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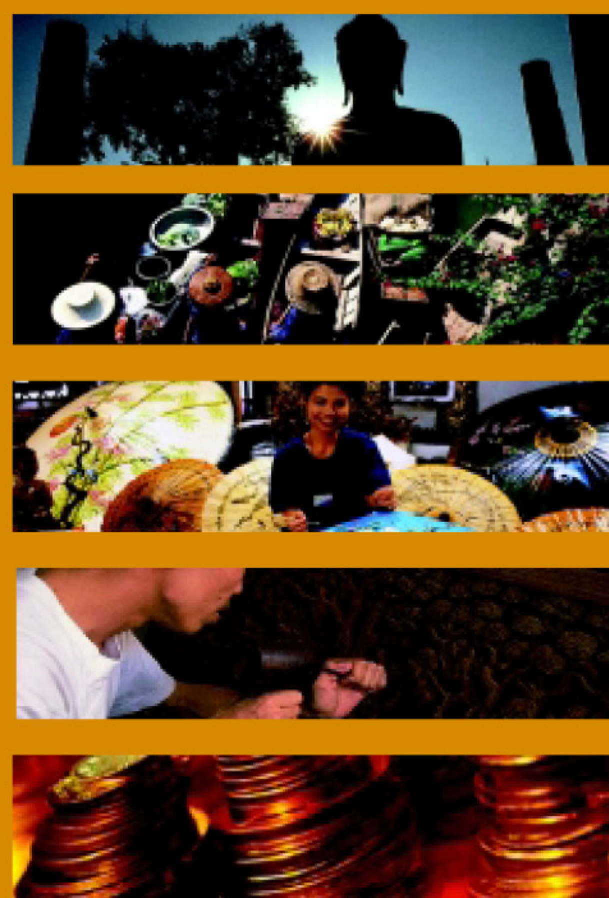
Thailand
ECONOMIC MONITOR



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ABBREVIATIONS

ADB	Asian Development Bank
AMC	Asset Management Companies
ASEAN	Association of Southeast Asian Nations
BAAC	Bank for Agriculture and Agricultural Cooperatives
BOI	Board of Investment
BOT	Bank of Thailand
CBC	Central Bankruptcy Court
CCI	Consumer Confidence Index
CEP	Closer Economic Partnership
CDP	Country Development Partnership
CDRAC	Corporate Debt Restructuring Advisory Committee
CEO	Chief Executive Officer
CPI	Consumer Price Index
DOT	Direction of Trade
DSI	Department of Special Investigation
EU	European Union
EXIM Bank	Export-Import Bank
FDI	Foreign Direct Investments
FIDF	Financial Institutions Development Fund
FPO	Fiscal Policy Office
FSAP	Financial Sector Assessment Program
FTA	Free Trade Agreements
FY	Fiscal Year
GDF	Global Development Finance
GDP	Gross Domestic Product
GHB	Government Housing Bank
GSB	Government Savings Bank
HADS	Household Attitude on Debt and Savings Survey
HS	Harmonized System
IBFs	International Banking Facilities
IFS	International Financial Statistics
ISIC	International Standard Industrial Classification

ITF	International Trading Firm
JBIC	Japan Bank of International Cooperation
LRC	Legal Reform Committee for Development of Thailand
MCFD	Mediation Center for Financial Disputes
MFN tariff	Most-Favored-Nation tariff
MOAC	Ministry of Agriculture and Cooperatives
MOC	Ministry of Commerce
MOE	Ministry of Education
MOU	Memorandum of Understanding
MLR	Minimum Loan Rates
MUV	Manufacturing Unit Value
NIDA	National Institute for Development Administration
NBFIs	Non-bank Financial Institutions
NCC	National Competitiveness Committee
NESDB	National Economic and Social Development Board
NLRDC	National Legal Reform and Development Committee
NPAs	Non-Performing Assets
NPLs	Non-Performing Loans
NSO	National Statistics Office
OECD	Organization for Economic Cooperation and Development
OPDC	Office of Public Development Commission
OTOP	One Tambon One Product
PAMP	Public Affairs Management Plan
PCA	Public Company Act
PCI	Private Consumption Index
PICS	Productivity and Investment Climate Study
PII	Private Investment Index
PPI	Producer Price Index
PPP	Private Public Partnership
PSA	Public Sector Account
ROE	Return on Equity
ROSCs	Reports on Observance of Standards and Codes
SARS	Severe Acute Respiratory Syndrome
SEA	Securities and Exchange Commission Act

SEC	Securities Exchange Commission
SES	Socio-Economic Survey
SET	Stock Exchange of Thailand
SFIs	Specialized financial institutions
SMEs	Small and Medium Enterprises
SML	Small-Medium-Large
SPVs	Special Purpose Vehicles
STF	Special Task Force
TAMC	Thai Asset Management Corporation
TFEX	Thailand Future Exchange
TFP	Total Factor Productivity
TMP	Thailand Market Place
TVQ	Thai Vocational Qualifications
WB	World Bank
WDI	World Development Indicator
WTI	West Texas Intermediate
WTO	World Trade Organization
yoy	Year-on-year

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OVERVIEW

Thailand grew by 6.1 percent in 2004, slower than in 2003, but a further slowdown to 5.2 percent is expected in 2005 in view of the adverse shocks. The rebound in tourism after the SARS scare in 2003 and a jump in public investment after many years of retrenchment, helped real GDP growth to exceed 6 percent last year despite slower increases in private consumption and a fall in net exports. Higher oil prices last year and election-related uncertainties had taken their toll. The tsunami, the increasing unrest in the South, the recent drought and further increases in oil prices have affected household and business confidence adversely. This is manifest in a slowing of quarterly growth rates as evident from the last quarter of 2004 and the first quarter of 2005. Slowing private consumption and net exports, the latter due to lower growth in world output and trade projected for 2005 despite rising imports, will reduce overall growth this year.

Poverty has continued to fall. After falling below pre-crisis levels in 2002, the incidence of poverty continues to decline. Thailand has adopted a new poverty-line reflecting more accurately the current consumption patterns. By this measure, the number of poor has fallen by 2 million between 2002 and first half of 2004 for which data is now available. Using the new poverty line, poverty has fallen from 15.6 percent to 12.0 percent.

Inflation could be close to 4 percent this year, up from 2.7 percent in 2004 driven largely by increases in oil prices. Upward adjustments of domestic prices of gasoline and diesel this year will have the largest negative impact on GDP growth, given the oil-intensity of the economy. Retail benzene prices have floated since October 2004. The continuing rise in world oil prices is likely to translate into a 17 percent rise in domestic retail benzene prices this year, the same as last year. Unlike last year, this year the Government raised the ceiling on the retail price of diesel in February and in March by a total of Bt 3.60 per liter, thereby lowering the subsidy to Bt 3 per liter[1]; this means that the retail price of diesel in Thailand will be almost 20 percent higher than last year.

External vulnerability fell further last year. In 2004, the external current account surplus fell relative to 2003 to US$7.3 billion or equivalent to 4.5 percent of GDP. The trade balance fell by more than half that of 2003, but was offset by increases in receipts of services incomes from tourism by almost US$2 billion. International reserves reached almost US$50 billion by the end of 2004 or 4.4 times of short term external debt and 6.3 months of imports. External debt at the end of 2004 was US$51.1 billion, similar to that of 2003, with short-term debt increasing by 1 percent of total external debt to 22.4 percent.

Nevertheless, the external current account and the fiscal balance are under pressure. The trade balance is in deficit in the first quarter given rising oil prices, higher capital imports and weakening world demand. Imports are expected to continue to grow at a faster rate than exports, given the large public investment program. Tourism receipts are also down which is likely to reduce the surplus on services account. On the fiscal front, revenue growth is likely to be slower with some slowdown in GDP growth, even as public debt servicing and other current expenditures remain strong. The Oil Fund already has a large deficit, and this is likely to rise further this year as oil prices remain buoyant. This is likely to constrain the

1 So far, the subsidy has cost the Fund Bt80 billion or 11 percent of GDP, and could rise to Bt100 billion or 14 percent of GDP by the end of the year.

size of the multi-year public investment program, as is probably reflected in recent announcements.

Private investment will have to grow to take up the slack in private consumption and net exports, if growth is to be higher over the medium-term. Private consumption growth slowed in 2004 and will slow further in 2005. Net exports will decline as imports pick up. Private investment is expected to grow at around 15 percent, the same rate as last year, given that the Board of Investment (BOI) approvals over the last two years and rising capacity utilization. But higher growth in private investment is needed, especially in more productive and efficient sectors, if growth is to be sustained at more than 6 percent. Foreign direct investment is expected to slowly pick up, probably because of a wait-and-see approach to the Southern unrest and its recent escalation and the newly-announced trust-building initiatives. This means that private domestic investment, which has been sluggish, needs to grow more.

Probably more important for sustaining private investment are the constraints like regulatory burden, skill-shortage and infrastructure costs, identified by firms[2] as severe. Preliminary findings also show that the performance of firms– measured by labor productivity and total factor productivity – is adversely affected by these constraints. Thus, unless these constraints are addressed adequately thereby raising the rates of return for investors, growth in private investment and flow of higher investment into highly productive sectors will slow down over the medium-term. It is in this sense that the Government's efforts under the National Competitiveness Committee, which is already working on these areas, now needs to accelerate the implementation of measures to alleviate these constraints for private firms.

Uncertainty about the economic situation and the market was also an issue for firms. This may have a lot to do with the recent experience of the East Asian crisis, China's WTO accession and impact of terrorism. Locally, the experience with SARS, the Avian flu and now Southern unrest have created greater uncertainty. This means that for investors to invest, rates of return will have to rise to compensate for the increased uncertainty and risk. Addressing the constraints identified above will be critical for encouraging private firms to invest more and in more productive sectors.

Some types of private firms are found to deal better with these constraints, than others. Medium and large firms are found to be performing much better than small firms. Similarly foreign-owned and exporting firms are found to be more productive than domestically-owned ones. In short, small firms, domestically-owned firms and domestic-market-focused firms – the very firms that the Government has been keen to promote – have their performance affected disproportionately more than others by these same constraints.

Firms in regions outside Bangkok and vicinity are found to have lower total factor productivity. This is particularly true in the Northeast, the North and the Central regions. Also, the severity of constraints varied across regions. While skilled-labor shortage was equally severe for firms in all parts of Thailand, poor infrastructure and lack of support services was much more of a constraint in the Northeast. At the same time, surprisingly, Northeast region faced less of a burden from regulations.

The shortage of skilled labor could potentially undermine sustained high private investment and growth. Nearly a quarter of firms report that they are not operating at full capacity due to a skill shortage. The survey also finds a significant wage-premium that has to be paid by firms for tertiary graduates. On the other side, Thailand is producing a lower number of secondary education graduates relative to countries at similar levels of income and development. Also the *quality* of the secondary school graduates produced is lower than those of its middle-income neighbors, as measured by test scores. On another dimension, 45

[2] The joint Government and World Bank *Productivity and Investment Climate Study* (PICS) initial findings show that a high proportion of the 1,385 private firms surveyed in 2004 confirm these constraints. However, further analysis is needed to fully understand the reasons behind the findings and the specific measures that are needed to address them. The full PICS report is expected in late June.

percent of the firms surveyed rated IT skills of their production workers as 'very poor'. Given the urgency for Thailand to move up the value-chain and create a knowledge-economy, these skill deficiencies identified by private firms are worrisome from the perspective of medium-to-long term private investment and growth.

Notwithstanding the above, Thailand continues to be a very attractive place for foreign investors. A. T. Kearney *FDI Confidence Index*, based on a 2004 survey of top multinationals, show that Thailand ranks as the third most attractive investment destination among Asian investors, after China and India. However, for all foreign investors, Thailand's rank has fallen from 16th to 20th rank, largely because other countries have made significant improvements in their investment climate.

Public investment is expected to grow more rapidly than last year. In 2004 it grew by 12 percent, having fallen in each of the previous five years, bringing total public investment to 6 percent of GDP. As the mega-infrastructure projects begin to be implemented, assuming a much slower rate of actual spending than is planned, public investment would grow in 2005 at almost twice the rate of last year.

Three challenges remain for public investment in infrastructure. First, it is not clear whether fiscal consolidation and the proposed large public infrastructure investment implementation are both doable. Is there adequate fiscal space for the program? This is something the Government is focusing on at present and will be important during the 2005-2007 period. Second, it is not clear if the policy changes needed to make infrastructure investments deliver the quality infrastructure services that businesses need are in the pipeline together with the investments. Third, the distribution of public infrastructure investment does not take into account adequately the needs of poorer regions.

The Northeast region is the poorest, but receives the lowest per capita public spending, including for transport[3]. The gap in per capita spending is largest in transport and agriculture. Firms in the region also confirm that transport and other infrastructure services constitute one of their severe constraints to productivity and investment growth. There is thus an urgent need to revisit the allocation of public spending on infrastructure, if regional equity is to be improved.

Exports receipts last year grew by 23 percent year-on-year largely due to price increases. Prices of Thai merchandise exports grew by almost 16 percent last year while volume expanded by 6.2 percent. Exports of goods and services together in real terms grew by 7.8 percent in 2004, largely due to the rebound in tourist arrivals.

In 2005, export value growth is expected to decelerate to around 15 percent. Merchandise export volume growth is expected to slow down as growth in world output and world imports decelerate. Growth in output of the countries that are markets of Thailand is slowing not only relative to 2004, but also relative to 2003. Export price is also projected to rise, but at a slower rate than last year. Thus, exports receipts will likely expand not much more than 15 percent in 2005. In addition, growth of tourism receipts will be limited by the impact of the tsunami related disaster late last year.

Thailand's exports to China grew at around 25 percent in 2004 compared to 60 percent in 2003. Electrical machinery and parts, non-electrical machinery and parts, plastic products and rubber products were the four items contributed more than 60 percent to this growth.

There is an emerging agenda of reform to be addressed, on top of those being addressed, if competitiveness is to be enhanced further and high growth is to be sustained. The Government remains focused on its strategy to improve Thailand's competitiveness, which is appropriate and is confirmed by the preliminary findings of the *Productivity and Investment Climate Study* (PICS). The Cabinet has recently approved the National Socio-economic Restructuring Plan proposed by the NESDB, which aims to promote higher annual economic growth

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3 Recent World Bank-NESDB study, *Public Expenditures and the Development of Northeast Thailand (Draft Final Report)*, January 2005 has revealed this differential allocation.

over the next 4 years and highlights the urgency of improving Thailand's overall and sectoral competitiveness. The niche sectors identified by the National Competitiveness Committee, that is, automotive, food, and fashion, including promotion of industry clusters remain part of that strategy. Logistics issues are also part of that program. However, there are three general constraints that appear to affect a large number of firms operating in many sectors, including the niche sectors that are reducing their investment and productivity.

First is the need to reduce the regulatory burden that the firms face. This is the least costly to implement, in terms of budgetary resources, and yet they are likely to have a large favorable impact on firms. The specific actions in this area need to be identified and prioritized. Recent actions on trade reform and the FTA initiatives are all good steps in that direction, but more is needed in other areas.

Second is the issue of skilled-labor shortage and can be addressed at more than one level. Strengthening the education system, especially at the secondary level, in respect to both access and quality which will help in the long run and this is already on the Government's agenda. There is need for some urgency in terms of implementation. The other is enhancement and expansion of appropriate skill-development and training institutes which can have a more immediate impact. For example, IT training can be very useful in this regard. The incentive systems for training and skill development need to be re-evaluated to see if more needs to be done.

Third is the need to enhance availability and quality of infrastructure services, especially in the regions. If regional development is important, firms need to have better quality of infrastructure services than they have currently. This will require a reallocation of public spending in favor of the regions on the grounds that private supply of infrastructure is more of a possibility in more developed parts of the country like Bangkok and vicinity. But that may need changes in policies that will increase the rate of return to private investors in infrastructure.

In addition, the Government should continue its reform of the financial and corporate sector. For example**,** the Bank of Thailand has tightened the loan classification rules, including qualitative assessment of loans, raising non-performing loans (NPLs) of banks. The implementation of this rule has raised NPLs in state-owned banks. Though the impact on private banks has been less obvious and may have been less in reality, NPLs of private banks to total loans still remain important. Also the implementation of the Financial Sector Master Plan and financial institution consolidation should be continued.

There is also some urgency to convert several draft laws into laws especially those relating to the financial and corporate sector. For example the collateral law, the secured transaction act, the bankruptcy code etc are all important steps for ensuring that firms have access to finance and there is discipline for the corporate sector. Recent Government initiative to review all laws is a good step in that direction.

Improvements in corporate governance area should also be sustained. The SET and the SEC have strengthened disclosure standards through monitoring financial and non-financial disclosure and providing incentives for such disclosure, including monitoring of audited financial statements and annual registration statements of listed companies. Use of administrative sanctions has increased and liaison arrangements with the Department of Special Investigation (DSI) have helped in this area. The establishment of a mandatory Director Registration program by SEC, in which all listed company directors and senior executives are required to register and questionable actions can be evaluated by an independent Director Disciplinary Committee, is a good step for greater accountability.

If the Government is to attain its 4-year growth targets of more than 6 percent a year on average, movement on the above agenda is important. That will help to sustain high rates of private investment, as well as encourage those investments to go into more productive and more efficient sectors. That will help to improve total factor productivity growth, something that will be key to achieving high growth.

SECTION 2

RECOVERY AND OUTLOOK

2.1 Real GDP Growth 2004 and 2005

The Thai economy weathered both domestic and external shocks last year and will also do so this year. Real GDP last year grew by 6.1 percent despite higher oil prices, the Avian Influenza, and the unrest in the far South, which had adversely affected household confidence and consumption as well as foreign direct investments last year. Growth last year was partly helped by the rise in public investment after its retrenchment for 6 consecutive years. In addition, tourism revenues rebounded from the SARS scare in 2003 as reflected in the growth of exports of services, of over 10 percent last year. Some of the negative shocks such as the Southern unrest and the higher oil prices extend into this year (see Box 1 for discussion of oil price impact). In addition, the severe drought towards the end of last year and early this year would reduce agricultural production this year and could hurt farm incomes and rural consumption. The tsunami disaster in the six southern provinces late last year also has an adverse impact on tourism receipts, although to a large extent mitigated by the relief measures. With the world economy expected to slow down this year, Thailand's key export markets will also grow at slower rates. Given these negative factors, real GDP growth this year will therefore likely slow down to 5.2 percent.

Growth this year will rely more on private and public investments. With higher oil prices and inflation and the slow down in world trade volume this year, household consumption and net export growths are also expected to slow down and, thus, contribute less to GDP growth when compared to last year. On the other hand, investments, particularly public investment, will increase their contributions to GDP growth this year. As the mega-projects are implemented, public investment should expand at almost twice the rate of last year. Private investment will continue to grow at a slightly higher rate as than last year as more sectors approach full capacity. Foreign direct investment is also expected to pick up as election uncertainties have passed and concerns over the economic impact of the Southern unrest somewhat reduce.

External vulnerability continues to fall. In 2004, the current account remained high at US$7.3 billion or 4.5 percent of GDP, though a reduction from US$8 billion in 2003. The decline in the trade balance by more than half from that of 2003 was somewhat offset by the receipts of services incomes from tourism, which increased by almost US$2 billion. With such a current account surplus, Thailand's international reserves has reached almost US$50 billion by the end of 2004 or 4.4 times of short term external debt and 6.3 months of imports. External debt at the end of 2004 was US$51.1 billion, similar to that of 2003, with short-term debt increasing by 1 percent of total external debt to 22.4 percent. This year, the current account will decline as the trade account will likely be in deficit with the acceleration of imports in line with the rising investments and values of oil imports (see Box 2 for discussion of impact of oil imports on total imports). In addition, as a result of the tsunami disaster, tourism service receipts will not grow as much as last year.

Box 1. Impact of World Oil Price Rise and Increase in Retail Diesel Price Ceiling

The rise in world oil price this year coupled with the increase in the retail diesel price ceiling will raise retail diesel price by almost 20 percent year-on-year and average petroleum product retail price by 14 percent. The world oil price[4] is expected to rise by another 10 percent this year in addition to a sharp increase of 30 percent last year. Thailand has floated the retail benzene price in late October 2004 and raised retail diesel oil price ceiling by Bt0.60 per liter in February and by another Bt3 per liter in March 2005 after fixing it at Bt14.59 since January 2004. This will result in benzene prices this year rising by around 17 percent and diesel prices rising by almost 20 percent year-on-year (assuming there will be no further raise of the retail diesel price ceiling this year) (see Table 1).

