiscal year runs from October of the previous year to September in the current year. FY2007 runs from October 1st, 2006 to September 30th, 2007.

**Table 18. Public Investment Budget and Disbursement,
FY2006-2008**

(Million baht)

Fiscal Year	2006	2007*	2008*
Central Government			
Approved Budget	358,336	374,649	404,677
% Growth		4.6	8.0
Actual disbursement	263,147	262,706	303,508
% Growth		-0.2	15.5
Disbursement rate	73.4	70.1	75.0*
SOE			
Approved disbursement	254,118	307,916	289,756
% Growth	2.8	21.2	-5.9
Actual disbursement	184,473	215,541	226,010
% Growth	6.7	16.8	4.9
Disbursement rate	72.6	70.0*	78.0*
Total Approved budget			
% Growth	612,454	11.4	1.7
Total Disbursement			
% Growth	447,620	6.8	10.7
Disbursement rate		70.1	76.3

Source: Fiscal Policy Office and NESDB

* Estimated

Public investment growth next year will accelerate as the government's investment budget increases and the funds unspent this year are carried-over to next year. The government's investment budget will increase by 8 percent next year, accelerating from the 4.6 percent increase this year. Moreover, the disbursement rates of both the government and the state-owned enterprises are expected to rise next year as the agencies are better adjusted to new measures to make public procurement more transparent and accountable. Carry-overs from this year's budget will be spent next year as well. As a result, the actual disbursements could total up to around 76 percent next year. Total public investment could therefore expand by around 11 percent next year (see Table 18).

Increasing public investment would help stimulate overall economic growth both directly and indirectly, hence, the risk of delays in public investments next year should be minimized. The direct impacts of the public investments are the injection of funds into the economy through the purchases of both local materials and labor needed for the investments and involvement of the private sector through public-private partnership (PPP) arrangements. PPPs could also help relieve the financing constraints of the government (see Box 2 on What is a Public-Private Partnership (PPP)?). The indirect impacts include the boost in private investment as it helps build private investor confidence. Investments to improve the infrastructure also help lower the costs of operations for firms. Better road and rail systems, for example, help reduce the logistics costs for firms. When the cost of doing businesses and investing are lowered, most firms will find it profitable to expand their production and invest. However, there is the risk that the approvals and disbursement of some of the large public infrastructure investments, such as the underground mass transit lines would be delayed, when the new government takes office. This should be minimized as they would hurt investor confidence and impedes the recovery of private investment next year.

Box 2. What is a Public-Private Partnership (PPP)?

PPP can certainly play an important role in Thailand, particularly when the government faces fiscal constraints but infrastructure investment and development is needed. However the modality and arrangement of the PPPs are different for different sectors. Therefore, understanding what they are and how they are implemented are important. The remaining of this box discusses these issues.

The “partnership” part of PPP is closely tied with the contract, which can span from a simple public procurement to privatization. PPP lies between these two extremes. While outsourcing and management contract are also in the PPP spectrum in a broad sense, most projects referred as PPP involve financing by private sector.

PPP is frequently seen as an investment tool, in which private-sector finance can fill in necessary public investment gap. This is often true and apparent, but more importantly, PPP is a procurement tool which serves as an alternative to a conventional public procurement. PPP is also believed to bring private-sector management practices, an efficiency enhancement feature, into a public project.

One major distinct characteristic of PPP is the output-based procurement. While the regular public procurement usually is input-based (i.e. defining and describing the input required), PPP procurement and its bidding documents define level of services and targeted performance expected from the procurement.

The contract is the key that defines the relationship among stakeholders (such as government agency, investors, and implementing agency) as well as the agreed practice guidelines (such as targets, obligations, incentives, penalties, follow-up measures, and dispute resolution). Standardized contracts, which can be seen in many developed countries, can be useful in shortening the bidding and negotiation process as well as in clearly specifying policies and boundaries of the public sector. Higher certainty and speed is expected.

Another key element of PPP is the risk allocation scheme. Many risks arise during various stages of a project, i.e. in planning, design, financing, management, and construction. The core principle is that each risk should be taken by the party who has the best capability to manage it. For example, riderships on a mass transit line can be managed by re-arranging and optimizing bus routes which can only be done by the public sector. If it comes to construction and preventing cost overrun, a construction company might handle it more efficiently. Therefore, risk should be analyzed carefully in order to determine the appropriate stakeholders that fit the risk profile of a project.

Successful international experiences can be found in many countries (e.g. United Kingdom, Korea, and Chile), in which the practices vary from country to country. The Value-for-Money (VfM) is widely applied along with the standard contract and a strong policy framework in place in the UK, where solid legal framework is the foundation for the PPP program in Chile.

Thailand’s experience in private participation in public project is rather mixed. Each project appears to be unique. Common PPP practice has been vague, despite that there exists the “Royal Act on Private Participation in State Undertaking (1992)” which is currently under amendment.

The challenge for Thailand is to appropriately approach the introduction of standard PPP practices, where related risks are properly analyzed, suitable PPP option (or conventional procurement) is selected, and implementation process fits well with social and political contexts.

Note: The above box was prepared by Chanin Manopiniwes, Junglim Hahm, and Fei Deng, World Bank

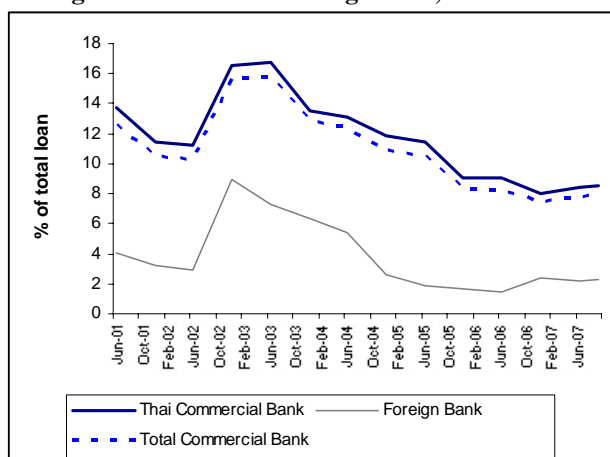
2.7 Financial and Corporate Sector Development

Financial Sector Developments

Thailand's financial sector continues to strengthen, supported by favorable economic developments through mid 2007, although challenges may appear in the lending portfolios of banks if NPLs continue to rise. The banking sector continues to play a large role in the economy with estimated financial sector assets at 200 percent of GDP. NPLs as a share of total loans remain below 10 percent although it has increased slightly from the beginning of this year. Political uncertainty continues to weigh on the minds of financial sector participants despite the fact that economic conditions appear to continue to support stability of the sector; this uncertainty may be resolved after elections are held at the end of this year.

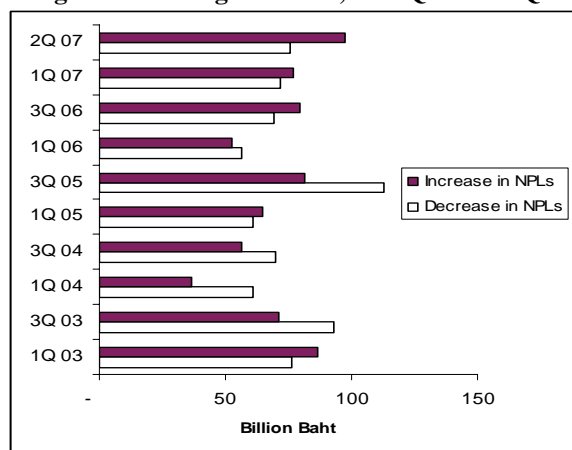
The non-performing loans (NPLs) of commercial banks which had been continuously decreasing since 2003 have started to pick up in 2007. Although the BOT announced early in 2006 a number of measures aimed to lower system-wide NPLs, the NPLs of commercial banks started to climb up since early 2007, from 7.5 percent of total loans in December 2006 to 7.9 percent in September 2007 (see Figure 25). The increase of NPLs comes mainly from Thai commercial banks which include both private banks and state-owned banks. The increase in NPLs has also risen from the previous quarter (see Figure 26), especially in the manufacturing sector and commercial sector.

Figure 25. Non-Performing Loans, 2001-2007



Source: BOT

Figure 26. Change in NPLs, 2003Q3 – 2007Q2



Source: BOT

There continue to be two long outstanding issues confronting the Thai banking sector; the long standing issue of residual crisis and post crisis problem assets within the financial sector (not necessarily in the banking sector) and delay of passing the much needed financial sector laws by the Government. A stock of distressed assets remain in the sector, and the AMC's which were created to help address these assets by removing them from the banks, have not dealt with many of the distressed assets which remain on their books. Structural weaknesses in the legal regime identified immediately following the crisis have yet to be adequately addressed in new legislation. However, some progress has been done as the Bank of Thailand Act, the Financial Institutions law, and the draft of the Deposit Insurance Institution Act have passed the Council of State and are expected to be approved by the National Legislative Assembly (NLA) before the end of 2007.

The banking sector performance has slipped this year. In 2007, the interest margin of the commercial banking sector is at 1.57, only half of the 2006 figure. Return on assets (ROA) and return on equity (ROE) declined to 0.29 and 5.8, respectively. Average capital adequacy in the banking sector is reported to be in the 13 percent range, above the BIS suggested amount of 8.5 percent. Profitability continues in most banks, although it appears to be dropping (see Table 19).

Table 19. Indicators of Commercial Banking Sector Health, 2003-2007

	(in percent)				
	2003	2004	2005	2006	2007*
Interest margins	2.0	2.5	2.9	3.11	1.57
Rate of return on assets (ROA)	0.7	1.2	1.4	0.77	0.29
Rate of return on equity (ROE)	10.5	16.8	16.5	8.49	5.8
Capital adequacy ratios	13.4	12.4	13.2	13.59	12.88
Net profits as percent of average assets (ROAA) *	0.7	1.3	1.4	0.8	0.8
<i>Net profits as percent of average equity capital (ROAE) *</i>	7.8	13.3	12.1	7.1	8.1

Source: BOT and World Bank's estimates

* Latest available

In addition, the role of Government in the banking sector continues to be extensively long after the crisis. Ten years after the Government stepped in to support the banking sector during the crisis, it continues to be a major equity holder in the sector having an interest in approximately 50 percent of all current banking sector assets. A reduction in Government ownership interest in banks continues to be discussed, with little happening due to limited options and a continued desire to “wait to get the best price”.

