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## Executive Summary

Since the publication of the last Economic Monitor in June 2000, the level of global and domestic uncertainty facing Thailand has increased, suggesting a mixed outlook on social and economic developments.

Recent government data show that poverty increased significantly during the crisis, with nearly 3 million additional people falling below the poverty line according to the 1999 household survey. Although economic recovery is on track, it remains fragile. Downside risks to growth have increased as a result of the increase in oil prices and softening global growth. Progress has been made in financial and corporate sector restructuring (e.g., the headline NPL figures have fallen from a peak of 48% in May 1999 to 22% in October 2000, including transfers to AMCs), but key challenges remain. A slowdown in growth could force many banks to raise additional capital next year. A stronger foundation for medium term growth has been established with the passage of the new Education Act, Competition Law, SOE Corporatization Act, and reforms in the trade regime. The key to success is in stronger implementation. Thailand has made substantial progress with its governance reform program, although its implementation has been uneven in some areas.

The forthcoming national elections have created some uncertainty on future policy directions. The current Monitor assesses the quality of social and economic developments in Thailand against the backdrop of increased uncertainty. This perspective is used to assess the structural basis for sustained medium-term poverty reduction, competitiveness, and governance.<sup>1</sup>

**Strengthening Social Policy.** According to the 1999 household survey, the share of poor increased from 11.4% of population in 1996 (6.8 million) to close to 16% in 1999 (9.8 million). Since 1999, the economic recovery--witnessed by the gains in real wages, and job creation (more than half a million new jobs were created in May 2000)--has reduced the likelihood of deep and lasting reduction in living standards. Long-term social gains are intact. Thailand's achievements in the fight against poverty have been remarkable with nearly one million individuals lifted out of poverty every year between 1988 and 1996.

Looking forward, important challenges remain in terms of reducing poverty and inequality. The empowerment of local communities, in line with the new constitution of Thailand, will be an important vehicle for reducing poverty and achieving broader social objectives (for example, reducing gender inequality, addressing HIV/Aids). As economic recovery continues to be fragile, temporary and well targeted safety nets should be maintained as part of the fiscal stimulus package. Growth was the main engine for poverty reduction in the past, but now that growth is unlikely to be very high in the medium-term, and the vulnerabilities facing the economy and the households have increased substantially, it is essential that Thailand devotes more attention and resources towards developing social safety nets. The reform of the public sector institutions aimed at providing medium-term safety nets (e.g., pension reform, expanding the opportunities for the poor to participate in the education and health programs) will continue to be a high priority.

**Cementing Economic Recovery.** Thailand's economic recovery is on track, but it remains fragile. While the year-on-year growth rates for the first half of this year look impressive, the overall picture is mixed. The weak balance sheet of the private sector and the sluggish progress in

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<sup>1</sup> For an assessment of the environment, please see the Environment Monitor.

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financial and corporate restructuring, which continue to suppress private investment, together with the rise in oil prices, and the prospect of declining exports to the US, constitute increased downside risks to growth. A growth rate of around 5-6 percent next year, will only be possible with a full recovery of the private sector. Private investment has started to pick up but recovery is confined to selected sectors. Some segments of the economy, such as SMEs, have difficulty accessing credit.

Market volatility has increased, but this is unlikely to lead to a second crisis. Macroeconomic policies have been strengthened, exchange rate made flexible, and external balances have been restored. Fiscal and monetary policies continue to be, appropriately, supportive of recovery. Public debt has increased, but it remains manageable. Going forward, the transition from stimulus to consolidation in fiscal policy will need to be carefully managed to achieve the twin objectives of cementing recovery and keeping public debt on a sustainable debt path.

**Strengthening Competitiveness.** Thailand's structural reform program appears to have graduated from crisis management to strengthening medium-term competitiveness. Significant progress has been made in rebuilding the banking sector, improving corporate governance, modernizing regulatory institutions, enhancing private participation in public infrastructure, and introducing domestic and external competition. Most private banks have made significant progress towards meeting the regulatory capital adequacy standards. Some progress has also been made in the restructuring of state banks with the transfer of non-performing loans (NPLs) to Asset Management Companies (AMCs). The process of facilitation by the Corporate Debt Restructuring Advisory Committee (CDRAC), and the steps being taken to strengthen the legal framework have contributed to debt restructuring.

But key challenges remain. Markets have raised concerns on the pace and quality of financial and corporate restructuring. Although a large number of firms have used the voluntary CDRAC process to help restructure their debt, the overall pace of restructuring could be further accelerated. The CDRAC is drawing to a close, with almost half of the total cases unsettled being transferred to the civil courts, contributing to a major judicial backlog. The backlog of cases in the civil courts poses a threat to the resolution of distressed assets. Capital constrained banks, the high level of NPLs, the high debt to equity ratio of the firms, and a clogged judicial system, could all slow down the pace of recovery.

The restructuring of the banking sector and corporate sector will be important for accelerating recovery. Yet, an acceleration of restructuring may trigger a further decline in the market-prices for bank-held assets, and therefore pose a risk to banks in the absence of a comprehensive recapitalization. Without a write-off or transfer of NPLs, the balance sheets of the banking sector will only improve through a revitalization of the real sector. The development of a new innovative business sector, the widening and deepening of the stock market, and productivity increases can all contribute to the generation of new bankable loan demand.

Addressing medium term challenges to strengthen competitiveness will require increased attention. Secondary education in Thailand has expanded slowly compared with other countries in the region. Quality of secondary and higher education does not match the requirements of an increasingly knowledge based economy. The digital divide between Thailand and its neighbors and within Thailand between urban and rural people is on the increase. Thailand's Ninth Plan recognizes the importance of enhancing medium-term competitiveness by shifting away from a pre-crisis development model driven by the accumulation of physical capital and towards a productivity and knowledge based economy. While Thailand deserves credit for putting in place a

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comprehensive reform program, there is a need to strengthen capacity to implement these reforms.

**Strengthening Governance.** Thailand has made enormous progress in building institutions to improve governance. The 1997 Constitution mandates the formation of various institutions that increase citizen participation, enhance transparency, and decentralization and improve public sector governance. The public is increasingly demanding better public services and less corruption from the Government. Thailand's Public Sector Management Reform Program seeks to improve governance in central agencies and line ministries and to enhance the efficiency, effectiveness, equity, and transparency of public resource management and service delivery.

While the governance reform program is ambitious, the strategy is sound and reflects the Thai context and international governance experience. The program recognizes that institutional reforms require time to implement and are inherently uneven in pace. The program has been designed around concrete objectives with defined but flexible benchmarks that can be adjusted to accommodate variable implementation progress. Progress across program areas has generally been positive although uneven. As reforms are maintained and deepened over the medium term, interventions will increasingly be required to address complex problems that span several agencies; systems and incentives for agencies to assure greater integration and coordination must be developed and promoted. Investment in corollary information systems could enhance the management and implementation of reforms. Information system inputs are necessary for many reform areas: expenditure management (accounting and financial management systems), human resource management (human resource management information system), revenue management (various revenue administration systems), and cross-government accountability and transparency (databases and tracking systems). The experience of other countries undergoing similar public sector reforms is that reforms cannot be sustained unless they are well planned and sequenced, supported by key stakeholders, and adequately funded.

Integration and coordination of reforms is crucial to successful implementation. The reform process is being managed by a series of committees, which meet infrequently and have other responsibilities. As a result, cross-cutting issues and broad policy frameworks are only beginning to be considered and established. Further coordination would enhance the reform process; especially important is integrating performance budgeting and results-based-management reforms, and the recent establishment of the Public Management Reform Office in the Office of the Civil Service Commission may provide this coordination. Delays have occurred in establishing and funding the Administrative Courts and the Office of the Ombudsmen. The Government should enhance its efforts to institutionalize and empower these newly established independent bodies and to integrate them better into the overall reform program. Financial and human resources are clearly insufficient at present for the offices to be fully operational. Establishing these institutions well is especially crucial during the next few years when public expectations for the Constitution and these institutions are high.

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## CHAPTER 1: STRENGTHENING SOCIAL POLICY

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### Poverty, Inequality and Human Development

**Thailand's long term achievements in the fight against poverty have been remarkable, although the 1997 crisis interrupted this process.** Between 1988 and 1996, poverty incidence dropped from 32.6% of the population to 11.4%, implying that one million individuals were lifted out of poverty each year. In eight years the absolute number of poor was more than halved, falling from 17.9 million in 1988 to close to 7 million in 1996.

**Poverty reduction was accompanied by significant improvements in social indicators.** Life expectancy increased from 60 years during the late 1970s to 69 years in the late 1990s. Similarly, the infant mortality rate dropped from 74 deaths per 1,000 births in 1970 to 26 in 1999. Currently, the primary enrollment rate is close to 100% and the adult illiteracy is below 5%. Eighty percent of the population has access to safe water and 96% has access to sanitation. Thailand is ranked 76<sup>th</sup> out of 174 countries in terms of the level of human development.

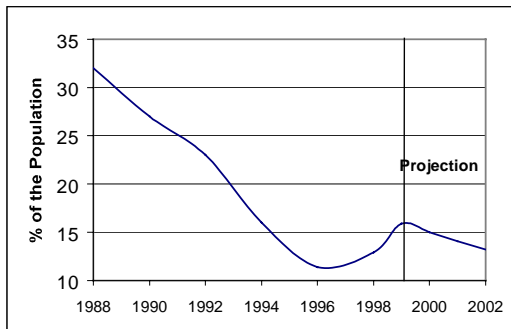
**Rapid growth compensated for rising inequality.** The elasticity of poverty incidence to real per capita GDP is estimated to be in the range of 1.3 %, indicating that a 1% increase in real GDP per capita is likely to reduce the poverty rate by 1.3%. Between 1988 and 1996, the Thai economy expanded at an impressive rate of 8% per year, while the average developing country grew at only 2% per year. Thus, between 1988 and 1996, Thailand almost doubled its income per capita. This rapid expansion of average income compensated for the increase in income inequality, between 1988 and 1994, as everybody grew richer. While the income distribution appeared to improve between 1994 and 1996 a disruption occurred as a result of the crisis. Future trends remain uncertain.

**Inequality remains high, with the poorest 20% of the population accounting for merely 3.8% of aggregate national income and the richest 20% accounting for 58.5%.** Inequality in the distribution of income is highly correlated to regional inequality. Rural areas, in particular the Northeast regions, have both the lowest income per capita, and the highest poverty incidence (23.2% Vs. 0.6% in the Bangkok vicinity). But other forms of inequality, such as gender inequality, are prevalent as well. For instance, in 1996, other things being equal, wages for women were 25% lower than for men among individuals with high school education or less.

**The crisis in 1997 reverted over 3 million individuals back into poverty.** Although high levels of social capital (i.e., strong family ties) contained the social impacts of the crisis, the sharp contraction of the economy (-2% in 1997 and -10% in 1998) increased the share of poor in the population from 11.4% in 1996 (6.8 million) to close to 16% in 1999 (9.8 million), according to the 1999 household survey. In addition, households, already poor before the crisis, saw their income fall even further as a result of the crisis.

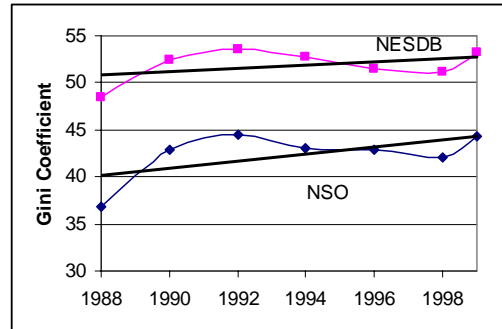
## Box 1.1: Poverty and Inequality in Thailand, before and after the Crisis

### Poverty sharply reduced in Thailand...



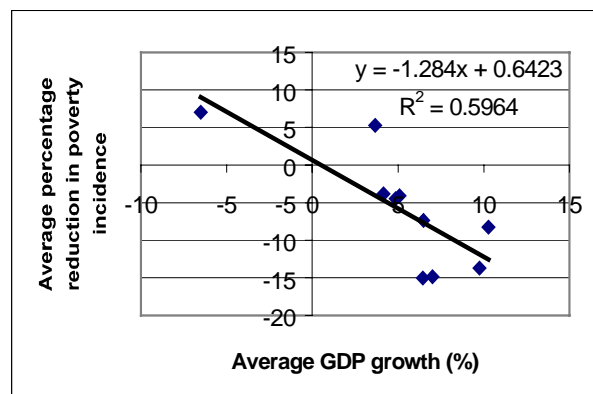
Source: NESDB and staff calculations

### ... despite high inequality ...



Note: NESDB measure is based on population; NSO measure is based on households.

### ... given the strong response to economic growth



Source: NESDB and staff calculations

### Income inequality remains high in Thailand (average of 1991-1999)

	Indonesia	Malaysia	Philippines	South Korea	Thailand
<b>Gini Coefficient (%)</b>	<b>33.3</b>	<b>43.6</b>	<b>44.3</b>	<b>29.4</b>	<b>42.8</b>

Source: East Asia and Pacific Regional Brief, September 2000

Note: The Gini coefficient is a measure indicating the distribution of income across five population quintiles, ranked by income. It varies between 100 and 0, 100 meaning that 100% of income is earned by the richest 20% of the population, 0 meaning that every quintile of the population earns the same amount of income.



**Table 1.1: The Regional Distribution of Poverty**

Region	Number of Poor (ml.)		Poverty Headcount		Share of Total Poor Persons	
	96	98/99	96	98/99	96	98/99
<b>Bangkok &amp; Vicinity</b>	0.1	0.02	1.3	0.2	1.8	0.2
<b>Central</b>	0.7	0.8	5.9	6.8	9.7	7.7
<b>North</b>	1.3	1.2	11.2	10.6	18.3	12.2
<b>Northeast</b>	3.9	6.6	19.4	30.8	57.9	66.8
<b>South</b>	0.9	1.4	11.5	15.7	13.3	13.7
<b>Total</b>	6.8	9.8	11.4	15.9	100	100

Source: NESDB

Note: The Poverty Headcount is the share of poor in a group's total population (poor/all), Share of total poor is the share of poor in a sub-group to all poor (poor in region i/all poor). 1999 SES household survey covered only 6 out of 12 months (2 quarters) and is not therefore strictly comparable to the earlier household surveys which covered all four quarters.

**The increase in poverty was distributed unevenly throughout the country, affecting mostly rural areas.** While poverty incidence rose between 1996 and 1999 in the country as a whole, it actually declined in the municipal areas (inner urban) from 1.6% to 1.3%. In the sanitary areas (outer urban), poverty incidence increased from 5.8% to 8.8%, while it jumped from 14.9% to 21.5% in the villages (rural areas). Likewise, between 1996 and 1999, the incidence of poverty declined in the North and Bangkok vicinity, while it increased in the Northeast, South, and Central Regions. The Northeast experienced the largest increase in poverty incidence during this period -- from 19.4% in 1996 to 30.8% in 1999.

**In the rural areas, low-income households were the most affected by the crisis.** Total real income of poor rural households declined by close to 20%, while the income of rich farmers rose by over 50%. Richer households are highly exposed to agricultural output and input prices shocks, while poor households have comparatively greater exposure to labor market shocks. During the crisis period, rice and fertilizer prices moved in a direction favorable to farmers, while the wages fell because of the downturn in the labor market. Remittances to rural households from urban regions contracted by close to 50%.

**Table 1.2: Poverty by Economic Status**

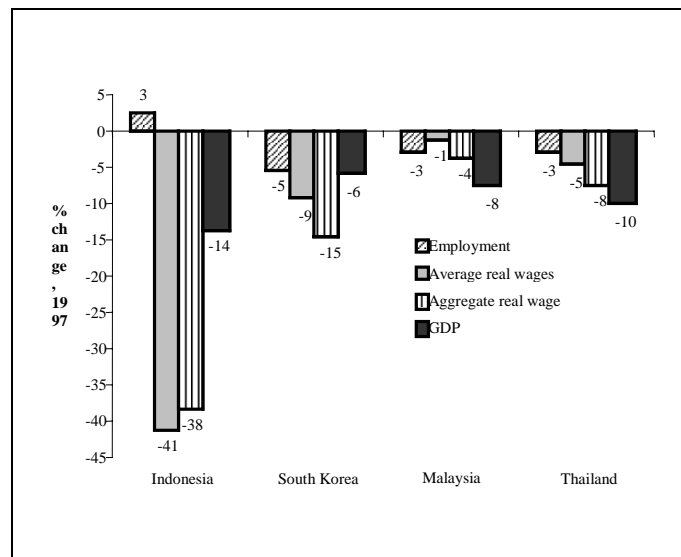
Economic Status of Household Head	Number of Poor (m.)		Poverty Headcount		Share of Total Poor Persons	
	96	98/99	96	98/99	96	98/99
<b>Agriculture</b>	4.0	5.3	44.7	59.8	58.8	54.1
<b>Entrepreneurs, Trade and Industry</b>	0.3	0.5	3.2	4.7	4.4	5.1
<b>Professional Technical &amp; Managerial</b>	0.1	0.1	1.7	1.1	1.5	1.0
<b>Farm Worker</b>	0.9	1.5	25.5	37.9	13.2	15.3
<b>General Worker</b>	0.2	0.2	12.7	20.1	2.9	2.0
<b>Clerical, Sale &amp; Service Worker</b>	0.1	0.3	1.4	3.7	1.5	3.1
<b>Production &amp; Construction Workers</b>	0.7	0.8	7.6	10.1	10.3	8.2
<b>Economically Inactive</b>	0.5	1.1	8.3	14.0	7.4	11.2
<b>Total</b>	<b>6.8</b>	<b>9.8</b>	<b>11.4</b>	<b>15.9</b>	<b>100.0</b>	<b>100.0</b>

Source: NESDB

**Poverty is also concentrated among certain population groups.** Households headed by farmers, the elderly (aged 70 and over), and people with less-than-primary schooling are particularly vulnerable to poverty.

**The flexibility of the Thai labor market helped to spread the effects of the crisis more broadly.** The flexibility of the labor market as well as the government-supported employment creation and training programs helped to prevent large scale unemployment and fall in aggregate real wage earnings. Despite Thailand's experiencing one of the severest declines in real GDP in the region in 1998, the reduction in aggregate real wage labor earnings was more modest than that of GDP. In Indonesia and South Korea the decline in wage labor earnings was nearly three times as large as the GDP decline. In this sense, the Thai experience was closer to that of Malaysia, where labor also weathered the economic crisis relatively well.

**Figure 1.1: Percentage Change of Labor Market Indicators and GDP in Four Crisis Affected Countries of Asia, 1997-1998**



Source: Social Monitor, World Bank, July 2000

**Child and youth labor fell during the crisis.** The less educated, less skilled and low wage employees were more adversely affected by the downturn. It is the poorest group of workers which was most adversely affected by the crisis. There was a shift in the distribution of the aggregate wage earnings from the rural to the urban areas, from the poor (i.e. Northeast) to the rich regions (i.e. Bangkok), from the less to the better educated, from the young to the old, from low wage occupations to high wage occupations. In each case there was a shift in the distribution of aggregate wage earnings from groups with low pay to groups with high pay. There is some evidence that these groups are also lagging behind during the process of economic recovery.

**As a response to the crisis, the Government deployed safety net programs which have been relatively successful in containing social costs.** In 1999, expenditures in-kind and in-cash transfers and income generation programs amounted to 2% of GDP. While data about the number and socio-demographic characteristics of beneficiaries from the different social programs is still scarce, preliminary estimates suggest that original targets were usually achieved. For instance, in the case of the Miyazawa Plan programs for employment generation, 65,223 educated workers and 3.5 million unskilled workers had been hired by the end of 1999 for three months or more. For programs providing in-cash or in-kind transfers (e.g., meals for children), estimates suggest that over 1.2 million persons or 35,000 households have benefited. The programs also included provision of financial support (Baht 10,000) to 990 HIV/AIDS affected persons, and monthly transfers of Baht 300 to 400 for the elderly poor.

**The Social Investment Fund (SIF) has also contributed to poverty alleviation.** Since the Social Investment Fund (a component of the Social Investment Project financed by the World Bank), was launched on September 9, 1998, a total of 3,146 sub-projects have been approved with a total budget of Baht 2,948 million (approximately \$77.95 million). The sub-projects cover 76 provinces with over 7.5 million beneficiaries. The demand for Social Investment Fund resources continues to grow. The Social Fund has stimulated the emergence of community organizations/community networks capable of efficient sub-project and local community management and administration. This growing partnership with civil society has yielded direct benefits in terms of the growth of disbursements and the delivery of social assistance to those most vulnerable to the economic shocks of the crisis.

**Table 1.3: Percent Changes in Labor Market Indicators during the Crisis, by Age**  
 % Change in

Age group (years)	Employment	Monthly wages	Aggregate wage earnings	Unemploy- ment	Under- employ- ment	Labor force
13-17	-18.73	-5.46	-24.19	85.66	70.61	-14.59
18-24	-12.13	-8.04	-20.17	133.12	43.45	-5.59
25-34	-1.10	-7.28	-8.38	172.52	58.97	2.35
35-44	3.01	-4.66	-1.65	263.00	68.22	4.72
45-54	8.64	1.41	10.05	177.99	55.77	9.77
55 & over	-0.52	15.07	14.55	113.46	41.43	0.14

Notes: Changes are defined over the period before the crisis (first quarter of 1996, third quarter of 1996, and first quarter of 1997) to the period during the crisis (first quarter of 1998, third quarter of 1998, and first quarter of 1999).

Source: Social Monitor, World Bank, July 2000

**Nevertheless, important challenges remain in terms of reducing poverty and addressing social problems such as gender inequality and child labor.** Besides a renewed challenge to reduce poverty beyond pre-crisis levels, other social problems such as child labor, gender inequality, and HIV/AIDS need to be addressed.

## Social Policy: Challenges Ahead

Policies conducive to growth will be essential, but actions to redistribute the gains from growth are required as well. These include for instance:

- Better targeting to protect the poor (e.g. self-targeting employment programs and better use of available survey data to locate the poor geographically)
- Redressing rural and urban imbalances
- Empowering local communities (e.g., expansion of community programs)
- Strengthening institutions in charge of designing and implementing social policy

**The Government strategy for poverty reduction is beginning to empower vulnerable populations groups and to enhance their opportunities.** Traditionally, the Government strategy to reduce poverty relied on economic growth and rural development. The Government recognizes, however, that, in the future, a broader array of policies will be needed to improve the welfare of low- income population groups and generate a more equitable society. The government's general strategy has three components: i) empowering communities, ii) strengthening mechanisms to protect vulnerable population groups; iii) and expanding their opportunities by ensuring access to basic services such as health and education, and promoting rural development.

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## Community development

**The Thai Government's approach emphasizes community strengthening as a vehicle for reducing poverty and achieving other social objectives.** This approach stresses the empowerment of local community-based organizations. An example is the Poverty Alleviation Project, launched in 1993 by the Ministry of Interior. The project provides interest-free loans to poor rural households as seed money for investments in income generating activities, operated through village committees. More recent examples are the Social Investment Fund, which aims to increase social capital at the community level. The SIF is supported by the World Bank and the Community Organization Development Institute, which focuses on strengthening community based organizations through financial and technical support.

