

Thailand Economic Monitor

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ABBREVIATIONS

AFTA	ASEAN Free Trade Agreement
ASEAN	Association Of Southeast Asian Nations
BAAC	Bank for Agriculture and Agricultural Cooperatives
BI	Inspection Body
BIBOR	Bangkok Interbank Offered Rate
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BIS	Baseline Indicators System
BOI	Board of Investment
BOKI	Board of Knowledge Investment
BOT	Bank of Thailand
CEOs	Chief Executive Officers
CG	Central Government
CNG	Compress Natural Gas
CPI	Consumer Price Index
CPSC	Colombo Plan Staff College for Technician Education
DIT	Department of Internal Trade
EDI	Electronic Data Interchange
EU	European Union
EXIM Bank	Export-Import Bank
FDI	Foreign Direct Investments
FIDF	Financial Institution Development Fund
FPO	Fiscal Policy Office
FSMP	Financial Sector Master Plan
FTA	Fiscal Trade Agreements
FY	Fiscal Year
GCCC	Government Counter Corruption Commission
GDP	Gross Domestic Product
GMO	Genetically Modified Organism
GMS	Greater Mekong Sub-Region
GNI	Gross National Income
HS	Harmonized System
IAS	International Accounting Standard
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communications Technology
IOSCO	International Organization of Securities Commission
JBIC	Japan Bank for International Cooperation
JTEPA	Japan-Thailand Economic Partnership Agreement
KEI	Knowledge Economy Index
LIBOR	London Interbank Offered Rate
LME	London Metal Exchange
MFN	Most Favoured Nations
MLR	Minimum Loan Rates
MOF	Ministry of Finance
NAL	National Legislative Assembly

NCB	National Credit Bureau
NCCC	National Counter Corruption Commission
NESDB	National Economic and Social Development Board
NLA	National Legislative Assembly
NPLs	Non-Performing Loans
NRCT	National Research Council of Thailand
NRPM	National Research Project Management
NSTDA	National Science and Technology Development Agency
NTMs	Non-Tariff Measures
OCSC	Office of Civil Service Commission
OECD	Organization for Economic Cooperation and Development
OIE	Office of Industrial Economic
OPDC	The Office of the Public Sector Development Commission
OPEC	Organization of the Petroleum Exporting Countries
PAOs	Provincial Administration Organizations
PPP	Private Public Partnership
PSA	Public Service Account
PSO	Public Service Obligation
PSR	Product Specific Rules
PTI	Post-Trade Integration
R&D	Research and Development
SEC	Securities and Exchange Commission
SEK	Swedish Export Credit Corp
SET	The Security Exchange of Thailand
SMEs	Small and Medium-sized
SOEs	State-owned Enterprises
SPS	Sanitary and Phytosanitary standards
SSS	Social Security Scheme
TCH	Thailand Clearing House Co., Ltd.
TFEX	Thailand Future Exchange
TISI	Thai Industrial Standards Institute
TNC	Trade Negotiating Committee
TRQ	Tariff Rate Quota
TSD	Thailand Security Depository
TSD	The Thailand Securities Depository
URR	Unremunerated Reserve Requirement
UTCC	University of The Thai Chamber of Commerce
WB	World Bank
WTO	World Trade Organization

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SECTION 1

OVERVIEW

Real GDP in Thailand is projected to grow at 5.0 percent in 2008, driven by recovery in domestic demand. The key reason for the strengthened growth this year is the higher confidence of both consumers and investors with the return of democracy and the election of a new government late in 2007. Last year's better-than-expected growth of 4.8 percent was due to buoyant export performance throughout the year even as domestic consumption and investment declined amidst the uncertain political environment and sudden shifts in policy. But this year, the opposite is likely. The new government announced a set of economic policies and measures – including higher levels of public investment – which are expected to boost domestic demand by reviving confidence and stimulating private investment and consumption. They include the revival of the mega-infrastructure projects as well as tax cuts for businesses and individuals and grants and loans to the grass root communities¹. Interest rates in Thailand will also likely remain low as inflation, although rising, will likely be within the inflation target. The balance of trade, on the other hand, is likely to contribute less to real GDP growth than last year, in part because rising aggregate demand will boost import growth, while exports will be constrained by an appreciating Thai baht and the slowdown in major export markets.

The external current account may weaken slightly in 2008, as the global downturn slows exports and robust domestic demand stimulates imports. Growth in exports of goods is expected to slow from around 18 percent to 13 percent (in US dollars) due to sluggish demand in Thailand's key export markets (US, EU, and Japan), although intra-regional trade will mitigate some of the slowdown as it did last year. The appreciation of the baht could also play a role.² Growth in exports of services, especially tourism, is also expected to slow as high fuel prices and sluggish income growth in industrial countries dampens international travel globally. Imports on the other hand are expected to rise as higher investment and consumption increases demand for imported consumer, intermediate, and capital goods. The current account is therefore expected to decline from 6.1 percent of GDP last year to 2.1 percent this year.

Private investment should recover after its slump last year. Private investment growth in 2007 was a mere 0.5 percent (in real terms), the lowest since 2000. Gross foreign direct investment inflows fell to US\$21 billion, well below its post-crisis peak of US\$32 billion. Capacity utilization reached 75 percent in 2007, the highest since the crisis, and in many industries, it exceeded 80 percent. Last year, several policy changes took their toll on investor confidence, including the introduction of unremunerated reserve requirements on capital inflows and the proposed amendments to the Foreign Business Act that would increase restrictions on foreign investments. The new government had announced measures to boost public and private investment. Growth in public investment is expected to more than double this year to 9 percent, as implementation is expected to resume on public mega-infrastructure investment projects such as the mass transit lines in Bangkok and the dual track rail system.

¹ The tax package includes a higher deductible for personal income taxes, a reduction in corporate income tax rates, increased tax deduction on machines and equipment for investment purpose, and reduced property sales transaction fees. It is estimated at Bt40 billion or 0.4 percent of GDP. The grant to grass root communities includes a direct transfer to villages and urban communities totaling Bt20 billion per year. Moreover, a 2-year debt moratorium for farmers and an expansion of loans by state-owned financial institutions to low-income groups have been approved by the Cabinet.

² Thailand's key exports (such as integrated circuits and computers) have high import content, so the exchange rate appreciation is likely to be of limited consequence. They are to a larger extent affected by the slow down in global demand. Those exports with low or no import content for which the appreciation would matter more (such as canned fruits and furniture) represent only a small share in total exports.

To boost private investment, in March the new government removed the 30 percent unremunerated reserve requirement for capital inflows and has introduced tax cuts for small and medium enterprises, firms listed in the stock exchange, and on property transactions. Firms have indicated plans to invest but had delayed it in them in the past two years. The Board of Investment's investment promotion applications and approvals since 2004, for example, has been quite large compared to the years before that. However, low investment growth in the past 2 years indicates that they have not been translated into actual investments. With a stable policy direction this year, the investments can be expected. Several large firms have publicly announced plans to increase investment in plant and equipment this year. Real private investment is expected to expand by 10 percent this year from its historical low growth last year.

Recovery in private consumption and investment could be fragile as there remain large down side risks to their growth, but could be mitigated by additional fiscal stimulus. Risks to growth this year comes mainly from external factors such as the high oil and food prices and the potential significant slowdown in world economic growth. Inflation is forecasted to be rise to 5.0 percent this year as world crude oil and world rice prices are expected to increase by 20 and 55 percent, respectively³. However, should oil and food prices rise sharply, inflation would rise by more than that. This could dampen household consumption growth. Moreover, should global economic growth decline significantly, this would lower export growth which would affect growths of consumption and investment as well. On the domestic side, should the uncertainties in policy directions return, such as from a change in government, consumer and investor confidence will be adversely affected. However, in the case that the global environment turns out to be more unfavorable than expected, Thailand's strong fiscal and macro-economic stance would be able to cushion some of the negative impacts. The government's fiscal deficit and public debt are currently low at 2 percent and 38.5 percent, respectively. Foreign reserves have climbed to over \$90 billion or some four times short term external debt. There is therefore room for additional fiscal stimulus if needed.

The rise in agricultural prices has meant higher incomes for the rural population but has adversely affected the poor engaged in non-farming activities. Around forty percent of the population and of the poor are engaged in agriculture. The rise in agricultural prices since 2004 has raised farm incomes by more than 15 percent annually. Farm incomes are estimated to have climbed by another 26 percent in first two months of this year. From 2004 to 2006, Thailand's poverty headcount fell by almost 2 percentage points (over 1 million people) with most of the reduction occurring in rural areas. This trend is expected to have continued in 2007 and early 2008. But there is evidence that the urban poor, as well as the rural poor engaged in fishing and other non-farm activities have been adversely affected by the higher food prices.

A big challenge for Thailand is to sustain the momentum of growth in the longer term and to avoid getting stuck in the "middle income trap". Thailand has rapidly transitioned from a low-income country to a middle-income country⁴ within the span of only a few decades (from 1970s to mid-1990). This was the result of the rapid growth in per capita income during that period. However, in recent years, real GDP growth has slowed down and so has per capita income growth, making it lower than those of other developing countries in East Asia⁵. With intensifying global competition and higher commodity prices, Thailand faces a real challenge of sustaining its growth and transitioning into a higher income country. While short-term policies to address the immediate downside risks to growth are being put in place, Thailand needs to turn to the longer term challenges by improving its productivity and competitiveness if it were to avoid being stuck in a middle-income trap in which

³ Headline inflation was 2.6 percent in 2007 and 4.7 percent in 2006. Inflation began to rise in the fourth quarter of 2007 and has averaged at 5 percent in the first quarter of 2008 despite an appreciating Thai baht and price controls on more than 200 products. Higher prices for meat, vegetables, fruit and fuel were the key contributors.

⁴ The World Bank's definition of a low income country is one with per capita gross national income (GNI) of less than US\$900; a lower middle income country is one with per capita income between US\$900 and US\$3,500; an upper-middle income country is one with per capita income between US\$3,500 and US\$11,000, and high income countries are those with per capita income greater than US\$11,000. Currently, Thailand is a lower-middle income country; its per capita income is around US\$3,000.

⁵ Thailand's real GDP growth was 6.2 percent from 2002-2004 and 4.8 percent in from 2005-2007. Developing East Asian growth from 2005-2007 was 9.7 percent.

many Latin America countries have been in for several decades.

In addition to the short-term measures have been introduced by the government to mitigate risks this year and next, longer term measures are needed to sustain Thailand's growth and poverty alleviation. Some of the short-term measures introduced are the expansion of price controls, continued intervention of the exchange rate, and grants to all villages and communities⁶. While these measures may be helpful in mitigating the impact of higher prices and exchange rate volatility in the short-run, but they are costly and unsustainable in the longer term. Prolonged price controls, for example, lowers the productivity of firms and discourages them from expanding or establishing new operations, which is the opposite to what Thailand needs to increase its productivity and competitiveness. Instead, the more desirable longer-term measures such as ones that help alleviate the supply constraints and increase competition such as allowing imports. In addition to those, measures that would help firms increase production efficiency, such as greater energy efficiency, would not only lead to lower cost and prices but would also increase firms' competitiveness. Similarly, exchange rate intervention to slow down the baht appreciation is costly and is a short-term measure. With the baht remaining appreciated in the foreseeable future, targeted assistance to the industries directly affected by the stronger currency to help them increase their productivity would enable them to survive with less support from the government. In the extreme case that a particular industry is no longer competitive, assisting them to move to a more productive, higher value-add industry would be beneficial not only to the firms themselves but to the economy as a whole. Grant transfers to the villages are not sustainable in the long-run either. As grants are transferred to the villages and communities in this year and next, capacity building programs should also be provided to promote the best use of these resources at the village level, as well as provide capacity building for them to develop sustainable income-generating activities for the future. These should preferably be done through the local government organizations.

Thailand has passed several new acts that would facilitate reforms and better performance in the financial sector and the public sector. Last year, many laws were passed that would strengthen the operations and governance of the financial institutions as well as the supervision of the Bank of Thailand. They include the Bank of Thailand Act, the Financial Institution Business Act, and the Deposit Insurance Institution Act. Reforms have also been implemented in the public sector. The Public Debt Management Act also was passed and would strengthen the management of public debt to be timely and of a broader coverage. It also allows the government to issue bonds in excess of its budget deficit. The new civil service structure was also implemented last year to better categorize civil servants so that their performance can be better recognized as well as to attract capable individuals from outside. On the macroeconomic front, the 30 percent unremunerated reserve requirement for capital inflows were lifted on March 3, 2008.

However, measures to improve Thailand's productivity are urgently needed to ensure that growth is sustainable and is balanced among all groups in the country. Thailand needs to improve its productivity in all the sectors – agriculture, industry, and services. The services sector, in particular, has a high growth potential. However, its productivity growth so far has been low⁷. Increasing its productivity through allowing greater competition, for example, would help unleash its potential growth which could be an important source of growth for Thailand in the future. Surveys of firms have also pointed that regulatory issues as well as inadequate infrastructure and skills mismatch are constraining firms' productivity and investment, which are in turn discussed below.

Regulations and bureaucratic procedures have been limiting competitiveness and added costs for firms. Firms have voiced that there are laws and regulations that are limiting competition and growth of firms. These included the Foreign Business Act which limits foreign participation in many services businesses and the price

⁶ There are over 78,000 villages and communities in Thailand. The grants will total up to Bt20 billion (US\$650 million) per year.

⁷ In a recent study by the NESDB and the World Bank titled *Measuring Output and Productivity of Services-producing Industries in Thailand* (2008), productivity growth of Thailand's services sector from 1985 to 2005 is negative compared to positive growths in the industry and agriculture sector.

controls. On the other hand, the Secured Transactions Act⁸ which has not been passed could help increase access to loans especially for small and medium-sized firms (SMEs) as well as for services firms. According to firms, bureaucratic procedures and corruption have also been costly for them⁹. These have increased the uncertainty of the time and costs taken to obtain, for example, permits, approvals, and clearances. Strengthening the integrated one-stop public service centers and minimizing the face-to-face interactions with government officials, possibly through the use of IT, would greatly help reduce the time uncertainties and also the opportunities for corruption.

Additional public investments in infrastructure are needed to not only lower production and logistic costs, but also promote equity among regions. With public investments continuously shrinking from 1998 to 2003 and no large public infrastructure investments since the crisis, Thailand's infrastructure is proving to be inadequate and a bottle neck to further expansion of firms as logistics costs have risen. Public investments would therefore not only directly inject funds into the economy, but also reduce operations and logistics costs for firms, thus, encourage them to expand. In addition, as trade in the greater Mekong sub-region (GMS)¹⁰ expands, infrastructure development particularly in the Northeast would facilitate not only trade among the GMS countries, but also growth within the Northeast which is the poorest region in Thailand¹¹. Better roads and public utility services (electricity, water, and telecommunications), for example, would promote higher industrial expansion, such as in food processing, in the Northeast and thus help increase trade between the Northeast and the neighboring countries. This would also help alleviate poverty, promote greater equity, and reduce migration from the Northeast.

Skills and knowledge urgently need to be improved today if Thailand were to escape the middle income trap. With the intensifying competition from countries with lower wages and abundant resource, Thailand needs to move towards more specialization and greater innovation, and stronger tertiary education outcomes in order to remain competitive in the coming years. As international experience such as from South Korea, Singapore, and Taiwan has shown, higher quality of human resource with better skills and knowledge is the key to achieving them. Thailand's move towards a knowledge economy is therefore critically needed for it to remain competitive in the coming decade. However, Thailand's world ranking on the extent of being a knowledge economy has fallen over the past decade, while countries like China and Vietnam have increased their ranks significantly¹². Improving the quality of education at tertiary levels, especially the science programs, are needed, but the quality of students coming out of secondary school level has to be improved as well¹³. In addition, linkages between education and research institutions and firms must be strengthened so that the students and research and development (R&D) produced meet firm's needs. Firms themselves need to also be more proactive in demanding these from the education and research institutions. In some cases, firms could be proactive in finding ways to fill the gaps themselves such as by conducting in-house training or pooling resources together for R&D activities. Experiences from countries that have successfully transitioned to a knowledge economy both in Europe and East Asia show that this is not an easy process and takes time. It requires serious efforts from both the government and the private sector to make it happen¹⁴. Thailand has to therefore urgently make serious efforts today as other countries are quickly catching up.

⁸ A Secured Transactions Act would allow firms to use assets other than physical ones (e.g. land, buildings, and equipments) such as future cash flows as collateral when borrowing from financial institutions. SMEs and services firms generally do not have a large amount of physical assets, but they have contracted future cash flows. The Secured Transactions Act would therefore allow them to use these non-physical assets to secure loans from financial institutions.

⁹ See Thailand Investment Climate, Firm Competitiveness, and Growth (2006) by the NESDB and World Bank

¹⁰ GMS includes Cambodia, Lao PDR, Myanmar, Thailand, and Vietnam.

¹¹ The Northeast region of Thailand borders Cambodia and Lao PDR.

¹² Thailand's ranking in the World Bank's Knowledge Economy Index fell from 48 in 1995 to 56 in 2007 (from 137 countries). China's rank jumped up by 25 ranks, putting it at rank 75. Vietnam jumped up by 12 ranks, putting it at 97.

¹³ PISA scores in mathematics from 2006, for example, showed that more than 50 percent of Thai secondary school students have scored lower than minimum acceptable levels.

¹⁴ See Towards a Knowledge Economy in Thailand (2008), a joint report by the NESDB and the World Bank, for a detailed discussion of experiences from countries that have successfully transitioned to a knowledge economy.

SECTION 2

RECOVERY AND OUTLOOK

2.1 Real GDP Growth and Macroeconomic Developments

Real GDP in Thailand is expected to grow at 5.0 percent this year, up from 4.8 percent growth last year. Last year, real GDP expanded at 4.8 percent, much better than most expected. It was due to the buoyant export growth that last through all the quarters of last year. Domestic consumption and investment growths, on the other hand, declined last year from the fall in consumer and investor confidence amidst the uncertain political environment and policy directions (see Table 1). Domestic demand is expected to recover in 2008 with the revival in public investment and higher investor confidence as the newly elected government (elected in late December 2007) has issued clearer policy directions and measures stimulate private investment and consumption. Interest rates will also remain low because inflation, despite rising, is forecasted to be within the targets set by the Bank of Thailand. However, with the rise in investment, import growth can be expected to rise as well. On the other hand, exports of goods and services are expected to grow slower than its last year's 19.5 percent growth rate (in US dollar terms) in an environment of a slowing global demand and an appreciating baht. In sum, *net* exports will contribute much less to real GDP growth this year, but would be offset by growth in the domestic demand. Real GDP growth this year will speed up slightly to 5 percent.

There are however large downside risks to this forecast. Some of the risks include the uncertain growth of the global economy, which would affect world trade. Current projections suggest that world global trade volume growth will fall from 7.5 percent last year to 4.5 percent this year (see External Environment section). However, should the large economies of the world – US, EU, and Japan – which accounts for around 40 percent of Thai exports slow down more sharply than expected Thai exports growths will be lower than expected. Moreover, the sharp rise in world commodity prices, particularly food and oil prices, will raise domestic inflation and may hamper the expected recovery in household consumption. A sharp rise in inflation would prompt policy interest rates to rise. Should demand growth falls while inflation and interest rates rise, investors may continue to delay investments further. Moreover, uncertainties on the continuation of government policy directions stemming from an unstable political situation may also dampen investor confidence. Nevertheless, in addition to assuring the continuation of policy direction, the government has room to undertake further stimulative fiscal and macroeconomic policies to cushion some of the impacts by stimulating domestic demand.

The downside risks could be somewhat mitigated by stimulative fiscal policies. The central Government has been running a fiscal surplus for several years after the crisis. Last year, the government planned a 2 percent budget deficit but was able to run only 1.7 percent that due to the lower-than-planned disbursement rate. This was the result of the reconsideration of many large public infrastructure projects as well as stricter monitoring of procurement procedures that was imposed to make public procurement more transparent and accountable. Public debt (includes government and state-owned enterprise debts) is currently low. It has been falling continuously since 2000 and was 37.5 percent of GDP at end-2007. There is therefore room to increase public debt to finance investment projects. The Government plans to run a deficit of around 1.8 percent of GDP this year. However, its

Table 1. Real GDP Growth, 2006-2008

(Percent)

	Share in			
	2007 GDP	2006	2007	2008p
Total Consumption	61.1	3.0	2.7	4.6
Private C	51.9	3.2	1.4	4.0
Gov C	9.2	2.3	10.8	8.0
Gross fixed capital formation	22.4	3.8	1.4	9.7
Private Investment	16.6	3.7	0.5	10.0
Public Investment	5.8	3.9	4.0	9.0
<i>Change in Inventories</i>	0.0	-84.8	84.2	1100.0
Total Domestic Demand	83.5	1.3	2.1	6.5
Exports	69.7	8.5	7.1	6.3
Goods	56.8	8.3	7.2	6.3
Services	12.9	9.2	6.6	6.2
Imports	53.8	2.6	3.5	8.0
Goods	43.5	0.2	1.5	8.7
Services	10.3	15.9	12.4	5.0
Net Foreign Demand	15.9	40.5	21.6	0.5
GDP	100.0	5.1	4.8	5.0

Source: NESDB 2006-2007; World Bank projections for 2008

actual deficit may be around 2 percent as the disbursement rate this year is expected to be higher than last year's. Income collection, on the other hand, could be below target as the government has so far announced two stimulus packages to stimulate private consumption and investment.

The Government has recently announced fiscal packages to stimulate domestic demand. The first package announced on March 4th includes a higher deductible for personal income taxes, a reduction in corporate income tax rates, increased tax deduction on machines and equipment for investment purposes, and reduced property sales transaction fees (see Private Section for a discussion of the government's tax measures to stimulate investments). The total package could total up to Bt40 billion (0.4 percent of GDP). The second package announced on April 1st includes (1) a grant transfer to the villages and communities amounting to roughly Bt20 billion (0.2 percent of GDP) per year this year and next¹⁵, (2) a 2-year debt moratorium of loans to farmers worth around Bt18 billion, (3) small loans and mortgages to lower-income individuals and retired government officials amounting to Bt5 billion and Bt50 billion, respectively, (4) loans to farmers by the Bank for Agriculture and Agricultural Cooperatives (BAAC) targeted at a total of Bt325 billion in 2008, and (5) additional funds from the Government Savings Bank and BAAC for the Village and Urban Community Fund for on-lending to villages and urban communities in the amount of Bt27.8 billion.

Large public infrastructure projects are also being revived. The new government has announced its intention to continue the implementation of the public mega-infrastructure investment projects which were halted by the last government. So far, they include the mass transit lines in Bangkok and dual rack railway. Moreover,

¹⁵ Each villages and community are requested to submit a plan for the use of the grant, which will be granted to them upon the approval of the plan.

the public (government plus state-owned enterprise) investment budget for this year is higher than last year's with disbursement rate expected to be higher than last year's rate of 70 percent. Last year, public investment expanded by 4 percent (in real terms). This year, it is expected to speed up to 9 percent (see Public Investment section for a detailed discussion).

