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Acknowledgements

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

We would like to acknowledge input from Renuka Vongviriyatham (Financial and Corporate Sector), Tanatat Puttasuwan (Corporate Sector and Business Climate), Eric Sidgwick (Public Sector Reforms), Kaspar Richter (Poverty), Khuankaew Varakornkarn (Poverty and Public Sector Reforms), John D. Blomquist and Nantaporn Ieumwananonthachai (Social Protection). Valuable comments and information were provided by officials of the Bank of Thailand, Board of Investment, CLSA, Department of Trade Negotiations, Department of Export Promotion, Energy Policy and Planning Office, EXIM Bank, Federation of Thai Industry, Fiscal Policy Office, Fiscal Policy Research Institute, Government Savings Bank, Ministry of Labour, National Economic and Social Development Board, National Statistics Office, Office of Agricultural Economics, Office of Industrial Economics, Office of the Decentralization to Local Government Organization Committee, Office of the Public Sector Development Commission, Phatra Securities, Securities and Exchange Commission, Stock Exchange of Thailand, Siam Commercial Bank, Thai Bond Dealing Club, Thai Chamber of Commerce, Thailand Development Research Institute, UBS Warburg, as well as by World Bank staff including Homi Kharas, Ian C. Porter, Jonathan Walters, Milan Brahmhatt, and Zhi Liu.

ABBREVIATIONS

AMC	Asset Management Companies
ASEAN	Association of Southeast Asian Nations
BAAC	Bank for Agriculture and Agricultural Cooperatives
BAM	Bangkok Asset Management Corporation
BCI	Business Competitiveness Index
BOI	Board of Investment
BOT	Bank of Thailand
CB	Commercial Bank
CBC	Central Bankruptcy Court
CCI	Consumer Confidence Index
CDP	Country Development Partnership
CDRAC	Corporate Debt Restructuring Advisory Committee
CEO	Chief Executive Officer
CGD	Comptroller General's Department
CPI	Consumer Price Index
D/E ratios	Debt to Equity ratios
DBD	Department of Business Development
DEP	Department of Export Promotion
DOI	Department of Insurance
DOT	Direction of Trade
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EHS	Early Harvest Scheme
EU	European Union
EXIM Bank	Export-Import Bank
FDI	Foreign Direct Investments
FPO	Fiscal Policy Office
FTA	Free Trade Area
FTAs	Free Trade Agreements
FY	Fiscal Year
GCI	Growth Competitiveness Index
GCR	Global Competitiveness Report
GDP	Gross Domestic Product

GFMS	Government Financial Management Information system
GGA	Good Governance Awards
GHB	Government Housing Bank
GSB	Government Savings Bank
IAS	International Accounting Standard
ICAAT	Institute of Certified Accountants and Auditors of Thailand
IFS	International Financial Statistics
IMF	International Monetary Fund
IRB	Internal Ratings Based Approach
ISIC	International Standard Industrial Classification
LED	Legal Execution Department
LDD	Labor Development Department
LGOs	Local Government Organizations
LRC	Legal Reform Committee for Development of Thailand
M&A	Mergers and Acquisitions
MBNQA	Malcolm Baldrige National Quality Award
MCFD	Mediation Center for Financial Disputes
MFN tariff	Most-Favored-Nation tariff
MOAC	Ministry of Agriculture and Cooperatives
MOC	Ministry of Commerce
MOE	Ministry of Education
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MLR	Minimum Loan Rates
MUV	Manufacturing Unit Value
NCC	National Competitiveness Committee
NESDB	National Economic and Social Development Board
NCC	National Communications Commission
NPLs	Non-Performing Loans
NSO	National Statistics Office
NTBs	Non-Tariff Barriers
NTC	National Telecommunications Commission
OECD	Organization for Economic Co-Operation and Development
OPDC	Office of Public Development Commission

OTOP	One Tambon One Product
PAOs	Provincial Administrative Organizations
PCI	Private Consumption Index
PDC	Public Sector Development Committee
PII	Private Investment Index
PPI	Producer Price Index
R&D	Research and Development
RCA	Reveal Comparative Advantage
RD	Revenue Department
RDD	Rural Development Department
REER	Real Effective Exchange Rate
ROE	Return on Equity
ROSCs	Reports on Observance of Standards and Codes
SARS	Severe Acute Respiratory Syndrome
SEC	Securities Exchange Commission
SES	Socio-Economic Survey
SET	Stock Exchange of Thailand
SFIs	Specialized financial institutions
SMEs	Small and Medium Enterprises
SOCBs	State-Owned Commercial Bank
SOEs	State-Owned Enterprises
SPVs	Special Purpose Vehicles
TAMC	Thai Asset Management Corporation
TNCs	Transnational Corporations
TQA	Thailand Quality Award
UNCTAD	United Nations Conference on Trade and Development
VC	Venture Capital
WB	World Bank
WDI	World Development Indicator
WEF	World Economic Forum
WTI	West Texas Intermediate
WTO	World Trade Organization
yoy	Year-on-year

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SECTION 1

OVERVIEW

The Thai economy continues to perform well this year though growth will be lower than last year's.

Thailand's real GDP growth for the whole year is estimated to be 6.4 percent, compared to 6.8 percent last year. Higher oil prices have reduced growth but not as much as the actual rise in world prices would suggest as the domestic retail price of diesel has not been raised this year. Growth of private consumption is down relative to last year due in part to higher retail prices of gasoline for cars, and in part to slower growth in rural incomes. Growth of private investment has slowed too relative to last year, especially foreign direct investment, probably due to volatile oil prices and pre-election uncertainties. Public investment, however, has risen significantly this year, in sharp contrast to the previous five years of continuous retrenchment in public capital formation. Receipts from tourism are up strongly after the slump last year due to Severe Acute Respiratory Syndrome (SARS). Export earnings are growing strongly, though growth in export volumes is down compared to 2003, and the terms of trade will improve by roughly 3.5 percent notwithstanding higher world oil prices.

GDP growth in 2005 is projected to be around 5.8 percent, slower than this year.

This is in part due to deferred adjustment of retail prices of diesel and lower world demand for exports. The Government has announced its intention to float the retail price of diesel early next year, which would raise diesel price by more than a third of its current price; this will affect private consumption and private investment. Also, world demand for exports will be lower than 2004 – including overall growth in import demand from China.

Imports on the other hand, are projected to continue growing more rapidly given Government's plans for public investment generally and infrastructure investment particularly.

The macroeconomic situation remains robust, though higher oil prices and rising interest rates are likely to take their toll.

Headline inflation will rise to 3 percent in 2004, compared to 1.8 percent last year, largely due to the increases in oil and electricity prices. Projections for 2005 indicate that inflation will rise further to around 4 percent as retail prices of diesel are adjusted fully to reflect world prices. Real interest rates are at their lowest level. Total investment is strong as public investment is increasing rapidly after five-years of retrenchment; private consumption growth, while slower than last year, continues to be an important driver of growth.

External vulnerability to shocks has fallen further.

Total external debt has fallen to US\$50 billion by July this year (around 31 percent of GDP) – falling from \$52 billion in end-2003 – as the Government continues to prepay loans, including some to the international financial institutions. The current account surplus, though falling, will be around 4 percent of GDP in 2004, as trade surpluses narrow further with further pick-up in import demand. External reserves now exceed US\$40 billion, around 4 times the level of short-term external debt. Next year, the current account surplus is expected to decline further given the projected increases in both public and private investment and the resulting rise in imports.

Exports earnings grew by 24 percent in the first 9 months of this year¹. This growth was made possible by a 17 percent increase in world prices of exports, since export volumes grew by only 7 percent in 2003. Three export categories – electrical machinery and parts, non-electrical machinery and parts, vehicles and parts – comprised 44 percent of export earnings this year. In terms of contribution to export growth, the developed country markets (US, Europe & Japan) provided most to the growth in export-earnings, followed by ASEAN; together they accounted for two-thirds of this growth, with China contributing a tenth, significantly lower than last year. Exports to ASEAN grew by 30 percent, twice the rate of last year, while exports to China grew by 26 percent, two fifths of last-year's rate.

However, export volumes grew slowly at only 6.7 percent, compared to almost 10 percent in 2003. Clearly negative growth in volumes of agricultural and fishery exports contributed, but most of it is accounted for by a slowdown in volume-growth of manufactured exports. Within manufactures, volume growths of resource-based products and high technology products have fallen relative to last year. With rising capacity-utilization, supply-side constraints are becoming major influences on Thailand's export performance. Future private investment in manufacturing will be a key determinant of Thailand's ability to sustain high export growth.

This performance should be viewed against the remarkable Thai export performance since 1999. Exports have grown rapidly in every year except 2001, thereby raising the export share in Thailand's GDP significantly (relative to pre-crisis years) and Thailand's export share in world market. This success has been accompanied by a significant shift in the composition of exports towards higher value-added items like electrical/non-electrical machinery and parts as well as vehicle and parts. This has been driven in part by higher foreign direct investment inflows in the post-crisis period, encouraged no doubt by the liberalization of foreign entry soon after the crisis, and by the further rationalization of the import regime.

Private investment grew by 15 percent in last 9 months, a slower rate than last year. Most of this is probably accounted for by little or no growth in foreign direct investment flows. This maybe due to the uncertainties arising from higher world oil prices, the nature of adjustment in Thai retail prices of petroleum products and of course, the impending elections. However, two positive aspects of this year's growth in private investment are worth noting. First, there is a significant increase in Board of Investment (BOI) approvals of private investment applications, including FDI, suggesting that lack of FDI growth is likely to be a 'blip' rather than a trend. Second, despite the above uncertainties, private domestic investment growth remains particularly robust, a good sign for the future.

Nevertheless, some private investment characteristics suggest fragility. First, while recovery continues, private investment as a share of GDP is still only 16 percent, significantly lower than the annual average of the 1980s. Second, residential construction investment is still contributing around a fifth of the annual increase in private investment; additions to capacity supported in part by the low real interest-rates. Third, given that capacity in manufacturing appears to be constraining export-volume growth, even a temporary slowdown in private investment growth is likely to slow export volumes next year.

Banks increased corporate lending is likely to sustain increasing private investment. There is a rise in banks lending to businesses this year relative to last year, growing at an annualized rate of 14 percent over last year. These loans appear to be going mainly to tradable sectors, and relatively large firms.

Public investment will grow this year for the first time since the crisis. After retrenchment for the past 5 years, public investment grew by more than 7 percent this year. With the Cabinet approval of large infrastructure projects, growth in public investment next year is likely to be much higher than 2004. This continuing rise in public investment will thus become an important driver of growth in future.

¹ Based on BOP basis.

The Government is considering a large five-year program of public infrastructure investments.

The financing mechanisms are still not clear. The final size of the program will depend on how the financing constraint is addressed. Nevertheless, a large investment program will have several macroeconomic implications, one of which relate to the evolution of current account balance; it is very likely that Thailand will generate a current account deficit sooner than would happen on current trends.

But will these investments “crowd-in” private investment and promote sustained growth.

This will depend on whether public infrastructure investments will enhance competitiveness of the Thai economy, thereby raising rates of return on private investment. This can happen if the Government addresses three issues. First, public infrastructure investment program should be embedded in an overarching strategy for delivering better quality and more cost-effective infrastructure services aimed at improving competitiveness. Second, these investments will have to be accompanied by policy changes that will promote inter-modal and logistics efficiency and ensure better mix of public-private investments in infrastructure and logistics. This means that current restrictions on private entry and operation will have to be relaxed. Third, public organizational arrangements – in Bangkok and in the provinces – will have to be developed in a way that increases operational efficiency of public infrastructure investments.

Addressing the existing restrictions on the services sector will be important in this context.

A recent study shows that regulations restricting domestic and foreign entry in air transport services, ports, and telecommunications are raising costs and prices of those services. In these sub-sectors, despite some relaxation in the early post-crisis years, restrictions remain high compared to countries in the region and outside. They probably reduce the size of investment going into those sectors and certainly lower the size of the sector. Thus relaxation of these restrictions is likely to enhance competition and investment, reduce cost, and raise incomes in the services sector, and generate an additional source of growth for the

economy. While regulations for distribution services as well as for banking were relaxed in the early post-crisis years, and the current situation compares favorably with other countries, given the size of these service sectors there is considerable room for further growth too.

The 2004 Global Competitiveness Report shows that other countries are moving ahead in competitiveness.

Thailand’s rank in overall “Growth Competitiveness” has slipped from 32 in 2003 to 34 in 2004. This is notwithstanding the significant improvement in ranking on macroeconomic environment. The largest declines in ranking are in respect of public institutions (by 7 places) and in technology (by 4 places), largely because other countries have moved ahead.

Household consumption growth slowed relative to last year, but continues to be an important growth driver.

Household consumption in the first half of this year grew by 5.8 percent, a slow down from 6.2 percent in the same period last year, and will likely slow down in the second half when oil prices has rises sharply and consumer confidence declines. Continued growths in consumer credits and farm incomes this year and supportive government measures, will support consumption growth, helping to cushion some of the adverse impacts of the oil price rise. Consumption of services accounts for more than half of consumption growth, at least for the first half of the year, compared to only a quarter last year. This is primarily because of the rebound of tourism-related services such as hotels and restaurants and transportation services from their slump last year.

While banks’ exposure to households has risen further, household debts look manageable.

Thailand’s household debt to disposable income has been rising since 2002 and is close to 62 percent this year. This has been accompanied by rising household debt for all income groups; the lowest income group and the highest have the highest debt as a share of household income, making them vulnerable to a rise in interest rates.

Positive developments are seen in the financial and corporate sector, though more remains to be done. In the financial sector, bank supervision was strengthened by the Bank of Thailand (BOT) and prudential regulation on loan classification and enforcement has been tightened. Aggressive loan expansion by a large state commercial bank has slow down following the BOT's intervention. In the corporate sector, the Parliament has passed partial amendments to the Bankruptcy Act, which are aimed at ameliorating the legal framework for individual bankruptcies. Nevertheless, NPLs are still in double-digits and measures to expedite NPL resolution has been delayed and still awaits the enactment of amendment to AMC law.

Implementation of reforms in 2004 continue, but at a relatively slow pace. There has been further rationalization of import tariffs and signing of FTAs that are increasing competition for producers and opening up better export opportunities. Similarly, changes in public sector governance in respect of public financial management and public administration streamlining continue. There have been fewer changes in respect of private investment regulations while the changes in legal framework formulated for the financial sector, secured transactions, collateral and so on, still remain to be enacted and implemented.

SECTION 2

RECOVERY AND OUTLOOK

2.1 Real GDP Growth 2004 and 2005

The Thai economy weathered both internal and external shocks this year. Higher oil prices, the Avian Influenza, and the unrest in the far South have adverse impacts on output growth. The rise in oil price and the Avian Influenza outbreaks are expected to shave real GDP growth this year by 0.7 and 0.4 percent², respectively (see Box 1 for the discussion on the impact of oil price rise). Albeit the subsidies provided on retail prices of certain types of gasoline, gasoline prices this year have risen on average by 7 percent year-on-year, leading to a rise in inflation. For the whole year, inflation will rise to about 3 percent, up from 1.8 percent last year. The rise in oil prices and inflation, coupled with the unrest in the South has reduced not only, consumer's confidence and consumption, but also, to a certain extent, business sentiment and private investments. The direct impact of the unrest in the three Southern provinces is, however, expected to be minimal as they account for less than 2 percent of total GDP. Most of the impact will be on consumers and business confidence.

Nevertheless, real output growth this year continues to be robust. The adverse impacts are somewhat mitigated by continued low real interest rates, growth in investments and exports and favorable terms of trade. Real GDP is likely to grow around 6.4 percent this year, a slow down from 6.8 percent last year. Real lending rates have been declining since 2002 as

inflation has been rising faster than interest rates. Continued double-digit growth in private investment has brought its share in GDP up to about 17 percent, a 2 percent increase from that of last year. Public investment grew for the first time this year after declining for 5 consecutive years since the crisis. Real exports of services, grew faster this year with the rebound of tourist receipts which slumped last year due to the Severe Acute Respiratory Syndrome (SARS) outbreak. Despite the rise in oil import prices, the terms of trade³ continues to be favorable this year, as export prices have increased considerably. Improved terms of trade, rising farm incomes, low real interest rates, and continued expansion in consumer credits, have helped support private consumption growth this year.

Growth next year will slow down slightly due to the impact of high oil prices, a slow down in exports growth, and declining terms of trade. With retail diesel price ceilings likely to be lifted early next year, the rise in gasoline prices and inflation will decelerate consumption growth and reduce GDP growth next year by 0.4 percentage-point. In addition, real exports will likely expand at a slower pace as growths of world trade volumes and real output, including those of China, are projected to slow down from those of this year. Real imports, on the other hand, will grow as public investment accelerates, thus, further reducing the contribution of net exports to overall

² See discussion on the impact of the Avian Influenza in the Thailand Economic Monitor April 2004 issue.

³ Terms of trade is the ratio of export prices to import prices.

Box 1. The Impact of the Oil Price Rise

The impact of the global oil price rise, though cushioned by subsidies on retail gasoline prices, is estimated to reduce GDP growth by 0.7 percentage-points this year and by another 0.4 percentage-points next year. Crude oil prices have risen sharply in 2004 by about 35 percent from the levels in 2003. The main impacts would be on transportation and production costs, which would translate into higher general price levels and a respective fall in real demand. As diesel consumption is the largest share of oil consumption in Thailand followed by benzene, the ceilings imposed on retail diesel and benzene prices since January this year will result in their prices this year rising on average by approximately 4 percent and 18 percent, respectively. Benzene retail price ceilings have been gradually raised and since September, they are comparable to market prices. Benzene prices were later floated in late October. The retail diesel price ceiling on the other hand has not been revised since January this year. However, the Government has announced that the ceiling will be lifted in the second quarter of 2005. Should this be the case, retail diesel prices next year will likely rise by almost 10 percent (see Table 1). In addition to higher commuting costs for consumers, the rise in retail oil prices will also raise the general price level as the costs of production and transportation rises. The rise in these costs could increase headline inflation by an additional 0.9 percentage-points this year and another 0.4 percentage-points next year. These could result in a decline in real consumption, thus, reducing overall real GDP growth by 0.7 percentage-points this year and approximately another 0.4 percentage-points next year. This estimation, however, has not taken into account other indirect impacts such as inefficient energy use propagated by lower-than-market retail gasoline prices, loss in terms of trade⁴, and economic losses from other measures put in place to lower oil consumption⁵.

Table 1. Petroleum Retail Price Increase, 2004 and 2005

(Percent)

	Share in total oil consumption (2003)	Price Increase	
		2004	2005p
Premium Gasoline	8.1	18.0	-3.04
Regular Gasoline	12.0	20.0	-2.4
Diesel (Highspeed)	46.0	4.0	8.7
Fuel Oil	13.1	5.5	-7.7
LPG	10.5	10.7	8.3
	Weighted average	7.5	3.3

Source: World Bank staff computation Note: 2005 projections are based on the assumption that the diesel and LPG price ceilings will be lifted in 2005Q2. Average crude oil price (equally weighted average of prices of Brent, Dubai, and WTI) is estimated to be US\$39 per barrel in 2004 and US\$36 per barrel in 2005 (Source: DECPG, World Bank, October 2004).

The direct cost of the cushion in the form of subsidies provided by the Oil Fund is estimated to total up to Bt90 billion. By the end of 2004, the Oil Fund would have subsidized approximately Bt65 billion baht and will be running a deficit of around Bt60 billion⁶. The deficits have so far been financed by commercial bank loans. More than half of the subsidies are for diesel. Should the subsidies continue into the first quarter of 2005, it would likely cost the Oil Fund an additional Bt20 billion⁷.

⁴ Terms of trade loss this year is estimated to be about 2 percent

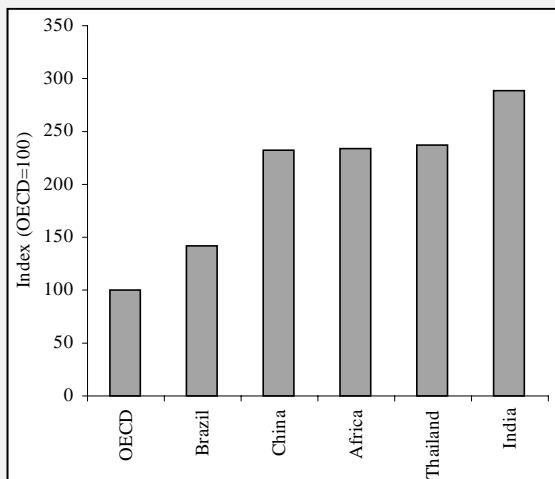
⁵ An example is the restriction on operating hours of discount stores.

⁶ Prior to April 2004, the Oil Fund was able to finance approximately Bt 5 billion of subsidies from its prior accumulated revenues (a required fraction of the sales of each liter of gasoline is contributed to the Oil fund).

⁷ Assuming that average world crude oil price is US\$39 per barrel in 2004 and US\$36 per barrel in 2005.