**Looking forward, new community participation mechanisms are needed.** The new Constitution, which emphasizes community participation and decentralized policy making, sets the proper context to extend existing schemes for strengthening the resource base and the capacities of local communities. A major challenge is to ensure that vulnerable population groups can participate in the local government's decision making process, when they are concerned.

## Strengthening mechanisms to protect vulnerable population groups

**The government has been active in designing and implementing anti-poverty programs.** Today, over a hundred in-cash and in-kind transfer programs have been implemented. An example of an in-cash transfer program is the Education Loan Program, run through the Ministry of Education, which provides loans to students from low-income households. The main in-kind transfer program targeted to the poor is the low-income health card program, providing free health services at public hospitals and clinics.

**During the crisis, safety nets became a key component of the government strategy to minimize social costs.** Safety net programs financed through the Miyazawa package included in-kind transfers, in cash-transfers and public work programs. These programs are estimated to have benefited 35,000 households.

**The continuation of these programs remains essential to protect the poor from risks related to the labor market, harvest failure or price fluctuations.** The government has initiated the evaluation of poverty and safety net programs. The results of these evaluations suggest that there is room to improve the timing of response, targeting and coordination. In terms of timing, the programs' flexibility needs to be improved to reduce delays between crisis and response. Targeting mechanisms also need to be enhanced, implying a need to improve the availability and reliability of information systems to monitor poverty and unemployment. Finally better coordination between implementing agencies are required to reduce duplication of efforts and to improve the flow of information.

**Additional mechanisms are also required to tackle such social problems such as domestic violence or child labor.** Substantial progress has been made in terms of documenting the magnitude of social problems such as violence against women, gender inequality or child labor and their consequences. The government is now giving priority to the development of public and civil programs to address these problems.

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### Box 1.2: Working To Bring Women “Out of Silence”

"Violence against women is a crime. Women and families should not accept it in silence," explained Dr. Pensri Phijaisanit, Professor Emeritus of Mahidol University, in her opening remarks during the World Bank in Bangkok's latest roundtable discussion of civil society issues.

A group of about 20 people from NGOs, embassies and United Nations agencies met at the Bank's invitation on May 9, 2000 to discuss the problem of abuse of women in Thailand, the obstacles women face when trying to get help, and how government, law enforcement, NGOs, the healthcare community and others can work to prevent it.

One in a series of roundtables, this meeting followed the release of a new book, *Out of the Silence: Fighting Violence Against Women in Thailand*, which was produced jointly by the Office of the National Commission on Women's Affairs of the Office of the Permanent Secretary of the Prime Minister's Office of the Thai Government, and the World Bank.

"The report brings to public light not only an age-old issue, but it also underscores the cultural and gender barriers that perpetuate and even protect such crime," commented J. Shivakumar, Country Director, World Bank Office, Bangkok.

Mr. Shivakumar stressed that violence against women is not a problem unique to Thailand. "As cited in the report, domestic violence is more common in the United States than in Thailand. However, since the onset of the Asian economic crisis over two years ago, the absolute number of women as well as children who are abused at home has increased," he noted. Mr. Shivakumar also explained that projects, such as the book, is one way the World Bank is supporting campaigns to raise awareness and dialogue for improving the strength of civil society in Thailand.

*Out of the Silence* contains detailed accounts of women's experiences with violence and profiles the government's policies, laws and responses of NGOs, law enforcement and the medical community. One of the main issues raised during the roundtable discussion is the need to change the attitude of policy makers, law enforcement officers, judges and other officials toward this problem.

"The attitude (of most officials) is that domestic violence is a family issue that should be resolved within the home," said one participant. NGOs working on the issue were applauded for their efforts. "They are really on the front line of this issue," said Dr. Pensri. Some of the initiatives taken on by NGOs are shelters for battered women and assistance for women prisoners, who are often victims of violence.

One survivor of abuse, Khun Areewan Jatuthong, who appears on the cover of *Out of the Silence*, recounted her story, including the troubling responses by the police and the courts. "They told me, 'Why don't you just divorce him?'" She made the difficult choice to continue her legal battle. "In Thai culture, a divorced woman is seen as a problematic woman," she explained. She had to convince witnesses to testify. It took years, but eventually her husband was found guilty and sentenced a prison term. "It would have been very different without (so many) supporters," she added.

Dr. Prisana Pongtadsirikul, Director of the Office of the National Commission of Women's Affairs, emphasized the need to collect better data on the problem and ways to encourage the various agencies to work together to monitor the problem and target government policies and programs.

Although *Out of the Silence* focuses on domestic violence, the discussion group raised trafficking, rape and forced sex, forced prostitution, justice for disenfranchised survivors of violence, as well as treatment programs for abusers as further issues for study and action.

*Out of the Silence* is available in both English and Thai versions and is on the web at <http://www.worldbank.or.th/social>.

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## Expanding opportunities

**While Thailand has made significant progress in terms of primary education, the expansion of secondary education has been slow, particularly among low income population groups.** The primary enrollment rate approximate 100% of the age group, but the gross enrollment rate of formal secondary education remains below 75%. Although access to secondary education has improved, the expansion has been slow compared with other countries in the region. The current provision of secondary and higher-education does not match the quality and skills requirements of an increasingly knowledge-based economy.

**The major challenge ahead is the implementation of the new Education Act.** The Education Act of 1999 legislates reform of the entire system and expansion of secondary education. The Act envisions to fully implement over the next 5 years 9-year compulsory education and 12-year free education. In addition, the power of the central ministry will be reduced and that of the new school districts increased over the next three years. Universities are to be made autonomous, with increased power to mobilize and utilize resources and revenues. The reform agenda is ambitious, and faces important budgetary constraints. Education currently accounts for 26% of government expenditures. About half goes toward salary and administrative expenditures, leaving only a small portion for investments to improve quality.

**Thailand is well endowed with physical and human health resources, excellent access to public facilities, and good health outcomes in terms of disease burden and mortality rates.** Over the last 30 years, Thailand has achieved remarkable progress in health, due largely to the efforts of the public sector. Infant mortality declined from 70% in the early 1970s to 26% in the late 1990s. Mortality rate declined from 200% in 1990 to 44% in 1997. Immunization programs now cover almost 90% of the population and contraceptive use is above 75%.

**The major issues now relate to disparities in health status and health access and a changing epidemiology.** Disparities in health status and access to health care remain between disadvantaged groups and the rest of the population. In addition, Thailand is undergoing an epidemiological transition, with a growing burden of communicable, chronic and degenerative diseases in an aging population and the emergence of new health problems such as accidents and occupational hazards, addiction (tobacco, alcohol, drugs), environmental pollution, a resurgence of tuberculosis, as well as HIV/AIDS. Thailand continues to have one of the most severe AIDS epidemics in Asia, with 700,000 Thai infected.

**The Ministry of Public Health is moving forward on a broad program of health sector reform.** This program encompasses performance-based budgeting, decentralized management of health care at the provincial level, harmonization of health insurance schemes, improved equity, and renewed emphasis on key disease control priorities.

**Thailand was late to control AIDS but responded with one of the most comprehensive and effective programs to curb transmission by commercial sex.** The government launched a vigorous public campaign to raise condom use in commercial sex, including the 100% condom program in brothels. This strategy has prevented the infection of an estimated 395,000 Thais since 1993, lowering the total cumulative number of people infected in 2000 to 29% less than originally projected.

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**Thailand is predominantly rural, yet development has been biased in favor of urban areas.** Nearly 60% of the population live in rural areas and agriculture provides 45% of employment. Only 10% of income is generated in rural areas, however. Poverty incidence is higher than in urban areas (21.5% vs. a national average of 16%). Only limited non-farm opportunities exist. The insecurity of land titles limits access to credit for productive investments.

**The government's strategy focuses on redressing rural-urban imbalances that surfaced during the bubble economy.** The strategy proposes a more balanced access to social services and infrastructure, more diversified employment opportunities, increased income, and enhanced food security for the rural poor.

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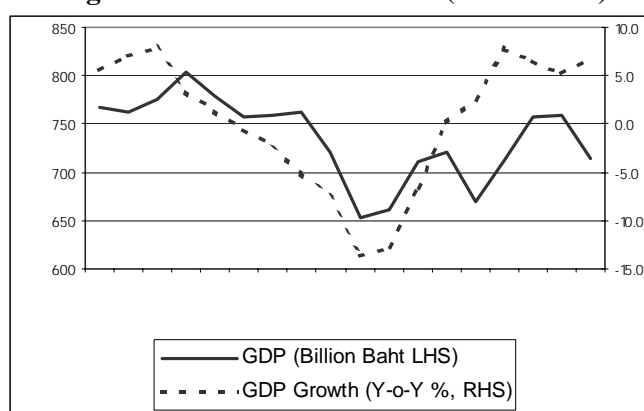
## CHAPTER 2: CEMENTING ECONOMIC RECOVERY

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### Recovery is on Track though Fragile

By the end of 1998 the financial crisis had reduced GDP per capita back to 1994 levels. The recession was severe, but the comprehensive emergency program introduced by the government helped resume growth in a relatively short period of time. In the first quarter of 1999, the economy grew at 0.2% and by the second and third quarters growth had accelerated to 2.5% and 7.8% respectively, leading to an annual growth rate of 4.2%. During the first two quarters of year 2000 the economy grew by 5.1 and 6.6% respectively, with exports acting as the major driver.

**Figure 2.1: Real GDP Growth (1988 Prices)**



Source: NESDB

**Table 2.1: EA5 Real Growth (% Change)**

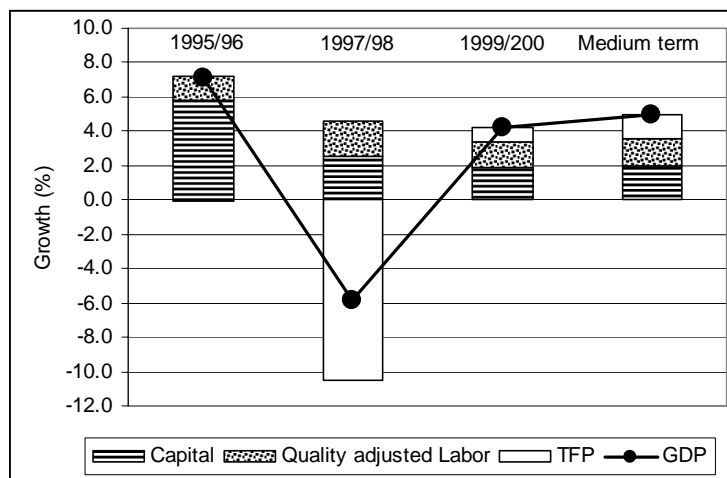
	Actual				Projected	
	1996	1997	1998	1999	2000	2001
<b>Indonesia</b>	8.0	4.5	-13.7	0.2	4.0	4.0
<b>Malaysia</b>	8.6	7.5	-7.5	5.6	8.0	6.0
<b>Philippines</b>	5.8	5.2	-0.4	3.3	4.0	4.5
<b>South Korea</b>	6.8	5.0	-5.8	10.7	8.5	6.5
<b>Thailand</b>	5.5	-1.3	-10.0	4.2	4.5	4.5

Source: East Asia Brief, World Bank, September 2000

**Quality of Growth is improving.** Total factor productivity growth (TFP), quality adjusted labor growth, changes in the structure of manufacturing exports, and the steps taken to modernize regulatory institutions and business environment, all suggest that the quality of growth has begun to improve. Thailand appears to be shifting away from the pre-crisis growth strategy based on the accumulation of physical capital and towards a productivity based growth strategy. Although it is difficult to separate structural from the cyclical components of the productivity changes, there is some evidence at the firm level that the recent recovery is being led by the more efficient outward oriented manufacturing sector.



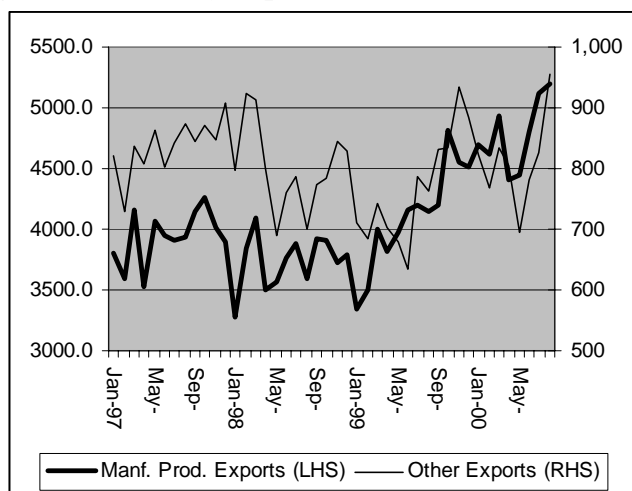
**Figure 2.2: TFP and GDP Growth before and after the Crisis (1995-2000)**



Source: Staff Calculations

**Exports continue to be strong.** Helped by regional recovery, a competitive exchange rate, and real wages that are below pre-crisis levels, the growth of exports during the first eight months of 2000 was impressive (26.4% on average in US\$ terms). Volume is expected to grow by 19% for the whole year 2000. In the first quarter 2000, exports in US\$ grew at 28.5% y-o-y. In the second Quarter, it was still a substantial 14.1%. This positive trend continued in September with a y-o-y rate of 20%.

**Figure 2.3: Monthly Exports 1997-2000 (millions of US\$)**



Source: Bank of Thailand and staff calculations

**Exports appear to be growing across all sectors. Machinery and technology exports have exhibited the highest growth.** Since 1993, the structure of exports has tilted away from agricultural products to manufacturing. In 1993, almost 20% of exports were agricultural products and 80% were manufactures. Now manufactures make up 86% of exports, as they have grown faster than agricultural exports. Within the manufacturing sector, the textiles sector has lost ground, whereas machinery and technology products went up from 32% of all exports to almost 50% in 2000. As also apparent on the employment side, these structural changes show

that Thailand is developing the right capacities in order to stay competitive in growing sectors of world demand.

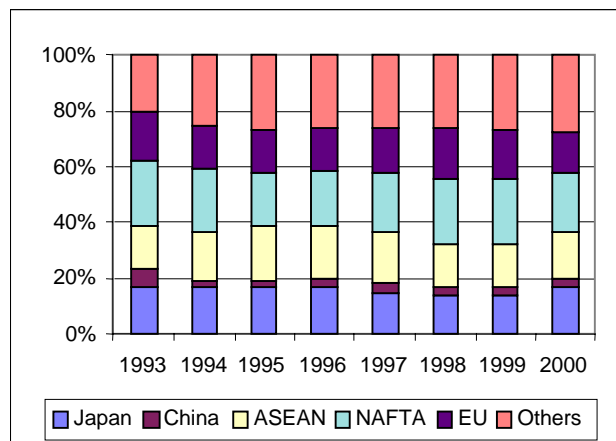
**Export markets are relatively diversified.** The relative importance of different markets for Thai exports has remained roughly constant over time, with NAFTA accounting for about 20%, Asia for about 37% (Japan 16, China 4, and ASEAN 17%) and Europe for 15%. A lower demand from the US and Japan would most likely be felt in Thailand also indirectly through ASEAN demand. In the long term, however, the performance of the export sector will depend on Thailand's ability to reduce transaction costs and improve competitiveness (see chapter 3).

**Table 2.2: Thai Exports (1999-2000, Share of Total Exports)**

	1993 Jan-Dec	1997 Jan-Dec	1999 Jan-Dec	2000 Jan-Aug	2000/99 Growth Jan-Aug
<b>Manufactured Products</b>	80.4	82.4	84.3	85.5	27.9
<b>Textiles</b>	17.3	11.9	10.5	10.0	17.0
<b>Machinery, etc</b>	31.9	41.6	45.7	47.6	31.5
<b>Other consumer goods</b>	11.6	8.6	8.7	8.4	22.8
<b>Other</b>	19.7	20.3	19.4	19.5	27.5
<b>Agricultural Products</b>	18.4	15.1	12.5	11.6	17.5
<b>Other</b>	1.2	2.5	3.2	2.9	23.1
<b>Total Exports (ml. US\$)</b>	36,962	57,589	58,513	45,187	26.4

Source: Bank of Thailand and staff calculations

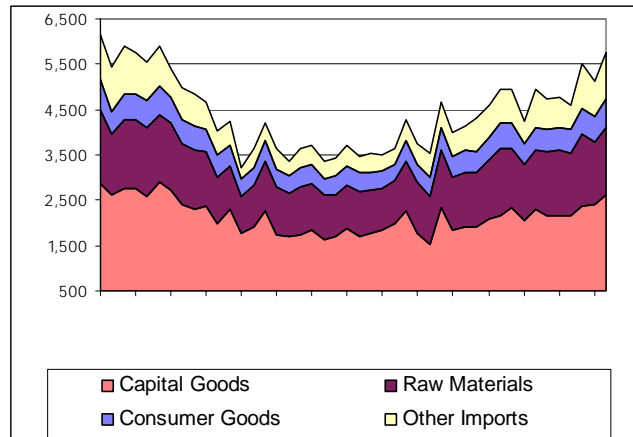
**Figure 2.4: Destination of Thai exports**



Source: Bank of Thailand and staff calculations

**Imports grew by 26% in the first eight months of 2000 in US\$ terms. Although increased oil prices are driving imports up lately, this is likely to moderate and grow over the year by 25%.** Since February 1999, imports have been growing rapidly. In August, imports grew by almost 40% as a result of the increased oil prices. Import of capital goods (46% of imports) and raw materials (28%) also continues to grow, however. Consumer goods imports (11%) have grown faster than imports of capital goods since August 1999. Other imports, 70% of which are oil and related imports, have expanded by more than 60% in the first eight month of the year (by more than 90% in the month of August), increasing their share in total imports from 12% last year to 15% this year.

**Figure 2.5: Composition of Thai Imports**



Source: Bank of Thailand and staff calculations

**Foreign Direct Investment continue to be important.** FDI is mellowing to about 2% of GDP or 200 million US\$ a month. During the crisis net FDI had peaked at levels of more than 600 million US\$ a month, which amounted to almost 10% of GDP and more than 40% of the GDFI. After the waves of the crisis had settled a little in 1999, FDI peaked again at around 500 million US\$, as more family silver was sold. In 2000, most extraordinary FDI opportunities have been exhausted, so that FDI has fallen considerably. FDI now is, however, still higher than before the crisis, and still constitutes about 10% of GDFI or about 3% of GDP.

**Table 2.3: Net FDI as a share of GDP by Country (%)**

	1999	2000	2001
<b>Indonesia</b>	-0.34	1.29	1.63
<b>Philippines</b>	2.28	1.77	1.61
<b>Singapore</b>	5.78	5.79	5.38
<b>Thailand</b>	4.30	3.49	2.97
<b>Malaysia</b>	0.13	0.57	1.45
<b>Korea</b>	1.20	1.21	0.87

Source: ABN-AMRO and Staff Calculations for Thailand

**The drivers of growth are broadening.** Rapid export growth, helped by an expanding global economy, helped to pull Thailand out of the crisis. Looking forward, the upside potential for additional export growth may be limited, as global growth may have peaked, although exports will continue to be strong in the coming years. At present, domestic activity still remains below the pre-crisis levels, but is expected to continue to expand.

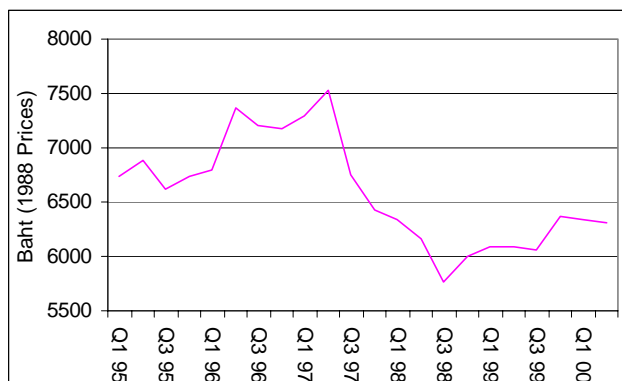
**Table 2.4: Contribution to GDP Growth (%)**

	1999	2000	2001
<b>Real GDP</b>	4.2	4.5	4.5
<b>Consumption</b>	1.6	2.4	3.9
<b>Public</b>	0.3	0.3	0.3
<b>Private</b>	1.3	2.1	3.6
<b>GDFI</b>	-1.0	0.94	1.4
<b>Public</b>	-0.2	0.04	0.2
<b>Private</b>	-0.8	0.90	1.2
<b>Change in Inventories</b>	3.4	1.0	0.2
<b>Exports</b>	5.3	10.9	4.3
<b>Imports</b>	-6.4	-10.8	-5.4
<b>Statistical discrepancy</b>	1.4	0.1	0.1

Source: staff calculations

Though data present a mixed picture, domestic demand appears to be weakening. Private consumption appears to be weak with sales of consumer durables flattening out. The growth in private consumption may be moderating as a result of high oil prices, and continued uncertainty about job and income prospects.

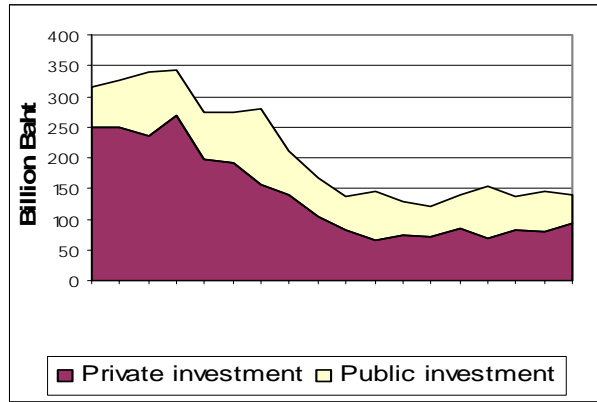
**Figure 2.6: Real Private per Capita Consumption**



Source: Bank of Thailand and staff calculations

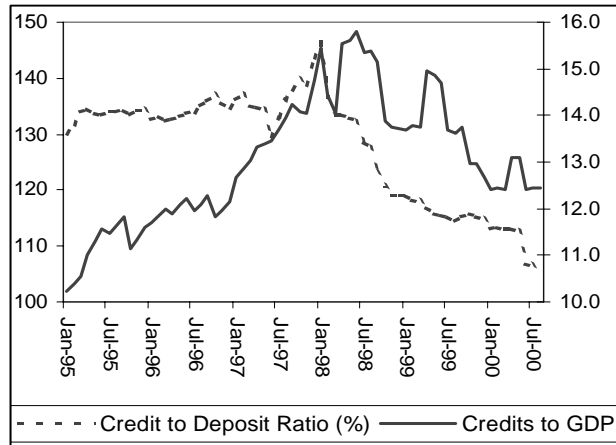
**Private investment has started to recover but it is confined to selected sectors. Some segments of the economy, such as the SMEs, have difficulty accessing credit.** Despite high levels of liquidity in the financial system, banks have been reluctant to lend, in part due to still high levels of NPLs and the weak financial position of the corporate sector. The credit to deposit ratio has fallen from 130% before the crisis to just above 100%. Although deposits are on the rise, lending remains conservative. While this indicates more prudent lending practice as a result of the crisis, it might eventually hamper private sector development, as viable investment projects also get excluded--especially SMEs, where excess capacity is, in fact, relatively low, and downside risk to be credit constrained is high. The slow pace of financial and corporate sector restructuring, which make banks reluctant to lend, may become a major constraint to lending and output growth. New investments that have materialized are largely in the tradable goods sector and financed through corporate bonds, FDI, and the savings of corporations.