Firms' investment should recover this year after its slump last year. Private investment grew by merely 0.5 percent (in real terms) last year, which is the lowest since 2000. Investor's confidence fell sharply last year in an environment of uncertainties surrounding the government's policy directions, particularly after the announced 30 percent unremunerated reserve requirement on capital inflows and the proposed amendments of the Foreign Business Act to increase restrictions on foreign investments. Gross foreign direct investment (FDI) last year fell from its post-crisis peak of US\$32 billion to US\$22 billion. This year, with the new government recently announcing clearer policy directions as well as measures to boost both private investment and consumption, investor confidence should pick up. Real loan rates are also low and supportive to investments. Several large private firms have announced plans to increase investment in plant and equipment after having delayed their investments last year. This is consistent with the high investment applications and approvals from the Board of Investment (BOI) since 2004, which have not yet been translated into actual investment in the past few years. As a result, capacity utilization in many industries has exceeded 80 percent (see Private Investment section for a detailed discussion). Real private investment growth is therefore expected to increase to 10 percent this year. The Private Investment Index in the first two months of this year shows that private investment growth is higher than its growth in all quarters last year. However, as the year progressed, planned investment could be further delayed should public investment and household consumption do not recover as expected, policy uncertainty resumes, and global demand falls sharply. On the other hand, oil price and external competition will remain high.

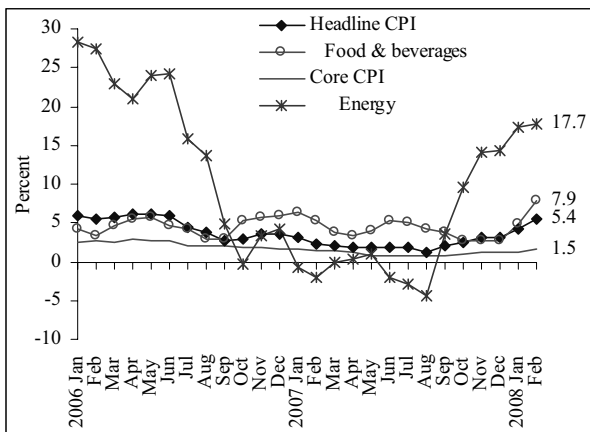
Household consumption would cautiously recover from its slump last year. Last year, household consumption grew by only 1.4 percent (in real terms), the lowest since 1999. Consumer confidence which has been falling since 2005 was the lowest in the first 3 quarters of last year, partly because of the uncertainty in future incomes as firms were not expanding amidst uncertainties in policy directions. Furthermore, certain labor-intensive exporting industries such as the garment industry were affected by the rapid appreciation of the baht and had to lay-off employees. Others had to reduce the work hours, particularly, overtime. This has affected the incomes and sentiments of consumers. Household consumption is expected to grow cautiously at 4 percent this year (in real terms) from the low base last year. As investments in the manufacturing sector expand and farm incomes rise more sharply this year particularly from the rise in international rice prices, household consumption should recover. Moreover, supportive interest rates and the extensive government stimulus packages should help raise household incomes and confidence. The Consumer Confidence Index has started to increase since November last year. Growth of the Private Consumption Index has also significantly strengthened since January this year. Nevertheless, households in the non-agriculture sector, particularly low-income ones, could still be cautious as inflation especially on food rises sharply this year. In addition, the uncertain performance of exporting firms, particularly labor-intensive ones, affected by the uncertain global demand and baht appreciation, would dampen the confidence of workers in those industries, making them cautious in their spending (see Household Consumption section for a detailed discussion).

Inflation is on the rise with the increase in food and fuel prices Inflation has started to rise in the last quarter of 2007 as fuel prices rose rapidly, after declining in the first three quarters. Headline inflation was only 2.6 percent in 2007 compared to 4.7 percent in 2006. In the first two months of 2008, headline and core inflation has risen to 4.8 and 1.4 percent, respectively (see Figure 1). The sharp rise in inflation were the result of the sharp rise in both food and fuel inflation. Food inflation came mainly from the increase in the prices of meats, vegetable and fruits, and grains due to the higher international prices, higher input prices, and higher domestic demand for

agricultural produce to be used for producing bio-fuels. Fuel inflation has risen by 6.3 percent in the first two months of this year, lower than the rise in world oil prices as the baht strengthened. On the other hand, the government has strengthened its price administration of more than 200 products in its attempt to keep a lid on price rises. Headline inflation for this entire year is expected to increase to 5 percent, partly cushioned by the appreciation of the baht.

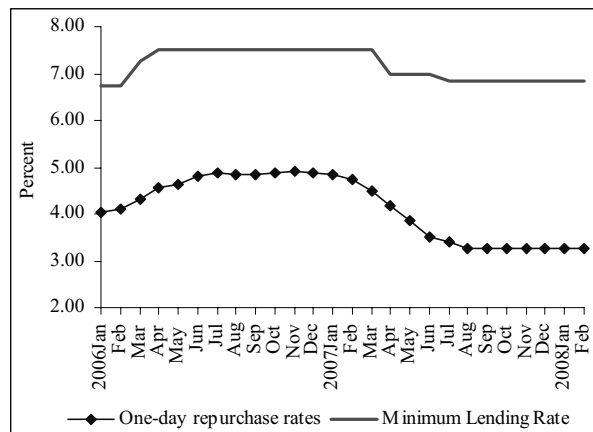
Interest rates, however, would likely remain low and supportive to growth. The Bank of Thailand's policy rate and the minimum lending rate (MLR) have been falling continuously since January 2007. They are currently 3.25 percent and 6.9 percent, respectively (see Figure 2). The real MLR is currently at around 1.5 percent, while the deposit interest rate is negative. Moreover, lending rate in Thailand as proxied by the overnight inter-bank lending rate is lower than many countries in East Asia¹⁶. At these low rates and the threat of rising inflation, interest rates will unlikely fall much this year, but will however remain low.

Figure 1. Inflation, 2006-2008 February



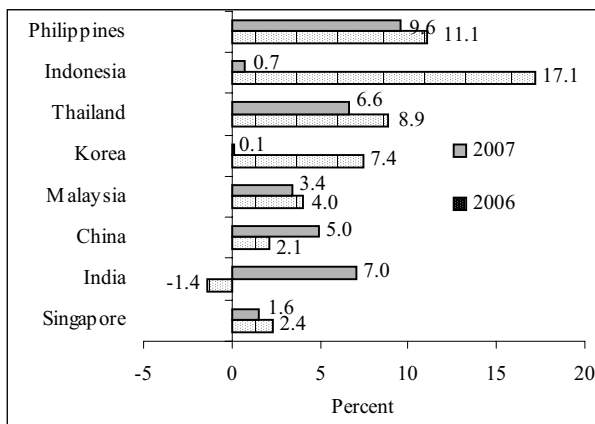
Source: BOT

Figure 2. One-day Repurchase Rate and Minimum Lending Rate, 2006-2008 February



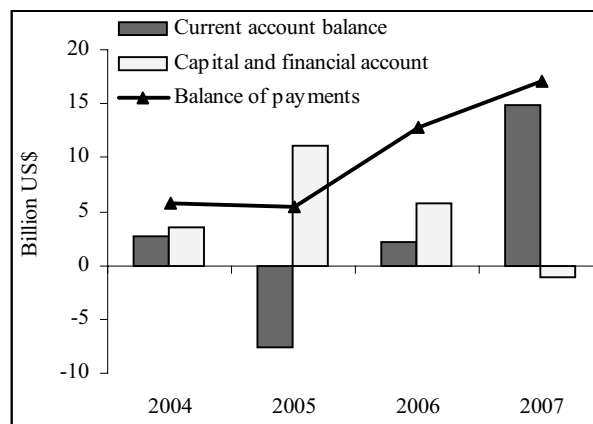
Source: BOT

Figure 3. Real Exchange Rate Appreciation of Asian Currencies, 2006-2007



Source: World Bank

Figure 4. Balance of Payments, 2004-2007



Source: BOT

¹⁶ In December 2007, overnight inter-bank rate was 3.2 percent, which is lower than that of Philippines (7.25 percent), Indonesia (5.09 percent), South Korea (4.99 percent), and Malaysia (3.5 percent).

The baht will continue to appreciate as the balance of payments remains in surplus and the US dollar continues to depreciate. The baht continue to appreciate in 2007 by 9 percent compared to the US dollar. In terms of the real effective exchange rate, the baht has appreciated by 6.6 percent last year on top of 8.9 percent in 2006. The baht's appreciation was more than other currencies in the region except for the Philippines peso and the Indonesian rupiah (see Figure 3). The baht's real effective exchange rate should appreciate further this year as the balance of payment remain in surplus and the value of the US dollar continues to fall.

The balance of payments surplus, though lower than last year's will provide a cushion against an event of a global down turn. The balance of payments (BOP) was US\$17 billion in 2007 and foreign reserves were US\$87.5 billion. The main reason for the large BOP surplus in 2007 was the US\$15 billion current account surplus, equivalent to 6.1 percent of GDP (see Figure 4). In February 2008, foreign reserves increased to US\$100.5 billion or 4 times that of short-term external debt. In 2008, the current account surplus is expected to decline to US\$6 billion or 2.1 percent of GDP as exports growth declines while that of imports rise with the recovery in domestic demand (see Table 2). Capital account, on the other hand, was in a US\$1.1 billion deficit last year due to the outflows from the government and the state-owned enterprises as public debts were repaid, and Thai investment in overseas portfolio sharply increased as regulations to do so have been relaxed last year (see Table 3). This year, continued outflows are expected as capital will be flowing out of East Asia to the US and EU markets to recapitalize the losses of their financial institutions from the sub-prime loans. This would be somewhat facilitated by the Bank of Thailand's relaxation of the restrictions on capital outflows (see Box 1). However, net foreign direct investments could increase this year as foreign investors make investments that were delayed from last year when policy directions were unclear. Hence the balance of payments is expected to remain in surplus this year, though much lower than last year.

Table 2. Trade and Current Accounts

	(Million US\$)		
	2006	2007	2008p
Exports of Goods	127,941	151,147	170,041
(% change)	17.0	18.1	12.5
Imports of Goods	-126,947	-139,174	-167,009
(% change)	7.9	9.6	20.0
Trade Account	994	11,973	3,031
as % GDP	0.5	4.9	1.0
Net services income & transfers	1,180	2,950	3,097
(% change)	92.8	150.0	5.0
Current Account	2,174	14,923	6,129
as % GDP	1.1	6.1	2.1

Source: BOT for 2006-2007; World Bank projections for 2008

Exports have been resilient last year. Despite the slow down in the global economy and the real appreciation of the baht last year, exports of goods (which is 80 percent of total exports) in terms of the US dollar sped up to 18 percent last year, surpassing its 17 percent growth in 2006. The resilience is the result of the diversification of Thai exports to new markets, while exports with high import content had benefited from the stronger baht. Exports with high import content includes high-tech manufacturing products which accounts for around 65 percent of total export value and had contributed most to export growth in 2007. They include computers, air-conditioner,

Box 1. Relaxing Capital Outflows Restrictions in Thailand¹⁷

The Bank of Thailand has relied on both capital inflows and outflows measures to curb the pace of the baht appreciation.

To slow down the excessive pace of stronger baht, the Bank of Thailand (BOT) introduced various measures that aim to rationalize the surge of capital inflows. Examples include foreign exchange intervention, anti-speculative exercises, and Unremunerated Reserve Requirement (URR). Another dimension of policies, which is much less widely discussed, is policies that seek to encourage greater capital outflows from Thailand. In addition to lessening the upward pressure on the baht, timely outflows policies could also enhance risk management and offer higher returns. This box briefly reviews recent BOT policies on capital outflows promotion.

Capital outflows liberalization was strengthened in 2007. Capital outflows measures have been in place since 2002-2003, when eased regulations encouraged more portfolio and equity investments by resident individuals, corporations, and mutual funds. More substantive measures were however launched throughout 2007 after the baht had been strengthening rapidly. Policies that promote capital outflows can be classified into those that encourage (1) direct investment abroad, (2) portfolio investment abroad, (3) foreign currency deposit, and (4) other relevant policies. The details are as follows:

1. *Direct investment abroad.* A Thai parent company is now allowed to invest or lend to its subsidiary companies abroad up to 100 million USD per year (previously capped at 50 million USD in January 2007). A similar ceiling amount is also given to a Thai subsidiary company that wishes to invest or lend to a parent company. In addition, listed firms in the Stock Exchange of Thailand can currently make foreign investment without limit, up from 100 million USD per year announced in July 2007.

2. *Portfolio investment aboard.* Qualified institutional investors are permitted to invest in securities abroad worth up to 50 million USD without seeking for approval from the Bank of Thailand. The BOT also approved a quota of 10 billion USD to the SEC, which will subsequently be allocated among mutual funds, pension funds, and private funds for acquiring securities abroad or foreign securities issued in the Thai markets.

3. *Foreign currency deposit.* For funds originating abroad, there is now no limit on foreign currency deposit. For funds originating domestically and have obligations within 12 months, the limit is now doubled to 1 and 100 million USD for individuals and juristic persons, respectively (previously 0.5 and 50 million USD in August 2007).

4. *Other relevant policies.* The limit on fund remittances by Thai residents to a family who is a permanent resident abroad was lifted to 1 million USD. Meanwhile, surrender requirements were abolished, while repatriation requirement was expanded from 120 to 360 days. Finally, the maximum value of property abroad that Thai residents can purchase is now 5 million USD, up from 1 million USD previously.

As a result, capital outflows rose in 2007 but had a limited effect on the baht appreciation. For example, direct investment abroad climbed to 1.8 billion USD in 2007, up from 1.0 billion USD in 2006. It is however important to note that much of capital outflows are invested in fixed income instruments, where most of foreign exchange exposure is hedged. These outflows may therefore not help to slow down the baht appreciation because the pressure from forward purchase of the baht will at least partly offset weakening pressure on the baht. Nonetheless, international experience shows that, as the share of equity investment in portfolio outflows increases, the hedging ratios tend to be lower. Thus, the weakening effect on capital outflows on the baht could be more influential in the future.

¹⁷ This box largely summarises discussions in a paper by Bank of Thailand “Thailand’s experiences with rising capital flows: Recent challenges and policy responses”, presented at the BIS meeting in January 2008.

Table 3. Net Capital Flows, 2006-2007

	(Million US\$)	
	2006	2007
Monetary Authorities	416	-619
Government	-567	-2,136
Bank	-7,409	368
Other sectors	13,279	1,238
Non-bank	13,161	2,283
FDI	10,031	7,523
Portfolio	1,642	-4,045
- Foreign	3,205	4,472
- Thai	-1,563	-8,517
Loans (foreign)	2,867	1,304
Others	-925	-2,499
State Enterprises	-337	-1,045
Total Capital Flow	5,719	-1,149

Source: BOT

and parts of passenger car. Exports of high-tech products which declined last year are ones that have the US as their major final export destinations, such as computer parts, integrated circuits parts, and television (see Export Performance section for a more detailed discussion). The overall exports to the US contracted by 1.2 percent last year. It was, however, offset by the expansion of Thai exports to Japan as well as new markets such as ASEAN, China, the Middle East, Russia and Australia.

Exports, although slowing down this year, will remain an important driver of growth. With the further appreciation of the baht and the significant slowdown in the economic growth of Thailand's major trading partners this year, particularly the US, growth of Thai goods exports is expected to slow down. However this would be partly offset by exports to new markets which include those in East Asia in which economic growth will still be robust despite slowing down from last year. Export growth of goods this year will therefore slow down to around 12.5 percent in US dollar terms or to 6.3 percent in real terms (compared to 18 percent and 7.2 percent last year, respectively). Exports of high-tech, high-import content products will continue to expand. Exports of certain labor-intensive and resource-based manufactures such as garments and furniture will continue to suffer as the baht appreciates and competition intensifies. Exports of rice and grains, on the other hand, will expand well this year from the rise in world prices and high demand as other major rice exporting countries face supply constraints this year. Export of services, coming primarily from inbound tourism, is expected to slow down from 6.6 percent (in real terms) last year as the baht appreciates and growth slows down in most economies of the world.

With the recovery in domestic demand, imports will see a much stronger expansion this year than last year. Imports growth has been low since 2006 with the low expansion in domestic demand for consumption and investment (see Table 4). Last year, imports grew by only 1.5 percent in real terms and 9.6 percent in US dollar terms. This is mainly because of the deceleration in the imports of capital goods from the depressed investment growth and the decline in the imports of fuel as a result of the heavy promotion of bio-fuel last year. Imports are expected to speed up to 20 percent this year with the recovery of domestic demand. In the first two months of 2008, imports (in US dollar) increased sharply by 36 percent. With the exception of fuel imports, import growths

in other categories were driven mainly by the expansion of import volume. This is particularly true for the import of capital goods whose volume increased by 63.5 percent in January 2008, which in response to the recovery in private investment. Import value of fuel increased sharply by 65 percent, mainly from its price increase of almost 50 percent.

Table 4. Import Value and Volume Growth, 2005-2007

	(Percent)		
	2005	2006	2007
Consumer Goods			
Value (7.9%)	12.4	15.3	13.8
Volume	10.0	15.2	9.8
Raw Materials & Intermediate Goods			
Value (42.9%)	18.1	5.7	15.0
Volume	16.0	1.7	8.8
Capital Goods			
Value (25.6%)	24.4	8.0	3.7
Volume	21.8	5.8	1.5
Fuel & Lubricant			
Value (18.4%)	58.4	20.3	2.8
Volume	17.2	-1.4	-5.0
Total			
Value	25.8	7.9	9.6
Volume	18.4	1.4	4.1

Source: BOT

2.2 POVERTY

Poverty has been falling in Thailand, with the largest reduction in the rural areas. Data from the latest 2006 Socio-economic Survey shows that poverty headcount has continuously fallen since its recent peak of 21 percent in 2000 to 9.6 percent or 6.1 million people in 2006 (see Table 5). The reduction was largest in the populous rural areas¹⁸, especially in the Northeastern part of Thailand. Nevertheless, around 5 million poor are currently living in the rural areas, while around 2.5 million or 40 percent of the poor are directly engaged in farming sector (see Figure 5).

Poverty should continue to fall in 2007 and 2008 with farm incomes continuing to grow at double digits as crop prices rise sharply. Farm incomes have risen by 17 percent last year, mainly as a result of the rise in prices by 15 percent (see Figure 6). Farm incomes this year should continue to rise by more than it did last year as crop prices, particularly rice, palm and cassava, continue to rise sharply¹⁹. International prices of rice rose by 7 percent last year and are forecasted to rise by 55 percent this year as supply from other major rice producers (India and Vietnam) declined due to weather conditions. This translates into higher rice prices in Thailand as well.

¹⁸ Around 65 percent of total population or 42.3 million lives in non-urban areas.

¹⁹ Rice accounts for 37 percent of crop production in Thailand; palm and cassava accounts for 3 and 4 percent, respectively.

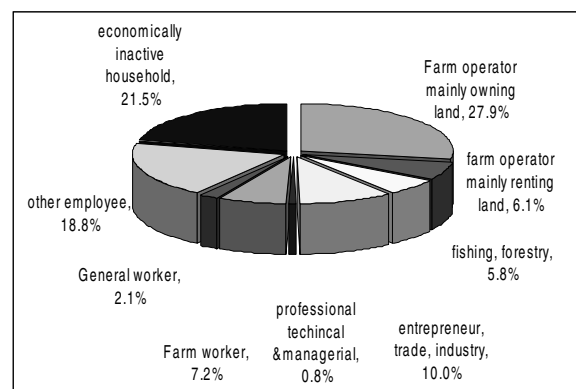
Table 5. Thailand Poverty Headcount ratio classified by region, 2000-2006
(Percent of total population)

	2000	2004	2006
Thailand	21.0	11.2	9.6
Northeast	35.3	18.6	16.8
North	23.1	15.7	12.0
South	16.6	6.0	5.5
Central	9.0	4.5	3.3
BKK	1.7	0.8	0.5
Urban	8.6	4.6	3.6
Rural	26.5	14.2	12.0

*2006 National Poverty Line is Bt1,386/head/month

Source: NESDB

Figure 5. Proportion of the Poor Household Classified by Economic Activities, 2006

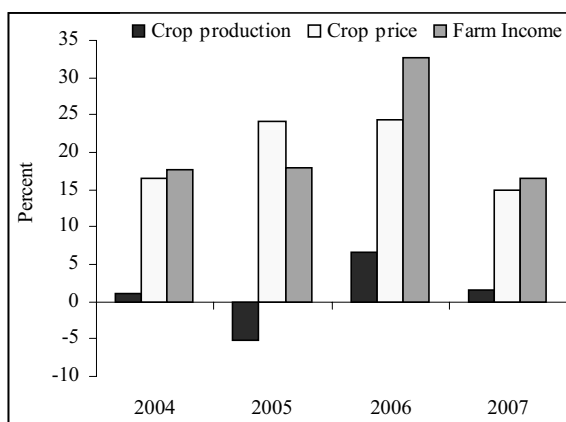


Source: SES (2006)

On the other hand, prices of palm and cassava also rose because of the higher demand for them as key inputs in bio-fuels. Although their production and transportation cost as well as the rural consumer price index have risen²⁰ (see Figure 7), the sharp rise in the prices of farm outputs have offset them. As a result, real incomes of those in the farming sector had increased. This would also help raise the incomes of the poor who are mostly engaged in the farming sector. Real wages of farm workers, for example, rose last year as their nominal wages increased by 5.5 percent, while the CPI for rural households rose by 4.1 percent (see Figure 8).

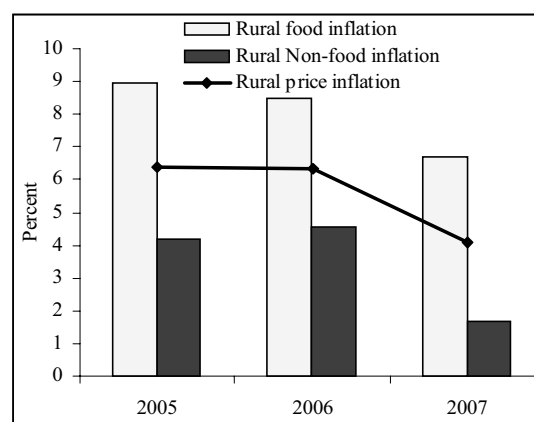
The rapid rise in food and fuel prices has, however, adversely affected the poor in non-farming sectors, as their incomes have not been rising as quickly. Poverty among those in the fishing and forestry activities, for example, has increased sharply from a headcount ratio of 1.8 percent in 2004 to 5.8 percent in 2006. One of

Figure 6. Growth in Crop production and Price and Farm Incomes



Source: BOT

Figure 7. Rural Consumer Price Index



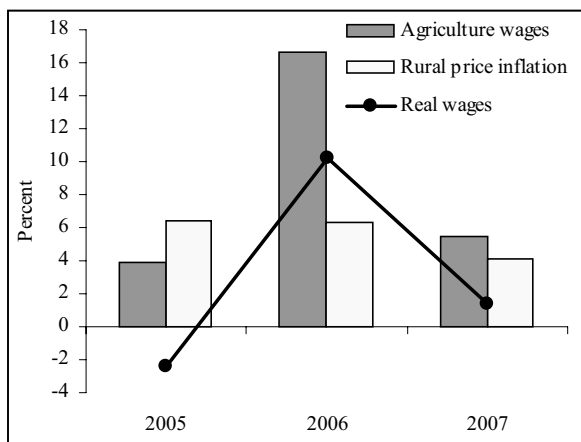
Source: BOT

²⁰ Prices of fertilizer and fuel and transportation costs have also risen with the sharp rise in world oil prices since the last quarter of 2007. The consumer price index (CPI) for rural households rose by 4.1 percent in 2007 and is expected rise by 7 percent this year.

the reasons was the impact of the tsunami at the end of 2004 on the livelihood of fishing households along the Andaman coast. The other reason is the sharp rise in the price of diesel which has significantly raised the operation cost of fishing boats. On the other hand, the prices of fishery products have not increased as much, resulting in the reduced margins for fishermen (see Figure 9). Real wages in the fishing sector has also fallen in 2007. In 2007 nominal wages increased by only 3.8 percent, while inflation for rural households was 4.1 percent (see Figure 10). Similarly, the consumer price index for low-income urban households has risen by 2.7 percent in 2007, mainly as a result of high food prices²¹, while wages in the non-agricultural sector have risen by only 2.3 percent (see Figure 11). As a result, their real incomes have fallen.