Although there are issues needing to be addressed in the sector, several recent events have been very positive. Bank of Ayudhya recently completed a transaction with GE Capital resulting in GE Capital's acquisition of a 34.9 percent stake in the bank. It is anticipated that this transaction will not only add capital to the bank but also position Bank Ayudhya to expand its customer base and to grow its lending portfolio. In November 2007, Thai Military Bank finalized the recapitalization plan with the ING group of the Netherlands. The total recapitalization amount will be 37,623 million baht, increased from 35,000 million baht previously. According to the finalized plan, TMB will increase its capital by issuing 25,000 million new shares, of which approximately 13,112.6 million shares will be allocated to ING at a price of 1.60 baht per share and the remaining shares will be allocated to the Ministry of Finance and other existing shareholders at 1.40 baht per share. Consumer protection in the banking sector is being given greater attention and recently the Bank of Thailand announced that it was to issue new guidelines for collection of credit card and personal loan debts. In addition, in another area of the financial sector, the Office of the Insurance Commission was established on September 1, with the transformation of the Insurance Department into a more autonomous body, although it has been placed under the Ministry of Finance. Finally, the Bank of Thailand has shown great interest in further strengthening the financial sector, and in particular, the banking sector. To that end, it has recently been holding a round of public consultations with various interested parties on the Government's draft Second Financial Sector Master Plan II for the development of the financial sector. While the plan seems to do a good job addressing furthering access to financial services, it appears to be limited to the banking sector. The public discussion of the draft document has been very good, with many valuable suggestions for strengthening the draft. This dialogue over such an important developmental issue is very encouraging for the longer term modernization of the financial sector.

Corporate Sector Developments

Performance of the non-financial listed companies in first half of 2007 has declined from last year's. Even though the revenue of non-financial listed companies has increased, it cannot keep up with a faster growth of the companies cost. As a result, their net profit margin declined by 20 percent year-on-year this year. In addition, abilities to generate income from assets have also been declined. In the second quarter of 2007, the return of capital employed (ROCE) and the return on equity (ROE) fell by 18.5 and 22.3 percent compared to the same quarter last year. However, the financial risks of non-financial listed companies remain stable at a low level. Interest coverage ratio decreased by 18.6 percent and debt to equity ratio dropped by 6.8 percent from the same quarter last year (Table 20).

Table 20. Corporate Financial Ratios (Listed Companies of non-financial industry), 2004-2007

(Percent)

	2004		2005		2006		2007	
	Q1	Q2	Q1	Q2	Q1	Q2	Q1	Q2
Return on Capital Employed (ROCE)	17.0	17.5	19.7	19.2	18.3	18.9	15.7	15.4
(percent Y-O-Y)	11.1	12.2	15.9	9.7	-7.1	-1.6	-14.2	-18.5
Return on Equity (ROE)	20.5	21.2	22.6	22.2	19.4	19.7	15.5	15.3
(percent Y-O-Y)	-2.4	5.5	10.2	4.7	-14.2	-11.3	-20.1	-22.3
Interest Coverage Ratio	7.64	7.61	8.84	7.98	9.13	8.16	6.76	6.64
(percent Y-O-Y)	40.4	54.7	15.7	4.9	3.3	2.3	-26.0	-18.6
Net Profit Margin	10.2	10.3	10.7	10.2	8.7	8.5	6.9	6.8
(percent Y-O-Y)	12.1	17.0	4.9	-1.0	-18.7	-16.7	-20.7	-20.0
Debt to Equity Ratio	1.27	1.25	1.17	1.19	1.19	1.17	1.09	1.09
(percent Y-O-Y)	-23.5	-20.4	-7.9	-4.8	1.7	-1.7	-8.4	-6.8

Source: SET

2.8 Medium Term Development

Thailand's output growth in the future would rely on greater investments today that would lead to greater productivity improvements in the future. Thailand's real GDP growth during 2005-2007 averaged 4.6 percent per year, which is below its potential growth of 5.5-6.0 percent. As Thailand's private investment growth has continuously slowed down for the past 4 years, the need to promote investments as well as to ensure that these investments will lead to higher productivity growths are critical to achieve higher competitiveness and Thailand's potential growth. Higher investment and productivity improvements can be promoted through a conducive business and investment climate as well as through competition and a workforce with higher skills level.

Improvements of the business and investment climate such as the reduction of regulatory burden and infrastructure bottlenecks can immediately start. Reducing the regulatory burden can be done quickly and would yield large efficiency gains. A survey of firms in the study of Thailand's investment climate⁴⁰ revealed that the top constraint to firm's operations and expansion is regulatory burden. It includes the length and uncertainty in the time taken to obtain approvals and licenses from relevant government agencies, multiple inspections by tax authorities, the delays in tax returns, as well as price controls. These were largely reported by firms in the garments, food processing, and auto-parts industries. In recent years, the relevant government agencies have made progress in stream-lining some of these processes, resulting in Thailand's improvement in the World Bank's Doing Business rankings from rank 20 in 2004 to rank 17 in 2006 and rank 15 among the 178 countries this year⁴¹. However, some of the key concerns above as voiced by firms can be further addressed both at the cross cutting level and at the industrial level. These would reduce firms' costs in dealing with government bureaucracy, thus, allowing firms to focus more on improving their productivity. Similarly, better transportation infrastructure provided through public investments, for example, would help improve the investment climate as they reduce the logistics cost for firms.

Promoting greater competition in the services sector can unleash the sector's large potential growth, which would also enhance the performance of the manufacturing sector. The services sector accounts for roughly 45 percent of Thailand's GDP and its share has not changed since 2003. A

⁴⁰ *Thailand Investment Climate, Firm Competitiveness and Growth* (2005), a joint study of the NESDB and the World Bank

⁴¹ The 2-rank improvement in Thailand's ranking this year from last year was mainly due to the number of days taken in exporting and importing after the introduction of e-Customs. See www.doingbusiness.org for more details of the Doing Business report.

recent sectoral analysis of total factor productivity growth in Thailand over the last 25 years shows that the services sector has lagged behind industry and agriculture⁴² in terms of productivity growth (see Table 21). Based on the Thai national accounts data, productivity growth in the wholesale and retail industry and the hotel and restaurant industry were particularly low. Growth in the services industries from 1980 to 2005 came mostly from employment growth as workers move out of the agriculture sector to the services sector. This urgently calls for policies to promote productivity improvements in the services sector. Increasing competition in the services sector through liberalization could unleash its productivity growth, which would also benefit the manufacturing sector which is the users of many of these services such as logistics and engineering. Liberalizing a few of the service industries currently restricted to foreign operators under the List 3 of the Foreign Business Act⁴³, for example, would not only promote higher productivity in those industries and the related manufacturing industries, but also help boost investor confidence.

Table 21. Sources of Growth, 1985-2005

	(Percent)			
	Total Economy	Agriculture	Industry	Services
Output growth	5.9	2.8	7.6	5.4
of which				
Employment	2.6	0.5	4.9	4.5
Education	0.4	0.2	0.4	0.4
Capital	2.0	1.9	1.9	0.9
Factor Productivity	0.9	0.2	0.4	-0.4

Source: *Measuring Output and Productivity in Thailand's Services-Producing Industries* (forthcoming)

Thailand's productivity growth in the future would rely heavily on the quality of its human resource. A higher skilled workforce will enable Thailand to move towards a knowledge economy in which products of higher valued-added based on technological, process, and design innovations are produced. Being a knowledge-based economy will allow Thailand to raise its productivity and competitiveness, since competitiveness based on having low wages and a depreciated exchange rate are no longer options for Thailand as an increasing number of countries with lower wages such as China and Vietnam are participating in the global trade. Moreover, even these countries are rapidly developing themselves towards a knowledge economy and are becoming more competitive in higher-tech export products.

Development of knowledge and skills takes time, so Thailand needs to act immediately if it does not want to be left behind in the next few years. The latest World Bank's Knowledge Economy index (KEI)⁴⁴, which is an aggregate index representing the overall preparedness of a country towards a knowledge economy, showed that Thailand's KEI ranking has fallen from 48 in 1995 to 56 (out of 137 countries) in 2007. China and Vietnam, on the other hand, have quickly increased their rank and is catching up with Thailand (see Table 22). The level of education and training is one of the key pillars of a knowledge economy. The network of higher education institutions, public research institutions, and the private sector must play an increasingly role in the creation of new knowledge and its dissemination. However, as knowledge is mainly generated in the universities, universities need to develop superior research capabilities. Experiences from countries that have been successful in moving towards a knowledge economy such as the UK, Korea, and Taiwan all have world class research universities in their countries. Science

⁴² Finding from *Measuring Output and Productivity in Thailand's Services-Producing Industries*, a joint study of the NESDB and the World Bank (forthcoming)

⁴³ Foreign firms must receive prior approval from the Ministry of Commerce in order to operate in the industries under List 3. These include logistics, engineering, architectural, and retail services.

⁴⁴ KEI is a simple average of 4 sub-indexes which represents the 4 pillars of the knowledge economy: (1) economic incentive and institutional regime, (2) education and training, (3) innovation and technological adoption, and (4) information and communications technologies (ICT) infrastructure. See www.worldbank.org/kam.

parks and incubator facilities adjacent to universities such as those in Korea had facilitated the linkages and knowledge flow between the universities and firms. Intermediary organizations such as those in the UK also play an important role in improving the information flow between the universities and firms such that knowledge generation, transfer, and use for germinating commercially viable technologies are encouraged. Providing incentives that can be easily accessed by firms has also helped to increase R&D within firms and encourage inter-firm collaboration on research. Moreover, innovations generally happen more rapidly in an environment of open competition in goods and services and financial markets and an efficient labor market⁴⁵.

Table 22. Knowledge Economy Index (KEI), 1995 and 2007

Rank	Change in Rank from 1995	Country	Knowledge Economy Index
2007			
1	+ 8	Sweden	9.3
40	+ 13	Malaysia	6.2
56	- 8	Thailand	5.4
75	+ 29	China	4.4
97	+ 12	Vietnam	3.1
1995			
9		Sweden	9.2
48		Thailand	5.7
53		Malaysia	4.9
104		China	2.6
109		Vietnam	2.2

Source: World Bank

⁴⁵ A more detailed discussion can be found in the *Towards a Knowledge Economy in Thailand Report* (forthcoming), a joint study by the NESDB and World Bank.

