World Bank Thailand Office
Country Director: Ian C. Porter
Chief Economist: Homi Kharas

Comments to:
Kazi M. Matin
kmatin@worldbank.org
Kirida Bhaopichitr
kbhaopichitr@worldbank.org

14th Floor Tower A
Diethelm Towers
93/1 Wireless Road
Bangkok 10330, Thailand
(662) 256-7792
http://www.worldbank.or.th

Acknowledgements

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

We would like to acknowledge input from Michael Markels and Renuka Vongviriyatham (Financial and Corporate Sector), Tanatat Puttasuwan (Corporate Sector and Business Climate), Behdad Nowroozi (Corporate Governance), Kaspar Richter (Poverty), Sethaput Suthiwart-Narueput (Public Sector Reforms), Khuankaew Varakornkarn (Poverty and Public Sector Reforms), Walker Hanlon (Competitiveness), Ana Revenga and Achariya Kohtbantau (Education), and John D. Blomquist and Nantaporn Ieumwananonthachai (Social Protection). Valuable comments and information were provided by officials of the American Chamber of Commerce in Thailand, Bank of Thailand, Board of Investment, British Chamber of Commerce in Thailand, Bureau of the Budget, Comptroller General's Department, Delegation of the European Commission to Thailand, Department of Trade Negotiations, Department of Exports Promotion, Department of Foreign Trade (Ministry of Commerce), EXIM Bank, Fiscal Policy Office, Fiscal Policy Research Institute, JETRO Bangkok, National Economic and Social Development Board, National Statistics Office, Office of Agricultural Economics, Office of the Public Sector Development Commission, Prime Minister's Office, Tourism Authority of Thailand, as well as by World Bank staff including Homi Kharas and Ian C. Porter.

ABBREVIATIONS

AFMIS	Agency Financial Management Information System
AFTA	ASEAN Free Trade Area
AMC	Asset Management Companies
BAAC	Bank for Agriculture and Agricultural Cooperatives
BAY	Bank of Ayudhya
BBL	Bangkok Bank
BOA	Bank of Asia
BOI	Board of Investment
BOT	Bank of Thailand
BPA	Budget Procedure Act
BT	Bank Thai
CB	Commercial Bank
CBC	Central Bankruptcy Court
CDP	Country Development Partnership
CDRAC	Corporate Debt Restructuring Advisory Committee
CEO	Chief Executive Officer
CEP	Closer Economic Partnership
CEPT	Common External Preferential Tariff
CGD	Comptroller General's Department
D/E ratios	Debt to Equity ratios
DAP	Directors Accreditation Program
DTDB	DBS Thai Dhanu Bank
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
ETA	Enterprise Training Advisory Body
EU	European Union
EXIM Bank	Export-Import Bank
FDI	Foreign Direct Investments
FFAA	Financial Fiscal and Accounting Act
FIDF	Financial Institutions Development Fund
FPO	Fiscal Policy Office
FRA	Financial Sector Restructuring Authority
FTA	Free Trade Area

FTAs	Free Trade Agreements
FTI	Federation of Thai Industries
GFMIS	Government Financial Management Information system
GHB	Government Housing Bank
GPF	Government Pension Fund
GSB	Government Savings Bank
GSP	Generalized System of Preferences
IAS	International Accounting Standards
ICT	Information and Communication Technology
IFCT	Industrial Finance Corporation of Thailand
IGAAP	International Generally Accepted Accounting Principles
IIP	International Investment Position
IMF	International Monetary Fund
IOD	Thailand Institute of Directors
KBANK	Kasikorn Bank
KTB	Krung Thai Bank
LEAs	Local Education Areas
LGOs	Local Government Organizations
LLR	Loan Loss Reserves
LRC	Legal Reform Committee for Development of Thailand
M&A	Mergers and Acquisitions
MCFD	Mediation Center for Financial Disputes
MDGs	Millennium Development Goals
MFN tariff	Most-Favored-Nation tariff
MOE	Ministry of Education
MOF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
NCC	National Competitiveness Committee
NCI	National Competitiveness Institute
NESDB	National Economic and Social Development Board
NP	Notice Pending
NPLs	Non-Performing Loans
OECD	Organization for Economic Co-Operation and Development
OPDC	Office of the Public Sector Development Commission

OSH	Occupational Safety and Health
OTOP	One-Tambon-One-Product
PCA	Public Company Act
PDC	Public Sector Development Committee
PDMA	Public Debt Management Act
R&D	Research and Development
RBM	Results-Based Management
ROSCs	Reports on Observance of Standards and Codes
SARS	Severe Acute Respiratory Syndrome
SCB	Siam Commercial Bank
SEC	Securities Exchange Commission
SES	Socio-Economic Survey
SET	Stock Exchange of Thailand
SFIs	Specialized Financial Institutions
SMEs	Small and Medium scale Enterprise
SP	Suspend Trading
TAMC	Thai Asset Management Corporation
TAS	Thai Accounting Standards
TEP	Teacher and Education Personnel
TMB	Thai Military Bank
TSD	Thailand Security Depositary Company
WB	World Bank
WDI	World Development Indicator
WEF	World Economic Forum
WTO	World Trade Organization
yoy	Year-on-year

TABLE OF CONTENTS

TABLES

FIGURES

BOX

SECTION 1

OVERVIEW

Thailand is poised to record the fastest growth-rate since the crisis. Rapid expansion in private consumption has been the chief driver, but private investment and exports have also grown faster than before. Policies to promote consumption and certain types of investment have been successful, as has macroeconomic adjustment to reduce external vulnerability. While private investment has continued its rise, private investment's contribution to growth has been weaker than in previous Thai recoveries. The challenge is now to convert this strengthening recovery into sustained high growth over the medium-term and for structural reforms to gain greater momentum.

Recovery and Outlook

Growth in 2003 is expected to reach an impressive 5.8 percent. This follows a growth rate of 5.2 percent in 2002 and 6.2 percent in the first half of 2003. The adverse impact of SARS on growth in the second quarter was much less than was originally feared. Also, in the fist half of 2003, private consumption grew by 6.2 percent, private investment by 12.4 percent and exports of goods by 11.9 percent, on a year-on-year basis, all substantially higher than was achieved last year.

Poverty has fallen below 10 percent, lower than in 1996. The latest survey for end-2002 shows that the poverty incidence fell to 9.8 percent, compared to 11.4 percent in 1996 and the peak post-crisis rate of 13.8 percent in 2000. Thailand has thus exceeded its two poverty targets– millennium development goal of halving poverty to 13.7 percent and the Ninth Plan objective of 12 percent – ahead of time.

Increase in real farm incomes was a key driver of poverty reduction in the Northeast, though other factors had a role. Given that two thirds of Thailand's poor lived in the Northeast region, the reduction in poverty incidence from 28.1 percent to 17.7 percent in that region between 2000 and 2002, was clearly a very significant factor in this remarkable overall performance. Agricultural growth rates of 2.7 percent and 0.5 percent in 2001 and 2002 made a relatively small contribution to poverty-reduction during this period, but higher crop prices relative to other prices boosted real farm incomes and benefited the poor. This argues well for 2004 when agricultural output is projected to grow faster and world commodity prices is expected to continue to rise, albeit more modestly. Movement of labor out of agriculture into better-paying off-farm jobs has raised income of the poor too. Public spending has had a favorable impact, though its quantitative impact is yet to be ascertained.

Sustained macroeconomic adjustment reduced external vulnerability further. Higher growth and poverty reduction has been accompanied by a current account surplus of around US$7 billion a year. This has kept foreign exchange reserves high at close to US$39 billion, equivalent to more than three times Thailand's short-term debt and to six months of its imports, and permitted the country to make pre-payments of its external debts. As of July 2003, total external debt has fallen to around $52 billion.

With exports estimated to grow by 12 percent for the whole year, the external sector remains robust. Like last year, Chinese and ASEAN markets contributed more than half of this export growth, but unlike last year, Japan, USA and Europe as a group contributed more than a quarter of that growth. In terms of export products, labor-intensive *components and parts* for vehicles, for other non-electrical machinery and for electrical machinery is estimated to account for more than two-fifths of the export growth in 2003. Their current share in total Thai exports to each of the following markets are as follows: more than 50 percent for ASEAN, more than 40 percent each for Japan, Europe, and the USA, and more than 35 percent for China. On the other hand, the share of traditional labor-intensive manufactures like garments, textiles, jewelry, and footwear in total Thai exports has fallen, despite recovery in their growth this year.

A significant shift in the composition of exports towards labor-intensive *components and parts for assembly elsewhere*, is underway. This trend received a boost with China's emergence as a global base for low-cost final production and assembly, following its WTO accession. Within Thailand, this shift is being supported mainly by the foreign-invested enterprises that are part of the well-integrated production networks in the region and elsewhere. There is however limited linkage of these firms with the small and medium Thai firms, but recent investment applications suggest that such linkage can be encouraged by further liberalization and improvement of the business climate.

Private investment has grown more than last year, with modest increases in gross inflows of foreign direct investment (FDI). Though higher residential construction and transport equipment explains a good deal of the private investment growth, manufacturing investment has begun to pick up with increased capacity-utilization. Eight sub-sectors have capacity utilization equal to or exceeding 80 percent and another nine exceeding 70 percent. The rise in foreign investment applications at the BOI in the first eight months of 2003 suggests that actual FDI inflows may increase in the future.

Nevertheless, private investment recovery appears weak on several other counts. First, the contribution of private investment to growth recovery during the post-crisis period (1999-2003) has been more muted than in the previous three Thai recoveries. Second, despite increases, the share of private investment in GDP has risen to only 15.5 percent this year, compared to an average of 22 percent achieved in the 1980s. Third, Thailand's private investment rate remains lower than countries in the region like Malaysia, Indonesia, Korea, and Singapore.

There are several reasons for this characteristic of private investment recovery. Investors are clearly more cautious now given their experience of the crisis, and excess capacity in the post-crisis period, following the investment boom in the pre-crisis years, also inhibited investment demand. Many firms in the corporate sector still suffer from fragile balance sheets. But even if excess capacity is reduced as is increasingly the case and corporate balance sheets improve further, investors may continue to be constrained by the cautious lending of private commercial banks to the corporate sector as well as by slower structural reforms that delay significant improvements in Thailand's competitiveness and increasing rates of return on investment in the country.

Better and larger bank lending to the corporate sector will be critical going forward. The recent corporate sector growth, driven mainly by the tradable sector, is being funded by internally generated finance, equity, bonds and some bank credit. Outstanding bank credit has increased only by 5 percent this year compared to 3 percent in 2002. With household credit growing at more than 14 percent, corporate sector credit growth remains constrained at around 4 percent this year. This is in part because corporate lending is still viewed as more risky than other forms of lending, and further strengthening of the legal framework for such lending is awaited.

The outlook for 2004 is good as recovery is expected to continue. Private consumption will continue to grow as real farm incomes rise, real interest rates remain low and the current tax-breaks for low-income earners are maintained. Despite the projected global recovery, export growth may not exceed this year's rate, in part because of pressures for the exchange rate to appreciate and in part because of capacity constraints that could become more binding. Given the current pace of private investment recovery and the uncertainty about how quickly investment decisions can be converted into additional operational capacity, export response could be constrained next year. Nevertheless, at the momentum of the ongoing recovery, a growth of around 6 percent is likely next year.

Implementation of structural reforms

Structural reforms made modest progress this year, as a fuller strategy to improve competitiveness continues to be developed. The National Competitiveness Committee (NCC) took several initiatives in building institutions, promoting niche sectors, and supporting SMEs. In particular, it has approved the establishment of a National Competitiveness Institute (NCI) under the NESDB, a venture capital fund for SMEs, funding for several tourism development projects and a project for improving productivity in the automotive sector through skills and systems development. Studies to benchmark Thailand's competitiveness and productivity growth potential as well as to examine several niche sectors have also been launched. Specific measures have been implemented with respect to trade, financial and corporate restructuring, corporate governance and public sector governance but few reforms have been implemented recently with respect to further business deregulation or reforms in non-bank and capital market areas.

Specific measures were implemented in the trade area as part of Thailand's continuing reforms. Import tariffs of 8 percent of the tariff lines, were reduced in the second half of this year, and more reductions approved by the Cabinet are under review by the State Council. This will further bring down the current average MFN tariff of 14.7 percent. Thailand is also negotiating several free trade agreements (FTAs), with the China-Thailand 'early harvest' program of zero tariffs for fruits and vegetables becoming effective this October. Though average Thai tariff on agricultural products of 25 percent is much higher than that on manufactures, the FTA is likely to open up this sector to more competition, spurring improvements in efficiency and productivity of the agricultural sector.

Financial and corporate sector restructuring made more progress this year. The health of the banking system has improved with increases in bank profitability and capital. However, the system-wide headline non-performing loans (NPLs) rate have not declined and re-entry NPLs have increased. On corporate restructuring, debt equity ratios below 2 and rising interest-coverage ratios suggest overall progress. Nevertheless, large firms' balance sheets remain weak, in part because of the lack of credible mechanisms to bring the large and heavily indebted firms to the table to restructure. Further steps were taken to improve corporate governance, continuing earlier trend. However, progress of reforms in banking and the capital market remained limited, as was the case with the implementation of legal reforms.

Fiscal consolidation continues. Rising revenues resulting from higher growth and restrained expenditures have advanced the date for reaching a balanced budget. Public debt has fallen to below 50 percent of GDP. Most of the stimulus measures have been credit-based with the exception of the tax cut for low-income groups, advance retirement benefits and tax breaks for housing. Initiatives that continued from last year include credit extension to SMEs, the Village Fund, the People's Bank, and debt suspension for farmers, funded mainly by SFIs and state-owned banks.

Reforms in public administration and in public expenditure management have also continued. Following the two public sector reform acts last year, the Royal Decree on Good Governance has been approved and nine ministries have implemented the new cluster management scheme this year as laid out in the Public Administration Act. Various acts with respect to budgetary management have been presented to the Cabinet and several changes in the budgetary processes have already been implemented; the financial management information system has also been put in place.

To convert recovery into sustained high growth over the medium-term, Thailand will have to improve its competitiveness and productivity. This will become more imperative as market pressures to appreciate the exchange rate will require productivity improvements to maintain Thailand's competitiveness and export growth. This means that the Government will have to continue its planned trade reforms and move more purposefully to deregulate the business environment further and to strengthen its knowledge economy. There are signs that increasing attention is being given to skills development, information and communication technology and reforms.

SECTION 2

RECOVERY AND OUTLOOK

2.1 Real GDP Growth

Thailand's recovery has strengthened further. GDP growth is expected to reach 5.8 percent in 2003, following a 6.2 percent rate of growth in the first half of this year and 5.2 percent, in 2002. The impact of SARS on second quarter growth was less than expected, largely due to sustained domestic expansion (see Box 1).

Growth in private consumption, private investment and exports made this possible. Private consumption (with automobiles, motorbikes, electronic goods and mobile phones making up more than half), is sustained by rising farm incomes, double-digit growth in consumer credit, and tax breaks for low-income earners, most of whom are in rural areas. Exports on the other hand are supported by faster growth in both new and existing markets. Japan, USA and Europe contributed almost a third of the export growth in the first half of 2003 after contributing almost nothing to export growth last year. Private investment continued double-digit growth, prompted in part by rising utilization of existing capacity, led by both consumption and export growth.

Sustained macroeconomic adjustment continues to reduce external vulnerability. The generation of current account surplus of around US$7 billion a year has kept foreign exchange reserves high at a US$39 billion, equivalent to three times Thailand's short-term debt and to six months of its imports. This has permitted the country to prepay external debt down to around US$52 billion by July 2003, a reduction of US$7 billion relative to December 2002.

This rate of growth is expected to be sustained next year, given the projected improvements in the global economy and higher commodity prices. Export and private consumption growths will make this possible. Private investment is expected to pick up further momentum as capacity utilization rises. The risks to this will depend in part on whether private commercial banks will expand their corporate sector lending and whether investors will be sufficiently attracted by the available returns on investment. Structural reforms to improve the secured transactions regime and to improve the business environment can help to ensure significant investment responses and strengthen investment.

Box 1. Economic Impact of SARS

The economic impact of SARS is expected to shave off only around 0.2 percent of this year's GDP growth. SARS broke out in the region in March and reached its peak in April. It was then anticipated to adversely affect tourism, private consumption, and exports. Its impact, however, is much less than originally expected mainly because the adverse impacts seemed to be contained in the tourism sector and concentrated in second quarter of this year. Even within the tourism sector, the impact was less severe than expected. Outbound tourism also saw a decline, which helped soften the decline in *net* tourism receipts.

SARS did not impact private consumption and exports as previously anticipated. Thailand's private consumption continued to grow robustly at 6 percent in the second quarter at the peak of the SARS epidemic. Real retail sales, in particular, rose steadily by more than 10 percent in both the first and second quarter of this year, partly due to exceptionally high growth in farm incomes, which grew by more than 20 percent year-on-year as a result of rises in both prices and outputs. The value of exports also increased by 16 percent year-on year in the second quarter of 2003, with growth of exports to China growing by an impressive 75 percent.

Inbound tourism receipts in the second quarter contracted by 27 percent, but this was less than expected. Tourism income year-on-year started to decline in March and bottomed out in May with a 45 percent decline before rebounding to positive growths in July and August. The year-on-year percentage decline in tourism income is reflected in an almost identical percentage decline in the number of tourists. In fact, spending per tourist remained steady in the second quarter, declining by a mere 1 per cent from that of the second quarter of 2002, defying gloomier predictions.

Fewer Thais travel abroad during the SARS outbreak. Outbound tourism expenditures began to decline in March and recorded a 15 percent year-on-year contraction in the second quarter. It has begun to rebound only in July. This resulted in a 40 percent decline in net tourism receipts in 2003Q2 before rebounding in third quarter.

In sum, the impact of SARS seemed to be contained in the tourism sector and in the second quarter of the year. As a result, net tourism receipts in 2003, which includes transportation fees to Thailand and expenses within Thailand, are estimated to decline by 3.6 percent year on year. This would reduce the share of net tourism receipts to GDP from 5.0-6.0 percent in previous years to 4.7 percent in 2003, and reduce GDP growth by about 0.2 percentage points.

Table 1. Impact of SARS on Tourism Receipts

(percent yoy)

	2002	2003				
		Q1	Q2	Q3p	Q4p	2003
Inbound tourism receipts[1/]	7.2	0.8	-27.0	1.4-2.3	10.5	-2.3
Outbound tourism receipts[2/]	12.4	6.2	-14.8	2.5-3.5	8.5	-0.2
Net tourism receipts	4.4	-1.4	-39.5	0.7-1.7	11.7	-3.6
Contribution to GDP growth	0.2	-0.1	-1.4	0.03-0.08	0.7	-0.2

Source: BOT and World Bank calculations

1/ Includes transportation fees to Thailand and expenditures in Thailand.

