# THAILAND ECONOMIC MONITOR , APRIL 2007

**World Bank Office - Bangkok**
**Country Director: Ian C. Porter**

**Comments to:**
**Kazi M. Matin**
**Kmatin@worldbank.org**
**Kirida Bhaopichitr**
**Kbhaopichitr@worldbank.org**

**30th Floor, Siam Tower**
**989 Rama I Road, Pathumwan**
**Bangkok 10330, Thailand**
**(662) 686-8300**
**http://www.worldbank.or.th**

**Acknowledgements**

This report was prepared by Angkanee Luangpenthong, Cheanchom Thongjen, Kirida Bhaopichitr (Task Team Leader), Ruangrong Thongampai, and Wallada Atsavasirilert under the overall supervision of Kazi M. Matin.

We would like to acknowledge input from Chanin Manopiniwes (Infrastructure), Chinnakorn Chantra (Procurement), Kwanpadh Suddhi-Dhamakit (Social Protection), Thomas A. Rose (Financial and Corporate Sector), and Vatcharin Sirimaneetham (JTEPA). Valuable comments and information were provided by officials of the Bank of Thailand, Board of Investment, Comptroller General's Department, Customs Department, Department of Skill Development, Department of Trade Negotiations, Energy Policy and Planning Office, EXIM Bank, Federation of Thai Industry, Fiscal Policy Office, Government Savings Bank, Ministry of Labor, Ministry of Foreign Affairs, Office of Metropolitan Electricity Authority, the National Economic and Social Development Board, National Credit Bureau Co., Ltd., National Statistics Office, the National Telecommunications Commission, Office of Agricultural Economics, Office of Industrial Economics, Office of the Decentralization to Local Government Organization Committee, Office of the Public Sector Development Commission, Office of the Trade Competition Commission, Public Debt Management Office, Securities and Exchange Commission, Stock Exchange of Thailand, Thai Chamber of Commerce as well as by World Bank staff including Ian C. Porter and Milan Brahmbhatt.

# TABLE OF CONTENTS



## BOXES



## FIGURES

## TABLES

# SECTION 1

# OVERVIEW

**Growth is slower in recent years.** GDP grew by 5 percent in 2006, modestly better than 4.5 percent in 2005, but is projected to fall to 4.3 percent in 2007, driven mainly by exports. Average, annual GDP growth rate of 4.6 percent during 2005-07 will be nearly 1.5 percentage points below Thailand's own annual average during 2002-04. This slowdown is in part because the easy gains from increased utilization of excess capacity have been exhausted and in part because new capacity is expanding slowly as confidence of investors are at a low point. Some recent initiatives however give cause for hope that this will turn around starting in 2008.

**Thailand's growth performance is also not keeping pace with its neighbors.** Indonesia, Philippines and Malaysia is growing on average by around 5.5 percent a year during 2005-07, while China and Vietnam are averaging 10 and 8 percent respectively. Thus competition for foreign investment and exports remain strong, as the region becomes increasingly more integrated, and middle-income countries face new and additional challenges of moving forward in the medium-term.

**However, macro fundamentals remain sound, providing an excellent basis for raising the growth-rate.** Inflation is expected to fall by more than 2.5 percentage points to be around 2 percent. The fiscal balance will have a small deficit but public debt as a share of GDP will continue to fall and fiscal space for appropriate increases in public investment is considerable. External vulnerability remains very low, with external debt at only 32 percent of GDP and foreign reserves at an all time high of US$ 67 billion.

**Thailand's overall poverty is low, but it is still significant in poorer regions and rural areas.** Higher national growth transmits to poorer regions and to the poor generally even if not in the same proportion, but a lower growth rate also generally transmits as lower increase in the poor's income. Thus efforts to enhance the poor's share in national growth to raise the quality of growth, is appropriately an important Thai objective. Increased public expenditures in poorer regions can contribute to that objective, as will improved support for increased agricultural productivity, as well as better training and education of the rural labor force to facilitate their movement into higher productivity non-agricultural occupations. Thus increasing the annual average rate of growth to 5.5-6 percent and improving its equity can ensure both a better quality of and a higher rate of overall growth.

**The challenge of achieving a higher rate and quality of growth in the short and medium term is considerable.** In the short term, investor and consumer confidence have to be enhanced, and this can be done through greater clarity on the impending transition and on policy direction for investors. The latter will require actions this year. These actions can be in terms of an announced plan to address exchange-rate pressures so as to reassure the market, and it could include measures to assist directly agricultural and labor-intensive sectors, as well as in terms of implementation of actions that are favorable for investors generally. For the medium-term, the focus will have to be on how to engineer the upgrading of the manufacturing and services sectors to keep them competitive, and this will require significant and sustained improvements in Thailand's intellectual and physical infrastructure.

*Recent Developments*

**GDP growth in 2006 was driven mainly (as will in 2007) by relatively strong export growth.** Domestic demand grew by only 1 percent last year, the lowest in many years, as growth in private consumption and private investment fell due to both political and policy uncertainty. Export in real terms grew more rapidly in 2006 (8.5 vs 4.3 percent in 2005) while import growth fell (1.6 vs 9.3 percent), accounting for most of the GDP growth.

**Total exports topped US$ 130 billion, with exports of agriculture, as well as of labor-intensive and machinery manufacturers growing robustly.** Their growth rates were either similar to earlier years or significantly higher, as in the case of agriculture which was recovering from drought. Exports of machinery reached US$57 billion, while agriculture and labor intensive manufactures remained close to US$11 and US$10 billion respectively, higher than the receipts in 2005. Exports to China grew just as strongly as earlier years.

**Like in other countries in this region, current account surplus and capital inflows are projected to continue in 2007.** The surplus may fall slightly to 1.5 percent instead of 1.6 percent of GDP in 2006, reflecting in part depressed investment levels; it will also be accompanied by falling debt-service obligations. The annual net capital inflow into Thailand was US$ 8.9 billion in 2006, lower than in 2005, and it is expected to remain significant in 2007. Thus exchange rate pressures from these sources are likely to continue.

**These balance of payment inflows led Thailand to use capital controls, most of which are now withdrawn, but impact on market confidence lingers.** The baht appreciated in real terms by 8 percent in 2006, and the temporary unremunerated reserve requirement (URR) of 30 percent imposed on most capital inflows in December 2006**,** sought to reduce the pace of appreciation. The Bank of Thailand has, in stages, exempted virtually all of the inflows from the URR as long as they are hedged. Nevertheless, the impact of controls on market confidence lingers even now, though these controls proved temporary.

**Since pressures for appreciation will continue in 2007, announcing a plan with measures to address these pressures directly, can reassure the market.** Signals from the Government that there is a coherent *plan* to address these pressures at their source would help to reassure the market that a re-imposition of capital controls is unlikely. This *plan* could include four types of measures. First, the Government could use a process to select, on the basis of employment-size and vulnerability to appreciation, an initial set of export sub-sectors. Second, it could adopt a set of *time-bound* targeted financial assistance measures for these sub-sectors that would allow them to adjust gradually by funding productivity-enhancing actions and/or by re-training their employees for employment in other related sub-sectors, if productivity-enhancing potential is limited in existing sub-sectors. Third, there could be a set of general measures aimed at raising domestic demand and reducing the current account surplus in order to lower pressures for exchange rate appreciation, including increases in public investment through the budget and increases in private investment through policy actions cited below. Fourth, implement a set of general measures that could strengthen Thailand's existing social safety net, especially for supporting the transitional unemployed.

**The decline in private investment growth is not only problematic in terms of the current account but also in terms of adding to existing capacity.** Private investment grew by only 4 percent in 2006 down from 11 percent in 2005, and is projected to be not much better in 2007. This low growth last year would have been much lower if foreign investment did not rise at a real rate of nearly 18 percent, as private *domestic* investment experienced negative growth. Thai investors, in both tradable and non-tradable sectors, have remained skittish throughout the recovery period because of structural factors -- in part due to greater market uncertainty arising from China's WTO accession and the resulting competition and in part due to investment climate constraints like high regulatory burden, inadequate availability of right skills and a growing deficit in infrastructure.

**Shorter-term factors worsened investor confidence further, especially the heightened policy uncertainty resulting from recent changes.** Higher oil prices from 2004 onwards imposed adjustment costs on investors. Political disturbances in 2005, the coup in 2006, and the impending election and transition in 2007 – has created considerable *political* uncertainty, which cannot be addressed quickly, though greater clarity about the process can be helpful. In addition, there is investor perception of greater *policy* uncertainty arising from economic policy changes like the December 2006 capital controls (discussed above) and the January 2007 Cabinet approval of amendments to the Foreign Business Act (FBA).

**This Cabinet-approved amendment rationalizes the FBA Act in three key ways to ensure that it met the goal of Thai control in these sectors.** First the amendment redefined 'majority foreign ownership' in terms of majority shareholding as well as *majority voting rights*, which is a common definition used in many countries. But this was a significant change for foreign investors in Thailand where the earlier 1999 Act had permitted majority foreign voting rights (through preferred shares) to coexist with minority foreign shareholding in a company, making it possible for more foreign investors to come into these restricted sectors. Second, the proposed amendment applied this new definition *retrospectively* for sub-sectors in lists 1 and 2 in the Act. This means that existing foreign investors would either have to give up majority voting rights and if not divest within a pre-defined period. Third, it increased the penalty for using Thais as "nominee" share holders if beneficial ownership of those nominee-held shares go to foreigners. This was not a change from earlier Act as 'nominees' were also illegal under the 1999 Act, but was not actually being enforced.

**These FBA amendments were widely perceived by investors as restricting foreign investment and increasing policy uncertainty.** The redefinition of 'majority foreign owned' would prevent those foreign investors who wanted to have management control in the restricted sectors from coming in. Second, *retrospective* application in proposed amendment increased perception of increased uncertainty and unpredictability about existing policies, something that was uncharacteristic of Thailand. Though Government's announcements have continued to emphasize that nothing has changed in terms of Thailand's strategy, policy direction or policy stability, foreign investors have remained skeptical.

**Going forward, Government could take some policy actions this year to improve investor confidence.** The signing of the Japan-Thailand Free Trade Agreement (FTA)[1] is already having a positive effect on investor confidence, even if the actual impact on exports and investment will only be felt after it is fully effective in October 2007. If the FTA is followed by National Legislative Assembly (NLA) approval of a *modified* FBA amendment that rationalizes the Act but modifies the current version - by dropping the *retrospective* application of the changed voting-rights-requirement from the amendment and by excluding some of the key services sub-sectors critical to Thailand's development from list 3 of the Act so that foreign majority shareholding is permitted in them – these modifications could remove many of the recent misgivings of foreign investors. In addition, the Government could take actions to reduce structural constraints on investment like the regulatory burden, poor availability of skills and high infrastructure costs, the private investment situation can start to turn around.

[1] Known as Japan-Thailand Economic Partnership Agreement (JTEPA).

**Public investment growth is unlikely to offset the weak private consumption and investment demand.** This is in part because good governance is, rightly, a key policy plank of the Government, and the increased scrutiny as well as adoption of good practices will slow disbursement of public funds. For example, several measures are being put in place to make public procurement more transparent and accountable, which is indeed commendable. Similarly, earlier planned projects are being re-assessed. Despite the best efforts by the Ministry of Finance to expedite public investment, especially in appropriate infrastructure, it will be difficult to ensure public investment growth of more than 4.2 percent in 2007.

***Medium-Term***

**In the medium-term Thailand has the potential to raise long term growth by one and half percent over the recent growth rates.** But such increases in growth will require enhanced productivity and innovativeness, as well as higher investment. There is currently very little innovation taking place in manufacturing. Concerted efforts will have to be made by the Government, the private sector and households if this medium-term challenge is to be met.

**The challenges for encouraging innovation come from several areas.** First, the business sector, barring few exceptions, appears to be inadequately unmotivated to invest substantially in R&D or introduce process innovations on a routine basis. Second, numerous government programs to encourage R&D, technology absorption and technology development have failed to produce the desired effect. Third, the supply of science and technology workers as a percent of university graduates is below that of Thailand’s principal competitors but more serious is the quality of Thailand’s upper secondary education. And fourth, FDI has transferred amazingly little tacit knowledge and technology, as only a handful of companies have set up research establishments in Thailand.

***Reforms***

**The Government took actions over the last six months in respect of the business environment (see above), the financial sector and the energy sector.** Measures to enhance independence of the regulatory agencies were approved by the Cabinet (i.e. Central Bank Act, the Securities Exchange Commission Act, and Insurance Act), and would now have to be approved by the NLA to become effective. Several measures have also been adopted to promote alternative and renewable energy sources as a response to higher oil prices and oil intensity: these include policies to subsidize gasohol to make it cheaper than premium gasoline, to promote investments through incentives in ethanol production and in import of flexible fuel vehicles, and to subsidize renewable energy generators (hydro, bio-mass, solar, wind) of larger sizes to join the grid. In respect of the medium-term agenda, an intellectual infrastructure master plan and productivity improvement master plan have been prepared for implementation.

**There remains a significant unfinished short and medium-term reform agenda, which if acted upon, can pay rich dividends.** The agenda over the next 12 months will comprise of announcement of a Plan to address exchange rate appreciation pressures and implementation of actions to increase the low investor confidence. The medium term agenda will comprise of measures to reduce investment climate constraints as well to move Thailand towards a knowledge economy.

**The short term agenda over the next twelve months comprise of four sets of measures that could improve investor confidence and productivity significantly.** *First,* implement the Japan-Thailand FTA effectively. *Second* modify the FBA amendment so that it drops “retrospective” application of voting-rights change and excludes key service sectors from the restricted list 3 of the Act. *Third,* implement following actions to reduce investment climate constraints facing firms which would raise their productivity: (a) reduce time needed to register/start a business by reducing procedures and simplifying the ones that stay (b) reduce the coverage of sub-sectors under price controls (c) reduce time needed for customs clearances (d) reduce administrative barriers to investment processing and implementation (e) reduce time taken for infrastructure connections (water, power, phones etc) (f) approve by Cabinet and NLA the *Deposit Insurance Act* and the *Secured Transactions Act* (g) liberalize further the process for setting up private vocational schools to deliver training (e.g. on ICT, English language, and sector-specific). *Fourth,* announce a Plan that includes measures to address exchange rate pressures like targeted and time-bound financial assistance for a few selected agriculture and labor intensive sub-sectors for gradual adjustment; a measure to improve social safely net and general measures to raise domestic demand by raising public and private investment.

**The medium-term agenda for a longer period comprise of measures to move Thailand towards a knowledge economy that promotes innovation**. This would include actions to improve the policy framework in providing appropriate incentives, actions to improve the intellectual infrastructure, and actions to ensure that physical infrastructure is supportive of this move. The first set would include reduced regulatory burden, increased competition for all firms, flexible labor and financial market, and incentives for R&D and in-firm training. The second would require actions to promote greater private participation in education services, development of at least one world class university and one premier research institute, enhanced university enrollment in science and technology and improved university-research institute-business linkages. The third would cover better ICT infrastructure, more efficient transport and logistics, better quality and cost-effective services and most importantly an increasingly efficient Bangkok city.

# SECTION 2
# RECOVERY AND OUTLOOK

## 2.1 Real GDP and Macroeconomic Development

**Real GDP growth in 2007 will decelerate from that of 2006 to 4.3 percent.** Real GDP this year would grow by 4.3 percent, slowing down from 5 percent last year. These growths are the lowest among those of the emerging East Asian countries (see Table 1). Exports will continue to be the key driver of growth as it did last year although it will grow at a slower rate of 6 percent, compared to 9 percent last year. However, the higher import growth will slow down the overall growth in GDP. Net foreign demand this year will therefore grow by only 6 percent compared to 46.7 percent last year (see Table 2). Domestic demand, on the other hand, will accelerate from its 0.3 percent growth in 2006 to around 5 percent this year as consumption and the building up of inventories pick up. Nevertheless, the growth in domestic demand this year will be constrained by the low consumers and investors' confidence, even though oil prices, inflation, and nominal interest rates will decline. A brief discussion of each of the components of GDP is presented in this section, while their details can be found in their respective sections in this Economic Monitor.

**Table 1. East Asia Real GDP Growth**

(Percent)

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| **Emerging East Asia** | **7.6** | **8.1** | **7.3** |
| **Develop. E. Asia** | **9.0** | **9.5** | **8.7** |
| S.E. Asia | 5.1 | 5.4 | 5.5 |
| Indonesia | 5.7 | 5.5 | 6.3 |
| Malaysia | 5.2 | 5.9 | 5.6 |
| Philippines | 5.0 | 5.4 | 5.6 |
| Thailand | 4.5 | 5.0 | 4.3 |
| Transition Econ. | | | |
| China | 10.2 | 10.7 | 9.6 |
| Vietnam | 8.5 | 8.2 | 8.0 |
| Small Economies | 7.6 | 7.2 | 5.9 |
| **Newly Ind. Econ.** | **4.8** | **5.4** | **4.5** |
| Korea | 4.0 | 5.0 | 4.4 |
| 3 other NIEs | 5.5 | 5.8 | 4.6 |
| Japan | 2.6 | 2.2 | 2.3 |

Source: World Bank East Asia Region (March 2007) and Consensus Forecasts for NIEs.

**Inflation and interest rates are likely to fall this year, but real interest rate may not.** Headline inflation is expected to decline from its 8-year peak of 4.7 percent last year (see Figure 1) to around 2 percent this year as the baht strengthens and petrol prices decline. Petrol prices are expected to decline by around 10 percent, in line with that of world crude oil prices (see discussion of world oil prices in External Environment section). Last year, to cope with the high inflation, the Bank of Thailand (BOT) raised its policy interest rate by 2 percentage-points. Policy rate was reduced by 0.5 percentage-points in the first two months of this year as inflation declines. Headline inflation has declined to 2.7 percent on average in the first two months of this year as the energy price declined by 1.4 percent. For the remaining of the year, the policy rate is expected to be reduced further by another percentage-point or slightly more. However, this reduction will be less than the fall in inflation. Hence, real interest rates would be slightly higher than last year's.

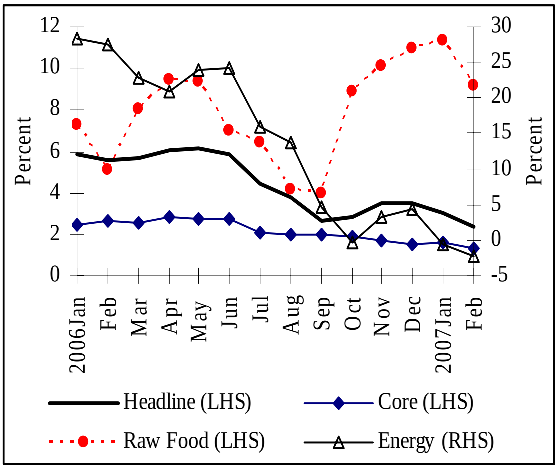
**Table 2. Real GDP Growth by Demand Components**

(Percent)

| | Share of 2006 GDP | 2005 | 2006 | 2007p |
|---|---|---|---|---|
| **Total Consumption** | **62.6** | **5.5** | **3.2** | **4.1** |
| Private C | 53.7 | 4.3 | 3.1 | 3.5 |
| Gov C | 9.0 | 13.7 | 3.4 | 8.0 |
| **Gross fixed capital formation** | **23.3** | **11.1** | **4.0** | **4.1** |
| Private Investment | 17.4 | 10.9 | 3.9 | 4.0 |
| Public Investment | 5.9 | 11.3 | 4.5 | 4.2 |
| ***Change in Inventories*** | *-0.9* | *29.4* | *-155.1* | *60.0* |
| **Total Domestic Demand** | **85.0** | **7.3** | **0.3** | **5.0** |
| **Exports** | **68.6** | **4.3** | **8.5** | **5.9** |
| Goods | 56.0 | 4.3 | 9.0 | 6.0 |
| Services | 12.7 | 4.3 | 6.7 | 5.5 |
| **Imports** | **54.3** | **9.3** | **1.6** | **5.9** |
| Goods | 44.6 | 8.8 | -0.8 | 5.0 |
| Services | 9.7 | 12.1 | 14.3 | 10.0 |
| **Net Foreign Demand** | **14.3** | **-16.5** | **46.7** | **6.0** |
| **GDP** | **100.0** | **4.5** | **5.0** | **4.3** |

Source: NESDB (2005 and 2006), WB projections (2007)
p = projections

**Figure 1. Inflation**




Source: BOT

**Table 3. Trade and Current Accounts**

**(Million US$)**

| | 2005 | 2006 | 2007p |
|---|---|---|---|
| **Exports of Goods** | **109,193** | **128,220** | **141,042** |
| % change | 15.0 | 17.4 | 10.0 |
| **Imports of Goods** | **-117,722** | **-125,975** | **-137,943** |
| % change | 25.9 | 7.0 | 9.5 |
| **Trade Account** | **-8,530** | **2,245** | **3,099** |
| as % GDP | -4.8 | 1.1 | 1.3 |
| **Net services income & transfers** | **677** | **996** | **506** |
| % change | -48.2 | 47.0 | -49.2 |
| Receipts | 26,810 | 32,073 | 128,193 |
| % change | 9.7 | 19.6 | 7.0 |
| Payments | -26,132 | -31,077 | -125,963 |
| % change | 13.0 | 18.9 | 8.8 |
| **Current Account** | **-7,852.0** | **3,240.0** | **3,605.0** |
| as % GDP | -4.5 | 1.6 | 1.5 |

Source: BOT (2004-2006), WB projection (2007)

**Thailand's current account will continue to be in surplus this year.** With import growth slowing down sharply while exports continued to perform well last year, the current account reverted to a surplus of US$3.2 billion or 1.6 percent of GDP in 2006 compared to a deficit of US$7.9 billion in 2005 (see Table 3). The balance of payments registered a surplus of US$12.7 billion by the end of the year and foreign reserves reached US$67 billion. The strong inflows were the main reason for the 13-percent appreciation of the baht since the beginning of last year (see Box 1 on The Baht's Appreciation and Implications). This had promoted the imposition of the capital controls which has been subsequently relaxed (see Table 1). The current account should remain in surplus by around 1.5 percent of GDP this year as imports will not recover quickly.