SECTION 3

Implementation of Structural Reforms

Many reform measures issued this year have laid a strong foundation for future growth. The current Cabinet has endorsed many acts and regulations that would lead to greater liberalization, competition and improved governance. An example is the draft Public Procurement Decree, recently approved by the Cabinet, which would enhance the transparency of the procurement process as well as cancel the privileges of state-owned enterprises which used to have the sole right to sell certain services to the public sector. Another example is the proposed amendments of the Life Insurance Act and Non-Life Insurance Act, which will allow insurance institutions to increase their foreign equity from the current 25 percent to 49 percent. Moreover, the State Enterprise Corporatization Act and the Deposit Insurance Institution Act have been approved by the Cabinet and will likely be passed by the National Legislative Assembly this year.

3.1 Financial and Corporate Sector Reforms and Restructuring

Financial Sector Reforms and Restructuring

Many of the draft financial laws have been submitted to the National Legislative Assembly (NLA) and are waiting to be passed. The Office of the Insurance Regulation and Promotion Commission Act was enacted on September 1st, 2007. The Financial Institution Business Act, the Bank of Thailand Act, the Securities and Exchange Act are under consideration of the NLA. The Currency Act has been withdrawn and is expected to be resubmitted to the Cabinet of the next government. In addition to these five Acts, the amendments of the Insurance Acts (Life-Insurance Act and Non-Life Insurance Act) were approved by the Cabinet on September 18, 2007, and the draft of the Deposit Insurance Institution Act passed the Council of State and will be submitted to the NLA.

To promote the insurance industry, the Government has enacted the Office of the Insurance Regulation and Promotion Commission Act, and is amending the Life-Insurance Act and the Non-Life Insurance Act. The Office of the Insurance Regulation and Promotion Commission Act has been effective since September 1st, 2007, while the Life-Insurance Act and the Non-Life Insurance Act was approved by the Cabinet on September 18th, 2007. Following the enactment of the Office of the Insurance Regulation and Promotion Commission Act, the Office of the Insurance Commission (OIC), the national insurance regulator, was set up on September 1st, 2007. The OIC is a transformation of the Insurance Department under the Ministry of Commerce (MOC) to the OIC office under the Ministry of Finance (MOF). Under the new Act, the MOF will directly be responsible to supervise the OIC with supports from the MOC. The initial budget of 1 billion baht and the budget from the former Insurance Department in fiscal year 2008 will be transferred to the OIC. In the following year, the OIC will receive contributions (0.1-0.3 percent of life-insurance written premiums, and 0.27 percent of non-life insurance written premium) from insurance companies. Going forward, the OIC aims to increase the roles of the insurance industry in Thailand by proposing an expansion of tax deduction for life insurance premium, a tax break for group insurance, and VAT exemptions for insurance agents and retirement products. For the Life Insurance Act and the Non-Life Insurance Act, the key amendments are (i) requiring all insurance companies to transform into public companies within 5 years after the law has been effective; (ii) liberalizing the insurance industry by relaxing the foreign share ratio restriction from 25 percent to 49 percent; (iii) adjusting prudential regulations; and (iv) setting up life-insurance funds and non-life insurance funds to protect insurers from a bankrupt insurance company or a banned insurance company.

Thailand Securities Depository Co., Ltd (TSD) revised the regulation on a clearing house to meet the international standard set by the International Organization of Securities Commission (IOSCO). The revisions include (i) enabling the depository, as the clearing house, to perform as Central Counterparties (CCPs) after stock-trading transactions to assure that possible damages resulting from delays in clearing and settlement of securities will be responsible by the official agency; (ii) changing settlement finality by recognizing the completion of clearing and settlement process only after the member has delivered the securities and settled payment with the clearing house. After these steps are completed, the rule of finality is in effect and irrevocable. TSD started post-trade services on its Post-Trade Integration (PTI) system on October 22, 2007. With the PTI system, equity depository, clearing and settlement and registrar operations are automatically linked. The infrastructure boosts service efficiency and, as it meets international standards, can handle overseas connections. Securities and custodian firms that are direct users of the PTI system will have access to real-time information and features which can efficiently and automatically cope with system-to-system connections among brokers. Furthermore, listed companies that use TSD's securities registrar service will receive quicker and better services because the internet-based system slashes paperwork, handling, and time.

Corporate Sector Reforms and Restructuring

The new Accounting Standard (IAS 39), which requires firms to calculate all financial items from cash flow based on fair value, is now undergoing public hearings. The new accounting standard will allow a balance sheet to better reflect cash flow. The Federation of Accounting Professions, which is Thailand's advisory body of the accounting, is working on the new accounting standard. The new standard expects to provide clear guidelines on (i) the treatment of deferred income tax as expenditure; (ii) the calculation of employee benefits (such as retirement compensation) as expenditure in the balance sheet, as opposed to the existing practice of booking retirement compensation when a company actually pays the sum; and (iii) the requirement on local firms to compute intangible assets (goodwill, license, and R&D expenditure) in its accounts. The new accounting standard will also increase the use of fair value as base of calculation and improve disclosure of information.

The Cabinet approved the draft amendment of 1997 Emergency Decree on Special Purpose Vehicle for Securitization on October 9th, 2007. The amendment aims to clarify the existing law in order to reduce the use of discretionary decision and to legalize some forms of securitization which have not been accepted yet. The key changes are (i) allowing Special Purpose Vehicle (SPV) to use a secured loan as an asset in securitization process in addition to the existing law which only allows SPV to use only an absolute assignment; (ii) increasing types of assets for issuing securities by allowing the use of future flow receivable and claimable rights of court proceeding case as assets for issuing securities; (iii) allowing SPV to be set up in the form of trust or multi-tier structure; (iv) approving the use of accounting value, accounting net asset value or fair value for asset transfers from an originator to SPV; and (v) cancelling rules which grant securities holder in SPV a preferred share.

To develop an integrated transportation system, the draft Transport Administration Act was approved by the Cabinet on June 5th, 2007 and is currently under consideration of the NLA. The draft Act proposes to set up the National Transport Policy Committee which has the Prime Minister as the chair and is responsible for designing the master plan of Thailand's integrated transport system. Five supervisory bodies will be set up consisting of road transport, water transport, air transport, railway transport, and public transport. The draft Act will also liberalize the transport business by requiring business operation licensing instead of the current system of concession. The proposed Act will also set up a mechanism to incorporate private sector in the development of the transport system.

Aiming to provide long term sufficiency energy in Thailand and to promote competition among energy operators, the draft Energy Operation Act has been approved by the Cabinet and it is currently under consideration of the NLA. The term "energy" under the draft Act covers both electricity and natural gas energy. According to the act, the National Energy Committee will be set up to monitor and supervise energy operators. The committee will have an authority to grant energy-operation licenses by considering social and economic impacts as well as ensuring a fair competition

among energy operators. The committee is also responsible for setting up energy pricing regulations by considering actual costs of investment and proper business profit margin. In addition, the Act will also specify the standards both in terms of manufacture and safety.

3.2 Recent Trade Reforms

Tariff reform

Since April 2007, Thailand's import tariff rates are lowered for many products. These include both universal tariff reductions, which apply to goods from all countries, and specific tariff reductions that result from free trade agreements (FTAs) with other countries and regions (see Box 3 on the progress of FTAs that involves Thailand). As for the former, the government announced in September 2007 tariff reductions and exemptions for hundreds of products that cover both agricultural and manufactured products. This is particularly for goods under the following two-digit Harmonised Code: HS29 (organic chemicals), HS72 (iron and steel), HS84 (machinery and mechanical appliance), and HS85 (electrical machinery and equipment).

The Japan-Thailand Economic Partnership Agreement (JTEPA) is effective from 1 November 2007. One of the several topics covered in the Agreement is trade in goods where tariff and non-tariff measures for a variety of goods between the two countries will be relaxed. According to the Department of Export Promotion, about 31.1 percent of Thailand's import tariffs for Japanese products will be exempted since the first year, while another 66.5 percent will be lifted in the next 2-10 years. These numbers of Japan's tariffs for Thai products are 86.1 percent and 5.1 percent (but for the next 2-15 years), respectively. Overall, the JTEPA should enhance Thailand's overall exports to Japan, especially for most agricultural products, garments, and certain manufactured products (see Box 1 on the potential impacts of the JTEPA on Thailand's exports to Japan).

In addition to the JTEPA, trade agreements with other regional blocs and trading partners also lowered Thailand's trade barriers. These include the World Trade Organisation (WTO), ASEAN Free Trade Agreement (AFTA), China-ASEAN, Australia, and New Zealand. The type and number of product lines that are included vary across these arrangements. For example, although most of these agreements seek more liberalised trades in electronics products (under HS85, electrical machinery and equipment), the agreements with Australia and New Zealand also focus on products such as chemical products, iron and steel products, and building materials.

New ASEAN members also enjoy lower import tariffs. Imports of certain agricultural products that are produced under the contract farming schemes in Lao PDR, Cambodia, and Myanmar are exempted from tariff payment. This covers nine products such as sweet corns, corns used for animal feeding, peanuts, and sesames. Under different arrangements, Thailand also waived import tariffs for dry skins of sheep or lambs exported by these three countries, and reduced tariffs for a couple of agricultural products from Lao PDR.

Tariff measures are also used to promote international technology transfer. Among other projects, imports of all machinery, appliances, and materials by Japan's New Energy and Industrial Technology Development Organisation (NEDO) are exempted from tariff payment. This is part of a demonstration project that aims to transfer advanced technology on aluminium-melting process to Thai entrepreneurs.

