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THAILAND ECONOMIC MONITOR
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ABBREVIATIONS

ACMECS	Ayeyawady-Chao Phraya-Mekong Economic Corporation Strategy
ARMS	Advanced Resilient Matching System
ASEAN	Association of Southeast Asian Nations
ASSET	Automated System for the Stock Exchange of Thailand
BAAC	Bank for Agriculture and Agricultural Cooperatives
BIMSTEC	Bay of Bengal Initiative for MultiSectoral Technical and Economic Cooperation
BIS	Bank for International Settlement
BOB	Bureau of Budget
BOI	Board of Investment
BOP	Balance of Payments
BOT	Bank of Thailand
CDS	Credit Default Swaps
CMDF	Capital Market Development Fund
CPI	Consumer Price Index
CSMBS	Civil Service Medical Benefit Scheme
DALY	Disability-adjusted Life Year
DPA	Deposit Protection Agency
ETF	Exchange-traded Fund
EU	European Union
EXIM Bank	Export-Import Bank of Thailand
FDI	Foreign Direct Investments
FIBA	Financial Institution Business Act
FIDF	Financial Institutions Development Fund
FPO	Fiscal Policy Office
FSMP	Financial Sector Master Plan
FTA	Free Trade Agreements
FY	Fiscal Year
GDP	Gross Domestic Product
ICT	Information and Communications Technology
JTEPA	Japan-Thailand Economic Partnership Agreement
KEI	Knowledge Economy Index
KPIs	Key Performance Indicators
LGO	Local Government Organizations
LTF	Long Term Fund
MOC	Ministry of Commerce
MOPH	Ministry of Public Health
MTEF	Medium Term Expenditure Framework
NCB	National Credit Bureau

NCD	Non-Communicable Diseases
NEER	Nominal Effective Exchange Rate
NESDB	National Economic and Social Development Board
NHSO	National Health Security Office
NPLs	Non-performing loans
NSO	National Statistic Office
OCSC	Office of Civil Service Commission
OECD	Organization for Economic Cooperation and Development
OPDC	Office of Public Development Commission
REER	Real Effective Exchange Rate
RMF	Retirement Mutual Fund
ROH	Regional Operating Headquarters
SET	Stock Exchange of Thailand
SMEs	Small and Medium Enterprises
SML	Small-Medium-Large
SOEs	State-owned Enterprises
SSO	Social Security Office
SSS	Social Security Scheme
TCH	Thailand Clearing House Co., Ltd.
TFEX	Thailand Futures Exchange
TSD	Thailand Security Depositary Co., Ltd.
UC	Universal Coverage Scheme
WB	World Bank
WTO	World Trade Organization
yoy	Year-on-year

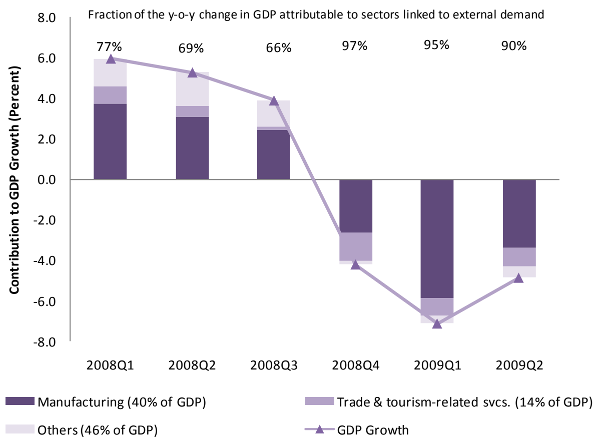
TABLE OF CONTENTS

SECTION 1

SUMMARY

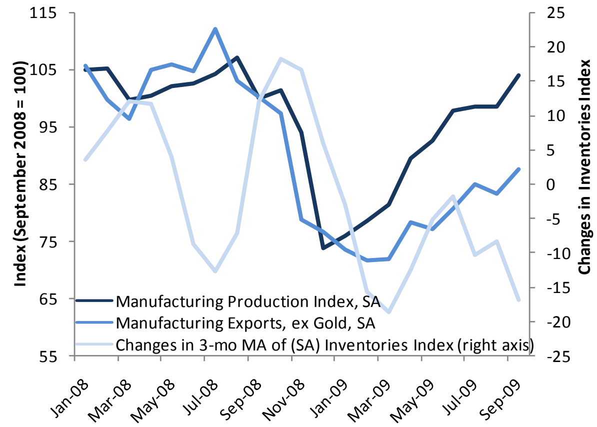
The Thai economy is on the rebound, with real GDP projected to grow 7 percent in the second half of 2009, for an overall 2.7 percent contraction year-on-year. The sharp acceleration in the second half of 2009 is due to the fact that the impact of the crisis has been concentrated on the manufacturing-for-exports sector, which has been able to restore production almost as quickly as it cut output in late 2008 and early 2009. The pick-up in production is based on an improving trend in external demand, which remains the main driver of Thai economic activity (over 95 percent of the GDP decline in Q4 2008 and Q1 2009 was concentrated in sectors linked to external demand, namely manufacturing, transportation, storage, communications, hotels and restaurants – see Figure 1). The recovery of external demand, in turn, has been supported by large and relatively coordinated fiscal and monetary stimuli in the G20 countries, which has prevented deeper contractions in advanced economies and promoted continued robust expansion in China. Adjustment took place very quickly, and a bottom to the contraction was reached for most industries in the first quarter of 2009, when demand for Thai manufactures exceeded supply (production). Orders had to be met from inventories, which contracted sharply (Figure 2). Although this contributed negatively to GDP growth at the time, the early inventory draw-downs imply that stocks had to be replenished, which will provide an additional boost to growth over the next two to three quarters. Similarly, inventories in developed countries were also depleted and will support export demand going forward.

Figure 1. Manufacturing and service sectors linked to external demand drove economic activity during the crisis.



Source: NESDB and World Bank staff calculations.

Figure 2. Production initially lagged export demand, leading to inventory accumulation in Q4 2008 and draw-downs in Q1 2009.

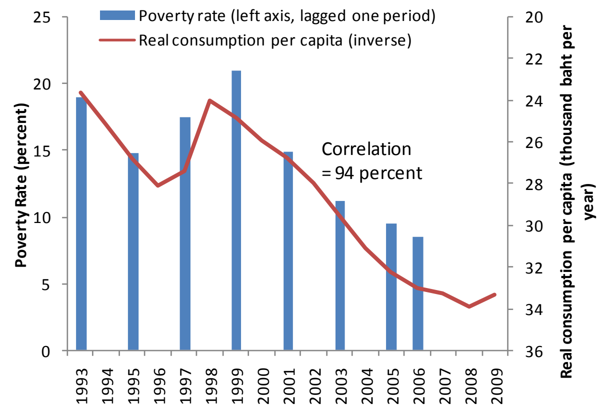


Source: Bank of Thailand, Office of Industrial Economics and World Bank staff calculations.

Note: Manufacturing Production Index and Inventory Index re-weighed by share in manufacturing exports and do not correspond to the aggregate indices published by BoT and OIE, respectively.

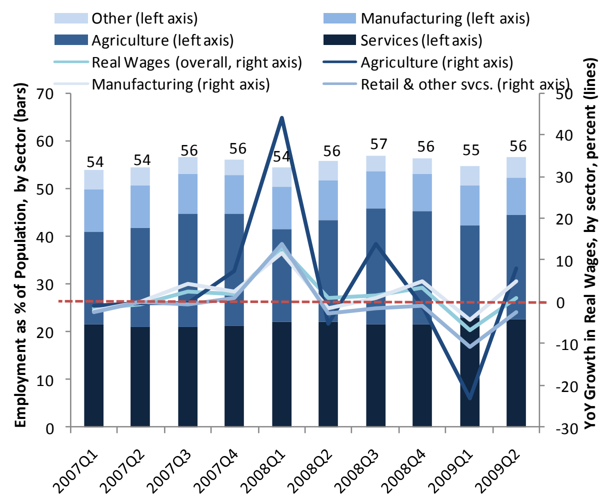
Although most of the contraction in GDP was concentrated in the relatively capital-intensive manufacturing sector, the crisis also hit the agricultural and tourism sectors, with potentially negative implications for household consumption and poverty. Incomes in agriculture, which employs nearly 40 percent of the workforce, have declined along with the prices of agricultural commodities. In addition, agriculture has served as a safety net to many workers displaced from the manufacturing and tourism-related sectors. While this role of agriculture supports stable employment in the broader economy, it places additional downward pressure on incomes of vulnerable households. The aggregate impact of this decline in the incomes of a large number of households is a projected contraction in household consumption in 2009 by 1.1 percent (the first contraction since the 1997/1998 financial crisis), and an associated increase in the poverty rate between ½ to one percentage point (Figure 3). The impact on consumption and poverty may have been greater absent the government's consumption-focused first stimulus package. While the stimulus may have been imperfectly targeted, it was disbursed quickly, likely containing the decline in consumer confidence and also reaching a number of vulnerable households. For example, the pensions given to the elderly outside the formal social security system is likely to have been particularly effective, as the elderly are overrepresented among the poor. Notwithstanding the impact of the crisis, average real wages may actually increase slightly in 2009 thanks to a decline in consumer prices. In addition, overall employment appears to have returned to pre-crisis levels after declining in Q4 2008 and Q1 2009 (Figure 4).

Figure 3. The poverty rate is highly correlated with household consumption, which is expected to decline in 2009 for the first time since 1998.



Source: NSO, NESDB and World Bank staff calculations.

Figure 4. Employment and wages were down in the first quarter, but already showed signs of recovery.

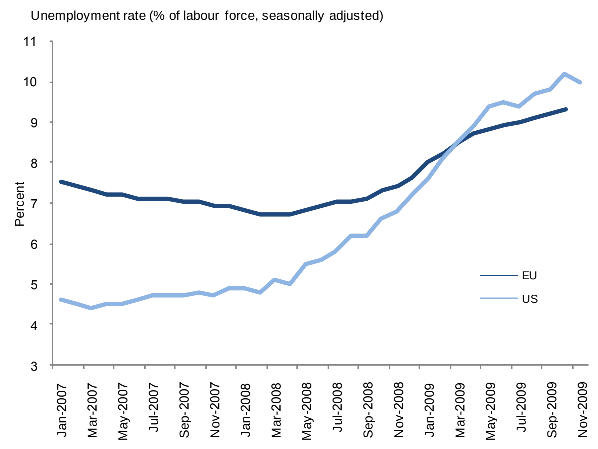


Source: NSO, MoC and World Bank staff calculations.

The medium-term outlook is sobering, with growth expected at 3.5 percent in 2010 and likely remaining below potential for the next three years. Because the Thai economy is largely dependent on final demand in advanced economies, a return to pre-crisis rates of economic growth (a full recovery vs. a rebound to pre-crisis levels) will require a combination of (i) a recovery of demand from advanced economies and (ii) a rebalancing of the sources of growth to reduce Thailand's dependence on demand from advanced economies. Neither process is likely to be swift. Recovery from a financial crisis is a lengthy process that involves the rebuilding of balance sheets, and the IMF estimates that half of the losses in the financial system in advanced economies are yet to be recognized. In addition, labor markets are expected to remain weak. Unemployment rates in advanced economies are at historically high levels, and the IMF and OECD estimate that they will remain over 10 percent in 2010 (Figure 5). Rebalancing the economy towards greater reliance on domestic and regional demand would also take time. Diversification of export destinations requires not only that a higher share of exports go to the region, as has been observed, but that final consumption also takes place in the region (Figure 6). Regional exchange rate policies that currently favor export-oriented growth are unlikely to change in the near term, delaying a rebalancing. Finally, structural changes are needed to boost domestic consumption, and domestic investment faces continued headwinds from excess capacity and political instability.

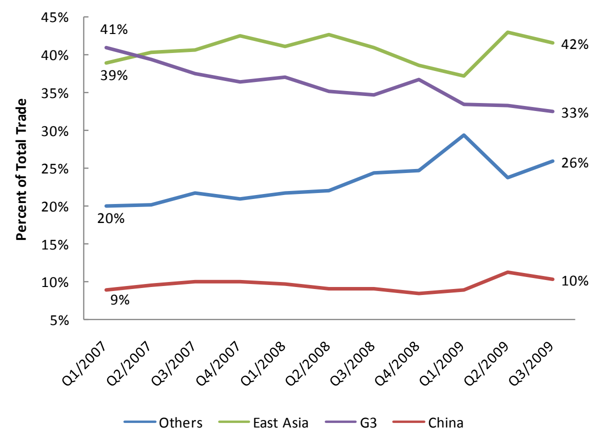
Key risks to the outlook are (i) political uncertainty and (ii) the timing of the withdrawal of fiscal and monetary stimulus. Increased political tensions may have a long-lasting impact on investment, and withdrawal of stimulus (in Thailand and the advanced economies) must be precisely timed to avoid macroeconomic imbalances (including new asset bubbles) while also ensuring that the recovery is on a sufficiently solid footing.

Figure 5. Unemployment rates in advanced economies are at historically high levels, dampening demand for Thai exports.



Source: CEIC and World Bank staff caulculations.

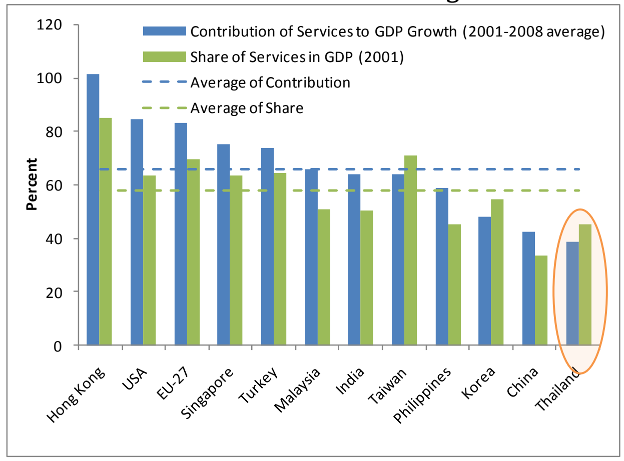
Figure 6. Although the share of Thai exports going directly to advanced economies has declined, most exports to East Asia are intermediate goods that still rely on final demand from the "G3".



Source: Bank of Thailand and World Bank staff calculations.

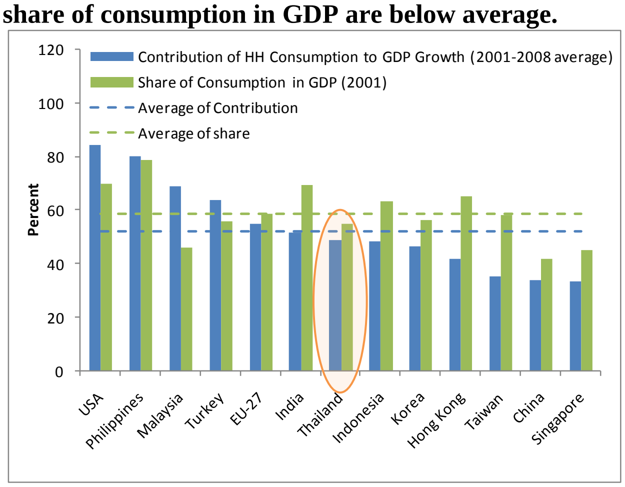
Long-term growth will require improving productivity and greater focus on distributional issues. Imbalances present before the crisis remain, but the crisis has increased the urgency of reforms to improve productivity, enhance competitiveness, and promote more equitable growth. Openness to trade and investment have been – and will continue to be – essential to Thailand's long-term growth. However, a return to high growth will require boosting domestic consumption and developing additional sources of external demand. On the supply-side, long-term growth requires enhancing competitiveness and productivity especially in the services sector, including through increased trade in services, upgrading manufacturing to higher value-added activities, and improving agricultural productivity and risk management in light of climate change (Figure 7). On the demand side, growth will require removing constraints to a higher potential growth rate in domestic consumption and investment, with coordinated action across the region in this area also leading to higher final demand from the region (Figure 8). Domestic consumption can be bolstered by enhanced social safety nets, which reduce the equilibrium level of household savings and allow households to undertake riskier activities (such as employment in manufacturing, opening a business, etc.); and a greater focus on equity in the growth process, which would contribute to long-term growth in at least three ways: (i) increasing the size of the middle-class; (ii) helping lagging regions catch up; and (iii) addressing some of the underlying issues that have fomented political instability. Expected returns to private investment are likely to be lower in the near future due to weaker global demand, still-high capacity and possibly higher perceptions of political risk. In this context, policies should be aimed at reducing the costs of investing, especially by improving the "software" (skills, regulations) available to firms, as a fair amount of attention has already been devoted to "hardware" (infrastructure).

Figure 7. Thailand has one of the smallest service sectors among middle-income countries and services also have made a small contribution to growth.



Source: CEIC and World Bank staff calculations.

Figure 8. Private consumption has a potential to expand, since both the contribution to growth and share of consumption in GDP are below average.



Source: CEIC and World Bank staff calculations.

SECTION 2

MACROECONOMIC DEVELOPMENTS AND OUTLOOK

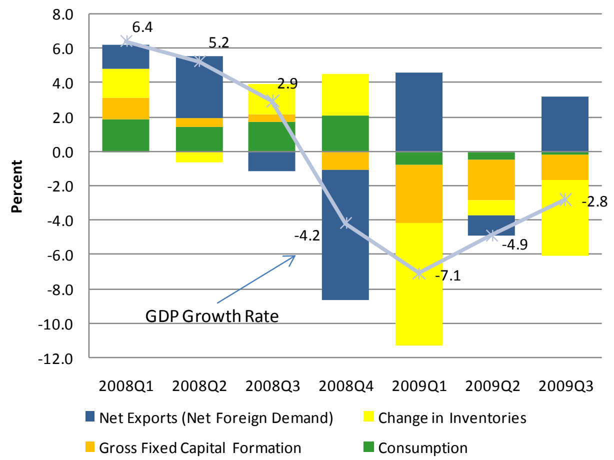
Thailand's economy is expected to contract by 2.7 percent in 2009 before expanding by 3.5 percent in 2010, adjusting to a lower level of external demand in the aftermath of the global financial crisis. In response to reduced export demand and perceived risks of a deep and protracted slump in global consumption, the export-oriented manufacturing sector cut production drastically in the fourth quarter of 2008 and the first quarter of 2009. However, early production cuts proved to be based on overly pessimistic demand forecasts, and improved sentiment about global economic prospects starting around March translated into improving external demand and a decisive rebound in production that became firm in the second quarter. While the outlook for external demand remains subdued compared to pre-crisis levels, a bottom was clearly reached earlier this year, supported by massive and relatively coordinated fiscal and monetary stimulus, and a rebound is currently underway that is likely to extend at least into the first half of 2010 (see Table 1 and Figure 9).

Table 1. Real GDP Growth, 2008-2010
(Percent, year-on-year)

	Share in 2008 GDP	**2008**	**2009**					**2010**
		Year	**Q1**	**Q2**	**Q3**	**Q4 (p)**	**Year(p)**	**Year (p)**
Consumption	61.8	3.0	-1.3	-0.8	-0.3	1.8	-0.1	1.9
Private	52.5	2.7	-2.5	-2.2	-1.3	1.1	-1.2	1.5
Public	9.3	4.6	5.9	7.8	4.7	6.0	6.0	4.0
Gross Fixed Capital Formation	22.2	1.2	-15.9	-10.2	-6.3	3.3	-7.4	3.6
Public	5.4	-4.6	-9.0	8.7	8.0	17.0	6.1	2.5
Private	16.8	3.2	-17.8	-16.1	-12.2	-0.5	-11.8	4.0
Total Domestic Demand	85.3	4.1	-14.0	-4.3	-7.0	0.3	-6.2	5.6
Exports	72.9	5.1	-16.7	-21.7	-15.0	7.9	-11.9	7.7
Goods	59.5	6.0	-17.9	-22.8	-16.0	8.6	-12.7	8.5
Services	13.4	1.3	-12.0	-16.3	-10.1	5.0	-8.3	4.5
Imports	58.2	8.5	-30.5	-25.6	-23.8	2.9	-19.3	12.7
Goods	47.2	8.4	-35.1	-29.6	-25.0	4.0	-21.7	14.7
Services	11.0	8.6	-11.0	-7.0	-18.2	-1.0	-9.1	5.5
Net Foreign Demand	14.7	-6.5	27.5	-7.6	21.5	34.6	17.9	-5.9
GDP	**100.0**	**2.5**	**-7.1**	**-4.9**	**-2.8**	**4.0**	**-2.7**	**3.5**

Source: NESDB and WB staff calculations
Note: p = World Bank projection

Figure 9. Changes in inventories and net foreign demand have been driving GDP fluctuations since the onset of the global financial crisis.

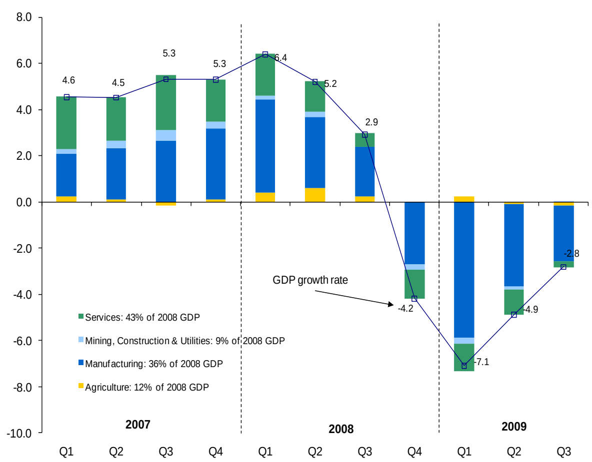


Source: NESDB, World Bank calculations

2.1 Production

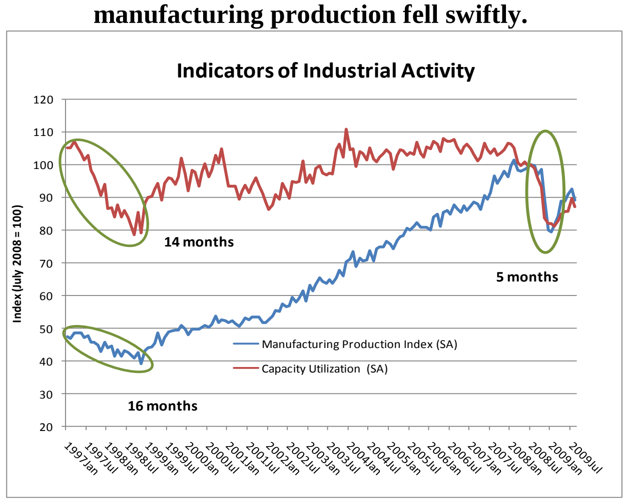
The output contraction has been concentrated in the manufacturing sector, which accounts for 40 percent of GDP but 75 percent of the GDP decline during the crisis (Figure 10). Manufacturing value-added contracted by 14.4 percent at its lowest point in the first quarter, corresponding to sharp declines in manufacturing production (18 percent) and capacity utilization (15 percentage points). In just five months between October 2008 and February 2009 capacity utilization fell from about 70 percent to 55 percent (levels close to the troughs following the 1997/1998 financial crisis), and manufacturing production in January 2009 was 20 percent lower than five months earlier, a larger retrenchment than the one observed during the entire 1997/1998 financial crisis (Figure 11). Manufacturing has also led the rebound, with manufacturing production returning to pre-crisis levels by September. Manufacturing output is expected to expand in 2010 between 5 and 6 percent (therefore above overall GDP growth), as export demand stabilizes and inventories are replenished.

Figure 10. Output contraction was concentrated in the manufacturing sector…



Source: NESDB and World Bank staff calculations.

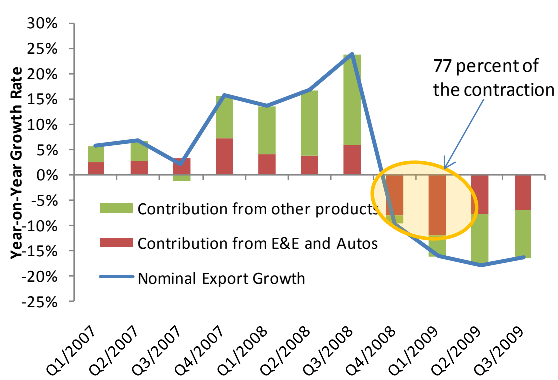
Figure 11. …as capacity utilization and manufacturing production fell swiftly.



Source: Bank of Thailand and World Bank staff calculations.

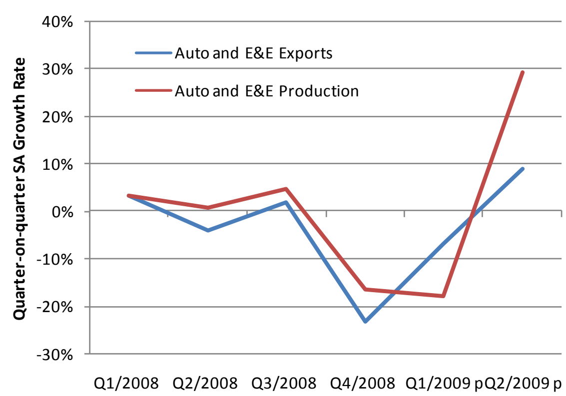
Manufacturing supply chains played a key role in the dynamics of the crisis and rebound, as factories could be switched off and on with little lead time. Within manufacturing, the export-oriented auto and E&E sectors made a disproportionate contribution to the swings in economic activity over the past year. The E&E and auto sectors account for about 43 percent of Thai exports, but were responsible for 83 and 74 percent of the year-on-year declines in goods exports in the fourth quarter of 2008 and first quarter of 2009, respectively (Figure 12 and Figure 13). These sectors are now leading the rebound, with production jumping by 29 percent (not annualized) between the first and second quarters of 2009. These rapid production adjustments and output swings were made possible by advances in supply chain management, including improved use of information technology and the increased use of local suppliers, both of which allowed a reduction in production lead-times and inventory levels. The strong balance sheets of most companies within the supply chain – supported by these firms' ability to react quickly to cut costs during the downturn – allowed firms to absorb the shock and resume operations with little disruption. There have been greater frictions in the rebound, however, as firms have found it difficult to re-hire workers that were let go earlier, and some suppliers could not re-start production because of financing or technical reasons. This suggests that there is continued momentum going into 2010, as inventories remain low and production has yet to fully catch up.

Figure 12. E&E and automotive supply chains played a key role in the transmission of the crisis.



Source: Bank of Thailand and World Bank staff calculations.

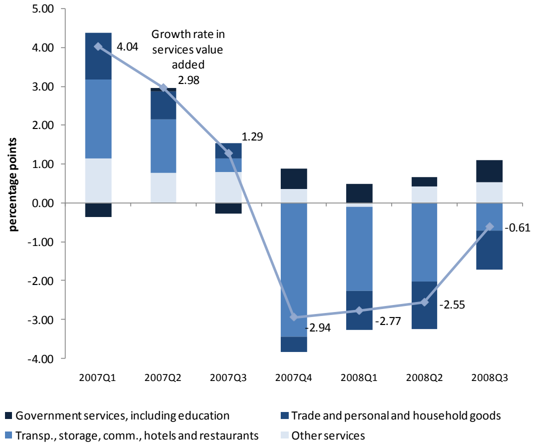
Figure 13. Exports recovered faster than production in the E&E and auto sectors.



Source: Bank of Thailand and World Bank staff calculations.

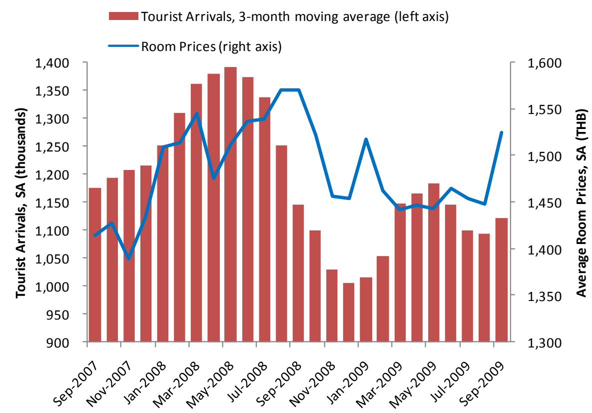
The nexus between the shock to external demand and overall economic performance extended to the services sectors, where the crisis disproportionally affected services related to trade and tourism. Transportation, storage, communications, hotels and restaurants – sectors linked to trade and tourism –suffered disproportionally during the crisis, highlighting the dependence of the Thai economy on external demand (Figure 14). The larger role of the tourism sector in the Thai economy compared to other economies in the region also helps explain why Thailand's recovery has lagged other regional economies. The tourism sector has been hit particularly hard: the combined impact of the closure of the two Bangkok airports in December 2008, the global economic and financial crisis, and most recently fears about the H1N1 flu epidemic led to a sharp reduction in tourist arrivals (Figure 15). The number of tourists has recovered in the second half of 2009 from the lows following the airport closure and doldrums of consumer confidence observed in December 2008 and January 2009, but room rates only started increasing since September. The outlook for 2010 is one of continued improvement, although pre-crisis levels of tourist receipts are not likely to be reached until 2011 or later.

Figure 14. Sectors dependent on external demand drove the contraction in services value added.



Source: NESDB and World Bank staff calculations.

Figure 15. The tourism sector showed signs of recovery in September after a protracted contraction.



Source: Bank of Thailand and World Bank staff calculations.

The construction sector has also started to pick up thanks to the ramping-up of public investment. The construction sector posted sharp contractions of 13 and 8 percent in Q4 2008 and Q1 2009, as public and private construction investment collapsed by 12 and 8 percent, respectively, initially driven by a 23 percent contraction in public investment in Q4 2008. Despite continued declines in private construction investment, the sector has posted modest but positive year-on-year growth rates in Q2 and Q3 2009, as public construction investment picked up by 12 and 9 percent, respectively, on the back of the government's fiscal stimulus program. Despite the initial declines in value-added, employment in construction did not contract, and as of Q2 2009 it was up 7 percent from the previous year.

Box 1. The Thai Automotive Industry during the Crisis[1]

1. Background

History: Automotive manufacturing in Thailand started 50 years ago after a Japanese company set up operations as an import substitution activity to take advantage of preferential tax and import duty treatment. Laws mandating local content were subsequently introduced, with the limits raised from an initial 30 percent to 40 percent and then 60 percent, to be abolished after the 1997-98 financial crisis. All pickup truck production prior to the 1997/1998 financial crisis was intended for domestic consumption, but companies began exporting after Japanese pickup producers shifted production from Japan to Thailand at the turn of the century. Tax and excise incentives by the Thai authorities encouraged domestic sales of pickups at the expense of cars, and pickups still amount to almost three-fourths of current output. The cost of local labor appears to amount to just 5 percent of the value of output, half the level in the U.S., likely reflecting much lower wages and the high labor component of imported electronics in Thailand. Thanks to the relocation of pickup producers to Thailand, and the spillovers into car manufacturing, automotive production has surged in the past decade, rising from about 145,000 cars in 1998 to 1.4 million in 2008, establishing Thailand as the largest automotive producer in Southeast Asia and the largest producer of light pickup trucks in the world.