**Imports have slowed down significantly in 2006 and would increase slightly this year with the slow recovery in investments.** Last year, imports of goods in real terms contracted by 0.8 percent from that of 2005 as a result of the contraction of oil imports and the sharp deceleration of capital good and raw material imports growth (see Table 8). This contraction is partly due to the running down of inventories in 2006 and exceptional high base in 2005 in which import of oil and iron and steel rose sharply, the latter for stocking up. As a result, import values increased by only 7 percent compared to over 26 percent in 2004 and 2005. This year, imports in real terms should increase from its low base last year by around 5 percent as inventory is rebuilt. Import values would speed up slightly from 7 percent growth last year to 9.5 percent this year.

**Exports, on the other hand, grew robustly last year but will slow down this year with the slow down in the global economy.** Exports of goods in real terms grew sharply last year by 9 percent. As a result, export values of goods grew by more than 17 percent last year compared to 15 percent in 2005 (see Table 3). Services receipts also grew sharply at 19.6 percent with the recovery of the tourism after 2005 which was a tsunami-affected year. Given that both the global demand and the growth of Thailand's key trading partners are projected to slow down this year, exports growth will unlikely be as impressive as last year's. Export volume and values of goods this year would therefore unlikely to increase by more than 6 percent and 10 percent, respectively (see Export Performance section for more details). Exports of services will also expand at a slower rate this year with the slow down in tourist receipts are negatively affected by the new year bombing and political issues in Thailand.

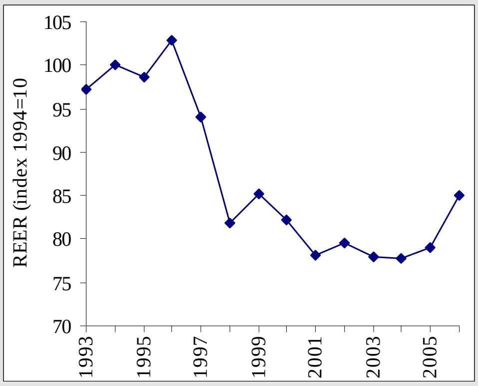
**Household consumption growth this year will accelerate slightly on the back of a quite dampened one last year.** Household consumption in real terms grew by 3.1 percent last year, the lowest expansion since 1999 (see Table 2). It should accelerate to around 3.5 percent this year. Last year, the sharp rise in inflation and lending rates had dampened household consumption growth. This year, lower inflation and interest rates would help increase the purchasing power of consumers. However, the subdued consumer confidence, as shown by the declining Consumer Confidence Index, will restrain household spending. This year, farm incomes will not support rural household consumption as much as in the past few years. Farm incomes should increase at a much slower rate than last year's 30 percent increase, as key crop prices are expected to increase only slightly compared to a 12.5 percent increase last year. (See Household Consumption section for more details)

**Box 1. The Baht's Appreciation and Implications**

**The pressures for appreciation are likely to continue in 2007, but temporary assistance can be provided to assist export sectors that are particularly vulnerable in the transition.** Thailand's export sector overall has been quite resilient despite many pressures, including real appreciation of 8 percent last year. Clearly a few sectors (e.g. agriculture and labor-intensive manufactures) are hurting more than others and temporary assistance and support for these sectors could be helpful during the transition. The Government would have to go about this systematically to ensure its effectiveness at reasonable cost. First, the Government would use a process to select an initial set of export sub-sectors with high employment that are vulnerable to appreciation and then adopt some *time-bound* targeted financial assistance measures for the selected sub-sectors. Such assistance would allow firms in these sub-sectors to adjust gradually by funding productivity-enhancing actions to stay competitive at more appreciated exchange rates or if that is not possible, by re-training their employees for employment in other related sub-sectors that have better competitive and growth potential.

**The Baht appreciated rapidly last year in both in nominal and real terms.** In 2006, the annual average baht to the US dollar exchange rate was Bt 37.88 compared to an average rate of Bt40.22 in 2005, faster than neighboring countries. The Baht's nominal effective exchange rate (NEER), which is the baht's exchange rate weighted by the currencies of Thailand's trading partner, appreciated by 5.7 percent. Its real rate (Real Effective Exchange Rate or REER) also appreciated by 8 percent (Figure 2). The year-on-year nominal appreciation speeded up since June 2006, peaking in December when the average for that month was 13 percent more appreciated than that of December 2005. But during the two year period (2005-06), overall real appreciation of the baht was in line with those of other currencies in the region (Table 4).

**Figure 2. Baht's Real Effective Exchange Rate (REER), 1995-2005**




Source: BOT

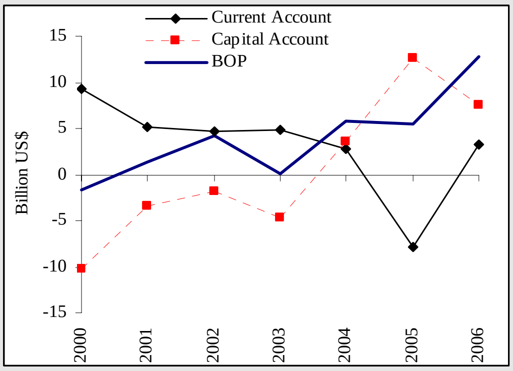
**Table 4. Change in Annual Average of Exchange Rates, (Local Currency to the US Dollar)**

| | **% change 2004 to 2005** | **% change 2005 to 2006** | **% change 2004 to 2006** |
|---|---|---|---|
| Korea | -10.58 | -6.77 | -16.64 |
| Philippines | -1.70 | -6.85 | -8.44 |
| Singapore | -1.53 | -4.53 | -5.92 |
| **Thailand** | **-0.01** | **-5.81** | **-5.82** |
| China | -1.00 | -2.70 | -3.74 |
| Malaysia | -0.34 | -3.40 | -3.42 |
| Taiwan | -3.73 | 1.10 | -2.69 |
| India | -2.68 | 2.74 | -0.02 |

Source: International Financial Statistics

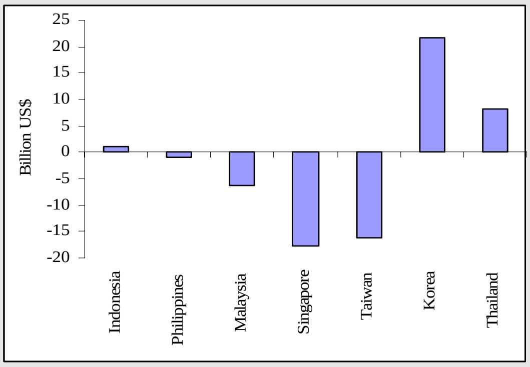
**The Baht's appreciation in 2006 was due to pressures from the current account surplus and net capital inflows.** The current account surplus (US$3.2 billion in 2006) and the net capital inflow (US$8.9 billion in 2006) came together (Figure 3). Outflows in terms of debt-service obligations were also lower. The surplus came from high export value growth of 17 percent, when import value growth slowed to only 7 percent (compared to 26 percent in 2005) due to depressed domestic demand, and the current account surplus was particularly large in November and December 2006. Net capital inflows in 2006 into Thailand was higher than other countries in the region except South Korea (Figure 3). It was, however, lower than US$12.6 billion net inflow in Thailand in 2005.

**Figure 3. Thailand's Current Account, 2006 Monthly**




Source: BOT

**Figure 4. Capital Accounts of Selected East Asia Countries, January-Sept 2006**




Source: BOT
Note: Korea's data is for the whole year

**In 2006, portfolio net inflows into the stock almost doubled that of 2005, even if total net capital inflow in 2006 was lower than in 2005.** The stock market received US$5 billion, compared to US$2 billion in 2005 (see Table 5), with half coming in January 2006. In the bond market, there was a small net outflow during the whole year, with relatively large net inflows in April, July, October and December, but this cannot be disaggregated into short-term or long-term bonds. The increase in the outstanding short-term bonds (both foreign and domestic) peaked in December 2006 at Bt88 billion (US$2.5 billion). Short-term loans however increased by 18 percent year-on-year in 2006 on top of its 32 percent increase in 2005. At the end of 2006, the stock of total short-term debt was 32 percent of total debt, compared to only 24 percent in 2004.

**Table 5. Net Flows of Capital**

(Million US$)

| | 2005 | 2006 | 2006 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q1 | Q2 | Q3 | Q4 | Dec |
| Monetary authorities | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Government | -952 | -558 | 66 | -262 | -179 | -183 | -323 |
| Bank | 290 | -8,609 | -5,413 | 512 | -846 | -2,862 | 683 |
| Other sectors | 13,220 | 18,033 | 8,272 | 2,711 | 3,659 | 3,390 | 1,082 |
| Non-bank | 10,969 | 17,195 | 7,904 | 2,603 | 3,973 | 2,714 | 783 |
| FDI | 7,412 | 9,619 | 4,210 | 1,768 | 1,737 | 1,904 | 620 |
| Portfolio | 2,645 | 4,948 | 2,462 | 39 | 2,130 | 318 | -674 |
| *of which* | | | | | | | |
| Equities | 2,158 | 4,907 | 2,695 | 61 | 1,752 | 399 | -607 |
| Debt securities | 487 | 41 | -233 | -22 | 378 | -81 | -67 |
| Foreign Loans | -1,308 | 2,981 | 1,185 | 628 | 248 | 920 | 777 |
| Others | 2,220 | -354 | 48 | 167 | -141 | -428 | 61 |
| State enterprises | 2,251 | 838 | 368 | 108 | -314 | 676 | 299 |
| **Total capital flow** | **12,558** | **8,866** | **2,925** | **2,961** | **2,635** | **345** | **1,442** |

Source: BOT

**A reduction in the current account surplus as well as increased outflows of Thai capital could lower the pace of appreciation.** Raising domestic investment demands, particularly increased investments both by the Government and the private and the private sector, will help. But the latter will need improved political certainty, greater policy stability, effectiveness of Japan-Thailand FTA, a modified FBA amendment and of course other policy actions supportive of private investment.

**Overall, it remains difficult to claim that Thailand's real exchange rate, even after the recent appreciation, is overvalued and that is for several reasons.** First, the real exchange rate even after recent appreciation remains more depreciated than the pre-crisis period **(**Figure 2). Second, the medium-term appreciation of the baht has been in line with other currencies of the region. Third, Thailand continues to demonstrate increasing competitiveness as manifest in sustained strong export growth during the recovery as well as 11.6 percent export volume growth in 2006 when baht appreciated rapidly; in fact the GDP share of exports rose from the pre-crisis rate of 45 to more than 65 percent in 2005. Fourth, survey-based indicators of competitiveness show that Thailand remains well placed vis-à-vis other emerging economies. Fifth, other real exchange rate studies, including purchasing power parity (PPP) estimates, provide no evidence of deviation from an equilibrium level.

**Thailand's exports as a whole are not very sensitive to appreciation but some sub-sectors are more than others.** The Bank of Thailand's estimation showed that the overall elasticity of exports to exchange rate of 0.1 (see Table 6). Agriculture and labor-intensive manufactures are the most sensitive, but even for them a 10 percent real appreciation will lower exports by 3.6 and 2.3 percent respectively. However, these sectors are vulnerable as they have under threat from lower income competitors and have been loosing market-share even before the large recent appreciation.

**Table 6. Elasticity of Thai Exports to Exchange Rate**

| Exporting Sub-sectors | Elasticity |
|---|---|
| **Agriculture** | **0.36*** |
| Fishery | 0.05 |
| Manufacturing | 0.07 |
| **Labor-intensive** | **0.23** |
| High technology | 0.07 |
| Resource-based | 0.01 |
| **Total export** | **0.1** |

Source: BOT

**The most important measure to consider in the face of appreciation pressures is assistance to sub-sectors that are vulnerable to such appreciation.** A process could be set up to identify those sub-sectors that have high employment and high vulnerability to exchange rate appreciation given current levels of competitiveness, and, based on agreed, criteria select a few. Those with potential for productivity increases would benefit from such assistance as also those that do not have such options but have high employment and thus may have significant re-training and other needs during the transition.

**To reduce pressures for appreciation, some general measures to raise domestic demand that are also desirable for other reasons.** Alternatives to capital controls to reduce the pace of appreciation are to reduce the current account surplus through increased imports and to promote outflows through Thai investments overseas. Promoting investments, both public and private, would not only raise imports of capital goods, but also ensure a sustained growth in the coming years. This is especially crucial this year when many industries currently have capacity utilization exceeding 80 percent. A reduction in the real interest rates as well as the policy uncertainties would help stimulate private investment and consumption this year. Investments by the public sector, if sped up this year, would help raise imports as well as build a more conducive investment climate for private investment to follow. As domestic demand is stimulated, imports of consumer goods and capital goods will rise. The increase in imports and the subsequent reduction in the current account surplus could help slow down the pace of appreciation but would unlikely reverse it. Hence, industries in Thailand, especially exporting ones, must adjust to the appreciation trend.

**Table 7. Measures on Capital Flows**

| Issued date | Measures |
|---|---|
| 10 May 2006 | Raise the limit of outstanding balance in the foreign currency deposit (FCD) accounts of corporate resident from 10 to 50 million US dollars. |
| 3 November 2006 | Request cooperation from financial institutions not to issue and sell bill of exchange (B/E) for all maturities to non-residents. |
| 4 December 2006 | Non-residents are required to hold Thai-baht-denominated government securities for at least 3 months<br>Financial institutions could borrow Thai baht from non-residents without underlying trades in Thailand only for borrowing with maturities longer than 6 months |
| **19 December 2006** | **Impose 30 percent unremunerated reserve requirement on transaction exceeding US$20,000 with the exchange to the baht, *except* for trade in goods and services, transfers, and FDI (excluding loans)** |
| 20 December 2006 | URR no longer applies to portfolio investment in the Stock Exchange of Thailand |
| 1 February 2007 | Provide option for loans to be exempt from URR by fully hedging for the maturity of the loan or up to one year for maturities exceeding one year |
| 15 March 2007 | Provide option for inflows into debt securities, mutual funds, and property funds to be exempt from URR by fully hedging at least 3 months |

Source: BOT

**Table 8. Import Value and Volume Growths, 2004-2006**

(Percent)

| | 2004 | 2005 | 2006 |
|---|---|---|---|
| **Consumer Goods** | | | |
| Volume | 14.0 | 10.0 | 14.1 |
| Value (7.5%) | 17.8 | 12.4 | 14.2 |
| **Raw Materials** | | | |
| Volume | 23.9 | 16.0 | 1.2 |
| Value (40.9%) | 26.8 | 18.1 | 5.1 |
| **Capital Goods** | | | |
| Volume | 15.1 | 21.8 | 1.3 |
| Value (26.1%) | 17.3 | 24.5 | 3.4 |
| **Fuel & Lubricant** | | | |
| Volume | 24.2 | 17.2 | -1.4 |
| Value (19.7%) | 47.1 | 58.4 | 20.2 |
| **Total** | | | |
| Volume | 20.5 | 18.5 | 0.5 |
| Value | 25.7 | 25.9 | 7.0 |

Source: BOT

Note: Figures in parentheses are shares in total imports in 2006

**Private investments, however, will unlikely pick up much from last year as policy uncertainties dampened investor's sentiments this year.** Last year, private investment in real terms only grew by 3.9 percent, its lowest rate since 2000 (see Table 2). It was supported mainly by foreign direct investment which increased by 18 percent in real terms. The capital inflow control, the proposed amendments to the Foreign Business Act, the Baht appreciating trend, and the new year eve bombings have further dampened investor sentiments, particularly those of foreign investors, since the beginning of this year. However, the signing of the Japan-Thailand free trade agreement in April would help increase sentiments and confidence of at least the Japanese investors. Private investment this year will therefore expand at around 4 percent, as investors wait and see. (See Private Investment section for more details)

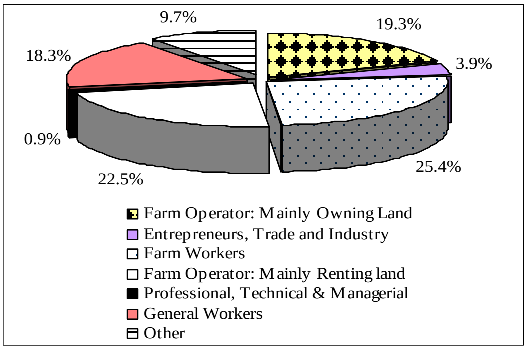
**Public investment will expand from a low base last year, but will remain subdued due to delays in disbursements.** Last year, investments made by the central government and state-owned enterprises expanded by only 4.5 percent in real terms due to the slow disbursements of government spending in the first and last quarters of the year. The overall disbursement rate for the government investment was only 66.4 percent last year. Moreover, the state-owned enterprise's investment budget last year was reduced from that of 2005. This year, disbursements of public investment would continue to be slow with changes in investment policies and the closer monitoring of the procurement processes. The budget needed for the import-intensive projects also declines in baht terms as the baht appreciates. Given so, public investment this year will most likely expand around 4.2 percent. (See Public Investment section for more details)

**Government's fiscal stance remains strong.** Because of the delay in investment, the central government will likely run balanced budget this year, even though it had planned to run a deficit of around 1.7 percent of GDP. Last year the central Government ran a slight deficit equivalent to 0.3 percent of GDP. However, including net revenues of the extra-budgetary funds and the Social Security Fund, the Government ran a surplus of around 1.7 percent of GDP. Public debt also declined significantly last year to 32 percent from 44 percent in 2005 and will continue to decline this year.

## 2.2 Poverty

**Agriculture production growth is crucial for alleviating poverty as most of the poor in Thailand resides in the agricultural sector**. More than two-thirds of the poor in Thailand work in the agriculture sector and most are landless farmers (see Figure 5).