Box 3. Major progress on Thailand's Free Trade Agreements (FTAs)

Agreements	Details of Progress Until October 2007
Thailand - India	In September 2004, Thailand and India agreed to reduce and lift import tariffs of 82 products under the Early Harvest Scheme. Since 1 September 2006, tariffs of these products, such as certain tropical fruits, canned seafood, jewellery, vehicles parts, and electrical appliances, became zero percent. The 15th meeting of the Trade Negotiating Committee (TNC) in September 2007 was rather successful. The number of products that tend to enjoy lower tariffs increases from 82 products under the Early Harvest Scheme to over 3,000 products.
Thailand - Japan	The JTEPA was signed in April 2007 and is effective from 1 November 2007. Over 90 percent of all goods now have lower or zero tariff rates. The Agreement also eased the rules that restrict investments from Thailand and employment of Thai workers in Japan. See Section 3.2 and Box 1 for more details.
BIMSTEC	The 15th meeting of the TNC in September 2007 made some progress. The size of the negative list (no tariff reduction) is set at about 15 percent of all tariff lines. If this is achieved, about 40-70 percent of all tariff lines will be tariff-free, while another 5-35 percent will have tariffs of 1-5 percent. Each country will also submit export products that will be under Product Specific Rules (PSR).
ASEAN - China	Since October 2003, Thailand and China have reduced their import tariffs for certain vegetables, fruits and nuts products following the Early Harvest Scheme. Tariffs of agricultural products under HS1-HS8 were also lifted in 2006 in six ASEAN foundation members. Topics that are still under consideration include Tariff Rate Quota (TQR), PSR, and implementation. Provisions on investment and other areas of economic partnership are still ongoing, e.g. agriculture, information technology, human capital, quality standards, and intellectual property protection.
ASEAN-Australia-New Zealand	In the 11th meeting in September 2007, the TNC concluded some provisions on sanitary and phytosanitary standards (SPS), although no significant progress on trade in goods was made. It also considered trade in services in financial sector, telecommunication sector, and e-commerce but movements of natural persons are not yet agreed. The next meeting will be in December 2007, when topics such as non-tariff measures and treatment of the WTO disciplines will be discussed.
ASEAN - Korea	The 20th meeting of the TNC in October 2007 reached the agreement on trade in services. Thailand still requests Korea to further liberalise its labour market. Provisions on investment (e.g. prudential measures and exchange rate and financial stability) and trade in goods (e.g. compensation for delayed reduction in tariffs) need more discussions.
ASEAN - India	The agreement on trade in goods between ASEAN and India has been ongoing since 2003 and is expected to be effective this year. Negotiations of trade in services and investment agreements will however begin after trade in goods agreement becomes effective. Products that enjoy zero tariffs will be about 80 percent of all products, while sensitive list will be about 2-3 percent. In August 2007, India agreed that the final periods of tariff reductions would be 1 January 2011, 2015 and 2018, depending on the products. The next meeting was originally scheduled in September 2007 but postponed.
ASEAN - Japan	The ninth meeting of the TNC in August 2007 was productive. For trade in goods under the normal track, Japan agreed to lower import tariffs of about 92 percent of all tariff lines (but still with some minor disagreements). For trade in services, the TNC follows a minimalist approach, where a sub-committee will be set up within one year after the effective date of the Agreement. Examples of topics that need further discussion are rules of origins and SPS.
ASEAN - EU	The initiative to start the partnership began in May 2007. The second meeting of the Joint Committee in October 2007 discussed the direction and scope of the negotiation. The extent of lowering trade barriers between the two parties is not yet fully agreed, while it also remains uncertain whether topics such as intellectual property, government procurement, and sustainable development will be included in the negotiation. The next meeting will be in January 2008.

Source: Department of Trade Negotiations

Note: The members of the BIMSTEC are Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand. During April and October 2007, trade agreements between Thailand and Bahrain, Peru, United States and EFTA exhibited no significant progress. Note that the meetings scheduled for Thailand-Australia and Thailand-New Zealand agreements were also postponed (trade agreements between these two countries and Thailand have been effective since 2005).

Export promotion and assistance

The Customs Department adopted the e-Export system at key customs points. This new system, which is a direction towards paperless customs or e-Customs, aims to speed up and increase the transparency of the customs procedures, and to reduce the transaction costs incurred to exporters. It replaced the old system, called electronic data interchange (EDI), which relies on both electronic data submission and paper documents. The number of customs procedures for exports of goods decreases from 8 steps under the EDI to 5 steps under the e-Export system. This new system is effective from 1 July 2007 at Leam Chabang seaport and 1 September 2007 at the Suvarnabhumi airport.

Tariff and other customs payments can be done via an e-payment system with commercial banks. To facilitate payment and reduce the transaction costs, the Customs Department has set up an e-payment system with commercial banks which firms can use to pay their tariffs and other customs fees. Currently, the four commercial banks participating in the programme are Krung Thai Bank, Bank Thai, Citibank, and Sumitomo Mitsui Bank. Since its first operation in June 2007, the value of payment via the e-payment system has increased by several folds.

The Export-Import Bank of Thailand reduced its fees for the information on foreign buyers. The new fee rate that the EXIM Bank charges to its customers, who use bank's export insurance services, for information on buyers in other countries is now 20 percent lower. The Bank also places more emphasis on purchasing foreign buyers information from international online databases, which contain more up-to-date information and help to reduce the default risk.

The EXIM Bank also implemented Credit Fast Track. This aims to accelerate the decisions on financial credits provided to small exporting firms, which accounts for about 40 percent of all EXIM Bank's customers. The value of loans that is eligible under this new scheme must not be greater than 5 million baht, and applied by firms whose total sales is not over 100 million baht per year.

3.3 Public Sector Reform

The interim government has successfully set up important platforms to promote good governance, transparency and improve human resources management in the public sector. Many important laws which were revised and approved by the Cabinet are expected to pass the National Legislative Assembly (NLA) before the new elections. These amendment laws include the State Enterprise Corporatization Act, the Public Debt Management Act, the Private Participation in Public Works Act, and the Public Procurement Royal Decree. In addition to these, the Office of the Civil Service Commission has also proposed the amendment of the 1992 Civil Servant Act which will bring about wide-range of reforms in the area of human resources management in the public sector (see Box 4).

On April 3, 2007, the cabinet approved the principle in redefining "public sector". Clearly defining the term "public sector" shall improve financial transparency and financial management in the public sector. The term "public sector" consists of 4 types of organizations including (i) government agency; (ii) stated-owned enterprise (SOE); (3) public organization; and (4) a new government unit which can be both an independent administrative organization and a corporate fund. The criteria used to define public sector include the relationship with the government (whether it is set up under the public law or general law, authority to set up boards and regulate works), type of activities (whether it is public service or general service), sources of budget, income and debt guarantor, status of staff or employment (whether they are civil servants or SOE employees), and ownership (source of set-up fund, the proportion of shares owned by a government agency, and decision making authority).

The Cabinet decided in March 2007 that all ministries will have to prepare a governance risk analysis for a project or plan that aims to support key government policies starting from FY 2008 onwards. The governance risk analysis shall be submitted together with the budget proposal

prepared by each ministry to the Bureau of Budget. Inspectors in each ministry will rank the projects from high to low risk and incorporate them into an integrated inspection process.

In April 2007, the cabinet approved the draft Promoting Good Governance in Public Sector Act. All government officers including ministers, members of the parliament, judges, civil servants, and temporary employees in government offices, state-owned enterprises and local administration units are subjected to this Act. The National Governance Committee will be set up, which is responsible for developing strategies and giving suggestions on how to promote governance and morality in the public sector.

Box 4. The amendments of the State Enterprise Corporatization Act, the Public Debt Management Act, the Private Participation in Public Works Act, the Public Procurement Royal Decree, and the Civil Servant Act

1) The State Enterprise Corporatization Act: In June 2007, the cabinet approved the draft Rules and Procedure for Privatization of State-Owned Enterprise Act. This Act will cancel the 1999 State Enterprise Corporatization Act and highlight the followings:

- **Identifying rules and procedures of corporatization and privatization of state-owned enterprises (SOEs)** which have more than 2,000 million baht value of assets
- **Stipulating types of SOEs that can be privatized.** According to the amendment, the SOEs which have a monopoly and oligopoly power or provide goods and services relating to health and morals cannot be privatized
- **Cancelling the transfer of privileges entitled by SOEs to a privatized company.** Therefore, a privatized company shall not be exempted from any trade competition act and tax laws, etc
- **Authorizing committees to monitor and supervise corporatization and privatization procedures**
- **Setting up a regulatory body to monitor privatized companies**
- **Granting SOEs to transfer their rights, debts, assets, and liabilities to a privatized company.** Ministry of Finance shall provide loan guarantee and charge a guarantee fee

2) The Public Debt Management Act: The amendment of draft Public Debt Management Act was approved by the cabinet on May 15, 2007 and it is currently under consideration of the NLA. The amendment aims to enhance the roles of government bonds to promote Thai bond market and increase flexibility of the Ministry of Finance (MOF) in managing government's debt. The key revisions include the followings:

- **Empowering the MOF to reschedule its debt repayment by "extending" and "shortening" debt repayment period.** Under the existing law, the MOF cannot shorten debt repayment period, therefore, the amount of debt due can be excessive.
- **Allowing the MOF to borrow money in order to repay public debt in advance.** In some cases, the MOF may have to repay a huge amount of debt in a single day. For the purpose of public debt restructuring, the amendment will thus grant the MOF more flexibility in borrowing money in order to repay public debt in advance. This repayment may not however be more than 12 months earlier than the debt repayment date.
- **Granting the MOF to re-borrow money both in Thai and foreign currencies.** The MOF can only re-borrow in foreign currencies under the existing law. Consequently, it hinders the development of Thai bond market as it lacks reference rate in Thai currency.
- **Allowing the MOF to issue bonds to help develop the Thai bond market.** Under the existing law, the MOF can only issue bonds to (a) finance budget deficits; (b) support economic and social development; (c) on-loan to other government agencies and SOEs; and (d) restructure public debt. According to the amendment, the MOF will be able to borrow money via bond issuances for the purpose of developing the local bond market. Capital fund will be set up with three separate accounts, namely the Public Debt Restructuring Account, the Thai Bond Market Development Account, and the Yield Account. The amendment also specifies that the Public Debt Restructuring Account can be used only for debt repayment. The Thai Bond Market Development Account can be used for financing budget deficits, supporting economic and social development, restructuring public debt, and re-lending. The Yield Account can be used for operation management and administration of the capital fund. The amendment also identifies that the capital fund must be invested in AAA bonds or AAA debt instruments.