With uncertainties in the oil price trends, retail prices ceilings need to be revised upwards or abandoned to promote more efficient energy use. Thailand's oil intensity as measured by oil consumption per unit of real GDP is 2.5 times higher than OECD countries (see Figure 1). Compared to countries with similar real GDP to Thailand, Thailand's oil consumption is currently almost double those of the other countries (see Figure 2). With the future oil prices likely to remain high, the upward revisions of the ceilings or their abolishment will be necessary to signal the need for more efficient use of oil and the adoption of alternative fuels. In addition, the upward revisions of the ceilings or their abolishment would keep the subsidies at levels that will not impose heavy fiscal burdens nor impede growth in the future

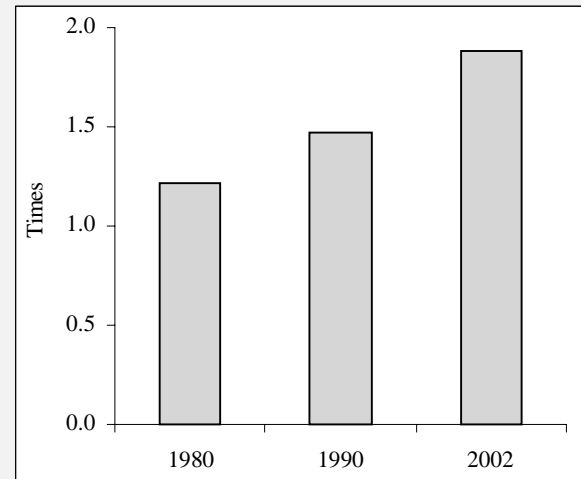
Figure 1. Oil Intensity, 2002



Source: IEA

Note: Oil intensity is oil consumption per unit of GDP

Figure 2. Thailand's Oil Consumption compared to Countries with Similar Real GDP Levels



Source: GDF and IEA

Notes: Net oil importer countries with real GDP level within US\$20 billion higher or lower than Thailand's are included in the group. There are 10, 4 and 3 countries in 1980, 1990 and 2002, respectively.

GDP growth next year. Moreover, terms of trade will likely decline next year as export prices are on a declining trend. As a result, real GDP will likely grow at around 5.8 percent.

External vulnerability continues to fall. The current account this year remains positive at US\$6 billion or almost 4 percent of GDP, although it has declined by US\$2 billion from that of last year due to the narrower trade surplus. The surplus has contributed to a further build-up of reserves to over US\$40 billion or around 4 times that of short-term external debt in the first 9 months of this year. External debt at the end of July has declined by US\$2 billion from that of end 2003 and stands at 31 percent of GDP,

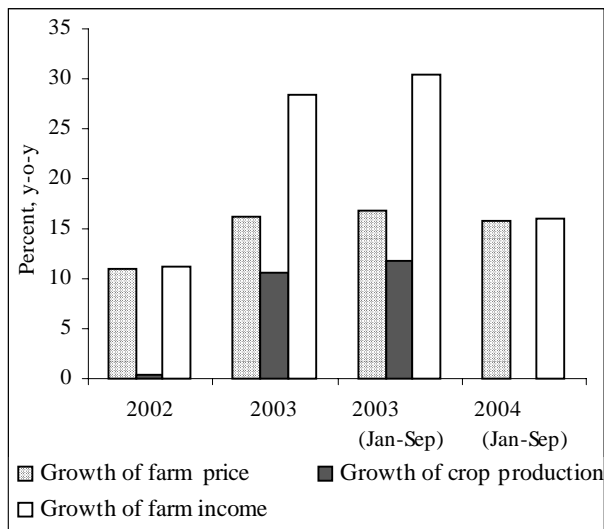
lower than half the level in 2000. Short-term external debts have been stable at around 20 percent of total external debt. However, next year the current account surplus should decline further as the trade account will be close to balanced as imports continue to grow rapidly with the acceleration in investment.

2.2 Poverty

A sharp rise in farm incomes for the past 3 years has helped alleviate poverty. Due to increases in the world prices for Thailand's major crops, farm prices and nominal farm incomes have been rising rapidly since 2002 (see Figure 3). As agriculture prices continue to

rise faster than those of manufactures⁸, *real* farm incomes also rose. This has helped lift consumption of rural farm households and reduce poverty as the majority of the poor in Thailand is engaged in rural farming activities. The poor have especially benefited from the rise in rice prices⁹ as a fifth of them are rice farmers of which the majority is located in the North-east where two-thirds of Thailand's poor resides.

Figure 3. Farm Production, Price, and Income



Source: BOT

In addition, public programs targeted at eradicating poverty have made progress. As part of the efforts to eradicate poverty within the next 6 years, the National Poverty Eradication Center, announced in October 2004 new measures to assist the registered poor people. During the first half of 2004, impoverished and vulnerable persons were asked to register and to state the major reasons for their poverty. Building on this initiative, poverty-relief caravans will be sent out from November 2004 onwards. The caravan of experts and advisers aims to meet with every registered family to advise and train them on how to make a living. In

⁸ Agriculture prices as a ratio of manufactures prices have been rising from 1.1 in 2002 to 1.3 in 2004.

⁹ Rice prices have risen by more than 15 percent year-on-year this year on top of a 3 percent rise last year (See Table 6 in Household Consumption Section)

addition, five state-owned financial institutions – Krung Thai Bank, Government Savings Bank, Government Housing Bank, Bank for Agriculture and Agricultural Cooperatives, and Small and Medium Enterprises Development Bank – will be asked to assist the 2.5 million people who registered under the poverty registration scheme with debts totaling about Bt 280 billion.

Additional grassroots financial schemes have also been put in place. Two new initiatives signal the consolidation of the revolving Village Fund scheme¹⁰. First, the Small-Medium-Large (SML) scheme, initiated in the second half of this year will complement the Village Fund scheme by providing grants to villages to fund village-level infrastructure projects. The SML-scheme will be piloted in 1,002 villages. If successful, the project will be scaled-up to all 75,000 villages by the end of next year. Second, the Bank for Agriculture and Agricultural Cooperatives (BAAC) has encouraged villages to pool together their resources from the Village Fund by establishing community banks.¹² The BAAC will stop lending to villagers and instead grant corporate loans to the community bank for re-lending to villagers. The Village Fund offices will serve as branches of the community bank.

2.3 Uncertain External Environment

Oil prices are expected to remain at a high level. Oil prices have been steadily rising since the beginning of the year and should average at around US\$39 per barrel this year, compared to an average of US\$29 per barrel last year. Oil prices on average next year are

¹⁰ The Village Fund scheme was started in 2002 and initially provided Bt 1 million to each village.

¹¹ Small villages will receive grants of Bt200,000, medium-size villages Bt250,000, and large villages Bt300,000.

¹² For example, the eleven villages of the Puanpu sub-district (tambon) in the Northeastern province of Loei have pooled their resources from the Village Fund scheme to set up a community bank for the entire sub-district.

likely to decline to around US\$36 per barrel, although prices will be higher in the beginning of the year.

World real output growth this year has been robust but is expected to slow down next year.

World real output this year grew by 4.0 percent, with the OECD countries, including the US and Japan, growing faster than last year. With continued high oil prices, world output next year will grow at a slightly lower rate than that of this year as growths in the United States and Japan are expected to slow down, while growth in the Euro area will likely accelerate (see Table 2).

World trade volume growth will likely slow down next year after having grown robustly this year.

World trade volume growth this year was exceptionally high at 11 percent year-on-year. On the back of this high growth, world trade volume next year will continue to grow at almost 9 percent. Imports of the United States and China, two of Thailand's major export markets, will likely grow slower next year as output growth slows down in the two countries. However, their slow down will be partly offset by Japan's higher import growth.

Table 2. External Environment, 2003-2005

	(Percent yoy)		
	<i>Est.</i>	<i>Forecast</i>	
	2003	2004	2005
Growth of Real Output			
World	2.7	4.0	3.2
o/w OECD	2.0	3.5	2.6
United States	3.0	4.3	3.2
Japan	2.5	4.3	1.8
Euro Area	0.5	1.8	2.1
China	9.3	9.2	7.8
Growth of Trade Volume a/			
World Trade Volume	6.7	11.1	8.7
o/w G-7 Import volume	3.7	7.8	6.3
o/w North America	4.5	10.1	4.7
o/w Japan	6.1	6.5	9.0
o/w Euro Area	3.0	5.6	6.6
Growth of Price Indicators in U.S. dollars			
G-5 MUV index in U.S. dollars b/	7.4	6.0	-1.6
Oil prices (US\$/barrel) c/	16.0	35.0	-7.7
Non- Oil Commodity Price Index (current dollars) d/	10.0	17.1	-3.3
LIBOR (US\$6 month)			
(% per year)	1.2	1.6	3.5

Source: DECPG, World Bank (October 2004)

a/ Merchandise exports/imports

b/ MUV is the manufacturing unit value. The G-5 countries are France, Germany, Japan, United Kingdom, and United States

c/ Oil prices are the annual average prices of Brent, Dubai, and WTI, equally weighted.

d/ The World Bank index of 33 non-oil commodity prices, weighted by 1987-89 developing countries exports.

Non-oil commodity and manufacture prices are projected to decline next year after rising for the past 2 years. International non-oil commodity and manufacture prices have been increasing rapidly since 2003 (see Table 2). Next year, however, these prices are projected to fall. With the fall in the international non-oil commodity prices, prices of Thailand’s major crop exports are also expected to fall by around 6 percent on average (see Table 6 in Household Consumption section). International manufacture prices, proxied by the G-5 (France, Germany, Japan, UK, and US) manufacturing unit value (MUV), are also expected to decline by roughly 1.5 percent next year.¹³ This would put a downward pressure on Thai manufacture export prices as the G-5 countries are Thailand’s major export markets.

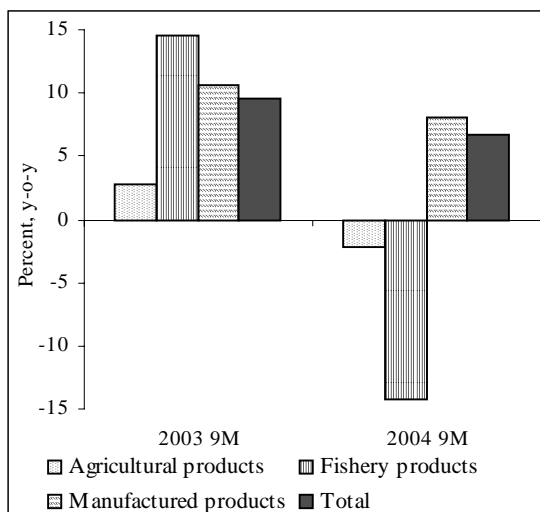
2.4 Export Performance

In the first nine months of 2004, export value grew by over 20 percent supported by buoyant export prices despite sluggish export volume growth. Export value during January to September 2004 grew by 22.8 percent in US dollar terms compared to 16.1 percent in the previous period¹³. Export prices grew by 16.3 percent compared to 6.7 percent in 2003 while export volume grew by 6.7 percent compared to 9.6 percent last year.

The reduction in export volume growth this year is attributed to the decline in agricultural and fishery export volumes and to the slowing down of manufactured exports volume growth. Total export volume expanded by 6.7 percent in the first 9 months of this year. This can be partly explained by the decline in the agricultural and fishery export volumes from the same period last year (see Figure 5) as a result of a contraction of export volume of shrimps, poultry and rubber¹⁴. In addition, labor intensive and resource based manufactured products also recorded negative export volume growths, while those of high-tech products slowed down (see Figure 5).

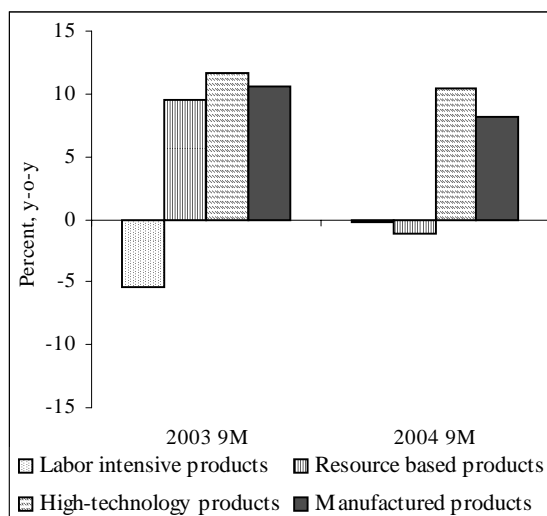
¹³ The growth rate is based on customs basis while export growth rate based on the BOP basis is 24 percent.

Figure 4. Export Volume Growth, January-September 2004



Source: BOT

Figure 5. Export Volume Growth of Manufactured Products, January- September 2004



Source: BOT

¹⁴ Total shrimp exports in the first nine months of 2004 reduced by 13.3 percent due to a decrease in exports to major markets like the US (-29.9 percent) and Japan (-4.2 percent). A temporary implementation of 5.56-10.25 percent anti-dumping duties on Thai shrimp exports to the US, Thailand's biggest shrimp importer, effective in August 2004 would further affect shrimp exports in the rest of the year. Poultry exports also fell by 44 percent as a consequence of the Avian Influenza. Export shares of the two together declined from 2.3 percent in January to September 2003 to 1.3 percent in 2004. Rubber export volume also declined by 10.6 percent.

**Table 3. Contribution to Export Growth Classified by Sectors
in the First Nine Months of 2003 and 2004**

(Percent)

	2003 9M			2004 9M		
	Export share	Export growth	Contribution to export growth	Export share	Export growth	Contribution to export growth
Agriculture 1/	10.4	22.0	13.5	10.2	20.0	9.1
Manufacture	85.8	16.3	86.5	86.8	24.2	91.1
Resource based products	8.5	12.6	6.8	7.4	7.3	2.7
Others manufacture products 2/	77.3	16.7	79.6	79.4	26.0	88.4
Others 3/	3.8	0.0	0.0	3.0	-1.3	-0.2
Agriculture and resource based products	18.9	17.6	20.4	17.6	14.3	11.9
Total exports	100.0	16.1	100.0	100.0	22.8	100.0

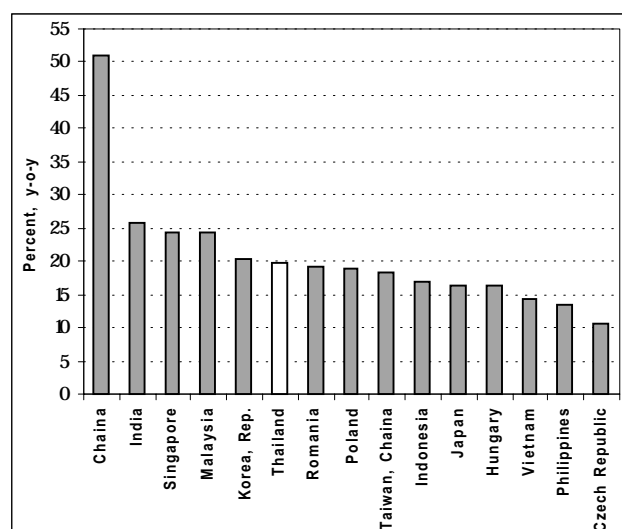
1/ including crops, fisheries and forestry

2/ including labor intensive and high-tech products

3/ including mining, sample & other unclassified goods, and re-exports

However, in terms of export values, Thailand's performance this year is exceptionally strong, surpassing many countries in the region. In the first 9 months of this year, export values have expanded by 22.8 percent year-on-year (see Table 3). Compared to other countries in the first 7 months of this year¹⁵, Thailand export growth rate of 19.8 percent surpassed the average export growth rate of ASEAN-6 which grew by 18.9 percent¹⁶. Except for Malaysia and Singapore, other ASEAN-6 members did not perform as well as Thailand. However, China remained the export leader in the region with 51 percent growth rate, outperforming others in the region and those from Eastern Europe (see Figure 6).

Figure 6. Growth Rates of Selected Countries' Exports to World Market, January-July 2004



Source: DOT

¹⁵ Data for other countries' exports is available for only the first seven months of 2004.

¹⁶ ASEAN-6 includes Indonesia, Philippines, Malaysia, Singapore, Thailand and Vietnam. Thailand.

Exports to traditional and regional markets helped support export growth this year as export growth to the Chinese market slowed down.

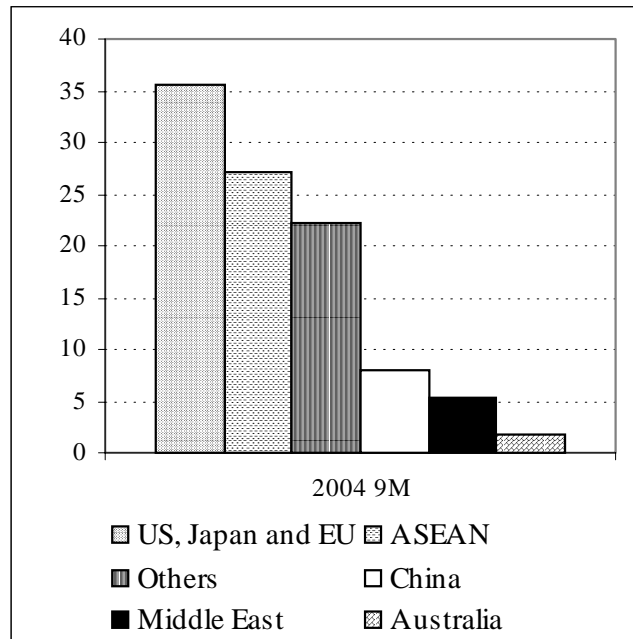
Exports to the G-3 markets and ASEAN contributed almost two-thirds of total export growth during the first nine months of 2004 compared to half of the growth last year. In contrast, exports to China attributed less than 10 percent to total export growth, only two fifths of last year's contribution (see Figure 7). Exports to the US, Japan and the EU grew at an average rate of 17.4 percent while export growth rate to ASEAN was 30 percent, almost double the rates of last year's. Exports to China grew by 26.4 percent, around two fifths of the growth rate in January to September last year (see Figure 8).

Manufactured products were still the engine of export growth, while export performance of the agricultural sector was weaker than last year.

Exports of manufactured products excluding resource-based ones during January to September 2004 contributed almost 88.4 percent to total export growth compared to 79.6 percent of last year (see Table 3). Strong export performance of the manufacturing sector is a result of the recovery in the electronics sector in line with increased global demand for information technology products. Exports of agriculture produce and resource-based manufactured products contributed less than 12 percent of total exports growth compared to 20 percent in last year. Drought and the Avian Influenza resurgence resulted in the sluggish exports of the agricultural sector, however high agricultural prices this year have helped support the growth of agricultural exports¹⁷.

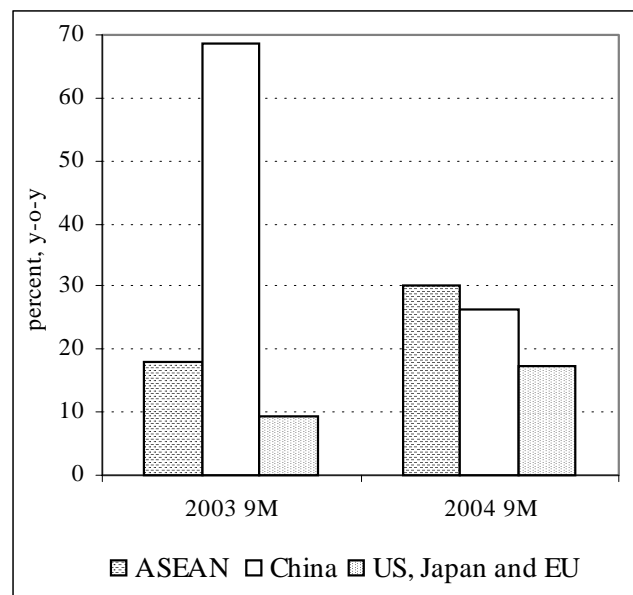
At two-digit HS code, vehicles and parts have entered the top 3 list, replacing rubber and its products. Thailand exports were dominated by three major categories. Electrical machinery and equipment (HS85), non-electrical machinery and parts (HS84) and

Figure 7. Contribution to Export Growth of Various Export Markets, January-September 2004



Source: BOT

Figure 8. Export Growth to Various Markets, January-September 2003 and 2004



Source: BOT

¹⁷ Unit value of agricultural export products grew by 28.6 percent in the first nine months of 2004, compared with 21.9 percent last year.

Table 4. Top Ten Export Products in the First 9 months of 2003 and 2004

(Percent)

No.	HS Code	Description	2003 9M			2004 9M		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	85	Electrical machinery and equipment	20.9	11.7	15.4	21.7	26.5	25.7
2.	84	Non-electrical machinery and parts	16.1	16.3	15.8	16.3	23.0	17.2
3.	87	Vehicle and parts	5.1	37.9	9.9	6.0	42.6	10.1
4.	40	Rubber and articles thereof	5.5	51.0	13.0	5.5	22.4	5.7
5.	39	Plastics and articles thereof	4.3	23.6	5.7	4.6	30.2	6.0
6.	27	Mineral fuel oil wax	2.6	19.9	3.1	3.2	47.6	5.8
7.	10	Cereal	2.1	5.8	0.8	2.8	67.7	6.5
8.	16	Preparation of meat fish	3.4	14.3	2.9	2.8	1.6	0.2
9.	71	Pearls, precious stones and metals	3.1	16.2	3.1	2.7	4.2	0.6
10.	61	Knitted or crocheted apparel and Clothing accessory	2.1	2.0	0.3	1.9	11.3	1.1

Source: MOC

vehicles and parts (HS87) are the top 3 Thai exports, in the first nine months of this year, contributing 53 percent of total export growth. In the first nine months of 2004, exports of vehicles and parts contributed 10 percent to total export growth and grew by 43 percent due to a strong demand in the region.¹⁸ Rubber exports (HS40), in contrast, contributed 5.7 percent to total export growth, half of last period's contribution, with growth rate also around half of last year's. Cautious economic expansion in China, Thailand's major export market of rubber, was a part of the reason of a slower export growth of rubber this year¹⁹ (See Table 4).