2/ Includes transportation fees out of Thailand and expenditures outside Thailand.

2.2 Poverty

Poverty has fallen below 1996 levels. The latest survey[1] for 2002 shows that at the purchasing-power adjusted national poverty line of US$1.50, Thailand's poverty incidence fell to 9.8 percent of the population last year, below the level of 11.4 percent in 1996 and the peak level of 14.2 percent in 2000. The absolute number of poor fell to 6.2 million in 2002, from 6.8 million in 1996 and 8.8 million in 2000. Other indicators of poverty – the poverty gap (average income shortfall of the poor compared to the poverty line), and poverty severity (a distribution-sensitive poverty indication) also fell.

Thailand exceeded its poverty targets ahead of time. The target of reducing poverty to 13.7 percent, to achieve the Millennium Development Goal (MDG) of halving the proportion of the population below the poverty line between 1990 and 2015, has been met ahead of time. The same is true of the more ambitious target of reducing poverty rates to 12 percent under the Ninth National Economic and Social Development Plan (2002-2006).

This performance is due to a dramatic reduction in poverty in the Northeast. In 2000, two-thirds of Thailand's poor lived in the Northeast and almost one in three people there were classified as poor, compared to only one in fourteen in the rest of Thailand. However, between 2000 and 2002, the poverty headcount in the Northeast fell from 28.1 percent to 17.9 percent, a decline of two-fifths in two years (see Table 2); the absolute number of poor in the Northeast fell from 5.9 million to 3.8 million, and the share of Thailand's poor residing in the Northeast dropped from 67 percent to 61 percent[2].

[1] Thailand Socio-economic Survey (SES) 2002

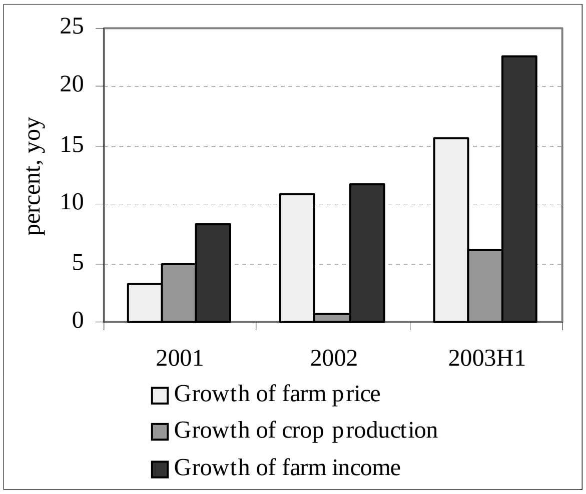
[2] Across all regions, consumption and asset ownership increased between 2000 and 2002, confirming the improvement in poverty numbers and general living standards. Progress in the Northeast was faster than other regions for some assets. For example, ownership of telephones, including mobile phones, increased from 0.09 to 1.04 in the Northeast, and from 0.26 to 1.07 in the rest of Thailand.

Poor people in the Northeast benefited from the large increases in real farm incomes, the movement of labor out of agriculture into better-paying off-farm employment, and increases in public programs that were directed to the rural areas since the crisis.

Sectoral growth rates explain little of the Northeast's poverty reduction during this period. Though living standards in the Northeast are more dependent on farming and animal husbandry, low growth rates in agriculture (2.7 percent in 2001 and 0.5 percent in 2002) relative to the non-agricultural sectors (1.8 percent and 5.8 percent respectively), led to a limited impact on poverty reduction (dropping from 28 percent to 27 percent in the Northeast, and from 7.1 percent to 6.7 percent in the rest of the country). In other words, the bulk of poverty reduction in the Northeast is not explained by sectoral growth rates.

Instead, a rise in relative prices of crops increased real farm incomes. Due to increases in world prices, prices of major crops, including rice, rubber, tapioca, palm, and oilseeds, rose and nominal farm incomes rose in both 2001 and 2002 (see Figure 1). The relative price of agricultural products to manufactures also increased. With low inflation, higher real farm incomes lifted household consumption and reduced poverty. Among farming households, poverty in the Northeast declined by more than in other parts of the country.

Figure 1. Changes in Farm Production, Price and Income



Source: BOT

Table 2. Poverty and Inequality in Thailand, 1996-2002

	1996	1998	2000			2002		
			Thailand	Thailand without Northeast	Northeast	Thailand	Thailand without Northeast	Northeast
Headcount ratio (%)	11.4	13	**14.2**	7.1	28.1	**9.8**	5.8	17.7
Gap (%)	2.8	3.3	**4.1**	1.9	8.3	**2.4**	1.4	4.5
Severity (%)	1.1	1.3	**1.7**	0.7	3.4	**0.9**	0.5	1.7
Poor ('000)	6,831	7,943	**8,874**	2,947	5,927	**6,215**	2,445	3,771
Gini	0.498	0.501	**0.500**	0.478	0.465	**0.501**	0.487	0.466

Source: Thailand Socio-Economic Survey (SES) 2002

Note: The poverty line used for the headcount ratio equals Bt30 per person per day, or US$ 0.70 or about US$1.50 in terms of purchasing power parity.

The shift out of agriculture into off-farm employment also contributed to increased real income of the poor in the Northeast. The share of households declaring rice farming as their main occupation declined from 26 percent to 22 percent, and the Labor Force Survey shows that the share of workers employed in agriculture declined from 44.2 percent to 42.5 percent over the same period. Economic growth appears to have promoted off-farm employment bringing supplemented cash wages, and higher income.

Table 3. Poverty in Northeast and Other Regions

Headcount Ratio (%)

	2000		2002	
	Thailand without Northeast	Northeast	Thailand without Northeast	Northeast
Farmers owning/ renting	17.8	42.4	12.2	26.3
Rice farmers	19.7	38.7	16.7	25.5

Source: SES 2002

Increased public programs especially at the grassroots levels, also contributed, though further analysis is needed to confirm its quantitative impact. For example, the Village Fund, a revolving fund of Bt1 million (about US$23,000), was established for each of the 70,000 villages[3]. The take-up was larger in the Northeast. Poverty rates among participating households are lower than non-participating households. For this data, it is however impossible to tell the actual contribution of the Fund to poverty-reduction; it could reflect the fact that better-off households took out more village-fund loans.

[3] Local committees grant loans to households at favorable interest rates which have to be repaid within one year. The Socio-Economic Survey 2002 included a question on household loans from the Village Fund.

Box 2. Development of Poverty Reduction Strategy for the Northeast

The Government plans to develop strategies for each region including the Northeast. Each regional strategy is expected to provide a framework with specific measures and an action plan that will be integrated into national policies. Currently, the National Economic and Social Development Board (NESDB), through its Northeastern regional office and under the guidance of a Deputy Prime Minister, has developed a Northeast regional strategy through a consultative process. The strategy focuses not only on the issues of poverty but also on the issues of enhancing regional competitiveness and achieving sustainable development, based on regional comparative advantage.

To assist the NESDB and its regional office in implementing the Northeast strategy, the NESDB's Northeast center and the NESDB, in close collaboration with the World Bank, will work together to conduct analytical work and reports that would serve as inputs into the Government's process of implementing a regional strategy and an action plan. Currently, a local consultant team is studying the current poverty situation in the Northeast, and a more elaborate work-program is under preparation by the NESDB. Future collaboration would include compiling a comprehensive comparative database for the Northeast, reviewing the success and failures of public actions, evaluating the contribution of various factors to the Northeast's economic situation, and implementing specific measures.

2.3 Improving External Environment

Developed country growth is expected to pick up mildly to about 1.8 percent in 2003, well below its longer run trend. After sharp slow down in growth in the last quarter of 2002 and the first quarter of 2003, all over the developed world, there is evidence of improving confidence, demand and activity, notably in the United States and Japan. In the *United States* second quarter 2003 growth picked up to 3.1 percent at an annual rate and business fixed investment showed the first robust growth in a while. In *Japan*, second quarter growth jumped to an unexpectedly high 3.9 percent helped by stronger growth in exports and in non-residential investment. However, Euro Area growth for 2003 as a whole is still only expected to reach around 0.5 percent.

Overall developed country growth could reach 3 percent in 2004, but there is a downside. This recovery is exposed to significant macroeconomic imbalances and structural weaknesses. A world recovery led by the United States will tend to further widen the already large US current account deficit, which could precipitate exchange rate instability at some point in the future. Japan has experienced a number of 'false dawn' economic recoveries over the last decade, and difficult structural reforms will be needed to revitalize growth in Europe. Interest rates have already been pushed near zero and sharply higher fiscal deficits will likely constrain the ability of governments to continue expansive counter-cyclical fiscal policies of recent years.

Primary commodity prices are expected to increase by 7 percent in 2003 but more modestly in 2004. This is driven by the recent fall in the US dollar, specific supply conditions in individual commodities, and improving outlook for stronger world growth. Thailand has enjoyed rising prices since 2002 for rice, coconut oil, palm oil, and rubber and should see that continued for some of them, given the projected global recovery.

2.4 Export Performance & Outlook

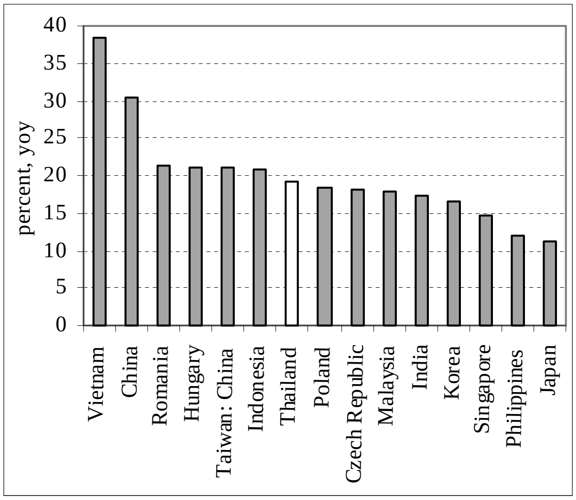
Export in 2003 out-performed that of last year. In the first 8 months, export earnings grew by nearly 17 percent year-on-year, and export volume rose by 10 percent. Thailand is doing better than its regional competitors like Malaysia, Philippines and Singapore (see Figure 2) but not as well as China and Taiwan or Eastern European countries like Romania and Hungary. It is estimated that export earnings will grow by around 12 percent in 2003.

Regional markets dominate export growth, even as USA, Japan and Europe pick up[4]. China and the ASEAN markets contributed 44 percent to Thai export growth as of August 2003 (see Figure 3), with exports to China growing at more than 75 percent year-on-year (see Figure 4), three times as fast as last year. Exports to the US, Japan and the European Union (EU) are growing again and accounting for 27 percent of Thailand's export growth this year, compared to their negligible contribution last year.

Export growth to the EU market is especially strong this year. Overall, exports to Europe grew at around 15 percent in the first eight months of 2003, year-on-year, compared to minus 9 percent last year, helped in part by supportive measures taken by the European Union (EU). The revocation of the 100 percent testing of Thai consignments of poultry contributed to the increase of 26 percent in poultry exports to EU. The readmission of products into its Generalized System of Preferences (GSP) tariffs from January 2003 has helped too.

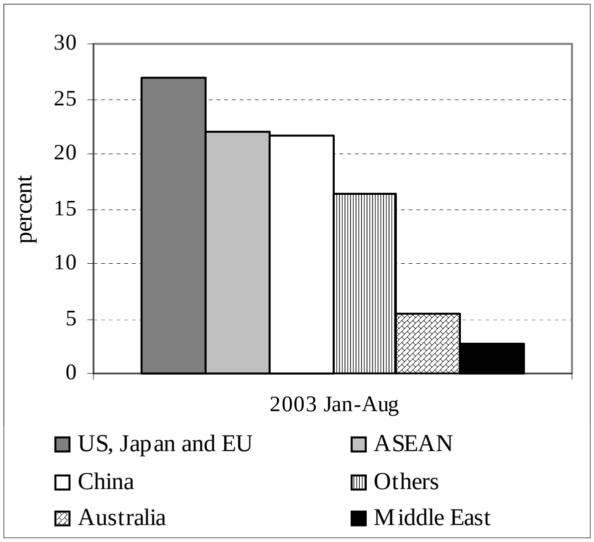
Components and parts of machinery contributed more than half of the export growth in 2003. This includes parts of vehicles, of other non-electrical machinery and of electrical machinery (for assembly elsewhere) accounting for nearly 42 percent of total exports and growing at around 22 percent this year. More traditional manufactured exports of garments, footwear, and jewelry grew at 7 percent this year, better than the negative growth last year. Rubber was the main driver of agricultural exports, growing at around 80 percent in the first 8 months of 2003, with most of it going to China.

Figure 2. Export Growth Rates of Selected Countries in 2003



Source: Direction of Trade, June, 2003

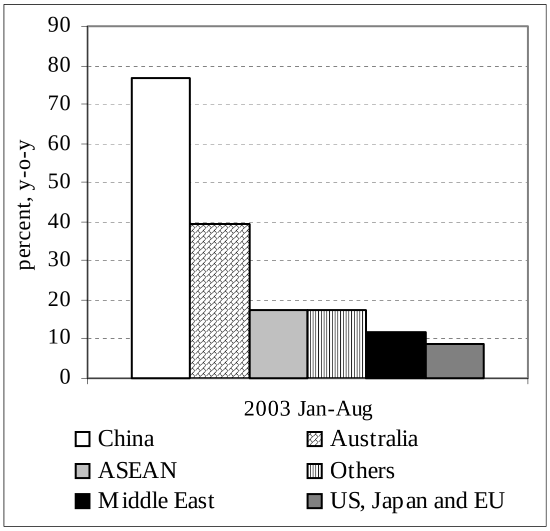
Figure 3. Contribution to Export Growth by Various Markets, January to August 2003



Source: BOT

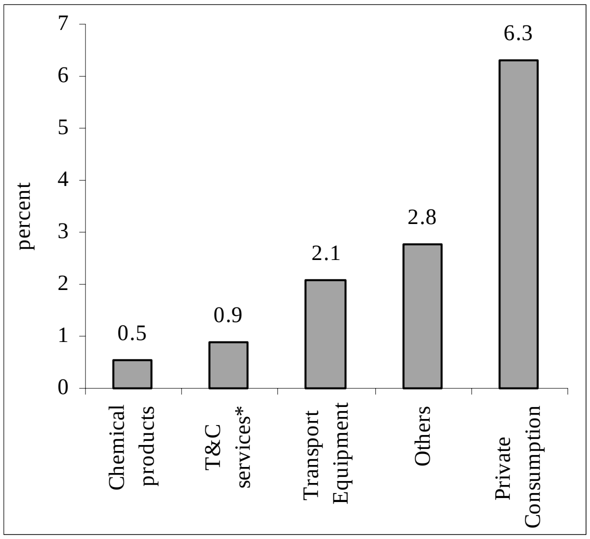
[4] China and ASEAN countries comprise more than a quarter of Thailand's export market, with USA, Japan and Europe comprises around half.

Figure 4. Export Growth Rates in Various Markets, January to August 2003



Source: BOT

Figure 5. Contribution to Private Consumption Growth, 2003H1



Source: BOT

*Transport and communication services

Export growth in 2004 is unlikely to exceed this year's rate. Global demand for Thai exports will clearly improve next year, as the economies of US and Japan pick up and the Chinese economy continues to expand rapidly. But other factors are less propitious. The exchange rate is likely to appreciate next year, given the willingness of the Government to let the market determine the rate and strong market pressures for a correction. This will clearly slowdown export growth. Also, more sectors will reach fuller capacity utilization and this capacity constraint is likely to become more binding in several export sectors. Though investment applications to the BOI have risen by a third, there is uncertainty on how quickly these intentions can be converted into additional capacity that is needed and whether there will be an adequate investment response in several of the sub-sectors.

2.5 Household Consumption

Real household consumption grew by 6.3 percent in the first half of 2003. The Consumer Confidence Index[5] was at a record high in July 2003. Increases in farm incomes (see Figure 1), expansion tax-breaks for low-income earners, low real interest rates, end consumer credit have supported this consumption boom. Transport equipment, electrical appliances, mobile phones, and telecommunication services, contributed more than half of this growth (see Figure 5).

Expansion in consumer credit[6] underpins consumption growth. Low real interest rates, averaging at around 4 percent in 2003, and revival in growth of disposable income have encouraged consumers to borrow. Banks and financial institutions are willing to extend consumer loans through credit cards, personal loans and loans for purchases of durable goods, given the difficulties in corporate lending. Consumer credits have increased by 20 percent year-on-year in July and are expected to grow equally robustly for the whole year (see Figure 7).

---

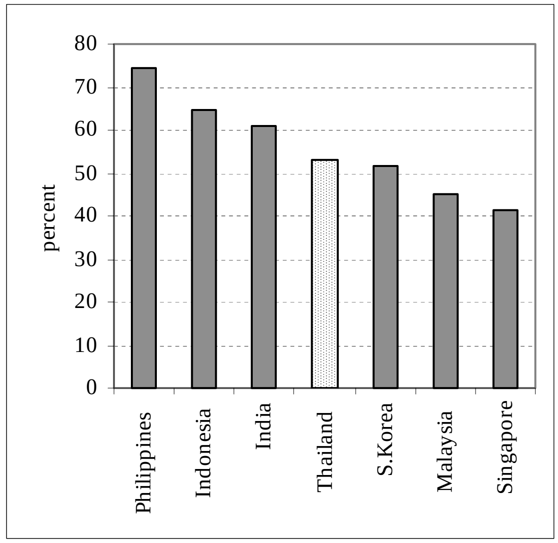
5 Consumer Confidence Index is produced monthly by the University of Thailand, Chamber of Commerce.

6 Consumer credits do not include mortgages.

Total household financial sector debt has been rising steadily since 2001 with share of consumer credit in it higher than before. Household debt to GDP will reach 20 percent this year, lower than in Malaysia and Korea where they reached around 50 and 70 percent in 2002, respectively[7]. Consumer credit, which is not supported by fixed assets as mortgages, has risen to about one-fourth of that debt. If interest rates rise and growth in disposable income slows down, servicing of consumer debt will become problematic.

Private consumption is expected to continue growing. Sustained growth in real farm incomes next year, continued tax-breaks for low-income households, and consumer credit growth will maintain private consumption growth next year.