3) The Private Sector Participation in Public Works Act: On September 4, 2007, the Cabinet approved the draft amendment of the Private Sector Participation in Public Works Act, 1992. The key changes in the amendment are as follows:

- **Clarifying the descriptions of types of private sector participation in public works.** There are three aspects of private sector participation, namely, conventional procurement, turn key, and public private partnership (PPP). According to the amendment, "*conventional procurement*" refers to the use of government budget to procure goods

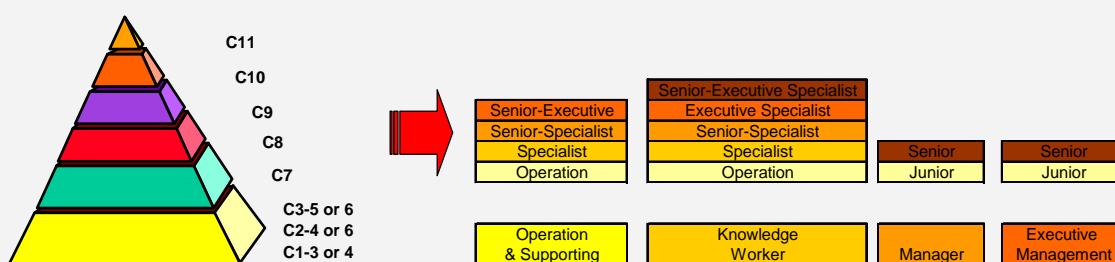
and services from the private sector. “Turn key” is when the private sector is hired to complete work before transferring the completed work to the public sector. “Public Private Partnership” is the coordination project where the public sector invests in basic infrastructures and the private sector invests in operation. For example, a sky-train project which the public sector invests in the construction of stations and railways, while the private sector invests in train operation system, traffic signs, etc.

- **Adjusting the minimum value of a project to reflect present value.** The minimum value of the project will be increased from 1,000 million baht to 3,000 million baht. In addition, the amendment also requires the government to adjust the minimum value every 5 years.
- **Changing roles of government agencies in project selection processes.** Under the current law, the MOF is responsible for the selection of old projects (defining as projects which already have assets), while the NESDB is responsible for the selection of new projects (defining as projects which currently have no asset). In practice, definition of assets has not been clearly identified and the selection processes done by MOF and NESDB are different. Therefore, the amendment aims to improve transparency and fairness in the project selection process. The NESDB will review the appropriateness in terms of country strategies, economic, social and environment development, while the MOF will review the projects by assessing financial obligation and cost-benefit analysis comparing between public investment and private investment.
- **Increasing authorities of a project coordinator committee.** Under the existing law, the project coordinator committee is responsible for monitoring and supervising the project. It does not have an authority to amend agreements or to continue its works and responsibility after the end of the contract. Thus, the amendment will allow the committee to continue the works after the contract ends in order to improve continuity of the project.

4) The Royal Decree on Public Procurement: The draft Royal Decree on Public Procurement was approved by the Cabinet on October 22, 2007. It aims to increase the transparency and fairness of the public procurement system. *To improve transparency*, the draft Royal Decree requires that all government agencies announce an annual procurement plan to the public in advance in order to give sufficient time for the private sector to prepare itself for a bidding application process. In addition, the Comptroller General Office must prepare a data base on reference prices of goods to be used by other government agencies. Procurement methods under the draft are classified into 3 types: general invitation, general selection, and specific selection. Selection criteria are not only the lowest cost but also other qualities. *To enhance competition and fairness*, the Royal Decree also cancels special procurement method that requires government agencies to give priority in procuring goods and services from other government agencies, provincial authorities, and state-owned enterprises, rather than using market competitive mechanism. As a result, the amendment will help the private sector to compete with government agencies, provincial authorities and SOEs in providing goods and services to the public sector.

5) The Civil Servants Act: The cabinet approved the amendment of 1992 Civil Servants Acts on June 26, 2007. The new Act, which is expected to be effective in FY 2008, aims to improve human resources management in the public sector. The details of the proposed amendments and their significance are summarized below:

- **Abolishing the sole standard on civil servant positions and salary levels which are used to classify civil servants into 11 levels (C1 to C11) for every function.** According to the amendment, the 11 Common Levels (11 C) will be re-categorized into 4 groups according to civil servants’ functions and expertise, depicted in the figure below. Therefore, the uniform salary level will be diversified to match functions. There will thus be more flexibility in designing salary levels. This should reduce the salary-gap between public and private sectors for specific works or functions which need special expertise or experience.



- **Decentralizing human resources management by transferring the power to designate the numbers of civil servants and positions from the Office of Civil Service Commission (OCSC) to ministries and departments.** Each ministry and department will have authority to determine the numbers of positions and staffs according to its allocated budget.
- **Improving human resources management through adjusting recruitment and employment process.** The amendment also emphasizes the creation of incentive schemes that promote the quality of works and civil servants.
- **Opening positions to people outside the public sector to apply for a civil servant position.** Under the current law, only civil servants can apply for a position in the public sector. The amendment will allow people from outside public sector to apply for a civil servant position.
- **Transferring functions to promote and to maintain moral and ethics among civil servants from the OCSC to the new agency called the Moral and Ethics Committee that will be set up under this new amendment.**

Appendix 1: Key Economic Indicators

	2005	2006 p /	2006	2007			2007		
	Year	Year	Q4	Q1 p/	Q2 p/	Q3 p/	Jul p/	Aug p/	Sep p/
Output, Employment and Prices									
GDP									
(% change, previous year)	4.5	5	4.3	4.2	4.4	..	..	..	..
Manufacturing production index (2000=100)	155.6	167.1	171.1	177.1	172.1	182.1	174.7	183.6	187.9
(% change, previous year)	9.1	7.4	6.7	6.0	5.6	9.0	7.7	10.1	9.3
Unemployment rate (%)	1.8	1.5	1.3	1.6	1.6	1.2	1.2	1.2	1.2
Real wage growth (%) 1/	2.3	1.2	3.1	-2.1	-0.9	..	..	..	..
Consumer price index									
(% change, previous year)	4.5	4.7	3.31	2.41	1.92	1.65	1.7	1.1	2.1
Public Sector									
Government cash balance (Billion Baht)	-45.8	88	-25.5	-127.6	44.7	14.3	-54.1	4.6	63.9
Government cash balance (% GDP)	-0.6	1.1	-1.2	-6.1	2.2	..	..	..	..
Public sector debt (% GDP, end of period) 2/	46.4	40.5	40.5	38.1	37.7	..	..	..	..
Foreign Trade, BOP and External Debt									
Trade balance (US\$ million)	-8,530	994	1,655	3,592	1,489	2,942	41	973	1,927
Exports of goods (fob, US\$ million)	109,193	127,941	34,076	34,460	36,182	38,790	11,725	13,818	13,246
(% change, previous year)	15.0	17.2	20.0	18.9	18.8	12.6	6.6	18.4	12.6
Imports of goods (cif, US\$ million)	-117,722	-126,947	-32,420	-30,867	-34,693	-35,847	-11,684	-12,845	-11,318
(% change, previous year)	25.9	7.8	11.2	5.9	7.4	8.4	3.8	12.1	9.3
Current account balance (US\$ million)	-7,918	2,174	2,559.64	4,963.86	1,369.68	2,928.43	382	735	1,812
(% GDP)	-4.5	1.1	4.6	9.2	2.6	..	..	..	..
Foreign direct investment, net (US\$ million)	6,503	10,031	1,934	2,579	1,565	..	553.79	735.17	..
Total external debt (US\$ million)	52,040	59,643	59,643	59,837	58,601	..	..	..	..
(% GDP)	32.5	32.9	32.9	31.9	30.2	..	..	..	..
Short-term debt (US\$ million)	16,014	17,812	17,812	18,918	20,487	..	..	..	..
Debt service ratio									
(% exports of goods and services)	10.8	11.3	12.2	18	11.2	..	..	..	..
Reserves, including gold (US\$ million)	52,066	66,985	64,592	68,611	71,718	76,368	73,977	74,439	80,687
(months of imports of goods)	5.3	6.3	6.0	6.7	6.2	6.4	6.3	5.8	7.1
Financial Markets									
Domestic credit (% change, previous year) 3/	7.7	3.8	3.8	3.3	4.1	..	..	..	..
Short-term interest rate (average period) 4/	1.6	3.9	4.1	3.8	2.5	2.2	2.1	2.1	2.3
Exchange rate (average period)	40.2	37.9	36.5	35.5	34.6	34.0	33.7	34.1	34.2
Real effective exchange rate (1994=100)	79.0	85.4	88.0	89.5	91.7	91.5	93.1	91.0	90.5
(% change, previous year)	1.6	8.1	9.9	8.3	7.6	6.6	9.1	6.0	4.8
Stock market index (Dec 1996=100)	713.7	866.0	679.8	673.7	776.8	845.5	859.8	813.2	845.5
Memo: GDP (US\$ billion)	176.2	206.3	56.1	53.8	52.6	..	..	..	..

p = preliminary

1/ Computed from average wage of employed person from Labor Force Survey

2/ Include direct government debt, non-financial-state-enterprise debt and financial institutions development fund (FIDF) debt

3/ Yearly and quarterly data include credits extended by all financial institutions

4/ Average interest rates on time deposits of less than 6 months (percent per annum)

Appendix 2: Monitoring Matrices for Structural Reform Implementation

1. Poverty Reduction Diagnostics
2. Financial and Corporate Sector Reform
3. Reforms to Improve Business, Investment Environment and Trade
4. Social Protection
5. Public Sector and Governance Reform

1. Poverty Reduction Diagnostics

	Objective	Reform Measures Taken
A.	Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve the local economy	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> • The 2006 national poverty line was announced. It is 1,386 Baht/person/month, and the 2006 poverty headcount ratio was 9.6. The income inequality as measured by the Gini-coefficient fell by 1.69 percent from 0.426 in 2004 to 0.418 in 2006. • Promoting self-dependence using community development mechanism under the name of “Good Living and Happiness Society Strategy” has been implemented. The implementation started in February 2007. Currently, 55,400 projects are under implementation (out of 66,415 projects approved) with the total cost of 4,187.62 million baht (from the total of 5,000 million baht). More than 95 percent of the approved projects have been implemented by communities, while another 2 percent have been implemented by the government agencies. Forty percent of the approved budget was used for sufficiency economy plan, 26 percent for community development and opportunity creation plan, 12 percent for rehabilitation of natural resource, 2 percent for assisting vulnerable people and senior citizen, and 20 percent for the provisions of basic services. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • In fiscal year 2008, the government plans to allocate 15,000 million baht budget for “Good Living and Happiness Society Strategy”. Ninety percent of the FY2008 budget will be allocated based on provincial data on (a) population size, (b) per capita income, and (c) poverty headcount ratio. Note that each province will first obtain an equal of amount of fund. The additional amount is determined by criteria (a) and (c) above.