**Figure 2.7: Real Public and Private Investment (1988 prices)**



Source: Bank of Thailand and staff calculations

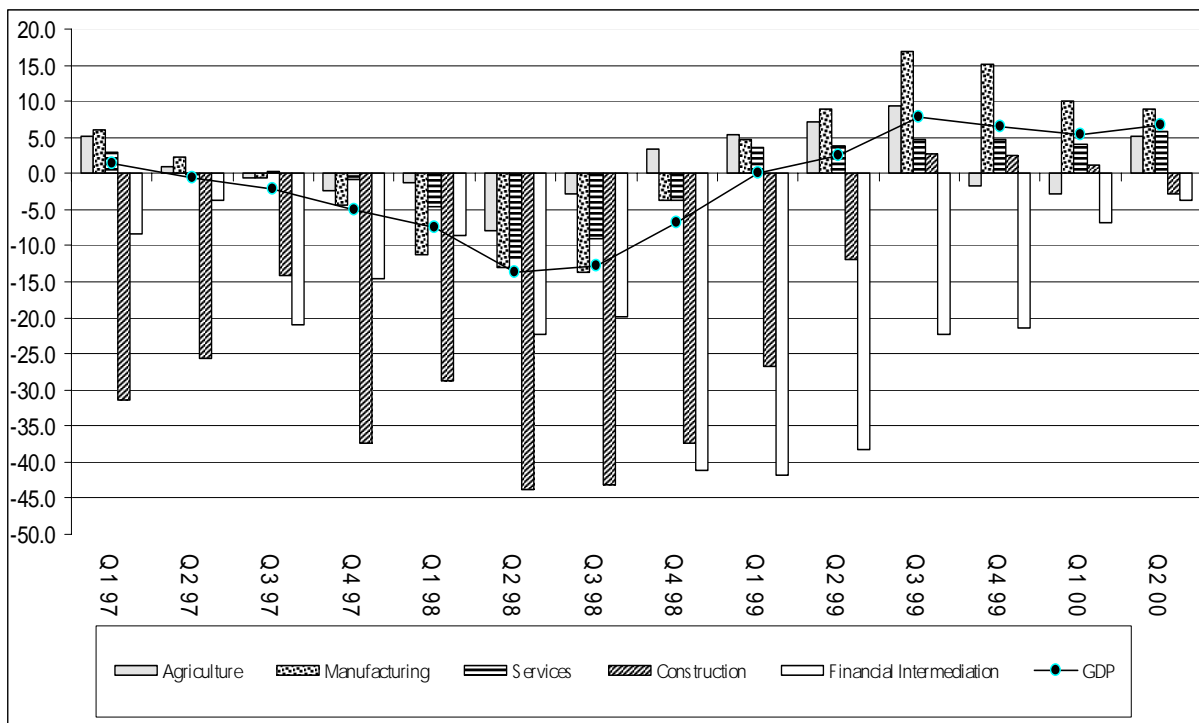
**Figure 2.8: Credit to Deposits and to GDP**



Source: Bank of Thailand

**From the supply side, the recovery appears to be broadening across sectors.** Initially, the recovery was driven by the manufacturing sector, in particular outward oriented industries (the sector grew at 9.0% in Q2 2000 with sectors such as electronics and computers growing by over 15%). Gradually, other sectors are expanding as well. For instance, the construction sector, badly hit by the crisis (the sector contracted by almost 9% in 1999), has started to show signs of recovery (the sector grew positively in the last two quarter of 1999 and the first quarter of 2000. Q2, 2000, however, was negative), mainly as a result of an increase in private construction. Nonetheless, industrial capacity utilization remains low (65% by Q2 2000) particularly in inward oriented sectors. Within services, the financial sector continues to carry the weight of the crisis, contracting by 3.6% in Q2 2000. The agricultural sector has also been showing signs of weakness during Q3 1999 and Q1 2000 (in both quarters the sector contracted by 1.6 and 2.8% mainly due to weather problems, which affected the production of shrimp as well as the increase in the price of oil, which increased production costs in fisheries).

**Figure 2.9: Real GDP Growth and the Supply Side (1988 Prices)**



Source: NESDB

## Labor Market Developments

**The May 2000 Labor force data confirms that the recovery of the labor market has been more prolonged than the general economic recovery.** While, on a y-o-y basis, GDP has been growing since the first quarter of 1999, unemployment began falling only in late 1999, underemployment started declining in early 2000 but is stagnating now at higher than pre-crisis levels of about 800,000 persons. Seasonal unemployment is back to pre-crisis levels, low in the rainy seasons (about 140,000 in August 1999) and high in the dry season (about 1,500,000 in May 2000).

**During the crisis, the agricultural sector released 0.6 to 1.1 million less people than expected. There was, however, no remarkable return migration to the rural areas as a result of the crisis.** Agricultural employment has been declining steadily by about half a million jobs per year since 1989, which is part of a long-term structural shift in production from agriculture to industry. This decline in agriculture's share in the labor force slowed down in 1997, as agriculture exported fewer workers to other sectors than would be expected on the basis of long-term trends. Thus even though agricultural employment did only increase by about 200,000 persons during crisis, it still played an important role in cushioning the adverse impact of the crisis.

**Table 2.5: Unemployment in Thailand (Based on May Round, in Thousand)**

Labor Force Status	May-96	May-98	May-99	May-00
Persons aged 13 and over	45,759	47,148	47,854	48,542
Labor Force	32,504	32,170	32,971	33,266
Participation Rate	71.0	68.2	68.9	68.5
Employed	30,375	28,555	29,832	30,445
Underemployed (<20 hours/week)	373	363	753	785
% of Labor Force	1.1	1.1	2.3	2.4
Unemployed	660	1,613	1,759	1,363
% of Labor Force	2.0	5.0	5.3	4.1
Seasonally Inactive	1,469	2,002	1,380	1,459
% of Labor Force	4.5	6.2	4.2	4.4

Source: Labor Force Surveys (LFS)

**In May 2000, employment was up by about 600,000 jobs y-o-y. New jobs were created in all sectors apart from agriculture and in transport.** Whereas about 200,000 jobs were eliminated in the agricultural and the transport sector (in other), 800,000 jobs were created in the manufacturing, construction, commerce and services sectors. More than 400,000 were created in the manufacturing sector alone. This job creation is most likely to have taken place in the growing export oriented sectors. Encouraging is also the fact that employment in the construction sector has continued to expand in May by about 10% or approximately 130,000 new jobs, although the sector is far from its pre-crisis high of 2.7 million jobs. Mirroring the output side, the service sector has created almost 150,000 jobs between May 1999 and 2000. These numbers show that structural adjustment is moving in the right direction in Thailand after the crisis. While agriculture is deflating again, employment is being created in the growth driving sectors, services and manufacturing, and the huge loss of employment in the construction sector is slowly netting itself out.

**Table 2.6: Employment by Sectors (Based on May Round, in Thousand)**

	May-96	May-99	May-00	May-99	May-00/May-99	
				Share of Total %	Change %	Jobs Created
<b>Total Employment</b>	30,375	29,832	30,445	100.0	2.1	612.3
<b>Agriculture</b>	12,756	12,984	12,859	43.5	-1.0	-124.9
<b>Manufacturing</b>	4,745	4,654	5,088	15.6	9.3	433.6
<b>Construction</b>	2,690	1,475	1,605	4.9	8.8	130.1
<b>Commerce</b>	4,621	4,795	4,881	16.1	1.8	86.5
<b>Service</b>	4,220	4,674	4,823	15.7	3.2	149.4
<b>Other</b>	1,334	1,250	1,188	4.2	-5.0	-62.5

Source: Labor Force Surveys (LFS)

## Risks to Growth Outlook

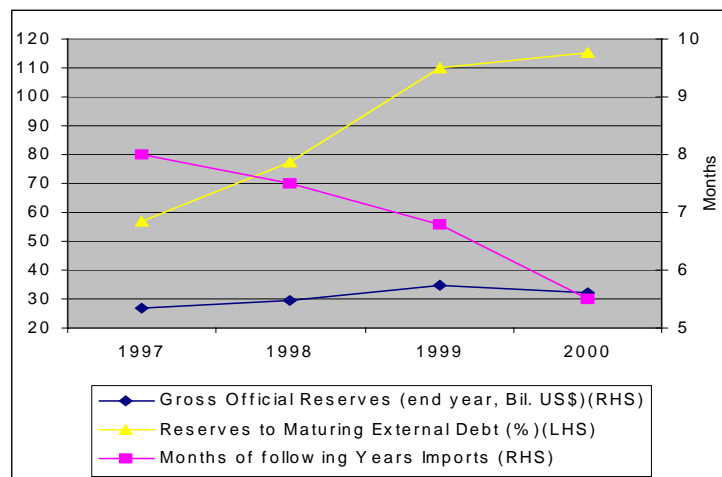
**Increase in oil prices, a potential slow down in global growth, and market concerns on the pace and quality of financial and corporate restructuring pose downside risks.** There are some signs that manufacturing production and consumption growth may be slowing down. Growth in the second quarter 2000, was mostly due to a build-up of inventories. Because the crisis has left three enduring legacies – heavy debt, skittish investors and greater household insecurity – Thailand remains vulnerable to demand shocks. Recovery remains dependant on the virtuous circle that growth has unleashed. If demand collapses, companies that can now pay their debt and are beginning to invest could quickly go under.

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## Maintaining Flexible Macroeconomic Policies

**Macroeconomic stability has been achieved.** Although market volatility increased in the second and third quarters of 2000, it is unlikely to result in a liquidity crisis. Thailand's external position remains strong, with falling short term debt and stable international reserves. The growth of exports during the first half of year 2000 was impressive (25% on average). Despite growing imports, following the recovery, the current account is expected to generate a surplus of 7 to 9% of GDP in 2000, compensating for capital outflows. While foreign direct investment flows are slowing down as extraordinary opportunities that have arisen with the crisis disappear, they are likely to stabilize above pre-crisis levels. International reserves are expected to be adequate to cover current levels of short-term debt.

**Figure 2.10 : Maturing External Debt and Import to Reserves**



Source: Staff estimates

**Fiscal policy continues to support the recovery.** The stimulus package introduced by the government in 1998, is estimated to have contributed close to 1 percentage point to the 1999 GDP growth rate, and will contribute 1 percentage point to growth of the economy this year. Given that the recovery remains fragile, the Government has announced another stimulus package in October 2000. The key elements of the package include:

- **Direct and indirect support to farmers.** First, the program contains 2 billion Baht for the fund for Farmers Assistance, aiding occupational operations of farmers. Second, additional 2.9 billion Baht have been allocated to 10,000 villages under the Poverty Alleviation Fund. The Fund's main objective is to redistribute income and enhance growth in provincial areas through revolving funds that are allocated at 0% interest to poor villages. The Fund was founded in 1998. Third, a 2 billion Baht recapitalization for the Bank of Agriculture and Agricultural Cooperatives (BAAC), in order to further strengthen the financial base of the BAAC and to expand the coverage of the BAAC's services to the agricultural sector and rural areas and lower interest rates.
- **A two-year Deferment of the Pending Increase in Contribution Rates to the Social Security Fund of 3 percentage points,** which was originally planned for the beginning of 2001 (evenly split between the employer and employee). Contributions to the Social Security Fund are paid by employees and employers in private firms with 10 or more



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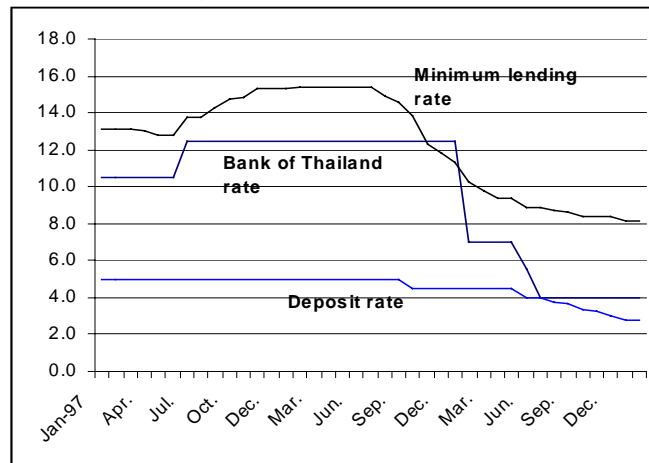
employees. Deferring the increase for 2 years would thus provide relief to lower income workers as well as lowering employer costs.

- **Additional 200 million Baht for the Revolving Fund for Debt Remedy for Government School Teachers.** The revolving fund for debt remedy for government school teachers was established in fiscal year 1997. The objective is to relieve debt problems for government school teachers. The teachers can borrow money from the revolving fund at low interest rates. At present, the revolving fund has the total operation fund of 600 million Baht. This amount can be used to alleviate debt problems of some government school teachers. But, there are 378,000 teachers who have debt (75% of all government school teachers). The total debt is approximately 139,000 million Baht.
- **Tariffs on 73 items will be reduced, with most tariff cuts to the 0-5% level.** This is a continuing effort to lessen cost of production and improve competitiveness of Thai industries in Asian and World market. The government estimates a small revenue loss of 2 billion Baht as a result of the cuts.
- **In addition, the Retirement Mutual Fund – RMF—was set up. A mutual fund targeted at increasing savings among professionals,** such as medical doctors or lawyers, along with farmers and others who are not covered by any social security or provident fund system. As well as **the Lending and Guarantee Program for Small and Medium Enterprises (SMEs).** The Ministry of Finance has set up a support plan for SMEs for 2001 as a comprehensive package initiated since 1999. For the year 2001, the lending and guarantee program is worth 52,100 million Baht, which consists of loan support 50,500 million Baht and guarantee support 1,600 million Baht.

**Fiscal consolidation is expected to start in the next fiscal year and will need to be carefully aligned with the strength of the recovery in the real sector.** If there are signs that the recovery is slowing down, fiscal consolidation may need to be delayed. While public debt has increased, and will need to be carefully managed, it is sustainable.

**Government is working towards strengthening capacity to manage public debt.** The Ministry of Finance and the Bank of Thailand are currently working together to increase efficiency in public debt management including an action plan to increase institutional capacity in Public Debt Management Office (PDMO). Updated information systems and targeted training programs for staff are critical elements of this action plan.

**Figure 2.11: Interest Rates**



Source: Bank of Thailand

**The BOT is maintaining an accommodative monetary policy and has started to target 0-3.5% inflation.** While resistance to lower deposit rates has constrained the transmission of low money markets rates to other bank rates, gradual declines in deposit and lending rates have taken place. Given the still frail asset markets, the BOT has appropriately chosen to maintain low market rates at the expense of a weaker Baht.

**Inflation is not a risk.** High oil prices and a shrinking output gap could eventually create inflationary pressures. Nonetheless, given low commodity prices and low capacity utilization, forecasts suggest that inflation in year 2000 will not be above 3%. In fact, month-on-month inflation rate for October fell, despite the increase in oil prices and the depreciation of Baht. The inflation rate should be monitored carefully as this could be another data point on whether growth is starting to moderate.

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## CHAPTER 3: STRENGTHENING COMPETITIVENESS

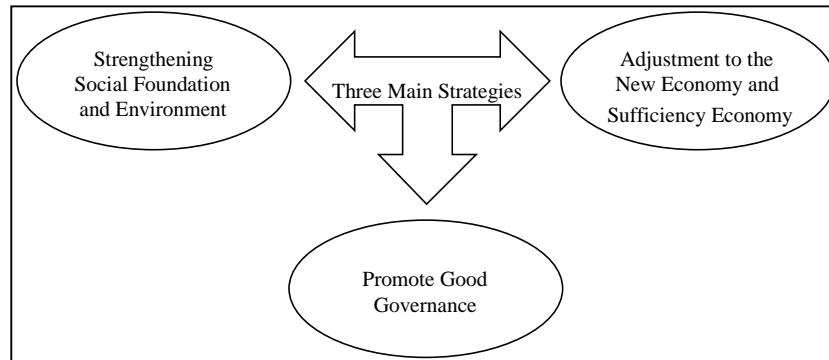
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**Thailand's structural reform program has graduated from crisis management to strengthening medium-term competitiveness.** Significant progress has been made in rebuilding the banking sector, improving corporate governance, modernizing regulatory institutions, enhancing private participation in public infrastructure, and introducing domestic and external competition. Most private banks have made significant progress towards meeting the regulatory capital adequacy standards. Thailand is emerging from the crisis with nearly 70% of the banking system in private hands. Some progress has also been made in the restructuring of state banks with the transfer of non-performing loans (NPLs) to Asset Management Companies (AMCs). The process of facilitation by the Corporate Debt Restructuring Advisory Committee (CDRAC), and the steps being taken to strengthen the legal framework have contributed to debt restructuring. A stronger foundation for medium term competitiveness has been established with the passage of the Competition Law, SOE Corporatization Act, new Education Act, tariff reductions, and Foreign Ownership Act.

**But key challenges remain, which have prevented Thailand from fully cementing its recovery process.** Markets have raised concerns on the pace and quality of financial and corporate restructuring. A potential slowdown in growth could force many banks to raise additional capital next year. Although a large number of firms have used the voluntary CDRAC process to help restructure their debt, the overall pace of restructuring is slow, with debtors using the legal framework to frustrate negotiations. The CDRAC is drawing to a close, with almost half of the total cases unsettled being transferred to the civil courts, contributing to a major judicial backlog. The backlog of cases in the civil courts poses a serious threat to the resolution of distressed assets. The capital constrained banks, the high level of NPLs, the high debt to equity ratios of the firms, and a clogged judicial system, could pose downside risks to Thai recovery on the heels of a global slowdown. To strengthen recovery, the next Government will need to implement key reforms to (a) improve the legal framework for debt restructuring to force the pace of judicial proceedings, (b) extend the life of CDRAC, as it expires in December 2000, and make the organization more autonomous, (c) identify modalities for any new initiatives to alleviate concerns about the adequacy of bank capital, strengthen bank supervision, and improve the quality of management of AMCs .

**Eliminating medium-term structural constraints to competitiveness will be important.** As financial sector reform may take several years to be completed, Thailand's future growth is less likely to come from capital growth, and more from productivity and knowledge-intensive growth. Thailand's Ninth Plan recognizes the importance of shifting away from a pre-crisis development strategy based on the accumulation of physical capital and towards a productivity and human capital based economy. A good start has been made to strengthen corporate governance, information technology, skills development, technological capability, SOE reform and competition policy. While Thailand deserves credit for putting in place a comprehensive reform program, stronger implementation holds the key to success.

**Figure 3.1: Strategy for the Ninth Plan (2002-2006)**



Source: NESDB, August 2000

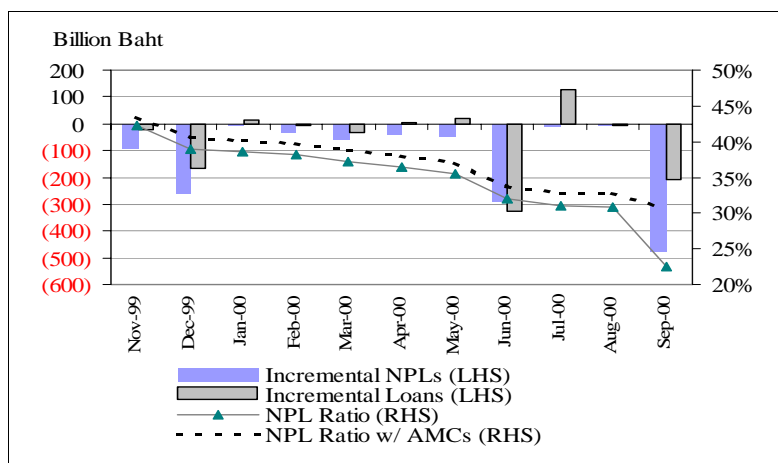
This chapter reports the progress that Thailand has made in implementing its structural reform program aimed at strengthening competitiveness. It also identifies the remaining bottlenecks and possible options for further deepening the program. The rest of the chapter focuses on (a) financial market development, (b) corporate restructuring, (c) corporate governance, (d) information technology, (e) skills development, (f) technological capabilities, (g) private participation in infrastructure and SOE reform, (h) competition policy, foreign trade regime for goods and services, public procurement policy, and business laws.

## Financial Market Development

### Financial Restructuring

**Non-performing loans have been reduced but its level remains high.** The ratio of the financial system’s NPLs to total system loans declined substantially in September to 22.6%, following large transfers of NPLs to an AMC (see Figure 3.2).

**Figure 3.2 : Non-performing loans remain high**



Source: Bank of Thailand

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**Around 72% of the reduction in NPLs in Q3 2000 came from transfers to asset management companies (AMCs), mainly by KTB.** Debt restructuring was a key contributor to NPL reduction in Q2 2000 (42%), but its contribution fell to 20% of NPL reduction in Q3 2000. The improving economy has enabled some defaulted debtors to start paying interest again such that their loans are removed from NPL status. Economic recovery accounted for 7% and 4% of the decline in NPLs in Q2 and Q3 2000, respectively. Write-offs were one of the major contributors to total NPL reduction (42%) in Q2 2000, but write-offs became insignificant in Q3 2000 (1%). NPL reduction due to write-offs are an accounting entry which reflects 100% provisioning for a loan which usually occurs at the end of an accounting period (June and December). The remaining contributions, including sale of bad loans, could explain 5% of the reduction in NPLs in Q3.

**New NPLs have slowed, but NPL re-entry has increased.** In general, new NPLs have trended down from 0.7% of total loans per month to about 0.3% of total loans. The NPL re-entry has been small at only 0.2-0.3% of total loans per month. However the amounts of NPL recidivism per quarter have gradually risen from Baht 32 billion in Q4 1999 to Baht 57 billion in Q3 2000. The extent of NPL re-entry may increase over time, given the current incentives for banks to reschedule instead of restructure loans such that repayments are sustainable by the borrower's underlying cash flows.

**Private Asset Management Companies (AMCs) have not progressed as planned.** Since the removal of tax disincentives in October 1999, the BOT has approved the establishment of eight AMC subsidiaries by seven banks and one finance company, and is reviewing the application for the set up of four more. However, only Thai Farmers Bank has established a wholly owned AMC and transferred NPLs at fair value. Those loans are managed by third party asset managers. Because some other private banks are under-provisioned and are capital constrained, their proposed transfers of NPLs to AMC subsidiaries have not been at fair market value. This has resulted in a deadlock with auditors, who will not recognize the transfer. This has stalled the implementation of private AMCs. BOT is planning to issue an accounting rule which requires market value transfer pricing, which should resolve the deadlock. Total transfers to private AMCs have been only Baht 304.5 billion.