Table 1. Petroleum Product Price Increase, 2004-2005

	Share in Petroleum Consumption (%)		Petroleum Product Price Increase (%)	
	2003	**2004**	**2004**	**2005p**
Premium Gasoline	8.1	7.3	15.2	16.7
Regular Gasoline	12.0	11.1	17.2	17.4
Diesel (High speed)	46.0	46.9	4.0	19.8*
Fuel Oil	13.1	14.6	8.0	8.4
LPG	10.5	9.7	10.7	2.0
	Weighted average		**7.3**	**13.9**

Source: EPPO and World Bank estimation

Note: * Under the assumption of no further increase in retail diesel price ceiling this year since the increase in March

Because diesel is used mostly for commercial transport and manufacturing production, the rise in retail diesel price could raise inflation by over 1.5-percentage point and reduce GDP growth by 1-percentage point this year. Petroleum products, on average, account for about 10 percent of manufacturing costs and commercial transportation adds roughly 2.5 percent to product costs. Since diesel accounts for around 40 percent and 50 percent of total petroleum consumption the manufacturing and transport sectors, respectively, the rise of retail diesel price by 20 percent, on top of the rise in other petroleum product prices, could raise inflation by over 1.5-percentage point. With higher gasoline prices and higher prices of goods in general, household consumption would be reduced. Consequently, consumption of non-oil imports would also slowdown. As a result of the rise is retail petroleum prices, real GDP growth this year could be cut by 1-percentage point[5].

The subsidies from the Oil Fund could reach up to Bt100 billion by the end of this year. Despite the increase of the retail diesel price ceiling by Bt3.60 per liter in the first quarter of this year, the Oil Fund continues subsidize retail diesel consumption at about Bt3 per liter. From January 2004 to the end of March this year, total subsidies from the Oil Fund amount to Bt78.3 billion. If the diesel price ceiling is kept as it is at Bt18.19, the Oil Fund would need provide an additional subsidy of at least Bt20 billion by the end of this year [6], raising total Oil Fund subsidy to about Bt100 billion. This amount, of which Bt 5 billion was funded by the Oil Fund revenues and the remaining by commercial bank loans, will be almost 8 percent of Government budget and 1.4 percent of GDP this year.

[4] World oil prices are the annual price average of Brent (US$/barrel), Dubai, and WTI, equally weighted: see Table 3 in the Uncertain External Environment section.

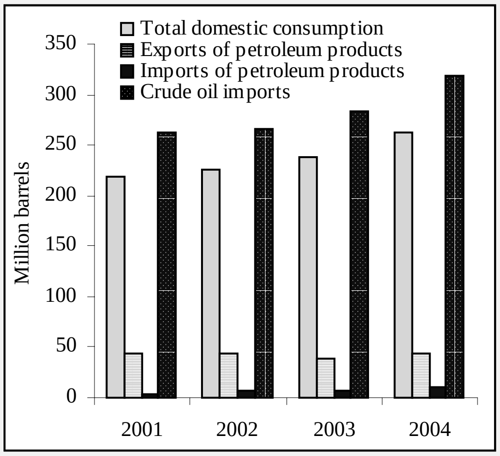
[5] This estimation has not taken into account other indirect impacts such as inefficient fuel use propagated by the lower-than-market retail diesel price, loss in terms of trade, and other measures put in place to reduce petroleum consumption such as restrictions on operating hours of discount stores.

[6] Assuming that diesel consumption from April-December this year is 148 billion liters, which is similar to that of the same period in 2004 and world crude oil prices average at US$42 per barrel this year.

Box 2. Impact of Oil Price Rise on Thai Oil Imports

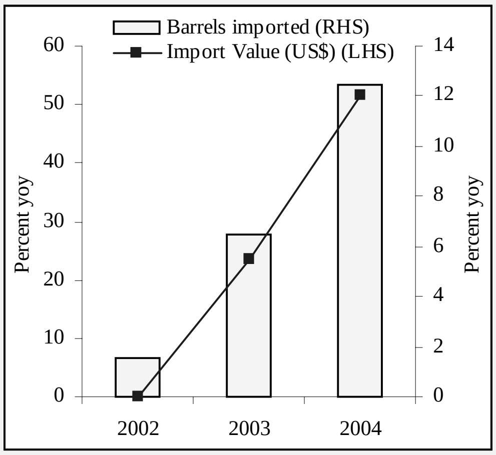
Over 95 percent of Thailand's domestic demand of petroleum products is served by local refineries. From 2001 to 2004, domestic consumption of petroleum products[7] totaled an average of 236 million barrels annually, while imports of petroleum products were on average only 7 million barrels a year. The remaining domestic demand was met by locally refining on average 282 million barrels of imported crude oil annually. In addition, a small portion of the refined petroleum was exported. Thailand exported 42 million barrels of petroleum products per year on average from 2001-2004 (see Figure 1).

Figure 1. Crude Oil Imports and Domestic Consumption, Exports, and Imports of Petroleum Products



Source: EPPO

Figure 2. Growth in Crude Oil Import Value and Volume



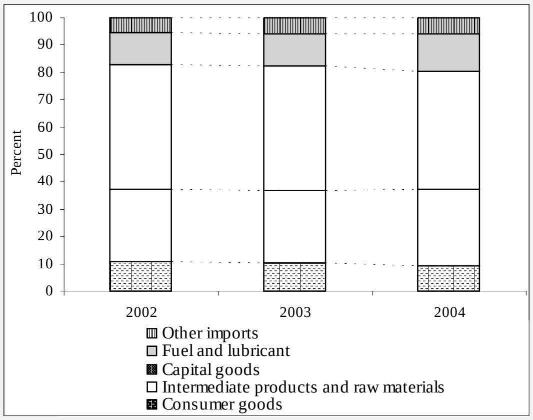
Source: EPPO and MOC

The rise in world oil price in 2004 led to an increase in Thailand's crude oil import values by 52 percent year-on-year and raised total imports by 5-percentage points. Last year, world oil price increased by 30 percent from the year before[8]. However, domestic weighted average retail prices of petroleum products rose by only 7 percent last year due to the price ceilings that were imposed on retail gasoline prices. As a result, domestic petroleum product consumption expanded by almost 10 percent year-on-year, while crude oil imports rose by 12.4 percent or 35 million barrels from the previous year (see Figure 2). As a result, crude oil imports in US dollar terms rose to US$10.7 billion or a 50 percent year-on-year increase. This raised its share in total imports from 9.5 percent in 2003 to 11.3 percent in 2004 (see Figure 3). Nevertheless, its share remains much lower than those of imports of raw material and capital goods, which are 28 percent and 43 percent, respectively. Thus, the rise in crude oil imports contributed to a 5-percentage point increase in or one-fifth of the 27 percent total imports growth last year (see Figure 4).

[7] Petroleum products are the products obtained from refining crude oil such as benzene, diesel, liquefied petroleum gas (LPG), fuel oil and kerosene.

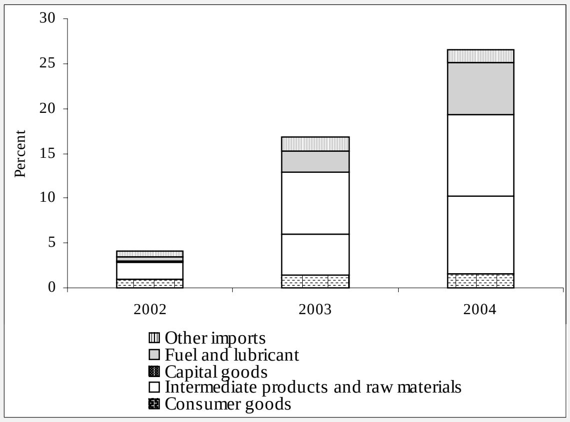
[8] Simple weighted average of WTI, Brent, and Dubai crude oil prices (See Table 3 in Uncertain External Environment section).

Figure 3. Shares in Total Imports



Source: BOT

Figure 4. Contribution to Import Growth



Source: BOT

The impact of rising crude oil imports last year was somewhat cushioned by exports of petroleum products. Exports of petroleum products last year totaled US$1.76 billion, which represents a US$0.74 billion or a 72 percent increase from that of 2003. This has somewhat helped offset the US$3.66 billion rise in oil imports.

With world crude oil price likely to rise further this year, import values of crude oil could increase by around 18 percent this year. World crude oil price this year is expected to continue to rise by around 10 percent. Crude oil imports will also increase but at a slower rate than last year as domestic consumption of petroleum products decelerates with the higher retail petroleum prices and the slow down in real GDP growth. With the elasticity of demand for oil imports to real GDP estimated at 1.4 percent9, imports volume of crude oil will therefore increase by around 7 percent this year, given a 5.2 percent GDP growth. With the increase in world crude oil price, imports of crude oil in US dollar terms this year is estimated to rise by around 20 percent or US$2 billion from last year. This could raise total import values this year by 2.3-percentage points.

Should world oil prices in 2006 remain at a high level as this year's, import values of oil could rise by another 10 percent next year. If world oil price do not rise further next year, while domestic demand for petroleum products grows further as output growth continues, imports of crude oil next year could rise by 10 percent year-on-year or by US$1.2 billion. This would raise total import growth in 2006 by 1-percentage point.

2.2 Poverty

Poverty continues to fall. After lowering in 2002 the poverty headcount below the 1996 pre-crisis level for the first time, Thailand was able to further reduce the number of poor by about 2 million people between 2002 and the first half 2004[10] of as the poverty headcount fell from 15.6 percent to 12.0 percent the first half of (see Table 2). These numbers use a new series of upward-adjusted poverty lines, which raise measured poverty by about 50 percent and reflect more accurately the current consumption patterns of the poor (see Box 3 for discussion on Thailand's poverty line).

[9] Estimation by the Ministry of Energy, 2004.

[10] Preliminary estimates of the National and Economic and Social Development Board based on the latest round of the Socio-Economic Survey (SES).

Table 2. National Poverty Headcount

(Percent of Population)

	Based on old poverty line	Based on new poverty line
2000	14.2	21.3
2001*	12.9	19.1
2002	9.8	15.6
2004, First half	n.a.	12.0

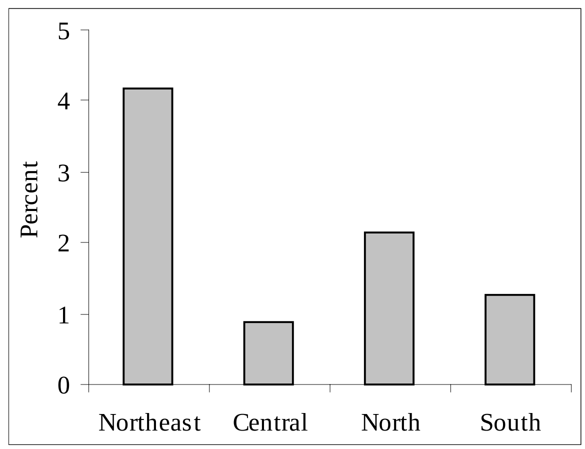
Source: NESDB and NSO

Note: *Based on special round of SES (smaller sample sizes)

Poverty reduction was achieved most in the Northeast as a result of favorable farm incomes and government poverty alleviation programs. According to the new poverty line, the Northeast was the region where two-thirds of the poor resides **in 2000** and almost two in every five persons there are poor, which is about four times higher than in the rest of the country. By mid-2004, poverty incidence in the Northeast was halved. Farm prices and farm incomes that grew by double-digit rates since 2001 have benefited the poor as most of them are in farming households. Government grassroot programs aimed at alleviating poverty, such as the Farmers' Debt Moratorium and the Village Fund, have also helped the poor, especially in the Northeast which has the highest share of poor farmers benefiting from both programs (see Figure 5 and Figure 6).

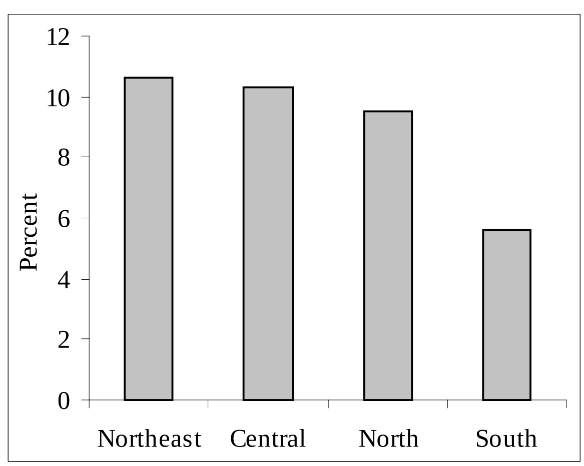
Nevertheless, the Northeast still has the largest number of poor and receives the lowest per capita public spending. Despite the significant poverty reduction in the Northeast over the past few years, the Northeast remains the poorest region in the country where more than half of the poor resides. Compared to other regions in the country, the Northeast has also been receiving the lowest per capita public spending (see Figure 7). The largest gap in per capita public spending is between the Northeast and the Central region. In 2003, the Northeast receives only two-thirds of per capita public spending of that of the Central, while its poverty incidence is four times higher.

Figure 5. Share of Poor Farmers Benefiting from Debt Moratorium by Region, 2002



Source: World Bank

Figure 6. Share of Poor Farmers Benefiting from Village Fund by Region, 2002



Source: World Bank

Box 3. Thailand's Poverty Line

Thailand's poverty statistics are calculated using a poverty line developed by Nanak Kakwani and Medhi Krongkaew in collaboration with NESDB in 1996. This poverty line is compared to total household income per capita to obtain the poverty incidence. The calculation of poverty numbers is conducted by the National Economic and Social Development Board (NESDB) using the Socio-Economic Survey, the national household survey collected by the National Statistical Office (NSO). The poverty line is both "absolute" and "objective". It fixes a given standard of living over time and space, anchored in the attainment of basic nutritional and non-nutritional requirements. The consumption bundle is fixed to be adequate for basic consumption needs. A person is considered to be poor if it cannot meet the cost of the consumption bundle.

The poverty line is composed of two elements, the food and the non-food components. First, the food component is based on the required caloric intake of individuals separated by age and sex groups, as specified by the Thai Ministry of Public Health. The weights of the items in the food bundle were calculated with reference to one common food basket, defined as the average consumer basket in sanitary districts in 1992. Second, in order to allow for basic-needs non-food expenditures, the food component of the poverty line is divided by some estimate of the budget share devoted to food. The food share is fixed at 60 percent, giving a non-food share of 40 percent. The poverty line is updated using spatial food and non-food price indices, which are available by region on a monthly basis (urban and rural North, Northeast, Central, and South; and Bangkok).

The methodology has been subject to two criticisms. First of all, the use of 1992 as a base year may be outdated as the consumption pattern of Thai population has changed over time. Second, fixing the ratio of food to non-food expenditure across all regions at 60 to 40 percent appears arbitrary and does not reflect differences in non food expenditure incurred by households residing in different areas. For example, those living in urban areas may have higher rental cost that those living in rural areas.

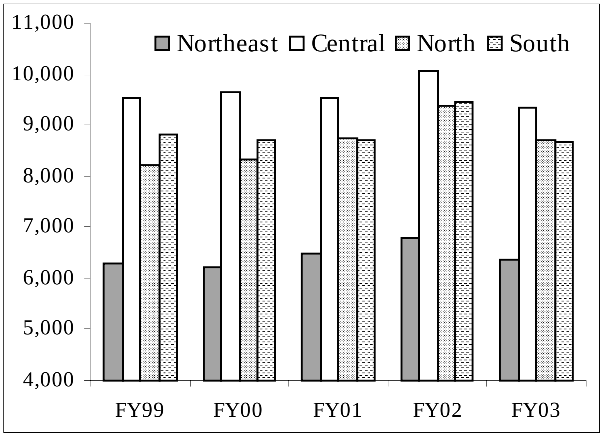
To address these issues, the NESDB has decided to revise the poverty line. The new poverty line incorporates the following changes:

- Consumption pattern and spatial price indices in the food expenditure component have been updated from using 1992 as based year to 2002;
- Calorie requirement has been changed from using international standard in the year of 1992 to calorie requirement for Thai people in the year 2003;
- Non food expenditure has been adjusted to reflect real expenditure and vary by different consumption pattern in different regions; and
- Economy of scale for different sizes of household has been incorporated into new poverty line.

With this new methodology, poverty line in 2002 will be Bt 1,190 per head per month, instead of Bt 922 from the earlier methodology and the headcount ratio in 2002 will be 15.5 percent rather than 9.8 percent.

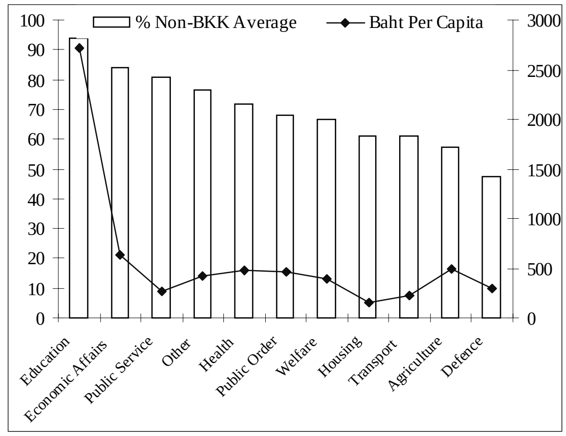
The gap in per capita public spending between the Northeast and other regions is highest in the transport and agriculture sectors which are sectors important for poverty alleviation. The infrastructure supporting the production and access to markets of agricultural products are important for the incomes of poor households in the Northeast who are mostly in the agricultural sector. However, per capita spending on the transport and agriculture sectors in the Northeast is only two-thirds that of other regions or less than Bt500 per person on average (see Figure 8).

Figure 7. Central Government Spending by Region FY99 to FY03 (Bt Per Capita, FY99 Prices)



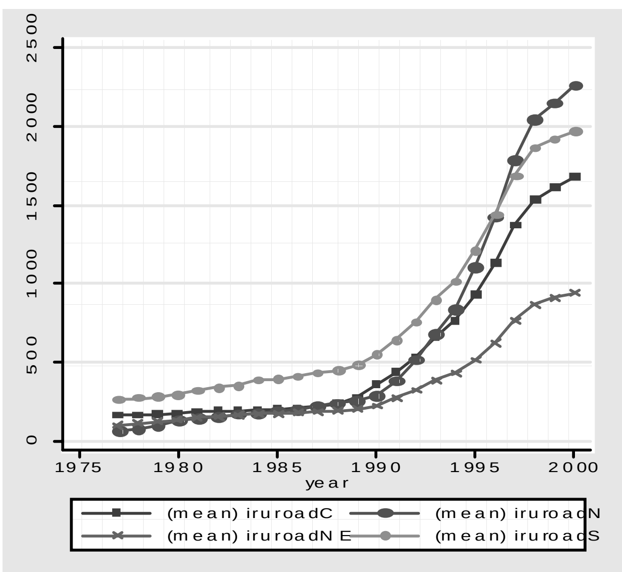
Source: World Bank calculations

Figure 8. Composition of Central Government Spending in Northeast, FY03



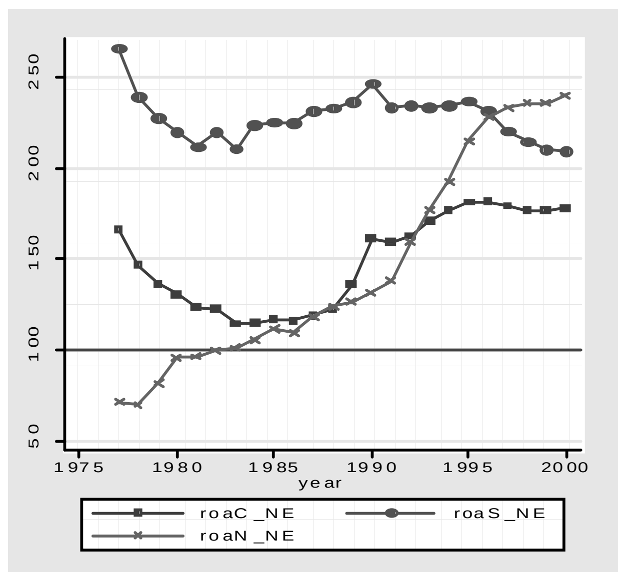
Source: World Bank calculations

Figure 9. Length of Unpaved and Asphalt Rural Roads (Kilometers)



Source: World Bank calculations

Figure 10. Density of Unpaved and Asphalt Rural Roads Relative to Northeast



Source: World Bank calculations

Within the agriculture and transport sectors in the Northeast, irrigation and rural roads are two areas that can be significantly improved. Irrigation expenditure is the largest group of overall agriculture expenditures. The Northeast accounts for 45 percent of agricultural land in the country but receives only 18 percent of irrigation expenditure. Moreover the Northeast has the shortest length of rural roads (see Figure 9). By 2000, other regions have more than 1.5 times density of rural roads compared to the Northeast (see Figure 10). Moreover, most rural roads in the Northeast are of sizeable underdesign, with low traffic volumes, and impassable in the rainy season[11].

[11] Source: Public Expenditures and the Development of Northeast Thailand (Draft Final Report), World Bank, January 2005.

2.3 Uncertain External Environment

Oil prices this year are expected to rise further from that of last year. On contrary to expectations at the end of last year, oil prices this year are expected to rise by another US$4 per barrel or 11 percent year-on-year this year on top of the 30 percent year-on-year increase last year (see Table 3).

World real output growth this year as well as world trade volumes will decelerate from those of last year. With deceleration of the US, Japan, and EU economies, the world output growth this year is expected to slow down to 3.1 percent from 3.8 percent last year (see Table 3). World trade volume growth are expected to also decelerate to 7.8 percent this year with import volumes of the G-7 countries growing slower than last year by 1.8-percentage points as US import volume decelerates.