Rice exports increased this year because of lower supply from Thailand's major competitors. Rice production in India, Vietnam, and Pakistan is will be lower this year due to poor weather conditions in those countries. With the supply constraints, international rice prices this year will rise by more than 16 percent. As

a result, in the first nine months of 2004, exports of Thai rice increased significantly by 64.3 percent in US dollar terms compared to 5 percent in same period last year.

¹⁸ Exports of vehicle and parts (HS87) to ASEAN members increased by 72.5 percent in US dollar terms, the first nine months of 2004 and so did exports to US market which grew by 50.4 percent. However, exports of vehicle and parts to EU and Japan decreased by 2.7 and 2.2 percent, respectively.

¹⁹ In the first three quarters of 2004, rubber exports to China grew by 13.6 percent in US dollar terms compared to an expansion of over 139 percent in the last period and making China the second largest rubber importer from Thailand (16 percent of Thailand's total rubber exports). The largest rubber export market is Japan with a share of 16.3 percent of Thailand's total rubber exports.

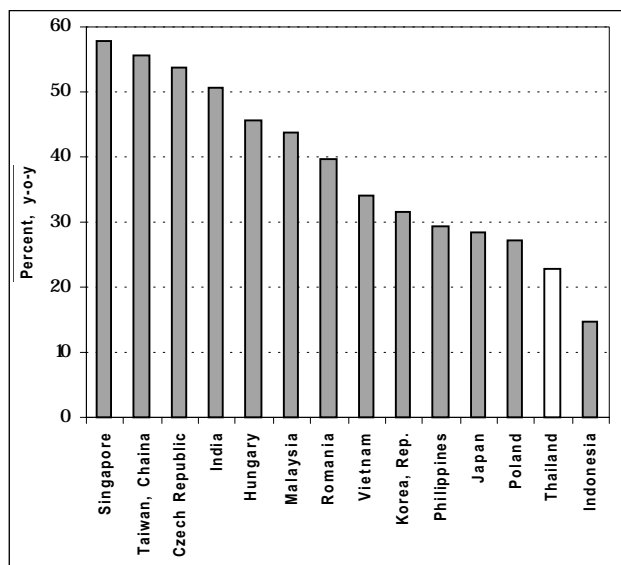
Exports will do very well for the whole of this year, but are likely to slow down next year. World trade volume in 2004 is expected to grow by 11 percent, twice last year's growth, mainly due to the economic recovery in major markets like the US, EU and Japan. In addition, export prices have been quite buoyant. These would help support Thailand's robust exports growth this year. Next year, growth of Thai goods exports will slow down slightly as world trade volume, including China's imports slows down, while energy prices remain high. Growth of services exports will likely remain high, though will be lower than this year's as there will no longer be a base effect as there was this year.²⁰ As a result, growth of real exports of goods and services should experience a slight slow down next year.

Exports to China

Overall exports to China slowed down this year as a consequence of tightening policies aimed to slow down the overheated Chinese economy. Thai exports to China in the first nine months of 2004 grew only by 26.4 percent compared to 68.6 percent last year. Thailand's exports to China also grew slower than those of other countries, at least in the first 7 months of this year (see Figure 9). The slowdown of Thai exports can be attributed to the tighter policies implemented since 2003 to slow down the Chinese economy. These include, for example, restrictions on bank loans to the property sector, increases in reserve requirements, a reduction in the budget deficit from 2.7 percent of GDP in 2003 to 2.2 in 2004, and increase in retail electricity prices and water rates. These have affected Thai exports to China as many of them are inputs to the sectors affected by the tightening policies. Nevertheless, Thai exports to China in January to September this year remains high at US\$ 5 billion which is over two times that of 2001 and 2002.

Exports of the top ten products to China generally slowed down this year. Export growth rates of seven of the top ten products slowed down from an average growth rate of 103.9 percent in Jan-Sep 2003 to 11 percent in January to September 2004²¹ (see Table 5). Export growth of iron and steel (HS72) had turned negative, while that of rubber and their products have declined significantly. These exports were to a large extent affected by China's policies to cool down the overheated sectors, particularly the steel and property sectors, to which these exports are inputs²².

Figure 9. Growth rates of Selected Countries' Exports to China, January to July 2004



Source: DOT

²⁰ Services exports, primarily tourism, slumped in 2003 because of the SARS outbreak. The high growth of services exports this year reflected the low base in 2003.

²¹ These include Non-electronical machinery and parts(HS84), Electrical machinery and equipment(HS85), Rubber and its products(HS40), Mineral fuel oil wax(HS27), Organic chemical(HS29), Wood and articles(HS44) and Iron and steel(HS72).

²² The over-invested industries include steel, aluminum, cement, automobile and property.

Table 5. Top Ten Export Products to China in the First Nine Months of 2003 and 2004

(Percent)

No.	HS Code	Description	2003 9M			2004 9M		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	84	Non-electrical machinery and parts	22.4	79.5	16.8	22.9	28.1	6.3
2.	85	Electrical machinery and equipment	14.0	79.7	10.5	13.3	18.3	2.6
3.	40	Rubber and articles thereof	13.7	139.3	13.5	12.4	13.6	1.9
4.	27	Mineral fuel oil wax	11.0	78.0	8.1	10.2	16.3	1.8
5.	39	Plastics and articles thereof	7.2	33.1	3.0	8.5	47.9	3.5
6.	29	Organic chemical	5.5	125.9	5.2	4.9	12.4	0.7
7.	07	Edible Vegetables	2.4	8.7	0.3	3.3	69.1	1.7
8.	10	Cereal	1.0	-14.8	-0.3	3.0	266.3	2.7
9.	44	Wood & articles	2.6	56.2	1.6	2.9	39.6	1.0
10.	72	Iron and steel	3.8	168.8	4.0	1.5	-51.5	-1.9

Source: MOC

Tariff reduction under the ASEAN-China Free Trade Agreement was effective this year; so far, their contribution to export growth was negligible.

Tariffs on products under codes HS01 to HS06 will be reduced to zero by 2006²³. From January to September 2004, export products under these categories accounted for 0.9 of total exports to China and contributed less than 1 percent to export growth to China. Similarly, imports of the six categories from China accounted for 0.7 percent of total imports and contributed around 0.1 percent to growth of Thai imports from China.

²³ These include HS01 (Live animals), HS02 (Meat and Edible Meat Offal), HS03 (Fish), HS04 (Dairy Products), HS05 (Other Animals Products), and HS06 (Live Trees). Those with tariffs less than 5 percent have been reduced to zero in 2004; those between 5 to 15 percent have been reduced to 5 percent in 2004 and will be 0 percent in 2005; those exceeding 15 percent have been reduced to 10 percent in 2004 and will be 5 and 0 percent in 2005 and 2006, respectively.

Nevertheless, on these products, Thailand has a surplus of US\$5.8 million in the first 9 months of this year compared to a US\$ 11.5 million surplus last year.

Thailand also remained a net exporter of vegetables (HS07) and fruits (HS08) after 12 months of zero-tariff implementation under the early harvest program with China.

From October 2003 to September 2004, Thailand ran an export surplus of US\$164 million from vegetable trade with China through a substantial expansion of manioc exports²⁴. The surplus has significantly increased compared to US\$97.3 million in the previous year. Net exports of fruits were also in surplus by US\$5.4 million; however, it was only one fifth the level of last year.

²⁴ Manioc is the largest vegetable exports to China accounting for 3.3 percent of total Thailand exports to China in the first nine months of 2004 compared to 2.4 percent in the last period and growing over 70 percent during this period.

The Thai Government has been successful in lowering Chinese non-tariff barriers (NTBs) on vegetables and fruits. Previously, there were two main concerns on the Chinese NTBs on vegetables and fruits imports, namely the required high qualifications of trading firms and the sanitary and phytosanitary measures²⁵. The Thai Government has worked to resolve these issues and on July 1, 2004, China has lowered the required qualifications for trading firms, allowing small and medium size firms to enter the market and thus facilitating Thailand's trade on these products with China. China and Thailand have also signed a Memorandum of Understanding (MOU) in April 2004 to collaborate on sanitary and phytosanitary measures in order to accelerate the goods inspection process once Thai exports arrive at Chinese ports²⁶.

2.5 Household Consumption

Real household consumption growth slowed down slightly from last year and will slow down further next year. Household consumption in the first half of this year grew by 5.8 percent, a slow down from 6.2 percent in the same period last year, and will likely slow down in the second half when oil prices rise sharply and the unrest in the far South negatively affect consumer confidence (see Figure 10). However, continued growth in consumer credit and farm incomes and supportive government measures will support consumption growth and help to cushion some of the

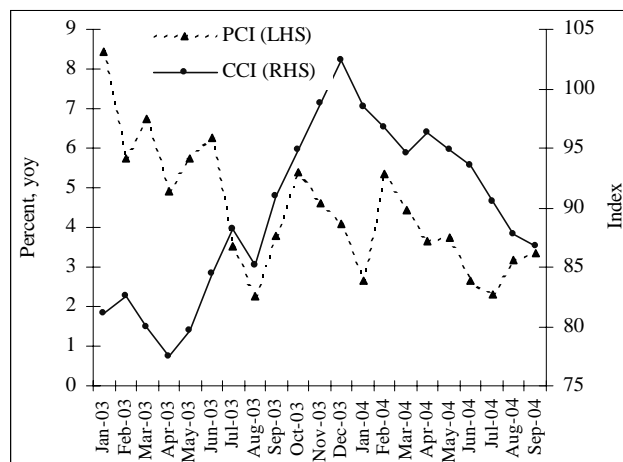
²⁵ There are unfounded claims that China exercises VAT on imported fruits and vegetables but not on domestic ones. In fact, China has three VAT rates; 0 percent for export products, 13 percent for 19 product categories such as agricultural products and some manufactured products, and 17 percent for other products categories. The 13 percent VAT applies to both Chinese domestically produced vegetables and fruits and those imported from Thailand.

²⁶ Thai exporters need to request for a sanitary license from China in advance before the shipment arrives at a Chinese port. If imported products meet the details of the license, the shipment will be released and only a sample of the shipment will be sent for examination.

adverse impacts of the oil price rise. Household consumption next year will continue to grow but at a slower pace as retail diesel price ceiling is lifted and inflation is on the rise. Farm incomes are also expected to grow much more modestly as international prices of key crops are projected to fall. Consumer credit expansion will also decelerate further as households become more leveraged.

Consumption of services rebounded from its slump last year, while transport equipment continues to grow robustly. Consumption of services accounts for more than half of consumption growth, at least for the first half of the year, compared to only a quarter last year (see Figure 11). This is primarily the result of the rebound of tourism-related services such as hotels and restaurants and transportation services from their slump last year due to the Severe Acute Respiratory Syndrome (SARS) outbreak. In non-service consumption, transport equipment purchases, though slowed down from last year's, has expanded by 20 percent in the first half of the year, and still accounts for a significant share of household consumption growth. Non-service consumption will likely resume its significance next year as the growth of services slow down after having fully recover this year.

Figure 10. PCI Growth and CCI



Source: BOT and UTCC

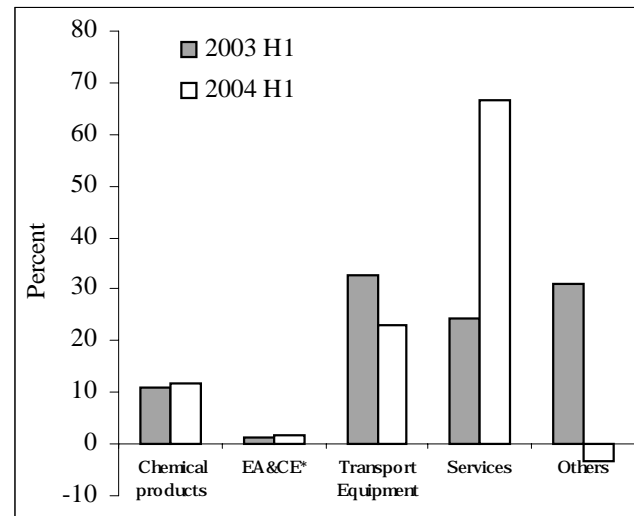
Rises in oil prices have adverse impacts on household consumption. With the rise in oil prices, inflation has risen in addition to the increase in retail benzene prices in the second half of this year and would lead to a reduction in consumption by households. Private consumption growth is estimated to be reduced by approximately 1-percentage point this year. Next year, when the ceiling on diesel retail price is lifted, the rise in prices could reduce real private consumption by another 0.5-percentage point (see Box 1) for a discussion of oil price impact on private consumption).

Consumer credit expansion continues to support household consumption. Expansion of consumer credit this year slowed down from 2003, but is still high at almost 15 percent year-on-year, while with real interest rates fell further this year to just around 3 percent (see Figure 12 and Figure 13). With steady growth in consumer credit and mortgages, household loans from the financial institutions will be approximately 25 percent of GDP by year-end with a little more than a third being consumer credits. This has resulted in the household debt to income ratio rising from 0.51 in 2002 to almost 0.60 in the first quarter of 2004 (see Box 2 on Household Debt). Next year, as households become more leveraged, consumer credit expansion is expected to further slow down from that of this year.

Continued growth in farm incomes also helped support household consumption this year but will not do so next year. Despite the contraction in farm output due to drought conditions, farm incomes this year continue to grow at double-digit rates as global prices of key Thai crops increased sharply (see Figure 3 in Poverty Section). As agriculture prices continue to rise faster than those of manufactures, *real* farm incomes have also been rising and supporting rural household consumption²⁷. Farm incomes next year will likely grow much more modestly than this year as international crop prices are expected to fall by around 6 percent (see Table 6), while crop production is projected to increase by less than that.

²⁷ Agriculture prices as a ratio of manufactures prices have been rising from 1.1 in 2002 to 1.3 in 2004.

Figure 11. Contribution to Real Private Consumption Growth

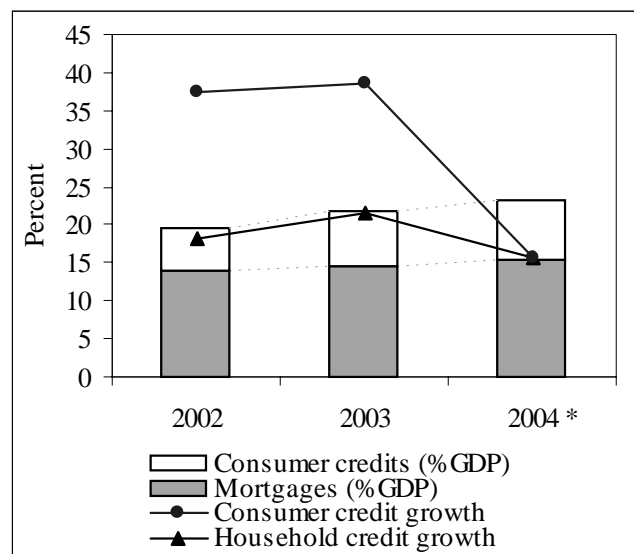


Source: NESDB

Note: * Electrical appliance and communications equipment
Services include trade services, hotels and restaurants, transport and communications services, business services, and social and personal services.

Others includes Agriculture, forestry and fishery products, food and beverages, apparels and textiles, other transportable goods, metal products, and machinery and equipment.

Figure 12. Household Credits from Financial Institutions



Source: BOT and World Bank's calculation

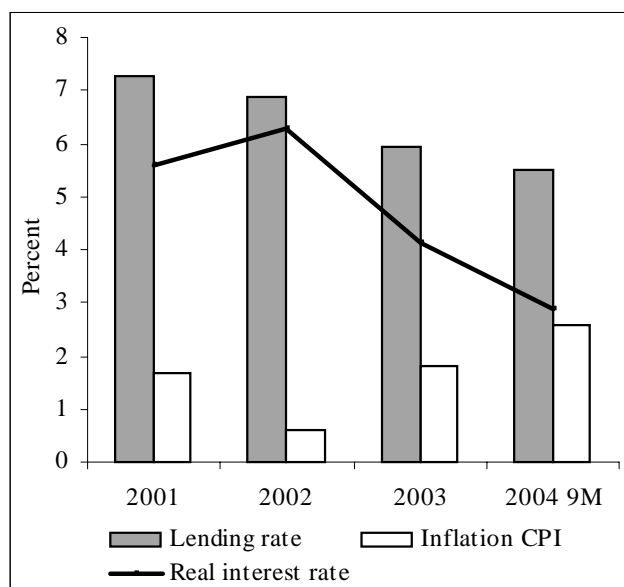
Note: * Annualized as of June 2004

Table 6. Growth of Thailand's Key Crop Prices

	Weights*	Growth rates of crop prices			Growth of Production		
		2003	2004p	2005p	2003	2004p	2005p
Rice indic 5%	36.6	3.0	16.4	-4.3	8.6	-4.7	2.8
Rubber	17.0	41.5	18.1	-10.3	2.0	5.9	4.6
Maize	4.4	19.0	7.2	-2.7	-0.1	4.2	2.9
Palm oil	2.9	42.9	8.3	-6.3	14.7	2.2	8.5
Coconut oil	1.8	11.0	41.2	-9.1	1	4.7	0.4
Coffee robusta	1.1	-10.8	-1.8	10.2	63.9	14.6	-3.6
Weighted average	63.8	16.2	16.2	-5.8	7.3	-0.3	3.4

Source: MOAC

Figure 13. Real Lending Interest Rates



Source: IFS

Note: Inflation is the change in consumer price index (CPI)

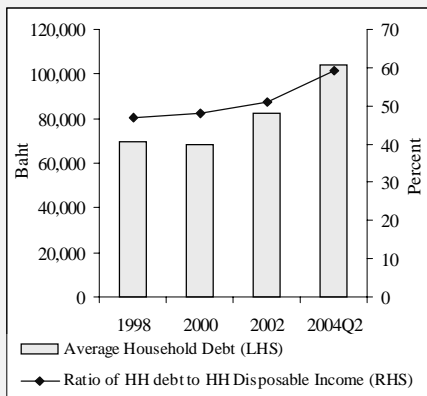
Government officials' salary increases and income tax breaks for low income earners effective this year will help cushion the adverse impacts on household consumption. In April this year, salaries were increased for government employees. The increases were largest for those in the lowest salary bracket. The public servant early retirement and the pension and gratuities programs, costing about Bt69 billion, were also launched earlier this year. In addition, the Government has announced that beginning this year, the minimum income after deductions on which income taxes will be applicable will be raised from Bt80,000 per annum to Bt100,000 per annum²⁸. These measures could help cushion the adverse impacts on the consumption levels of low-income earners in particular

²⁸ Income taxes, if deducted in 2004, will be reimbursed in 2005 to comply with the new income tax requirements

Box 2. Household Debt in Thailand

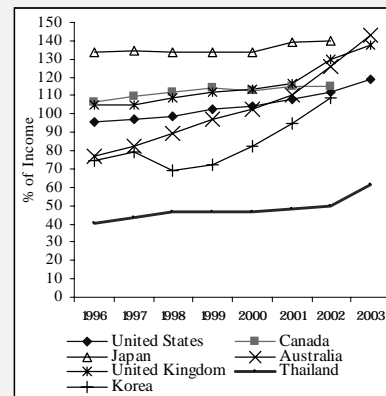
Household debts continue to rise. The Social Economic Survey (SES) conducted every 2 years by the National Statistics Office (NSO) shows that in the first half of 2004, average household debt was Bt103,940 or a Bt21,500 increase from that of 2002. This raises the household debt to disposable income ratio from 0.51 to 0.59 (see Figure 14). Over third of the debts are for mortgages, a third for business loans, and consumption loans accounts for the rest²⁹. Compared to other countries, Thailand’s household debt to disposable income ratio remains low though it is on an uptrend (See Figure 15). As a share of GDP, Thailand’s household debt is 33 percent in 2003, which is half those of Korea and Malaysia (see Figure 16). This level, though not alarming, is not insignificant given that Thailand’s per capita income is only one-half that of Malaysia and one-fifth that of Korea.