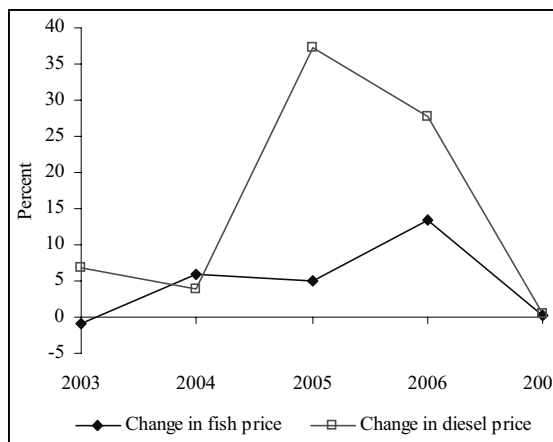
Effective assistance to mitigate the negative impact of the rising prices on the poor would be ones that are targeted to them. As the prices of fuel and food will likely remain high, measures are needed to

Figure 8. Growth in Real Wages in Agricultural Sector



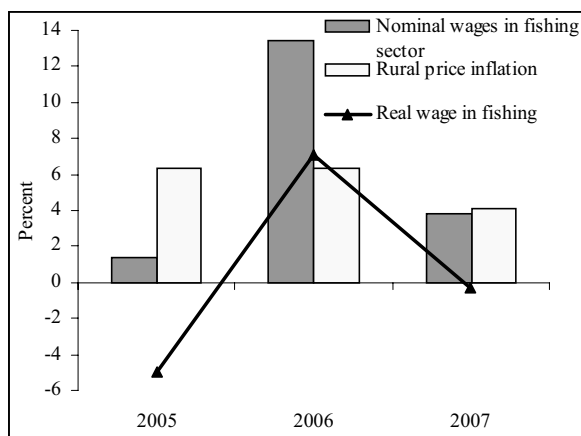
Source: BOT, NSO, and WB calculations

Figure 9. Changes in Fish Price to Diesel Price



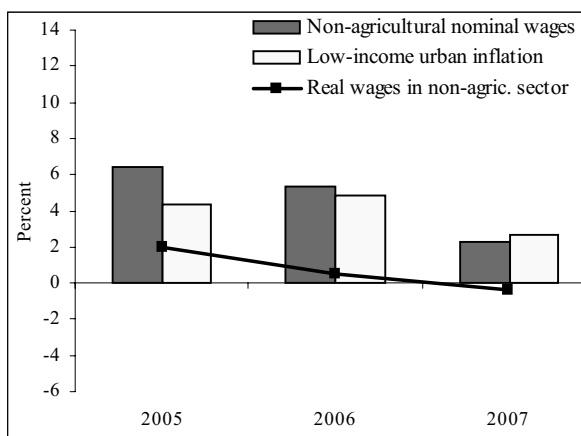
Source: BOT

Figure 10. Growth in Real Wages in Fishing Sector



Source: BOT, NSO, and WB calculations

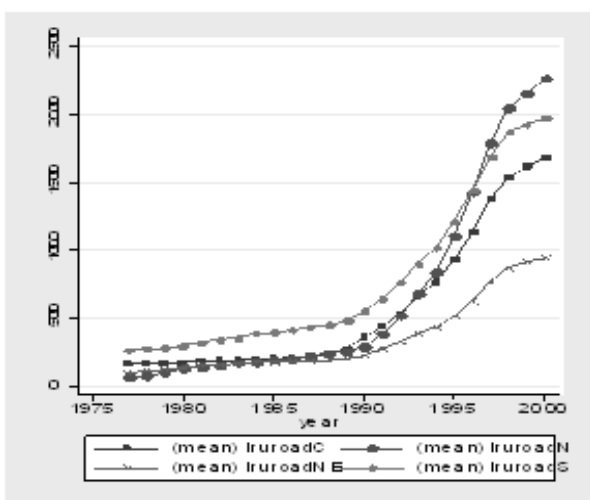
Figure 11. Growth in Real Wages in Non-Agricultural Sector



Source: BOT, NSO, and WB calculations

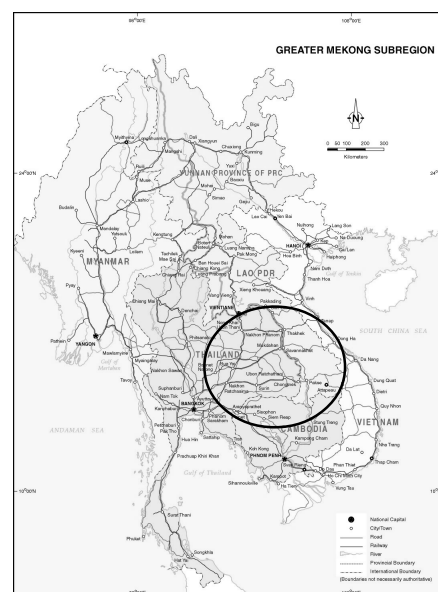
²¹ Food stuff accounts for around 42 percent of the urban poor’s consumption basket.

Figure 12. Length of Rural Roads (Kilometers)



Source: Northeast Development Report (2005),
NESDB & World Bank

Figure 13. Greater Mekong Sub-region (GMS)



reduce their impact on the poor in both the short and long term. The government has recently implemented some short term measures such as imposing price controls, tax breaks for low-income earners, and providing grants and loans to villages and urban communities (see Real GDP Growth and Macroeconomic Development section for details of the measures) While these broad measures may somewhat help the poor, targeted measures would be more effective in helping the poor as most of the poor may not have access to the grants or loans. Short-term targeted measures that have worked well in other countries under good monitoring, targeting and governance systems include food programs for vulnerable groups such as food stamps and school lunches for poor households and students and self-targeted public work program such as food for work. Longer term measures include relaxation of food import restrictions to reduce domestic supply shortages, greater investment in agricultural support services to help improve the productivity of the farmers, promoting market-based risk management instruments, improving rural infrastructure, and increasing trade facilitation.

Better rural infrastructure and trade facilitation could play an important role in reducing poverty, especially in the Northeast. In the rural areas in the Northeast where the majority of the poor resides and are engaged in agricultural activities, better rural infrastructure such as roads and water system can greatly help in the reducing the costs production and transportation for farmers. Roads in the Northeast are, however, few compared to other regions in Thailand (see Figure 12) and are impassible in the rainy season²². Better infrastructure in the Northeast would also help facilitate economic activities and trade not only between the Northeast and the other regions in Thailand, but also between the Northeast and the neighboring countries (Cambodia, Lao PDR and Vietnam). Trade is developing quickly within the Greater Mekong Sub-region (GMS)²³. The Northeast has a large potential to gain from this trade as it is well-placed in the middle of the GMS (see Figure 13). Among other trade facilitating measures, better rural infrastructure would enable many of the villages in the Northeast to participate in this trade, which would also benefit the poor in the region.

²² See *Thailand Northeast Development* (2005), a joint report by the NESDB and World Bank

²³ GMS includes Cambodia, Lao PDR, Myanmar, Thailand, Vietnam, and Southern China.

2.3 EXTERNAL ENVIRONMENT²⁴

World output growth will most likely decline this year as the US economy slow down. Growth of the US economy is projected to sharply decline this year as a result of the turmoil in the sub-prime mortgage market that began last August. It has broadened and intensify, leading to a tightening in the global credit markets and failing financial institutions. The US output growth is expected to decline to 0.5-1.4 percent from its 2.2 percent growth last year. This scenario sees growth of the industrial world in 2008 slowing down by 1.0-1.5 percentage points, with the sharpest deceleration in the US and Europe which are the two areas most affected by the financial turmoil. The slowdown in demand in the industrialized countries would affect the volume of world trade this year. World trade volume is projected to grow by only 4-5 percent after expanding bullishly in the past few years (see Table 6).

Table 6. International Economic Environment
(Percentage change from previous year, unless otherwise stated)

	2005	2006	2007e	2008p
GDP Growth (%) a/				
World	3.4	3.9	3.6	2.4 - 2.8
High Income OECD	2.4	2.9	2.5	1.1 - 1.6
USA	3.1	2.9	2.2	0.5 - 1.4
Euro-zone	1.5	2.8	2.7	1.3 - 1.7
Japan	1.9	2.2	2.1	1.3 - 1.7
Emerging East Asia	7.7	8.4	8.7	7.3
SE Asia	5.1	5.5	6.1	5.6
China	10.4	11.1	11.4	9.4
World trade volume (%)	7.8	10.1	7.5	4.0 - 5.0
Oil price (US\$/barrel) b/	53.4	64.3	71.1	80-90
Non-oil commodity	13.4	24.7	15.8	10-20

Source: World Bank DEC Prospects Group (March 2008)

Note: e = estimate; p= projected

a/ GDP in 2000 constant dollars; 2000 prices and market exchange rates

b/ Simple average of Dubai, Brent and West Texas Intermediate

Oil prices will continue to rise although not at the levels of the recent spike due to the slow down in the world economy. Oil prices are forecast to average at US\$80-90 per barrel in 2008 and 2009, easing from the average of US\$95 per barrel in the first quarter of 2008. The main factors supporting the easing from recent highs is the lower expected world demand due to the possible recession in the US economy and slowdown in overall OECD growth, as well as projected moderation in China's growth towards its potential rate. Rising upstream investment in both OPEC and non-OPEC countries should also result in new capacity and gradually expanding supply potential.

Non-oil commodity prices will rise sharply this year, particularly those of grains, edible oils and metals. Non-oil commodity prices increased 15 percent in dollar terms over 2007, a fifth year of solid dollar price gains,

²⁴ Material in this section is drawn from the *East Asia Regional Update* (April 2008).

and are expected to rise by another 10-20 percent this year. Grains, edible oils, and metals prices have been especially buoyant in recent months, supported by strong investment and physical demand (the latter especially from developing countries) as well as by a variety of more specific factors on both the demand and supply sides of the markets. Low initial stocks; rising input costs (especially energy); competition for limited arable land; weather-related production shortfalls; and strong demand for food, animal feeds, and bio-fuels have produced a surge in prices for corn, wheat, rice, and soybeans. Grain and edible oil prices rose 21 percent and 15 percent, respectively, in just the first 2 months of 2008. Metals prices gained 27 percent in the same period, led by iron ore, copper, lead, aluminum, and precious metals. China's consumption of the 6 main metals traded on the London Metal Exchange (LME) grew by nearly one-third, or 5.8 million tons, in 2007, up from an average 16 percent growth rate in the previous 7 years. Growth in Chinese demand alone more than offset lower 2007 consumption in the OECD. A 21 percent increase in China's steel production—the largest in the world—helped set the scene for a 65 percent increase in iron ore prices in early 2008.

2.4 EXPORT PERFORMANCE

Exports remained Thailand's growth engine last year but will be less so this year. Despite US economic downturn and stronger baht, exports continued to perform well in 2007. As in the past years, this was mainly driven by resilient high-tech goods exports, which accounted for nearly two-third of total export value. Exports of agricultural commodities and other types of manufactured products also grew favorably. Despite strong overall performance, exports of certain products dropped noticeably. For high-tech products, it appears that weaker external demand largely accounted for this, while the adverse effect of stronger baht was more pronounced in industries that are labor-intensive or rely heavily on domestic resources. This is because high-tech goods that Thailand produces and exports (such as electronics and electrical products and motor vehicle parts) generally have high import content. Stronger baht thus helped to lower the prices of parts and components that Thailand imported from other East Asian countries as part of the regional production networks. Labor intensive and resource-based industries, such as garments and furniture, however do not benefit from cheaper imported production factors, and these are where the government support may be desirable.²⁵ Looking forward, while it is anticipated the baht will continue its upward trend against the US dollar, a perhaps more worrying downside risk is the deepening economic slowdown in other large economies such as the EU, Japan, and China. Exports to these markets have helped Thailand to sustain its strong export growth in a wake of sluggish US demand. The rest of this section provides more detailed discussion of Thailand's export performance in 2007.

Export growth in 2007 and the first two months of 2008 accelerated. Exports continued to be Thailand's main growth driver last year, amounting to 152.5 billion USD or up 17.5 percent from 2006. This sped up slightly compared to growth rates in 2005 and 2006 (Table 7). High overall export growth was underpinned by strong performance in all manufactured product groups, especially labor-intensive and resource-based goods, while agricultural exports slowed down relative to a remarkable expansion in 2006. Robust exports have so far been sustained in 2008, expanding by nearly 25 percent in the first two months. As in last year, growth was broad-based. Agricultural and manufactured exports expanded solidly at 35.4 and 24.4 percent, respectively. As a result of stronger baht, export values in 2007 and January-February 2008 only grew 6.4 and 15.7 percent in baht terms, respectively.

²⁵ Last year, the government set up a fund to help manufacturing and services firms that are adversely affected by free trade agreements (FTAs). The support is non-financial, and focuses more on programs that help firms to improve knowledge, R&D, business development plans, and labor skills. Funds of similar nature could be established for industries that became disadvantaged from the baht appreciation.

Table 7. Export value growth rates and shares by sub-sectors, 2005-2007

	Share (%)	Growth (%)		
	2007	2005	2006	2007
Agriculture 1/	9.4	-0.6	26.7	15.0
Manufacturing	88.4	16.3	16.1	19.1
Labour intensive products	8.6	9.8	6.8	19.2
High-tech products	64.5	17.8	17.8	17.9
Resource-based products	10.2	12.0	13.8	21.8
Other manufactured products	5.0	21.4	16.9	30.9
Others 2/	2.2	28.5	12.4	-18.2
Total	100.0	15.0	16.9	17.5

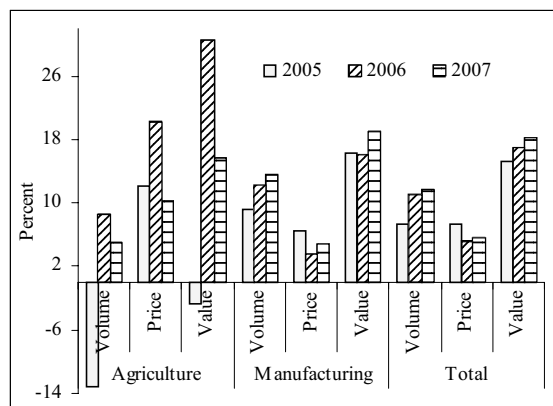
Source: BOT

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

2/ “Others” refers to mining, samples & other unclassified goods, and re-exports

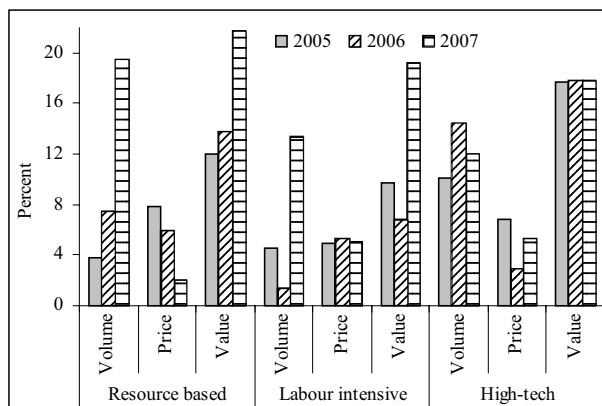
Export growth last year came from the acceleration in both export price and quantity. Higher volumes and prices boosted overall growth of manufactured exports last year (Figure 14). The magnitude of the price effect however varied across product groups. In particular, larger export volumes growth mainly explained the healthy expansion in resource-based and labor intensive goods exports, while favorable prices helped to sustain strong exports of high-tech products (Figure 15). Slower agricultural export growth was a result of both decelerated export volume and less supportive prices (Figure 14). For instance, the average export value per ton of para rubber increased moderately at 7.1 percent in dollar terms compared to a 42-percent rise in 2006. Many other key agricultural products also experienced less favorable prices²⁶.

Figure 14. Changes in overall export volume, price and value, 2005-2007



Source: BOT

Figure 15. Changes in export volume, price and value of manufactured products, 2005-2007



Source: BOT

²⁶ For example, Office of Agricultural Economics data show that average export values per ton of sugar and chilled and frozen fresh prawns dropped by 13.4 and 0.9 percent in 2007, respectively, after a price hike in 2006. The average rice price also rose more moderately last year.

Despite strong overall performance, exports of certain key products declined due to both weak external demand and less competitive products. Table 8 shows export growth of major products in each product group. Overall, these products expanded robustly. Slower agricultural growth was largely caused by much decelerated rubber exports. In contrast, sugar and jewelry mainly drove booming exports of resource-based and labor intensive goods. Table 9 however highlights that not all products performed well. Products with lower export value in 2007 were not limited to a particular product group. Most of these are high-tech products, which were offset by the weaker demand in their final markets, particularly, the US. For example, exports of televisions (harmonised code: HS 8528) to the US dropped nearly 47 percent last year²⁷. For the three non-high-tech

Table 8. Export value growth rates and shares by key products, 2005-2007

	Share (%) 2007	Growth (%)		
		2005	2006	2007
Agriculture				
Rubber	3.7	8.2	45.5	4.5
Rice	2.3	-13.5	10.9	34.3
Tapioca products	0.9	-1.4	34.3	23.2
Fresh and frozen prawns	0.8	16.1	20.2	10.5
Resource-based products				
Rubber products	2.2	20.6	23.5	22.1
Canned food	1.6	16.7	13.7	28.5
Sugar	0.8	-12.9	5.0	70.7
Furniture & furnishing items	0.8	3.8	-1.3	-9.4
Labour-intensive products				
Precious stones & jewelry	3.5	22.0	13.7	46.7
Garments	2.0	2.0	1.5	-6.5
Other textile products	1.0	7.3	8.7	14.2
Wood products	0.8	3.0	18.6	11.1
High-tech products				
Machinery & mecha. appliances	15.4	25.7	25.2	16.4
Electrical apparatus for circuits	10.3	5.6	8.0	12.1
Vehicles, parts & accessories	8.4	41.7	22.1	28.2
Electrical appliances	7.5	4.9	9.4	17.4
Top 5 sub-products				
Computers	8.1	56.4	28.7	14.8
Integrated circuits	4.8	18.2	16.4	16.9
Parts of passenger car	2.2	50.4	16.6	36.9
Computer parts	2.1	-12.0	18.1	-11.0
Air-conditioner	2.1	10.2	3.9	39.5

Source: BOT

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

²⁷ Similarly, computer parts exports (HS 847330) to Singapore and Malaysia, which together accounted for over one-third of Thailand's total computer parts exports, fell by 27.0 and 9.4 percent in 2007, respectively. As these countries are a part of the production networks in East Asia, this essentially reflected lower demand from the final markets, especially the US.

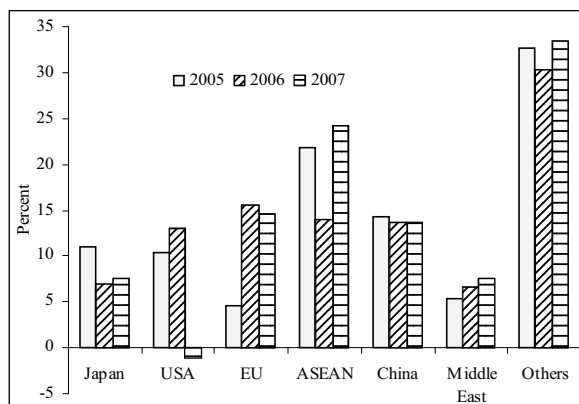
Table 9. Some key export products with negative growth rate in 2007

Products	Share (%)	Growth (%)		Category
	2007	2006	2007	
Computer Parts	2.1	18.1	-11.0	High-tech
Garments	2.0	1.5	-6.5	Labour intensive
Televisions	1.0	19.8	-24.2	High-tech
Furniture and Furnishing Items	0.8	-1.3	-9.4	Resource-based
Parts of Integrated Circuit	0.5	35.2	-4.9	High-tech

Source: BOT

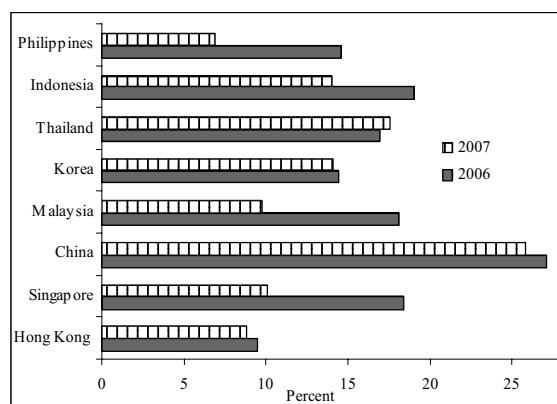
products here (garments, furniture, and toys), it appears that their falling exports were more attributable to lower competitiveness (likely due to both less competitive baht and high labor cost) than weak US demand. For instance, while total US garments imports (HS 61 and HS 62) in 2007 decreased by less than 2 percent, these imports from Thailand fell around 9 percent. In contrast, the US imported significantly more from China (+14.5 percent) and Vietnam (+28.4 percent).²⁸ Overall, this suggests that both weak foreign demand and strong baht damage export performance, although the impact varies across product categories.

Figure 16. Contribution to total export growth by export markets (%), 2005–2007



Source: BOT

Figure 17. export growth rates in selected East Asian Countries (%), 2006 – 2007



Source: World Bank

Exports to the US declined last year, but was offset by the expansion of exports to other key markets.

Exports to the US, accounting for 15.5 percent of Thailand’s total exports during 2004-2006, fell 1.2 percent in 2007. This was the first decline since 2001, when economic slowdown also took place. As depicted in Figure 16, strong exports to ASEAN (+20.4 percent) and “other markets” (+24.7 percent) (e.g. Australia, Hong Kong, India, South Korea, and Taiwan) helped to support overall export growth. Although their market shares remain relatively small, exports to the Middle East and new EU member countries also expanded steadily over the past several years. In the first two months of this year, exports to the US appeared to rebound strongly (+12.6

²⁸ Similarly, US furniture imports dropped 6.7 percent in 2007, while these imports from Thailand were 22.2 percent lower.

percent), largely due to an increase in bulky items exports and higher prices of commodity products.²⁹

Decreasing reliance on and diversified exports to the US market as well as large share of high-tech products helped Thailand to sustain high export growth. Figure 17 shows that major East Asian economies, except Thailand, experienced lower export growth rates last year compared to those in 2006. This was especially true among countries that relied rather heavily on the US market, such as Malaysia, Singapore, and the Philippines. The impact of a weakening US economy on overall Thai export growth was lower for at least two reasons. First, Thailand's reliance on the US market has been diminishing. Even before the slump last year, US market share already fell from 22.3 percent in 1998 to 15.0 percent in 2006 (and 12.6 percent in 2007).³⁰ Second, a more diversified export basket to the US seemed to help. At the 4-digit HS level, Thailand's top 5 export products to the US were a mix of electronics, jewelry, and food products, and account for only a third of Thai exports to the US. The large share of high-tech products helped Thailand to sustain high export growth despite the rapid appreciation of the baht by 15 percent since 2006.³¹ As mentioned above, a dominant share of high-tech, high import-content exports generally means that stronger baht will have a lower negative impact to those exporting industries. In 2007, the share of high-tech products climbed to 64.5 percent from 46.5 percent in 1995 while that of agricultural and labor-intensive products declined. Between 1990 and 2003, the share of parts and components in total exports doubled from 11 to 22 percent, reflecting Thailand's greater involvement in production networks in this region.³²

For this year, Thai export growth will likely slow down, but may be cushioned by the intra-regional trade and exports of agricultural commodities. The World Bank estimated (in March 2008) that world trade growth this year will slow down to 4-5 percent from 7.5 percent in 2007. The world economy is also expected to grow slower from 3.6 percent last year to around 2.4-2.8 percent this year. Growth decelerations are predicted in all large economies³³. There is no clear sign that the US near-term demand for many durable goods will recover³⁴. Affected by the growth in developed countries, growth in emerging East Asia, though projected to also down, will be over 7 percent, with China's economy growing close to 10 percent, supported mainly by the expansion in domestic demand³⁵. With this respectable growth in East Asia, intra-regional trade would therefore

²⁹ Customs Department data shows that Thailand exported aircraft parts worth 86.1 million USD in the first two months of 2008. Commodities with much rising export value were, among others, cooking oils, cereals, flour, prepared vegetables, and organic chemical products.