Domestic component and value-added: The domestic content of automotive output varies between 50 and 90 percent (see Table 2) and averaged about 62 percent. For Isuzu (the largest pickup producer), domestic value-added is probably closer to 90 percent. Electronic and computer components are largely imported (from Japan), as are most transmissions (from the Philippines and India). Electronic components are of high value added and are used globally by the producers. Moreover, their development requires substantial R&D expenditures. Car manufacturers, as a result, prefer to concentrate the production of these electronic components in their home country – notably Japan – limiting technological spillovers. Only Toyota has a local transmission plant, with the remainder imported from India and the Philippines.

[1] Prepared by Ivailo Izvorski, Kirida Bhaopichitr and Vatcharin Sirimaneetham.

Table 2. Thailand's Automotive Industry: Basic Data

	Production (in thousands)			Factories and suppliers	Domestic value-added (In percent)
	Export	Domestic Sales	Total		
Cars	195	214	409	9 factories	60 (small), 50 (large)
Pickups	585	397	982	7 factories	75-80
Total	780	610	1,390	645 first-tier suppliers, 1,600 second-tier ones	62

Source: Thai authorities and Thai Automotive Institute.

At present, there are 645 first-tier suppliers and about 1,600 second-tier ones. Thai companies own majority stakes in about 30 percent of the first-tier suppliers, foreign companies in about one-half, with the remainder organized as joint ventures with equal stakes. The number of companies with majority Thai stakes has fallen significantly since the Asian crisis, when the turmoil left firms many in difficult financial positions that led to either bankruptcy or foreign acquisition by foreign companies eager to avoid disruption to production. Interlocutors suggested that Thai-owned first-tier suppliers are in much better financial strength than ten years ago, and have even begun to acquire companies in Japan.

2. Impact of the crisis

Output: Output started easing in late 2008, but the decline accelerated in early 2009, reducing production to an average of about 65,000 vehicles a month in the first quarter of 2009 compared with 120,000 vehicles last year on average. Output fell 43 percent year-on-year in the first quarter and reached its lowest level in April - facilitated by a week-long public holiday around the Thai New Year. Production began to recover in May, rising subsequently to about 80,000 vehicles in August, but still leaving the January-August total about 36 percent below the output a year earlier. Capacity utilization in the industry fell to 44 percent in the first half of the year from about 75 percent in 2008 on average before rising to 55 percent in August. The recovery has been driven by a pickup in demand in the Middle East, Australia and Asia, while demand for Thai cars in Europe – a major market – remains depressed because the incentives for new car purchases there favored smaller and more fuel efficient vehicles that are largely absent in Thailand's production lineup.

Exports: Automotive exports – the second largest item in the country's exports after electronics - fell sharply early this year by about 45 percent from a year before. (During 2009, exports slumped through May before rebounding in the third quarter, although data of late suggest some leveling off of foreign demand.) Compared with electronics, automotive exports are half as large in value but have twice as large value-added per unit of output, leaving the contributions of both sectors to GDP about equal.

Employment and wages: The industry employed 340,000 workers in mid-2008, of which 300,000 were engaged in producing parts for shipment to other countries for assembly. Companies reacted to the slump in demand swiftly by first reducing overtime, cutting work hours, eliminating extra shifts, and laying off contract workers before shedding full-time employees, largely contractual, employees. With contract workers (who are not owed severance packages as a result of redundancies), accounting for one-third of the labor force, companies were able to reduce their labor force by about 100,000 employees in early 2009. It is unclear what share of workers left voluntarily after companies cut working hours to an extent that reduced take-home pay to a level that made it uneconomical to commute to work.

Starting in May and June, employers have begun hiring again after production and orders began to pick up. It is estimated that employment is rising somewhat more slowly than production, by perhaps by 3-4 percent a month. Interlocutors indicated that many of the laid off workers are reluctant to return to work, as the former full-time employees laid off are still receiving government unemployment benefits equivalent to half their wage at termination (the duration of benefits which was extended to 9 months from 6 months at the height of the crisis). Some of them have also found informal sector jobs.

Auto workers are one of the highest paid in Thailand, with the average monthly wage – across the manufacturers and the suppliers – of about 9,000 baht (compared with an average in manufacturing of about 6,000 baht). Wages have risen only modestly over the last ten years, helping maintain Thailand's competitive advantage but also indicating that a shift to higher value-added activities in automobile production is taking place at a very slow pace.

Domestic sales and credit conditions: One of our interlocutors indicated that the slump in domestic sales of pickup trucks (90 percent of which are sold on credit) was exacerbated by tighter credit conditions among the domestic banks. The average downpayment has risen substantially in 2009 from a year earlier, with more than half of all buyers required to put at least 25 percent down (compared with 20 percent a year ago). The average term of loans has been shortened while interest rates have remained unchanged despite substantial cuts to the policy rate. Finally, the number of required documents has risen sharply, especially for first-time buyers of lower-income occupations (farmers notably) that are judged to pose higher risk than repeat customers.

3. Prospects

Production, exports and employment began to recover in May, as demand and orders picked up. In the near term, prospects for the industry are clouded by uncertainties about the strength of the global recovery that could influence especially strongly demand for pickup trucks that account for the bulk of production. In the medium term, challenges for the industry will include the shift at home and abroad toward more fuel efficient cars, more sluggish demand for pickups at home, and intensified competition from China and India after free trade agreements enter into force from the start of 2010. Of continued concern is the pace with which local companies are moving up the value added chain and the rather limited speed and breadth of technology spillovers from the producers and suppliers. Such spillovers appear to have been the greatest for pickup trucks, given Thailand's unique role as a major producer and consumer. But they are much smaller for passenger cars. Tax breaks and import duty concessions for "eco-friendly" car production is one avenue the authorities are exploring for dealing with the competitive challenge posed by India and China and for attracting more advanced new technologies which they hope will spread faster through the economy. Other efforts include measures to improve the quality of education, strengthen linkages between producers and universities and boost entrepreneurship.

Based on current trends in domestic and export orders, recovery is likely to be slow but steady. Importantly, most companies have resumed the second shift in September after reducing production to only one shift in January. Nonetheless, recovery will be complicated by the existing product mix which is biased in favor of trucks and SUVs based on the same platform. The industry is attempting to restructure the mix, and the government has stepped in by offering tax incentives to car makers to invest in the production of small, eco-friendly cars. (These cars should meet higher fuel efficiency and emission standards, notably Euro 4 as defined by the European Commission – or the level currently in force in Europe.) The Board of Investment (BOI) is offering reductions of import tariffs of 90 percent on parts and components that are not available from local suppliers. News sources report that several manufacturers, including Tata Motors from India, have expressed interest in investing 10 billion baht ($295 million) each. Tariff exemptions offered will be in addition to tax breaks for five years (already offered to manufacturers) should their output of small vehicles exceeds 100,000 in the first five years of operations.

Interlocutors also suggested that producers, secondary schools and universities – with the intermediation of the Automotive Institute – are forging stronger links. Such links should help improve training for workers and encourage more students to study engineering, overcoming what interlocutors called a bias among students towards humanities in Thai universities. Interlocutors noted the R&D centers that most Japanese manufacturers opened in Thailand, which currently employ about 3,000. Importantly, the leading pickup truck manufacturers have moved R&D centers to the region. A large share of those employed at these centers appears to be engaged in testing, but companies appear determined to increase the share of original design and research work carried out by the sectors. Importantly, interlocutors indicated that R&D centers far away from production facilities– as they have been in Japan after production was shifted to Thailand – are of increasingly lower value.

Interlocutors viewed the further increase in domestic value-added as crucial for Thailand to retain and attract more car manufacturers after free trade agreements with China and India come into effect from the start of 2010 and existing tax incentives (five-year corporate tax holiday) run out. While domestic value added has been rising over the years, some of the interlocutors were ambivalent whether there was much technological spillover from the foreign suppliers – or well-established domestic suppliers with foreign ownership – into other companies. Low quality of education and weak entrepreneurial spirits, as well as large capital outlays required to enter the market with sufficient scale, are also key factors.

2.2 External Demand

Thailand's GDP growth remains largely tied to external demand and developments in advanced economies will continue to dominate the path of the economy in the short- and medium-term. The external environment has been relatively more favorable in the past six months as the effects of fiscal and monetary stimulus are felt and inventories in the advanced economies are being replenished, supporting production into the medium term. However, full recovery from the financial crisis and a return to high rates of import demand growth in developed countries is not expected in the near term, as US consumers have to rebuild their balance sheets following a decrease in wealth in the order of US$14 trillion while employment prospects remain weak. As a result, growth rates of high income countries are expected to be subdued at under 2 percent in 2010 (Table 3), implying continued weak demand for Thai exports.

Table 3. International economic environment
(percentage change from previous year)

	2007	2008	2009f	2010f
GDP Growth				
World 1/	3.8	1.9	-2.3	2.8
High Income 1/	2.6	0.7	-3.4	1.9
USA	2.0	1.1	-2.5	2.6
Euro-zone	2.7	0.6	-4.0	0.8
Japan	2.3	-0.7	-5.7	1.5
Developing East Asia 2/	11.4	8.0	6.7	7.8
China 3/	12.9	9.0	8.4	8.7
World trade volume 4/	7.5	3.7	-9.7	3.8
Oil prices 4/	10.6	36.4	-42.7	13.4
Non-oil commodities 4/	17.1	21.0	-30.1	-2.1

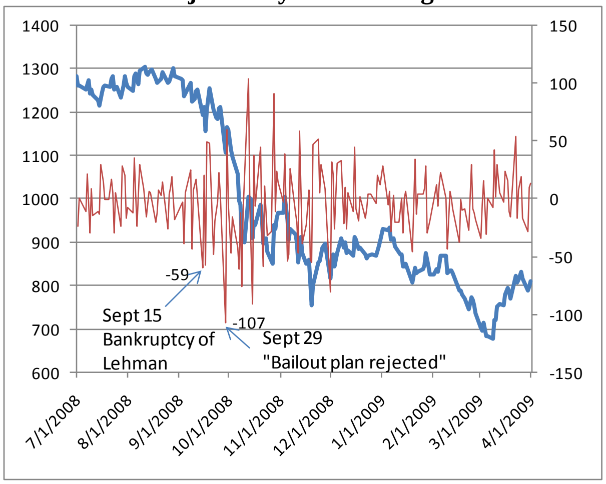
Source: 1/ Consensus Economics; 2/ World Bank (2009); 3/World Bank (2009b); 4/ DECPG

2.2.1 External Environment

Governments in advanced economies played a major role in leading the recovery from the economic and financial crisis. At the outset of the crisis, frozen credit markets and uncertainty about the ability of governments to respond quickly and effectively to the shock led to the formation of pessimistic expectations by consumers and firms. The steepest fall of the S&P 500 in 2008 happened not following the collapse of Lehman Brothers on September 15 2009, but rather following the failure of the US Congress to approve the US government's first attempt at a stimulus package two weeks later (Figure 16). The resulting negative outlook was reflected in the cut in global production. However, governments did come through with massive and relatively coordinated fiscal and monetary stimuli that acted initially to restore liquidity and boost consumer confidence, causing demand to exceeded supply in the first quarter of 2009 (Figure 17). This led to a drawdown in global inventories, which at the time contributed negatively to growth, but set the stage for the production gains that were to follow.

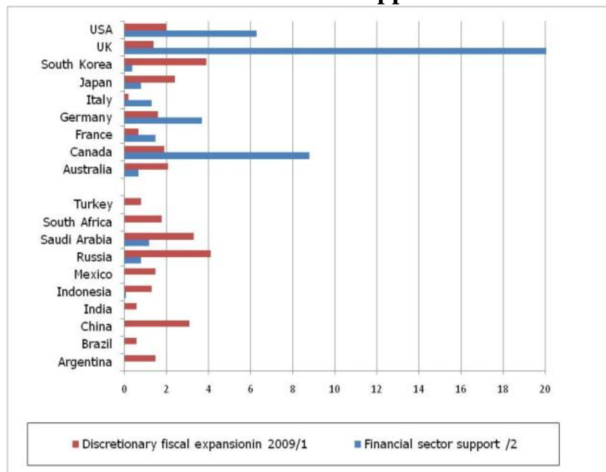
The rebound has also been a result of swift adjustment of production, which resulted in a fast "bottoming out". Technological improvements in supply chains and the concentration of the crisis in those sectors meant that the overall adjustment of East Asian economies took place at a faster pace than in previous crisis. Once a bottom was reached, it was natural for recovery to follow.

Figure 16. The largest one-day drop in the S&P500 happened when the initial fiscal stimulus proposal was rejected by the US congress.



Source: Haver and World Bank staff calculations.

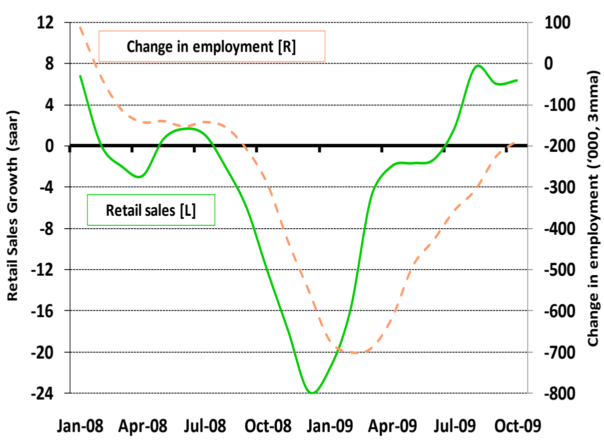
Figure 17. But governments eventually implemented massive and coordinated fiscal expansion and financial sector support.



Source: [ ]

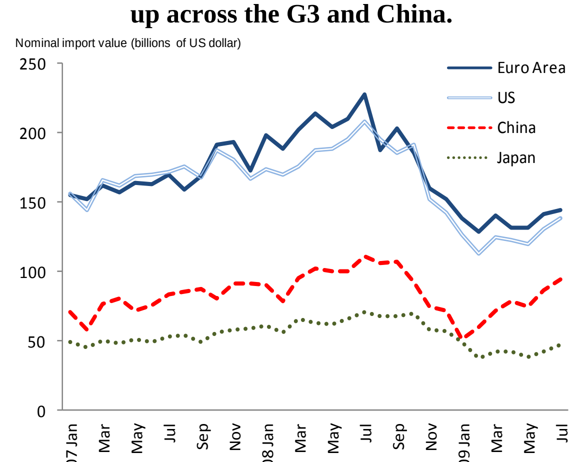
Stimulus programs were implemented throughout 2009, confirming improved expectations, boosting demand and supporting the momentum of the economic recovery. In the US, the "cash for clunkers" program and the US$8,000 credit for first-time homebuyers, among other indirect measures, eventually led to a steady reduction in the pace of job losses (from a peak of 700,000 per month in early 2009 to 190,000 in October), an increase in retail sales (up 3.6 and 1.4 percent in September and October, respectively) and a stabilization in housing markets (Figure 18). In the euro area, although the pace of job cuts accelerated in September and household spending remains weak, government incentives for the purchase of new cars also boosted economic activity and consumer confidence, leading to increases in import demand (Figure 19).

Figure 18. US Employment and retail sales have recovered…



Source: U.S. Departments of Commerce and Labor and DECPG calculations.

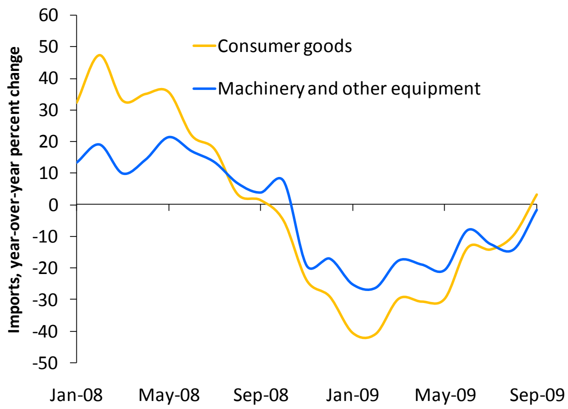
Figure 19. …boosting import demand, which picked up across the G3 and China.



Source: World Bank (2009).

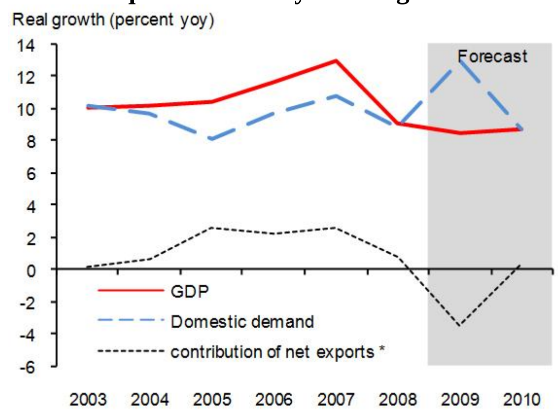
Fiscal stimulus in China offset the decline in exports and is playing a role in the region's rebound. Although China's fiscal stimulus has focused on public investments and led primarily to an increase in commodity imports, it also included higher income transfers and other measures supporting consumption and leading to a recovery in imports of consumer goods (Figure 20). Sales of cars and electronic appliances have been particularly strong due to falling prices and government measures such as lower consumption taxes for small cars and subsidies for rural consumption of appliances. Going forward, domestic demand is expected to decelerate, mostly due to a slow-down from the breakneck pace of investment growth in 2009 (Figure 21).

Figure 20. Consumer goods imports also expanded along with imports of investment goods.



Source: World Bank (2009b)

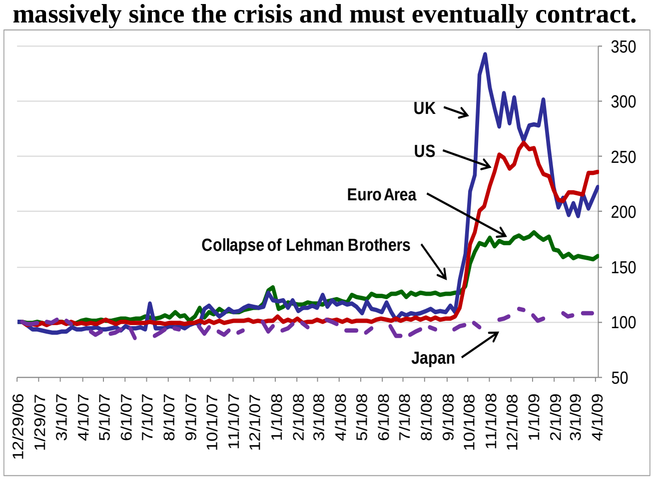
Figure 21. High growth rates in China in 2010 will also require a recovery in foreign demand.



Source: World Bank (2009c)

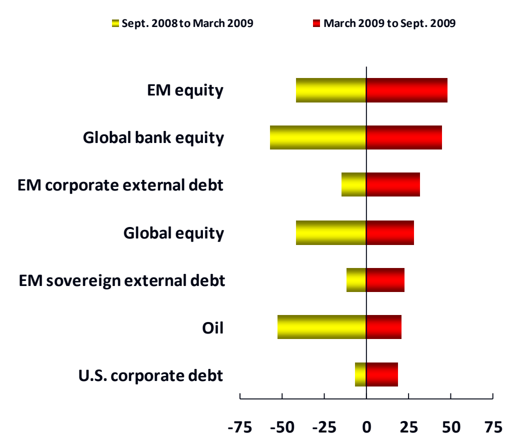
The key risk to the global recovery lies in the need to get the timing of withdrawing fiscal and monetary stimulus just right. Withdrawal of fiscal stimulus too early may lead to another negative demand shock and a negative expectations spiral, whereas withdrawing the stimulus too late may lead to high inflation, further weakening of the US dollar, and possible asset price bubbles. It is in the nature of financial crises that their resolution tends to be lengthy because of the need to rebuild balance sheets. In Thailand, for example, more than ten years since the 1997/1998 financial crisis banks still have bad loans in their books and the government still holds a large amount of debt related to the recapitalization of financial institutions. Given the expected length of recovery, it is important not to withdraw stimulus programs too soon, before the recovery is on a firm footing. On the other hand, macroeconomic imbalances are accumulating and eventually fiscal and monetary authorities, especially in the US, must consolidate their fiscal position and withdraw liquidity (Figure 22 and Figure 23).

Figure 22. Central bank's balance sheets expanded massively since the crisis and must eventually contract.



Source: IMF.

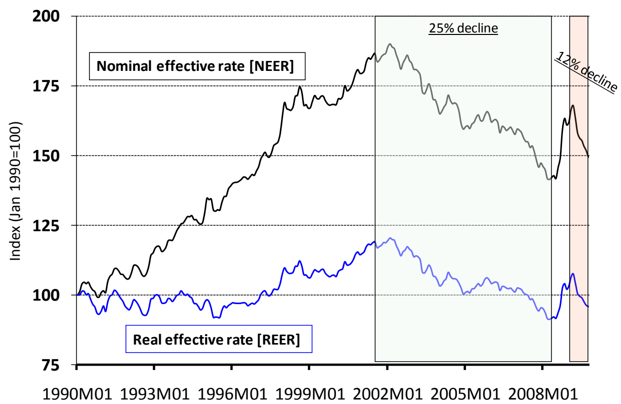
Figure 23. Risky asset classes have rallied since March 2009, raising the specter of asset bubbles.



Source: IMF.

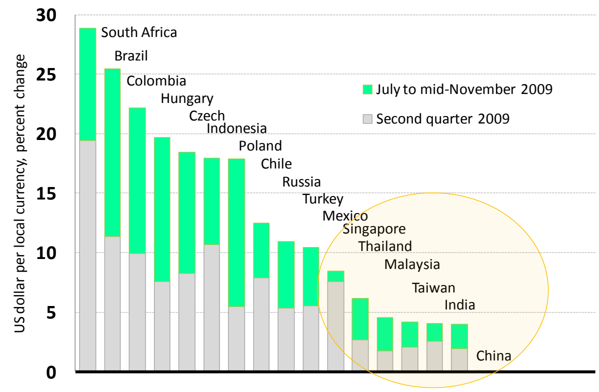
Against the backdrop of a weakening US dollar and mounting trade surpluses, East Asian currencies have appreciated only modestly (Figure 24 and Figure 25). It may be argued that East Asian exchange rate policy has contributed to fiscal stimulus in advanced economies by putting a lid on import prices, reducing inflationary pressures and providing more latitude for monetary authorities to keep rates low for longer. However, the same risks entailed by late withdrawal of fiscal stimulus– inflation and asset price bubbles – apply to the policies used by East Asian central banks to prevent the appreciation of their currencies. Given still-weak demand for East Asian exports and declines in core prices, the policy can be maintained in the near term, but an orderly withdrawal will eventually be required, especially as economies in the region attempt to rebalance growth away from excessive reliance on exports and towards a greater role for domestic demand.

Figure 24. The US dollar has depreciated sharply since March…



Source: JP Morgan Chase, DEC Prospects Group.

Figure 25. …but not against Asian currencies



Source: World Bank, DEC Prospects Group.

2.2.2 Merchandise Exports

The current export collapse has been the most severe in Thailand's recent history. The magnitude of the decline has been unprecedented. Since 1957, there have been nine episodes where exports contracted for at least six consecutive months (Table 4). Losses to date are more than double those in the 1997-98 Asian financial crisis and the 2001 "dot.com" bubble turmoil. Thailand's export performance tracked developments in world merchandise trade, which dropped around four and eight percent in the 1997 and 2001 meltdowns, respectively, but 22.2 percent so far during the current global financial crisis.

Table 4: The current export slump is the most severe in a recent history of Thailand

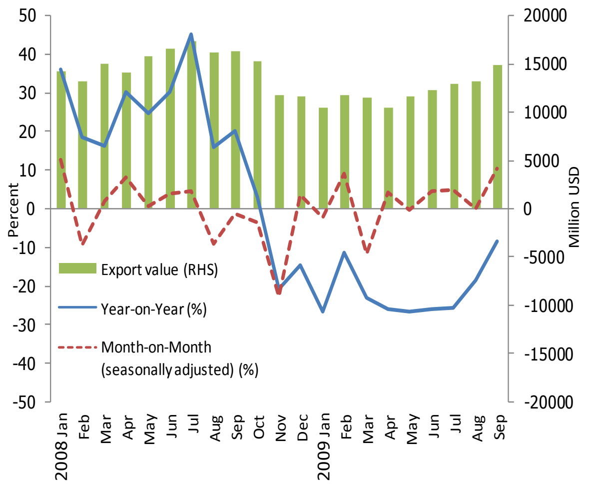
Period	Number of consecutive months with negative export growth	Average monthly decline (year-on-year %)
Feb 1958 – Jan 1959	12	- 21.8
Oct 1967 – Jun 1968	9	- 18.6
Jan 1975 – Jun 1975	6	- 18.3
Jul 1982 – Aug 1983	14	- 13.6
May 1985 – Nov 1985	7	- 7.0
Jun 1996 – Dec 1996	7	- 5.8
Mar 1998 - Mar 1999	13	- 6.6
Jun 2001 – Mar 2002	10	- 9.4
Nov 2008 – Sep 2009[1]	11	- 20.7

Note: [1] Data as of mid-October 2009

Source: CEIC, Bank of Thailand, and World Bank staff calculations

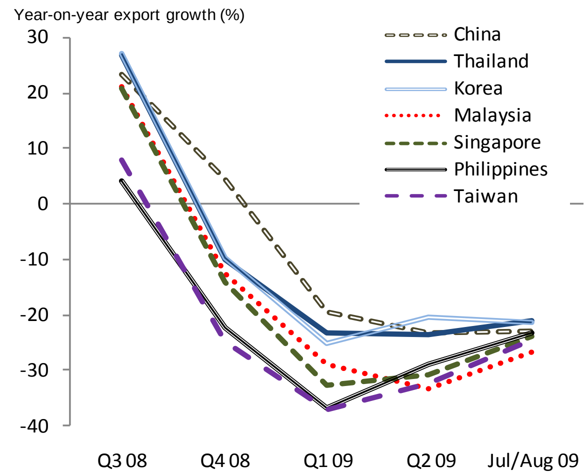
Goods exports have rebounded, although levels remain well below the pre-crisis peaks. Since April this year, export growth in US dollar terms has generally moved into a positive territory on a month-on-month, seasonally adjusted basis (Figure 26). On this basis, exports jumped 10.3 percent in September after the much more sluggish pickup in preceding months. The current level is over 80 percent of the peak in July 2008. The year-on-year contraction in September was under nine percent, much smaller than the average of -22 percent between November 2008, when the downturn began, and August 2009.[2]

Figure 26. Goods exports rebounded in recent months



Source: Bank of Thailand and World Bank staff calculations.

Figure 27. An export rebound is a regional trend



Source: Haver Analytics and World Bank staff calculations

Given the concentration of the turmoil on regional supply chains, the turnaround has also been a regional phenomenon. Shipments from East Asia started to climb after hitting the bottom in the first half of this year (Figure 27). Although severe compared to the historical experience, Thailand's exports have been less heavily affected by the global meltdown relative to many other regional economies. Countries with high share of high-technology, electronics products such as Taiwan (China), Philippines, Singapore, and Malaysia appeared to suffer the most.[3] Despite stronger domestic demand in the region led by China, the crisis highlights that East Asian production network of high-technology exports still rely greatly on demand in G-3 economies.

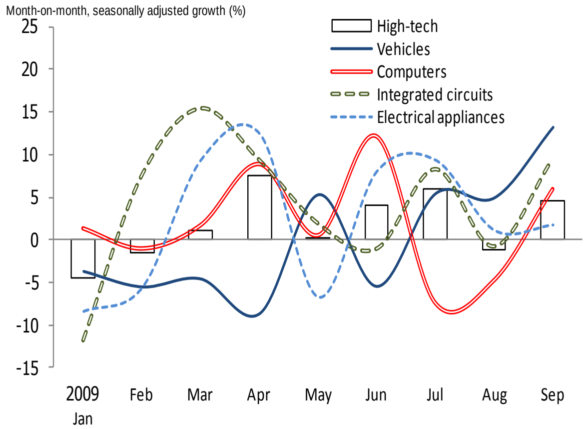
But demand for high-tech products is still fragile, depending to a large extent on restocking in advanced economies, so it remains unclear if the pickup can be sustained beyond the first half of 2010. The robust performance in September is a sharp turn from a slow and fragile pickup between April and August; it remains to be seen whether this sharper rebound is sustainable. Shipments of high-tech goods such as electronics and vehicles, which drove the pre-crisis export growth, are still highly volatile (Figure 28). None of major high-tech products exhibits a steady month-on-month, seasonally adjusted growth although overall exports have gradually improved since April. Figure 29 highlights that high-tech products have performed much worse than other product groups since the downturn started, especially in

[2] This is not due to the low base effect. Export level in September 2008 was still near the peak level and expanded robustly at 20 percent year-on-year.

[3] According to World Bank's World Development Indicators, the shares of high-technology exports in total exports in 2008 in these four economies were among the highest in the world (between 45-54 percent). This compares to 27-30 percent in China and Thailand.

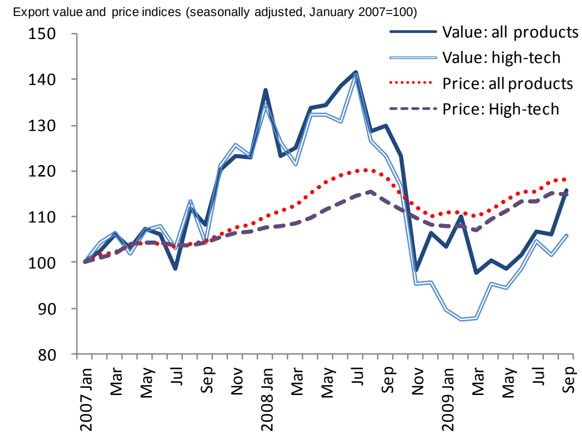
the first quarter of this year.[4] In addition to falling export volume, export prices of high-tech goods also deteriorated 5.6 percent between September 2008 and March 2009, which is comparable to the magnitude of price drop in the 2001 dot.com crisis.[5]

Figure 28. High-tech exports remain subdued and uncertain



Source: Bank of Thailand and World Bank staff calculations.

Figure 29. High-tech goods picked up slower than others



Source: Bank of Thailand and World Bank staff calculations.