Figure 14. Household Debt and Ratio of Household Debt to Disposable Income



Source: Taicharoen et al (2004)

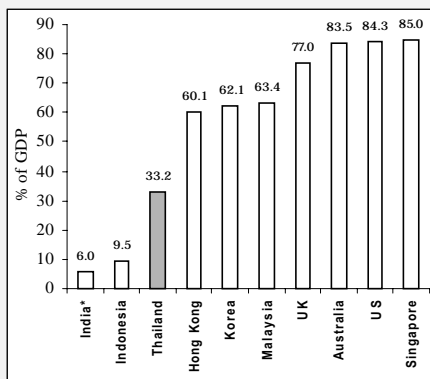
Figure 15. Ratio of Household Debt to Income for Selected Countries



Source: Taicharoen et al (2004)

Households in the lowest income decile are the most vulnerable to interest rate shocks. The debt to income ratio has increased in all income groups from 2002 to 2004 (see Figure 17). Households in the lowest income decile and ones in the highest income decile have the highest debt to income ratio. Occupational groups in the lowest income decile include farm-operators, laborers, and entrepreneurs with no employees. In addition to having a low income and high debt to income ratios, they are also characterized by low education and are exposed to predominantly floating rate loans, making them highly vulnerable to an interest rate rise or income decline.³⁰

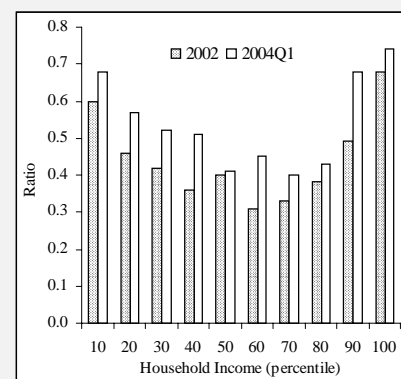
Figure 16. Household Debt to GDP Ratio for Selected countries, 2003



Source: Taicharoen et al (2004)

Note : * As of Q2 2003

Figure 17. Debt to Income Ratio for Thai Households



Source: Taicharoen et al (2004)

²⁹ From NSO, Summary of Preliminary Socio-economic Survey (SES) 2004.

³⁰ Taicharoen, Ariyapuchya and Chucherd, *Rising Thai Household Debt: Assessing the Risks and Policy Implications*, a paper presented at the Bank of Thailand Symposium 2004.

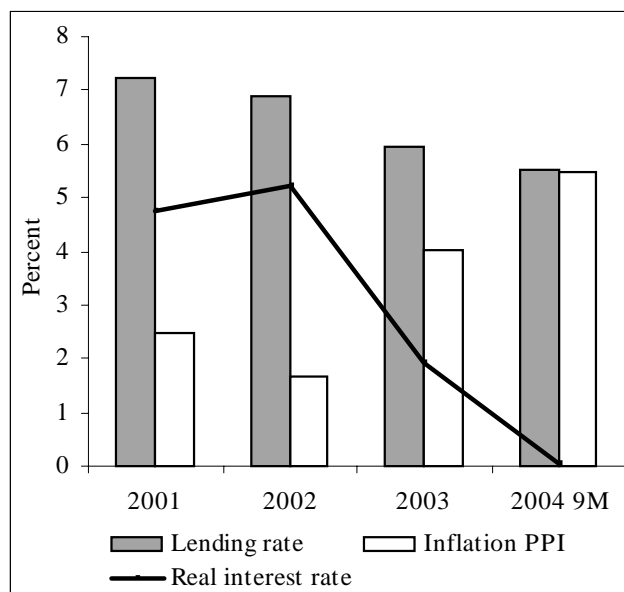
2.6 Investment

Total investment this year and next will continue to be driven by private investment, while public investment has turned around after having retrenched for the past 5 years. Private investment growth this year and next will continue to be in the in the double-digits but will see a slow down from that of last year due to the uncertain business environment, particularly related to higher oil prices, uncompleted free trade agreements (FTAs) and unrest in the South. Public investment, on the other hand, will see a turnaround from its retrenchment since the crisis as the Government focuses on investments to improve competitiveness. Total investment should reach 22 percent of GDP this year and 24 percent next year, a gradual rise from 21 percent in 1998.

2.6.1 Private Investment

Private investment grew at double-digit rates again this year, though slowed down from 2003. With uncertainties in the business environment, particularly those related to the impact of oil prices, uncompleted FTAs and unrest in the South, private investment growth this year has slowed down to roughly 13 percent from 18 percent last year. Nevertheless, private investment is still growing at double-digit rates along with the acceleration of loan expansion to the business sectors. So far this year, gross foreign direct investment (FDI) inflows have been more or less stable compared to that of last year as foreign investors delay their investment amidst the uncertain business environment. A continued rise in capacity utilization and a significant increase in the Board of Investment's (BOI) promotion approvals indicate that private investment should continue growing robustly into next year with gross FDI inflows also expected to increase. As a result, the share of private investment in GDP should rise to 16.5 percent this year and near 18 percent next year, compared to its share of 22 percent in the 1980s.

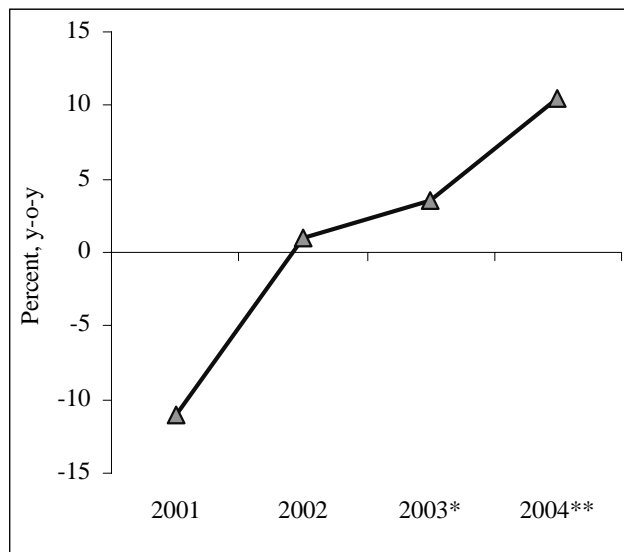
Figure 18. Real Lending Rates



Source: IFS

Note: Inflation is the change in producer price index (PPI)

Figure 19. Corporate Loan Growth



Source: BOT

Note: *Change in classification of business types in accordance with the International Standard Industrial Classification (ISIC) in December 2003.

**Annualized as of June 2004

Low real interest rates and further expansion of business loans have supported private investments. Real lending rates in Thailand remain low as the producer price index is on an uptrend (see Figure 18). Financial sector loans to the business sector could expand up to 10 percent by the end of this year (see Figure 19), driven mainly by commercial bank loans to this sector (see Table 7)³¹. Business sectors to which commercial bank loans have been increasing by more than 10 percent this year include the manufacturing sector, the transportation sector, and the real estate sector (see Box 3 for detailed discussion of loans to the real estate sector).

Investment in the form of construction sped up this year, while growth of equipment investment slowed down. With the rebound in the property sector this year in an environment of rising property prices and low real interest rates (see Box 3),

residential construction has increased by roughly 25 percent year-on-year in the first half of this year, driving total construction to grow by almost 20 percent and contributing to almost a fifth of total private investment growth. On the other hand, investment in the form of equipment, the bulk of private investment in Thailand, grew slower at 16.6 percent year-on-year in the first half of this year compared to 19.0 percent growth in the same period last year (see Figure 24). This results mainly from the slow down in investments in the form of transport equipment which had expanded rapidly in 2002 and 2003. Private investment indicators show that in the later half of this year, private investment will likely decelerate further, particularly in investments in the form of commercial cars or pickup trucks as their sales in the latter half have slowed down considerably compared to last year (see Figure 25). Overall, private investment growth this year would grow at around 13 percent.

Table 7. Total Loans by Commercial Banks*

(Percent)

(End of period)	2004**	
	Share of Loans	Growth
Total Loans	100.0	6.7
Household Loans	17.7	16.3
Loans to Financial Institutions	9.7	-22.7
Business sector loans	73.4	11.2
Of which		
Manufacturing	27.0	10.8
Public Utilities	1.8	10.5
Construction	2.6	-1.4
Commerce	17.9	7.6
Hotel and Restaurant	3.3	8.4
Transportation	3.8	17.2
Real Estates	8.2	18.4
Others***	8.8	18.0

Source: BOT

Note: * All loans are unadjusted for write-offs, write-backs, and transfers to AMCs due to lack of sectoral adjustment data

** Annualized as of June 2004

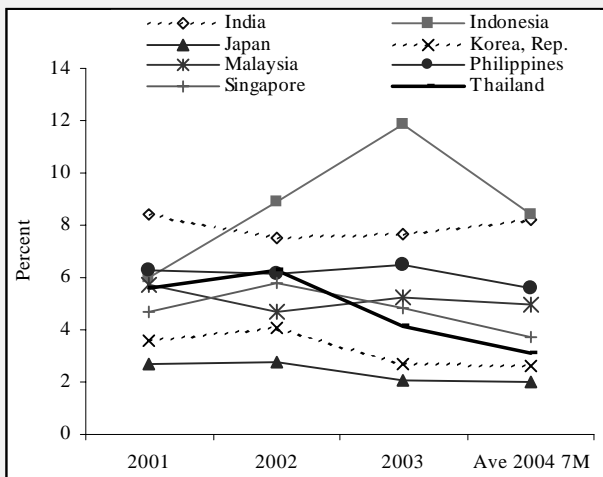
*** Agriculture, fishing, mining and other business sectors

³¹ Data on sectoral loans to the business sector are only available for commercial bank loans.

Box 3. Is a Property Bubble on Its Way?

Low interest rates and rapid expansion of loans to the property sector have helped support recent property sector growth. Real lending rates in Thailand have been on the downtrend and are currently below 4 percent, a rate lower than most countries in the region (see Figure 20). This has helped to facilitated the increase in demand for housing. Mortgages have been expanding at double-digit rates since 2002, while loans to real estate developers grew rapidly this year (see Figure 21). These have helped support the revival of the property sector since its slump in 1998.

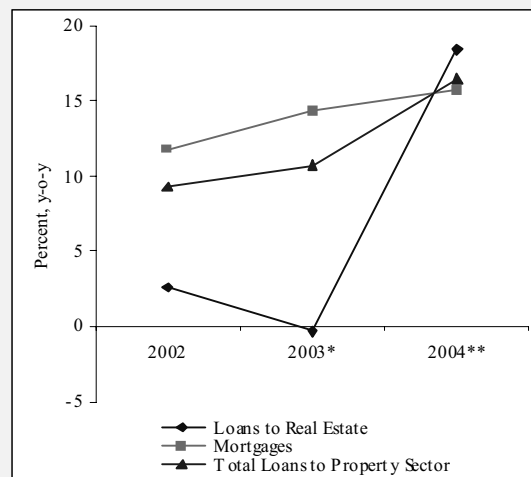
Figure 20. Real Lending Rates



Source: International Financial Statistics, IMF

Note: Japan's is an average of 6M in 2004

Figure 21. Growth of Financial Sector Loans to Property Sector



Source: BOT

Note: Data is unadjusted

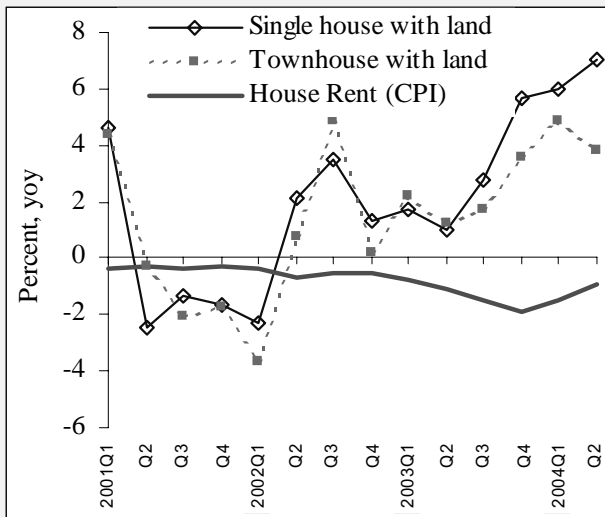
*Change in classification of business types in accordance with the International Standard Industrial Classification (ISIC) in December 2003

** Annualized as of June 2004

Property prices have risen in all residential property sectors, but more so for the high-end ones, while rents have been declining. Prices of houses and condominiums have been on the uptrend beginning in 2002 and 2001, respectively, and have been increasing more rapidly since the second half of 2003³². Rents on the other hand have been declining (see Figure 22 and Figure 23). A reason for rents of houses and condominiums not rising in this period is that people have switched from renting to buying their own homes as interest rates are low and mortgage terms are quite favorable. Because prices, particularly of condominiums, have been rising rapidly recently, buying the house and condominiums for investments have also become more attractive, even though their rentals have been growing at a slow pace.

³² Single house and townhouse price index are those of middle to low-end and are located in sub-urban Bangkok and surrounding areas. Condominium prices are those of Grade A condominiums located in Bangkok. Rental rates of Grade A apartments in Bangkok are used as a proxy for the Grade A condominium rental rates.

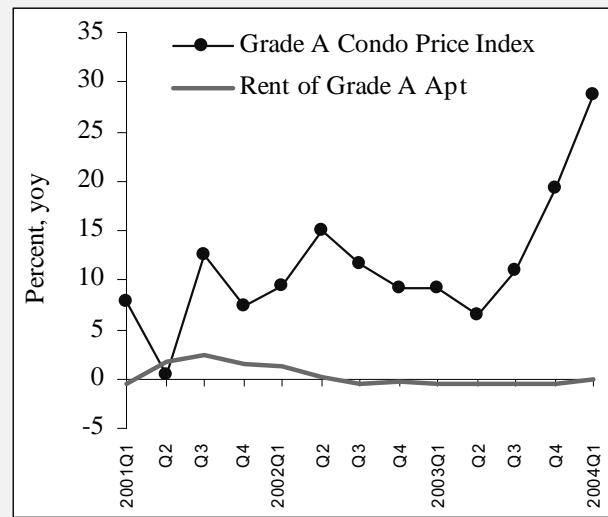
Figure 22. Changes in Housing Price and Rent Indices



Source: Buranathanang et al (2004) and MOC

Note: House rent includes single houses, town houses, and row houses

Figure 23. Changes in Grade A Condominium Price and Grade A Apartment Rental Rate



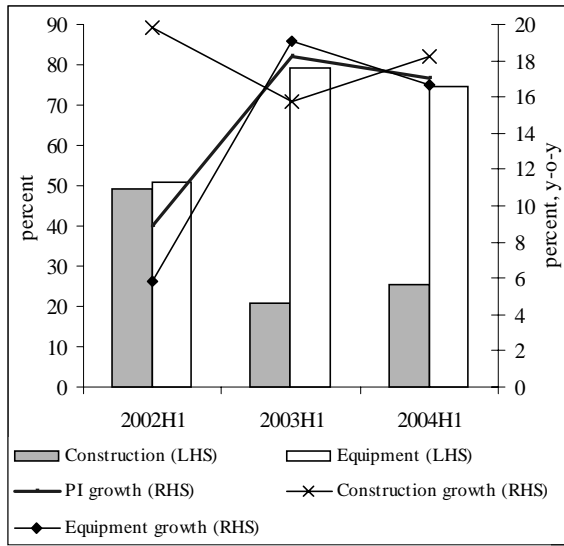
Source: CB Richard Ellis Research

Future rises in interest rates and a decline in property prices will impose a higher burden for mortgagers. Should interest rates rise³³, mortgagers may be eventually asked to increase their monthly payment. Nakornthab et al (2004)³⁴ showed that should MLRs rise by about 1 percentage-point after the first 2 years of fixed interest rate, mortgagers will be likely need to increase their fixed monthly payments or extend their repayment duration. For example, an interest rate rise by 2.5 percent age-points in the third year could increase the monthly payments by 5 percent. However, given that current bank practices place ceiling of monthly payment to borrowers' incomes at no greater than 30-40 percent, borrowers should be able to more or less afford the minimal increase in monthly payments. In addition, given that incomes of most people rise over time, they should be able absorb, at least partly, the increase in monthly payments. However, should property prices decline in addition to the interest rate rise, while rental rates remained subdued, property investors, would face lower net returns. They may be therefore inclined to sell their properties, which would further depress the property prices, thus setting prices in a downward spiral.

³³ The Bank of Thailand has so far this year raised interest rates by 50 basis parts, leaving the policy rate at 1.75 percent per annum.

³⁴ Nakornthab et al., *Bank Lending, the Housing Market and Risks: A Test for Financial Fragility*, a paper presented at the Bank of Thailand 2004 Symposium, September 6-7, 2004.

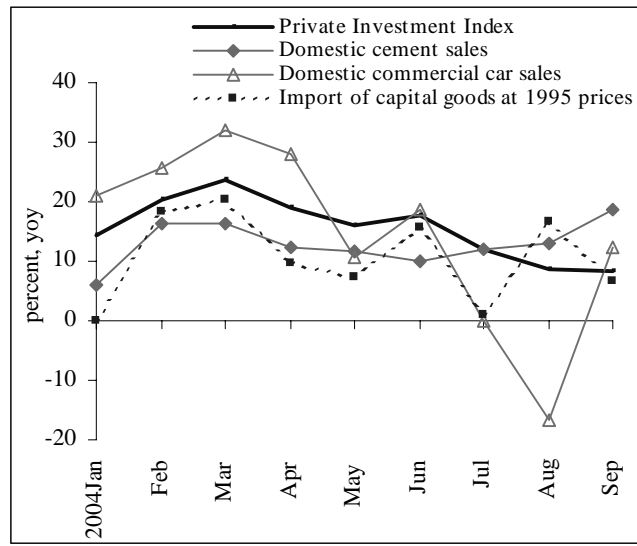
Figure 24. Private Investment Growth and Contributions to Real Private Investment



Source: NESDB

A continued rise in capacity utilization and a significant increase in the Board of Investment’s (BOI) promotion approvals indicate that private investment should continue to grow at double-digit rates next year, mainly driven by larger firms. Compared to last year, additional sectors in which capacity exceeded 70 percent this year include the compressor, cars, and electric motor sectors (see Table 8). In line with the increase in capacity utilization over the past few years, BOI approvals in 2003 almost doubled those of 2002 (see Table 9). Approvals have again almost doubled in the first 9 months of this year to Bt330 billion compared to the same period last year. The paper and plastic, the electronics and electrical appliance, and the services and infrastructure sectors have so far received more than 60 percent of total promotion approvals this year. Almost two-thirds of the approvals are for large firms³⁵. Small and medium enterprises (SMEs)³⁶, on the other hand, make up less than 15 percent of the total approvals, though they account for three-fourths of the *number* of projects approved. As the BOI promotion approvals are a good 1-2 year leading indicator for actual investments

Figure 25. Private Investment Index and Indicators



Source: BOT

trends in the country, the significant rise in promotion approvals in the past 2 years indicate that private investments are expected to grow further next year. The slow down in private investment growth this year can be therefore attributed to investors delaying their investments in the light of the many uncertainties arising from high oil prices, unconcluded FTAs, and unrest in the far Southern provinces.

Gross foreign direct investment inflows are stable from last year’s, suggesting its lower contribution to total private investment growth. In the first 8 months of this year, gross FDI inflows registered US\$4.5 billion, a level very similar to those of last year’s (see Figure 26). Gross FDI inflows increased most in the food and the machinery and transport equipment sectors but were offset by the decline in inflows to the trade sector. The minimal growth in gross FDI inflows this year suggests that its role in private investment

³⁵ Firms with registered capital greater than Bt 1 billion

³⁶ Firms with registered capital up to Bt 200 million.

Table 8. Capacity Utilization*

(Percent)

	Weights**	Avg 1995-96 (Jan-Sep)	2002 (Jan-Sep)	2003 (Jan-Sep)	2004 (Jan-Sep)
Total Capacity Utilization	44.5	74.2	58.2	65.2	72.0
CU in 2004 (Jan-Sep) >90%	4.46				
Tire	0.66	88.9	92.9	103.6	119.7
Upstream petrochemical	0.39	74.5	81.7	103.6	99.7
Pulp	0.17	77.1	89.3	96.0	98.8
Motorcycle	1.32	79.5	61.4	83.7	97.0
Zinc metal	0.03	91.0	93.9	98.9	96.1
Integrated circuit	1.89	76.4	64.9	78.8	90.8
80% < CU in 2004 (Jan-Sep) < 90%	8.86				
Battery	0.38	81.7	71.6	80.5	88.7
Synthetic fiber	0.71	86.9	83.3	77.9	86.6
Petroleum products	7.15	87.6	75.7	79.5	84.6
Wire rod	0.21	62.0	75.9	71.8	83.5
Galvanized iron sheet	0.27	68.8	87.7	87.2	83.5
Compressor	0.14	66.7	71.9	71.4	83.4
Milk products	n.a.	64.2	65.6	71.2	80.3
70% < CU in 2004 (Jan-Sep) < 80%	8.08				
Commercial car	3.63	87.4	53.2	63.8	79.6
Electric motor	0.03	88.4	58.3	70.4	77.0
Hot & cold rolled sheet	0.23	60.5	75.5	79.7	74.7
Passenger car	4.19	56.6	38.1	59.7	72.4

Source: BOT

Note : * Capacity utilization figures presented here are from the BOT's monthly survey of 32 industries which accounts for 44.5 percent of the 1995 manufacturing sector value added.