Prepared by Cheanchom Thongjen

2. Financial and Corporate Sector Reform

	Objective	Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • The National Credit Bureau (NCB) has reduced fee for individuals requesting credit information report from 200 to 100 baht/person since October 1st, 2007. The lower fee can help reduce cost of individual borrowers to get credit information and increase chances to access formal loans. • In August 2007, the National Credit Bureau (NCB) proposed the amendment of the 2002 Credit Data Business Operation Act to the Ministry of Finance. According to the proposed amendment, NCB will be responsible for ranking customer's credit using credit scoring measures which will help improve the quality of a credit historical record used by a financial institution. For individual borrower, the proposed amendment will also grant individual the right to check his/her credit information once a year without charging any fee. • To improve the transparency of monetary policy and to promote the development of financial market, the BOT has released its daily transactions on BOT website (www.bot.or.th/bothomepage/databank/FinMarkets/FinMarket.htm) since July 2007. The transaction information consists of Bilateral Repurchase Transaction, and Outright Purchases and Sales of Government Securities. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • The Credit Information Protection Committee meeting in November 2007 will decide whether insurance companies are required to report their information on customers, who could not afford to pay their premiums and have received automatic lending from an insurance company to the National Credit Bureau (NCB). Currently, insurance companies are required to report the NCB about their customers who had secured their loans by placing property assets as collateral. However, insurance companies are not required to report the NCB the information on customers who could not afford to pay their premiums, so that insurance companies had to provide lending, whose amount is based on the cash value of customers' current insurance policy, in order to extend the validity of their policy.
B.	Formulate and implement a medium-term strategy for Thai financial sector	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • To promote Thailand debt instrument market by encouraging foreigners to invest in the Thai market, the Minister of Finance has signed an agreement granting six international financial institutions to issue bonds or debt instruments in Thai currency. The six financial institutions are Central American Bank for Economic Integration: CABEI (4,900 million baht), International Bank for Reconstruction and Development: IBRD (5,000 MB), International Finance Corporation: IFC (5,000 MB), Japan Bank for International Cooperation: JBIC (3,000 MB), KFW development bank (4,000 MB), and Nordic Investment Bank (5,000 MB). <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • The draft Financial Sector Master Plan (FSMP) Phase II is expected to be submitted to the Cabinet in the second quarter of 2008. After conducting several focus group meetings and public hearing seminars, the Bank of Thailand (BOT) is currently

	Objective	Reform Measures Taken
		<p>working on the issues which had been debated in the meetings and is expected to have policy papers to support the final draft of FSMP phase II. The key areas of studies include measures to reduce cost of laws and regulatory; development of basic infrastructure in the financial sector such as database system, risk management; and capacity building for human resources in the financial sector, etc.</p> <ul style="list-style-type: none"> • The Master Plan for Grass-Root Financial Services is expected to be submitted to the Cabinet within November 2007 and will be implemented in early 2008. After the law becomes effective, many government agencies involved in this master plan will set up action plans and start their implementation. Aiming to legalize the financial services for the informal groups including the informal microfinance institutions like savings groups or cooperatives in the rural areas, the Master Plan will provide a framework to promote informal financial services to be more sufficient and sustainable. Implementation will be focused on three strategies which are (i) developing human capital and strengthening microfinance institutions; (ii) promoting integration between the public sector and other development partners by focusing on improving rules and regulations to legalize and promote the development of microfinance institutions; and (iii) establishing knowledge networks • The Fiscal Policy Office (FPO) is working on the final draft of the Financial and Fiscal Master Plan for a Better Society, 2008- 2011, which is expected to be submitted to the Cabinet at the end of this year. After conducting several focus group meetings with relevant agencies, the FPO is currently working on the final draft of the master plan aiming to build up a better society with self-sustainable sufficiency by using the financial and fiscal measures. The master plan aims to achieve four objectives which are (i) building sustainable self-sufficiency by encouraging knowledge development and occupation trainings in the communities; (ii) supporting social safety net by focusing on improving health and welfare of the poor and vulnerable people; (iii) promoting good culture through family and religion; and (iv) creating equilibrium society by reducing the income gap and the difference between rural and urban opportunities. According to the plan, the Ministry of Finance (MOF) will encourage government financial institutions to provide credit to projects which are consistent with the plan and reconsider various tax measures especially environmental tax, excise tax on harmful consumer products, inheritance tax, and housing tax, etc.
C.	Remove legal impediments and provide an enabling environment for derivative products.	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • The Thailand Futures' Exchange PCL (TFEX) started trading the SET 50 Index Options in October 2007. The SET 50 Index Option will help attract investors into the future exchange market. The index options which TFEX open for trade consist of both call options and put options with 4 different time periods in which each time period has 11 different price levels. • The TFEX introduced trading operation through direct market access (DMA) in July 2007. With the implementation of DMA system, investors can connect directly to the TFEX system to perform trading transactions.
D.	Develop the domestic financial markets, including bond, capital, and money markets.	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> • To promote the insurance industry, the government has enacted the Office of the Insurance Regulation and Promotion Commission Act, and is amending the Life-Insurance Act and the Non-Life Insurance Act. The Office of the Insurance Commission was set up on September 1st, 2007, while the Life-Insurance Act and the Non-Life Insurance Act were approved by the Cabinet on September 18th, 2007, and they are currently under consideration of the NLA. • The Council of State passed the draft Financial Institution Business Act on to the NLA. The law is expected to improve the regulation and supervision of the financial institution business in response to the developments and changes in the financial system. • The draft of the amendment of the Bank of Thailand (BOT) Act has passed the Council of State and it is under consideration

	Objective	Reform Measures Taken
		<p>of the NLA. The draft amendment clarifies the roles and authorization of the BOT, the BOT's governor selection process and terms, the structures of the BOT related committees such as Monetary Policy Committee, Financial Institution Committee, and Payment Systems Committee.</p> <ul style="list-style-type: none"> • The Council of State and the Cabinet passed the draft of the amendment of the Securities and Exchange Act on to the NLA. The key amendments are restructuring of capital market's regulatory agency and the SEC committee; enhancing governance in public companies by tightening supervision on stock trading, stock holding, securities companies, securities exchange, and securities depository. • The draft Deposit Insurance Institution Act has been passed by the Office of the Council of State and will be submitted to the NLA. Upon the enactment of the Act, a Deposit Insurance Agency will be established and will offer a limited deposit guarantee of not more than 1 million baht per deposit account. • Thailand Securities Depository Co.,Ltd (TSD) revised the regulation on a clearing house to meet the international standard set by the International Organization of Securities Commission (IOSCO). The revisions include (i) enabling the depository, as the clearing house, to perform as Central Counterparties (CCPs); and (ii) changing in settlement finality. • Thailand Securities Depository Co., Ltd. (TSD) started post-trade services on its Post-Trade Integration (PTI) system on October 22, 2007. With the PTI system, equity depository, clearing and settlement and registrar operations are automatically linked. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • Following the reform of BOT's monetary operation framework, the BOT will close its repo market at the end of the year. The BOT is currently requesting financial institutions to apply for a primary dealer in bilateral repo transaction before the closure of the BOT repo market. Currently, 14 financial institutions have been accepted by the BOT to be the primary dealers. • The draft Currency Act will be further delayed and is expected to be resubmitted to the new government next year. Due to several debates on the authorization of the BOT in managing international reserve, the draft of the Currency Act has been withdrawn from the current government and is expected to be resubmitted to the next government. • The Securities and Exchange Commission (SEC) plans to set a High Risk Fixed Income Fund for investors who are interested in debt-instruments with non-investment grade or below BBB grade. The SEC will conduct the public hearing before setting up rules and regulations for this Fund.
E.	Rationalize state holding of specialized financial institutions, state owned enterprises, and state commercial banks	<p><i>Measure over the last 6 months and significance</i></p> <ul style="list-style-type: none"> • The State Enterprise Policy Office (SEPO) is working on the draft of the Prime Minister's regulations on the Public Services of the State Owned Enterprises (SOEs) to disaggregate State Owned Enterprises (SOEs) account into two accounts: Public Service Account (PSA) and Public Service Obligation (PSO). The regulations aim to promote SOE's services which are eligible to receive financial supports from the government to alleviate people's hardship and enhance national competitiveness. Thus, PSA which reflects the commercial business of SOEs will be separated from the PSO which shows the obligation of SOEs to support the government economic and social policy. For example, the fares for train and bus services shall be clearly disaggregated between the commercial lines and the non-commercial lines in order to clarify the amount of budget support needed from the government.

	Objective	Reform Measures Taken
F.	Strengthen corporate practice through improved legal framework and standards	<p><i>Measure over the last 6 months and significance</i></p> <ul style="list-style-type: none"> • The Cabinet approved the draft amendment of 1997 Emergency Decree on Special Purpose Vehicle for Securitization on October 9th, 2007. The amendment aims to clarify the existing law in order to reduce the use of discretionary decisions and legalize some forms of securitization which have not been accepted yet. <p><i>Measure to be taken in the next 6-12 months</i></p> <p>New Accounting Standard (IAS 39), which requires firms to calculate all financial items from cashflow based on fair value, is under preparation. The new accounting standard should allow balance sheet to better reflect cash flow and increase the use of fair value as base of calculation. The new standard also includes clearer guidelines on deferred income tax, employee benefits, government grants, and intangible assets. It is now undergoing public hearings.</p>