Shipments to emerging East Asia already surpassed the 2008 peak level but those to EU, Japan and ASEAN are slow. Taken together, exports to Hong Kong (China), Korea and Taiwan (China) in September this year stood at 101 percent of the pre-crisis peak level in September 2008. This is 122 percent for Australia relative to July last year (Figure 30).[6] The overall exports now regained around 85 percent of the peak in July 2008, after hitting the bottom in April with shipments only 60 percent of the peak. In the months before their respective troughs, demand from China, ASEAN and Japan plunged much more swiftly than the US and the EU (Figure 31). Falling orders from the Western economies and subsequent de-stocking virtually stalled activities in regional production network of high-tech goods, which ASEAN, China and Japan play a vital role. Exports to the US and the EU fell more modestly partly because they also imported many food items from Thailand, such as rice, prepared meat and crustaceans (shrimp, crab), demand for which tends to be more stable. The pace of the rebound in ASEAN and Japan has been slower than the fall. More solid pickup in China, the US and the EU is preliminarily supported by stimulus measures.[7]

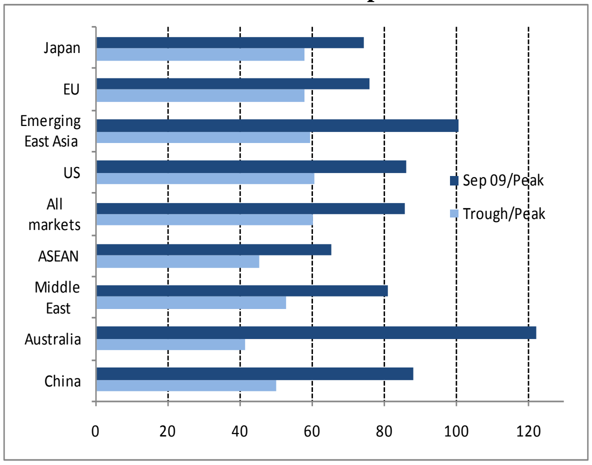
[4] This was partly driven by huge gold exports that led to a four times year-on-year increase in precious stones exports in February 2008.

[5] Between March 2001 and February 2002, this was -6.0 percent.

[6] The recovery is largely due to a 144-percent increase in gold exports in September 2009, accounting for one-third of Thailand's shipments to Australia. Vehicle exports also increased in recent months, and helped to boost a month-on-month surge in auto exports since July 2009 (Figure 30). In the first nine months of 2009, vehicle orders from Australia were 55 percent of Thailand's total auto exports.

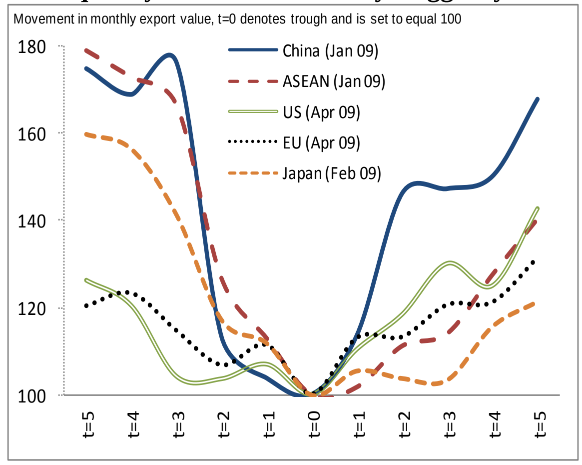
[7] China's domestic electronic market has rebounded since the first quarter of 2009 benefitting from programs such as Home Appliance Products to Rural Area program. The consumption tax cut for new small car purchases also boosted demand for electronic goods used in vehicles production.

Figure 30. Shipments to emerging East Asia and Australia have reached the pre-crisis levels



Note: Emerging East Asia: Hong Kong (China), Korea and Taiwan (China)
Source: Bank of Thailand and World Bank staff calculations

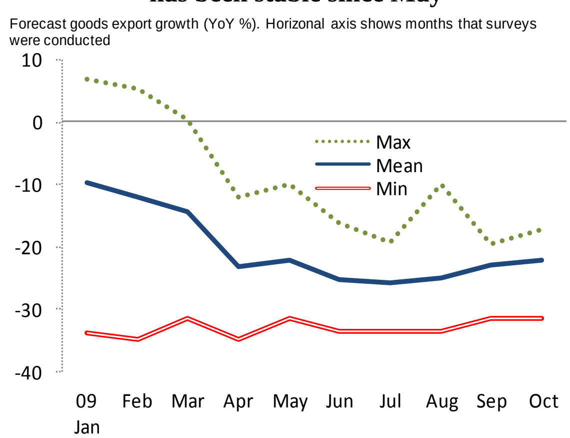
Figure 31. Exports ASEAN and Japan dropped quickly but rebounded only sluggishly



Source: Bank of Thailand and World Bank staff calculations.

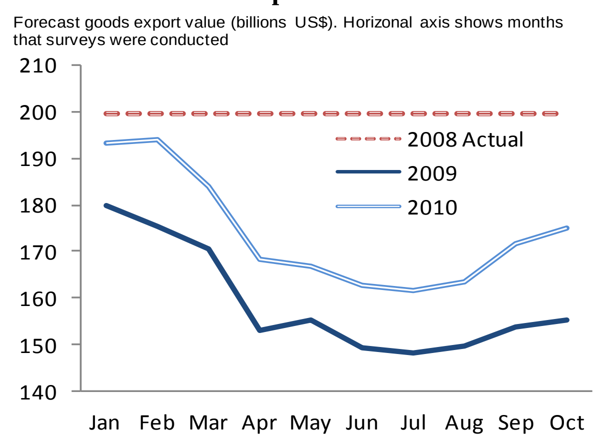
The market's views on export performance in 2010 have improved. Since May, private sector forecasts of the export contraction this year have remained at slightly over 20 percent, after a sharp deterioration in forecasts made between January and April (Figure 32). This is in line with a gradual improvement in the actual data that is observable since April. Over the year, these views have converged with narrower gap between the highest and lowest estimates.[8] For 2010, market's forecasts clearly improved since September as various indicators point to stronger economic activities in advanced and large emerging economies (Figure 33). But the 2010 level is still lower than that in 2008 so export recovery will be slow. This viewpoint is also shared by public agencies.[9]

Figure 32. Market views on 2009 export contraction has been stable since May



Source: Consensus forecasts and World Bank staff compilation

Figure 33. Views on export outlook in 2010 recently improved



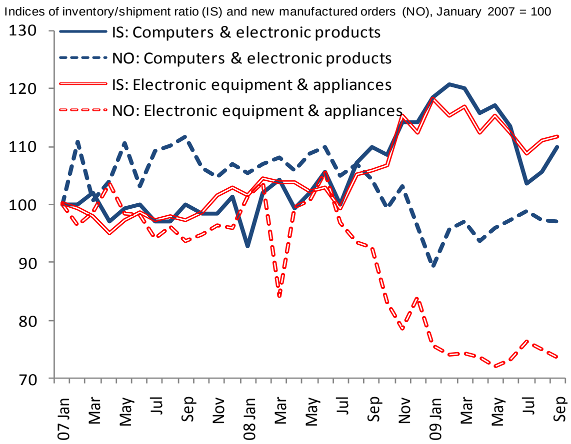
Source: Consensus forecasts and World Bank staff compilation

[8] Although the convergence is natural because more actual data are available over the year, it occurs mainly because analysts have become less optimistic. The minimum estimates have been very stable.

[9] The Fiscal Policy Office estimated in September 2009 that goods exports in US dollar term will grow 10.0 percent in 2010 after shirking 17.2 percent this year. These figures from Bank of Thailand (as of October 2009) are 14.5 and -15.0 percent on average, respectively.

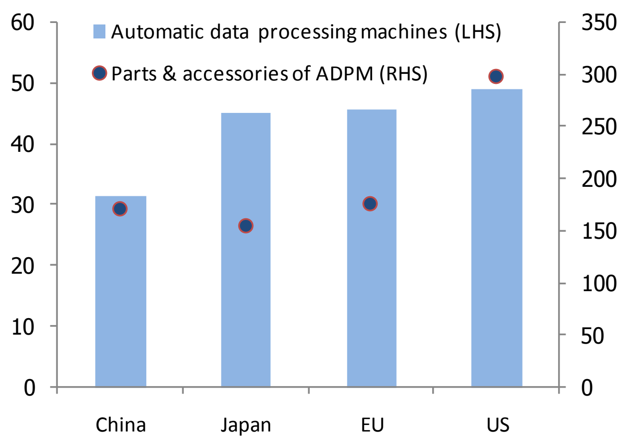
Despite the rebound, Thailand's export recovery is still subject to several downside risks. A recent export pickup in East Asia benefits mainly from (i) coordinated and massive policy responses in G-3 economies and China that have boosted their demand for imports, and (ii) inventory re-stocking worldwide that followed a swift and large de-stocking in early-2009 as orders fell less than production. These two factors are temporary, as governments have to unwind injections to maintain fiscal discipline and companies resume their normal stocking levels. In fact, data shows that US inventory-to-shipment ratios for computers, electronic products, and electronic appliances started to rise again in August and September, thus leading to weaker new orders (Figure 34). This likely adds pressure on Thailand's electronic shipments to the US in the coming months. Moreover, although the recent export pickup is largely propelled by Chinese import demand, its size is still much smaller than the G-3 economies. Goods consumed in China also seem to have lower unit value relative to richer economies (Figure 35).[10] Additional downside risks include higher oil prices as global demand picks up, and stronger baht as the region likely regains capital inflows in the post-crisis period. International trade competition will also be fiercer as import volume from high-income economies will shrink for some time.[11]

Figure 34. New manufactured orders weaken as inventory-to-shipment ratios rose again



Source: US Census Bureau and World Bank staff calculations

Figure 35. Imports from China have lower unit values compared to imports from the G3.



Source: World Bank staff calculations.

2.2.3 Exports of Services

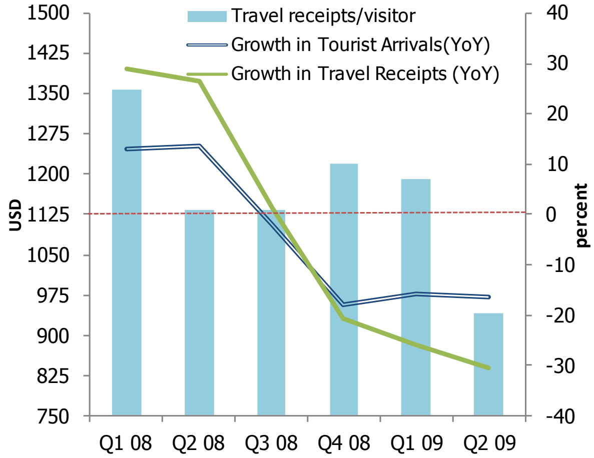
The tourism sector has been hit by multiple shocks but finally appears to have joined the rebound. Tourist arrivals expanded 6.3 percent in September 2009 on a month-on-month, seasonally adjusted basis, extending a two-percent growth in August. The very high year-on-year increase in September is driven by the low base as rising political tensions in September 2008 led to the lowest number of visitors since May 2005. The rebound is also reflected in higher average room prices in September (seasonally adjusted) after the sluggish movements in the preceding months. An estimate based on travel receipts seems to

[10] For example, the average value of Thailand's automatic data processing machine (HS8471) to China in the first three quarters of 2009 was 31 US dollar, much lower than 45-49 US dollar for those destined to the G-3 market.

[11] So far it does not appear that Thailand's composition of export baskets has changed much during the crisis. Automatic data processing machines and electronic integrated circuits are still dominant in all key markets. China continues to import various chemical substances; ASEAN, Japan and Australia order much of Thailand's vehicles and parts and rubber, while the EU and the US still order electrical appliances, jewelry, and food items.

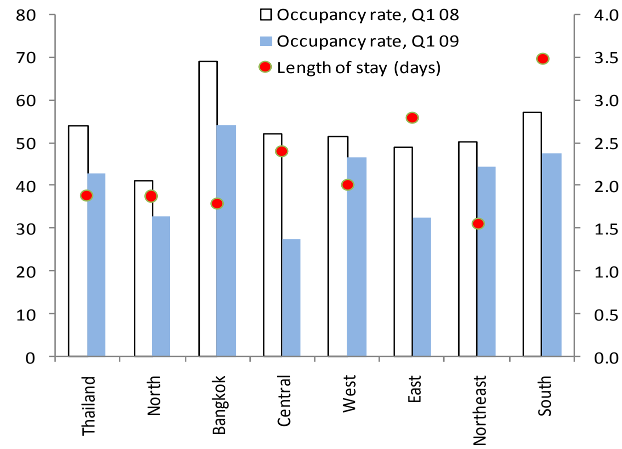
suggest that, in addition to fewer visitors, they also spent less during their trips (Figure 36).[12] The average length of stay is also shortened by six percent to 1.9 days in the first quarter of 2009. This has hampered pricing power of tourism operators. Meanwhile, the collapse in arrivals has a disproportionate impact on occupancy rates in the Central and the East (Figure 37). Overseas tourists tend to spend longer time in the East (and the South) so lower occupancy rate weakens their revenues to a greater extent.[13]

Figure 36. Tourist arrivals started to rebound slowly, but receipts are recovering more slowly.



Source: Bank of Thailand and World Bank staff calculations

Figure 37. Occupancy rate dropped sharply in the Central and the East



Source: Office of Tourism Development.

Arrivals from Europe have resumed year-on-year growth, as Thailand is relatively more inexpensive destination for Europeans compared to Americans due to the shorter distance. The latest data in August 2009 shows that the number of European tourists, including those from all large economies such as France, Germany, Italy and the UK, grew year-on-year since July (Figure 38). Unlike China and Japan which exhibited sharp swings since the turmoil began, inflows of European visitors (and ASEAN to a lesser extent) have been rather less volatile. Preliminary data for September 2009 indicates that key markets such as the US, Australia and Korea continued to contract year-on-year amidst the overall jump in tourist numbers.[14] The cross-correlation analysis suggests that domestic retail sales in the US and Australia moved concurrently with their residents' departures in the past few years.[15] Retail sales in these two economies remain relatively muted but rising consumer confidence should translate into future retail sales growth and the return of overseas tourists to Thailand. The increase in European tourists compared to other nationalities may be due to the fact that demand for tourism is a relatively more inelastic for European households relative to their American and Korean counterparts because on average they have more vacation time, and Thailand is a relatively inexpensive destination, suggesting a positive substitution effect.

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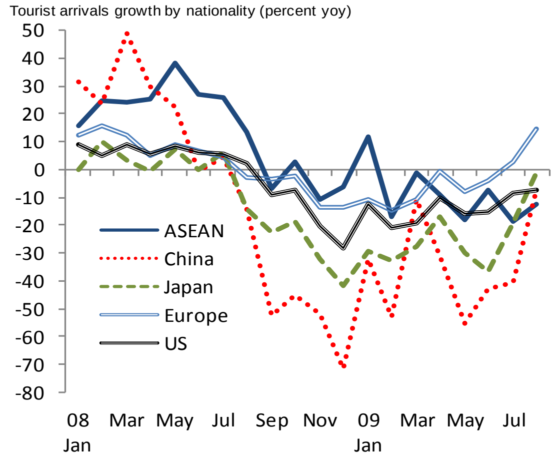
[12] The value of travel receipts (from balance of payments, reflecting revenue in the tourism sector) per tourist has been decreasing since the third quarter of 2008, the same time that tourist arrivals started to fall. In the first two quarters of this year, these stood at 1,189 and 940 US$ per visitor, down 13 and 17 percent year-on-year, respectively. A more accurate indicator is per capita daily expenditure but recent data is not available.

[13] Although country's occupancy rate in the first quarter of 2009 was only 43 percent (down 11 percentage points year-on-year), the numbers of accommodation businesses and rooms shrank by less than one percent. This perhaps helps to explain why employment in the hotels and restaurants sector did not fall (although working hours and compensation were cut).

[14] This considers only arrivals at the Suvannabhumi airport, which account for three quarters of all visitors.

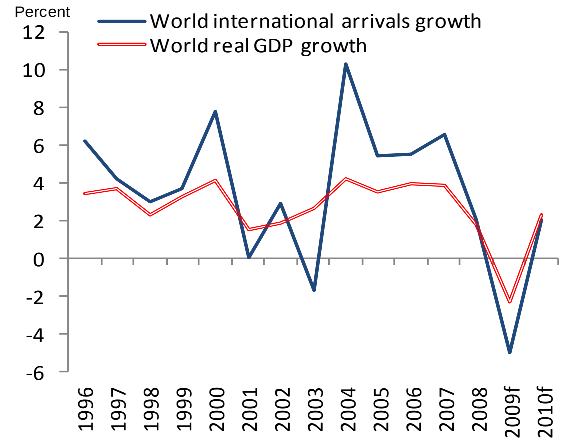
[15] The correlation coefficients at time t=0 (same months) are 0.63 and 0.97 for the US and Australia, respectively.

Figure 38. European tourists are returning more quickly.



Source: Office of Tourism Development

Figure 39. World tourism is expected to return to growth in 2010.



Source: Source: World Tourism Organisation for tourism (November 2009) and IMF for GDP (October 2009).

The tourism sector worldwide and in Thailand is likely to grow modestly next year. According to the World Tourism Organisation, international tourist arrivals worldwide dropped around seven percent between January and August this year. As for merchandise exports, recent months witnessed some improvement. The contraction eased to three percent in July-August, while available September data also suggests an encouraging trend. Visitors to Asia and the Pacific fell by five percent so far this year so Thailand has been affected more heavily than most other regional economies (-14.5 percent). Worldwide arrivals are predicted to drop between 4-6 percent this year before expanding about 1-3 percent in 2010 (Figure 39). A more robust recovery is held back by the phasing out of stimulus measures, high and rising unemployment rates in advanced economies, the need to re-build household wealth, and the influenza A(H1N1) pandemic. For Thailand, the Tourism Council of Thailand estimated in August 2009 that tourist arrivals will drop by nearly ten percent in 2009. Most analysts speculated a modest growth in 2010 but government measures, such as waiving of visa fees, tax exemptions, and financial loans to small tourism operators, should help to support the sector somewhat.[16]

2.3 Private Domestic Demand

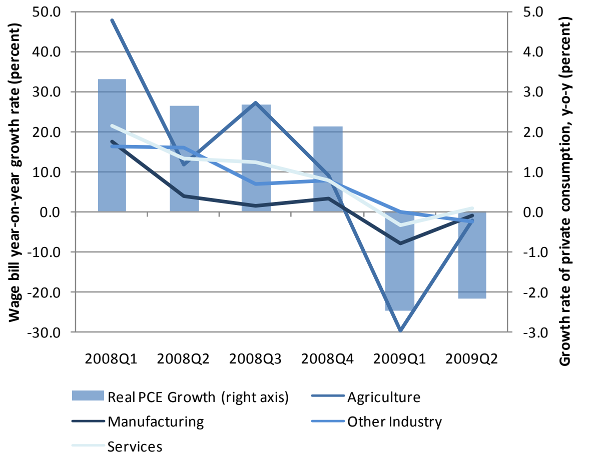
2.3.1 Household Consumption

The global economic and financial crisis led to a contraction in household consumption primarily through lower agricultural commodity prices. Although manufacturing was the hardest-hit sector, it is relatively capital intensive, employing only about 14 percent of the work force. Wages and employment in manufacturing fell in the first quarter of 2009, but had already rebounded by the second quarter along with production (Figure 40). The overall labor market picture also appears relatively benign on the surface: average real wages may actually increase slightly in 2009 thanks to a decline in consumer prices and overall employment appears to have returned to pre-crisis levels. However, incomes in agriculture, which employs nearly 40 percent of the workforce, have declined along with the prices of agricultural commodities (Figure 41). In addition, agriculture and the informal economy (seen as an increase in

[16] For more information on Thailand and policy responses in other countries, see World Tourism Organisation's *Tourism and Economic Stimulus-Initial Assessment* (September 2009).

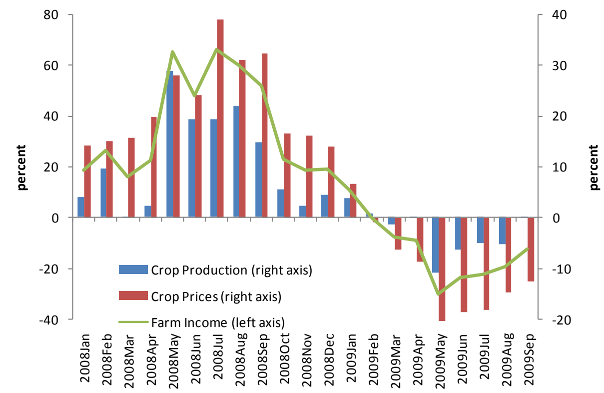
services employment – see Figure 42) has served as a safety net to many workers displaced from the manufacturing and trade-related sectors; this supports stable employment in the broader economy, but places additional downward pressure on wages.

Figure 40. The wage bill declined sharply in the first quarter of 2009, but started recovering in Q2.



Source: NSO, NESDB and World Bank staff calculations.

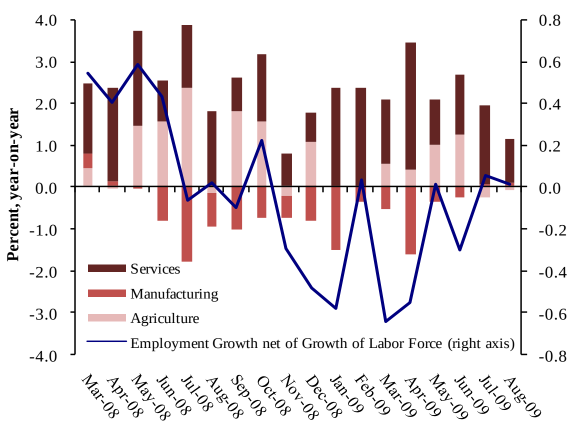
Figure 41. Farm Incomes declined from their peak, but have bottomed out in May.



Source: Bank of Thailand and World Bank staff calculations.

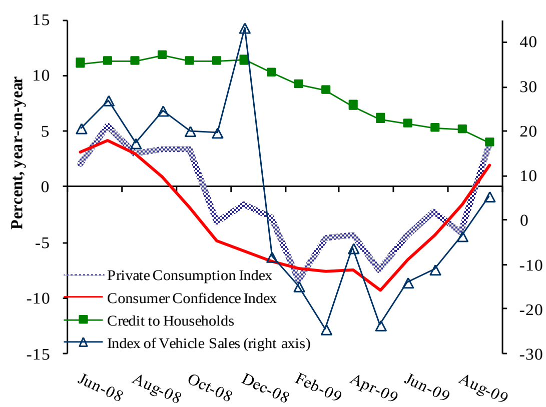
Private consumption is picking up on the back of improved employment outcomes and stabilization of agricultural prices and should post positive growth in 2010. Household consumption, which is normally the least volatile item of GDP, contracted more than expected in the first half due to a combination of deteriorating employment prospects, declining prices of agricultural goods, and uncertainties from April's political turmoil. Since June, labor market prospects have improved and agricultural prices have stabilized, as did the political situation, thus supporting a pickup in consumption. As a result, household consumption grew by 2.5 percent (seasonally adjusted) in the third quarter following 1.8 percent growth in the previous quarter, and further acceleration in the next quarter is likely based on improved consumer sentiment as the rebound continues (Figure 43). Improved employment prospects and stability in agricultural prices will support modest gains in household consumption in 2010.

Figure 42. Employment growth had been negative since the onset of the crisis, but has returned to positive growth since July.



Source: NSO

Figure 43. Despite a continued decline of credit to households, other consumption indicators point to a rebound.



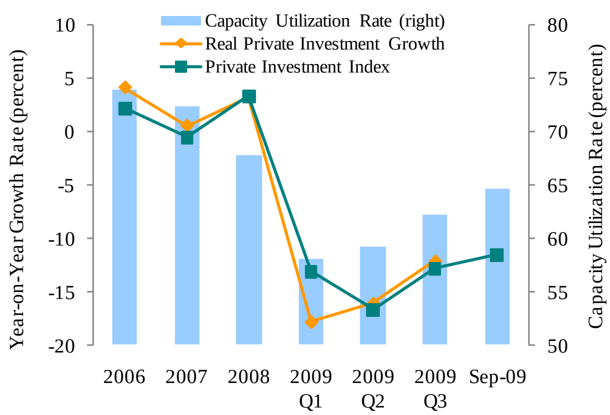
Source: Bank of Thailand and UTCC.

The government's first stimulus package, while unlikely to have had a large impact on overall GDP growth, may have helped limit the negative multiplier effect on household consumption. Disbursements under the first stimulus package are estimated at 0.8 percent of GDP between March and September, and public consumption contributed half a percentage point to GDP growth in the second quarter. While the magnitude of the impact on the economy may have been small, the positive quarter-on-quarter growth in private consumption in the second quarter context of uncertain employment prospects and aggravation of the political crisis may be evidence of a positive multiplier effect of the measures, which were largely consumption-focused. In addition, while the stimulus package was not particularly well-targeted towards the poor, it did contain a number of measures that likely reached vulnerable households with a high propensity to consume. The old-age pension may have been especially effective given evidence that funds trickle down to children and grandchildren.

2.3.2 Private Investment

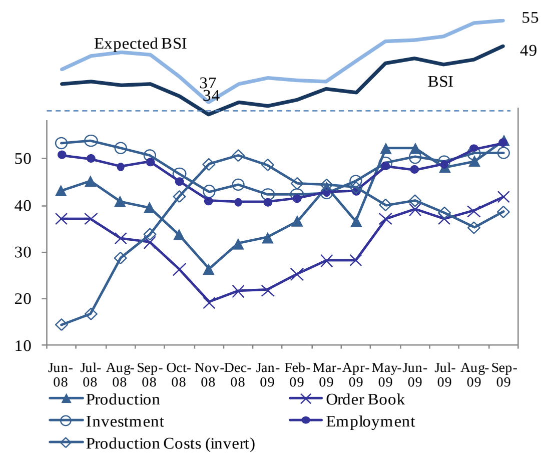
Although private investment has joined the rebound, the outlook remains weak relative to other demand components as capacity is still ample and prospects for demand from advanced economies uncertain. The rebound in manufacturing production has implied an increase in capacity utilization from its lows in February and a resumption of capital expenditures (Figure 44). Business sentiment has been improving, with the expected business sentiment index (BSI) above 50 since May. While the current BSI remains below 50, it is on an improving trend, and the investment component has been above 50 since June (Figure 45). These developments supported a rebound in private investment, which grew by 2.1 and 2.3 percent (quarter-on-quarter) in the second and third quarters, respectively, in line with a projected 7 percent expansion in the second half of 2009 compared to the first half, when private investment plummeted by 13 percent from the previous six months. While the rebound should correct for the excessive contraction in capital expenditures at the onset of the crisis, firms are still operating at around 65 percent capacity, well below the historical average of between 70 and 75 percent (Figure 44), which coupled with the uncertain outlook for external demand in 2010 has reduced imports of machinery (Figure 46), suggesting investment is taking place primarily through upgrades and maintenance of existing machines.

Figure 44. Investment is recovering, but at a slower pace given still high capacity utilization.



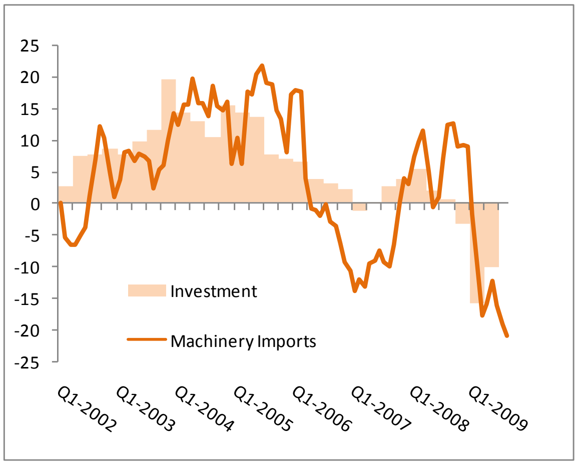
Source: NESDB, Bank of Thailand

Figure 45. Business sentiment has been on an improving trend, providing momentum to the rebound.



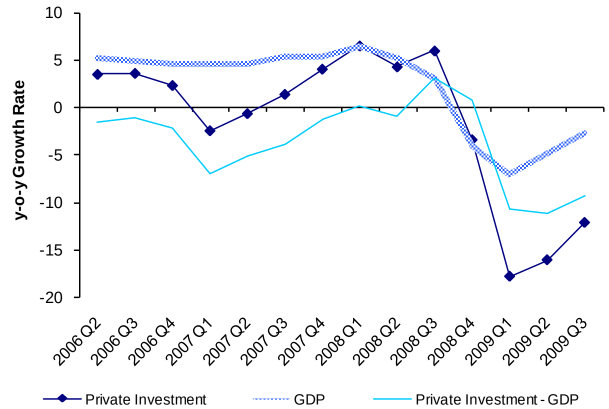
Source: NESDB, Bank of Thailand and World Bank staff calculations.

Figure 46. Machinery imports have been declining, which does not bode well for private investment.



Source: NESDB and Bank of Thailand

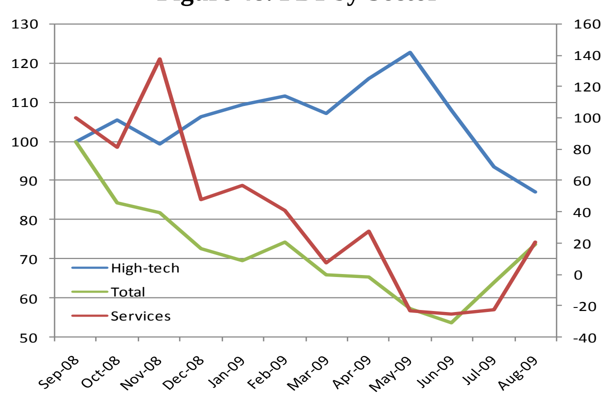
Figure 47. Private investment has consistently underperformed relative to GDP since 2006, suggesting a low base and upside potential.



Source: NESDB and World Bank staff calculations.

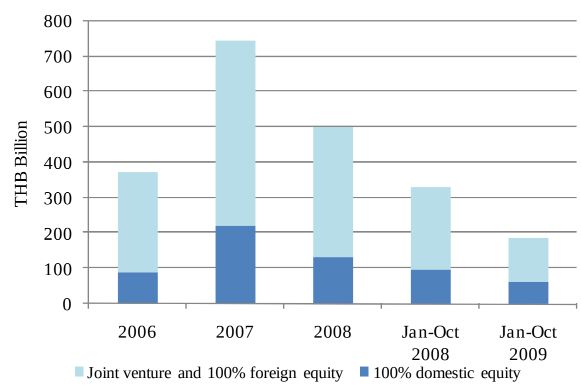
Foreign direct investment has decelerated markedly, but inflows should continue in 2009 and 2010 due to the secular trend to move production away from advanced economies. Gross FDI inflows have picked up since June on the back of investments in the services sector. A contemporaneous decline in FDI from the auto and E&E sectors reflects the fact that investment in the capital-intensive high-technology sectors has a longer lead time, and some of the investments realized between January and May of 2009 were planned before the crisis. The high-tech sectors should join the investment rebound from the second quarter of 2010, offsetting the moderation of investment in other sectors. While a rebound from crisis levels and continued inflows are expected, volumes should remain subdued, as suggested by the continued decline in applications for BOI privileges by foreign firms (Figure 49).