**KTB has been split into a good and bad bank, which should accelerate resolution of its NPLs.** In September, KTB completed the transfers of its Baht 520 billion (over \$12 billion) NPLs to Sukhumvit AMC, which is wholly owned by the FIDF. Transfer pricing of NPLs were set such that KTB's capital position becomes adequate, but uncovered losses were transferred to the AMC. KTB retained its retail NPLs. After the transfer, KTB's NPLs dropped to Baht 92 billion (about 11-12% of outstanding loans) and its capital adequacy ratio is estimated to be approximately 10%. The risk going forward is from re-entry of rescheduled NPLs that were retained by KTB, especially those acquired in the merger with First Bangkok City Bank. This transfer of NPLs to an AMC will allow KTB's management to focus on growth. Third party managers will be selected by the FIDF's board to manage tranches of loans for the AMC by January 2001. Hiring third party specialists is expected to speed up the resolution of state bank's NPLs, which has so far been slow since state banks' employees are afraid of being prosecuted from causing damage to the state as a result of restructuring losses.

**Cabinet approved the final terms of Bangkok Metropolitan Bank's (BMB) privatization. But the bidding for Siam City Bank (SCIB) did not yield an acceptable bid. The resolution of this troubled institution is not in sight.** Hong Kong Shanghai Bank Corporation (HSBC) will acquire 75% stake in BMB for Baht 29.4 billion, but the net payment after capital reduction will amount to Baht 14.7 billion. Payment will be in the form of cash (Baht 12.9 billion) and 10-

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year promissory notes (Baht 16.5 billion). NPLs will be kept in BMB within a covered asset pool, but the FIDF will compensate the purchaser for lost income on the NPLs with yield maintenance, and will compensate further losses under a loss sharing agreement similar to the agreement reached with Standard Chartered Nakornthon Bank (SCNB). In addition, the FIDF will compensate HSBC for corporate income tax liabilities arising from government support. In case of SCIB, both the MOF and the BOT were reported to have agreed that SCIB's NPLs (Baht 230 billion) will be transferred to the FIDF's wholly owned AMC with third party managers. However, this is not certain, and a plan for the remaining good assets and franchise is not finalized.

**Special purpose vehicles, which promote foreign investment in property and loans, were set to expire, but a new type of property fund will extend most of those benefits for the next two years.** Two types of property fund (type II and III), allowed by the SEC, were designed to promote foreign investment in income property and loans respectively. The funds allowed for foreign ownership of these assets on a tax advantaged basis. Funds were set up and used to invest in assets auctioned by the Financial Sector Restructuring Authority (FRA), as well as other assets. The SEC designed these benefits as a temporary measure to stimulate the demand side of the secondary markets, which is the key platform for financial institutions to resolve their NPLs. Many of the funds expired without investing because financial institutions have been reluctant to accept market pricing for their assets, given regulatory forbearance on provisioning for loan losses. As a result, many property funds expired without investing. Recently, the SEC Board approved the creation of the property fund type IV, which is more flexible than types II and III. Type IV can invest in fixed assets, claims on assets and both secured and unsecured loans. The minimum size of type IV fund is Baht 500 million, and the fund must invest at least 75% of net asset value within 6 months after establishment. The fund will be exempted from corporate tax, specific business tax and property transfer tax, but not VAT. Similar to type II and III, type IV funds must mobilize funds from institutional investors. The SEC does not allow the conversion of type II and III into type IV.

**The Cabinet approved a mechanism to fiscalize FIDF losses going forward.** The authorities have estimated the present value of FIDF's losses at Baht 717 billion (Baht 840 billion future value). This is an addition to Baht 500 billion in Government bonds which fiscalized the first tranche of FIDF's losses. Given that new issuance of Government bonds is restricted by a debt ceiling under current law, in the next phase the Government will guarantee FIDF bonds instead. The Government will audit FIDF's negative net worth at the end of each September. The first lot is estimated at Baht 206 billion. With the government guarantee, FIDF will refinance its short term debt consisting of local repo paper with longer term bonds. Each fiscal year, the Government will budget for the interest costs of those bonds.

## **Supervisory Regime**

**Supervision regime is being strengthened.** The Draft "Financial Institution Law" was approved by Cabinet and the Council of State in Q1 2000. The BOT is reengineering its supervision function, with the assistance of a management consultant and professional supervisors from other countries. Risk-focused supervision is being phased in addition to the traditional transaction testing approach. Examiners must now go through a rigorous training program to qualify as commissioned examiners. The Department of Insurance has begun a review of its supervision practices.

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## Capital Markets

### **The SEC issued its medium-term strategy to boost competitiveness of Thai capital market.**

Its strategy focuses on six areas: equity market, bond market, futures market, securities industry, fund management industry, and investors. Its strategies for the equity market include: improve the quality and quantity of supply; stimulate demand by encouraging contractual savings in the country; and restructure the stock exchange (SET). Its strategies for the bond market include: enhancement of the primary market activities by improving flexibility in bond issuance, encouraging new instruments and enforcing credit ratings for new issues. The investor base should be expanded, and infrastructure for the secondary market will be developed further. Standards and practices of both the securities and mutual fund industries should be improved, clients should be well protected, and supervision will be improved to ensure stability. In order to set up the domestic futures market, the SEC plans to develop the necessary legal framework and infrastructure.

**Domestic bond issuance slowed in 1H 2000.** From January-June 2000, issuance amounted to Baht 229 billion, which was about 29% of the 1999 total (Baht 795 billion). Bond issuance by the central government in the first half was Baht 31 billion, as compared to Baht 333 billion in 1999. However, government bond issues should continue to lead activity in the primary bond market due to fiscalization of FIDF's losses over the next five years. FIDF's losses are from the failed financial institutions now under Government control, and include losses on lending to those institutions and the guarantee of deposits. The amount of corporate bonds issued in the first half of 2000 has also declined substantially following the SEC's new requirement that debentures issued after April, 2000 must be rated.

**The BOT is reviewing a pricing scheme to promote the wider use of a more efficient and lower-risk electronic payment system.** The payment system in Thailand has undergone substantial technological development in the past decade. However, it is still paper-based (cash and checks), relatively high cost and is characterized by relatively high systemic risk. For example, the cost of using and clearing checks significantly exceed fees, and are subsidized by other payment channels. More importantly, checks are settled on a net basis, which means that systemic risk may be higher than gross settlement via electronic payment. However this risk has not been accurately priced into the costs of using checks. The BOT is facing many challenges in the development of a new pricing scheme to encourage migration into electronic payments. While increasing fees for using checks may encourage firms to switch to electronic payments, retail customers do not have similar access. An unintended result may be more cash payments. Accessibility by all non-bank financial institutions (as well as foreign banks) is also an issue going forward. Thai banks have legacy systems which slow the transition to electronic payments.

**A National Real Estate Information Center is now being incubated within the Government Housing Bank.** The goal of the center will be to provide the government and market participants (financial institutions, developers, appraisers, etc.) with market intelligence in order to minimize overshooting and the misallocation of investment in the property markets. The center will collect information on sales prices and appraised values for key property types by location, and will distribute analysis via various media. The Board is active, both Thai and foreign consultants are building capacity with support from the Bank, and management plans to have a detailed business plan done in Q1-2001.

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## Financial Reform : Challenges Ahead

**Every Baht not repaid by borrowers on loans in the state banks and intervened banks must be paid by the Thai taxpayer.** To minimize public burden, the loans must be effectively managed from the creditor's standpoint, and there needs to be an efficient legal regime for debt collection which requires the borrower to take the first loss. Roughly three out of four NPLs by value are owned by the FIDF; the balance are in the private banks. The key issue is not whether there is a national asset management company, which if not properly designed and implemented could easily turn into a freezer where the loans are not aggressively worked. More important is effective management, which requires the use of private sector specialists who have profit incentives to maximize recoveries on the loans, thereby minimizing the cost to the taxpayer. This is FIDF's strategy going forward. The next phase will be more coordination of NPL resolution by the FIDF among the various asset managers on both a customer and industry basis, which will reduce inter-creditor problems in NPL resolution.

**The secondary markets for bank shares, loans and collateral (property) are moribund, given that over a third of the Thai credit assets are locked up in NPLs, and a quarter are headed for the courts.** The key steps for the Government are to expedite mortgage enforcement via the courts (see "Corporate Restructuring" section), and to require full transparency on losses on bank balance sheets. This will give banks a way to collect on defaulted loans, and will remove negative incentives for banks to restructure or sell loans and collateral at values which reflect underlying cash flows.

**DBS Thai Danu Bank's (DTDB's) loan sale provides another reference point for market valuation of NPLs on bank books.** DTDB's recent sale of its NPLs is the first competitively bid, private sale of NPLs by a Thai bank. The sale is more recent than the FRA auctions of assets from the failed finance companies, and its portfolio should be more similar to NPLs of other banks. But prices were similar to prices achieved by the FRA (about 50% of outstanding principle balance for retail NPLs and 22% for corporate NPLs). DTDB sought bids for the same loans a year ago, but did not sell them at that time. According to management, prices offered in last year's bid were not substantially different from prices offered in the recent loan sale. DBS, the parent of DTDB, was motivated to sell because the high NPLs in DTDB reflected poorly on DBS, and could negatively affect the parent bank's credit rating. The key issue is what does this pricing mean for the other banks. Management estimates that if it held onto the loans, their auditors would have forced them to provision for losses of between 35-40% on the retail loans and 40-45% on the corporate loans, which add back the estimated profit margin required by the purchasers of the NPLs. Other private banks would need to significantly increase their provisions to match this level, some more than others.

**While banks will meet the year-end 2000 provisioning requirements set by the regulator, the banking system remains capital constrained.** Thai banks have raised Baht 844 billion tier-1 capital (Baht 58 billion tier-2 capital) of which Baht 314 billion came from private investors. Although significant unrealized losses remain on the balance sheets of some banks, regulatory forbearance allows banks to delay loss recognition such that banks are not forced to recapitalize quickly and sufficiently. Explicit forbearance, which includes the phase-in of provisions over time, will cease at end 2000. However, implicit forbearance, which is less transparent, will continue after 2000. Implicit forbearance allows banks to provision for loan losses net of collateral value, which is mostly property. Collateral value appears overstated due to the weakness in the profession, practices and standards of property valuation in Thailand. Sampling of bank credit files shows that most appraisals employ only the cost approach, which bears no



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relation to market value which has declined. In addition, quality control on the reclassification of restructured NPLs appears weak. For example, repayment history is not required to reclassify a restructured loan. Capital constraints in the banking system, together with a weak legal regime for collection, are slowing the pace and quality of loan restructuring.

**The Government's program, which provides public capital as a last resort to private banks, will expire Q1-2001.** The government established a public recapitalization program in August 1998 to provide public funds to recapitalize private financial institutions on a matching basis with private capital. Banks view the scheme as a last resort because they fear that accepting public investment will be perceived as a sign of weakness by the market, and will invite government interference in management, even after 1999 amendments to the scheme. To date only 23% or Baht 70.5 billion has been utilized by private banks. Going forward, private banks have little interest in public support as long as the regulator provides forbearance on provisioning.

**The challenge ahead is to attract private capital to invest in Thai banks to provide a platform for new lending, once capacity utilization picks up.** Otherwise, the taxpayers will pay for remaining losses. This will require clean opinions from auditors on bank balance sheets, so the investors know what they are buying, and an expedited process for mortgage enforcement in the civil courts, so that banks know they have a way to get paid back on their loans. A change in the incentives would give investors confidence that banks (and borrowers) can more expeditiously resolve outstanding NPLs, would stimulate the secondary markets for loans and collateral, and would more evenly distribute the losses among taxpayers, borrowers and lenders.

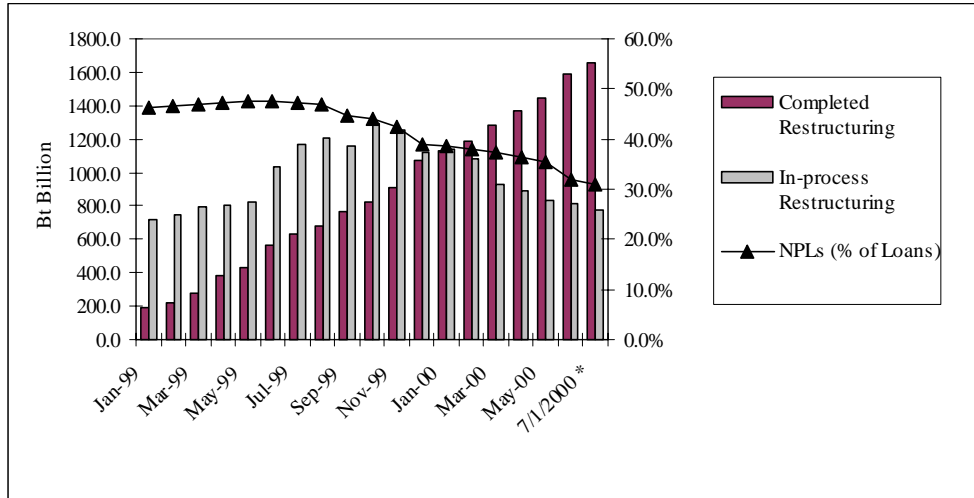
**The Financial Restructuring Authority (FRA) is ready to start distribution of proceeds to creditors from the sale of assets from the failed finance companies.** FRA has disposed of 86% of the assets from failed finance companies; the remainder includes assets in litigation, loans over collateralized beyond 200% and contingent liabilities of the former finance companies. Of the 56 closed finance companies, creditor claims have been adjudicated for the first eight institutions, and prorata distributions to creditors (mostly FIDF) is scheduled for Q2 2001, with the remainder of the firms to follow soon thereafter.

## **Corporate Restructuring**

**Steady progress on corporate restructuring.** The debt restructuring completion rate increased in the second quarter of 2000 compared to the first quarter of 2000. This was in part due to financial institutions booking the activity at the end of the accounting period.

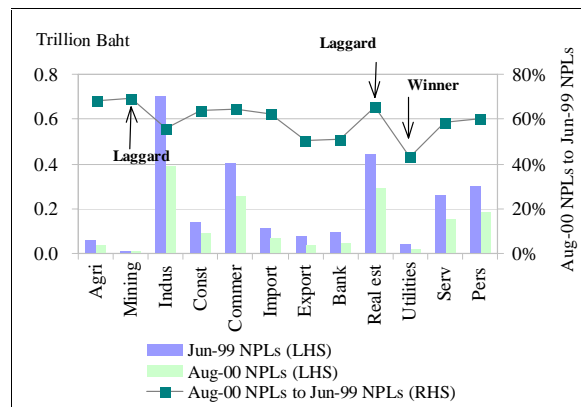
Figure 3.3 shows that at the end of July 2000, a cumulative total of 281,222 cases were restructured (Baht 1.66 trillion). This is a significant progress over 1999 (173,709 completed cases for a cumulative total of Baht 1.07 trillion), and 1998 (9,015 completed cases for a cumulative total of slightly over Baht 100 billion).

**Figure 3.3 : Progress on Debt Restructuring**



Source: Bank of Thailand

**Figure 3.4 : Sectoral NPL Comparison**



Source: Bank of Thailand

**NPLs in tradable sectors performed better than in non tradable sectors.** From June 1999 to August 2000, the reduction of NPLs in export and import sectors (and utilities) have been among the fastest. On the other hand, NPLs in real estate and construction sectors (non-tradable) have lagged others in term of decline during the same period (see Figure 3.4). Thailand's export-led recovery has allowed tradable sectors to pick up faster than non-tradable. The performance differential between tradable and non-tradable sectors could widen further following the recent Baht depreciation, which may benefit tradable sectors disproportionately.

### **Voluntary Framework for Debt Restructuring: CDRAC Process**

Initially, the Corporate Debt Restructuring Advisory Committee (CDRAC) monitored 702 large corporate "target debtors". Since October 1999 an additional 2,071 target cases were added, increasing the number of cases to 2,773 (total value Baht 2.29 trillion). Of the total corporate target cases, 2,124 firms (or 77%) signed the *Debtor Creditor Agreement (DCA)*. Unlike most of the regional variants of the London Rules, CDRAC requires that a plan be confirmed on its second vote, within 6-8 months. At the end of September, 44% (credit exposure of Baht 1.01 trillion) of the corporate target cases were restructured, while 45.2% (credit exposure over Baht

1.04 trillion) have failed to settle and must be resolved by the courts. The total credit value that failed the CDRAC process and proceeded to legal action is a growing concern; it exceeds the amount of completed restructuring (see Table 3.1).

**In addition to the large corporate cases, CDRAC is also responsible for 6,829 small-medium-sized loans, with credit exposure of Baht 295 billion.** To date, restructuring of this target group has produced a 35.4% completion rate as compared to 25.9% completion rate at the end of July 2000. By credit value, 52.77% of this group failed the process and must be resolved by the courts.

**Table 3.1 :Status of CDRAC Target Cases  
As of September 30, 2000 (Unit: Million Baht)**

Stages	Corporate (Groups 1,2,3,4)		SMEs		Total		
	#Cases	Amt.	#Cases	Amt.	#Cases	Amt.	% of Total
Completed cases (signed restructuring contract, agreed on plan & in process of signing )	571	692,256	4,616	101,385	5,187	793,641	
Agreed on plan, in process of signing restructure contract	167	151,308	-	-	167	151,308	
Plan accepted, will file in court	27	166,838	-	-	27	166,838	
<b>Total Completed Cases:</b>	<b>765</b>	<b>1,010,402</b>	<b>4,616</b>	<b>101,385</b>	<b>5,381</b>	<b>1,111,787</b>	<b>43.0%</b>
In Restructuring Process (draft/ propose/amend plan, to be voted)	336	90,296	336	33,651	672	123,947	4.8%
Plan Rejected (after 2 <sup>nd</sup> vote) – Will Proceed to Court Action	520	299,984	813	62,259	1,333	362,243	
Debtors not signatory under DCA/ICA/SA, proceed to court	1,019	656,865	667	50,905	1,686	707,770	
Unsuccessful restructuring	73	81,127	370	37,759	443	118,886	
In Process of Legal Action	1,612	1,037,976	1,850	150,923	3,462	1,188,899	46.0%
In Process of Signing Debtor Accession	-	-	27	608	27	608	
Returned to performing loans	60	159,662	-	-	60	159,662	
<b>Total Approved Target Debtors</b>	<b>2,773</b>	<b>2,298,336</b>	<b>6,829</b>	<b>286,567</b>	<b>9,602</b>	<b>2,584,903</b>	<b>100.0%</b>

**Voluntary workouts of small-medium-sized cases continue at a steady but slow pace.** The CDRAC Program is beginning to add to restructuring volumes since corporate cases are beginning to reach deadlines. However, the process is resulting in both agreements and failures, which will have to be resolved in the courts. The CDRAC monitors the restructuring of both corporate and small-medium-sized loans. A total of 9,602 target cases with the credit exposure of Baht 2.59 trillion is monitored by CDRAC. At the end of September 2000, Baht 1.11 trillion or 43% of total credit exposure has been restructured as compared to the completion rate of 39% at the end of July 2000. 46% of the total credits have failed the CDRAC process and must be resolved through the courts. The majority of the target cases currently in the process are from the manufacturing sector, followed by the commercial wholesale & retail and real estate sectors.

### **Court-Supervised Restructuring and Liquidation**

**Court-supervised resolution of NPLs was slow in 1999, but the volume of court filings for business reorganization and liquidation appears to have picked up since January 2000.** Through December 1999 the Central Bankruptcy Court has received 37 business reorganization petitions (value over Baht 362 billion) and 441 liquidation petitions (value under Baht 11 billion), of which 416 were smaller liquidation cases. Since January 2000, the volume of court filings in both categories has increased significantly. From January-September, 102 reorganization

petitions (value over Baht 577 billion) were filed with the court. Liquidation petitions have also increased during the first nine months of year 2000. 620 petitions were filed (value over Baht 45 billion) at the end of September (see Table 3.2).

**The completion rate has been moderate in both reorganization and liquidation cases.** From January-September 2000, reorganization judgements averaged 12 cases per month, while liquidation judgements averaged 70 cases per month. However, most liquidation filings are small-medium-sized loans, and were filed for debt collection purposes, which undermined the intent of the Bankruptcy Court. However, court officials felt that the debtors and creditors have a better understanding of the bankruptcy law and process, and are more confident in the legal protection under the court system. While still slow, debtors are increasingly filing petitions to protect their businesses as out-of-court negotiations with creditors proved futile.

**Table 3.2 : Progress of the Central Bankruptcy Court  
Business Reorganization and Liquidation\***

Type of Filings	Volume	Jun-Dec 1999 (6 months)	Jan-Mar 2000 (3 months)	Apr-Jun 2000 (3 months)	Jun-Sept 2000 (3 months)	Jan-Sept 2000 Total
Business Reorganization	Cases	37	14	51	37	<b>102</b>
	Mill Baht	362,841	169,938	248,226	159,160	<b>577,324</b>
Liquidation	Cases	441	167	224	229	<b>620</b>
	Mill Baht	10,500	10,707	17,845	16,570	<b>45,742</b>

Source: Central Bankruptcy Court of Thailand

\* As of September 30, 2000

### **Corporate Restructuring : Challenges Ahead**

**The voluntary agreements under CDRAC will expire at the end of December 2000.** The crucial issue is what will happen to the incomplete cases at the end of the year when the voluntary agreements under the CDRAC process expires. Following the timeframe advocated by the formal intercreditor agreement and the debtor/creditor agreement, the Bank of Thailand expects that 70% of the work-in-process cases will be completed or forwarded to the courts by the end of year 2000, and the remaining 30% will be completed or forwarded to the courts by March 2001. Most of the work-in-process cases are the small-medium-sized loans. CDRAC also resolved to add to the list of target debtors the subsidiary and affiliate companies and walk-in cases. The BOT is considering two options for the on-going case load, either wind down the CDRAC process such that the unfinished cases will have to be resolved through the courts, or extend the voluntary agreements and allow the Office of CDRAC to continue to facilitate debt restructuring until the voluntary process is completed. If the BOT winds down the CDRAC process, it is expected that the court filings, especially in the Civil Court, will dramatically increase during the first quarter of 2001, creating a larger backlog. The court will need to increase capacity and streamline the processes for both judgements and post-judgement auctions in order to bring timely resolution to the pending cases. The more likely scenario is the extension of the voluntary agreements under the auspices of CDRAC and BOT, the process of which is likely to continue until mid-2001. Under this scenario, the potential failure of cases in the CDRAC process still remains, and the failed cases will have to be resolved in court. The most effective means to accelerate resolution of cases under CDRAC is one of the most crucial considerations for the BOT in the immediate future.

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**The backlog of cases in the Civil Courts poses a serious threat to the resolution of distressed assets.** The backlog is estimated to be about six to seven years for judgements, and an additional one to two years to auction the collateral once a judgement is reached. At the end of September 2000, 46% of the target cases with credit exposure value over Baht 1.19 trillion have failed the CDRAC process and have proceeded to the courts. Most cases are filed in the Civil Court. Several remedial measures can be implemented immediately: (1) The Civil Courts can establish a special division to process commercial cases which involve financial institutions, which will accelerate the pre-trial phase. This can be accomplished by issuing a ministerial decree; (2) proactively engage the pre-trial mediation support that was mandated by the Cabinet in August 2000 (a budget of Baht 254 million was approved by the Cabinet); and (3) in the Civil Court of Southern Bangkok, where most of the non-performing loan cases are filed, there are approximately 130 judges, and only about 20% are senior judges. Non-performing loan cases are more complex than other cases, and require knowledgeable and experienced judges. Due to the shortage in the number of judges, a postponement of a typical court hearing often takes up to four months, which further delays the judgement process. Senior judges and experienced administrators should be dedicated to the commercial mortgage enforcement cases. The number of judges should be increased and adequate training and institutional building capacity support should be the priority of the Courts of Justice.