Prepared by Cheanchom Thongjen

3. Reforms to Improve Business, Investment Environment and Trade

	Objective	Reform Measures Taken
A.	Improve competitiveness of business sector	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • The Cabinet approved the draft Wholesale and Retail Businesses Act. The Act, proposed by the Ministry of Commerce, aims to promote fair competitions between large wholesale stores and small retail stores in local communities. A regulations committee will be set up, chaired by Minister of Commerce, and is responsible for designing, implementing, and monitoring policies that oversee wholesale and retail business sector. Particular business types will need permissions to operate. Location, zone and premise size of wholesale and retail stores as well as population size in the areas are also determining factors to grant permissions. • The Cabinet approved the draft National Standards Act. A new Standards committee will be set up following this Act, which was proposed by the Ministry of Industry. Among others, this committee will administer overall national standards, specify the authority of Thai Industrial Standards Institute, and assign other relevant agencies to prevent and resolve domestic and international standard-related problems that could affect national competitiveness. • The National Productivity Master Plan was approved by the Cabinet. The Master Plan was prepared by a high-level committee chaired by a Deputy Prime Minister. The Plan aims to raise the productivity at both the industrial level and at the national level. • Intellectual Infrastructure Master Plan (2008-2012) was drafted. This is jointly proposed by the Ministry of Science and Technology and Ministry of Industry. It aims to strengthen Thailand's intellectual infrastructure that enhances national competitiveness, supports manufacturing sectors (through greater technological capabilities and innovation), and builds linkages among manufacturing sector, researchers, educational system, and economic system. Among others, these can be achieved by developing infrastructure, institutions and laws that promote R&D, raising standards of quality, establishing specialised centres that are closely linked manufacturing firms, and introducing innovation networks. This Master Plan also involves the Ministry of Commerce in the area of intellectual property rights protection. • The Cabinet approved the draft National Science, Technology and Innovation Act and Advanced Science and Technology Institution Act. These two acts, which will later be considered as a single Act, will set up an institution that serves as a core unit in coordinating both local and foreign science and technology agencies. An example of partnership is networks of institutions. It also seeks to enhance the confidence of foreign institutions in conducting R&D in Thailand. • The draft Transport Administration Act was approved by the Cabinet on June 5th, 2007 and is currently under consideration by the NLA. The draft Act proposed to set up of the National Transport Policy committee to design the master plan of Thailand integrated transportation system. Five supervisory bodies (road transport, water transport, air transport, railway transport, and public transport) will be set up. The draft Act also liberalizes the transport business by granting business operation license instead of the current system of concession. • The draft of Energy Operation Act is under scrutiny by the NLA. The draft aims to provide long-term sufficiency energy to Thailand and promote competition amongst energy operators. According to the Act, the National Energy Committee will be set up to monitor and supervise energy operator. The committee has authority to grant energy operation license, and to set up energy pricing regulation.

	Objective	Reform Measures Taken
		<ul style="list-style-type: none"> • Ministry of Industry introduced new web portal (Thailand Industrial Gateway). This will provide all the information on services that the Ministry offers. Among others, these include e-licensing (e.g. applying for a permission to establish new manufacturing plants), e-Industrial Community (providing general information on industries and industrial clusters), e-Investment (providing information on investment opportunities and regulations), e-Standard (Industrial standards), and online library services. • The Ministry of Science and Technology launched a project to enhance technological capabilities in the electronics industry. This is particularly for hard disk drives sub-industry. The National Science and Technology Development Agency (NSTDA) will be a core responsible unit with the budget of 1.36 billion Baht to be spent during the fiscal years 2007-2011. This allows tax-free imports of appliances and facilities to conduct research and development (R&D). • The Government set a fund for firms in the manufacturing and services sectors that are adversely affected by free trade agreements. This fund, currently administered by the Ministry of Commerce, is initially for the period of 2007-2008. The support will be non-financial. Rather, it aims to help small firms in developing knowledge, R&D, business development plans, and labor skills. Note that this new fund will be in addition the existing fund, managed by the Ministry of Agriculture, that supports affected farmers in restructuring their production and enhance output productivity. • The Department of Business Development introduced e-services for registering businesses online. This facilitates and saves transaction costs for registering new businesses. This e-services system will also serve as Thailand's central database on registered firms where the public and government agencies can check certain details of registered firms. The Department also recently offers e-learning courses on e-commerce (previously classroom-based), where registered users can learn about e-commerce online. This should help to promote more business transactions online in Thailand, which is still relatively low. • The Board of Investment (BOI) relaxed its criteria on the use of area in industrial estates. Consistent with the Industrial Estate Authority of Thailand, the BOI now allows industrial estates to use more than 75 percent of their total area for manufacturing plants. Previously, factories could occupy only up to 75 percent of the area where the remaining are for shared basic infrastructure such as pollution management system. This applies only to industrial estates that are larger than 1,000 Rai. This should help to reduce cost of developing industrial estates and lower land price within estates. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • The National Telecommunication Commission (NTC) will implement e-licensing to promote the fair competition in telecommunication sector. According to the NTC's implementation plan for 2007, the NTC plans to formulate license issuing policy that promotes competition, prevents the monopoly, and supports retail enterprises. The e-licensing will be implemented to create a transparent license issuing which is consistent with international standard.
B.	Reform of legal and judicial regime	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • In May 2007, the Cabinet approved the draft master plan on the use of information technology in the justice process. The major aim is to establish a justice data exchange centre, which provides information on offenders, court cases and their progress, and other justice issues. Currently, such information is created and used rather independently by agents such as police officers, attorneys, and court officials.

	Objective	Reform Measures Taken
C.	Improve the skills and quality of labor	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • The Department of Skill Development has initiated again the roles of a Committee on Labor Development and Training. This committee is responsible for setting country-level policies on labor trainings to coordinate trainings provided by different government and private sector units. This committee will also serve as a central database on labor demand. In doing so, this central committee will set up provincial committees that collect data in each areas. • The Commission of Higher Education has recently approved the 15-year Higher Education Development Plan (2007-2021). The Plan focuses on raising the access to and quality of higher education in Thailand in order to raise the quality of academic institutions and graduates and move Thailand towards a knowledge economy. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • The Thai Vocational Qualification Institute (TVQI) will be established within 2007/2008. As of March 2007, there has not been much progress in the establishment of the TVQI which was approved in September 2005. However, the committee of TVQI establishment expects to set up both the institute and the TVQ program within 2 years. • The strategic plans regarding the skill development of three more industries will be approved this year. The strategic plans for three industries are pending for the cabinet approvals. These include vehicles, electronics and electrical appliances, and tourism industries. The main objectives of the strategic plans are to improve labor skills and thus enhancing competitiveness of these industries.
D.	Reduce tariff to improve Thailand's competitiveness 1/	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • In September 2007, the Customs Department announced tariff reductions and exemptions for hundreds of product lines. These cover both agricultural and manufactured products. Many products under the following product groups (according to two-digit Harmonised Code) enjoy lower or zero tariffs: HS29 (organic chemicals), HS72 (iron and steel), HS84 (machinery and mechanical appliance), and HS85 (electrical machinery and equipment). • The Japan-Thailand Economic Partnership Agreement (JTEPA) is effective from 1 November 2007. Tariff and non-tariff measures for many goods between the two countries are now relaxed. The Department of Export Promotion reveals that about 31.1 percent of Thailand's import tariffs for Japanese products will be exempted since the first year, while another 66.5 percent will be lifted in the next 2-10 years. These numbers of Japan's tariffs for Thai products are 86.1 percent and 5.1 percent (but for the next 2-15 years), respectively. Overall, the JTEPA should enhance Thailand's overall exports to Japan, especially for most agricultural products, garments, and certain manufactured products • Thailand's import tariffs are also lowered following trade agreements with other regional blocs and trading partners. Since April 2007, these include agreements with the World Trade Organisation (WTO), ASEAN Free Trade Agreement (AFTA), China-ASEAN, Australia, New Zealand, Lao PDR, Myanmar, and Cambodia. The type and number of product lines that are included are varying, although most of these agreements (except those with new ASEAN members) focus on lower tariffs for electronics products.

	Objective	Reform Measures Taken
E.	Promote Thai exports to new markets ^{2/}	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> • The bilateral free trade agreements between Thailand and Japan and Thailand and India have made a significant progress. Japan-Thailand Economic Partnership Agreement (JTEPA) is effective from 1 November 2007 (See above for more details). The number of products considered for tariff reduction between Thailand and India increases dramatically from 82 products under the Early Harvest Scheme to over 3,000 products. • Multilateral free trade agreement that involve Thailand also stepped forward. These include BIMSTEC and trade agreements between ASEAN and China, Australia and New Zealand, Korea, India, and Japan. The negotiations result in agreements on several topics, e.g. sanitary and phytosanitary standards in ASEAN-Australia-New Zealand and trade in services in ASEAN-Korea. • The initiative for trade agreement between ASEAN and EU began in May 2007. The most recent Joint Committee meeting in October 2007 still considered the scope and direction of the Agreement. • The government approved partnership agreement between Thailand and Kuwait. As proposed by the Ministry of Foreign Affairs, the draft agreement was signed in August 2007. The areas of cooperation will include economic, commerce, services, banking, industry, energy, tourism, and academic. <p><i>Measures to be taken in the next 6 -12 months</i></p> <ul style="list-style-type: none"> • The implementation of the agreement on trade in services between ASEAN and China was expected to be effective on 1 July 2007. ASEAN member countries and China signed a framework agreement on trade in services in January 2007. The framework agreement, which is consistent with the General Agreement on Trade in Services (GATS) under WTO, will allow and facilitate Thai investors to expand their businesses in China. • A tariff reduction under the Early Harvest Scheme between Thailand and Peru was expected to be effective in July 2007. According to the protocol on the acceleration of liberalization on trade in goods, the two countries agreed to reduce the tariff rates of items in the Early Harvest Scheme once the agreement on rules of origin is signed. This was in fact signed in November 2006, so half of Thailand's all traded goods and 54.6 percent of Peru's all goods should have had lower tariffs. These tariff reductions are however not yet effective, as Peru still seeks to complete its internal legal processes.

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Notes: 1/ See *Tariff Reform* in Section 3.2 on Recent Trade Reforms for more detailed discussion.

2/ See Box 1 more details.

