Board Meeting of July 9, 1998
Statement by Juan L. Cariaga

Thailand - Country Assistance Strategy

General Observations

The countries of East Asia and especially Thailand have made remarkable progress in poverty alleviation during recent years. The over-riding purpose of this Country Assistance Strategy (CAS) must be to protect and restore the many gains that have been made, and to establish the basis for renewed growth.

Wage increases above the rate of growth in the country’s productivity, an inconsistent exchange rate peg to the US dollar and large short-term capital inflows in a poorly regulated and over-protected financial sector triggered the most severe economic and social crisis the country has seen in thirty years. The government maintained strict fiscal discipline in its aggregate expenditures and revenues, but both are regressive and growth, even though sustained, has been inefficient. Moreover, benefits have not reached important segments of the poor, especially women and the rural population. As in other Asian countries, much of this growth is explained by large increases in investment and savings, albeit with low total factor productivity increases.

These are the issues addressed in this CAS. It is well structured and appropriately focussed on the country’s severe economic and social crisis, but it also recognizes that the situation remains very fluid and volatile, with broader regional recovery playing an important role also.

The three information boxes provided, which discussed women’s issues, the new constitution and corporate and public governance issues, were particularly useful. The candid and forthright description of Thailand’s present situation, and the serious challenges the country faces, are also especially appreciated.

The overall strategy is generally appropriate. We also support the two loans for projects involving social investment and economic/financial adjustment that are being considered today and are within CAS guidelines. Policy based lending represented by these loans – one of which addresses economic and financial reforms and the other social investments protecting the poor and vulnerable – has our support. The Economic and Financial Adjustment Loan is front loaded
and the balance of payment support provided in this case is appropriate in view of the government’s commitment to structural adjustment.

There is also strong ownership in the CAS and we are impressed with the reforms the Royal Government of Thailand has taken, including fiscal and monetary measures. Thailand’s response is rightly perceived as among the more positive in the region. This is reinforced when we consider the replacement of a previous government that had been seen to respond badly after the crisis began. Moreover, the present government has expressed its intention to continue significant reforms and has already taken a number of steps.

We are impressed with the political vibrancy evident in Thailand, which places it in a favored position, and especially note its having a vigorous private sector and an active middle class and NGO community. Although some groups in civil society are described as being skeptical of the government’s intentions and capabilities, Thailand’s democratic system and the open consultation evidenced are important elements that will contribute to implementation. Nevertheless, this is a signal the government should heed concerning the need for increased attention to good governance and transparency.

**An opportunity missed…**

Thailand discontinued its participation in a previous structural adjustment loan (SAL) that would have addressed many of the issues now of concern. The CAS describes this as “ironically, a third SAL, which was to set the groundwork for structural and regulatory reforms in the banking system, and for privatization, was dropped.” We find this more than just ironic, it is truly regrettable. As the CAS notes, albeit with hindsight the Bank might have more energetically argued for structural reforms at that time, but there is also understandably little likelihood this would have been heeded in view of the general situation then.

**…but now possible**

Broad political agreement supporting reforms and “…a widely shared consensus that a period of austerity and painful economic reform is an inevitable precondition for economic recovery” provides an opportunity to pursue reforms in the Thai economy. As such, we hope that Thai authorities will seek the enhanced base case, taking advantage of what may be a unique opening to advance needed reforms.

**Specific Comments**

1. The present crisis raises many challenges and potentially serious consequences, but as noted is an opportunity to undertake significant changes to improve economic policies. We welcome front loading the lending pipeline, but also think that some of the proposed reforms might be more aggressively pursued. For example:

(a) Privatization planning sends mixed signals and could be strengthened. On the one hand, plans are to privatize some state owned enterprises (SOEs), liquidate others and strengthen some. To maintain a large SOE sector in an environment where there have been endemic problems does not appear the best way to encourage good
governance or corporate reform. The loan paper does not describe those SOEs to be maintained and we would appreciate knowing more about the rationale for this approach.

(b) Trade policies remain highly distorted. Currently, with a large surplus in the trade account and with sluggish exports, there appears to be a good opportunity to enhance trade reform, lowering import tariffs and eliminating non-tariff restrictions to reduce the anti-export bias of the trade regime.

2. As has happened in periods of economic distress in many countries, some evidence of strongly nationalistic reactions has been reported. This needs to be addressed right from the beginning. We agree that the country’s development partners should make every effort to demonstrate that “...an open, outward-looking, transparent financial system and foreign investment regime remain the best means to access capital and knowledge for reviving growth.” We would add, however, that the government must emphasize its support and ownership for needed reforms. This is especially true in the case of direct foreign investment (DFI). Moreover, we believe the DFI regime should be liberalized even more than the reforms being proposed. Incomplete DFI liberalization in a country seeking to regain international confidence may not offer the most convincing argument to foreign capital.

3. We concur that the tax system needs to be streamlined to permit a more fluid restructuring of the financial and corporate sectors, but a word of caution might be appropriate. The government should be careful not to be too generous in providing tax relief if this were to promote spurious or doubtful mergers motivated only by such advantages.

4. Before the crisis, there was a misalignment of wages and productivity, but in view of the real devaluation that has occurred, can staff clarify if this misalignment still persists?

5. Food security is an important consideration. We welcome the attention being given to addressing rural-urban imbalances. If 55% of the country’s population accounts for only 12% of its GDP, there would appear to be an opportunity to improve conditions through the programs being proposed as well as the Rural Development Strategy, which we look forward to seeing.

Conclusion

Overall, we believe that the Bank’s support for Thailand’s medium-term strategy addressing the country’s need to renew competitiveness, improve governance and share growth and quality of life is appropriate. We look forward to working with the Royal Government of Thailand and the Thai people in pursuit of renewed progress.