**The amendment to the Code of Civil Procedures on default was passed into law in March 2000, but the impact on judgement rates has been minimal.** The amendment eliminates a frequent delay tactic by enabling judges to issue a judgement in favor of the plaintiff if the defendant fails to appear for a hearing. However, since the enactment of the new default procedures, creditors have reported increasing delays in the civil court process for enforcing security interests, and in the execution of the auction of the collateral in the market. A ministerial decree is needed which would speed up the auction process. For example, reserve prices could be eliminated so that the collateral would be sold in the first round of auction instead of delays from multiple rounds.

**The enactment of the Evidence Laws would accelerate the legal process in the resolution of NPLs.** The Ministry of Justice drafted two Evidence Laws in 1997 called the Codes of Civil and Criminal Procedures (Evidence). The Council of State has completed the review of the laws in mid-2000, but has not forwarded them to the Parliament for consideration. The passage of these two laws would allow the Courts of Justice to issue decrees to streamline the evidence discovery process and provide for continuous hearings to speed up the process of rendering judgements.

**The Bank of Thailand has promulgated the Principles and Guidelines of Debt Restructuring for State Banks.** While state banks have 3 times the outstanding classified loans of private banks, private banks have restructured 3.3 times the number of cases. To facilitate more rapid progress, the Bank of Thailand promulgated the "Principles and Guidelines of Debt Restructuring for State Banks" in October 2000. The guidelines provide state bankers with a systematic approach to calculate the least-cost solution of debt restructuring. It is aimed to reduce the potential for legal liability associated with the State Enterprise Employees Act. Under this act, state employees may be criminally liable if they accept a loss on behalf of the state, even if it was a reasonable write-off accepted in a debt restructuring. In November 2000, the Bank of Thailand conducted "train-the-trainers" sessions for both the policy and working levels for the state banks and their AMCs.

**Few, if any, mergers between distressed firms have occurred.** The merger process in Thailand is time consuming and onerous, requiring six months notice period during which creditors may object to the merger or demand immediate payment. The Civil and Commercial Codes and the

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Public Limited Companies Act require that the two merged entities lose legal status before creating a new legal entity out of the two independent units. In addition, although the Government has extended numerous tax incentives to induce mergers such as the waiver of tax on non-cash mergers, the actual transactions are few in number. The primary obstacle to the mergers is the inability to carry net losses from the merger candidates forward into the new entity.

**The fiscal stimulus measures have not been widely utilized.** Since January 2000, the Royal Thai Government has announced several measures aimed to facilitate debt restructuring. Property transfer tax is waived if the proceeds from the sale of the collateralized property (sold to either financial institutions or to a third party) are used to repay outstanding bad debts. The announcement was not widely known to the public, and in some cases, the Land Department failed to grant the tax waiver on transactions that comply with the announcement. The Small Industry Credit Guarantee Corporation (SICGC) was mandated to provide credit guarantees for credit lines granted to small-medium-sized borrowers involved in debt restructuring. However, SICGC requires guarantees from the counterpart financial institutions or a personal guarantee, which has made the instrument unattractive. Both of these measures have not produced the “quick win” debt restructuring results desired by the Government.

### **Box 3.1 : Corporate Restructuring Outlook: A Selected Analysis**

**Real Estate Sector.** The recovery of real estate market value in Thailand is largely driven by property type: residential or commercial. Currently, the market condition is considered poor; there are both excess supply and shortage of demand for both types of properties. Property values have been either stabilizing or falling depending on location. Based on the electricity meter statistics from the Metropolitan Electricity Authority (MEA), which measures vacancies in the Bangkok Metropolitan Area (BMA), there is a 47% vacancy rate of all properties.

Completion rates for debt restructuring are therefore slow in the real estate sector. Property sector restructuring includes substantial asset redeployment, for which the court process is very slow. In addition, most loans involve multi-creditors and/or syndicated lenders which increases the complexity and time in restructuring. Finally, the lack of legal action has kept assets from distressed owners out of the market.

During the last quarter of 1999, Land and House, Plc., the largest real estate developer in Thailand, successfully restructured its Baht 20 billion debt and raised Baht 2.5 billion capital through public offering. In March, 2000 Sansiri Plc., another large real estate developer, also successfully restructured its Baht 14 billion debt and brought in a foreign strategic partner. The market viewed these developments positively. As mortgage interest rates have fallen in recent months, the outlook for improvement is favorable in the residential property market.

**Steel Industry.** Over-supply of steel products continues to persist due to declining construction activity. The demand for steel is sluggish and may not recover for some time. There are several large-scale steel producers, most with sizeable, multi-creditor, foreign currency debts. Progress is slow- in some cases, negotiations with creditors have been ongoing for over two years without resolution. Recently, merger discussions were restarted which may ultimately reduce the number of producers. Currently, at least two of the top four producers (SCC, NTS, BSI, and Nam Heng Steel) are negotiating a merger, and an MOU is expected to be signed by late 2000. To this end, the government is considering incentives to the merger that would prevent foreign take-over of the companies.

## **Corporate Governance**

**There is broad recognition that poor systems of corporate governance contributed to the financial crisis by shielding banks, specialized financial institutions, and corporations from market discipline.** The Thai corporate governance practices were characterized by ineffective

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boards of directors, weak internal controls, unreliable financial reporting, inadequate protection of minority shareholder rights, lack of adequate disclosure, poor audits, and lax enforcement to ensure compliance.

The Government's reform strategy has focused on streamlining institutional arrangements, enhancing the reliability of financial information and disclosure, improving corporate board oversight and effectiveness, and increasing shareholder rights. It has also focused on improving the effectiveness of the legal and regulatory framework for enforcement of laws and regulations related to public companies.

**The Public Companies and Securities and Exchange Acts are being amended to increase shareholders' rights and the ease with which they exercise those rights, improve accountability of boards of directors and officers, and improve enforcement of sanctions for violation of law.** The enforcement of these provisions is intended to improve incentives and the business environment. Efforts are underway to strengthen institutions responsible for ensuring accountability and compliance, including professional organizations, and to improve and enforce mechanisms such as the code of ethics and code of conduct for accountants and the code of best practices for directors. All listed companies are now required to have an audit committee of boards of directors.

An Institute of Directors has been established and by the end of the year, 120 executives of Thai companies will have completed the Institute's training program for company directors. Significant effort has been expended to improve accounting and auditing standards and practices in the last few years. While further improvement in accounting standards is warranted, the challenge now is to ensure the proper and effective application of these standards as early as possible.

**While significant progress has been made, the reform agenda remains unfinished.** The most critical challenge lies in implementation--changing from a culture of minimal disclosure to one of adequate disclosure. Beyond the adoption of international standards, this involves strengthening institutions and setting mechanisms to ensure that the standards are applied properly. Minority shareholder rights must be strengthened, and accountability and liability of directors in the case of breach of duty must be clarified further. Efforts should intensify on improving effectiveness of the legal and regulatory framework.

**Amendment of laws, including the Public Companies and Security and Exchange Acts, has been very slow and needs to be expedited.** Amendment of the Accounting Professional Act to allow establishment of the Thailand Financial Accounting Standards Board and strengthening of the ICAAT needs to be expedited as well. Now that the corporate governance framework is largely in place, efforts should focus on transparency of business practices and promotion of business ethics. Efforts are also needed to promote good corporate governance among non-listed companies, especially medium-size firms.

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### **Box 3.2: Progress on the Accounting and Auditing Reform in Thailand**

#### **Auditing Standards**

Twenty five exposure drafts on auditing standards have been issued and presented at public hearings. By the end of the year, Thai auditing standards are expected to be fully consistent with international auditing standards.

#### **Accounting Standards**

A total of 17 improved or new accounting standards that are consistent with international standards have been adopted. In addition, 10 exposure drafts on new or revised accounting standards have been issued and are scheduled for adoption.

The recent revision of accounting standards completed last May includes: construction contracts, segment reporting, development stage enterprises, income taxes, financial instruments, events after the balance sheet date, contingent liabilities and contingent assets, classification of financial instruments, jointly controlled entities, and property, plant, and equipment.

#### **Specific Rules on Accounting and Disclosure for Banks**

Several draft specific rules on accounting and disclosures for banks have been prepared and are expected to be issued by the Bank of Thailand (BOT) by the end of the year. These include: sale of foreclosed assets, accounting for impairment of a loan, accounting for investment in securities, accounting for loan restructuring, accounting for leases, and accounting for derivatives.

#### **Strengthening of the Institute of Accountants and Auditors of Thailand (ICAAT)**

The draft Accounting Professional Act, which grants more independence to the ICAAT and allows establishment of the Thailand Financial Accounting Standards Board (TFASB), has been approved by the Cabinet. The draft legislation is currently with the Council of States, a legal advisory body to the Parliament.

#### **Improving Audit Reports**

Prior to the 1998, audit reports were prepared in two paragraphs, which was not consistent with international standards. There was no paragraph explaining management responsibility in preparing financial statements. As part of the reform starting in 1999, audit reports have been prepared in three paragraphs in a manner consistent with international best practice.

#### **Streamlining Audit of Limited Partnerships and Disciplinary Measures for Accountants**

The Accounting Act has been amended to remove the burdensome statutory requirements for submitting audit reports for limited partnerships, enhance disciplinary measures for accountants, and require compliance with accounting standards issued by ICAAT.



**Box 3.3 Financial Accountability and Corporate Governance Reform in Thailand, Korea and Malaysia**

Item	Thailand	Korea	Malaysia
<b>1. Financial Reporting and Disclosure</b>	<ul style="list-style-type: none"> <li>• Cabinet approved framework for changes to Accounting Professional Act to establish TFASB and strengthen ICAAT. Amendments to Accountant’s Professional Act are pending.</li> <li>• Amended Accounting Act to enhance disciplinary measures for accountants and require compliance with standards issued by ICAAT.</li> <li>• Issued new and improved accounting standards consistent with international standards.</li> <li>• Issued exposure drafts for auditing standards fully consistent with international standards.</li> <li>• Required preparation and audit of financial statements in accordance with improved standards beginning in 1999.</li> <li>• Issuance of new specific rules on accounting and disclosures for banks are pending.</li> <li>• Enforcement of enhanced disciplinary measures for accountants are under way.</li> </ul>	<ul style="list-style-type: none"> <li>• Established KASB in September 1999 to set accounting standards. Strengthened the role of KICPA. Amended relevant laws and regulations.</li> <li>• Issued new and improved accounting standards consistent with international standards.</li> <li>• Issued revised auditing standards fully consistent with international standards.</li> <li>• Required preparation and audit of financial statement in accordance with improved standards beginning in 1999.</li> <li>• Issued specific accounting standards for commercial banks.</li> <li>• Enforcement of enhanced disciplinary measures for accountants are under way.</li> </ul>	<ul style="list-style-type: none"> <li>• Established MASB in 1997 as the sole authority to set accounting standards and required compliance with standards issued by MASB mandatory by law.</li> <li>• Issued improved accounting and auditing standards consistent with international standards.</li> </ul>
<b>2. Board of Directors and Shareholder rights</b>	<ul style="list-style-type: none"> <li>• Cabinet approved framework for changes to PCA and SEA to clarify duties and accountabilities of officers and directors, increase protection of shareholder rights, and improve sanctions for violation of laws.</li> <li>• Amendments to PCA and SEA are pending.</li> <li>• Issued revised guidelines on the code of best practices for company directors and audit committees.</li> <li>• Established an Institute of Directors.</li> </ul>	<ul style="list-style-type: none"> <li>• Established FSS.</li> <li>• Amended relevant laws and regulations to clarify duties and accountabilities of officers and directors, increase protection of shareholder rights, and improve sanctions for violation of laws and regulations.</li> <li>• Reviewed existing requirements for the audit committees of the boards of directors. Amended laws and regulations and required establishment of audit committees of the boards of directors for large listed companies in year 2000.</li> </ul>	<ul style="list-style-type: none"> <li>• Improved listing rules to enable KSLE to act against negligent directors, in addition to suits by aggrieved parties. Amended relevant laws and regulations to strengthen the powers of KLSE.</li> <li>• Issued a comprehensive code of corporate governance by High level Finance Committee in May 1999.</li> <li>• Issued revised Code on Takeovers and Mergers in January 1999.</li> <li>• Established Malaysian Institute of Corporate Governance (MICG) to promote awareness and best practices.</li> <li>• Required all listed companies to have audit committees.</li> </ul>
<b>3. Regulatory framework and enforcement</b>	<ul style="list-style-type: none"> <li>• Reviewed roles and responsibilities of SET and SEC. Put in place clarified enforcement arrangements.</li> <li>• Amendments to the PCA and SEA to support the arrangement are pending.</li> </ul>	<ul style="list-style-type: none"> <li>• Amended relevant laws to strengthen enforcement.</li> </ul>	<ul style="list-style-type: none"> <li>• Strengthened enforcement.</li> </ul>

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## Information Technology

**The digital divide between Thailand and its neighbors and within Thailand between urban and rural is on the increase.** There are growing gaps between Thailand and its regional counterparts in the application of information technology in commerce, academia, and society, as well as a wide gulf between rural and urban areas in the use of IT. Internet penetration (internet users as a share of total population) is less than 2%, compared to global average of 5%, and penetration rates exceeding 30% in more developed Asian economies. Computer penetration, e-commerce revenues and teledensity all indicate that Thailand is increasingly on the wrong side of the digital divide. To date, the limited diffusion of the Internet in non-metropolitan areas limits the size of domestic market for IT applications.

**There are eight key factors constraining internet diffusion, particularly for electronic commerce.** (1) High access costs, particularly leased line services, which are a direct result of the Communication Authority of Thailand's regulation of internet service provision. (2) Low awareness, particularly in rural areas and in small and medium-sized enterprises, of the utility of IT; (3) a lack of trust in online transactions, which limits e-commerce and e-government acceptability; (4) a lack of specific skills and management capacities in such areas as back office process management and fulfillment, XML programming, and English language. (5) slowly emerging legal and policy framework, a factor which was set back further by the delay in passing the Digital Signature and National Information Infrastructure laws before Parliament was dissolved; (6) underdeveloped third-party and intermodal logistics, and online payment systems; (7) poor diffusion of common standards in both industry and government in such a manner as to promote interoperability and data sharing; (8) a lack of Thai product development, due to difficult market conditions for Thai technology entrepreneurs.

**Thailand is in the process of developing a comprehensive information technology strategy – IT2010.** The strategy has three major aims: i) to facilitate access to information technologies to different segments of the society ; ii) to promote the diffusion of e-commerce; and iii) to optimize service delivery, participation, and governance through electronic government. The National Information Technology Committee (NITC) located in the Prime Minister's Office is coordinating this task.

As an interim measure in the context of E-ASEAN, NITC has recently embarked on e-Thailand, a project designed to accelerate the diffusion of information technology in six areas: (1) e-society. Reduce the digital divide for the Thai population, and help build an e-Thailand community, and preparing people to participate in the next phase of the electronic era. (2) e-government. Develop linkages in the public sector, which will enable the public to access services electronically, and promoting transparency in government procedures. (3) International economic policy. Develop cooperation between the public and private sectors, so that the e-Thailand concept can be realized. (4) Liberalization involves promoting, developing, strengthening and enhancing competitiveness in the local IT and telecommunication sectors. (5) Making e-commerce transactions based on international standards, while developing secure electronic payment and settlement within the country. (6) Developing interconnectivity and interoperability standards to facilitate the government, the private sector and the general public to go online.

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**The implementation of the new constitution and the process of decentralization make it necessary to dramatically scale up e-government capacity.** An updated e-government strategy is therefore required which defines the overall vision, articulates clear implementation objectives, builds awareness, and presents specific e-government plans for each government agency. As a first step NITC and NECTEC need to assess the organization and technical readiness of these institutions. NECTEC is now in the process of developing a draft strategy. Given the complexity of this task, the capacity of NITC will need to be substantially upgraded as has been included in the National Information Infrastructure Act. Some leading e-government agencies appear to be the Revenue Department, Department of Commercial Registration, Ministry of Commerce, and Department of Local Administration.

**The Cabinet has approved NECTEC's Framework for Thailand e-Commerce Policy, but important legislation was delayed.** Two laws, the combined E-Transaction-Digital Signature Act and the National Information Infrastructure Act, have been forwarded to Parliament but were not passed by the Senate for Parliament was dissolved. The pending agenda items will await the new Parliament. NECTEC, meanwhile, will develop a package of laws which address security and online payments. A second challenge for the government will be to accelerate reforms in the telecommunication sector and coordinate these reforms to better serve the needs of the National IT strategy.

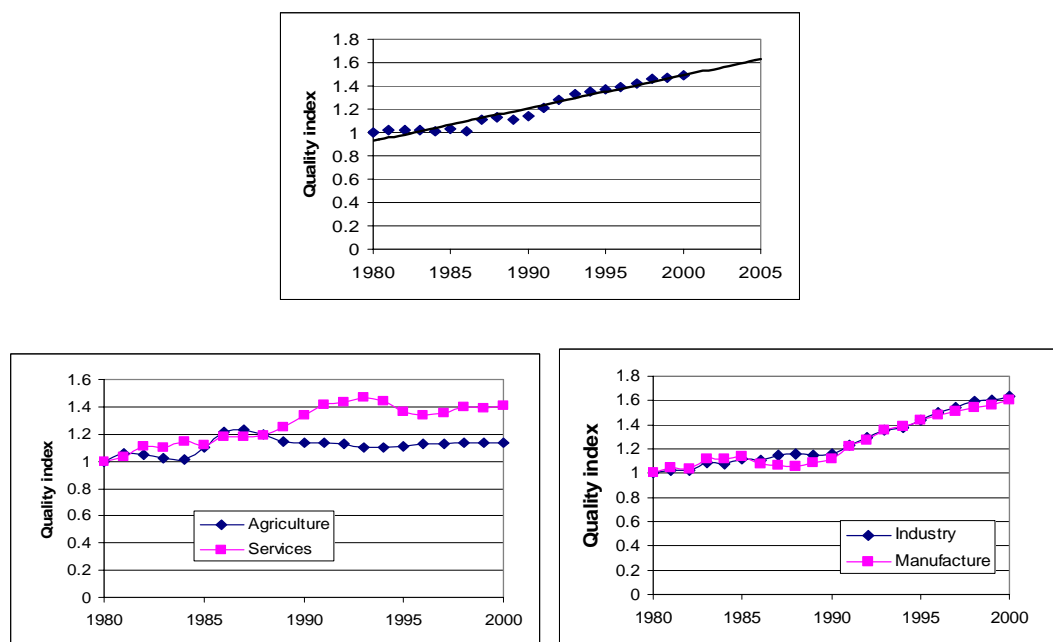
**Reforms in the area of skills development will also need to be responsive to the National IT strategy.** This will require strong coordination channels between NECTEC and the Department of Skills Development.

## **Skills Development**

**While the average worker in Thailand is becoming more productive, the observed mix of skills in the labor market is not well suited for the emergence of a knowledge economy.** The productivity of the labor force in Thailand has been growing steadily in all sectors (with the exception of agriculture) since 1980, mostly as a result of an increase in the share of the labor force with more than primary education (see Figure 3.5). Despite the fact that Thailand has a strong foundation in basic education, however, important challenges remain in terms of post-basic education and development of workers' skills.

**Thailand has important manpower gaps in the areas of science and technology.** In part this can be explained by Thailand's low enrollment rates in scientific disciplines relative to other countries in the region. To date, Thailand faces a large IT skills gap with domestic supply of specific IT skills lagging far behind Malaysia, Philippines, India, and China (annual supply of specialized IT skills at the graduate level is less than 5,000).

**Figure 3.5: Labor productivity in Thailand has been growing**



**The problem is reinforced by observed low levels of employer-provided training.** While modern sector wage employees have on average 9 years of formal education, much lower levels of education persist among older workers and workers in the informal sector. This restricts labor mobility to modern sector wage employment and imposes constraints to the adoption and diffusion of new technologies. Yet, the distribution of employer-provided formal training is very uneven, with the incidence of training being particularly low among small and medium-size companies. Almost forty percent of manufacturing establishments provide formal skills training to some members of their workforce, either through in-house training programs, or through courses given by external training providers. However, many firms do not train, and SMEs in particular, given high labor turnover (and loss of training investments). Poor knowledge about how to train or the benefits of training, and restricted access to appropriate financing mechanism are other constraints.

**The institutional framework developed to stimulate employer provided training is failing to generate expected results.** The tax exemption incentives of 1994 and 1995 are relatively benign, however, there is a very low rate of use by companies. One of the reasons is that tax-based training policies tend to be very diffused and difficult to target. International experience indicates that training tax incentives tend to be used mainly by large companies and multinationals, most of whom already train, so that there is little "additionality". In particular, they do little to induce training among SMEs, the population of firms least likely to train.

**Thailand is reviewing its strategy on skills development, particularly in small and medium sized enterprises.** The objectives include: i) reforming the current Vocational Education Act and the Joint Public and Private Sectors Committee for Occupational Development Act (this is the responsibility of the Sub-Committee of Vocational Education and Training Reform appointed by

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the Ministry of Education); ii) strengthening the organizational structure, financing mechanisms, and medium term strategy for specialized institutes; and iii) amending the Skills Development and Promotion Act.

**Institutional capacity within the Sub-Committee of Vocational Education and Training will need to be expanded.** The committee needs to be endowed with appropriate human and financial resources. There is also need for a set of analytical studies on linkages between the supply of vocational education and the demand of different types of skills. For instance, it is critical to understand how alternative policy variables (e.g., tuition, maximum enrollment rates, academic requirements, information about job opportunities and expected wages within alternative fields) affect individuals demand for training and how these can be accommodated to ensure that the supply of skills meets the demands of the industrial sector.

**In the case of specialized institutes detailed working plans will need to be developed.** These should lay down targets in terms of training, identify evaluation mechanisms, and design a sustainable financial plan with an appropriate balance of public and private resources. The organizational structure of the institutes and needs in terms of infrastructure and human resources should need to be reassessed to guarantee that objectives are achieved cost-effectively.