³⁰ This decreasing trend also took place in other traditional, large markets. The market shares of Japan and the EU dropped to 11.9 and 14.0 percent in 2007 from 13.7 and 18.4 percent in 1998, respectively. In contrast, markets such as China, Australia, India, South Africa, and Russia emerged robustly. Together, the share of these markets rose rapidly from 6.2 percent in 1998 to 16.5 percent last year.

³¹ Thailand's key high-tech products and their shares in total high-tech exports are machinery and mechanical appliances (24.7 percent), electrical apparatus for electrical circuit (16.5 percent), electrical appliances (11.9 percent), vehicles and parts (13.5 percent), base metal products (7.9 percent), plastic products (7.9 percent), and petroleum products (5.9 percent).

³² Okamoto, Yumiko (2005), "Emergence of the 'Intra-Mediate Trade': Implications for the Asia-Pacific Region", Mimeo (cited in Gill, Indermit and Homi Kharas (2007), *An East Asian Renaissance*, World Bank)

³³ For example, real GDP growth in the US could decelerate to around 0.5-1.4 percent from 2.2 percent in 2007. Japan and the Euro Zone are likely to grow 1.3-1.7 percent, down from 2.1 and 2.7 percent last year, respectively.

³⁴ New orders for computers, communications equipment, and electrical appliances and components in January-February 2008 barely changed (-0.8 to 0.7 percent growth) compared to the same earlier period. New orders for motor vehicles and parts also decreased 5.2 percent.

³⁵ Emerging East Asian real GDP growth is projected to decelerate from 8.7 percent last year to 7.3 percent this year. China's growth is projected to decelerate from 11.4 percent last year to 9.4 percent this year.

help support export growth this year. In addition, supported by sharp rise in prices, agricultural exports growth should accelerate after a slowdown in 2007. The World Bank's commodity price index for food items rose over 33 percent in the first two months of this year, and food prices are expected to remain high this entire year³⁶. Thus, the rebound in growth of agricultural commodities exports, with its 10 percent share in total exports, could somewhat help cushion the slow down in manufacturing export growth. However, there are risks that export growth this year may slow down by more than projected should growth in the developed countries slump much more than projected, thus, affecting growth in East Asia as well. A continued appreciation of the baht in real terms by greater margins than its competitors' currencies from the unexpected large capital inflows may also hurt export performance this year.

2.5 Household Consumption

Household consumption will cautiously recover from its slump last year. Last year, household consumption grew by only 1.4 percent (in real terms), the lowest since 1999. Consumer confidence which has been falling since 2005 was the lowest in the first 3 quarters of last year, partly because of the uncertainty in future incomes as firms were not expanding amidst uncertainties in policy directions. Furthermore, labor-intensive exporting industries, particularly the garment industry, were affected by the rapid appreciation of the baht and had to lay-off employees. Others had to reduce the work hours, particularly, overtime. This has affected the incomes and sentiments of consumers. The Consumer Confidence Index has started to increase since November last year. Growth of the Private Consumption Index has also significantly strengthened since January this year. As investments in the manufacturing sector expand and farm incomes rise more sharply this year particularly from the rise in international rice prices, household consumption should recover. In addition, supportive interest rates and the extensive government stimulus packages should help raise household incomes and confidence. Nevertheless, households in the non-agriculture sector, particularly low-income ones, could still be cautious as inflation especially on food rises sharply this year. In addition, the uncertain performance of exporting firms, particularly labor-intensive ones, affected by the uncertain global demand and baht appreciation, would dampen the confidence of workers in those industries, making them cautious in their spending. Household consumption is expected to grow cautiously at 4 percent this year (in real terms) from the low base last year.

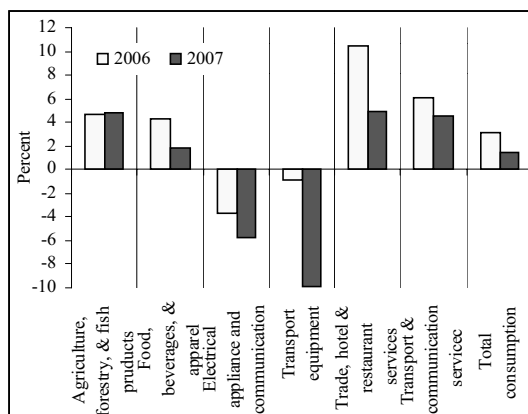
Households' consumption growth fell in almost all product groups last year. This was particularly true for the consumption of durable goods. Consumption of vehicles fell by 10 percent last year, while that of electrical appliances fell by 6 percent. Consumption of services also slowed down last year. Growth of transport services consumption declined to 2.6 percent from 5.4 percent in 2006. Similarly, those of hotels and restaurants' services fell to 5 percent from 11.2 percent (see Figure 18). Purchases of raw food, particularly agricultural produce and fish, however, increased last year. This could indicate that households have turned to cook at home instead of purchasing ready made food or eat out.

Indicators in the beginning of the year have shown recovery in consumer confidence and household consumption. The Consumer Confidence Index has increased in November after falling consecutively since November 2006 (see Figure 19). This has translated into a recovery in consumption early this year. The Bank of Thailand's Private Consumption Index grew by 8.5 and 6.0 percent in January and February, respectively. This

³⁶ Thailand's major agricultural products also enjoyed higher prices so far this year. For instances, the average export value per tonne (in dollar terms) of chilled and frozen fresh prawns, preserved tunas, Thai Hom Mali rice, and smoked rubber sheets (grade 3) were 7.0, 19.3, 22.0, and 21.4 percent higher in January-February 2008 compared to the same period in 2007, respectively.

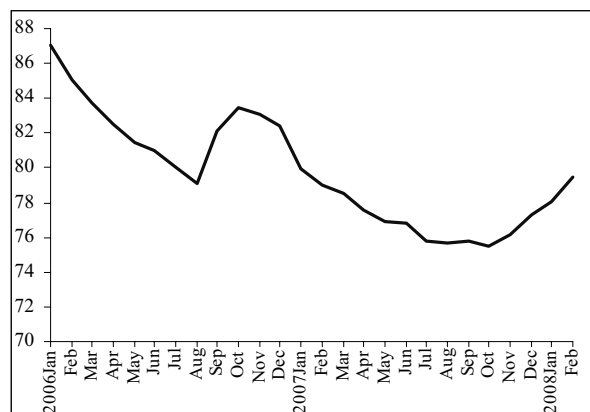
was supported by the increase in the retail sales which is also reflected in the increase in value-added tax collections. Purchases of passenger cars and to a certain extent motorcycles have also rebounded after falling last year (see Figure 20).

Figure 18. Growth of Household Consumption by Product Groups



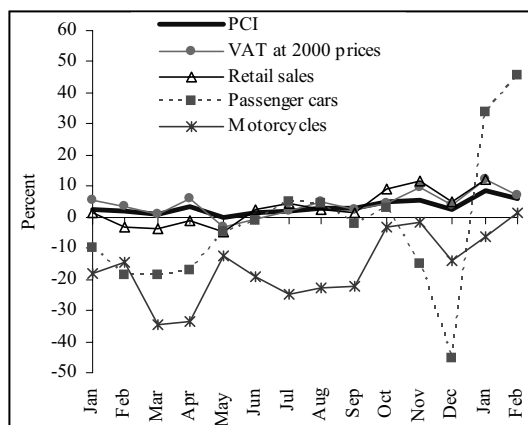
Source: NESDB

Figure 19. Consumer Confidence Index



Source: UTCC

Figure 20. Change in Private Consumption Index (PCI) and Consumption Indicators



Source: BOT

Table 10. Change in World Price of Key Thai Crops

(Percent)

	Share in Total Thai Crop Production	2006	2007	2008p
Rice	36.6	6.5	5.8	55.0
Rubber	17.0	40.3	8.6	2.6
Sugar	6.6	49.5	-31.9	26.1
Palm Oil	2.9	13.3	63.3	34.4
Coconut Oil	1.8	-1.6	51.4	8.8

Source: BOT for shares; WB for prices

p = projected

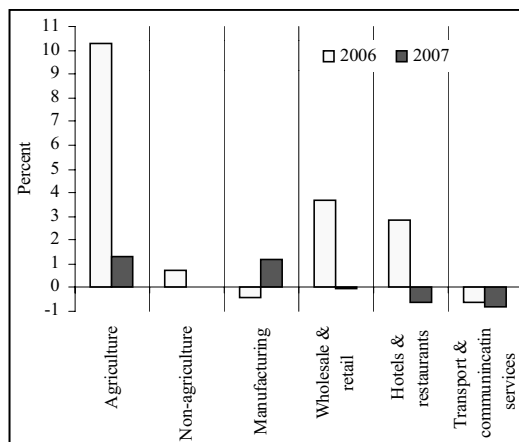
The expected rise in farm incomes, low interest rates, and the Government’s stimulus package would all help boost consumption growth this year. Farm incomes rose by 16.6 percent last year, on top of its 33 percent increase in 2006. It should continue to expand robustly this year as key crop prices are projected to rise sharply this year. World prices of rice³⁷, for example, are projected to rise by 55 percent this year, while those of rubber, sugar, and palm oil are all projected to increase robustly this year (see Table 10). The rise in farm incomes would directly help stimulate consumption of rural households in which two-thirds are engaged in agricultural activities. The Government’s recently announced consumption stimulus measures would also help raise the

³⁷ Rice production accounts for around 37 percent of total crop production in Thailand.

confidence and incomes, particularly of lower-income households. Some of the measures include the reduction in income taxes for low-income earners and community enterprises³⁸ and grants³⁹ and loans to urban communities and villages. In addition, the currently low interest rates are supportive to consumption growth. Nominal loan rates are low at around 7-8 percent, while real deposit interest rates are negative.

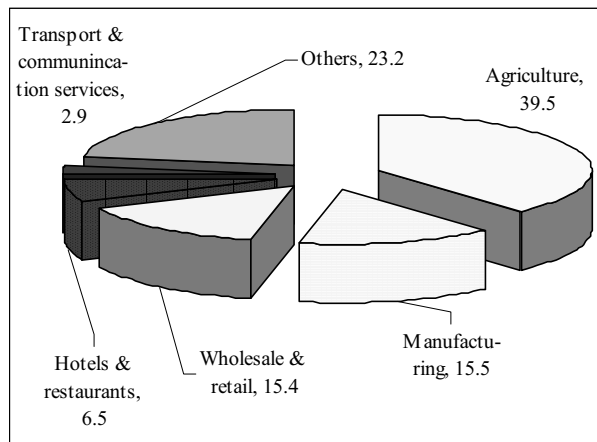
However, the recovery in household consumption could be fragile as inflation rises and exports performance is uncertain. Inflation which is expected to rise to 5 percent this year, compared to 2.3 percent last year will erode households’ purchasing power and may lower their confidence, particularly those in the non-agricultural sector who may not see their incomes rise as quickly. Moreover, the performance of exports of manufacturing products still remains to be seen as growth of key trading partners slow down, and the baht remains appreciated. This would particularly affect the confidence of those working in certain labor-intensive industries, such as garments and furniture, that exports have been slowing down over the past year. While real wages in the agricultural sector has risen over the past 2 years, the non-agricultural sector’s real wages did not increase in 2007 and only modestly increased in 2006. This is particularly true in the manufacturing industry and certain services industries such as wholesale and retail, hotels and restaurants, and the transport and communications services (see Figure 21). These industries collectively employ up to 40 percent of Thailand’s workforce (see Figure 22). With inflation rising and exports performance uncertain this year, there are fears that the growth of real wages in some of these industries may be muted, and so is the strong recovery in consumption of those who work in these industries.

Figure 21. Change in Real Wages in Agriculture and Non-Agriculture Sectors



Source: NSO & WB calculations

Figure 22. Employment Shares in the Agriculture and Non-Agriculture Sectors (Percent)



Source: NSO

³⁸ Personal income tax waiver was increased from Bt100,000 to Bt150,000 per person. Previously, annual income in excess of Bt100,000 will be taxed 10 percent and above, depending on the excess amount. Community enterprises are granted a tax waiver of income less than Bt1.2 million for 3 consecutive years.

³⁹ The grant allocation to the 75,000 villages and 3,000 communities in Thailand will be based on the population size of the villages and communities. The smallest size with a population of less than 50 will receive a grant of Bt50,000. The largest size with a population of greater than 1,500 will receive a grant of Bt350,000. The total allocation is around Bt20 billion per year.

2.6 Investment

Investment is expected to speed up this year after slowing down significantly last year. The low investment growth last year comes mainly from the significant decline in private investment growth by both domestic and foreign firms to almost zero growth. Private investment should speed up this year as investor confidence has begun to recover after the elections. The government has announced clear policy directions as well as measures to boost domestic investment and consumption. It is also committed to increasing investments in public infrastructure projects. Public investment growth this year is therefore projected to also rise this year as well. Nevertheless, the recovery in total investment could be fragile should there be policy uncertainties, a slow recovery of household consumption amidst rising inflation, and a global downturn, while oil prices and global competition remains high.

2.6.1 Private Investment

Private investment should recover this year after its slump last year, but downside risks remain.

Private investment grew by merely 0.5 percent (in real terms) last year, which is the lowest since 2000. This year, with the new elected government recently announcing its commitment to resume public investment in the infrastructure mega-projects as well as measures to boost both private investment and consumption, investor confidence has continuously picked up. The Private Investment Index in the first two months of this year shows that private investment growth is higher than its growth in all quarters last year. Real loan rates are also low and supportive to investments. The high investment applications and approvals from the Board of Investment (BOI) since 2004 could be translated into higher actual investment this year compared to the past few years. Real private investment growth is therefore expected to increase to 10 percent this year. However, the recovery could be fragile. The planned investment could be further delayed should public investment and household consumption not recover as expected, policy uncertainty resumes, and global demand falls sharply, while oil price and external competition will remain high.

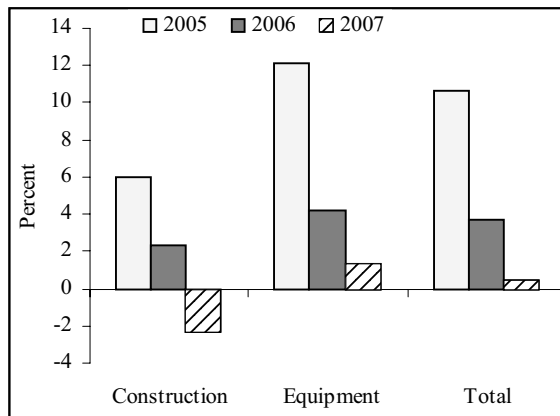
Private investment growth declined sharply since 2006. Investor sentiment had been falling amidst the unstable political situation since 2006, resulting in uncertain policy directions⁴⁰, fell since 2006 (see Figure 26), which resulted in the sharp fall of private investment growth from 10.6 percent in 2005 to 3.7 and 0.5 percent in 2006 and 2007, respectively. In 2007, private investment in the construction sector contracted, while investments in equipment expanded by only 1.3 percent (see Figure 23). Gross foreign direct investment (FDI) had been the main supporter of private investment growth in 2005 and 2006 declined by US\$10 billion last year (see Figure 24).

With the rapid slow down in private investment growth, capacity utilization has increased quickly and could pose a supply constraint should demand pick up in the near future. With manufacturing production expanding by 5-6 percent per year since 2005, while private investment growth was minimal, capacity utilization rates in the industrial sector rose quickly. Capacity utilization was only 64.4 percent in 2002 and rose to 74.6 percent in 2007 (see Figure 25). By the end of 2007, 20 industries⁴¹ had higher than 80 percent capacity utilization. They include chemical products, integrated circuits, and paper industries. Unless firms invest to expand their capacity, Thai industries will find it difficult to respond should demand growth pick up quickly in the near future.

⁴⁰ In 2006, there was a parliamentary dissolution in April and a coup in September. In December 2006, the 30 percent unremunerated reserve requirement on capital inflows was announced. In early 2007, the Ministry of Commerce proposed amendments of the Foreign Business Act to increase restrictions on foreign investments. The unremunerated reserve requirement on capital inflows has been fully lifted in March 2008. The amendments of the Foreign Business Act are still not approved.

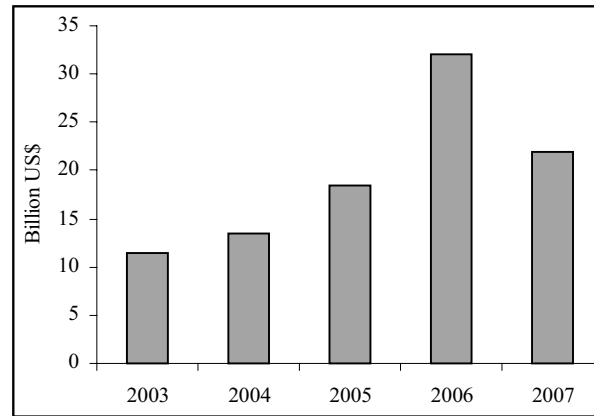
⁴¹ These industries account for 37 percent of total industry production in Thailand.

Figure 23. Growth of Real Private Investment



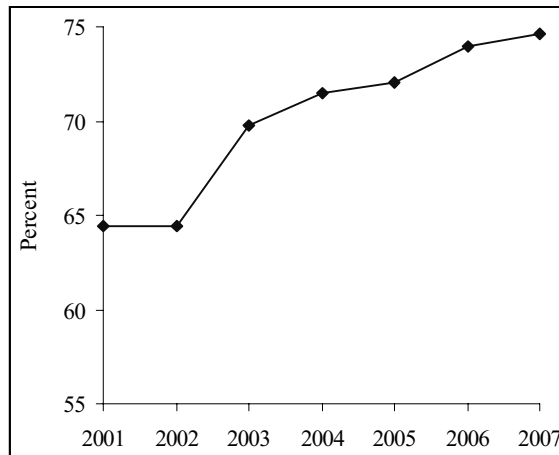
Source: NESDB

Figure 24. Gross Foreign Direct Investment



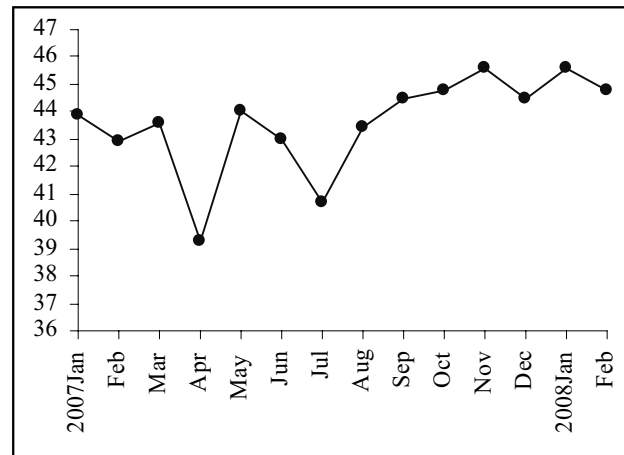
Source: BOT

Figure 25. Industrial Capacity Utilization



Source: BOT

Figure 26. Business Sentiment Index



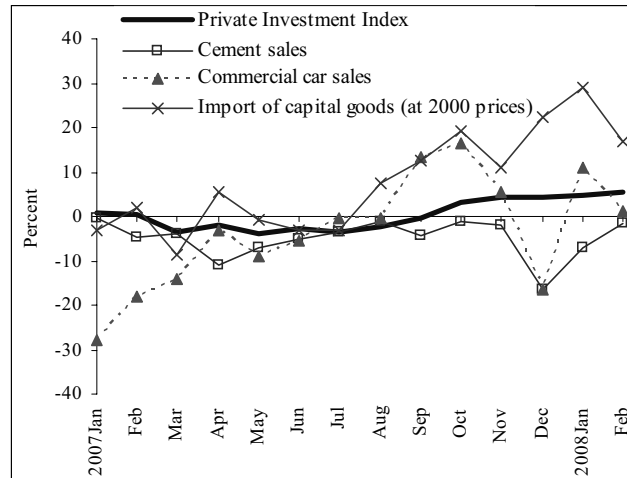
Source: BOT

Since the elections, the business sentiment has improved as well as the indicators of private investment. The Bank of Thailand’s Business Sentiment Index shows that investor sentiments have picked up since August last year, though they are still low (see Figure 26). The Stock Exchange of Thailand’s survey of CEOs of listed companies⁴² in February also shows that more than half of the listed firms intend to expand their investments in the next 12 months and will mostly finance them by either retained earnings or domestic bank loans. Indicators of private investment such as imports of capital goods and commercial car sales have also recovered (see Figure 27). Cement sales, however, continue to decline, indicating that the recovery in construction will take some time.

Loan rates are also supportive and loan growth has been picking up since the end of last year. The minimum lending rate (MLR) has been falling since September 2007 and is currently at 6.87 percent. Adjusted for the inflation this year, MLR is currently at 1.5 percent (see Figure 28). These low interest rates would support

⁴² Listed Companies CEO Survey (Quarter 1, 2008) conducted by the Stock Exchange of Thailand Research Institute and Thailand Listed Companies Association (February 2008).

Figure 27. Change in Private Investment Indicators

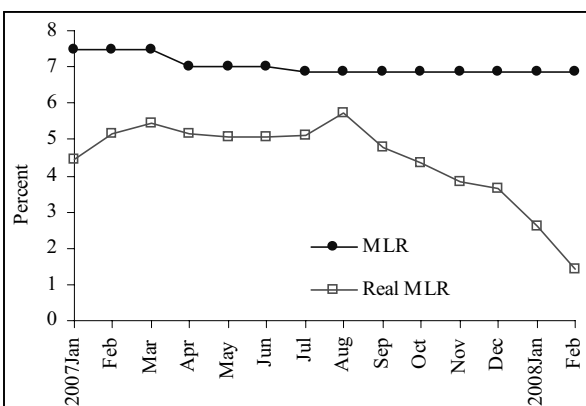


Source: BOT

loan growth for investments. Commercial bank’s loan growth to firms has started to pick up in the last quarter of the year after slowing down since the last quarter of 2006 (see Figure 29).

The government has also issued tax measures to stimulate investments and business operations. The tax deductions announced as a part of the March 4th stimulus package also aimed at promoting investment and business operations. They include a 40 percent tax deduction for depreciation of the cost of machinery, equipment and computer softwares on the day of purchase and a tax deduction of up to 1.25 times of the costs of purchase and installation of energy efficient machineries and equipment. Other tax cuts for firms include the reduction of corporate income tax for firms that list themselves in the Stock Exchange of Thailand this year. Moreover, listed firms are given a corporate income tax cut for their first Bt300 million net profit. The registration and transfer fees are also reduced for property transactions. Community enterprises that are not corporatized are given a tax waiver on income of less than Bt1.2 million for 3 consecutive years. Small and medium sized enterprises (SMEs) with less than Bt5 million paid-up capital are exempted from corporate income tax for the first Bt150,000 of their profit.