Figure 48. FDI by Sector



Source: Bank of Thailand.

Figure 49. BOI Applications

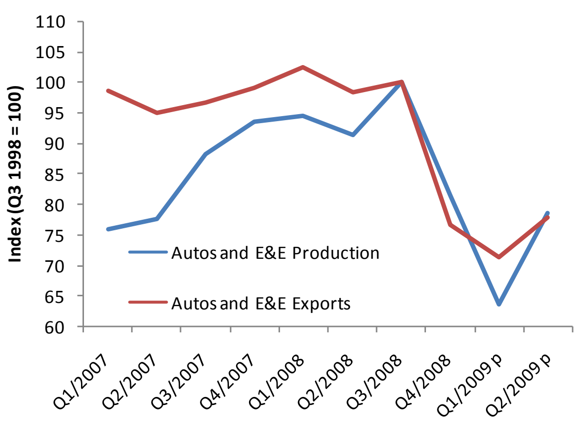


Source: BOI

Private investment is likely to grow in 2010 (albeit at a slow pace) as the base is low and FDI in the high-tech sectors should pick-up. Growth will be modest, however, owing to subdued external demand and concerns about political risks. The share of private investment in GDP is currently about half the pre-crisis average of 28 percent, and private investment growth has consistently underperformed GDP growth since 2006 even as manufacturing value added has grown on average at the same rate as GDP, even when the crisis period is included (Figure 47). This low base of investment, combined with a tendency of foreign firms to respond to the uncertainty about demand in advanced economies with further moves of production to lower-cost countries such as Thailand should result in modest gains in private investment in 2010 notwithstanding the risks related to political uncertainty and weak external demand.

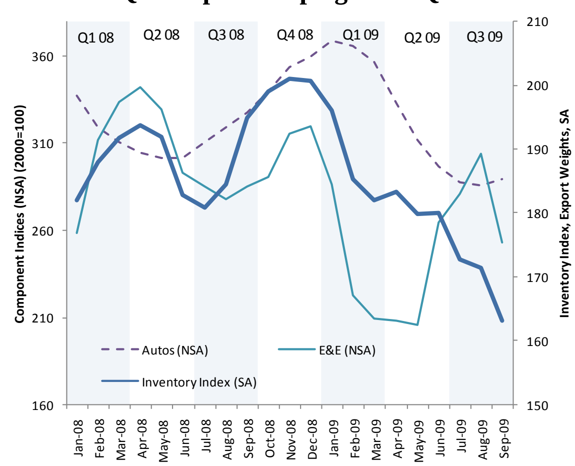
The sharp volatility in economic activity reflected a mismatch between the supply and demand sides of the economy, which are currently being corrected through an inventory cycle. Inventories include both inputs of intermediate goods (imported and domestic) that are not utilized in current production, as well as work in progress and finished goods that have not yet been sold. Inventories are primarily a device to buffer temporary misalignments between supply and demand, and therefore they have little impact on long-term growth. They can, however, be important to understanding developments in the near term. The inventory cycle started in the fourth quarter of 2008: the shock from the financial crisis led to a cut in orders and export sales declined sharply. Notwithstanding improvements in supply chain management, cuts in production and imports of inputs lagged, and inventories built up as a consequence (Figure 50). By early 2009, firms had made production adjustments, and the logic of the inventory cycle would dictate that orders and production be met first from inventories rather than outputs or imports. While this was indeed the case, inventory drawdowns in the first quarter exceeded the accumulation in all of 2008, suggesting that production was cut by more than actual demand – a reflection that cuts were based on what turned out to be overly pessimistic forecasts. Firms would eventually have to increase production levels to meet the new expected equilibrium demand levels, but in addition would also rebuild the stocks that had been depleted. Therefore, production is likely to exceed demand for the next few quarters to allow for the rebuilding of inventories depleted in the first three quarters of the year (Figure 51).

Figure 50. Exports initially fall faster than production, but the decline is less severe the first quarter…



Source: NSO

Figure 51. …leading initially to a build-up in inventories and later a reduction, which was slower in Q2 but picked up again in Q3.



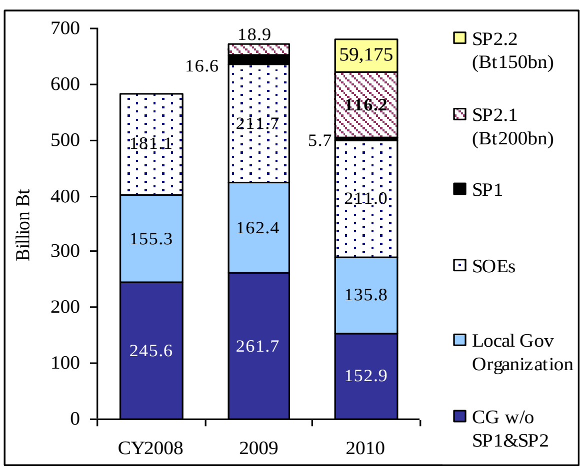
Source: Office of Industrial Economics

2.4 Fiscal Policy

2.4.1 Public Investment

Public investment will grow by around 15 percent from 2008, benefitting from higher disbursements and the greater focus given by the two stimulus packages. Disbursement of public investment spending[17], particularly for construction, has picked up since the second quarter of this year given the political imperative in the face of ongoing political turmoil. Public investment in Q2 2009 rose by 8 percent year-on-year. It accelerated in Q3 2009 to 12 percent year-on-year as a result of the rise in central government and local government organization investments by Bt10 billion in addition to around Bt20 billion (0.2 percent of GDP) of spending from the first two fiscal stimulus packages released this year. In the last quarter of this year, public investment will be significantly higher than that of Q4 2008, mainly as a result of the recovery in state-owned enterprises (SOE) investments as their investment budget for FY2010 (which starts in Q4 2009) was increased and both the global and domestic economies showed signs of recovery. SOE investment had dropped significantly in Q4 2008 due to the uncertainties stemming from the global financial crisis and political turmoil. The rise in SOE investments in the last quarter of this year coupled with additional investments of Bt15 billion from the two stimulus packages will raise total public investment in Q4 2009 by Bt50 billion (0.6 percent of GDP) from that in 2008Q4. Hence, total public investment in 2009 is projected to rise by around Bt89 billion or 15 percent in nominal terms from its 2008 level (see Figure 52). As a result, public investments will rise to 7.5 percent of GDP this year after averaging at around 6.8 percent from 2002-2008 (see Figure 53).

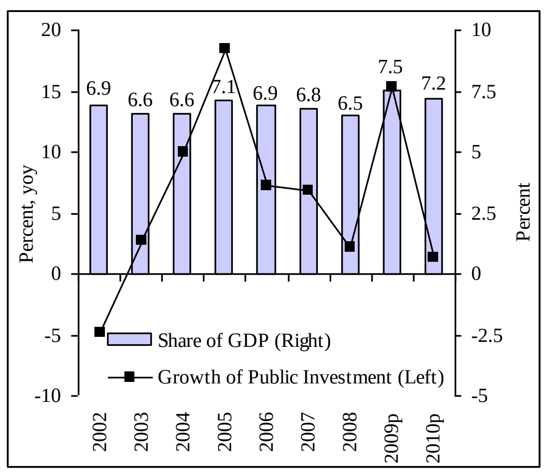
Figure 52. Public Investment Disbursement by Source of Funding, CY 2008-2010



Source: FPO, PDMO, BOB, and WB calculations

Note: CY = Calendar year

Figure 53. Nominal Public Investment, CY2002-2010



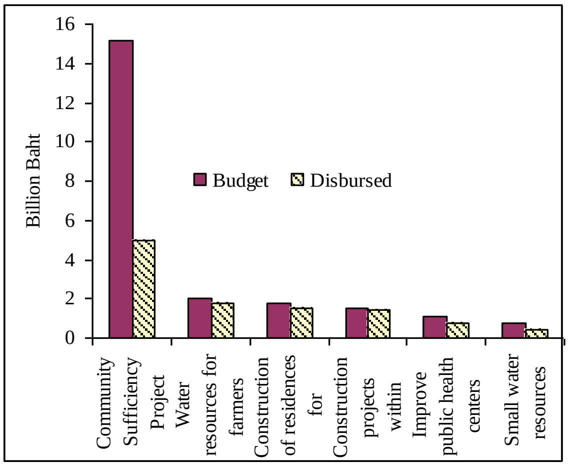
Source: NESDB and WB calculations

The two stimulus packages have helped raised public investments this year, though only marginally. The first two stimulus packages will increase total public investment in 2009 by around 5.3. The first stimulus package (or "SP1") approved in January and worth Bt93.4 billion (1.1 percent of GDP) focused mainly on measures to stimulate consumption. Only a quarter of the package or Bt22 billion was earmarked for investments (construction and equipment), of which the Community Sufficiency Project

[17] Public investment spending includes investments of the central government, local government organizations, and state-owned enterprises.

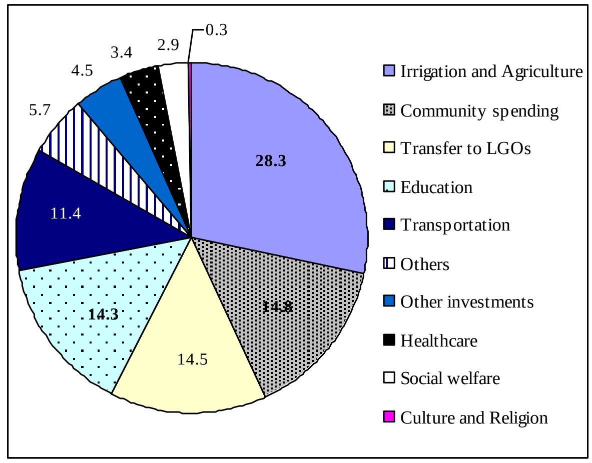
has a large share of Bt15.2 billion. By September 2009, only a third of the budget for the Community Sufficiency Project was disbursed due problems arising in procurement in the middle of the year. As a result, only around Bt11 billion or half of the SP1 budget for investments has been disbursed by September this year (see Figure 54). However, this means that the disbursement of the Community Sufficiency Project will likely continue into the first quarter of next year. In addition, the first tranche of the second stimulus package (or Thai Kem Kaeng Program or "TKK") worth Bt200 billion which was approved by the Cabinet in September and disbursed since the third quarter is estimated to add Bt19 billion or around 2.8 percent to total public investment this year.

Figure 54. Budget and Disbursement of Investment Projects under Stimulus Package 1



Source: CGD

Figure 55. Share of Spending under Bt350 bn of Thai Kem Kaeng Program (2009-2012)



Source: PDMO

Public investment will expand only slightly next year as the Thai Kem Kaeng Program will just about compensate for the reduction in the government's on-budget investment in 2010. So far, two tranches of the TKK Program (2009-2012)[18] worth Bt350 billion (US$10.5 billion) have been released, with the first tranche in the amount of Bt200 billion and the second tranche of Bt150 billion. The focus of the TKK Program so far has been on quick disbursing investment projects as well as transfers and subsidies to local governments, communities, and farmers. A large share of the package is allocated to the agriculture and education sectors and community spending (see Figure 55). Around two-thirds of the Bt350 billion or Bt230 billion is to be used for construction and equipment purchase, of which around three-quarters or Bt175 billion (1.9 percent of GDP) is expected to be disbursed in 2010, thus contributing to public investment. This will help compensate for an almost equal reduction in the central government and local government organization investment budgets, which will reduce their investments by Bt145 billion (1.6 percent of GDP) compared to 2009. As a result, total public investment in 2010 will increase by less than 1.5 percent from that of this year (Figure 52), and its share in GDP will fall slightly to 7.2 percent but remain higher than those of 2002-2008 (see Figure 53).

Implementation of the Thai Kem Kaeng program could have important long-term implications if it sets an example for greater efficiency and transparency in government investments. With the TKK Program being an off-budget item, a few new rules and regulations have been applied to make disbursement of projects in TKK faster and its implementation more transparent and monitorable. Some examples include the relaxation of the requirement for all projects to undergo e-auction for procurement,

[18] The Thai Kem Kaeng is a 4 year program (2009-2012) with a planned budget of Bt1.44 trillion. The first two tranches of Bt350 billion approved this year are an off-budget items finance by domestic loans. Details of the Thai Kem Kaeng are available at www.tkk2555.com.

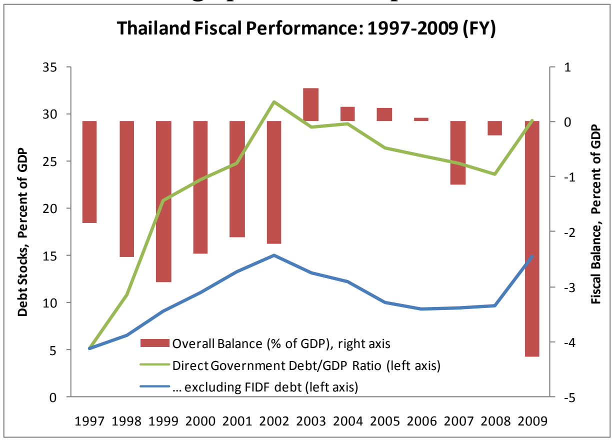
increasing the threshold amount of projects that can be approved by ministerial departments, and projects can continue even if there are appeals or disputes. Given these innovations, the disbursement rate for TTK projects could be at least 80 percent as compared to 70-75 percent for regular central government investment projects. In addition, a system for monitoring and evaluating the progress and outcomes of the projects under TKK has been put in place to ensure that the projects are implemented on time, that problems that arise in the course of implementation can be addressed in a timely manner, and that the projects either individually or collectively achieve their set-out objectives.

Future tranches of Thai Kem Kaeng program should put a greater emphasis on investments in economic "software" (skills, regulations), in addition to economic "hardware" (infrastructure). The first two tranches of the TKK program (worth Bt350 billion) are aimed to provide a fiscal stimulus to cushion the immediate impact of the global financial crisis as well as substitute for the reduction in regular on-budget government expenditures. While this may be appropriate for the immediate economic situation and government's fiscal stance, future tranches should focus on projects that would facilitate long-term growth and development and promote equity. These include projects such as those that will increase supply and access to agricultural and industrial water as well as those that will help to reduce logistics costs. However, the management, regulations, and policies (or "software") around the usage of these infrastructures are equally important to ensure the effectiveness, efficiency, and equity of their service delivery. Building infrastructure for more extensive agricultural water supply or rail lines, for example, are important for service delivery; but equally important are their management that would ensure that the infrastructures are used efficiently and are benefited by the bulk of the population. Building large number of schools and health centers in the rural areas could increase access to these public services; however, equally important is the quality of the education and health care and the policy reforms to make sure that their costs will be sustainable into the future. A final example is that sufficient supply of basic infrastructure such as electricity, water, and pollution control facilities for industrial estates would help the private sector grow, but having policies and regulations to ensure that they can co-exist with the population around the estates is equally important.

2.4.2 Fiscal Sustainability

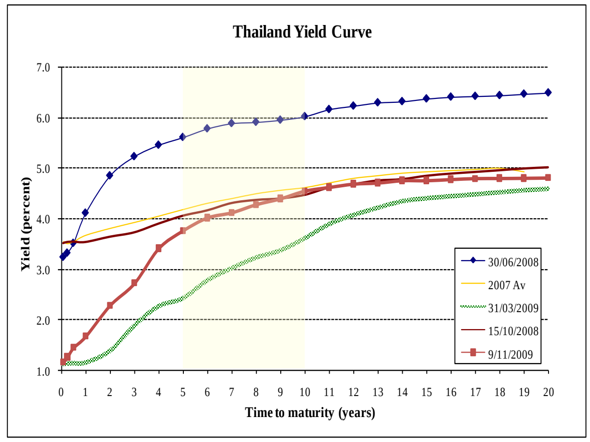
Financial markets have so far been accommodative of the government's borrowing plans. The expansion of expenditures stemming from the stimulus packages combined with a decline in revenues due to the economic crisis has led to an increase in the fiscal deficit and, consequently, government debt ratios, which have reached 45 percent of GDP in September. Because Thailand entered the crisis with a relatively strong fiscal position, the cyclical increase in debt levels is not by itself a concern as long as Thailand's historical fiscal performance is maintained in the future. Thailand's yield curve (Figure 57) shows that interest rates on the more liquid three- to five-year part of the curve are still below where they were in July of 2008 (a time when debt levels were declining) and about at the same level as in 2007, suggesting that borrowing costs are driven primarily by the underlying interest rate environment rather than concerns about fiscal sustainability; in other words, the market is not placing a fiscal risk premium on government borrowing at this time. The market's view is underpinned by a history of fiscal responsibility: since the 1997/1998 financial crisis, Thailand ran small deficits and often fiscal surpluses, which resulted in a reduction of direct government debt from 31 percent of GDP in 2002 to 24 percent in 2008 (Figure 56).

Figure 56. The previous increase in debt levels following the 1997/1998 financial crisis was reversed through prudent fiscal policies.



Source: Bank of Thailand, World Bank staff calculations.

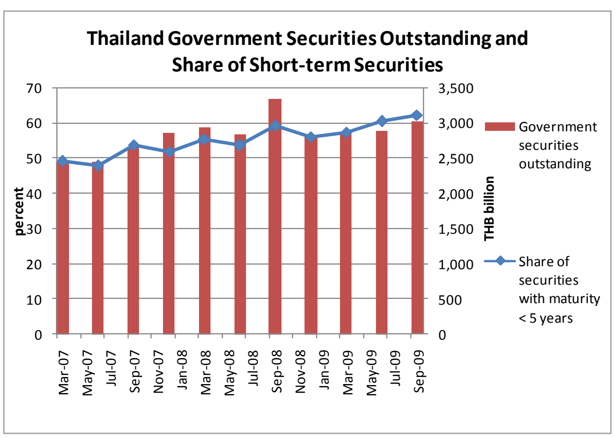
Figure 57. As a result, Thailand's yield curve suggests borrowing costs remain a function of the overall interest rate environment.



Source: Thai Bond Market Association

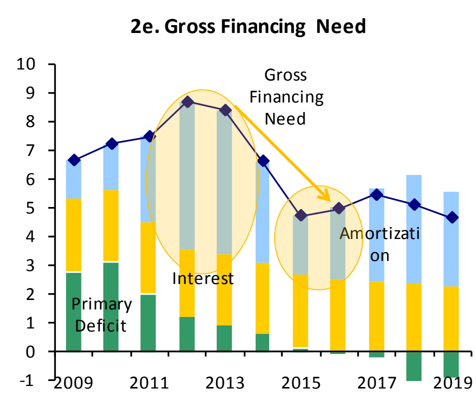
However, a clear exit strategy from the fiscal stimulus has yet to be articulated. Because part of the government's capital budget has been moved off-budget as part of the stimulus package, some additional capital expenditures, as well as the maintenance expenditures of the newly-built infrastructure, must be incorporated into future budgets once the stimulus package is finalized. Some items from the first stimulus package, notably the program of free education for 15 years and the pension to the elderly outside social security, have now been moved on-budget and are likely to be kept in future budgets. Similarly, some items from the second stimulus package may also become ongoing programs that have to be brought on-budget, notably the agricultural price insurance scheme. Other off-budget items constitute implicit contingent liabilities, for example the fuel subsidies are currently being financed from the oil fund (see Box 2). While many of these programs are worthwhile and fiscal stimulus should not be withdrawn prematurely, it is important for the government to articulate which of the recently-introduced programs will be ongoing, what is the target level of capital expenditures beyond the stimulus package, and which (eventual) revenue measures, if any, will be required to ensure a return to a sustainable fiscal position.

Figure 58. The share of debt with maturity under 5 years has increased since the onset of the crisis.



Source: Asian Development Bank.

Figure 59. Financing needs are expected to decline in the medium-term amortizations are shifted to periods when the government has a primary surplus.



Source: PDMO, World Bank calculations

Pressures on the budget are likely to increase in the medium-term, as interest rates rise with the economic recovery and the government must refinance large amounts of recently-issued debt at higher interest rates. The composition of the debt issued since the onset of the crisis – including debt to finance the infrastructure investments under the stimulus package – has shifted towards relatively short maturities. Debt with maturity under five years now comprises 61 percent of total debt (up from 54 percent in June 2008, see Figure 58). One likely reason for the market's reluctance in lending long-term is the expectation that rates are likely to be higher as the economy recovers into 2010. The consequences of this are a likely increase in the interest bill in the medium-term, putting pressure on current expenditures. The government is aware of the need to extend the maturity profile of the debt, and the PDMO has announced borrowing plans for 2010 that explicitly aim at extending maturities, which should eventually shift debt amortization to periods when the government can run a primary surplus (Figure 59).

An analysis of the trajectory of debt ratios based on the assumption of gradual fiscal consolidation and eventual return to potential growth suggests debt levels would start declining by 2014. Based on Thailand's track record for fiscal prudence, expenditures are projected to gradually decline, allowing a primary surplus to emerge and debt levels to decline. Revenues are expected to increase based on historical buoyancy levels, reaching 17.3 percent of GDP, which corresponds to the historical average between 2002 and 2008. Meanwhile, expenditures are assumed to steadily decline to 17.1 percent of GDP by 2017, generating primary surpluses (Table 5). Interest rates are assumed to be 5 percent on average, slightly higher than the average in 2007 but below mid-2008 levels as the policy rate is expected to be on hold for most of 2010 and then only gradually increase. As a result, debt levels are projected to increase until 2013, before starting to decline with improved economic performance and ongoing fiscal consolidation (Figure 60 and Figure 61).

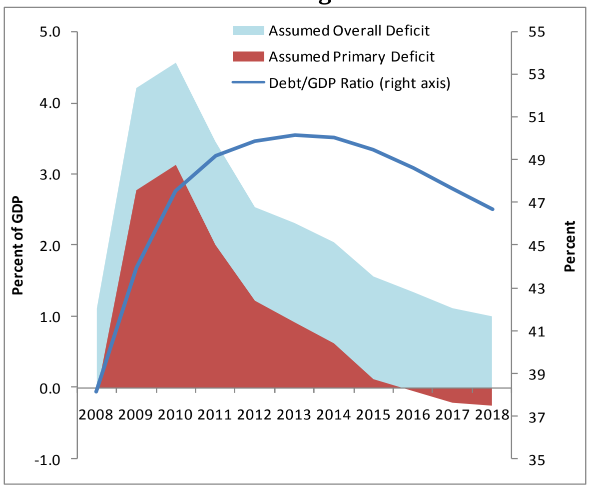
Key risks to the fiscal outlook include low growth and a lack of fiscal consolidation going forward. Although it is too early to consider withdrawing fiscal stimulus and consolidating the budget, a lack of an eventual consolidation could have adverse impacts to fiscal sustainability in two related ways – directly, through growing borrowing needs, but also indirectly, as markets may start placing a risk premium on government borrowings, raising borrowing costs and putting further pressure on the budget. Figure 61 simulates a scenario where fiscal consolidation is delayed, leading to a spike in interest rates in the medium-term. As the figure suggests, the higher interest rates prevent debt levels from declining even as primary deficits are eventually reduced. This is due to the fact that interest as a percent of the overall budget nearly doubles compared to the baseline scenario with fiscal adjustment.

Table 5: Medium-term Fiscal Framework

Billions of Thai Baht and *percent of GDP*.

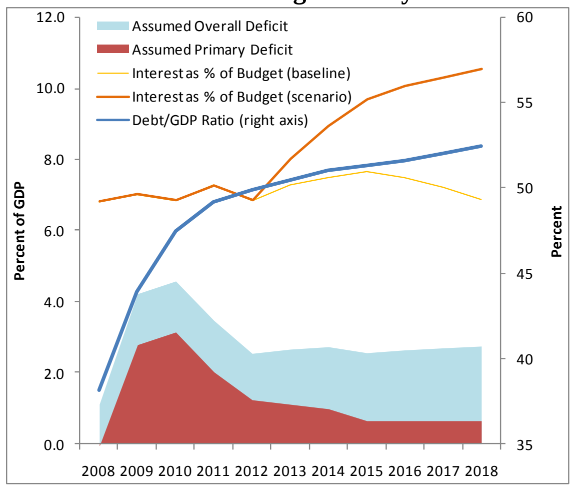
	2008	2009p	2010p	2011p	2012p	2013p	2014p	2015p	2016p	2017p	2018p
Revenues	1,497	1,453	1,543	1,663	1,803	1,966	2,142	2,362	2,554	2,763	2,988
	16.4	*16.4*	*16.5*	*16.6*	*16.7*	*16.8*	*17.0*	*17.3*	*17.3*	*17.3*	*17.3*
Primary Expenditures,											
Original	1,489	1,580	1,608	1,656	1,706	2,070	2,218	2,376	2,545	2,726	2,808
SP1/SP2		116.7	224.7	206.5	226.8						
	16.4	*19.2*	*19.6*	*18.6*	*17.9*	*17.7*	*17.6*	*17.4*	*17.2*	*17.1*	*16.3*
Primary Deficit	*-0.1*	*2.8*	*3.1*	*2.0*	*1.2*	*0.9*	*0.6*	*0.1*	*-0.1*	*-0.2*	*-1.0*
Fiscal Balance	*1.1*	*4.2*	*4.5*	*3.5*	*2.5*	*2.3*	*2.0*	*1.5*	*1.3*	*1.1*	*0.2*
Gross Financing Needs	*1.6*	*5.0*	*5.0*	*5.1*	*6.8*	*6.5*	*4.7*	*2.8*	*3.0*	*3.5*	*3.1*
Total Public Debt	*38.1*	*44.2*	*47.7*	*49.3*	*50.0*	*50.3*	*50.1*	*49.5*	*48.6*	*47.7*	*45.9*

Figure 60. Assuming deficits decline, debt levels start declining in 2014.



Source: PDMO, BoT, World Bank calculations.

Figure 61. A higher interest rate shock could increase debt levels significantly.



Source: PDMO, BoT, World Bank calculations

Box 2. The Oil Fund as an Implicit Contingent Liability

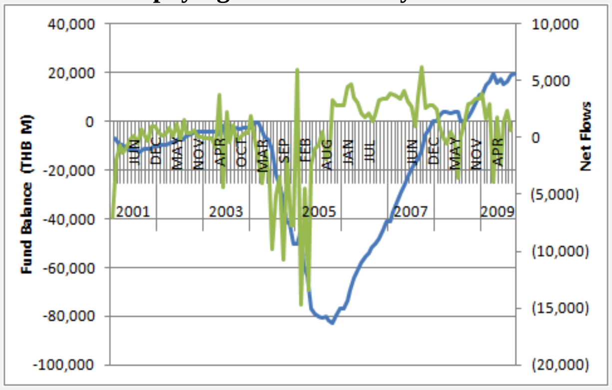
The Oil Fund was originally created in 1979 to finance certain fuel subsidies. The fund remained quite small until around 2004, when diesel prices were frozen. This created a large amount of debt (THB 80 billion) in the fund between 2004 and 2005. Starting in January 2006, the debt began to be repaid with revenues from a fuel surcharge that was paid into the oil fund. The debt was fully repaid by December 2007, but the surcharge (which represented contributions to the fund) remained in place, and the fund was repurposed as an instrument to promote alternative fuels (Figure 62) such as “gasohol” (the mixture of ethanol with gasoline).

In 2008, as part of the government’s measures to reduce the impact of high fuel prices, excise taxes on fuel were cut to finance diesel subsidies. This led to a sharp decline in fuel excise tax revenues in 2008 (Figure 63), but accounts for the financial health of the Oil Fund, which accumulated assets throughout 2008.

In August 2009, the government announced the implementation of five types of energy subsidies: (1) cutting the pump price of diesel; (2) subsidize LPG, which is imported at Bt25.73 a kilogram but resold domestically at only Bt18.13; (3) CNG subsidies for another year; (4) subsidies for 30,000 taxis that want to convert to running on NGV; and (5) electricity subsidies. Altogether, the measures are expected to cost the government approximately THB48 billion. However, instead of cutting the excise tax on fuels as it did in 2008, the government instead cut contributions to the Oil Fund.

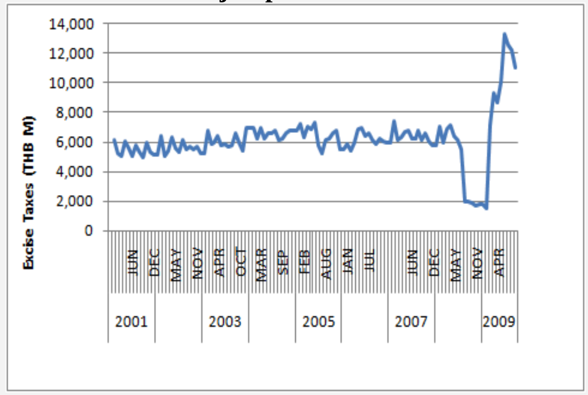
The consequence of this policy has been an increase in the collection of fuel excise taxes in 2009 (FigureXX), while the subsidies are being paid from savings in the Oil Fund, thus potentially reducing government borrowing needs by boosting revenues without creating debt in the Fund. However, should the subsidies be renewed in the future, as has been the case previously, it is possible that the Oil Fund will be depleted and incur debt, which then would add to the government’s debt. For this reason it is important for the government to articulate a clear medium-term fiscal strategy that includes all programs – both on and off budget.

Figure 62. The oil fund has been in surplus since repaying its debt in early 2007.



Source: EPPO, World Bank calculations.

Figure 63. Financing fuel subsidies from the oil fund has led to a jump in fuel excise taxes.



