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# Thailand

## Social and Structural Review

### Beyond the Crisis: Structural Reform for Stable Growth

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B 1.00 = US\$0.0269

### ABBREVIATIONS

AAT	Airport Authority of Thailand	MOI	Ministry of Interior
AFTA	ASEAN Free Trade Area	MOSTE	Ministry of Science, Technology and Environment
AMC	Asset Management Corporation	MWA	Municipal Water Authority
ASEAN	Association of Southeast Asian Nations	NEPO	National Energy Policy Office
BIBF	Bangkok International Banking Facility	NESC	National Economic and Social Council
BMA	Bangkok Metropolitan Administration	NESDB	National Economic and Social Development Board
BMTA	Bangkok Metropolitan Transport Authority	NGO	Non-Governmental Organization
BOI	Board of Investments	NPLs	Non-Performing Loans
BOT	Bank of Thailand	NSPC	National Social Policy Committee
BTO	Build, Transfer, Operate	OEPP	Office of Environment Policy and Planning
CAPS	Capital Augmented Preferred Securities	OSE	Office of State Enterprises
CAT	Communication Authority of Thailand	PCA	Public Company Act
CDRAC	Corporate Debt Restructuring Advisory Committee	PCD	Pollution Control Department
CODI	Community Organization Development Institute	PDMO	Public Debt Management Office
DCA	Debtor-Creditor Agreement	PWA	Provincial Water Authority
DIW	Department of Industrial Works	RFA	Financial Restructuring Authority
DOLA	Department of Local Administration	RTG	Royal Thai Government
EDI	Electronic Data Interchange	SCB	Siam Commercial Bank
EF	Environmental Fund	SEA	Security Exchange Act
EGAT	Electricity Generating Authority of Thailand	SEC	Securities and Exchange Commission
EGCO	Electricity Generating Company Plc	SEPC	State Enterprise Policy Committee
ESSN	Environmental Sector Strategy Note	SET	Stock Exchange of Thailand
FDI	Foreign Direct Investments	SFIs	Specialized Financial Institutions
FIAS	Financial Investment Advisory Service	SLIPS	Stapled Limited Interest Preferred Securities
FIDF	Financial Institutions Development Fund	SMEs	Small and Medium Enterprises
FRA	Financial Restructuring Authority	SRO	Self-Regulatory Organization
GOT	Government of Thailand	SRT	State Railways of Thailand
ICA	Inter-Creditor Agreement	SSO	Social Security Office
ICAAT	Institute of Certified Accountants and Auditors of Thailand	TDRI	Thailand Development Research Institute
KTB	Krung Thai Bank	TFASB	Thailand Financial Accounting Standard Board
LTB	Laem Thong Bank	TFP	Total Factor Productivity
MBIs	Market-Based Instruments	TFB	Thai Farmers Bank
MFN	Most-Favored Nation	TMB	Thai Military Bank
MOAC	Ministry of Agriculture and Cooperatives	TOT	Telephone Organization of Thailand
MOC	Ministry of Commerce	WMA	Waste Management Authority
MOF	Ministry of Finance	WTO	World Trade Organization

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# THAILAND: SOCIAL AND STRUCTURAL REVIEW

## Beyond the Crisis: Structural Reform for Stable Growth

### TABLE OF CONTENTS

	Page
<b>PREFACE</b>	
<b>EXECUTIVE SUMMARY</b> .....	i
<b>CHAPTER 1: MEDIUM-TERM PROSPECTS FOR ECONOMIC GROWTH</b> .....	1
A. Introduction .....	1
B. Thailand's Pre-Crisis Growth Performance: Was it Sustainable?.....	1
C. Prospects for Growth.....	8
<b>CHAPTER 2: LESSONS OF THE CRISIS FOR POVERTY ALLEVIATION PROGRAMS</b> .....	14
A. Introduction .....	14
B. The Impact of the Crisis .....	14
C. Adjustments to the Crisis.....	17
D. Government Policy and Risk Reduction .....	20
E. Lessons of the Crisis .....	22
F. Information and Commitment for Policy Reform.....	24
G. Social Capital and Effective Poverty Alleviation.....	24
<b>CHAPTER 3: FINANCIAL SECTOR REFORM</b> .....	29
A. Introduction .....	29
B. The Crisis of 1997 .....	29
C. The Governments' Restructuring Efforts in the Financial Sector.....	31
D. Improving the Framework in the Financial Sector .....	35
E. Increasing Contestability .....	37
F. The Agenda Ahead .....	39

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<b>CHAPTER 4: PRIVATE SECTOR DEVELOPMENT</b> .....	42
A. Introduction.....	42
B. The Enabling Environment for Fostering Competitiveness.....	44
C. Removing Hurdles to Competition.....	52
D. Improving Factors of Production.....	55
<b>CHAPTER 5: ENVIRONMENTAL CHALLENGES AND STRATEGY</b> .....	63
A. Introduction.....	63
B. State of the Environment .....	64
C. An Agenda for Reform .....	66
D. Implementing the Policy Agenda.....	69
<b>CHAPTER 6: DEBT MANAGEMENT AND PUBLIC SECTOR REFORM</b> .....	71
A. Introduction.....	71
B. Public Debt Management and Fiscal Sustainability.....	72
C. Reform of State-Owned Enterprises .....	76
D. Public Sector Reform.....	81

## TABLES

Table 1.1: Contributions to Growth per Capita .....	4
Table 1.2: Structural Growth Indicators for Thailand and Comparator Group.....	7
Table 1.3: Contributions to Growths in the Medium-Term.....	10
Table 1.4 Amortization due.....	12
Table 1.5 Comparative International Financing Statistics for Selected Countries.....	13
Table 2.1: Poverty Rates and Changes in Selected Groups.....	16
Table 2.2: Unemployment and Inequality.....	16
Table 2.3: Social Protection in East Asia after Crisis.....	28
Table 3.1: A Comparison of Financial Sector Restructuring in the Asian Economies in the Crisis.....	41
Table 4.1: Status of CDRAC Target Cases .....	47
Table 4.2: Legal Protection for External Financiers of Firms.....	51
Table 4.3: A Comparison of Corporate Restructuring, August 1999.....	61
Table 5.1: Overview of Environmental Trends and Responses .....	65
Table 5.2: Proposed World Bank Involvement.....	70
Table 6.1: Regional Ranking of Public Sector Management and Institutions.....	71
Table 6.2: Perceptions of Public Sector Competitiveness.....	72
Table 6.3: Thailand's External Debt, 1997-2000.....	73
Table 6.4: Public Enterprise Financial Indicators: 1998.....	77
Table 6.5: State Enterprise Reform - The Critical Agenda for 1999/2000.....	78
Table 6.6: Thailand Public Sector Reform Program .....	83

## **FIGURES**

Figure 1.1:	Average Growth in Real GDP per Capita .....	2
Figure 1.2:	GDP Growth Decomposed by Component of Aggregate Demand.....	3
Figure 1.3:	Overheating Symptoms .....	3
Figure 1.4:	Thailand - Incremental Capital-Output Ratio, 1972-96.....	5
Figure 1.5:	Performance of Thai Corporates.....	5
Figure 1.6:	Growth Diamonds.....	6
Figure 1.7:	Human Capital.....	8
Figure 1.8:	GDP Growth Projection by Component.....	9
Figure 1.9:	Change in Private Investment since 1996.....	11
Figure 1.10:	Foreign Capital Flows .....	12
Figure 1.11:	Current Account Balance.....	12
Figure 2.1:	Poverty Rates .....	15
Figure 2.2:	Poverty Rates 1996-1998.....	17
Figure 4.1:	Selected Indicators of Private Sector Development.....	42
Figure 4.2:	Structure of Exports.....	43
Figure 4.3:	Science-based and Scale Intensive Exports.....	44
Figure 4.4:	Distribution of Number of Classified Loans by Size Category.....	45
Figure 4.5:	Capacity Utilization.....	45
Figure 4.6:	Gross Secondary Enrollment Ratios in Selected Asian Countries, 1970-1995 .....	56
Figure 4.7:	Gross Tertiary Enrollment Ratios in Selected Asian Countries, 1970-1995...	56
Figure 6.1:	External and Domestic Public Sector Debt .....	74
Figure 6.2:	Debt Sustainability .....	75

## **BOXES**

Box 2.1:	Education Impacts and Responses .....	19
Box 2.2:	Coping with the Crisis in Health.....	22
Box 2.3:	Summary of Program for Poverty and Social Protection.....	27
Box 3.1:	Restructuring of Finance Companies and Commercial Banks.....	32
Box 3.2:	Main Elements of the Financial Sector Restructuring Plan Announced on August 14, 1998 .....	33
Box 3.3:	Review of Financial Sector Laws.....	36
Box 3.4:	Needed Improvements of Supervisory Functions .....	37
Box 4.1:	Accelerating Corporate Debt Restructuring.....	50
Box 4.2:	Reform Program for Private Sector Development.....	60
Box 6.1:	The New Constitution .....	81

## **ANNEXES**

Annex I:	Financial Sector Reform: Indicators of Progress .....	90
Annex IIa:	Thailand - Financial Sector Restructuring.....	93
Annex IIb:	Thailand - Strengthening Business Environment.....	94
Annex IIc:	Thailand - Macroeconomic Program and Social Protection.....	95
Annex Tables 1-22	.....	96



**Thailand: Social and Structural Review**

**Beyond the Crisis:**

**Structural Reform for Stable Growth**

**PREFACE**

The Bank had a modest role in Thailand in the years leading up to the crisis. There was occasional Economic and Sector Work (ESW) and a knowledge base in education and energy, sectors in which we had maintained a small lending program.

The Bank's involvement in Thailand intensified after the crisis broke out in July 1997. The Government of Japan hosted a donors conference in Tokyo in August 1997 at which the IMF unveiled a financing gap of \$17.2 billion and invited multilateral and bilateral partners to provide balance of payments support.

The Bank sequenced its lending as part of the financing package in three interlinked loans. The first, Finance Companies Restructuring Loan (\$350 million, December 1997), focused on the financial sector. The second, Economic and Financial Adjustment Loan (\$400 million, July 1998), supported the next phase of financial sector reform but also broadened the scope to include measures aimed at the corporate sector. By the time we took the third adjustment loan to the Board in March 1999, the prolonged recession had necessitated a fiscal stimulus to the economy as well as measures to protect the vulnerable. A Social Investment Project (\$350 million, July 1998) provided supplemental funding for selected government programs aimed at the poor and the unemployed. A Public Sector Reform Loan (\$400 million) was presented to the Board in October 1999. Quick disbursing support is anchored in technical assistance through loans and Asian Financial Crisis Response Fund and Policy and Human Resources Development grants.

The analytical work underpinning adjustment lending enabled the Bank to engage the Government of Thailand in multifaceted stabilization and structural reform. In turn, this required the Thailand team to deepen its knowledge in a number of areas in a compressed period of time.

The Social and Structural Review has drawn upon this rich body of knowledge. In one volume, it seeks to collect the central messages of the ongoing policy dialogue with the Thai authorities regarding short- and medium-term reform through a number of instruments (ESW and adjustment operations anchored in technical assistance loans and ASEM and PHRD grants). A reading of the longer reports is essential for a fuller understanding of the analytical foundations and the recommendations made in this volume.





## EXECUTIVE SUMMARY

### Reviving Growth

1. *For nearly a decade up to 1990, Thailand enjoyed rapid economic growth led by exports.* GDP growth averaged a remarkable 10 percent a year in 1986–90. Growth was well-balanced, driven by both capital accumulation and improvements in labor quality. The contribution of total factor productivity growth to annual GDP growth jumped from 0.6 percent in 1981–85 to 3.2 percent in 1986–90. This increasing efficiency in resource use enabled Thailand to capture new markets and sustain its remarkable export performance.

2. *But the record was not unblemished, and vulnerabilities accumulated rapidly in 1991–96.* Rapid growth was accompanied by rising income inequality and environmental degradation. There was also a concern voiced by domestic and foreign observers that public institutions and policymaking capacity would prove incapable of adequately addressing these shortcomings. Capital was flowing swiftly into the country, attracted by past economic success, a lifting of capital controls, and a macroeconomic framework that encouraged short-term external borrowing. Soon capital had replaced exports as the primary engine of growth (investment as a share of GDP reached 41 percent). The rapid buildup of capacity, especially in commercial property and other nontradable goods, turned the current account negative and put pressure on wages. Critically, total factor productivity growth collapsed to 0.1 percent and exports began to falter.

3. *Imprudent investment decisions by the private sector and the failure of public policy to bring about changes in economic behavior led to a crisis of confidence in 1997 and deep recession.* Financial institutions and nonfinancial corporations were awash in cheap capital, and regulators were not attentive enough to the problems that were building. Banks and finance companies faced weak prudential standards and even weaker supervision. Creditors, too, failed to enforce financial discipline because of gaps in the legal system. Poor corporate governance allowed majority shareholders to diversify investments recklessly. Financial reporting was inadequate, and minority shareholder rights were unprotected. The failure to recognize contingent liabilities in the financial sector and the fixed exchange regime distanced the day of reckoning. This enabling environment for weak governance created a speculative bubble in the nontradables sector, while little was being done to address real sector weaknesses. The bubble finally burst in the summer of 1997 when creditors called in their loans amid the widespread perception that Thailand's growth was unsustainable.

4. *To deal with the crisis and promote longer-term growth, Thailand has embarked on a twin strategy of macroeconomic stabilization and deep structural reform.* The policies are designed to regain market confidence and address vulnerabilities affecting medium-term growth prospects. The stabilization program, developed with assistance from the IMF, the World Bank,

and other multilateral and bilateral partners, provided critical support for the balance of payments and for reform of the macroeconomic framework.<sup>1</sup> With a market-determined exchange rate, supportive monetary and fiscal policies, and resolution of weak and failed financial institutions (discussed below), confidence and capital have begun to return. A GDP growth rate of 2.5 percent is expected for 1999, following the 8 percent contraction in 1998. The exchange rate has stabilized, and Thailand's risk rating has improved. Conservative projections put GDP growth in 2000 at 3–4 percent. But significant concerns remain, including slow progress in corporate debt and bank restructuring, high levels of nonperforming loans, and the mixed evidence on recovery of demand.

5. *Medium-term growth prospects are good, but implementation of unfinished structural reforms is essential.* Reforms are needed to inculcate habits of prudent risk taking in a liberalized economic environment and to strengthen the international competitiveness of firms.

6. *Growth strategies must incorporate safety nets for the poor and the vulnerable and must explicitly consider environmental implications.* The social impact of the crisis has shown the need for policies that specifically incorporate safety needs for vulnerable groups—relying on growth alone is not enough. Thailand's new Constitution also recognizes a more central role for communities in decisionmaking and calls for decentralization of environmental and natural resources functions to local governments. Sustainable growth also requires a transformation of public sector institutions and policymaking capacity to meet the challenges of a sophisticated modern economy.

## THE PROGRAM OF STRUCTURAL REFORM

### Poverty Alleviation Strategies

7. *In the years of rapid GDP growth leading up to the crisis, Thailand relied primarily on economic growth, a flexible labor market, and informal networks of income transfer to reduce poverty.* A flexible labor market facilitated the movement of labor to areas where jobs were being created, while strong familial ties ensured that the poor who remained behind were looked after. There were few direct transfers through public programs, and the information base for assessing the incidence of poverty was weak. Thus Thailand entered the crisis and a period of potentially long drawn-out income losses with no formal blueprint or institutional machinery for protecting the vulnerable.

8. *Thailand's flexible labor market and familial support mechanisms diminished the crisis's impact on unemployment and poverty compared with effects in the Republic of Korea and Indonesia, even though the macroeconomic downturn was equally severe.* Income losses in urban areas triggered migration to rural areas, and wages adjusted downward to accommodate the additional workers. The bulk of the adjustment took place through wage reduction rather than open unemployment. Rural wages did not collapse in part because devaluation helped spur agricultural exports and because families withdrew labor. Intrafamily lending also increased to smooth consumption.

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<sup>1</sup> Announced in August 1997, the stabilization program is supported by a financing package of \$17.2 billion of which \$14.08 billion have been disbursed.

9. *But the ability of family ties and wage adjustments to moderate the impact of the economic crisis would be severely tested in a prolonged crisis.* Crises will recur, and income losses may well be more severe. Family ties will weaken over time and will need to be supplemented by formal public programs. It is thus imperative that a poverty program be designed today to protect the poor against the risk of income loss in future.

10. *Several steps are needed to strengthen public sector social programs and institutional capacity:*

- Better coordination of social policy is needed to implement coherent poverty support programs that cut across line agencies. The government has appointed the Council for Social Ministers, with the National Economic and Social Development Board as its Secretariat to provide technical support in designing antipoverty programs. The action plan for strengthening the technical capacity of the Secretariat now needs to be implemented.
- Improvements in targeting mechanisms and automaticity are needed in order to deliver timely support to the poor and to expedite fiscal stimulus effects. These would include workfare programs based on higher labor intensity than has been the norm in the past and wages benchmarked to those of unskilled rural workers, as well as increased coverage of in-kind transfers and cash transfer program for needy families and the elderly poor. These programs would need to be evaluated to ensure that criteria for targeting and timeliness are met.
- Timely and reliable information for monitoring poverty and public programs is needed to ensure cost-effectiveness. Adequate resources must be provided to accelerate turnaround time for the socioeconomic survey, increase the frequency of the labor force survey, and support in-depth studies of programs.

11. *Programs aimed at the poorest segments of society must be complemented by a well-designed social security system that addresses the needs of an increasingly sophisticated labor force:* The agenda of the tripartite task force of labor, industry, and government, which includes establishment of an equitable, efficient, and fiscally sustainable social security system, needs to be implemented.

12. *Concerns about income distribution, a recurrent theme in Thailand, will resurface as the debate on who bears the costs of the crisis warms up.* This will require more careful evaluation of tax and expenditure policies to ensure that low-income groups do not bear a disproportionate burden.