** Weights are based on the 1995 manufacturing sector value added.

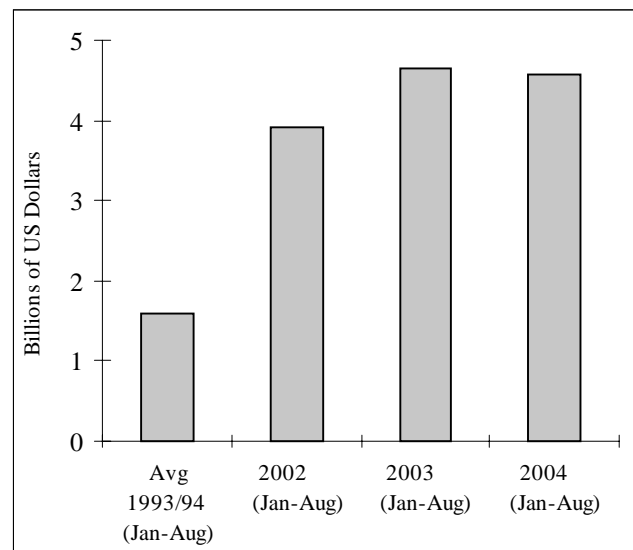
Table 9. BOI Promotion Approvals by Sector

	(Percent of Total Approvals)			
	2002	2003	2003 (Jan-Sep)	2004 (Jan-Sep)
Total (Billions of Baht)	162.5	283.8	192.9	330.0
Agriculture	24.9	10.6	10.6	12.5
Mining, ceramics and base metal	1.3	6.0	0.9	2.5
Light industry	11.4	4.5	3.5	3.8
Metal products, machinery and transport equipment	17.5	24.5	26.7	16.2
Electronics and electrical appliance	18.1	15.6	18.4	22.9
Chemical, paper and plastic	10.5	17.4	22.7	24.1
Services and infrastructure	16.4	21.4	17.2	18.0

Source: BOI

growth is likely lower than that of last year. However, with levels almost 4 times that of the pre-crisis period, FDI continues to be an important component of private investment in Thailand since the crisis.

Next year, FDI should increase as uncertainties are reduced. BOI promotion approvals of FDI in 2003 were double that of 2002. In the first 9 months of 2004, the promotion approvals went up by more than 60 percent from the same period last year (Figure 27). The significant increase in BOI FDI promotion approvals last year seemed to have not been translated into increased gross FDI inflows. Reasons for this delay in investment may be the uncertainties surrounding the performance of the Thai and global markets in the light of the oil price rise and unrest in the Southern provinces of Thailand. Another possible reason is that foreign investors are waiting for clearer results from negotiations on the various free trade agreements (FTAs) (see Section 3 on Trade Reforms for more details on Thailand's FTAs). However, should the uncertainties more or less clear up next year, foreign direct investment will likely rise as the pending BOI promotion-approved projects are translated into actual investments. Moreover, a survey of 80 top transnational corporations (TNCs) by the UNCTAD³⁷ this year

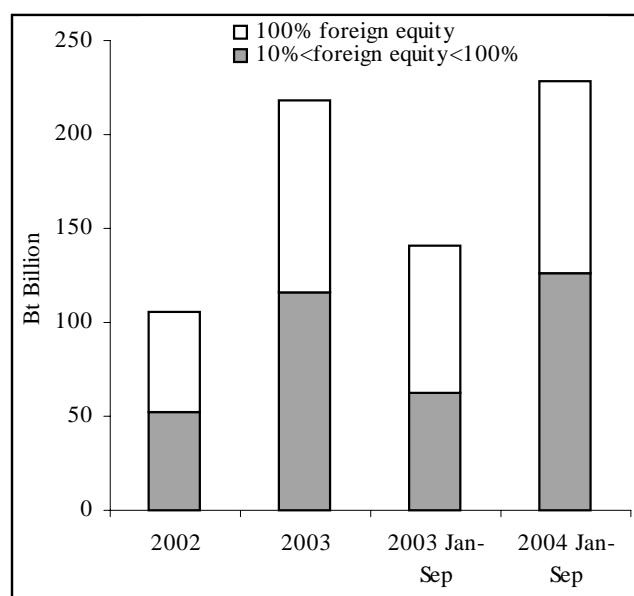
Figure 26. Gross FDI inflows

Source: BOT

³⁷ United Nations Conference on Trade and Development, "Prospects for FDI Flows and TNC Strategies", 2004-2007, June 2004.

indicated that TNCs have plans to expand their investments in 2004 and 2005. In the survey, Thailand ranks third as the most attractive location for FDI in 2004-2005 after China and India. This confirms that FDI to Thailand will likely rise in the next year.

Figure 27. BOI FDI Approvals



Source: BOI

2.6.2 Public Investment

After retrenching for the past 5 years, public investment began expanding this year with the initiation of large infrastructure projects. Public investments³⁸ have been declining since the 1998 crisis with retrenched central government and state-owned enterprise investments. However, beginning this year, both the central government and state-owned enterprises have increased their investment budget and spending. The central government has increased its capital expenditures in fiscal year (FY) 2004³⁹ by 7 percent or Bt16 billion from the supplementary budget, though this represents only a 22 percent disbursement rate (see Table 10). Adding the undisbursed portion of FY2004's supplementary budget to the FY2005 budget, the central government's investment budget in FY2005 will be 50 percent greater

than that of the previous fiscal year. The shortfall in spending in FY2004 has resulted in reduced fiscal deficit in that year, while the use of this shortfall in FY2005 would raise spending and deficit this year (see Figure 28).

Infrastructure investments are needed to enhance Thailand's competitiveness. Thailand's infrastructure needs to be upgraded if it is to improve business efficiency and competitiveness⁴⁰, especially as the economy is growing and demanding more and better infrastructure services. The Government's plans to invest in infrastructure projects are therefore timely as Thailand has not been doing much so since the crisis. Although the final amounts are still being finalized, the investments could total up to Bt1-1.5 trillion over the next 4 years or approximately 5 percent of GDP per year on average. The projects include the expansion of the underground mass rapid transit system in Bangkok, the interstate highway, and PTT gas pipeline project.

Developing a comprehensive and coordinated investment policy framework is key to success.

For investment spending to achieve its objectives and at the same time sustain growth, there needs to be a coordinated investment policy and framework at both the microeconomic and macroeconomic levels. As infrastructure upgrading is a long term and on-going activity that involves a number of agencies in the country, there needs to be a central body that will articulate the long-term strategy and coordinate the policies of different agencies, which is currently lacking in Thailand. Infrastructure policies include not only those of project prioritization and coordination, but also those that will enhance the performance of infrastructure services, whether it be the inclusion of private players

³⁸ Public investments are investments by the central government, the local governments, and state-owned enterprises.

³⁹ FY2004 runs from October 1, 2003 to September 31, 2004.

⁴⁰ For example, logistics cost in Thailand amounts to 15-18 percent of GDP annually, compared to around 10 percent in the US, Japan, and EU countries (Source: NESDB).

Table 10. FY2004 Supplementary Budget and Actual Disbursement

(Billion Bt)

	Supplementary Budget	Actual Disbursement
Current Expenditures	64.2	68.9*
Civil servant salary increase	16.6	11.9
Pension and gratuities	33.1	43.3
Civil servant early retirement program	14.6	13.7
Capital Expenditures	71.3	16.1
Transfer to local government for investments	12.3	11.0
Competitiveness enhancement program	59.0	5.1
Total	135.5	85.0

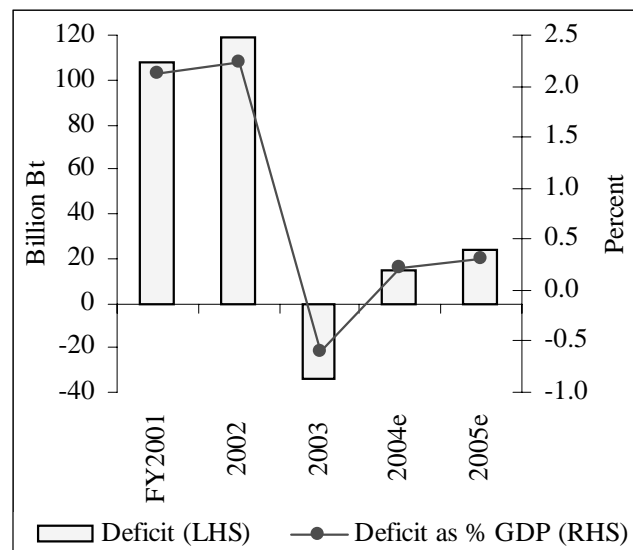
Source: MOF

* The sum of disbursement exceeding the budget will be financed from the FY2005 budget.

or the liberalization of certain infrastructure sectors or sub-sectors to promote competition. Project review and evaluation capacity to ensure that priority projects that meet the long-term strategic goals of socio-economic improvements and are economically sound gets financed need to be strengthened. Moreover, the financing of the investments should be transparent with accountability mechanisms in place, so that any associated risk could be reduced and are more manageable. In some cases, creating additional fiscal space to finance the investments is better in the long-run (see Box 4 on Critical Elements of Infrastructure Development). With decentralization in progress, local governments will play an increasingly important role in infrastructure provision and could self-finance some of the associated expenditures, if facilitated to do so. Nevertheless, the objectives of overall debt sustainability and macroeconomic stability are to be closely monitored.

Macroeconomic implications of the large infrastructure projects will have to be carefully worked out and closely monitored. As the Government is committed to balancing the budget from FY2005 onwards, most of the investments will be financed by

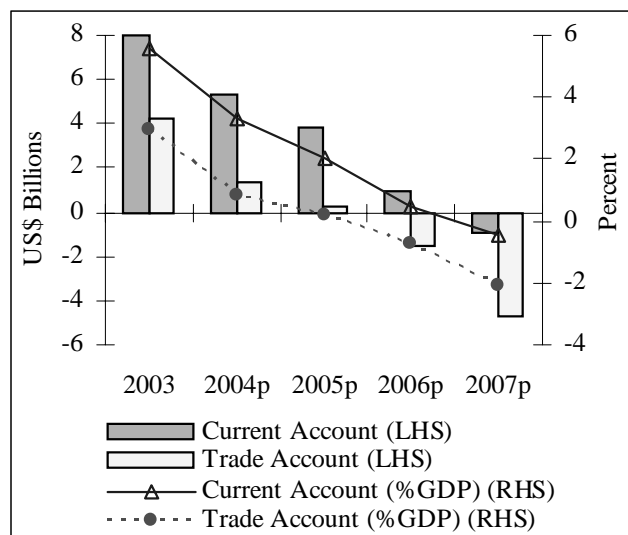
Figure 28. Central Government Finances, (FY 2001-2002)



Source: BOT, MOF

Note: FY2004 is estimated and FY2005 is budgeted.

state-owned enterprises and the private sector through debt and equity instruments and by the Government through securitization. Financing by the state-owned

Figure 29. Current Account, 2003-2007

Source: BOT, WB Staff projections

enterprises could contribute to increased public debt⁴¹ and other forms of financing may require implicit government guarantee, adding to the central government's contingent liabilities. In addition, some of these projects may perhaps require operational subsidies (e.g. urban rail), which should be factored into the fiscal impact of the planned infrastructure investment. Debt financing in the initial phase would likely be from domestic financing, as there remains excess liquidity in the domestic financial system. However, when liquidity becomes tighter, foreign financing will be needed. Financing such large amounts will put pressure on the current account to decline and on interest rates to rise. Since public infrastructure projects on average have a 25 percent import content⁴², they will contribute to increased imports. It is estimated that the trade balance could be in deficit as early as 2006 and the current account in 2007 (see Figure 29). This could have a negative exchange rate impact on public debt service, as well as on the finances of infrastructure projects (which tend to have largely domestic currency revenues but some foreign currency costs). In addition, the impact on higher interest rates and inflation could result in the "crowding out" of private investments, thus affecting longer-term growth.

This underscores the need for a comprehensive impact analysis and policy framework for the infrastructure investments.

2.7 Financial and Corporate Sector Developments

Financial Sector Developments

Asset quality of Thai commercial banks, with the exception of the largest state bank, continued to show improvements. Strong economic growth and asset price appreciation enabled private banks to reduce their non-performing loans (NPLs) but their NPL ratios still remain in double digit ranges (see Figure 30). On the other hand, NPLs at the largest state bank increased significantly from 8 percent of total loans in 2003 to 15 percent of total loans in 1H 2004, which can be equally explained by both the "actual" deterioration in its asset quality and the reclassification of its rescheduled loans into NPLs. The Bank of Thailand (BOT) has enforced since last year the qualitative assessment in addition to aging criteria for loan classification. This enforcement would make reported NPLs better reflect the loan quality at Thai banks. Restructured loans, which already exited the NPL status, are estimated to range between 14-25 percent of total loans at the four largest Thai private banks⁴³. Three banks have so far been affected by this enforcement with Krung Thai Bank being the last one. However the actual deterioration of the loan quality at the largest state bank is not believed to be a sector-wide issue but specific to the largest state bank which has grown its loan portfolio aggressively over the past two years.

⁴¹ Public debt includes central government's domestic and external debts, government-guaranteed and non-government guaranteed non-financial state-owned enterprises' domestic and external debts, and Financial Institution Development Fund (FIDF) debt.

⁴² Source: *Medium-term Trends and Management of the Macroeconomy 2005-2009*, NESDB (September 2004).

⁴³ USB Investment Research, Thai banks, July 27, 2004.

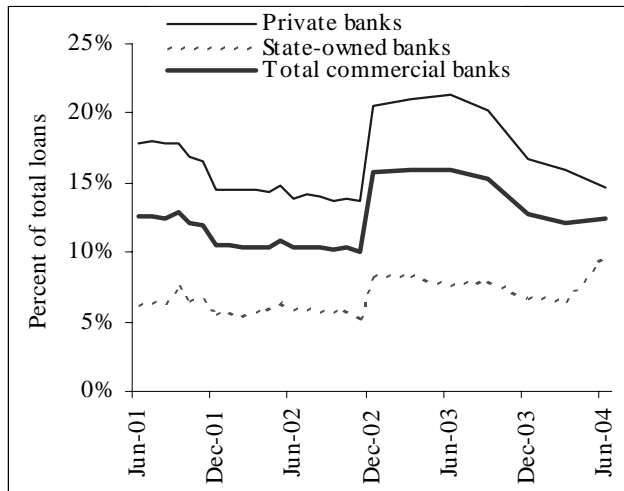
Box 4. Critical Elements of Infrastructure Development ^{a/}

Large sums needed for infrastructure investments require mechanisms and measures to ensure that the money is used effectively and the risks are recognized and well managed. Thailand's and East Asia's lessons and experience in the past decade suggest the following critical elements for infrastructure development:

- **Central planning matters.** Sectoral ministries and local governments cannot work in policy-making isolation, subject to only budget constraints. The private sector is not going to do everything and needs the government to have a strategic vision. Building institutions that can articulate long-term strategies after evaluating both the macroeconomic and microeconomic implications of the investments and can coordinate the policies of different agencies is essential to effective and efficient infrastructure service provision.
- **Policies to promote performance and accountability are needed.** Infrastructure policies include those aimed at improving the performance of infrastructure service provision such as private participation or the liberalization of service provision in certain infrastructure sectors or sub-sectors. Infrastructure projects and service provision involves the complex interactions of many actors, often with a high degree of monopoly power: government agencies at various levels, state-owned enterprises, the private sector, NGOs, etc. Accountability of these actors to ensure their performance and integrity in infrastructure service provision needs to be enhanced.
- **Pursue private sector participation, but be realistic.** The private sector remains very interested in infrastructure investments in Thailand and in the East Asia region in general. Involving them could bring about financing as well as efficiency in service provision. However, do not over assume that the private sector will always assess risk and reward well – regulatory frameworks and concession contracts need to be very carefully crafted, and should take account of potential crises.
- **Financial markets for infrastructure are not substitutes for good policy.** Being able to raise funds in the financial markets both domestically and abroad for infrastructure investments by using new financial instruments is important as it relaxes the budget constraint on these investments. However, funding from the financial markets does not necessarily mean good projects or good policies are supported. Financial support for projects is therefore secondary to a comprehensive infrastructure development framework, accompanied by appropriate policies and projects.
- **More fiscal space for infrastructure may be warranted.** Debt sustainability and macroeconomic stability are overriding objectives, but are sometimes best-served in the longer-run by higher fiscal deficits incurred in the short-run, if those deficits result from infrastructure expenditures that are growth-promoting. Some countries choose to create that space quasi-fiscally, which is usually non-transparent and with limited accountability. Fiscalizing these hidden deficits may actually help reduce them or at least make the associated risks more manageable.
- **Local governments can play a more significant role in infrastructure financing.** The role of local governments has increased over the past decade in many East Asian countries, including Thailand. Infrastructure service provision is one such role. To lessen the burden on the central government in providing subsidies to the local governments for such purposes, mechanisms to facilitate local government's ability to finance local infrastructure projects and service provision are essential. They include providing additional tools that would strengthen local governments' own-revenue collection such as improved local government property tax rates and collection methods. Institutions facilitating local government financing such as Municipal Funds could increase local governments' borrowing capacity, while managing the associated risks.

^{a/} Except for the last bullet point, materials in this box are drawn from the draft report outline of "Connecting East Asia Pacific: Towards a New Infrastructure Paradigm" (September 2004)

Figure 30. Non-performing Loans, 2001-2004



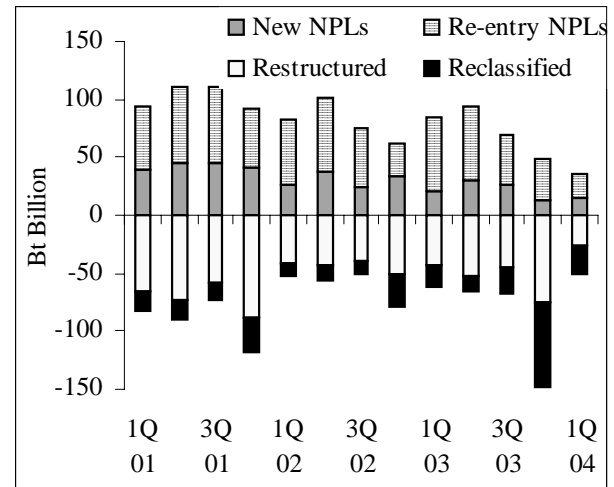
Source: BOT

Note: Increase in headline NPLs as of December 2002 was due to a change in definition

Profitability of Thai banks has improved and their capital bases have strengthened. Thai banks continued to report improvement in their operating profits, mainly due to wider interest margins. Their provisioning expenses have become normalized, declining from 5.5 percent of total assets in 1999 to 0.1 percent of total assets in 2004. Their capital adequacy ratios declined slightly from 13.4 percent at end 2003 to 11.7 percent at end June 2004 as many banks grew their loans and redeemed their hybrid tier one capital⁴⁴, which were issued during the early part of the crisis. However shareholders' equities of Thai banks as a percentage of total assets remained unchanged at about 7 percent (see Table 11)

The resolution of distressed assets by the TAMC has shown some progress. As of June 2004⁴⁵, the Thailand Asset Management Corporation (TAMC) had approved resolution plans for 97 percent of total transferred assets or Bt779 billion. Debt restructuring plans have been approved for over 66 percent of the amount. For the remaining 34 percent, the TAMC has given its debtors the opportunity to renegotiate out-of-court in the hope of reaching a better resolution. TAMC's special power to foreclose is planned for

Figure 31. Increase and Decrease in NPLs



Source: BOT

the remaining cases where the TAMC was unable to contact debtors or rejected debt restructuring proposals resubmitted by debtors. TAMC outsourced the management of the smaller 10,390 accounts, approximately 3 percent of transferred assets, to the largest state commercial bank and one public asset management corporation (AMC). TAMC expects to complete the restructuring of smaller accounts by 3Q 2004.

⁴⁴ Many Thai banks recapitalized their tier one capital by issuing innovative instruments. High premium preferred shares were issued in a package with subordinated debentures. Although the instruments behaved like debentures with limited life, these preferred shares were recognized as tier one capital by the BOT because of their similar characteristic to "permanent" capital and a bank having discretion on dividend payment. All packages were made attractive to investors as subordinated debts offered extraordinarily high coupon to compensate for zero return on preferred shares as a bank was not profitable enough to pay dividends. Since the instruments were issued when interest rates were high, many banks redeemed these expensive instruments in early 2004.

⁴⁵ June 2004 is the most recent statistical period published by TAMC.

Table 11. Indicators of Health of Commercial Banking Sector

(Percent)

	2000	2001	2002	2003	2004*
Interest margin	1.1	1.6	1.8	2.0	2.4
Rate of return on equity	-4.8	32.8	4.2	10.5	20.5
Rate of return on assets	-0.2	1.5	0.2	0.7	1.5
Pre-provision profit to assets	0.0	0.4	1.0	1.4	1.8
Provision expenses to assets	2.2	0.6	0.7	0.7	0.1
Total capital adequacy ratio	11.3	13.3	13.0	13.4	11.7
Tier-1 capital	7.5	8.9	8.9	9.6	8.5
Equity to total assets	4.3	5.0	5.5	7.1	7.2

Source: BOT

Note: Data are end of period

* Annualized as of June 2004

Corporate Sector Developments

The profitability of publicly listed firms has improved markedly in the last three years. The rate of return on their equities (ROEs) has steadily increased from a negative figure in year 2000 to over 20 percent in 2003, and it is expected to grow further in year 2004. Similarly, the interest coverage ratio has increased from a negative ratio to over 3 times during the same period (Figure 32).