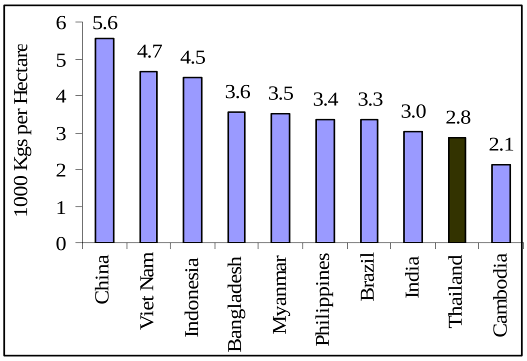
**Figure 5. Proportion of the poor classified by occupation, 2004**




Source: SES, compiled by NESDB

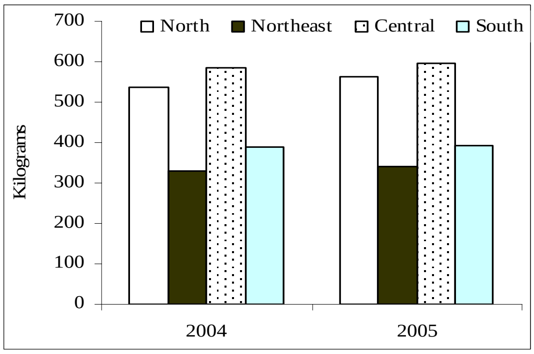
**One important way to ensure agriculture production growth and poverty reduction is through increased productivity of the agricultural sector, particularly in the Northeast where half of the poor resides.** When compared to the ten major rice production countries of the world, Thailand has almost the lowest rice yield per hectare (see Figure 6). Moreover, the yields differ greatly between the different regions in Thailand. The Northeastern region, which is a major producer of rice in Thailand, has the lowest yield in rice production especially for in-season rice farming, the season when most of the rice production takes place[2] (see Figure 7).

**Figure 6. Rice Yield of 10 World's Major Rice Producers, 2001-2005 Average**




Source: FAO

**Figure 7. In-Season Rice yield classified by region, 2004 and 2005**




Source: OAE

**Targeted measures are needed to increase the productivity of the agricultural sector which includes the move of some labor from the agricultural sector to the manufacturing and services sectors.** Some of the ways to increasing the yield per rai are to improving research and extension services; increasing the skills of agricultural workers especially in cultivation, harvesting, and post-harvesting; improving public infrastructure, especially irrigation and road system; and adopting appropriate pricing schemes. Labor productivity in the agriculture sector can also be increased by the relocation of the excess labor in the agricultural to the manufacturing and services sectors. The increase in labor productivity from this cross-sectoral shift in labor has helped increase the total factor productivity of Thailand over the past 30 years[3]. The relocation also had an impact on poverty as the relocation of labor resulted in remittances to the agricultural sector from those working in the other sectors with families in the agricultural sector. For example, in the Northeastern region of Thailand, remittances have been a major form of income of rural households in the region, thus helping to alleviate poverty in the Northeast in the recent years[4].

**The Government continues efforts to reduce poverty.** The Tenth National Economic and Social Development Plan (2007-1011) has set the target of reducing poverty from 13 percent in 2004 to 4 percent by 2011. It also targets the ratio of the richest quintile to the poorest quintile to be no more than 10 times. Starting in FY 2007, The Government has allocated a Bt5 billion budget for the implementation of the "Good Living and Happiness Society Strategy" which consists of five

---

[2] In Thailand, there are two rice growing seasons – in-season and out-season. In-season rice growing accounts for 85 percent of the land used to grow rice in a year and for 80 percent of total rice production in a year.
[3] See a detailed discussion of Thailand's total factor productivity (TFP) in Chapter 1 of the *Thailand Investment Climate, Firm Competitiveness and Growth Report* (2006). The report can be found at www.worldbank.or.th.
[4] Finding from the NESDB-World Bank *Thailand Northeast Development Report* (2005). The report can be found at www.worldbank.or.th.

development plans: (i) sufficiency economy plan aimed at building up knowledge and creating occupational skills; (ii) community development and opportunity creation plan focusing on reducing household expenditures (e.g. use of organic fertilizer and vegetable home gardening) and creating market opportunities for community products; (iii) rehabilitation plan for natural resource; (iv) vulnerable people and senior citizen assistance plan; and (v) provision plan for basic services (e.g. health, education, and vocational training). The plans will be implemented through projects jointly designed and implemented by the community leaders, local governments, provincial governments and central government. In addition, the Center of Poverty Eradication and Rural Development was established under the Prime Minister's Office to help improve the efficiency and cost effectiveness of poverty programs across many government agencies. Under this Center, the processes of any poverty reduction program from policy design to implementation and monitoring will be integrated. This is aimed to help reduce the redundancies and improve the monitoring and evaluation of the programs.

## 2.3 External Environment*

**Global economic growth will continue to slow from last year but similar to 2005 growth.** World GDP growth rose to 4 percent last year but will decelerate to 3.4 percent this year with most of the slow down coming from the US economy (see Table 9). Growth in Japan and EU are expected to slow be close to those of last year.

**Developing countries growth is also expected to slow down modestly from last year to similar level of 2005.** Developing countries' real GDP will collectively grow by 6.5 percent this year compared to 7.2 last year and 6.6 percent in 2005 (see Table 1). Among the developing economies of East Asia, all economies will register slower real GDP growth rates with the exception of the Philippines, Indonesia, and a few small island countries. China's growth, for example, will slow from 10.2 percent and 10.7 percent in 2005 and 2006 to 9.6 percent this year.

**World trade volume growth is expected to also decelerate this year.** The rotation in the balance of growth from the US to the rest of the world should help stabilize and begin a gradual adjustment in global macroeconomic imbalances. The US current account deficit has shown a significant fall in the fourth quarter of 2006. In line with the fall in the US current account deficit, the world trade volume is projected to grow by 7.9 percent this year, a slow down from 9.9 percent last year. For Thailand, this means a slower export growth particularly to the US, Japan, EU, and China, which are Thailand's main export destinations.

**World oil price this year is estimated to fall from last year's but would remain at a high level.** Oil prices are forecast to be around US$56.5 per barrel this year compared to US$64.3[5] in 2006, although there is high volatility and uncertainty surrounding oil prices in the present climate. The decline in world oil prices would help reduce the average prices of imports to Thailand as oil accounts for almost one-fifth of Thailand's total imports. However, this price level is higher than that of 2005 and is almost double that of 2003. For Thailand, this implies that firms will have to continue adjusting to cope with the high petrol prices.

**Prices of manufactured exports from developed countries are projected to rise by less than last year's.** The manufactured unit value (MUV), a measurement of the prices of manufactured goods from major developed economies, have increased by 1.6 percent last year and will slow down to 0.8 percent this year in line with the decline in inflation in those countries (see Table 9). This means that

[5] Simple average of the Dubai, Brent, and West Texas Intermediate (WTI)'s prices

the price of capital goods that Thailand imports from the developed countries would increase only slightly from this year. Coupled with the fall in oil import price, the average price of imports this year will increase only marginally.

**Prices of non-oil commodities, including Thailand's key crops, are expected to increase only modestly this year.** Non-oil commodity prices are expected to rise by only 1.5 percent this year compared to 24.7 percent last year (see Table 9). The price level however will remain high. The current boom in non-oil commodity prices has been both longer lasting and bigger than most cyclical commodity price upturn over the last 50 years. Thailand's average key crop prices in 2006, for example, are more than double that of 2001 prices. However, with the downturn in non-oil commodity prices this year, Thailand's key crop prices are expected to grow by 0.8 percent on average compared to 12.5 percent last year.

**Recent indicators provide a mixed picture of the demand trends in global high tech markets, a key export for most middle-income countries in East Asia, including Thailand.** Growing inventories in some segments of the market appear to have led to some slowdown in exports and high tech production and exports from several countries. US business investment spending on high tech products tailed off during 2006, and orders from the G-3 countries also showed month to month declines in the latter months of 2006. Market researchers also reported increases in the global semiconductor inventories in the global electronics supply chain in the second, third and fourth quarters of 2006[6].

**Inflation in the G-7 countries is estimated to fall this year, as the developed countries have been adopting tighter monetary policies.** The raising of short-term interest rates last year appear to be succeeding in curbing the incipient upturn in inflation in developed economies, and also to be providing some check to danger of excessive euphoria or bubbles in financial and other asset markets. Short term interest rates have risen from 3.6 percent in 2005 to 5.2 percent last year and are expected to rise further this year (see Table 9). As a result, inflation based on the consumer price index in the G-7 countries is estimated at 1.6 percent, a decline from 2.6 percent last year. This would however translate into a lower price for Thai exports to these countries this year.

**The net overall balance of payments inflows to emerging East Asian countries have risen to unprecedented levels in 2003-06.** It averaged 7 percent of GDP during those years. In the last two years these inflows have been principally driven by current account surpluses (see Figure 8). Although net capital inflows were negative for the region as a whole, they made a significant contribution in economies like Thailand and Korea. Both capital inflows to and outflows from East Asia remain buoyant, reflecting the growing integration financial markets within the region, as well as growing integration of the region into global financial markets. While both were growing, they balanced each other out.

---

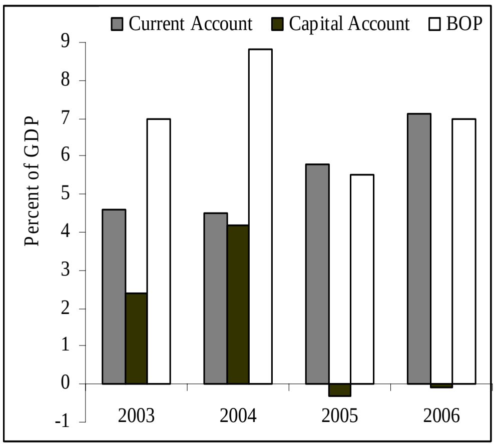
[6] Ann Steffora Mutchaler, "Chip Inventories Still on Rise, but won't derail market growth." Electronic News, Januarty 10, 2007.

**Table 9. International Economic Environment**
(% Change from previous year, except interest rates)

| | 2005 | 2006 | 2007 |
|---|---|---|---|
| GDP Growth | | | |
| World | 3.5 | 4.0 | 3.4 |
| World (PPP Weights) | 4.7 | 5.3 | 4.7 |
| OECD | 2.5 | 3.0 | 2.4 |
| United States | 3.2 | 3.4 | 2.1 |
| Euro Area | 1.3 | 2.7 | 2.5 |
| Japan | 2.6 | 2.2 | 2.3 |
| Developing Econ. | 6.6 | 7.2 | 6.5 |
| World Trade(Volume) | 7.7 | 9.9 | 7.9 |
| Manufactures unit value[a/] | 0.0 | 1.6 | 0.8 |
| CPI Inflation - G7 [b/] | 2.5 | 2.6 | 1.6 |
| Oil Price - $/bbl | 53.4 | 64.3 | 56.5 |
| - % Change | 41.5 | 20.4 | -12.2 |
| Non-oil Commodity Prices | 13.4 | 24.7 | 1.5 |
| LIBOR - US$. 6 Mo. | 3.6 | 5.2 | 5.4 |
| -Euro 6 Mo. | 2.2 | 3.1 | 3.8 |

Source: World Bank DEC Prospects Group update (March 2007). a/ It is a proxy of the manufactures export price from developed countries b/ In local currency, aggregated using 1995 weights.

**Figure 8. East Asian* Current Account, Capital Account**, and Balance of Payments*****
(As % of GDP)




Source: EAP Regional Update, April 2007

Remarks: * Includes China, Indonesia, Malaysia, Philippines, Thailand, Hong Kong, Korea, Singapore, Taiwan (China)

**Includes errors and omissions

*** Equal change in foreign reserves

**Emerging East Asia continues to receive strong net inflows of foreign direct investment, but was largely offset by net outflows of portfolio and other capital.** Net inflows of foreign direct investment were strong, an estimated $95 billion in 2006, down mildly from $101 billion in 2005. Roughly 70 percent of it went to China. In 2005 and 2006, however, there have been net outflows of portfolio and other capital (chiefly bank lending), a sharp swing from 2004, when there were net inflows of such capital of about $100 billion.

**Higher short term interest rates in developed countries will have a bearing on capital flows into East Asia.** Capital flows to developing countries rose once again in 2006, but their rate of growth slowed as interest rates in developed economies became more competitive with those in developing economies. These flows may remain somewhat flat in the coming year.[7]

[7] The Institute of International Finance forecasts private capital flows to emerging economies to fall from $502 billion in 2006 to $469 billion in 2007, with nearly all of the fall in bank lending and portfolio debt flows. "Capital Flows to Emerging Markets", January 18, 2007.

## 2.4 Export performance

**Exports this year are expected to grow slower than last year.** In 2007, Thailand is exposed to an unfavorable external environment. The weighted average growth rate of Thailand's major trading partners is estimated to slow down from 4.9 percent in 2006 to 4.4 percent in 2007[8]. The real appreciation of the baht is likely to continue from 2006 due to the shifting of the capital flows from US to the region, the current account surplus, and the depreciating US dollar. This would impact the competitiveness of Thai exports this year. Exports prices are projected to increase but less than they did last year as inflation in Thailand key exports markets, namely, the US, EU and Japan, will decline. International prices of Thailand's key crops are also projected to increase by only 0.8 percent, significantly lower than the growth rate of 12.5 percent last year. However, the extension of US Generalized System of Preferences (GSP) for two more years would benefit exports this year[9]. Given the above, the export volume growth in 2007 is projected to be 6 percent compared to 9 percent last year, while export values will expand by 10 percent this year compared to 17.4 percent last year.

**In 2006, Thailand's exports grew robustly.** The export growth in 2006 increased by 17.4 percent, in US dollar terms, relative to 15 percent in 2005. This double digit growth rate was contributed by an 11.6 percent growth rate of export volume, almost twice that of last year (see Figure 9). The recovery in agricultural exports and higher growth of manufactured exports, particularly hard disk drive, were the main drivers to a strong growth last year[10]. In terms of export markets, exports to Australia and to the Middle East expanded significantly by growing at 37.2 percent and 28 percent, respectively, and together contributing around 12.8 percent to the total export growth. The remarkable export performance to these countries was partly a result of trade facilitation and better market access due to the implementation of the FTA between Thailand and Australia as well as the higher income of oil exporters due to a surge in oil prices. However, their exports' share only accounted for 7.8 percent of total exports. In terms of the top five export products[11], they all grew at double-digit level with a slowdown in vehicle exports (HS87) by growing at about half of the previous year due to a weaker demand from Southeast Asian trading partners[12].

[8] Thailand's trading partners include US, Japan, Europe, East Asia & Pacific, Middle East and South Asia, accounting for 86 percent of Thailand's total exports in 2006.

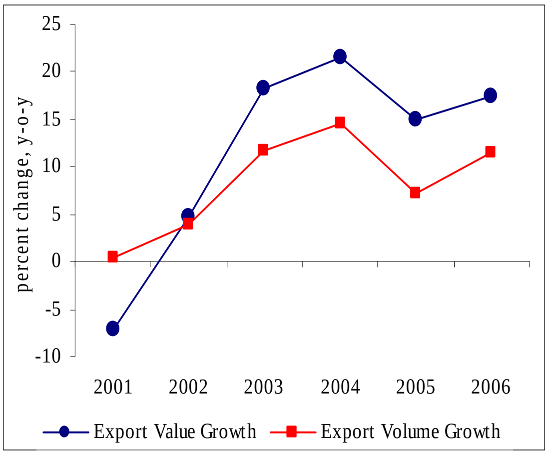
[9] In December 2006, the U.S. Congress approved an extension of the Generalized System of Preferences (GSP) for Thailand to December 2008. This GSP program allows Thai exporters to export some manufactured products to the US without tariffs. Currently, US imports under the GSP program accounted for almost one fifth of its total imports from Thailand in 2006. However, tariffs on these products charged to Thailand's key competitors are only around 1-3 percent.

[10] Last year, agricultural production in GDP expanded by 4.4 percent compared to -3.2 percent in 2005 and hence reducing supply constraint in agricultural exports. Exports of hard disk drive (HS 8471), accounting for 8.3 percent of the total exports, grew by 30% in 2006.

[11] The top five export products, accounting for 56 percent of total exports, include HS84 non-electrical machinery and parts (24%), HS85 electrical machinery and equipment (10%), HS 87 vehicle (24%), HS40 rubber and its products (41%), and HS27 mineral fuel oil and wax (36%). Export growth rates are shown in parenthesis.

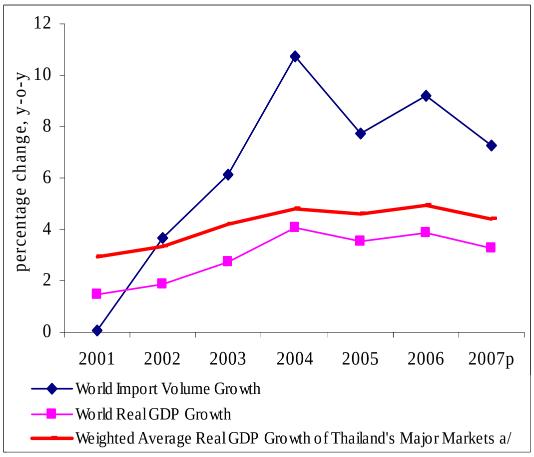
[12] Southeast Asian countries were the major importers of Thailand's vehicle exports (HS87) accounting for about 24 % of total exports of HS87 and contracting by 0.4% last year. However, exports of vehicles to the second largest importer-EU, accounting for 17 percent of total exports of HS87, continued to grow robustly at 54.3%

**Figure 9 Growth Rates of Export Value and Export Volume, 2001-2006**




Source: BOT

**Figure 10. Growth Rates of World Import Volume, World GDP and Weighted Average Real GDP of Thailand's Major Export Markets *, 2001-2007**




Source: World Bank
Remarks: *Thailand's major export markets accounted for 85 percent of total exports in 2006

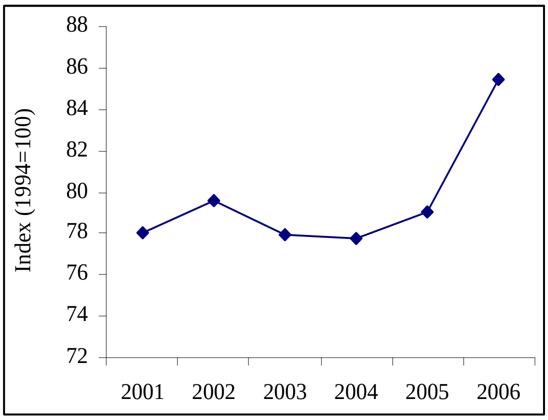
**The demand for Thai exports continued to grow despite an upward pressure on the baht in 2006.** The global demand for imports in real terms sped up to 9.2 percent in 2006 compared to an average of 5.7 percent in the last five years (see Figure 10). This was consistent with the world real GDP growth which also picked up in 2006. The weighted average real GDP growth of Thailand's major markets also showed the similar trend by growing at 4.9 percent in 2006 and thus leading to a strong export of Thailand despite an 8.1 percent real appreciation of the baht in 2006 (see Figure 11). The baht's appreciation in 2006 did not seem to hurt exports as the currencies of other countries in the region were also on an appreciation trend. When compared to 2004, it even clearer that the baht appreciation in 2006 was in line with other currencies in the region, which had started appreciating since 2005 when the Baht did not. This results in a slight change in export price competitiveness since 2004[13] (see detail in Box 1 on the baht's appreciation and implications).

**In terms of export categories, the strong baht seemed to affect exports of labor-intensive manufactures while the impact on the exports of the agriculture and the top three manufactures was unclear.** The impact of the baht appreciation on the exports was somewhat consistent with the BOT's study on the exchange rate elasticities of exports. In the study, the agricultural and labor-intensive exports were the two most affected categories from the change in the exchange rates as suggested by the high exchange rate elasticities of 0.36 and 0.23, respectively[14]. Growth in exports of labor-intensive manufactures in 2006 slowed to 6.8 percent from an average export growth rate of 7.7 percent in 2003-2005. However, in US dollar terms, exports of all categories in 2006 were higher than those in 2005 and in 2004. This is also true in Thai baht terms despite the appreciation, suggesting higher total revenue for the exporters in 2006 (see Figure 12).

[13] The upward pressure on the currencies in the region was partly due to an appreciation of Chinese Renminbi (about 3 percent last year) allowing a smaller intervention by the Asian central banks to maintain their competitiveness with China on top of the weak US dollar.

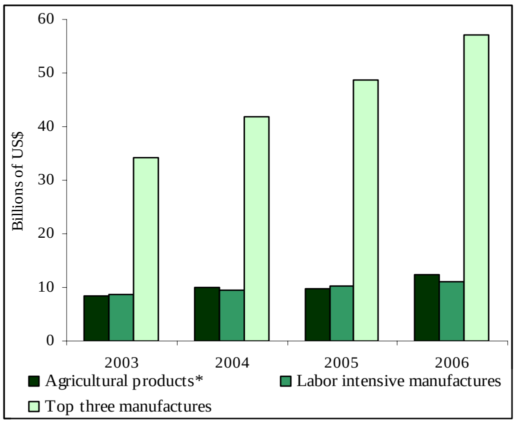
[14] The exchange rate elasticities of other export categories include fishery exports(0.05), total manufactured exports(0.07), high-tech exports(0.07), resource-based exports(0.01) and total exports (0.10).