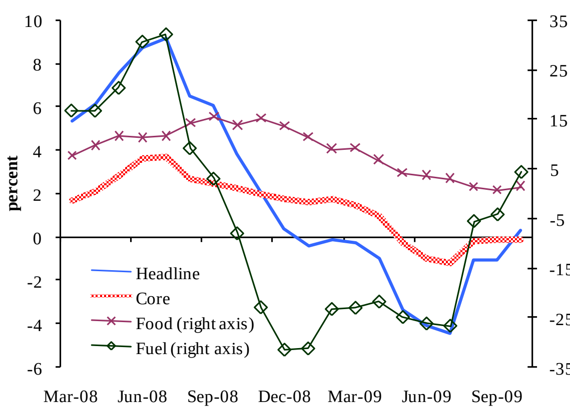
Source: EPPO, World Bank calculations

2.5 Inflation, Exchange Rate and the Balance of Payments

2.5.1 Inflation

The burst of the commodity bubble of mid-2008 coupled with subdued levels of economic activity have led to price deflation for most of 2009. Year-on-year inflation had been negative until October, when the headline CPI posted a small gain of 0.4 percent due to higher energy prices (Figure 64). Core inflation (excluding raw food and energy) has remained negative since May, supporting an accommodative monetary policy stance by the Bank of Thailand, which targets this measure of inflation. Because core inflation in Thailand includes prepared food, which is a non-trivial part of the consumption basket, it was also influenced by the bubble in commodity prices that caused large variations in the headline CPI. Consumer prices excluding all food and fuel have also been declining, however, largely because of government efforts to reduce the price of certain goods such as transportation and education (Figure 65).

Figure 64. Both core and headline inflation measures have been negative through most of 2009.



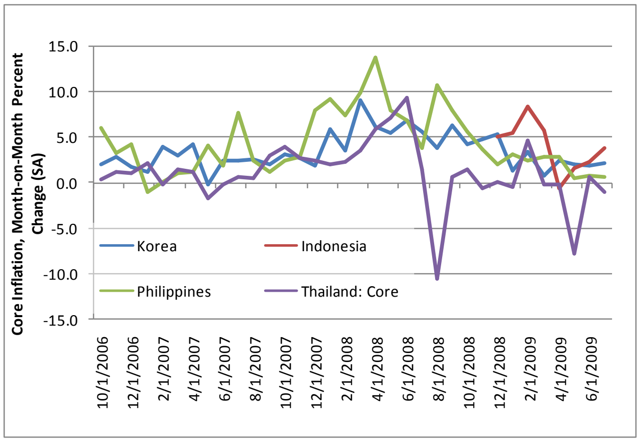
Source: Ministry of Commerce.

Figure 65. When all food and energy prices are excluded, prices fall even further due to government policies to reduce prices of certain consumer goods.

Source: Ministry of Commerce

Base effects are expected to lead to an increase in inflation readings in the fourth quarter of 2009 and into 2010, but monetary policy is likely to remain accommodative. Because price deflation in 2009 has been attributed to "one-off" factors, it is natural that year-on-year inflation readings should become positive even as the price level remains below its mid-2008 levels. Therefore, in the same way that the deflation in 2009 has not warranted a more aggressive monetary policy reaction despite the BoT having a lower bound of zero on its inflation target, positive inflation in 2010 should not lead to aggressive tightening either, and the BoT is not expected to raise rates until the second half of 2010 despite rising inflation readings. Indeed, given Thailand's low levels of inflation relative to its East Asian peers (Figure 66), positive levels of inflation into 2010 would be a healthy sign that deflation was not associated with deflationary expectations that could cause a damaging spiral of the kind Japan suffered in the 1990s. Given Thailand's structurally low inflation levels, excess capacity and stable commodity prices, prices are expected to increase only about 2 percent in 2010.

Figure 66. Inflation in Thailand has been lower than in neighboring countries.

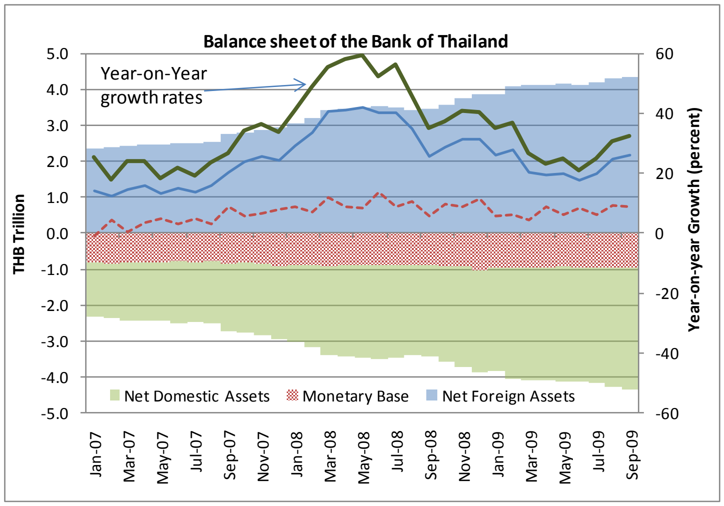


Source: CEIC, World Bank Staff calculations

2.5.2 Exchange Rate

With inflation subdued and policy rates at an all-time low, monetary policy has been mindful of the potential impact of trade inflows on the exchange rate. Since the onset of the crisis, the Bank of Thailand cut interest rates four times by a total of 250 basis points. The last rate cut was in April, however, and the BoT has chosen to keep the policy rate at 1.25 percent in its past four meetings, likely because the impact of further cuts would be limited by the lack of demand for credit. Instead, the BoT's interventions have focused on the impact of large current account surpluses on the exchange rate. This policy has required large accumulation of reserves (net foreign assets), which are currently at US$135 billion or nearly 12 months of imports. In order to keep the monetary base stable, reserve accumulation has been followed by sterilization measures (issue of BoT securities) to remove the resulting excess liquidity from the market (hence the increase in net domestic liabilities, see (Figure 67). As long as inflationary pressures remain subdued and credit demand sluggish, this policy is both sustainable and not very costly, as sterilization can be achieved at the currently low interest rates. However, as the economy recovers, inflationary pressures and risks of asset price bubbles could emerge and lead to higher interest rates, which in turn could put further pressure on the baht.

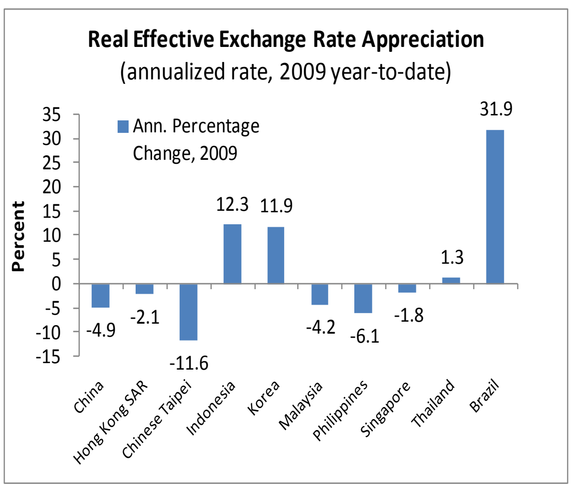
Figure 67. The accumulation of foreign reserves is mirrored by a proportional decline in net domestic assets through sterilization.



Source: Bank of Thailand

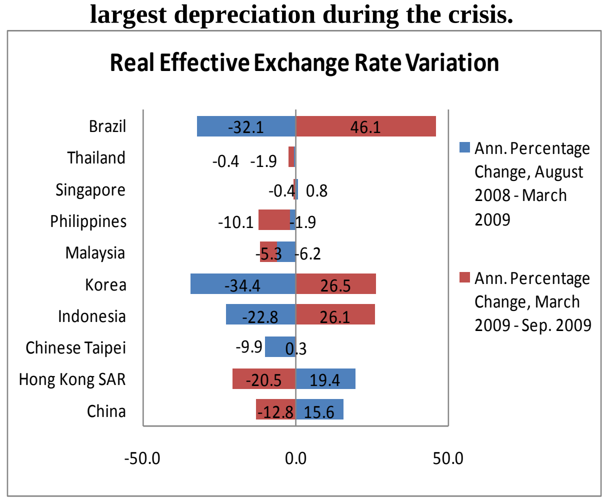
The baht has appreciated, but only to the extent of other regional exchange rates. The baht has appreciated 4.9 percent in 2009, compared for example to over 30 percent of the Brazilian real. Meanwhile, the real effective exchange rate has been practically flat due to the deflation during the period, whereas other countries have seen an appreciation since March (Figure 68 and Figure 69).

Figure 68. Real exchange rates in most Asian are still depreciated in 2009.



Source: BIS, World Bank calculations.

Figure 69. Those countries that experienced an appreciation in 2009 were those that also faced the largest depreciation during the crisis.



Source: BIS, World Bank calculations

Supply chains may also provide an explanation for central banks' concerns with currency appreciation. One interesting feature of Figure 25 is that all countries on the right-hand side are Asian high-technology exporters that are part of manufacturing supply chains. No single country within the supply chain wants to see its currency appreciate more than the others, lest their export competitiveness be severely undercut. Given that manufacturers have multiple production bases and there is currently excess capacity, there is a credible threat that currency appreciation could severely harm exports, especially in the near term. The Chinese RMB peg to USD has been hardened since the onset of the crisis, making it especially difficult for another country within the supply chain to allow its currency to appreciate.

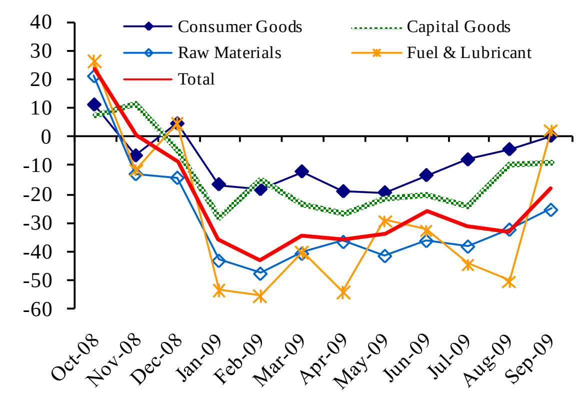
2.5.3 Balance of Payments

Subdued levels of private investment are reflected in large current account surpluses. The mirror image of an excess of domestic savings over investment has been large account surplus of 8.5 percent of GDP in the third quarter of 2009, of which 8 percent corresponds to the trade account. Despite the slump in exports described in Section 2.2.2, the value of imports declined even more drastically, leading to large trade surpluses of 8 percent of GDP through the third quarter of 2009. Given the composition of exports (primarily of high-tech goods and agricultural commodities), export prices have declined by less than those of imports (Figure 70). Prices of imports (primarily raw materials and fuels) plummeted by as much as 60 percent (Figure 71) while import volumes have also declined more sharply than export volumes: besides intermediate inputs that are closely linked to exports, imports also include machinery and other equipment, which have declined along with private investment. The services account registered a small deficit in the second quarter – the first since 1994 – reflecting a 31 percent year-on-year decline in travel receipts. The decline in service exports has driven the net services and income account into deficit for most of 2009 (Table 6). These dynamics suggest that current account surpluses are likely to continue into 2010.

Figure 70. Prices of imports declined more and faster than prices of exports…

Source: Ministry of Commerce

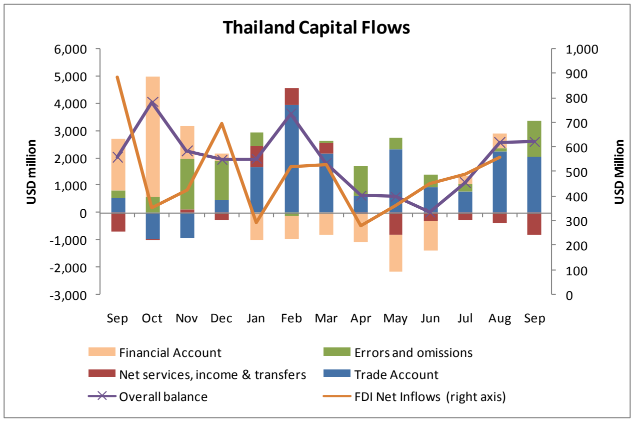
Figure 71. …largely due to sharp declines in the price of fuel and raw materials.



Source: Bank of Thailand

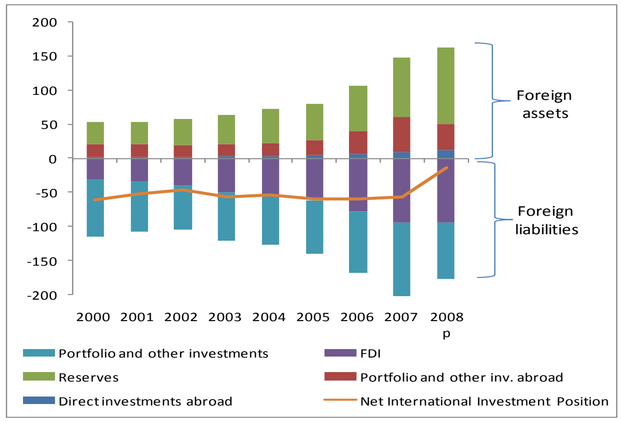
The surplus in the current account implies that Thai savings have been sent overseas, either as net outflows in the financial account or as accumulation of reserves at the Bank of Thailand. Net FDI flows remained positive in 2009 (Table 7 and also see Section 2.3.2), whereas the sum of portfolio and other investment registered net outflows in 2009. Capital outflows in the first half of the year were first driven by banks, then by portfolio outflows of debt securities. Net flows of investments in equity securities have been stable, with outflows from Thais offsetting inflows from foreigners (see Table 7). The resulting deficit in the financial account did not offset the large current account surpluses, leading to a balance of payment surplus in the first half of 2009 of US$8.7 billion (Figure 72 and Table 6). The financial account turned into a surplus in the third quarter as banks posted inflows, inflows into Thai equity markets picked up and FDI rebounded, leading to a surplus in the balance of payments of US$6.3 billion in the third quarter alone. The shifting of savings overseas which results from private capital outflows and reserve accumulation corresponds to a reduction in Thailand's net international debtor position (Figure 73), a trend that is likely to continue in 2009 and 2010 as weak private investment drives continued current account surpluses.

Figure 72. Outflows in the financial account did not offset capital inflows coming from the trade account…



Source: Bank of Thailand

Figure 73. …leading to reserve accumulation at the same time as the stock of portfolio and other investments in Thailand have declined.



Source: Bank of Thailand

Table 6. Balance of Payments

(Million US$)

	2006	2007	2008	2009p
Exports of Goods	127,941	151,258	175,232	151,515
(% change)	17.0	18.2	15.9	-13.5
Imports of Goods	126,947	138,477	175,060	132,910
(% change)	7.9	9.1	26.4	-24.1
Trade Account	994	12,781	172	18,604
as % GDP	0.48	5.17	0.06	7.08
Net services income & transfers	1,321	2,900	1,450	2,875
Current Account	**2,315**	**15,681**	**1,622**	**21,480**
as % GDP	1.12	6.35	0.60	8.18
Capital and financial account including net errors and omissions	**10,426**	**1,420**	**23,060**	**-2,627**
Balance of payments	**12,741**	**17,101**	**24,683**	**18,853**
Foreign Reserves (year-end)	66,985	87,455	111,008	129,861

Source: BOT and WB projections; p = projections

Table 7. Net Capital Flows

(Million US$)

	2008	2008		2009		
		Q3	Q4	Q1	Q2	Q3
1. Monetary authorities	61	-56	-149	-149	-60	358
2. Government	-502	-504	-156	-158	39	644
3. State Enterprises	-2,419	-1,098	-484	-743	-470	-560
4. Bank	10,602	2,117	618	-2,170	176	4,158
5. Non-Bank Private	6,862	-673	6,058	555	-3,139	-2,853
FDI	7,574	2,030	1,472	1,336	1,088	1,222
- Equity investment	7,776	1,912	2,075	1,538	1,484	1,367
- Direct loans	-202	118	-602	-202	-396	-145
Portfolio	53	-2,597	5,182	503	-3,863	-2,825
- Foreign	-875	-512	-525	5	145	952
- Equity securities	-1,004	-503	-348	-46	165	804
- Debt securities	129	-9	-177	51	-20	148
- Thai	928	-2,085	5,707	498	-4,008	-3,777
Loans (foreign)	776	388	1,222	4	-71	-525
Trade Credits	714	51	-1,313	-1,156	501	692
Others	-1,540	-494	-1,818	-1,289	-294	-725
Total capital flows	**14,604**	**-214**	**5,887**	**-2,666**	**-3,454**	**1,746**

Source: Bank of Thailand

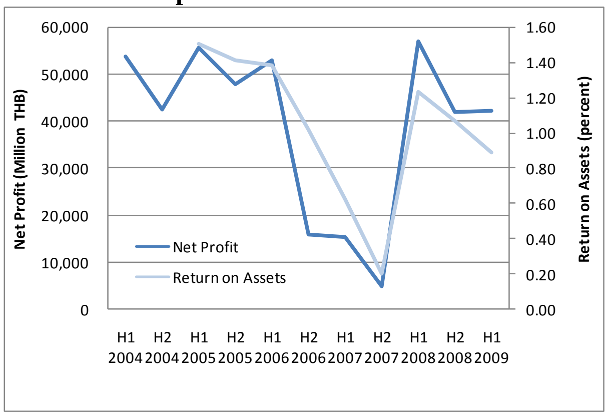
2.6 Financial and Corporate Sector

The overall health of banking and corporate balance sheets has been critical to the recovery. Whereas balance sheet effects amplified the impact of the 1997/1998 financial crisis, relatively strong corporate and banking balance sheets have dampened the impact of the financial crisis and allowed for a faster recovery. Solid corporate finances are mirrored in a healthy banking sector, creating a positive feedback loop. Non-performing loans did not rise as expected, falling in the third quarter for the second consecutive quarter despite the crisis. Small and medium enterprises (SMEs) did not fare as well as their larger counterparts; the larger number of business dissolutions in the second quarter reflects this fact. Nevertheless, and despite the ongoing deceleration in credit growth, firms in the supply chains of multinational corporations were in general sufficiently well-capitalized, or received assistance from their larger clients, allowing for minimal disruption once orders resumed.

2.6.1 Financial Sector Developments

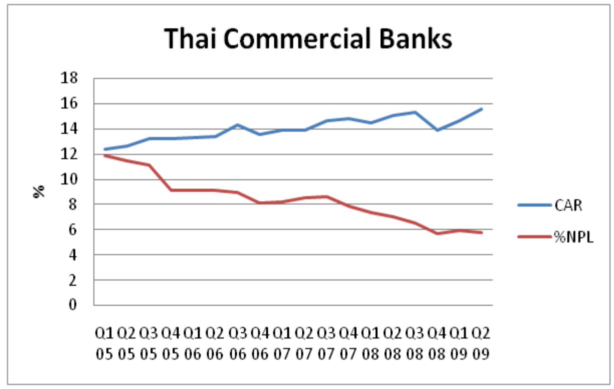
Tighter credit controls have kept the Thai banking system sound during the crisis, but resulted in limited credit to the real economy. Following three years of volatility due to the implementation of BASEL II standards, the profitability of Thai banks has stabilized (Figure 74). Every Thai bank is now well-capitalized, with an average capital adequacy ratio (CAR) of 16.2 percent as of the end of August 2009, (compared to 14.0 percent and 14.9 percent in December 2008 and 2007, respectively), well above the regulatory requirement of 8.5 percent (Figure 75). This performance has followed stricter implementation of credit risk management measures. Gross NPLs of the Thai banking sector have declined from 12 percent in 2005 to 6 percent in 2009(Figure 75). Contrary to earlier concerns that NPLs would rise due to the global financial and economic crisis, net NPLs increased only slightly from 3.19 percent in December 2008 to 3.33 percent in June 2009, having declined again in September. Loan quality needs nevertheless to be closely monitored for possible adverse effects of the prolonged recession. The agriculture and industrial sectors, which experienced around 10 percent of NPLs (Figure 76), are especially vulnerable.

Figure 74. Following volatility during the implementation of Basel II, Thai banks have posted solid profits even amid the crisis.



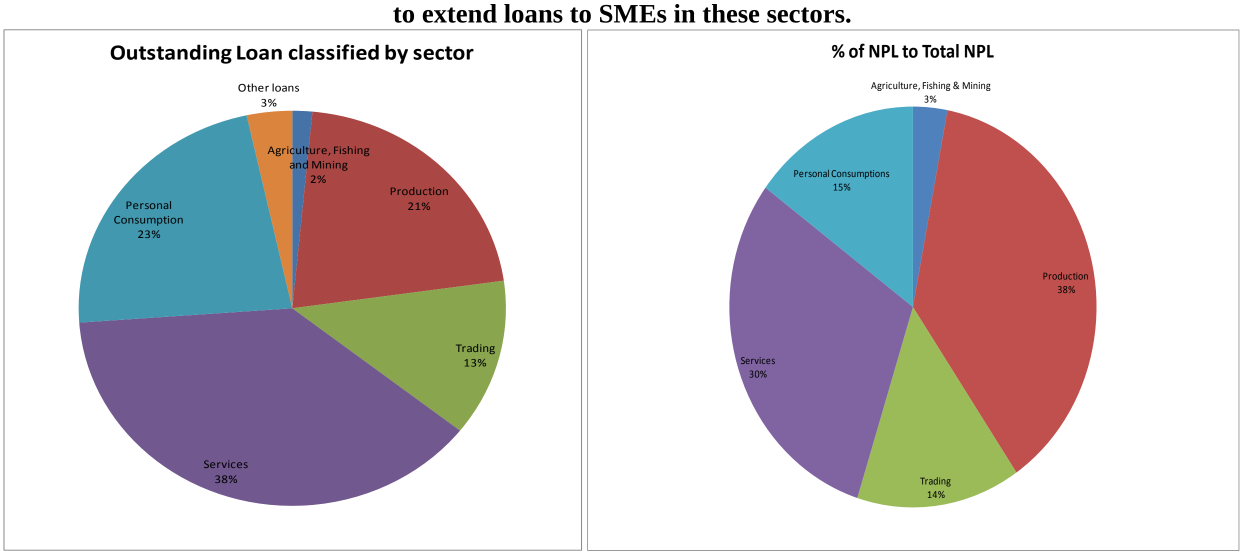
Source: BoT.

Figure 75. Capital adequacy has continued to increase, whereas NPLs have declined.



Source: BoT

Figure 76a and b. NPLs are concentrated in the industrial and services sectors, explaining banks' reluctance to extend loans to SMEs in these sectors.



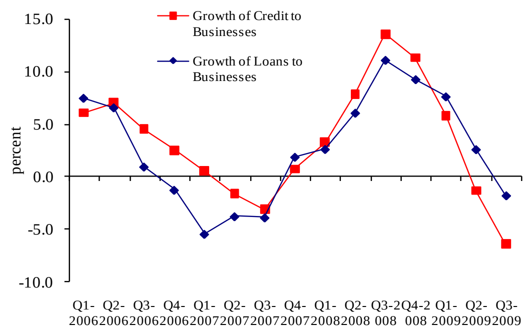
Source: BoT.

Note: Services includes electricity, construction, hotel, restaurant, transportation, storage, financial intermediaries and real estate.

The consequence of stricter credit controls has been a contraction in commercial bank lending in the first half of the year. Measures to protect the quality of portfolios during the crisis may have protected banks' balance sheets, but resulted in reduced access to finance. Credit to businesses has been contracting for the past four quarters (Figure 77). There are signs, however, that demand from SMEs and consumers are on the rise with the economic recovery. Based on the past experience on low NPLs in consumer loan, banks have warmed up to new consumer loans, but remain reluctant to lend to SMEs, which have experienced cash shortages and have had to resort to short-term loans for working capital rather than long-term loans.

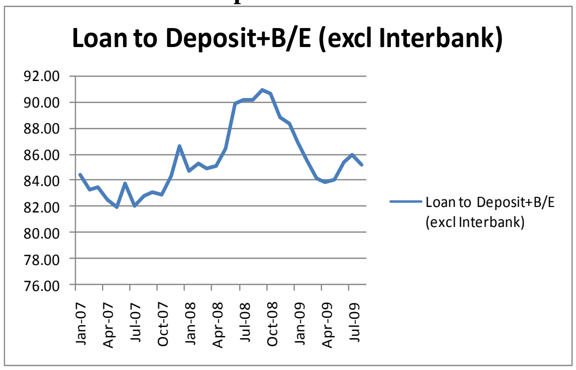
High capital inflows and subdued credit has resulted in ample liquidity in the financial system. The loan to deposit and B/E ratio has peaked at 91 percent in September 2008, just before the crisis, dropping to earlier levels around 85 percent more recently as banks reduced their appetite for new loans and deposits expanded with capital inflows and higher precautionary savings (Figure 78). Liquidity could increase further due to capital inflows from foreign portfolio investments, but as competition for funds from the private sector starts to increase along with the rebound, credit should begin to expand again, resulting in lower levels of liquidity in the market.

Figure 77. Credit growth has become negative since the second quarter as demand has been subdued.



Source: BoT.

Figure 78. As loan growth declined, liquidity in the financial system increased, as reflected by a decline in the loan-to-deposit ratio since the crisis.



Source: BoT

The government's policy of direct lending through Specialized Financial Institutions to ease the credit crunch needs to be carefully monitored for contingent liabilities. The government has responded to the credit contraction from commercial banks in the first half of 2009 with an increase in the lending target of the Specialized Financial Institutions (SFIs), from THB 625 billion to THB 927 billion (see Table 8), and by introducing a Portfolio Loan Guarantee Scheme to help offset credit risks carried by lenders. In order to implement these facilities in a timely manner, the Government approved a capital increase of THB 14.5 billion for the SFIs in the financial year ended 2009 and THB 6 billion in financial year ended 2010 (see Table 9). By introducing the Public Service Accounting (PSA) system to compensate any losses incurred from directed lending policies on an ex-post basis, the SFIs are able to accelerate the lending activities under the Fast Track program by offering relaxed terms, payment periods, collateral rules and interest rates for loans to key sector such as SME in tourism industry. This raises concerns on credit quality and possible political intervention. In addition to constituting contingent liabilities to the government, such acceleration of lending could lead to problems for the banking system if the government pays for the losses incurred in the form of non-marketable government securities instead of cash as experienced in other countries.

Table 8. Details of new loan targets

SFIs	Loan Target (Bil THB)	
	Jan-09	Aug-09
Bank of Agriculture & Agricultural Cooperatives	323	470
Government Saving Bank	162.6	242.6
Government Housing Bank	73.5	100
Small & Medium Enterprise Bank of Thailand	26	43.5
Export-Import Bank of Thailand	19.7	37.2
Islamic Bank of Thailand	20.7	33.7
Total	625.5	927

Source: Cabinet Synopsis Aug 5,2009
Fiscal Policy Office.

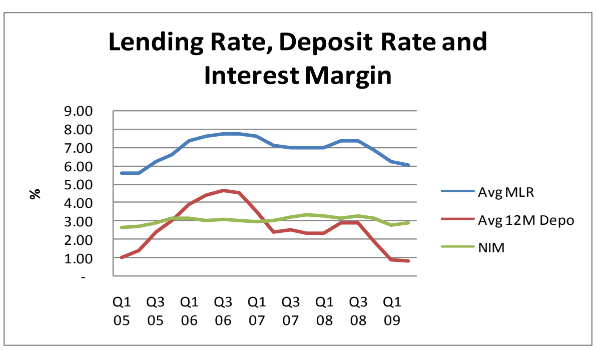
Table 9. Capital increase for SFIs in financial year ended 2009

Specialized Financial Institutions (SFIs)	Increased Capital Amount (THB Billion)
Small Industry Credit Guarantee Corporation (SBCG)	2.0
Small and Medium Enterprise Development Bank of Thailand	2.5
Export-Import Bank of Thailand	5.0
Bank for Agriculture and Agricultural Cooperatives	2.0
Government Housing Bank	3.0
Islamic Bank of Thailand*	6.0

Source: Cabinet Synopsis Jun 16, 2009
Note:*: Government plans to allocate budget of financial year 2010 for capital increase in Islamic Bank of Thailand.

Interest rates in the financial markets are likely to increase gradually next year as monetary policy slowly moves to a less accommodative stance in the second half of 2010. The policy rate has been cut by 250 basis points over the past year, but has been kept at 1.25% since April 8. Interest rates in the financial markets have only gradually declined, which has implied higher net interest margins. The overwhelming Government Saving Bonds program announced in July 2009 benefited from this high spread by offering attractive terms to retail investors. The net interest margin (NIM) for the whole industry has been stabilized at around 3.0% even the fluctuation in lending and deposit rates. (Figure 79)

Figure 79. Lending rates decline more slowly than deposit rates since the onset of the crisis, leading to a modest increase in the net interest margin.



Source: Source: Bank of Thailand
Noted: Net Interest Margin = % of Average Asset

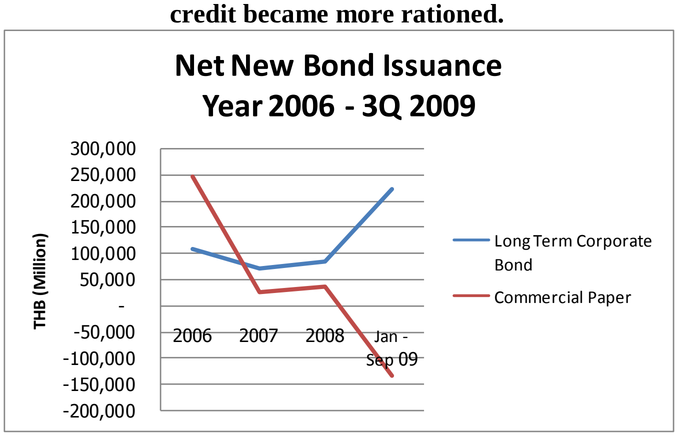
As banks reduced lending, large commercial borrowers turned to the bond markets, which experienced a sharp increase in volumes in 2009. New domestic bond issues added up to THB8.76 trillion for the nine months period of 2009 compared to THB8.55 trillion for 2008, representing an increase of 2.45 percent (Table 10). Government Securities dominated the primary market, with corporate securities accounting for only 10 percent of new issues. Corporate issuance picked up sharply as a result of a desire to extend maturities due to the anticipated future increase in interest rate, as well as banks' stricter credit control. Large Thai companies switched new debt issuance from short-term commercial paper to longer term corporate bonds with a maturity of three to five years, which resulted in negative net new commercial paper issuance in 2009 (Figure 80). Most corporate issuers have targeted their debt issues at retail investors, taking advantage of large spreads between deposit and lending rates. In order to promote sustainable bond market development, risk management and benchmarking practices should be educated among retail bond investors who are new to the fixed income instruments.

Table 10. New Bond Issuance for the first nine months of the year 2008 and 2009

	Jan - Sep 08	% Total	Jan - Sep 09	% Total	% Increased
Government Debt Securities					
Gov Bond	168.09	1.97	395.27	4.51	135.15
T-Bills	385.00	4.50	750.85	8.57	95.03
SOE Bond	103.81	1.21	84.73	0.97	(18.38)
BOT Bond	6,887.33	80.52	6,759.01	77.14	(1.86)
Corporate Debt Securities					
Long-term Corporate Bond	165.71	1.94	349.87	3.99	111.14
Short-term Commercial Paper	820.32	9.59	400.82	4.57	(51.14)
Offshore	4.81	0.06	9.91	0.11	106.20
Foreign Bond					
Unsecured Foreign Bonds	18.09	0.21	12.00	0.14	(33.66)
Total	8,553.15	100.00	8,762.46	100.00	2.45

Source: The Thai Bond Market Association

Figure 80. Corporate bond issuance jumped in 2009 as the cost of borrowing from banks increased and access to credit became more rationed.