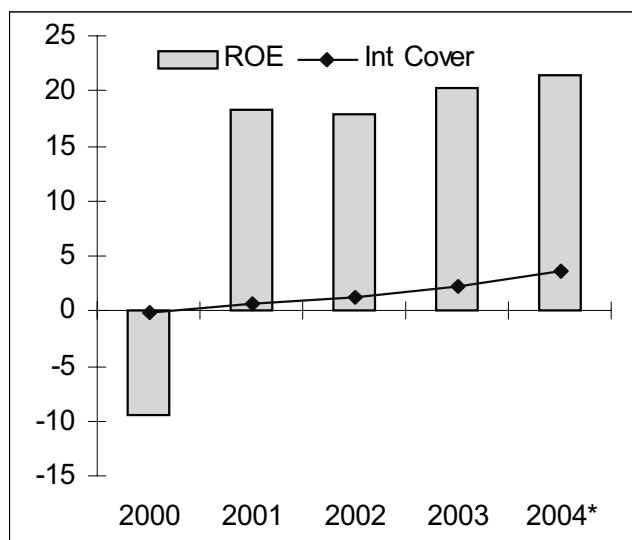
Progress in corporate debt restructuring is still limited in 2004, and there remain significant backlog of unresolved NPLs. As of March 2004⁴⁶, a cumulative total of Bt3.1 trillion of NPLs was restructured by financial institutions. Progress is considered slow in 2003 given a cumulative total of Bt3.0 trillion at the end of 2003, Bt2.8 trillion at the end of December 2002, and Bt 2.4 trillion at the end of December 2001 (see Figure 33). The reasons for the slowdown in the pace of restructuring are perhaps (1) the closure of the Corporate Debt Restructuring Advisory committee (CDRAC) voluntary debt workout framework, which ended in mid-2003⁴⁷; (2) remaining NPLs are complex; and (3) TAMC only afforded NPLs from state owned banks and AMCs, while a sizeable proportion of NPLs in the private banks are left to bilateral negotiations and court-supervised workouts.

The Bank of Thailand has introduced the out-of-court mediation framework to help accelerate debt restructuring for debtors. At the closure of the CDRAC process, the Bank of Thailand (BOT) introduced a new initiative - a voluntary mediation framework - led by the CDRAC for private banks and AMCs to accelerate debt restructuring for debtors in different stages of resolution. The initiative also meant to help lessen the backlog of NPL cases in the Civil Courts. There are two groups of target debtors: (1) cases that are in the court process; and (2) cases that are in the legal execution process after court judgments are rendered. In this process, creditors and debtors agree to enter the CDRAC-led mediation

⁴⁶ Sources: Bank of Thailand and WB analysis. The cumulative debt restructuring figures for December 2003 and 1Q2004 are estimates based on BOT statistics. The BOT reports on the cumulative total completed restructuring have been under reviewed and constantly revised since September 2003. The reasons, being in certain cases, statistical errors and duplications were found in the data base submitted by financial institutions. The review is expected to be completed by early 2005.

⁴⁷ In five years of operations from 1999-2003, the CDRAC process completed 49 percent of its Bt2.9 trillion target cases by credit value, a significant contribution to the cumulative completed debt restructuring.

Figure 32. Publicly Listed Companies' Average ROE and Interest Coverage



Source: SET and WB analysis

*Annualized

Note: Statistics include the Rehabilitation Companies category which was insignificant to the results.

process to further negotiate a debt settlement under a required guideline and timeframe. Failure to reach an agreement within the timeframe would result in continued legal process.

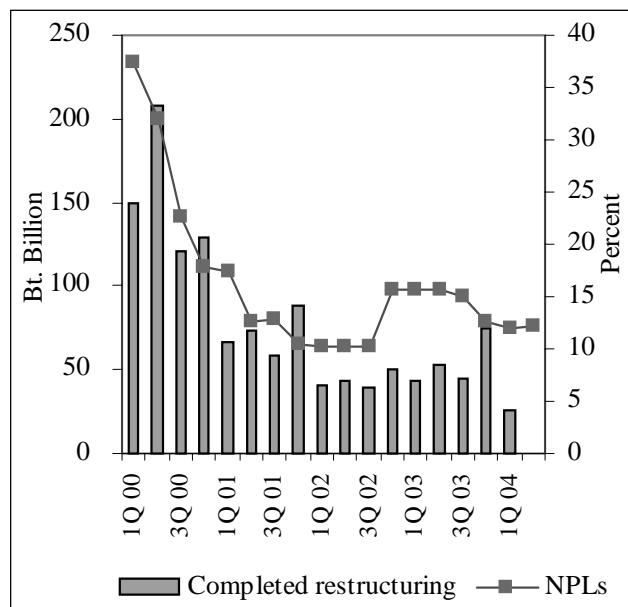
So far, the out-of-court mediation has had a small impact on removing the NPL overhang. The BOT selected a target group of 136,728 cases, with the value of Bt 426,843 million. In 15 months of operations through August 2004, the progress has been slow. Creditors have selected only 8.9 percent of the total target debtors by credit value, and only 2.3 percent of the selected debtors have participated in the program. The completion rate is 0.90 percent of the total target debtors by value, an insignificant improvement from 0.18 percent completion rate in July 2003 and 0.64 percent in December 2003.

2.8 Improving Competitiveness

Thailand's macroeconomic environment has improved further this year. Thailand's macroeconomic environment now ranks 23rd among the 104 countries surveyed in the latest *Global Competitiveness Report (GCR) 2004-2005*⁴⁸. This is a 3-rank improvement from last year as inflation remains low; external vulnerabilities continue to be reduced; fiscal stance is strong with declining government budget deficits; national savings rate is high; and growth prospects are good.

Some indicators of Thailand's business environment have also improved. Based on the seven groups of business environment indicators in the World Bank's *Doing Business 2005* report⁴⁹, Thailand ranks 20 among the 145 countries surveyed and 1st in Southeast

Figure 33. Completed Corporate Restructuring and NPLs, 2000-2004



Source: BOT and WB analysis

Note: Increase in headline NPLs as of December 2002 was due to a change in definition.

⁴⁸ The Global Competitiveness Report is produced by the World Economic Forum (WEF).

⁴⁹ The seven indicators are (1) starting a business, (2) hiring and firing workers, (3) registering property, (4) getting credit, (5) protecting investors, (6) enforcing contracts, and (7) closing a business.

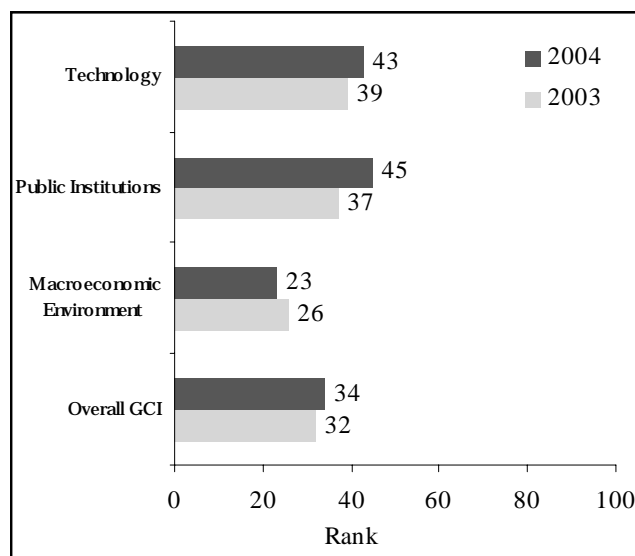
Asia in terms of ease in doing business. For example, starting a business in Thailand is relatively easy compared to other countries in East Asia with the costs of starting businesses higher than only Singapore's and Taiwan's. It takes only 2 procedures and 2 days to register a property. Hiring and firing employees are also relatively easy. Moreover, according to the *GCR*, Thailand ranks favorably among countries with relatively low tax burden, efficient tax system, and comparable pay with productivity.

However, Thailand still has room to improve on important areas of business environment, particularly on technology, corruption, skills, and efficiency of the bureaucracy. According to the *GCR*, Thailand's rank in the Technology Index dropped by 4 ranks from last year to rank 43 out of the 104 countries surveyed this year, mainly due to the low availability and usage of ICT such as the number of telephone lines, internet hosts, personal computers, and internet users. Similarly, Thailand's rank under the Public Institution Index has declined by 8 ranks to rank 45. Notable disadvantages contributing to a sharp fall in this ranking include irregular payments in exports and imports, organized crime, and favoritism in decisions of government officials. Bureaucratic red tape has also been noted to be severe as Thailand ranks 90 out of 93 countries surveyed on this issue. Thailand's ranks are also poor in the pervasiveness of money laundering through non-bank channels⁵⁰. These rankings are consistent with the Executive Opinion Survey (2004) conducted as part of the *CGR*, which revealed that Thailand's inefficient bureaucracy, corruption, and lack of an adequate educated workforce are key barriers found in doing business in Thailand⁵¹. In summary, notwithstanding the improvement in macroeconomic environment, Thailand's overall competitiveness rankings have dropped (see Figure 34 and Figure 35).

⁵⁰ Thailand ranks 86 out of 104 countries surveyed.

⁵¹ 17 percent of executives surveyed indicated that inefficient bureaucracy is the most problematic factor for doing business in Thailand, 15 percent indicated corruption, and 13 percent indicated inadequately educated workforce.

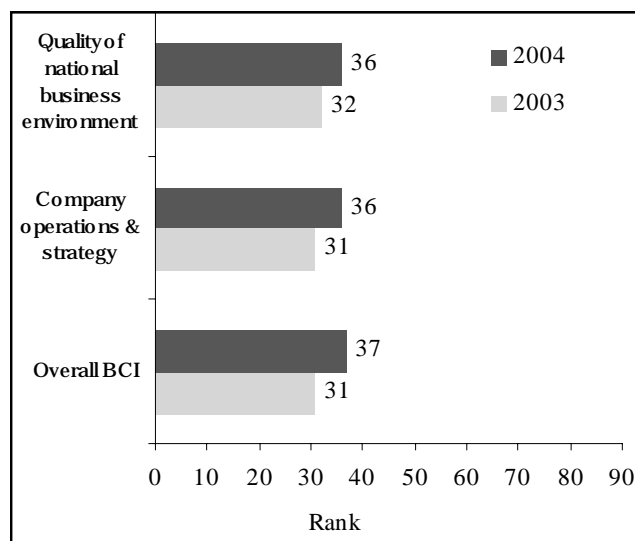
Figure 34. Thailand's Ranking in Growth Competitiveness Index (GCI) and Components



Source: Global Competitiveness Report 2004-2005

Note: (1) GCI rankings are out of 104 countries.
(2) Lower rank indicates better indicator.

Figure 35. Thailand's Ranking in Business Competitiveness Index (BCI) and Components



Source: Global Competitiveness Report 2004-2005

Note: (1) BCI rankings are out of 93 countries.
(2) Lower rank indicates better indicator.

SECTION 3

IMPLEMENTATION OF STRUCTURAL REFORMS

Thailand continues to push ahead with its national agenda to improve competitiveness. Thailand ranks in the top 5 countries of the world with organized efforts to improve its competitiveness, according to the *Global Competitiveness Report 2004-2005*. In 2004, the Thai Government continues to promote business cluster development, long-term savings and investments, small and medium enterprises (SMEs), as well as improve the logistics systems and labor skills. These have been done through direct measures, fiscal incentives, and infrastructure development (see Box 5).

Implementation of reforms in 2004 continue, but at a relatively slow pace. There has been further rationalization of import tariffs and signing of FTAs that are increasing competition for producers and opening up better export opportunities. Similarly, changes in public sector governance in respect of public financial management and public administration streamlining continue. There have been fewer changes in respect of private investment regulations while the changes in legal framework formulated for the financial sector, secured transactions, collateral and so on, still remain to be enacted and implemented.

This issue of the Monitor examines in detail the progress in the implementation of the financial and corporate sector reforms and restructuring, public sector governance reform, and trade reform. In the first two areas, there is on-going work

carried out with Government agencies under the relevant Country Development Partnership (CDP) programs. In the area of trade reform – which is critical for competitiveness improvement – but where there is no CDP, work with relevant agencies was carried out to ascertain the state of the progress. Below we look at the three areas.

3.1 Financial and Corporate Sector Reforms and Restructuring

Financial Sector Reforms

The BOT has taken several measures to expedite NPL resolution by Thai banks, including tightening provisioning requirement on long standing NPLs and amending laws to allow voluntary assets carved out from private banks to public AMCs. The Bank of Thailand (BOT) targets non-performing loans (NPLs) of Thai banks to decline below 5 percent by 2006. The new provisioning requirement, which will take effect on December 31 2004, will increase in four years costs of “doing nothing”. Required provision on NPLs in existence for over a year without either restructuring or legal action will increase to 100 percent of total principal amount disregarding the collateral value. The impact may not be significant, as NPLs,

Box 5. Efforts to Improve Thailand's Competitiveness

This year, the Royal Thai Government in collaboration with the private sector has pushed ahead with its efforts to improve Thailand's competitiveness. These include measures and studies undertaken by the National Competitiveness Committee (NCC) which is chaired by the Prime Minister; tax incentives provided by the Ministry of Finance; and an infrastructure development strategy proposed by the National Economic and Social Development Board (NESDB).

Actions by the National Competitiveness Committee (NCC):

- **Developing business clusters.** After piloting business clusters development in the automotive and parts, fashion and textiles, and electric and electronics product industries earlier this year, the promotion of these clusters has moved ahead and the ceramics and digital content industries clusters have been added to the list.
- **Improving logistics system.** In the last 6 months, the NCC has made progress in its efforts to improve Thailand's logistics systems with the aim to reduce the high logistics costs and to promote Thailand to be the logistics hub of Indochina. Four task forces – (1) infrastructure development, (2) logistics database, (3) public information linkage system, and (4) personnel and logistics knowledge development – have been established, each comprising of government agencies and private sector representatives. Each taskforce has begun drafting workplans to improve their respective areas. A consolidated logistics development master plan will be completed at the end of this year.
- **Improving skills.** The NCC has identified the number of people and skills needed for the 12 targeted industries to be competitive in the next 5 years. The industries selected are those with competitiveness potential (namely, strategic industries – automobile and parts, garments and jewelry, shrimp, chicken and pineapple, tourism, software, wooden furniture, and rubber products) and those which are the basic and supporting industries (electrical and electronics products, printing mold, petrochemical, steel and metals, and logistics system)
- **Promoting “green productivity”.** With the aim to reduce non-tariff barriers (NTBs) against Thai exports, the NCC has developed guidelines in formulating an action plan to promote green productivity or production processes aimed at reducing pollution and waste. The promotion will be targeted at small and medium enterprises (SMEs) in the electrical and electronics and the hotel industries. In addition, the Government will support the expansion of markets for products and services which are environmentally friendly and the formulation of proactive measures in handling arising NTBs.

Fiscal incentives aimed at improving competitiveness:

- **Promoting SMEs' competitiveness.** The Cabinet has endorsed the revision of income tax exemption for Venture Capital (VC) in SMEs. VCs investing in SMEs for more than 5 consecutive years are now eligible for the income tax exemption (Previously, VCs had to invest for more than 7 consecutive years to be eligible). In addition, SMEs with sales of less than Bt1.8 million per annum do not need to register in the VAT system, an increase from the earlier requirement of Bt1.2 million per annum. Corporate income taxes are also reduced for firms with registered paid up capital which have annual net profits not exceeding Bt5 million.
- **Encouraging Thai investments abroad.** Thai firms investing abroad are now exempted from taxes on dividend income.
- **Encouraging factories to move into industrial estates.** Firms that would like to sell their factories and land in order to move into industrial estates are exempted specific taxes on the sale of the assets. An objective of this measure is to encourage industrial clusters.
- **Promoting long-term savings and investment.** Investors in retirement mutual funds and long term equity funds are now eligible for income tax deductions of up to Bt300,000 per year.

Infrastructure development to improve competitiveness:

- **Developing Bangkok into a regional business hub.** This includes developing the Bangkok underground mass rapid transit system and connecting different modes of transportation in Bangkok to reduce traffic and road congestion; developing the new Suwannapum International Airport to be the regional hub for air transportation; and relocating activities which creates road congestion to outside Bangkok such as moving activities of the Bangkok Port to the Lamchabang Port.
- **Developing the transport system as part of the overall logistics system improvement.** This entails developing transshipment corridors to promote the Lamchabang Port as the regional gateway for shipments. To do so, both road and rail systems will have to be developed to create an appropriate transportation network to the Lamchabang Port.
- **Improving communications system.** Additional investments will be used for expanding fixed-line coverage to regional areas and promoting internet access.
- **Building energy security.** Alternative fuel options will be developed to diversify Thailand's future energy consumption so that it will not be primarily dependent on a single source of energy.
- **Increasing water service provision and developing water sources.** Several industrial and tourist areas in Thailand are already facing water shortages. To ease the current water shortage problems and be prepared for the increasing demand for water, water allocation and management systems will be revised and new water sources explored.

Source: NESDB and MOF

subjected to the new requirement, are not expected to be large. In addition, laws are being amended to allow two public asset management corporations (AMCs) – the Bangkok Asset Management Corporation (BAM), originally set up to manage distressed loans of one nationalized bank, and the AMC which is a bidder of last resort for the liquidation of distressed assets held over from 58 finance companies – to buy assets from private banks and AMCs. Thai private banks are encouraged to voluntarily sell their distressed loans to these AMCs with the pricing formula already agreed with the authorities. The amended legislations were approved by the Cabinet but have yet been reviewed by the Parliament. These measures however could be strengthened if complemented by the improvement in the legal regime to protect creditors' right. The governance and disclosure of these public AMCs should also be enhanced.

Consolidation as a result of the Financial Sector Master Plan appears at this stage limited to small players except a state-initiated merger between two commercial banks and a state-owned specialized financial institution. The implementing regulation issued by the MOF gave financial institutions until July 30, 2004 to apply for bank licenses. By the deadline, eight finance companies applied for an upgrade into four commercial banks and eight groups applied for seven retail bank licenses. Two finance companies will be transformed into credit-only financial institutions and four finance companies will be sold or merged with other financial institutions. The authorities have until end January 2005 to approve these plans. Financial institutions of which plans get approved have about one year to start their new operations. Consolidation could become more radical with the implementation of a partial deposit guarantee and the opening up for more foreign competition. However the plan to allow foreign banks to open additional branches by upgrading the branches into subsidiary status have attracted limited interests as only one foreign bank branch applied for an upgrade.

The full implementation of the Basel II Accord by Thai banks is planned for late 2008. The BOT announced that it would initially require Thai banks to

comply with the Standardized Approach but they can choose to implement “Internal Ratings Based Approach (IRB)”. Before the full implementation, banks will have to run risk-weighting under Basel I in parallel with Basel II starting from 2007. The BOT has adopted a number of measures in line with the New Basel Capital Accord such as shifting the supervision and examination process from evaluating transactions to reviewing a bank's risk management system and process. A policy statement on good governance was issued in 2002. Banks will be required to make sufficient disclosure especially their risk profile.

Progress has been made to promote the supply-side development of the domestic bond market.

Under an APEC initiative, the Ministry of Finance (MOF), the Securities Exchange Commission (SEC), and an expert panel have identified impediments to the development of asset and mortgage backed securitization in Thailand. Corrective action could contribute to the availability of long term, fixed rate funding and further investment in Thailand. The action plan to remove the impediments was developed and the implementation is underway. The implementation will be carried out by Thai authorities since the APEC initiative was dissolved after recommendations were delivered. A draft amendment to the Special Purpose Vehicle (SPV) Act was submitted by the MOF to the Cabinet and the draft Trust Act, approved by the Cabinet in December 2003, is being reviewed by the Office of the Council of State. The BOT and the SEC are drafting policy statements on securitization. The Revenue Department is considering options to facilitate a tax neutral status for SPVs. Practical guidelines for securitization are being developed by ICAAT to clarify the definition of “fair market value”, taking into account the International Accounting Standard (IAS) 39. In parallel, the MOF issued a notification to allow international finance institutions, governments in this region and their agencies to issue Baht denominated securities. This will increase high quality supplies of Baht denominated securities in the market and attract more interest from foreign investors in Baht denominated securities.

Non-life insurance companies have until the end of the year to maintain a higher proportion of their unearned premium reserve in liquid assets. The Ministry of Commerce's (MOC) Notification on unearned premium reserve effective on January 1, 2001 stipulated that assets qualified as reserve by non-life insurance companies include cash, government bonds, and properties. However from January 2003, properties will not be considered as reserve fund. This aims to improve the liquidity of general insurance companies since a recent examination by the Department of Insurance (DOI) indicated some non-life insurance companies encounter liquidity problems. Non-compliance firms will be subjected to a legal penalty. The MOC may impose stricter measures on non-compliance companies, including prohibition from sale of insurance premium until liquid assets can be built up or suggested mergers with others.

Corporate Sector Reforms

The long-awaited National Telecommunications Commission has been established. After a delay of more than two years, the Senate voted in August 2004 to appoint a 7-member National Telecommunications Commission (NTC) as a supreme regulator of the telecommunication industry. The long-awaited NTC is consistent with the modernization of the regulatory regime under the 1997 Constitution, and market liberalization under the WTO agreement. The selection of the National Communications Commission (NCC) as a regulator of the airwave and communications industry is yet to be finalized.