Rises of non-oil commodity prices and manufactured product prices are projected decelerate this year. After rising at double-digit rates for the past 2 years, international non-oil commodity prices are expected to rise by only 4.7 percent this year. With the slow down in world import demand, international manufactured prices as proxied by the manufacturing unit values (MUV) are expected to rise by only 3

Table 3. External Environment, 2004-2006

	Est.	*Forecast*	
	2004	**2005**	**2006**
Growth of Real Output (%)			
World	3.8	3.1	3.1
o/w OECD	3.1	2.3	2.5
United States	4.4	3.9	3.0
Japan	2.6	0.8	1.9
Euro Area	1.8	1.2	2.2
Growth of Trade Volume (%) a/			
World Trade Volume	10.8	7.8	7.7
o/w G-7 Import volume	8.1	6.3	6.1
o/w North America	10.0	5.2	4.6
o/w Japan	5.4	7.5	7.1
o/w Euro Area	6.6	6.0	7.0
Growth of Price Indicators in U.S. dollars (%)			
Manufactures unit export value b/	7.0	3.0	2.8
Oil prices c/	30.5	11.4	-14.3
Non-oil Commodity Price Index d/	17.5	4.7	-5.2
LIBOR (in percent per year)			
U.S. dollar	1.7	3.5	4.7

Source: World Bank, Growth of Trade Volume is as of February 2005 and otherwise as of March 2005

a/ Merchandise exports/imports

b/ Unit value index of manufactured exports from major economies, expressed in USD

c/ Oil prices are the annual price average of Brent (US$/barrel), Dubai, and WTI, equally weighted: US$37.7/barrel in 2004, US$42/barrel in 2005, and US$36/barrel in 2006

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

percent this year, after having risen by 7 percent in the past 2 years (see Table 3). This means export prices of manufactured goods from the major economies will rise at a slower rate this year, which could benefit Thai imports; but this could also put a downward pressure on the prices of Thai exports of manufactured goods that are inputs to the production in the major economies.

2.4 Export Performance

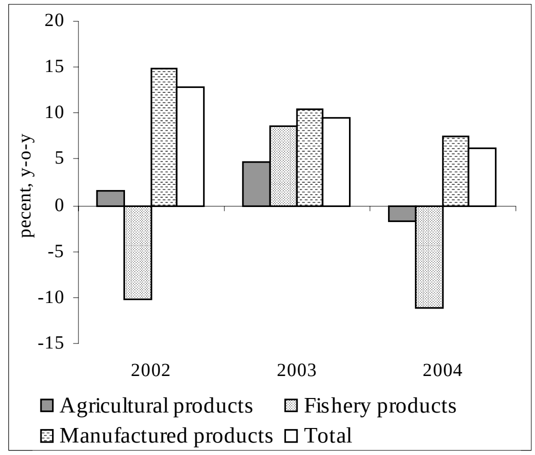
Exports grew at double-digit rates last year, but its growth is expected to slow down this year with the deceleration in the world economy. Exports growth last year was driven mainly by the rise in exports prices as volume growth slowed down from that of 2003. As world output growth and import volumes of Thailand's major export markets decelerate this year on top of the expected slowdown in world prices of manufactured products, Thai exports this year will likely expand at a slower rate than that of last year. Similarly, exports to China will be affected by the Chinese economy slowdown, while significant impact of the ASEAN-China Free Trade Agreement (FTA) is yet to be materialized.

Export performance in 2004 was robust, driven mainly by a surge in export prices. Export value in 2004 grew by 23 percent in US dollar terms compared to 18.2 percent in 2003. Export prices grew substantially by almost 16 percent, twice of growth rate in 2003 while export volume increased by merely 6.2 percent, relative to 9.6 percent in 2003. A contraction in the agricultural and fishery export volume together with the decline in resource-based manufactured exports were the main contributors to the slowdown in export volume last year (see Figure 11 and Figure 12). In the first two months of 2005, export volume growth has declined by 4.7 percent year-on-year. However, an increase in export prices of 14 percent led to an overall year-on-year export value growth of 8.7 percent during January to February 2005.

Last year (11 months data), Thailand's export growth was lower than its competitors'. China's export growth rate was still exceptionally high at almost 45 percent year-on-year, outpacing others in the region. Thailand exports during January to November 2004 grew by 21.5 percent year-on-year, lower than an average export growth rate of 25.3 percent of the ASEAN-6. However, Thailand's export performance was better than those of some countries in Eastern Europe (see Figure 13).

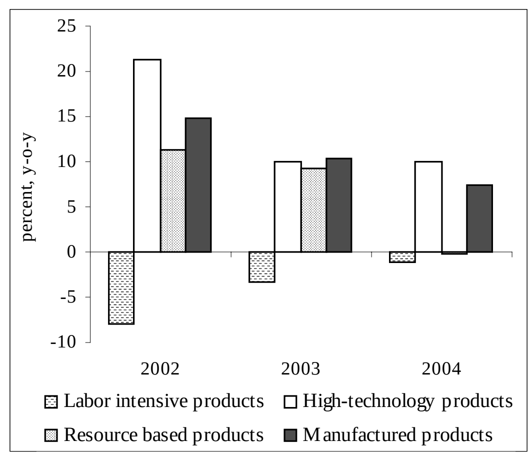
Exports to traditional markets (US, EU and Japan) expanded robustly last year on top of

Figure 11. Export Volume Growth by Product Group, 2002- 2004



Source: BOT

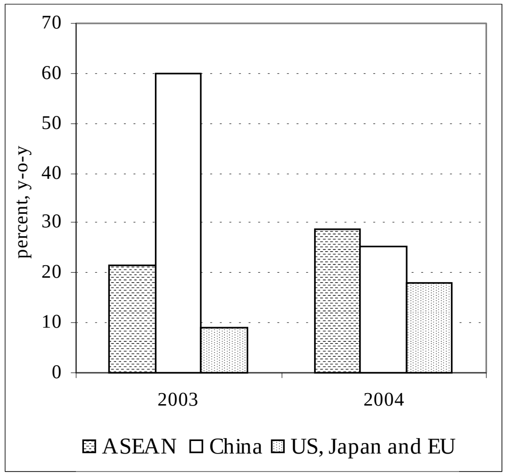
Figure 12. Export Volume Growth of Manufactured Products, 2002-2004



Source: BOT

resilient export growth to ASEAN market. Exports to the three traditional markets, which accounts for almost half of Thailand's total exports, grew at an average rate of 18 percent in 2004, twice the rate in the previous year (see Figure 14) and accounted for almost two-fifths of total export growth (see Figure 15). The robust exports were mainly the result of the recovery of exports to the US market which grew by 14 percent in 2004 compared to less than one percent in 2003. In addition, exports to the ASEAN markets last year grew by 29 percent and contributed around a third of total export growth. On the other hand, export growth to China during this period slowed down from 60 percent in 2003 to 25 percent in 2004, partly due to the Chinese government's contraction policies to slowdown several overheated industries in China[12].

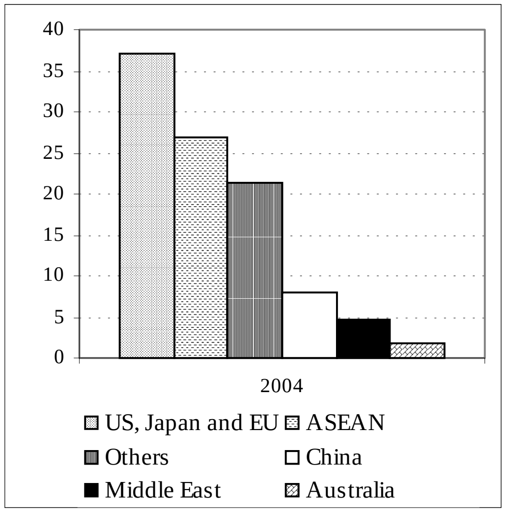
Figure 14. Export Growth Rates to ASEAN, China and G-3 Markets, 2004



Source: BOT

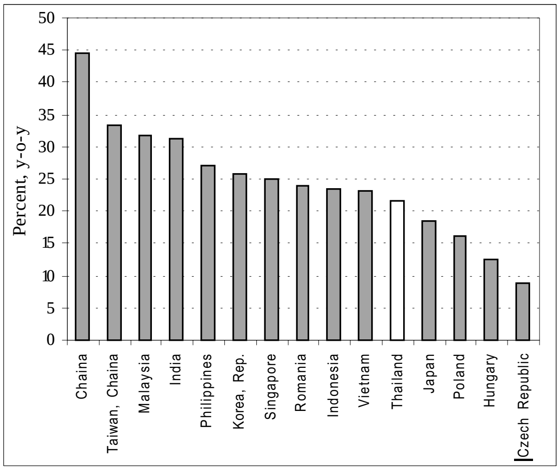
In terms of export products, export values of manufactures continued to grow significantly in 2004, while agricultural exports slowed down. Exports of manufactured products, which accounts for

Figure 15. Contribution to Export Growth by Various Markets, 2004 (Out of 100 percent)



Source: BOT

Figure 13. Growth Rates of Country's Exports to World Market, January-November 2004



Source: DOT

almost 90 percent of Thai exports, grew by 23.4 percent in 2004 compared to 17.7 percent in 2003 (see Table 4). This was particularly driven by the expansion in non-resource based manufactures, which grew by almost 25 percent year-on-year, contributing to almost 90 percent of total export growth last year. Agricultural exports, on the other hand, grew at a slower rate of 17.0 percent in 2004 compared to 23.7 percent in the previous year due mainly to the lower supply caused by the drought and the Avian Influenza.

[12] China has attempted to slow down several overheated sectors including steel, automotive and real estate since 2004. Several tighter policies include, for example, restrictions on bank loans, an increase in reserve requirement, a reduction in budget deficit from 2.7 percent of GDP in 2003 to 2.2 in 2004 and to 2.1 in 2005, an increase in retail electricity prices and water rates, and an increase in interest rates in late October 2004.

Table 4. Contribution to Export Growth Classified by Sector in 2004

(Percent)

	2003			2004		
	Export share	Export growth	Contribution to export growth	Export share	Export growth	Contribution to export growth
Agriculture 1/	**10.7**	**23.7**	**13.8**	**10.3**	**17.0**	**8.3**
Manufacture	**85.8**	**17.7**	**86.8**	**86.8**	**23.4**	**91.1**
Resource based products	8.3	12.8	6.3	7.4	9.0	3.4
Others manufacture products 2/	77.6	18.2	80.5	79.4	24.9	87.7
Others 3/	**3.4**	**-2.5**	**-0.6**	**2.9**	**4.3**	**0.7**
Total exports	**100.0**	**17.5**	**100.0**	**100.0**	**22.1**	**100.0**

1/ including crops, fisheries and forestry

2/ including labor intensive and high-tech products

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

Table 5. Top Ten Export Products in 2003 and 2004

(Percent)

No.	HS Code	Description	2003			2004		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	85	Electrical machinery and equipment	21.3	15.5	19.0	21.3	21.2	20.9
2	84	Non-electrical machinery and parts	16.0	17.7	16.0	16.4	24.3	18.0
3	87	Vehicle and parts	5.2	37.8	9.4	6.1	44.5	10.6
4	40	Rubber and articles thereof	5.6	45.6	11.5	5.7	24.1	6.2
5	39	Plastics and articles thereof	4.3	24.4	5.5	4.8	35.8	7.0
6	27	Mineral fuel oil wax	2.6	16.7	2.5	3.5	61.1	7.5
7	16	Preparation of meat fish	3.3	8.1	1.6	3.0	9.1	1.4
8	10	Cereal	2.3	12.6	1.7	2.9	51.7	5.6
9	71	Pearls, precious stones and metals	3.1	16.3	2.9	2.7	4.9	0.7
10	61	Knitted or crocheted apparel and clothing accessory	2.0	0.6	0.1	1.9	13.7	1.3
Total Top Ten Export Products			65.8	19.2	70.2	68.2	26.1	79.2

Source: MOC

Growth of Thailand's top ten export products accelerated in 2004 with an exception of rubber and jewelry exports. Top three export products, namely, electrical machinery and equipment, non-electrical machinery and parts, and vehicle and parts, were the major export products with double-digit growth rates and contributed to almost half of total export growth in (see Table 5). In addition, exports of cereal (HS10), particularly rice and maize, recorded high growth of 52 percent in 2004, four times that of last year[13]. Exports of rubber and its products (HS40) grew considerably by 24 percent last year, though a slow down from its 46 percent growth in 2003. This is the result of deceleration in the economic growth of Thailand's major importers of rubber, namely, China and Japan[14]. Similarly, jewelry exports (HS71) growth also slowed down in 2004, partly due to a shortage of domestic raw materials.

Exports in 2005 are expected to grow at a lower rate compared to that of 2004 as growth of Thailand major markets slowdown. The weighted-average growth of Thailand's major markets is expected to slowdown from 4.5 percent in 2004 to 3.7 percent in 2005 (See Table 6). Furthermore, the import volume growth of the G-7 countries, which are Thailand's major markets, is also expected to slow down from 8.1 percent in 2004 to 6.3 per cent this year (see Table 3 in Section 2.3). World prices of manufacture goods are also expected to grow at a slower rate than last year. As a result, growths of both Thai export volume and values this year will most likely decelerate from that of last year.

Exports to China

Exports growth to China in 2004 slowed to a still robust 30.7 percent. China's import growth rate had fallen but only marginally, and this affected East Asia[15] too (see Figure 16). Exports from Vietnam and Taiwan[16] to China continued to grow faster in 2004 than in 2003. This means that the share of Thailand in China's imports has fallen slightly from 2.14 percent to 2.06 percent.

Table 6. Weighted Average Real GDP Growth of Thailand's Major Markets*

(Percent)

	2003	2004	2005f
US	0.5	0.7	0.6
Japan	0.2	0.4	0.1
Europe	0.1	0.3	0.2
East Asia	2.8	2.8	2.5
Middle East	0.2	0.2	0.2
South Asia	0.1	0.1	0.1
Weighted Average Real GDP Growth of Major Markets	**4.0**	**4.5**	**3.7**

Source: GDF 2005 and World Bank's calculations

Note: *The average real GDP growth was weighted by Thailand's export shares.

Thailand's major markets accounted for 85 percent of total exports in 2004.

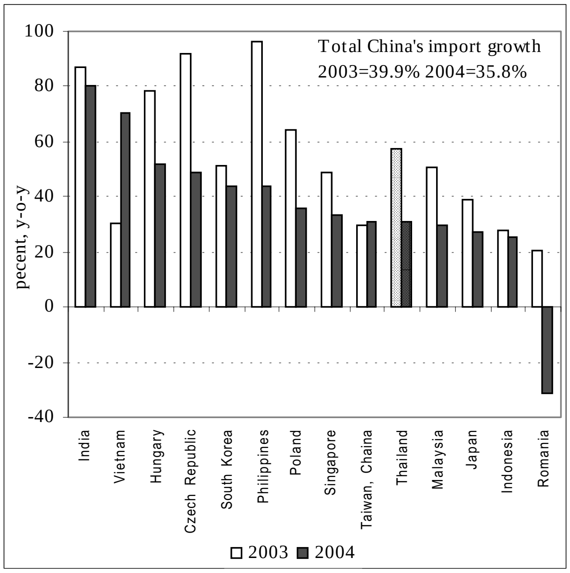
13 Export of Rice (HS 1006) and Maize(HS 1005) in terms of US dollar grew by 48 percent and over 280 percent in 2004 compared to 12 percent and 32 percent in 2003, respectively. The two were the main export products under cereal category (HS 10) accounting for over 99 percent of total cereal exports in 2004.

14 China and Japan account for a third of Thailand's total rubber exports in 2004.

15 Due to unavailability of export data by countries to China, data on China's imports was employed here as a proxy of the countries' export performance in the Chinese market.

16 Vietnam's market share in China's imports accounted for less than 0.5 percent of total market, while Taiwan (China), the second largest exporter to China, accounted for 12 percent of China's total imports.

Figure 16. China's Imports from Selected Countries, 2003 and 2004



Source: World Trade Atlas

Thailand's exports of manufactured products to China grew at a slower rate last year, while agricultural exports growth picked up. In 2004, non-electrical machinery and parts (HS84) and electrical machinery and equipment (HS85), the top two exports, grew by 33.5 percent and 20.7 percent, respectively, which are less than half of 2003's growth rates (see Table 7). In contrast, exports of cereal (HS10), particularly rice, grew sharply over 130 percent and thus almost doubling its share of exports to China to 3.1 percent in 2004. Also, zero tariffs on vegetables exports (HS07) to China under Thailand-China Early Harvest Program under the Thailand-China Free Trade Agreement (FTA) helped vegetables exports to China to grow robustly by over 60 percent in 2004.

In the last quarter of 2004, vegetable trade with China continued to expand, while fruit trade

Table 7. Top Ten Export Products to Chinese Market in 2003 and 2004

(Percent)

No.	HS Code	Description	2003			2004		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	84	Non-electrical machinery and parts	22.9	92.8	29.3	24.5	33.5	30.8
2	85	Electrical machinery and equipment	13.8	58.4	13.6	13.4	20.7	11.5
3	40	Rubber and articles thereof	13.7	99.2	18.1	12.5	14.0	7.7
4	27	Mineral fuel oil wax	10.9	49.4	9.6	9.3	6.6	2.9
5	39	Plastics and articles thereof	7.5	38.4	5.5	8.7	44.6	13.4
6	29	Organic chemical	5.0	61.8	5.1	4.7	15.3	3.1
7	10	Cereal	1.7	-7.2	-0.3	3.1	132.4	9.0
8	07	Edible Vegetables	2.3	26.8	1.3	3.0	64.1	5.9
9	44	Wood & articles	2.4	50.0	2.2	2.9	49.9	4.9
10	72	Iron and steel	3.2	113.3	4.5	1.5	-41.2	-5.2

Source: MOC

slowed down compared to the last quarter of 2003 when Thailand started its Early Harvest Program with China. Thailand was a net exporter of vegetable (HS07) to China with a surplus of US$ 36.7 million during October to December 2004, compared to US$ 23.1 million in the same period in 2003. On the other hand, Thailand registered a deficit of US$13.3 million in fruit (HS08) trade in the last quarter of 2004. Although Thailand's imports of Chinese fruits declined in the last quarter of 2004 compared to the same period of 2003, exports of Thai fruits to China declined by even larger amount, thus reducing total fruit trade to China in the last quarter of last year[17].

Thai exporters have not benefited much from the tariff reductions of items HS01 to HS06 under the Early Harvest Program (EHP) of the ASEAN and China FTA[18], effective in the beginning of last year.[19] Thailand's market shares of HS03(Fish and Seafood) and HS06(Live trees) in the Chinese market increased slightly from 1.4 percent and 12.1 percent in 2003 to 1.7 percent and 14.5 percent, respectively, in 2004. On the other hand, market shares of HS04(Dairy Products) and HS05(Other Animal Products) were roughly the same at 0.1 percent and 0.8 percent, respectively. However, market shares of HS 01 (Live Animals) and HS02 (Meat and Edible Meat) were reduced from 8.4 percent and 0.3 percent in 2003 to 0.3 percent and 0.1 percent in 2004. ASEAN members did not seem to be Thailand's competitors in the last two categories for their market share were less than 0.1 percent. The potential competitors are likely to be those developed countries like Australia and New Zealand whose market share increased more than twice between 2003 and 2004.

Trade with China in the second half of this year could benefit from an additional tariff reduction under the ASEAN and China FTA. According to an agreement on trade in goods signed in November 2004, tariff rates of products not listed in the Early Harvest Program will be reduced on July 1, 2005 and become zero by 2010[20]. Tariff rates of at least 40 percent of items under the normal track list must be 0-5 percent by 1 July 2005 and tariff of at least 60 percent must be 0-5 percent by 1 January 2007. This should result increased trade flows between ASEAN and China, including that between Thailand and China.

2.5 Household Consumption

Household consumption grew at a slower rate last year and will decelerate further this year as the result of rising oil prices and severe drought. Amidst the rising retail oil prices, real household consumption last year grew by 5.6 percent year-on-year. This growth was supported by the continued low interest rates, a large expansion of consumer credits, and a sharp rise in farm incomes. Major consumption items last year included purchases of vehicles and hotel and restaurant services as tourism rebounded from the SARS scare in 2003. Household consumption growth is projected to decline this year as inflation rise with higher oil prices. In addition, rural household consumption should decline as farm incomes are negatively affected by the decline in crop production from the severe drought towards the end of last year and early this

[17] However, exports of tropical fruits like durian and mangosteen have expanded after the tariff elimination.