**Figure 11. Real Effective Exchange Rates, 2001-2006**




Source: BOT
Note: An increase in REER implies an appreciation of the baht.

**Figure 12. Export Value in billions of US$ of Agricultural Products, Labor-Intensive Manufactures and Top Three Manufactures**




Source: BOT and MOC
Note: *Agricultural products include fishery products

**At the disaggregated level, exports of the sub-categories represented the same trend as the main categories.** Exports of all major agricultural products grew substantially in 2006 due to the favorable weather compared to 2005 while the slowdown in exports of labor-intensive products occurred mainly in footwear and leather (See Table 10). However, export growth rates of the top three were mixed. Exports of non-electrical machinery and parts (HS84) continued to grow at 24 percent while exports of electrical machinery and equipment (HS85) picked up in tandem with global demand for electronics. On the other hand, export growth rate of vehicle and parts (HS87) was around half of last year's rate because of a weaker demand from Southeast Asian trading partners[15]. The major slowdown of vehicle and parts was from exports of buses, trucks and motorcycles.

**The slowdown in exports of labor-intensive and resource-based manufactures would affect the employment of these sectors.** According to the labor force survey in 2006, the employment of textiles, wearing apparels and footwear industries accounted for 3.6 percent of total employment. In terms of exports, these three sectors accounted for 49 percent of labor-intensive manufactured exports in the same period. Similarly, processed food industry also employed around 2.9 percent of total employment with 15 percent export share of total resource-based manufactured exports. Therefore, a slowdown in exports of these sectors would impact the employees in the sectors and thus economy as a whole.

**In fact, agriculture and labor-intensive manufactured exports have experienced a falling share despite a more depreciated real exchange rate in 2000 than in 1995.** Shares of agriculture and labor-intensive manufactured products in total exports reduced continuously during 1995 to 2005. The sub-categories also showed the same pattern except rubber exports which was boom in the recent years due to higher demand from an economic expansion in China (see Table 11). Export shares of labor-intensive manufactures, in particular garments and other textile products, and footwear, decreased by more than half over the same period. However, total export shares of the top three manufactures, namely HS84, HS85 and HS87, increased from 32.4 percent of total exports in 1995 to 43.9 percent in 2006 although export shares of HS85 faced a slight decline in the past few years.

[15] Southeast Asian countries were the major importers of Thailand's exports of vehicles and parts (HS87) accounting for about 24 % of total exports of HS87.

**Table 10 Thailand's Export Growth Rates, 2003-2006**

(Percent)

| | Avg 2003-2005 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|
| **Agricultural products** | **13.2** | **23.5** | **16.6** | **-0.6** | **26.9** |
| *Of which* | | | | | |
| ***Major agricultural products*** | ***13.7*** | ***25.2*** | ***15.5*** | ***0.5*** | ***27.9*** |
| *Rice* | 15.2 | 12.4 | 46.9 | -13.5 | 10.2 |
| *Rubber* | 30.5 | 60.2 | 23.0 | 8.2 | 45.4 |
| *Tapioca products* | 18.1 | 23.1 | 32.5 | -1.4 | 33.4 |
| *Fresh and frozen duck and chicken* | -48.8 | 11.6 | -92.6 | -65.4 | 20.1 |
| *Fishery products* | *5.7* | *6.4* | *1.6* | *9.2* | *13.5* |
| *Of which* | | | | | |
| *Fresh and frozen shrimps* | *5.8* | *7.8* | *-6.5* | *16.0* | *20.8* |
| **Labor intensive manufactures** | **7.7** | **5.1** | **8.3** | **9.7** | **6.8** |
| *Of which* | | | | | |
| ***Major labor intensive products*** | ***6.4*** | ***3.8*** | ***10.7*** | ***4.9*** | ***3.3*** |
| *Garment and other textile products* | *6.9* | *3.2* | *14.0* | *3.3* | *3.9* |
| *Footwear* | *5.6* | *3.4* | *-4.2* | *17.6* | *3.1* |
| *Leather and leather products* | *5.6* | *9.1* | *9.3* | *-1.6* | *-2.0* |
| **Resource-based manufactures** | **12.3** | **13.3** | **11.8** | **11.9** | **14.3** |
| *Of which* | | | | | |
| *Canned foods* | *13.2* | *14.0* | *8.9* | *16.7* | *14.0* |
| **Exports of the top three (HS 84, 85 and 87)** | **18.5** | **16.6** | **22.7** | **16.0** | **17.8** |
| *Of which* | | | | | |
| *HS 84 non-electrical machinery and parts* | *20.7* | *16.9* | *23.0* | *22.2* | *23.6* |
| *HS 85 electrical machinery and equipment* | *11.6* | *12.3* | *18.3* | *4.0* | *10.2* |
| *HS 87 vehicles and parts* | *39.6* | *37.5* | *40.1* | *41.2* | *23.5* |

Source: BOT and MOC

**Table 11. Thailand's Export Shares in 1995, 2000, and 2006**

(Percent)

| | 1995 | 2000 | 2006 |
|---|---|---|---|
| **Agricultural products** | **16.3** | **10.3** | **9.6** |
| *Of which* | | | |
| *Major agricultural products* | *14.8* | *9.2* | *8.7* |
| *Rice* | *3.5* | *2.4* | *2.0* |
| *Rubber* | *4.4* | *2.2* | *4.2* |
| *Tapioca products* | *1.2* | *0.7* | *0.9* |
| *Fresh and frozen duck and chicken* | *0.7* | *0.6* | *0.0* |
| *Fishery products* | *5.1* | *3.3* | *1.7* |
| *Of which* | | | |
| *Fresh and frozen shrimps* | *3.6* | *2.2* | *0.9* |
| **Labor intensive manufactures** | **19.8** | **12.2** | **8.5** |
| *Of which* | | | |
| *Major labor intensive products* | 13.2 | 7.5 | 4.5 |
| *Garment and other textile products* | *8.5* | *5.6* | *3.5* |
| *Footwear* | *3.8* | *1.2* | *0.7* |
| *Leather and leather products* | *0.8* | *0.6* | *0.3* |
| **Resource-based manufactures** | **11.4** | **10.4** | **9.9** |
| *Of which* | | | |
| *Canned foods* | *3.2* | *1.7* | *1.5* |
| **Exports of the top three (HS 84, 85 and 87)** | **32.4** | **43.3** | **43.9** |
| *Of which* | | | |
| *HS 84 non-electrical machinery and parts* | *14.0* | *17.1* | *18.3* |
| *HS 85 electrical machinery and equipment* | *17.2* | *22.5* | *17.8* |
| *HS 87 vehicles and parts* | *1.2* | *3.7* | *7.7* |

Source: BOT and MOC

***Exports to China***

**Though the baht appreciated the most relative to the yuan, Thai exports to China grew by 28 percent y-o-y**. This was lower than the average export growth rate of 34.4 percent during the last four years (See Figure 13). The strong Chinese demand for imports appears to offset any adverse effect of the appreciation.

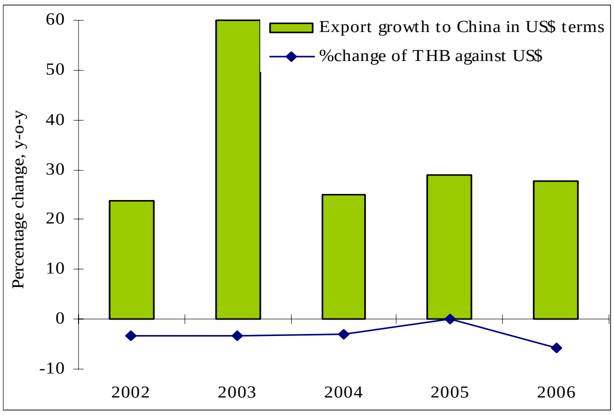
**Exports of the top three products to China except non-electrical machinery and parts (HS84) continued to grow last year.** The top three included HS84, HS40 and HS85 accounting for 52 percent of total exports to China (see

Table 12 Export of non-electrical machinery and parts (HS84) slowed down from 50.2 percent in 2005 to 3.8 percent in 2006 due in part to a high base effect in 2005 and intense competition in Chinese market[16]. Rubber exports to China rose sharply by over 70 percent in value terms due to a surge in rubber prices as well as a high domestic demand. Similarly, exports of electrical machinery

[16] The data on Chinese imports indicated that Chinese imports from the four major exporters of HS 84, namely Japan, Germany, US and South Korea sped up during this period. Their exports accounted for 55% of Chinese total imports of HS84.

and equipment (HS85) also increased by 36.5 percent relative to 29.8 percent in 2005. It is noteworthy that exports of vehicle and parts (HS87) to China contracted by 6 percent in 2006 due mainly to a lower demand of vehicle parts (HS8708) accounting for 75.5 percent of total exports of HS87 to China.

**Figure 13. Thailand's Export Growth to China in US Dollar Terms and the Percentage Change of THB per US$ , 2002-2006**




Source: BOT

**Some exports to China were less sensitive to the exchange rate fluctuation due to the vertical production network.** As being a part of the vertical production network, some Thai manufacturers have supplied raw materials and parts to be assembled in China. Therefore, exports of these products continue to grow despite the appreciation of the currency. Exports of electrical machinery and equipment (HS85) were the case in point. About 39 percent of the HS85 exports to China were electronic integrated circuits (HS8542) which were assembled in China before exported to the third markets.

**Table 12. Thailand's Top Ten Export Products to Chinese Market in 2005 and 2006**

(Percent)

| No. | HS. code | Descriptions | 2005 Share | 2005 Growth | 2005 Contribution to export growth | 2006 Share | 2006 Growth | 2006 Contribution to export growth |
|---|---|---|---|---|---|---|---|---|
| 1 | 84 | Non-electrical machinery and parts | 28.6 | 50.2 | 43.0 | 23.0 | 3.8 | 3.8 |
| 2 | 40 | Rubber and articles thereof | 10.6 | 9.3 | 4.1 | 14.4 | 74.7 | 27.7 |
| 3 | 85 | Electrical machinery and equipment | 13.5 | 29.8 | 14.0 | 14.3 | 36.5 | 17.2 |
| 4 | 29 | Organic chemical | 5.3 | 45.2 | 7.4 | 9.6 | 134.8 | 24.7 |
| 5 | 27 | Mineral fuel oil wax | 8.9 | 23.2 | 7.6 | 8.5 | 21.8 | 6.8 |
| 6 | 39 | Plastics and articles thereof | 8.8 | 30.9 | 9.4 | 8.3 | 20.2 | 6.2 |
| 7 | 07 | Edible vegetable | 3.2 | 38.7 | 4.1 | 3.5 | 40.4 | 4.6 |
| 8 | 10 | Cereal | 2.1 | -13.7 | -1.5 | 2.4 | 43.3 | 3.2 |
| 9 | 44 | Wood & article | 2.5 | 9.9 | 1.0 | 2.2 | 11.1 | 1.0 |
| 10 | 74 | Copper & article | 1.0 | 66.9 | 1.9 | 1.4 | 76.6 | 2.8 |

Source: MOC

## 2.5 Household Consumption

**Household consumption will be supported in part by the lower inflation and interest rates this year, but low consumer confidence and farm incomes will constrain its growth.** Last year, lending rates, which rose by 1.5 percentage-points, and an inflation which reached 4.7 percent, the highest since the crisis, had dampened household consumption growth last year to 3.1 percent, the lowest expansion since 1999. With the exception of hotels and restaurants and transport and telecommunications which benefited from the recovery in tourism after the aftermath of the tsunami in 2004, all other categories of household consumption registered lower growth than those in 2005. This year, expected lower inflation of around 2.0-2.5 percent would help increase the purchasing power of consumers, thus, raising household consumption growth. Moreover interest rates declining from 7.5 percent last year would also partly stimulate household consumption. However, low consumer confidence and farm incomes will limit its growth. Household consumption growth this year is therefore projected to accelerate only slightly from last year to 3.5 percent.

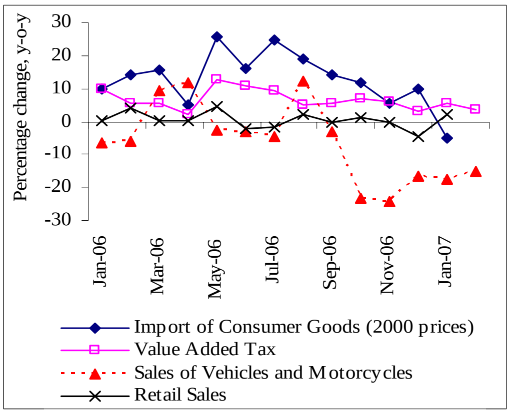
**Low consumer confidence and a significant deceleration in farm income growth will negatively affect the household consumption growth this year.** The consumer confidence, as indicated by the Consumer Confidence Index has been declining every month since last October and hitting its 5-year lows in February this year. Moreover, farm incomes, which have supported rural household consumption in the past few years, will increase at a much slower rate than last year's 30 percent increase. This is due to the expected decline in the prices of Thailand's key export crops to around 1 percent, compared to 12.5 percent last year (see Table 13). As a result, although agricultural production this year is expected to increase by more than 10 percent[17], compared to roughly 4.5 percent growth last year, farm incomes will not rise as much as last year. Hence, rural household consumption, which accounts for roughly 10 percent of total household consumption, will not expand as much as it did in the previous years. Data from the Bank of Thailand shows that imports of capital goods have contracted year-on-year in January, while the sales of vehicles and motorcycles in January and February continued to contract from last year. On the other hand, value-added tax and retail sales, have picked up (see Figure 14).

**Table 13. Thailand's Key Crop Prices, 2006-2008**

| | Weights (%) | Growth Rates of Crop Prices (%) | | |
|---|---|---|---|---|
| | | 2005 | 2006 | 2007p |
| Rice indic 5% | 36.6 | 20.4 | 6.5 | 5.0 |
| Rubber, Singapore | 17.0 | 15.2 | 39.9 | -23.8 |
| Maize | 4.4 | -11.7 | 23.5 | 14.9 |
| Palm oil | 2.9 | -10.4 | 13.3 | 12.9 |
| Coconut oil | 1.8 | -6.6 | -1.6 | 15.3 |
| Coffee robusta | 1.1 | 40.5 | 33.7 | 10.7 |
| **Weighted average** | | **13.3** | **12.5** | **0.8** |

Source: World Bank (January 2007)

**Figure 14. Changes in Household Consumption Indicators, January 2006-February 2007**




Source: BOT

[17] The Ministry's of Agriculture estimation

## 2.6 Investment

**Investment growth slowed down considerably last year and will not speed up much this year.** Last year, investments grew at 4 percent, much slower than 2005's 11 percent. This is because private investment, particularly those by the domestic investors, decelerated sharply as real interest rates rose and political uncertainties loom. Public investment growth also slowed down as the government face disbursement problems in the first and last quarter of 2006, while the state-owned enterprise's investment budget was cut in FY2006. This year, private investment is expected to grow at a similar rate as last year as investor's confidence is severely dampened by the policy uncertainties. Public investments are expected to decelerate from last year with lower disbursements as policy changes and the focus on improved procurement processes are put in place. State-owned enterprise investment budget was also cut from that of last year. Total investments this year is therefore expected to expand by 4.1 percent, similar to last year's.

### 2.6.1 Private Investment

**Private investment growth slowed down significantly since last year as investor's confidence is dampened amidst political and policy uncertainties in addition to the existing structural issues.** Growth in private investment was only 4 percent, down from 11 percent in 2005, and is projected to be similar in 2007. Last year, private investment growth was supported almost entirely by the 18 percent real growth in FDI. This reflected low, if not negative, investments by domestic investors amidst political uncertainties. The capital inflow control, the proposed amendments to the Foreign Business Act, the Baht appreciating trend, and the new year eve bombings in December last year have further dampened investor sentiments, particularly those of foreign investors, this year. Moreover, the continued slow growth in household consumption this year as well as a slow down in global demands for Thai exports do not support high private investment growth. These are on top of the high oil price and the unresolved supply side constraints that continue to restrain returns on investments[18]. Private investment this year will therefore expand at only around 4 percent, similar to that of last year's, unless policy measures and reforms are taken to improve investor's sentiments and raise their returns to investments.

**The signing of the Japan-Thailand free trade agreement could help boost investors' confidence.** The Japan-Thailand Economic Partnership Agreement (JTEPA) was signed in early April 2007 but will be effective in October at the earliest. Nevertheless it will increase sentiments of at least the Japanese investors, who are the largest foreign investors in Thailand. The actual impact of the FTA on investments, however, would likely be late this year at the earliest.

**Private investment growth in 2006 was the lowest in the past 6 years, resulting in rapid increase in the capacity utilization rates.** Private investment in equipment, which comprised around three-fourths of total private investment slowed down from 12.5 percent in 2005 to 4.3 percent in 2006. Construction growth on the other hand declined from 6.1 percent last year to only 2.5 percent in 2006. On the other hand, the manufacturing production last year increased by 6 percent, speeding up from its 5.2 percent in 2005. As a result, the overall capacity utilization has increased quickly and by the end of 2006 was only 2 percentage-points below its 77 percent pre-crisis level. At the industry level, an increasing number of sectors have exceeded its pre-crisis capacity utilization levels. At the end of

[18] These include the regulatory burden, lack of skilled labor, and inadequate infrastructure as reported by firms in the *Thailand Investment Climate, Firm Competitiveness and Growth Report* (2006).

2006, around 20 percent of the manufacturing industries has reached over 80 percent capacity utilization, of which 10 percent are operating at above 90 percent capacity utilization. Should private investment continue to expand slowly, the manufacturing sector could hit a supply constraint should demand pick up next year.

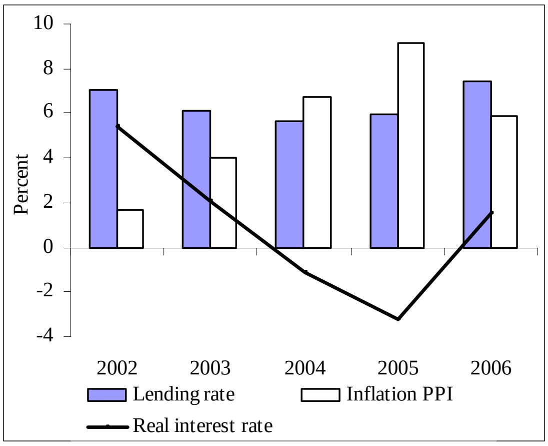
**The slow investments had also been reflected in the slow down in commercial bank's loan growth last year**. Commercial bank loans to businesses last year expanded by only 1.4 percent compared 4.9 percent in 2005. The transportation and real estate industries registered the largest slow down. Loans to the transportation sector contracted by 11 percent last year compared to a 10 percent increase in 2005. Loan growth to the real estate sector fell from 10 percent in 2005 to merely 0.2 percent in 2006. Loan growth to the manufacturing sector, which accounts for one-fourth of commercial bank loans, also decelerated from 4.7 percent in 2005 to 2.6 percent last year.

**This year's private investment will continue to be restrained by the unfavorable investment environment.** Private investment this year would likely be concentrated in sectors with capacity utilization of over 90 percent such as paper, petrochemical, and integrated circuits industries. However, in addition to the policy uncertainties, the uncertain demand conditions – both exports and domestic consumption – this year and next would restrain rapid increases in capacity this year. Oil prices which are almost double its level in 2003 will require continued adjustment by firms. Moreover, real interest rates will remain positive and likely to be similar to that of last year's (see Figure 15) as nominal rates will fall more or less in line with the projected 2.5 percentage-point decline in inflation this year. The real interest rate will therefore not be a major support to private investment growth. In addition, other supply constraints like high regulatory burden, inadequate availability of right skills and a growing deficit in infrastructure continue to keep investment costs in Thailand high relative to competitors[19]. Price controls have also not been relaxed with the list of more than 200 products under the controlled and monitored lists. These have restricted firms' margins and productivity[20] as well as capacity expansion. On top of these, policy uncertainties as perceived by both Thai and foreign investors since the latter half of last year continue to dampen investor's sentiments, resulting in their wait-and-see stance.