### **Financial Sector Reform to Restructure Financial Institutions and Strengthen Supervision**

13. *The financial sector illustrates clearly the high price of postponing structural reform.* The failure to strengthen bank supervision and upgrade prudential regulations, combined with lax enforcement, had enabled financial institutions to lend for highly risky investments. When

the bubble burst in the summer of 1997, financial institutions experienced a severe loss of capital and confidence.

14. *Market observers have praised the monetary authorities in Thailand for persisting with prudential and regulatory reform and relying on market-based recapitalization strategies.* To regain full market confidence, financial institutions need to be recapitalized quickly, aggressively address their nonperforming loans, and operate in a prudential and regulatory environment that meets international standards. The experience of the Asian crisis economies shows that this is a daunting challenge. Banks in Korea and Malaysia resumed lending quickly, made possible in part by regulatory forbearance and heavy-handed government intervention. Thailand has taken a different approach. Still, banks have been slow to address nonperforming loans and to recapitalize, and they remain reluctant to lend. Efforts to resolve this tradeoff have stretched Thailand's financial and administrative reserves.

15. *Improved prospects for recovery should not be allowed to weaken the resolve to address key vulnerabilities of the financial system.* Vulnerabilities arise from both the ongoing resolution and restructuring of financial institutions and an incentive framework that does not yet adequately support prudent risk taking by lenders and borrowers.

#### **Resolution and Restructuring of Troubled Financial Institutions**

16. *The state-owned Asset Management Company's procedures need to be made transparent and its ability to manage assets strengthened.* The Asset Management Company has purchased some 40 percent (185 billion baht ) of the total assets of the closed finance companies sold to date by the Financial Restructuring Authority. There have also been delays in privatizing intervened banks, whose assets have sometimes been sold at a low price. These factors will all have fiscal implications and could distort the operating environment in the financial sector.

17. *Bank recapitalization and enhanced capacity to absorb losses must remain top priorities for sustainable corporate restructuring and recovery of growth.* A high ratio of nonperforming loans and incomplete recapitalization have made banks slow to resume lending, and the banking system remains fragile. Sluggish economic growth and the slow pace of corporate debt restructuring have contributed to the stickiness of nonperforming loans, which remain high at 47 percent. Some banks appear unable to provision against losses from their own funds in order to meet 100 percent provisioning standards by the end of 2000. Progress on other recapitalization fronts has also been slow. Despite some successes, banks generally have not attracted sufficient new investment. There is a reluctance to draw on the government recapitalization scheme (August 14 package for Tier I and Tier II capital) for fear of loss of control. Innovative approaches for raising capital domestically (CAPS and SLIPS) have been successfully tried, but they increase the cost of funds.

18. *Limited progress in restructuring and recapitalizing state financial institutions has blunted their ability to direct credit to meet equity objectives.* Recapitalization and restructuring of the state-owned Krung Thai Bank (KTB), a thorough review of the financial health of the specialized financial institutions, and the streamlining of supervision of specialized financial institutions must be top priorities.

## **Toward Incentives for Prudent Decisionmaking**

19. *Bank restructuring has resulted in a more highly concentrated banking system, which may impede innovation and diversification.* Continued permanent restrictions on foreign ownership of financial institutions, other restrictions on granting banking licenses, and high minimum capital requirements have limited entry and contributed to concentration. A more transparent licensing system and removal of restrictions on foreign bank branches, among other reforms, are needed to increase contestability and exposure to competition. Thorough reform of corporate governance is also needed.

20. *The financial system remains unbalanced, leaving the economy vulnerable to internal and external shocks and reducing contestability.* Financial assets are 150 percent of GDP, and nearly 70 percent of the assets are in the banking sector. Markets for bonds (12.5 percent of GDP) and securities (19 percent of GDP) are underdeveloped, especially relative to other emerging markets. The tax and regulatory regimes (including those affecting the Bangkok International Banking Facility) need to be reviewed with an eye toward leveling the playing field. In addition, corporate governance reform is needed in the securities market in order to deepen capital markets.

21. *Financial sector laws need to be amended to clarify roles and responsibilities and to define the scope of operations of financial institutions.* Special attention needs to be given to the Central Bank Law, Financial Institutions Law, Deposit Insurance Law (including clear exit procedures), Stock Exchange Law, and regulations affecting the Securities and Exchange Commission. To provide adequate incentives for prudent and efficient financial intermediation, further changes are needed in regulations on credit risk management, connected lending, and internal control. Deposit protection must replace the comprehensive guarantee given to depositors to inculcate responsible banking habits. Reforms of the broader operating environment affecting credit-debtor relationships and corporate governance also need to be consolidated.

22. *Eliminating weaknesses in bank supervisory and regulatory capacity is critical for instilling prudent behavior.* A comprehensive reform of banking supervision has been initiated. It needs to be complimented by reforms clarifying the lines of responsibility between the Ministry of Finance and the Bank of Thailand, providing legal cover for supervisors to act, and curbing discretionary exemptions that weaken enforcement.

## **Creating an Improved Enabling Environment for Private Sector Development**

23. *In the years leading up to the crisis, Thailand's private sector consisted of highly leveraged firms whose ability to compete in the international market was being blunted.* Debt-equity ratios had reached an all-time high, and corporations had diversified into myriad activities, often not based on any comparative advantage. Total factor productivity growth was declining across the board, and exports, the engine of growth in the previous three decades, were beginning to lose their competitive edge. The share of high technology products in exports was well below that of important competitors such as Malaysia, Singapore, and the Philippines, and backward linkages were weak. Prospects for continued export-led growth did not look good.

This pessimistic view of Thai corporate prospects reinforced financial sector vulnerability and contributed to the massive loss of confidence in 1997.

24. *Structural reforms for revitalizing the private sector aim to facilitate the debt and operational restructuring of firms, remove hurdles to competition, and boost the quality of factors of production.* Debt restructuring is critical for reducing the nonperforming loans of financial institutions so that they can resume lending to viable firms. With restored balance sheets following debt restructuring, greater flexibility to adjust to shocks under a regulatory regime that fosters competition, and higher quality factors of production, Thai firms will enjoy a sharper competitive edge in the international market that will enable them to sustain growth in the medium term.

### **Promoting Corporate Restructuring**

25. *Debt restructuring is being facilitated by strengthening the legal framework for court-supervised settlements, establishing a credible voluntary process, and removing regulatory and tax disincentives.* Key amendments to the Bankruptcy Act and relevant Codes of Civil Procedure have been enacted, and a Bankruptcy Court has been established to simplify and speed up court-supervised restructuring. Voluntary restructurings are being promoted through the Corporate Debt Restructuring Advisory Committee (June 1998), a framework for voluntary debt restructuring (September 1998), and debtor-creditor and intercreditor agreements (March 1999). Tax and regulatory measures have also been implemented to remove disincentives to restructuring debt, including changes in the income tax, value-added tax, specific business tax, taxation of debt write-offs, and the stamp duty on restructuring cases. The Stock Exchange of Thailand and the Securities and Exchange Commission have started to suspend and delist firms with large debt overhangs.

26. *The three-pronged framework to promote debt restructuring is beginning to yield results.* Case flow in the Bankruptcy Court has quickened, and out-of court restructurings have increased. Cumulative restructured debt at the end of July was \$16.5 billion (about a third was restructured between May and July), and a dent was made in the overall volume of nonperforming loans.

27. *Much, however, remains to be done to accelerate restructuring and prevent restructured debt from becoming nonperforming again.* The key is to implement the three-pronged framework and to strengthen it further. Still needed on the legal and regulatory front are a credible secured lending regime (including a registry), implementation of the remaining amendments to the Code of Civil Procedures on default judgments, removal of obstacles to restructuring by state-owned financial institutions, and completion of the Ministry of Justice's ongoing review of the insolvency regime. The voluntary regime for debt restructuring needs to be buttressed by a program of mediation; by expanded accounting, legal, and industry expertise; and by improved reporting on the restructuring process. The enabling environment can be further strengthened by extending tax incentives for restructuring to the private asset management companies, opening up a credit bureau that allows financial institutions to share information on potential borrowers, and encouraging specialized financial institutions to participate actively.

28. *Corporate governance reforms to promote responsible corporate management (attentive to shareholder interests, prudent in taking risks) are moving slowly and need to be accelerated.* The reforms are intended to curb excessive indebtedness and aid the operational restructuring of corporations. They include strengthening the institutional framework for setting standards and regulating accounting and auditing practices, improving the quality and reliability of corporate financial and nonfinancial information, strengthening the financial oversight role of the board of directors, and intensifying enforcement. While the line agencies have nearly completed their lengthy reviews of laws and regulations and have proposed changes, amendments to the relevant laws have yet to go through the parliament and much-needed institutional changes have not been implemented.

### **Removing Hurdles to Competition**

29. *The slow pace of tariff reform has resulted in high effective protection rates and distortions, particularly in the automobile, petroleum, and agriculture sectors.* The tariff structure is also riddled with specific duties and a complex system of exemptions that render it opaque. Commitments under the ASEAN Free Trade Area (AFTA) to liberalize the tariff regime will pose challenges to Thai producers serving the domestic market. Tariff reform to lower the duties on imports and simplification of the regime are now a priority.

30. *The complex investment incentives that lower the marginal effective corporate tax rate from 46 percent (one of the highest in the region) to 7 percent have been shown to be discretionary, inconsistent, nontransparent, and contrary to the principles of good governance.* The entire system of incentives is being reviewed. One thrust of reform would be replacing broad instruments such as tax holidays with narrower investment tax credits and depreciation allowances (already initiated in the August 10, 1999 package). The Board of Investment's role should shift from incentive intermediation to investment promotion.

31. *The new Competition Act passed in 1999 clearly defines abuse of dominance, price fixing, and collusion and permits advance judgments and appeals in cases of mergers and acquisitions suits.* The Act will strengthen the domestic competitive environment. It should be followed up with detailed regulations to give substance to a modern competition policy. The institutional capacity to oversee and enforce the new law and associated regulations needs to be strengthened and a supportive legal infrastructure put in place.

### **Improving Factors of Production**

32. *A shortage of skills has increased unit labor costs and hurt the international competitiveness of firms.* Lowering unit labor costs by increasing worker productivity would require upgrading the education system. That means giving universities greater autonomy to play a larger role in improving secondary and post-secondary education, decentralizing public education resources and increasing accountability, reforming teacher employment, and modernizing teaching practices and curricula. Vocational secondary education also needs to be tuned to the requirements of industry.

33. *Logistics costs in Thailand are well above those of competitors with better developed infrastructure.* Measures have been implemented in recent years to reduce freight costs and

shorten customs clearance time. To lower costs further, an integrated government-industry group needs to be set up to oversee supply chain management and remove bottlenecks. The persistent problem of duty drawbacks and VAT rebates needs to be addressed.

34. *At only 0.5 percent of GDP, R&D expenditures are lower than for virtually all of Thailand's competitors.* ISO 9000 certifications are also relatively low. Private sector R&D currently constitutes a meager 10 percent of total R&D expenditure in Thailand. To increase the technological capabilities of private firms, closer links need to be established between the economy's technology infrastructure and enterprises.

## **Environmental Protection and Growth**

35. *As the economy recovers, the focus will again shift to the interrupted environmental agenda.* The environmentally laissez-faire growth of the three decades leading up to the crisis inflicted large costs on Thai society (for example, particulate emissions cost city residents 8-10 percent of their annual incomes; unchecked, these cost are expected to rise to 20 percent in the next two decades). The government responded to citizens' concerns by establishing a legal and institutional framework for environmental protection, increasing budgetary allocations, undertaking remedial initiatives (phase-out of unleaded gasoline, energy conservation, waste water treatment), and announcing a long-term plan for environmental protection. The environment appears not to have suffered too severely from the budgetary cutbacks during the crisis because pollution emissions declined as output fell. With recovery, however, pollution and associated costs will rise along with concerns about the livability, and hence competitiveness, of Thailand.

36. *Selective investments are needed for reviving the environmental agenda.* Priority investments are needed to reduce airborne particulate of less than 10 microns in size (emissions from two-stroke motorcycle engines, diesel-powered buses and trucks, and road dust), build wastewater schemes for Thonburi and Klong Toey, and build up the capacity of the Bangkok Metropolitan Authority.

37. *These investments would be supplemented by a program of institutional and policy reform that strengthens environmental governance and establishes a sustainable financing mechanism.* The authorities are committed to creating more responsive public institutions for dealing with the environment, improving enforcement, building the capacity of local governments, and encouraging greater community participation. Sustainable financing requires restructuring the Environment Fund (in particular, rationalizing the uncoordinated funding sources), instituting cost-recovery measures, and developing market-based instruments for pollution control to promote voluntary compliance.

38. *The Chao Phraya River system, Thailand's lifeline, needs to be revived by protecting the watershed and improving management of surface water and groundwater.* Inefficient past water management is threatening the ecological balance of the river system and impeding the socioeconomic development of the region. The government needs to get out of water service provision and focus instead on the legal and regulatory framework and the design of incentives to make Chao Phraya water management more effective. Institutional mechanisms are needed at different levels—ranging from water user associations to basin organizations—through which



civil society can participate with government in decisionmaking to balance the competing demands of different users, give greater attention to environmental sustainability, and ensure that policies outside of the water sector (such as land use policy) consider the implications for water management.

## **Public Sector Reform**

39. *Thailand's medium-term growth prospects will be influenced by its success in key aspects of public sector reform, especially those related to the quality of public institutions.* These include its ability to manage domestic and external debt, which has increased sharply in recent years; reform or privatize state-owned enterprises to strengthen the competitiveness of downstream users of infrastructure; and develop capable public institutions and a modern, performance-oriented civil service that can fine-tune and implement the complex structural reforms outlined in the previous sections. The momentum for public sector reform also comes from widespread concern that growth should be broad-based and government decisionmaking should be transparent.

40. *Comprehensive debt management is crucial for ensuring medium-term fiscal sustainability and minimizing fiscal risks.* Especially important is the implementation of the staffing plan for the recently created Debt Management Office and developing diagnostic capabilities on sources of fiscal and financial risk. Developing an integrated debt database and information system with information on private nonguaranteed debt and government contingent liability will also be important as will deepening of the domestic bond market.

41. *After initial progress on state enterprise reform (the master plan was announced in September 1998 and several detailed sector studies have been completed), the pace has slowed.* Among the factors responsible are employee opposition, the unclear mandate and inadequate funding of the Office of State Enterprise Reform, and slow progress in developing regulations for entities to be privatized and continued nervousness among investors regarding growth prospects. Clear benchmarks for gauging progress in 1999/2000 have been established, covering coordination among line agencies, attention to employee concerns, the regulatory and legal framework for entities to be privatized, and adequate sequencing of reforms in water, telecommunications, energy, and transport sectors.. The Government is committed to meeting the benchmarks and will monitor them vigorously.

42. *Debt management and state enterprise reform are part of a more comprehensive agenda for public sector reform.* Constitutional changes have been put in place to promote broader participation in decisionmaking, greater decentralization, and increased accountability and transparency in government. Measures to achieve these goals include the introduction of performance-based budgeting by line ministries anchored in sectorwide policies developed by central ministries. A regulatory framework for autonomous public organizations will be announced and public access to information will be improved. Revenue management will benefit from improved tax compliance, enforcement of collections, and introduction of information technology. Decentralization will be achieved by devolving expenditure and revenue functions to appropriate subnational levels of government and revising the intergovernmental grants system. A civil service renewal program will be launched, headed by a motivated and politically neutral cadre of senior civil servants. Better matching of staffing

profiles with service responsibilities will be undertaken to improve service delivery. Specific, time-bound targets have been announced under each of these programs.

43. **To conclude**, the crisis has imposed hardships, but it also presents an opportunity to strengthen the economy to meet future challenges. The structural reforms outlined above aim to address vulnerabilities before they threaten economic stability. The Government's commitment to the reform program offers a promise of stable and broad-based growth as Thailand enters the 21<sup>st</sup> century.

# 1. MEDIUM-TERM PROSPECTS FOR ECONOMIC GROWTH

## A. INTRODUCTION

1.1 The economic crisis has taught valuable policy lessons for restructuring the economy to achieve sustainable growth in the medium term. This Social and Structural Review elaborates on the reform program in six important dimensions of the economy:

- Thailand's growth performance and its prospects for the future (Chapter 1).
- Protection of the poor against the risk of economic downturns and the resultant loss of incomes (Chapter 2).
- Reform of the financial sector to complete the ongoing restructuring of financial institutions, strengthen supervision and prudential regulations, and sharpen competitiveness in service delivery (Chapter 3).
- Development of the private sector through improved corporate governance, an enabling legal framework, a sharper competition policy, and stronger foundation for international competitiveness through programs for skills development, logistics modernization, technology upgrading, and export marketing and finance (Chapter 4).
- Environmental protection that enhances the quality of life beyond the simple measures of growth accounting (Chapter 5).
- Strengthened public policymaking through improved governance and implementation of the reform programs mentioned above (Chapter 6).

1.2 The rest of this Chapter analyzes Thailand's growth performance and prospects for the future. This will provide the context for discussions of structural reforms in the remaining chapters.