[18] Under the framework agreement on comprehensive economic cooperation between ASEAN and China, tariffs on products under HS01 (Live animals), HS02 (Meat and Edible Meat Offal), HS03 (Fish and Seafood), HS04 (Dairy Products), HS05 (Other Animal Products), HS06 (Live Trees), HS07 (Edible Vegetables) and HS08 (Edible Fruits and Nuts) started to reduce on 1 January 2004. Tariff rates will become zero by 2006. However, the framework agreement on accelerated tariff elimination under the EHP of the aforementioned framework agreement between China and Thailand, signed in June 2003, has led to tariff elimination of items under HS07 and HS08 since October 2003

[19] In general, Thailand's export growth of items under HS01 to HS06 to China in 2004 declined by 11.2 percent in 2004 compared to positive growth rate of 25.8 percent in 2003 and thus reducing export share of HS01 to HS06 from 1.1 percent of total exports to China in 2003 to 0.8 percent in 2004

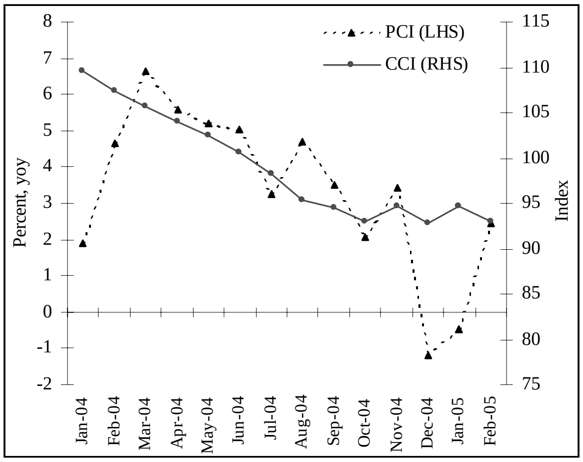
[20] This is subject to items under normal track list only Tariff rates of those in the sensitive list will be reduced to 20% by 2012 and to 0-5 percent by 2018 while tariff rates of highly sensitive products will be reduce to 50 percent by 2015 (See further details in Box 6).

year, while crop prices grow slower than last year as international prices ease. The tsunami disaster late last year has affected mainly household consumption in the 6 affected provinces. However relief measures, including soft loans and donations, have somewhat mitigated the impacts. While rises in nominal lending rates and inflation will leave the real lending rates similar to those of last year, financial institutions expansion of consumer loan will likely slow down as their loans to the business sector speed up. Households' ability to borrow is also more constrained as average household debt to income ratio rate has risen by almost 10 percentage-points from 2002 to 2004. As a result, household consumption this year would grow at a slower rate than that of last year as suggested by the low private consumption index growth in the first 2 months of this year. Consumer confidence index in the beginning of this year is also much lower than that of last year (see Figure 17).

The rise in oil prices and the raising of the retail diesel oil price ceiling this year has a large impact on private consumption. The floating retail benzene prices and the Bt3.60 increase in the retail diesel price in the first quarter of this year, with world oil prices expected to increase by around 10 percent from last year, will raise average retail oil prices by 14 percent this year (see Box 1) compared to 7 percent last year. As diesel is used mostly for commercial transportation and manufacturing production, the rise in these costs could raise inflation by above 1.5-percentage points this year. Higher retail gasoline prices and high inflation should slow down consumption growth this year.

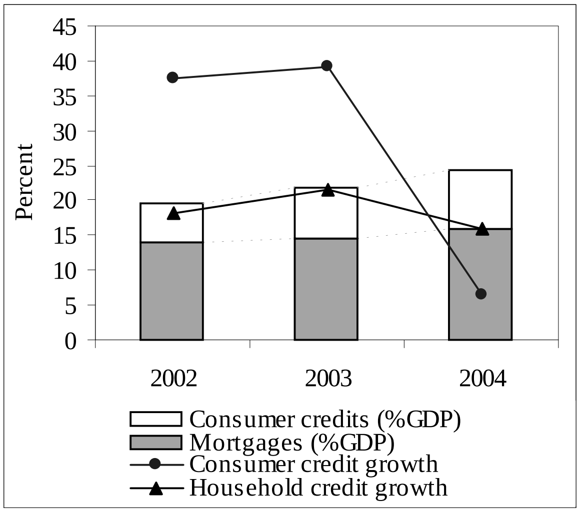
Consumer credit expansion should slow down this year, thus, lending less support to consumption growth. Consumer credit expansion has slowed down sharply from over 30 percent in 2002 and 2003 to 5 percent in 2004 (see Figure 18). This trend should continue as financial institutions' loans to the business picked up since the beginning of last year. Nevertheless, with real interest rates expected to remain at low levels as nominal interest rate rises with inflation (see Figure 19), consumer credits will likely continue to expand this year albeit at a slow pace.

Figure 17. Private Consumption Index (PCI) Growth and Consumer Confidence Index (CCI)



Source: BOT and UTCC

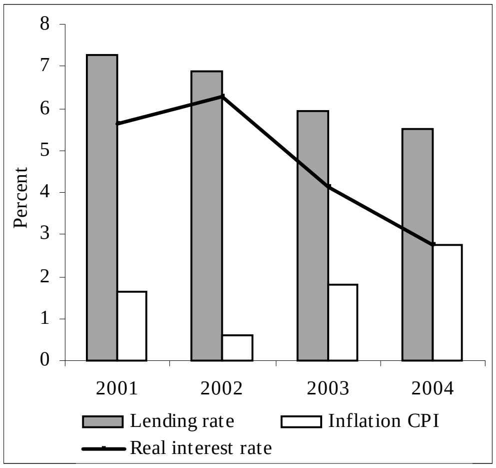
Figure 18. Household Credits from Financial Institutions



Source: BOT and World Bank's calculation

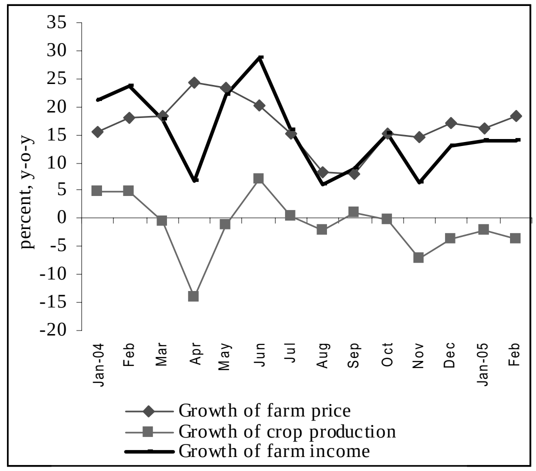
Farm incomes may not support rural household consumption as much as it did in the past few years. Farm incomes have recorded double-digit growth since 2002 mainly as a result of the sharp rises in crop prices. Crop prices last year rose by 17 percent, raising farm incomes by 14.7 percent despite the 1.8 percent decline in production. Crop production will likely

Figure 19. Real Lending Interest Rates (CPI-adjusted)



Source: BOT and IFS

Figure 20. Farm Income, Price, and Production Growth



Source: BOT

Table 8. Rise of Thailand's Key Crop Prices, 2003-2005

	Weights*	Growth rates of crop prices		
		2003	2004	2005p
Rice indic 5%	36.6	3.0	20.3	5.3
Rubber, Malaysia	17	41.5	20.4	-5.3
Maize	4.4	6.1	6.1	-10.6
Palm oil	2.9	13.6	6.3	-4.5
Coconut oil	1.8	11.0	41.4	-9.2
Coffee robusta	1.1	23.1	-2.6	11.2
Weighted average		**9.6**	**19.5**	**0.9**

Source: World Bank Development Economic Prospects Group and MOAC

Note: * weights based on 1988 values of agricultural production of the MOAC

p= projections

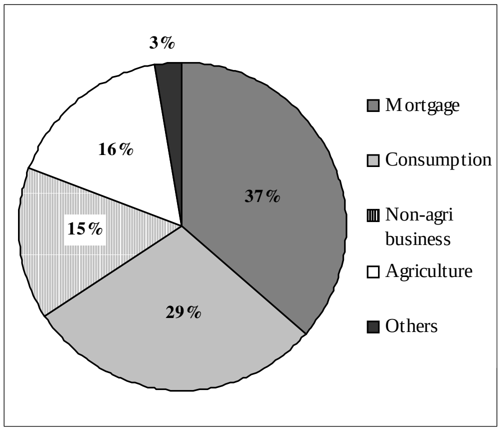
2005 projections are as of March 2005

decline further this year as a result of the drought towards the end of last year and early the year. Due to the reduction in the domestic supply, average crop prices should rise though not as high as last year as export prices of key Thai crops are expected to rise marginally by 0.9 percent this year compared to 19.5 percent last year (see Table 8). Farm incomes are therefore expected to grow at a much slower rate this year. Since the beginning of the year, farm incomes have been expanding at a slower rate (see Figure 20).

Rising household debt will limit the ability of households to borrow to finance their consumption. The latest Socio-economic Survey conducted in 2004 shows that, on average, almost one-third of total household borrowing is for consumption (see Figure 21). It also shows that average debt per household has increased by 27 percent from 2002 to 2004[21].

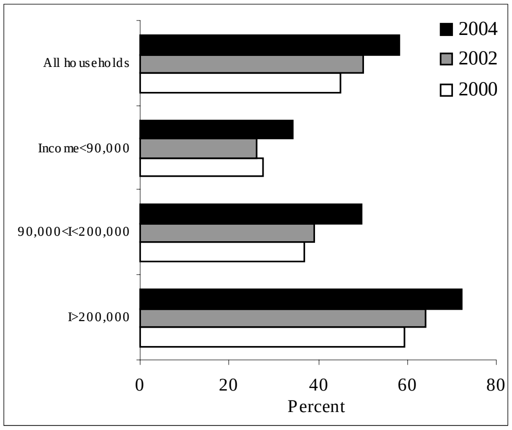
[21] Average household debt was Bt82,485 in 2002 and Bt104,571 in 2004.

Figure 21. Household Loan by Purpose, 2004



Source: SES 2004

Figure 22. Household Debt to Annual Income Ratio



Source: SES 2004

Households in the lowest income bracket had the largest average debt increase of 44 percent from 2002. This is partly a result of Government programs aimed at increasing access to finance particularly of grassroot households (see Box 4. Thai Household Access to Credit). Overall household debt to income ratio increased to 58 percent in 2004, an 8-percentage point rise from that of 2002 (see Figure 22). Average household debt to income ratios of all income groups has risen with the largest increase in the households with incomes between Bt90,000 to Bt200,000 per year. Households in the highest annual income groups are those with the highest debt to income ratio, exceeding 70 percent. Given the higher level of debt, households' ability to increase borrowing, particularly, for personal consumption will be more limited.

2.6 Investment

Investment growth this year will benefit from the sharp increase in public investments, with private investment maintaining its momentum. After retrenching for many years, public investment started to expand last year and will do so at an even higher rate this year with the start of the implementation of the mega-projects. Private investment growth is expected to pick up slightly this year after slightly decelerating last year as investors hold back when faced with the uncertainties surround the Southern unrest, high oil prices, pending elections, and unconcluded FTAs.

2.6.1 Private Investment

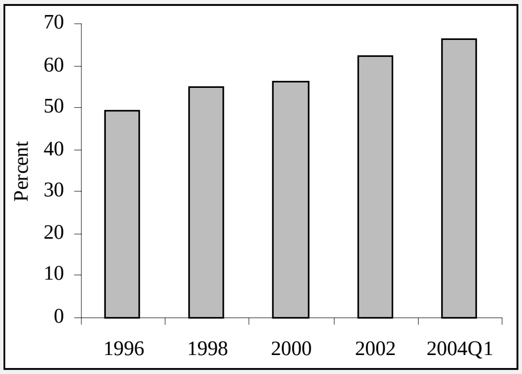
Private investment this year will likely speed up slightly after decelerating last year. Since the crisis, private investment has been recovering at a slow pace. This is partly because of the large excess capacity that exists in the manufacturing sectors post-crisis. However, as excess capacity continuously declined and business loans from the financial sector gradually picked up, private investment growth has been accelerating. Its share in GDP has climbed up slowly from 11 percent in 1999 to 16 percent in 2004, though remaining lower than its share in the 1980s[22]. Last year, private investment growth decelerated to 15.3 percent from 17.5 percent in 2004 as investors are faced with uncertainties in the oil prices, outbreaks of violence in the three southern-most provinces, unconcluded FTAs, and pending elections. Investments in the forms of equipment and construction grew at the same rate last year, with residential construction accounting for slightly more than half of construction (see Figure 27). Private investment growth will likely accelerate this year as more sectors now have almost full capacity. Private construction should grow more rapidly with continuous recovery of the property sector

[22] Private investment as a share of GDP in the 1980s was 22 percent per year on average. We do not compare to the 1990-1997 levels (which private investment was about 30 percent of GDP) as that was the period of over investment.

Box 4. Thai Household Access to Credit

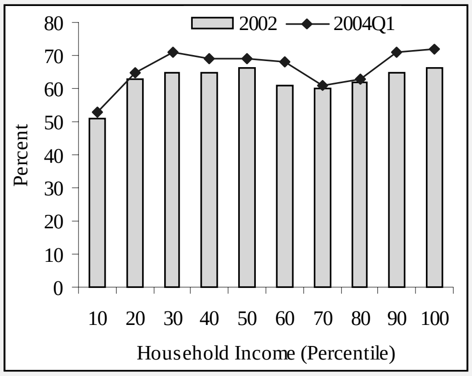
Thai households in all income groups have on average increased their debt levels over the past few years, which can be partly attributed to their greater financial access. From 2000 to 2004, the share of all households with debt has increased by 10 percentage-points (see Figure 23). The share of indebted households increased in all income groups (see Figure 24). Average debt level for households in each income group also rose as households with previously no debt started borrowing and those that already have debt borrowed more[23].

Figure 23. Share of Indebted Households to All Households



Source: NSO

Figure 24. Share of Indebted Households to All Households by Income Groups



Source: NSO

Greater financial market efficiency and higher market supply of loans have helped increase the access to financing for households[24]. The rise in market efficiency arose from increased competition in the financial sector with the entry of foreign banks after the 1998 crisis, better customer information sharing with the establishment of the credit bureaus, and improvements in banks' risk management systems. These have resulted in lower interest rates and expanded loan coverage. On the supply side, given the large amount of excess liquidity in the financial system, commercials banks over the past few years have become more aggressive in extending household loans as demand for business loans was only slowly picking up after the 1998 economic crisis. The Government has also encouraged state-owned banks and specialized financial institutions (SFIs)[25] to extend credit to credit-constrained borrowers.

The Government loan programs targeted at borrowers in the lower income brackets have also provided additional sources of fund for households, particularly those in the lower income group. Such programs include the Village Fund and the People's Bank, both of which are administered by the Government Savings Bank (GSB), a specialized financial institution. Over the past few years, specialized financial institutions have provided a greater share of loans to households (see Figure 25). According to the Bank of Thailand's Household Attitude on Debt and Savings Survey (HADS)[26], the Village fund is the major source of loans for households in the lower income brackets, followed by the Bank for Agriculture and Agricultural Cooperatives (BAAC) which primarily lend to rural farm households (Figure 26).

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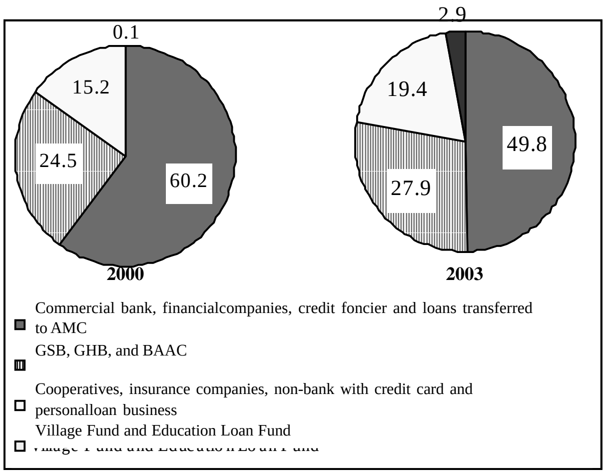
[23] Thaicharoen et al (2004) in Rising Thai Household Debt: Assessing Risks and Policy Implications showed that the increase in household debt levels was mainly attributed to the increase in average debt for households with existing debt.

[24] Thaicharoen et al (2004)

[25] SFIs are government-owned financial institutions such as the Government Savings Bank, Government Housing Bank, SME Bank, Bank for Agriculture and Agricultural Cooperatives.

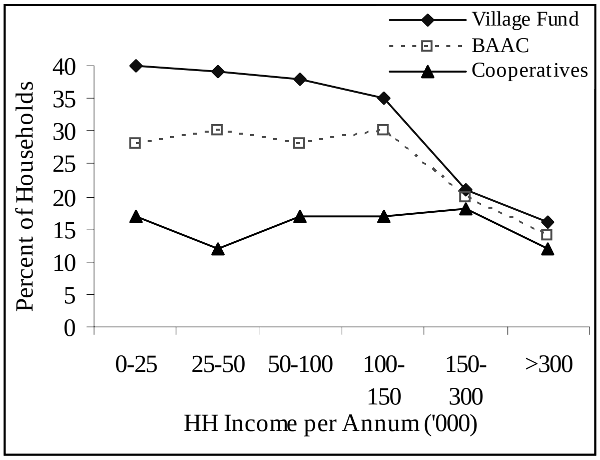
[26] The HADS conducted in 2004 surveyed 2,800 household in 14 provinces in all regions of the Thailand.

Figure 25. Formal Sources of Household Credits



Source: BOT

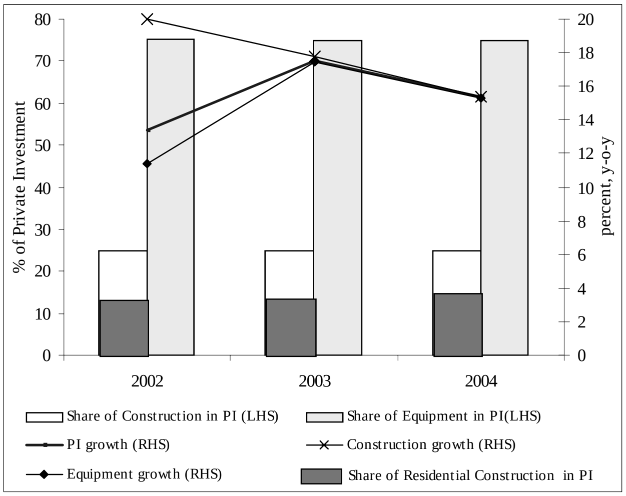
Figure 26. Formal Sources of Funding for Lower Income Groups, 2004



Source: BOT

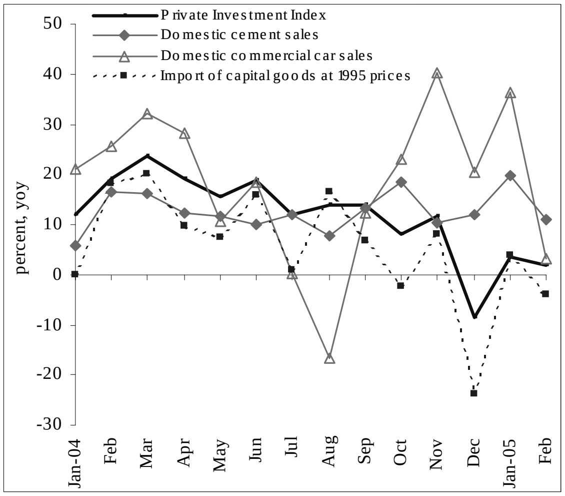
and the reconstruction of the tsunami-affected areas. The reduced concerns on the economic impact of the Southern unrest should particularly increase gross foreign direct investment (FDI) inflows this year after its decline last year. Significant rise in the Board of Investment's (BOI) approvals of both domestic and foreign investments over the past two years also confirms this positive trend. However, the higher than expected oil prices seemed to discourage some investments in the beginning of the year as shown by the slower growth of private investment in the first 2 months of this year compared to the same period last year (see Figure 28). For the whole year, however, private investment is expected to grow but only slightly faster than that of last year.

Figure 27. Private Investment Growth and Contributions to Real Private Investment (Out of 100 percent)



Source : NESDB

Figure 28. Private Investment Index and Indicators



Source: BOT

Table 9. Capacity Utilization

	Weights	Ave 95-96	2003	2004p	Avg Jan-Feb 1995/96	Jan-Feb 2004	Jan-Feb 2005
Total Capacity Utilization	59.1	76.7	67.5	69.2	76.2	69.5	68.0
CU in 2004 >90%	3.9						
Soy milk	0.1	55.3	95.4	116.9	45.8	86.6	115.5
Synthetic fibers	0.8	87.4	95.1	102.3	85.9	100.5	92.2
Intermediate petrochemical	0.7	56.6	96.5	97.4	54.0	99.7	88.8
Zinc metals	0.1	90.3	100.0	96.7	92.5	101.7	87.0
Upstream petrochemical	0.4	41.1	97.5	94.9	45.2	87.1	88.0
Downstream petrochemical	1.2	128.2	95.1	93.1	120.1	97.7	89.3
Compressor	0.2	64.3	85.6	90.7	62.0	88.4	102.0
Printing & writing paper	0.2	n.a.	93.7	90.4	n.a.	89.4	93.2
Washing machines	0.1	72.7	85.6	90.3	65.5	93.3	77.7
80%<CU in 2004 <90%	16.7						
Tire	0.9	90.1	87.8	88.4	84.6	85.9	83.9
Pulp	0.6	77.6	94.3	88.4	72.1	94.4	94.2
Petroleum products	9.5	88.6	79.0	85.4	84.7	83.7	81.7
Battery	0.4	80.5	75.7	83.3	88.4	85.0	73.3
Hard disk drive	4.7	n.a.	102.0	82.7	n.a.	72.2	88.0
Craft paper	0.6	n.a.	81.3	81.5	n.a.	78.9	99.7
70%<CU in 2004 <80%	14.8						
Motorcycle	0.7	78.0	66.9	80.0	81.3	75.6	86.4
Commercial car	2.1	88.7	61.5	78.8	78.0	67.2	69.4
Rubber glove	0.3	n.a.	88.8	78.5	n.a.	78.4	80.9
Electric motor	0.6	88.0	67.7	76.0	85.4	69.4	74.4
Paper board	0.0	n.a.	74.1	75.8	n.a.	74.4	82.8
Glass sheets	0.3	86.5	76.5	75.7	82.8	72.6	75.9
Refrigerators	0.4	79.6	68.7	74.9	82.1	75.7	66.4
Tinplates	0.1	56.5	62.4	74.8	54.4	72.8	80.3
Rice cookers	0.1	90.7	74.2	74.0	89.1	69.4	69.5
Concrete products	0.2	n.a.	58.8	73.8	n.a.	68.2	75.4
Integrated circuits	3.8	77.1	60.6	72.4	69.4	75.1	74.3
Passenger car	2.8	58.1	69.1	72.2	50.7	69.0	56.7
Galvanized iron sheet	0.2	67.4	86.6	71.8	62.2	80.1	65.8
Clinker	0.7	n.a.	70.9	70.7	n.a.	67.7	78.2
Milk products	n.a.	59.2	69.2	70.7	58.5	69.5	77.2
Canned seafood	1.3	45.2	71.6	70.3	40.7	74.5	66.5
Hot and cold rolled sheet	1.1	47.7	74.8	70.3	44.5	71.2	50.1
Computer	0.0	n.a.	51.8	70.1	n.a.	61.9	75.0

Source: BOT (revised series)

Note:*Weights are based on the 2000 manufacturing sector value added.