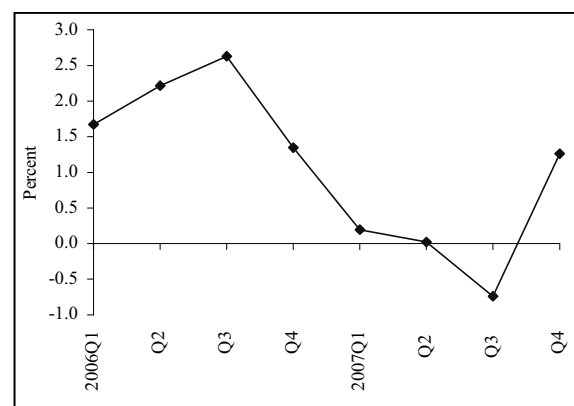
Figure 28. Minimum Lending Rates



Source: BOT

Note: Real MLR is deflated by contemporaneous headline inflation

Figure 29. Growth of Commercial Bank Loans to Businesses



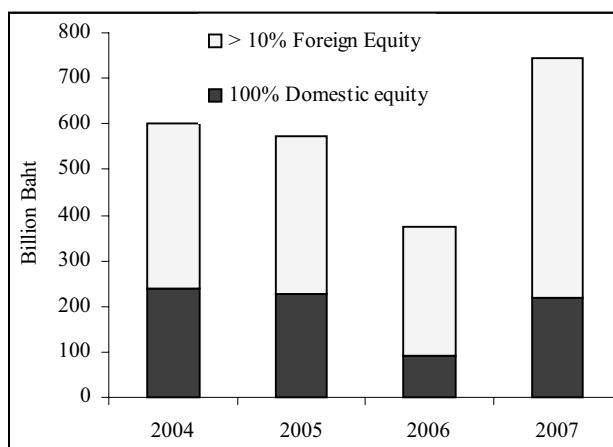
Source: BOT

Note: Change is from end of previous year

Amidst a better investment climate this year, the Board of Investment (BOI) investment promotion approvals should be translated into investments on the ground. Investment promotion applications and approvals from the BOI have been high for both Thai and foreign firms since 2004 (see Figure 30). The large approvals in the past few years have not been reflected in the rise in the investments, suggesting that firms had delayed their investment although they had planned for them⁴³. With clearer policy directions, a recovery in domestic demand, low interest rates, and improved investor's confidence, a large share of these approvals should be translated into actual investments this year.

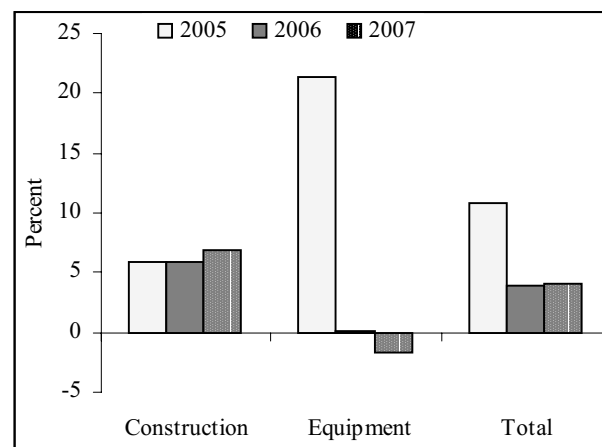
However, a sharp slow down in demand, uncertain policy directions, and prolonged price controls amidst higher costs could undermine the recovery in private investment this year. Investors in the Bank of Thailand Business Sentiment Survey⁴⁴, for example, have in the past few months cited the top three constraints to production to be the high cost of production, difficulty in price adjustment, and uncertainty about economic conditions. More than 60 percent of CEOs in the Listed Companies CEO survey indicated that the domestic economic condition is the key determinant of their investment decision, followed by the political stability. Hence, should these factors deteriorate, investments decisions could again be delayed.

Figure 30. BOI Approvals of Applications



Source: BOI

Figure 31. Public Investment Growth



Source: NESDB

2.6.2 Public Investment

Public investment should speed up this year after its slow disbursement last year. Despite the increase in the both the government's and state-owned enterprises' investment budget last year, public investment increased by only 4 percent (in real terms) year-on-year, similar to its growth in 2006. This was the result of the reconsideration of many large public infrastructure projects as well as stricter monitoring of procurement procedures by the previous government that was imposed to make public procurement more transparent and accountable. Public investment in equipment purchases last year declined by 1.7 percent, while growth of construction sped up to 6.8 percent (see Figure 31). With the newly elected government coming on board in late January, the disbursement rate of public investment funds is expected to increase, and public investment should rise by 9 percent this year (in real terms).

⁴³ It generally takes two years on average before the approvals are translated into investments on the ground.

⁴⁴ Business Sentiment Survey (February 2008) by Bank of Thailand

The increase in the government's investment budget and its disbursement rate will help raise public investments this year. The government's capital expenditure budget for fiscal year 2008 is set at Bt 405 billion, an increase of 8 percent from that of last year. Moreover, as the new government has expressed its intention to increase public investments, its disbursement rate should be higher than last year's 70 percent. This should be achievable as the disbursement rate was already at 27 percent by January, which is the fourth month of the fiscal year.

The government has announced the revival of mega-public infrastructure projects and public-private partnership will be one of the main sources of funding. Some of the announced projects include the urban mass transit system, the inter-province dual rail track, and the water irrigation system in the Northeast. However, concrete plans have yet to be announced for the latter two. The financing plan for five urban mass transit lines has been announced. The plan is divided into two phases: the first phase is for 8 years and is costed at Bt260 billion and the second phase is costed at Bt511 billion. Around 7 percent of the total cost will be funded by the central government's budget, while 70 percent comes from loans (of which 40 percent domestic loans and 60 percent foreign loans). The remaining 23 percent or Bt178 billion would be funded through public-private partnerships (see Table 11). It is therefore very important that appropriate public-private partnership (PPP) framework is in place as different types of projects require different PPP schemes to be effective⁴⁵.

Table 11. Financing Plan for Mass Transit System (5 Lines*)

(Billion Bt)

	Phase 1 (2008-2015)				Phase 2				TOTAL
	Govern-ment			Total	Govern-ment			Total	
	Budget	Loans	PPP		Budget	Loans	PPP		
Land purchase & project consultants	27.1	-	-	27.1	30.7	-	-	30.7	57.8
Infrastructure system	-	162.3	-	162.3	-	328.0	-	328.0	490.3
Train system	-	12.7	57.7	70.3	-	31.9	120.4	152.2	222.6
Total	27.1	175.0	57.7	259.8	30.7	359.9	120.4	511.0	770.7

Source: MOF, March 2008

* Blue, purple, red, light green, and dark green lines

There is enough fiscal space to make greater investments, but good governance is needed to ensure that the needed projects are undertaken. The government has been running a balanced budget since 2005 and a small deficit of 1.7 percent in 2007. It is expected to run a deficit of 2 percent of GDP this year. Public debt has also been continuously falling and was at the end of last year 37.5 percent of GDP, well below its self imposed ceiling of 50 percent. There is therefore room to increase the government's budget or borrow to expand public investments without posing fiscal risks. Investments in public infrastructure are badly needed as Thailand has not invested heavily in it since the 1998 crisis. Firms have voiced concerns that inadequate infrastructure (road, electricity, water, etc.) has posed constraints to doing business as it raises the operation costs for them. These need to be urgently addressed. To ensure that public funds are effectively invested in projects that are needed

⁴⁵ See Box 2 of the Thailand Economic Monitor (November 2007) for a detailed explanation of the PPP.

and will lend the highest benefit to citizens, a proper governance system needs to be in place. This would start from choosing the right projects and the appropriate mode of financing, to the procurement, and to the monitoring of the implementation and outcomes of the project. The processes also need to be transparent and accountable so as to make sure that public resources are spent on the needed projects and corruption and risks are minimized.

2.7 Financial and Corporate Sector Developments

Financial sector development

Commercial banks loans accelerated while deposits barely grew. At end-2007, total outstanding commercial banks loans stood at Bt6 trillion, or up 5.2 percent from 2006 (Table 12). This sped up in the second half of the year, supported by improved business confidence and more accommodative interest rate level. As loans to manufacturing industries continue to decelerate, overall loans expansion was supported by robust credits to wholesale and retail trade and personal consumption. Meanwhile, commercial banks deposits registered virtually no growth (0.01 percent) last year, amounting to 6.6 trillion baht. This was the slowest pace since 1999 when total deposits contracted by 0.3 percent. Even when deposits from other financial institutions are included, total deposits only grew by 0.5 percent.⁴⁶ For the near-term outlook, it is anticipated that both corporate and personal loans will continue to expand. The quarterly survey of financial institutions by the Bank of Thailand however indicate that credit policy is likely to be more strict in the coming months, following rising uncertainties in the global financial markets.

Non-performing loans were relatively stable last year. At end-2007, the share of gross non-performing loans (NPLs) in total loans stood at 7.3 percent, down only marginally from 7.5 percent at end-2006. This is in

Table 12. Outstanding commercial bank loans growth, 2005-2007

Sectors	Share (%)	Growth (%)		
	2007	2005	2006	2007
Agriculture 1/ Production	1.7	2.0	-2.2	-8.1
Wholesale and retail trade	25.2	4.7	2.6	0.8
Financial intermediation	16.3	3.1	3.0	3.8
Real estate activities	11.4	5.0	-8.0	7.9
Personal consumption	7.2	9.7	0.2	4.2
Other sectors 2/	23.3	24.0	18.7	16.6
	14.8	5.3	-1.3	-0.8
Total loans	100.0	8.0	3.4	5.2

Source: BOT

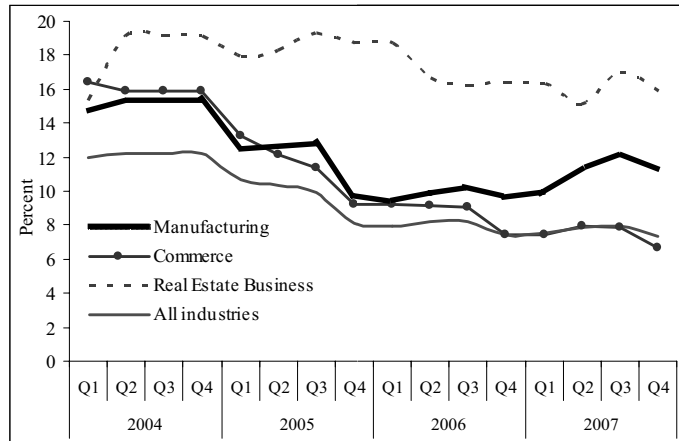
Note: 1/ "Agriculture" refers to agriculture, forestry, and fishing

2/ "Other sectors" include mining, electricity & water supply, construction, hotels & restaurants, transport, and other loans

⁴⁶ These include Government Savings Bank, Bank for Agriculture and Agricultural Co-operative, finance companies, and credit foncier companies. Data for the last quarter of 2007 for Government Housing Bank and life insurance companies are not yet released.

contrast to a continuous reduction in bad loans in 2005 and 2006 (Figure 32). Across sectors, the most improved sector is commerce, whose bad loans decreased from 16.5 percent in Q1 2004 to 6.7 percent at end-2007. In contrast, NPLs in real estate businesses have remained steadily high (nearly 16 percent at end-2007), suggesting that sizeable troubled assets following the 1997 financial crisis are still unsolved. Bad loans in manufacturing industries, which account for about 40 percent of all bad loans, also picked up in 2007.

Figure 32. Non-performing loans (NPLs) in total loans, Q1 2004- Q4 2007

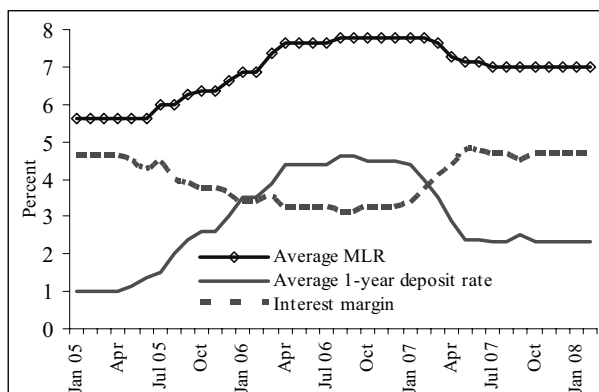


Source: BOT

Domestic interest rates decreased and interest margin widened. The average minimum lending rate (MLR) decreased from 7.44 percent in the first half of 2007 to 6.99 percent in July and has remained at this level since (Figure 33). During this period, the average one-year deposit rate also fell from 3.25 to 2.35 percent. Following larger cuts in the deposit rate, interest margin widened to 4.68 percent at end-February 2008 from only 3.25 percent at end-2006. Meanwhile, Figure 34 shows that, after a series of sharp interest cuts in the US, BIBOR (Bangkok Interbank Offered rate) exceeded LIBOR (and the Federal Funds rate) in February this year (3.29 compared with 3.13 percent).

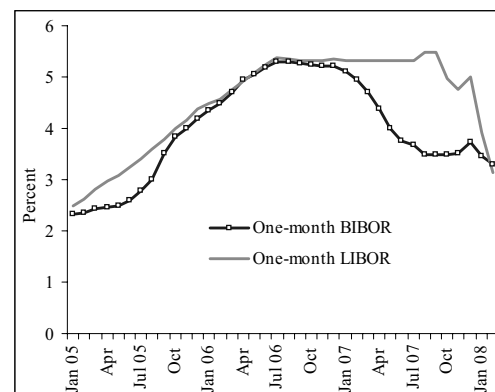
The banking sector remained healthy although net profits dropped significantly. Thai commercial banks' assets grew 3.5 percent last year to Bt553.3 billion, mainly due to higher amount of net loans. Total net profits

Figure 33. Lending and deposit rates, January 2005 - February 2008



Source: BOT

Figure 34. BIBOR and LIBOR, January 2005 - February 2008



Source: BOT

however fell notably from Bt4.1 billion to Bt0.6 billion. Despite a strong increase in net interest income and dividend (supported by growing loans and wider interest margin), a combination of lower non-interest income (from investment losses), higher operating expenses (on salaries & employee benefits), and much higher tax expenses caused net profits to fall. Table 13 shows some financial ratios of Thai commercial banks at the ends of 2004-2007. Overall, asset adequacy remains high, as reflected in a continuous rise in capital funds relative to risk assets. With expanding credits and stagnant deposits, loans-deposits ratio climbed rapidly to 93 percent at end-2007. Meanwhile, all profitability ratios, except the one based on interest income, worsened as a result of both larger net assets and weaker non-interest income and profits.

Table 13. Financial performance of all Thai commercial banks, 2004-2007

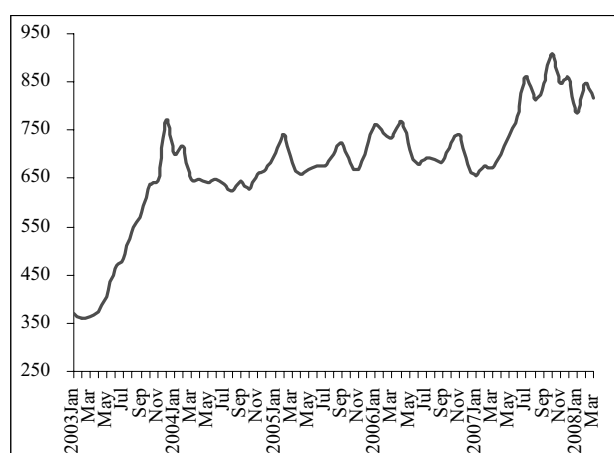
	2004	2005	2006	2007
Asset Quality and Capital Adequacy Ratio (%)				
Capital funds/Risk assets	11.9	13.2	13.6	14.8
Actual allowance for possible loan losses/ Required allowance for possible loan losses	136.7	143.6	121.3	121.0
Loans/Deposits	87.6	83.2	87.7	93.0
Profitability Ratio (% , per year)				
Net interest income & dividend / Average net assets	2.6	2.9	3.2	3.3
Non-interest income / Average net assets	1.2	1.1	1.2	1.1
Profit from operation / Average net assets	1.8	1.9	1.9	1.7
Net profit / Average net assets	1.3	1.4	0.8	0.1
Efficiency Ratio (Million baht per year)				
Net profit / Number of bank's employees	0.9	1.0	0.7	0.1
Net profit / Number of bank's branches	19.9	22.6	11.6	1.7

Source: BOT

Corporate sector development

The stock market index generally rose but also more volatile last year. At end-2007, the SET index stood at 858, up from 680 at end-2006 (Figure 35). The market has so far somewhat retreated in 2008, and reached 826 on 9 April. Figure 35 also shows that the stock market index rose rather smoothly in the first half of last year, but has become more volatile after the sub-prime loan problems unveiled in August last year. At end-March 2008, market capitalization was Bt6.4 trillion, a remarkable 26-percent increase from the level at end-2006. During this period, the price-earning ratio also increased from 9.4 to 15.0.

Listed firms were less profitable. The number of firms listed in the stock market was unchanged at 462 firms last year. Generally, these firms enjoyed lower profits in 2007 (Figure 33). Although this in part reflects slower sales growth given weak domestic demand in the past years, it appears that firms' ability to generate profits has also been declining since 2005. For example, the share of net profits in total assets fell from 4.3 percent in 2004 to 3.2 percent last year. This is also true if we compare net profits with total equities. Finally, as reflected by continuously decreasing debt-equity ratio, it seems that firms have relied less on debt (and more on stockholders' equity) as a source of their funding.

Figure 35. SET Index, January 2003 - March 2008

Source: SET

Table 14. Financial performance of listed firms, 2003-2007

	2003	2004	2005	2006	2007
Total listed (firms)	364	404	431	462	462
Net profits growth (%)	47.7	61.7	0.7	1.4	-9.9
Sales growth (%)	14.4	22.0	21.3	18.0	9.2
Net profits / total assets (%)	2.9	4.3	3.9	3.8	3.2
Net profits / total equities (%)	3.6	5.5	5.1	5.1	4.4
Debt-equity ratio (times)	4.4	3.7	3.4	3.0	2.8

Source: SET

2.8 Medium Term Development

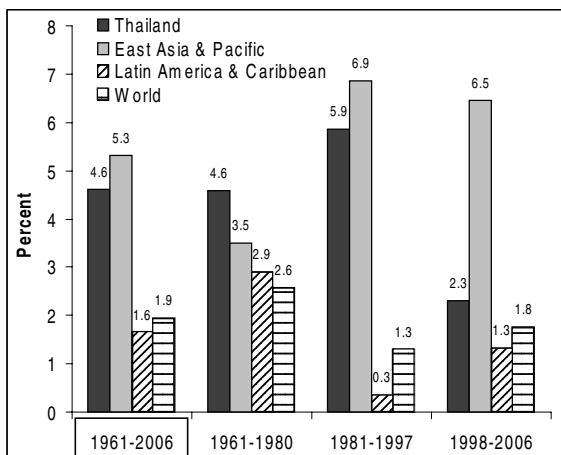
Thailand has transitioned quickly to a middle-income country and the challenge it now faces is to avert the “middle-income trap”. As with many emerging countries in East Asia, Thailand’s rapid per capita income growth of almost 6 percent over the period of 1980-1997 has enabled Thailand to transition quickly from a low-income to a lower middle-income country⁴⁷ (see Figure 36). Its exports have also moved from primarily resource-based, labor intensive to high-tech and capital intensive (see Figure 37). This was the result of many factors including its export-orientated policies, opening up of the industrial sector to foreign direct investment (FDI)⁴⁸, and making use

⁴⁷ The World Bank’s definition of a low income country is one with per capita gross national income (GNI) of less than US\$900; a lower middle income country is one with per capita income between US\$900 and US\$3,500; an upper-middle income country is one with per capita income between US\$3,500 and US\$11,000, and high income countries are those with per capita income greater than US\$11,000. Currently, Thailand is a lower-middle income country; its per capita income is around US\$3,000.

⁴⁸ Thailand has adopted export-oriented policies since the mid-1970s and has opened up the manufacturing sector to foreign direct investment since the 1980s. In the late 1980s, there was an influx of Japanese FDI into Thailand as the Japanese yen had appreciated sharply after it signed the Plaza Accord. It was after that that Japanese firms relocate their production to other countries in East Asia to take advantage of lower production costs.

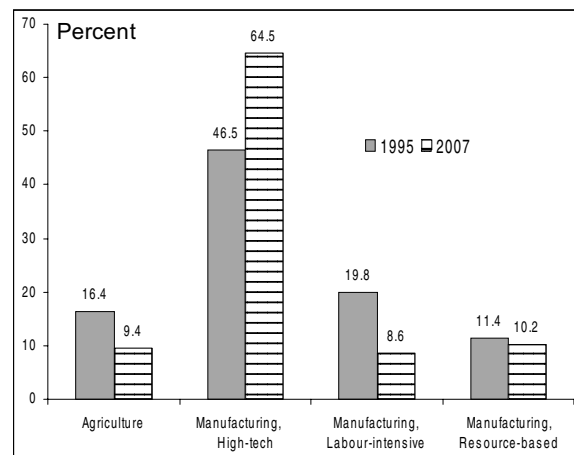
of the abundant cheap labor as well as accumulating capital. However, in recent years, Thailand’s real GDP growth has decelerated and is lower than those of other developing East Asian countries⁴⁹. With the intensifying global competition and higher commodity prices, Thailand faces a real challenge of sustaining higher growth and transitioning into a higher income country. While short-term policies and stimulus measures to mitigate the downside risks to growth in the short-run are being put in place, Thailand also needs to turn to the longer term challenges by improving its productivity and competitiveness if it were to avoid being stuck in a middle-income trap in which many like those in Latin America countries have been in for several decades.

Figure 36. Average annual GDP per capita growth, 1961-2006



Source: World Bank

Figure 37. Export share by product groups, 1995 and 2007



Source: BOT

Thailand’s rapid growth and transition to a middle-income country was mainly the result of rapid increase in employment and capital goods, but productivity growth was low. From 1985-2005, Thailand’s real GDP growth expanded at a respectable average rate of 5.9 percent per annum. Almost half of this growth came from the increase in employment, particularly in the industry sector to which labor from the labor-excess agricultural sector migrated. A third of this growth came from the increased use of capital goods (machines and equipment) which came with foreign direct investments. Education or the improved labor quality accounts for only a fraction of this growth. Productivity growth accounts for only 15 percent of the growth. Productivity growths actually have contributed only a small fraction to growths of all the sectors – industry, agriculture, and service. It was actually negative in the services sector (see Table 15). This calls for greater attention to productivity improvements in all sectors. In the increasingly competitive global economy where more and more countries with cheap labor and abundant resources are entering world trade, Thailand can no longer rely on cheap labor and accumulating capital in supporting its growth as was in the past. Instead, to remain competitive and sustain high and balanced growth, Thailand needs to improve productivity in all sectors.

The services sector holds a large potential to be Thailand’s new source of growth. Services sector accounts for 45 percent of Thailand’s GDP and its employment is more than double that of industry. It includes the retail and wholesale businesses, hotels and restaurants, as well as other business services such as logistics, accounting, and engineering. However, calculations of its productivity based on national accounts data shows that

⁴⁹ Thailand’s real GDP growth was 6.2 percent from 2002-2004 and 4.8 percent in from 2005-2007. Developing East Asian growth from 2005-2007 was 9.7 percent.

its growth came mostly from the growth in employment, which came from the labor abundant agricultural sector. Its productivity growth was, however, negative (see Table 15). One of the reasons for such low productivity growth is the fact that the services sector, unlike the industrial sector, has long been protected from foreign participation until recently. Thailand has started to open up its services sector after the 1998 crisis. Sectors that were allowed greater foreign participation were the banking sector and the property sector, and more recently, the telecommunications sector. Nevertheless, foreign share-holding in those industries are capped at less than 50 percent. These have led to inefficiencies and high costs of many services in Thailand such as telecom and logistics, which is translated to higher the cost of operations for the industry and agriculture sector as well. Promoting greater competition in the services sector and improving the skills and knowledge of those working in this sector would help unleash its large growth potential. Higher productivity and efficiency of the services sector would benefit not only those who work in the sector, but also for those in the industry and agriculture sectors as well.