## B. THAILAND'S PRE-CRISIS GROWTH PERFORMANCE: WAS IT SUSTAINABLE?

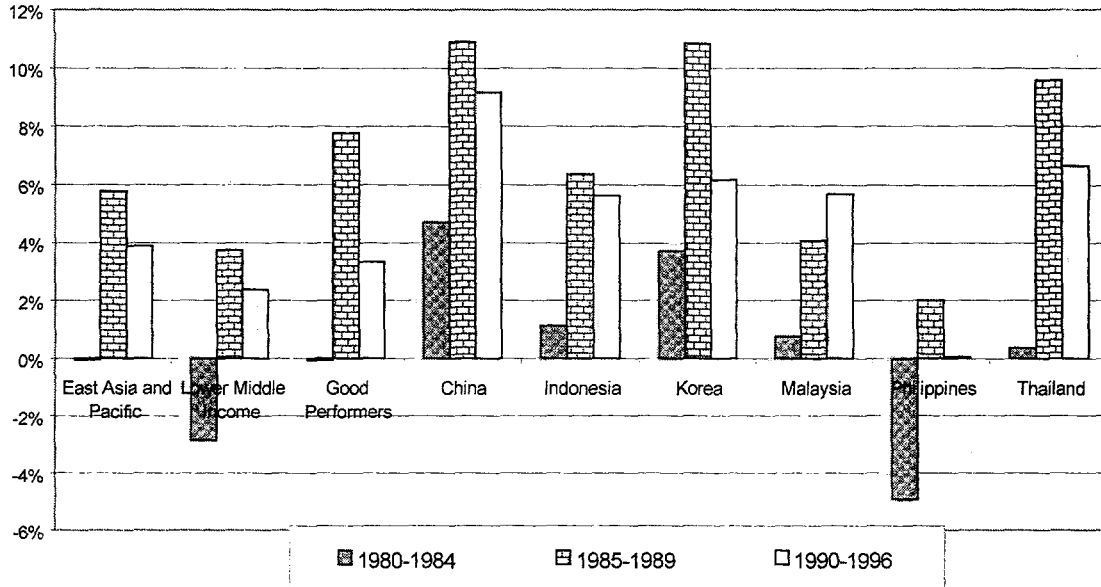
1.3 Thailand has an impressive growth history, outperforming the East Asia region, lower middle-income countries,<sup>1</sup> and a group of good performers<sup>2</sup>, on average per capita growth in

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<sup>1</sup> As defined by the World Bank, World Development Indicators.

1980-84, 1985-89, and 1990-96 (Figure 1.1). In the decade leading up to 1996, growth averaged more than 9 percent a year, which more than doubled the size of the economy.

Figure 1.1: Average Growth in Real GDP per Capita



Source: World Development Indicators, The World Bank.

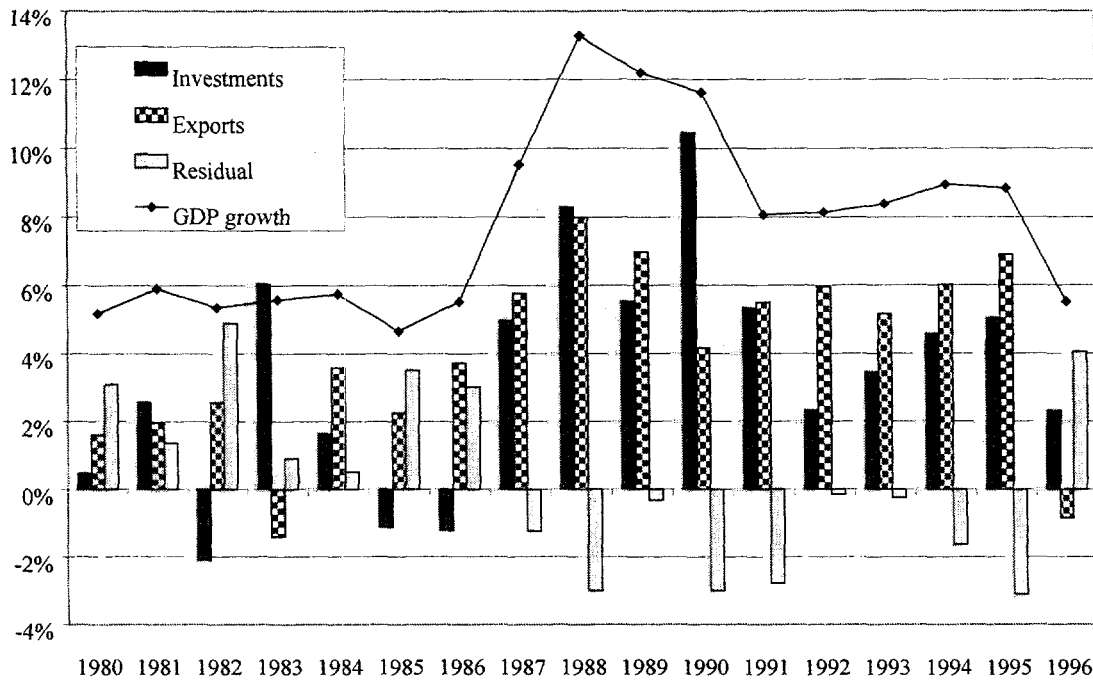
### Sources of Growth

1.4 **Demand Side.** Exports and investment played a critical role in growth takeoff in 1987 (Figure 1.2). Investment not only grew quickly throughout this period, but the average investment rate was very high in the 40-43 percent range by the late 1990s. The high levels of investment led to a rapid expansion in capacity, while the high export growth rates reassured investors of Thailand's repayment capacity and, together with large capital inflows, provided the foreign exchange required for massive capital goods imports.

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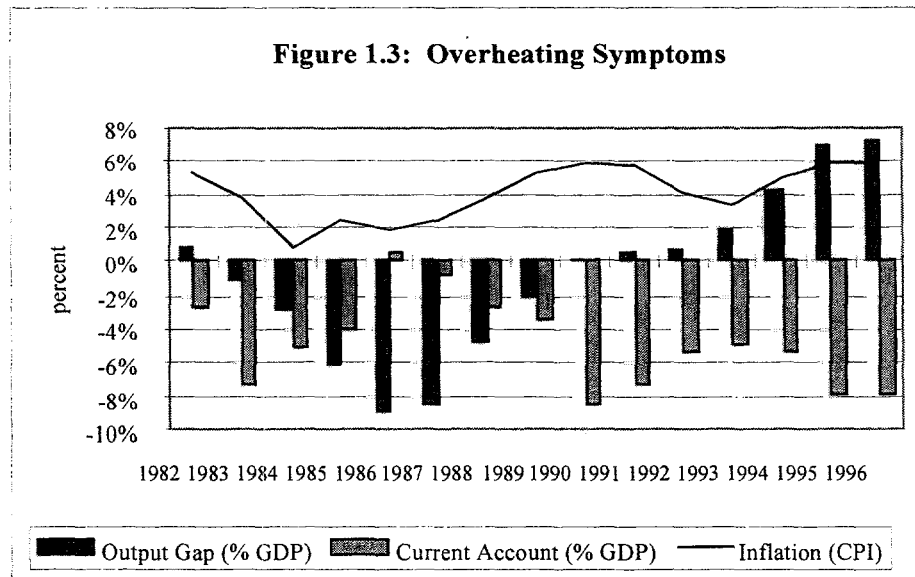
<sup>2</sup> "Good Performers" are defined as the 10 best performers in the middle income group measured by real GDP per capita growth in the period 1980-1996.

**Figure 1.2: GDP Growth Decomposed by Component of Aggregate Demand**



Source: World Bank, World Development Indicators, various years.

**Figure 1.3: Overheating Symptoms**



Source: Bank of Thailand, Monthly Bulletins, and World Bank Staff estimates.  
 World Bank, Pedro Alba, Leonardo Hernandez, and Daniela Klingebiel. 1999. "Financial Liberalization and the Capital Account: Thailand 1988-1997."

1.5 Symptoms of overheating began to emerge in 1995-96. Overheating manifests itself through increases in the current account deficit when the excess demand is in the tradable sector and inflationary pressures when the excess demand is in nontraded goods and services (Figure 1.3). The increase in the output gap (the difference between actual and potential GDP, measuring overheating pressures<sup>3</sup>) suggests a decline in the efficiency of investment and productivity during the second half of the boom period.

1.6 **Total Factor Productivity.** Total factor productivity (TFP) growth also began to decline. A recent growth accounting study by the Thailand Development Research Institute<sup>4</sup> (TDRI) concluded that:

**Table 1.1: Contributions to Growth, 1981-95**  
(Annual percentage rate)

	GDP growth	Contribution from Inputs				TFP growth	
		Land	Capital <sup>a</sup>	Labor		Not adjusted for labor quality	Adjusted for labor quality
				Employment	Adjusted for quality		
1981-85	5.5	0.3	3.3	1.1	1.4	0.9	0.6
1986-90	10.3	0.0	4.8	1.4	2.2	4.2	3.4
1991-95	8.6	0.0	6.7	0.4	1.8	1.5	0.1
1981-95	8.1	0.0	4.9	1.0	1.8	2.2	1.4
Relative contribution (%)	100	0.4	60.7	11.9	22.2	27.0	16.7

Notes: a. Gross capital stock.

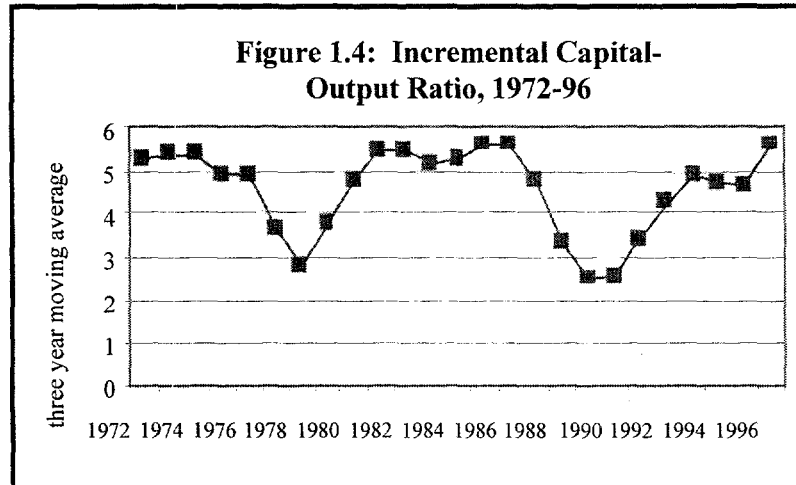
Source: Tinakorn and Sussangkarn (1998).

- Capital accumulation was the main source of growth since 1980 (Table 1.1).
- In the late 1990s, GDP growth declined by almost two percentage points as a result of a collapse in TFP, even though the contribution of capital increased to almost 7 percentage points a year.
- Improvements in labor quality through education and experience made a significant contribution to GDP growth.
- Results at the sectoral level for agriculture, industry, and services also suggest that factor accumulation was the main source of output growth, not TFP.

<sup>3</sup> Potential GDP is measured by a Hodrick-Prescott trend.

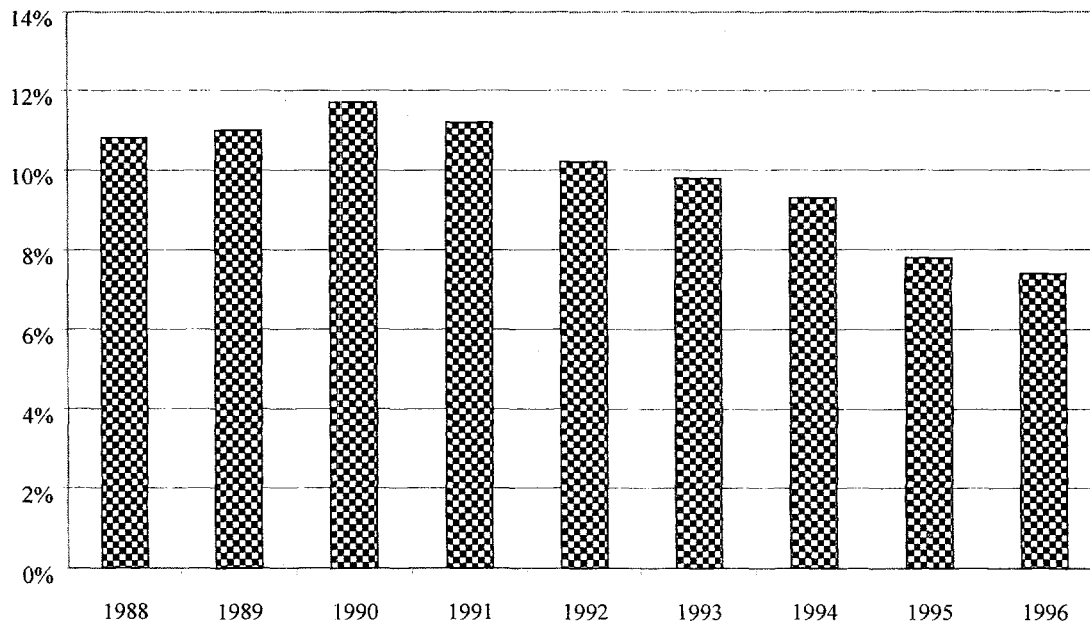
<sup>4</sup> Tinakorn, Pranee and Chalongphop Sussangkarn. 1998. "Total Factor Productivity Growth in Thailand: 1980-1995." Thailand Development Research Institute. Bangkok.

1.7 Other evidence also points to declining productivity in Thailand. The three-year moving average of the incremental capital-output ratio during 1991-95 (Figure 1.4) was almost at its historical high in 1996. Average real returns on assets in the corporate sector were also declining (Figure 1.5).



Source: World Bank Live Data Base and World Bank staff estimates.

**Figure 1.5: Performance of Thai Corporates**  
Return on Assets in real local currency



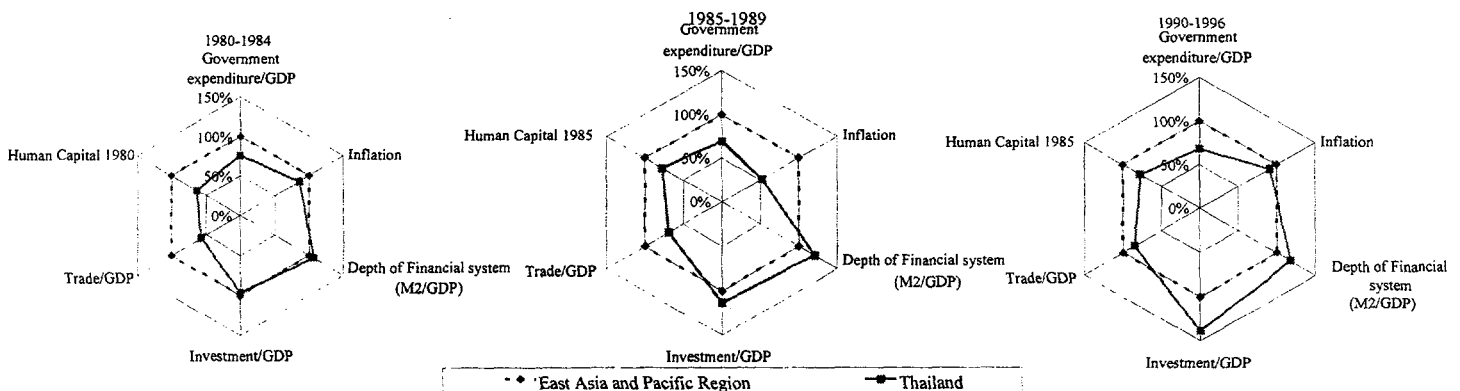
Source: Claessens, Djankov, and Lang (1998).

## Factors Contributing to Swings in Growth and Productivity Performance

1.8 International experience identifies several factors contributors to swings in growth and TFP performance as important: inflation, ratio of government expenditures to GDP, ratio of M2 to GDP, ratio of imports and exports to GDP, ratio of investment to GDP, and human capital development. Comparison of these indicators with countries in the East Asia and Pacific region and other comparators across time periods (1980-84 to 1985-89 and 1985-89 to 1990-96) shows that (Figure 1.6 and Table 1.2):

- **Government expenditure** was less than the average for the region and declined over the two periods.
- **Inflation** was well below rates in comparator countries but was beginning to pick up in the second period.
- **Money supply** was higher than in comparator countries and grew rapidly across the two time periods.
- **Investment** rose sharply in the period preceding the crisis, reaching substantially higher levels than in comparator countries.
- **Trade** also expanded rapidly, increasing by 22 percent in the period preceding the crisis.
- **Human capital** development in Thailand at the lower end of the skills range was about average for the region, but achievements were less satisfactory for secondary education, which affects the trainability of workers producing high value-added goods (Figure 1.7).