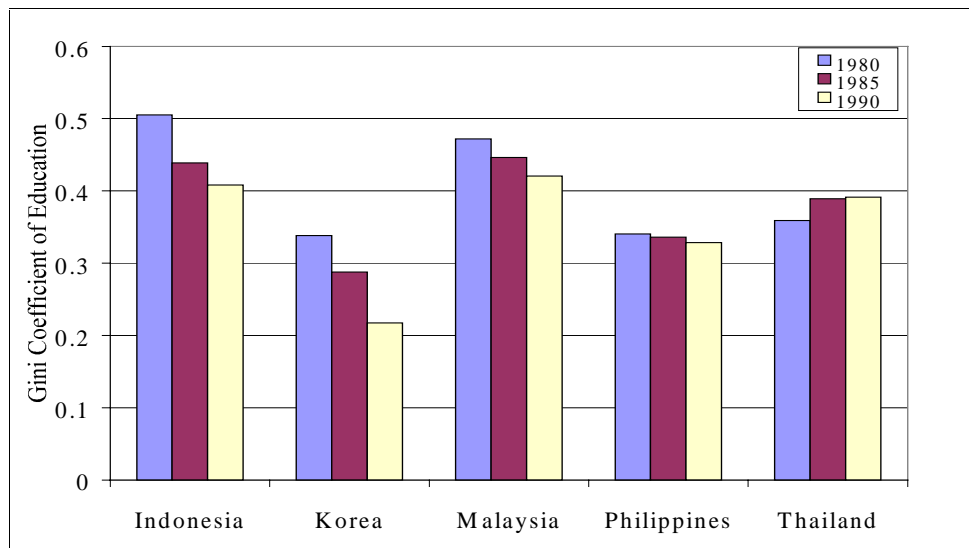
**A major challenge will be to ensure that the Skills Development Fund does not generate incentives that go against its original intend of increasing employer provided training.** To this end, the regulations governing the operation and financing of the fund will need to be carefully assessed. It is important to involve in this process workers and firms and ensure that the final regulatory framework benefits from the experiences of other countries which have adopted similar systems.

**Despite high economic growth period, Thai students have received less equal education access.** The Gini coefficient ranges from 0, which demonstrates perfect equality, to 1, which represents perfect inequality. The Gini coefficients for education in Thailand have been increasing during 1980-1990. This signifies that general education coverage has been declining. Consequently, potential human capital may be underutilized reflected in low productivity growth.

**Improvements in quality of education complement the expansion of education opportunity as well as enhancing productivity growth.** If poor children can only attend low-quality school, they are less likely to get high-paying jobs, and parents are disinclined to send them to school and keep them there. Quality can be measured as a combination of inputs and outputs of education. Inputs include expenditure per student, the number and quality of teachers, length of school term, and the quality of the curriculum. Outputs involve cognitive achievements, attitudes, test scores, and dropout rates. In order to enhance the productivity and competitiveness, Thailand has to move forcefully to ensure universal access to quality education for its next generation.

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**Figure 3.6: Gini Coefficients for Education for Selected Countries**



Source: World Bank, 2000, Quality of Growth, New York, Oxford University Press.

## Technological Capabilities

**Thailand is lagging behind other countries in the region in terms of indicators that reflect technology-related capabilities.** Slow growth in total factor productivity, stagnant market shares of technology intensive exports, and low levels of R&D activity are some manifestations of Thailand's weak technological capability. It has been estimated for instance that in order to reach the level of technology system development that Korea had reached around the early 1980s, total R&D expenditure as a share of GDP in Thailand would have to increase five fold; the share of business-funded R&D would have to increase more than twenty fold, the number of researchers per 10,000 population would need to increase four-fold, and the number of international patenting per million population would need to increase around six fold.

**The problem is being addressed at three levels – the enabling policy and institutional environment, the university system, and at the firm level.** Technology development is constrained by the Thai business environment through as low levels of competition, shortages of manpower trained in scientific areas, or the lack of a body of technological capabilities within firms which affect the acquisition, utilization, adaptation, and development of technology as well as inventions, innovation, and diffusion processes. The second cause is an inefficient institutional framework to stimulate technological development in the presence of market failures (e.g., public benefits arising from increased diffusion of knowledge, skill and experience in an economy).

**The government has started to address the problem through a detailed evaluation of the current institutional framework for technology development.** One on the policy framework and institutional structure for industrial technology development in Thailand, and a second which reviews the organization and strategies of a number of industrial technical support institutes. The first study has two major aims: i) to review the structure and functioning of the whole array of government policy and institutions that are concerned with industrial technology development;

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and ii) to examine the role of NSTDA within that overall structure. The second study examines the effectiveness of technical institutes in delivering satisfactory services to target clients while attaining financial independence.

**Preliminary results suggest that existing tax incentives for R&D are not generating expected results, and are geared excessively toward stimulating capital investment, rather than knowledge investment, and may not create sufficient new technology development.** Grant-based mechanisms may be more powerful. The incentive system managed by BOI has had little impact as it is only used by few firms. The incentive system managed by MOF includes depreciation provisions which allow machinery and equipment for R&D to be written-off faster than other forms of equipment. It is unlikely, however, that the small marginal change in the financing cost for only the capital cost of R&D expenditures has contributed to expand R&D activity. The incentive package also includes a 100% expensing of R&D expenditure, plus a further 100% credit against income taxes. Again, it seems unlikely that the incentive is affecting R&D activities or stimulating firms to deepen their technological development capabilities. First, firms are reluctant to claim tax allowances because of uncertainty about eligibility. Second, the current basic definition of R&D tends to exclude a large proportion of the activities that contribute to technology development. Finally, operation procedures are complex. While in principle NSTDA has a grant-awarding facility, it has only awarded eight grants during the 1992-97 period. A recommendation is to consider a flexible grant-based mechanism to stimulate firms to undertake technology development activities involving forms of design and engineering, basically operations that do not meet the eligibility criteria of the R&D tax incentive.

**A simplification of the current system and better targeting of R&D activities could improve efficiency.** Thailand should explore, i) the need to continue operating the scheme on the basis of firm's payments to approved R&D organizations; ii) the possibility of redefining R&D in ways that come close to meeting priorities at the current stage of development in Thailand; and iii) the value of operating both the BOI and standard MOF schemes in parallel.

**Utilization of available soft credit mechanisms remain low.** One of these mechanisms is the Research and Technology Development Revolving Fund managed by MOSTE. Low utilization is explained in part by the fact that financing organizations operate like conventional banks, expecting well-defined projects with 'visible' commercial returns.

**A plan to establish the National Science and Technology Policy Committee has been submitted to Cabinet.** Combined with university autonomy, this presents an opportunity to dramatically enhance technology manpower. Through programs such as the Royal Golden Jubilee Program, Thailand has made important strides in creating a base of Ph.D. graduates necessary to serve Thailand's long-term knowledge needs. However, at their current scale, these programs are unlikely to be sufficient to provide a replacement resource for academic positions. They will not be sufficient to serve any increase in R&D by the private sector, or an expansion of the university system. A formal university-based research system, based on international norms, is necessary. University autonomy creates an ideal opportunity to create such a system.

**Weak linkages between technology institutions and industrial firms.** Only 3-5% of industrial firms have used the services of any of a range of science and technology programs. In addition, there is a lack of institutional specialization and a pervasive overlapping functions among MOI Institutes, NRCT, NSTDA, TRF, TISTR and Universities.

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**The major challenge in the future will be to make use of the studies diagnosis and recommendations to develop a technology development strategy.** This strategy should emphasize intra-firm technology transfers, a system of financial incentives that encourages better coordination between research institutions and firms, and a rational utilization of public resources which makes proper assessment of market failures such as those related to the production of public goods (e.g., basic research) or the existence of knowledge spillovers (e.g., adoption of a technology by early users).

**The success in the implementation of this strategy will also depend on NSTDA flexibility to restructure its own organization.** For instance, by exiting areas where there is a duplication of responsibilities with the private sector, universities or other government agencies.

## **Private Participation in Infrastructure and SOE Reform**

**Thailand's commitment to reforming state owned enterprises (SOE) and implementing a divestiture program is articulated under the 1998 Privatization Master Plan.** The objective is to improve the economic efficiency of key industries including energy, telecommunications, water and transport. The Government's privatization efforts are designed to enable competitive markets to emerge in these sectors in a framework that stimulates private investment, protects consumers and provides a basis for Thailand's long term competitiveness in the global economy. The Bank's ongoing Economic Management Assistance Project (EMAP) supports RTG's strategy of preparing the ground for privatization by putting into place a strong regulatory framework, building institutional capacity and beginning a well contemplated, time bound program of corporatization and divestiture of selected state owned enterprises.

**Progress on the privatization and SOE reform has been slower than anticipated at the time when the Privatization Master Plan was passed by the Cabinet in September 1998.** This is mainly due to a heavy reform agenda; a weak legal framework; lack of institutional capacity to implement the agenda; the absence of a vision and articulation of a strong strategy and public campaign to build consensus among stakeholders, especially SOE employees and consumers, as to the benefits of privatization; and the absence of a systematic public information campaign, which led to anti-foreign ownership sentiments and resistance from employee unions. It must be acknowledged that in spite of these drawbacks, there has been a steady movement in the implementation of the agenda. However, some areas such as the water sector have lagged behind; employee issues have yet to be addressed systematically; remaining legal reforms are likely to move at a slow pace; and institutional capacity, especially in regulation, remains a key issue.

**Progress has been made in the legal framework to facilitate SOE reform and divestiture.** RTG's emphasis has been on putting in place a strong regulatory framework and creating independent regulatory bodies, free from political intervention, to ensure a stable investment environment and to help protect consumer interest. The State Enterprise Corporatization Act was passed in December 1999 and will enable RTG to corporatize individual enterprises without further parliamentary involvement. Some SOEs which are expected to undergo corporatization under this Act in the near future are Telecommunications Organization of Thailand (TOT), Communications Authority of Thailand (CAT), Petroleum Authority of Thailand (PTT) and State Railways of Thailand (SRT). The enactment in 1999, of the Alien Business Act and the Act on Leasing of Property for Commerce and Industry, is significant in promoting direct investment and greater liberalization. The State Employees Labor Relations Act (SELRA), which repeals



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restrictions on the rights of state enterprise workers to unionize and strike, was also passed by the Parliament.

### **Telecommunications**

The Act on Organization of Radio Frequency Wave Allocation and Supervision of Radio Broadcasting and Radio Television Broadcasting Business; and Telecommunication Business B.E. Frequency (The Frequency Management Act) became effective in March 2000 and will allow for the establishment of the National Communications Commission (NCC). The NCC will facilitate the establishment of an independent regulator in the sector. The selection committee for the telecommunication commissioners has begun work, however, the commission which was expected to be set up by October 2000 will now likely be in place in March 2001. The Telecom Bill which provides guidelines for the regulator was endorsed by the Cabinet in March 2000 and has been presented to the Parliament. The conversion of existing Build-to-Operate (BTO) concession contracts essential for full liberalization of the telecomm sector remains one of the most challenging issues in the sector. The Cabinet recently issued a resolution specifying guidelines for conversion concessions and a committee has been formed to oversee the conversion process which is expected to be completed within the next six months.

### **Transport and Energy**

The cabinet has approved the regulatory framework and market structure for the energy and transport sectors and independent regulators in these sectors are expected by the end of year 2001. A comprehensive Transport Sector Framework Reform Study was undertaken and completed in April 1999. The report provides a framework for improved policy and planning in the transport sector, development of modal regulatory framework and the direction of reform for the 14 SOEs in the sector. The partial privatization of Thai Airways is expected by the end of year 2000, the privatization of AAT is being accelerated. The state expects to sell AAT's major airports and shares in AAT early next year. In the energy sector, NEPO has prepared detailed plan for transition to a power pool. The partial privatization of Ratchburi power generating plant is on schedule and the IPO in October 2000 was oversubscribed.

### **Water and Wastewater**

The Government has recently launched a study for the restructuring and privatization options for the water sector. Reforms in the water and wastewater sector have lagged behind, mainly because Government's focus has been on other sectors. The Government now plans to accelerate reforms in this sector. The study is scheduled to be completed by February 2001.

**Employee interests need to be addressed in a systematic manner.** A key issue for Government is to address employee resistance to SOE reform and corporatization, and to protect their interest. In the absence of safety nets training programs, employee resistance is likely to increase. Government has entered into a dialogue with labor on key issues in the program. As a part of the effort to address employment impacts, MOF has been preparing a series of proposals on severance pay, early retirement, training and shares distribution to employees.

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## Business Environment

### Trade Policy Reform

**Trade regime has been liberalized.** As part of the stimulus package announced in October 2000, import tariffs have been reduced on several items including chemical, medicine, automotive parts and equipment (e.g., safety belt and airbag). This tariff reduction package is estimated to cost the Treasury 3.3 billion Baht per year. The shares of import duties in total revenue have declined from 16% in 1995 to 10% in 1999.

**Transparency and efficiency of customs being improved.** The Electronic Data Interchange (EDI) system has been implemented by the Customs Department in an effort to develop Thailand's import and export systems to meet internationally accepted standards. Between February and August of this year the volume of EDI transactions has surpassed manual transactions averaging 56% of total transactions.

**The use of the EDI system for exports and imports could be enhanced by further strengthening the basic infrastructure, utilization of the Internet with proper security measures, and cooperation among operators and users.** The utilization of the Internet and interoperable systems would further reduce the cost of transactions and enhance the operational efficiency, provided that security issues are thoroughly addressed. Additionally, the absence of laws governing electronic transactions and signatures may delay the decision to join the system. The relevant laws are currently under consideration by the Senate. Furthermore, to complete the transaction, financial institutions would have to be integrated into the EDI system. Today, most international trade payments are carried out manually.

**Thailand cannot retain significant duties on capital goods and raw materials and still be competitive with tariff of zero to five percent on regional imports of finished goods.** Given that the Baht depreciation has helped to improve the balance of payments, import tariff surcharges introduced during the crisis have been eliminated. Nevertheless, the simple average import tariff of 18.4% in September 1999 is still one of the highest in the region.

**The publication of a single and comprehensive tariff encompassing the Most Favorite Nations (MFN) and preferential duties would greatly enhance the transparency of the import regime.** Currently, the import valuation system is based primarily on the values of imported articles as declared by importers. This leads to the incidence of arbitrary "uplifts."

### Services

**Thailand has continued to open its services sector to foreign investment.** Low FDI in services tends to hamper productivity improvement in critical business services, and also cripples efficiency improvement in the economy at large. Pre-crisis, Thailand had one of the tightest restrictions on Foreign Direct Investment (FDI) in services, especially in communication and financial sectors, in East Asia.

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**Table 3.3 : Foreign Direct Investment Restrictiveness Before the Crisis for Services**

Regional / Country	Average	Business	Communication	Distribution	Financial	Transport
Thailand	81	78	84	78	88	78
Indonesia	56	56	64	53	55	53
Korea	67	57	69	63	88	57
Malaysia	31	32	42	8	61	12
Philippines	73	48	76	48	95	98
East Asia	59	51	70	46	72	57

Note: Index value of 100 represents maximum restrictiveness.

Source : Hardin, A., and L. Holmes. Forthcoming. "Measuring and Modelling Barriers to FDI." In B. Bora, ed., *Research Issues in FDI*. London; Routledge.

Findlay, Christopher, and Tony Warren. 1999. "Impediments to Services Sector Trade and Investment." Pacific Economic Cooperation Council.

<http://www.fortunecity.com/business/turn/207/impediments.html#Impediments> Report.

**Since 1997, Thailand has made new commitments with respect to insurance, banking, and other financial services, first in its Schedule annexed to the Second Protocol to the General Agreement on Trade in Services (GATS) on Financial Services.** The 25% limit on foreign equity participation in banking and other financial services, except insurance, has been lifted. In the insurance sector, 25 new insurance licenses (12 life and 13 non-life insurance companies) were granted to enhance the competition. The amendment of insurance laws to further increase foreign equity participation in this sector is underway.

The telecommunication sector is undergoing liberalization process, as a result of the Telecommunication Development Master Plan. (See SOEs Reform section).

Thailand has included accounting, auditing and bookkeeping services in its GATS Schedule of Specific Commitments. Cross-border supply of such services and movement of natural persons have been left unbound. In contrast with accountancy services, in practice, legal advice can be sought abroad. Although, foreigners are not allowed to practice law in courts, they may act as legal advisers or work as solicitors for companies if they have work permits.

**Pace of liberalization should be accelerated.** The pace of liberalization could be accelerated to strengthen the competitiveness of firms. The foreign participation in the equity of most of the service providers are still restrictive despite the enactment of the new Foreign Business Act 1999. The two most notable sectors are insurance and telecommunication.

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**Table 3.4 : Limits of Foreign Ownerships in the Service Sector**

Service Sector	Foreign Ownership Limit (% of total equity)
<b>Life Insurance</b>	25
Non-life Insurance	25
Other Financial Institutions	None
Telecom. Suppliers	40
Accountancy	49
Architectural and Engineering	49
Air Transportation	49
Maritime	None

Source: WTO 1999. Trade Policy Review in Thailand

**Thailand has not included a number of professional services in its GATS schedule, especially in light of the shortage in science and technology personnel.** The sample of science and technology related professional services not included in GATS consists of research and development services, integrated engineering, testing and analysis services, technical consultation, geological services, medical, dental, and veterinary services. Since, foreign individuals may not be licensed as certified public accountant (CPA) in Thailand, the number of internationally qualified auditors are limited.

**Increased market access for foreign service providers (cross-border supply) in Thailand's GATS schedule should be considered carefully as a vehicle to foster the competitive environment.** However, it is also crucial to evaluate the impact of the Thai liberalization programs on various sectors so as to identify the most vulnerable ones. Supporting measures can then be formulated.

### **Foreign Investment Regime**

**BOI has revised its investment policy to reflect the changing economic and investment environment and to lessen the tax burden on the government budget. The new policy took effect on August 1, 2000.** The new key provisions include the following measures: First, to facilitate foreign investment, the new criteria allow total foreign shareholding in almost all eligible activities according to the Foreign Business Act (FBA). Only activities listed under List One of FBA require Thai majority shareholding. Second, the system of performance-based system has been adopted requiring a promoted investor to provide evidence of qualified performance before claiming the proposed incentives. Third, the new policy also aims at promoting quality improvement. A project with more than 10 million Baht investment (excluding the cost of land and working capital) must obtain a quality certificate such as the ISO 9000. Fourth, Small and Medium Size Enterprises with only a million Baht investment (excluding the cost of land and working capital) will now be able benefit from investment incentives from BOI. Fifth, to encourage prudent financial strength, the requirement of a debt-equity ratio has been reduced from 4:1 to 3:1, under the new policy.

**The Thai authority has been responsive to the changing business landscape. The new economy where knowledge is highly valued and rewarded, however, may require different**

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**investment incentives.** Currently, the major investment incentives provided by the BOI focus on the investment in physical capital such as the reduction of import duty on machinery and raw materials. To stimulate knowledge accumulation and enhance technological capability, which are crucial for the medium term competitiveness of Thailand, additional investment incentives that promote such activities especially in the area of design and engineering are needed. The existing BOI policy provides tax allowances only for the selected R&D investment.

### **Intellectual Property Rights**

**Thailand has amended its legislation in order to implement the WTO agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which was required of developing country members of WTO by January 1, 2000.** In particular, the Patent Act was amended to introduce the principle of national treatment and elimination of the requirement that products under a patent must be manufactured locally. Since its inception in 1997, the Intellectual Property and International Trade Court has been working on all civil and criminal cases involving intellectual property rights violations. The Coordinating Center for Suppression on Intellectual Property Rights Violation, under the Department of Intellectual Property, Ministry of Commerce has apprehended approximately 5,000 cases involving 5 millions pieces of goods, since 1996. The first nine months of 2000 alone accounted for 1/3 or 2,000 cases and ½ of the evidence. The cases are roughly split in half between violations of Trademark and Copyright Acts.

**Thailand has put tremendous efforts to lessen the problem of infringement. However, the United States have still placed Thailand under its Watch List according to the “Special 301” of Trade Act 1974.** Typically, most infringement cases have been prosecuted as criminal offences. However, these are often not sufficient to deter infringement because of the disagreement between the right holders and the defendants in determining the value of the counterfeit. Consequently, the revenue and custom laws have been rarely invoked. The government has stepped up the efforts against infringing production, but it needs to do more to tackle the increasing level of illegal optical media production. The right holders have been actively involved in the enforcement process in coordination with the Thai authorities.

### **Government Procurement Policy**

**Thailand’s regulations on government procurement have recently been amended to enhance openness, transparency, and fair competition in the government procurement market.** Normally, foreign bidders are allowed to compete for a contract, however, preference is given to Thai products, contractors, and consultants. The price preference for Thai products that meet national standards is 7%, and if there are three such Thai products bidding, only these products will be considered; the preference for Thai products registered at the Ministry of Industry is 5%; the preference for other Thai product is 3%; and for consultancy and engineering services, a Thai consultant must be engaged as the leading firm.

**E-Procurement system utilizing the open systems and the Internet can be used as a part of the E-Government strategy to achieve transparency, competition, lower acquisition costs, and better value for the taxpayers’ money.** The E-Procurement system may consist of the following modules: supplier registration, catalogue, tendering process, ordering and payment systems, contract management, and security system. This information when made available on the Internet then more suitable suppliers local or otherwise can be identified. The process can be

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monitored by the government agencies, media, and civil groups in order to ensure the transparency and fair competition among contenders. Acquisition costs, especially searching costs can be greatly reduced from the utilization of the E-procurement system. Manual processes that are susceptible to errors and irregularities can be replaced by the electronic systems where the audit trails can be tracked and reconciled. The competition and transparency in the government procurement system would, therefore, improve the efficiency of government purchases of goods and services.

### **Competition Policy and Business Laws**

**Since its inception in November 1999, the Trade Competition Committee (TCC), which was created under the Trade Competition Act 1999 (TCA), has been investigating three highly visible cases.** The first two cases involve Bundling of Whisky and Beer and the formation of the United Broadcasting Corporation (UBC). The first case was found that they may violate TCA under the excessive market dominance section. In the second case, TCC found no wrong doing under Section 27(1) of the Act. The third case is currently under the investigation.

**The guidelines following the enactment of the Foreign Business Act 1999 which took effect earlier this year are now under the review by the CST.** The new law replacing a more restrictive one, National Executive Council announcement number 281, 1972 provides three lists of business activities. Foreigners are not allowed to operate the business activities under list one, such as land trading, newspaper, radio and television broadcasting, and extraction of Thai herbs, with special reasons. Business activities under list two must be approved by the cabinet in order for the foreigners to operate. List two includes such activities as firearms related business, silkworm farming, and manufacturing of sugar from sugarcane. To operate businesses under list three, a foreigner must obtain the approval from the Director General of the Commercial Registration Department (CRD) in the Ministry of Commerce. List three includes mainly service activities such as accounting, legal, advertising, auction, and engineering services.

**To encourage more transparency and accountability in accounting, the new Accounting Act 2000 makes an accountant liable for any wrong doings.** Furthermore, all accountants of juristic entities must have certain qualifications and experience as specified by the CDR. An accountant who works for a company that has more than 5 millions Baht of registered capital must have at least a bachelor degree in accounting or equivalent. Accountants are also required to take approved training course at least once every three years.

**Capacity building of the implementation and enforcement agencies must be strengthened in order to uphold the newly enacted laws and regulations.** Typically when a new legislation is passed, the responsible agency, newly established or otherwise, is vested with the implementation and enforcement tasks of issuing detail guidelines, operating procedures, developing ministerial regulations, monitoring of the relevant entities, and communicating with the public. In order to effectively carry out these assigned tasks, the agency clearly needs to build its capacity along the following fronts: human and financial resources, technical capability, organizational structure and management, and change management.