The progress in corporate restructuring in Thailand increasingly depends on the effective functioning of the legal and judicial regime. A long list of agenda remains on the legal and judicial fronts to advance corporate restructuring in Thailand. For example, the Secured Transaction Act, which could greatly enhance the corporate restructuring framework by providing greater flexibility in collateralization of other assets besides the traditional practice of pledging real estate, has been awaiting Parliamentary consideration for over two years. Moreover, the legal execution process which was streamlined in late 2003

by the Legal Execution Department (LED) to circumvent the "reserve price" requirements during auctions of foreclosed properties⁵², has not be expanded to cover property foreclosed before the last 10 years. The progress in bankruptcy liquidation reform has also been slow. The three-point amendment to the Bankruptcy Act, aimed to meliorate the "individual bankruptcy liquidation framework"⁵³, was endorsed by the Cabinet since late 2003 but was only recently passed by the Parliament.

The proposed amendments to the Civil Commercial Code on Legal Execution are unlikely to accelerate the sale process, and more rigorous amendments to the legal execution procedures are still needed. The amendments for the reduction in fees have been awaiting parliamentary consideration since early 2004. It is not certain that the amendments will be passed into law before the current Parliamentary session closes at the end of October 2004. The amendments proposed to (1) reduce the auction fee

⁵² The reserve price is the appraised value of the property at time of foreclosure, and could be higher than the true market value of the property. As required by law, the minimum bid price on the first round of auction cannot be less than the reserve price. The changes include lowering the starting bid price, if a property fails to be sold in first round of auction, to 80 percent of the reserve price in the second round, 65 percent in the third round, and 50 percent in the remaining rounds.

⁵³ The amendments only cover individual bankruptcies, while the corporate bankruptcy framework remains the same. The amendments proposed to (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; (3) disallow the collection of repayments or assets from family members of bankrupted individuals who are under 18 years old, while the spouse's assets must be divided 50:50 before collection under the Thai marital law.

from 5 percent to 3 percent of the sale value; (2) reduce the foreclosed property-discharging fee from 3.5 percent to 2 percent; and (3) reduce the fee for sales not going through the auction process from 3 percent to 2 percent. These are not procedural changes to expedite the sale process, but rather fee reductions to attract buyers to the foreclosed properties market.

The efficacy of the reform in the judicial process to lessen the backlog in the Civil Courts remains an on-going concern due to delays in remedial actions. The courts are required to schedule continuous hearings, and cases must be presided by a set of two judges through judgments. In practice, there is limited number of days available to schedule continuous hearings. The earliest a new civil court case can be scheduled continuously through completion would be between 9-12 months. With the existing volume of more than 74,000 civil cases awaiting court judgments, the possibility of an accelerated NPL resolution is remote. The Courts of Justice has been considering remedial actions including establishing special hours for trial and increasing budgetary resources for additional measures. However, specific remedial actions have not been proposed to the National Judicial Committee for approval. A swift decision is not expected due to extended debates and differences in opinion.

3.2 Recent Trade Reforms

Tariff Reform

Over half of Thailand's 5,505 tariff lines have been rationalized under the three-rate system⁵⁴ since January this year⁵⁵. In addition, the proposed restructuring of an additional 43 percent of tariff lines into the three-rate system have been considered by the Cabinet, of which roughly 17 percent will be effective next January. The remaining tariff lines that have not been submitted to the Cabinet will be done so within this year. However, roughly a quarter of the total tariff lines, though rates reduced, do not have a definite timeline for entering the three-rate system as some of them are set aside for trade negotiations.

Tariffs on parts and raw materials for electronics and electrical appliance industries were reduced in May. Tariff adjustments of parts and raw materials used to produce 76 items under the electronics and electrical appliance categories regardless of their sub-categories were effective in May 2004. Parts and raw materials with MFN rates exceeding 5 percent were reduced to 5 percent while those below 5 percent were reduced to zero⁵⁶. The new tariff rates are expected to help SME entrepreneurs compete in the highly competitive environment as well as increase incentives for prospective investors to expand their subsidiaries in Thailand.

Thailand has not made much progress on removal of non-tariff barriers. Since 1995, there has been little change in non-tariff barriers. A number of products is protected by non-tariff barriers for reasons of economic or industry protection.⁵⁷ Therefore, these protected sectors have fewer incentives to innovate and reduce costs in order to compete with international competitors. Going forward, non-tariff barriers would not be an efficient strategy to accommodate industry's competitiveness. The superior strategy would be a transformation of non-tariff barriers to tariff schedule and to reduce tariff rates over time in order to prepare the protected industries to encounter global competition.

⁵⁴ The three rates capture each stage of production as follows: 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods.

⁵⁵ As of January 2003, almost 38 percent of tariff lines are under the three-rate system. The major tariff reduction effective in October and December 2003 immediately brought an additional 19 percent of total tariff lines into the three-rate system. By January 2004, over 55 percent of total tariff lines are under the three-rate system.

⁵⁶ These include, for example, parts and raw materials for producing refrigerator, washing machine, rice cooker and microwave machine.

⁵⁷ These include, for example, dairy products (protected by tariff quota), marble (non-automatic import licensing), jute and sacks and bags made from jute or other textiles (non-automatic import licensing).

Services Trade Reform

While Thailand has a very open regime for trade in manufactures, the services sector generally is less open and more restricted. A recent study of a sub-set of Thai service sub-sectors for which data are available (i.e. air passenger transport, banking, distribution services, port services, professional services and telecommunications) show that their index of restrictiveness⁵⁸ of regulations, though falling in recent years, remain high relative to countries in other regions, and in some cases relative to countries in this region⁵⁹.

Restrictions in the services sector, like in goods, have a direct price-raising effect. This is the result of either higher mark-ups by producers or because of higher costs, both resulting from reduced competition. They also lead to reduce entry and thus reduced investment. Table 12 shows estimate of these effects in respect of domestic and foreign providers in Thailand. The numbers in parenthesis shows the arithmetic average of these effects for countries having similar estimates. They show that in telecommunications, ports, and banking (foreign providers) there is significantly higher price-raising impact in Thailand than in other countries. There is thus considerable scope to relax restrictions in these service sectors and generate significant efficiency and investment gains.

There was some relaxation of restrictions in the early post-crisis years. As a result, restrictiveness in air passenger transport, in banking and in distribution services fell and Thailand's current policy framework is relatively more open than many other middle-income countries. There has been relaxation of terms in recent air agreements as well as for domestic entry. In the banking sector, limits on foreign equity participation and on number of branches for foreign banks have been relaxed, and in the distribution services, there have been

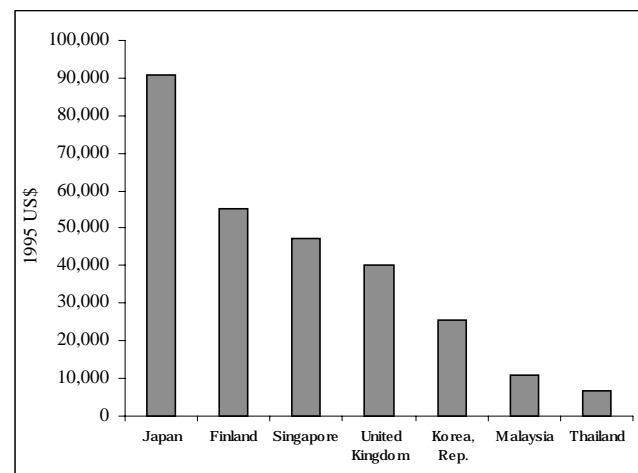
⁵⁸ Philippa Dee, "Cost of Services Trade Restrictions in Thailand", revised Sept 2004 (earlier version of the paper was presented at the TDRI, Bangkok, in July 2004).

⁵⁹ Most of the comparisons are with the average for a set of countries, depending upon the availability of data.

improvements in the competition policy and lower limits on foreign equity. There have been relatively fewer improvements in other areas.

Further improvements in the efficiency and productivity of the sector can make a significant contribution to the overall growth of the economy. Thailand's services sector accounts for nearly 50 percent of GDP and 40 percent of employment. However, Thailand's labor productivity in the services sector is low compared to other countries (see Figure 36). Moreover, the better quality and lower cost of business services could also contribute to higher efficiency and productivity of the manufacturing sector too. On the other hand, non-price regulatory restrictions that protect existing service providers from new competition and/or discriminates explicitly against foreign operators reduces competition, efficiency, and the quality of services, and raises costs.

Figure 36. Labor Productivity in the Services Sector, 2001



Source: World Bank staff calculations

Export Promotion and Assistance

In 2004, FTAs with China and India have led to tariff reductions under the Early Harvest Schemes, while the remaining FTAs are under negotiation. So far, Thailand has signed framework

Table 12. Estimated Direct Price - Raising Impacts of Trade and Regulatory Restrictions in Services in Thailand and the Rest of the World^a

(percent)

Sector and policy measure	Direct price impact	
	via markups	via costs
International air passenger transport (domestic and foreign providers)^b		
Restrictions on designation, capacity, price and non-scheduled services	8 (6)	8 (6)
Banking — domestic providers		
No restrictions	0 (3)	
Banking — foreign providers		
Restrictions on equity, lending, expanding branches, movement of people	11 (7)	
Distribution services — domestic providers		
Zoning restrictions, some statutory monopoly		4 (4)
Distribution services — foreign providers		
Zoning restrictions, some statutory monopoly, limits on land ownership, inadequate protection of intellectual property rights.		4 (2)
Maritime — domestic and foreign providers		
Mandatory port services, organised crime		4 (5)
Professional services – domestic providers^c		
Restrictions on form of establishment		2 (2)
Professional services – foreign providers^c		
Restrictions on form of establishment, equity, movement of people	4 (6)	
Telecommunications — domestic providers^d		
Restrictions on competition, interconnection	26 (8)	
Telecommunications — foreign providers^d		
Restrictions on equity, competition, interconnection	86 (19)	

^a Estimated direct price impacts in the rest of the world are in parenthesis.

^b In the absence of definitive research, the 50/50 split between price and cost impacts is arbitrary.

^c Lower bound estimate based on findings for engineering services.

^d A simple average of price impacts for fixed line and cellular services.

Source: Dee, Phillipa, “Cost of Services Trade Restrictions in Thailand” (Sept 2004).

agreements on Free Trade Areas with five countries and an economic integration, of which the Early Harvest Schemes with China and India have resulted in tariff reductions which were effective in October 2003 and September 2004, respectively. In addition, Thailand also signed a framework agreement with Australia in July 2004 which will be effective in January 2005, while FTAs with the US, Japan and New Zealand are still under negotiations (see Box 6).

The Ministry of Commerce continues to pursue proactive strategies to promote Thailand’s exports. An implementation of proactive strategies to support Thai exporters helped support export expansion in 2003. The Department of Export Promotion (DEP) under the Ministry of Commerce, has therefore, continued to employ the strategies to increase value-added of export products as well as enhance Thai exporters’ capabilities. The strategies

Box 6. Progress on Thailand's Free Trade Agreements (FTAs)

In 2004, Thailand has been negotiating FTAs with its several trading partners as well as potential markets to expand and diversify its export markets. The current stage of these negotiations are as follows:

- **ASEAN and China:** In a recent meeting in September 2004, the two parties agreed on a tariff reduction schedule for items under the Normal Track. The tariff reduction will start on 1 January 2005 and gradually reduce to zero percent by 1 January 2010. However, the schedule for items under the Sensitive Track is still under negotiation.
- **Thailand and India:** The two countries mutually agreed on the application of the rule of origins for 82 items out of the initial 84 items under the Early Harvest Scheme (EHS). The two items, namely polypropylene in primary forms and polyethylene terephthalate in primary forms were removed from the EHS list. The tariff reduction period for the remaining 82 items has started from 1 September 2004 to 1 September 2006. The tariff rates will be reduced by 50 percent, 75 percent and 100 percent, respectively. In addition to tariff reduction under EHS, Thailand and India are also negotiating tariff reduction of other goods and services
- **Thailand and Bahrain:** There is no significant progress on the negotiation between the two countries since Bahrain is as interested on trade in goods compared to trade in services, particularly the financial sector. However, it is likely that the two would renegotiate the FTAs. Therefore, there has been no further progress on the tariff reduction on 626 items under the Early Harvest Scheme in the framework agreement signed in 2002.
- **Thailand and Peru:** Thailand and Peru signed a framework agreement on Closer Economic Partnership on 17 October 2002. In a recent meeting in October, Peru agreed to reduce tariff rates of half of the total items to zero but would like to have a list of products on which tariff reduction will be implemented over a period of ten years. The next meeting will be in November this year.
- **BIMST-EC 6⁶⁰:** All members of BIMST-EC signed a framework agreement to include Bangladesh into the BIMST-EC Free Trade Area, effective on 30 June 2004. The agreement covers several issues such as trade in goods, negotiation on tariff reduction, trade in services and investment. The first meeting of the trade negotiating committees was held in September 2004 and concluded that priority would be given to the negotiation on trade in goods followed by trade in services and investment⁶¹.
- **Thailand and Australia:** Thailand and Australia signed a framework agreement on Free Trade Area on 5 July 2004. The framework will be effective on 1 January 2005. Tariff rates of nearly half of Thailand's 5,505 items, such as mineral, fuel, chemical products, and leather will be reduced to zero on the effective date and so will 83 percent of Australia's 6,108 items which includes, for example, fruits and vegetables, canned pineapple, processed food, paper, jewelry, and compact and pick-up cars.

Several other bilateral agreements are under negotiation and study. These include Thailand and the US, Thailand and Japan, and Thailand and New Zealand.

- **Thailand and US:** The two countries held a second round of negotiations in October 2004. The contents of the meeting were to clarify and exchange information on several issues such as services, safeguards, government procurement, transparency, intellectual property, agricultural products, Sanitary and phyto-sanitary (SPS) measure, textiles, labor and environment. The third round of negotiations will be in December 2004.
- **Thailand and Japan:** A recent meeting in September 2004 covered negotiations on trade in goods and services. However, there is no significant progress on the negotiations as both countries still have an irreconcilable product list. Thailand would like to include agricultural products into the list while Japan is more interested in vehicles and parts. In addition, at the meeting the two countries also exchanged comments on the proposals to reduce tariffs on trade in the service sector, but no conclusion was reached.
- **Thailand and New Zealand:** In a recent meeting in September 2004, the two countries have not yet agreed on a tariff reduction schedule. Thailand has proposed the same list of tariff reduction as in the Thailand-Australia FTA to New Zealand which will adjust its list accordingly and discuss it in the next meeting in November 2004. As for trade in services, Thailand and New Zealand agreed to negotiate on this matter in the next three years.

⁶⁰ BIMST-EC includes seven countries, namely, Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

⁶¹ The negotiation on trade in goods is expected to complete in December 2005. As for trade in services and investment, the negotiation will start in 2005 and complete in 2007.

include the Special Task Force (STF), Thailand Market Place (TMP), the International Trading Firm (ITF), Intertrader Project and OTOP to the World.⁶²

The EXIM Bank introduced new services to support SME exporters and existing business. The Packing Credit Plus program, which combines working capital loans together with export credit insurance services, was launched in June 2004. The program is designed to increase not only exporters' liquidity but also their confidence in receiving payment from purchasers and allow exporters to employ EXIM Bank's networks in monitoring foreign importers and collecting default payment. In addition, the EXIM Bank has adjusted the new criteria of overseas credits to Thai restaurants abroad in order to efficiently respond to the demand for credits in line with the government policy to support Thailand as a Kitchen of the World. The EXIM bank also signed a Bilateral Payment Agreement with the Export Development Bank of Iran to facilitate the payment system between the two countries.

⁶² A STF will survey new markets and analyze market potential for Thai export products. Currently, there are 12 STF teams responsible for target markets like China, South Asia, the Middle East, Russia and the Commonwealth of Independent States (CIS), Africa, Latin America, Australia and New Zealand. The TMP will expand the distributions and permanent marketing channels both domestically and internationally for Thai products through Integrated Marketing Communication. ITF is a joint collaboration between the Ministry of Commerce and other related government agencies to facilitate exporters and private trading companies in acting as mediums of network between the foreign importers and the SMEs and the One-Tambon-One-Product (OTOP) producers. The Intertrader Project is aimed to encourage new entrepreneurs to become international traders through training, seminars and data support in order to increase exports to existing and new markets. OTOP to the World Project is established to support OTOP producers who are mainly from the grassroot level with limited experience in exports processes. In September 2004, two OTOP shops were established in Bangkok and Chiangmai to be a center of OTOP products for foreign importers.

3.3 Public Sector Reforms

Public sector reform is being implemented according to the Strategic Plan approved by Cabinet in May 2003. This year, further progress has been made in improving public service delivery and financial management of public funds. Progress in decentralizing resources, functions, and personnel to the lower levels of government has continued, including through the "CEO Governor" approach, and central departments have decentralized some of their authority and resources to provincial levels. Delays in decentralizing resources and financial management are gradually being solved and service delivery time is also improving.

Service delivery has been improved through the implementation of specific service programs. In particular, "service link units" have been established to act as a single coordination unit for related services provided by different Ministries or Government agencies. The service link units will improve both the quality and the processing time of the particular service provided (e.g. connection of phone line, electricity and water supply for newly constructed houses). Other forms of cooperation across government agencies are also being explored to improve service delivery. For example, a "One Stop Export Service Center", combining public and private agencies providing export-related services, is being piloted under the Ministry of Commerce. Other programs, such as "Knowledge Management", "Training of Trainers", and electronic learning programs through the "mini Modern Public Management" scheme are also being implemented to enhance the capacity, management, and performance of the public sector. Finally, a "Good Governance Award" has been launched to increase the incentive to improve the quality of public service delivery.

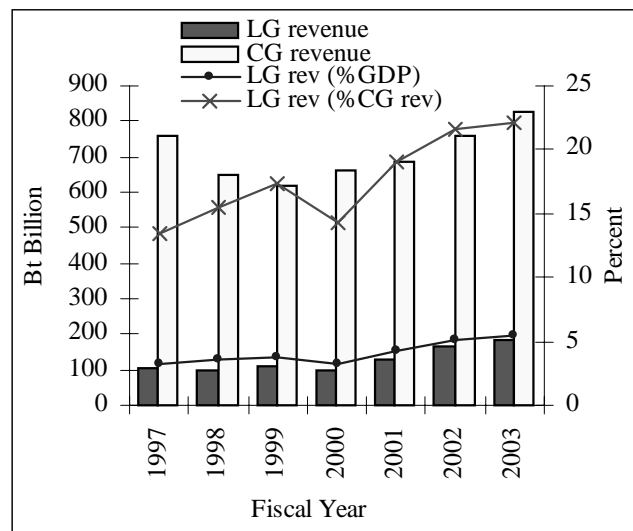
Government financial management is being further strengthened. A Government Financial Management Information System (GFMS) has been implemented in all ministries, provincial administrative organizations (PAOs) under the CEO Governors, and Thai embassies. As part of the electronic government framework, the GFMS links budget planning and

appropriation systems with other financial management systems, including national accounting, procurement, budget execution and payment, and personnel benefits. With the implementation of GFMS, withdrawal of budget allocation is no longer being made through the Comptroller General's Department, reducing processing time and improving overall control and monitoring. Also, price differences among suppliers can now be compared on line in real time, and payments can be made directly to suppliers, reducing the opportunities for corruption. Finally, the personnel information system can be used to more effectively manage government officials.

Fiscal decentralization is proceeding, albeit slowly.

In FY 2004, revenues of local government organizations (LGOs) were 22.8 percent of national government revenues (See Figure 37). While this was slightly above the level projected for FY2004, it remains far below the 35 percent target set for 2006 under the Decentralization Act of 1999. Although the share of LGO revenue has been increasing over time, most of the increase has come from centrally collected taxes for LGOs and subsidies from central government (approximately 87 percent collectively over FY2000-FY2004), not from revenues collected directly by LGOs (13.1 percent over the same period). Moreover, only 174 out of 245 functions have been transferred so far, partly because some function transfers have been delayed pending necessary revisions to laws and regulations. As for personnel decentralized, 4,111

Figure 37. Local Government (LG) and Central Government (CG) Revenues, FY1997-FY2003



Source: Department of Provincial Administration, Ministry of Interior. Compiled by Fiscal Policy Office, Ministry of Finance

personnel from 5 departments were transferred in FY 2003. While the target for FY2005 is to transfer at least another 925 officials from 3 departments, it is likely that only 348 additional personnel from only 2 departments will be transferred as some originally proposed transfers of functions are being reviewed by the Office of Public Development Commission (OPDC) to assess whether they remain appropriate.