**Figure 1.6: Growth Diamonds**  
Thailand Relative to the East Asia and Pacific Region



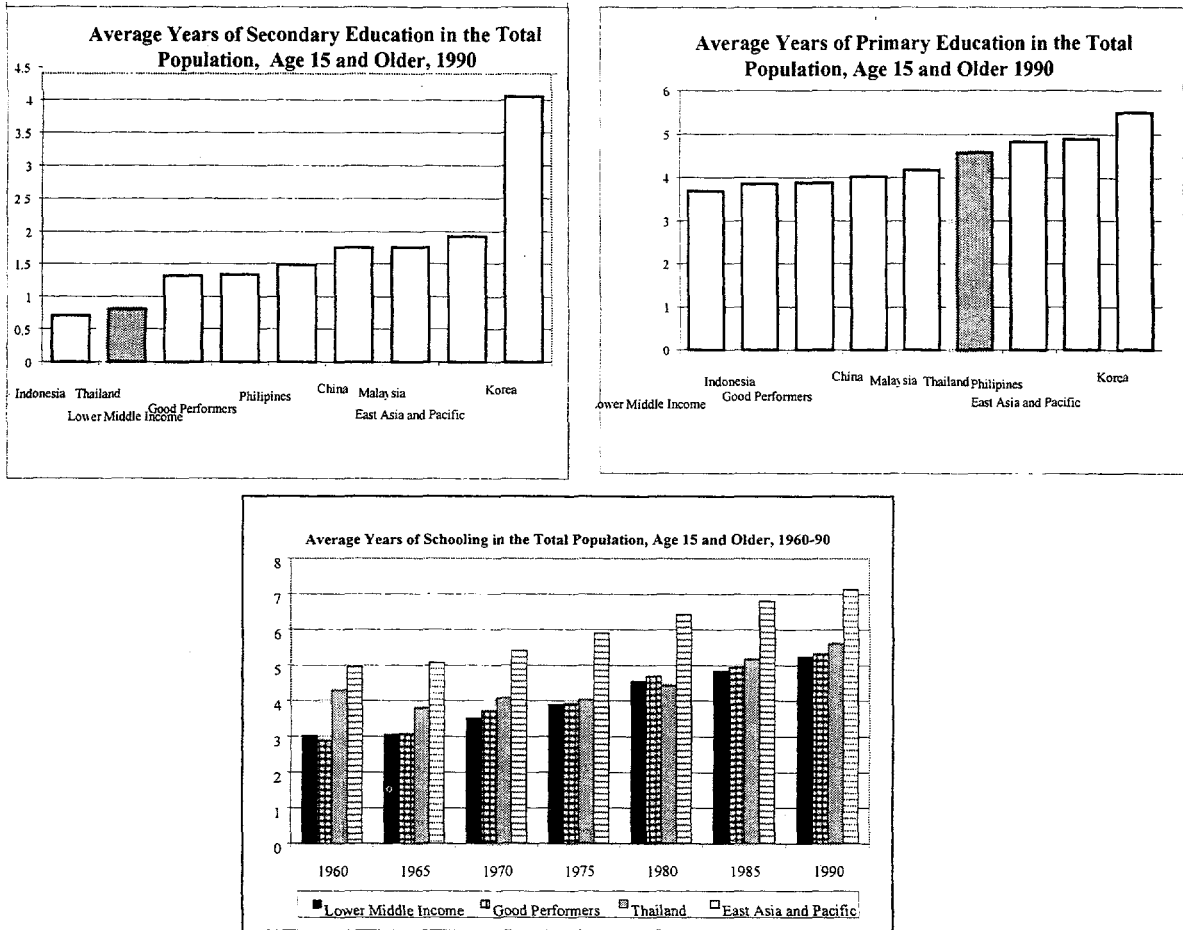


**Table 1.2: Structural Growth Indicators for Thailand  
and Comparator Groups, 1980-96**  
(percent)

Indicator		Period average			Change	
		1980-84	1985-89	1990-96	1980-84 to 1985-89	1985-89 to 1990-96
Government Expenditure/GDP	<b>Thailand</b>	<b>19.4%</b>	<b>17.4%</b>	<b>15.4%</b>	<b>-2.0%</b>	<b>-2.0%</b>
	East Asia and Pacific	25.8%	25.2%	22.8%	-0.6%	-2.3%
	Lower Middle Income	24.2%	22.5%	21.9%	-1.7%	-0.6%
	Good Performers	30.3%	29.3%	27.6%	-0.9%	-1.8%
Inflation	<b>Thailand</b>	<b>8.4%</b>	<b>3.2%</b>	<b>5.1%</b>	<b>-5.3%</b>	<b>1.9%</b>
	East Asia and Pacific	9.9%	6.1%	5.6%	-3.8%	-0.5%
	Lower Middle Income	17.8%	55.0%	66.7%	37.2%	11.7%
	Good Performers	15.7%	10.0%	11.6%	-5.7%	1.6%
M2/GDP	<b>Thailand</b>	<b>44.5%</b>	<b>60.8%</b>	<b>76.4%</b>	<b>16.3%</b>	<b>15.6%</b>
	East Asia and Pacific	41.6%	50.4%	64.6%	8.7%	14.2%
	Lower Middle Income	36.3%	40.9%	47.6%	4.5%	6.8%
	Good Performers	53.9%	60.7%	65.4%	6.8%	4.7%
Investment/GDP	<b>Thailand</b>	<b>29.0%</b>	<b>29.9%</b>	<b>41.0%</b>	<b>1.0%</b>	<b>11.1%</b>
	East Asia and Pacific	30.1%	26.5%	29.5%	-3.6%	3.1%
	Lower Middle Income	25.7%	22.4%	24.3%	-3.4%	2.0%
	Good Performers	28.4%	28.4%	32.0%	0.0%	3.6%
Trade/GDP	<b>Thailand</b>	<b>50.3%</b>	<b>59.1%</b>	<b>81.0%</b>	<b>8.8%</b>	<b>21.9%</b>
	East Asia and Pacific	88.1%	86.0%	95.2%	-2.2%	9.2%
	Lower Middle Income	66.0%	64.6%	75.0%	-1.3%	10.3%
	Good Performers	111.8%	113.6%	84.6%	1.7%	-29.0%

Source: World Bank , World Development Indicators, various years.

Figure 1.7: Human Capital



Source: Barro and Lee Dataset.

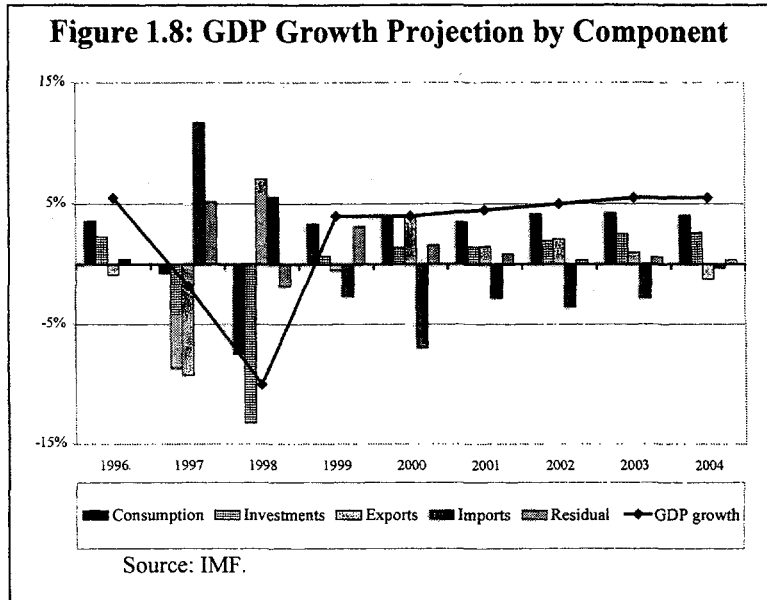
### C. PROSPECTS FOR GROWTH

#### Short-Term Challenges

1.9 Thailand's prospects for growth depend critically on resolving quickly the deep crisis that started in July 1997. Thailand's short-term prospects have improved significantly in recent months, although downside risks remain. The economy has bottomed out, and a broad-based recovery is underway. Economic growth of 3-4 percent was estimated for 1999, following negative growth in 1997 and 1998 and initial forecasts for continuing negative growth for 1999. Key macroeconomic indicators show substantial improvement. Interest rates have come down to pre-crisis levels, sovereign spreads have come down steadily since September 1998, net reserves have increased significantly, the current account surplus is now supported by improved export performance, and monetary and fiscal policies are accommodating growth.

1.10 A key downside risk is whether **aggregate demand** will support sustained growth. The severe contraction in 1997 and 1998 was the result of a collapse in both external and domestic demand. Thus, in the near term the recovery will be driven mainly by a recovery in consumption and exports with investments more in the background (see discussion below).

1.11 **Recovery of domestic demand** will be aided by rising private consumption in response to better economic prospects and the temporarily lowered value-added tax (VAT). Public sector demand will remain strong because of the two stimulus packages (March and August 1999), whose impact is likely to continue well into 2000. The stimulus packages (and the interest rate costs of the financial sector restructuring) are expected to increase the fiscal deficit for 2000 to 7.1 percent of GDP. The deficit will be gradually reduced as the economy recovers to ensure long-run sustainability. If other demand components deviate from expectations, fiscal policy will be adjusted accordingly, as fiscal sustainability allows.



1.12 In the short term, excess capacity and the lack of access to credit will keep **private investment** depressed, but they should pick up over the medium term. The Government's fiscal stimulus package of August 1999 focused on encouraging private investments through tax and tariff measures, equity investment measures, measures for promotion of the recovery of the real estate sector, and measures for improving financing for small- and medium-size enterprises (SMEs). And because of the increasing evidence that returns to investment had been declining before the crisis, Government is engaged in a World Bank-supported program to improve competitiveness that should have a strong impact on the efficiency of investments as well as their level.

1.13 **External conditions both in terms of foreign demand and the availability of foreign funds**, will be important for future growth. Export expansion will remain important in the medium term. Early export recovery in the region is being driven by manufacturing industries, and in particular electronics exports. Overall exports increased by 3 percent in US dollar terms in the first three quarters of 1999 over the same period in 1998, with most of the growth in manufacturing exports (4.5 percent and accounting for almost 85 percent of all exports). More detailed data for the first half of 1999 show that total growth in manufacturing exports of 3.2 percent over the same period in 1998 was due mainly to technology-intensive products such as vehicle parts and accessories, machinery and mechanical appliances (mainly computers and parts), and electrical equipment. Exports of

labor-intensive products such as textiles, sugar, and rubber declined over the same period. This pattern reflects a structural trend in the Thai economy that has remained fairly persistent.

1.14 Export performance over the medium and long term will be closely connected to improvements in competitiveness and the Government's success in implementing structural reforms to enhance the productivity of the firms. Since the financial crisis erupted in mid-1997, the baht has depreciated 24 percent in real effective terms, which has improved export competitiveness. Capacity utilization in the manufacturing sector, which declined from historical levels of 70-80 percent to around 50 percent in 1998, is projected to improve to around 60 percent while some industries have recovered to pre-crisis levels. Construction and iron and steel production, among others, remain well below normal capacity utilization levels.

### **Medium-Term Prospects**

1.15 Labor, capital and TFP growth are all expected to contribute in varying degrees to Thailand's GDP growth in the medium term (Table 1.3).

**Table 1.3: Contributions to Growth in the Medium Term**

<b>Land</b>	<b>Capital</b>	<b>Quality adjusted employment</b>	<b>TFP growth</b>	<b>GDP growth</b>
0.0%	2.0%	1.5%	1.5%	5.0%

### **Labor**

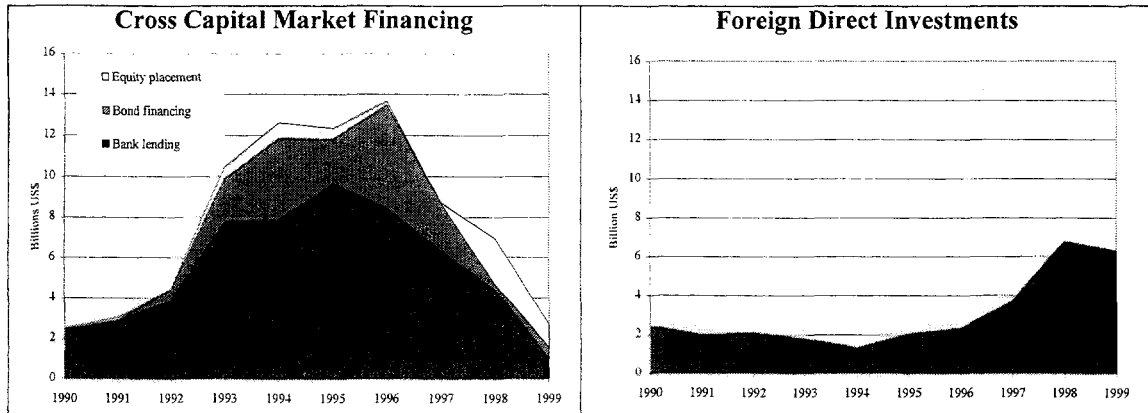
1.16 Labor's contribution to growth is likely to remain strong, arising mainly from improvements in the quality of the labor force. Much of the improvements remains potential, however, and a lot still needs to be done to achieve it (see Chapter 4).

### **Capital**

1.17 Private investment is key to the resumption of growth. Analysis shows that the collapse of investment during the crisis was strongly correlated with a collapse in expectations about economic activity (lagged income) and macroeconomic uncertainty (measured in the variation of the exchange rate). As the recovery sets in, these expectations will be revised and investment will pick up. Estimates also show that in the medium term private investment will likely be in the order of 20 percent of GDP, about 10 percentage points lower than in 1996. This is because of tempered expectations about economic activity



Figure 1.10: Foreign Capital Flows, 1990-99



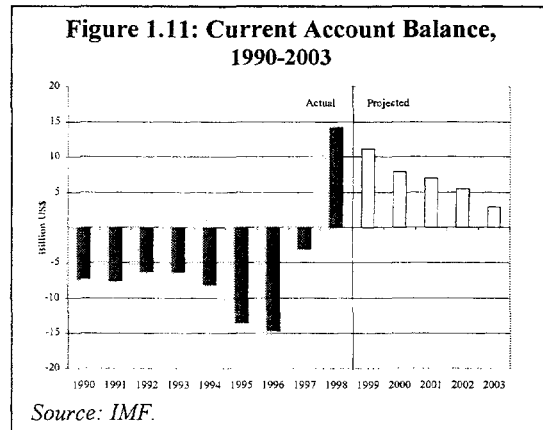
Source: Bank Staff Estimates (1999).

1.20 In the near term, large current account surpluses will take some of the pressure from the demand for foreign capital (Figure 1.11), but over the medium term the surplus is expected to decline. However, with the large amortization due on bonds and syndicated bank lending, (Table 1.4), and some US\$ 24 billion worth of short-term bank lines of credit as end-1998 (most of it not included in the syndicated lending figures), the need for new foreign financing remains substantial. While the public sector has access to foreign borrowing at reasonable rates, access for the private sector to foreign capital remains strained with easing expected only gradually over the medium term. Given the private sector's large obligations, it will come under great pressure over the next two or three years. The scope for attracting foreign equity financing lies mostly in privatization and cross-border placements rather than listing of depository receipts. The latter requires transparency and compliance with stringent accounting regulations, and given the state of corporate sector restructuring, most firms will not see that as an attractive source of capital. FDI rose during the crisis, reflecting a large number of mergers and acquisitions and the greater opening of the Thai economy to foreign investment. The mergers and acquisitions activity is expected to decline over the medium term, as post-crisis production adjustments slow and sale of distressed assets ends. New FDI inflows are dependent on continued structural reforms.

**Table 1.4: Amortization Due**

	2000	2001	Private sector share (%)
Billions US\$			
Bonds	1.2	2.4	70%
Syndicated bank lending	3.7	2.9	90%
<b>Total</b>	<b>4.9</b>	<b>5.3</b>	

Source: Bank Staff Estimates (1999)



Source: IMF.

**Table 1.5: Comparative International Financing Statistics for Selected Countries**

<i>(Percent of gross domestic capital formation)</i>	Thailand			Korea			Malaysia			Chile			Mexico		
	1990	1995	1999	1990	1995	1999	1990	1995	1999	1990	1995	1999	1990	1995	1999
Capital market financing <i>(% of GCF)</i>	7.4	17.6	11.0	5.2	12.0	14.4	27.8	32.7	57.2	14.6	16.5	19.6	10.3	26.3	9.9
Bond financing	0.0	3.1	3.1	1.6	6.4	3.2	1.6	8.8	16.0	0.0	3.2	6.6	2.5	12.2	5.6
Syndicated bank lending	7.2	13.7	2.2	3.2	4.9	4.0	26.2	22.1	41.2	13.2	11.8	13.0	7.8	14.0	4.3
Equity placements	0.2	0.8	5.6	0.4	0.7	7.2	0.0	1.8	0.0	1.4	1.4	0.0	0.0	0.0	0.0
Foreign direct investment <i>(% of GCF)</i>	7.2	2.9	17.7	0.8	1.0	10.3	18.7	13.2	32.9	8.4	19.1	22.9	5.6	15.6	4.3
Share of short-term debt in total bank debt (BIS) (%)	64.7	69.4	54.9	70.9	70.0	53.7	28.3	47.0	42.3	46.0	54.7	39.8	35.8	45.4	41.6
Share of foreign reserves in short-term debt (%)	150.3	81.3	159.6	71.0	58.8	180.9	454.3	290.6	376.7	148.3	189.9	152.4	52.3	58.6	116.5

Source: Bank Staff Estimates (1999).

Note: 1999 data are as of June, except for gross domestic capital formation for Chile, which is as of 1998.

1.21 **Total Factor Productivity.** TFP will likely once again become an important source of growth in Thailand, although it is difficult to quantify its contribution. In the short term, as growth and capacity utilization recover, TFP growth will likely turn strongly positive. But even over the medium term, TFP should improve from its low levels in the first half of the 1990s. The structural decline in the share of labor in agriculture is likely to resume, although the impact on TFP may not be as large as in the past. The allocation of capital is likely to improve, however, boosting TFP growth. Similarly, the share of trade in GDP is likely to rise closer to shares found in neighboring countries, leading to increased competition and exposure to new technology. The recovery in FDI should also improve TFP through the adoption of new technology and management and organization skills. Overall TFP growth in the medium term could thus be similar to rates achieved during 1980-95.

1.22 These favorable outcomes are not automatic, however. In the short term, they depend on the authorities' ability to maintain a sound macroeconomic framework and to make substantial progress in financial sector and corporate restructuring. In the medium term, they depend on the ability to carry through on structural reforms as detailed in the chapters that follow.

## 2. LESSONS OF THE CRISIS FOR POVERTY ALLEVIATION PROGRAMS

### A. INTRODUCTION

2.1 After many years of continuous improvement, progress in poverty reduction came to a sudden halt as the crisis began in 1997. Poverty, which had fallen from 30 percent of the population to 11 percent in just 8 years, rose again to 13 percent. The pain this has caused is substantial, particularly when contrasted with the positive expectations for the future that developed during the long period of growth.

2.2 The crisis revealed three areas to be especially important for the design of longer-term poverty programs. Most important, the crisis showed how many of the Thai people adjusted to the economic shock by migrating to rural areas, suggesting that government should aim to complement rather than displace these adjustments. The crisis also revealed that current policies were inadequate to reduce risks in the market economy, particularly for the poor, and that government lacked timely information on the impact of economic conditions on people's well-being.

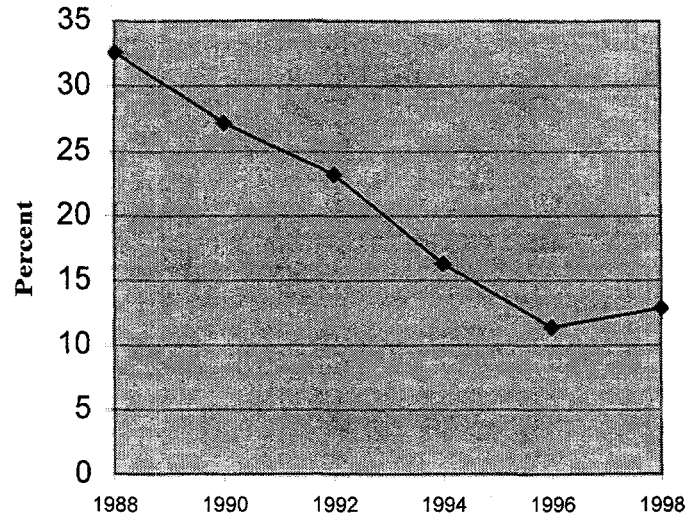
2.3 This chapter estimates the impact of the crisis on selected broad indicators of employment, poverty, and well-being and evaluates government response to these crisis-related developments. A more comprehensive assessment of Thailand's social protection system and the strategy for strengthening it will be undertaken in a separate report, currently under preparation.