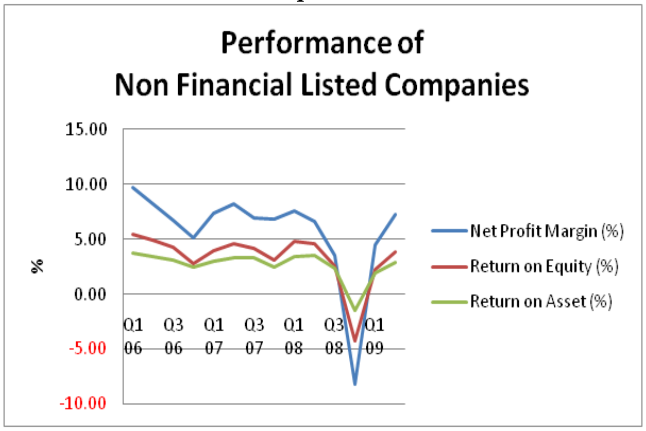
Source: The Thai Bond Market Association

The stock Exchange of Thailand (SET) has been one of the best performing markets in the region this year, attracting portfolio inflows in the third quarter. The index was closed at 717.07 on September 30, 2009 gaining 59% from the low of 449.96 at the end of 2008. The market rebound came as investor confidence on improving economy which is expected to result in increases in future corporate earnings. In addition, the TSFC Securities, owned by SET, MOF, and local stock brokers, reopened its operations with securities margin lending and securities borrowing and lending (SBL) activities after last year's default on its debt payments. However the market remains subject to volatility, as seen by the broad sell-off that took place in October on account of a rumor, resulting in a drop of as much as 8 percent in one trading session and almost triggering the circuit breaker.

2.6.2 Corporate Sector Developments

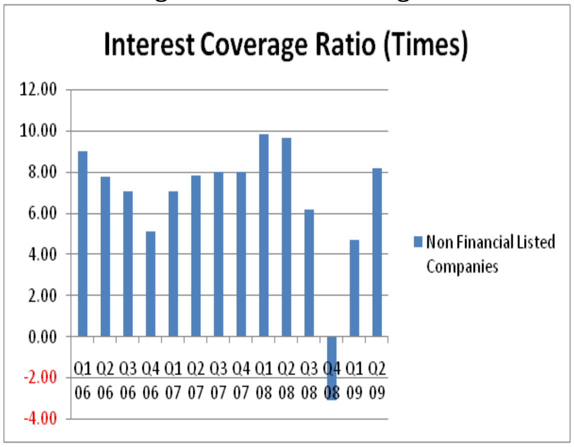
Thai listed companies reached a bottom in the fourth quarter of 2008 due to a combination of the shock from the global financial crisis as well as the political crisis that led to the closure of Bangkok's airport. Thai listed firms reached a bottom in terms of profitability in the fourth quarter of 2008, which recorded negative interest coverage ratios and negative net profit margins (Figure 81 and Figure 82). Although firms adjusted quickly, they were unable to cut costs in a single quarter as a response to the unexpected and deep cuts in orders. The result was a 70 percent drop in earnings before interest, tax, depreciation and amortization (EBITDA) and the lowest Return on Equity (ROE) and Return on Assets (ROA) since 1999. This sharp drop in profitability is due in large part to the global financial crisis, but also in part to the political instability related to the airport closure in November and December 2008. The resources and industrial materials industries were seriously impacted from price volatility in commodities, and also reported negative EBITDA and negative interest coverage ratios.

Figure 81. Thai listed companies reached a bottom in the fourth quarter of 2009.



Source: Stock Exchange of Thailand

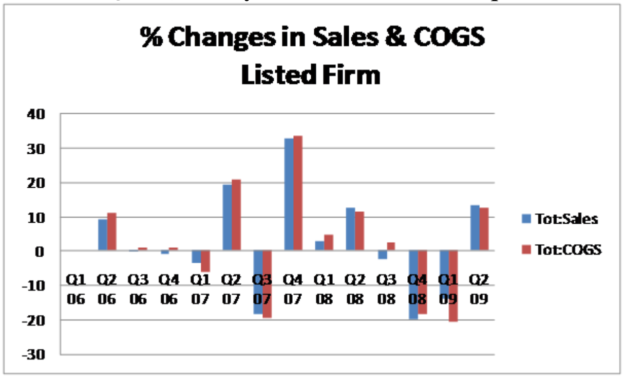
Figure 82. Losses in the fourth quarter of 2008 led to a negative interest coverage ratio.



Source: Stock Exchange of Thailand

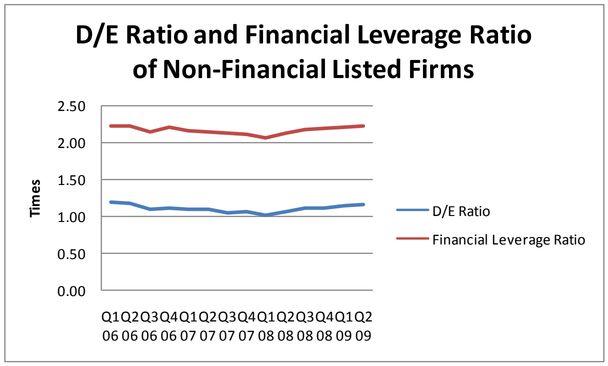
Firms cut costs aggressively in the first quarter, limiting losses and protecting their balance sheets. The performance of every sector in the SET, with the exception of the industrial materials & machineries industry, has been on an improving trend since the first quarter. Although sales revenues were still below last year's figure, gross profit of most industries returned to their normal level before crisis. Cash flows of listed firms returned to normal levels. Profitability ratios picked up, initially due to aggressive cost management measurements following the crisis. As Figure 83 and Figure 84 illustrate, the cost of goods sold (COGS) fell more than sales revenues in the first quarter, and more than they had fallen in the fourth quarter, when firms had already committed to a number of expenses. These aggressive cost-cutting initiatives protected firms' balance sheets, as seen by the debt to equity and financial leverage ratios shown in Figure 84. Healthy corporate balance sheets have been supportive of the rebound, since the restart of the supply chain could take place with minimal disruption.

Figure 83. Cost of goods sold declined by less than sales in Q4 08, but by more in the second quarter…



Source: Stock Exchange of Thailand

Figure 84. …limiting losses and protecting firms' balance sheets.



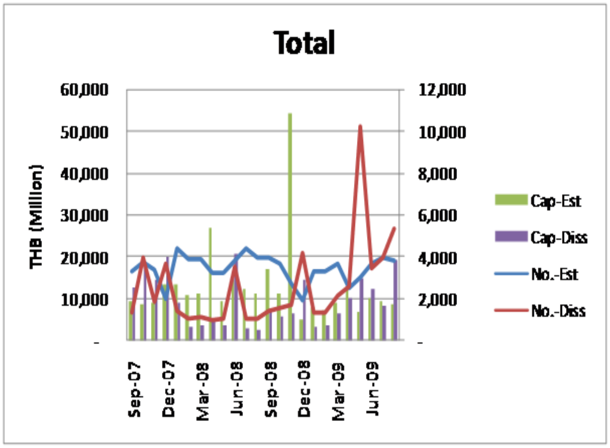
Source: Stock Exchange of Thailand

The number of firms declined by 2 percent in 2009 as the number of firms exiting exceeded the number of entrants (Figure 85 and Figure 86). Firm dissolutions spiked in May, whereas new number of new firms entering the market has increased slowly. Less than 500 firms were registered in Stock Exchange of Thailand (SET) and the Market for Alternative Investment (MAI) out of 2.8 million entities operating in Thailand, of which 5,000 firms are considered 'large enterprises' by the Ministry of Commerce. The market capitalization of listed firm had been on average 65 percent of GDP over the past five years, but it declined to 40 percent of GDP during the bottom of the crisis in 2008.

Figure 85. The number of firms registered with the Ministry of Commerce declined slightly since the onset of the crisis…

Source: Department of Business Development, Ministry of Commerce

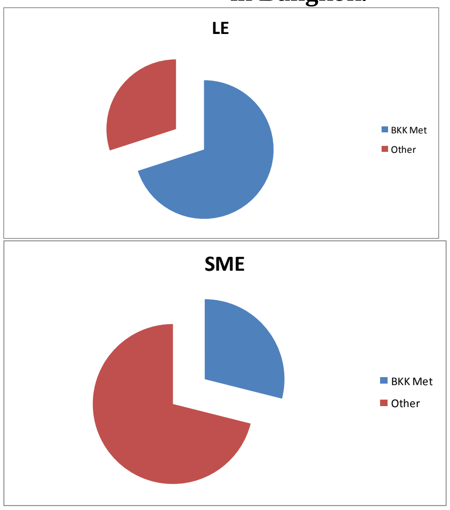
Figure 86. … as more firms exited than entered the field in 2009.



Source: Source: Department of Business Development, Ministry of Commerce

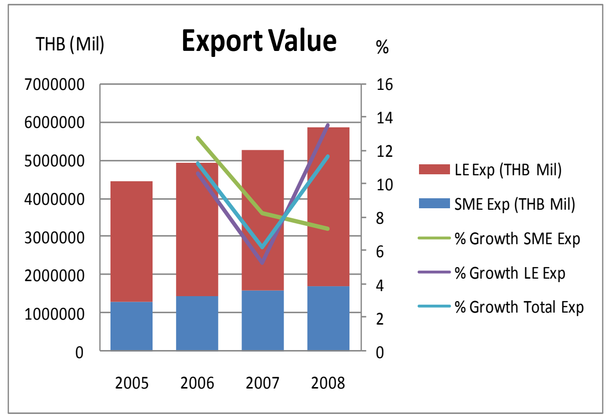
Although SMEs represent 99 percent of the national total number of firms, there are challenges for them to make a greater contribution to the economy. In 2008 the growth rate of large enterprises was approximately 8 percent, higher than overall GDP growth, which stood at 7 percent. However, SMEs are important in terms of job creation and job distribution across regions. Their contribution to employment stood at 76 percent of all jobs, with 71 percent of their business located outside of Bangkok Metropolitan region (Figure 87). A key challenge for SMEs is to access export markets. Currently SMEs only account for 30 percent of total international trade (Figure 88). Figure 88 also illustrates that SMEs suffered more than large companies during the crisis, large enterprises experiencing positive growth already in 2008.

Figure 87. SMEs are present throughout the country, whereas large enterprises are concentrated in Bangkok.



Source: Office of SME Promotion

Figure 88. Exports by SMEs correspond to less than 30 percent of total exports



Source: Office of SME Promotion

Box 3. The Map Ta Phut Court Case[19]

A long-running dispute between heavy industries and local residents of Rayong province has heated up this year, resulting in a halt of 65 industrial projects which the residents claim dangerously pollute the environment. The immediate impact on the gross domestic product and on the financial sector of Thailand is expected to be small. However, the case provides a major test of the government's ongoing effort attract foreign investments and improve domestic private investment. If not resolved, this case could have a long-lasting impact on industrial development and the overall economy. The underlying issue is how to strike a balance between rapid economic growth and the quality of life, which is receiving increasing attention. Virtually every advanced and middle income country has had to address this balance. The Map Ta Phut case is a testament to the fact that investments considered harmful to the people and the environment will not be sustainable – or profitable – in the long run.

History of local complaints and legal action

The Map Ta Phut Industrial Estate was set up in 1989 to be a production hub for heavy industries. While the original intention was to serve 26 factories, there are now close to 200 plants owned by 85 companies operating petrochemicals (the estate has become the world's eighth biggest hub for petrochemical industry), as well as fertilizer, cement, steel, oil refining, and other businesses.

From the outset, local residents blamed Map Ta Phut for growing local health problems. There is evidence to support this contention. For example, one recent report shows that heavy metals in the local environment are at levels that far exceeded safety standards.[20] Other studies show that the rate of cancer and leukemia among Rayong residents is much higher than the national average. Children also suffer from abnormal levels of respiratory disease and genetic defects.

In 2007, a group of local residents filed a petition with the Provincial Administrative Court of Rayong, arguing that the National Environment Board (NEB)[21] had neglected its duty by not declaring Map Ta Phut a pollution-control

[19] Prepared by Ratchada Anantavrasilpa and Pichaya Fitts.

[20] Chang Noi, The Nation, 21 September 2009

[21] The NEB is made up of 20+ cabinet members and senior government officials, led by the Prime Minister. Set up to be the inter-governmental coordinating body, the NEB is tasked with defining environmental standards, advising the government on environmental protection measures, reviewing and approving pollution control measures proposed by the Department of Pollution Control, and recommending secondary/additional regulations to facilitate the implementation of existing environmental laws, among other things.

zone. In March 2009, the court ruled in their favor. The NEB was then ordered to declare Map Ta Put as a pollution-control area within 60 days.

The reemerging controversy: retrospective law enforcement vs. community rights:
At the heart of this dispute is Section 67 of the 2007 Constitution, which provides for enhanced protection of the citizens' rights by requiring all industrial projects to undergo a health impact assessment, in addition to an environmental impact assessment. The Constitution further requires an independent body to oversee the HIA. However, this body has yet to be set up. To clarify the issue, the government requested a legal opinion from the Council of State[22], which later advised that, in absence of an independent body, the concerned authorities should be able to approve industrial projects that are in compliance with existing environmental laws. As a result, the authorities granted in August licenses to 55 new projects at Map Ta Phut (some of the licenses were for the expansion of current projects that had already compiled with existing environmental laws).

The people from Rayong, led by environmental activists, challenged this decision, as well as the Council of State's opinion, in court. They argued that existing laws are insufficient to protect public health and the environment, and that the Council of State's opinion overrides the people's rights to protect themselves; rights which are also guaranteed by the Constitution. This criticism has been supported by villagers, NGOs, legal experts, and several senators. In September, the Central Administrative Court ruled in the complainants' favor, issuing a blanket injunction on 76 upcoming projects in six industries: petrochemicals, oil refining, chemicals, power, plastics and steel.

The government argued that there should not be a blanket injunction on all industrial activities at Map Ta Phut. It cited 11 out of the 76 projects affected by the court ruling as having little or no impact on the people and the environment in their appeal filed with the Supreme Administrative Court On Dec. 2, the Supreme Administrative Court delivered a landmark ruling that allowed the 11 projects to go ahead. However, the court also argued that the spirit of the 2007 Constitution, which intended to protect the rights of the people, is more important than the mechanism by which such rights will be protected. Therefore, the requirement for HIA takes effect immediately, even if the government has yet to create the mechanism by which such assessments will be carried out.

In the meantime, the government estimated that the damage from delays of new investment to be at least 250 billion baht, and the loss of up to 48,000 jobs. The impact on the financial sector is expected to be marginal, given the strong balance sheets of companies affected by the court ruling, and the impact on Thailand's GDP also be marginal. However, industry figures and analysts expect the impact on investor confidence and on the investment climate to be long-lasting.

[22] Modeled after Europe's *Counseil d'Etat* , the Council of State was set up by King Rama V to be his legal adviser on a particular draft law. In addition to its law-drafting duty, the Council of State provides opinions on legal disputes involving the State, as well as reviews complaints from the people affected by activities of the State or of individuals holding public offices. In 1999, the latter responsibility was transferred to the Administrative Court.

SECTION 3

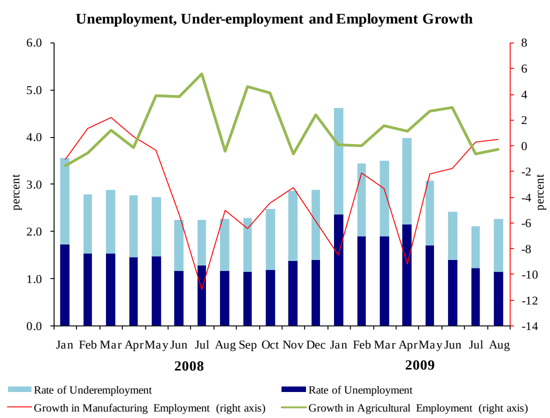
SHARED AND SUSTAINABLE GROWTH

3.1 Poverty and Inequality

Because the crisis has primarily affected the capital-intensive manufacturing sector, headline GDP numbers may overstate the social impact of the crisis, which has nonetheless been substantial. Manufacturing employment (which accounts for about 14 percent of the workforce) has fallen by only 3.2 percent and wages in the sector have actually increased from 2008. The crisis did nevertheless have a clear negative impact on overall welfare. It was accompanied by a decline in agricultural commodity prices, which have a substantial impact on the more than 40 percent of Thais who work on agriculture. Moreover, layoffs in manufacturing and tourist sectors implied increased labor supply in agriculture and the informal sector, which serve as a de facto safety net. These developments, along with uncertain job prospects among workers in the formal sector, have caused household consumption to decline by 2.4 percent in the first half of 2009. Consumption is projected to contract by 1.1 percent for the year as a whole, the first year of negative growth since the 1997/1998 Asian financial crisis.

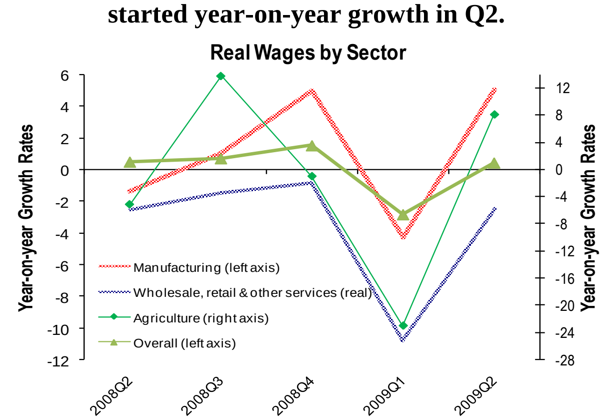
The concentration of the crisis in manufacturing helps explain the limited impact on employment and wages. Layoffs were concentrated on subcontracted, low-skill workers most of whom returned to farming or other informal sector activities – or have by now have been re-hired as part of the rebound in manufacturing output. Layoffs overall rose in the first quarter, and the unemployment and underemployment rates peaked at 4.6 percent in January vs. 3.6 percent in the best January since 2001 (when the rate was around 11.3 percent; this rate is also cyclically high in January – see Figure 89). The rate of unemployment and under-employment currently stands at 2.1 percent, about the same as where it was in 2008 and lower than July 2007. Considering only employment, the fraction of the overall population who was employed in July 2009 is slightly higher than the same figure for July 2007 and July 2008. Labor incomes may actually increase in 2009 (albeit at a much slower pace than in the past) and the wage bill was already up year-on-year in the second quarter by 3.4 percent in real terms.

Figure 89. The crisis had only a temporary, small impact on employment.



Source: Ministry of Commerce.

Figure 90. Wages fell in the first quarter, but already started year-on-year growth in Q2.

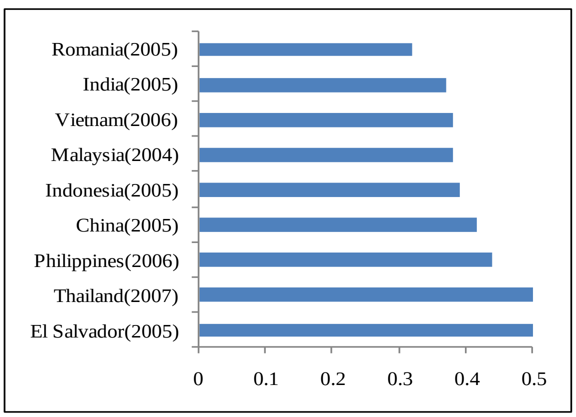


Source: Ministry of Commerce

The net effect of the economic volatility of 2008 and 2009 on Thailand's poor is difficult to measure, but poverty is likely to increase in 2009 compared to 2008. The past two years were characterized by a sequence of crises that, on balance, slowed the pace of poverty reduction. The sharp increase in food and fuel prices in mid-2008 helped a number of poor households in the rural sector; increases in labor supply to agriculture seen at that time were likely driven by higher farm incomes and reflected improved economic opportunities. However, vulnerable populations in cities and a large number of rice-deficit farming households suffered and may have been pushed into poverty. The global economic crisis brought about a sharp decline in the prices of agricultural commodities (on average, rice prices in 2009 have declined by 15 percent from 2008) as well as food. These declines have helped informal urban workers and rice-deficit households, but also led to a decline in farm incomes. The increases in labor supply in agriculture in 2009, although small, come from a high base and at a time when farm incomes were declining, reflecting not better economic opportunities but rather the role of agriculture as a safety net, absorbing workers displaced by the economic crisis. On balance, given the high correlation between poverty and private consumption, the pace of poverty reduction between 2007 and 2009 is expected to slow down. Given the expected 1.1 contraction in private consumption, an associated increase in the poverty rate between ½ to one percentage point from 2008 is expected, although the poverty rate would still be below the latest published figure from 2007 due to gains in 2008.

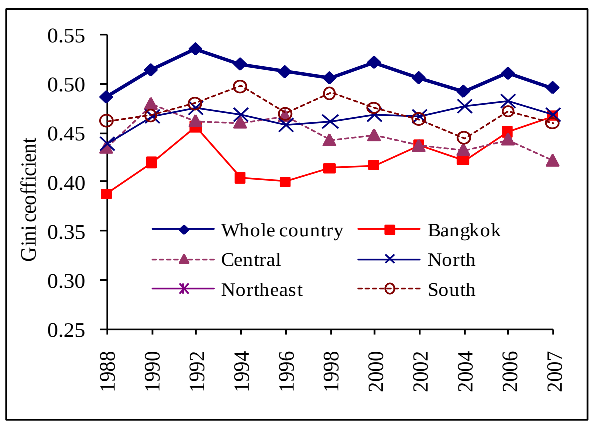
The government's first stimulus package, while unlikely to have had a large impact on the overall GDP, may have helped limit the impact of the crisis on the poor. Disbursements under the first stimulus package are estimated at 0.8 percent of GDP between March and September. While the stimulus package was not particularly well-targeted towards the poor, it did contain a number of measures that likely reached vulnerable households. The old-age pension may have been especially effective, since the elderly are over-represented among the poor and the measure specifically targeted those individuals not receiving formal pensions.

Figure 91. Thailand has higher level of income inequality than its East Asian neighbors and other middle-income countries



Source: World Bank and NESDB
Numbers in ( ) are years data is reported

Figure 92. Lower levels of inequality within regions suggest that inequality between regions contributes to high inequality at the national level



Source: NESDB

Inequality in Thailand is higher than in most countries in the East Asia region. Thailand's Gini coefficient[23] on income inequality for the 2007, the most recent year for which data is available, was

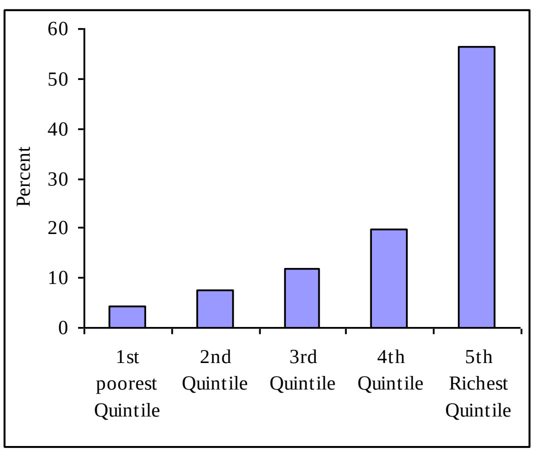
[23] Gini coefficient measures the distribution of income and is between 0 to 1. Zero indicates perfect equality among income groups, while 1 is perfect inequality.

around 0.5. This is relatively high compared to other countries in the East Asia region and those outside the region with per capita income levels similar to that of Thailand, most of which have Gini coefficients below 0.45 (see Figure 91).

Inequality in Thailand has been mostly the result of inequality between the regions. Nation-wide inequality has been higher than those within each region, with nation-wide Gini coefficient averaging at 0.5 from 1988 to 2007, while that in other regions average from 0.43 to 0.47 (see Figure 92). The higher nation-wide Gini coefficient reflects the fact that there is high inequality between the regions. As an illustration, inequality in 2007 within the Northeast is similar to that within Bangkok with Gini coefficients of both at 0.47. However, if one were to calculate the inequality between Bangkok and the Northeast, the Gini coefficient would be higher than 0.47 as inequality between Bangkok and the Northeast is high.

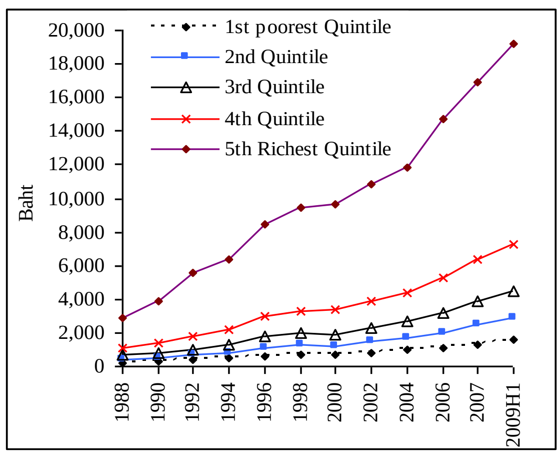
Although slightly lower than that of other regions, inequality in Bangkok has been rising. The average Gini coefficient for income inequality within Bangkok over the last two decades is 0.43, slightly lower than those within the North, the Northeast, and the South which are around 0.47. However, income inequality within Bangkok has been on an upward trend, while that within the other regions remain more or less stable. Gini coefficient for Bangkok increased from 0.39 in 1988 to 0.47 in 2007 (see Figure 92). One of the explanations is the high labor mobility in Thailand which has enabled individuals from other regions to migrate into Bangkok to work in relatively low paying jobs. Hence, Bangkok has been an area of high economic activity in Thailand, which is home to both high-paying jobs and low-paying ones.

Figure 93. The average income of an individual in the top 20 percent of the income distribution was nearly 13 times that of the bottom 20 percent (Average 1988-2007)



Source: NESDB

Figure 94. The growth rate of incomes in the different income brackets has been similar over the years, which has kept inequality largely unchanged.



Source: NESDB

The average income of a person in the richest quintile was around 12-15 times that of the lowest quintile. The richest 20 percent of the population (richest quintile) earns around 55 percent of the income while the poorest 20 percent (poorest quintile), which includes those below the poverty line[24], earns only 4 percent (see Figure 93). The latest socio-economic survey data shows that in the first half of 2009, the average monthly income of the richest quintile is Bt19,223 per person or 12.5 times that of the poorest

[24] Poor is defined as those whose consumption levels are below the poverty line. As of 2007, Thailand's poverty line was Bt 1,443.50 per month per person and there were 8.5 percent of the population or around 5.4 million people who are poor.

quintile which is Bt1,544 (see Figure 94). The persistent income inequality in Thailand is the result of the fact that annual income growth rates of the poorest and richest quintiles over the last two decades are, on average, not very different at around 5 percent. This has meant that levels of income inequality have remained stable at around 0.5 between 1988 and 2007 (Figure 92). Income growth rates of other quintiles were around 5.3-5.5 percent. Data on income by quintile shows that incomes per month of the richest quintile increased from 1988 to 2009 by around Bt16,000, while that of the poorest quintile increased by only Bt1,300 (see Figure 94). Inequality in consumption is lower, but has also been generally unchanged between 1988 and 2007 at just above 0.4.

Box 4. Migration and the Economic Crisis[25]

During economic crises, migrant workers are often among the most vulnerable in terms of job losses in destination countries (IOM, 2009). The primary destination for international migrants from Lao PDR is Thailand, and therefore Lao workers in Thailand could be especially vulnerable to a labor market downturn in Thailand. Increases in unemployment are expected as a result of the economic crisis. The National Economic and Social Development Board (NESDB) forecast a number of unemployed and under-employed workers in Thailand to be around 900,000-1,200,000 persons or around 2.5-3.5 percent of labor force. Thailand's Ministry of Labour reported during the period of January 1st to May 15th, 2009 there were around 762 enterprises that intended to lay off around 106,936 workers. The workers who are most likely to be laid-off are in electronics and electronic components, textiles and apparels, tanneries and foot wears, motor transport equipments, and furniture. While employment has picked up in some of those industries, some of the laid off workers did not return.

Migration in Thailand is driven primarily by wage differentials: Thailand's per capita GDP in 2006 was 6.1 times that of Laos, 8.9 times that of Cambodia, and 19.2 times that of Myanmar (in PPP terms). Second, there is strong demand for migrants as Thai economic policies have focused on improving the capital-intensive sectors such as auto and electronics, while maintaining a labor-intensive sector, especially in agriculture, hiring low-skilled and temporary workers. Thai employers need Laotian workers and other unskilled migrants who work for lower wages. This demand for unskilled migrant workers is increased by demographic change in which there is a long-term pattern to a decline of the proportion of young working-age in Thailand (15-39 years). Third, there are similarities of traditions, customs, and languages, especially among Thailand and Lao PDR that provide easy access to job information, especially for workers living along border areas.

Many of these push and pull factors seem to have remained strong or largely unchanged by the economic crisis. Thai migration policy has made a strong commitment not to lay off or repatriate migrant workers home, emphasizing the need for the private sector to employ migrant workers in order to reduce their cost of production in labor-intensive sectors. The bilateral MoUs established between Thailand and three migrant sending countries (Myanmar, Cambodia, and Lao PDR) allows migrants to apply for a temporary passport without returning home, further facilitate migration.

Furthermore, the rebound in economic activity since mid-year has further increase the pull factors. There is strong demand for unskilled labor, and the Ministry of Labor reported a shortage situation of unskilled workers in some occupations that Thai workers are not willing to work, categorized under the 3D jobs (Dirty, Dangerous, and Difficult). Approximately one third of registered Lao workers in Thailand are categorized as domestic workers (IOM, 2008), jobs which are unlikely to be desirable even to unemployed Thai workers. Through observation of primary sectors employing migrant workers, Chalamwong (2008) concludes that demand for employees in construction and domestic work will remain strong for years to come. The agricultural sector, which is an informal sector that absorbs a large number of migrants, seems to have been less affected by the crisis.

In addition, the upcoming registration process for migrants started in this July 2009, approved in principle on March 29th, 2009 by the Committee on Illegal Migrant Workers Administration, means that migrants will be able to legally

[25] Prepared by Piriya Pholphirul.

work in certain sectors. Overall, the policy environment is likely to encourage migrants crossing border or remaining to stay in Thailand.