**Firms' concerns about the unfavorable business and investment environment are reflected in the falling business sentiment and BOI applications.** The business sentiments as measured by the Business Sentiment Index have been falling since mid-2004. In the January 2007 Business Sentiment survey[21], firms indicate that difficulty in adjusting prices, uncertainty about economic conditions, and the high cost of production are the top three constraints to doing business. These have been their constraints since the middle of last year. BOI applications have also fallen by about a quarter in 2006 compared to its 2005 level, especially by the metal products, machinery, and transport equipment industries. This indicates the wait-and-see stance of investors. The reduction came mainly from the much lower applications of foreign investors and joint ventures (see Table 14). This has translated into a lower investment approval, which has been declining since 2005.

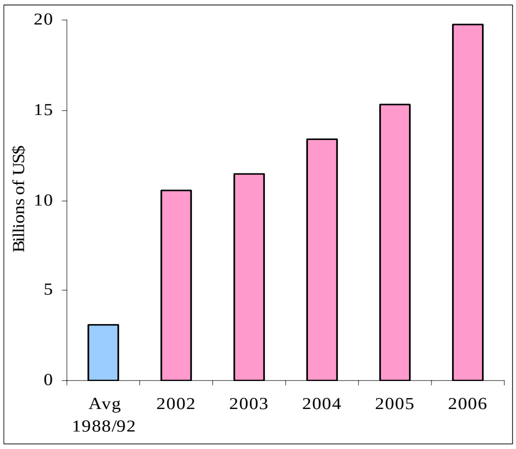
[19] As reported by 1,300 firms in the *Thailand Investment Climate, Firm Competitiveness and Growth Report* (2006).
[20] Details of price control list and measures were presented in the Thailand Economic Monitor November 2006 issue.
[21] A survey by the Bank of Thailand of 550 large and medium firms

**Figure 15. Real Interest Rates (PPI adjusted), 2002-2006**




Source: BOT

**Figure 16. Gross Flows of Foreign Direct Investment, 2002-2006**




Source: BOT

**Table 14. Net BOI Applications and Approvals**

(Billion Baht)

| | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|
| **Total Net Applications** | **304.7** | **637.2** | **674.7** | **512.2** |
| Net applications by foreign firms and joint ventures | 243.6 | 340.4 | 527.2 | 325.8 |
| **Total Approvals** | **283.8** | **600.8** | **571.3** | **373.5** |
| Approvals of FDI applications | 218.3 | 362.4 | 342.9 | 282.4 |
| 100%<foreign equity<100% | 115.6 | 234.4 | 203.7 | 158.1 |
| 100% foreign equity | 102.7 | 128.0 | 139.2 | 124.3 |

Source: BOI

**Foreign direct investment was a major driver of private growth last year, but will likely dampen this year.** In 2006, FDI reached its highest level since the crisis of US$ 20 billion or a 30 percent increase from that of 2005 (see Figure 16). In Baht terms, the increase would be a 22 percent from 2005 to 2006 or a 17.5 percent in real terms[22], bringing FDI to roughly 45 percent of total private investment. Given that total private investment growth was only around 4 percent in real terms, it implies that investment by locals had probably contracted last year. However, FDI may not perform as well this year as foreign investor's confidence has been greatly dampened. Japanese and EU firms have announced in the beginning of this year the reductions of their investments in Thailand. Another indication is the decline in applications by foreign firms and joint ventures last year. It was only 60 percent of its 2005 level (see Table 14). As a result, BOI approvals of foreign investments have decreased last year by 18 percent, translating into lower investments this year.

**Given that the external environment for private investment does not look favorable this year, it is even more urgent today that policy measures and reforms are taken to help improve investor's sentiment and increase investments.** Unless the Government adopts measures to address

[22] Deflated by private investment deflator in GDP

the sources of the policy uncertainty, it is likely to linger in 2007. The signing of the Japan-Thailand FTA in early April 2007 will no doubt contribute to improving investor perceptions, especially the Japanese. The approval of a modified Foreign Business Act amendment, that not only rationalizes the law but also includes liberalization of some key services sub-sectors critical to Thailand's development strategy, will also remove many of the misgivings of foreign investors. In addition, if the Government takes actions to reduce the regulatory burden – actions that were highlighted in the NESDB-World Bank *Thailand Investment Climate, Firm Competitiveness and Growth study* – investor confidence will improve.

### 2.6.2 Public Investment

**Public investment growth this year would likely slow down from last year's, as the Government is focusing on promoting better governance in order to increase the transparency and efficiency in public spending.** The Government is currently paying close attention to improve governance, including that on public procurement so that going forward public spending will be done in a more transparent, accountable and efficient manner. To do so, the Government has, for example, currently set up a committee to draft the strategic plan to improve the standards of the public procurement system (see detailed discussion in the Public Sector Reform section). In addition, reforms and policies are now being proposed to promote sufficient and efficient provision of infrastructure services (see Box 2 on Investment Plans and Policies for the Energy and Transport Sectors). While those would benefit the country in the medium term, they could slow down disbursements on public investments in the transition period this year. Public investment this year would therefore increase by around 6 percent in nominal terms or by 4 percent in real terms compared to 4.5 percent last year, which was also a slow down from 2004 and 2005. The Government has announced efforts to speed up the disbursements on public investment spending this year. If that could done, especially on public infrastructure, it would not only serve as a direct stimulus for growth, but also as a way to slow down the baht appreciation as well as to facilitate the pick up in private investments.

**Public investment was slow last year as the central government's disbursements were delayed**. The disbursement rate on government investment, which is roughly half of the total public investment, was 66.4 percent last year. The government's cash flow management problems in the beginning of the year and the delay in passing the FY2007[23] budget have slowed the government's investments in 2006. In the first quarter of 2006, because the government's outstanding T-bills have reached the Bt170 billion ceiling, the government was unable to issue additional T-bills to finance the investment projects. Investments had to be timed with revenue receipts which is in March[24], thus delaying investments. The T-bill ceiling was raised in the second quarter of the year, thus, relaxing the investment constraints. Due to the change in the Government after the coup in September, the budget for FY2007 was not approved until December 2006 and was effective only in January 2007. Hence there was very little disbursement from the central government in the first quarter of FY2007 (October-December 2006). Government investments in 2006 grew by 13.4 percent from 2005. Although state-owned enterprises (SOEs) were able to disburse more than 70 percent of their investment budget in 2006, their investments have decreased by 5 percent compared to that in 2005 as the 2006 budget is lower than that of 2005. Much of the undisbursed investments by the SOEs will be carried forward into this year.

[23] Fiscal year 2007 runs from October 2006 to September 2007.
[24] The bulk of revenues from income and corporate taxes are received in March, May, and August each year.

**Box 2 Investment Plans and Policies for the Energy and Transport Sectors**

In order to promote efficient use of energy as well as to ensure energy security, the Government has approved and announced investment plans for the energy sector as well as policies to promote alternative energy and to set up an energy regulatory body. Related to the issue of efficient energy use, policies in the transport sector are aimed at reducing Thailand's reliance on fossil fuels as well as promoting more fuel-efficient forms of transportation. This box reviews some of the key planned infrastructure investments in the energy and transport sector as well as the policies around them.

**Energy Sector**

Plans in the energy include policies to (1) promote the use of fuels alternative to fossil fuel and (2) set up an energy regulatory board, and investment plans in electricity and natural gas to ensure that the growing demand is met.

***Policies***

**The Government has indicated its strong support in promoting alternative energy.** The current effort is focused on the promotion of biofuels for the transport sector as well as the generation of power using renewable energy. Gasohol and biodiesel are alternative renewable fuels promoted for the transport sector. The target is to replace the use of gasoline and diesel by at least 10 percent by 2012. Several government measures to promote gasohol are (1) price measure: Gasohol price is cheaper than the premium gasoline at 1.50 Baht (around US$0.04) per liter and (2) government support: BOI investment promotion for fuel-ethanol production plants, reduction of import & excise taxes for flexible-fuel vehicles (FFV), soft-loans for domestic FFV manufacturing, and the liberalization of fuel ethanol plants and distribution.

**Regulations regarding the generation of power using renewable energy has been amended in order to promote greater use of renewable energy in Thailand.** The original regulation (May 2002) allowed very small power producers (VSPP) with renewable energy generators to connect to the grid at commercial rates. The new regulation (November 2006) introduces a subsidy on the commercial rates, ranging from Bt0.3–Bt8.0 per kilowatt hour, for renewable energy generators for seven years. The sources of renewable energy are biomass, hydro-power, wind, municipal waste, and solar. In addition to the subsidy, a generator's net flow to the grid was expanded from 1 megawatt to 10 megawatts. This allows the larger generators, or projects that require scales, to connect to the grid. The new regulations also extend eligibility to cogeneration as well.
The drafting of the new Energy Regulatory Act is underway (proposed to EPPO in early March 2007), which implies the establishment of the Energy Regulatory Board to regulate both the operation of electricity and natural gas industries. In the transitional period, four sub-committees under the Committee on Energy Policy Administration are (1) Sub-Committee Regulating the Power Tariffs and Service Charges, (2) Sub-Committee on Load Forecast, (3) Sub-Committee on the Power System Interconnection Regulations, and (4) Sub-Committee on the Purchase of Power from Independent Power Producers

***Investments***

**In ensuring that the growing demand for electricity is met, Thailand sees the need to invest more in power plants and promote more independent power producers (IPP).** EGAT has approved 4 new power plants with the total capacity of approximately 3,000MW. These new plants are expected to start operation in 2008-10. Three IPPs with capacity of about 1,400MW each have also been approved. All of which should be up and operating by 2008.

**Correspondingly, investments in the electricity transmission system are needed.** The construction of the transmission lines from the Gulf Power Generation Plant has started. Transmission projects from the Nam Theun 2 and the Nam Ngeum electricity generation projects in Lao PDR is planned for 2008 and 2010, respectively.

**Moreover, the supply of natural gas, which currently fuels 80 percent of electricity generation, must also be secured.** The supply of natural gas at present comes mainly from the Gulf of Thailand and imported from Myanmar. The Energy Policy and Planning Office (EPPO) under the Ministry of Energy estimates that the demand for natural gas is projected to increase by 6.4 percent during the next 15 years. This is because (i) natural gas is clean energy and can be produced domestically, (ii) it is the major fuel for electricity generation, and (iii) natural gas is recently heavily promoted in the industrial & transportation sectors. In the near future, more exploration in the Gulf of Thailand will be necessary, and the import of liquid natural gas will be needed to meet the future demand.

**New gas transmission lines and receiving terminals need to be constructed.** An emerging issue, which could constrained the supply of natural gas, is that the existing natural gas pipelines are fully used. Currently the 3rd Offshore Natural Gas Transmission Pipeline is being constructed, and its first phase is expected to be completed in early 2009. There is also a Liquid Natural Gas Receiving Terminal Project in Map Ta Phut Industrial Estate. The initial phase is at 5 million tons per year, which will be expanded to 10 million tons per year by year 2011.

**Transport sector**

***Policies***

**Policies in the transport sector are closely tied to energy efficiency issues.** In order to promote more efficient energy use in the transport sector as well as reduce reliance of petroleum, the following policies were proposed by the Government:

1) Lower logistic cost to GDP from 19 percent to 17 percent in 5 years
2) Promote Multi-modal Transport
3) Mode-shift implementation

| | | | |
|---|---|---|---|
| Present: | Inland Water 10% | Rail 3% | Road-based 87% |
| Future: | Inland Water 11% | Rail 10% | Road-based 79% |

4) Less reliance on petroleum such as promoting the use of CNG and replacing current trains with electric locomotives, medium-speed train (120-140 km./hr.)
5) Develop mass transit in Bangkok and other regional metropolises
6) Promote mass transit to replace private vehicles
7) Develop inter-city electric train

***Investment***

**The Government has plans to invest in large scale transport infrastructure.** For example, about 832 kilometers of double rail tracking is planned for with 184 kilometers approved by the Cabinet. This is aimed to lower the logistic costs as well as support the modal-shift from road to rail. Another large scale project is the urban rapid transit (MRT) project with five lines to be built by 2012. The estimated investment is around Bt200 billion or US$ 5.5 billion. The government's financing strategy is to publicly finance civil works of all five lines (plus rolling stock for one line – red line – only). The remaining rolling stocks will be financed by the private sector.

**While it is currently difficult to determine the exact time of implementation for each of the five lines, the important issues on the prospectively larger MRT system remains.** These issues are the transition from stand-alone to an integrated network, integration of the MRT system with other mode of transport (e.g. bus and walking), establishment of an independent regulatory agency, maximization of the benefits and minimizing risk involved in the MRT system, land use along MRT lines and nearby the MRT stations, and the efficiency in MRT services delivery. Appropriate government policies, regarding the mentioned issues, would help Thailand optimize the returns on such infrastructure investment.

**Public investment growth this year will likely be lower than last year's as the disbursement targets are unachieved.** Of the total public investment, government investment this year will grow by 4.0-4.5 percent in nominal terms or roughly 2.0-2.5 percent in real terms from last year as the disbursement rate is expected to be no more than 75 percent of the budgeted Bt 374.6 billion[25] . On the other hand, state-owned enterprise's (SOE) investment budget this year was cut by roughly 5 percent from Bt350 billion last year. Adding the disbursements from projects carried over from last year, SOE's investments should increase by 7-8 percent in nominal terms or 5-6 percent in real terms this year. However, this would unlikely achieve their 85 percent disbursement target[26]. Overall public investment growth this year would therefore be roughly 6.0 percent in nominal terms or 4.0 percent in real terms.

**The lower than targeted disbursement rates for both the government and the SOEs can be attributed to the following:** (1) changes in policies which have especially affected the implementation of the planned large infrastructure projects (known as the "mega-projects") such as the underground mass transit lines[27], (2) closer attention paid to the public procurement process which has affected some large projects such as the low-income housing project, resulting in a significant reduction of the number of houses to be built, and (3) the stronger baht making imports for the investments cheaper in baht terms and thus requiring a lower budget for investments that are import-intensive.

**Public infrastructure investments, if sped up this year, could help slow down the pace of the baht appreciation and build a stronger foundation for investment by the private sector next year.** With private investment being sluggish this year amidst policy uncertainties, infrastructure investments by the public sector will help not only to stimulate growth and boost private investors' confidence, but also will help slow down the appreciation of the baht as imports are brought in for those investments. Moreover, the investments will facilitate the pick up of private investment as some of the infrastructure bottlenecks faced by firms are relaxed[28].

**There are currently reforms to improve the efficiency of the public infrastructure services.** These would ensure that the selection of public infrastructure projects best serve the public needs and are financially viable. Moreover they will help promote sufficient, efficient and better management of the provision of public infrastructure services. In the energy sector, for example, the draft of the new Energy Regulatory Act proposed to the Energy Policy and Planning Office (EPPO) under the Ministry of Energy in early March 2007 will lead to the establishment of the Energy Regulatory Board, which will regulate both the operation of electricity and natural gas industries. Currently, the natural gas businesses are unregulated. Policies to provide a wider network and a better integrated public transportation system are not being proposed by the Ministry of Transport. Box 2 reviews

---

[25] To achieve a 75 percent disbursement rate this year, acceleration in the disbursement for the following agencies are needed: Prime Minister Office of Bt 3 billion (currently disbursed 0.7 percent of total disbursement), Ministry of Agriculture of Bt 25 billion (currently disbursed 18.1 percent) and Ministry of Transport of Bt 47 billion (currently disbursed 26 percent) and unallocated budget of Bt 43 billion (currently disbursed 1.3 percent).

[26] Since 2001, the average disbursement rate for SOEs in previous years was no more than 70 percent, and last year's was 70 percent.

[27] The construction format for railways has been changed from *Design and Built* to *Detail Design*, further deferring the bidding process.

[28] Infrastructure inadequacy was cited by 1,300 firms surveyed under the *Thailand Investment Climate, Firm Competitiveness and Growth* study (2006) to be one of the three top constraints to their business operations and expansion.

some of the key reforms and policy measures that have been taking place in the energy and transport sectors.

## 2.7 Corporate and Financial Sector Developments

***Corporate Sector Developments***

**Financial ratios of non financial listed companies in Q4 2006 indicated a slightly lower performance in corporate sector.** The return on capital employed (ROCE) in 2006 Q4 (16.5 percent) was lower than that in 2005 Q4 (17.0 percent) and in 2004 Q4 (19.1 percent), representing a slightly lower efficiency of the companies in using their capital investment (see Table 15). The companies' profitability, as represented by the return on equity (ROE), also showed the similar trend during the same period. The ROE in 2006 Q4 was 17.3 percent compared to 18.9 percent in 2005 Q4 and 22.2 percent in 2004 Q4. The fall was mainly due to a decline in net profit margin resulting from a slower consumer's demand and higher cost of production during this period. The financial leverage remained stable. However, the higher asset turnover reflected the companies' attempts to generate higher revenues from their existing assets. The performance of the companies in terms of the return on asset also showed that the ability of companies to generate net income from their investment has reduced since 2004.

**Table 15. Corporate Financial Ratios**
**(Listed Companies Including only Non-Financial Industry)**

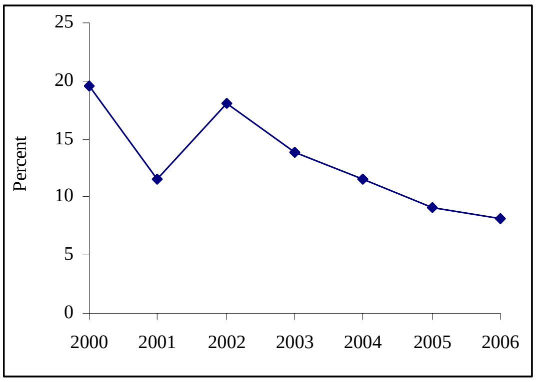
| | 2004 Q4 | 2005 Q4 | 2006 Q4 |
|---|---|---|---|
| Return on Capital Employed, ROCE (%) | 19.1 | 17.0 | 16.5 |
| Return on Equity, ROE (%) | 22.2 | 18.9 | 17.3 |
| Net Profit Margin (%) | 10.6 | 8.7 | 7.4 |
| Asset Turnover (%) | 91.9 | 96.1 | 105.4 |
| Financial Leverage (Times) | 2.3 | 2.3 | 2.2 |
| Return on Asset, ROA (%) | 13.9 | 12.4 | 12.2 |

Source: SET

***Banking sector developments***

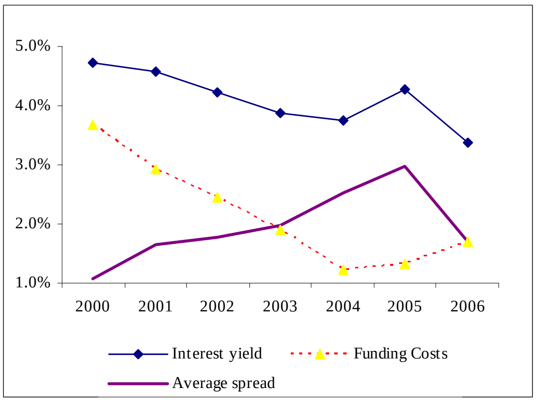
**The BOT announced earlier in 2006 a number of measures to accelerate the NPL resolution in the banking system.** The aim was to lower system-wide NPLs to 5 percent or less by the end of 2006 with further reductions coming in 2007. To achieve this, the state-owned Bangkok Commercial Asset Management (BAM) was merged with government owned AMC. BAM was given the mandate to bid for troubled loans and distressed assets (NPAs) from commercial banks. There were some delays in negotiating transfer of assets pushing back the timeframe, although the non-performing loans (NPL) trend continues to be clearly downward. Year 2006 ended with a reporting of 8.1 percent total NPLs (see Figure 17). NPLs net of provisioning at the end of the year were approximately 4.5 percent. The substantial difference reflects the Bank of Thailand's adoption of an accounting change associated with International Accounting Standards (IAS) 39. Implementation started in the fourth quarter of 2006 and is expected to be completed in 2008. The change requires banks to set aside full provisions against outstanding bad loans after collateral.

**Figure 17. NPLs, 2000-2006**




Source: BOT
Note: Excluding transfers to AMCs. Jump in headline NPLs in December 2002 was a one-off increase, reflecting a change in definition and did not affect provisioning.