### B. THE IMPACT OF THE CRISIS

2.4 *Trends.* The National Economic and Social Development Board (NESDB) has conducted extensive analyses of changes in poverty over the crisis period and before (Figure 2.1). They show clearly the sudden halt in progress made. Though the crisis did not change the overall picture of poverty (before and after the crisis the poor were disproportionately rural villagers, owning little or no land, and living in the Northeast, with little education and, to some extent, are households with elderly heads), it did change its composition (Table 2.1). The long-term poor and the newly (crisis-induced) poor have different characteristics. The largest increases in poverty were in the South and Central regions and in sanitary districts rather than villages. Public policy needs to distinguish between the long-term poor and the crisis-induced poor (a distinction noted in Malaysia and Indonesia as well) because the two groups require different programs and tools.



Figure 2.1: Poverty Rates



Source: NESDB, "Poverty and Inequality During the Economic Crisis in Thailand," Volume 3, Number 1, January 1999.

2.5 *International Comparisons.* While the macroeconomic consequences of the crisis were as severe in Thailand as in the rest of the region, the effects on social indicators were not as bad (Table 2.2 and Figure 2.2). The increase in unemployment was smaller (in absolute terms) than in Korea and Indonesia. The increase in poverty was less severe as well. Thailand's relatively flexible labor market absorbed much of the impact of the crisis through lower wages, thus spreading a smaller effect across more people.

2.6 The crisis had no clear effect on the distribution of income. Income inequality in Thailand (measured by the Gini coefficient) has always been high by Asian and international standards, having risen considerably during the period of rapid growth through 1992 (World Bank, 1996). Inequality had started to improve before the crisis period, but there has been no further improvement since then. Whether income distribution improves with economic recovery as it had started to do before the crisis bears careful monitoring.

**Table 2.1: Poverty Rates and Changes in Thailand for Selected Groups**

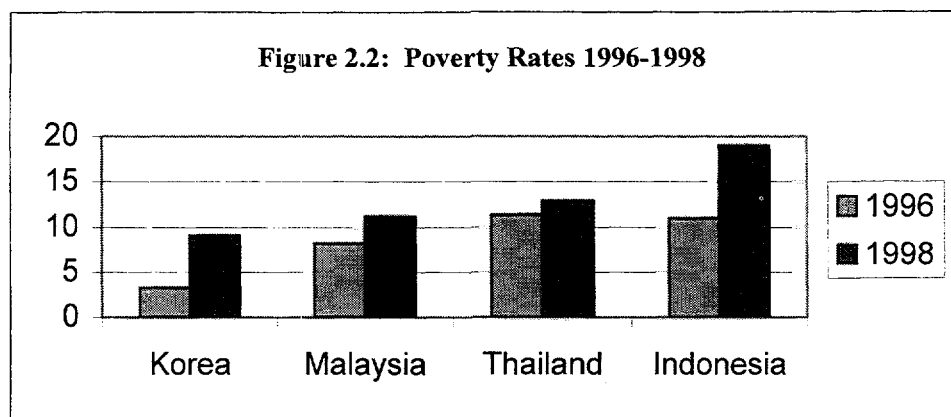
Item	1996	1998	Percentage Change
<b>Region</b>			
Central	6.3	7.7	22.4
Northern	11.2	9.0	-19.7
Northeast	19.4	23.2	19.4
Southern	11.5	14.8	28.7
Bangkok and vicinity	0.6	0.6	-12.7
<b>Type of area</b>			
Municipal	1.6	1.5	-6.6
Sanitary district	5.8	7.2	24.4
Village	14.9	17.2	15.3
<b>Age of head of household</b>			
20-29	7.7	8.7	13.1
30-39	12.0	13.1	9.2
40-49	11.7	12	2.5
50-59	10.5	13.6	29.2
60-69	11.6	12.7	9.9
70+	14.0	16.3	16.3
<b>Education of head of household</b>			
None or nonformal	20.7	21.8	5.3
Lower elementary	12.9	15.3	18.6
Upper elementary	7.8	12.8	64.1
Lower secondary	4.0	4.0	0.0
Upper secondary	4.3	2.7	-37.2
<b>Employment status of head of household</b>			
Farm owner (< 5 rai)	37.2	41.9	12.7
Farm owner (5-19 rai)	29.9	29.3	-2.1
Farm owner (20+ rai)	12.1	13.5	11.9
Farm renter (< 20 rai)	35.2	32.6	-7.3
Farm renter (20+ rai)	13.8	16.0	15.9
Laborers (includes agriculture)	20.9	29.0	38.7

Source: NESDB and World Bank staff estimates from socioeconomic surveys, NSO.

**Table 2.2: Unemployment and Inequality: Measures for Thailand, Malaysia, and Korea**

	Thailand	Malaysia	Korea
<b>Unemployment</b>			
1996	1.1 (August)	2.7 (December)	2.3 (December)
1998	3.4 (August)	3.2 (December)	7.9 (December)
<b>Gini coefficient</b>			
1996	0.477	0.496	0.296 (Urban)
1998	0.481	N.A.	0.293 (Urban)

Source: Thailand: NESDB, Malaysia, Korea: World Bank.



Source: Thailand: NESDB, Others: World Bank.

Note: Malaysian figures from simulations.

2.7 Policy responses in the countries differed in many ways as dictated by political pressures. One worth highlighting is Korea's employment scheme that grew enormously in the crisis period. The scheme paid wages lower than the prevailing wage for unskilled workers so as to attract only those in need of employment. This is a characteristic that is particularly helpful as a risk-reducing mechanism targeted accurately to the needy. In this important sense, the policy addressed the problems of the crisis-induced poor. The nonpoor affected by the crisis would not take advantage of such a scheme and while the long-term poor might take advantage of it, the jobs are not likely to be better than the ones they already had.

### C. ADJUSTMENTS TO THE CRISIS

2.8 People responded to the economic shock by adjusting their behavior. Some responses reflected the normal functioning of labor markets and household consumption decisions. Others were part of an informal network of support among extended family members or community members. How people react to adversity affects the design and impact of poverty programs and whether government policies are likely to undermine or bolster existing social and economic systems.

2.9 **Migration.** The principal reason for the increase in poverty in rural areas during the early crisis period, particularly in the Northeast, was the integration of rural and Bangkok labor markets through migration. The regular flow of workers to Bangkok, particularly from the Northeast, slowed dramatically during the crisis while the types of workers who did move to Bangkok changed dramatically. The number of recent migrants to Bangkok (those who had moved there in the past year), was half as large in February 1998 as it had been a year earlier, and the share from the Northeast fell from 68 percent to 38 percent. Unskilled workers, in particular, stopped going to Bangkok, while workers who migrated for higher paying jobs made few changes in plans. Between February 1997 and February 1998, the share of migrants to Bangkok who had less than an elementary

education fell from 25 percent to 13.5 percent while the share with secondary or higher education rose from 28 percent to more than 41 percent.

2.10 The crisis also changed the seasonality of migration. Whereas before the crisis, there had been pronounced differences in outmigration from Bangkok during wet and dry seasons. In 1998, there was similarity in the increase of outmigration both in wet and dry seasons.

2.11 Finally, the type of migrant leaving Bangkok changed. More families were moving as a result of the crisis and the proportion of single people migrating was much smaller. Fewer people migrating to the Northeast cited "return home" as the reason while the proportion of those accompanying family members rose (from 26 to 35 percent). The shift in the seasonal pattern and family structure of migrants indicates that there were more permanent decisions involving whole families. While both types of movements will likely be reversed with the resumption of growth, the costs involved in moving dependents, including disruption of education, will be higher than would be the case with normal seasonal migrations.

2.12 *Employment Patterns.* The net return migration had several consequences. Wages fell in the rural areas, spreading the impact of the returning migrants widely. Within households, however, there may have been a less formal adjustment in the form of "sharing" jobs. The socioeconomic survey shows a substantial shift in peoples' employment status from the category of "unpaid family labor" to "not in labor force," particularly in rural areas. The motives behind this shift cannot be known for sure but the effect was that a larger overall labor force in agriculture and a fall in rural wages were accompanied by a reallocation of people's time. Family members other than the main income earner who worked in family businesses or on farms appear to have cut back on their work and shifted to nonearner status.

2.13 This reallocation of peoples' time helped to avoid an adjustment that many had feared: that children would be taken out of school to help support the family. Analysis by NESDB shows an increase in school attendance after the crisis. Children in agricultural households were among the group of unpaid family labor that declined in size during the period. This is consistent with studies elsewhere that find a countercyclical pattern in school enrollments, because children's opportunity cost of time falls when less work is available.

2.14 *Sources of Income.* Sources of income changed very little. The main exception was among the poorest people who remained in Bangkok. The 3 percent of Bangkok residents who are among the poorest 40 percent of people in the country as a whole saw a major shift in earnings from wages to self-employment. For this group, earnings fell from 60 percent in 1996 to 37 percent in 1998 while entrepreneurial income rose from 22 percent to 40 percent. Construction jobs and other relatively formal types of employment were replaced by informal trade, resulting in a 7.4 percent decline in real incomes. This is a group for which the informal network of support does not seem to work.

### Box 2.1: Education Impacts and Responses

**Predictions Dire.** As the magnitude of the crisis became more evident, concerns mounted over the possible negative and irreversible consequences for the education of children, particular poor children. Many predicted drastic cuts in education spending, large price increases, significant shifts from private to public schools, declines in education quality, the withdrawal from school of large numbers of students, and increases in child labor.

**Impacts Cushioned.** Data available to date, however, reveal that these expectations have not been realized. Impacts on education outcomes have been limited. In fact, the functional literacy rate and average educational attainment of the population 15 years and older increased between 1996, the year prior to the crisis onset, and 1998.

Public and private spending on education increased in real terms. *Government* maintained real education expenditures and sensible allocations within the aggregate education budget despite early stabilization measures imposing fiscal constraints. To protect education opportunities for vulnerable groups, fees were accepted in installments and were waived in some cases, grant scholarships were introduced, and the education loan program was expanded. Disbursements of government funds were irregular, and nongovernmental sources of revenue decreased in some areas, but *schools* managed to sustain services by employing innovative coping strategies such as soliciting contributions from families and communities, rotating students receiving free milk and lunches, converting unused spaces, and reusing materials. With declining incomes and rising costs, *households* made optimal expenditure reallocation decisions, reducing spending on tobacco and alcohol, clothing and footwear, and household goods while increasing real expenditures on education.

Changes in utilization of education services were also limited. In the year following the onset of the crisis, overall enrollments increased. There was some shift from private to public schools as families sought to reduce educational expenditures. Although trends in enrollment rates may have been interrupted, dropouts did not increase significantly and child labor rates held steady.

**Toward Reform.** Thailand's education reform agenda, embodied in the new Education Act, envisions a national education system that strengthens the responsibility and authority of principals, teachers, and communities. The commitment and creativity of school administrators and communities in managing resources uncertainties give considerable confidence that this decentralization is likely to succeed. The reform program envisions a broad set of social partnerships for education embodied in the slogan "Education for all and all for education." Implementing reform strategies aimed at reducing constraints on the expansion of private education and at reducing the role of central public education authorities will be important.

2.15 **Consumption Patterns.** The share of income devoted to food rose by 5 percentage points fairly consistently across the country, as prices rose and income fell. In poor rural households home-produced food increased as a proportion of total consumption, presumably to feed returning family members.

2.16 Consumption levels varied much less than income, a reflection of long-standing practices of consumption smoothing frequently observed in the country.<sup>1</sup> Farmer's incomes vary substantially from year to year, leading to large discrepancies between income and consumption. They save in good years and draw down their savings in bad. They were joined in 1998 by people who were "economically inactive," or waiting out the recession. Dissaving among the poor averaged about 20 percent of family income. While the surveys do not assess net worth, 20 percent is large enough to raise doubts that the dissaving can continue, and thus that the safety net can hold, much longer.

2.17 *Borrowing and Lending.* Rural informal support networks included loans from farmers who were having a good year and who did not have extra people to support to their neighbors in greater need. This support mechanism works best when people face different kinds of risk (not "covariate" risks, which move together). A recession in the urban economy and its indirect effects in the rural market are likely to be uncorrelated with rainfall and earnings in agriculture. In fact, 1998 was a good year for agriculture and low wages would be expected to increase profits on larger farms.

2.18 There is no evidence, however, of systematic increases in interhousehold borrowing and lending. The socioeconomic surveys even show a reduction in such loans, through they also show an increase in other types of loans that might reflect transfers between members of extended families or other people living in the same house. In that case, the informal network may work more within families than within the larger community.

#### **D. GOVERNMENT POLICY AND RISK REDUCTION**

2.19 Poor people are vulnerable to many types of risks. Uncertain prospects are a significant part of the burden of poverty when there is little margin of security. A clear lesson of the crisis is that incomes and other components of well-being are much less severe than they seemed to be during the boom years. The informal network left gaps in the protection of the poor during the crisis, gaps that the private economy will not fill. Insurance markets either do not exist for most kind of risks or cover only small portions of the risks. Protection against unemployment and most other sources of income variation (wage fluctuation, farm prices and yields, disability, and health care costs) are rare in private markets, especially at Thailand's level of income. The poor need insurance as much as anyone else, but they are the last to benefit from whatever markets for insurance emerge.

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<sup>1</sup> Paxson, C., 1992, "Using weather variability to estimate the response of savings to transitory income in Thailand," *American Economic Review*, 82,15-33. Paxson, C., 1993, "Consumption and income seasonality in Thailand," *Journal of Political Economy*, 101,39-72.

2.20 Dealing with such market failure is important for poverty alleviation and requires corrective action by government. Action need not take the form of direct insurance provision. Many other risk reduction measures are possible, even measures whose primary goal may not be risk reduction. Macroeconomic stability means fewer fluctuations for people to adjust to. Similarly, in the absence of efficient health insurance markets, public hospitals serve the purpose of relieving the fear of catastrophic financial loss due to health care costs.

2.21 Whether explicitly insurance based or not, the essential feature of government policy to reduce and cope with risk is automaticity. It is important that government policy be triggered quickly by adverse events.

2.22 In Thailand, government policy during the crisis did not fill much of the gap left by markets and informal transfers, at least through 1998. There were virtually no cash payments by the Government or by those regulated by the Government. Indeed, pension payments among the poor were lower in 1998 than in 1996. Termination payments, which the Government had hoped to increase during the crisis, were also lower in 1998 than in 1996. It is not realistic to increase firms' liabilities in the middle of a business downturn, and not surprisingly, few people received much in the way of termination payments.

2.23 Transfer programs, such as to the elderly, were very small (virtually undetectable) in keeping with the Government's reluctance to undermine the informal safety net. However, although the elderly have higher poverty rates under normal conditions, and would benefit from pension programs under any circumstances, they were not a large part of the newly poor. Expansion of transfer to the elderly would not thus have reduced many peoples' risk of falling into poverty.

2.24 Social expenditures appear to have been pro-cyclical rather than countercyclical, contracting with the economy rather than expanding. This was a result of conflicting pressures, more rather than a deliberate choice. Such pressures are one reason why even the most efficient governments may not be able to react quickly to crises and why deliberate policy change may be too slow to help the poor cope with risks.

2.25 One program with an automatic trigger was the low-income health cards issued by the Ministry of Health. Thailand has a large private health sector, and before the crisis many eligible Thais did not take advantage of the health cards. With the downturn in the economy, however, more people became eligible automatically and more chose to switch out of the private sector. That there was not an increase in the budget available to the Ministry of Health to deal with the increased potential demand has been a concern, but the program's design and automaticity in response to shocks are a definite strength.

**Box 2.2: Coping with the Crisis in Health**

**Health Achievements Threatened.** As in the education sector, many feared that the crisis would threaten Thailand's impressive achievements in health. Higher costs for drugs and other imported inputs and decreased funding of public health services were likely to hurt the effectiveness, affordability, financial viability, and equity of health services. On the demand side, concerns were voiced about the diminished capacity of households to pay for health services, uncertainties in insurance scheme subsidies, and the emergence of new health needs.

**Impacts Limited.** Two years after the onset of the crisis, most of the pessimistic predictions have not materialized. There is little evidence of impacts on health outcomes. Mother and child health indicators are stable or increasing. There is no evidence of a rise in health care needs.

Crisis-driven budget reductions were concentrated on capital investment and, to a lesser extent, on specific programs such as health promotion and communicable diseases, including HIV. Personal spending on medical services declined steeply, but self-medication spending rose slightly, suggesting that more expensive treatments may have been postponed. The decline in spending was less dramatic for the poor than for the nonpoor, suggesting that the poor have sustained their essential health expenditures and protected by the public health insurance safety nets.

The Government enlarged its health safety net by increasing the coverage of public health insurance. Utilization of health services increased within schemes aimed at protecting the vulnerable (the Public Assistance Scheme) and the near poor (Voluntary Health Card Scheme). Indirect evidence suggests a shift from the fee-for-service private sector to the subsidized public sector. There was an increase in the utilization of public health services.

**Issues for the Future.** The crisis has shifted the government's attention from wide-ranging initiatives framed in a long-term context of growth and prosperity to more immediate priorities such as protecting key programs, expanding health insurance coverage to those in need, and managing the higher costs of imported goods and other new challenges. These urgent issues have turned attention to ensuring equity and access to services during a volatile economic downturn, and using the crisis as an opportunity to improve efficiency.