Table 15. Sources of Growth in Thailand, 1985-2005

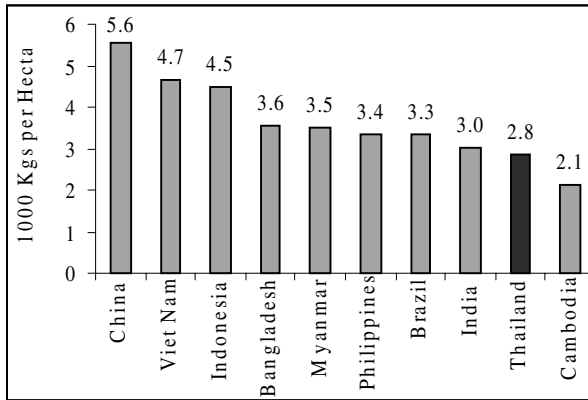
	Total Economy	Agriculture	Industry	Services
Output growth	5.9	2.8	7.6	5.4
of which				
Employment	2.6	0.5	4.9	4.5
Education	0.4	0.2	0.4	0.4
Capital	2.0	1.9	1.9	0.9
Factor Productivity	0.9	0.2	0.4	-0.4

Source: *Measuring Output and Productivity in Thailand's Services-Producing Industries* (2008), NESDB and World Bank

Improving productivity in the agricultural sector will also have positive equity implications. Productivity growth in the agricultural sector has been low from 1985-2005. With the shrinking amount of available agricultural land and number of people working in agriculture, sustaining growth of the agricultural sector would have to come mainly from increased productivity from, for example, higher yields per acre or higher value-added produce (e.g. free from disease, looks attractive, and can be kept fresh for an extended period of time). Rice yields per acre in Thailand, for example, have been low when compared to other major world rice producers (see Figure 38). Although agriculture's share in GDP is 10 percent, the sector is home to 40 percent of the population and also 40 percent of the poor in Thailand. Increasing their productivity will not only sustain the growth of agriculture supply in Thailand but also raise the livelihoods of those in the sector. Some of the measures to do so include capacity building to farmers on many fronts, for example, on new farming techniques, on the knowledge of market demand, and on the input choices. Better infrastructure (e.g. irrigation system and roads) will also help improve yields and lower the cost of production and transportation.

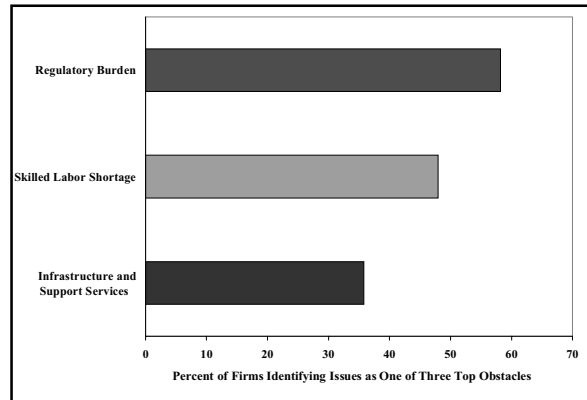
Improving the productivity of industries, including those that are negatively affected by the stronger baht, would sustain growth of the sector in the long-run. Exchange rate intervention to slow down the baht appreciation is costly and unsustainable. Measures to facilitate capital outflows such as investment by Thais abroad to alleviate the pressures on the baht to appreciate are being devised but would have an impact in the medium to long run. Hence, the baht will likely remain appreciated at least in the medium term. A longer term solution for firms to thrive in such an environment would be to target support to industries that are negatively affected by the baht appreciation to help them increase their productivity. In the extreme case that firms in a particular industry are no longer competitive, encouraging them to move to a more productive, higher value-add industry would be a solution that would benefit not only the firms themselves, but also the economy as a whole.

Figure 38. Rice Yield of World’s Major Rice Producers, 2001-2005 Average



Source: FAO

Figure 39. Constraints to Investment as Reported by Firms



Source: *Thailand Productivity and Investment Climate Study* (2006), NESDB & World Bank

Improvements in the skills and knowledge, public infrastructure, and regulatory environment, could stimulate the needed investment and productivity growths in all the sectors. Levels of private investment in Thailand have been low since its significant retrenchment during the crisis. Private investment dropped by 52 percent in 1998 and its share in GDP fell from 33 percent in 1996 to 12 percent. After ten years, private investment’s share in GDP today is 17 percent, which is still lower than even its 1980s period share of 22 percent. On the other hand, excess capacity which was quite high right after the crisis is drying up. Capacity utilization in industry is now back to pre-crisis levels of 75 percent with many industries running at above 80 percent capacity utilization. If investments do not pick up quickly, there would be an imminent supply constraint should demand growth picks up in the next couple of years. On the other hand, a survey of 1,300 firms across Thailand pointed out that firms are reluctant to expand their businesses because of three main reasons: mismatch of skills and knowledge, inadequate public infrastructure, and unfavorable regulatory environment⁵⁰ (see Figure 39). These resulted in higher costs for firms and reduce their ability to make productivity improvements and expand their operations. They are discussed in turn below.

Table 16. World Bank’s Knowledge Economy Index* (1-10)

Rank	Change in Rank from 1995	Country	Knowledge Economy Index
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

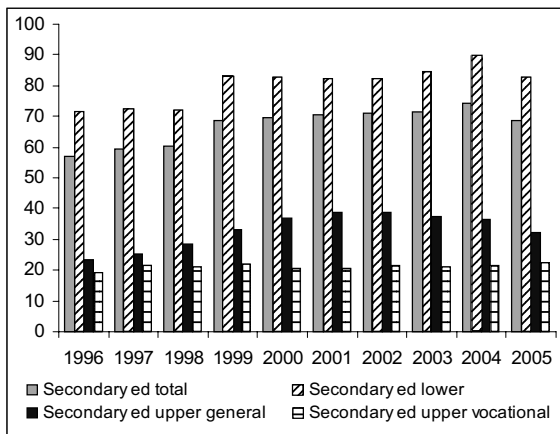
Source: World Bank

* 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.

⁵⁰ See *Thailand Investment Climate, Firm Competitiveness, and Growth* (2006) by the NESDB and World Bank

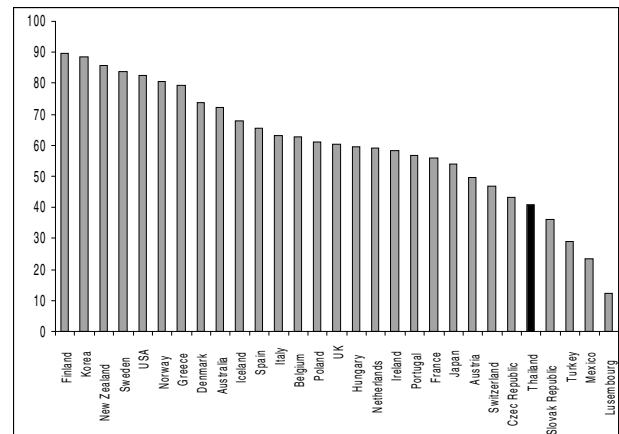
Skills and knowledge urgently need to be upgraded if Thailand were to survive the global competition in the coming years. With the intensifying competition from countries with lower wages and abundant resource, Thailand's future competitiveness would need to come from specialization and innovation rather than cost competitiveness⁵¹. Experience from countries that have successfully done so in the recent past such as South Korea, Singapore, and Taiwan has shown that higher quality human resource with better skills and knowledge is one of the key factors to achieving them. These are the countries have also successfully transitioned to a knowledge-based economy. On the other hand, Thailand's world ranking on the extent of being a knowledge economy has fallen over the past decade, while countries like China and Vietnam have increased their ranks significantly (see Table 16). In order to move towards a knowledge economy, education outcomes in Thailand especially at the university level as well as the role of the education institutions and the private sector needs to be greatly strengthened.

Figure 40. Secondary Education Gross Enrollment Rates, 1996 - 2005



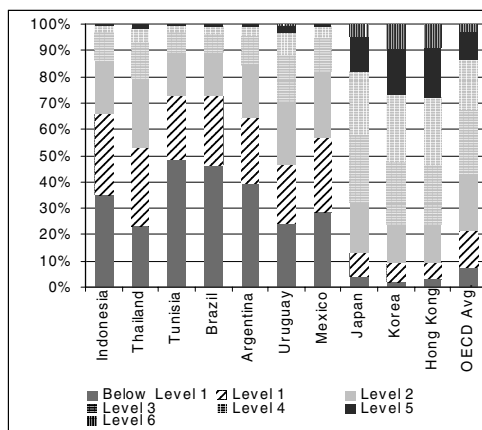
Source: OEC 2006 and ONEC 1998

Figure 41. Tertiary Gross Enrollment Rate in Thailand vs OECD Countries, 2004



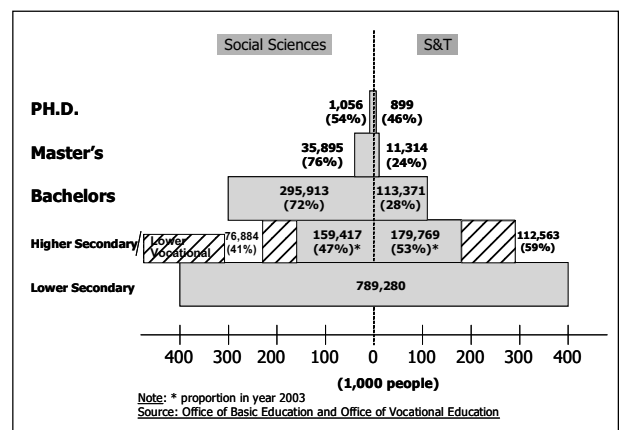
Source: EdStats, World Bank, 2007

Figure 42. PISA Test Scores in Mathematics, 2006



Source: PISA, 2006

Figure 43. Number of new students in Thailand, 2005



Source: Office of Basic Education and Office of Vocational Education

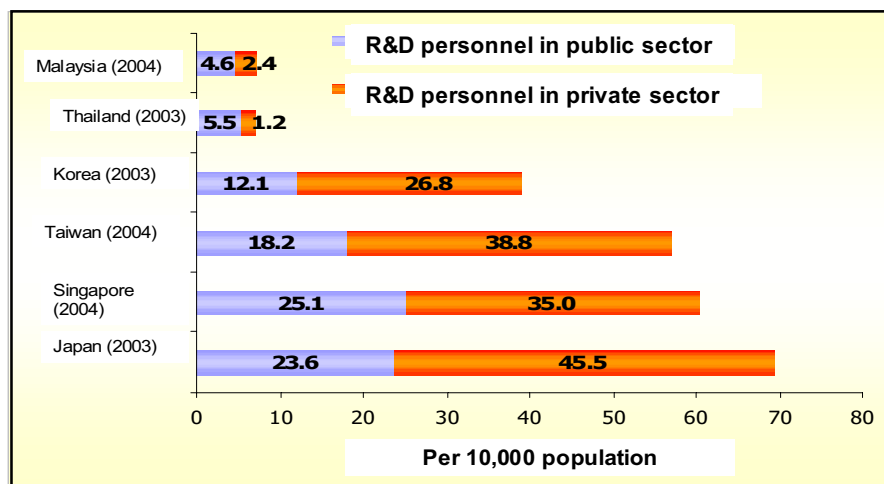
⁵¹ See *An East Asian Renaissance: Ideas for Economic Growth* (2007) by the World Bank for further discussion of this at the regional (East Asia) level

Improvement in education outcomes is the key to upgrading skills and knowledge. They include improving the quality of education at tertiary levels, especially the science programs, the quality of students coming out of secondary school level as well as those from vocational schools. Student enrolment in secondary and tertiary levels in Thailand has been rising and are comparable to some higher income countries (see Figure 40 and Figure 41), but their quality is worrisome. PISA scores in mathematics from 2006, for example, showed that more than 50 percent of Thai secondary school students have scored lower than minimum acceptable levels (see Figure 42). This translates into the bias of students at the tertiary levels towards social sciences (see Figure 43). On the other hand, enrolment in upper vocational education has been falling as students increasingly prefer to attend secondary schools and to universities (see Figure 40). This is mainly because there are certain biases in social values against vocational education. Firms have now indicated that there are shortages of employees with vocational training skills. Increasing the number of graduates from vocational schools as well as ensuring that their skills match with the needs of firms are therefore critical.

The education institutions, firms, and government have important roles to play in upgrading the needed skills and increasing innovation. Education and research institutions need to be responsive to firms' needs so that the students and research and development (R&D) they produce are most useful to firms. Firms themselves need to also be more proactive in demanding these from the education and research institutions. In some cases, firms could be proactive in finding ways to fill the gaps themselves such as by conducting in-house training or pooling resources together for R&D activities. R&D in Thailand is low and is particularly so in the private sector (see Figure 44). The government also has an important role in facilitating these linkages and promoting R&D in the private sector. Experiences from countries in Europe and Asia that have successfully done so show that these require serious efforts from all parties, and the process takes many years⁵². Thailand has to therefore urgently make serious efforts today before other countries quickly catch up.

The public sector also has an important role in developing public infrastructure which would not only lower production and logistic costs for firms and communities, but also promote equity among regions in Thailand. With public investments continuously shrinking from 1998 to 2003 and no large public infrastructure

Figure 44. Personnel in R&D per 10,000 population



Source: NSTDA

⁵² See *Towards a Knowledge Economy in Thailand* (2008), a joint report by the NESDB and the World Bank, for a detailed discussion of experiences from those countries

investments since the crisis, Thailand's infrastructure is proving to be inadequate and a bottle neck to further expansion of private firms as logistics costs have risen. Additional public investments would therefore help reduce costs for firms, thus, encouraging them to expand. In addition, as trade in the greater Mekong sub-region (GMS)⁵³ expands, infrastructure development, particularly the Northeast would facilitate not only trade among the GMS countries, but also growth within the Northeast⁵⁴. Better roads and public utility services (electricity, water, and telecommunications), for example, would promote higher industrial expansion, in the Northeast. This would help not only increase trade between the Northeast and the neighboring countries, but also raise income growth in the Northeast which, in turn, would also help alleviate poverty, promote greater equity, and reduce migration from the Northeast which is the poorest region in Thailand.

Regulations limiting competitiveness need to be revisited, as they have been shown to limit productivity and growth in the long run. These include the Foreign Business Act which limits foreign participation and competition in many services businesses, which has not helped to increase productivity growth in this sector as discussed above. Prolonged price controls also lower the firm's productivity. It reduces profit margins of firms, thus, limit their ability to improve their production process. It also discourages firms from expanding or establishing new operations, which is the opposite of what Thailand needs. Instead, the more desirable longer-term measures are ones that increase the supply of goods and increase competition such as allowing imports. In addition to those, measures that would help firms increase their production efficiency, such as greater energy efficiency, would not only lead to lower cost and prices, but would also increase firms' competitiveness.

Streamlining bureaucratic procedures would reduce their costs to firms. Firms in the *Thailand Investment Climate, Firm Competitiveness, and Growth* study have voiced that cumbersome bureaucratic procedures have been costly for them. They result in the uncertainty of the time and costs taken to obtain, for example, permits, approvals, and clearances. This was confirmed by an in-depth interview of firms in the garments, auto-parts, and food processing industries. Firms cite that improvements over the years are apparent, but tax refunds from the Customs Department and the Revenue Department are still often slow and unpredictable⁵⁵. Moreover, visits from the tax departments are frequent and take up a large amount of time, though firms report that the officials were more courteous and knowledgeable than in the past. Firms in the food processing industry voiced that a single food product require food safety certification from many government agencies, which proves to be timely and cumbersome as most of them required similar documents. Strengthening the integrated one-stop public service center would greatly help reduce the time spent on this.

The government has given priority to improving Thailand's competitiveness and productivity, but implementation needs to speed up. Improving competitiveness and productivity are key themes in the 9th and 10th National Economic and Social Development Plans which has a focus on education and developing a knowledge economy. In 2003, the Government has established the National Competitiveness Committee chaired by the Prime Minister to draft and oversee programs and projects aimed at increasing competitiveness of key manufacturing industries e.g. food, automobile and parts, and fashion products. Last year, the Government approved the National Industrial Productivity Master Plan which aimed to raise productivity in the industrial sector. It is being implemented starting this year (see Box 2). Moreover, the current government has announced the continuation of the public infrastructure mega-projects with an emphasis on the mass transit system in Bangkok. Efforts to improve public services and streamline bureaucratic processes are also on-going. One stop service centers have

⁵³ GMS includes Cambodia, Lao PDR, Myanmar, Thailand, and Vietnam.

⁵⁴ The Northeast region of Thailand borders Cambodia and Lao PDR.

⁵⁵ From *Enhancing Regulatory Framework in Thailand* (forthcoming), a joint NESDB-World Bank report.

been established in each ministry. In addition, greater use of information technology (IT) is being adopted to reduce the number of steps, days, and face-to-face interaction with government officials. The Customs Department, for example, has last year introduced e-Exports which has helped reduced the number of days taken to clear customs⁵⁶. These represent a good start for Thailand in trying to improve its competitiveness and productivity. However, many of the plans still need to be translated into action on the ground and many programs need to be expanded especially to the services sector. Successful implementation of the plans and programs would require greater political will and effort and collaboration of the relevant government agencies. These actions cannot wait as other countries are catching up quickly with Thailand, while others are increasingly leading Thailand.

Box 2. The National Industrial Productivity Master Plan and Its Implementation

In 2007, the Government issued a Cabinet-approved National Industrial Productivity Master Plan (2007-2011). It is aimed to raise the productivity of the 13 key industries in Thailand*. The key agency in drafting and implementing the Master Plan is the Office of Industrial Economics under the Ministry of Industry. The Master Plan follows from the Tenth National Economic and Social Development Plan (2007-2011) which has given priority to improving national productivity.

The implementation of the Master Plan has started in fiscal year 2008. In FY 2008 (October 2007-September 2008), projects under the Plan was allocated Bt567 million, which includes 43 projects on the 13 industries as well as 6 cross-industrial projects. Some of the projects are administered by the technical industrial institutes such as the Automotive Institute, Food Institute, and Textile and Garment Institute. Others are administered directly by the Ministry of Industry.

The projects in the first phase (FY2008) focused on developing human resource and raising firm knowledge and productivity. Many projects are aimed at upgrading the skills of labor in the industries which includes setting up training programs and establishing job and accreditation standards for the industries. Other projects such as those in the automotive and steel industries are aimed at improving productivity at firm level by introducing new technologies and production processes. Small and medium enterprises (SMEs) are also a focus of the implementation of the Master Plan. There are several projects that are aimed at improving the productivity of SMEs. Other cross-industrial projects include studies and technical assistance to help firms improve their productivity.

Source: OIE and NESDB

* Food, automobile and parts, electrical appliance and electronics, textile and garments, iron and steel, machineries, pharmaceutical, plastic, shoes and leather products, ceramics, software, ship building and repair, and printing industries

⁵⁶ See Doing Business 2008 (2007), World Bank

SECTION 3

IMPLEMENTATION OF STRUCTURAL REFORMS

Many reforms that were announced last year are being implemented this year. Several acts that were enacted last year are beginning to be effective this year. They include those relating to the financial sector such as the Financial Institutions Act and the Bank of Thailand Act. The enactment of the draft acts that have been approved by the Cabinet regarding the improvement of governance, transparency and anti-corruption are however delayed. The Civil Servants Act, on the other hand, aimed at improving human resource management and development is now effective. Reforms to reduce trade barriers have also made progress in the last six months. Tariffs on many products were reduced both unilaterally and bilaterally under the free trade agreements. In addition, the Customs Department has extended the application of paperless customs procedures that would help reduce the time taken to import and export goods. The reforms in the financial and corporate sector, the trade sector, and the public sector are discussed in detail below.

3.1 Financial and Corporate Sector Reforms and Restructuring

Financial Sector Reforms and Restructuring

Many laws enacted last year relating to financial sector are effective this year. These laws include the (i) Financial Institution Business Act, (ii) Bank of Thailand Act, (iii) Securities and Exchange Act, (iv) Institute of Deposit Protection Act (formerly called the Deposit Insurance Institution Act), and (v) Trust for Transaction in Capital Market Act. In addition to the above, various acts which have been amended and will be effective in 2008 are the Provident Fund Act, Derivative Act, Credit Data Business Operation Act, and Life and non-life insurance Act. Other draft acts such as Secured Transaction Act and Currency Act are expected to be resubmitted to the Cabinet. The Prime Minister's regulation called the Public services of State-owned Enterprise which requires the disaggregation of state-owned enterprises' accounts into one that is commercial and one that is government directed was also effective. Moreover, the Master Plan for Grass-root Financial Services which is aimed at increasing financial access to the grass root communities was also approved by the Cabinet. The rest of this section elaborates the above.

The Financial Institution Business Act (2008) has been enacted on February 5th, 2008 and will be effective in August 2008. The new Financial Institution Business Act is the combination of two acts – the Commercial Banking Act and the Act on the Undertaking of Finance Business Securities Business and Credit Foncier Business. Under this new act, the definition of financial institutions will be extended to include all types of commercial banks (fully incorporated commercial bank, subsidiaries of foreign bank, and branches of foreign bank) as well as the finance business, securities business and credit foncier business. The Bank of Thailand

(BOT) is authorized under this Act to regulate financial institutions using the more unified regulations to ensure the same level of playing field and standards. Though the Act allows a finance company or a credit foncier company which has not yet transformed into a bank under the Financial Sector Master Plan Phase I to continue their operation, a credit foncier which chooses to not receive deposit will be forced to transform into a credit company and will be strictly regulated by the BOT using the organic laws (the royal decrees) under this Act. This Act will also give power to the BOT to relax the restriction on foreign ownership shares and the number of foreign directors in the commercial bank. As a result, this Act is viewed as greater opening up of the banking sector to foreign investment. In addition, the new Act will also fully enforce consolidated supervision on which the BOT has been engaging in consultation with financial institutions since 2005. The consolidated supervision would help BOT to supervise groups of financial institutions (parent company and its subsidiaries) and audit their consolidated account of the groups instead of auditing each financial institution separately.

The amendment of the Securities and Exchange Act was enacted and was effective on March 5th, 2008. The amendment will restructure the Office of the Securities Exchange Commission (Thailand's capital market's regulatory agency) and the Securities and Exchange Commission (SEC). It will also establish the new capital market committees to oversee regulations, while the SEC oversees the policy formulation. It also encourages the enhancement of governance in public companies by tightening supervision on their stock trading, stock holding, securities companies, securities exchange and securities depository.