**Figure 18. Average Interest Yields, Funding Costs, and Average spread of Thai Commercial Banks**




Source: BOT

**Banking sector fundamentals remain strong, although performance in 2006 was not as good as those of the previous years.** In the past few years, banks have benefited from favorable growth, low interest rates and ongoing restructuring efforts. Banks have been showing consistent profitability from their core operations (before-provision and tax returns), but that began to drop by year end 2006 (see Table 16). In prior years, the improving fundamentals of banks could be attributed to a combination of factors, including high and rising interest margins, strong growth in high margin consumer credit, banks' strategy to diversify their revenue base, with greater reliance on fees and trading income, and efforts to lower operating costs. In 2006, the interest yield has begun to drop and funding costs appear to have increased (see Figure 18). In addition, the 2006 performance of Thai banks was hit by the need to provide increased loan-loss provisioning. The results show that most Thai banks saw their net profit drop from their 2005 results. The reduction in profits has mainly been attributed to impairment from yield maintenance and the industries efforts to meet International Accounting Standard 39.

**Ownership within the Thai banking system has begun to see change.** Over the years there had been little change in ownership of Thai banks. Immediately following the crisis there was some change in ownership, most notably an increase in government ownership through the FIDF, but only a few small banks such as Bank of Asia, Thai Danu and Nakornthon saw the entry of foreign ownership. The larger banks remained family-owned as they had been for years. This appears to be changing with GE Capital Asia Pacific acquiring approximately a 25 percent stake in the mid-sized Bank of Ayudhya (Thailand's 6$^{th}$ largest bank by assets). Many see this acquisition as a positive step toward increasing competition, services, products and efficiency within the banking sector. In addition, late in 2006 the FIDF announced that it would be reducing its share in Siam City Bank and in Bank Thai. It is expected that FIDF will dispose of its stake by selling shares to both domestic and foreign investors.

**Table 16. Indicators of Health of the Commercial Banking Sector**

(Percent)

| | Dec. 2003 | Dec. 2004 | Dec. 2005 | Dec. 2006 |
|---|---|---|---|---|
| Interest margin | 2.0 | 2.5 | 3.0 | 1.7 |
| Net interest income to average assets | 2.1 | 2.5 | 2.9 | 3.2 |
| ROE | 10.5 | 16.8 | 16.5 | 8.5 |
| ROA | 0.7 | 1.2 | 1.4 | 0.8 |
| Pre-provision profit to assets | 1.4 | 1.7 | 1.9 | 0.9 |
| Provision expenses to assets | 0.7 | 0.5 | 0.4 | 0.7 |
| Total capital adequacy ratio | 13.4 | 12.4 | 13.3 | 13.6 |
| Tier-1 capital | 9.6 | 9.0 | 10.0 | 10.7 |
| Equity to total assets | 7.1 | 7.7 | 9.0 | 7.8 |

Source: BOT

## 2.7 Medium-Term Development

**In the medium-term Thailand can raise and sustain growth-rates that are higher by one or one and half percent over the recent rates.** But such increases in growth will require enhanced productivity and innovativeness, as well as higher investment. There is a need for significant upgrading of the manufacturing and services sector and greater efforts by these sectors to innovate in design, processes and products. Competition from other lower-income countries as well as from higher-tech products produced by both lower and middle-income countries will make this essential for Thailand. Thus concerted efforts will have to be made by the Government, the private sector and the households if this medium-term challenge is to be met.

***Context***

**Innovation will have to become increasingly important for total factor productivity (TFP) growth in Thailand**. Most of TFP growth in the past has come from reallocation of labor across sectors rather than *within* the manufacturing sector, where the latter depends more on within sector innovations. Between 1977 and 1996, the increase in TFP contributed about 1.5 percentage-points to Thailand's aggregate growth, while between 1999 and 2004 it contributed around 2 percentage-points. Most of this was generated by the transfer of workers from low productive jobs in rural areas to more productive urban employment in the manufacturing sector. As nearly two-fifths of the labor force is employed in the primary sector, the transfer of workers to the urban non-agricultural sector will continue for some time providing a productivity bonus, but it will be increasingly less important. Thus the focus has to be on innovation and upgrading of the manufacturing and services sectors, for TFP growth in the future.

**Also, Thailand's strategy to transition from middle income to high income status will be different from those for moving from low income to middle income status.** As countries grow from low income towards a middle income status, their economic structure tends to become more diversified. But as they make the transition towards high income status, Thailand must begin to specialize in selected areas in order to achieve economies of scale and more importantly, technological innovation and leadership. This transition is complex and difficult to accomplish, as countries like Thailand gets squeezed between low-wage competitors in poor countries and innovators in rich countries, and increasingly innovators in not-so-rich countries with lower costs, that have or are beginning to, dominate sectors requiring rapid technological change.

**Thailand's competitiveness in higher-tech products is lower than OECD countries as well as Singapore, Malaysia, Taiwan (China) and Korea.** But increasingly, China, Vietnam and India are also becoming more competitive in some higher-tech export niches. Survey-based indicators of competitiveness suggest the need for urgent progress in technology development and innovation. The World Economic Forum's Competitiveness index, Thailand ranked $35^{th}$ behind $24^{th}$-ranked Korea and $25^{th}$-ranked Malaysia. IMD placed Thailand in $32^{nd}$ place in 2006 a small drop from the $30^{th}$ spot in 2003. The World Bank's Doing Business Survey for 2007 ranked Thailand as $18^{th}$ among 175 economies while AT Kearney's Global Services Location Index for 2005 ranked Thailand $6^{th}$ among 40 countries. Finally the World Bank's Knowledge Economy Index gave Thailand a rating of 4.88 in 2006 as against 8.12 for Taiwan (China) and 8.20 for Singapore.

**Thailand has started to successfully upgrade its manufacturing output and exports, though its services sector lags.** Today machinery (electrical, non-electrical and transport) exports comprise close to 45 percent of total exports, when it was slightly over 20 percent in 1996. But, most of the upstream design tasks are still done abroad and foreign investors have put up too few of their research and development centers in Thailand. The services sector is further behind than manufacturing, with their cost and quality often lower than in many competitor countries. These services are important inputs (e.g. logistics, ICT, financial, business etc) into manufacturing output and productivity.

**The challenges for successful upgrading, specialization and innovation come from several sources.** First, the business sector, barring few exceptions, appears to be inadequately unmotivated to invest substantially in R&D or introduce process innovations on a routine basis. Second, numerous government programs to encourage R&D, technology absorption and technology development have failed to produce the desired effect. Third, the supply of science and technology workers as a percent of university graduates is below that of Thailand's principal competitors but more serious is the quality of Thailand's upper secondary education. Fourth, the quality of tertiary education as well as upper secondary education falls short of what maybe needed to promote more innovation and upgrading. And fifth, foreign companies have transferred amazingly little tacit knowledge and technology, as evident from a handful of companies setting up research establishments in Thailand and from the scope of research undertaken.

***Going Forward*[29]**

**The Tenth National Economic and Social Development Plan also emphasizes the urgent need to move towards an innovation and knowledge-based economy.** This will require appropriate policies and targeted investments to encourage efforts by private sector firms to innovate and be more productive, for education and skill-training providers to make arrangements for delivering training of adequate quality and for workers to seek skill development to get high returns from their labor. The Government has already taken many actions in respect of the above, but greater leadership and a sense of urgency is needed going forward.

**The medium term need is for a focused strategy with strong leadership both from the Government and the private sector**. Joint and coordinated efforts are needed from the government, from the private sector and of course the workers to embed technological change into the urban

[29] This section draws on a joint NESDB-WB report 'Towards a Knowledge Economy' prepared as an input into the Tenth Plan

industrial economy and routinize the process of innovation. Such an unwavering commitment contributed to the technological ascent of Korea and Taiwan (China) from a modest initial base of natural resources and human capital.

**The incentive to innovate typically derives from competitive pressures.** Firms tend to be knowledgeable and keep close tabs on the activities of their competitors inside and outside their countries so as not to be late in innovating processes and introducing new technology. This is clearly evident among Korean firms that identify competitors as the second most significant source of information. Innovation is being rapidly integrated into the strategies of the leading Chinese and Taiwanese firms. Thai firms seem not to pay much attention to their competitors. There is evidence of insufficient competition in many sectors and thus the potential of adequate profits without having to innovate to grow and survive.

**The aggregate spending on R&D in Thailand as a percentage of GDP is low and rising only slowly from a low base**. It has been repeatedly observed that Thai firms in the automotive, jewelry, food processing and electronics industries focus on the labor intensive and lower technology areas and rely more on low labor costs and overheads to compete. One good reason may be because they are able to compete and achieve their desired returns on sales *without* having to conduct research and that the technology they require is embodied in the equipment they purchase, supplemented by the support they receive from suppliers and buyers. Leading Thai firms, which depend on exports appear not to recognize the business case for R&D investment for routinizing technology and basing their competitiveness on innovation. And thus they remain unconvinced about the highly attractive returns from R&D.

**The few firms that are so persuaded, have issues with education quality and the industrial skills in Thailand.** The focus is on tertiary level institutions, but the acquisition of science and technology (S&T) skills rests on the foundations laid by the secondary education system. If these are weak, then it requires more resources at the tertiary level to remedy earlier deficiencies and even then it is not always successful to reverse the weaknesses at tertiary level. The most common complaints of Thai employers are that skills are in short supply, that workers are insufficiently computer and IT literate, and that few have a working knowledge of English. The high wage premium offered for skills does point to shortages—those with college degrees command starting salaries much higher than secondary school graduates.

**However, the tight labor market for skills is not a new development in Thailand or elsewhere.** Where firms are determined to compete, they increase their in-house spending on training; more fully utilize the training facilities and subsidies offered by the state and by private providers, and business lobbies attempt through political channels to push measures to raise the outlay of education as well as to improve its quality. The problem never goes away in any country—it is severe in the US—but firms learn to cope and to push for improvements. It is the use of 'voice' and initiatives by firms individually and collectively which leads to change, as also a relatively open environment for private entry in the provision of education and skill-development. The need is for market flexibility to respond to demand.

**Technological capability of firms is increasingly more dependent upon basic science and upstream applied research.** These are areas in which top quality universities and dedicated research institutes have a comparative advantage and can add value to corporate research. But much depends on the quality and scale of these institutions, and the mix of incentives influencing research collaboration, and therefore there should be *demanding hurdle criteria* to justify use of public money for this purpose.

**ICT investment has been a consistent source of productivity growth and economic growth.** This has been true from US to EU to transition economies such as Estonia, Latvia, Lithuania, Poland and Russia. The recent World Bank surveys of over 20,000 firms in developing countries reveal that firms that effectively utilize ICT show faster growth in sales and employment. Telemedicine, E-tourism, computer-aided design & engineering, computer-aided factory, car-rental IT processing, just-in-time IT inventory systems, and e-commerce etc all depend on successfully harnessing IT.

**But firms in Thailand complain the most about poor ICT use and inadequate availability of skills**. Even web-site use is limited as is use of e-commerce. The infrastructure is expensive, including access to broadband. Poor availability of trained people prevents firms from using computer-controlled machinery for higher-tech production. This is an important source of process and product innovation that is not fully available to firms in Thailand.

**The medium-term agenda comprises of measures to move Thailand towards a knowledge economy will have three parts.** These parts would include actions to improve the policy framework providing appropriate incentives, actions to improve the intellectual infrastructure, and actions to ensure that physical infrastructure and services is supportive of this move. The *first* set thus would include reduced regulatory burden, increased competition for all firms, flexible labor and financial market, and incentives for R&D and in-firm training. The *second* would require actions to promote greater private participation in education services, development of a top-notch university and a premier research institute, enhanced University enrollment in science and technology, and improved university-research institute-business linkages. The *third* would cover better ICT infrastructure, more efficient transport and logistics services, better quality and cost-effective business services, and most importantly improved infrastructure to make Bangkok an increasingly efficient city.

# SECTION 3
# IMPLEMENTATION OF STRUCTURAL REFORM

## 3.1 Financial and Corporate Sector Reforms and Restructuring

***Financial Sector Reforms and Restructuring***

**In the past six months, the Cabinet approved the principles of the five drafts of the Acts regarding the financial sector to improve its efficiency and transparency.** Firstly, the draft of the Financial Institution Business Act was endorsed in November 2006. This Act will combine major laws on financial institutions and improve the regulations and supervision of the financial institutions. In February 2007, four more drafts of (1) the Office of the Insurance Regulation and Promotion Commission Act, (2) the Bank of Thailand Act, (3) the Securities and Exchange Act, and (4) the Currency Act was also approved by the Cabinet (see details in Box 3). Currently, these five drafts of the Acts are being scrutinized by the Office of the Council of State before they are submitted to the National Legislative Assembly for consideration. The enactments of these Acts would enhance the independence, transparency and flexibility of the relevant agencies and raise the efficiency of Thailand's financial sector to the international standards.

**The Thailand's Futures' Exchange PCL (TFEX) will start trading a new product and launch a new market access system this year.** The TFEX's board approved the launch of its latest product- the SET 50 Index Options - in October last year and expects to start trading in the third quarter of this year. Currently, there is only one product - the SET 50 Index Futures - trading on the futures market. The new product is expected to provide investors with a new instrument for risk management and flexible investment. In addition, the TFEX will implement a new direct market access (DMA) within this year. Since its inauguration in April 2006, the trading in the futures market has been done through the marketing representatives or online via the internet system of the TFEX's members. This new direct market access will allow the investors to make the direct connection to the system and thus facilitating and enhancing the trading efficiency.

**The Bank of Thailand (BOT) plans to close its repurchase (RP) market this year to encourage the development of the money and derivatives markets[30].** According to the reform of the BOT's monetary operation framework, the BOT aims to close the BOT's RP market within 2007 to reduce the market distortion in terms of pricing mechanism and risk management. Currently, the financial institutions in Thailand rely mainly on the BOT's RP market which is uncomplicated and has low risk and low costs in managing their short-term liquidity, thus discouraging market players to trade among themselves as well as to develop new financial tools for risk management. In addition, the BOT is restructuring its monetary operation framework to enhance efficiency and transparency of the monetary policy operations. Firstly, as of January 2007, the 1-day RP rate is employed as a policy rate instead of the 14-day RP rate to better reflect the liquidity condition of the money market. Secondly, the required reserve maintenance periods will be synchronized with Monetary Policy

[30]The repurchase market is a market in which the financial institution will exchange their securities for a loan with an agreement to later repurchase the securities on a predetermined date at a specified price. The securities are serve as a collateral for the loan and the most commonly used securities are the sovereign debt instruments.

Committee (MPC)'s meeting dates to reduce interest rate fluctuation[31]. Lastly, the BOT will narrow the interest band for lending and borrowing from the BOT through its end-of-day liquidity adjustment window. The band will be +0.5 percent on the BOT's policy rate for borrowing and -0.5 percent for lending.

**Box 3 Details of the Financial Acts approved in the past six months**

In the past six months, five drafts of the Acts regarding the financial sector were approved by the Cabinet. Currently, they are being scrutinized by the Office of the Council of State before being submitted to the National Legislative Assembly for further consideration. The details of each draft and their significance are summarized below:

**1) The draft of the Financial Institution Business Act:** The main contents of the Act are to incorporate the Commercial Bank Law and the Capital, Securities, and Credit Foncier Business Law into one. This Act will improve the regulation and supervision of these businesses in response to developments and changes in the financial system. It will also standardize operational standard of the financial institutions.

**2) The draft of the Office of the Insurance Regulation and Promotion Commission Act:** The Office of the Insurance Regulation and Promotion Commission Act would result in an establishment of the Office of the Insurance Regulation and Promotion Commission, an independent regulatory agency for insurance business. The Act aimed to strengthen the roles and structures of the insurance regulatory agency such that it is independent, transparent and flexible in accordance with the international insurance business standards.

**3) The draft of the Bank of Thailand (BOT) Act:** The BOT Act includes objectives, missions, authorities of the BOT, operational structure of the BOT, selection method of the governor and BOT's board and their's terms. The structures of the BOT related committees such as, the Monetary Policy Committee, Financial Institution Policy Committee and Payment Systems Committee, and their regulations are also included. The BOT Act aims to restructure the BOT to be able to implement the monetary policy more effectively in accordance with the BOT's missions and the international standards.

**4) The draft of the Securities and Exchange Act:** The Ministry of Finance proposed the amendments of the Securities and Securities Market Bill (1992) since the Bill is inconsistent with the current developments of the capital market particularly the structure of the regulatory agency for the capital market and securities trading. The draft of the Securities and Exchange Act covers the formulation of the structure of the regulatory agency of the capital market, selection method and members of the committees, as well as the supervision on stock trading, stock holding, securities companies, securities exchange and securities depository.

**5) The draft of the Currency Act:** The draft of the Currency Act will abolish the roles of the Exchange Equalization Fund, expand the types of assets including in the currency reserves, increase the assets in the currency reserves that backs note- issuing, change the calculation of the asset value in the currency reserves, and add the BOT's authorities. This new Act will replace the current Currency Act (1958) and its amendments which are outdated.

[31] For example, if the MPC's meeting is scheduled in the middle of the reserve maintenance period, and there are anticipations that interest rate will be raised after the MPC meeting, financial institutions tend to build up the reserves (in cash and bonds) before the meeting date and lower its reserves level after the meeting. By doing so, commercial banks will be able to lend more after the MPC meeting when interest rates are higher and at the same time meet the reserve requirement for that period. In accumulating reserves prior to the MPC meeting, commercial banks will purchase more bonds, thus pushing up the price of bonds in effect lowering the interest rate on bonds prior to the MPC meetings and mislead the market.

*Corporate Sector Reforms and Restructuring*

**The amendments to the Asset Management Corporate (AMC) Act, effective in March 2007, would help reduce the level of NPLs in the financial system.** The amendments to the AMC Act expand the AMC's businesses so that it can purchase or transfer the distressed assets from the financial institutions, which were closed after the financial crisis in 1997[32].In addition, AMC can be hired to manage the distressed assets on behalf of other financial institutions, which may not specialize in managing distressed assets. These amendments would accelerate the resolution of distressed assets in financial institutions and lessen their bad debt portfolio leading to a reduction of NPLS in the financial system. The AMC is obliged to report its performance and financial statements to the Bank of Thailand regularly.

## 3.2 Recent Trade Reforms

### *Tariff Reform*

**On 1 January 2007, an additional 2.2 percent of the total tariff lines entered the three- rate system.** According to the tariff restructure effective in 2003, about 179 items or 2.2 percent of total tariff lines including iron and steel, copper and plastic resin was brought into the three-rate system. The three-rate system captures each stage of production as follows: 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods. The major tariff restructure began in 2003 leading to two major tariff reductions, effective in October and December 2003. As of January 2007, three forth of the total tariff lines are consistent with the three-rate system.

**In February 2007, the Cabinet approved a tariff reduction of vehicle parts for assembling NGV vehicles and a tariff restructure of other 20 miscellaneous items to enhance competitiveness of domestic manufacturers[33].** Import tariffs of parts for assembling CKD chassis with engine under HS8706 and parts of new NGV combustion engines were exempted. The tariff rates of CKD chassis with engine under HS 87060020 and a natural gas container used for diesel and benzene engines are temporarily reduced to zero rates until December 31, 2008. This tariff reduction is expected to support the domestic assembly of NGV vehicles. In addition, import tariffs of another 20 miscellaneous items were restructured to reduce a redundancy of the current tariff structure. These include, for example, a tariff exemption of a blood container for the Red Cross, a tariff reduction for ores, pearls and iron sheet coated with plastic, and an increase in tariffs of copper wires, copper sheets, and copper foils.

### *Export Promotion and Assistance*

**The Ministry of Commerce (MOC) planned to achieve an export target of 12.5 percent by encouraging the cooperation between public and private sectors.** The export growth rate in 2007 was targeted at 12.5 percent compared to an actual growth rate of 17.4 percent last year[34]. In order to achieve the target rate amidst the global slowdown, the MOC will implement the proactive strategies in conjunction with private sector to maintain export growth in Thailand major markets and to expand

---

[32] Previously, the AMC is only allowed to purchase or transfer distressed assets from operating financial institutions.

[33] The criteria of the NGV vehicle subjected to the tariff reductions include a vehicle with over 10 passengers, total weight exceeding 6 tons, and using only NGV combustion engine.

[34] The lower target was a result of a possibility of the slowdown in economy of Thailand's major markets as well as sluggish export prices (see export section for details).

exports to new potential markets. 393 export promotion projects will be organized to promote exports in Thailand's main markets, namely US, EU, Japan and ASEAN[35] while the Department of Export Promotion will directly organize Thailand's exhibitions in 18 potential countries, including, for example, China, India, Middle East and African countries.