**E. LESSONS OF THE CRISIS**

2.26 **Public Expenditure.** The health cards program is one of the few government programs that respond automatically to crises. Another is the guaranteed employment scheme discussed above. Such programs have been highly successful in many countries in reducing poverty and maintaining steady employment. Such schemes work best where there is wage stickiness and outright unemployment. Their effectiveness may be limited in Thailand, however, where labor markets are flexible and migration is common. They may be more suitable to the southern region, where unemployment grew faster than elsewhere, and to the cities, where more of the poor lack extended family ties.



2.27 A conventional approach for reaching the poor through grants or regional investments may not be as effective as has been the case elsewhere and needs to be examined carefully in the context of Thailand's mobile labor force and because migration is an important feature of the country. High wage jobs could benefit the inhabitants of the rural Northeast wherever the jobs are located. And just as agricultural wages fell as migrants returned to rural areas, those wages should rise when migrants leave, benefiting even those who are less mobile. While unskilled workers have so far also benefited from this national integration of the labor market, continued progress will require a sustained commitment to education, especially by the central government, since the benefits of education are reaped nationwide, not just regionally.

2.28 People who are left out of the informal network lacked family ties in rural areas or who are unable to leave Bangkok for other reasons switched from wage earning to self-employment. Many poor people, though still a small part of the population, need public attention. An inability to rely on family ties leaves these people vulnerable to risk. Whether it is possible to serve this population with conventional policy measures is unclear. The Government should explore the use of NGOs for the delivery of services to small, difficult-to-serve groups.

2.29 An absence of the necessary data for identifying the beneficiaries of government spending on broadly based programs of basic education and health is a serious impediment to policymaking and is discussed in more details below.

2.30 ***Transfer Programs.*** The Government is concerned that a large expansion in transfer programs could undermine the social relations that served the country well in the current crisis. But a lack of data makes it impossible to demonstrate such displacement and several factors argue for the need for greater government involvement. Urbanization always accompanies development, and a reduction in family ties may be inevitable. Government programs may have little to do with this process. Also, economic inequality is quite high in Thailand by international standards. While the informal safety net and familial support are great assets, they may not be sufficient to achieve the degree of social justice to which the Thai people aspire.

2.31 ***Insurance- and Savings-Based Programs.*** The crisis uncovered weaknesses in the severance pay system for dealing with uninsured risk of unemployment, while the rise in demand for low-income health cards exposed the inadequacies of private health insurance. Reliable and portable pensions can also reduce the financial risks of unemployment.

2.32 Unemployment, health, and pensions are all areas of substantial market failures and of relative weaknesses in government policy. These are difficult areas, without universal solutions and require intensive policy analysis. The recently enacted Social Security Act is one response, through it may need to readdress portability. Another promising set of policies is savings-based schemes that are portable across firms, such as the provident funds, unemployment insurance, and the medical savings plan used in

Singapore. Given all the different kinds of uncertainty that people face, another way to help people better manage risk might be to allow people to link schemes together, allowing unused health benefits to be added to pension funds, for example.

#### **F. INFORMATION AND COMMITMENT FOR POLICY REFORM**

2.33 In many ways, the crisis caught the Government unprepared. Routine data collection was inadequate for tracking the effects of the crisis. This report drew on regular labor force surveys, the socioeconomic surveys of 1996 and 1998, and a recent series of reports published by the NESDB. These surveys and reports shed some light on the problem but leave many important questions unanswered. They also came too late to be used to monitor events and guide policy in the midst of the crisis. To be prepared for any future economic downturns, the Government needs to improve data collection now.

2.34 To assess how policies affect poverty, it is necessary to know who is reached or has access to public services. Despite concern that public policies will undermine the informal safety net, the regular surveys do not distinguish public pensions or transfers from private. There is no way to know whether public subsidies displace private support, whether children are in public or private school, whether school lunch programs reach their intended beneficiaries. Prospectively, there is no way to find out who is likely to benefit from an expansion of such programs, whether a new unemployment insurance program decreases wages or demand for unskilled workers? Similarly, there is no way to know how to adjust or improve such policies once enacted.

2.35 Thailand has made great strides in poverty alleviation. Progress should resume with a return to a stable economy. But Thailand's poverty programs have long had problems in design and implementation (World Bank 1996). The Government has relied instead on continued economic growth to solve the poverty problem. What the crisis showed was that such a strategy has its risks and cannot be relied on exclusively. The period of easy gains in alleviating mass poverty is likely over. Further progress will depend on better policy design and a strong commitment by the Government.

2.36 The crisis has illustrated the complex nature and interactions of Thai economy and society. Tracing the effects of policy will require better analysis and more careful monitoring of the conditions of the poor. Using this information to good effect requires high-level commitment and coordination of effort.

#### **G. SOCIAL CAPITAL AND EFFECTIVE POVERTY ALLEVIATION**

2.37 This section explores ways to strengthen informal mechanisms of responses to the crisis and the issue of social capital more broadly.

### **Social Capital: Definition**

2.38 Social capital is defined as the capital or assets embedded in society that bond people together into organizations, provide a safety net, improve the well-being of society, and sustain economic and social development. Social capital involves rules, norms, reciprocity and trust embedded in social relations, structures, and institutional arrangements.

2.39 Thai scholars have identified components of Thai social capital which strengthen local communities:

- (a) Norms, ethics, values, and beliefs that reflect a respect for nature and that see people as part of nature.
- (b) Local knowledge that carries on from one generation to the next, such as local handicrafts and traditional medicine.
- (c) A horizontal social structure which emphasizes reciprocity among communities and groups.
- (d) Community rights to manage resources.
- (e) Diversity of local cultures that can enrich knowledge among communities.

### **Erosion of the Old Society's Social Capital**

2.40 Accompanying the rapid economic growth of recent decades has been a rapid shift, especially in the rural areas, from mutual help and reciprocal labor exchange to a cash economy in which rural laborers work primarily for a wage. Younger generations migrate to the urban areas for employment, leaving the elderly to care for young children. The new generation of workers has become somewhat detached from the extended family and village life. The cultural and social norms that were essential to the institutions and relationships of an earlier agrarian era have been eroding. There is a greater tendency for open confrontation, yet the national political system has not established new rules to mediate these conflicts and create new and enduring institutions. In sum, new institutions are tentative and still in the making.

### **Rebuilding Social Capital: New Structure for Better Governance**

2.41 The Eighth National Economic and Social Development Plan of 1997 lays out a new basic social and administration framework with greater emphasis on horizontal relationships than on the former hierarchical one. It calls for the development of "popular governance" by enhancing public participation in policy formulation and implementation, strengthening the application of the rule of law in public administration, and improving the efficiency and effectiveness of public services administration.

2.42 Thailand's Constitution promulgated in October 1997 elevated the role of civil society in policymaking and established new mechanisms for increasing government accountability to the public.<sup>2</sup> The NESDB is responsible for the establishment of the National Economic and Social Council, an important mechanism for public voice in policymaking at the national level. The NESDB has set up a working group, headed by Secretary-General of the Cabinet, to provide input on the law which will govern the council. The draft law for the composition, source, powers and duties, and operation of the Council is complete.

### **Social Capital and Community Strengthening**

2.43 **The National Social Policy Committee (NSPC)**, established in July 1998, has funded a 40 million baht pilot project to create more space for civic group participation, to participate both formal and non-formal in local policy formulation at the local level. NSPC has convened fora and meetings and trained local facilitators to bring stakeholders into discussion of policy issues, while guarding against domination by local power magnates.

2.44 **The Ministry of Finance** has established the Community Organization Development Institute (CODI) to oversee funding and activities for community groups and income generation and strengthening. The draft law on CODI has been passed by the Council of State and is to be submitted to the Cabinet.

2.45 **The NESDB** has set up a subcommittee on Civil Society to provide input and monitor implementation of the Eighth Plan.

2.46 **The Bank Poor Network** links 8 savings groups and microcredit organizations to try to coordinate their efforts and know-how to help strengthen local community finance. Local savings groups have also been expanding.<sup>3</sup>

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<sup>2</sup> Article 76: The State shall promote and encourage public participation in laying down policies, making decisions on political issues, preparing economic, social, and political development plans, and inspecting the exercise of State Power at all levels.

Articles 89: For the purpose of the implementation of this Chapter (Directive Principles of Fundamental State Policies), the State shall establish the National Economic and Social Council to be charged with the duty of giving advice and recommendations to the Council of Ministers on economic and social problems. National economical and social development plans, as provided by law, shall be reviewed by the national Economic and Social councils before they can be adopted and published. The composition, source, powers and duties, as well as the operation, of the National Economic and Social Council shall be in accordance with the provision of law.

<sup>3</sup> For example, in Trade, the savings group activity started in May of 1990 with the amount of a 12,550 baht per month contribution per person from 320 people. A total of 2 percent of these monthly contributions was used to set up a welfare fund for the members. Up until December 1998, there were 123 savings groups with 26,779 members. Total amount of funding was 38,973,393 baht with 3,903,379 of

2.47 **The Social Investment Project** supported by the World Bank focuses on long-term community strengthening through capacity building and networking of community-based organizations.

#### **Next Steps**

- Stimulate research efforts to link social capital with other areas especially economic development.
- Assist the Government to improve the roles and capacity of various elements of social capital, especially in the areas of social protection and safety net.

#### **Box 2.3: Summary of Program for Poverty and Social Protection**

**Coordination of Social Policy.** NESDB's role as secretariat to the Council of Social Ministers is to be strengthened by (i) assigning a strong management team, (ii) upgrading technical skills, (iii) preparing a work plan to develop concrete options for social policy reform; and (iv) identifying and implementing advanced staff training in critical areas.

**Old-age Pension and Family Allowances System.** Drawing up a plan based on tri-partite consultations (labor, industry, and government) to reform the SSO old-age and family allowances schemes, with a view to making them more equitable, efficient, and financially sustainable.

**Severance Pay Provisions.** Development of a savings-based severance payments system for workers not covered by the Social Security System, pursuant to the Labor Protection Act of 1998.

**Voluntary Provident Funds for Private Employees.** Development of a robust supervision and regulatory structure for voluntary provident funds and improvement of their portability across firms.

**The Information Base for Monitoring.** Adequate funding for frequent monitoring of poverty through the socioeconomic survey; increased frequency of the labor force survey to four rounds per year, with appropriate questionnaire improvements.

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this amount invested in social welfare activities for their members. Total accumulated funds were 57,100,049 baht.

**Table 2.3: Social Protection in East Asia after the Crisis**

Country	Employment/ workfare programs	Micro- credit	Unemploy- ment insurance/ severance	Food security	Cash transfers	Social funds	Health and education	Training of unemployed
<b>Korea, Rep. Of</b>	A		B		B <sup>1</sup>		B(health)	
<b>Malaysia</b>		B					C (hth,edn,hsing)	B
<b>Thailand</b>	B		B		B <sup>2</sup>	A	B(hth+ed) <sup>3</sup>	B
<b>Philippines</b>	C	C		B <sup>4</sup>	C	C	B(hth+ed) <sup>5</sup>	
<b>China</b>	C		B		B <sup>6</sup>		D <sup>7</sup> , B <sup>8</sup>	A
<b>Indonesia</b>	B	D <sup>9</sup>		A <sup>10</sup>		D	B(hth+ed) <sup>11</sup>	

Source: Compiled by World Bank staff.

Note:

- A Newly introduced
- B Ongoing, being expanded
- C Ongoing, no change
- D Proposed

Countries are ranked in terms of GNP PPP per capita in 1996. (Korea -\$13,080 ; Malaysia-\$10,390; Thailand-\$6,700; Philippines-\$3,550; China-\$3,330 Indonesia -\$3,310)

- <sup>1</sup> disabled poor
- <sup>2</sup> elderly poor, needy families, poor children
- <sup>3</sup> health cards, school lunch, student loans
- <sup>4</sup> increased rice imports and distribution
- <sup>5</sup> increased share of public expenditures
- <sup>6</sup> minimum living stipend to urban poor
- <sup>7</sup> extension of medical insurance scheme to entire rural population
- <sup>8</sup> urban health insurance
- <sup>9</sup> credit for small and medium enterprises
- <sup>10</sup> increased imports of rice, targeted distribution to poor families
- <sup>11</sup> stay in school campaign, scholarships for primary and junior school, block grants, subsidies on essential drugs.

### 3. REFORM OF THE FINANCIAL SECTOR

#### A. INTRODUCTION

3.1 The purpose of the Government's financial sector reforms is to improve the robustness of the financial sector against future crisis and the allocative efficiency of financial intermediation. The allocation of financing to the most productive investments on both a cost-effective and risk-adjusted basis is prerequisite to a competitive Thailand. A stable and robust financial sector also reduces the risk of a systematic system crisis in the future. The key components of the Government's reform program in the financial sector are the resolution and restructuring of financial institutions, strengthening of the financial sector structure, and improvement of the legal, regulatory, and safety net regime. This chapter discusses the micro causes of the recent crisis, the restructuring and reform process to date, and outstanding challenges.

#### B. THE CRISIS OF 1997

3.2 **Background.** Thailand had made significant progress in developing its financial sector since the banking crisis of the mid-1980s. It kept the macro-financial fundamentals right (by keeping real deposit interest rates positive), gradually liberalized its financial system, and improved on the supporting institutional framework. This led to high mobilization of household savings (intermediated mainly through banks), a very deep financial system (as demonstrated by the amount of credit provided by the banking system as a ratio of GDP), and provided funding for high private investment, contributing to large economic growth rates. Yet the financial sector reform agenda was inconsistent and incompatible with a sound financial system. Micro-level weaknesses that had long been festering, combined with some macro-related policies (for example, monetary and exchange rate policy that encouraged offshore short-term funding), resulted in the emergence of many vulnerabilities starting in the mid-1990s. These vulnerabilities were brought into the open by the financial crisis in mid-1997.

3.3 **The Crisis.** The legal, regulatory, and supervisory framework for financial institutions was not conducive to prudent banking. Deregulation, particularly of finance companies' sector, had increased competition and reduced the franchise value of financial institutions, further undermining incentives to act prudently. Thailand also had weak accounting and auditing standards, poor financial disclosure, and inadequate corporate governance of financial institutions. Market oversight was limited by poor information and a concentrated ownership structure with cross-ownership links between financial and nonfinancial entities. In addition, incentives for market oversight had been further weakened by a bailout of depositors following the mid-1980s crisis.

3.4 Weak governance of financial institutions—due to a lack of market for control, and nontransparent, cross-ownership links between banks and nonfinancial corporations—allowed for bank lending to and investment in unviable projects. Financial institutions

based their decisions more on collateral than on evaluations of project viability, borrower creditworthiness, or cash flows. This encouraged the build-up of real estate exposure and increased vulnerabilities. The lending boom strained credit assessment and monitoring capacity and, coupled with poor internal risk management mechanisms and practices, rendering financial institutions vulnerable to shocks.

3.5 The resolution framework for problem financial institutions was incomplete. Rules on liquidation and bankruptcy were the same for banks and finance companies as for other companies and failed to provide an adequate legal framework for supervision. The authorities lacked explicit intervention powers (provisions requiring prompt corrective actions), which limited their ability to deal promptly and properly with financial distress. Supervision was institutionally fragmented<sup>1</sup> and overall supervisory capacity was weak. The regulatory framework was inadequate and regulators engaged in forbearance. Up to mid-1997, the authorities did not intervene in insolvent finance companies. Instead the liquidity support provided through the Financial Institution Development Fund soon turned into solvency assistance.

3.6 *The Government's response.* Thailand has made strides in restructuring its financial sector since the crisis, applying a five-prong strategy:

- Closing or nationalizing insolvent financial institutions (finance companies and some banks).
- Encouraging commercial bank restructuring, and related corporate restructuring, through voluntary, but government-supported means.
- Upgrading the regulatory and supervisory framework and improving intervention and exit mechanisms.
- Improving the broader institutional framework, especially by strengthening the bankruptcy and foreclosure laws.
- restoring public confidence in the financial system by issuing a blanket guarantee for depositors and creditors.

3.7 This chapter first takes stock of the Government's restructuring efforts and the current condition of the banking system, highlighting areas where reform is incomplete. Recent changes to the framework for the financial sector are then analyzed, since restructuring measures should be aligned with medium-term objectives in the financial sector. Improvements are suggested for the current framework to provide adequate incentives for prudent financial intermediation and the development of a financial sector robust to shocks. Policy recommendations for the medium term and indicators of future progress conclude the chapter.

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<sup>1</sup> The legal powers for supervision rested with MOF while BOT was responsible for the daily supervisory authority.



### C. THE GOVERNMENT'S RESTRUCTURING EFFORTS IN THE FINANCIAL SECTOR

3.8 *Resolution and Restructuring.* Since mid-1997, the Government has closed or intervened in 70 finance companies (accounting for over 13 percent of total assets of banks and finance companies). In December 1997, 56 institutions were closed and their assets were transferred to the Financial Sector Restructuring Authority (FRA) for quick disposition. Subsequently another institution was closed and 12 finance companies were merged with a large publicly owned finance company and a bank to form Bank Thai. To date FRA has disposed of 77 percent of its portfolio (664 billion baht in assets) at an average 72 percent discount. The publicly owned Asset Management Corporation (AMC) purchased nearly one-third of the core assets, or an outstanding principal balance of 197 billion baht<sup>2</sup>.

3.9 The Government also intervened in seven commercial banks (accounting for 14 percent of total financial system assets; see Box 3.1). One bank has almost been wound down and its nonperforming loans (NPLs) have been transferred to a private asset management corporation. Three banks were merged with other institutions; one of these has been privatized (with controlling foreign shareholding) and the other two may also be privatized. Of the remaining intervened banks, one has been privatized and the other two are to be privatized soon. Two smaller banks had earlier attracted new controlling foreign shareholders. Following these restructuring efforts, the number of financial institutions (commercial banks, finance companies, and specialized government banks) fell from 133 in mid-1997 to 63 by December 1999.