**Table 3.5 : Inventory and Status of Legal Reforms in Thailand**

Laws	Current Status	Agencies	Remarks
<b>Financial sector</b>			
Financial Institutions Act	Approved by Council of State and Cabinet; to be submitted to Parliament for approval into law	BOT, MOF	Because of the specific nature of these laws, they were drafted by BOT and reviewed by MOF with little involvement from MOJ
Bank of Thailand Act	Same as FI Act	BOT, MOF	
Currency Act	Same as FI Act	BOT, MOF	
Deposit Insurance Act	On hold for policy reasons	MOF	
Derivatives Act	Under review by MOF	SEC	
<b>Corporate Reorganization</b>			
Bankruptcy Act	Under comprehensive review by "Legal Expert Comm." No timeframe or completion date.	MOJ	Kenan Institute & ABI assist CBC w/ reforms of administrative procedures
Code of Civil Procedures on Default (Foreclosure / Debt Collection Regime)	Passed into law in February 2000	MOJ	Utilization is seen as slow and costly. Enforcement of post-judgement is weak. Potential backlog in Civil Court from cases that failed CDRAC process and lawsuits filed by creditors.
Evidence Laws (Code of Civil and Criminal Procedures)	Council of State completed the review, but has not forwarded the laws to the Parliament.	Courts of Justice	
Secured Transactions Act	Under review by Council of State Need to set up Collateral Registration Office, but have not identified responsible RTG agency or allocated the budget	MOJ, MOC	Responsible agencies have not prepared the work plan for establishing the Collateral Registry System. Cabinet did not allocate new budget for the office.
Credit Bureau Act	Passed 2 <sup>nd</sup> reading of the Parliamentary Sub-Comm. Should be passed into law after the general election (Q2 2001)	BOT	Two Credit Bureaus have been set up: Government Housing Bank and Thai Bankers Association, but awaiting legal framework
SEC Act	Under consideration by MOF	SEC	
Public Company Act	Awaiting Parliamentary consideration	MOC, SEC	
Foreign Ownership Act	Passed into law in Dec 1999		Regulations on allowing foreigners to own land is under review by Council of State.
State Enterprise Employees Act	Cabinet resolution, but no change of law to date.	MOF	Need to remove cloud of personal liability for reasonable write-downs in debt restructuring

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<b>Laws</b>	<b>Current Status</b>	<b>Agencies</b>	<b>Remarks</b>
<b>E-Commerce</b>			
Electronic Transaction Act	Passed the Lower House, awaiting consideration by the Senate	NECTEC	The private sector and academia were not fully involved with the drafting process.
Digital Signature Act	The draft law was combined with the Electronic Transaction Act	NECTEC	
Universal Access Act	Drafting stage	NECTEC	
Electronic Fund Transfer Act	Drafting stage	NECTEC	
Computer Crimes Act	Drafting stage	NECTEC	
Data Protection Act	Drafting stage	NECTEC	
<b>Selected Recent Laws</b>			
Intellectual Property Act	Passed into law in Oct 1996	IP/IT Court	
Trade Competition Act	Passed into law in mar 1999	MOC	
Accounting Act	Passed into law in May 2000	MOC	
Foreign Business Act	Passed into law in Nov 1999	MOC	
Anti-Dumping and Countervailing Act	Passed into law in Mar 1999	MOC	
SMEs Promotion Act	Passed into law in Feb 2000	MOI	
SOEs Corporatization Act	Passed into law in Dec 1999	MOF	



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## CHAPTER 4 : STRENGTHENING GOVERNANCE

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### Responding to the Governance Challenge

**Thailand is emerging from the biggest economic crisis in a generation, which has changed the environment within which the public sector is managed.** After a decade of surpluses and skillful management of its aggregate fiscal accounts, Thailand faces recession-induced lower revenues, rising social expenditures, costly restructuring of the financial system, and higher public debt. Reforms emphasizing accountability and transparency; changes in financial management and reporting, and service delivery; as well as the decentralization of government activities to local administrations are also mandated by the new Constitution. Thailand's ability to respond to these pressures depends critically on the quality and capability of its institutions and tools for governance.

**Thai fiscal policy can generally be characterized by fiscal conservatism in Thailand<sup>1</sup>.** The Government is legally restrained from running a large deficit, and fiscal policy has traditionally played a stabilizing role on the economy. This conservatism served it well during the boom years, when fiscal policy provided a healthy macroeconomic environment for growth. From 1976 to 1996, the average economic growth was 8% annually, placing Thailand firmly among the East Asian miracle countries.

**However, there were problems—even during the boom period—in governance that were little observed.** Growth was accompanied by increasing income inequality through the early 1990s, and the efficiency and effectiveness of spending were poor (as noted in Chapter 1). Revenue growth was disproportionately allocated to investment spending, which failed to surmount the infrastructure bottlenecks of Thailand's rapidly growing economy. The string of fiscal surpluses during the pre-crisis period largely reflected a continuous underestimation of revenues, whereas actual expenditures were considerably lower than planned. Poor transparency in public expenditure management has emerged as a major concern. The lack of a service-oriented, cost-effective civil service driven by results rather than entitlements has impeded implementation of government programs. Public institutions are highly segmented, with limited cooperation among agencies and ministries. Frequent complaints about alleged corruption further erode the confidence of Thai people in public management.

**The crisis revealed both strengths and weaknesses in governance that were often undetected during the boom period.** To its credit, the Government was able to maintain social spending directed toward disadvantaged groups. On the other hand, a clear asymmetry was observed in the Government's capacity to use fiscal policy as a tool of demand management. In the initial crisis period, the Government effectively cut budgeted expenditures by almost 20%. However, fiscal expansion proved more difficult than budget cuts. The fiscal stimulus program did, over time, succeed in supporting the recovery.

**The governance challenges posed by the crisis and the new Constitution call for concerted effort on several interrelated fronts.** The task for Thailand's policy makers will be: first, to ensure fiscal sustainability by sound public debt management, asset disposal/privatization, and

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<sup>1</sup> The background of this chapter draws heavily on *Thailand: Public Finance in Transition* (World Bank, 2000); also available on the World Bank Bangkok Office website, <http://www.worldbank.or.th/economic/index.html>

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mobilizing adequate resources through improved revenue administration. Second, Thailand's capacity for prioritizing and targeting public expenditures must be strengthened. Third, more efficient public management requires a more performance-based and transparent management of public expenditures, revenues and liabilities, as well as human resources. Fourth, careful steps toward decentralization of fiscal responsibility, and strengthening accountability and transparency are required by the new Constitution.

**The Government has responded to these pressures by launching an ambitious program to reform the public sector.** In May 1999, the Cabinet issued its three-year Public Sector Management Reform Plan, which provides the Government's vision for modernizing the public sector in the areas of: (i) expenditure management, (ii) human resource management, (iii) revenue management, (iv) decentralization, and (v) accountability and transparency. The reform program is designed to enhance public sector effectiveness in mobilizing and allocating resources, provide high-quality public goods and services, protect vulnerable socio-economic groups, and promote greater transparency and accountability. Its core components include a more performance-oriented budget system, a flexible and effective civil service, and enhanced transparency and accountability. The reform efforts involve not only the Government's central agencies, but also line ministries such as education and health which have embarked upon substantial reforms to deliver better services in their sectors.

## **Public Expenditure Management**

**Thai budget processes are strongly centralized by the standards of well-performing countries.** While this centralization ensures effective achievement of overall fiscal targets, it also imposes inflexibility and distortions on government agencies. These agencies face no incentives to use the budget as a management tool to increase the performance—i.e., the efficiency, effectiveness and equity—of government programs.

**Fiscal transparency is weak in Thailand.** The Government does not have a clear medium-term fiscal strategy, fiscal planning is based on cash flows of a narrowly defined central government, off-budget operations dilute fiscal responsibility and accountability, fiscal risks arising from government's contingent liabilities are not considered properly, and lack of ministry and department level financial reporting hides the true cost of government policies and services. This lack of transparency distorts the prioritization and allocation of public resources, and diminishes accountability.

**Enlargement of poverty alleviation programs and improved targeting will be critical to reduce the population of poor persons and to protect against periodic downswings in the economy.** Although expenditures allocated to these programs are growing, the Government should increase the use of geographical targeting and self-targeted programs in allocating resources to meet distributional objectives. Critical needs are to shift away from the current, equal distribution of resources across regions, and to define better criteria for allocating resources (e.g., on the basis of per capita income or regional poverty levels).

**As part of the Public Sector Management Reform Program, the Bureau of the Budget has launched a comprehensive budget modernization program that will reform Thailand's budget management so that it promotes better performance and transparency.** Expenditure management reforms are underway to:

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- **Introduce performance-based budgeting.** In the context of performance-based budgeting, the Bureau of the Budget is defining a new “flexibility and accountability” framework for sector ministries, which will delegate more authority to these ministries in return for greater performance and reporting standards. Such a framework will improve the management of outputs and outcomes rather than control inputs. The Comptroller General’s Department is concurrently identifying financial reporting requirements for ministries and departments, improving the Government’s accounting policies, and developing an integrated financial management system.
  - **Strengthen evaluation of sector policies and performance.** In the new performance framework, as central agencies relinquish line-item control they will focus more on reviewing and evaluating the performance of ministries and departments and on analyzing whether their policies are consistent with the Government’s strategic priorities. A first step in this process is to coordinate evaluation and policy analysis among the Bureau of the Budget, the NESDB and line ministries.
  - **Improve fiscal transparency.** The Bureau of the Budget and the Comptroller General’s Department are developing a policy to improve fiscal transparency, and standards for reporting off-budget fiscal operations as part of budget documents and financial statements. The Bureau of the Budget and Public Debt Management Office are compiling information on contingent liabilities. A fiscal strategy extending over the “general government financial position” with a medium-term outlook will also be developed. Additional reforms are needed to manage fiscal risks within the budget process and to meet international public accounting standards.

#### **Recent Key Developments in Public Expenditure Management**

- **A subcommittee chaired by the Deputy Minister of Finance has been established to recommend reforms to the existing Budget Procedures Act.** Work has commenced on defining a legal framework within which performance-based budgeting will operate, which could include the preparation of a new Budget Act in the future.
- **The Comptroller General’s Department (CGD) has completed a set of high-level accounting guidelines (on assets, liabilities, revenues and expenditures together with reporting formats), which will establish standards for agency charts of account.** The CGD is responsible for establishing the accounting standards which pilot agencies will observe in order to meet the financial management hurdles developed by the BOB (see Box 4.1).
- **The Bureau of the Budget (BOB) has revised budget regulations to permit block granting.** In the FY01 budget, the BOB has allocated block grants to two pilot agencies; the Provincial Hospitals Division of the Ministry of Public Health, and the Department of Commercial Registration in the Ministry of Commerce. In addition, BOB forward estimates for pilot agencies have been included in the budget ‘Red Book’ for the first time.
- **A Memorandum of Understanding (MOU) between the OCSC and the BOB on Performance Budgeting in the OCSC was signed in April.** This MOU is a prerequisite for developing a Resource Agreement that allows block-granting. It is expected that the OCSC will be block granted in the FY02 budget.

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### **Box 4.1 : The “Hurdle” Approach to Budget Reform**

Budget reform is one of the critical areas of the Thai Government’s Public Sector Management Reform Program. One of the major objectives of budget reform is to move from the current system of input-oriented or line-item budgeting to a more performance based system in a devolved environment. This means replacing detailed external control by central agencies with internal control by the spending agencies themselves. Under the envisioned reforms, the Bureau of the Budget (BOB) will delegate the necessary budgetary authority to sector ministries and to hold them accountable for performance. The performance of sector ministries can be measured across two dimensions: their ability to reflect Government priorities in their strategic plans and their ability to deliver promised results. The task of the central agencies, particularly of the BOB, is to define a new “flexibility and accountability” framework for sector ministries and to enable them to implement it.

The reforms begin with the identification of strategic priorities across the Government: key ministries, departments and public organizations will be required to produce strategic plans showing their objectives and desired outcomes, outputs, performance standards, management plans and resource requirements. These plans are then published and disseminated widely. Thereafter, central agencies review these strategic plans as part of the budget formulation process to determine whether they both reflect government-wide priorities and are well prepared. After this review, resource agreements will be established between central agencies and line ministries where, for a given level of resource allocation and flexibility, the expected performance of a line ministry will be clearly defined and agreed.

Such agreements will provide the foundation for a new budget formulation process that will focus not on inputs but on outcomes and outputs. Central agencies will gradually devolve detailed line-item controls to line ministries, monitor their performance and hold them accountable for results. Management reforms within line ministries would shift the management culture from “compliance” to “managing for results.”

The BOB’s strategy for implementing performance budgeting involves piloting financial devolution in spending agencies, before rolling out the reforms across all government agencies. However, devolution will not be granted unless agencies meet certain minimum conditions generally related to improved management and reporting. These conditions, also known as the “Seven Hurdles”, are meant to ensure that the agencies are capable of managing resources in a devolved environment before block-granting occurs. These hurdles will also ensure that central agencies, the Parliament, and public have access to accurate and complete financial and performance information in the devolved financial environment. These seven “hurdles” are: (i) budget planning, (ii) costing, (iii) asset management, (iv) financial and performance reporting, (v) financial and budget control, (vi) internal audit, and (vii) procurement management. To date, the Office of Budget Reform in the BOB has commissioned various studies to identify gaps in the hurdle areas. These studies have identified where the gaps are, and clear work-programs have been defined to fill the gaps in three pilots.

The BOB has provided most pilot agencies with an external sector expert to analyze gaps in the seven hurdle areas. Such analysis has been prepared by sector experts in five pilot agencies: Office of the Civil Service Commission (OCSC), Provincial Hospital Department of Ministry of Public Health (MoPH), Department of Commercial Registration of Ministry of Commerce (MoC), Ministry of Foreign Affairs (MoFA) and Chulalongkorn University. Taken together, the five reports provide a comprehensive analysis of pilot agency weaknesses in the seven hurdle areas, together with the sector expert’s views on the steps required to overcome these weaknesses.

## **Human Resource Management**

**Several key problems are linked to the under-performance of public administration.** First, the role, organization, and processes of government are in need of serious overhaul to streamline

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procedures, eliminate duplicative structures, and shed and/or devolve activities inappropriate for central government administration. Second, the civil service is overstaffed and underpaid, resulting in difficulties in attracting, retaining and motivating good staff and, ultimately, in poor performance of basic government functions. Third, the current civil service's organizational culture, reinforced by cumbersome and antiquated regulations, does little to reward performance or service to citizens.

**Effective civil service reform must focus on three important objectives:** (i) enhancing the quality of service through more effective performance; (ii) increasing the efficiency of government operations by reducing its cost; and, (iii) reducing the scope for corruption and political interference in civil service activities. Several inter-related measures are proposed to achieve these reform goals. Delivering better services in a cost effective and equitable way will require enhancing the access, timeliness and quality of public services through outsourcing, restructuring or decentralizing activities and being more responsive to clients. Administrative renewal involves modernizing the role, organization, and processes of key line ministries to enhance their performance in delivering services. More efficient use of public resources requires streamlining procedures, eliminating duplicative structures, and devolving to local governments or outsourcing activities inappropriate for government involvement to the private sector.

**As part of the Public Sector Management Reform Program, the Office of the Civil Service Commission has launched a program that will reform Thailand's human resource management so that it promotes better performance and transparency.** Human resource management reforms are underway to:

- **Develop detailed programs to align organizational structures of line ministries with their new functional objectives** to achieve the optimal mix of government functions and most efficient processes and staffing allocations for effective policymaking and service.
- **Match staffing profiles and numbers to the new functional requirements of the civil service and containing the cost of government** through various mechanisms.
- **Develop modern, performance-based human resource management systems for civil service.** This may include an updating of out-of-date procedures, or the introduction of performance management through results-based human resource approaches that couple greater managerial discretion with performance incentives, and can include individual job description and classification systems, greater flexibility in employment system, performance appraisal and remuneration, career development and advancement, and disciplinary and complaint systems.
- **Develop a well-motivated, politically neutral, cross-governmental senior cadre to lead civil service renewal program,** which would build a professional class of higher civil servants.
- **Develop a regulatory framework for autonomous public organizations (APOs).**

#### **Recent Key Developments in Human Resource Management**

- **A voluntary Early Retirement Plan (ERP) yielded the retirement 24,000 civil servants, teachers, police and military, with estimated budget savings of Baht 8.4 billion over 10 years.**
- **In August, the Cabinet approved the establishment of a Senior Executive Service (SES).** Through the SES, the OCSC will develop a well-motivated, politically neutral, cross-

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governmental senior cadre to lead the civil service renewal program. Full implementation of an SES will require a new salary system. In its current form, the proposal does not envisage “radical” change (e.g. existing position holders will transfer across to the SES, new open recruitment will apply only when these positions become vacant, and outside recruitment is not yet envisaged). In January 2001, Level-9 government officers in the economic ministries (Finance, Commerce, Industry, Agriculture, Transport, Science and Technology) will be enrolled in the program, followed in October 2001 by the Level-9 officers in all other ministries. Level-10 and Level-11 officers across all government agencies would be enrolled in the program in October 2002 and October 2004, respectively.

- **The OCSC is addressing several key, emerging issues in civil service management reform.** The OCSC is proposing to develop a Human Resource Management Information System (HRMIS) that would be used by all ministries and agencies. Better personnel information (e.g. on location, personal profiles etc.) is a key aspect of a performance-based and more devolved Human Resource Management System. The OCSC is also working to establish a Remuneration Tribunal, which would establish salary levels across all government employment to avoid “leapfrogging,” and provide salary guidelines for independent organizations.

## Revenue Management

**Thailand’s revenue mobilization is on par with other Asian countries—averaging 18.4% of GDP before the crisis—though taxes account for a relative larger share of GDP (16.6%).** Compared to other, similar-income countries, it has traditionally relied heavily on indirect taxes and corporation taxes. The revenue share from direct taxes is low--about one-third of total revenues--and is composed mostly of corporation taxes (personal taxes are less significant). Substantial revenue comes from import duties and selective sales taxes, which tend to be more distortionary than broader-based taxes like the value added tax (VAT). State Owned Enterprises generate net revenue; remittances contribute 1% of GDP (around 5% of total revenues). During the boom years, Thailand’s revenue collection systematically exceeded expectations without significant effort, and it was characterized by the IMF as “modern, reasonably efficient, and broadly in conformity with international good practices.”

**Tax policy changes (e.g., broadening tax bases, reducing tax rates, etc.) will also be needed to enhance the productivity, efficiency, and equity of the tax system.** The area in greatest need of reform is the personal income tax, which suffers from a number of structural weaknesses and distortionary features. These include a narrow tax base (due to extensive exemptions, income deductions, allowances and other tax relief mechanisms), and a highly complex tax system that is non-transparent, unfair, and distortionary, as well as difficult and costly to administer. The IMF recently assessed Thailand’s personal income tax system and recommended a series of reforms, which the Government is considering, to simplify the personal income tax system, enhance its transparency and ease its administration.

**Equally important is the need to strengthen tax administration, to ensure adequate and sustainable revenue flows.** As part of the Public Sector Management Reform Program, the Revenue Department has launched a reform program that seeks to improve revenue collection and minimize tax evasion, and to achieve a more equitable distribution of the tax burden. These objectives will be achieved by:

- **Strengthen collection enforcement.** The first priority is to accelerate efforts to collect current debts, and to develop debt collection strategies by debt category. Accurate and timely

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information about tax arrears will also be developed, as well as a debt case management application to improve controls over casework, and audit case selection methods. Collectible debt is expected to be reduced to a manageable level of no more than 5% of total annual tax collections. Development of an arrears strategy is a critical next step.

- **Improve taxpayer compliance.** Important steps taken so far include the establishment of the Large Business Tax Administration Office and designing an automated audit case selection system. Other critical tasks include: (i) developing and implementing a more comprehensive audit strategy; (ii) improving the quality and availability of audit data; (iii) unifying taxpayer identification numbers; (iv) establishing a more streamlined and focused VAT refund control system; and (v) coordinating audit and delinquency collection. Development of a compliance strategy is a critical next step.
- **Enhance information technology as a means to strengthen management.** The Revenue Department's computer system lacks basic functionality to maintain taxpayer accounts, identify arrears, select quality audit cases, and provide timely management information. Efforts will be made to develop an operational, functional and integrated computer system and to align business and operational priorities with the envisaged developments in technology.

### **Recent Key Developments in Revenue Management**

- **Taxpayer compliance has improved.** There are now 324,000 registered VAT taxpayers, an 11% increase since 1998. Revenue collected from audit activities improved significantly in FY00. A national audit plan has been prepared with target audit revenue to be collected each month by each region.
- **Tax collection enforcement has also been strengthened.** Collectible debt in September 1999 was Baht 47 billion (1% of GDP), but by February 2000 this figure had fallen to Baht 34.5 billion, representing 7.6% of the estimated revenue for FY00. Factors contributing to this improvement are the increased attention given by management to tax arrears, greater control over debt cases in the regions, and a reduction in the number of new debt cases raised by auditors.
- **The Revenue Department is completing its new strategic plan, which will extend from FY01 to FY03.** The Plan will incorporate critical success factors and key performance indicators, consistent with the Results Based Management approach. The Plan is based upon five objectives: (i) collecting revenue more efficiently; (ii) helping taxpayers meet their obligations under the self-assessment system; (iii) strengthening compliance (control and enforcement); (iv) developing, training and encouraging staff so that they can perform their work more effectively; and (v) strengthening management performance and promote community confidence in the organization.

### **Decentralization**

**Thailand is a unitary government that presently has a highly centralized fiscal system that grants limited local autonomy in terms of functions, area, staffing, funding and decision making.** The Government has only recently begun implementing the decentralization reforms mandated by the new Constitution, which include increasing the share of local government expenditures, assigning more revenue sources to local governments, revising the system of intergovernmental transfers to provide grants in a more transparent and predictable way, and promoting mechanisms for local accountability. Because most Thai local governments are weak in financial management, planning and service delivery, and generally lack adequate resources to

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deliver services effectively or to undertake needed capital projects, implementing the proposed program of decentralization reforms will require significant strengthening of local capabilities. As part of the Reform Program, the Government is designing the decentralization framework for subsequent implementation. Decentralization reforms are underway to:

- **Clearly define central-local expenditure functions.** Clarity in expenditure assignment is necessary to eliminate the overlapping functions performed by the central and local governments, and to improve expenditure effectiveness. The National Decentralization Act specifies a phased approach—spanning four years—to the devolution of administrative power to prepare central and local governments to assume their new roles.
- **Devolve revenue authority.** The proposed devolution of revenue authority is based on the goal that, by 2001, the share of local revenue relative to total government revenues (including intergovernmental transfers) will increase to 20%, largely by increasing transfers to local governments. Local revenue shares are expected to increase to 35% of total government revenues by 2006. International experience shows that decentralization can have negative effects—including overlapping expenditure provision and macro-instability—if financing precedes functional assignment of responsibilities. Equally important, the potential disincentive effects of large central transfers on local resource mobilization should be carefully considered.
- **Improve local revenue mobilization.** As additional responsibilities are devolved to local governments, they must improve their revenue mobilization both to assure fiscal sustainability and to promote local accountability. Options include introducing new taxes, reforming existing taxes and enhancing collections from charges and fees. To meet the targets for 2006, local governments may need to double their own revenue collections (from 1.5% of GDP to 3% of GDP). In many countries around the world, property taxes, which are underutilized in Thailand, serve as an important local revenue source. Proposed property tax reforms could enhance local revenues, although establishing competent, local administration may be costly and require significant capacity building.
- **Reform the intergovernmental transfer system.** Thailand’s intergovernmental transfer system is neither transparent nor stable. Over 70% of intergovernmental transfers (or “subsidies”) are allocated for specific investment projects, in an ad hoc and highly politicized manner. Reforms will reduce the reliance on specific project grants and increase reliance on general-purpose grants that are allocated according to transparent formula(e) that address vertical imbalance and equalization objectives.
- **Promote responsible local borrowing.** While municipalities have the legal right to borrow, few do so because of limited resources and experience, and cumbersome approval processes by the Ministry of Interior. International experience has shown that macroeconomic fiscal imbalances can arise if local government borrowing is not managed carefully. Reforms underway include the development of the Regional Urban Development Fund as a mechanism to channel credit to viable projects managed by creditworthy local governments. Future reforms include potential aggregate limits on local indebtedness, local bankruptcy regulations and mechanisms for promoting responsible local borrowing.
- **Enhance local accountability.** Local accountability must be enhanced if decentralization is to succeed, and reforms must be introduced to strengthen local fiscal reporting and local revenue mobilization, and to engage civil society in local decision making and monitoring.