**The FTA negotiations will continue to increase market access and reduce trade barriers.** Since early this year, bilateral FTA negotiations with countries in the region have shown some progress. ASEAN and China signed an agreement on trade in services in January and expected to be effective in July this year. Thailand and Japan also signed the Japan-Thailand Economic Partnership (JTEPA) on April 3, 2007 which will lead to a tariff reduction of about 90 percent of total tariff lines later this year. The negotiations with India and BIMSTEC regarding trade in goods are proceeding. However, FTA negotiations with US and EU are on hold (see Box 4).

**The Customs Department has applied the 2007 Harmonized System in consistent with the international standard since 1 January 2007[36].** According to the 2007 HS nomenclature, the 8 digit code will be applied for all imported goods while the previous HS nomenclature applied the 6 or 7 digit code for the non-ASEAN imported goods and applied the 8 digit code for the ASEAN imports. In addition, the new HS disaggregates products in more details allowing the customs to further classify the tariffs to 8,301 tariff lines compared to 5,505 tariff lines in the 2002 HS. However, the 2007 HS does not affect the import tariffs.

## 3.3 Public Sector Reform

**Improving public procurement system is a priority of the Thai government.** On October 27, 2006, the National Legislative Assembly announced an economic policy to improve the principles of economic development which emphasized a fair and free trade system to elevate Thailand's competitiveness. Under this policy, the need to ensure a well performing public procurement system is being seen as a priority. The Government through Comptroller General's Department (CGD) under the Ministry of Finance has set up a committee in December 2006 to review and expand the Baseline Indicators System (BIS) assessment done in 2005 and to draft a strategic plan for improving the standards of the public procurement system. Using the BIS assessment, the committee will review the current public procurement system and provide policy advice to increase transparency and fairness of the public procurement system (see Box 5).

[35] 392 projects include organizing domestic trade exhibitions (13 projects), attending international trade exhibitions (173 projects), promoting sales in collaboration with department stores abroad(137 projects), and promoting exports through trade mission (63 projects).

[36] The Harmonized Commodity Description and Coding System (HS) is an international classification system for traded goods developed by the World Customs Organization (WCO) and widely used among the WCO member countries as a basis for their customs tariffs and for the collection of international trade statistics. Currently, about 98% of total international trade employed this system. The HS is revised every 4-5 years to capture changes in technology and international trade.

**Box 4. Progress on Thailand's Free Trade Agreements (FTAs)**

In the last six months, Thailand has made some progress in FTA negotiations with China, India and BIMSTEC while the negotiations with others have had a stable progress. The progress of each FTA can be summarized as follows:

- **ASEAN and China:** ASEAN member countries and China signed a framework agreement on trade in services in January 2007. The framework agreement is consistent with the General Agreement on Trade in Services (GATS) under WTO. In this agreement, Thailand proposed to open market access in business services, education, tourism and maritime transport while China proposed to liberalize its computer services, real estates services, road transport and other business services. The framework agreement is expected to be effective in July this year and thus facilitating Thai investors in expanding their business in China.
- **Thailand and India:** After the tariff exemption of 82 items under the Early Harvest Scheme (EHS) in September last year, Thailand and India have continued to work together to facilitate the trade flows by reducing the non-tariff barriers like Sanitary and Phyto-Sanitary issue. However, the two countries plan to hold a meeting in April to discuss on the items to be included in the tariff reduction schedule under normal track list as well as issues on trade in services and investment.
- **Thailand and Australia:** There has been no significant progress since the first meeting of Thailand-Australia FTA Joint Commission in December 2005. However, the second meeting of the FTA Joint Commission to review the progress of the FTA implementation is expected to be held within this year. The trade flows between the two have expanded significantly with the 37 percent export growth to Australia and the 4 percent of imports growth from Australia in 2006[37].
- **Thailand and New Zealand:** There has been no significant progress since the first meeting of Thailand-New Zealand Closer Economic Partnership (CEP) Joint Commission in May 2006. However, the second meeting of the CEP Joint Commission to review the progress of the FTA implementation is expected to be held within this year.
- **Thailand and Peru:** Thailand and Peru signed the official agreement on the rules of origin in November 2006. However, the tariff reduction under the Early Harvest Scheme (EHS) has not been effective since Peru is proceeding the internal legal process to reduce the tariffs. However, the tariff reduction under the EHS is expected to be effective in July this year.
- **BIMSTEC[38]:** In November 2006, the BIMSTEC members organized a meeting to discuss on the draft of trade in goods. The members mutually approved on the amendments by the law specialists while the measures on goods in transit are still under negotiation. However, the negotiation on tariff schedule has not been agreed as Thailand would like to keep the negative list at 10 percent of total items at 6-digit HS code while the others would like to maintain the negative list at 20 percent.
- **Thailand and Japan:** The signing ceremony of the Japan-Thailand Economic Partnership Agreement (JTEPA) was held in April 2007. This agreement is a comprehensive agreement covering trade in goods and services as well as investment. Once the agreement become effective, tariff rates of about 90 percent of total tariff lines will be reduced. These include, for example, frozen shrimps and fish, fruits and vegetables, wearing apparels, leather goods, textiles, and jewelry. In terms of trade in services, Thai investors will allow to expand more businesses such as spas, hotels, and restaurants in Japan. As for investment, Thai investors will allow to invest in all industries except medicine, aerospace, oil production, energy, mining, fishery, agriculture, forestry and other related industries.

**There has been no progress in the following FTA negotiations from the previous report in November 2006.** These include US, EFTA, Bahrain, ASEAN and Korea.

---

[37] Thailand imports from Australia increased by 4 % in 2006 compared to 48 % in 2005 due to a high base effect.
[38] BIMSTEC includes seven countries, namely, Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

**The Cabinet approved on January 16, 2007 the draft laws on criminal conflict of interest between politicians, government officials and the public to improve transparency and reduce corruption.** The proposed law defines the types of actions and criminal penalties on politicians, government official including their spouses or relatives who may have direct or indirect benefits resulting from conflicts of interest. The law also states that gifts or cash given to politicians and government officials are to be treated as Government property. Moreover, agreements which are signed by any politician or government official which are proven to be conflicts of interest must be withdrawn.

**To improve the monitoring and evaluation system on government agencies' performance, the Government plans to integrate currently two inspection processes into one by this fiscal year.** Currently, each government agency is subject to two inspection processes – one by the Prime Minister's Office and the other by their respective ministry. The proposed integrated inspection process will involve monitoring and evaluation on four dimensions to assess how well the government agencies' activities achieve their target outcomes. The four dimensions are effectiveness, efficiency, quality of services, and organization's development. In addition, state-owned enterprises, for the first time, will also be subjected to this inspection.

**The Decentralization Act No. 2 (2006) was approved by the National Legislative Assembly and announced in the Royal Gazette on January 8$^{th}$, 2007.** The Decentralization Act No.2 (2006) has postponed the time frame for achieving the target that local government's revenues should be 35 percent that of the central government by 2006[39]. However, the new law did not specify a target year for this to be achieved[40]. The new law stated that the amount of subsidy and the share of local government's revenue to the central government's revenue shall not be less than that of FY 2007's target of 25 percent and that the amount of funds transferred shall correspond to the activities transferred to the local governments.

[39] This target was stipulated by the Decentralization Act No. 1 (2000).
[40] In 2006, local government's revenues were less than 25 percent that of the central government. There are about 8,000 local governments in Thailand.

**Box 5. Improving Thailand's Public Procurement System**

In 2005, the Thai Government with collaboration from the World Bank assessed the public procurement system in Thailand using OECD/DAC Baseline Indicator System (BIS). The 2005 BIS assessment highlighted areas to improve public procurement, mainly (i) improving the existing legislative and regulatory framework with international best practice aiming to increase efficiency and transparency of public procurement; (ii) standardizing procurement practices; and (iii) improving monitoring system to enhance agency procurement performance in both central and provincial government as well as municipality. In December, 2006, the Government through the Comptroller General's Department (CGD), Ministry of Finance (MOF) set up a committee to expand the 2005 BIS assessment and to draft a strategic plan for improving standard of public procurement system. The draft plans and recommendations are expected to be submitted to the government in April 2007.

The CGD, in partnership with the World Bank, is now planning to conduct two studies. One is to develop the strategic action plan for improving the public procurement system, including policy recommendations for strengthening the legal and regulatory framework for public procurement in the country. The second study will focus on improving the monitoring and evaluation of performance and outcomes of the public procurement system by developing and piloting a procurement measurement tool in selected government agencies with the intention that this pilot would form the basis for subsequent full scale roll-out and establishment of a procurement monitoring and evaluation system at the national level which is a critical need for the effective functioning of the public procurement system in Thailand.

# Appendix 1: Key Economic Indicators

| | 2005 | 2006 p / | 2006 | | | | 2006 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Year | Year | Q1 p/ | Q2 p/ | Q3 p/ | Q4 p/ | Nov p/ | Dec p/ | Jan p/ |
| **Output, Employment and Prices** | | | | | | | | | |
| GDP (% change, previous year) | 4.5 | 5.0 | 6.1 | 5.0 | 4.7 | 4.2 | .. | .. | .. |
| Manufacturing production index (2000=100) | 155.6 | 167.1 | 167.1 | 163.0 | 167.0 | 171.2 | 170.8 | 173.7 | 169.6 |
| (% change, previous year) | 9.1 | 7.4 | 9.7 | 6.6 | 6.6 | 6.8 | 8.0 | 6.6 | 8.4 |
| Unemployment rate (%) | 1.8 | 1.5 | 1.9 | 1.7 | 1.2 | 1.3 | 1.2 | 1.0 | 1.6 |
| Real wage growth (%) 1/ | 2.3 | 1.6 | 0.5 | 1.1 | 1.6 | 3.1 | .. | .. | .. |
| Consumer price index (% change, previous year) | 4.5 | 4.7 | 5.7 | 6.0 | 3.6 | 3.3 | 3.5 | 3.5 | 3.0 |
| **Public Sector** | | | | | | | | | |
| Government cash balance (Billion Baht) | -45.8 | 88.0 | -28.8 | 97.9 | 44.5 | -25.5 | -20.0 | 6.9 | 11.0 |
| Government cash balance (% GDP) | -0.6 | 1.1 | -1.5 | 5.2 | 2.3 | -1.2 | .. | .. | .. |
| Public sector debt (% GDP, end of period) 2/ | 43.4 | 35.6 | .. | .. | 38.3 | 35.6 | .. | .. | .. |
| **Foreign Trade, BOP and External Debt** | | | | | | | | | |
| Trade balance (US$ million) | -8,530 | 2,245 | -224 | -1,705 | 1,450 | 2,723 | 1,269 | 732 | 808 |
| Exports of goods (fob, US$ million) | 109,193 | 128,220 | 29,091 | 30,592 | 34,555 | 33,981 | 11,767 | 10,843 | 10,373 |
| (% change, previous year) | 15.0 | 17.4 | 17.7 | 16.0 | 16.3 | 19.7 | 21.7 | 16.4 | 17.8 |
| Imports of goods (cif, US$ million) | -117,722 | -125,975 | -29,316 | -32,297 | -33,105 | -31,258 | -10,498 | -10,111 | -9,565 |
| (% change, previous year) | 25.9 | 7.0 | 5.5 | 3.3 | 12.2 | 7.2 | 6.3 | 6.5 | 4.0 |
| Current account balance (US$ million) | -7,852 | 3,240 | 609 | -2,201 | 1,250 | 3,582 | 1,512 | 1,215 | 1,536 |
| (% GDP) | -4.4 | 1.5 | 1.2 | -4.4 | 2.4 | 6.4 | .. | .. | .. |
| Foreign direct investment, net (US$ million) | 7,412 | 9,619 | 4,210 | 1,768 | 1,737 | 1,905 | 681 | 620 | 616 |
| Total external debt (US$ million) | 4,518 | 4,140 | 4,661 | 4,483 | 4,270 | 4,140 | .. | .. | .. |

| | 2005 | 2006 p / | 2006 | | | | 2006 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Year** | **Year** | **Q1 p/** | **Q2 p/** | **Q3 p/** | **Q4 p/** | **Nov p/** | **Dec p/** | **Jan p/** |
| (% GDP) | 32.5 | 33.0 | 35.0 | 33.9 | 34.1 | 33.0 | .. | .. | .. |
| Short-term debt (US$ million) | 16,014 | 18,340 | 19,129 | 17,927 | 21,097 | 18,340 | .. | .. | .. |
| Debt service ratio (% exports of goods and services) | 10.8 | 8.3 | 9.2 | 7.0 | 9.1 | 8.1 | .. | .. | .. |
| Reserves, including gold (US$ million) | 52,066 | 66,985 | 55,266 | 58,057 | 61,593 | 66,985 | 64,488 | 66,985 | 66,769 |
| (months of imports of goods) | 5.3 | 6.4 | 5.7 | 5.4 | 5.6 | 6.4 | 6.1 | 6.6 | 7.0 |
| **Financial Markets** | | | | | | | | | |
| Domestic credit (% change, previous year) 3/ | 7.7 | 3.8 | .. | 6.7 | 4.6 | 3.8 | .. | 3.8 | .. |
| Short-term interest rate (average period) 4/ | 1.6 | 3.9 | 3.4 | 4.0 | 4.1 | 4.1 | 4.1 | 4.1 | 4.0 |
| Exchange rate (average period) | 40.2 | 37.9 | 39.3 | 38.1 | 37.6 | 36.5 | 36.5 | 35.8 | 35.9 |
| Real effective exchange rate (1994=100) | 79.0 | 85.4 | 82.6 | 85.2 | 85.9 | 88.0 | 88.2 | 88.9 | 88.9 |
| (% change, previous year) | 1.6 | 8.1 | 4.5 | 8.7 | 9.4 | 9.9 | 9.9 | 11.3 | 9.2 |
| Stock market index (Dec 1996=100) | 713.7 | 679.8 | 733.3 | 678.1 | 686.1 | 679.8 | 739.1 | 679.8 | 654.0 |
| Memo: GDP (US$ billion) | 176.2 | 206.2 | 49.2 | 49.7 | 51.5 | 56.0 | .. | .. | .. |

p = preliminary
1/ Computed from average wage of employed person from Labor Force Survey
2/ Include direct government debt, non-financial-state-enterprise debt and financial institutions development fund (FIDF) debt
3/ Yearly and quarterly data include credits extended by all financial institutions
4/ Average interest rates on time deposits of less than 6 months (percent per annum)

# Appendix 2: Monitoring Matrices for Structural Reform Implementation

1. Poverty Reduction Diagnostics

2. Financial and Corporate Sector Reform

3. Reforms to Improve Business, Investment Environment and Trade

4. Social Protection

5. Public Sector and Governance Reform

## 1. Poverty Reduction Diagnostics

| | Objective | Reform Measures Taken |
|---|---|---|
| A. | Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve the local economy | ***Measures taken over last 6 months and their significance***<br>• **In early 2007, the government has allocated the budget of 5 billion baht to promote self-dependence using community development mechanism under the name of "Good Living and Happiness Society Strategy".** The strategy consists of five development plans including (i) sufficiency economy plan aiming to build up knowledge and create occupations skills; (ii) community development and opportunity creation plan focusing on reducing household expenses (i.e. use of organic fertilizer and vegetable home gardening) and creating market opportunities for community products; (iii) rehabilitation of natural resources; (iv) assisting vulnerable people and senior citizen; and (v) provision of basic services (i.e. health, education, vocational training, etc). This is the bottom-up policy design by allowing community leaders, local government, provincial government and central government in each district to jointly design community master plan and projects which will respond to needs of people in the community. The program will also emphasize the learning process to integrate and to exchange knowledge among communities, local governments and every partner of government agencies.<br>• **In January 2007, the prime minister office set up the "Center of Poverty Eradication and Rural Development under the Sufficiency Economy Philosophy".** This center will be responsible in all processes of poverty eradication and rural development programs of the government starting from policy design, implementation, monitoring and evaluation. The center will also integrate data base of poverty and income inequality from every agency so that these data can be used more efficiently. In addition, the center will also incorporate both private sector, citizen, local government and every relevant government agency to work together in order to achieve their common goal in reducing poverty. |

Prepared by Cheanchom Thongjen

## 2. Financial and Corporate Sector Reform

| | Objective | Reform Measures Taken |
|---|---|---|
| A. | Enable sharing of credit information among financial institutions | ***Measure taken over last 6 months and significance***<br>• **The Credit Information Protection Committee (CIPC) issued an order regarding rules, method, and condition on a disclosure of credit information on 28 February 2007 which was made effective on 21 March 2007.** The main contents of the orders are as follows: 1) consumers can provide their consent to disclose their credit information through website, fax, ATM, and automatic answering phone on top of a written document 2) consumers only need to give a consent once if the purposes of the credit disclosure are for credit reviews, extension of credit or credit card, and risk management according to BOT's order. The order will allow the National Credit Bureau (NCB) to widely disclose credit information to the financial institutions for reviewing credits, extending credit and credit card, and managing risk. |
| B. | Formulate and implement a medium-term strategy for Thai financial sector | ***Measures to be taken in the next 6-12 months***<br>• **The draft of the Financial Sector Master Plan (PSMP) Phase II is expected to complete in this year.** The Bank of Thailand (BOT) is currently conducting an assessment of the Financial Sector Master Plan Phase I implemented in 2004 through the interviews with the focus groups as well as the public hearings. The result of this assessment will be inputs for the Financial Sector Master Plan (PSMP) Phase II, which is expected to complete within this year and submit to the Cabinet by next year.<br>• **The Master Plan for Grass-Root Financial Services is expected to implement in this year.** The draft of the Master Plan was revised and submitted to the Minister of Finance for an approval. Then, it will be submitted for the Cabinet approval. The implementation of this Master Plan is expected to start within this year. The main focus of the Master Plan is to legalize the financial services for the informal groups including the informal microfinance institutions like savings groups in the rural areas. The Master Plan will provide a framework to promote the informal financial services to be more sufficient and sustainable.<br>• **The draft of the Financial and Fiscal Master Plan for the Better Society will be completed this year.** The Fiscal Policy Office (FPO) is currently drafting the Financial and Fiscal Master Plan. The main objective of the Master Plan is to create a better society with self-sustainable sufficiency by using the financial and fiscal measures. Currently, the FPO plans to organize a workshop to discuss with the focus groups. The inputs from the discussion will be incorporated into the Master Plan. |

| | Objective | Reform Measures Taken |
|---|---|---|
| C. | Transition from the current blanket government guarantee on deposits to a limited deposit insurance scheme | ***Measure to be taken, but has been delayed***<br>• **The draft Deposit Insurance Institution Act has been scrutinized by the Office of the Council of State since December 2005.** The draft Act was endorsed by the Cabinet in November 2004. It has been under review by the Office of the Council of State since then. Once the legal review has been completed, the draft Act will be submitted to the Parliament for further consideration. Upon the enactment of the Act, a Deposit Insurance Agency will be established with an initial capital base of Bt 1 billion and will offer a limited guarantee on deposits at insured financial institutions. This will replace the current blanket guarantee of the BOT's Financial Institutions Development Fund (FIDF). |
| D. | Remove legal impediments and provide an enabling environment for derivative products. | ***Measures to be taken in the next 6-12 months***<br>• **The Thailand Futures' Exchange PCL (TFEX) will start trading the SET 50 Index Options in Q3 2007 on top of its current product- the SET 50 Index Futures.** The TFEX board approved the launch of the SET 50 Index Options in October 2006 and expected to start trading in 2007 Q3. This product will provide a wider range of risk management and flexible investment to the investors. In addition, the TFEX is also considering the feasibility of launching other products including interested-linked and commodity-linked derivatives in the future.<br>• **The TFEX plans to introduce direct market access (DMA) to investors in 2007.** Currently, the investors can trade through marketing representatives or online via the internet system of TFEX's members. With this new DMA, the investors will be allowed to connect directly to the system. The direct connection is expected to facilitate and enhance trading efficiency. |
| E | Develop the domestic financial markets, including bond, capital, and money markets. | ***Measures taken over last 6 months and their significance***<br>• **In November 2006, the draft of the Financial Institution Business Act was also approved by the Cabinet.** The main contents of the Act are to incorporate the Commercial Bank Law and the Capital, Securities, and Credit Foncier Business Law into one as well as to improve the regulation and supervision of the financial institution business in response to the developments and changes in the financial system. The Office of the Council of State is now scrutinizing the draft of this Act which will be submitted to the National Legislative Assembly for consideration.<br>• **The Cabinet approved in the principle the draft of the Office of the Insurance Regulation and Promotion Commission Act in February 2007.** The Act aimed to strengthen the roles and structures of the insurance regulatory agency to be independent, transparent and flexible in accordance with the international standard of the insurance business. Currently, the draft of this Act is being scrutinized by the Office of the Council of State before submitting to the National Legislative Assembly for consideration.<br>• **An approval of the draft of the Bank of Thailand (BOT) Act was made by the Cabinet in February 2007.** The draft of the BOT Act includes objectives, missions, authorities of the BOT, the governor election method and the governor's term. The structures of the BOT related committees such as Monetary Policy Committee, Financial Institution Committee and Payment Systems Committee are also included. The draft is being considered by the Office of the Council of State. Then, it will be submitted to the National Legislative Assembly for further consideration. |