A continued rise in capacity utilization and investment promotion approvals of the Board of Investment suggests that private investment should continue to grow at a double-digit rate this year. Overall capacity utilization has reached 70 percent by the end of 2004, with 2 more sectors, namely battery, and petroleum products, having capacity utilization rates of greater than 80 percent when compared to the previous year (see Table 9). Two sectors – soy milk and synthetic fibers – were, in fact, running at above full capacity[27]. To meet both the growing domestic demand and exports, investment in these sectors should accelerate this year. Along with the rapidly increasing capacity utilization over the past few years, the Board of Investment's (BOI) investment promotion approvals, a good 1-2 year leading indicator of private investment, have been rising rapidly particularly in the services and infrastructure, the chemical, paper, and plastics, and the electronics and electrical appliance sectors (see Table 10).

Table 10. BOI Promotion Approvals by Sector

(Billions of Baht)

	2002	2003	2004
Total	162.5	283.8	600.7
Services and infrastructure	26.7	60.7	170.6
Chemical, paper and plastic	17.1	49.4	121.9
Electronics and electrical appliance	29.4	44.3	94.3
Metal products, machinery and transport equipment	28.4	69.5	75.1
Mining, ceramics and base metal	2.1	17.0	64.3
Agriculture	40.5	30.1	57.1
Light industry	18.5	12.8	18.6

Source: BOI

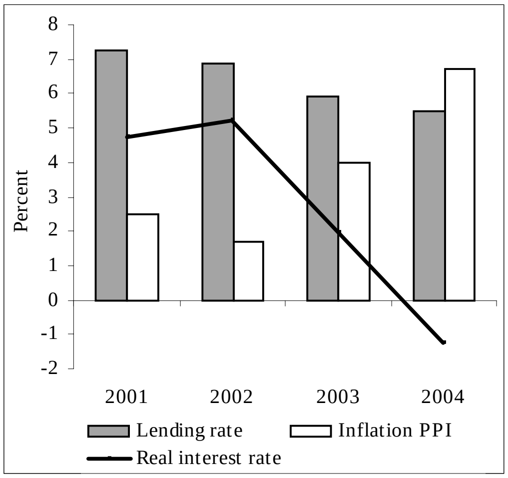
Low real interest rates and further expansion of business loans will help support private investments this year as they did last year. Real interest rates[28] have been low since 2003 and were negative in 2004 (see Figure 29). With the inflation rate this year expected to be close to 4 percent and the nominal interest rates expected to rise to a similar rate, real interest rate this year will still remain low. In addition, expansion of business loans from financial institutions has accelerated since 2002 and expanded by almost 10 percent last year (see Figure 30). This was driven mainly by commercial banks' loans to the manufacturing, transportation, commerce, hotel and restaurant, and real estate sectors (see Table 11). These trends are expected to continue into this year, thus, supporting investment expansions.

Gross FDI inflows declined last year but should rebound this year as uncertainties clear up. Gross FDI inflows in 2004 has declined slightly from that of 2003 by US$0.7 billion to US$7 billion (see Figure 31), suggesting that the gross FDI inflows did not contribute to total private investment expansion last year. The decline in gross FDI inflows last year despite the sharp increase in the BOI investment promotion approvals for FDI in the past 2 years (see Figure 32) could be attributed to the decline in foreign investors' confidence amidst the uncertain environment of rising oil prices,

[27] Capacity utilization of over 100 percent suggests that the sector is running above their respective normal full capacity levels, such as operating their machines overtime or increasing operation shifts.

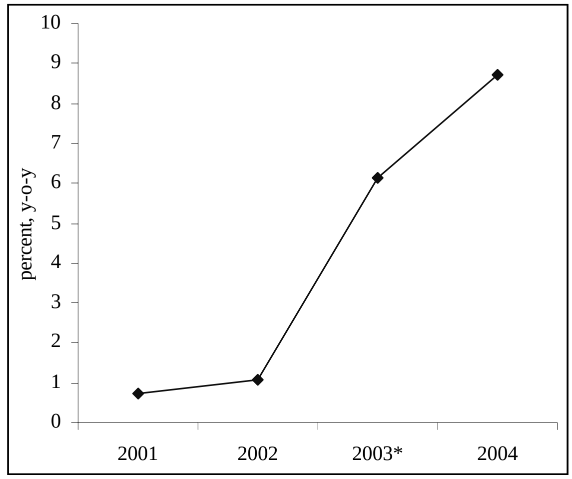
[28] Real interest rate is defined as nominal MLR minus the percentage change in the producer price index.

Figure 29. Real Lending Rates (PPI-adjusted)



Source: BOT and IFS

Figure 30. Financial Sector Business Loan Growth



Source: BOT

Note: * Change in classification of business types inaccordance with the International Standard Industrial Classification (ISIC) in December 2003**Adjusted by adding back loan write-off and loan transfer to AMCs excl. loan to AMCs

Table 11. Growth of Commercial Bank Loans

(Percent)

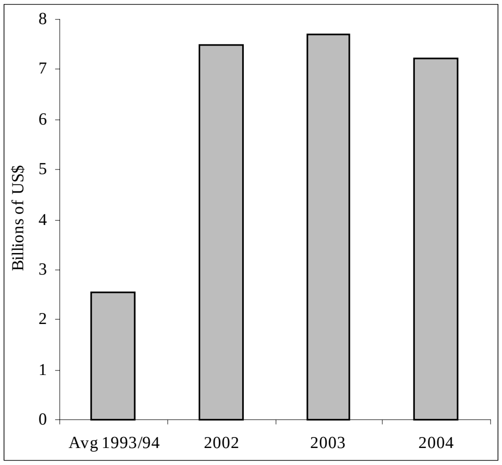
	2004	
	Share of Loans	**Growth**
Total Loans	**100.0**	**8.3**
Household Loans	16.0	12.2
Loans to Financial Institutions	12.9	(10.7)
Business Sector Loans	71.19	11.8
of which		
Manufacturing	27.3	16.1
Public Utilities	2.0	23.3
Construction	3.0	13.9
Commerce	17.4	6.1
Hotel and Restaurant	3.7	22.7
Transportation	4.3	41.0
Real Estate	7.4	15.1
Others***	6.0	(13.8)

Source: BOT

** Due to lack of sectoral adjustment data, these growth figures are unadjusted for write-offs, write-back, transfers to AMCs, and the effect of a merger in 2004 between a specialized financial institution and two commercial banks.

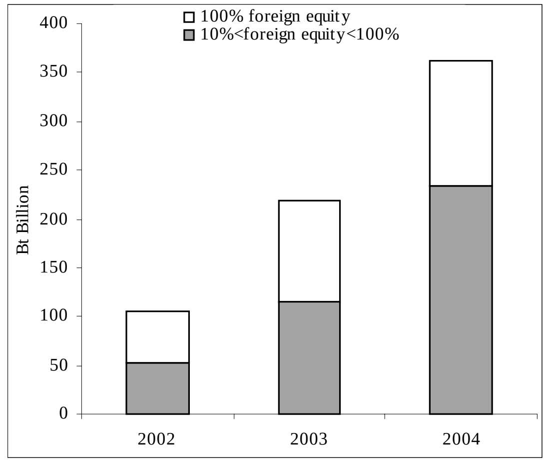
*** Agriculture, fishing, mining, and other business sectors

Figure 31. Gross FDI Inflows



Source: BOT

Figure 32. BOI FDI Approvals



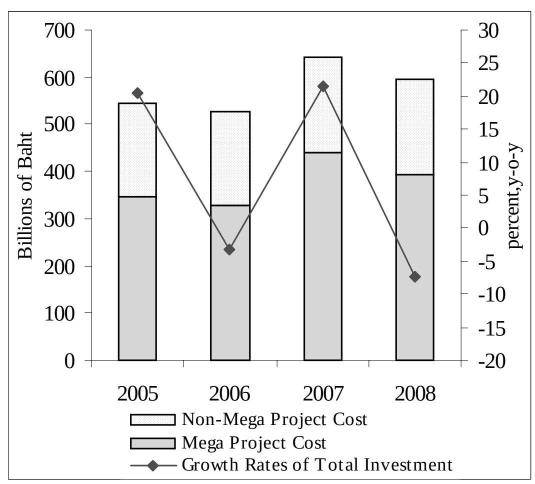
Source: BOI

unrest in the far south, unconcluded FTAs, and upcoming elections. As some of these uncertainties are resolved this year in addition to the political stability with the Thai Rak Thai party back as a majority government, FDI is expected to increase this year.

2.6.2 Public Investment

Public investment could increase significantly this year as mega-projects investments implementation begins and supplementary budgets are disbursed. After retrenching since 1998, public investment grew by almost 12 percent last year as investments by state-owned enterprise picked up, while the Government investment spending increased by Bt16 billion or 7 percent year-on-year from the supplementary budget in fiscal year (FY) 2004[29]. This year, public investment should speed up further as the implementation of the mega-projects[30] commences. Furthermore, the undisbursed Bt50 billion baht investment budget from FY2004 supplementary has been carried over to this fiscal year (see Table 12). In addition, the Cabinet has recently approved an additional Bt50 billion supplementary budget for this fiscal year, making this year's budget Bt12.5 trillion in total (see Table 13). The total amount of this year's supplementary budget will be financed by revenues collection which is forecasted to exceed its target by the same amount. Public investment could contribute up to one-fifth of real GDP growth this year. Public investment will be in the range of Bt500-650 billion annually in the next 4 years as the mega-projects are implemented in addition to other non-mega project investments (see Figure 33 and Figure 34).

Figure 33. Public Investment Plan, 2005-2008

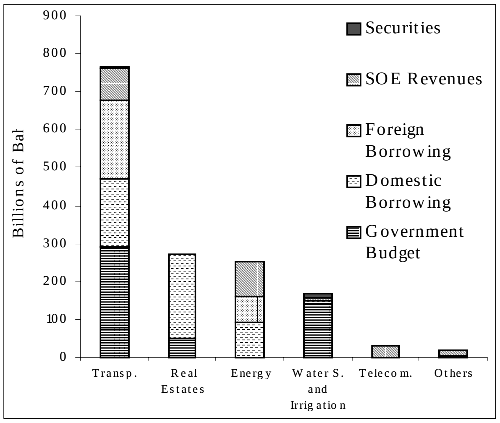


Source: FPO, 20 December 2004

29 FY2004 runs from 1 October 2003 to 31 September 2004.

30 Mega-projects are defined as projects costing at least Bt3 billion (US$80 million).

Figure 34. Mega-projects Investment by Sector and Source of Financing, 2005-2008



Source: FPO, 20 December 2004

Public investment plans, including the mega-projects, for the next 4 years could total up to around Bt1.5 trillion, raising the share of public investment in GDP to pre-crisis levels. The share of public investment in GDP was roughly 8 percent pre-crisis but gradually declined to below 6 percent with its continuous retrenchment from 1998-2003 before rising to 6 percent in 2004. Although final mega-project investment plans are not expected to be approved until May this year, preliminary information on the mega-projects investments indicates that it would average roughly Bt375 billion per year over the next four years. Non-mega project investments, on the other hand would be roughly Bt210 billion per year. These would raise public investment's share in GDP to its pre-crisis level

Table 12. Supplementary Budget in FY 2004

(Billion Baht)

	Supplementary Budget	Disbursement as of Sep 2004	Disbursement as of Mar 2005
Current Expenditures	64.2	68.9*	69.0
Civil Servant salary increase	16.6	11.9	11.9
Pension and gratuities	33.1	43.3	43.4
Civil servant early retirement program	14.6	13.7	13.7
Capital Expenditures	71.3	16.1	24.1
Transfer to local government for investments	12.3	11.0	11.0
Competitiveness enhancement program	59	5.1	13.1
Total	**135.5**	**85.0**	**93.1**

Source: FPO

Note: * The amount of disbursement exceeding the target will be financed from FY2005 budget

Table 13. Supplementary Budget in FY 2005

Purpose	Bt Billion
Reserve for Emergencies	17.0
Provincial Development under CEO Governor	15.0
Village and Community Capacity Building	9.4
Poverty Alleviation	4.0
Subsidy to Local Government to implement drought alleviation measures	4.6
Total	**50.0**

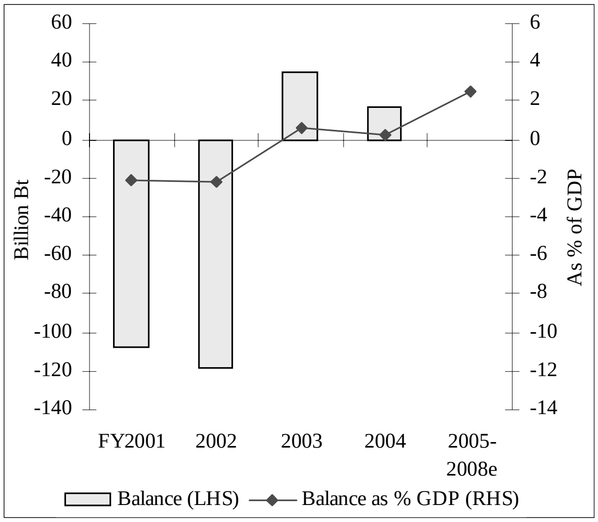
Source: FPO

by 2008. The investment sum is therefore not high when compared to pre-crisis levels or when compared to the infrastructure improvements that Thailand needs to improve its competitiveness. However, most effective use of the funds requires the projects to be well-integrated, be ones that are most needed, and foster private businesses and investments. The challenge facing the Government is how to select such projects and how to finance and implement the projects quickly and appropriately (see Box 5).

The mega-projects will focus on improving transportation and have the majority of funding from domestic borrowing and the government's budget. Over half of the mega-project investment is planned for the transport sector, particularly land transport, followed by the real estate and energy sectors (see Figure 34). The majority of the financing of the mega-projects in the transport and water sectors will be from the government budget, while those in real estate development will be from domestic borrowing, particularly securitization. Foreign borrowing will be used primarily to finance investments in the transport and the energy sectors, while state-owned enterprise revenues will be used to finance those in the transport, energy, and telecom sectors. Because only a third of the financing will come from the government's budget, representing on average roughly 10 percent of the Government's total budget in the next 4 years, the mega-projects should not run the government's cash balance into deficits. In fact, the Ministry of Finance expects the government budget to remain in surplus for the next 4 years (see Figure 35).

Increased public investments on top of the rising private investment will put a downward pressure on the current account. With the import content of the mega-projects being around 35 percent[31], imports will rise from the increase in public investments in addition to from the increase in private investment and oil imports. The trade account is therefore expected to be in deficit as early as this year (see Figure 36), while the current account will gradually decline, putting pressure on interest rates to rise. Public debt service and the crowding-out effects on private investments of these public investments are therefore key macroeconomic issues to be considered when prioritizing the projects.

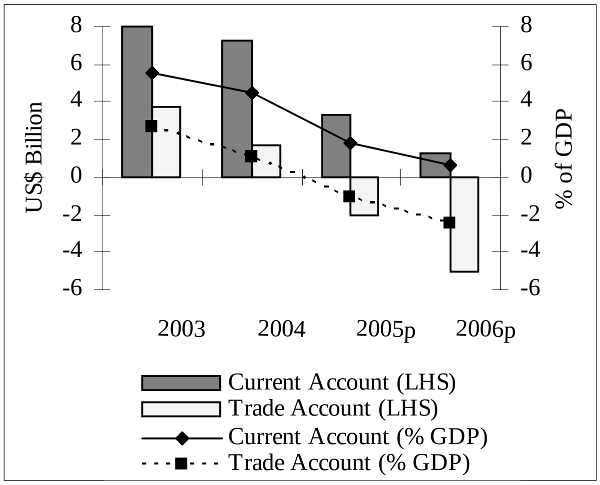
Figure 35. Central Government Cash Balance



Source: BOT (2001-2004), MOF (2005-2008)

Note: FY2004 is estimated. FY2005-2008 is budgeted.

Figure 36. Current and Trade Account Balances



Source: BOT and World Bank's projection

31 Source: Fiscal Policy Office, From Mega-project to Macroeconomic Projections, 20 December 2005

Box 5. Challenges in Implementing Mega-projects in Thailand

One of the major challenges Thailand faces in undertaking large infrastructure investments is the efficiency of the infrastructure delivery system. The Thai Government is embarking on a major infrastructure investment program in order to improve Thailand's competitiveness and the well-being of the population. The mega-projects are estimated to cost over Bt 1.5 trillion (US$39 billion) for the next five years or roughly 5 percent of GDP per years. In the short term, the program would contribute significantly to the aggregate level of public investment. In the medium and long term, it is expected to contribute to improved national competitiveness. The challenge facing the Government is the efficiency of the infrastructure delivery system – how to select the good projects and how to finance and implement the projects quickly and appropriately.

Major weaknesses in the infrastructure delivery system will have to be overcome. Historically, major weaknesses in Thailand's infrastructure delivery system have been the un-integrated infrastructure planning and provision and slowness in the approval processes and delivery, and the low user fees. To prevent the slowness of the delivery system, a number of institutional hurdles need to be overcome. The involvement of key stakeholders and project-affected persons early in the project design process needs to be increased. In addition, the greatest obstacle to sustainable infrastructure provision is the lack of user fees or lower-than-desirable level of user fees. It is a political issue, but the Government should think how to break the political impasse as it could put the sector onto the financially sustainable track in the long-term.

Private sector participation in infrastructure financing and service provision will be increasingly important as public resources will be insufficient to meet the high and increasing demands for infrastructure services in the coming years. Since the financial crisis, private sector investment in infrastructure has diminished. Are they coming back? And how soon? A survey undertaken for the recently published East Asia infrastructure study[32] shows that private sector sentiment is contingent on policy improvements and reduced risks.

An enabling environment for private sector participation needs to be strengthened. Private sector involvement in the provision of infrastructure in Thailand has an irregular record. A few sectors—expressways, electricity generation, water supply, telecommunications, and affordable housing—have performed notably well. However, there was little private interest shown in other sectors such as wastewater. Much of the framework in which private sector is currently working in the delivery of infrastructures was set in 1992. A major problem is the lack of clear regulatory environment and specific subsector guidelines both at national and local levels. Recently, a new remodeling of the legal framework, particularly the definition of clear guidelines in private public partnerships (PPP), has been undertaken. Other areas such as evaluation of projects and guidelines for the feasibility studies are also under a much-needed reform. With updates in the law, improvements in institutional arrangements, new regulatory bodies, and improved monitoring processes, there is scope for considerably increased private participation in infrastructure delivery in Thailand.

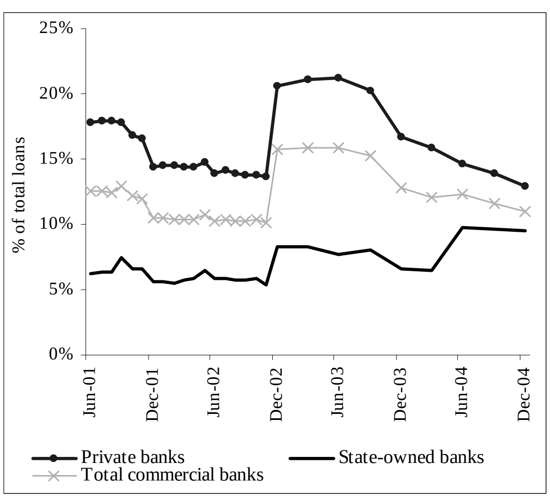
[32] *Connecting East Asia-A New Framework for Infrastructure*, ADB, JBIC, and World Bank (2005)

2.7 Financial and Corporate Sector Developments

Financial Sector Developments

Continued economic recovery has gradually improved the asset quality of Thai private banks. Despite the Bank of Thailand's (BOT) tightened loan classification rule, average non-performing loans (NPLs) of financial institutions have declined in 2004. Since the second quarter of 2004, the BOT has enforced a tightened loan classification rule, imposing a qualitative assessment on borrowers' ability to repay loans in addition to the aging criteria. The implementation of this rule has a strong impact on state banks, which reported a significant increase in their NPLs, while the impact on private banks has been subtle. After a substantial increase in their NPLs in the second quarter of 2004, state banks' NPLs have hardly declined. On the other hand, NPLs of private banks have declined approximately by 14 percent in 2004. However their NPLs relative to total loans remain high and vulnerable to an economic slowdown and an upward trend in interest rate (see Figure 37). The BOT's initiative to allow private banks to transfer their distressed assets to two state-owned AMCs has yet to materialize awaiting the enactment of legislative amendments.