The Institute of Deposit Protection Act (2008) has been enacted and will be effective on August 11st, 2008. According to this Act, the Institute of Deposit Protection will be established. The Institute would be a juristic entity which is neither a public service nor a state enterprise. Thus, it would not submit its revenue to the government. Its board will be comprised of representatives from the Ministry of Finance, Bank of Thailand, and other experts with at least one legal expert and one financial and treasury expert. The current system of full guarantee will expire in August 2009 and the partial guarantee that follows will be reduced step by step to not more than the accumulated deposit of 1 million baht per person per financial institution by 2012. The deposit protection will only cover the Thai baht deposit or domestic deposit account but excluding any baht deposit in a non-resident baht account. During transition periods, the deposit guarantee will be gradually phased out (see Table 17). All member banks and financial institutes would be required to transfer 0.4 percent of the average value of their deposit accounts (the ceiling under the law is 1 percent of average total bank deposit amount) which they used to contribute to the Financial Institution Development Fund (FIDF) to the Deposit Protection Fund. After the system has been well established, the 0.4 percent contribution will be adjusted depending on the fund balance and the creditability of each bank or financial institution. The new system is expected to improve the efficiency and transparency of the banking system because they must try to obtain higher credit ratings to gain trust from depositors. In addition, the Basel II which is expected to be enforced in the middle of next year will also force banks to disclose information on capital and risk-management which will increase the information on banks' financial status to depositors.

The Trust for Transaction in Capital Market Act was effective on January 15, 2008. Under this Act, unit trusts, trustees and trust funds shall be established. Setting up trust funds will help reduce default risk and attract new investors who are interested in investing in the capital market.

The amendment of the 2002 Credit Data Business Operation Act was enacted and effective on February 14th, 2008. The Credit Business Operation Act no.3 (2008) which is the amendment of the 2002 Act allows the National Credit Bureau (NCB) banks to develop customer's credit ranking. Using the historical record of credit and payments, number of credit cards for each holder, period of card holding, the NCB will be able to score the

Table 17. Schedules of bank deposit protection under the Institution of Deposit Protection Act

Number of years after the Act is effective	Level of protection(Baht)
1	100%
2	100 million
3	50 million
4	10 million
5	1 million

credit customer and pass on credit information to financial institutions for lending decision. This system will help financial institutions to differentiate lending rate for customers who have good and bad credit rating. The NCB is currently working with a consulting firm to develop the customer credit data base and evaluation software for ranking customer credit.

The Bank of Thailand's repurchase market is officially closed on February 13th, 2008. Replacing the Bank of Thailand's repurchase or repo market, the private sector's repo market has started its operation but the amount of transaction is still very small. Without the BOT repo market, financial institutions have to improve its liquidity management. A financial institution which has extra cash-flow or large short term fund will be no longer deposit and get interest payments from the BOT repo market. Similarly, a financial institution which has a cash-flow shortage can no longer borrow from the BOT repo market. These will help strengthen the financial institutions short-term liquidity management. The BOT can, however, continue to intervene in the money market through 14 primary dealers in bilateral repo transactions. These 14 primary dealers will be acting as middlemen between the BOT and other financial institutions.

The Master Plan for Grass-root Financial Services (2008-2011) was approved by the Cabinet on December 18th, 2007. The Plan aims to legalize and promote financial services for the grass-root people in the local communities. This plan includes the development of informal microfinance institutions like savings groups or cooperatives in the rural areas. Implementation will be focused on three strategies which are (i) developing human capital and strengthening microfinance institution, (ii) promoting integration between the public sector and other development partners by focusing on improving the rules and regulation to legalize and promote the development of microfinance institutions, and (iii) establishing knowledge network.

The Thailand Securities Depository Co., Ltd. (TSD) has been fully operating the post-trade integration (PTI) system since October 2007 and is now providing foreign investors with dividends in six foreign currencies other than the Thai baht. The six foreign currencies are euros, Hong Kong dollars, pounds sterling, Singapore dollars, US dollars, and yen. The dividend payment in foreign currencies will be available from January 15, 2008 for firms that have completed their book-closing. This system will reduce red-tape, fees, time and the risks associated with foreign exchange rates and missing cheques.

The Prime Minister's regulation on the Public Services of the State-owned Enterprises (SOEs) has been effective since January 26th, 2008. This regulation disaggregates state-owned enterprises' accounts into two: the Public Service Account (PSA) and the Public Service Obligation (PSO). The PSA which reflects the commercial business of SOEs will be separated from the PSO which shows the obligation of SOEs in support of government-directed policy spending and lending. This would ensure greater transparency and accountability he operations of state-owned enterprises, including financial institutions.

Corporate Sector Reforms and Restructuring

The Escrow Account law was enacted on February 20th, 2008 and will be effective in May 2008. The Law will help protect property buyers who are defrauded by the developers from paying down payment and are not compensated if the construction project is not completed as planned. The Law will prevent property developers that do not have proper creditability or secured financial status to channel down-payments made by property buyers to cash flows for developing their projects. According to this Law, the approved financial institutions shall act as the third-person guarantor. The financial institutions will keep deposits or down payments and will return them to the property developers when they fulfill the immovable property purchase agreement. If a developer fails to deliver the promised developed property, the financial institutions will return the down payment plus interest to property buyers. Thus, the Escrow Account Law shall help to guarantee that property buyers will get back what they pay in full amount. However, the law will also increase the cost to developers due to a rising cost of escrow service fee and a requirement that developers should have solid financial status before starting up the project.

3.2 Recent Trade Reforms

Tariff reform

Thailand's import tariff rates are now lower 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. Under the universal tariff reduction, tariffs of many agricultural and manufacturing products were reduced in February 2008 (in addition to a major tariff cut that took place in September last year). Examples include duck feathers, dye, carbon black, carbon papers, and power motor parts. Following various agreements under the ASEAN Free Trade Area (AFTA), Thailand's import tariffs for various products made in ASEAN member countries are also reduced or exempted. Among others, these include wooden products, wheat, textiles, iron and steel products, and aluminium.

Environmental-friendly products and schemes enjoyed lower import tariffs. For example, the government announced in December 2007 that all tools and equipments imported by Department of Industrial Works under Thailand National CFCs Phase-out Plan will be exempted from tariffs. Imported public buses installed with compress natural gas (CNG) also enjoy lower tariffs.

The progress on FTAs in the recent months has been slow. After the Japan-Thailand Economic Partnership Agreement (JTEPA) became effective in November 2007, progress on other FTAs that involve Thailand has been somewhat limited (see Box 3 on the progress of these trade agreements). The negotiations on the ASEAN and India FTA, for example, are now put on hold after India declined ASEAN's final offer in March 2008. On a more positive side, the ASEAN-Japan FTA was signed in late March, and is expected to be effective in the coming months. For bilateral agreements, the delay in the past few months was partly due to the impact of the 2007 Constitution⁵⁷ as well as the transition period during the change in the government.

⁵⁷ There are clauses in the Constitution that mandates that activities such as FTAs negotiations and their terms must be approved by the Parliament.

Export promotion and assistance

The Customs Department has greatly extended the application of paperless customs procedures. The paperless customs or e-Customs aims to speed up customs procedures, enhance the transparency of these processes, and reduce the transaction costs incurred to exporters. The e-Customs framework comprises of two systems: e-Export and e-Import. The e-Export has been effective since July 2007 at Leam Chabang seaport and September 2007 at the Suvarnabhumi airport. It replaced the old Electronic Data Interchange (EDI) system that relies on both electronic data submission and paper documents. In 2008, paperless customs services are now used for both import and export transactions at many customs points (both large and smaller ones) as well as seaports and airports nationwide. In order to fully implement the system by May 2008, the Customs Department will link the database between the Port Authority of Thailand, the Airport of Thailand Plc, and shipping agents. For the next fiscal year, the Customs Department plans to set up the e-Free Zone which will accelerate custom refund to businesses in bonded warehouse and free-trade zones.

The government approved plans to enhance competitiveness of certain export products. First is the export promotion plan for orchid flowers, worth Bt606 million. Led by Ministry of Agriculture and Cooperatives, the plan will consider the re-arrangement of orchid planting areas, encourages technology transfer, and set quality standards of exporting orchids. Draft strategy on hen (2008-2012) was also recently drafted. In addition to enlarging hen exports, the plan also attempts to raise the world markets' confidence on the quality of Thai hens, especially following the bird flu turbulence. Finally, a committee on Halal food products will be set up. This committee will design short and medium-term plan on Halal food products, in which branding, packaging, and quality standards are given top priority.

The Export-Import Bank of Thailand expanded and improved its export insurance services. The EXIM Bank has offered export insurance services since 1996. With this, EXIM Bank guarantees to pay Thai exporters in case of a default by foreign buyers. In February 2008, the Bank introduced EXIM FLEXI, an enhanced export insurance service, which now offers lower premiums, faster implementation process, and higher compensation rate compared to the previous schemes. EXIM Bank now also offers its export insurance scheme to Siam City Bank (SCIB) customers. This service will be extended to customers of other commercial banks in the coming months.

Cooperation between ASEAN and China on sanitary issues of their exports is enhanced. The government agreed on closer cooperation between ASEAN and China on sanitary and phytosanitary standards (SPS) issue. Raising compliance with the WTO, this is expected to facilitate exports of food and agricultural products in the region.

3.3 Public Sector Reform

Five laws which will lead to improved governance, enhanced transparency and reduced avenues for corruption have been delayed. In addition, there is uncertainty as to whether the laws passed by the former government and the National Legislative Assembly (NLA) will come into force. The laws that were delayed include State Enterprise Corporatization Act, Public Debt Management Act, Private Participation in Public Works Act, Public Procurement Royal Decree, and Promoting Good Governance in Public Sector Act. In addition, the Constitutional Court ruled that three approved draft of the organic laws of the 2007 Constitution related to counter corruption will have to be resubmitted because of insufficient quorum at the NLA at the time of their passage.

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, jewelry, 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. Nonetheless, in the March 2008 meeting, India reconsidered the goods list, which could lead to re-negotiation of certain goods.
Thailand - Japan	The JTEPA was signed in April 2007 and has been effective since 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 Box 1 of Thailand Economic Monitor, November 2007 issue for a more detailed discussion).
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). Since then, there has been no major change.
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. In the latest meeting (October-November 2007), ASEAN and China proposed to set up a working group on economic partnership, and exchanged information on non-tariff measures (NTMs) that are being implemented. The second round of services liberalization will be held in July 2008. 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). It also considered trade in services in financial sector, telecommunication sector, and e-commerce. In the latest meeting (December 2007), progress on goods liberalization remained limited, so bilateral negotiations among individual ASEAN member countries, Australia, and New Zealand were recommended. Nonetheless, the negotiations reached certain agreements in the areas of accelerations of tariff commitments, elimination of agricultural export subsidies, and treatment of internal taxation and regulation. Topics such as intellectual property and laws and institutions relating to economic partnership were also discussed.
ASEAN - Korea	The 20th meeting of the TNC in October 2007 reached the agreement on trade in services, while Thailand requested Korea to further liberalize its labor market. In the December 2007 meeting between Korea and Thailand, Thailand agreed to join other ASEAN member countries in the pact. The latest meeting in January 2008 saw no major progress on trade, while that of services liberalization is also limited. Among others, topics that need further discussions include automatic MFN as well as protection and coverage of foreign investments.
ASEAN - India	The agreement on trade in goods between ASEAN and India had been ongoing since 2003. As of March 2008, ASEAN and India agreed to put the trade negotiations on hold after India declined the final offer by ASEAN. As benefits to ASEAN countries are constrained by India's rule of origins, it was recommended that rules and regulations that facilitate international trade among these countries should be first relaxed.
ASEAN - Japan	The free trade agreement between ASEAN and Japan was signed in 28 March 2008. Japan will eliminate import tariffs that worth 93 percent of imports from ASEAN within 10 years. The six ASEAN foundation members will also cancel tariffs on 90 percent of imports from Japan within 10 years. This is expected that the accord will become effective in the next few months.

Agreements	Details of Progress Until October 2007
ASEAN - EU	The initiative to start the partnership began in May 2007. In the March 2008 meeting, the EU requested that negotiations should include topics such as sustainable development, environmental conservation, labor standards, sanitary, domestic competition laws, public sector procurement, and intellectual property. These are in addition to liberalization in goods trade, services, and investment.

Source: Department of Trade Negotiations

Note: The members of the BIMSTEC are Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand. Since November 2007, trade agreements between Thailand and Bahrain, Peru, United States and the EU exhibited no significant progress.

They are the draft of organic laws on Ombudsman, National Counter Corruption, and National Audit must be resubmitted for approval.

The eleven common levels (C1 to C11) in the civil service structure will be abolished by October 2008. After the Civil Servants Act (2008) was effective on January 26, 2008, the Office of Civil Service Commission (OCSC) has been organizing “caravan road shows” to inform civil servants in every province about the changes in the Civil Servant Act. The OCSC is also working with 19 Ministries to set up the “Human Capital Change Management Center” in each ministry aiming to answer any questions or problems with regard to the new Act and to work on a transition into the new position and salary structure (see Box 4 : Changes under the New Civil Servants Act). The OCSC expects that the new structure will be fully implemented by October 2008 from which all civil servants who are currently classified into the 11 common levels (C-levels) will be transferred into the new structure.

The FY2009 provincial administration budget and the provincial cluster administration budgets were approved by the Cabinet. According to the amendment of the Rules for Administration of the Kingdom Act no.7 (2007), the Cabinet has approved the provincial administration budget and the provincial cluster administration budget for FY 2009. The Act has been effective from September 2007. To allow greater autonomy for administration at the provincial level, under this Act, the provincial administration offices can bypass the line ministries and directly request their budget through the Bureau of the Budget and the Cabinet.

The updated Decentralization Plan aims to increase decentralization and to improve capacity of Provincial Administration Office. The Decentralization (i) increase decentralization and allow Provincial Administration Organizations (PAOs) to have more freedom in policy decision, human capital and fiscal management, (ii) promote public participation in monitoring the PAO’s works, (iii) transfer functions in six areas similar to the previous plan, but the readiness and capacity of each PAO will be taken into account and the central government will monitor every three months the quality of services provided by the PAO, (iv) adjust the revenue structure and improve fiscal management in the PAOs, (v) transfer personnel with functions (especially complicated functions) which require specialized personnel (however, the transferred officials who are currently working in complicated functions will retain the same level of welfare and benefits), and (vi) require every ministry to amend any law which conflicts with this Decentralization Plan.

Sub-district councils will be legalized. On February 8th, 2008, the Sub-District Council Act was announced in the Royal Gazette. This Act legalizes the sub-district councils which comprise of community representatives and

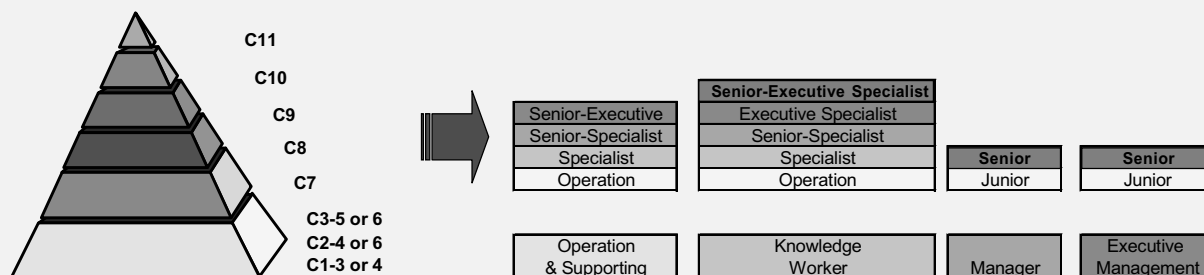
mandates that they receive budget support from respective provincial administration offices. The objective of the Act is to empower the councils to play a more active role in voicing community needs and conducting community activities, which will strengthen community development and community networks with other sub-districts.

On February 26, 2008, the Cabinet has approved the set up the Office of the Government Counter Corruption Commission. The Cabinet has approved the proposal from the Ministry of Justice to set up the Government Counter Corruption Commission (GCCC), a new oversight institution under the 2007 Constitution. After the GCCC is established, counter corruption tasks shall be divided between the GCCC and the existing National Counter Corruption Commission (NCCC). The GCCC shall be responsible for corruption charges against junior to mid management civil servants (civil servants who have C-level below C9), while the NCCC shall be responsible for corruption charges against senior civil servants (higher than C9), politicians, judges, and prosecutors.

Box 4. Changes under the new Civil Servants Act

The amendment of the 1992 Civil Servants Acts was effective on January 26th, 2008. The new Civil Servants Act (2008) aims to improve human resources management and development in the public sector. The details of the proposed amendments and their significance are summarized below.

- **By October 2008, abolish 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.



- **Decentralize 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.
- **Improve human resources management through adjusting the recruitment and employment process.** The amendment also emphasizes the creation of incentive schemes that promote the quality of works and civil servants.
- **Allow people outside the public sector to apply for positions in the government.** Under the pre-amended law, only civil servants can apply for a position in the public sector. The new law allows people from outside public sector to apply for a civil servant position.
- **Transfer functions of promoting and sustaining moral and ethics among civil servants from the OCSC to a new agency called the Moral and Ethics Committee which will be set up under the amended Act.**

Source: Thailand Economic Monitor (November 2007)

Appendix 1: Key Economic Indicators

	2006	2007	2007	2007	2007	2007	2007	2008	2008
	Year	Year	Q1	Q2	Q 3	Q4	Dec	Jan	Feb
Output, Employment and Prices									
GDP (% change, previous year)	5.1	4.8	4.2	4.3	4.8	5.7	..	..	..
Industrial production index (2000=100)	167.0	180.7	177.0	172.0	181.9	191.8	193.5	192.3	..
(% change, previous year)	7.4	8.2	6.0	5.5	8.9	12.1	11.6	12.5	..
Unemployment rate (%)	1.5	1.4	1.6	1.6	1.2	1.1	0.8	..	..
Real wage growth (%) 1/	1.6	1.0	-1.3	-0.5	2.8	1.9	..	..	..
Consumer price index (% change, previous year)	4.7	2.3	2.4	1.9	1.6	2.9	3.2	4.3	5.4
Public Sector									
Government balance (% GDP) 2/	1.1	-1.7	-6.1	2.2	0.7	-3.3	..	..	..
Domestic public sector debt (% GDP, end-period) 3/	40.4	37.5	38.6	39.0	38.3	34.6	..	..	..
Foreign Trade, BOP and External Debt									
Trade balance (US\$ million)	994	11,973	3,318	1,240	2,942	4,473	1,069	170	..
Exports of goods (fob, US\$ million)	127,941	151,147	34,180	35,916	38,790	42,262	13,174	13,843	..
(% change, previous year)	17.0	18.1	17.9	18.0	12.6	24.0	19.5	33.6	..
Key exports: Machinery & mach. appliances (% chg in US\$)	25.2	16.4	9.7	11.6	18.3	24.1	14.7	41.7	..
Imports of goods (cif, US\$ million)	126,947	139,174	30,862	34,676	35,847	37,789	12,106	13,673	..
(% change, previous year)	7.9	9.6	5.9	7.3	8.4	16.6	10.6	40.1	..
Current account balance (US\$ million)	2,174	14,923	4,689	1,121	2,928	6,184	1,661	1,396	..
(% GDP)	1.1	6.1	8.0	1.9	4.8	9.1	..	..	..
Foreign direct investment, net (US\$ million) 4/	10,031	8,120	2,579	1,601	1,960	1,979	619	..	..

	2006	2007	2007	2007	2007	2007	2007	2008	2008
	Year	Year	Q1	Q2	Q 3	Q4	Dec	Jan	Feb
Total external debt (US\$ million) 5/	59,643	61,486	59,832	59,030	60,560	61,486	..	..	..
(% GDP)	32.8	29.3	31.9	30.4	30.1	29.3	..	..	..
Short-term debt (US\$ million) 5/	18,554	21,838	19,766	20,453	21,389	21,838	..	..	..
Debt service ratio (% exports of goods and services) 6/	11.3	11.1	18.0	11.1	7.5	8.5	..	..	..
Reserves, including gold (US\$ million)	66,985	87,455	70,863	73,000	80,687	87,455	87,455	92,769	100,539
(months of imports of goods)	6.3	7.5	6.1	6.3	7.0	7.5	7.5	6.8	..
Financial Markets									
Domestic credit (% change, previous year) 6/	3.4	5.2	2.2	2.5	3.5	5.2	..	..	..
Short-term interest rate (average period) 7/	4.64	3.77	4.69	3.84	3.30	3.25	3.20	3.16	3.18
Exchange rate (average period)	37.9	34.5	35.6	34.7	34.1	33.9	33.7	33.2	32.6
Real effective exchange rate (2000=100, +=appn) 8/	105.2	112.2	111.0	113.3	113.1	111.3	112.0	..	..
(% change, previous year)	8.9	6.6	8.6	8.5	7.4	2.2	1.6	..	..
Stock market index (SET)	680	858	674	777	846	858	784	858	846
Memo: Nominal GDP (million Baht)	7,830,329	8,485,200	2,082,688	2,030,992	2,073,728	2,297,791	..	..	..
Memo: Nominal GDP (million USD)	206,449	245,495	58,522	58,545	60,891	67,743	..	..	..

e = estimate

p = projection

1/ Average wage of employed person from Labour force survey, National Statistical Office deflated by CPI inflation

2/ Cash balance of central government.

3/ Include domestic central government (CG) debt, domestic debt of non-financial state enterprise and Financial Institution Development Fund (FIDF) debt. Series was revised by adding VF & EFPO, no data before 2005 is available

4/ Non-Bank FDI

5/ Source: Bank of Thailand

6/ Loans of commercial banks

7/ One-day repurchase rate

8/ Source: World Bank's estimates

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. Public Sector and Governance Reform
5. Social Protection

1. Poverty Reduction Diagnostics*

Objective	Reform Measures Taken
<p>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>	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ Tax relief packages have been introduced on May 4th, 2008 which could help reduce some tax burden on the poor. Following the new government’s announcement of its policy statement on February 18th, 2008 which includes many policies to help the poor and the grass root communities, the Cabinet on March 4th, 2007 approved a tax relief package to stimulate economy. Some of the tax relief packages that have direct impact on low-income people includes (i) increasing personal income tax waiver from Bt100,000 to Bt150,000 and (ii) granting personal income tax allowance for taxpayers who is a caretaker of handicapped or disabled parents or children in the amount of Bt30,000 per handicapped or disabled person. ▪ The Government has announced programs to generate greater income and access to loans to low-income groups on April 1st, 2008. The package includes (1) a grant transfer to the villages and communities amounting to roughly Bt20 billion (0.2 percent of GDP) per year this year and next, (2) a 2-year debt moratorium of loans to farmers worth around Bt18 billion, (3) small loans and mortgages to lower-income individuals and retired government officials amounting to Bt5 billion and Bt50 billion, respectively, (4) loans to farmers by the Bank for Agriculture and Agricultural Cooperatives (BAAC) targeted at a total of Bt325 billion in 2008, and (5) additional funds from the Government Savings Bank and BAAC for the Village and Urban Community Fund for on-lending to villages and urban communities in the amount of Bt27.8 billion.