Figure 6. Cross-Country Comparison of Household Consumption to GDP, 2002

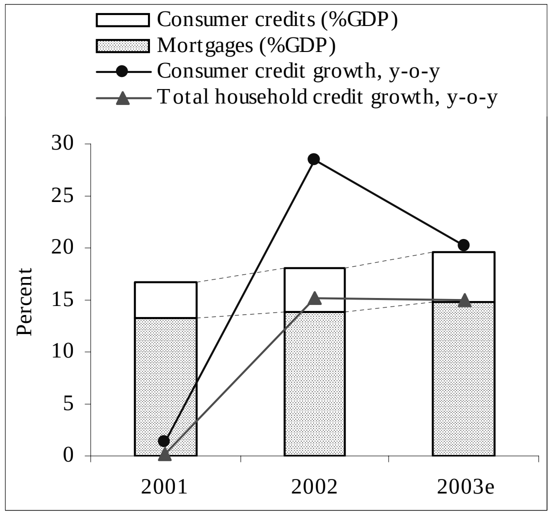


Source: WDI

2.6 Private Investment

Private investment is growing faster this year, after growing by more than 17 percent in the first half of 2003. Residential construction and transport equipment[8] have been driving this growth. Private residential construction grew by 32 percent in 2002 and by almost 20 percent in the first half of 2003, as households take advantage of low interest rate, loans and tax incentives that is expected to expire at the end of this year. Transport equipment purchases expanded at a high rate of nearly 25 percent in the first six months of this year. Thus, private investment, excluding residential construction and transport equipment is growing at a slower rate.

Figure 7. Household Credits from the Financial Sector*



Source: BOT

*Commercial banks, GHB, and GSB

2003 is annualized

Nevertheless, the pace of investment recovery compares unfavorably on several counts. First, its contribution to real GDP during this recovery (1999-2003) is less by a quarter relative to its contribution in the earlier recoveries in Thailand (see Table 4). Its share in GDP has only reached 15.5 percent this year, the highest since the crisis, but well below the average of 22 percent that Thailand reached in the 1980s. Also, it is lower than the current private investment rates in Malaysia, Philippines, Singapore, Korea and Indonesia (see Figure 9).

---

7 2002 data from Goldman Sachs

8 Transport equipment includes trucks, vans, company cars, boats, ships, and airplanes. Sixty percent of the total number of pick-up trucks are included as investment while the remaining are categorized as consumption.

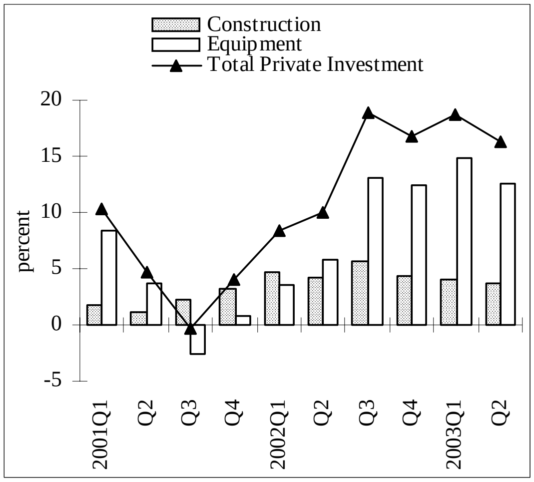
Table 4. Contribution of Private Investment to GDP Growth 1/

	Net export	Government	Private consumption	Private investment	Stock accumulation and statistical discrepancies
Typical expansion 2/	-0.16	0.25	0.54	0.36	0.02
1999-2003	0.09	-0.07	0.63	0.27	0.08

Source: Mallikamas, Thaicharoen, and Rodpengsangkaha, " Investment Cycles, Economic Recovery & Monetary Policy", 2003. Calculations for 1999-2003 average contribution to real GDP growth have been computed by the World Bank, using GDP growth estimates for 2003. 1/ Unweighted average 2/ Average of 3 cycles: 1966-1969, 1976-1978, and 1987-1996

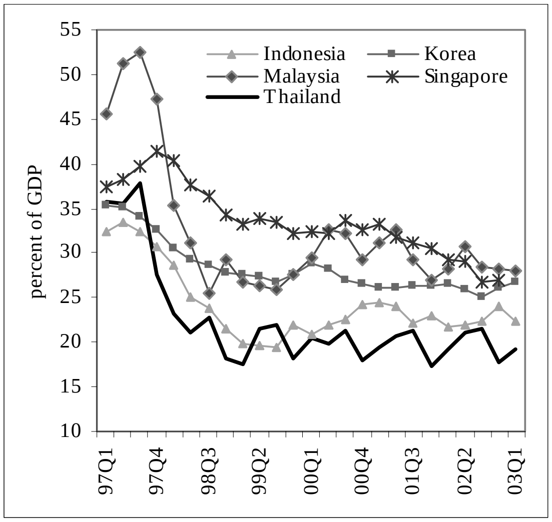
Slower recovery of private investment has many reasons, including slow structural reforms. Investors are clearly more cautious now, both because of their experience during the crisis, but also because there has been considerable excess capacity in the post-crisis period, following the investment boom that occurred in the pre-crisis years. Many firms in the corporate sector still suffer from fragile balance sheets. But even if excess capacity is reduced as is increasingly the case, and corporate balance sheets improve further, investors may continue to be constrained by the greater caution of private commercial banks in lending to the corporate sector and by the slow structural reforms, the latter delaying the strengthening of Thailand's competitiveness so as to reverse the rise in the rates of return on investment in recent years.

Figure 8. Contribution of Equipment and Construction to Private Investment Growth



Source: BOT

Figure 9. Cross Country Comparison Total Investment to GDP



Source: Mallikamas, Thaicharoen, and Rodpengsangkaha "Investment Cycles, Economic Recovery & Monetary Policy", 2003.

There have been increases in capacity utilization, with eight sectors exceeding 80 percent today. Tires, petrochemicals, integrated circuits, zinc metal, and pulp have exceeded 90 percent utilization rates. Similarly, galvanized iron sheets, hot and cold rolled steel, batteries as well as motorcycles have attained 80 percent while another 8 sub-sectors have exceeded the 70 percent utilization rate. All 17 of these sub-sectors are close to, or above the rates that were attained before the crisis (see Table 5). To the extent excess capacity was a constraint on a strong private investment recovery, it will be considerably relaxed in 2004 and beyond. But the same cannot be said of the other constraints cited above.

Bank lending to the corporate sector remains restrained. Recent corporate sector growth, driven mainly by the tradable sector, is being funded mainly by internally generated finance, equity and bonds; bank credit is funding only around a quarter. Outstanding bank credit increased by 5.5 percent this year compared to 3 percent in 2002[9] (less than 2 percent in 2002 excluding financial institutions lending). With household credit growing at around 14 percent annually, corporate sector credit growth has not exceeded 4 percent this year.

Private domestic banks have been less active than state banks in lending to firms. During the first half of 2003, the three largest private banks' corporate loans have increased by only 1.5 percent, housing loans by 17.6 percent and total loans by 6.7 percent. Credit risk on mortgage lending, is perceived to be relatively low compared to corporate credit, even though it takes years to foreclose on houses. Total loan is growing (excluding loans to other sectors and financial institutions) by the two largest state banks at 26 percent, an annualized rate of this year, with corporate loans increasing by 29 percent and housing loans at 25 percent.

Demand for bank-credit from Thai firms is expected to increase as recovery proceeds. Estimated private investment could be Bt one trillion in 2003. A portion of this private investment can be funded by internal cash flow. Since growth in private investment is exceeding growth in corporate internal cash flow based on current situation in 225 listed firms, firms will soon have to look for funding from banks. The size of this demand will rise with time as in the case over the last four years (see Figure 10). If private banks continue to view corporate lending as high credit risk – because legal framework for contract enforcement is not sufficiently efficient – then private investment recovery could be dampened. Improving credit infrastructure is vital to reducing this risk.

Table 5. Capacity Utilization by Sector, January-August, 2003

(Percent)

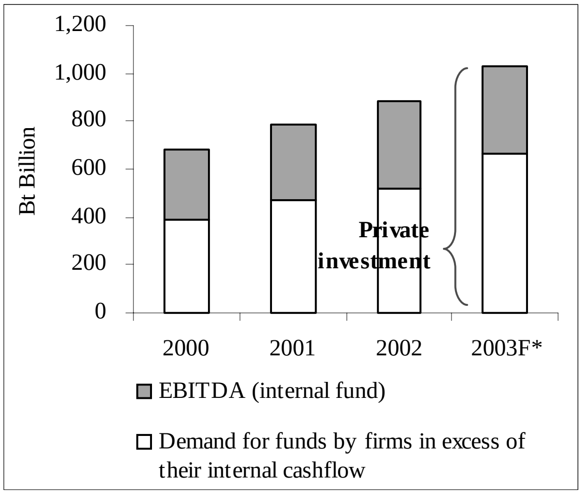
	Average (1995 Jan-Aug & 1996 Jan-Aug)	2002 Jan-Aug	2003 Jan-Aug
CU in 2003Jan-Aug >90%			
Tire	88.3	91.9	103.8
Upstream petrochemical	74.7	79.7	103.1
Integrated circuit	75.0	77.9	102.3
Zinc metal	92.1	94.9	98.7
Pulp	77.6	88.8	96.0
80%<CU in 2003Jan-Aug<90%			
Galvanized iron sheet	69.7	88.9	89.5
Motorcycle	79.3	59.9	85.7
Battery	82.4	71.5	80.7
70%<CU in 2003Jan-Aug<80%			
Hot & cold rolled sheet	49.1	77.5	79.5
Synthetic fiber	86.8	83.0	77.4
Block rubber	77.1	59.8	74.6
Compressor	67.4	71.7	72.2
Wire rod	60.6	75.3	72.0
Glass sheet	95.3	62.4	71.4
Milk products	64.4	66.7	71.1
Canned seafood	44.7	56.2	71.1
Electric motor	89.0	58.0	70.8

Source: BOT

Private investment recovery may also be constrained by insufficient improvements in Thailand's competitiveness. The Government has performed remarkably well in stimulating the economy and in implementing macroeconomic adjustment to reduce external vulnerability. It has also implemented significant structural reforms in the early post-crisis years in trade, business environment, banking, sectoral deregulation and so on. More recently, the Government established a high-level National Competitiveness

[9] Loans of commercial banks are based on reported loans on Table 14 of the BOT Economic and Financial Statistics excluding lending to financial institutions. The effect of technical changes is excluded when estimating loan growth. These technical changes are caused by write-off, write-back, transfers to AMCs, and redemption of AMCs' promissory notes, which are estimated by the BOT Montary Policy group.

Figure 10. Private Investment and Funding



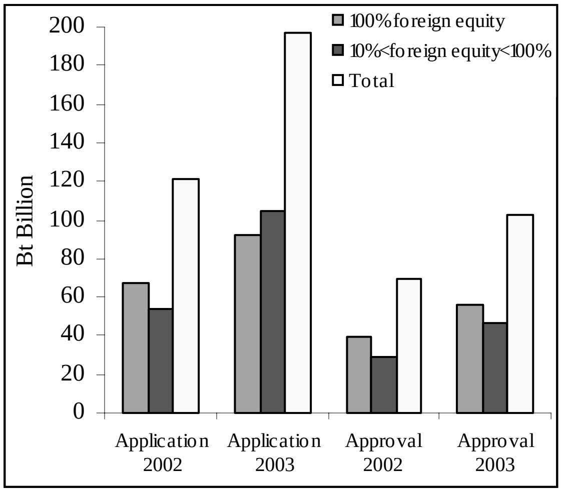
Source: the BOT, the World Bank's estimate

Note: Each bar represents total private investment.

Total private investment in 2003 is estimated based on 16% growth. A portion of private investment is funded by firms' internal cash flow, estimated by using EBITDA of 225 non-financial listed firms, with the assumption that the EBITDA of listed firms accounted for 80% of total EBITDA of all firms. The remaining has to be funded external to the firm.

* annualized

Figure 11. BOI FDI Applications and Approvals, January-August



Source: BOI

Committee (NCC), a year ago, to develop a comprehensive competitiveness strategy, and numerous projects and studies are underway. But actual implementation of structural reforms to improve competitiveness and efficiency over the last 12 months has been few. Even in the five sub-sectors chosen by NCC for special attention, few sectoral measures have been taken, though preparation to do so is well advanced. There have however been important measures to reduce import tariffs and to promote exports; and education reform is receiving increased emphasis.

Fortunately, there are modest signs of increased investor interest, especially foreign direct investment. As capacity utilization has improved, total value of investment applications to the BOI for accessing available incentives have risen by 36 percent in the first 8 months of this year compared to that of 2002 (see Table 6), albeit from a relatively low base. Applications from foreign firms[10] in the same period

Table 6. Sector Share in Total BOI Applications

(Percent)

	Applications	
	2002 (Jan-Aug)	2003 (Jan-Aug)
Total (Bt billion)	**166.2**	**227.6**
Metal products, machinery and transport equipment	23	25
Chemical, paper and plastic	7	21
Electronics and electrical appliance	13	16
Services and infrastructure	9	15
Mining, ceramics and base metal	1	9
Agriculture	40	8
Light industry	6	7

Source : BOI

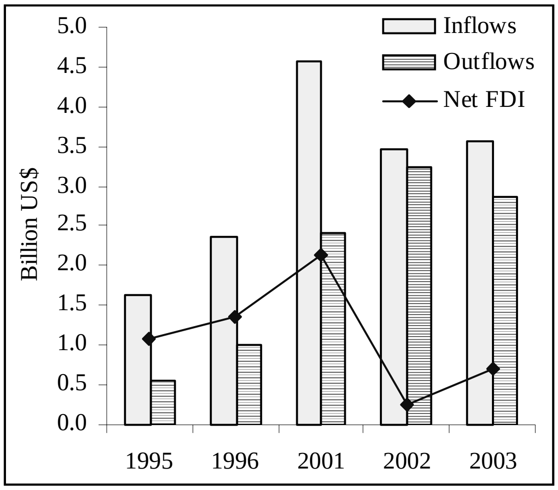
[10] Firms with 10 percent or more foreign share holdings

have increased by more (see Figure 11). They have been mainly in three areas – machinery and transport equipment; chemicals, paper and plastics; and electronics, and electrical appliances – areas that have seen the fastest demand growth from domestic consumers and the export market. Approvals of the applications have also increased after declining continuously since 2000. The metal, machinery, and transport equipment and the electronics and electrical appliance sectors alone have received over 60 percent of the total approved applications in the first 8 months of this year.

Net FDI[11] inflows[12] in the balance-of-payments have rebounded, largely due to a fall in outflows (see Figure 12). There is a modest increase in actual *gross inflows* in the first 8 months of this year, reconfirming improving perception about Thailand among foreign investors.

Foreign investors perceive Thailand as a better place in 2003 than in 2002, but it is still 16th among 60 countries[13]. Surveys of foreign investors generally indicate that the main drawbacks to their establishment of production and operation bases in Thailand are the poor skills and low productivity of labor, the legal system of contract enforcement and the red tape[14], including slow port and customs clearance. Uncertainties on the legal system raised doubts over investor protection and recourse to arbitration, with public officials frequently cited as giving more favorable treatment to domestic companies than to foreign rivals. Future structural reforms will be key to improving Thailand's attractiveness to investors.

Figure 12. Inflows, Outflows, and Net FDI, January-August 1995-2003



Source:BOT

There are gaps in the existing data on FDI. This makes it difficult for the Government to develop a comprehensive view of the real size of foreign investment in a particular year as well as changes in it year to year. The inflow and outflow numbers recorded by BOT in the balance of payments does not include investments by existing foreign-invested firms to expand capacity financed either by re-invested earnings or by domestic borrowing. Thus if that form of FDI becomes a larger share of total FDI, which some believe has been the case in recent years, the recorded change in FDI will be incorrect. The national accounts data on gross investment is unable to separate foreign investment from domestic investment (see Box 3), so it is currently not possible to have an accurate estimate of the share of FDI in gross investment in Thailand each year, or to make an estimate of foreign-owned capital stock at any point in time.

---

11 FDI statistics in Thailand includes foreign equity investment in and direct loans from affiliate companies of firms with 10 percent or more foreign share holdings. It does not include re-invested earnings by foreign firms.

12 Inflows refer to inflows of investment by foreign investors. Outflows refer to outflows of investment by foreign investors (it does not refer to Thais investing abroad).

13 A.T. Kearney FDI Confidence Index 2002 and Oxford Analytica, Thailand: Strong Supplier Ties sustin FDI Flows, October 1st, 2003

14 Oxford Analytica, Thailand: Strong Supplier Ties Sustain FDI Inflows, October 1st, 2003.

Box 3. Understanding FDI Statistics in Thailand

The two main sources of information on FDI in Thailand to date are the Bank of Thailand and the Board of Investment. It appears that the data from these sources do not cover FDI comprehensively. This box tries to clarify these issues.

Foreign direct investment (FDI) statistics normally records 3 main components: (1) Equity investment[15], (2) loans from affiliated companies[16], and (3) re-invested earnings of foreign firms[17]. The frequently cited FDI figures for Thailand are the monthly inflows and outflows of FDI[18] as reported in the balance of payments by the Bank of Thailand. However, this balance of payments data does not capture FDI in the form of re-invested earnings of foreign firms.

Attempts are currently underway to collect and report the re-invested earnings of foreign firms. The Bank of Thailand conducted the annual International Investment Position (IIP)[19] Survey for the first time in 2001. The Survey includes questions on foreign direct investment, which includes foreign firms' re-invested earnings. While some of the Survey results are available on the BOT's website[20], the disclosure of the re-invested earnings data is still under consideration. When this information is disclosed, Thailand's annual FDI data will be comprehensive and consistent with the international definition of FDI.

The other source of public information on FDI in Thailand is the Board of Investment (BOI). The BOI disseminates data on investment applications, approvals, certificates issued, and start-ups of domestic and foreign firms. Two points on the BOI information are worth noting: (1) FDI data available at the BOI are only a subset of total FDI in Thailand as the firms that apply for the BOI's incentives are in only a few industries to which the BOI provides relatively higher incentives e.g. the electronics and the machinery and equipment industries and (2) beginning in October 200,2 start-ups of the promoted firms is recorded only when the investment has been *completed.* Thus, its coverage is limited by design.

The extent to which FDI contributes to private investment currently remains unclear as the information collected on private investment on the national accounts basis[21] does not allow segregation of foreign investment from domestic investment. In addition, expansion of capacity in foreign-invested firm, financed by domestic borrowing, is to date unavailable.

---

15 Investment in equity is treated as a direct investment when the direct investors owning 10 percent or more of ordinary shares or voting power for an enterprise or the equivalent for an un incorporated enterprise.