Figure 37. Non-performing Loans, 2001-2004



Source: BOT and World Bank's estimate

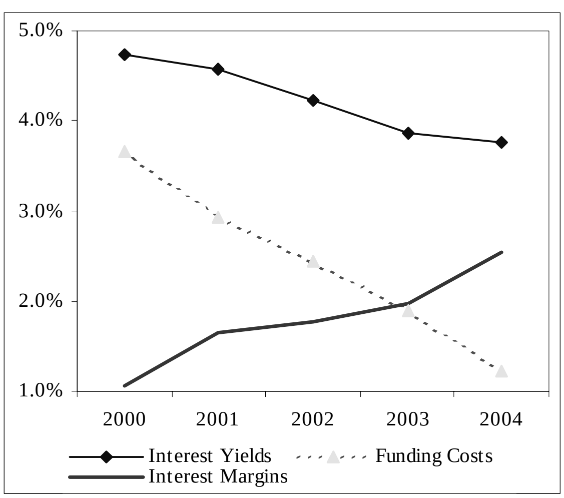
The resolution of distressed assets by the TAMC has shown progress. As of October 2004, the TAMC has approved resolution plans for 98 percent of the Bt 777 billion (US$19 billion) transferred to it. Debt restructuring plans have been approved for over 68 percent of the amount. The remaining 32 percent, the TAMC has given its debtors the opportunity to renegotiate out-of-court in the hope to reach a better solution. The TAMC's special power to foreclose assets is planned for the remaining cases where the TAMC was unable to contact debtors or rejected restructuring proposal submitted by debtors. The TAMC outsourced the management of the smaller 10,830 accounts, approximately 3 percent of transferred assets, to the largest state bank and one public AMC, and is expected to complete the restructuring of the smaller accounts by mid-2005.

Despite the TAMC's progress, challenges remain in executing new agreements, operations and disclosure, and resolving foreclosed assets. As of October 2004, about 45 percent of the book value of cases, for which resolution has been approved, has signed new restructuring agreements. Only 56 cases valued at Bt 2 million (US$50,000.) have completed the foreclosure process and awaiting public auction. A more significant challenge facing the Government is the resolution of Bt 289 billion (US$7 billion) non-performing assets (NPAs) being managed by TAMC. TAMC announced its board decision to seek private sector minority partnerships to invest in NPAs while TAMC retains majority ownership in the assets. The decision is guarding against a "fire sale" of NPAs, and while it is a viable consideration, the significant volume of NPAs is idle losses and must first be resolved before additional private investments and growth can be sustained. Alternatively, TAMC could consider a swifter resolution process through a transparent auction of NPAs by groups of property types, sizes and locations. However, a final determination is not expected until after the completion of the smaller cases.

The capital adequacy of Thai commercial banks has strengthened on an aggregate basis with some concern for a few banks. As of December 2004, the aggregate capital adequacy ratio of Thai banks was 11.9 percent, which was lower than their 13.4 percent capital adequacy ratio as of December 2003. While the aggregate amount of their capital base increased in 2004, higher growth in their risk assets has resulted in a slight reduction in the aggregate ratio of their capital adequacy. As of 2004, Thai banks have accumulated provisioning expenses up to 40 percent of their peak NPLs. Their profitability has continued to improve due mainly to wider interest margins and stronger loan growth. Abundant liquidity in the financial system has enabled Thai banks to reduce deposit rates faster than lending rates (see Figure 38). If the excess liquidity dries up, forcing upward trend in domestic interest rates, their interest margins could be under pressure. However lower interest margins can be compensated by stronger loan growth if the private investment continues to accelerate. The asset mix of Thai banks have also shifted slightly in 2004 as many banks liquidated their long-term investment in securities whose valuation can be under pressure with a higher interest rate trend (see Figure 39).

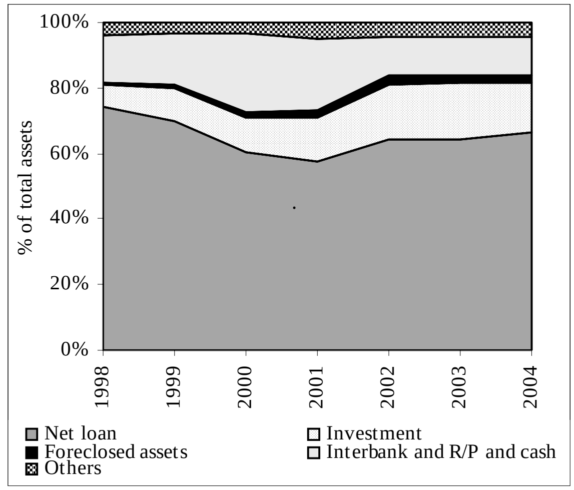
The Bank of Thailand (BOT) is considering imposing an interest rate ceiling on consumer loans. Without alternative measures to tackle immediate concern, the BOT hopes to use such regulation to curb substantial growth in consumer lending by financial institutions, reduce potential adverse impact of growing household debts, particularly among low-income

Figure 38. Average Interest Yields, Funding Costs, and Interest Margins of Thai Commercial Banks



Source: BOT and World Bank's Estimate

Figure 39. Assets of Commercial Banks, 1998-2004

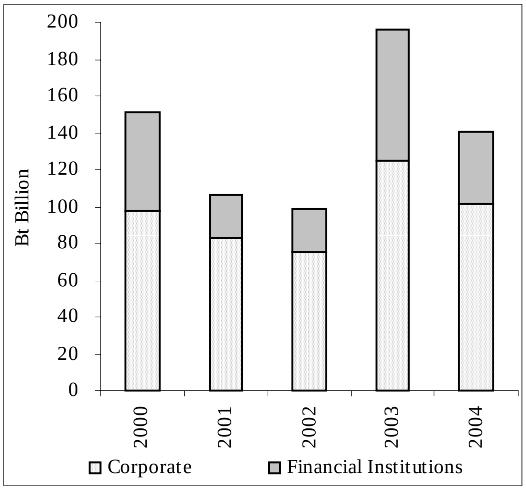


Source: BOT and World Bank's estimate

borrowers, and increase consumer protection. The regulation will be applied to both commercial banks and non-bank financial institutions (NBFIs). The interest rate ceiling has been set based on market average and accounted for potential interest rate increase. A few NBFIs, targeting low-income borrowers, were reported to have the maximum charge above the ceiling rates. The new regulation needs to be carefully implemented since it could have an unintended consequence on access to finance. Alternatively, financial institution themselves can help curb excessive consumer borrowing if it is observed by improving the sharing of credit information among the financial institutions. On the other hand, consumers can be better protected greater knowledge of financial products and improvements in information disclosure by financial institutions.

Fund raising activities in the domestic bond market by the private sector have slowed down in 2004. This can be attributed to the reduction of bonds issued by financial institutions, which in general have accounted for about 30 percent of total amount of debentures issued annually. On the other hand, firms in other industries have continued to actively raise funds in the bond market, taking the advantage of low bond yields (see Figure 40). The industries, which have been active in mobilizing capital from the bond market, include the construction, communication, entertainment, and real estate sectors. The upward shift in yield curve

Figure 40. Issuance of Debentures, 2000-2004



Source: BOT

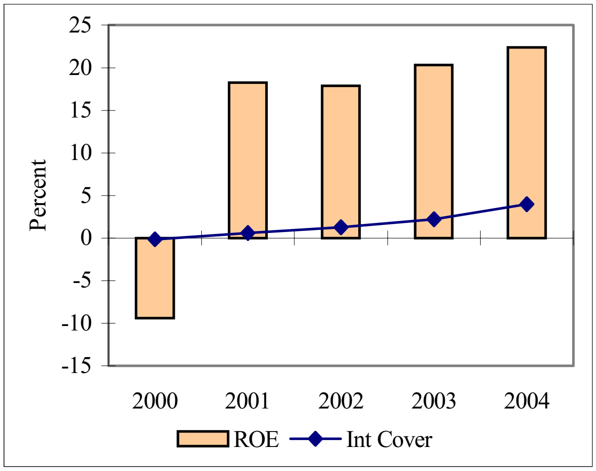
may be the main cause for inactive bond issuance by the private sector during third quarter 2004. However activities picked up substantially in the last quarter of 2004 as flattening yield curve may have induced more bond issuance by firms.

Corporate Sector Developments

The profitability of publicly listed firms has improved markedly in the last four years. Listed companies' return on equity (ROE) has increased from a negative figure in year 2000 to over 20 percent in 2004 (see Figure 41). Similarly, the interest coverage ratio has increased from a negative ratio to over 3 times during the same period.[33] The improved profitability and interest coverage provide a stronger assurance to banks as they consider an expansion in corporate credit.

Progress in corporate debt restructuring is limited in 2004. Overall, the slowdown in the pace of restructuring can be attributed to (1) the lack of a voluntary debt restructuring framework since the closure of the CDRAC voluntary debt workout framework in 2003[34]; (2) the remaining NPL cases are more complex and require more time to negotiate; and (3) TAMC only afforded NPLs from state owned banks and AMCs, while a sizeable proportion of NPLs in the private banks are left to bilateral negotiations and court-supervised workouts. As of September 2004[35], a cumulative total of US$ 72 billion (Bt3.0 trillion) of NPLs were restructured by financial institutions (see Figure 42). Progress has slowed in 2004 given a cumulative total of US$ 70 billion (Bt2.9 trillion) at the end of 2003, US$ 68 billion (Bt2.8 trillion) at the end of December 2002, and US$59 billion (Bt 2.4 trillion) at the end of December 2001.

Figure 41. Publicly Listed Companies' Average Return on Equity and Interest Coverage, 2000-2004



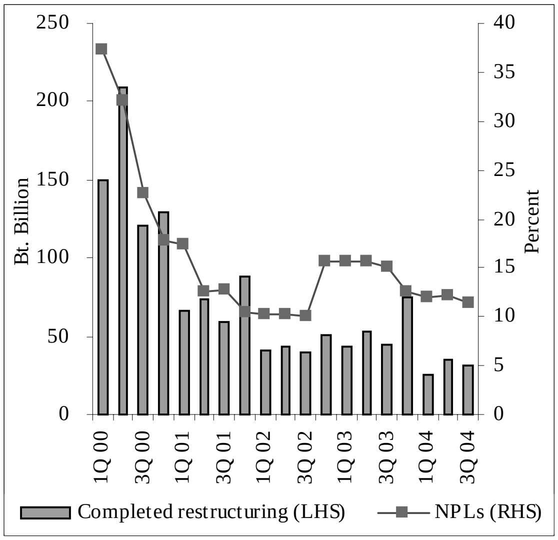
Source: SET and World Bank's estimate

[33] Sources: The Stock Exchange of Thailand and WB analysis Statistics include the Rehabilitation Companies category, which were insignificant to the results.

[34] In five years of operations from 1999-2003, the CDRAC process completed 49 percent of its US$ 67 billion (Bt29 trillion) target cases by credit value, a significant contribution to the cumulative completed debt restructuring.

[35] Sources: Bank of Thailand and WB analysis. The cumulative debt restructuring statistics since December 2003 are estimates made by the BOT. The BOT reports on the cumulative total completed restructuring have been under reviewed and constantly revised since December 2003. The reasons, being in certain cases, statistical errors and duplications were found in the reports submitted by financial institutions. The review is expected to be completed by mid-2005.

Figure 42. Completed Restructuring and NPLs, 2000-2004Q3



Source: BOT and World Bank's estimate

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

The BOT's initiative on out-of-court mediation framework has a small positive impact on removing NPL overhang. The BOT selected a target group of 136,728 cases, with the value of US$ 10 billion (Bt 426,843 million). In 18 months of operations through December 2004, progress remains slow. Creditors have selected only 8.9 percent of the total target debtors by credit value, and only 3.1 percent of the selected debtors have participated in the program. The completion rate is 1.4 percent of the total target debtors by value, an insignificant improvement from 0.18 percent completion rate in July 2003, 0.64 percent in December 2003, and 0.90 percent in June 2004.

The Mediation Center for Financial Disputes (MCFD) within the Office of the Judiciary continues to receive increasing requests from creditors and debtors to administer out-of-court mediation for financial disputes and NPL cases to relieve the backlogs in the courts. In 2003, a total of 1,983 cases requested out-of-court mediation as compared to 1,476 cases in year 2002. In 2004, 2,372 cases were requested while 1,844 cases were successfully mediated, and court filings withdrawn.

There remain growing concerns over the progress and impact of debt restructuring of small-medium-sized businesses (SMEs). While the CDRAC voluntary framework has wound down, there remains a large volume of SME loans to be worked out. Financial institutions intrinsically categorized SMEs by "loan-size", not by "size" of the business as defined by the legal definition of SMEs. It is, therefore, difficult for policy-makers to track and assess the overall progress of debt restructuring of SMEs. In addition, a comprehensive and reliable statistical database on SMEs is not available, thus an in depth assessment of SMEs is unachievable. Given the relative importance of the SMEs sector to the national economy and the fact that there remain substantial amount of NPLs in the financial system, it is particularly worrisome that debt restructuring of SMEs has not made significant progress.

2.8 Improving Competitiveness

Thailand needs to quickly improve competitiveness if it were to achieve the targeted average annual growth rate of 6.6 percent for the next 4 years as set forth by the Government. In January 2004, the Cabinet has endorsed the Strategic Framework for Socio-Economic Restructuring (2005-2008)[36] with the targeted average annual growth for 2005-2008 of 6.6 percent. To achieve this target, real GDP average annual growth in the next 3 years will need to be around 7 percent, given the real GDP growth of 5.2 percent this year. As labor force expansion is constrained, this target can only be achieved if Thailand increases its total factor productivity[37] (TFP) and investment levels. A simple growth accounting exercise in Table 14 below shows that Thailand's TFP average annual growth rate for this period needs to reach 2.9 percent if total

[36] Full document of the Strategic Framework (in Thai) is available on the NESDB's website www.nesdb.go.th

[37] Total factor productivity (TFP) growth is growth that arises from factors other than growth in physical inputs such as land, labor, and capital TFP growth is usually the result of improvements in technology, skills, management, etc.

Table 14. Required TFP Growth to Achieve 6.6% GDP Growth Target, 2005-2008

Average Annual Growth 2005-2008 (%)	
Land	0.02
Employment	1.0
Net Capital	2.7*
Required TFP	**2.9**
Real GDP Growth	6.6

Source: NESDB and WB calculations

* Corresponds to 15 percent total investment growth

Table 15. Required Investment Growth to Achieve 6.6% GDP Growth Target, 2005-2008

Average Annual Growth 2005-2008 (%)	
TFP (2000-2002)	2.3
Land	0.02
Employment	1.0
Required Net Capital	**3.3****
Real GDP Growth	6.6

Source: NESDB and WB calculations

** Corresponds to 18 percent total investment growth

investment grew by 15 percent per year on average[38]. Raising the TFP growth to 2.9 percent in the next 4 years would require significant improvements in competitiveness, given that the TFP growth after the crisis was at 2.3 percent. Without improvements in TFP growth, a high investment growth of 18 percent is needed to achieve the 6.6 percent growth target (see Table 15 and Table 16).

To sustain private investment, constraints like regulatory burden, skill-shortage and infrastructure costs, identified by firms[39] as severe, needs to be addressed. Preliminary findings show that the performance of firms– measured by labor productivity and total factor productivity – is adversely affected by these constraints. Thus, unless these constraints are addressed adequately thereby raising the rates of return for investors, growth in private investment and flow of higher investment into highly productive sectors will slow down over the medium-term. It is in this sense that the Government's efforts under the National Competitiveness Committee (NCC), which is already working on these areas, now needs to accelerate the implementation of measures to alleviate these constraints for private firms.

Uncertainty about the economic situation and the market was also an issue for firms. This may have a lot to do with the recent experience of the East Asian crisis, China's WTO accession and impact of terrorism. Locally, the experience with SARS, the Avian flu and now Southern unrest have created greater uncertainty. This means that for investors to invest, rates of return will have to rise to compensate for the increased uncertainty and risk. Addressing the constraints identified above will be critical for encouraging private firms to invest more and in more productive sectors.

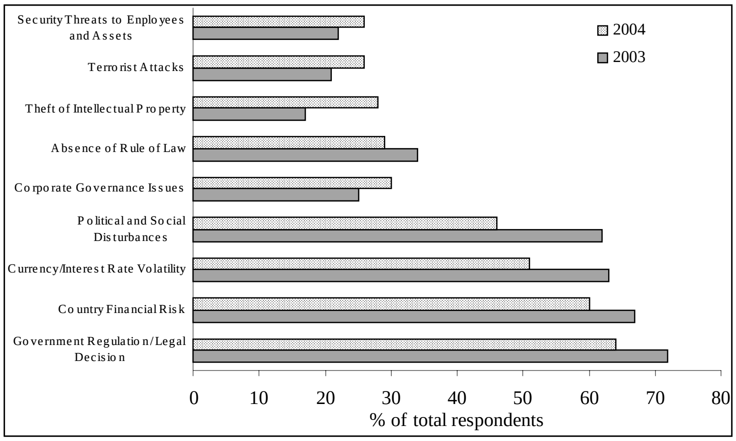
Some types of private firms are found to deal better with these constraints, than others. Medium and large firms are found to be performing much better than small firms. Similarly foreign-owned and exporting firms are found to be more productive than domestically-owned ones. In short, small firms, domestically-owned firms and domestic-market-focused firms – the very firms that the Government has been keen to promote – have their performance affected disproportionately more than others by these same constraints.

Firms in regions outside Bangkok and vicinity are found to have lower total factor productivity. This is particularly true in the Northeast, the North and the Central regions. Also, the severity of constraints

[38] Total investment annual average growth of 15 percent would requires an acceleration in current investment growth rates which was 13 percent on average for 2003-2004.

[39] The joint Government and World Bank *Productivity and Investment Climate Study* (PICS) initial findings show that a high proportion of the 1,385 private firms surveyed in 2004 confirm these constraints. However, further analysis is needed to fully understand the reasons behind the findings and the specific measures that are needed to address them. The full PICS report is expected in late June.

Figure 43. The Most Critical Risks to Firm Operations Overseas, 2003 and 2004



Source: A.T. Kearney, *FDI Confidence Index 2004*

varied across regions. While skilled-labor shortage was equally severe for firms in all parts of Thailand, poor infrastructure and lack of support services was much more of a constraint in the Northeast. At the same time, surprisingly, Northeast region faced less of a burden from regulations.

The shortage of skilled labor could potentially undermine sustained high private investment and growth. Nearly a quarter of firms report that they are not operating at full capacity due to a skill shortage. The survey also finds a significant wage-premium that has to be paid by firms for tertiary graduates. On the other side, Thailand is producing a lower number of secondary education graduates relative to countries at similar levels of income and development. Also the *quality* of the secondary school graduates produced is lower than those of its middle-income neighbors, as measured by test scores. On another dimension, 45 percent of the firms surveyed rated IT skills of their production workers as 'very poor'. Given the urgency for Thailand to move up the value-chain and create a knowledge-economy, these skill deficiencies identified by private firms are worrisome from the perspective of medium-to-long term private investment and growth.

Not withstanding the above, a 2004 survey of top multinational firms showed that Thailand ranks as the third most attractive investment destination among Asian investors but has fallen from 16th to 20th rank in the eyes of overall foreign investors. The 2004 A.T. Kearney's *FDI Confidence Index*[40] shows that Thailand's ranks as the third most attractive investment destination after China and India for Asian investors for the second year in a row. Asian investors are keen to take advantage of the free-trade agreements (FTAs) that Thailand has established as well as future ones. For all investors, however, Thailand's attractiveness fell by 4 ranks from 2003. Within this region, Hong Kong, Singapore, and Malaysia have moved up from ranks below Thailand in 2003 to above Thailand in the 2004 survey. Foreign investors reported the violence in the southern provinces and the less than stable legal and regulatory environment as well as corruption as main reasons for the reduced attractiveness of Thailand relative to other countries. This is in line with the concerns that investors have globally (see Figure 43).

[40] The FDI Index is compiled from a survey of top-decision makers in 1,000 multinational firms and is constructed from these multinational firms' views of 65 countries which receive more than 90 percent of global FDI flows.