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<sup>2</sup> The AMC's mandate is to acquire impaired assets auctioned by FRA for which no acceptable private sector bids were received and to manage, restructure and collect on such assets and

**Box 3.1: Restructuring Finance Companies and Commercial Banks**

**Finance Companies.** The Government ordered 16 finance companies to suspend operations in June 1997 and another 42 finance companies in August. The suspended institutions were ordered to submit rehabilitation plans and undergo due diligence audits. The Government also announced a blanket government guarantee for depositors and creditors. In October 1997, the Financial Restructuring Authority was set up with a mandate to evaluate the rehabilitation plans of the finance companies and dispose of the assets of any closed finance companies. In the end, all but two of the 58 suspended finance companies were closed. Before their closure, the Financial Institutions Development Fund (FIDF) had lent them an estimated 530 billion baht in liquidity support, as well as 160 billion baht to other finance companies.<sup>3</sup> The Bank of Thailand (BOT) intervened in seven more finance companies in May 1998 and another five in August 1998 and closed one finance company in August 1999.

**Commercial Banks.** On March 31, 1998, the Government instituted loan classification and interest accrual guidelines for banks and finance companies in line with international best practice. Loan loss provisioning guidelines were to be phased in gradually through the end of 2000 to allow banks and finance companies to obtain fresh capital. Around the same time, two of the leading domestic banks, Bangkok Bank and Thai Farmers Bank, raised Tier 1 and Tier 2 capital in international markets. By May 1998, BOT had intervened in four critically undercapitalized banks that were unable to meet loss provisioning requirements and recapitalization deadlines. The central bank took control of these institutions by writing down shareholder capital to the legal minimum and converting FIDF loans to equity. To address the deteriorating situation in the financial sector, the Government announced the August 14 restructuring plan and intervened in two more banks. The Government also announced plans for four intervened banks and the restructuring of the state-owned Krung Thai Bank. A small bank was intervened in mid-1999. Work on the privatization of the intervened banks has progressed slowly; two banks were sold recently to foreign strategic owners and the sale of another two is expected to be finalized shortly.

3.10 **Commercial Bank Restructuring.** Initially, the Government took a more hands-off market-based approach to bank restructuring, requiring banks to comply with stricter (strengthened) capital requirements or face intervention and closure. The strategy was based on a progressive strengthening of provisioning requirements (until the end of 2000), designed to prompt financial institutions to obtain fresh capital. The Government issued stricter loan classification and interest accrual guidelines and phased-in loan loss provisioning guidelines. Ownership restrictions were (temporarily) relaxed to help domestic banks attract foreign (controlling) shareholders. Despite some initial success, banks soon faced new problems in raising capital as nonperforming loans mounted and turbulence spread through emerging markets. The Government announced a financial sector restructuring plan on August 14, 1998 to encourage the injection of private capital (Box 3.2). The plan laid out the conditions under which the Government would invest public funds in banks.

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<sup>3</sup> FIDF also provided substantial liquidity support to commercial banks.

**Box 3.2: Main Elements of the Financial Sector Restructuring Plan  
of August 14, 1998**

On August 14, 1998, the Ministry of Finance and the Bank of Thailand announced three key enhancements to the financial sector restructuring program. First, capital adequacy requirements were eased and brought in line with international (Basle) standards by lowering Tier 1 requirements for banks from 6 percent to 4.25 percent and increasing Tier 2 requirements from 2.5 percent to 4.25 percent.

Second, the Government earmarked 300 billion baht for two capital support schemes. Under the Tier 1 scheme, Government will purchase shares in participating institutions to bring Tier 1 capital up to 2.5 percent. Beyond 2.5 percent, the Government will match amounts invested by the private sector on a one for one basis through the purchase of preferential shares. To participate in the Tier 1 scheme, a financial institution must have fully provisioned to BOT's loan loss provisioning requirements for 2000 and submit a restructuring plan. The new major equity investors or the Government can change management after existing shareholders have recognized losses. Private investors have a three-year buyback option for the government shares at the Government's cost plus carrying costs. Under the Tier 2 scheme, designed to speed up corporate restructuring, the Government will exchange nontradable government bonds for bank debentures up to a maximum of 2 percent of risk-weighted assets. The amount of funds available will depend on the write-down of retained earnings resulting from corporate debt restructuring net of existing provisions against those loans; the net increase in loans to the private sector.

Third, financial institutions obtained permission to establish individual asset management companies.

3.11 ***Restructuring is Not Yet Complete.*** As of March 1999, 821 billion baht in new capital had been injected into the banking system, 467 billion baht of it from the Government.<sup>4</sup> Despite significant advances, restructuring of the banking system is not yet complete and the banking system remains fragile. As the economy slowed and interest rates climbed during the first half of 1998, banks' NPL ratios rose and remained high, amounting to 43.8 percent of total loans as end-October 1999. This left most banks with little, if any, pre-provision operating profitability for the near future, implying that they would be unable to increase loan loss provisions for additional NPLs, cover additional restructuring losses, or simply increase their capital through retained earnings.

3.12 Many domestic banks are struggling to comply with the requirement for full provisioning by the end of 2000. While the August 14, 1998 package has improved confidence in the banking system by assuring a safety net for undercapitalized institutions, private commercial banks have been reluctant to take advantage of the scheme since it involves a dilution of ownership and control and risks a change of management. Only two banks -- Siam Commercial Bank (SCB) and Thai Military Bank -- have applied for Tier 1 support. Of SCB's recapitalization amounting to 65 billion baht, half came from the Government under Tier 1 support and a matching amount was raised from private investors. Other banks have raised capital on their own, using

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<sup>4</sup> Source: Market estimates.

innovative ways. Bangkok Bank, Thai Farmers Bank, Bank of Ayudhya and Thai Military Bank raised about 200 billion baht in capital, some of it through Capital Augmented Preferred Securities (CAPS), and Stapled Limited Interest Preferred Securities (SLIPS). CAPS and SLIPS allow banks to boost their capital adequacy ratio without risking loss of control of existing shareholders. This form of capital is costly, however, as it increases banks' overall funding costs and has to be refinanced within about five years.<sup>5</sup> Banks' capacity to recapitalize on their own through retained earnings is thus further constrained.<sup>6</sup>

3.13 These capital constraints not only reduce bank's ability to lend (as they tend to preserve capital by shifting from loan assets into government securities) but also induce them to engage in no more than cosmetic restructuring, a practice facilitated by a change in debt restructuring rules that allows banks to reclassify a loan as performing once it has been restructured. As the three major private banks together accounted for over 40 percent of banking system loans as of June 1999, their financial positions remain crucial to economic recovery and resolution of the debt overhang. The sale of four intervened banks to investors has progressed slowly (Box 3.1).

3.14 Limited progress has been made in restructuring and recapitalizing state banks. The FIDF recently provided the third tranche of new capital (108 billion baht) to Krung Thai Bank in a conversion of debt to equity, for a total recapitalization to date of approximately 205 billion baht. The market anticipates that significantly more capital will be required to cover the remaining losses. In addition, the Government injected approximately 87 billion baht into the recently created Bank Thai. These two state banks are in a slow process of organizational and operational restructuring. The functioning of the main specialized financial institutions (SFIs) is also being reviewed.<sup>7</sup>

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<sup>5</sup> Even in the case when banks book no earnings in one year and hence pay no dividends for preferred shares-cum-subordinated debentures, investors will receive about 11 percent from the investment, seven percentage points above current deposit rates.

<sup>6</sup> That even the large private banks remain capital constrained became clear at the beginning of July, with the announcement that Thai Farmers Bank planned to transfer 80 billion baht in non-performing loans to a wholly owned asset management company at their estimate of market value (55 percent of outstanding principal balance). These loans had been fully provisioned for loss according to prudential requirements. This transaction had to be put on hold and TFB had to raise an additional 23.5 billion baht in equity in October 1999 to cover the additional provisions.

<sup>7</sup> SFIs which act as credit institutions are still not under the same supervisory regime as commercial banks, and examination and prudential supervision is not conducted by a single authority. Special regulations are required to account for specific, non-commercial mandates of some SFIs, such as directed, policy-based lending. An action plan for the rationalization of the SFIs is being prepared by approximately year end 1999. The background is that some SFIs are expanding their services and target customer base, such that they face new risks. In addition, some SFIs need to be recapitalized to meet prudential standards, but recapitalization should be concurrent with rationalization of the sector and the restructuring of specific institutions to ensure that they carry out their specific mandates on a sustainable basis and on a level playing field with the private sector.

## D. IMPROVING THE FINANCIAL SECTOR FRAMEWORK

3.15 *Important Legislative Changes Are Pending.* The Government plans several modifications in the financial services framework, including the passage of the new Financial Institutions Law, the new Central Bank Law, the new Deposit Insurance Law, revisions to the Securities and Exchange Commission (SEC) and Stock Exchange (SET) laws and regulations, and changes to the regulatory and supervisory framework. The required modifications are significant (Box 3.3) and include redefining the role of finance companies, raising minimum capital requirements, and defining the degree and modes of permissible foreign ownership. The authorities also are committed to replacing the general guarantee with a self-financed deposit insurance scheme with limited coverage and to establishing an adequate framework for the timely exit of problem institutions. A comprehensive program of institutional and policy changes to tackle accounting and auditing weaknesses for all companies is being prepared, including specific rules on accounting, auditing and financial disclosure for financial institutions, to bring them in line with best international practices.<sup>8</sup> Improvements in these areas will remain a challenge for the Thai Government in the near future.

3.16 *Other Changes to the Regulatory Framework.* The regulatory framework does not yet provide adequate incentives for prudent and efficient financial intermediation and the development of a financial sector robust to shocks, and far from meeting the best international practices. Although critical steps have been taken, key regulations should be revised. BOT is reviewing and rewriting all regulations in conjunction with the drafting of the new banking law. A cross-country perspective on the regulatory environment suggests that regulations on capital adequacy (consolidated ratio), foreign currency exposure, connected lending, liquid asset ratios, and loan loss provisioning still need attention. Specific regulations are needed in such areas as credit risk management, connected lending, and internal control. Special attention should be directed to improving the basis for establishing provisions for loan losses. For example, loans are classified according to the number of months delinquent, instead of a forward looking estimate of future loan repayments. In addition, provisions are calculated net of collateral value, resulting in a time lag in loss recognition in a declining market, which may cause losses to be underestimated in existing portfolios.

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<sup>8</sup> Reforms have also been initiated to enhance the role of the board of directors and audit committees. Although new amendments to the bankruptcy and foreclosure laws represent major progress, full implementation will require further judicial reform. These reforms are discussed in more detail in a subsequent chapter.

**Box 3.3: Review of Financial Sector Laws**

**Suggestions to Strengthen the Central Bank Law:**

- Clearly define the central bank objectives.
- Establish the central bank's functional independence from the Government.
- Clearly define the supervisory responsibilities of the central bank and the Government.
- Enforce the accountability of the central bank through reports to the legislature.
- Establish clear lines of authority and responsibility within the central bank

**Suggestions to Strengthen the Financial Institutions Laws:**

- Clearly allocate authority and responsibility among government entities.
- Establish the functional independence of supervisory and regulatory entities from the Government and clearly define that authority and responsibility for financial institution licensing.
- Clearly define scope of permissible operations for each type of financial institution.
- Incorporate the Basle Committee's Core Principles for Effective Banking Supervision.
- Implement a legal process for intervening, rehabilitating, and liquidating failed financial institutions.
- Submit amendments to the Central Bank Law and a draft of the Financial Institutions Law to the Cabinet.
- Draft and enact the proposed secured lending law and establish a collateral registry (given the weakness of the current regime which lead to collateral-based lending, not cash-flow-based lending).

3.17 *Further Improving Bank Supervisory and Regulatory Capacity.* The Government has embarked on a comprehensive reform of banking supervision. However, despite the commitment to reform and the introduction of key measures, major weaknesses persist (Box 3.4).

3.18 *Deposit Protection Scheme.* The Government is committed to replacing the August 1997 comprehensive guarantee of all deposits with a more restricted deposit protection scheme, once financial markets stabilize. It is important that the new framework includes a clear institutional framework to manage the deposit protection scheme; a funding mechanism; explicit details on insured deposits and payment modalities; requirements for monitoring and corporate governance; prompt corrective action and strict exit procedures.

**Box 3.4: Needed Improvements in Supervisory Functions**

**Legal and Institutional Setting.** Most of the legal supervisory rests with MOF, whereas day-to-day supervision is handled by BOT. This has blurred the lines of responsibility and accountability while making decision process lengthy and complex. Legal provisions provide inadequate guidance and legal standing to the supervisory agency to discharge its responsibilities (lack of consolidated supervision, narrow definition of connected lending). The supervisory agency has broad discretion in granting exceptions and enforcing sanctions, resulting in significant prudential forbearance, waivers of legal limits beyond prudential consideration, and delayed sanctions. The new financial laws are expected to address some of these weaknesses.

**Supervisory Procedures and Capacity.** BOT is dealing with some issues (reform of regulatory reporting, a new on-site examination manual) but it has not developed detailed procedures for staff to discharge their supervisory duties and other weaknesses need to be addressed (automatic data transfer from financial institutions to BOT, an early warning system, financial analysis methodology, explanation and interpretation of prudential standards). BOT needs better internal communications, including more open discussion among staff, greater involvement of junior staff, deeper acceptance of new supervisory approaches, greater external hiring, and more extensive use of the new School for Examiners. The recent decision to hire a consulting firm to assist with the reform of the central bank, coupled with the internal rotation of managers, is encouraging.

**Enforcement.** Better definition of legal powers, less supervisory discretion, more detailed guidelines, and stronger technical skills are part of a new, stricter legal and regulatory framework. If it is to be effective, the rules will have to be enforced more consistently and strictly than they were before the crisis. Since the end of 1997, BOT has made difficult decisions, sending a strong signal that forbearance is no longer to be expected of supervisors. It must continue to send a consistent message of firmness.

**3.19 Broader Operating Environment.** Creditors and shareholders in Thailand are relatively well protected by the formal rules (property rights, creditor rights) and scope for corporate governance (ownership structure, mandatory dividends, anti-director rights). Yet, protections still fall short of those granted in developed countries, and they are undermined by a weak judicial system that lacks transparency, hindering efficiency and integrity as it affects the financial sector. Further improvements in this area are necessary (see also other chapters).

**E. INCREASING CONTESTABILITY**

**3.20 Thailand's Banking System Has Been Highly Concentrated.** The Thai banking industry continues to be highly concentrated. The three largest banks accounted for nearly one-third of financial system assets at the end of 1998. While concentration itself is not much greater than in some industrialized countries, Thailand's financial system suffered from the lack of a credible threat to entry. The market structure has impeded innovation and diversification and the development of private securities markets.

3.21 Before 1997, Thailand almost completely restricted entry, granting no new (domestic) banking licenses from 1965 to 1997.<sup>9</sup> Today, high minimum capital requirements (in absolute amounts) and a 25 percent limit on foreign ownership still block the entry of new financial institutions. The draft Financial Institutions Law considers granting BOT absolute authority to prescribe conditions and grant or deny licenses. The law needs to include objective and transparent criteria (at a minimum, those enumerated in Basle Core Principle No. 3), to ban economic needs tests and to state clearly the standards to be employed by BOT in assessing the applicant institution's ownership structure and the fitness and proper test of its owners and managers. The existing restriction of 25 percent foreign ownership of banks could be relaxed, subject to specific conditions, and the limit on the operations of foreign financial institutions to one branch needs to be removed. This is all the more important as Thai banks need to attract outside capital and to upgrade their product lines and skills and institutional development. Steps have been taken in this direction, such as permitting 100 percent foreign ownership (up from 25 percent) with some time-bound restrictions and the sale of problem franchises to foreign banks.

3.22 *Increase in Investments Needed.* Thai banks' average operating expenses are similar to those in other East Asian economies and slightly lower than those in many developed countries, except for Japan, and other developing countries. However, the lower cost reflects inadequate investments in risk management and internal control management systems (which are capital intensive). In addition to more investment in risk management systems, institutional development is also needed. Competition from foreign financial institutions can spur this development while also bringing in new technology.

3.23 *Correct the Unbalanced Financial System.* With financial assets of 150 percent of GDP, the Thai financial system is quite deep for an emerging market economy at its level of per capita income. The Thai system is heavily bank-oriented, however. Banks hold more than 70 percent of financial assets, and there is very limited financial intermediation through mutual funds and other type of institutional investors. Bond and stock markets are underdeveloped, with outstanding bond issues accounting for 12.5 percent of GDP and stock market capitalization amounting to 19 percent of GDP as of June 1998. The equity market lacks transparency and has only a limited role in corporate governance because family-controlled firms continue to dominate the corporate sector.

3.24 The unbalanced pattern of financial intermediation leaves the economy vulnerable to internal and external shocks. Better securities markets are needed, both as a competitive force in the banking system and as a complementary source of finance. Enforcing minority shareholders rights and improving the corporate governance framework are also important to well functioning capital markets. The Thai authorities have taken steps to improve capital markets, including the domestic bond market.

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<sup>9</sup> Last year the BOT issued one new domestic banking license and five new licenses for branches of foreign banks: to Radhanasin, a public bank that took over some of the good assets of Laem Thong Bank (LTB) and to five foreign banks (mostly of Japanese origin) which converted their BIBF licenses into full foreign branch licenses.



3.25 ***Better Definition of the Scope of Financial Services.*** Now that the finance companies sector has been significantly restructured, its future role and that of banks still need to be addressed. A December 1998 announcement by BOT allows finance companies to apply for a limited bank license, covering all activities allowed for commercial banks, except for checking accounts. This may accelerate the phasing out of finance companies -- they may become restricted banks, go into securities business, or be liquidated -- but it is not a long-term solution. The policy creates two classes of banks, which can be risky. In the past at least, the inability of finance companies to raise stable, low-cost funding through deposits was an important factor in motivating their risky investments. More generally, there is a need to review the scope of financial services provisions in Thailand. Licenses for different financial services are still fragmented and the organizational structures that allow for different types of financial activities are not necessarily optimal from either a risk or an economies of scope point of view.<sup>10</sup> A comprehensive review of financial services provision in Thailand is needed.