16 Loans from affiliated companies refer to borrowing or lending of funds between direct investors and subsidiary branches and associates. This excludes inter-office loan to and/or from finance companies.

17 Re-invested earnings is defined as investment earnings neither distributed as dividends nor remitted to direct investors.

18 FDI inflows and outflows refer to those that are conducted by foreign firms.

19 The IIP shows, at a particular point in time, the stock of an economy's external financial assets and liabilities, which a resident of the compiling economy engages with non-residents. The IIP comprises of several types of capitals featuring direct investment, portfolio investment, financial derivatives, other investments (such as loans, deposits, and trade credits) and reserve asset.

20 www.bot.or.th/bothomepage/databank/EconData/IIP/iip_e.htm

21 This refers to the domestic investment in Thailand's GDP.

2.7 Improving Competitiveness

Thailand's competitiveness ranking has improved in 2003, but remains below many of its competitors in the region[22]. This has been the result of recent strong macroeconomic stability and performance. On the other hand, slow developments in science and technology and skills are factors constraining Thailand's competitiveness.

However, cross-country comparisons show that the costs of doing business in Thailand are high. Comparisons with countries in East Asia and emerging markets in Eastern Europe show that to start up a business in Thailand would take an average of a month and a half while it takes a month in Malaysia, Poland, and Bulgaria and only 8 days in Singapore[23]. The costs of establishing a business in Thailand in terms of regulations and fees[24] involved are, however, lower than those of other East Asian countries, except for Singapore, Taiwan, and Hong Kong. The costs associated with hiring and firing workers[25], on the other hand, are one of the highest in the region. Hiring terms are quite inflexible with limited part-time and fixed term contracts, and the terms of employment impose a higher cost relative to most other countries in the region. The costs associated with enforcing contracts[26] are also higher than those of most countries in the region – twice that of Singapore and three times that of Vietnam. Closing a business in Thailand takes on average 2.6 years with associated costs of about 38 percent of the insolvency estate value, while in Poland and Malaysia it takes 2.2 years, and costs about 18 percent of the insolvency estate value.

Thailand's business environment could be much further enhanced to attract investments and increase competitiveness. Government effectiveness, regulatory quality[27] and corruption are key business environment factors that affect the performance of firms and investment decisions. According to a compilation of indicators drawn from 25 sources[28], Thailand ranks below Singapore, Malaysia, South Korea, Taiwan, and Hong Kong in all of these factors. In the area of control of corruption, Thailand ranks lower than almost half of the total 199 countries in the study. Thailand's low rank on the effectiveness of the Government and regulatory quality are consistent with the World Economic Forum (2003)'s ranking on quality of public institutions, where Thailand ranks 39 out of the 80 countries surveyed.

While Thailand has embarked on efforts to improve its competitiveness, more remains to be done to sustain the momentum of reform and ensure the implementation of reform measures. Thailand has taken measures to reform the education system and is expected to continue this reform program (Box 5). However, more needs to be done to enhance the business environment to make big business less costly, increase firm-level R&D, promote innovation systems, improve skills, and increase investment in ICT through liberalizing telecommunications.

---

22 Based on World Economic Forum (2002) and International Institute for Management (2003)

23 From *Doingbusiness* database http://rru.worldbank.org/doingbusiness/ which includes 133 countries covering the period of 2002 and 2003.

24 In all cases, costs and fees excludes bribes.

25 This includes the flexibility of hiring and firing and the conditions of employment (mandatory minimum daily rest, maximum number of hours per normal work week, premium for overtime work, minimum wage, etc.)

26 This includes court costs and attorney fees, as well as payments to other professionals such as accountants and bailiffs.

27 Government effectiveness refers to the quality of public service provision, the quality of the bureucray, civil service competence, the independence of the civil service from political pressures, and the Government's commitment to policies. Regulatory quality refers to extent of business harming regulations as well as burden of regulations on foreign trade and business development.

28 The governance indicators are compiled by Kaufmann, Kraay, and Zoido-Lobaton (2003). The indictors draw from 25 different data sources constructed by 18 different organizations worldwide and covers 199 countries. They are available at www.worldbank.org/wbi/governance/data.html

Box 4. Recent Progress in Education Reforms

Sparked by the 1999 National Education Act, Thailand's education reform program is moving forward. The reform covers 4 main areas: (1) administrative and structural reform, (2) learning reform, (3) personnel reform, (4) reform of resources and investments for education.

After the promulgation of the Ministry of Education Administration Act in July 2003, the Ministry has restructured the 17 existing departments and offices in to 5 offices[29], under the direct supervision of the Office of the Minister of Education. This is a step towards maximizing effectiveness and minimizing duplication of functions among departments. In addition, 175 Local Education Areas (LEAs) have been identified for a greater autonomy in administrating and providing basic education.

As first steps in implementing learning reform, five new school designs have been piloted in the first semester of the 2003 academic year[30]. They are the Autonomous schools, Bhuddhist way schools, Schools for Gifted Children, Bilingual schools, and Information and Communications Technology schools. These are aimed at promoting new ways of learning that involve new content, methods, and tools of teaching and learning as well as school management. Core curriculums for basic education have been developed for Pratom 1, Pratom 4, Mattayom 1, and Mattayom 4[31], and are used in every school in the 2003 academic year.

A reform program for the salary structure for licensed Teacher and Education Personnel (TEP) has been submitted to the Cabinet. The reform includes increases in the number of salary columns from two to five columns, with the maximum salary level of column 5 being the highest salary. Teachers wanting to remain in a column or move to a column with a higher salary would require evaluation after a certain number of years.

For the provision of basic education, the Ministry of Education has decided to subsidize students from pre-primary level to upper secondary level. Subsidies per student based on the level of schooling and geographical area have been computed. Currently, the MOE seems to be in agreement with the Cabinet to support a 15-year proposal (100% subsidies from 3-year kindergarten to Mattayom 3. For upper secondary level, the general stream (Mattayom 4-6) will be 50% financed while the vocational stream will be 100% financed). At present, the MOE is finalizing the proposal and supporting documents to be submitted for the Cabinet's review.

[29] Office of the Permanent Secretary, Office of the Basic Education Commission, Office of the National Education Commission, Commission on Higher Education and Office of the Vocational Education Commission

[30] First semester is from May-September. Second semester is from November-March.

[31] Primary Education - Pratom 1 - 6 (Grades 1 - 6)
Lower Secondary Education - Mattayom 1 - 3 (Grades 7 - 9)
Upper Secondary Education - Mattayom 4 - 6 (Grades 10 - 12)

SECTION 3

IMPLEMENTATION OF STRUCTURAL REFORMS

Structural reforms are making modest progress, even as a fuller strategy to improve competitiveness continues to be developed. The National Competitiveness Committee (NCC) has begun to take action in selected areas. In attempts to boost Thailand's competitiveness, the NCC has commissioned numerous studies and has begun working to promote the niche sectors[32], strengthen the SME sector, and build institutions (see Box 5). This includes the formulation of strategies and allocation of funds to strengthen the tourism, fashion, and automotive industries, the establishment of a Bt 5 billion SME venture capital fund, the restructuring of the technical institutes, and approval of the establishment of the National Competitiveness Institute.

In public sector governance as well as financial and corporate sector reform, there has been progress, but not across all its components. Reforms in public administration and in public expenditure management, has continued over the last six months. Specific reform measures have also been implemented in corporate governance this year. The health of the banking sector has improved considerably as have corporate balance sheets, but implementation of reforms in non-bank sector and capital markets as well as in legal reform have not taken place.

This Monitor examines in detail the progress in the implementation of financial and corporate reform, including corporate governance reform, public sector governance, and reforms in the trade and business climate. In the first two areas, there is ongoing work carried out together with Government agencies under the relevant Country Development Partnerships (CDPs). In the other two areas of trade and the business climate – which is also critical for competitiveness – but where there are no CDPs, work with the relevant agencies was carried out to ascertain the state of progress. Below we look at each of these four areas.

[32] Sectors as identified in *Visioning Thailand.* They include the processed food, furniture, rubber products, vehicles and parts, fashion, health and education services, tourism, and software design

Box 5. Actions by the National Competitiveness Committee

Since the endorsement of *Thailand's Vision*[33] (or also know as the *Seven Dreams*) at the beginning of this year, the National Competitiveness Committee (NCC) has developed strategic frameworks for the visions and actions have been taken as listed below.

On promoting the niche sectors identified in *Visioning Thailand*:

- Strategies to develop Thailand into the tourism capital of Asia, including the Phuket Tourism Strategy, has been formulated and will be implemented by the Ministry of Tourism and Transport in collaboration with the CEO Governor in each province.
- Bt 2 billion has been allocated to the Ministry of Industry to formulate strategies to develop Bangkok into a fashion capital of Asia as well as implement them.
- Bt 40 billion was allocated to the Automotive Institute to help improve productivity in the automotive and related sectors through skills and testing systems development, especially for SMEs in the supporting sectors.

On strengthening SMEs:

- The NCC in July 2003 has approved the establishment of a Bt 5 billion venture capital fund, which will be funded from the budget. The Fund is envisioned to not only assist SMEs financially but also promote their managerial skills, good corporate practices, and access to markets.

On institutional building to promote national competitiveness:

- The NCC in July 2003 approved the establishment of the National Competitiveness Institute (NCI), which will be under the NESDB. The NCI will help identify the key areas and formulate future strategies for competitiveness improvements. It will also work with academic institutions to support research and with line agencies to facilitate the implementation of the strategies.
- Based on a recently completed study commissioned by the NCC, the roles and financing structure of technical institutes will be revised so that they will better promote both Thailand's overall and sectoral competitiveness. Implementation has begun in the Food Institute and the Textile Institute.

Source: NESDB

[33] They include 1) a country with strong economic platform, 2) an active international player, 3) the world leader in niche markets, 4) and innovative nation with wisdom and learning base, 5) an entrepreneurial society, 6) a society with cultural pride and a global sense and 7) a country of decent environment for living.

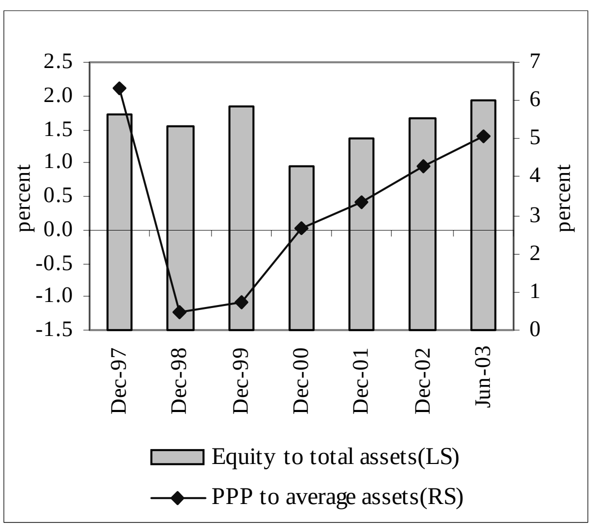
3.1 Financial and Corporate Reform and Restructuring

Financial Sector Developments

A. Developments in the Financial Sector

The performance and capitalization of Thai commercial banks has improved, but risk remains. Thai banks reported substantial improvement in their half-year 2003 operating profits, which can be attributed to wider interest margin, higher fee income, and reduced operating expenses. Improved operating profits have gradually strengthened Thai banks' core capital. Bullish sentiment in the stock market, stimulated by the recent upgrade of large banks to investment grade, has provided a window for capital raising. Two medium size banks successfully raised much needed capital through rights issues from the government and the markets, a positive development. The market anticipates that large banks will also refinance their high-cost hybrid capital, callable in 2004, to lower their funding costs and strengthen their capital base.

Figure 13. Improving Performance of Thai Banks

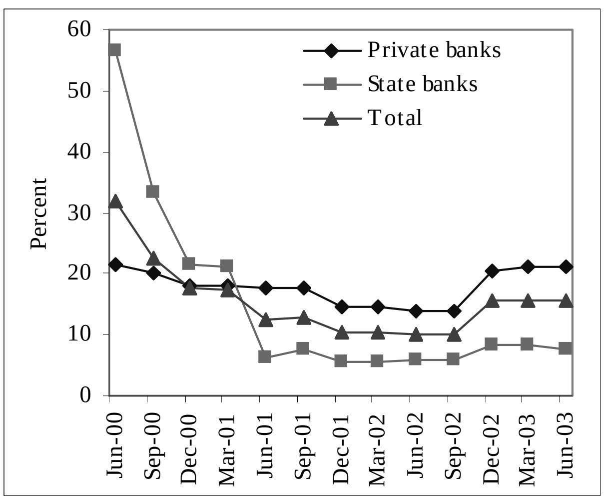


Source: the BOT, the World Bank's estimate

PPP means pre-provision profit

Asset quality problems remain for Thai private banks. Headline NPLs of private banks have slightly increased in the first half of 2003 to 21.3 percent due to an increase in re-entry NPLs, which have risen from 5.5 percent of average loans in 2002 to 8 percent of average loans in 2003. This largely reflects the poor quality of loan restructuring and the weak quality control over the reclassification of restructured loans to performing status, which can overstate asset quality. Much NPL restructuring has been simply loan extension, holidays on principal repayments and near term reduction in interest rates, which often postpones resolution of the problem and we can expect re-entry NPLs to remain high. Two thirds of private banks' restructured loans has so far reverted back to NPL status[34]. On top of reported NPLs, restructured loans currently accounted for about a third of total loans and foreclosed assets were about 3 percent of total assets.

Figure 14. NPLs of Commercial Banks



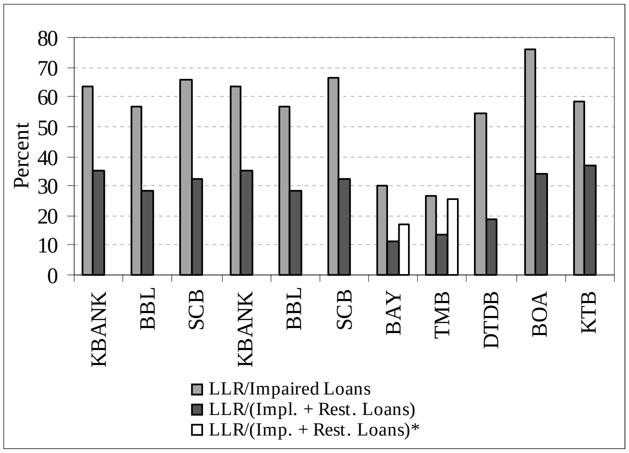
Source: the BOT and the World Bank's estimate[35]

[34] This is calculated by dividing accumulated reported re-entry NPLs by accumulated reported restructuring.

[34] (a) Excluding transfers to AMCs and writeoffs. (b)The one-off surge in headline NPLs in December 2002 was caused by a change in definition, and did not affect provisioning requirements. (c) The sharp decline in the NPLs of state banks in 2000 and 2001 was caused by transfers to government AMCs. (d) The BOT reported system-wide NPLs in June'03 at15.74%. A different ratio (17.6%) and calculation method used in the World Bank's "Regional Update" order to better compare NPL ratios across countries.

The BOT has instructed some banks to set aside additional reserves for future risks before increasing dividends. The BOT confirms that existing prudential standards are not being raised, but improved enforcement means that banks are being put on a more equal footing with regard to their reclassification and provisioning of restructured debt, which has been an area of significant latitude. One hybrid bank announced an increase in its loan loss coverage in response to BOT. The BOT's requirement to set aside reserves on a forward looking basis should impact medium-sized banks the most, because they have a lower level of loan loss reserves to NPLs. It will be even more encouraging if the BOT were to spell out the tightening of enforcement more explicitly. This would insure even implementation across banks, including those with weaker capitalization.

Figure 15. Loan Loss Reserves to Impaired Loans and Restructured Loans



Source: the BOT, Fitch, Banks, the SET, the World Bank's estimate

Notes: (a) Impl. = Impaired loans, classified as non-performing

(b) Rest. = Restructured loans, reclassified as performing

(c) LLR = Loan loss reserves

(d) The estimated loan loss reserve after recapitalization (*) is based on the assumption that the increase in loan loss reserve is equal to the amount of capital raised by banks.

(e) * after recapitalization

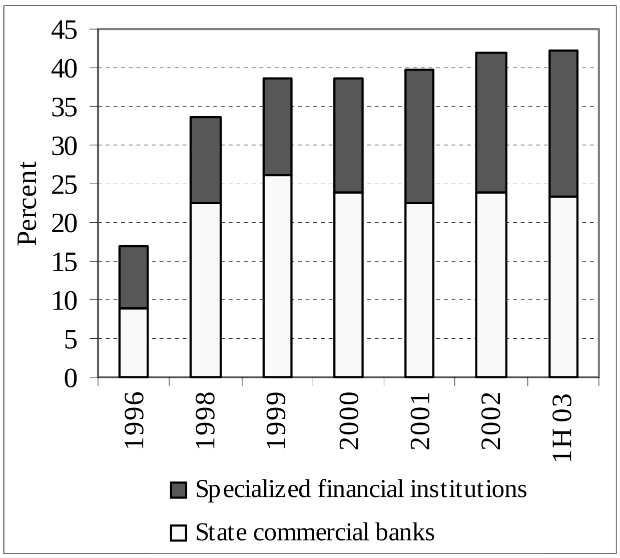
The BOT and banks are discussing the possibility that the government AMC would acquire from banks real estate owned and assets in foreclosure that have not yet been auctioned. This is expected to be an outright sale and on a voluntary basis. The BOT hopes that this measure will improve market perception of Thai banks by reducing nonperforming assets and loans from their balance sheets. It will allow banks to focus on new business instead of old problems. The impact of this scheme depends on both fair value pricing and whether the AMC's have comparative advantage and the mandate to expeditiously and efficiently sell the assets back into private market instead of warehousing them at taxpayer's expense. The AMC has not fully disclosed its asset restructuring and sales to date, so there is not enough information to judge its effectiveness. In addition to considering carve outs, it is also important to focus on streamlining the civil procedures to expedite judgments and foreclosure on property once a judgment has been handed down, instead of the current multi-year process.

In cooperation with the Legal Execution Department, the Financial Institutions Development Fund (FIDF) is moving remaining assets from the 56 failed finance companies out of the warehouse and into the market. Given the backlog in legal execution by the civil courts, FIDF has sold assets which are already in the foreclosure process in bulk via competitive bid to private financial institutions who see these assets as a profit opportunity. These assets are hire purchase contracts on vehicles which range from Bt 30,000 to Bt 200,000 per account. They have been in default for over six years, and debtors have failed to respond to FIDF's program to settle at a discount. The first tranche of Bt 4 billion were sold at a 14 percent recovery rate early in the year. Another Bt 10 billion is scheduled for sale in December. The SEC has recently granted an extension of the tax benefits under property funds (types II-IV) for acquisition of remaining FRA assets including hire purchase contracts from FIDF.