SECTION 3

IMPLEMENTATION OF STRUCTURAL REFORMS

Improving competitiveness is an important element in the recently approved Public Affairs Management Plan (2005-2008). On April 12th, 2005, the Cabinet has approved the Public Affairs Management Plan (PAMP)[41]. The PAMP sets a framework for public sector operations in 2005-2008. The PAMP specifies nine areas of public affairs[42] with a set of strategic goals defined for each area and a set of indicators for each goal. It also specifies the public agencies responsible for achieving the targets set for each indicator (see Public Sector Reform Matrix in Appendix 2) Improving competitiveness is an important motivation behind many of the PAMP's strategic goals. For example, in area of "Economic Restructuring", increasing the productivity of the industrial sector is a key indicator to achieve the strategic goal of industrial sector growth. Similarly, improving the productivity of the labor force through skills development was specified as a strategic goal under the under the area of "Human Development and Quality of Life".

Implementation of reforms continues but is uneven across reform areas. Financial consolidation has made progress following the implementation of the Financial Master Plan. Much progress has also been made over the last year in improving corporate governance. Cabinet approval of tariff restructuring of the remaining 2 percent of tariff lines into the three-rate system last December completes the tariff restructuring approvals for all tariff lines to be brought into the three-rate system. Progress in legal and judiciary reforms as well as plans to expedite corporate restructuring and resolve NPAs in private banks, however, remain slow.

This issue of the Monitor examines in detail the progress in the implementation of the financial and corporate sector reforms and restructuring and trade reforms. In the first two areas, there is on-going work carried out with Government agencies under the Country Development Partnership on Financial and Corporate Sector Competitiveness (CDP-FC). In the area of trade reform – which is critical for competitiveness improvement – but where there is no CDP work, dialogues with relevant agencies was carried out to ascertain the state of progress. Below we look at the areas.

[41] The PAMP (in Thai) can be downloaded from the NESDB's website www.nesdb.go.th

[42] The nine areas include (1) Poverty Eradication, (2) Human Development and Quality of Life, (3) Economic Restructuring to Create Equilibrium and Competitiveness, (4) Natural Resources and Environmental Management, (5) Foreign Affair and International Economy, (6) Development of Legal System and Good Governance, (7) Promotion of Democracy and Civil Society Process, (8) Maintenance of National Security, and (9) Responsiveness to the Global Dynamics.

3.1 Financial and Corporate Reforms and Restructuring

Financial Sector Reforms and Restructuring

Consolidation in the financial sector since 2002 has mostly involved small players with the exception of one large transaction in 2004. Total number of financial institutions[43] including stand-alone international banking facilities (IBFs) declined slightly from 72 in 2002 to 65 in 2004 (see Table 16). The largest transaction completed in the third quarter of 2004 was a merger between two commercial banks, of which one was foreign majority owned, and a state-owned specialized financial institution. The new merged entity has approximately 7 percent market share[44] in credits. The total number of small financial institutions is likely to reduce further with the implementation of the Financial Sector Master Plan. Out of 11 applications for new banking licenses from 16 small finance and credit foncier companies, the Minister of Finance has already approved applications for three commercial banks and four retail banks. New banks must be established within one year before they are officially granted with new licenses. The Minister has also approved applications for single branch operations of two foreign banks and one wholly owned subsidiary.

The Fiscal Policy Office of the Ministry of Finance recently presented its analytical study on a consolidated supervision framework to concerned supervisory authorities and financial institutions, which has stimulated debates and discussions. The study argues for separating the supervision functions from the central bank and integrating all supervisory authorities into one single institution. Such recommendation differs from the initial decision made by the Task Force of all supervisory agencies, established in 2001, to keep the current, multiple-agency regulatory structure and set a framework for periodic sharing of information on the financial conglomerate by different regulators. Consolidated supervision was identified as an area of weakness in the assessment of the Thai banking supervisory regime against the 25 Basel Core Principles for effective banking supervision by the World Bank in 1999, mainly due to lack of a regulatory framework for consolidated supervision.

The new Public Debt Management Act, enacted in February 2005, will facilitate flexibility in public debt management but may continue to restrict the MOF's ability to issue government debt securities to support the bond market development. The new law allows the government to issue debt securities for (i) financing the budget deficit, (ii) financing economic and social development expenditures, (iii) restructuring of public debts, and (iv) on-lending to other authorities. If the budget continues to be in surplus, the government may have a limitation to issue benchmark securities in a significant amount on a regular basis. The benchmark securities are crucial for the construction of the yield curve and the yield curve is needed for the pricing of corporate debentures. Regular and substantial supplies of government securities will enhance the liquidity in the secondary market and support the development of the bond futures market.

Corporate Sector Reforms and Restructuring

The Government's plans to expedite corporate restructuring and resolve NPAs in private banks have yet to materialize. The Cabinet has approved a legal amendment to allow the Government AMC, which was the bidder of last resort during the liquidation of distressed assets held over from the financial crisis, to acquire NPLs from private banks and AMCs. Private banks are encouraged to sell their NPLs to the AMC with the pricing agreement already reached with the authorities. The amended legislation was approved by the Cabinet and submitted to the Parliament in January 2005, but since has been withdrawn from the enactment process. If enacted, the measures could be strengthened if complemented by an improvement in the legal regime to protect creditors' right. The governance and disclosure of the public AMC(s) should also be enhanced.

[43] Excluding life and non-life insurance companies, leasing companies, factoring companies, and credit card companies.

[44] UBS Investment Research

Table 16. Total Number of Financial Institutions

	Pre-crisis Jun-97	Dec-02	Dec-04
Domestic Private Banks	14	6 [1]	6
Domestic Private Banks (with the majority foreign ownership and control)	0	4 [2]	3 [5]
State-owned Banks	1	3 [3]	3
Foreign (single branch) Banks	14	18	18
Total Commercial Banks	**29**	**31**	**30**
Finance Companies	91	19	18
Credit Foncier Companies	12	6	5
Specialized Financial Institutions	7	9 [4]	8 [5]
Total Financial Institutions	**139**	**65**	**61**
Stand-alone IBFs [6]	17	7	4
Total	**156**	**72**	**65**

Source: The BOT

[1] includes National Finance Bank (NFB) which was granted banking licenses in 2Q 2002.

[2] includes BOA, DTDB, SCNB and UOBR which have the majority foreign ownership and control

[3] does not include BBC (wound down), FBCB (merged with KTB), LTB (merged with RSB), and BMB (merged with SCIB).

[4] Secondary Mortgage Corporation was established in 1997 and Islamic Bank of Thailand was established in 2002.

[5] DTDB and IFCT were merged with TMB in 3Q 2004.

[6] Foreign banks have been allowed to operate international banking facilities in Thailand without a branch operation.

Progress in legal and judiciary reforms to promote corporate restructuring remains slow, while the proposed reforms so far are insufficient. The three-point amendment to the individual bankruptcy liquidation framework[45] of the Bankruptcy Act endorsed by the Cabinet over a year ago is still under review by the Council of State. Even so, the amendments only cover individual bankruptcies, while the corporate bankruptcy framework has not been amended. The amendments to the Civil Commercial Code on Legal Execution to expedite the sale of foreclosed properties by reducing fees to attract buyers to the foreclosed properties market have also been awaiting Parliamentary consideration since early 2004[46]. Nevertheless, the prevailing market consensus is the reduction in fees would minimally accelerate the sale process, and more rigorous amendments to the legal execution procedures are still needed to expedite the sale process. Similarly, the Secured

[45] The amendments proposed to (1) allow retroactive discharge from bankruptcy after three-year period for individuals whose court judgments were rendered after year 1994, or within five years prior to the 1998 bankruptcy amendment. Prior to 1998, bankrupted individuals are subjected to a ten-year bankruptcy period before they can petition for a discharge; (2) extend the bankruptcy period from five to ten years for individuals who are ruled dishonest or fraudulent by the CBC; but the revised law would allow those individuals to petition the court for discharge from bankruptcy after five years; (3) disallow the collection of repayments or assets from family members of bankrupted individuals who are under 18 years old, while the spouse's assets must be divided 50:50 before collection under the Thai marital law.

[46] The amendments proposed to (1) reduce the auction fee from 5 percent to 3 percent of the sale value; (2) reduce the foreclosed property discharging fee from 35 percent to 2 percent; and (3) reduce the fee for sales not going through the auction process from 3 percent to 2 percent.

Transaction Act has been awaiting a sub-Cabinet review before submission to the Cabinet and then the Parliament for approval since 2003. The Act would greatly enhance the corporate restructuring framework by providing greater flexibility in collateralization of other assets besides the traditional pledging of real estate.

In March, ten sub-committees were set up to review the 377 laws identified by line ministries to be redundant, outdated, or in need of a new law. However, specific reform activities and detailed work plan of the sub-committees and timeline have not been determined. The NLRDC, chaired by a Deputy Prime Minister, was established to replace the slow moving Legal Reform Committee for the Development of Thailand established in 2001 under the Council of State. The new committee comprised mostly government officials, with a few private sector and academic representatives, received a comprehensive mandate for legal reform and development.

Thailand continues to make good progress in improving corporate governance. In 2004, the Securities Exchange Commission (SEC) intensified its efforts to promote good corporate governance of listed companies. The SEC policy focused on 2 main areas: (1) closely monitoring and ensuring that accounting practices of listed companies are in compliance with the Thai accounting standards; and (2) preventing companies from misappropriating companies' assets through connected transactions.

Recent efforts to enhance the accountability of directors are commendable. The SEC established a mandatory Director Registration program beginning in March this year. All listed company directors and senior executives are now required to register. Under this program, Directors whom the SEC finds to have questionable actions will be evaluated by an independent Director Disciplinary Committee, which will make recommendations to the SEC whether or not to remove those directors from the Director Registration list. Directors who are removed from the list will no longer be allowed to become directors in any list company.

The self-assessment by the Securities and Exchange Commission (SEC) of objectives and principles of securities regulation against the IOSCO standards has revealed several strengths and identified areas for improvement. Significant improvement could be made in better assigning regulatory responsibilities provided under the Securities and Exchange Commission Act (SEA) and the Public Company Act (PCA), and strengthening the enforcement power of the SEC. A number of administrative sanctions have been used and liaison arrangements with the Department of Special Investigation (DSI) have been established to mitigate its enforcement difficulty under the current regime. In addition, the SEC is proposing amendments to the SEA to improve its ability to provide investigative assistance to foreign regulators, to improve information sharing with them, to increase the legal liability of senior management to the company and its shareholders, to strengthen client protection in the case of intermediaries' insolvency, and to reduce uncertainties in clearing and settlement in the case of intermediaries' insolvency. Official information sharing mechanism between different Thai regulators is being established in the form of an MOU.

A corporate governance assessment under the ROSC program is underway and is expected to be completed by June 2005. The ROSC benchmarks a country's corporate governance practices against OECD principles and international best practices, with the objective of recognizing strengths and identifying areas that need improvement in order to achieve compliance with the OECD principles.

3.2 Recent Trade Reforms

Tariff Reform

The tariff restructuring of the remaining tariff lines were approved by the Cabinet in December last year. These existing items accounted for less than 2 percent of total tariff lines and included products in petrochemical industry like polymers, plastic products and synthetic rubber. The tariff reduction resulting from this most recent approval together with the previous approvals in 2003 brought an additional 17 percent of total tariff lines into the three-rate system in January 2005. Therefore, as of January 2005, roughly 73 percent of total tariff lines have been restructured into the three-rate system since 2003[47].

Export Promotion and Assistance

Thailand has made a significant progress on FTAs leading to several tariff reductions this year. Australia and Thailand FTA, signed in July 2004, led to the tariff reductions between the two parties on 1 January 2005. This will be followed by the further tariff reductions between ASEAN members and China, effective on 1 July 2005 on top of the Early Harvest Program that has been implemented since 1 January 2004. In addition, the Closer Economic Partnership Agreement with New Zealand, signed on 19 April 2005, will result in the tariff reductions in July 2005 (see Box 6).

The Ministry of Commerce targets to increase export growth rate in 2005 by 20 percent through FTAs and proactive strategies. The Ministry of Commerce is expected to expand Thailand's total exports by 20 percent or around US$ 117 billion in 2005. Several strategies have been implemented to support Thai exports including negotiations on FTAs with major trading partners, an expansion and penetration of agricultural products such as rice, tapioca, rubber and processed food into major markets as well as new emerging markets, and collaboration between government agencies and private sector to promote exports[48].

The EXIM Bank organized several export-related seminars and established the EXIM Info Service to facilitate exporters. There were 50 seminars organized by the EXIM Bank last year to provide exporters information on export issues such as export procedures, export risk management, potential export markets, and laws and regulations on international trade with major trading partners. Moreover, the EXIM Info Service was set up in August 2004 to give information on bank's financing facilities including customer outstanding credit balance and foreign exchange rate as well as advisory services on export procedures and documents.

[47] The three rates capture each stage of production as follows: 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods. The major tariff restructure started in 2003 leading to two major tariff reductions, effective in October and December 2003.

[48] The Department of Export Promotion has implemented the following strategies to support Thailand's exports. These include the Special Task Force (STF), Thailand Market Place (TMP), the International Trading Firm (ITF), Intertrader Project and OTOP to the World (see details of each strategy in Thailand Economic Monitor November 2004 issue).

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

Thailand has employed FTAs as a proactive strategy to expand its international trade since 2003. In 2004, there was a significant progress in FTA negotiations and thus facilitating trade flows among the parties. The current stages of selected agreements are as follows:

- **ASEAN and China:** In November 2004**,** ASEAN members and China signed two agreements on trade in goods of the framework agreement on comprehensive economic cooperation between the ASEAN and China and on dispute settlement mechanism between ASEAN and China, effective on 1 January 2005. According to the former agreement, tariffs of normal-track products under HS09(Coffee, tea and spices) to HS97(Art and antiques) will be reduced on 1 July 2005 and become zero rates by 2010. However, tariff rates of sensitive products will be reduced to 20 percent by 2012 and to 0-5 percent by 2018 and tariff rates of highly sensitive products will be reduced to 50% by 2015[49].
- **Thailand and Australia:** Tariff reduction under a framework agreement on Free Trade Area signed on 5 July 2004 was effective on 1 January 2005. After the implementation of the agreement, FTA Joint Commission was established to ensure the proper implementation and to review the economic relationship and partnership of the two. The FTA Joint Commission is expected to meet within a year after the implementation or otherwise mutually determined by the parties.
- **Thailand and New Zealand:** The Thailand-New Zealand Closer Economic Partnership (CEP) Agreement was signed on 19 April 2005. The CEP covers trade in goods and services as well as investment. According to the CEP, on 1 July 2005, New Zealand's tariffs of 79 percent of total items will be exempted[50]. These include, for instance, pick-up truck, canned tuna, jewelry, frozen shrimps, electrical appliances, glass and glassware. Tariffs of 54 percent of Thailand's total tariff lines will also become zero rate including, wood and wood products, plastic and its products, and machinery.

Other bilateral agreements are also under negotiation and study. These include, for example, Thailand and Japan, ASEAN and Korea, and ASEAN and Australia &New Zealand.

- **Thailand and Japan:** In the recent meeting in late March**,** the two parties mutually agreed on trade in services allowing eligible Thai workers to work in certain occupational areas, such as advertisement, event organizer and spa management. As for trade in goods, the two are still negotiating on agricultural and manufactured products which will be included in the tariff reduction list.
- **ASEAN and Korea:** ASEAN and Korea organized the first meeting to discuss the framework agreement on free trade area including trade in goods and services, investment, economic cooperation, rules of origin and dispute settlement. According to this negotiation, tariffs of at least eighty percent of total tariff lines are expected to be reduced by July 2006 and become zero rates in 2009. The framework agreement on tariff reduction will be submitted to the ASEAN-Korea summit during ASEAN summit at the end of this year.
- **ASEAN and Australia &New Zealand in November 2004:** ASEAN and Australia & New Zealand mutually agreed to establish free trade area. The framework will be a comprehensive package covering trade in goods and services as well as investment without the Early Harvest Program. The negotiation is expected to be completed within 2 years.

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[49] There are 342 items (at 6 digit HS code) in Thailand's list of sensitive products including for example footwear, tiles, milk products, silk yarn, steel and its products, and marble As for China's, 261 items are included in the sensitive list. There are, for instance, coffee, maize, plywood, vehicles and parts Thailand's highly sensitive products must not exceed 100 items including, such as, milk and milk products, coffee, raw silk and marble. The same is true for China's highly sensitive products including, for example, rice, palm oil, sugar and plywood.

[50] Tariffs of the remaining products will become zero by 2010 and by 2015 for textiles and clothing.

Appendix 1: Key Economic Indicators

	2003	2004 e/	2004				2004	2005	
	Year	Year	Q1	Q2	Q3	Q4	Dec	Jan	Feb
Output, Employment and Prices									
GDP (% change, previous year)	6.9	6.1	6.7	6.4	6.1	5.1	..	..	..
Manufacturing production index (2000=100)	127.2	141.3	142.3	136.0	140.0	146.9	149.4	143.5	138.4
(% change, previous year)	13.7	11.0	13.3	9.6	12.4	9.0	6.3	3.2	-1.6
Unemployment rate (%)	2.2	2.1	2.9	2.5	1.5	1.5	1.5	3.3	2.3
Real wage growth (%) 1/	0.4	..	0.5	-1.1	-1.8	..	..	..	..
Consumer price index (% change, previous year)	1.8	2.8	2.0	2.7	3.3	3.1	2.9	2.7	2.5
Public Sector									
Government cash balance (Billion Baht)	24.0	4.3	9.4	39.9	5.4	-50.4	-21.7	..	..
Government cash balance (% GDP)	0.6	0.3	0.6	2.5	0.3	-2.9	..	..	..
Public sector debt (% GDP, end of period) 2/	48.9	48.3	44.1	45.4	48.2	48.3	48.7	..	..
Foreign Trade, BOP and External Debt									
Trade balance (US$ million)	3,759	1,682	236	-182	241	1,387	813	-1,475	-596
Exports of goods (fob, US$ million)	78,105	96,064	21,961	23,398	24,711	25,994	8,378	7,695	7,644
(% change, previous year)	18.2	23.0	21.9	24.6	25.4	20.3	16.7	11.6	5.9
Imports of goods (cif, US$ million)	74,346	94,382	21,725	23,580	24,470	24,607	7,565	9,170	8,240
(% change, previous year)	17.4	27.0	26.6	35.1	29.5	18.2	7.0	33.6	22.8
Current account balance (US$ million)	7,965	7,289	2,158	635	1,472	3,024	1,369	-942	106
(% GDP)	5.6	4.4	5.2	1.6	3.7	7.0	..	..	..

	2003	2004 e/	2004				2004	2005	
	Year	Year	Q1	Q2	Q3	Q4	Dec	Jan	Feb
Foreign direct investment, net (US$ million)	1,882	485	132	227	-354	480	350	44	..
Total external debt (US$ million)	51,783	51,077	51,461	49,821	50,701	51,077	..	51,181	..
(% GDP)	36.2	31.2	31.5	30.5	31.0	31.2	..	..	..
Short-term debt (US$ million)	10,904	11,435	11,505	10,464	11,449	11,435	..	..	..
Debt service ratio (% exports of goods and services)	16.0	8.2	10.3	7.8	9.7	5.5	..	..	..
Reserves, including gold (US$ million)	42,148	49,832	43,036	43,306	44,768	49,832	49,832	48,917	49,696
(months of imports of goods)	6.8	6.3	5.9	5.5	5.5	6.1	6.6	5.3	6.0
Financial Markets									
Domestic credit (% change, previous year) 3/	4.3	7.4	5.0	7.0	8.1	7.4	7.4	..	..
Short-term interest rate (average period) 4/	1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Exchange rate (average period)	41.5	40.2	39.2	40.2	41.3	40.2	39.2	38.7	38.4
Real effective exchange rate (1994=100)	78.0	77.7	79.1	78.8	76.7	76.2	77.2	78.4	79.4
(% change, previous year)	-2.1	-0.3	2.8	2.1	-2.5	-3.6	-1.7	-0.5	0.1
Stock market index (Dec 1996=100)	772.2	668.1	647.3	647.6	661.2	668.1	668.1	701.9	741.6
Memo: GDP (US$ billion)	143.0	163.5	41.0	39.7	39.6	43.2	..	..	..

e = estimate

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

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

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

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

Appendix 2: Monitoring Matrices for Structural Reform Implementation[51]

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

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

1. Poverty Reduction Diagnostics*

Objective	Reform Measures Taken
A. Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve the local economy	***Measures taken over last 6 months and their significance*** ▪ **The new poverty line has been constructed.** The new poverty line, with a revised consumption basket, calorie and protein requirement and incorporating changes in demography, has been constructed and will be officially adopted. Using the new methodology, the poverty line for 2002 will be revised upwards to Bt1,190 rather than Bt922 per person per month and for the first half of 2004 will be Bt1,230 per person per month. This will result in higher headcount ratio in 2002 of 15.6 percent as compared to 9.8 percent using the old poverty line. However, he over all trend of poverty is still declining with the headcount ratio for first half of 2004 at 12 percent. ▪ **The Small-Medium-Large (SML) Scheme has been piloted in 1,002 villages.** 1,002 villages are being piloted on the SML Scheme, which provides short term interest loans to villages. The government has allocated more than Bt250 million to the pilot villages and communities participating in the scheme. Each small village will receive 200,000 baht, each medium village will receive 250,000 baht, and each large village will receive 300,000 baht. The Government also expects to transfer more than Bt20 billion to the program in FY 2005. ▪ **A Debt Relief Program has been implemented following the poverty registration program.** The National Poverty Eradication Center is working with banks to provide debt relief to those who reported existing high personal debt as their problem under the Poverty Registration Program[52]. More than 5 million of indebted cases have been registered, of which 500,000 cases were reported as being indebted with formal debts and around 1,300,000 cases being indebted with both formal and informal debts. Currently, around 11 percent of the cases has already been transferred into system, equaling 15 percent of the total debt value. ▪ **On April 9, 2005, the Cabinet approved the Public Affair Management Plan, in which poverty is one of the nine areas that the government will focus on over the next four years.** Under this plan, several initiatives will be implemented, led by the Poverty Eradication Center. Various targets have been established to be achieved over the next 4 years. These include reducing income gap by raising income of those in the lowest quintile by 5 percent and 16,735 poor villages establishing their own poverty solving process and having access to capital. ***Measures to be taken in the next 6-12 months*** ▪ **More tambons will develop their Community Development Plans in the second phase of the program.** In its second phase, covering the period from June 2004 to June 2005, another 2,673 tambons are expected to develop their own community plans. ▪ **Poverty Eradication Caravan will be sent out.** In response to the issues registered under the Poverty Registration Program, government will send out mobile units, known as Poverty Eradication Caravan, to the grass root level to deal with poverty related problems and provide advices and services, including skill training, for professional development. ▪ **The Special Purpose Vehicles (SPV) will be established.** In order to maximize long term agricultural productivity, the Special Purpose Vehicles (SPV) will be established to manage production, processing, marketing and capital resource to mitigate risks faced by farmers.