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3.2 Sustainable Growth

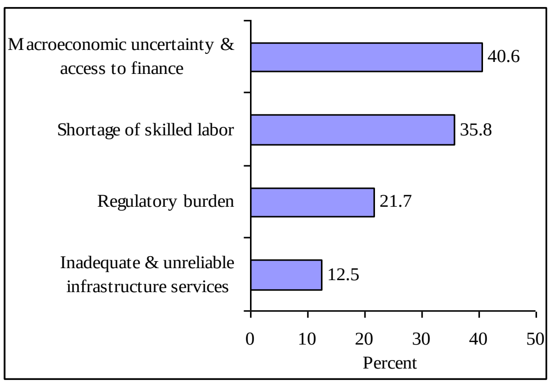
To thrive in the new global economic environment Thailand will need to seek new markets, pursue greater regional integration and move up the value chain. Thailand has successfully pursued a growth model for the last three decades that relied largely on final demand from advanced economies for exports of manufactured goods such as cars, electrical appliances and electronics. Given that demand growth of developed countries expected to be structurally lower in the post-crisis environment, Thailand will need to find new export markets and deepen regional integration. Coordinated efforts to boost domestic demand together with the regional agreements to reduce tariffs would promote greater trade within East Asian and could be a new source of growth for countries in the region. The production processes of most manufactured exports have remained primarily ones of assembly, with limited domestic value added. Although the level of technology of the exports has increased, Thailand has remained far from the technology frontier. Research and development remains limited, as have been technology transfers from the multinationals operating in the manufacturing-for-exports sector. Pursuing strategies to increase the value added of its products and moving closer to the technology frontier is therefore another requirement to restoring high levels of growth in the post-crisis environment.

A growth strategy focusing on shared and more equitable growth is also needed to boost domestic demand and address underlying issues that have caused heightened political uncertainly. Better and wider social safety nets would allow individuals to reduce savings, enter more productive and better-paying jobs that may have greater income volatility, and thus, raise consumption and investments. More equitable public spending across regions in the country, which contributes to higher access to public services and the development of lagging regions, could increase not only the equity among, but also the productivity and incomes of citizens in the regions. Importantly, Thailand's political uncertainties are linked to the high income inequality, especially between regions. Therefore, addressing lagging regions and pursuing more active policies to reduce income inequality may also reduce political tensions in the long run. These would also contribute to greater overall consumption levels in the country.

Reforms to enhance productivity of the various sectors in Thailand would be needed to raise domestic demand as well equity in the country. Higher domestic demand also requires reforms to increase productivity of economic activities in all sectors (industry, services, and agriculture), which generate higher disposable incomes. These reforms would include policies and measures that would reduce the constraints to growth and productivity in the manufacturing, services, and agricultural sectors. Top constraints to growth and productivity of major manufacturing industries in Thailand include the uncertain macroeconomic environment, mismatch of skills, regulatory burden, and inadequate infrastructure[26] (see Figure 95). Constraints to improving productivity of the agricultural sector, especially in the Northeast Thailand in which agriculture is its major economic activity, are insufficient irrigation facilities, fertilizers, and pesticides[27], the over-use of land for short-term gains, and lack of knowledge and instruments in coping with natural uncertainties such as drought and pest attacks which are increasing prevalent in the light of climate change. The services sector in Thailand has a high growth potential but has long been protected from foreign competition. Policies that would develop the services sector as well as allow greater competition could help unleash the productivity of the services sector.

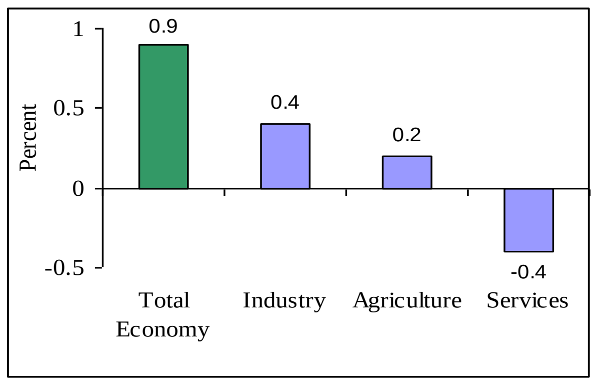
Unleashing the potential of the services sector would be a key to raising growth and domestic demand and reducing inequality. The services sector in Thailand accounts for 45 percent of GDP and employs around 14.5 million people or 40 percent of Thailand's labor force – almost twice that of the industrial sector. It includes sub-sectors such as banking, telecommunications, logistics, design, accounting, engineering, advertisement, health care, hotel, restaurant, and wholesale and retail businesses. These are mainly non-tradable sectors and sectors that support the manufacturing sector. Hence, with greater productivity in the services sector, the services sector would not only raise overall GDP growth, but would also raises incomes for those working in this labor-intensive sector.

Figure 95. Top Constraints to Business and Investments
(Percent of firms surveyed)



Source: Investment Climate Assessment Update (2008) Note: Survey of 1,043 firms in 9 manufacturing industries

Figure 96. Thailand's Total Factor Productivity (TFP) Growth (1985-2005)



Source: Measuring Output and Productivity in Thailand's Services-producing Industries (2008), NESDB & WB

Productivity in the services sector has been low, suggesting that reforms in this sector could have particularly high returns. Total factor productivity (TPF) calculations show that Thailand's service sector TFP has actually declined over 1985-2005 (see Figure 96). One of the reasons for low productivity of the services sector is the protection from foreign competition that it has been receiving through the various laws in Thailand such as the Foreign Business Act and the other sector-specific acts. Gradual liberalization of a few services sub-sectors, including greater openness to international trade, could help increase their productivity and, thus, provide better support services to the manufacturing sector and the public at a lower cost. At the same time, policies that would promote the development of the services

[26] See *Thailand Investment Climate Assessment Update* (2008), based on a survey of 1,043 firms in 9 major manufacturing sectors, a joint study by the Office of the National Economic and Social Development Board and the World Bank.
[27] See *Thailand Northeast Development Report* (2005), a joint study by the Office of the National Economic and Social Development Board and the World Bank.

sector such as access to finance must also be in place. Most services firms in Thailand are small and medium-sized, and due to the nature of business, do not generally have a large amount of fixed assets such as buildings and machinery. Without the Secured Transactions Act, which allows firms to use account receivables are collateral, services firms will continue to have difficulty accessing finance, which limits the investment and growth of their businesses.

Improving skills and promoting innovation is a critical factor for Thailand to move up the value chain. The quality of human resource is at the heart of the growth and productivity of all sectors. Higher level skills and knowledge are needed for all sectors to move up the value-chain. Thailand's ability to remain competitive in the global economy is closely linked to its ability to accelerate skill formation, as other countries are moving fast in this regard. The latest World Bank Institute's Knowledge Economy Index (KEI) shows that Thailand's ranking in being a knowledge economy has fallen by 9 ranks over the last 14 years, while other countries in the region such as China and Vietnam has continuously moved up in their rankings (see Table 11). The survey of firms in the latest *Thailand Investment Climate Assessment Update* also shows that firms' reluctance to engage in innovative activities comes as much from their high cost as from the lack of qualified individuals to do so (see Figure 97). This is one of the important factors that have contributed to the low in R&D among Thai firms surveyed when compared to other countries (see Figure 98). Finally, improving skills would also contribute to higher incomes, and therefore a higher growth rate in domestic consumption.

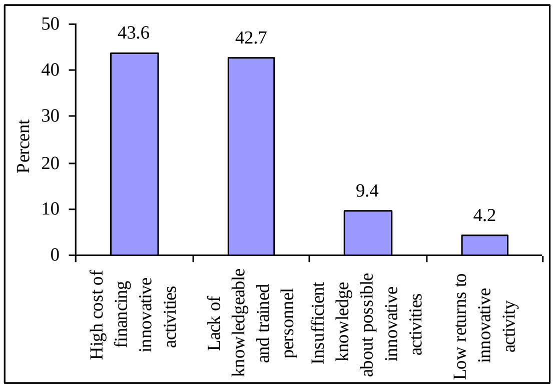
Table 11. Knowledge Economy Index (KEI)

Rank	Change from 1995	Country
1	0	Denmark
2	2	Sweden
18	7	Taiwan (China)
19	2	Singapore
23	0	Hong Kong (China)
29	-3	South Korea
48	0	Malaysia
63	**-9**	**Thailand**
81	19	China
100	14	Vietnam

Source: World Bank Institute

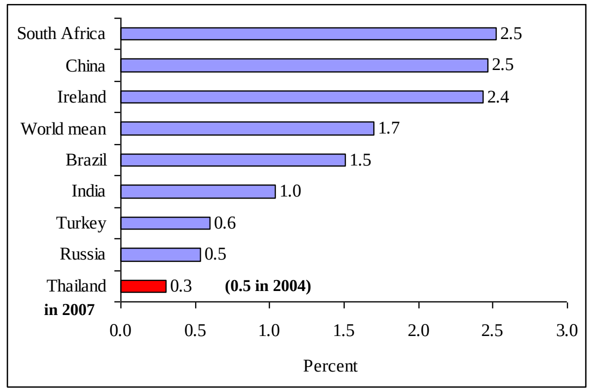
Note: KEI is a simple average of 4 sub- indexes which represents the 4 pillars of the knowledge economy: (1) incentive and institutional regime, economic, (2) education and training, (3) innovation and technological adoption, and (4) information and communications technologies (ICT) infrastructure.

Figure 97. Reasons for not Engaging More in Innovative Activities
(Percent of Firms Surveyed)



Source: Investment Climate Assessment Update (2008)

Figure 98. Share of R&D in Operating Costs
(Percent of Firms Surveyed)



Source: Investment Climate Assessments, various countries

The Government has embarked on several initiatives to alleviate some of the constraints to productivity growth discussed above. They include the planned spending over the next 3 years under the second stimulus package or Thai Kem Kaeng (TKK) Program which has so far emphasized on irrigation and agriculture, transportation, and education sectors (see Section 2.4.1 for more on TKK). Moreover, the Government has initiated the promotion of the development of a Creative Economy[28] in Thailand and has allocated around Bt12 billion (US$360 million) or around 3.4 percent of the Bt350-billon TKK budget allocated so far. There are 16 subsectors that have been classified in the creative economic sector[29], many of which are in the services sector such as design, architecture, advertisement, Thai restaurant, Thai traditional medical care, and entertainment. The focus of the development of the creative economy in this early stage is on building the creative economy infrastructure, human development, and an enabling regulatory environment.

The focus of government efforts in TKK has been on the "hardware" (physical investments), but there is a need to invest in the "software" (policy changes) as well. To effectively relax the constraints, Government policies and measures should focus on the implementation of both the hardware and the software and ensure more equitable distribution of opportunities and incomes across regions and groups of people. Projects under the TKK program are spread across the country and are also in subsectors that not have not been of focus in the past, hence benefiting regions and groups of people that may not have benefitted much from past programs. However, investment in the hardware of physical infrastructure needs to be coupled with reforms and good management of the programs (the software). Building large number of schools and health centers in the rural areas could increase access to these public services; however, equally important are the reforms in the education and health sectors to improve the quality of the public services these sectors and to make sure that their costs will be sustainable into the future. However, there is still a strong need for government spending allocations to increase equity among regions and groups of people. One of the means to do so is through better targeting, particularly for subsidies and transfers, to low income groups or lagging regions. Targeting could be enhanced if better databases of the population are developed and used across government agencies. Digital databases of land ownership with information of the land owners and users, for example, would be useful for targeting transfers to small or landless farmers or if land taxes were to be implemented in the future.

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[28] The Creative Economy development essentially refers to developing the knowledge and creativity which is based upon the country's culture and local wisdom with the application of innovation and modern technology.
[29] These were identified using the UNCTAD and UNESCO's classification system.

Broader and more effective formal social safety nets would provide greater access to social services and also support higher consumption. Formal social safety nets such as the universal health care (UHC), 15-year free schooling, and pensions can help bring about higher access to public services, especially by those who are in the low-income group, including the poor. More effective social safety nets reduce the need for precautionary savings, and therefore increase the potential growth of domestic consumption. Hence, they will be able to raise their consumption levels. Moreover, with formal social safety nets, individuals will be able to use their full potential and pursue jobs that are more productive but may be have greater income volatilities such as those in the manufacturing sector which is subject to more pronounced business cycles, as compared to the relatively more stable but lower-productivity jobs in the agricultural sector.[30] The Government has been building and expanding social safety nets such as reducing the payment for access to the UHC to zero and expanding free schooling from 9 years to 15 years. It is also establishing pensions for those who are not in the social security or government pensions systems. Under this new scheme, the Government will co-contribute a set amount to the monthly contribution by individuals. However, the sustainability and quality for these programs will need to be examined and addressed.

[30] While agricultural prices and output are highly volatile, farmer support schemes are more developed than other forms of formal safety nets.

SECTION 4

IMPLEMENTATION
OF STRUCTURAL REFORMS

4.1 Financial and Corporate Sector Reforms and Restructuring

The five-year Financial Sector Master Plan (FSMP) Phase II was approved in 2009 and is set to be implemented in 2010-2014. Following the FSMP Phase I during 2004-2008, the second phase aims to enhance the efficiency of the financial institutions system and enable the financial institutions to perform their role more efficiently, with good risk management and corporate governance. Accordingly, the financial institutions become more competitive, are able to compete with foreign competitors, maintain resiliency in the fast-changing economy and provide financial access to a broader group including not only low-income people but also SME. Greater efficiency in the financial market will reduce the financing cost of both individual and enterprises and, ultimately, increase Thailand competitiveness. Key measures of the FSMP Phase II can be summarized into 3 pillars; 1) reduce system-wide operating cost including regulatory cost and operating cost from remaining NPL and NPA, 2) promote competition and financial access through various measures such as enhancing the role of existing service providers and introducing new service providers into the system and 3) strengthen financial infrastructure including financial laws, risk management system, information technology and human resources.

Reforms aimed at developing domestic capital markets have continued, with a view of increasing firms' access to finance. The Capital Market Development Master Plan (CMDP) approved by the cabinet recently aims to raise the efficiency and potential of the Thai capital market. The success in implementing the master plan, apart from directly benefiting the capital market, will have far-ranging benefits to economy as a whole. The ultimate goal is to increase overall competitiveness of Thailand especially in the regional market. The plan aims to boost the market capitalization to 130% of gross domestic products (GDP) within 5 years, from the current level at around 65%. The CMDP consists of 8 major reforms; 1) abolish the monopoly and improve competitiveness of the Stock Exchange of Thailand (SET) or the SET Demutualization, 2) liberalization of securities business to promote market efficiency, 3) reforming legal framework, 4) streamline tax system, 5) develop financial products, 6) establishment of a national savings fund, 7) developing a culture of savings and investments and 8) development of domestic bond market.

4.2 Trade Reforms

Recent Trade Reforms

Tariff reform

Various products now enjoy lower or no import tariff. These include both universal tariff reductions, which are applicable to goods from all countries, and specific tariff reductions that result from free trade agreements (FTAs) with other countries and regions. An example of the former includes lower duty for vehicles that can run on gasoline both with and without ethanol components and are imported within this year. Tariffs on raw cow and water buffalo skins and certain raw and processed wood products are also waived. For ASEAN-Korea FTA, duties on a variety of food and beverage products, chemical substances, building materials, electrical equipment, computers, vehicles, and oil products are reduced or cancelled since October 2009. Tariffs on vehicle parts and components from Japan are also exempted benefitting from the Japan-Thailand pact.

Free trade agreements that involve Thailand demonstrated some progress in the past months. Table 12 reviews the recent progress on FTAs in more details. On bilateral agreement, Thailand still awaits India to confirm the extent of tariff reduction that was previously agreed. For BIMSTEC[31], the member countries agreed in June 2009 to cut or waive import tariffs of over 5,000 products. India, Sri Lanka and Thailand will cut tariffs for 10 percent of their agreed items by January next year. For ASEAN-China agreement, the investment agreement was signed in August 2009, while goods and services trade negotiations still continued. For the ASEAN-Australia-New Zealand pact**,** tariff rates under the normal track for the six ASEAN foundation members will be cancelled in 2013 for most products. ASEAN also signed goods and services trade agreements with Korea in February 2009 and on investment in June. Korea and Thailand will cancel around 90 and 80 of all tariff lines that are being traded, respectively. The pact between ASEAN and India is also agreed. Tentatively, over 70 percent of goods that are being traded will enjoy no tariffs by end-2012. For ASEAN and Japan, the latter abolishes 90 percent of tariff lines that are being traded since June 2009. This same figure is 93 percent for Thailand within 10 years. The cabinet agreed the agreements on services trade and investment in June 2009.

Table 12: Major progress on Thailand's Free Trade Agreements (FTAs)

Agreements	Details of recent progress
Thailand - India	In September 2004, Thailand and India agreed to reduce and lift import tariffs of 82 products under the Early Harvest Scheme. Since September 2006, tariffs of these products, such as certain tropical fruits, canned seafood, jewellery, vehicles parts, and electrical appliances, became zero percent. The two countries now reached a preliminary agreement. The negative list (no tariff reduction) has around 500 products or 10 percent of all goods that the two countries are willing to reduce or cancel import duties. Examples include textiles products, automotive parts, and steel products for Thailand, and textiles products, vehicles, and certain agricultural products for India. As of September 2009, Thailand awaits India to confirm the extent of tariff reduction that was previously agreed. The next steps are to review the agreement and start negotiation on services trade and investments.

[31] Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation consists of Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

Agreements	Details of recent progress
BIMSTEC	The 18th meeting of the TNC in June 2009 resulted in a significant progress. In addition to certain terms on rules of origin, the member countries agreed to cut or waive import tariffs of over 5,000 products. The three faster-growing nations (India, Sri Lanka, and Thailand) will cut tariffs for 10 percent of their agreed items by 1 January 2010. By January 2011, all members will offer at least half of listed items duty-free. The negative list is about 19 percent of all products being traded. For the next step, the pact will proceed with negotiations on investment and services.
ASEAN - China	Since October 2003, Thailand and China have reduced their import tariffs for certain vegetables, fruits and nuts products following the Early Harvest Scheme. Tariffs of agricultural products under HS1-HS8 were also lifted in 2006 in six ASEAN foundation members. On goods trade, the latest meeting in June 2009 mainly discussed operational certification procedure, non-tariff barriers and sanitary and phytosanitary standards. The second package of services trade negotiation continued. Both parties are now exchanging revised offers. The agreement on investment was already signed in August 2009.
ASEAN-Australia-New Zealand	Tariff rates under the normal track for the six ASEAN foundation members will be cancelled in 2013 for most products, and 2015 for the rest. All parties also agreed on trade in services and investments. Most issues on rules of origin also reached an agreement (except, for example, soybean oil between Thailand and Vietnam). The agreement is already drafted. Finance Ministers of all member countries signed the agreement in February 2009.
ASEAN - Korea	In May 2006, Korea and ASEAN member countries initiated free trade agreement on goods. The agreements on goods trade and services trade were signed by all parties in February 2009, and June for the agreement on investment. Services trade agreement has been since 1 June 2009. Korea and Thailand will cancel around 90 and 80 of all tariff lines that are being traded, respectively. The remaining will be subsequently abolished in 2012 and 2017, depending on product types. On trade in services, Korea liberalizes 43 areas such as legal services, construction, and entertainment. On economic cooperation, there are 19 areas in total, e.g. customs procedure, SMEs, and tourism.
ASEAN - India	The pact between ASEAN and India is preliminarily now agreed. On lowering trade barriers, about 70 percent of goods that are being traded will enjoy no tariffs by end-2012. Tariff rates on items in the sensitive list will be reduced to five percent or lower by end-2015. India and Thailand placed 5 and 14 items in the highly sensitive list, respectively. Import duties on these products will be 25-50 percent lower by end-2021. The agreement also sets the maximum number of goods in the exclusion list to 489 items. Merchandise trade agreement was signed in August 2009, with effective date of 1 January 2010. Negotiations on services trade and investment have a more limited progress.
ASEAN - Japan	The ASEAN-Japan FTA was signed in March 2008. Japan abolishes 90 percent of tariff lines that are being traded since the agreement became effective in June 2009 with Thailand. Thailand will eliminate import tariffs that are worth 93 percent of imports from Japan within 10 years. In June 2009, the cabinet agreed in principle the agreements on services trade and investment, which now seeks for parliament approval. In addition to merchandise and services trade, the pact will also result in closer economic cooperation between ASEAN and Japan in areas such as business environment, intellectual property, energy, ICT, human resources development, SMEs, tourism, transportation, agriculture, and competition policy.

Agreements	Details of recent progress
ASEAN - EU	The initiative for the partnership began in May 2007. The October 2008 meeting mostly discussed about the overall framework of the agreement, including modality (e.g. whether ASEAN could open up the markets later than the EU) and approach (e.g. whether investment liberalization, protection, and promotion should be negotiated together or separately). Both parties also exchanged ideas on rules of origin, trade facilitation, sanitary and phytosanitary standards (SPS), intellectual property, and trade competition. The latest meeting in March 2009 saw limited progress.

Source: Department of Trade Negotiations
Note: Bilateral agreements between Thailand and Bahrain, Peru, US and EU had no/limited progress recently.

The utilisation rate of potential benefits offered by these FTAs is varying. According to Ministry of Commerce, Thai exporters gain significantly from the agreement with Australia (mainly from demand for pickup trucks and parts) and India (as India's tariff rates were relatively high). The utilization is more limited for FTAs with Japan and China because their duties were already low. On import side, Australia's raw materials and China's electronic goods, Thailand's key import products from these countries, were already subject to low tariffs, hence low utilization. In contrast, solid local demand for New Zealand's dairy products and India's vehicle parts mean that Thailand placed more orders for these under FTAs.

Export promotion and assistance

The Customs Department set up Customs Clinic to facilitate importers and exporters. Introduced in August 2009, the clinic preliminarily takes care of requests and complaints of exporting and importing companies on customs procedure, and coordinates and provides information to the public regarding customs issues.

The Export-Import Bank of Thailand introduced new financial services to support Thai exporters. The EXIM Bank now provides credits to suppliers of exporters such as local parts and components producers and to foreign (Indonesian and Russian) buyers of Thai exporting products. This should help to ensure a smooth supply of materials for exporters and boost foreign demand for Thai products, respectively. These new services are additional to standard export insurance services. EXIM Bank now works with 10 commercial and specialized financial institutions in offering the insurances, which guarantee to pay Thai exporters in case of a default by foreign buyers, bankruptcy or refuse to accept delivery. Together with Nippon Export and Investment Insurance (NEXI), the EXIM Bank also introduced reinsurance agreement. The EXIM Bank provides insurance services to Japanese-owned or Thai-Japan joint ventures exporters located in Thailand, where NEXI will act as a reinsurer.

EXIM Bank also supports Thai design and construction industry. In early November 2009, EXIM Bank, Krung-Thai Bank and SME Bank signed a memorandum of understanding with five associations in the consultancy, design and construction industry to finance Thai companies in expanding their operations overseas. This including bidding for construction projects in target countries such as Bahrain, India, Vietnam and Brunei.

4.3 Public Sector Reforms

The Prime Minister Office's Regulation on the Administration of Stimulus Package 2 (Thai Kem Kaeng) (2012) was approved by the cabinet in June 30, 2009. The draft provides guidelines and steps to be taken in project implementation to help improve the efficiency and effectiveness of the implementation process. The key importance of the draft is to indicate how the project is implementing according to different sources of financing and to also authorize the Public Debt Management Office to provide loan necessary to finance projects.

The Prime Minister Office's Regulation on the Regional Public Operation delegates authority of budget approval to the Deputy Prime Minister. In case of urgent problems, the Deputy Prime Minister has authority to approve the annual budget allocation, central fund and reserved cash for emergency to line agencies with the amount no more than 900 million baht per year. Regional Public Operation Monitoring and Supervision Committee shall appoint the working committee attach to each Deputy Prime Minister to help scrutinize the necessity and appropriateness of the budget expenditure.

The Ministry of Finance has announced the regulation on re-division of authorities and responsibilities in Comptroller's General Department. Human Resource Development Division has been upgraded to the Personnel Development Institution in Public Finance and Accounting with increased authorities and responsibilities to provide recommendations on policy and strategies related to government officials' capacity enhancement in public finance and accounting as well as to extend the scope to which the training has been provided to other concerned agencies.

The Cabinet approved Local Civil Service Act in principle, as proposed by the Ministry of Interior. The Act provides these following mandates; (i) the set up of Local Civil Service Commission comprising of 7 representatives by position from related agencies and 8 representatives from each of local administration organization, local civil servant, external experts with Minister of Interior as a chair person and Secretary General of Local Civil Service Commission as Secretary to the committee, (ii) the establishment of the Office of Local Civil Service Commission (OLCSC) with departmental equivalent level under the Ministry of Interior, (iii) the set up of the Committee of Merit Systems of Protection Board to Local Administration comprises of 7 members with appointment from the His Majesty the King with Secretary General of Local Civil Service Commission as Secretary to the committee, (iv) Budget expenditure in personnel expense and compensation should not exceed 40% of the actual revenue from the previous fiscal year, excluding borrowing, subsidy and other source of fund (section 44) and (v) Head of the local administration, by law is the supervisor of teacher and other academicians of that local administration with the authorities to supervise and make policy decision on education that will be applied to all schools under the authorities of this local unit (section 97).

The Prime Minister Office's Regulation on Public Audit and Evaluation was approved in principle by the Cabinet on October 13, 2009. The draft has revised the components of Public Audit and Evaluation Committee (PAEC) and qualification of the member's committee. The draft proposed the replacement of the Director of Government Fiscal Management Information System by the Permanent Secretary of Finance Ministry as a member of committee with adding the Permanent Secretary of Interior Ministry to be a member of committee. The term of committee expands from 2 years to be 4 years.

The promulgation of Constitution 2007 together with the amended Public Administration Act to authorize provinces and provincial clusters to submit budget requests directly to the Bureau of Budget have made the inconsistencies to the current effective Budget Procedure Act (1959). The new Act indicates the establishment of the budget expenditure policy committee with authorization to decide the policy making related to budget expenditure, to draft the budget allocation strategy, to set framework to annual budget expenditure and expenditure in central fund, to set the ratio of capital expenditure to overall budget, budget burden from public debt and off-budget activities and also to set up of reporting system which requires all agencies who received budget appropriation shall submit the progress report to the BOB for the performance monitoring and evaluation purpose and BOB shall submit the report on budget allocation to the Parliament every 6 months.

By the Civil Service Act (2008) section 78 stating performance evaluation role of management, the OCSC announced the guideline on criteria and method of individual civil servant's performance evaluation. Individual performance evaluation system has been introduced as a tool for management to oversee the civil services' performance and to provide indicators necessary to give pay raise and award annual bonus for civil servants fairly. The system requires all government agencies and provinces to announce the principles and procedure of performance evaluation at the beginning of evaluation periods, March and October. The individual performance evaluation is conducted under the performance agreement where individual staff signed with his direct supervisor in a transparent and accountable way. The agreement contains details on job responsibilities and its related KPIs. All agencies are flexible to choose performance evaluation procedure that appropriates to different types of jobs in order to make the evaluation system effectiveness.

Appendix 1: Key Indicators Table

	2007	2008	2008		2009		2009	
	Year	Year	Q4	Q1	Q2	Q3	Aug	Sep
Output, Employment and Prices								
GDP (% change, previous year)	4.9	2.5	-4.2	-7.1	-4.9	-2.8	..	..
Industrial production index (2000=100)	180.7	190.2	176.4	162.5	171.9	184.9	178.0	196.2
(% change, previous year)	8.2	5.3	-8.1	-18.5	-9.2	-5.6	-10.1	0.4
Unemployment rate (%)	1.4	1.4	1.3	2.1	1.7	..	1.2	..
Real wage growth (%) 1/	0.7	4.8	3.6	-6.6	1.1	..	..	..
Consumer price index (% change, previous year)	2.2	5.5	2.1	-0.2	-2.8	-2.2	-1.0	-1.0
Public Sector								
Government balance (% GDP) 2/	-1.7	-1.1	-1.1	-2.6	-3.3	-4.4	..	..
Public sector debt (% GDP, end-period) 3/	37.5	38.2	38.2	41.3	43.0	45.2	45.5	45.3
Foreign Trade, BOP and External Debt								
Trade balance (US$ million)	11.6	0.2	-1.4	7.8	3.9	5.1	2.3	2.0
Exports of goods (fob, US$ million)	150.0	175.3	38.3	33.4	34.0	40.7	13.2	14.7
(% change, previous year)	17.3	16.8	-9.4	-19.9	-26.1	-17.5	-17.9	-8.3
Key exports: Machinery & mach. appliances (% chg in US$)	16.4	7.6	-20.1	-31.3	-24.9	-13.6	-13.5	-6.8
Imports of goods (cif, US$ million)	138.5	175.1	39.6	25.6	30.1	35.6	10.9	12.7
(% change, previous year)	9.1	26.4	5.3	-38.3	-32.3	-28.1	-19.9	-5.0
Current account balance (US$ million)	14.5	1.8	-1.5	9.6	2.8	3.7	1.9	1.3
(% GDP)	5.8	0.6	-2.3	15.3	4.5	5.8	..	..
Foreign direct investment, net (US$ million) 4/	10.3	7.6	1.5	1.3	1.1	..	0.6	..
Total external debt (US$ million) 5/	61.7	67.7	64.8	61.5	62.9	..	..	..
(% GDP)	24.8	24.9	23.8	22.6	23.1	..	..	..
Short-term external debt (US$ million) 5/	21.6	24.1	24.1	22.1	21.8	..	..	..
Debt service ratio (% exports of goods and services) 6/	11.9	7.1	8.0	7.3	6.4	..	..	..
Reserves, including gold (US$ million)	87.5	111.0	111.0	116.2	120.8	131.8	127.3	131.8
(months of imports of goods)	7.9	7.9	7.1	11.1	10.0	..	..	..