B. Financial Sector Reform

Intervention by the government in the financial markets continues to increase. State financial institutions have been increasing their loan market share since the crisis. This was initially driven by steady growth of lending by specialized financial institutions, continued nationalization of undercapitalized banks and NPLs, and the slow pace of re-privatization of these institutions and assets. The government-owned institutions now provide half the loans in the system (42 percent if TMB's share is excluded).

Figure 16. Loan Market Share of State Owned Financial Institution



Source: BOT, the World Bank's estimate. Specialized financial institutions include the GHB, GSB, BAAC, the SME Bank and three smaller institutions

Government intervention in the market can be most effective if tempered by a level playing field among state and private institutions, promotion of prudent risk management and minimal distortion of pricing and competition. The private banks cannot compete on loan pricing and volume with the state banks, which have had their NPLs removed. From KTB's perspective, it makes competitive sense to use its pricing power and balance sheet strength to increase lending to the limited pool of credit worthy corporate customers and to take more risk on firms in restructuring. From a public policy perspective, there are potential risks. New NPLs can be minimized by enhanced risk management, and KTB has started to improve their systems. And banks would have more incentive to improve their risk management if the legal and judicial framework for bankruptcy and foreclosure was improved. The implementation of risk adjusted pricing by state banks would minimize any distortions in the market which could harm private banks until they are able to match the low NPLs and stronger capitalization of state banks.

The Industrial Finance Corporation of Thailand (IFCT) and Bank Thai (BT) recently announced their planned merger, an encouraging step towards consolidation. Further rationalization of the mandates, business lines and fiscal treatment of the nine state specialized financial institutions (SFIs) is important, given that they compete with private financial institutions. The MOF plans to introduce a Public Service Account framework for SFIs, in which subsidies will be separated from finance on their balance sheets. By properly costing and budgeting their socially mandate loans, the SFIs can avoid running down their capital over time, and the MOF can hold them accountable for costs and benefits. The government strategy to boost lending by state financial institutions to stimulate the economy may be appropriate when the market mechanism fails. Effective policy will correct the underlying reasons for the market failure and find a "middle path" for intervention when the market resumes its function.

Recapitalization of weak banks is a positive step. To minimize future NPLs and cost to the taxpayer, recapitalization of a bank by the government is best accompanied by a change to good governance, enhanced risk management and cost reduction. Thai Military Bank's attempt to raise capital from a foreign strategic partner was not successful. Under direction of the Ministry of Finance, which along with the military, has a significant shareholding, approximately Bt 20 billion of NPLs were sold to Bangkok Asset Management (also controlled by the government) at 54 percent of the book value. A few days later, there was a successful rights offering to existing shareholders in which the Ministry of Finance fully subscribed to its share, making it a quasi state bank. Eventual transfer of the government's stake to private parties, coupled with new technology and products from a strategic partner, would enhance competitiveness and return on the taxpayer's investment.

Box 6. The Structural Agenda in the Financial Sector

- **Reduce risks and increase returns to the savings of Thai people through diversification.** Recent action by the BOT to allow mutual funds to invest in foreign assets is a positive start.
- **Broaden and deepen both debt and equity capital markets** in order to diversify channels for firms to fund themselves and for investment of savings. This will support the transition away from bank domination to a more balanced financial system.
- **Diversify collateral for bank lending by enacting the draft Secured Transactions Act.** Now most Thai savings channeled to the domestic economy are channeled through a few banks and collateralized by property. This scarcity of collateral can lead to future booms and busts in property. The draft act would allow banks to secure loans with other types of collateral such as receivables, inventory, etc. This could increase lending to SMEs, including those in the service sector.
- **Encourage new lending by reducing credit risk.** Enhancements are needed to the legal and judicial regime for bankruptcy rehabilitation regarding commencement of proceedings and enforcement of look-back provisions and disallow transactions among connected parties which damage the estate. Further enhancements are needed to civil procedures to expedite the multi-year foreclosure process, both to obtain judgments and to sell the collateral. Further enhancements may be needed to the Credit Information Act which would impose criminal penalties only for fraudulent disclosure of credit information, not negligence or other actions. Other innovations include the introduction of private mortgage insurance, which would insure against first loss on high loan to value mortgages. Full operation of the National Real Estate Information Center, linking transaction data from the Land Department with detailed property information, would help the market to assess the dynamics of supply, demand, pricing, valuation and to better underwrite loans and investments.
- **Start measured transition to limited deposit insurance from the current blanket government guarantee,** which was instituted in 1997. While almost all deposits will remain insured, the few depositors with large, uninsured deposits will move their money away from banks which are poorly managed. This is called market discipline, which is an important complement to regulatory discipline of banks. Prerequisites include resolution of weak banks through recapitalization, merger or exit, transfer of government control and ownership of state owned commercial banks to private shareholders, enhancing supervision and prompt corrective action by the regulator before a weak bank's capital base erodes, and announce a transparent transition plan which gives the government some flexibility in the speed of the transition. The draft act and transition plan have been prepared. The interim step of lifting the guarantee of claims by creditors other than depositors (about Bt 200 billion in claims) now awaits decision from the Cabinet. This step will signal the start of the transition, but will have no immediate impact by itself.
- **Return state owned commercial banks and assets to private ownership and governance over time** in order to provide a level playing field between state and private financial institutions and prepare for the transition to limited deposit insurance.
- **Enact the draft Law on Banks,** which will allow for consolidated supervision of financial conglomerates. In the interim, the different regulators should actively share risk analysis of the various businesses in a financial group, and risks they pose to the deposits in the bank.
- **Increase the availability of longer term, fixed rate financing in the mortgage markets.** Competition among the banks for mortgage loans is resulting in aggressive underwriting and pricing with floating rate mortgages. Payment shock and defaults could result if interest rates rise. Removal of legal, accounting and tax impediments to mortgage backed securitization, identified under an APEC initiative, would be a step towards offering longer term, fixed rate financing.
- **Enhance capital market infrastructure,** including the trading architecture and platforms for government and corporate bonds, the upgrade of settlement infrastructure for bonds and derivatives, introduction of securities borrowing and lending and the formation of a derivatives exchange.

Proper governance, commercial incentives and full disclosure would enhance the performance of the government's proposed Vayupak mutual fund. According to the announcement, Vayupak will mobilize investment from Thai citizens and institutions to invest in state owned enterprises, state owned banks, and firms which the MOF deems to be of national interest. The government will invest approximately 30 percent in the fund. Investees of the fund will use proceeds in part to retire debt owed to the government and to FIDF, an alternative to issuing more government bonds to refinance FIDF debt. A portion of the fund, offered to retail investors, will have principal protection and a minimum return above the bank deposit rate from the government for investors who hold until year 10. It will have a 10-year life and may be rolled over after maturity. The authorities hope to use this fund as a holding company to corporatize state enterprises, to improve governance of those enterprises and banks while maintaining full state control, and to promote long term investment in the capital market. Key to success of Vayupak will be the governance structure, including a Board of Directors which provides broad oversight, but does not select investments, private fund managers with commercial incentives and full disclosure to investors on the risks and benefits of the securities. Challenges include distortion of the market that could arise from the government's protection of principal and floor return on the retail securities, and whether Vayupak will be an activist shareholder, enforcing risk management, good governance and commercial incentives in the management of its investees. Finally, Vayupak I and II are projected to total about Bt 200 billion in capitalization, which is larger than the Bt 150 billion total free float currently invested by local financial institutions. This will require a significant expansion of shares in the market, or a displacement of foreign institutions and/or local retail investors.

Two credit bureaus have re-opened after the authorities took some measures to reduce some risk for their operations. The Ministry of Finance is considering amendment of the recently enacted law, which became effective on March 14, 2003. The law has many positive attributes, but mandates large fines and criminal penalties against the bureaus or their members for all violations, including negligence. International standards impose criminal sanctions only for willfull and fraudulent acts, such the disclosure of credit information for unpermitted purposes. As a result, both existing bureaus temporarily closed. The Credit Information Protection Committee subsequently issued notifications which clarified some issues on sharing of information and the process to receive debtors' consent. The Council of State has also issued its opinion on the interpretation of the law. The bureaus reopened, after some retooling of their management information systems. The authorities are considering amendment of the law to remove onerous liability and operating requirements faced by the bureaus.

Capital market development is progressing. The Derivatives Act was passed in May 2003 and has become effective. The accompanying amendment to the SEC Act, if passed, will allow mutual funds to encumber their assets, a prerequisite for repurchase agreements, short selling and the active management of their portfolios. A Derivatives Committee was set up to design a roadmap for the development of an organized derivatives exchange, infrastructure, operations, intermediaries, products, and investor education. The new derivatives market will be established with Bt 300 million seed capital from the Stock Exchange of Thailand (SET). The exchange is expected to begin its operations next year, and would initially limit its activities to futures in the stock index, interest rates and foreign exchange. The new SET Chairman has announced a vision for the SET to become an exchange for all securities. Besides the derivatives market, it plans to introduce a bond trading platform for retail investors by year end. The SET is leveraging on its strength since its affiliate, TSD, is currently a clearing and settlement agent for all corporate bond trading. The Securities and Exchange Commission is working on how to develop security borrowing and lending activities. Under an APEC initiative, the Ministry of Finance and the SEC and an expert panel are identifying impediments to the development of asset and mortgage backed securitization in Thailand. The next step will be implementation of the action plan to remove the impediments, which could contribute to the availability of long term, fixed rate funding in Thailand. A similar initiative is underway in China. Regionally, a “regional bond fund”, made up of contributions of dollar reserves by central banks in the region, has been established. Harmonization of bond market infrastructure, such as clearing, settlement, custody, trading conventions and taxation are the focus going forward.

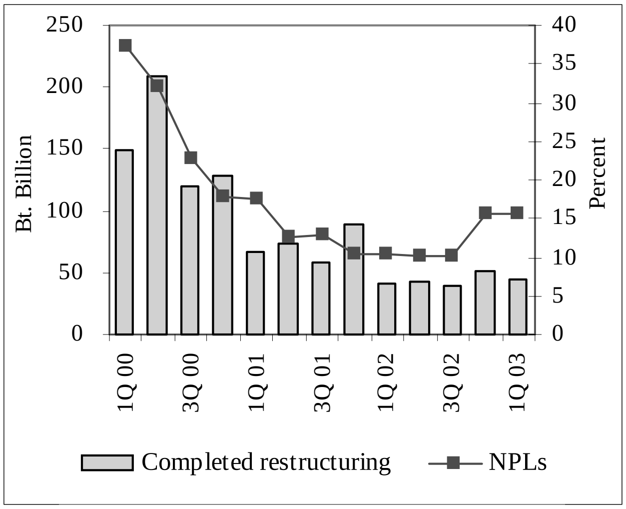
Corporate Sector Developments

C. Recent Developments in Corporate Debt Restructuring

Corporate debt restructuring continued to slow down in the first half of 2003, and there remains a significant backlog of unresolved NPLs. As of June 2003, a cumulative total of US$67 billion (Bt 2.9 trillion) of NPLs were restructured by financial institutions, compared to a cumulative total of US$65 billion (Bt 2.8 trillion) at the end of December 2002, and US$ 61 billion (Bt 2.6 trillion) at the end of June 2002. Included in the cumulative total, 47 percent or US$33 billion (Bt 1.4 trillion) of loans were restructured through the voluntary out-of-court workout framework led by the Corporate Debt Restructuring Advisory Committee (CDRAC). The CDRAC process has wound down and was completed in March 2003. In five years of operation, CDRAC restructured 49 percent of its US$67 billion (Bt 2.9 trillion) target cases by credit value. The remaining cases, with a total value of over US$ 34 billion (Bt 1.5 trillion), failed the CDRAC process and were transferred to TAMC (US$4 billion or Bt 150 billion), and to the Civil Court for resolution (US$ 30 billion or Bt 1.3 trillion). The on-going concern is the backlog of cases in the Civil Courts where mortgages are enforced. As of June 2003, the Office of the Judiciary reported that there remain over 76,000 civil cases pending court decisions, the same level of unresolved cases as reported back in year 2001.

The Thai Asset Management Corporation (TAMC) is making progress, but faces challenges with disclosure and operations. Resolution plans for the larger cases have been decided, and the average book value of each case decided has dropped from about Bt 500 million in 2002 to Bt 200 million in 2003. Most of the 12,000 small cases (Bt 24 billion) were acquired last quarter from state banks and AMC’s; they will be managed by KTB, the largest state bank, for resolution via their branch network. While TAMC has been effective in approving resolution plans for larger accounts, it has challenges with documentation and back office. About 60 percent of cases for which there is a Board resolution now have signed agreements, up from 30 percent two years ago. Of the cases which failed voluntary restructuring, TAMC is unable to contact about half of the debtors; the other half offered unacceptable proposals. Of those, about 200 cases (Bt 50 billion) have renegotiated and settled. TAMC utilizes the TAMC Act to foreclose; it does not use the civil courts. TAMC is now planning for November its first auction via competitive bid of between 50-100 assets, a positive step to return assets to productive use in the markets. TAMC reports several cases in which they acquired shares and convertibles in debtor firms as part of the settlement of debt. The value of those assets has risen such that TAMC has been able to offset the debt

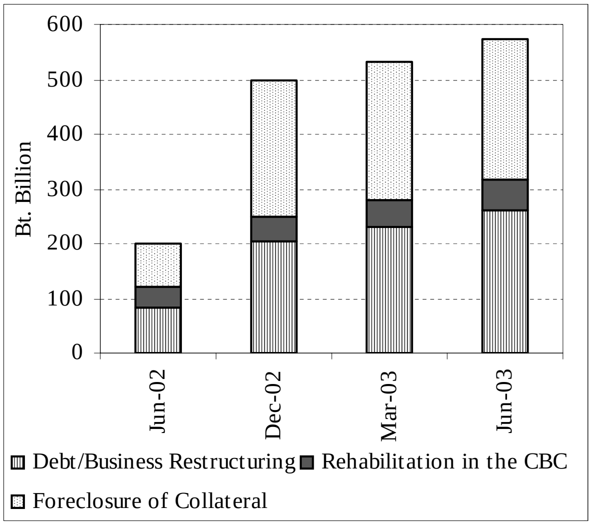
Figure 17. Quarterly report on completed restructuring and headline NPLs



Source: BOT

Remark: Increase in headline NPLs as of December 2003 was due to a change in definition

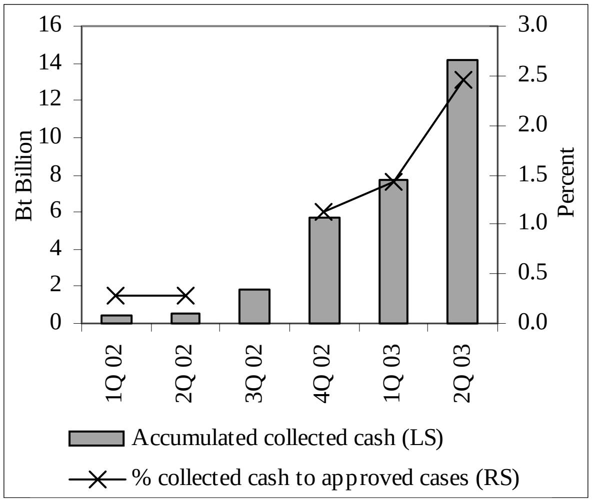
Figure 18. Resolution Approved by TAMC's Executive Committee



Source: TAMC

CBC: Commercial Bankruptcy Court

Figure 19. Accumulated Cash Collection by TAMC



Source: TAMC

reduction offered to the same borrowers. TAMC now has better information on its progress, and would benefit by improved disclosure to the public.

The Bank of Thailand (BOT) renewed a push in the out-of-court framework to accelerate resolution of NPLs, but start-up has been slow. In April 2003, the BOT initiated a new voluntary mediation framework for private banks and AMCs to accelerate debt restructuring for debtors in different stages of resolution. Target debtors are those going through the legal process, of which there are two groups: (1) cases that are in the court process; and (2) cases that are in the legal execution process after judgments are rendered. In this process, the creditors would select from the BOT list and submit to CDRAC on a monthly basis the cases they would like to further negotiate for debt settlement. CDRAC, in turn, would contact the debtors, and if agreed, both parties would enter the CDRAC-led mediation process to accelerate resolution under a required guideline and timeframe. For cases that are in the court process, a settlement or loan repayment agreement must be reached within 2 mediation sessions and 60 days. For cases that are in the legal execution process, settlement agreement must be reached within 2 mediation sessions and 45 days. It is also required that authorized decision-makers attend the negotiation sessions for both parties. Failure to reach an agreement within the timeframe would result in continued legal process.

In this first round, the BOT selected a target group of 136,728 cases, with the value of US$10 billion (Bt 426,843 million) as shown in Table 7. In the four months through July 2003, the progress has been slow. Creditors have selected only 5.3 percent of the total target debtors by credit value, and only 1.4 percent of those selected debtors have accepted participation in the program. As a result, the completion rate is a weak 0.18 percent.

While the objective and intention to accelerate NPLs resolution are clear, this voluntary mediation process could undermine the foreclo sure regime and the transparency of the legal execution process. If a court judgment is not considered final, it can be delayed or reversed by continued negotiations for a new, more favorable settlement agreement. Even though the process is voluntary, it also opens up a possibility for collusion between decision-makers of the two parties to further delay resolution under a new agreement, or to unrealistically inflate the liquidation price of the assets

Table 7. Status and Progress of CDRAC Mediation Program

As of July 31, 2003

(Million Bt)

Stages	Cases in Trial Process		Cases in Legal Execution Process		Total		
	#Cases	Amt.	#Cases	Amt.	#Cases	Amt.	Percent of Total
Target Cases in Legal Process	**25,956**	**168,896**	**110,772**	**257,947**	**136,728**	**426,843**	**100.0%**
Creditors selection of debtors to negotiate in the CDRAC mediation program	2,217	18,507	837	3,932	3,054	22,439	5.3 %
Selected debtors agreed to participate in CDRAC mediation program	417	5,758	48	128	445	5,886	1.4 %
Settlement Agreed and Resolution Completed	109	722	15	57	124	779	0.18 %

Source: BOT and WB Analysis

to minimize the losses on bank and firm balance sheets. The effectiveness of the judicial system could be compromised unless legal execution proceeds without delay in parallel with, and as a complement to, any on-going negotiations.