| | Objective | Reform Measures Taken |
|---|---|---|
| | | • **The draft of the Securities and Exchange Act was approved by the Cabinet in February 2007.** The draft of the Securities and Securities Exchange Act covers the formulation of the structure of capital market's regulatory agency as well as the supervision on stock trading, stock holding, securities companies, securities exchange and securities depository. The draft is being considered by the Office of the Council of State before submitting to the National Legislative Assembly for consideration.<br>• **The draft of the Currency Act was also approved in February 2007.** The draft of the Currency Act will abolish the roles of the Exchange Equalization Fund, expand the types of assets including in the currency reserves, increase the assets in the currency reserves backing the note issuing, change the calculation of the asset value in the currency reserves, and add the BOT's authorities. Currently, the draft is being considered by the Office of the Council of State and then submitting to the National Legislative Assembly for consideration.<br>• **The Thai Bond Market Association (BMA) launched new financial software – iRisk-Credit VaR1.0 for risk management.** The new financial software incorporates three models naming Actuarial Model, Moment-Matching Model and Marked-to-Market Model for calculating the credit value-at-risk. This software would help fund managers and risk management officers to better estimate the credit risk using the advanced quantitative techniques and thus reducing a potential loss for the investors in the bond market.<br>• **The Stock Exchange of Thailand (SET) started to implement its three-year strategic plan (2007-2009) in January this year**. The medium-term directions of the SET are (1) to become an integrated market (2) to be the important exchange market in the region, and (3) to be strategic partnership. In order to achieve the above mentioned directions, the SET will provide various products in respond to investor's demand, develop the IT system for trading, facilitate trading and expand the number of investors, improve its regulations to meet international standard, enhance the collaboration with commercial banks for capital market transactions, build the linkage with other exchanges, support public policies and measures regarding capital market development, and continuously increase collaboration with all stakeholders in the capital market.<br><br>***Measure to be taken in the next 6-12 months***<br>• **The reform of the BOT's monetary operation framework will be completed within this year.** After the consultation with the businesses in the financial sector, the Bank of Thailand (BOT) has shifted its focus from the Master Plan of the Development of Money and Foreign Exchange Market to the improvement of the current problems and obstacles in the market. This resulted in the reform of the BOT's monetary operation framework including the closure of the BOT's repurchase market and the reform of the monetary operation framework. The purposes of the reform are to facilitate the financial market developments and to enhance efficiency and transparency of the monetary policy operations. |
| F. | Rationalize state holding of specialized financial institutions, state owned enterprises, and state commercial banks | ***Measure over the last 6 months and significance***<br>• **The FPO submitted the draft of the Office of the Prime Minister's regulations on the Public Services of the State Owned Enterprises (SOEs) under the government special policy to the Cabinet.** The regulations are aimed to promote SOE's services which are eligible to receive financial supports from the government to alleviate people's hardship and enhance country's competitiveness. However, the SOEs are obliged to separately report revenues and expenses statements |

| | Objective | Reform Measures Taken |
|---|---|---|
| | | of the public services under this special policy from their normal business in order to receive financial support from the government. The committees of the public services under the government special policy will be set up to formulate rules and conditions to select the appropriate project, to produce and examine the revenues and expenses statements, to set up the budget, and to monitor the project. These regulations are aimed to make the public services supported by the specialized financial institutions be more transparent and reduce an impact on the financial liquidity of the SFIs. |

Prepared by Wallada Atsavasirilert

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

| | Objective | Reform Measures Taken |
|---|---|---|
| A. | Improve competitiveness of business sector | ***Measure taken over last 6 months and significance***<br>• **The Telecommunications Research and Industrial Development Institute (TRIDI) was established in November 2006.** The main objectives of the TRIDI are to support the R&D in telecommunication sector, to improve skilled labor for the sector, to promote an innovation exchange center for the development of information and communication technology, telecommunication industry and its downstream industries, to be a training center for telecommunication industry and its downstream industries, and to promote collaboration with international institutions in terms of R&D work. As a result, the TRIDI then coordinates with universities, research centers, private and public manufacturers to develop skilled labor and improve competitiveness of the telecommunication sector.<br><br>***Measure taken in the next 12 months***<br>• **The National Telecommunication Commission (NTC) will implement e-licensing to promote the fair competition in telecommunication sector.** According to the NTC's implementation plan for 2007, the NTC plans to formulate license issuing policy that promotes competition, prevents the monopoly, and supports retail enterprises. The e-licensing will be implemented to create a transparent license issuing which is consistent with international standard. |
| B. | Reform of legal and judicial regime | ***Measure taken in the next 6 -12 months***<br>• **The Ministries are requested to submit their legal reform plan for this year by April 2007.** The National Legal Framework and Policy committee requested all the Ministries to submit their legal reform plan for 2007 within April 2007. The legal reform plan must be consistent with the current governmental policies. After the submission, the plan will be reviewed and proceeded following the legal process. |

| | Objective | Reform Measures Taken |
|---|---|---|
| C | Improve the skills and quality of labor | ***Measure taken over last 6 months and significance***<br>• **The Cabinet approved the strategic plan to develop labor skill in logistics sector in March 2007.** The strategic plan aims to enhance efficiency in trade facilitation, which leads to a reduction in logistics cost, and to create economic value added in the logistics industry as well as in the downstream industries.<br><br>***Measures to be taken in the next 6-12 months***<br><br>• **The Thai Vocational Qualification Institute (TVQI) will be established within 2007/2008.** As of March 2007, there has not been much progress in the establishment of the TVQI which was approved in September 2005. However, the committee of TVQI establishment expects to set up both the institute and the TVQ program within 2 years.<br>• **The strategic plans regarding the skill development of three more industries will be approved this year.** The strategic plans for three industries are pending for the cabinet approvals. These include vehicles, electronics and electrical appliances, and tourism industries. The main objectives of the strategic plans are to improve labor skills and thus enhancing competitiveness of these industries. |
| D. | Reduce tariff to improve Thailand's competitiveness | ***Measures taken over last 6 months and significance***<br>• **Additional MFN tariff reductions were effective on 1 January 2006.** According to the tariff reduction schedule approved in 2003, another 2.2 percent of total tariff lines will be part of the three-band system on 1 January 2007. These include, for example, iron and steel, copper, and plastic resin. As a result of these additional MFN tariff reductions, in January 2007, about 75 percent of the total tariff rates is under the three-band system i.e. 1 percent tariff rate for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods.<br>• **The Cabinet approved tariff reductions of NGV vehicle parts and tariff restructure of 20 items in February 2006.** Import tariffs of NGV vehicle parts were reduced to support the domestic assembly of NGV vehicles. These include, for example, vehicle parts for assembling CKD chassis with engine under HS8706, parts of new NGV combustion engines, CKD chassis with engine under HS87060020, and a natural gas container used for diesel and benzene engines. In addition, tariff rates of 20 items like blood containers for the Red Cross, ores, pearls, and iron sheet coated with plastic were also restructured. The new tariff rates will be effective once the Minister of Finance signs the ministerial order. |
| E. | Promote Thai exports to new markets | ***Measure taken over last 6 months and significance***<br>• **Thailand and Japan signed the Japan-Thailand Economic Partnership Agreement (JTEPA) on April 3, 2007.** This agreement is a comprehensive agreement covering trade in goods and services as well as investment. Once the agreement becomes effective, tariff rates of about 90 percent of total tariff lines will be reduced. These include, for example, frozen shrimps and fish, fruits and vegetables, wearing apparels, leather goods, textiles, and jewelry. In terms of trade in services, |

| | Objective | Reform Measures Taken |
|---|---|---|
| | | Thai investors will be allowed to expand businesses such as spas, hotels, and restaurants in Japan. As for investment, Thai investors will be allowed to invest in all industries except medicine, aerospace, oil production, energy, mining, fishery, agriculture, forestry and other related industries. This agreement is expected to be effective in October this year.<br><br>***Measures to be taken in the next 6 -12 months***<br>• **The tariff reduction according to the JTEPA will be effective in this year.** Thailand and Japan signed the JTEPA in early April 2007. It is expected to take about 6-8 months for domestic legal process before the agreement become effective which will lead to a tariff reduction of about 90 percent of total tariff lines.<br>• **The implementation of the agreement on trade in services is expected to be effective on 1 July 2007.** ASEAN member countries and China signed a framework agreement on trade in services in January 2007. The framework agreement is consistent with the General Agreement on Trade in Services (GATS) under WTO. This agreement will allow and facilitate Thai investors to expand their business in China.<br>• **A tariff reduction under the Early Harvest Scheme (EHS) between Thailand and Peru is expected to be effective in July 2007.** According to the protocol on the acceleration of liberalization on trade in goods and trade facilitation between Thailand and Peru, the two sides agreed to reduce the tariff rates of items in the Early Harvest Scheme once the agreement on rules of origin was signed. Thailand and Peru signed this agreement in November 2006 and thus leading to the tariff reductions of 50 percent of Thailand's total traded goods and of 54.6 percent of Peru's total traded goods on the effective date. Currently, we are waiting for Peru to complete its internal legal process of tariff reduction which is expected to be effective in July 2007.<br><br>***Measure planned to be taken but has been delayed***<br>• **Thailand-Bahrain FTA is likely to be renegotiated to include other members of the Gulf Cooperation Council (GCC) into the FTA.** In the recent leader meeting in June 2005, Bahrain would like to renegotiate the previous framework agreement to include other members in the GCC and thus the Early Harvest Program agreed previously should be delayed. |

Prepared by Wallada Atsavasirilert

## 4. Social Protection

| Objective | | Reform Measures Taken |
|---|---|---|
| A. | Develop social insurance mechanisms for the elderly and those affected by unemployment, work related injuries or other shocks to income | ***Measures taken in the last 6 months and significance***<br>▪ **Cabinet Resolution on November 14, 2006 approved annual capitation rate for the Universal Health Care.** The capitation rate for the year 2007 is Baht 1,899.69. The rates for the years 2004, 2005, and 2006 were Baht 1,308.54, 1,396.30, and 1,510.50 respectively.<br>▪ **The Cabinet agreed in principle on December 19, 2006 with the ministerial order to revise payment rates for old-age benefits for social security scheme (SSS).** Under SSS, members aged 55 or more who have contributed to the scheme for more than 180 months are entitled to the old-age benefits. The benefit payment is currently at 15 percent of the average of salaries in the last 60 months prior to retirement. An extra 1 percent is also granted for any additional 12 months of contribution beyond the required 180 months. The proposal by the Ministry of Labor will increase the 15 percent rate to 20 percent and the 1 percent rate to 1.5 percent accordingly.<br>▪ **The Cabinet Resolution on February 27, 2007 to promote employment/education opportunities and non-discrimination policy towards people living with HIV/AIDS and rehabilitated drug users.** The Cabinet overruled the requirement for recipients of government scholarships to have HIV testing, and also endorsed the new resolution which states that government agencies and state-owned enterprises cannot deny employment, education, nor termination solely because of HIV status or records of drug use.<br>▪ **The Tsunami Early Warning Arrangement in the Indian Ocean and Southeast Asia has been in operation from November 2006 onwards.** The Arrangement has been financed by the Tsunami Regional Trust Fund to which Thailand provided seed money worth USD 10 million. Other international donors and countries have also contributed. The Early Warning Center will be established within the proximity of Asian Institute of Technology situated in Bangkok to send warning information to Myanmar, Cambodia, Vietnam and Thailand.<br><br>***Measure to be taken in the next 6-12 months, but delayed***<br>▪ **The plan to extend the Social Security Scheme (SSS) to labor in the informal sector is being revised.** It was envisaged that the scheme would operate on a voluntary basis. However, concern on the long-term viability of the scheme – due to potential adverse selection effect arising from operating on a voluntary basis - and consultation with workers in the informal sector have prompted the Social Security Office (SSO) to revise the plan and technical details. Good collaboration among various agencies (SSO, Ministry of Finance, and Ministry of Social Development and Human Security) working on social security/welfare coverage to the informal sector has also been witnessed. Given the prevailing political uncertainty, the planned launch date of the scheme's extension has yet been determined. |
| B. | Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement | ***Measures taken in the last 6 months and significance***<br>▪ **Review of daily minimum wages for 2006 has resulted in new daily wage rates, effective since January 1, 2007.** The previous principal rate of Baht 140 per day was increased to Baht 143 per day, and different rates for 16 provincial groupings ranging from Baht 143-191 per day will be applied. |

| Objective | | Reform Measures Taken |
|---|---|---|
| | | ▪ **The Cabinet accepted the Working Plan of the Ministry of Labor in accordance with the Government's Policy.** There will be a Master Plan for 2007 which will also be used as a basis to develop a 5-year labor plan. The 2007 Master Plan is one of importance relating to the principle of a self-sufficient economy as set out in the10th National Economic and Social Development Plan (2007 - 2011). The labor plan contains 5 strategic procedures, including i) Assistance to those facing difficulties, ii) Transparency in labor management, iii) Quality labor development and placement, iv) United workforce for harmonic society, and v) Effectiveness of labor management.<br>▪ **Cabinet Resolution on February 20, 2007 approved the draft Ministerial Order on Management of Occupational Safety and Health and Working Conditions and Environment.** The legislation stipulates the scope and effective date of enforcement on establishments with 50 employees or more in certain industries, such as mining, petrochemical, petroleum, etc. It requires that such establishments, with participation of their workers, put in place a plan on occupational safety and health and working conditions and environment. In addition, establishments are required to develop preventive, emergency and response plans as well as investigative mechanisms which will be evaluated at least once a year.<br>▪ **The issue of bail-out fees for the migrant quota granted in 2006 was resolved.** The high bail-out fees which caused discontent among employers had prompted the Cabinet to set up a tri-partite working committee to resolve the issue. The solution was that employers who registered migrant workers in 2006 were not required to pay for the bail-out fees.<br>▪ **Arrangement of migrant labor system for 2007, proposed by the Ministry of Labor and in accordance with the resolution of Administrative Committee on Illegal Migrant Labors, was approved on December 19, 2006.** Work permits for migrant workers whose citizenships are those of Myanmar, Laos, and Cambodia will be extended for one more year to expire on February 28, 2008 and June 30, 2008. Medical examination for these migrant workers will have to be completed before August 15, 2007. |
| C. | Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support | ***Measures taken in the last 6 months and significance***<br>▪ **Cabinet Resolution on December 12, 2006 approved in principle of draft bill to control beggars as proposed by Ministry of Social Development and Human Security.** The main purpose of draft legislation is to control the beggars and to protect and provide welfare for underprivileged person in order to improve quality of life and ability to earn money for taking care of themselves. Under the new bill, any acts of forcing others to beg will be considered as a criminal offense, especially forcing children under 18 years old, the elderly people, and pregnant women.<br>▪ **Cabinet Resolution on January 9, 2007 approved the draft Ministerial Order on Proportion of Employment for People with Disabilities in Private Establishments.** Establishments with 200 or more employees are required to employ people with disabilities in the proportion of 200:1, and an additional person with disabilities for any remaining employees exceeding 100 or more. People with disabilities needing work can register at the Office of Welfare Promotion, Protection, and Empowerment of Vulnerable Groups, Ministry of Social Development and Human Security (MSDHD), or at provincial MSDHS offices. Establishments failing to comply will be required to contribute to the Rehabilitation Fund for People with Disabilities on an annual basis. The required contribution is calculated as half the local minimum wage multiplied by 365 and multiplied also by the number of people with disabilities that the establishments are required to hire. |

| Objective | | Reform Measures Taken |
|---|---|---|
| | | ▪ **Cabinet Resolution on February 6, 2007 approved the first draft of the 5-year Master Plan to establish a social welfare system for all Thais.** The Cabinet accepted the Master Plan and the Operating Plan covering the period from 2007 to 2011 as proposed by Ministry of Social Development and Human Security. The Plan is aimed to provide decent social welfare to all Thais by promoting harmonization and cooperation among various sectors to develop the social welfare system which is aligned to the objectives of the plan.<br>▪ **The Cabinet acknowledged the draft resolution for the rights of the handicapped in accordance with the 61st United Nations General Assembly as reported by Ministry of Foreign Affairs.** The Cabinet was informed about the 61st United Nations General Assembly (UNGA) confirmation of drafting a resolution for the rights of persons with disabilities between nations, as well as approving the signing of the resolution on 30 March, 2007, at the United Nations Headquarters, New York, USA. This understanding, through the Ad Hoc Committee on a Comprehensive and Integral International Convention on the Protection and Promotion of the Rights of Persons with Disabilities' (AHC), will benefit the promotion and protection of the rights of persons with disabilities worldwide. This will also confirm the importance that Thailand has in promoting and protecting human rights.<br><br>***Measure to be taken in the next 6-12 months***<br>▪ **The Consortium of Harmonization of Three Public Health Insurance Schemes organized by the National Health Security Office (NHSO) is formed and will be working to reach a consensus on steps towards to a sustainable financing healthcare for the whole population.** The consortium, with additional technical support from the World Bank/Ministry of Public Health Country Development Partnership on Health (CDP-H), will be working to reach consensus on realistic steps towards harmonizing fund management, core benefit packages, financing modalities for healthcare providers, and financial accountability arrangements to endure effective use of resources in the three public health insurance schemes – which include the Universal Health Coverage, Civil Service Medical Benefit Scheme, and Social Security. |

Prepared Kwanpadh Suddhi-Dhamakit

## 5. Public Sector and Governance Reform[41]

| | Objectives | Reform Measures Taken |
|---|---|---|
| A. | Improving public service quality by streamlining and redesigning work processes and procedures | ***Measure taken over the last 6 months and ignificance***<br>• Government Counter Service (GCS) and Service link Unit (SLU) have been widely set up in every province to provide better and more convenient services to the public. |
| B. | Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels | ***Measure taken over the last 6 months and ignificance***<br>• **The Decentralization Act No.2 (2006) had been approved by the National Legislative Assembly and announced in the Royal Gazette on January 8th, 2007.** The 2006 Decentralization Act has deferred the target year for which the local government revenues are to be 35 percent of the Central's Government. It sets that the amount of subsidy and the share of local government revenue to the total government revenue shall not less than 25 percent. |
| C. | Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation. | ***Measure taken over the last 6 months and significance***<br>• **The government will integrate the inspection process both from the Prime Minister Office and from each ministry into one inspection process.** It will also require state enterprises to be subject to the government inspection in the same manners as other government agencies. The report of inspection will be released annually and made available for the public review.<br><br>***Measure to be taken in the next 6-12 months***<br>• **The regulation on Controlling and Monitoring Civil Affairs in Provincial Government Offices is being reviewed by the State Council and is to be presented to the Cabinet.** The regulation will empower the Deputy Prime Ministers to oversee the management of provincial clusters. |
| D. | Improving governance in public sector through participation, accountability, and transparency | ***Measure taken over the last 6 months and significance***<br>• **On January 16, 2007, the cabinet approved the draft law on "criminal conflict of interests among politicians, government officials and the public"**. The proposed law defines the types of actions and criminal penalties on politician, and government officials including their spouses and relatives who have direct or indirect benefits on conflict of interest issues. The law also confines that any gift or cash given to politicians and government officials shall be treated as government properties. Any agreement which are signed by politicians or government officials and proved to be subjected to conflict of interest must be withdrawn. |

Prepared by Cheanchom Thongjen

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