	2007	2008	2008		2009		2009	
	Year	**Year**	**Q4**	**Q1**	**Q2**	**Q3**	**Aug**	**Sep**
Financial Markets								
Domestic credit (% change, previous year) 6/	4.9	9.3	9.3	6.4	2.9	0.4	1.0	0.4
Short-term interest rate (average period) 7/	3.69	3.40	3.42	1.67	1.25	1.25	1.25	1.25
Exchange rate (average period)	34.2	33.4	33.9	34.8	35.3	34.7	34.0	33.8
Real effective exchange rate (2000=100, + = appn) 8/	114.7	114.5	111.4	111.0	112.3	111.6	111.7	110.6
(% change, previous year)	5.9	-0.2	-1.6	-4.2	-4.7	-1.1	-0.3	-1.5
Stock market index (SET), end of period	858	450	450	432	597	717	653	717
Memo Items:	249.0	272.0	65.4	62.9	62.4	64.3	..	..
Nominal GDP (Billion Baht)	8,529.8	9,075.5	2,216.2	2,191.2	2,203.9	2,233.5	..	..
Nominal GDP (Billion USD)	2,876.3	3,055.0	..	..	..	..	..	..
Real per capita GNI (constant 2000 US dollars)	4.9	9.3	9.3	6.4	2.9	0.4	1.0	0.4

1/ Average wage of employed person from Labour force survey, National Statistical Office deflated by CPI inflation
2/ Cash balance of central government.
3/ Include domestic central government (CG) debt, domestic debt of non-financial state enterprise and Financial institutions Development fund (FIDF) debt.
4/ Non-Bank FDI
5/ Source: Bank of Thailand
6/ IFS definition (net credit to the nonfinancial public sector, credit to the private sector, and other accounts).
7/ BoT Policy Rate (end of day liquidity adjustment window, average of borrowing and lending facilities).
8/ Source: Bank for International Settlements

Appendix 2: Monitoring Matrices for Structural Reform Implementation

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

1. Poverty Reduction

	Objective	Reform Measures Taken
A.	Improve quality of life for the poor by enhancing self-reliance and creating opportunities in the local economy	***Measures taken over last 6 months and significance*** • **The government introduced crop price insurance schemes for rice, cassava, and feeding corn.** This will eventually replace the current crop price hedging schemes. Under the pledging scheme, farmers obtain cash from the government in exchange with rice that they intend to use as collateral. This cash amount depends on pledging prices. At the end of the agreement, farmers have right either to redeem or let the government keep the rice. This has led to huge government financial burden since pledging prices are much higher than the market prices. Under the price insurance scheme, the government does not physically manage the stockpile but compensates farmers the differences between market prices and guaranteed prices, where farmers pay a small fee to participate into the program. The guaranteed prices take account average production cost, transport cost, and 25-percent profit margin. As of end-October 2009, the numbers of corn and cassava farmers who participated into the insurance schemes have exceeded the government's target (around 392 and 437 thousand farmers respectively). For rice farmers, this stood at nearly 85 percent. • **Draft Act on a farmers support fund.** The new act will replace the previous act announced in 1974**.** Managed by Ministry of Agriculture and Cooperatives, the fund committee will comprise of representatives from the public and private sectors, and is responsible for promoting the efficient production of agricultural primary and finished products and executing agricultural price stabilization programs. It also has a power to impose export/import fees on selected agricultural products. • **Implementation of several measures under the first stimulus package tends to benefit the poor.** This includes direct support programs to individuals, which generally have high fund disbursement rates, such as 15-year free education, 2000-baht cheques distributed to low-income groups and government officials, transfers of 500 baht/month to elderly groups, free basic public utilities such as water supply and electricity to low-volume users, and free economy-class public transport (buses and trains). A scheme to retrain unemployed and retrenched workers has so far achieved around 80 percent of the targets (over 190,000 participants). Other programs are related to construction projects such as developing new, small water sources for rural consumption and agricultural sector, which are typically more time-consuming and hence have lower disbursement rates. • **The cabinet approved an agriculture electrification project.** The Provincial Electricity Authority will expand the coverage of electricity services to nearly 300,000 rai of agricultural land. This tends to reduce agricultural production cost and benefits around 30,000 farmer households in remote areas in the North, Northeast, Central and South. The budget is 1.7 billion baht. • **Measures to stabilize paddy rice prices in 2009/10.** (i) Providing subsidized credits to rice traders to boost their financial liquidity, thus more demand and competition in paddy rice biddings. The extent of assistance amounts to two percentage points of lending rate for a period of six months (November 2009-April 2010). (ii) Organized 519 ad hoc retail markets for paddy rice in 57 provinces. (iii) Buying paddy rice from farmers through rice mills and farmer institutes at the reference prices between November 2009 and February 2010. The government then releases this stock through domestic sales, exports, and the futures agricultural market.

Prepared by Vatcharin Sirimaneetham.

2. Financial and Corporate Sectors Reforms

Objective		Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	***Measure to be taken in the next 6-12 months*** • **A national credit-scoring system is on process as planned.** The National Credit Bureau (NCB) plans to launch the Consumer Credit Scoring and Bureau Statistic Report in March 2010. In addition, the NCB plans to test-run the Commercial Credit Scoring for 10 months before the official launch in 2011. ***Measure to be taken, but delayed*** • **The Government's plan on submission of credit information by insurance firms will be reconsidered again when the time is appropriate.** The decision on whether insurance companies are required to report their information of customers to the National Credit Bureau (NCB) have not yet been finalized.
B.	Formulate and implement a medium-term strategy for Thai financial sector	***Measure taken over last 6 months and significance*** • **Overseas investment is possible for Thai national.** Bank of Thailand (BOT) relaxed its foreign investment regulations for both individual and institutional investors giving more investment options. ***Measure to be taken in the next 6-12 months*** • **The Financial Sector Master Plan (FSMP) Phase II is on track**. On November 4, 2009 the Economic Cabinet approved the second phase of the FSMP. The plan aims in setting the goals and strategic direction for continuous development of financial sector. The master plan is to be implemented during 2010 – 2014. ***Measure taken over last 6 months and significance*** • **Overseas investment is possible for Thai national.** Bank of Thailand (BOT) relaxed its foreign investment regulations for both individual and institutional investors giving more investment options. ***Measure to be taken in the next 6-12 months*** • **The Financial Sector Master Plan (FSMP) Phase II is on track**. On November 4, 2009 the Economic Cabinet approved the second phase of the FSMP. The plan aims in setting the goals and strategic direction for continuous development of financial sector. The master plan is to be implemented during 2010 – 2014.
C.	Transition from the current blanket government guarantee on deposits to a limited deposit insurance scheme	***Measure to be taken, but delayed*** • **Blanket guarantee on customer deposit is extended until 2011.**The deposit protection will be limited to THB 50 million and THB 1 million per person per financial institution on 11 August 2011 and 2012 respectively.
D.	Remove legal impediments and provide an enabling environment for derivative products.	***Measure taken over last 6 months and significance*** • **Extra tax privileges given to BOI-promoted firms for listing on the stock market.** The Stock Exchange of Thailand (SET) signed a Memorandum of Understanding with the Board of Investment (BOI) to promote BOI-promoted companies listing on the SET or the Market for Alternative Investment (MAI). The plan will facilitate every business of BOI-promoted firms seeking to list on SET or MAI to have the cap on income tax exemptions lifted, from previously having the cap on income tax exemption equaled to the size of the investment project. • **The Stock Exchange of Thailand (SET) amended listing requirements for foreign issuers to reduce listing obstacles and enhance competitiveness.** In the first phase, foreign issuers who are listed in another country will

Objective		Reform Measures Taken
		be allowed to list on SET or to do a dual listing. Issuing firms must be in a country whose Securities and Exchange Commission has agreed with SET to exchange information and investigate alleged wrongdoers. Foreign issuers must comply with regulations of the issuer's exchange of original listing.
E.	Development the domestic financial markets, including bond, capital, and money markets	***Measure taken over last 6 months and significance*** • **Tax break for saving accounts with interest less than THB 20,000.** Government approved an exemption from withholding tax on bank savings accounts which earn no more than THB 20,000 interest a year. • **The Stock Exchange of Thailand (SET) launched its first Shariah-compliant index.** The FTSE Group and the SET expanded the FTSE SET Index Series with the addition of the FTSE SET Shariah Index. The index aimed to open up a new asset class and allowed both domestic and international investors to invest according to the Islamic principles. The Shariah Index is suitable for benchmarking and can be used for a wide range of Islamic products • **Thai stock market started trading derivative warrants.** The derivative warrant (DW) traded in the SET on July 9, 2009 was the first DW issued by private sector, as in the past DWs were only issued by the Ministry of Finance. The DW is an alternative for investors but has high risk so the investor should understand its nature and risks prudently before trading. ***Measure to be taken in the next 6-12 months*** • **The Cabinet approved the Capital Market Development Master Plan (CMDP).** On November 4, 2009, the Economic Cabinet approved the 5-year plan formulating an overall master plan for the development of Thai capital market covering stock, bond and derivative markets. The plan expected to be implemented during 2010-2014. • **The Thailand Securities Depository Co.Ltd.(TSD) plans to adjust its regulation to comply with the amended Securities and Exchange Act.** TSD expects to adjust its regulations and its procedures in accordance to the amended Securities and Exchange Act by the end of 2009.
	(1) Domestic financial markets	•
	(2) Capital markets	
	(3) Derivatives markets	•
F.	Rationalize state holding of specialized financial institutions, state-owned enterprises, and state commercial banks	***Measure taken over last 6 months and significance*** • **State-owned banks received capital injection.** Government allocated THB 14.5 billion to 5 Specialized Financial Institutions (SFIs) to support capital and loan growth. These SFIs, namely Government Housing Bank, Small and Medium Enterprise Bank, Bank of Agriculture and Agricultural Cooperatives, Islamic Bank of Thailand and Small Industry Credit Guarantee Corporation, can extend credit facilities to the most affected enterprises.
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	***Measure to be taken in the next 6-12 months*** • **International Financial Reporting Standards (IFRS) will be implemented in phase.** SET 50 companies, the largest capitalization companies in the Stock Exchange of Thailand, will start applying IFRS international accounting standard on the first-quarter of 2011 financial report, followed by SET 100 companies in 2013. By 2015, IFRS will be a mandatory requirement for all companies listed on the SET and the Market for Alternative Investment (MAI).

Objective		Reform Measures Taken
H.	Government's stimulus package to support weakened industries during the global financial crisis.	***Measure taken over last 6 months and significance*** • **Government effort to ease liquidity shortage.** In order to support the recovery, the Finance Ministry increased its loan target for 6 Specialized Financial Institutions (SFIs) from THB 625 billion to THB 927 billion. Also, the government introduced a "Fast Track" program by accelerating the lending process in 6 SFIs. The 6 state banks are the Government Saving Bank, Government Housing Bank, Small & Medium Enterprise Bank, Export-Import Bank, Bank of Agriculture & Agricultural Cooperation and Islamic Bank of Thailand.

Prepared by Ratchada Anantavrasilpa

3. Reforms to Improve Business and Investment Environment and Trade Regime

Objective		Reform Measures Taken
A.	Improve competitiveness of business sector	***Measures taken over last 6 months and significance*** • **Draft second master plan on information and communication technology (2009-2013).** All new or existing ICT plans for central and local government agencies will be drafted/amended to be consistent with this master plan. Ministry of ICT will act as an implementing and coordinating agency. The vision is to become "Smart Thailand" through enhancing quantity and quality of ICT human capital, and developing high-speed ICT infrastructure including its management system and governance. The concrete objectives are (i) at least half of population has access to ICT, (ii) upgrading Thailand's ranking in the networked readiness index to the top quartile, and (iii) boosting the value added share of the industry to 15 percent of GDP. • **National strategy on intellectual property is passed by the cabinet**. Proposed by Ministry of Commerce, the strategy seeks to support Thailand's transition towards a creativity-based economy. In particular, the strategy has several key components: (i) build intellectual property (IP) through R&D, co-financing between private and public sectors for technological development and innovation, and creating IP database; (ii) commercializing IP through branding and setting up of a new agency to collect license fees for Thai products; (iii) protecting intellectual property rights through enhancing the efficiency and transparency of the verification and registration process of patents and trademarks, amending national IP rights laws, and joining international agreements on property rights protection, (iv) minimizing the violations of IP rights through new laws, stronger enforcement, and more comprehensive database on cases, and (v) eased access to finance to promote IP development such as joint foreign-local investments, asset evaluations methods for IP, and use of IP as collateral for commercial bank lendings. • **Project to enhance the competitiveness of the die and mould industry (2010-2014).** This will continue from the previous plan (2004-2009) that helped lead to lower import dependence (and also higher exports), more technical personnel, and seven new excellence centers for the industry. The remaining challenges are lack of design staff and limited technological capabilities in terms of accuracy to serve advanced industries like automotive and electronics industries. This new plan will focus on strengthening human capital and technological capabilities, encouraging joint work between researchers and industrialists for practical results, and investing more on downstream industries. • **Draft national research policy and strategy (2008-2011).** With the total budget of 96 billion baht over these five years, the strategy focuses on research in five areas: economic, social, human resources, natural resources and environment, and management and commercialization of research outputs. There are 12 priority research topics, such as governance, education reforms, water management, climate change and alternative energy, valued-added agriculture, new technology, tourism management, ageing society, and logistics. At the end of 2011, the success of the plan will be measured among others by fund disbursement, public research share in total research expenditures, number of research personnel, patents registered, number of publications, and commercialization of research.

Objective		Reform Measures Taken
		• **One start & one stop service center.** The cabinet approved the budget for setting up the one start & one stop service center. The center offers comprehensive services to all investor types (e.g. domestic/foreign and promoted/non-promoted companies), such as processing required documents, providing business and investment information, and having account executive for large investors. • **Tax incentives to promote Thailand as a center for jewellery production and trade.** Value-added tax is exempted for imports of uncut jewellery such as gems, ruby, opal and jade (but excluding diamond and pearl). This is to boost inflows of jewellery materials that tend to benefit the local production, cutting and refinement industry. Only importers who are subject to individual income tax (rather than corporate income tax) are eligible. • **The Board of Investment provides incentives for a wider range of business activities.** (i) Large-scale production of new car models that have never been produced in Thailand or those use new technology such as hybrid drive will enjoy exemption of import duties on machineries and corporate income tax for at least five years. (ii) The BOI offers maximum benefits to tourism-related businesses, i.e. if 80 percent of land space is used for tourism activities such as amusement park, art, cultural and handicraft center, aquarium, racing tracks, open zoo, movie town, and international exhibition center. (iii) To promote capital market development, the cap on corporate income tax exemption by BOI promoted firms will be lifted if they are listed on the Stock Exchange of Thailand or Market for Alternative Investment. (iv) Import duties on raw materials and parts used in ego-car production projects (those that cannot be produced locally) will enjoy 90 percent tariff reduction for two years. (iv) New business activities that are now eligible for BOI incentives include productions of nano materials and related products, musical instruments, and completely built units and completely knock-down houses. Additional investment incentives are also given to projects that promote technological development (e.g. engineering parts) and healthcare (e.g. hygienic paper products). • **Thailand signed various agreements and memorandums of understanding (MoU) with foreign counterparts.** (i) MoU between ASEAN and China on intellectual property issues, which include, among others, the protection of property rights, exchange of information, and international experiences on data collection. (ii) Academic cooperation on sanitary and phytosanitary issues with Chile. National Bureau of Agricultural Commodity and Food Standards will act as an implementing agency to limit the spread of diseases and pests. Activities include exchanging information on laws and regulations, training, and sanitary and phytosanitary situations update. (iii) The third phase of cooperation between EU and ASEAN on intellectual property. With financial support from the EU and the European patent office, the cooperation seeks to strengthen intellectual property (IP) rights protection, IP laws, and expanding education, training and research on IP. (iv) MoU on academic partnership with Spain. Spain will finance feasibility studies on areas such as water supply management, sanitation, infrastructure, environment, tourism, and renewable energy and climate change. (v) MoU with Argentina on joint cooperation that aims to tighten the link between the two parties as well as other countries in Latin America, mainly in the form of technical cooperation in agricultural technology, health, and alternative energy. (vi) Agreement on economic and academic partnership with Kuwait, which mainly covers areas such as commerce, finance, industry, energy, tourism, and academic affairs. (vii) Agreement with South Africa that sets up a joint committee to focus on commerce and investment, agriculture, education, tourism, and science and technology.

B.	Reform of legal and judicial regime	***Measure taken over last 6 months and significance*** • **Enhancing the IT system of Office of the Attorney General.** As part of the justice affairs administration plan (2009-2012) and IT plan for justice procedures (2009-2012), upgrading the IT system will allow an inter-agency, electronic exchange of justice information that has been agreed since early 2008. This fund is mainly used to purchase/upgrade computer facilities and train more staff. • **The Cabinet agreed with the draft Act on a committee for legal procedure reforms.** This will result in an independent committee on legal procedure reforms, which is responsible for improving and developing the operations of public justice agencies. The committee will conduct research and advise the cabinet on options to reform justice procedures.
C.	Improve the skills and quality of labor	***Measure taken over last 6 months and significance*** • **Proposal on educational reforms for the second decade (2009-2018).** National education act, implemented since 1999, has helped to enhance management structure and education zoning, and set up quality accreditation and evaluation agency. This proposal will introduce several sub-committees that focus on remaining challenges such as students' quality, production and development of academic personnel, education management efficiency, access to education, financing and technology for education, legal issues, and lifelong and informal education. • **Draft ministerial regulation on merging vocational academic institutions into vocational institutes.** Proposed by Ministry of Education, the regulation plans to merge **414 vocational academic institutions nationwide into 19 vocational institutes located in 18 provinces and Bangkok. The objective is to better utilize shared, limited resources to delivering, for example, an undergraduate degrees in technology and operations fields. It is anticipated that the mergence will result vocational graduates with stronger qualified technical skills.**
D.	Reduce tariff to improve Thailand's competitiveness 1/	***Measure taken over last 6 months and significance*** • **Various products now enjoy lower or no import tariff.** These include both universal tariff reductions and specific tariff reductions that result from FTAs. Examples of the former include lower duty for vehicles that can run on gasoline both with and without ethanol components, and cow and water buffalo skins and wood products. For ASEAN-Korea FTA, duties on a variety of food and beverage products, chemical substances, building materials, electrical equipment, computers, vehicles, and oil products are reduced or cancelled since October 2009. Tariffs on vehicle parts and components from Japan are also exempted benefitting from the Japan-Thailand pact.
E.	Promote Thai exports to new markets 2/	***Measure taken over last 6 months and significance*** • **Free trade agreements that involve Thailand demonstrated some progress in the past months**. On bilateral agreement, Thailand still awaits India to confirm the extent of tariff reduction that was previously agreed. For BIMSTEC[32], the member countries agreed in June 2009 to cut or waive import tariffs of over 5,000 products. India, Sri Lanka and Thailand will cut tariffs for 10 percent of their agreed items by January next year. For ASEAN-China agreement, the investment agreement was signed in August 2009, while goods and services trade negotiations still continued. For the ASEAN-Australia-New Zealand pact**,** tariff rates under the normal track for the six ASEAN

[32] Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation consists of Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

		foundation members will be cancelled in 2013 for most products. ASEAN also signed goods and services trade agreements with Korea in February 2009 and on investment in June. Korea and Thailand will cancel around 90 and 80 of all tariff lines that are being traded, respectively. The pact between ASEAN and India is also agreed. Tentatively, over 70 percent of goods that are being traded will enjoy no tariffs by end-2012. For ASEAN and Japan, the latter abolishes 90 percent of tariff lines that are being traded since June 2009. This same figure is 93 percent for Thailand within 10 years. The cabinet agreed the agreements on services trade and investment in June 2009.

Prepared by Vatcharin Sirimaneetham

Note: 1/ See *Tariff Reform* in Section 3.2 on Recent Trade Reforms for a more detailed discussion.
2/ See **Error! Reference source not found.** for more details.

4. Public Sector and Governance Reform[33]

Objective		Reform Measures Taken
A.	Improving public service quality by streamlining and redesigning work processes and procedures	***Measures taken over last 6 months and significance*** • **The cabinet approved the draft of Prime Minister Office's Regulation on the Regional Public Operation, proposed by the Permanent Secretary Office of the Prime Minister Office.** The regulation mandates that in case of urgent problems, the Deputy Prime Minister has authority to approve the annual budget allocation, central fund and reserved cash for emergency to line agencies with the amount not exceed to 900 million baht per year. Regional Public Operation Monitoring and Supervision Committee shall appoint the working committee attach to each Deputy Prime Minister to help scrutinize the necessity and appropriateness of the budget expenditure. • **By the Civil Service Act (2008) section 78 stating performance evaluation role of management, the OCSC announced the guideline on criteria and method of civil servant's performance evaluation.** Individual performance evaluation system has been introduced as a tool for management to oversee the civil service and provincial authority of their job performance according to policies, missions and objectives laid down in an effective, efficient and cost-efficient manner. This system is also to provide heads of government departments and other public organizations with indicators for giving pay raise and awarding bonus for civil service fairly. Each agency is free to choose performance evaluation method appropriated to nature of jobs. The system requires all government agencies and provinces to announce the criteria and method of performance evaluation at the beginning of evaluation periods, March and October. The individual performance evaluation is conducted under the performance agreement where individual staff signed with his direct supervisor in a transparent and accountable way. The agreement contains details on job responsibilities and its related KPIs. All agencies are flexible to choose performance evaluation procedure that appropriates to different types of jobs in order to make the evaluation system effectiveness.
B.	Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels	***Measures taken over last 6 months and significance*** • **The cabinet approved the Ministry of Finance's regulation on re-division of authorities and responsibilities in Comptroller's General Department.** Human Resource Development Division has been upgraded to the Personnel Development Institution in Public Finance and Accounting with increased authorities and responsibilities to provide recommendations on policy and strategies related to government officials' capacity enhancement in public finance and accounting as well as to extend the scope to which the training has been provided to other related agencies.

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

Objective		Reform Measures Taken
		• **Local Civil Service Act, proposed by the Ministry of Interior has been approved by the Cabinet in principle.** The Act provides these following mandates; (i) the set up of Local Civil Service Commission comprising of 7 representatives by position from related agencies and 8 representatives from each of local administration organization, local civil servant, external experts with Minister of Interior as a chair person and Secretary General of Local Civil Service Commission as Secretary to the committee, (ii) the establishment of the Office of Local Civil Service Commission (OLCSC) with departmental equivalent level under the Ministry of Interior, (iii) the set up of the Committee of Merit Systems of Protection Board to Local Administration comprises of 7 members with appointment from His Majesty the King with Secretary General of Local Civil Service Commission as Secretary to the committee**,** (iv) Budget expenditure in personnel expense and compensation should not exceed 40% of the actual revenue from the previous fiscal year, excluding borrowing, subsidy and other source of fund (section 44) and (v) Head of the local administration, by law is the supervisor of teacher and other academicians of that local unit with the authorities to supervise and make policy decision on education applicable to all schools under the authorities of this local unit (section 97).
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.	***Measures taken over last 6 months and significance*** • **Prime Minister Office's Regulation on the Administration of Stimulus Package 2 (Thai Kem Kaeng) (2012) was approved by the cabinet in June 30, 2009.** The draft provides guideline and step taken of project implementation to help improve efficiency and effectiveness. The key importance of the draft is to indicate how the project is implementing according to different sources of financing and to also authorize the Public Debt Management Office to provide loan necessary to finance projects. The loan for Thai Khem Kaeng must deposit to the Treasury Reserve Account at the Comptroller's General Department under the account title "Thai Khem Kaeng 2555". PDMO is also responsible on cash management, Project Financial Monitoring System as well as to report the updated borrowing status. • **The promulgation of Constitution 2007 together with the amended Public Administration Act to authorize provinces and provincial clusters to submit budget requests directly to the Bureau of Budget have made the inconsistencies to the current effective Budget Procedure Act (1959).** In this regards, the Bureau of Budget has abandoned the current effective one and drafted the new Budget Procedure Act B.E……… with the Cabinet approval in principle in October 13, 2009. The key elements of the new draft cover; (i) All agencies covering the government agencies, independent public agencies, parliamentary agencies, juridical agencies, agencies under the constitution and other autonomous agencies together with provinces and provincial cluster, State Owned Enterprises; (ii) to set up the budget expenditure policy committee with authorization to decide the policy making related to budget expenditure, to draft the budget allocation strategy, to set framework to annual budget expenditure and expenditure in central fund, to set the ratio of capital expenditure to overall budget, budget burden from public debt and off-budget activities; (iii) all agencies who received budget appropriation shall submit the report on non-budgetary status before submitting budget request to BoB; (iv) the set up of reporting system requires all agencies who received budget appropriation shall submit the progress report to the BOB for the performance monitoring and evaluation purpose and BOB shall submit the report on budget

Objective		Reform Measures Taken
		allocation to the Parliament every 6 months. ***Measures to be taken in the next 6-12 months*** • **Public Finance Act is tentatively to be effective by the beginning of FY2010.** The 2007 Constitution mandated the government to develop a new Public Financial Act. MOF as a key responsible agency prepared this draft Act, held inter-agency consultations, and submitted the revised draft to the cabinet with expected to be approved by the first half of this year. By the beginning of FY2010, Public Financial Act and respective regulations is tentatively to be approved by the Parliament, and implementation commences.
D.	Improving governance in public sector through participation, accountability, and transparency	***Measures taken over the last 6 months and their significance*** • **The draft of Prime Minister Office's Regulation on Public Audit and Evaluation was approved in principle by the Cabinet on October 13, 2009.** The draft has revised the components of Public Audit and Evaluation Committee (PAEC) and qualification of the member's committee. The draft proposed the replacement of the Director of Government Fiscal Management Information System by the Permanent Secretary of Finance Ministry as a member of committee with adding the Permanent Secretary of Interior Ministry to be a member of committee. The term of committee expands from 2 years to be 4 years.

* Prepared by Nattaporn Triratanasirikul

5. Social Protection

	Objective	Reform Measures Taken
A.	Develop social insurance mechanisms for the elderly and those affected by unemployment, work-related injuries or other shocks to income.	***Measures to be taken in the last 6 months and their significance*** • **The Cabinet, on October 20th, 2009, approved Draft on National Saving Fund Act B.E. to establish the national pension system to those who are not covered in any pension schemes.** Proposed by the Ministry of Finance, the National Saving Fund aims to allow general people without social welfare services such as farmer and vendor to apply. The new savings program aims to cover 24 million workers who currently lack any formal retirement coverage (Government Pension Fund, Social Security Fund, or other voluntary provident funds). Under the program, workers will contribute from 100 to 1,000 baht per month and the government will match the contributions with 50 baht per month for members aged 20 to 30 years, 80 baht per month for members aged 30-50 years, and 100 baht per month for members aged 50 to 60. A worker aged 20 who contributes the minimum 100 baht per month to the fund until retirement at 60 will receive pension benefits of around 3,000 baht per month, including a 500-baht payment already given by the government. This contribution scheme will cost the government around 0.08-0.14 percent of GDP per year if target group can be covered around 30-50 percent in the first year. • **The Cabinet, on September 1st, 2009, approved an amendment of Social Security Fund Act to extend benefits to spouses and dependents of social security members**. Proposed by the Ministry of Labour, approximated 5.88 millions of spouse and children of the social security members will be moved from the Universal Coverage scheme (UC) to Social Security Scheme (SSS) coverage of social security scheme. Four types of benefit compensations: Sickness, Maternity, Disability, and Death, will be covered under the system with additional estimated expense of 2,452 baht per person or 14,416 million Baht in total in the year 2009. • **The Cabinet, on August 25th, 2009, approved Draft Regulation of Pension Plan for Permanent Government Employees**. Proposed by the Ministry of Finance to be effective from October 1st, 2009, the draft regulation was amended from the Pension Plan for Permanent Employees B.E.2519 to provide pension to permanent government's employees who have worked for 25 years or more in governmental units. These officials will be entitled to receive monthly pension or special monthly pension upon their retirement. • **The Cabinet, on August 25th, 2009, agreed to support an establishment of the Islamic Micro Credit in the Southern border provinces.** Proposed by the Ministry of Interior, the government agreed to support the Islamic micro-financial system that aims to provide both technical and applicable knowledge of Islamic micro-financial system, build capacity, and strengthen linkages between the Islam Bank and the community.
B.	Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and	***Measures taken in the last 6 months and their significance*** • **The Cabinet, on August 25th, 2009, approved temporary payment for additional cost of living for State Enterprise Officials of the Metropolitan Electricity Authority.** The State enterprise officials of the Metropolitan Electricity Authority who salary are lower than 15,000 Baht per month will receive an amount of no more than 2,000 Baht per month in which the total amount received shall not exceed 15,000 Baht. • **The Cabinet, on July 28th, 2009, approved to expand the Registration of Illegal Myanmar, Laotian, and**

Objective		Reform Measures Taken
	placement.	**Cambodian Immigrants who are working in Fishery Industry.** The previously announced deadline was July 30, 2009 and the new deadline was September 30, 2009. The new registration gives a right to registered migrants from the three countries to live in Thailand until February 28, 2010.
C.	Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support	***Measures taken in the last 6 months and their significance*** • **The Cabinet, on September 15th, 2009, approved a measure give assistance to farmers/ members of agricultural cooperatives who were severely affected by the 2008 flood.** Proposed by the Ministry of Agriculture and Agricultural Cooperatives, the government agreed to help settle all debts for farmers who died because of the flood. For those who whose income was affected because their lands were destroyed, the government agreed to expand their debt payment period up to 3 years without interest. • **The Cabinet, on August 25th, 2009, agreed to support an establishment of Islamic Micro Credit in Southern Border Provinces**, Proposed by the Ministry of Interior, • **The Cabinet, on July 28th, 2009, approved the recall of one Million Rai of Ratchaphatsadu Land to allocate to farmers for agricultural use.** Proposed by the Ministry of Finance, a steering committee will be appointed to design policies and criteria to implement the recall. Chaired by the Provincial Governor, provincial-level committees will be set up to allocate land to farmers according to the regulations set by the steering committee. • **The Cabinet, on July 14th, 2009, considered the Ministry of Finance's proposal to extend Utility Subsidies for Low-Income Earners until December 31, 2009.** The government will financially support the responsible state-enterprises namely, 1) The Metropolitan Waterworks Authority (MEA), 2) The Provincial Waterworks Authority (PWA), 3) The Bangkok Mass Transit Authority (MBTA), and 4) The State Railway of Thailand (SRT) in total expenses of 11.12 Billion Baht. The Cabinet also agreed to expend the budget for the "6 Measures for 6 Months: Thailand's Way Out of Crisis" to those state-enterprises. • **The Cabinet, on July 9th, 2009, approved the distribution of 500-Baht allowances to 576,661 senior citizens who have not yet received the living allowance from the government**. Proposed by the Ministry of Interior, staring in April 2009, 500-Baht allowance has already been distributed to 3 million senior citizens with the total amount of 9,000 million Baht. The allowance was allocated for six months. After that, there were remaining 576,661 senior citizens who had not yet received the allowance. An additional budget of 1,730 million Baht was approved to be distributed to this group. • **The Cabinet, on July 9th, 2009, approved fringe benefits of 600 Baht to 153,686 village health volunteers who have not yet received the benefits.** Proposed by the Ministry of Interior, the grant for the fringe benefits (600 Baht) was approved to be given to about 833,000 village health volunteers for a total of 3,000 million Baht. There are however 987,019 village health volunteer. The remaining 153,686 volunteers have not yet received the grant. The government approved an additional budget of 553 million Baht to be paid to this group.

Prepared by Piriya Pholphirul