Reform in the judicial process has not generated a positive impact to lessen the backlog in the Civil Courts. Since October 2002, all the courts of first instance are constitutionally required to implement continuous hearings, and cases must be presided by a set of two judges until judgments are reached. The customary four to six month period between hearings should be reduced through continuous scheduling. The impact on trial speed and court backlog is difficult to assess in the first six months of implementation. However, there are signs of weakness. Creditors and debtors are voicing concerns over the limited number of days available for continuous scheduling, namely Tuesdays through Fridays, while Mondays are reserved for court administrative businesses. This causes further backlog in court scheduling. Presently, the earliest a new civil court case can be scheduled continuously through completion would be in early 2005, or over 18 months. With the existing volume of more than 76,000 civil cases are awaiting court judgments, the possibility of accelerated NPL resolution is remote. The Courts of Justice has recently come to realize the court scheduling problem, and is now proposing to remedy the backlog by possibly establishing special hours for trial, and increasing budgetary resources.

Out-of-court mediation framework continues to be in demand by creditors and debtors as alternative to trail, but requests for mediation are mostly on small-medium-sized and consumer loans. The Mediation Center for Financial Disputes (MCFD) is receiving a small but increasing volume of requests from creditors and debtors to administer out-of-court mediation for financial disputes and NPL. From January to June 2003, a total of 1,403 cases requested out-of-court mediation as compared to 1,164 cases from June to December 2002. With the increasing number of cases, and given only slight increases in the number of registered mediators, the rate of success has declined from 74 percent in 2002 to 62 percent during the first six months of 2003 (864 cases out of 1,403 total requested cases were successfully mediated, settlement reached, and court petitions withdrawn) However, requested cases are predominantly small-medium-sized loans and consumer credits, which suggests that the larger and more complex NPL cases are not actively utilizing the out-of-court mediation framework.

Court-supervised debt restructuring continues to be used as a debt collection mechanism. From January 2002 through February 2003, the Central Bankruptcy Court (CBC) received a total of 2,346 petitions. Of the total, 70 cases were filed for business rehabilitation, while the remaining 2,276 cases, with an average value per case of Bt51 million, were bankruptcy liquidation petitions. Although the volume of filings have increased substantially from prior years, the court seemed to have managed its resources well in terms of continuous scheduling and case load, and the small backlog of cases in the court is not critical. However, the relatively small average credit value per case of Bt 51 million suggests that the bankruptcy regime continues to be used as a debt collection mechanism. To date, there has not been a corporate bankruptcy liquidation filing of larger than Bt 1.2 billion (US$ 28 million) in credit value. The unpredictability of court decisions is a growing concern. Recent Bankruptcy court decisions have raised concerns among creditors, investors, and the legal community about the legal foundation and unpredictability of court decisions.

Progress in legal and tax reform to strengthen the corporate restructuring framework still is not complete. On September 15, 2003, after more than two and a half years of review, the Legal Reform Committee for Development of Thailand (LRC), a national committee established in 2001 by the Prime Minister, submitted a three-point revision of the Bankruptcy Act to the Economic Ministers meeting.[36] The LRC proposed to ameliorate the legal framework of bankruptcy liquidation for individual debtors by amending the Bankruptcy Act as follows: (1) allow retroactive discharge from bankruptcy after three-year period for individuals whose court judgments were rendered after year 1994, or within five years prior to the 1998 bankruptcy amendment. Prior to 1998, bankrupted individuals are subjected to a ten-year bankruptcy period before they can petition for a discharge, (2) extend the bankruptcy period from five to ten years for individuals who are ruled dishonest or fraudulent by the CBC; but the revised law would allow those individuals to petition the court for discharge from bankruptcy after five years, and (3) disallow the collection of repayments or assets under bankruptcy liquidation from family members of bankrupted individuals who are under 18 years old, while the spouse's assets must be divided 50:50 before collection as per Thai marital law. Although the Economic Ministers have endorsed the proposed amendments, the specific timeframe for submission to the Cabinet and subsequently to the Parliament for approval has not been designated.

The proposed amendments only cover individual bankruptcy cases, and the corporate bankruptcy framework remains incomplete. Needed enhancements include the legal definition of insolvency, which is now based on a balance sheet test instead of ability of debtors to honor debt obligations when they fall due; explicit procedures to commence bankruptcy proceeding if business rehabilitation fails; and redundant court procedures. These and other issues remain impediments to a well-functioning bankruptcy regime.

The LRC has also completed a review of the business rehabilitation chapter of the Bankruptcy Act, but the proposed revisions have not been submitted to the Government. Possible revisions would include (1) allowing honest debtors to petition

[36] The Economic Ministers meet weekly to review and screen economic-related agendas and proposals that are to be submitted to the Cabinet for approval. The meeting is chaired by Deputy Prime Minister in-charge of Economic Affairs, with the Ministers of Finance, Commerce, and Justice as key members. Agenda items that are endorsed by the Economic Ministers would then be forwarded to the Cabinet for approval.

for rehabilitation; (2) regrouping creditors to recognize the revenue and tax authorities as a creditor group on the same level as financial creditors; (3) requiring 75 percent of creditors' vote by credit value to accept a restructuring plan instead of the current 50 percent; (4) allowing for debtor in possession; and (4) imposing a limit on the fee paid to the Restructuring Plan Administrator. Given recent court decisions, enhancements are needed which would (1) commence proceedings based on the debtor's ability pay obligations and (2) would look back prior to the bankruptcy and disallow fraudulent transactions, including transactions among connected parties, which damage the estate and the ability of the firm to reorganize and repay creditors and other stakeholders according to their priority.

The Secured Transaction Act has not been enacted by the Parliament, but the draft act was reviewed by the Council of State and subsequently approved by the Cabinet in mid- 2002. The Act would greatly enhance the corporate restructuring framework by providing both debtors and creditors with greater flexibility in collateralization of other assets (e.g. receivables, inventory, etc.) besides the traditional practice of pledging real estate. In addition, mergers and acquisitions (M&A) can be an effective tool to streamline business operations, reduce excess capacity, and restructure viable businesses. Although the tax impediments have been well known for quite some time, the tax code on M&A remains unreformed and an obstacle to corporate restructuring. A new entity is not allowed to assume the accumulated net losses of the merged businesses, thereby restricting the tax benefit and potential mergers of businesses.

Corporate Governance

Significant efforts have been expended in 2003 to improve financial reporting and disclosure of listed companies. The Stock Exchange of Thailand (SET) and the Securities Exchange Commission (SEC) have been working to strengthen disclosure standards[37] through monitoring financial and non-financial disclosure and providing incentives for such disclosure.

The SEC has been reviewing all audited financial statements of listed companies and has required non-complying companies to make appropriate amendments and has imposed sanctions on violations of disclosure rules. The SET requires listed companies to specify the type of auditor's opinion on their financial statements and post a "SP" (suspend trading) or "NP" (notice pending) on the companies with adverse opinion from auditors. This measure will increase investors' confidence in using financial statements and increase companies' accountability in preparing financial statements. In addition, a number of companies are randomly selected and their financial statements examined in detail.

On the disclosure of non-financial information, the SEC samples listed companies' annual registration statements and reviews the quality of the presented information. Disclosure Awards are given to companies with relevant information[38], while those with unclear information are asked to amend their document per the SEC's order. Companies with high quality disclosure documents receive a fast track treatment for subsequent securities issuance.

Several knowledge programs have been provided to improve corporate governance. In 2003, The Thailand Institute of Directors (IOD) in cooperation with SET and SEC, are conducting training for directors and providing assessment of progress in corporate governance. The IOD initiated a 1-day Directors Accreditation Program (DAP), sponsored by the SET, which covered the compliance roles of directors of listed companies. Two hundred directors have completed this course. In addition, the Institute of Certified Accountants and Auditors of Thailand (ICAAT) has

[37] Thai accounting standards (TAS) have been upgraded to the level equivalent to that of the International Standard (IAS). Disclosure requirements were adopted from the US SEC S-K forms.

[38] In 2002, forty listed companies received the Disclosure Award. In 2003, 130 listed companies have applied to join this program. The qualified listed companies will be announced in November 2003.

Table 8. Average Corporate Governance Scores for Thailand

SET Principles	2001 Average*	2002 Average*	Statistically Significant Difference
1. Policy of Corporate Governance	1.95	2.11	Improved
2. Shareholder Rights and Equitable Treatment	2.56	2.56	No change
3. Shareholder Groups	1.64	1.82	Improved
4. Shareholders' Meetings	2.32	2.36	No change
5. Leadership and Vision	1.05	1.24	Improved
6. Conflicts of Interest	2.25	2.28	No change
7. Business Ethics	–	1.22	–
8. Balance of Power for Non-Executive directors	1.78	1.80	No change
9. Aggregation or Segregation of Positions	1.45	1.94	Improved
10. Remuneration for Directors and Management	1.60	1.64	No change
11. Board of Directors' Meetings	–	–	–
12. Committees	1.56	1.60	Improved
13. Controlling System and Internal Audit	2.56	2.48	Deteriorated
14. Directors' Reporting	–	1.41	–
15. Relations with Investors	1.96	1.98	No change
Number of Companies	**139**	**234**	

Source: Thai Institute of Directors, Baselining Survey 2001 and 2002.

* Based on the average corporate governance scores for selected SET Principles. The range is between 1 to 3: 1 (poor), 2 (fair), 3 (good).

improved and expanded the Continuing Professional Education (CPE) for accountants and auditors, including the development of accounting practice guidelines for SMEs.

In May 2003, the IOD released its second report, "Strengthening Corporate Governance Practice in Thailand 2002". The report benchmarks corporate governance practices of 234 listed companies against 15 SET "Principles of Good Corporate Governance," which are broadly consistent with OECD principles of corporate governance. Table 8 compares the 2002 survey result with 2001 showing encouraging results with respect to 5 out of the 15 SET principles.

Cross-country comparisons also show that Thailand is improving, but many countries in the region are doing much better. The recent CLSA report ranks corporate governance practices of East Asian countries and shows that Thailand compares favorably with countries like China, Philippines and Indonesia, but others like Malaysia, Korea, India are doing better than Thailand. Thailand's corporate governance score in 2003 is only 4.6 out of a possible 10.[39]

Reforms are needed in legislative and regulatory regime to improve the situation[40]. A revised Securities and Exchange Commission Act would tighten

[39] A broad assessment under the Reports on Observance of Standards and Codes (ROSCs), which benchmark a country's corporate governance practices and accounting and auditing practices against OECD principles and international standards, should provide more information on the extent to which progress has been made in Thailand. A corporate governance ROSC is planned to commence in early 2004.

[40] For details of unfinished agenda of corporate governance reform, see the Thailand Economic Monitor (May 2003), pg. 27.

Table 9. Corporate Governance in East Asia

	Rules & Regulations		Enforcement		Political/ regulatory environment		Adoption of IGAAP		Institutional mechanisms & CG culture		Country score[41]	
	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003
Singapore	8.0	8.5	7.0	7.5	5.5	6.0	9.0	9.0	8.0	8.0	7.4	7.7
Hong Kong	8.0	8.0	6.0	6.5	7.0	6.5	9.0	9.0	7.0	7.0	7.2	7.3
India	8.0	8.0	5.0	6.0	6.0	6.0	6.0	7.5	6.0	6.5	5.9	6.6
Taiwan	7.0	7.0	5.0	5.0	5.0	5.0	7.0	7.0	6.0	6.0	5.8	5.8
Korea	6.0	7.0	3.0	3.5	4.0	5.0	7.0	7.0	5.0	6.5	4.7	5.5
Malaysia	9.0	9.0	2.5	3.5	3.0	4.0	6.0	7.0	6.0	6.5	4.7	5.5
Thailand	**7.5**	**7.5**	**2.0**	**3.0**	**3.0**	**4.0**	**5.0**	**6.0**	**4.0**	**4.5**	**3.8**	**4.6**
China	4.5	5.0	3.0	4.0	5.0	5.0	7.0	5.0	3.0	3.0	4.4	4.3
Philippines	6.0	6.5	2.0	2.0	2.0	2.0	6.0	6.0	4.0	4.0	3.6	3.7
Indonesia	4.0	4.5	1.0	1.5	5.0	4.0	4.0	5.0	2.0	2.5	2.9	3.2

Source: CLSA, Emerging Markets (2002, 2003)

roles and responsibilities enhance fiduciary duties of directors, including sanctions for violations of these duties, and would strengthen the rules governing related party transactions. It has not yet been considered by the Cabinet and Parliament. The Public Company Act (PCA) needs to be amended to provide legal channels for shareholders seeking redress, and protection of and rights of small shareholders' rights. In addition, the threshold on the minimum percentage of shareholders that can exercise each right (e.g. right to make proposals and call a shareholders meeting) needs to be lowered. The Cabinet has approved the draft PCA in principle and is being reviewed by the Council of State. Going forward, the role of the regulators in the enforcement of securities regulations needs to be enhanced, the accounting and auditing practices improved, with enforcement of disciplinary actions and sanctions on violations strengthened.

3.2 Reforms to Improve the Business Climate

Numerous reforms to improve business climate were implemented since the crisis, but not much has happened recently. Investment restrictions were relaxed in various sectors, incentives were enhanced, legal framework was improved and labor issues were addressed. All this improved the overall climate for business relative to the pre-crisis period. Over the last 12 months, changes have been few and far between. There have been some efforts to strengthen the legal framework but not much has materialized yet. Studies have been undertaken to ascertain ways of developing skills and to improve the ICT situation, and recently some measures have been adopted. Some actions have been taken with respect to SMEs as well. But overall, reform in this area has stalled, with no reductions in existing restrictions on investments.

41 The scale of each of the above criteria is as follows: Clear, transparent and comprehensive rules and regulations (10); Committed and effective enforcement of rules and regulations (30); Political and regulatory environment affecting CG and ability of companies to maximize value without arbitrary restrictions (20); Adoption of International Generally Accepted Accounting Principles (20); Institutional mechanisms to promote awareness and a culture of good governance (20)

There are on going efforts at improving the legal framework. Thailand underwent substantial reforms to modernize the legal and judicial framework during 1998-2000, but a substantial reform agenda remained. The Legal Reform for Development of Thailand Committee (LRC) has been reviewing legislation and has recommended amendments to laws to improve business environment, but actual amendments have not taken place.

Recently, a program to improve the skills of Thai workers was launched. In the context of the Ninth Plan, the NESDB, in cooperation with the Ministries of Education and Labor and the Federation of Thai Industries, developed the Thai Vocational Qualifications (TVQs), a program aimed to establish a national occupational skills benchmark. It was aimed at enhancing workers' minimum skills and qualifications based on international standards and benchmark, and provide specialized skills training to industrial workers based on demand-driven needs (See Box 7). In August 2003, TVQs received endorsement from the Prime Minister during the Public-Private Business Forum. Initially, TVQ will focus on the five export industries under the Government's fast track promotion scheme. In each sector, business operators, Technical Institutes and trade associations would together conduct the needs assessment of workers' skills based on international standards. Training curriculums and certification programs would then be developed and implemented in each sector. Business operators would bear the cost of improving labor skills, but the Government is likely to contribute some financial support.

Efforts to enhance country's competitiveness through SME promotion continue, but few specific measures have been implemented. The One-Tambon-One-Product (OTOP) program was initiated to accelerate the development of SMEs, by promoting cottage industry products into world-class exports. Other measures were introduced to support SMEs such as credit expansion by the SME Bank, tax incentives and a myriad of business advisory services.

Box 7. Thai Vocational Qualifications (TVQs)

In Thailand, an average worker received 7 years of formal education. Vocational skills are largely learned on the job. The Government recognized that labor skills and productivities are not advancing in parallel with the fast-moving technology and skill sets of modern manufacturing. As a result, TVQ was developed to (1) enhance Thai firms' competitiveness; (2) increase workers' productivity; (3) support life-long learning for individuals; (4) and develop new vocational skills. The Federation of Thai Industries (FTI) is to be the core implementing agency.

Steps to implement TVQs[42]:
Conduct needs assessment, identify and benchmark vocational qualifications for specific job tasks in target industries

- Develop occupational standards for each job task and in each industry
- Form Enterprise Training Advisory Body (ETA) in each industry
- ETA to conduct competency evaluation in each industry
- Develop competency-based curriculum based on the occupational standards and best practice
- Develop accreditation system

To implement TVQs, a draft Act to establish a TVQ institute needs to be passed by the Parliament.

[42] Source: NESDB. FTI and NESDB plan to submit the TVQs Project to the Cabinet for approval in October 2003.

While some progress has been made, many SME operators, especially those associated with the Thai Chamber of Commerce, believe that there remain many challenges. On the domestic front, more deregulation maybe required, since the cost of regulation fall disproportionately on SMEs. On the foreign side – export market and distribution network – the Government has been organizing trade shows in ASEAN and the Middle East, but it is still unclear as to how effective these will be for SMEs and small scale operators to access international markets directly and at low cost.

3.3 Recent Trade Reforms

Tariff Reform

Thailand has been reforming its trade regime for a long time. Recent reductions in import tariff protection took place mainly in 1995 and then again in 1999, soon after the crisis. Tariff reform on these two occasions reduced average most-favored-nation tariff [43] to 23 percent in 1995 and 17 percent in 1999, with the average tariffs on the manufacturing sector coming down by more. Preferential tariffs vis-à-vis the ASEAN countries fell in 1999 too. Since then, 37 percent of the total tariff lines of 5,505 has been reduced to the following three-rates besides the zero rate i.e. 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods. As of January 2003, average applied MFN tariff was 14.7 percent and average agriculture tariff was 25.4 percent (see Table 10).

There have been further reductions in MFN tariffs this year. In October 2003, the tariff reduction of an additional 8 percent of total tariff lines into the three bands was effective. Without further work, it is difficult to say how protection levels in different sub-sectors have changed.

[43] Most Favored Nations (MFN) tariffs are those that apply to all countries other than those that have preferential trade agreements with Thailand as is the case with ASEAN.

More rationalization of tariffs is expected. The rest of the tariff lines remains on existing higher tariff rates. However the Cabinet has approved the gradual reduction of the remaining 53 percent of the total tariff lines into three bands by 2005. They include chemical products, base metal, petroleum products, textiles, iron and steel, machinery and electronic appliances.

Agricultural sector remains the most protected. In 2003, Thailand's simple average applied MFN tariff rate for agricultural products is as high as 25 percent, which is twice the average tariff on manufactured goods. This sector has been more protected historically with average tariffs of 43 and 32 percent in 1995 and 1999, respectively. There is also evidence to suggest that productivity growth in agriculture has been quite low. However, discussions on free trade agreements (FTA) with countries like China, India, Australia and so on (see Box 8) are seeking an 'early harvest program' focused on agriculture, especially fruits and vegetables. This implies that Thai import tariffs on those products would be significantly lower than the average shown in Table 10 below.