*Prepared by Kirida Bhaopichitr

2. Financial and Corporate Sector Reform

Objective	Reform Measures Taken
<p>A. Enable sharing of credit information among financial institutions</p>	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ The amendment of the 2002 Credit Data Business Operation Act was enacted and was effective on February 14, 2008. The Credit Business Operation Act no.3, 2008 which is the amendment of the 2002 Act allows the National Credit Bureau (NCB) to develop customer's credit ranking. The NCB is currently working with a consulting firm to develop the customer credit data base and evaluation software for ranking customer's credit <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The decision on whether insurance companies are required to report their information of customers, who could not afford to pay their premiums and have received automatic lending from an insurance company to the National Credit Bureau (NCB) have not yet been made.
<p>B. Formulate and implement a medium-term strategy for Thai financial sector</p>	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ Commercial banks had conducted stress tests in February 2008. The stress test is an international standard risk management tool used by financial institutions. The test aims to help the financial institutions prepare for a worst case scenario. Even though, there is a very small chance that this scenario can happen, this worst scenario can generate huge damages to the banking system and the economy. Some of the large banks in Thailand have already used this stress test, but the test systems are not the same across all banks. The BOT expects to conduct a stress test once a year, and it expects to have the first test result which was conducted in February this year within this June. ▪ To promote the development of the domestic debt instrument market, the Ministry of Finance has approved eight international financial institutions to issue bonds or debt instruments in Thai currency in the total amount of Bt48,900 million within June 30th, 2008. The ten financial institutions include Central American Bank for Economic Integration (CABEI), Deutsche Bank (DB), International Bank for Reconstruction and Development (IBRD), Japan Bank for International Cooperation (JBIC), Kommunalbanken Norway (KBN), KfW Development Bank, Nordic Investment Bank (NIB), and Swedish Export Credit Corp (SEK). ▪ The Master Plan for Grass-Root Financial Services (2008-2011) was approved by the Cabinet on December 18, 2007. The plan aims to promote financial services for the grass-root people in the local communities. This plan includes the development of informal microfinance institutions like savings groups or cooperatives in the rural areas. Implementation will be focused on three strategies which are (i) developing human capital and strengthening microfinance institution, (ii) promoting integration between the public sector and other development partners by focusing on improving the rules and regulation to legalize and promote the development of microfinance institutions, and (iii) establishing knowledge network. <p><i>Measure 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 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.

Objective	Reform Measures Taken
	<p><i>Measure to be taken, but delayed</i></p> <ul style="list-style-type: none"> ▪ The Financial and Fiscal Master Plan for the Better Society, 2008- 2011, which was expected to be submitted to the Cabinet at the end of 2007, is delayed. 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. Transition from the current blanket government guarantee on deposits to a limited deposit insurance scheme	<p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Institute of Deposit Protection Act, 2008 has been enacted and will be effective on August 11th, 2008. According to this Act, an Institute of Deposit Protection will be established. Within five years after the Act comes into force, depositors shall receive the accumulated amount of deposit protection of not exceeding Bt 1 million per person per financial institution. All member banks and financial institutions will be required to transfer 0.4 percent of the average value of their deposit accounts to the Deposit Protection Fund. The new system is expected to help improve the efficiency and transparency of the banking system because banks will need to obtain higher credit rating to gain trust from depositors. In addition, the Basel II which is expected to be enforced in the middle of next year will also force banks to disclose information on capital and risk-management which will provide banks' financial status information to depositors. The new Act will also encourage people to diversify their investment portfolio when deposits will no longer be fully guaranteed.
D. Remove legal impediments and provide an enabling environment for derivative products.	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ The Derivatives Act was amended to reflect the revised Securities and Exchange Act. Under the amended Derivatives Act no.2, 2008, the capital market commission established under the revised Securities and Exchange Act will be the regulator of the derivatives markets, while the Securities and Exchange Commission will be responsible for policy framework. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Thailand Futures Exchange (PCL) or TFEX is planning to increase its member and to start trading stock options in order to double the total turn over of derivatives trading to 10,000 contracts per day (currently, the average daily turnover is 5,172 contracts). In the 2008 TFEX business plan, it will accept new members into the market in March and will start trading stock options which are the option contracts for equities which are linked to an individual listed stock. Currently the TFEX is examining the equities which will be used as a reference for the stock options. It is expected to finalize its decision within the first quarter of 2008.
E. 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"> ▪ Following the Office of the Insurance Regulation and Promotion Commission Act which is effective in September 2007, the amendment of Life-Insurance Act and the Non-Life Insurance Act were enacted and was effective on February 2nd, 2008 and February 5th, 2008 consecutively.

Objective	Reform Measures Taken
	<ul style="list-style-type: none"> ▪ The amendment of the Bank of Thailand Act was effective in March 2008. The new Act clarifies the roles and authorities of the BOT, the BOT's governor selection process and terms, the structure of the three policy committees on monetary policy, the financial institution policy, and payment system policy. ▪ The amendment of the Securities and Exchange Act was enacted and was effective on March 5th, 2008. The new Act will restructure capital market's regulatory agency and the Securities and Exchange Commission; establishing the new capital market committees to oversee regulations, while the SEC oversee the policy formulation. ▪ The Trust for Transaction in Capital Market Act was effective on January 15th, 2008. Under this Act, unit trusts, trustees and trust funds shall be established. Setting up trust funds will help reduce default risk and attract new investors who are interested in investing in the capital market. ▪ The BOT repo market is officially closed on February 13th, 2008. Replacing the BOT repo market, the private sector repo market has started its operation, but the amount of transaction remains very limited. Without the BOT repo market, financial institutions have to improve their short-term fund (liquidity management /cash flow management). The BOT can, however, continue to intervene in the money market through 14 primary dealers in bilateral repo transactions. These 14 primary dealers will be acting as middlemen between the BOT and other financial institutions. ▪ The Securities Exchange of Thailand (SET) has revised the criteria and the securities lists which will form the basis for calculating the SET50 and SET100 indices for the first half of 2008 (Jan. 1 - Jun. 30, 2008). The list of stocks and shares in the SET50 Index and SET100 Index are revised and will be used starting from January 1st, 2008. In addition, from December 14th,2007 onwards, the SET also revised the selection criteria for computation of SET50 Index and SET100 Index to include a merge between a SET 50 (or SET100) firm with another firm to ensure that the SET50 and SET100 lists accurately reflect market movements. According to the revised calculations, SET allows for two types of mergers (i) a merger to become a new entity and listed and (ii) a merger into one existing entity. For a merger that becomes a new entity, if the new entity's free-float meets the requirement of no less than 20 percent, its securities will be included in the SET50 (or SET100) index calculation and, once the new entity's securities start trading, will replace the merged securities. For a merger into one existing entity, if the existing entity's free- float meets the requirement of no less than 20 percent, its securities will still be included in the SET50 (or SET100) index calculation. If the mergers resulted in an insufficient number of SET50 (or SET100) securities, a replacement will be selected to complete the lists and SET will announce the date of any constituent adjustments before they come into effect. ▪ The Thailand Securities Depository Co., Ltd. (TSD) has been fully operating the post-trade integration (PTI) system since October 2007 and is now providing foreign investors with the opportunity of receiving dividends in six foreign currencies other than Thai baht. The six foreign currencies are euros, Hong Kong dollars, pounds sterling, Singapore dollars, US dollars and yen. The dividend payment in foreign currencies have been available from January 15th, 2008 for firms that have completed their book-closing. The system will reduce red-tape, fees, time and the risks associated with foreign exchange rates and missing cheques. ▪ The Securities and Exchange Commission is now working on the rules and regulation for High Risk Fixed Income Fund, after the closing of public hearing on a plan to set the High Risk Fixed Income Fund for investors who are interested in debt-instruments with non-investment grade or below BBB grade.

Objective	Reform Measures Taken
	<p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Financial Institution Business Act was enacted on February 5, 2008 and will be effective in August 2008. Under this new Act, the definition of financial institutions will be extended to include commercial banks and the finance, securities and credit foncier businesses. The BOT will be authorized under this act to regulate all financial institutions. The BOT will have authority to relax the restriction on foreign ownership shares and the number of foreign directors in a commercial bank. ▪ To meet the international standard set by the International Organization of Securities Commission (IOSCO), the Thailand Securities Depository Co. Ltd. (TSD) will transfer its clearing and settlement unit to a subsidiary, the Thailand Clearing House Co., Ltd. (TCH). The clearing and settlement will be integrated into one clearing house for a variety of financial instruments. This initiative, to be completed in 2009, will reduce operational costs and make risk management measures more efficient. Before transferring to an integrated clearing house, the TSD is currently working on increasing its capital base and settlement fund, restructuring membership fees as well as its designing organizational structure, which should be in line with The Stock Exchange of Thailand. In addition, the TSD will also provide additional services to listed companies in 2008, including e-registration, e-voting and e-proxy voting. These facilities will promote better corporate governance by enhancing the accuracy and transparency of annual general meetings.
F. 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 Prime Minister's regulation on the Public Services of the State-owned Enterprises (SOEs) was effective on January 26th, 2008. This regulation disaggregates State-owned Enterprises (SOEs) account into two accounts: the Public Service Account (PSA) and Public Service Obligation (PSO). The PSA which reflects the commercial business of SOEs will be separated from the PSO, which shows the obligation of SOEs to support the government's economic and social policy. This would ensure greater transparency and accountability in the operations of state-owned enterprises, including financial institutions.
G. Enable Corporate Sector restructuring through out-of-court mediation, streamline the legal execution process for old foreclosed properties, and reduce the fees on the sale of foreclosed assets	<p><i>Measure over the last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ Even though the Federation of Accounting Profession has not yet announced the effective date of the Accounting Standard (IAS 39), which requires firm to calculate all financial items from cash flow based on fair value, the Bank of Thailand has requested commercial banks to comply with IAS 39 standard since 2007. The new accounting standard will allow firms' balance sheets to better reflect the cash flow and increase the use of fair value as the base for its calculation. The new standard also includes clearer guidelines on deferred income tax, employee benefits, government grants, and intangible assets. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Escrow Account Law was enacted on February 20th, 2008 and will be effective in May 2008. The Law will help protect property buyers by preventing property developers that do not have proper creditability or secured financial status to channel down-payments made by property buyers to cash flows for developing their projects. According to this Law, approved financial institutions shall act as the third-person guarantor. If a developer fails to deliver the promised developed property, the financial institutions will return down payment plus interest to property buyers.

3. Reforms to Improve Business, Investment Environment and Trade Regimes

Objective	Reform Measures Taken
<p>A. Improve competitiveness of business sector</p>	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ The government approved the plan to strengthen national industrial standards. This includes (i) speeding up the process of Thai Industrial Standards Institute (TISI) in giving Inspection Body (BI) status to certified laboratory centres, which would allow them to perform the same functions as TISI; (ii) encouraging TISI to extend the coverage of its industrial standards requirements; (iii) limiting the validity of permits for manufacturers and importers; and (iv) setting up National Standards Committee as an independent agency that will design, implement, and oversee policies and regulations on industrial standards. ▪ Proposals to reform national research system were agreed by the Cabinet. Proposed by National Research Council of Thailand (NRCT), the plans will (i) introduce the National Research Project Management (NRPM) used to manage government research budgets; (ii) strengthen the cooperation between NRCT and other public research funds to deliver research projects that correspond to national agendas; (iii) adopt Dominant Player Model, where only one public research agency coordinates research efforts by other state agencies to minimise overlapping work; and (iv) shift the role of public research units from conducting research themselves to facilitating research done by other parties. ▪ The Cabinet approved the participation of Thailand in the ASEAN-US agreement of science and technology (S&E) cooperation. The draft agreement seeks to (i) enhance S&E capabilities of ASEAN member countries, (ii) strengthen the connections among S&E associations in ASEAN and the US, and (iii) support the partnerships among private and public research institutes and manufacturing industries. ▪ SMEs Promotion plan was approved. This plan (2007-2011), proposed by Ministry of Industry, aims to move Thai small and medium-sized enterprises (SMEs) toward knowledge-based and knowledge skills-based business operations. The coming operational plan will complement other existing efforts that seek to support SMEs, such as Intellectual Infrastructure Master Plan and National Science, Technology and Innovation Act. ▪ The Cabinet approved 15-year tertiary education framework (2008-2022). The emphasis is on building knowledge and innovation to enhance national competitiveness. Basic research, energy conservation, and environmental preservation are among the priorities. ▪ The Cabinet passed a strategy to develop Thailand’s robotic technology and automation system. The objectives are to build a stock of capable human resources, transfer developed knowledge and technology, and translate these developments into industrial products. The implementation period is 5 years, and will be managed by National Science and Technology Development Agency (NSTDA). ▪ The government approved plans to improve the competitiveness of downstream iron and organic agricultural production. The government, through NESDB, launched a promotion plan for local downstream iron production. This will provide primary iron products used in upstream industries. At this initial stage, studies on appropriate location, infrastructure system, and environmental impact management will be conducted. A strategy plan on the national development of organic agriculture (2008-2011) was also drafted. This, among others, aims to raise the competitiveness of Thai organic agricultural export products. The plan emphasised more innovation and better marketing management. ▪ The Cabinet approved the draft Act on the safety of modern biotechnology. Proposed by Ministry of Natural Resources and Environment, this Act will particularly focus on the safety application of genetically modified organism (GMO) to food items. This should boost the confidence of Thai food export products.

Objective	Reform Measures Taken
	<ul style="list-style-type: none"> ▪ The National Industrial Productivity Master Plan has been implemented. The Plan is aimed at improving national and firm level productivity at the industry level. In FY2008, projects under the Plan were allocated Bt567 million. They are focused on developing human resource and raising firms' knowledge and productivity. <p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Cabinet agreed in principle the direction towards knowledge-based development strategy. The step forward could either be establishing the Board of Knowledge Investment (BOKI) or broadening the functions of the current Board of Investment (BOI) to include knowledge-based investment projects. ▪ The Board of Investment (BOI) will formulate a Competitiveness and Investment Fund. As part of the campaign "Thailand: Investment Year 2008-2009", a fund will be set up to (i) promote the acquisition of more modern production machineries and information technology system; (ii) encourage research and development and labour trainings in the manufacturing industries; and (iii) facilitate investments by Thai investors in targeted countries. ▪ Excellence centre in Physics will be established. The centre seeks to (i) create a pool of capable physicists who will conduct advanced physics-related research and technology, and (ii) improve the teaching of physics subject at the university level. The implementation period is 2008-2012.
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"> ▪ A committee on legal reform was set up. This committee will study and then propose new laws and/or desirable changes in the current laws. It will also draft laws that will enable the introduction of a new agency responsible for future legal reform.
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 government will set up pilot science-based technology schools. This project, proposed by Ministry of Education and Ministry of Science and Technology, will introduce schools for talented pupils in the fields of innovation and technological development. These schools will offer three subject branches on industry, food science, and commerce and services. The implementation period is 2008-2012. ▪ The Cabinet approved Thailand's re-participation in the Colombo Plan Staff College for Technician Education (CPSC). As proposed by Ministry of Education, Thailand's re-joining in the Colombo plan is expected to enhance local academic strength of technical and vocational education.
D. Reduce trade barriers to improve Thailand's competitiveness 1/	<p><i>Measure taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ Tariffs of many agricultural and manufacturing products were cut in February 2008. Examples include duck feathers, dye, carbon black, carbon papers, and power motor parts. Under the ASEAN Free Trade Area (AFTA), import tariffs for various products made in ASEAN member countries are also reduced or exempted. Among others, these include wooden products, wheat, textiles, iron and steel products, and aluminum. Environmental-friendly products and schemes also enjoyed lower import tariffs. For example, all tools and equipments imported by Department of Industrial Works under Thailand National CFCs Phase-out Plan will be exempted from tariffs. Imported public buses installed with compress natural gas (CNG) also enjoy lower tariffs.

Objective		Reform Measures Taken
		<p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Custom Department is planning to fully implement e-Customs by May 2008. The paperless customs or e-Customs aims to speed up customs procedures, enhance the transparency of these processes, and reduce the transaction costs incurred to exporters. The e-Customs framework comprises of two systems: e-Export and e-Import. The e-Customs which comprises of two systems, e-Export and e-Import, will replace the current Electronic Data Interchange (EDI) system. The e-Export has been effective since July 2007 at Leam Chabang seaport and September 2007 at the Suvarnabhumi airport. The full implementation of e-Customs is expected in May 2008. For the next fiscal year, the Customs Department also plans to set up the E-free zone which will help accelerate custom refund to businesses in bonded warehouse and free-trade zones.
E.	Promote Thai exports to new markets 2/	<p><i>Measures taken over last 6 months and significance</i></p> <ul style="list-style-type: none"> ▪ The bilateral free trade agreements between Thailand and other countries have seen limited progress. After the Japan-Thailand Economic Partnership Agreement (JTEPA) became effective in November 2007, other bilateral pacts have progressed slowly. In addition to agreements between Thailand and Bahrain, Peru, the US, and the EU, which experienced no major progress last year, the negotiations with India are also delayed recently. ▪ Trade agreements between ASEAN and other countries made some progress. This is especially the ASEAN-Japan accord, which was signed in late March 2008, and will lead a significant share of products that enjoy lower import tariff rates. Other ASEAN pacts that exhibited certain progress are with China, Australia and New Zealand, and Korea. In contrast, ASEAN-India negotiations are put on hold due to disagreements on benefits that were offered.

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

2/ See Box 3 for more details

4. Public Sector and Governance Reform^{58*}

Objective	Reform Measures Taken
<p>A. Improving public service quality by streamlining and redesigning work processes and procedures</p>	<p><i>Measure taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ OPDC is planning to expand a Change Management program using PMQA standard to other government agencies. After piloting the Change Management program in the Department of Internal Trade (DIT), the DIT has adapted the APEC framework which has 4 steps: Awareness, Passion, Education, and Competency. In the pilot program, the DIT had set up Change Targets and Change Agents which are working together. The Change Targets shall be later evaluated to find “the change in performance” by himself, his colleagues and his supervisors. Five key performance indicators which will be evaluated on each Change Targets are achievement motivation, service mind, expertise, integrity and teamwork. Key lesson learned from this pilot program are (i) time and human capital are the most important factor for success. (ii) emotional leadership and positive thinking to accept the changes are significant (iii) leaders should take a leading role in pushing forward Change Management.
<p>B. Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels</p>	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The 2008 Civil Servants Act (Amendment of 1992 Civil Servant Act) was effective on January 26th, 2008. The Act mandates the following: (a) 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, (b) 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, (c) improving human resources management through adjusting recruitment and employment process, (d) opening positions to people outside the 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. After the enactment of the Act, the Office of Civil Service Commission (OCSC) has been organizing “caravan road shows” to inform civil servants in every province about the changes in the Civil Servant Act. The OCSC is also working with 19 Ministries to set up the “Human Capital Change Management Center” in each ministry aiming to answer any questions or problems with regard to the new Act and to work on a transition into the new position and salary structure ▪ According to the Amendment of the Rules for Administration of the Kingdom Act no.7 (2007), the Cabinet has approved the provincial administration budget and the provincial cluster administration budget for FY 2009. The amendment act was effective in September 2007. This is the first time in history that each provincial government office can bypass a ministry and directly request a budget through the Bureau of the Budget and the Cabinet. ▪ The Decentralization Plan no.2 (2008) was announced in the Royal Gazette on February 26th, 2008. This plan identified decentralization strategies, targets, and scope of decentralization works until FY 2010. The Plan will (i) increase decentralization and allow Provincial Administration Organizations (PAOs) to have more freedom in policy decision, human capital and fiscal management, (ii) promote public participation in monitoring the PAO’s works, (iii) transfer functions in six areas similar to the previous plan, but the readiness and capacity of each PAO will be taken into account and the central government will monitor every three months the quality of services provided by the PAO, (iv) adjust the revenue structure and improve fiscal management in the PAOs, (v) transfer personnel with functions (especially

⁵⁸ 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.

Objective	Reform Measures Taken
	<p>complicated functions) which require specialized personnel (however, the transferred officials who are currently working in complicated functions will retain the same level of welfare and benefits), and (vi) require every ministry to amend any law which conflicts with this Decentralization Plan..</p>
<p>C. Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation.</p>	<p><i>Measure taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Energy Operation Act was effective on December 11th, 2007. The Act will provide long-term energy sufficiency to Thailand and promote competition amongst energy operators. The National Energy Committee will have the authority to grant energy operation license, and to set up energy pricing regulation. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ 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. ▪ The government will set up a central government email system which is expected to be tested in July-September this year. To protect the confidentiality of the government's information, the Cabinet agreed on December 18th, 2007 to stop within one year civil servants from using free-email services (e.g. Hotmail, Yahoo, and Gmail) for government work. The Office of the Public Sector Development Commission (OPDC) is currently developing a secure central government email system and expected to launch its test in July-September 2008.
<p>D. 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"> ▪ On February 8, 2008, the Sub-District Council Act was announced in the Royal Gazette. This Act legalizes the sub-district councils which comprise of communities representatives and mandates that they receive budget support from respective provincial administration offices. The objective of the Act is to empower the councils to play a more active role in voicing community needs and conducting community activities, which will strengthen community development and community networks with other sub-districts. ▪ On February 26th, 2008, the Cabinet approved the establishment of the Office of the Government Counter Corruption Commission. The GCCC shall responsible for corruption charges against junior to mid management civil servants (civil servants who have C-level below C9), while the NCCC shall be responsible for corruption charges against senior civil servants (higher than C9), politicians, judges, and prosecutors.

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5. Social Protection

Objective	Reform Measures Taken
<p>A. Develop social insurance mechanisms for the elderly and those affected by unemployment, work-related injuries or other shocks to income.</p>	<p><i>Measure to be taken in the next 6-12 months and their significance</i></p> <ul style="list-style-type: none"> ▪ There has been no significant change in this area during the past 6 months due to the change in the government. However, it is expected that progress will be made on the draft new Social Security Act, which was approved by the Cabinet on July 10, 2007. The draft Act includes amendments of the previous Acts, making it appropriate and responsive to the 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.
<p>B. Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement.</p>	<p><i>Measures taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Cabinet, on October 9th, 2007, approved the draft work permit arrangements for migrant workers from Myanmar, Laos, and Cambodia. Following up from the Arrangement of migrant labor system for 2007, proposed by the Ministry of Labor and in accordance with the resolution of Administrative Committee on Illegal Migrant Labors, this new Act will allow the Immigration Office to grant work permits to 10,000 migrant workers whose citizenships are those of Myanmar, 10,000 migrant workers whose citizenships are those of Laos, and 10,000 migrant workers whose citizenships are those of Cambodia. ▪ The Cabinet, on March 20th, 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.
<p>C. Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support</p>	<p><i>Measures taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Cabinet, on November 27th, 2007, approved the increase of the minimum wage rates for 2008 as proposed by the Ministry of Labor, and has been effective as of January 1, 2008. The minimum wage primary rate is set up at Bt144 per day. The minimum wage in Bangkok area, Nakhon Pathom, Nonthaburi, Samut Prakarn, and Samut Sakorn is set at 190 baht per day. ▪ The Cabinet, on January 15th, 2008, approved Prime Minister's Office Regulation on the Circulating Fund to provide loans to farmers and poor population. According to the Regulation, the scope of "Lenders" will not be limited to commercial banks but will be broadened to include specialized banks, i.e. Bank for Agriculture and Agricultural Cooperatives, Government Housing Bank, Government Savings Bank, and SME Bank. ▪ The Cabinet, on January 15th, 2008, endorsed the goals of minimum standards in public service to be implemented by local administrative organizations. The minimum standards will be used to support and promote the service of local administrative organizations in the following areas (1) infrastructure (2) promotion of quality of life (3) social organization (4) planning for promotion of investment, commerce, and tourism (5) natural resources conservation management (6) art, culture and religion. ▪ The Cabinet, on January 15th, 2008, approved the Master Plan for prevention of and victim relief from Tsunami Disaster. This Master Plan will be utilized as a framework and direction in aiding victims of Tsunami 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, on January 22nd, 2008, endorsed Draft Master Plan on Solving Problems of Poor and Slum Areas. The Act will assist people living in poor and slum areas in Thailand by offering legal support, accommodation support, and infrastructure support. Soft loans will also be offered to this group of underprivileged population to support the cost of housing. ▪ The Cabinet, on March 4th 2008, approved a new tax measure to stimulate and revive the economy. The new tax measure is expected to increase incomes for low income groups. Annual income of a tax payer that is exempted from personal income tax has been increased from Bt100,000 to 150,000. The Government also offers income tax allowance to those who care for spouses, parents, children who are handicapped or disabled in the amount of Bt30,000 per handicapped or disabled person.