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## Recent Key Developments in Decentralization

- **The National Decentralization Act, which became effective in November 1999.** The Act defines the roles and responsibilities of the National Decentralization Committee (NDC). The NDC was established in February 2000 and is located in the Office of the Permanent Secretary of the Prime Minister's Office. The Act also requires the NDC to prepare a "Plan to Decentralize Administrative Power to Local Authorities" and specific Action Plans within sectors by February 2001. In April, a Plan governing the general concept, principles and process of decentralization was approved.

## Accountability and Transparency

**Accountability of government agencies in Thailand has traditionally been weak and the functioning of the public sector is characterized by both poor service delivery and perceptions of widespread corruption.** As characterized in the 8<sup>th</sup> National Economic and Social Development Plan, the Thai public sector's problems include "centralized power structure, administrative inefficiency, tax law enforcement, lack of popular participation, unethical and unfair use of administrative power, lack of administrative accountability and lack of continuity in policy and implementation to meet the demands of national development plans."

**Public accountability is the degree to which the activities of government institutions, and the civil servants within them, are responsive to public needs, efficient in the use of public funds, and accountable to the public for their actions.** The new Constitution emphasizes the need to strengthen accountability in managing the affairs of Thai government institutions. Improved transparency and accountability in government policy making and public resource management is seen as a powerful tool for reducing corruption. Finally, civil servants are now paid salaries well below the private sector level and are not sufficiently protected from political pressures and corrupting influences. The negative effects of corruption – distorting government resource allocation decisions, reducing economic efficiency, impairing legitimacy of public institutions, and skewing income distribution in favor of the rich – are widely reported in the media. Perceived corruption also damages Thailand's international reputation and prospects for foreign investment. In 2000, Thailand ranked 60<sup>th</sup> of 90 countries surveyed by Transparency International.

**Thailand's Reform Program is strengthening the institutions responsible for ensuring public accountability and the Government's commitment to fight corruption.** Public accountability can be enhanced by encouraging civil society to participate in government decision making and to provide input on how to improve service delivery. Various articles under the new Constitution grant the right to individuals and civil society organizations to participate in policy formulation and implementation to ensure and improve government services. The Government has sought regular feedback from civil society, including through the "Good Governance" working groups of the Thailand Development Research Institute, a prominent think tank.

**To the extent that corruption is primarily a symptom of poor public management, reforms of public expenditure and human resource management under Thailand's Program are expected to lessen corruption.** It is difficult to build citizens' trust in Government but specific interventions to increase public accountability and transparency can serve both to reduce corruption and improve service delivery. In particular, the new Constitution provides a strong momentum for the creation of formal mechanisms for cross-government accountability and increasing the 'voice' of civil society.

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**The Office of the Administrative Courts (OAC) and the Administrative Judges organized a meeting in September to review a drafted 5-year strategic action plan.** They are working on the final strategic plan.

**The OOIC is developing a strategic plan.** The numbers you cited are the complaints received from January to September this year --100 complaints and 90 for the petition cases.

Specific objectives that will be supported under Thailand's Program include:

- **Increase institutional accountability**, by strengthening formal institutional structures.
- **Improve access to, and use of, public information** by individual citizens and by civil society, including improved responsiveness by Government in providing this access.
- **Increase probity among civil servants.**
- **Enhance civil society participation** in improving transparency.

#### **Recent Key Developments in Strengthening Accountability and Transparency**

- **Three diagnostic surveys of corruption perceptions in Thailand were conducted.** The surveys included (i) a household survey conducted by the Political Economy Center of Chulalongkorn University, (ii) a private enterprise survey conducted by the University of the Thai Chamber of Commerce, and (iii) a public officials survey conducted by UNISEARCH at Chulalongkorn University. As noted in Box 2, various stakeholder workshops and conferences have been held to discuss the preliminary survey findings and the broad elements of an anti-corruption strategy.
- **After two-years in operation, the National Counter Corruption Commission has gained public confidence in its mission to combat corruption.** It is expanding its anti-corruption activities to work with other government agencies and ministries. In the Ministry Public Health for example, the NCCC is coordinating with a newly established anti-corruption unit to develop an anti-corruption plan for the public health sector. Elsewhere, the NCCC is also working with the departments of Land Transportation in the Ministry of Transport, as well as with the Land and Local Administration departments of the Interior Ministry.
- **In June 2000, HM the King appointed 15 Supreme Administrative Judges to the new Administrative Courts.** Member judges then selected the President and Vice President of the Courts whose approval is pending approval of the Senate.
- **The Office of the Administrative Courts (OAC) drafted a five-year Strategic Plan,** which it has submitted to the newly appointed Supreme Administrative Judges.
- **The OAC is also in the process of recruiting the 164 judges of the Administrative Court of the First Instance.** The establishment of Judicial Commission of the Administrative Court as well as the opening of the Supreme Administrative Courts and Central Administrative Court of First Instance will proceed after the recruitment of new judges in November 2000.
- **The Ombudsman was appointed by HM the King in April 2000, and by August, the Ombudsman's office had already received 150 complaints.** The Office of the Ombudsman will be small and based largely in Bangkok but with links to organizations throughout the country to receive public complaints.
- **The Office of the Official Information Commission (OOIC) is developing a Strategic Plan.** To date, the Office has been able to process about 70% of the complaints received (100 complaints). The number of petition cases has increased (about 90 thus far). These gaps

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highlight the need for the OOIC to recruit more staff to manage its workload. It has also completed a two-year evaluation of all government agencies, and will intensify its efforts to increase awareness of its activities with civil society and local administrative organizations.

#### **Box 4.2: Results of Corruption Perception Surveys in Thailand**

At the end of August, results from three surveys on corruption *perceptions* were presented. The surveys were conducted by three Thai research teams, and were designed to quantify perceptions, and identify areas to be included in a national reform agenda to tackle corruption. Highlights of the surveys include the following:

##### ***Household Survey (based on a sample of 4013 households)***

- Household heads revealed that the majority of respondents believe that corruption is a serious national problem (worse than drugs); that the government is not sincere about tackling the problem; that corruption is infrequently reported because little will result and whistle-blowers will be at risk, and that corruption is worsening.
- Respondents also believe that corruption is worst among politicians, or bureaucrats in offices with large monetary transactions including land, tax, and customs, as well as public officials in the police and the courts,
- 10% of households surveyed were solicited for bribes by some public office each year; the average bribe solicited is about Baht 10,000.
- Almost one-third of households were offered money to buy votes at the last general election; the average bribe per household was Baht 678; vote buying is particularly prominent in Bangkok.
- Respondents also indicated that the media, academics and the new institutions such as the National Counter Corruption Commission hold the most promise in combating corruption.

##### ***Public Officials Survey (based on a sample of 597 public officials)***

- Petty corruption among public officials seems to be small. A national survey of households showed that most people dealing with district offices, utility suppliers, hospitals, post offices or passport offices did not pay bribes for these services. If bribes are paid, they are rather small.
- Yet, approximately half of central and provincial government bureaucrats that participated in the survey said they believed that there was corruption in their agencies and that the existing corruption reporting system is ineffective, and that the Government is not determined to tackle the problem.
- Nearly 40% of senior officials surveyed revealed that bureaucratic positions are purchased; the most common methods of buying and selling positions include: giving monetary and non-monetary gifts for an extended period of time; providing services on private matters; and making direct payments to superiors. Many officials refused to answer this question, an indication perhaps of the complexity of the issue.

##### ***Business Survey (based on a sample of 422 enterprises)***

- The survey of private businesses confirmed the finding of the household surveys that large payments are often demanded of private firms by government agencies with significant financial transactions.
- Approximately, four-fifths of those surveyed disclosed that paying government officials in return for government services was a normal practice although the average amount paid to bureaucrats was significantly lower than amounts paid to politicians.
- Forms of corruption reported to have the largest impacts on business firms included: mishandling of public funds by some of the key public financial institutions, bribes to public officials aimed at avoiding taxes and bypassing government laws and regulations, the sale of key policy decisions to private interests, the sale of parliamentary votes on particular laws to vested private interests, and nepotism and cronyism in the appointments of key government positions.
- Respondents ranked corruption as the fifth major factor negatively affecting business operations and growth (following exchange rate, infrastructure, financing, and political uncertainty and instability).

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## Performance Improvements in Line Ministries

**Delivering better services in a cost effective way is a key objective of the Government's Reform Program.** This requires enhancing the access, timeliness and quality of public services through outsourcing, restructuring or decentralizing activities and being more responsive to clients. Administrative renewal involves modernizing the role, organization, and processes of key line ministries to enhance their performance in delivering services. More efficient use of public resources requires streamlining procedures, eliminating duplicative structures, devolving to local governments or outsourcing activities inappropriate for government involvement to the private sector.

**Thailand's Reform program aims to achieve these objectives through a step-by-step process of improving the performance of selected line ministries.** This performance improvement process involves the close coordination of the Bureau of the Budget, the Office of the Civil Service Commission, and the line ministries to achieve synergies in translating public expenditures and human resources into performance. The performance improvement process is initially being piloted in three priority ministries and will then be rolled out to other ministries. Building on reform efforts already under way, the first year of the Government's reform focused on social and economic services delivered by the Ministries of Education, Health, and Commerce. Other ministries are expected to join the reform program in subsequent years and will design their reform programs based on the lessons learned from earlier ministerial reforms.

### Recent Key Achievements in Strengthening Line Ministry Performance

#### Ministry of Education

- **290 Local Education Authorities (LEAs) have been mapped,** and a decentralization proposal has been submitted to the ERC along with the recommendation that 12 LEAs serve as reform pilots.
- **A decree has been proposed to establish an Office for National Educational Standards and Quality Assessment**

#### Ministry of Public Health (MoPH)

- **The new Health System Reform Office was established in April 2000 (for 3 years), as an autonomous body based in the Health System Research Institute (HSRI).** The objectives of the Office are to (i) synthesize knowledge about best practices in health systems; (ii) promote social mobilization and mass communication; and (iii) prepare the National Health Act. Issues to be addressed by the National Health Act include: (a) preparation of universal coverage with health insurance; (b) technology assessment; (c) policy and planning; (d) provider-purchaser relationship; (e) family practice; (f) network of health services; (g) health manpower resources; and (g) National Health Council ("health parliament" or civil society).
- **Experts working on developing and implementing the hospital accounting system have made significant progress accounting and performance-based budgeting reform.** Ten hospitals have been chosen as "champion" hospitals to implement the reform.
- **A working ground has been formed at the MoPH to produce a decentralization plan for the National Decentralization Committee in the health sector by end August 2000.** A working group was established to prepare this plan, constituted of managers from the MoPH, directors of provincial health offices, and hospital directors.

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## Public Sector Management Reform: Challenges Ahead

**The Government's Reform Program recognizes that institutional reforms require time to implement and are inherently uneven in pace.** The Reform Program has been designed around concrete objectives with defined but flexible benchmarks that can be adjusted to accommodate variable implementation progress. Progress across program areas has generally been positive although uneven. *As reforms are maintained and deepened over the medium term, interventions will increasingly be required to address complex problems that span several agencies; systems and incentives for agencies to assure greater integration and coordination must be developed and promoted.*

- **Integration and coordination of reforms is crucial to successful implementation.** The reform process is being managed by a series of committees, which meet infrequently and have other responsibilities. As a result, cross-cutting issues and broad policy frameworks are only beginning to be considered and established. Further coordination would enhance the reform process; especially important is integrating performance budgeting and results-based-management reforms.
- **Delays have occurred in establishing and funding the Administrative Courts and the Office of the Ombudsmen.** The Government should enhance its efforts to institutionalize and empower these newly established independent bodies and to integrate them better into the overall reform program. Financial and human resources are clearly insufficient at present for the offices to be fully operational. Establishing these institutions well is especially crucial during the next few years when public expectations for the Constitution and these institutions are high.
- **Investment in corollary information systems could enhance the management and implementation of reforms.** Information system inputs are necessary for many reform areas: expenditure management (accounting and financial management systems), human resource management (human resource management information system), revenue management (various revenue administration systems), and cross-government accountability and transparency (databases and tracking systems.)
- The experience of other countries undergoing similar public sector reforms is that reforms cannot be sustained unless they are well planned and sequenced, supported by key stakeholders, and adequately funded.

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## PUBLIC FINANCE IN TRANSITION\*

1. The *Public Finance Review* assesses the performance of Thailand's fiscal institutions in responding to the pressures of the economic crisis, and its likely performance in meeting the challenges of the new Constitution and modernizing the public sector. It draws on the analysis conducted in designing the Government's Public Sector Management Reform Program, and lays out numerous reform options, many of which are incorporated in the Government's Program, which is being implemented by various agencies. It draws lessons from Thailand's experience during the economic crisis by examining policy responses, identifying institutional shortcomings, reviewing key challenges for fiscal policy and administration, and developing practical policy recommendations. While the *Review* is selective in its focus—issues such as human resource management and tax policy reforms are not directly addressed—it serves as a practical compendium of reforms currently underway, assessing progress achieved and suggesting priorities for further reform.

2. Thailand is emerging from the biggest economic crisis in a generation, which strained its public finances and fundamentally changed the environment in which it makes fiscal decisions. After a decade of surpluses and skillful management of its aggregate fiscal accounts, Thailand faces recession-induced lower revenues, rising social expenditures, costly restructuring of the financial system, and higher public debt. Fiscal reforms are also mandated by the new Constitution. These reforms emphasize accountability and transparency; changes in financial management and reporting, and service delivery, as well as the decentralization of government activities to local administrations. Thailand's ability to respond to these pressures depends critically on the quality and capability of its fiscal institutions and tools.

3. Thai fiscal policy can generally be characterized by fiscal conservatism. The Government is legally restrained from running a large deficit, and fiscal policy has traditionally played a stabilizing role on the economy. This conservatism served it well during the boom years, when fiscal policy provided a healthy macroeconomic environment for growth. From 1976 to 1996, the average economic growth was 8 percent annually, placing Thailand firmly among the East Asian miracle countries.

4. However, there were problems—even during the boom period—in fiscal planning and management that were little observed. Growth was accompanied by increasing income inequality through the early 1990s, and the efficiency and effectiveness of spending were poor. Revenue growth was disproportionately allocated to investment spending, which failed to surmount the infrastructure bottlenecks of Thailand's rapidly growing economy. The string of fiscal surpluses largely reflected a continuous underestimation of revenues, whereas actual expenditures were

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\* This note was prepared by Dana Weist, Senior Public Sector Specialist, World Bank. It is the executive summary of : "Thailand: Public Finance in Transition", World Bank (Report No. 20656-TH, dated August 29, 2000) which was prepared by a task team led by the author of this note. Electronic copies of the report are available at <http://www.worldbank.or.th/economic/index.html>.

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considerably lower than planned. Lack of transparency in public expenditure management has emerged as a major concern.

5. The crisis revealed both strengths and weaknesses in public institutions that were often undetected during the boom period. To its credit, the Government was able to maintain social spending directed toward disadvantaged groups. On the other hand, a clear asymmetry was observed in the Government's capacity to use fiscal policy as a tool of demand management. In the initial crisis period, the Government effectively cut budgeted expenditures by almost 20 percent. However, fiscal expansion proved more difficult than budget cuts. The fiscal stimulus program did, over time, succeed, spurring consumption and also leaving a legacy of substantially larger public debt—estimated to rise to more than 50 percent of GDP in the medium term from 16 percent in 1996.

6. The fiscal challenges posed by the crisis and the new Constitution call for concerted effort on several interrelated fronts. The task for Thailand's policy makers will be: *first*, to ensure fiscal sustainability by sound public debt management, asset disposal/privatization, and mobilizing adequate resources through improved revenue administration. *Second*, Thailand's capacity for prioritizing and targeting public expenditures must be strengthened. *Third*, more efficient fiscal management requires a more performance-based and transparent management of public expenditures, revenues and liabilities. Finally, careful steps toward decentralization of fiscal responsibility and accountability are required by the new Constitution. These individual challenges can be overcome within the Government's Public Sector Management Reform Program. The reform agenda, and actions that the Government has embarked upon, are described below.

## ANNEX

### Annex 1 : Competitiveness indicators and their effect on growth

It is widely recognized that standard of living of a nation depends on its productivity as measured by the value of goods and services generated per unit of nation's capital, human, and natural resources. Sound macroeconomic policies and stable political and legal frameworks are necessary but not sufficient to ensure sustained economic growth and higher standard of living. The nation productivity is derived from individual firm's productivity, therefore, strong microeconomic foundations such as firms operating practices and strategies, business inputs, infrastructure, institutions, and competitive environment are vital to enhance the productivity. Using data from 1999 Executive survey of more than 3,900 executives from both private and public sectors, Porter and Christensen (1999) found significant relationship between microeconomic factors and GDP per capita growth.

#### Selected competitiveness indicators and their effect on growth

Domain	Competitiveness indicator	Effect on growth of a 1% increase in the indicator*
<b>Knowledge economy</b>	Computer utilization	0.55%
	Quality of science and research institutions	0.10%
	University/industry research collaboration	0.23%
	Quality of scientist and engineers	0.02%
	Adequacy of average years of schooling	0.19%
<b>Financial and Regulatory framework</b>	Financial market sophistication	0.03%
	Stock market access	0.22%
	Venture capital availability	0.09%
	Judicial independence	0.27%
<b>Information / clusters</b>	Business information availability	0.44%
	Domestic supplier quantity	0.18%
	Domestic supplier quality	0.37%
<b>Infrastructure</b>	Overall infrastructure quality	0.12%
	Port infrastructure	0.19%
	Airport transport	0.01%
	Telecommunications infrastructure	0.39%
<b>Competition</b>	Intellectual property protection	0.19%
	Intensity of local competition	0.20%
	Effectiveness of anti-trust policy	0.15%
	Tariff liberalization	0.02%

Source: Porter, Michael E. and C. Roland Christensen. 1999. Microeconomic competitiveness: Finding from the 1999 Executive Survey. World Economic Forum.

\*It should be noted that these results arrived from a bivariate regression analysis, which assume that other factors are held constant.

Additionally, for middle income countries, the strongest influences on the level of GDP per capita comprise of cluster development (buyer sophistication and domestic supplier quality), computer utilization and telecommunication infrastructure, information availability, intellectual property protection, tariff liberalization, effectiveness of anti-trust policy, and personal security. The research evidence shows that without effective reforms on microeconomic fundamentals, GDP per capita growth generated by sound macroeconomic policies will not be sustainable. Productivity growth brought about by micro reforms can also lessen the burden of fiscal obligations in the medium term.

Source: 1997 Thailand Industrial and Competitiveness Survey (TICS)

Notes: Survey of 1277 firms in five sectors, with approximate inverse sampling weights

Size definitions: Small <50, Medium 50-300, Large >300 employees.



## Annex 2 : Thailand and Korea: Relative development of Economic and Technological Structures

ECONOMIC DEVELOPMENT INDICATORS		1967-71	1972-76	1977-81	1982-86	1987-91	1992-96
<b>Korea</b>	GDP * per capita	892.2	1,324.9	Thailand 1992-96 1,930.2	2,527.3	3,861.2	5,284.6
	Manufacturing value added * per capita	96.3	208.7	414.3	Thailand 1992-96 683.1	1,216.9	1,679.9
	Manufacturing value added * (% of GDP)	10.6	15.6	21.4	26.8	Thailand 1992-96 31.5	31.7
	Industry value added ** (% of GDP)	27.6	32.3	38.8	Thailand 1992-96 41.1	43.5	43.3
<b>Thailand</b>	GDP * per capita	457.4	547.1	694.7	827.1	1,172.8	1,687.7
	Manufacturing value added * per capita	73.9	111.7	157.5	188.1	308.5	507.1
	Manufacturing value added * (% of GDP)	16.1	20.4	22.7	22.7	26.1	30.0
	Industry value added ** (% of GDP)	25.4	26.8	29.6	31.4	36.0	39.1
TECHNOLOGY DEVELOPMENT INDICATORS		1970	1975	1980	1985	1990	1995
<b>KOREA - R&amp;D EXPENDITURE AND PERSONNEL</b>							
	Total R&D as a proportion of GNP (%)	Thailand 1996 0.38	0.42	0.77	1.58	1.95	2.69
	Business enterprise R&D as % of total	Thailand 1996 12.4	28.80	28.80	60.70	70.90	73.10
	Researchers *** per 10,000 population	1.7	Thailand 1996 2.9	4.8	10.1	16.4	28.6
<b>KOREA - PATENTS IN THE US</b>							
	Totals 5-year periods	1967-71 5	1972-76 39	1977-81 49	1982-86 157	1987-91 970	1992-96 4914
	5-year total/million population at end period	0.15	Thailand 1992-96 1.09	1.27	3.81	22.42	107.89
	Per hundred million Manuf. VA end period *	0.001	Thailand 1992-96 0.39	0.25	0.44	1.60	5.58
<b>THAILAND - R&amp;D EXPENDITURE AND PERSONNEL</b>							
	Total R&D as a proportion of GNP (%)				1987 0.21	1991 0.16	1996 0.12
	Business enterprise R&D as % of total				6.8	5	10.8
	Researchers *** per 10,000 population				0.16	0.17	2.14
<b>THAILAND - PATENTS IN THE US</b>							
	Totals 5-year periods	1967-71 1	1972-76 4	1977-81 6	1982-86 7	1987-91 11	1992-96 20
	5-year total/million population at end period		0.09	0.13	0.13	0.19	0.33
	Per hundred million Manuf. VA end period *		0.07	0.07	0.07	0.05	0.06
* Estimated in terms of Constant 1987 US\$		** Estimated in terms of current US\$		*** Excluding technicians and support staff			

Source : Arnold, et.al., 2000. Enhancing Policy and Institutional Support for Industrial Technology Development in Thailand, Draft Report.