Appendix 1: Key Economic Indicators

	2002	2003 e/	2003	2004			2004		
	Year	Year	Q4	Q1	Q2	Q3	Jul	Aug	Sep
Output, Employment and Prices									
GDP (% change, previous year)	5.4	6.8	7.8	6.6	6.3	..	..	..	..
Manufacturing production index (1995=100)	123.2	138.4	145.6	156.5	145.0	143.0	145.7	138.1	145.1
(% change, previous year)	8.5	12.3	11.7	11.4	7.5	7.8	9.4	6.3	7.7
Unemployment rate (%)	2.4	2.2	1.8	2.9	2.3	1.5	1.4	1.5	1.8
Real wage growth (%) 1/	-1.5	0.4	0.3	0.6	-1.1	..	..	..	..
Consumer price index (% change, previous year)	0.7	1.8	1.6	1.9	2.6	3.3	3.1	3.1	3.6
Public Sector									
Government cash balance (Billion Baht)	-76.8	24.0	-37.5	9.4	39.9	1.3	-11.4	-2.3	15.1
Government cash balance (% GDP)	-1.4	0.4	-2.4	0.6	2.5	..	..	..	..
Public sector debt (% GDP, end of period) 2/	54.3	48.9	48.9	44.2	45.4	..	45.6	46.2	..
Foreign Trade, BOP and External Debt									
Trade balance (US\$ million)	2,739	3,759	794	236	-182	173	95	-282	360
Exports of goods (fob, US\$ million)	66,092	78,105	21,612	21,961	23,398	24,711	8,007	8,209	8,495
(% change, previous year)	4.8	18.2	22.8	21.9	24.6	25.4	24.8	28.3	22.9
Imports of goods (cif, US\$ million)	63,353	74,346	20,818	21,725	23,580	24,538	7,912	8,491	8,135
(% change, previous year)	4.6	17.4	25.4	26.6	35.1	29.8	22.8	37.1	29.8
Current account balance (US\$ million)	7,008	7,965	2,462	2,158	635	1,404	610	215	579
(% GDP)	5.5	5.6	6.1	..	..	..	..	..	..

	2002	2003 e/	2003	2004			2004		
	Year	Year	Q4	Q1	Q2	Q3	Jul	Aug	Sep
Foreign direct investment, net (US\$ million)	1,023	1,882	551	132	223	..	182	76	..
Total external debt (US\$ million)	59,459	51,783	51,783	51,461	49,691	..	49,698	49,847	..
(% GDP)	46.9	36.1	36.1	..	..	..	..	..	..
Short-term debt (US\$ million)	11,919	10,904	10,904	11,505	11,296	..	11,457	11,686	..
Debt service ratio (% exports of goods and services)	19.6	16.0	10.5	10.3	8.3	..	..	..	..
Reserves, including gold (US\$ million)	38,924	42,148	42,148	43,036	43,306	44,768	43,451	43,861	44,768
(months of imports of goods)	7.4	6.8	6.1	5.9	5.5	5.5	5.5	5.2	5.5
Financial Markets									
Domestic credit (% change, previous year) 3/	3.6	4.3	4.3	5.0	7.0	..	..	..	..
Short-term interest rate (average period) 4/	2.0	1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Exchange rate (average period)	43.0	41.5	39.7	39.2	40.2	41.3	40.9	41.4	41.4
Real effective exchange rate (1994=100)	81.8	80.5	81.8	81.9	81.5	..	80.0	79.4	..
(% change, previous year)	2.8	-1.5	2.5	3.2	2.2	..	-0.6	-2.2	..
Stock market index (Dec 1996=100)	356.5	772.2	772.2	647.3	647.6	661.2	636.7	628.8	661.2
Memo: GDP (US\$ billion)	126.9	143.2	39.4	23.6	21.9	..	..	..	..

e = estimate

1/ Computed from average wage of employed person from Labour Force Survey

2/ Include direct government debt, non-financial-state-enterprise debt and Financial institutions Development fund (FIDF) debt

3/ Yearly and quarterly data include credits extended by all financial institutions

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

Appendix 2: Monitoring Matrices for Structural Reform Implementation⁶³

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

⁶³ 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
<p>A. Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve the local economy</p>	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ Scholarships have been provided to poor children, using the Government's revenue from sales of lottery tickets. This program is a part of the implementation of the strategy for poor and disadvantaged children aimed at providing support to poor children. The scholarship is granted to children who have submitted an article telling about their poverty. The scholarship will be awarded to children after verifying with their schools and teachers of their eligibility. Currently, around 250,000 children have received the scholarship with 150,000 applications are being processed. In total, the program is currently using about 67 percent of the allocated resources. ▪ Implementation of the first phase of the Community Development Plan has made progress. During its first phase, 3,657 tambons (sub-districts) have developed their community plans, well above the original target of 3,049 tambons. Out of this, more than 65 percent have started implementation. Different organizations, both government and non-government, have so far allocated more than 55 million baht to provide support to the implementation. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ A new poverty line will be constructed. Poverty line methodology is being revised and updated which would result in an increase in the number of those who fall below poverty line. The new poverty line reflects the current standard of living with a new consumption basket, new calorie and protein requirement and incorporates changes in demography. With then new methodology, the poverty line in 2002 will increase from 922 baht per person per month to 1,163 per person per month. The new methodology is under review and is expected to be used for poverty measurement in 2004, which will be reported in first half of 2005. ▪ Programs will be implemented in response to the issues raised through the poverty registration program. The National Poverty Eradication Center is currently working on identifying key programs in response to the three self reported key problems i.e. high personal debt, lack of agricultural land, and lack of shelter. Currently, five state banks have been assigned to solve the issue of personal debt in the system⁶⁴. In addition, plots of land will be distributed to both farmers and households. In addition, a caravan of experts will be arranged to go around the country to meet with registered households. Experts and advisors will provide advice and training to household on how to make a living. In addition, the student scholarship for poor children will continue to be provided. ▪ The full implementation of the Small-Medium-Large (SML) Scheme will take place next year. The Government has established the SML Scheme to complement the already implemented Village Fund Program. It aims to provide grant to villages. The amount of loans provided will vary positively with the size of the village. In its first phase, the SML will be piloted in 1,002 villages. If successful, the project will be scaled up to 75,000 villages by the end of next year. ▪ The second phase of the Community Development Plan will be completed next June. In its second phase, covering the period of June 2004 to June 2005, another 2,673 tambons (sub-districts) are expected to develop their own community plans.

⁶⁴ Five banks that have been assigned to work on solving the issue of personal debt in the system are Bank of Agriculture and Agricultural Cooperatives, Krung Thai Bank, Small and Medium Enterprise Bank, Government Saving Bank, and Government Housing Bank.

2. Financial and Corporate Sector Reform

Objective		Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	<p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ Two existing credit bureaus are to be merged. There are currently two credit bureaus: Central Credit Information Service Co., Ltd., sponsored by the Thai Bankers Association focusing on firm information and Thai Credit Bureau, sponsored by the MOF under Government Housing Bank, focusing on individual data. Merger of the two bureaus is expected to improve their commercial viabilities.
B.	Formulate a medium-term strategy for Thai financial sector	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The implementing regulation issued by the MOF gave finance and credit foncier companies until July 30, 2004 to apply for bank licenses. By the deadline, eight finance companies applied for an upgrade into four commercial banks and eight groups applied for seven retail bank licenses. Two finance companies will be transformed into credit only financial institutions and four finance companies will be sold or merged with other financial institutions. The same deadline is applied for foreign banks wishing to upgrade their domestic operations. However only one foreign bank branch applied for an upgrade. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The BOT will submit by the end of November to the MOF for its final approval the outcome of its review of finance companies' applications for commercial bank licenses. The authorities have until end January 2005 to approve these plans and financial institutions whose plans get approved have about one year to start their new operations. ▪ The BOT will soon launch a pilot project with state banks to improve capacity and infrastructure for the delivery of cost effective financial services to low-income households. The project is scheduled to start early next year. The BOT hopes to demonstrate that serving low-income household can be commercially viable if appropriate business models are used. The success of the project may persuade commercial banks to penetrate into this segment and subsequently improve access to financial services by the poor, which is an ultimate goal of the current financial sector master plan. ▪ BAAC will be transformed into a rural bank. The draft amendment to the BAAC Act was approved by the Cabinet and the Council of State and will be considered by the Parliament. Once the amendment to the Act is effective, BAAC will be able to expand its businesses beyond agricultural finance.
C.	Transit from the current blanket government guarantee on deposits to limited deposit insurance	<p><i>Measure taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Deposit Insurance Act was approved by the Minister of Finance and is awaiting Cabinet consideration before submission to the Parliament. The implementation of limited deposit insurance will add market discipline to the system because large and uninsured depositors (mostly institutions) will move their money away from weaker banks.
D.	Remove legal impediments and provide an enabling environment for derivative products	<p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The derivatives exchange is expected to begin its operations in 2005. The Stock Exchange of Thailand (SET) will provide Bt 100 million seed capital. The exchange would be initially limited to trading of stock index and interest rate futures. The Derivatives Act governing exchange-traded transactions has been effective since early 2004. The establishment of an organized derivatives exchange would add more players and liquidity to the financial market.

<u>Objective</u>		<u>Reform Measures Taken</u>
E.	Develop local market	<p><i>Measures taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Cabinet recently approved Bt 170 million for Thai Bond Dealing Center (TBDC) to become a full function Self Regulatory Organization (SRO) for the bond market. This is expected to create and maintain transparency, fairness and integrity of the secondary bond market. TBDC will continue to perform its role as an information center for corporate bond trading activities, which are mostly traded over the counter and not centralized.
F.	Rationalize state holding of specialized financial institutions, state owned enterprises, and state commercial banks	<p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ SME bank plans to implement a Public Service Account (PSA) by the end of the year. A public service account will report costs and performance of social mandate activities in separation from commercial activities. This is an initially step to improve the transparency of financial reports by specialized financial institutions (SFIs). By properly costing and budgeting socially mandate activities, the MOF can hold SFIs accountable for costs and benefits. The Minister of Finance is reviewing FPO's proposal for the implementation of the PSA by other public financial institutions. However a definite timetable has not been determined.
G.	Enable corporate sector restructuring through out-of-court mediation, streamline the legal execution process for old foreclosed properties, and reduce the fees on the sale of foreclosed assets	<p><i>Measure taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The legal execution process was streamlined to speed up the sale of foreclosed properties over 10 years old. In November 2003, the Legal Execution Department (LED) amended the "reserve price" requirement for the auction of foreclosed properties. If a property fails to be sold in the first round of auction at the reserve price, the starting bid price in subsequent rounds is lower to 80% of the reserve price in the second round, 65% in the third round, and 50% in the remaining rounds until the property is sold. The LED is considering expanding these guidelines to include new foreclosed properties to accelerate market clearance of distressed assets. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Parliament is expected to pass the amendments to the Civil Commercial Act on Legal Execution to reduce the fees on the sale of foreclosed properties. The proposed amendments would lower the fee for properties auctioned, the property discharging fee, and the fee for sales not through the auction by 1.5-2% in each category. Although these are not procedural changes to streamline the auction process, it is expected that the lower fees would attract more buyers to the foreclosed properties market. ▪ 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

<u>Objective</u>		<u>Reform Measures Taken</u>
A.	Reform institutions to enhance competitiveness	<p><i>Measure taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Senate selected and appointed the 7-member National Telecommunication Commission (NTC). The NTC was selected after over two years delay. The NTC will act as a supreme regulatory body, with the power to convert the existing telecommunication concessions, set market rules and regulations including tariffs and license fees and approving new entries to enhance competition and efficiency in the telecommunication industry. <p><i>Measure planned to be taken, but has been delayed</i></p> <ul style="list-style-type: none"> ▪ Technical institutes will be reformed and restructured. In July 2003, the NCC commissioned a study 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. The targeted technical institutes to undergo restructuring both in terms of roles and funding, are the Textile Institute, Thai Automotive Institute, Food Institute, and Thailand Productivity Institute. To date the progress of the reform has not been recorded.
B.	Reform of legal and judicial regime	<p><i>Measure taken in the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Parliament has passed partial amendments to the Bankruptcy Act with regards to individual bankruptcy. The amendments proposed to (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; (3) disallow the collection of repayments or assets from family members of bankrupted individuals who are under 18 years old, while the spouse's assets must be divided 50:50 before collection under the Thai marital law.
C.	Improve labor skills	<p><i>Measure to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ 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. A new vocational law and the TVQ Act have been drafted and are being reviewed by the Council of State before submission to the Parliament.

4. Trade Reforms

<u>Objective</u>		<u>Reform Measures Taken</u>
A.	Reduce tariff to improve Thailand's competitiveness	<p><i>Measure taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ MFN tariff reduction on parts and raw materials for electronics and electrical appliance industry was effective in May Tariffs on parts and raw materials for producing 76 finished items under electronics and electrical appliance categories like refrigerator, washing machine and rice cooker, were reduced in May 2004 such that those exceeding 5 percent were reduced to 5 percent and those less than five percent were reduced to zero rate. The restructuring is expected to help SME entrepreneurs and to increase incentives for foreign investors. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ Further MFN tariff reduction will take place next January. Two-fifths of 43 percent of total tariff items approved by the Cabinet will enter the three-band system in January 2005. These include, for example, paper, printed matters and based metal. ▪ The remaining tariff lines that have not been submitted Cabinet for restructuring will be done so later this year. The remaining 2 percent of tariff lines will be submitted to the Cabinet later this year.
B.	Promote Thai exports to new markets	<p><i>Measure taken over last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Early Harvest scheme between Thailand and India was effective in September. According to framework agreement on Free Trade Area signed in October 2003, Thailand and India mutually agreed to reduce tariff rates on 82 items out of the initial 84 items under Early Harvest Scheme.⁶⁵ These include mostly industrial goods such as iron and steel, and household electrical appliance and a few farm goods like fresh fruits and canned seafood. The tariff rates will be reduced by 50 percent, 75 percent and 100 percent, respectively. The tariff reduction began on 1 September 2004 and tariff rates on the 82 items will become zero in September 2006. <p><i>Measures to be taken in the next 6 -12 months</i></p> <ul style="list-style-type: none"> ▪ Thailand and Bahrain Early will renegotiate the Early Harvest scheme. It is likely that the two would renegotiate the FTAs. Therefore, the tariff reduction on 626 items under the Early Harvest Scheme in the framework agreement signed in 2002 would be on hold. ▪ Tariff reduction under FTA between Thailand and Australia will be effective next January. According to framework agreement on Free Trade Area signed in July 2004, tariffs on 49 percent of Thailand's total items, such as mineral, fuel, chemical products, and leather will be reduced to zero rate on the effective date and so will 83 percent of Australia's including, for example, fruits and vegetables, canned pineapple, processed food, paper, jewelry, and compact and pick-up car. The tariff reduction will be effective on 1 January 2005.

⁶⁵ The two items, namely polypropylene in primary forms and polyethylene terephthalate in primary forms are removed from the previous list announced last year.

5. Public Sector and Governance Reform⁶⁶

Objective	Reform Measures Taken
<p>A. Improving public service quality by streamlining and redesigning work processes and procedures</p>	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ Good Governance Awards (GGA) have been issued as an incentive scheme to encourage good governance in the public sector. The awards are given for efficiency in governance and better quality of service. Based on the same principle as the Thailand Quality Award (TQA) and the Malcolm Baldrige National Quality Award (MBNQA), the aim is to enhance the quality of services provided by the public sector. ▪ Service link units were established. Service link units were established in 4 districts in Bangkok and is being expanded to three pilot provinces (Nakorn Pathom, Chonburi, and Chiang Mai) to enhance efficiency and improve public service delivery. This service link unit provides a focal point for those who would like to receive or extend services such as telephone line, electricity, etc. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ Service Quality Awards will be issued to provide incentives for improved and timely service delivery. The Office of Public Sector Development Commission (OPDC), along with National Institute for Development Administration (NIDA), will monitor and evaluate the implementation of plans submitted by each office for reducing processing time and improving service delivery. In October 2004, each public office submitted plans to the OPDC to reduce the time taken to provide their regular services by at least 25 percent. The plan will be implemented and evaluated for the award to be given early 2005. ▪ The service link unit will be expanded to specifically serve SMEs. The SME service link unit has been piloted in Chaingmai in September 2004 and others will follow after the evaluation of the pilot center is completed.
<p>B. Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels</p>	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The linkage between CEO Governors and CEO Ambassadors has been established. As part of the dual track approach, provincial level strategies of the 8 northern provinces have been linked to the Thai ambassadors in the neighboring countries of the Greater Mekong Sub Region and BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, and Thailand) to promote collaboration between these provinces and neighboring countries especially in terms of trade, investment, tourism, infrastructure, and energy and to integrate provincial strategy with Thailand's strategy towards neighboring countries. ▪ Implementation of the CEO Governor scheme in 75 provinces has been reviewed through self-assessment reports. Lessons learned and ways to move forward will be discussed at the CEO Governor Retreat, which will be held in November 2004. ▪ The Fast Track Training Program has been approved by the Cabinet. The Cabinet approved the development of a Fast Track Training Program or Change Management Program. This 24-month program aims to develop a new generation of civil servants and encourage change leaders, visionary thinkers, developers, planners, and operators. Participants are trained in different departments, both at the central and local government offices, and spend 4 months in Thai embassies.

⁶⁶ The objectives of this matrix have been adjusted to reflect those of the Government's Public Sector Development Strategy (2003-2007)

<u>Objective</u>	<u>Reform Measures Taken</u>
<p>C. Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation.</p>	<p><i>Measures taken over the last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ The Government Financial Management Information System (GFMS) has been fully implemented in all government agencies, provincial administrative organizations (PAOs) and Thai embassies. GFMS serves as a real time financial management system for the public sector, linking all related systems including budget execution, electronic procurement, personnel information, and national accounting. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Prime Minister's Office regulation on Controlling and Monitoring Civil Affairs in Provincial Administration is being reviewed by the State Council and is expected to be presented to Cabinet before April 2005. The regulation will empower the deputy prime minister with the authority in overseeing the management of provincial clusters.
<p>D. Improving governance in public sector through participation, accountability, and transparency.</p>	<p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ Following the first phase, a curriculum for the people's audit system is currently being developed and will be used to train community leaders in monitoring and evaluating governance in the public sector. The King Prachadhiphok's Institute is now the main responsible agency. Once the curriculum is completed, it will be piloted in Pitsanuloke and expanded to 5 provinces in 5 regions.

6. Social Protection

Objective	Reform Measures Taken
<p>A. Develop social insurance mechanisms for the elderly and those affected by unemployment, work-related injuries or other shocks to income</p>	<p><i>Measures taken in last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ After the first six months of contributing to the Unemployment Insurance (UI) scheme which started on January 1st, 2004, the number of those who received benefits as of August 31st, 2004 totaled 4,908 persons, of which 3,524 have voluntarily left their jobs. Under the UI scheme, those who involuntarily leave their job and are eligible for the benefits would receive 50 percent of their former salaries for up to 180 days of unemployment. Those who voluntarily leave their jobs would receive 30 percent of their salaries for a maximum of 90 days. ▪ The Social Security Scheme has expanded its medical benefit to cover antiretroviral treatment for AIDS patients as of August 1st, 2004. Coverage includes drug and lab tests expenses within a limit of Bt5,000 per person per month. As of September 30th, 2004, there were approximately 3,500 patients under such coverage. Although the government announced its National Access to Antiretroviral Program for People Living with HIV/AIDS (NAPHA) since 2001, the limited quota for each hospital does not guarantee access to care for everyone with HIV/AIDS. <p><i>Measure planned to be undertaken, but has been delayed</i></p> <ul style="list-style-type: none"> ▪ The implementation of the multi-pillar pension system has been postponed to year 2007.– The reformed pension system would supplement the standard defined benefit pensions (first pillar) with private investment of the retirement funds (second pillar) to provide adequate coverage for the aging population. In addition, savings and risk mitigation mechanisms for workers in the informal sector will be examined with a view toward incorporation into the pension system.
<p>B. Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement</p>	<p><i>Measures taken in last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ On April 27, 2004, Ministry of Labor announced the ministerial order for domestic household worker protection which ensures fairness and safety for the workers. A contract will be required for any employment with specified rate of payment. Dangerous tasks, which involve flammable material, toxic chemical, and other hazard element, are prohibited. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ The Labor Protection Act for agricultural workers is now being reviewed by the State Council. Once approved by the Council and the- Department of Labor Protection and Welfare, it will cover up to 2.3 million agriculture workers in farming, fishing, forestry, animal husbandry, and salt cultivation.

<u>Objective</u>	<u>Reform Measures Taken</u>
<p>C. Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support</p>	<p><i>Measures taken in last 6 months and their significance</i></p> <ul style="list-style-type: none"> ▪ Government continues to expand the “Ua-Athon Program”. In addition to the Ua-Athon low-income housing, the new initiatives include free solar-cell electricity, airplane pilot program, low-price taxi limousine, low cost insurance for funeral expenses, and expansion of accident insurance toward students. ▪ Some social assistance programs are now decentralized to the Tambon Administration Organization (TAO) in order to better address local needs. The programs included allowances for the elderly, the disabled, and people living with HIV/AIDS. <p><i>Measures to be taken in the next 6-12 months</i></p> <ul style="list-style-type: none"> ▪ Low interest rate mortgage loan will be introduced by the Social Security Office for those registered in the scheme. The first registration is now planned for November 19, 2004. Then there will be a random draw with the final results to be announced on December 3, 2004. The loan is expected to provide the working population with housing security. The interest rate will be at 2.5 percent per annum for up to 5 years. ▪ Funds for “Child Protection”, “Senior Citizen”, and “Social Welfare Support” will start operating upon approval of the Bureau of the Budget. These funds are set up according to “the Child Protection Act”, “Senior Citizen Act”, and “Social Welfare support Act”, which have been effective since January 1st, 2004. The money will be used to support activities defined within the above Acts. ▪ The Universal Health Coverage under the 30 Baht Health Benefit Scheme is now considering an expansion to cover treatment for kidney disease and antiretrovirals. Due to capacity and budget limitations, the National Health Security Office will launch a pilot program for kidney disease treatment in three hospitals for one year before making any conclusion.