Table 10. Current Tariff Rates in Thailand

Tariff (percent)	1995	1999	2003[1/]
Effective tariff rate[2/]	7.3	4.1	3.7
Simple average applied MFN tariff[3/]	23.1	17.1	14.7
Agricultural products (HS01-24)	43.1	32.1	25.4
Industrial products (HS25-97)	20.7	14.6	12.9
Simple average CEPT for AFTA	19	9.8	4.6

Source: Trade Policy Review 1995, 1999, 2003 (forthcoming) and FPO

[1/]Effective tariff rates are as of June 2003. The rest are as of January 2003, [2/]Calculated by import duties divided by total imports. [3/]Calculated from from tariffs which are applied to general countries.

The Common External Preferential Tariff (CEPT) rates for ASEAN countries[44] are to be reduced in 2003. Thailand, as an original member of ASEAN, is committed to reducing 60 percent of tariff lines in the inclusion list to zero tariff rates. These cover mainly industrial goods, such as chemical products, ceramic products and machinery, and some agricultural goods, such as animal products and fruits. The draft of the ministerial order for this change is being reviewed by the State Council, and it will become effective once that process is completed. By 2010, 100 percent of the tariff lines in inclusion list will have zero rates. Again, the sectoral impact of this reduction has to be worked out.

Export Promotion And Assistance

Thailand's export promotion policy toward market diversification aims to increase exports to new markets, notably China, India and the Middle East. Exports to these countries in the first eight months of 2003 accounted for 11.4 percent of total exports and grew at an average rate of 47.9 percent. According to the export promotion and development plan for FY2003, Thailand targets to increase the export proportion of new market and existing market to 40: 60 percent by 2005[45]. In addition, Thailand plans to increase an annual export growth to China and India by 10 percent and increase exports to the Middle East by 50 percent within 2005.

In terms of products, the government will intensively promote agricultural products and products from grass root community. In January to August 2003, exports of agricultural products grew by 26.4 percent and accounted for 7.9 percent of total exports. The Government plans to stabilize export prices and expand export markets of agricultural products in line with the strategy to strengthen Thailand competitiveness as "the kitchen of the world". In addition, One-Tambon-One-Product will also be promoted through improving quality and design in order to help local SMEs as stated in national agenda.

In 2003, there is a small financial support from the BOT to Thai exporters through the EXIM Bank. In 2003, export market diversification promotion program was the only remaining financial support from the BOT. The five-year program, started in June 1999 and ended in December 2003, intends to encourage diversification of Thai exports to 141 markets in 8 regions by rebating interest to exporters who borrow from the packing credit facility and the direct packing credit facility[46]. As of June 2003, Bt 77.3 million of interest rebates have been reimbursed.

3.4 Fiscal Policy and Public Sector Reforms

Fiscal Policy

Fiscal policy has been less expansionary than planned in this fiscal year 2003. In FY 2003, the Government's budget and cash balance were in surplus by Bt 63.2 billion and Bt 35.5 billion, respectively. This is mainly the result of high revenue collections, which have exceeded target by Bt 42.8 billion, while disbursement was about 90 percent or 2 percent below the expenditure target.

---

[44] CEPT was an equal reduction of tariff rates in the inclusion list mutually agreed by member countries of ASEAN Free Trade Area (AFTA).

[45] The ratio was 28:72 percent in 1999 and 33:67 as of June 2003. The new markets include, for instance, China, those in Middle East, Latin America and Eastern Europe while the existing markets are ASEAN, Japan, EU and the US.

[46] These two programs, supported by BOT, aimed to encourage commercial banks to provide more financing to exporters and thus reducing credit crunch. Both programs are 50 percent financed by BOT through EXIM bank on the condition that the commercial bank will provide the other half. However, for the former package, EXIM bank allocated funding to commercial banks to provide loans to exporters while EXIM bank co-financed directly to exporters in the latter case. However, These programs were terminated in 2002.

Box 8. Thailand's Free Trade Agreements (FTAs)

Thailand has been actively negotiating FTAs with its major trading partners in order to expand trade, especially exports. The current stage of these negotiations are described below:

- **Thailand and China:** A bilateral agreement to reduce import tariffs on vegetables and fruits (HS07and 08) to zero rate has been effective since October 1, 2003 as part of an early harvest program between ASEAN and China. Under this scheme, tariffs on items in HS01 (live animals) to HS08 (Edible Fruits and Nuts) will all be reduced to zero rate by 2006.
- **Thailand and Bahrain:** The two parties agreed to reduce tariffs rate on 626 items including rice, plastic products, machinery, chemical products, jewelry and vehicles and parts to 0 percent and 3 percent under early harvest scehme in a framework agreement on Closer Economic Partership (CEP) signed in December 2002. The Cabinet have approved the tariff reduction and the draft of the ministerial order is being reviewed by the State Council. The effective date is also under negotiation.
- **Thailand and India:** The two governments signed the framework agreement on establishing Free Trade Area on October 9, 2003. Under the early harvest scheme, tariff rates on 84 items such as fresh fruits, plywood, jewelry, auto parts, auto engine parts, canned seafood, iron and steel, and household electrical appliance, will start to reduce in March 2004 and are expected to be at zero percent in 2006.
- **Several other bilateral agreements are under negotiation and study:** These include Thailand and Australia, Thailand and the U.S., Thailand and Japan and, Thailand and Peru.

Public debt continues to fall in 2003 but will rise in 2005 and 2006. Public debt[47] as of July 2003 is 50 percent of GDP compared to 54 percent at the end of 2002. The share of external debt has also declined from 27.8 percent of total public debt at the end of last year to 26.2 percent in the middle of 2003. However, public debt will see an increase in 2005 and 2006 when the bulk of the FIDF obligations under yield maintenance and gain/loss sharing and liquidity support to financial institutions are due.

The Government continues to boost domestic demand through credit-based initiatives. The Village Fund, the Debt Suspension for Farmers, and SME loans are examples of the credit-based fiscal initiatives undertaken by state-banks and specialized financial institutions (SFIs). Over the last two years, these programs have provided funds to date equal to 5.5-6.1 percent of GDP (see Table 11). The costs of the Village Fund and the Farmer's debt suspension programs have been fiscalized. There is always the possibility that source of the funding for the other programs will not be repaid. However, the upper limit of that risk is limited by their total size.

Public Administration Reform

The Strategic Plan for Thai Public Sector Development (B.E. 2546-2550) is being implemented and monitored. The Strategic Plan, approved by the Cabinet in March 2003, was formulated by the newly established Public Sector Development Commission (PDC)[48], following the enactment of the two corner stone public sector reform acts – the Ministerial Restructuring Act and the Public Administration Act – in October 2002. The plan has four main objectives

[47] Public debt comprises of direct Government domestic and external debt, Non-financial state enterprise Government guaranteed and non-government guaranteed domestic and external debt, and FIDF guaranteed and non-government guaranteed debt.

[48] The PDC was appointed in December 2002. The PDC is supported by the Office of the Public Sector Development Commission (OPDC) whose Secretary General is also a member of the Commission. The OPDC functions are to undertake research,

Table 11. Recent Credit Based Fiscal Initiatives

Initiative	Funding Agency	Duration	Estimated Funding (% GDP)	
			IMF (July 03)	Merrill Lynch (March 03)
1. Credit for SMEs	State banks and SFIs	FY02, FY03	2.7	2.8
2. Subsidized mortgage for public sector employees	GPF and GHB	FY03	0.5	0.6
3. Housing for the poor	GHB and GSB	FY03, FY04	0.25	0.2
4. People's Bank	GSB	FY03	-	0.4
5. Village Fund*	GSB	FY02, FY03	1.5	1.9
6. Debt suspension for farmers*	BAAC	FY02, FY03	0.5	0.3
Total			5.5	6.1

Source: IMF and Merrill Lynch

* Principle and interest payment of the Village Fund and the interest cost of the Farmer's debt suspension has already been fiscalized.

which are (i) improving public service quality both at the central and local government levels; (ii) changing roles, responsibility, and rightsizing the government bureaucracy; (iii) enhancing the capacity and performance of the public sector to efficiently and effectively perform their functions; and (iv) improving governance in public sector through participation, accountability, and transparency. To keep track of progress made in each area, several indicators and outcomes have been established and are monitored through a one-year public sector development monitoring report, prepared by the Office of the Public Sector Development Commission (OPDC).

The Cabinet has approved the draft Royal Decree on Good Governance which will be implemented in October. The Public Administration Act 2002 requires a Royal Decree that established principles and practices for the new directions in public administration. This draft Royal Decree on Good Governance requires that all public organizations perform on the basis of 'good governance'. The decree consists of ten chapters each providing direction for the performance of government agencies in accordance with the over-arching principles[49].

Nine ministries have implemented a cluster management scheme, as laid out by the Public Administration Act. Formation of clusters will facilitate coordination among departments in ministries, which have traditionally been operating separately. Departments in a cluster may choose to pull their budgets together in order to carry out the clusters' deliverables. Since the promulgation of the Act, clusters have been formed in nine out of the existing

[49] The 10 chapters include (i) administration for the benefit of the people; (ii) results oriented administration, (iii) effective public administration; (iv) worthiness of government functions; (v) de-layer the work process; (vi) abolishment of unnecessary agencies and functions; (vii) decentralization of missions and resources to local administrative units; (viii) empowerment of people in the decision making process; (ix) facilitation and response to customer needs; and (x) implementation of good governance.

20 ministries[50]. Additional authority has been assigned to Deputy Permanent Secretaries in each ministry to look over job promotion and compensation for Level 9 government staff[51], based on consultation with respective Permanent Secretaries.

Implementation of results-based management (RBM) is in progress. From 1999 until now, 49 government agencies have implemented the RBM while 9 additional agencies are working closely with the OPDC[52] to implement the RBM.

Public Financial Management Reform

The Budget Procedure Act (BPA) and the Financial Fiscal and Accounting Act (FFA) have been drafted but not yet approved by the Cabinet. Under the draft BPA, budget allocations will be linked to the Government's strategic goals and be more forward looking by utilizing a medium term expenditure framework. The draft FFA specifies public financial management and accounting procedures, particularly accrual accounting, to be used. Other expenditure- related acts include the Public Debt Management Act (PDMA) which has recently passed the first reading of the Parliament. The PDMA specifies the management of public debt, including limits on public debt obligation.

Although the Acts have yet to be passed, some elements of the Act have been incorporated into FY04 budgeting process. Initial measures undertaken in the budget process include the specification of indicative strategic targets and ministry service delivery targets, agency outputs, and initial performance indicators. Budgeting allocation for FY2003 is driven by the Government's priority policies, rather than traditional line item as practiced in the past. As for FY2004, the preparation of FY2004 budgeting process responds to the Government's strategic plan which focuses on four different areas: (i) sustainable economic growth; (ii) poverty reduction; (iii) better quality of life; and (iv) good governance. In addition, there has been a preparation for the Medium Term Expenditure Framework (MTEF), covering the period between FY2004-2006. This MTEF will be used as a framework for prioritizing government's policies under limited budget, with a forward-looking element.

The Agency Financial Management Information System (AFMIS) will be fully operational in mid December 2003 while the Government Financial Management Information system (GFMIS) will be implemented in all ministries by October 2004. Since October 1, 2003, the central Comptroller General's Department (CGD) has started to implement the AFMIS. Training is currently being provided to 9 regional offices of the CGD, with an aim to have AFMIS fully operational by mid-December. Currently, the GFMIS is being developed by Krung Thai Bank, based on the Cabinet's resolution on July 22nd, 2003. In October 2003, GFMIS will be piloted in two agencies i.e. the Ministry of Energy and Ministry of Information Communication and Technology, with an aim for all ministries to have GFMIS by October 2004.

Decentralization

Fiscal decentralization has proceeded with limited progress in transferring functions and personnel. Fiscal decentralization has proceeded without adequate functional decentralization taking place nor the appropriate costing of the expenditures associated with the decentralization of functions. In FY03, local government organization (LGOs) revenues

---

[50] The 9 ministries are the Ministry of Finance, Ministry of Agriculture and Agricultural Cooperatives, Ministry of Transportation, Ministry of Natural Resource and Environment, Ministry of Commerce, Ministry of Interior, Ministry of Justice, Ministry of Public Health, and Ministry of Industry

[51] There are currently 11 levels in the Thai civil service system. A Permanent Secretary of a ministry is of Level 11

[52] The nine agencies are the Department of Employment, Department of Science Service, the Cooperative Promotion Department, Department of Cooperative Auditing, Department of Livestock Development, Office of the Permanent Secretary at the Ministry of Industry, Office of the Sugar Cane and Sugar Committee, the Public Debt Management Office, the Office of the Constitution Court.

were approximately 22 percent of national government revenues, with a projection to be 22.5 percent in FY04. While this is still well below the 35 percent target set for 2006 under the 1999 Decentralization Act, it is nevertheless significantly higher than the roughly 5 percent recorded between FY 1981-99. By contrast, few personnel, expenditure and functions have been decentralized to date. By April, 3,983 civil servants have been transferred to LGOs and very few have been transferred since then. As a point of reference, Thailand has around 1.2 million public sector employees in total[53]. Limited progress has been made in decentralizing key services such as education and health. Furthermore, even if all functions were to be transferred to LGOs per the Decentralization Act, this is likely to represent a share of expenditure proportionately smaller than the 35 percent revenue target.

Key Challenges

While there has been significant ongoing progress in many areas, coordinating across the different areas of reform remains a key priority. Over many years, Thailand has had difficulty in integrating the set of reform initiatives that have been started. The set of reform initiatives now under way are appropriately more focused on an integrated 'whole of government' approach than has been the case with previous reform initiatives. To ensure that such integrated approached is realized, there will need to be consistency in the details of the design, implementation and continuing operation of the new system. This consistency will need to be in evidence in the laws that are being prepared, in the structures and processes that follow, and in the sequencing of the implementation of the changes. High-level leadership is required to ensure that the different government agencies involved work closely together.

Accountability for results is fundamental. Thailand's public sector has traditionally emphasized inputs and processes. The ongoing reforms indicate a welcome and greater focus on outputs and results. Such a focus, however, needs to be backed up by clear mechanisms for holding agencies and individuals accountable for such outputs and results. Without such accountability, there is a real danger that ongoing reforms in performance and results based management could be reduced to exercises on paper. Introducing such accountability could go a long way towards creating the performance-oriented culture needed for sustainable improvements in service delivery.

Ultimately, the success of the reform will depend upon whether a more performance-oriented culture is established. In addition to changes in structures and process, "softer" and more difficult issues of change management and culture change will need to be addressed. Effective change management requires careful planning, realistic timeframes, adequate resources, clear lines of accountability, continuous communication, and effective management of people. Ultimately, managing change is about managing people. Increasingly, attention should be given to softer issues of management such as leadership, values and ethics, communications, fairness, and openness. These will be required to build a new work culture and style that places less emphasis on hierarchy but more performance through teamwork.

---

[53] This includes 0.38 million civil servants with the remaining 0.82 million being teachers, university lecturers, prosecutors, judges, parliamentary staff, and temporary employees.

Appendix 1: Key Economic Indicators

	2001	2002 e/	2002		2003		2003		
	Year	Year	Q3	Q4	Q1	Q2	Jun	Jul	Aug
Output, Employment and Prices									
GDP (% change, previous year)	1.9	5.3	5.8	6.2	6.7	5.8	..	..	..
Manufacturing production index (1995=100)	113.6	123.3	121.2	130.4	140.4	134.9	130.8	132.7	129.9
(% change, previous year)	1.3	8.5	10.7	11.4	14.1	14.0	11.9	11.3	5.5
Unemployment rate (%)	3.3	2.4	1.8	1.8	2.8	2.5	2.1	1.4	..
Real wage growth (%) 1/	-0.6	-1.5	-1.2	-2.5	0.8	..	..	..	..
Consumer price index (% change, previous year)	1.6	0.7	0.3	1.4	1.9	1.7	1.7	1.8	2.2
Public Sector									
Government cash balance (Billion Baht)	-123.0	-76.8	-14.7	-27.2	11.6	35.5	38.1	-9.1	2.0
Government cash balance (% GDP)	-2.4	-1.4	-1.1	-1.9	0.8	2.5	..	..	..
Public sector debt (% GDP)2/	56.6	54.0	56.6	54.3	49.9	49.4	49.4	49.5	..
Foreign Trade, BOP and External Debt									
Trade balance (US$ million)	2,525	3,453	880	1,286	1,096	1442	696	-26	212
Exports of goods (fob, US$ million)	63,190	66,886	17,789	17,885	18,165	18,869	6,469	6,417	6,404
(% change, previous year)	-6.9	5.8	11.1	15.2	21.3	16.8	15	15.9	5.8
Imports of goods (cif, US$ million)	60,665	63,433	16,909	16,599	17,069	17,427	5,773	6,443	6,192
(% change, previous year)	-2.8	4.6	12.7	14.6	19.2	12.1	9.7	13.1	6.2
Current account balance (US$ million)	6,236	7,631	2,025	2,914	2,527	1,202	797	499	653
(% GDP)	5.4	6.0	6.3	8.9	7.4	3.6	..	..	..

	2001	2002 e/	2002		2003		2003		
	Year	Year	Q3	Q4	Q1	Q2	Jun	Jul	Aug
Foreign direct investment, net (US$ million)	3,759	899	-246	661	394	328	30	-10	..
Total external debt (US$ million)	67,511	58,922	61,644	59,459	56,528	55,404	..	..	..
(% GDP)	58.6	46.7	49.9	47.0	43.5	41.7	..	..	..
Short-term debt (US$ million)	13,389	11,898	14,505	11,919	12,084	12,403	..	..	..
Debt service ratio (% exports of goods and services)	20.7	18.0	18.6	18.8	22.8	12.2	..	..	..
Reserves, including gold (US$ million)	33,048	38,924	37,652	38,924	37,632	39,327	39,327	37,548	38,330
(months of imports of goods)	6.5	7.4	6.7	7.0	6.6	6.8	6.8	5.8	6.2
Financial Markets									
Domestic credit (% change, previous year) 3/	-4.6	3.6	-1.6	3.6	6.5	4.6	2.4	2.7	..
Short-term interest rate (end-of-period) 4/	2.4	1.8	2.0	1.8	1.7	1.4	1.3	1.1	1.1
Exchange rate (average period)	44.5	43.0	42.1	43.4	42.8	42.2	41.7	41.8	41.7
Real effective exchange rate (1994=100)	79.5	81.7	81.4	79.7	79.2	79.6	80.0	..	..
(% change, previous year)	-4.7	2.8	3.4	-0.5	-4.3	-4.0	-3.1	..	..
Stock market index (Dec 1996=100)	303.9	356.5	331.8	356.5	364.6	461.8	461.8	484.1	537.7
Memo: GDP (US$ billion)	115.2	126.3	31.9	32.8	34.1	33.7	..	..	..

e = estimate

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 while monthly data includes only those extended by commercial banks.