* Prepared by Khuankaew Varakornkarn

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

2. Financial and Corporate Sector Reform*

	Objective	Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	***Measures to be taken in the next 6-12 months*** ▪ **The newly merged credit bureau, the National Credit Bureau, will start its operation in June 2005.** As of April 2005, the legal process for a merger of the Central Credit Information Service Co., Ltd. and the Thai Credit Bureau has been completed. The two are in the process of combining their existing credit database, which will be completed before beginning its operation in June 2005.
B.	Formulate a medium-term strategy for Thai financial sector	***Measures taken over last 6 months and its significance*** ▪ **The Minister of Finance has approved applications for three new commercial banks and four new retail banks.** The new banks must be established within one year before they are officially granted with new licenses. The Minister has also approved applications for single branch operations of two foreign banks and one wholly owned subsidiary. The total number of small financial institutions is likely to reduce further with the implementation of the Financial Sector Master Plan. ***Measures to be taken in the next 6-12 months*** ▪ **BAAC will be transformed into a rural bank.** The draft amendment to the BAAC Act was approved by the Cabinet and the Office of the Council of State and will be submitted to the Parliament in the next session. After the endorsement by the Parliament, BAAC will be able to expand its businesses beyond agricultural finance. The transformation of BAAC into a rural bank is the one of the government's measures to improve access to finance in the rural areas, using BAAC's established branch network. ▪ **The BOT will launch a pilot project with state banks to improve the capacity and infrastructure for the delivery of cost effective financial services to low-income households.** The project is scheduled to start this year. The BOT hopes to demonstrate that serving low-income household can be commercially viable if appropriate business models are used. The success of the project may persuade commercial banks to penetrate into this segment and subsequently improve access to financial services by the poor, which is an ultimate goal of the current Financial Sector Master Plan.
C.	Transit from the current blanket government guarantee on deposits to limited deposit insurance	***Measure taken over the last 6 months and its significance*** ▪ **The Deposit Insurance Act was endorsed by the Cabinet in November last year.** The draft Deposit Insurance Act, endorsed by the Cabinet in November last year, is being reviewed by the Office of the Council of State. Once the legal review is completed, the draft law will be submitted back to the Cabinet and then the Parliament for its final endorsement. It is expected to be submitted to the Parliament in late 2005. The Act will become effective within 180 days, after it is published in the Royal Gazette, and the Deposit Insurance Agency can be established subsequently.
D.	Remove legal impediments and provide an enabling environment for derivative products	***Measures to be taken in the next 6-12 months*** ▪ **The Thailand Futures Exchange (TFEX) will open in November 2005.** The TFEX has been granted a license from the Securities and Exchange Commission (SEC) since February 2005 to operate a futures exchange. The TFEX is currently accepting member companies. Rules and regulations on futures trading on the exchange are being developed to be submitted for the SEC's approval. The first product to be traded on the TFEX is the SET 50 Index Futures. The establishment of an organized derivatives exchange would add more players and liquidity to the financial market and provide investors more tools to manage their risk.

	Objective	Reform Measures Taken
E.	Develop domestic bond market	***Measures taken over last 6 months and their significance*** ▪ **The new Public Debt Management Act was enacted in February 2005.** The new law aims to facilitate flexibility in public debt management. However the issuance of government securities for the bond market development may continue to be restricted. The government is allowed under the new law to issue debt securities for (i) financing the budget deficit, (ii) financing economic and social development expenditures, (iii) restructuring of public debts, and (iv) on-lending to other authorities.
F.	Rationalize state holding of specialized financial institutions, state owned enterprises, and state commercial banks	***Measures taken over the last 6 months and their significance*** ▪ **The Fiscal Policy Office (FPO) has established an electronic financial monitoring system for the state-owned specialized financial institutions (SFIs) in 2004.** SFIs are required to submit to the FPO their financial reports and key performance indicators electronically. This system is currently used by the FPO as its internal management tool. The new system enables the FPO to better monitor the financial performance of SFIs. ▪ **The SME Bank has taken an initial step to implement a Public Service Account (PSA).** A public service account will report costs and performance of socially mandated activities in separation from commercial activities. This is an initial step to improve the transparency of financial reports by specialized financial institutions (SFIs). By properly costing and budgeting socially mandated activities, the MOF can hold SFIs accountable for losses and profits. The FPO has yet to finalize its proposal and a definite timeframe for the implementation of the PSA by public financial institutions. Although uncertainty remains, SME bank has proceeded with an initial implementation of the PSA by separating social and commercial activities on its income statement since early 2005. It has yet to separate the accounts on its balance sheet.
G.	Enable corporate sector restructuring through reduced fees on the sale of foreclosed properties and streamlined the "buyer-take-possession" procedure following the sale of foreclosed properties	***Measures to be taken in the next 6-12 months*** ▪ **The Parliament is expected to pass the amendments to the Code of Civil Procedures on Legal Execution to reduce the fees on the sale of foreclosed properties, and to allow for an immediate "buyer-take-possession" following the sale of foreclosed properties.** The proposed amendments would lower the current fees of 5 percent for properties auctioned, 3.5 percent for property discharging, and 5 percent for sales not through the auction by at least half in each category. Although these are not procedural changes to streamline the auction process, it is expected that the lower fees would attract more buyers to the foreclosed properties market. Similarly, the immediate "buyer-take-possession" would eliminate the redundant requirement for the buyer to petition and obtain court order to transfer legal ownership of the properties, thus, reducing the transaction cost and time for both the seller and the buyer. After long delays in the approval process, the amendments are listed as Agenda Item No. 7 to be considered during the current parliamentary session.

Objective	Reform Measures Taken
	Measures planned to be taken, but have been delayed ▪ **The draft amendments to the Asset Management Corporate Act (AMC Act) to allow the Government AMC to purchase distressed assets from private financial institutions have been withdrawn from Parliamentary submission pending further review**. The amendments to allow private banks and AMCs to sell their distressed assets to the Government AMC were intended to accelerate the resolution of distressed assets in private banks, and at the same time to lessen their bad debt portfolios and reduce the level of NPLs in the financial system. The amended legislation was approved by the Cabinet and was submitted to the Parliament in January 2005 before being withdrawn. ▪ **The Courts of Justice's proposed remedial actions to lessen the backlog of cases in the Civil Court have not been approved.** The Courts of Justice has proposed establishing special hours for trial, increasing the number of judges, and increasing budgetary resources for the Civil Courts, but after over a year the proposals have not gained approval from the Judicial Commission, and alternative actions have not been proposed. ▪ **The Secured Transaction Act has been under review by the Joint Senate-House of Representatives Committee for two years.** The law would allow for more flexible collateralization of liquid assets other than the traditional real estate properties. Thus providing both creditors and debtors with more legal options in securing new credits as well as in debt restructuring. The draft law was approved by the Cabinet in mid-2003, but since has been under intensive review by the joint-committee. Given the general election and the new House of Representatives in 2005, the joint review process must start anew, further delaying the enactment process.

* Items A-F prepared by Renuka Vongviriyatham, Cristina Cotano, and Wallada Atsavasirilert
Item G prepared by Tanatat Puttasuwan

3. Reforms to improve Business and Investment Environment*

	Objective	Reform Measures Taken
A.	Reform institutions to enhance competitiveness	***Measure taken in the last 6 months and their significance*** ▪ **The plan to restructure and build capacity of the technical institutes has been approved by the National Competitiveness Committee (NCC), but implementation and actual progress have been slow.** The NCC has approved a three-year plan (2004-2006) to revise the roles and structure of the technical institutes to enable them to provide more in-depth services, which would enhance respective sectors' competitiveness. The technical institutes to undergo restructuring in terms of roles, technical capacity and activities are the Textile Institute, Thai Automotive Institute, Food Institute, and Thailand Productivity Institute. The progress of the restructuring has been slow due to insufficient allocation of government resources for the institutes, and the multi-layer bureaucratic procedures that delayed implementation.
B.	Reform of legal and judicial regime	***Measure taken in the last 6 months and their significance*** ▪ **In March, ten sub-committees were set up to review the 377 laws identified by line ministries to be redundant, outdated, or in need of a new law.** However, specific reform activities and detailed work plan of the sub-committees and timeline have not been determined. The NLRDC, chaired by a Deputy Prime Minister, was established to replace the slow moving Legal Reform Committee for the Development of Thailand established in 2001 under the Council of State. The new committee, comprised mostly government officials with a few private sector and academic representatives, has received a comprehensive mandate for legal reform and development.
C.	Improve the skills and quality of labors	***Measure planned to be taken, but has been delayed*** ▪ **The development of an implementation plan for the Thai Vocational Qualifications (TVQs) program to standardize and build vocational skills in a manner consistent with international standards has been delayed.** A new vocational law and the TVQ Act have been drafted and are still being reviewed by the Council of State before submission to the Parliament. The review process has been time consuming due to shortage in resources within the Council of State. Meanwhile, the Federation of Thai Industries, the sponsor of the program, has delayed the development of the plan and the set up of the TVQ Institute pending passage of the laws.

* Prepared by Tanatat Puttasuwan

4. Trade Reforms*

		Reform Measures Taken
Objective		
A.	Reduce tariff to improve Thailand's competitiveness	***Measures taken over last 6 months and their significance*** ▪ **MFN tariff reduction took place in January 2005.** Two-fifths of 43 percent of total tariff items approved by the Cabinet in 2003 entered the three-band system in January 2005. These include, for example, paper, printed matters and based metal. ▪ **The tariff restructure of the remaining tariff lines was approved by the Cabinet in December 2004.** The tariff restructuring of the remaining 2 percent of total tariff lines, which includes items in the petrochemical industry such as polymers, plastic products and synthetic rubber, was approved by the Cabinet in December 2004 and effective on 1 January 2005.
B.	Promote Thai exports to new markets	***Measure taken over last 6 months and its significance*** ▪ **Tariff reduction under the FTA between Thailand and Australia was effective on 1 January 2005.** According to the framework agreement on Free Trade Area signed in July 2004, tariffs on 49 percent of Thailand's total tariff lines, such as mineral, fuel, chemical products, and leather was reduced to zero rate on the effective date and so will 83 percent of Australia's total tariff lines including, for example, fruits and vegetables, canned pineapple, processed food, paper, jewelry, and compact and pick-up car. ***Measures to be taken in the next 6 -12 months*** ▪ **Further tariff reduction under the FTA between ASEAN and China will be effective on 1 July 2005.** Tariffs of items under the normal-track list will be reduced on 1 July 2005 and become zero rate by 2010[53]. ▪ **Tariff reduction under the FTA between Thailand and New Zealand will be effective on 1 July 2005.** The two parties signed a framework agreement on the Thailand and New Zealand Closer Economic Partnership in April 2005, which will lead to a tariff exemption of 79 percent of New Zealand's total tariff lines and of 54 percent of Thailand's total tariff lines on 1 July 2005[54]. ***Measure planned to be taken but has been delayed*** ▪ **Implementation of the Thailand-Bahrain FTA is delayed.** It is likely that the two would renegotiate the FTAs such that the implementation will start once all the negotiations are completed. Therefore, the Early Harvest Program previously agreed upon is currently cancelled.

* Prepared by Wallada Atsavasirilert

[53] See details in Box 4 Progress on Thailand's Free Trade Agreements

[54] Same as above

5. Public Sector and Governance Reform[55]*

	Objective	Reform Measures Taken
A.	Improving public service quality by streamlining and redesigning work processes and procedures	***Measure taken over the last 6 months and their significance*** ▪ **The Public Affairs Management Plan for (2005-2008) (PAMP) was approved by the Cabinet** and was published in the Royal Gazette on April 12th, 2005. Currently, the Office of the Council of the State and the Secretariat of the Prime Minister are formulating a legislative plan which must be completed within 120 days after the PAMP is published. The plan includes 9 areas, and corresponding strategic goals, indicators, and targets for the management of public affairs in 2005-2008. It also emphasizes on the agencies responsible for the implementation of each strategic goal, the draft laws to be amended under each strategic goal, and monitoring and evaluation based on the indicators and targets[56]. ***Measures to be taken in the next 6-12 months*** ▪ **Consistent with the PAMP, a Four Year Implementation Action Plan will be developed** such that specific implementation plans will be transferred to ministries and departments (functional-based approach), provinces and provincial clusters (area-based approach), as well as across functions and areas (agenda-based approach). The Four Year Implementation Action Plan will be submitted to the Deputy Prime Minster or the responsible Minister for approval. After that, it will be submitted to the Cabinet on June 13th, 2005. ▪ **Service Quality Awards will be issued to provide incentives for improved and timely service delivery.** The Office of Public Sector Development Commission (OPDC), along with National Institute for Development Administration (NIDA), have monitored and evaluated the implementation of plans submitted by each office for reducing processing time and improving service delivery. On May 3rd, 2005, 26 awards will be provided to the public offices which have succeeded in reducing the time taken to provide their regular services by 30-50 percent. Out of the 23 awards, 11 will be awarded to central offices and 12 to regional offices. ▪ **The service link unit will be expanded to specifically serve SMEs.** The SME service link unit, which provides basic information to set up and register a business, was piloted in Chiangmai in September 2004, and other units will follow. The pilot project is now being monitored and evaluated; however, there has not been any expansion of the other service link unit.

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

[56] The nine areas include (1) Poverty Eradication, (2) Human Development and Quality of Life, (3) Economic Restructuring to Create Equilibrium and Competitiveness, 4) Natural Resources and Environmental Management, (5) Foreign Affair and International Economy, (6) Development of Legal System and Good Governance, (7) Promotion of Democracy and Civil Society Process, (8) Maintenance of National Security, and (9) Responsiveness to the Global Dynamics.

Objective		Reform Measures Taken
B.	Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels	***Measure taken over the last 6 months and their significance*** ▪ **The Strategic Plan of Provinces and Provincial Clusters in 75 provinces was submitted to the Deputy Prime Minister.** After being reviewed by the central office and CEO Governors, the Plan was submitted to the Deputy Prime Minister for consideration and signature. In addition, the Prime Minister also provided five strategies to be implemented in the areas of (1) tourism, (2) industrial estates, SMEs and OTOP, (3) agriculture, (4) social issues, and (5) border trade. ▪ **The Regional Operation Center (ROC) was established in Khon Kaen.** Based on the meeting organized in Chiang Mai, on July 11 2004 among the CEO Governors and CEO Ambassadors, the first Regional Operation Center (ROC) has been established in Khon Kaen to serve as a forum for CEO Governors in the Northeast and CEO Ambassadors to share experiences and discuss related issues. In addition, based on the meeting in Chiang Mai, a curriculum for CEO Governors and CEO Ambassadors will be developed and regular meetings will be conducted.
C.	Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation.	***Measure taken over the last 6 months and their significance*** ▪ **Public Debt Management Act was approved by the Cabinet.** The Act specifies the management of public debt which includes limitation of public debt obligation. ***Measure to be taken in the next 6-12 months*** ▪ **The Prime Minister's Office regulation on Controlling and Monitoring Civil Affairs in Provincial Administration is being reviewed by the State Council and is expected to be presented to the Cabinet before April 2005.** The regulation will empower the deputy prime ministers with the authority in overseeing the management of provincial clusters.
D.	Improving governance in public sector through participation, accountability, and transparency.	***Measure to be taken in the next 6-12 months*** ▪ **A curriculum for the people's audit system is currently being developed and will be used to train community leaders in monitoring and evaluating governance in the public sector.** After having been piloted and developed in Pitsanuloke, Sakornakorn, and Petchburi provinces, it has been extended to Mahasarakam, Songkhla, and Chiangrai provinces.

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6. Social Protection*

Objective		Reform Measures Taken
A.	Develop social insurance mechanisms for the elderly and those affected by unemployment, work-related injuries or other shocks to income	***Measures taken in last 6 months and their significance*** ▪ As a social safety net mechanism for agriculture sector, **the Cabinet approved in principle on March 29th, 2005 the establishment of the Thai Agricultural Business Promotion Company** as proposed by the Ministry of Finance. The company aims to accelerate programs related to agricultural industry in order to support farmers in the forms of capital, seed, and production material. ▪ **The Government provides an interest tax exemption on long-term savings for the elderly.** The exemption is effective on interest incomes received on and after January 1st, 2005. This aims to lessen the tax burden of those who are 55 years old and older.
B.	Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement	***Measures taken in last 6 months and their significance*** ▪ **The Labor Protection Act for agricultural workers has been effective since April 13th, 2005.** It provides protection for labor in the agriculture sector, which includes faring, fishing, forestry, animal husbandry and salt cultivation. ▪ **The Cabinet has approved in principle on January 1st, 2005 the draft Workmen Compensation Fund Act** and had sent it to the Office of the State Council for review. This new Act will apply to everyone enrolled in the social security program as well as specify the types of business to which the Act does not apply. It also specifies medical costs of treatment and rehabilitation at rates which are consistent with those of the Ministry of Labor. ▪ **The Cabinet has approved in principle the draft Ministerial Order on Standards for Occupational Safety and Health Management and Administration**. In the draft Ministerial Order, the Ministry of Labor proposed the standards for occu pational safety and health by the types of business, establishments, and number of employees. ▪ **The Cabinet has approved in principle on November 30th, 2004 the Minimum Standards of Employment Condition for State Enterprise Employees.** With the Cabinet approval of its principle, the State Enterprise's Labor Relations has prepared the announcement of the standards, which is now being reviewed by the State Council. The new standards will be similar to those of the private sector. ▪ **The Ministry of Labor has submitted on February 15th, 2005 the draft Ministerial Order on Labor Protection for Workers in Private Academic Institutions to the Office of the State Council.** Since private academic institutions are not covered under the Labor Protection Act, this Ministerial Order will provide job security and benefits for workers in private academic institutions. The draft Ministerial Order is currently being reviewed by the State Council.

Objective		Reform Measures Taken
C.	Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support	***Measures taken in last 6 months and their significance*** ▪ **The Office of the Prime Minister approved the appointment of the Human Trafficking Control Board on April 5th, 2005.** The Committee, chaired by a Deputy Prime Minister, will be responsible for formulating policies, approaches and measures to prevent and solve human trafficking problems. The Committee will also seek international cooperation especially with international organizations and neighboring countries. ▪ **On November 30th, 2004, the Cabinet has approved ten draft ministerial orders related to the Child Protection Act.** The ministerial orders define the direction to protect children and their welfare, including minimum standards for raising a child and ensuring child development. ▪ **A low interest-rate mortgage loan scheme by the Social Security Office has started implementation since December 3rd, 2004.** Registration for the scheme was completed in November 2004, and the first round of random draws was done on December 3rd, 2004 for loans totaling to Bt 3 billion. The loan is expected to provide the working population with housing security. The interest rate will be at 2.5 percent per annum for up to 5 years. ▪ **The expansion of the 30 Baht Health Benefit Scheme to cover treatment of kidney diseases has been implemented in pilot provinces.** On October 2004, the National Health Security Office launched the pilot program in one hospital in each of the three provinces, namely, Samutsakorn, Khonkaen, and Songkla. The pilot program will last a year after which a decision will be taken on the nation-wide expansion of such coverage. ***Measures planned to be taken, but has been delayed*** ▪ **The Government has decided to delay the provision of locally-made anti-AIDS drugs under the 30 Baht Health Benefit Scheme** claiming that it was not ready for such a long-term commitment. It has previously aimed to provide the services by fiscal year 2006, which starts this October, but the issue is now under discussion.

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