4. Social Protection

	<u>Objectives</u>	<u>Reform Measures Taken</u>
A.	Develop social insurance mechanisms for the elderly and those affected by unemployment, work-related injuries or other shocks to income.	<p><i>Measures taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Cabinet, on June 12, 2007, approved the draft Social Security Promotion Act. The draft focuses on strengthening local communities and civil societies. In this regard, local communities and civil societies will be encouraged to promote social security locally, and to respond to local needs. It is expected that networks of community social security will be established and operated on a sustainable basis. Government's local administration units will cooperate and support the establishment and operation of these networks of community social security. ▪ The Cabinet, on July 10, 2007, approved the draft of new Social Security Act. The draft Act includes amendments of the previous Acts, making it appropriate and responsive to current social and economic needs in Thailand. The amendments include potential extension of the Social Security Scheme (SSS) to cover labor in the informal sector, and provide more flexible benefits to members of the SSS.
B.	Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement.	<p><i>Measures taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Cabinet, on March 20, 2007, approved the draft Establishment of the Labor Court and the Labor-Case Judging Methods Act. According to the Act, the Labor Court will be given the authority to judge Employee-Employer Violation cases. ▪ The Cabinet, on June 12, 2007, approved the national strategy for Thai Wisdom and the Well-being of the Thai Way of Life for the years 2007-2011. One of the aims of the strategy is to strengthen the health system and enhance human resources development for local practitioners and practitioners of traditional Thai medicine. ▪ The Cabinet, on June 12, 2007, approved the amendments of the draft Safety, Health, and Environment in the Workplace Act. The Draft will be submitted to the National Legislative Assembly for consideration.
C.	Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support	<p><i>Measures taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ Thailand's first National Health Act 2007 was enacted. According to the Act, the health of children, women, disabled persons, elderly persons, socially deprived persons as well as groups of people with specific health characters shall be relevantly and appropriately promoted and protected. Moreover, the National Health Commission is formed, with mandatory functions to: 1) prepare the statute of national health system as the policy guideline for formulating policy, strategy, and implementation on national health; 2) organize national health assembly and support health assembly in a specific locality or on a specific issue; 3) provide, promote or support the process of healthy public policies and strategies development for continuity of performance of activities and public participation from all sectors; 4) give suggestions or advices related to policies and strategies on health to the Council of Ministers, and to follow-up the implementation of such suggestions or advices, as well as to disclose such implementation to the public including prescribing rules and procedures on monitoring and evaluation in respect of national health system and the impacts on health resulting from public policies, both in the level of policy making and implementation.

		<ul style="list-style-type: none"> ▪ The Cabinet approved, on May 1, 2007, the joining of the International Drug Purchase Facility Global Initiative of the Clinton Foundation by Thailand. The Clinton Foundation will act as the coordinator for price negotiation and medicine procurement of HIV/AIDS medication without any management charge. As a result of the joining, the treatments for HIV/AIDS will be more affordable, and will particularly benefit the people in the lower strata in the society. ▪ The Cabinet approved, on May 15, 2007, the Pilot Project for Poverty Alleviation and the Promotion of Food Security in Northeastern Thailand. The Food and Agriculture Organization (FAO) provides USD 376,000 to support this pilot project. The objectives of this project are to increase the commodity production of the agriculture sector and promote self-reliance, and to secure incomes of the target groups and set up the strategy for expansion of the target groups to other areas of Thailand. The project also aims to promote food security and living standard, which is the main focus and strategy of the government development plan. The target groups for this pilot project will includes 3 provinces: Mahasarakam, Nakon Panom, and Srisaket. ▪ The Cabinet approved, on June 12, 2007, the ratification of the convention 159 on Vocational Rehabilitation and Employment (Disabled Persons) 1983. The convention 159 is for the government to ensure the law or the improvement of the law, regulations, and effective practices to guarantee the right of disabled persons as equal as another person in the society. The ratification will create positive outcomes such as efficiency in the protection of disabled persons, vocational rehabilitation and employment opportunity for disabled persons, and enhancing the cooperation at the sub-regional, regional, and international levels to help and support the disabled persons. ▪ The Cabinet approved, on September 25, 2007, the Natural Disaster Master Plan for victim relief and prevention of flood, storms and mudslides. This master plan will be utilized as a framework and direction in aiding victims of natural disaster in an efficient way, to reduce risk and loss to victims and to empower communities in self sufficiency and self-aid in the beginning stages. It also aims to rehabilitate the quality of life and minds of victims to allow them to return to normality as soon as possible. ▪ The Cabinet approved, on September 25, 2007, the bill to protect patients from health service malpractice. This bill provides better protection for patients of state hospitals and clinics after the resolution of the screening committee. The screening committee will be submitting observations and recommendations to the Coordination Committee of the National Legislative Assembly before submitting to the National Legislative Assembly for consideration. This bill seeks to allow patients injured as a result of treatment at state hospitals or clinics to receive compensation promptly without having to wait for a court trial to determine the guilty parties in the prescribed treatment. It will also establish a compensation fund for patients who experience suffering caused by health service treatment.
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Prepared by Sutayut Osornprasop

5. Public Sector and Governance Reform⁴⁶

	Objectives	Reform Measures Taken
A.	Improving public service quality by streamlining and redesigning work processes and procedures	<p><i>Measure taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> • Department of Internal Trade pilots “Change Management” in the public sector. In June 2007, the Department of Internal Trade (DIT) and the Office of Public Sector Development Commission (OPDC) started a program called “<i>Going Forward to Change Management: Piloting Change Management in the Public Sector</i>”. This program plans to develop DIT to effectively change work-procedure, increase quality of its services, and enhance its management using Public Sector Management Quality Assessment (PMQA) standard. Lessons learned and results of this pilot program shall be used for policy recommendations and strategic planning to apply change management in other government agencies.
B.	Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> • Rules for Administration of the Kingdom Act (1991) have been amended and announced in the Government Gazette on September 15th, 2007. The key changes include (i) allowing Ministries to have additional Deputy- Permanent-Secretary if it has more responsibilities and necessities; (ii) increasing flexibility for government officers to delegate their power to their representatives; (iii) granting provincial administration to directly request budget from the Bureau of budget and revising responsibilities and authorities of provincial governors. • In June 2007, the Cabinet approved the draft of the Rules and Procedures for Privatization of State-Owned Enterprise Act to replace the 1999 State Enterprise Corporatization Act. The new act will identify (i) rules and procedures for privatization of state-owned enterprises; (ii) corporatization procedure and distribution of shares process; and (iii) regulator of a privatized company. • The Cabinet approved the amendment of the 1992 Civil Servants Act on June 26, 2007. The new act which is expected to be effective in FY 2008 will (i) abolish the sole standard of civil servant positions which classifies civil servant’s positions and salaries into 11 levels (C1 to C11) for every function; (ii) improve decentralization in human resources management in the public sector by transferring a power to identify the numbers of civil servants and positions from the Office of Civil Service Commission (OCSC) to government agency; (iii) improve human resources management by adjusting recruitment and employment procedure as well as incentive schemes; (iv) open position to people outside the public sector to apply for a civil servant position; and (v) transferring functions to maintain moral and ethics of civil servants from the OCSC to the new agency called Moral and Ethics Committee.
C.	Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> • The draft amendment of Public Debt Management Law was approved by the Cabinet on May 15, 2007 and it currently is under consideration of the National Legislative Assembly. The draft focuses on improving the roles of government bonds to promote Thai bond market and increasing flexibility of the Ministry of Finance (MOF) in managing government’s debt. • On September 4, 2007, the Cabinet approved the draft amendment of the Private Sector Participation in Public Works Act, 1992. The key changes in the draft amendment include (i) clearly classify types of private sector participation in public works in to three categories: conventional procurement, turn key, and public private partnership (PPP); (ii) increase the minimum value of the

⁴⁶ The objectives detailed in this matrix are consistent with the Government’s Public Sector Development Strategy (2003-2007) and the more recent Public Affairs Management Plan.

	Objectives	Reform Measures Taken
	<p>system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation.</p>	<p>projects from 1,000 to 3,000 million baht to reflect the present value; (iii) adjust the roles of government agencies in project selection process; and (iv) increase the authority of a project coordinator committee.</p> <ul style="list-style-type: none"> • In April 3, 2007, the Cabinet approved the principle of redefining “public sector”. The term “public sector” will now consist of 4 types of organization including (i) government agencies; (ii) stated-owned enterprises (SOE); (3) public organizations; and (4) new government units which can be both an independent administrative organization and a corporate fund. • The Cabinet decided on March 2007 that all ministries will have to prepare a governance risk analysis for all projects or plans that aims to comply with the key government policies starting from FY 2008 onwards. The governance risk analysis shall be submitted together with the budget proposal prepared by each ministry to the Bureau of Budget and incorporate into the integrated inspection process. • To reduce salary gap between public and private sectors, the Cabinet agreed to increase salary base of civil servants by 4 percent which shall be effective from 1 October 2007. This salary increase shall apply for all civil servants and government retirees. • The draft royal decree on public procurement was approved by the Cabinet on October 22, 2007. The purpose of this royal decree is to increase transparency and fairness in public procurement system. To improve transparency, the government agencies are required to announce their annual procurement plans to the public and use the reference price of goods set by the Comptroller General Office. To enhance competition and fairness, the royal decree has cancelled procurement with special method which requires government agencies to give the priority in procuring goods and services from other government agencies, provincial authorities, state-owned enterprises instead of using the general public procurement procedure. Therefore, private sector can now compete with government agencies and SOEs in providing goods and services to the public sector. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> • In FY 2007, 78 projects from 18 ministries will be inspected under the integrated inspection process from the Prime Minister Office and from each ministry’s own integrates inspection process. • The regulation on Controlling and Monitoring Civil Affairs in Provincial Government Offices is being reviewed by the State Council and is to be presented to the Cabinet. The regulation will empower the Deputy Prime Ministers to oversee the management of provincial clusters.
D.	<p>Improving governance in public sector through participation, accountability, and transparency</p>	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> • In April 2007, the Cabinet approved the draft Promoting Good Governance in Public Sector Act. According to this draft, all government officers including ministers, members of the parliament, judges, civil servants, and temporary employees in government offices, state-owned enterprises and local administration are subjected to this Act. The National Governance Committee will be set up to responsible for developing strategies and suggestions on how to promote governance and morality in the public sector. • The Government has been focusing on promoting participatory governance both at the provincial administration level. The OPDC has been working with every provincial administration to develop participatory governance by promoting local people with better access to government information and to enhance their participation in the provincial administration by setting areas where the local people can monitor and work with the provincial administration. In addition, Thammasat University Research and Consultant Institute (TU-RAC) has been working with the OPDC and three pilot agencies (Ministry of Health, Ministry of Social

	Objectives	Reform Measures Taken
		<p>Development and Human Security, and the Public Relations Department) in the one-year project on “Development of participatory administration within Ministry and Department”. This project aims to (i) study the participatory administration at the policy level; (ii) increase public participation in government administration; (iii) improve understanding of participatory approach amongst government agencies. The result of this project shall be used to propose the changes in government rules and regulations and to determine policy at the agency level in order to implement the participatory administration in all government agencies.</p>

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