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

Appendix 2: Monitoring Matrices for Structural Reform Implementation[54]

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

[54] This appendix specifies in some detail, the reform measures taken during the last 6-12 months and their significance as well as measures to be taken in the next 6-12 months, the latter identifying key process steps that may have been taken as a prelude to those measures to be taken.

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 local economy	***Measures taken over last 6 months and their significance*** ▪ **Village support packages have been implemented.** 98.7 percent of total villages and urban communities have established their village fund and 98.3 percent of the funds have been distributed. In 2002, products from the One-Tambon-One-Product scheme have achieved sales volume more than Bt 23,000 million. Furthermore, under the 30 Baht health scheme, more than 45 million of eligible people, or 97.4 percent, have been issued health insurance cards, allowing more poor people to get access to public health system. ***Measure to be taken in the next 6-12 months*** ▪ **Holistic community poverty alleviation plans will be prepared in more than 3,000 tambons.** Government, development partners and local communities have successfully organized various workshops at the local level to prepare local communities in developing their own holistic community plan to eradicate poverty at the local level. From now until the end of 2003, the government aims to assist at least 3,049 tambons in developing their community plans. In 2004, community plans will be developed for another 2,673 tambons with low levels of living standards. It is expected that all 7,405 tambons will be equipped with their community plans by 2005.

<

2. Financial and Corporate Sector Reform

Objective		Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	***Measures taken over last 6 months and their significance*** ▪ **The two credit bureaus have re-opened, after ceasing operations upon the enactment of the Credit Information Business Act in late 2002.** The Act has many positive attributes but mandates large fines and criminal penalties against the bureaus or their members for all violations, including negligence. International standards impose criminal violations only for willful and fraudulent acts, such as the disclosure of credit information for unpermitted purposes, in violation of the law. The Credit Information Protection Committee subsequently issued notifications which clarified some issues on sharing of information and the process to receive debtors' consent. The Council of State has also issued its opinion on the interpretation of the law. The credit bureaus was recently reopened with some retooling of their management information system. ***Measure to be taken in the next 6-12 months*** ▪ **The Ministry of Finance is considering the amendment of the Credit Information Business Act.** In the meantime, two credit bureaus are still operating under legal risks.
B.	Formulate a medium-term strategy for Thai financial sector	***Measures to be taken in the next 6-12 months*** ▪ **The MOF endorse the draft of the financial sector blueprint.** The Bank of Thailand (BOT) has submitted a draft financial sector blueprint to the Ministry of Finance (MOF) for endorsement. The purpose of blueprint was to further modernize, balance and enhance the productivity of the Thai financial sector and to increase access to financial services by users in all market segments in both urban and rural areas. ▪ **The blueprint will be disseminated and implementing directives will be issued.** For example, a workshop for senior bankers to consult on a microfinance pilot is planned. The workshop will transfer international experience on institutional channels for microfinance.
C.	Transit from the current blanket government guarantee on deposits to limited deposit insurance	***Measures to be taken in the next 6-12 months*** ▪ **Blanket guarantee for creditors expected to be lifted by the end of this year.** The Economic Screening Committee, chaired by Deputy Prime Minister, Somkid Jatusripitak, recently approved a proposal by the BOT to lift a blanket guarantee for creditors of financial institutions while maintaining guarantee for depositors. Once effective, a financial institution will no longer be required to pay a fee to the FIDF on an outstanding balance of borrowing from creditors other than depositors. ▪ **The start of a measured transition to limited deposit insurance from the current blanket guarantee has been delayed, and timing is uncertain.**

	Objective	Reform Measures Taken
D.	Strengthen capacity to supervise financial institutions	***Measures to be taken in the next 6-12 months*** ▪ **The authorities are considering if and when to participate in the Financial Sector Assessment Program.** The supervisory authorities (BOT, the Securities and Exchange Commission (SEC), Department of Insurance (DOI)) are in the process of conducting self assessments on supervisory and legal framework, capacity and practice according to the reports on standards and codes (ROSCs), in preparation for possible participation in a future Financial Sector Assessment Program (FSAP). Those ROSCs include the OECD Principles on Corporate Governance, the Basel Core Principles on banking supervision and the IAIS Principles on insurance supervision.
E.	Remove legal impediments and provide an enabling environment for derivative products	***Measures taken over last 6 months and their significance*** ▪ **Derivatives Act, passed in May 2003, has become effective.** The development of derivative products and markets will allow market participants to hedge some of their risks ▪ **Derivatives Committee was set up** to design a roadmap for the development of an organized derivatives exchange, including infrastructure, operations, intermediaries, products, and investor education. ***Measures to be taken in the next 6-12 months*** ▪ **An amendment to the SEC Act will be enacted** to allow mutual funds to encumber their assets such that they can actively manage their portfolio through repurchase agreements, short-selling and derivatives ▪ **The new derivatives market will be established with Bt 300 million seed capital from the Stock Exchange of Thailand (SET).** The exchange is expected to begin its operations next year, and would initially limit its activities to futures on the stock index, interest rates and foreign exchange. ▪ **The SEC will complete phase one of a project to implement securities borrowing and lending.** ▪ Under an APEC initiative, **the MOF is reviewing recommendations from an expert panel on identification and removal of impediments to asset-backed securitization.** Securitization will provide originators of mortgages, car loans and credit card receivables with funding through the capital markets. This technology is a key ingredient to longer term, fixed rate mortgage financing.
F.	Develop local and regional bond markets	***Measure taken over last 6 months and their significance*** ▪ **Regional bond fund was established** with contributions from central banks in the region. ***Measure to be taken in the next 6-12 months*** ▪ **An action plan to harmonize the bond market infrastructure among key markets in the region will be developed.**

	Objective	Reform Measures Taken
G	Rationalize the State holding of specialized financial institutions, state owned enterprises, and state commercial banks	***Measures to be taken in the next 6-12 months*** ▪ **The merger of the Industrial Finance Corporation of Thailand (IFCT) and Bank Thai (BT)** has been recently announced and the merger will soon take place. ▪ The MOF plans to introduce the **Public Service Account framework for state owned specialized financial institutions,** which will separate subsides for publicly mandated work from finance of their commercial activities. This will allow proper budgeting on a forward-looking basis of costs for publicly mandated activities. It will also allow the MOF to hold SFIs accountable for their costs and benefits ▪ **The Vayupak Fund's launch was announced for November 2003.** The MOF will establish the Vayupak Fund, a new investment vehicle, to mobilize domestic savings for investments in government assets. A portion of the fund, offered to retail investors, will have a government guarantee on the principal and a floor rate of return. This vehicle will be a holding company for the State, with an intention to corporatize SOEs and state owned banks, and promote market-based governance while maintaining full state control.
H.	Enable corporate sector restructuring through out-of-court and court-supervised framework	***Measures taken over last 6 months and their significance*** ▪ **The new CDRAC mediation framework for debtors in the legal process has been established and implemented.** The CDRAC now provides mediation services for debtors in the legal process. In April 2003, the BOT initiated a new voluntary mediation framework for private banks and AMCs to accelerate debt restructuring for debtors in different stages of resolution. In this process, the creditors would select from the BOT list and submit to CDRAC on a monthly basis the cases they would like to further negotiate for debt settlement. CDRAC, in turn, would contact the debtors, and if agreed, both parties would enter the CDRAC-led mediation process to accelerate resolution under a required guideline and timeframe. ***Measures to be taken in the next 6-12 months*** ▪ **The Courts of Justice is proposing to remedy the backlog by possibly establishing special hours for trial, and increasing budgetary resources.** Concerns remain about the backlog in continuous hearings. The limited number of days available for continuous scheduling per week (only Tuesdays through Fridays while Mondays are reserved for court administrative businesses) is the main contributor to the backlog.

3. Reforms to improve Business and Investment Environment

	Objective	Reform Measures Taken
A.	Reform institutions to enhance competitiveness	***Measure to be taken in the next 6-12 months*** ▪ **Technical institutes will be reformed and restructured.** A recent study commissioned by the NCC to revise the roles and structure of the technical institutes to enable them to provide more in-depth services, which would enhance respective sectors' competitiveness, was completed in July 2003. Technical institutes, which will be the first to undergo restructuring both in terms of roles and funding, are the Textile Institute, Thai Automotive Institute, Food Institute, and Thailand Productivity Institute.
B.	Reform of legal and judicial regime	***Measure to be taken in the next 6-12 months*** ▪ **Partial amendments to the Bankruptcy Act are expected to be completed by mid-2004.** The Legal Reform Committee for Development of Thailand (LRC), a national committee established in 2001 by the Prime Minister, has proposed to ameliorate the legal framework of bankruptcy liquidation for individual debtors by amending the Bankruptcy Act. The amendment is currently awaiting submission to the Cabinet.
C.	Improve labor skills	***Measure taken over last 12 months and their significance*** ▪ **The Thai Vocational Qualifications (TVQs) program has been developed.** NESDB, in cooperation with the Ministries of Education and Labor and the Federation of Thai Industries, has developed the Thai Vocational Qualifications (TVQs), a program aimed to establish a national occupational skills benchmark. In August 2003, TVQs received endorsement from the Prime Minister during the Public-Private Business Forum. ***Measure to be taken in the next 6-12 months*** ▪ **The implementation plan for the Thai Vocational Qualification (TVQs)** program to standardize and build vocational skills in a manner consistent with international standards will be developed. The next steps will be to enact a new vocational law and the TVQ Act and set up a core implementing agency.

4. Trade Reforms

Objective		Reform Measures Taken
A.	Reduce tariff to improve Thailand's competitiveness	***Measure taken over last 12 months and their significance*** ▪ **Implementation of MFN tariff reduction.** The Thai government targets to reduce tariff structure into 3 bands namely, 1 percent for raw materials, 5 percent for semi-finished goods and, 10 percent for finished goods. Eight percent of total tariff lines are reduced into the three-band system in October 2003. As of January 2003, 37 percent of the total 5,505 tariff lines were already under the three-band system. In October 2003, tariff reduction of an additional 8 percent of the total tariff lines into the 3 bands became effective. ***Measures to be taken in the next 6-12 months*** ▪ **Implementation of tariff reduction under AFTA agreement.** According to the Common Effective Preferential Tariff, 60 percent of total tariff lines or 5,527 out of 9, 211 tariff lines in the inclusion list must be reduced to zero rates by January 1, 2003. However, the tariff reduction is not effective yet as the draft of ministerial order is being reviewed by the State Council. Once the ministerial order is signed by the minister of finance, the new tariff under AFTA agreement will become effective and retroactive. The items under inclusion list include industrial goods such as chemical products, ceramic products and machinery, and some agricultural goods such as animal products and fruits. ▪ **Continued implementation of MFN tariff reduction.** Another 53 percent of total tariff items or 2,930 out of 5,505 tariff lines was approved by the Cabinet this year to gradually adjust to the three-band tariff by 2005. These include chemical products, base metal, petroleum products, textiles, iron and steel, machinery and electronic appliance. ▪ **Submission of a MFN tariff restructure of the remaining tariff lines to the Cabinet.** The remaining 2 percent of tariff lines or around 108 out of 5,505 tariff lines will be submitted to the Cabinet by the end of 2003.

Objective		Reform Measures Taken
B.	Promote Thai exports to new markets	***Measure taken over last 12 months and their significance*** ▪ **Implementation of zero duties on vegetables and fruits between Thailand and China.** Trade on vegetables and fruits among the two will be subjected to zero duties starting in October 2003 as a part of trade agreement on Early Harvest program. ***Measures to be taken in the next 6 -12 months*** ▪ **Implementation of an Early Harvest scheme between ASEAN and China.** According to a framework agreement on the Comprehensive Economic Cooperation signed in November 2002, the two parties will reduce tariff on items under HS 01(live animals) to HS 08 (edible fruits and nuts) on January 1, 2004 and tariff rate will become zero by 2006 ▪ **Implementation of Early Harvest scheme between Thailand and India.** According to framework agreement on Free Trade Area signed in October 2003, Thailand and India have agreed to reduce tariff rates on 84 items. ▪ **Implementation of Early Harvest scheme between Thailand and Bahrain.** According to framework agreement on Closer Economic Partnership signed in December 2002, Thailand and Bahrain are agreed to reduce tariff rates on 626 items to 0 percent and 3 percent. The draft ministerial order of the tariff reduction is under revision by the State Council and will be effective once it is signed by the Minister of Finance.

5. Public Sector and Governance Reform[55]

Objective		Reform Measures Taken
A.	Improve public service quality by streamlining and redesigning work processes and procedures	***Measure taken over last 6 months and their significance*** ▪ **The Cabinet has approved the draft Good Governance Royal Decree, effective on October 1st, 2003.** The Royal Decree requires all public organizations' management, including budget and personnel management to perform on the basis of 'good governance' i.e. accountability, public participation, transparency, monitoring and evaluation of performance. ***Measure to be taken in the next 6-12 months*** ▪ **Implementation of results based management will begin in FY 2004.** Key performance indicators and critical success factors have been developed in all agencies. An information system, which will be linked to the Ministerial Operation Centers for a better monitoring and evaluation system, has been prepared to support the implementation of results based management.
B.	Change roles and responsibilities and right-size the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels	***Measure taken over last 6 months and their significance*** ▪ **Matrix Management System will be extended to cover all provinces except Bangkok.** In October 2003, the CEO Governor will be expanded to all provinces. The CEO Governors, appointed by the Prime Minister, act as a local administrator held accountable for meeting performance goals and has the authority to review and approve certain issues as assigned by the central government. ***Measure to be taken in the next 6-12 months*** ▪ **CEO Ambassadors will be expanded to Thai embassies in every country** after being piloted in and six embassies[56] over the past one year. All ambassadors will have to submit their plans to the Prime Minister at the end of November and the plan will be operated in January 2004.

[55] The objectives of this matrix have been adjusted to reflect those of the Government's Public Sector Development Strategy (2003-2007)

[56] Japan, USA, China, India, Belgium and Laos

	Objective	**Reform Measures Taken**
C.	Enhance 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 values, and modernizing government operation	***Measures taken over last 6 months and their significance*** ▪ **The Draft Public Debt Management Act (PDMA) passed the first hearing of the Parliament.** The PDMA specifies the management of public debt, including limits on public debt obligation. ▪ **The Agency Financial Management Information System (AFMIS) has been piloted in the Comptroller General's Department.** The development of the Government Financial Management Information System (GFMIS) is now underway and developed by the Krung Thai Bank. ▪ **The PDC has approved a plan to develop the Ministerial Operation Centers (MOC) and a budget of Bt 130 million for implementation.** This project will assist each ministry in establishing their MOC and develop its own information technology system and link it with other ministries, paving the way for the preparation of an E-government. ***Measures to be taken in the next 6-12 months*** ▪ **The Budget Procedure Act and the Financial Fiscal and Accounting Act will be submitted to the Cabinet and the Public Debt Management Act will be considered by the Parliament.** ▪ **The Agency Financial Management Information System (AFMIS) will be expanded to the regional offices of the Comptroller General's Department.** In addition, **the Government Financial Management Information System (GFMIS) will be piloted in two ministries** i.e. Ministry of Energy and Ministry of Information Communication and Technology. ▪ **The sub-committee of the PDC will develop a strategy for a new mindset, work culture and values,** as the plan was approved by the PDC on July 3, 2003. In addition, **a monitoring and evaluation system will be established to keep track of changes in mindset, work culture, and value and identify possible factors of success and lesson learned.**
D.	Improve governance in public sector through participation, accountability, and transparency	***Measure to be taken in the next 6-12 months*** ▪ **The people's audit system will be developed in pilot provinces.** This system will allow local communities to participate in decision-making processes and monitor and evaluate issues that relate to public services, environmental management, and decentralization in their communities.

6. 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	***Measure taken over last 6 months and their significance*** ▪ With cooperation from commerical insurance companies, the government introduced the **Ua Athon Accident Insurance program.** The insurance will cover accidental death or disability for anyone paying Bt1 per day premium for Bt300,000 coverage. ***Measures to be taken in the next 6-12 months*** ▪ In May 2003, the Government has announced the intention to launch a **nationwide Unemployment Insurance beginning on January 1st, 2004.** It will cover workers in the formal private sector, with equal contributions of 0.5 percent of covered wages each from employers, employees, and 0.25 percent from government. Payments will be made to employees voluntarily leaving or terminated without cause. ▪ **Proposal for multi pillar pension system will be submitted for Cabinet approval.** The reformed pension system would supplement standard defined benefit pensions (first pillar) with private investment of retirement funds (second pillar) to provide adequate coverage for an aging population. Workers in the formal sector would be covered, however consideration to savings and risk mitigation mechanisms for the informal sector are under consideration.
B.	Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement	***Measures taken over last 6 months and their significance*** ▪ **The Labor Market Information system (LMI) has been improved.** It now provides an overall picture of the labor market on the provincial and aggregate levels for macro policy formulation, and tracks unemployment and job openings on a quarterly and annual basis. ▪ **Ministry of Labor has set up a one-stop service for overseas Employment,** expected to reduce placement expenses and processing time for oversea workers. The services include skills assessment, criminal background check, physical check up, passport processing and travel arrangements, and credit for travel costs. ***Measures to be taken in the next 6-12 months*** ▪ **Proposal of an Autonomous Organization for Occupational Safety and Health (OSH) will be sent for Cabinet consideration.** Reform is under study and is expected to focus on organization mandates, resources, and capacity needs. The organization would be responsible for research and promotion of occupational safety and health in the private sector. ▪ **Labor Protection Act will be extended to agricultural workers,** including those who work in farming, fishing, forestry, animal husbandry, and salt cultivation. This extends compensation for sickness and temporary disability to up to 2.3 million agricultural workers, many of whom were previously excluded from the Act.

	Objective	Reform Measures Taken
C.	Provide effective poverty alleviation and social assistance programs for those with limited or no means of support	***Measures taken over last 6 months and their significance*** ▪ **Ministry of Social Development and Human Security launched the Ua Athon Housing project,** which gives the means-tested low income population an opportunity to own a house. The government provides anBt80,000 subsidy per qualified person and additional low interest loans. The target is to provide 1 million houses within 5 years, with a goal of 30,000 units in 2003.