## F. THE AGENDA AHEAD

3.26 The Thai authorities have made substantial progress in financial sector reform, though deficiencies remain and activities fall short of international best practice in several areas. Over the short to medium term, Thailand could focus on four areas:

3.27 ***Completing the Restructuring Agenda.*** International experience suggests that rapid recognition of losses and aggressive restructuring accelerate economic recovery over the medium term by facilitating real sector restructuring and restoring bank lending capacity. Thus all commercial banks and finance companies need to meet full provisioning requirements and full recapitalization needs to be completed so that loan portfolios can be cleaned up and losses fully absorbed. Pressure should be maintained on banks to fully complete the recapitalization process. If recapitalization and loss absorption capacity continue to be delayed, a financially weak banking system may impede sustainable corporate restructuring and hamper economic recovery.

3.28 ***Enhancing Intervention and Exit Mechanisms and Enforcement.*** Thailand has made some progress last year in bringing its incentive framework in the financial sector in line with global best practice. Because highly concentrated ownership patterns limit the scope for market discipline, Thailand may need to rely more on (improved) supervision and owners' discipline. Supervision can be enhanced by increasing the automaticity of penalties for weak, undercapitalized institutions and those that fail to comply with prudential regulations (through a specific catalogue of penalties for

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<sup>10</sup> In particular, more integrated banking would permit Thai banks to fully realize informational advantages, economies of scope, diversification benefits, and increased revenues. Moreover, as integrated banks have to report their activities on a consolidated basis, it would increase transparency for market participants and the supervisory authority. While a full-fledged integrated banking system has some risks, the authorities could implement policy-measures to keep these to a minimum. These include credible mechanisms to prevent the extension of the safety net for deposit-taking financial institutions to other financial activities. The authorities also could limit, at least initially, the extension of powers to engage in securities markets and other non-credit financial activities to those banks which have strong capital positions and which have shown to have the internal capacity to manage the associated risks appropriately.

example). Owner discipline can be strengthened by increasing the legal liability, and increasing their duties and strict rules on early intervention in weak financial institutions.

**3.29 *Increasing Competitiveness.*** Lowering minimum capital requirements and increasing the transparency of licensing process would greatly enhance contestability in the Thai financial sector. Through more open than before to foreign competition, the Thai banking sector is still behind developed and emerging market economies and should open up further. Maintaining restrictions on foreign banks' branches for the next year can maintain investors' interest in buying recently intervened banks, but over the medium term Thailand should abolish those and other restrictions on foreign participation in its financial sector.

**3.30 *Moving to a More Balanced Financial System.*** While it is too early to move to a full-fledged integrated banking system, the Thai authorities should take some steps to rationalize financial services provision. They could rationalize the different types of licenses granted and reconsider the policy of allowing different types of commercial banks. To create a more balanced financial sector, the authorities should also promote capital markets development. Improving the protection of minority shareholders' rights would help and would also improve corporate discipline.

**Table 3.1: A Comparison of Financial Sector Restructuring  
in the Crisis-Affected Asian Economies**

<b>Indicator</b>	<b>Indonesia</b>	<b>Korea</b>	<b>Malaysia</b>	<b>Thailand</b>
<b>Financial distress resolutions</b>				
Bank shutdowns	66 out of 237	None	None	1 out of 15
Shutdown of other financial institutions	Not applicable	More than 117	None	58 of 91
Mergers of financial institutions	4 of 7 state banks to merge	11 out of 26 absorbed by other banks	58 to be merged into 6 groups	3 banks and 13 finance companies
Nationalizations	12	4	1 and 3 finance companies	7 (1 shut down, 3 privatized, 3 to be privatized)
<b>Bank recapitalization strategies</b>				
Public funds for recapitalizations	Plan in place Some bonds issued	Government injected \$8 billion into 9 commercial banks	Donamodal injected \$1.6 billion into 10 institutions	Plan in place Government injected \$8.9 billion into private banks and \$11.7 billion into public banks
Majority foreign ownership of banks	Allowed; 1 potentially	Allowed; 2 completed and 1 near finalization.	Not allowed	Allowed temporarily, 4 completed and 2 pending
Weak financial institutions still in system	Many weak commercial banks	Many weak non-bank financial institutions	Difficult to assess	Some weak public and private commercial banks
<b>Asset resolution strategies</b>				
Assets transferred	66% of total NPLs (35% of GDP)	26% of total NPLs (10% of GDP)	50% of total NPLs (14% of GDP)	Not applicable.
Assets disposed of over amount of total assets transferred.	0.7%	4.7%	0.1%	Not applicable.
<b>Non-performing loans ratio (percent)</b>				
NPL ratio	Not applicable.	16.6 (Dec-98) 17.9 (Mar-99)	19.7 (Dec-98) 19.4 (May-99)	45.0 (Dec-98) 47.5 (Jun-99) 43.8 (Oct-99)

Source: Compiled by World Bank staff.

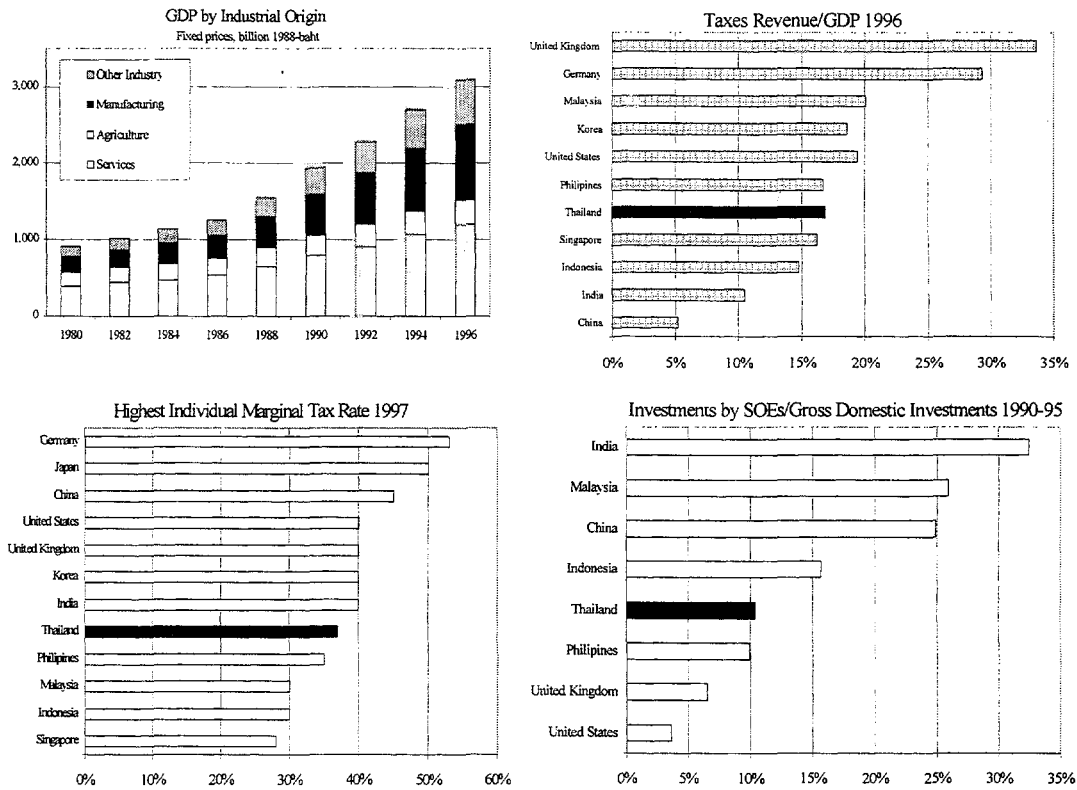
Note: Nonperforming loans are measured on a gross, three-month basis and include assets carved out for sale by the asset management agencies.

## 4. PRIVATE SECTOR DEVELOPMENT

### A. INTRODUCTION

4.1 Once a relatively closed economy, highly dependent on a few primary commodities, Thailand has become much more open and has penetrated export markets for a growing number of manufactured goods. High levels of saving and investment and modest public spending have underpinned two decades of rapid growth, steady shift in output from agricultural to manufactured goods, and increasing technological sophistication of exports (Figure 4.1).

**Figure 4.1: Selected Indicators of Private Sector Development**

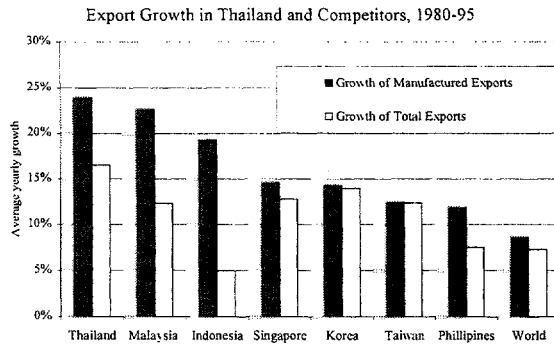
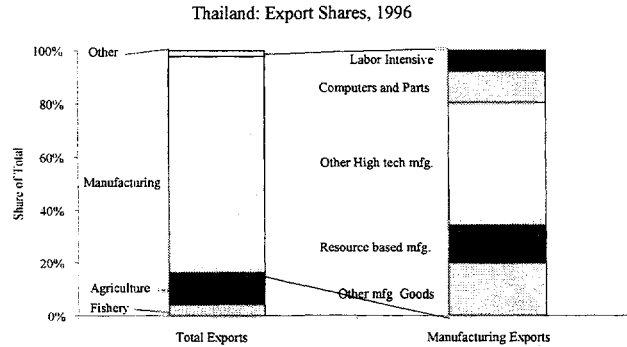


Source: Thai authorities.

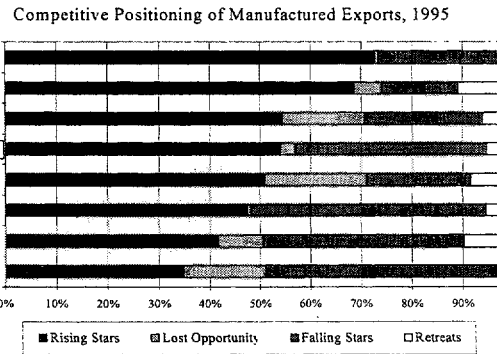
4.2 **The Export Sector.** Manufactured exports have been the main engine of growth. Manufactured goods rose from 25 percent of exports in 1980 to 73 percent in 1996, displacing food, agricultural products, and ores and metals (Figure 4.2). Total exports grew ninefold over this period, with much of the growth in computers and parts (mainly hard disk drives), electrical appliances, garments, integrated circuits, and textiles and yarn.

4.3 Thailand is well placed against competitors in key segments of exports. “Rising stars”<sup>1</sup> account for 54 percent of exports, not as high as in Malaysia or Singapore but better than in Indonesia, China, the Republic of Korea, and Taiwan (China). Only a small portion (2.8 percent of exports) are “lost opportunities.”

Figure 4.2: Structure of Exports



Source: Thai authorities.

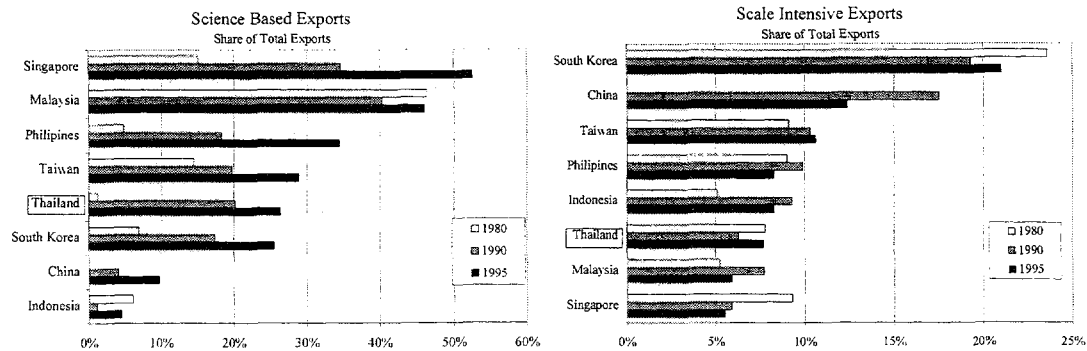


4.4 But, the share of high technology products, with relatively secure market niches, better growth prospects, and greater technological spillovers, is well below that of such competitors as Malaysia, Singapore and the Philippines. Backward linkages in these products are generally lower than in Malaysia, especially in electronics. Thai semiconductor exports have stagnated or declined while such exports have grown rapidly in the Philippines, apparently because of a massive influx of foreign direct investment (FDI) to take advantage of the skill base and an English-speaking labor force.

<sup>1</sup> The competitive positioning of Thailand’s exports can be assessed by looking at the growth of global export markets and seeing what is happening to Thailand’s share in each market. This suggests a four-way classification between dynamic and static products in world trade (depending on whether they are growing faster or slower than world trade as a whole) and between products in which Thailand is competitive (has rising market shares) or not (declining market shares). This yields a matrix with four groups of products. “Rising stars” are dynamic products in which Thailand is competitive. “Falling stars” are static products in which Thailand is competitive. “Lost opportunities” are dynamic products in which Thailand is losing market share, and “retreat” are those products where Thailand has a declining share of a shrinking market. An economy with solid growth prospects will have a high proportion of rising stars and a low proportion of lost opportunities in its export mix (see annex for the empirical details).

4.5 Of greater concern is that medium-technology exports (which account for nearly half of world trade and present the greatest opportunities for growth) make up only 27 percent of Thailand's total exports, less than in all key regional competitors (Figure 4.3). Thailand maintains high protective tariffs in this sector, particularly for automobiles. Developing the strong engineering base required for medium-technology products may be one of Thailand's most pressing challenges.

**Figure 4.3. Science-Based and Scale-Intensive Exports**



4.6 Operational restructuring of firms to sharpen competitiveness will require:

- Restructuring corporate debt to facilitate operational restructuring of firms to become more competitive.
- Reforming corporate governance to improve corporate balance sheets and empower shareholders to demand that management maintain a competitive edge.
- Removing hurdles to competition by eliminating trade distortions, introducing a modern competition policy, and streamlining the investment incentive regime.

4.7 In addition to strengthening the enabling environment to foster competition, Thailand also needs to reform policies affecting factors of production directly. This includes:

- Removing distortions in labor markets, education, and training.
- Reducing the costs of infrastructure and trade logistics.
- Strengthening R&D and technology upgrading.

4.8 Finally, operational restructuring must ultimately reduce operating expenses and increase revenues. This requires decisions that change the mix of outputs, the nature of product lines, the production technology, and the marketing strategy. Debt restructuring, and the actions of creditors can play an important role when changes of ownership or management are needed to support this process.

## **B. THE ENABLING ENVIRONMENT FOR FOSTERING COMPETITIVENESS**

### **Corporate Debt Restructuring**

4.9 A combination of poor capital structures, poor asset utilization, and declining demand has undermined the profitability of the Thai corporate sector since well before the flotation of the



4.12 ***Institutional Framework for Corporate Restructuring.*** The government's policy response has been to:

- Strengthen the *legal framework for recovery* of nonperforming debt through bankruptcy reorganization and enforcement of security interests.
- Provide a *structured out-of-court process* for debt restructuring negotiations, with institutional support through the Bank of Thailand.
- *Provide regulatory and tax incentives to corporations and banks* through bank recapitalization, tax policy of the Bank of Investments and the Securities and Exchange Commission regulations.

4.13 ***To strengthen the legal framework for formal (court supervised) bankruptcy and reorganization*** the government has:

- Passed a reorganization amendment to the Bankruptcy Act in April 1998 and other amendments in March 1999.
- Passed an act establishing a bankruptcy court in March 1999 and opened the court in June 1999.
- Amended the Code of Civil Procedure and Petty Cases on Legal Execution in March 1999.

4.14 As of July 1999, 26 firms had applied for business reorganization, representing total outstanding debts of 98.6 billion baht (\$2.7 billion). Of these, 19 were in the process of business reorganization, and seven reorganization plans were rejected by the court.

4.15 Banks do not appear to be filing petitions for bankruptcy liquidation or rehabilitation to a degree commensurate with the magnitude of distress. There is concern among some creditors that the framework for corporate restructuring and insolvency is biased in favor of debtors. The concern merits close monitoring as the foreclosure amendments begin to be used and the Bankruptcy Court is challenged to reorganize insolvent debtors with positive net worth. The perception by both debtors and creditors of a balance sheet test of insolvency has undermined the leverage of the legal reform package on restructuring. In addition to the solvency criteria, observers cited the uncertainty over the naming of a planner in the bankruptcy, the roles and liability of the planner, and the exit provisions as additional reasons for low utilization levels to date.

4.16 ***Voluntary Corporate Restructuring.*** Government actions have included:

- Establishing a Corporate Debt Restructuring Advisory Committee in June 1998.
- Establishing a Framework for Voluntary Debt Restructuring in September 1998.



- Signing the Debtor-Creditor Agreement on Debt Restructuring Process in March 1999.
- Signing the Inter-creditor Agreement on Restructuring Plan Votes in March 1999.

4.17 With the support of the Thai Bankers Association, Foreign Banks Association, Board of Trade, Association of Finance Companies, and Federation of Thai Industries, the Corporate Debt Restructuring Advisory Committee (CDRAC) created two civil contracts: Debtor Creditor Agreement and Intercreditor Agreement. Signatories agree to defined procedures for case entry, information sharing, negotiations, and 75 percent majority voting approval. The contracts allow CDRAC to arrange mediation, and intercreditor arbitration, empower the Bank of Thailand to enforce creditor compliance (through warnings and monetary penalties), and allow creditors to enforce debtor compliance through bankruptcy filings. As of November 1999, the agreements had been signed by 84 financial institutions and more than 406 debtors bringing the number of "target cases" to 702<sup>2</sup> (Table 4.1).

**Table 4.1 Status of CDRAC Target Cases**

STAGE	NUMBER OF CASES	OUTSTANDING CREDIT	SHARE OF OUTSTANDING (%)
Completed cases under previous framework	59	158,841	10.6
Completed cases under Debtor-Creditor Agreement	45	65,889	4.4
Completed cases pending legal documentation	53	209,986	14.0
<b>Total completed cases</b>	<b>157</b>	<b>434,716</b>	<b>29.0</b>
<b>Cases in process of debt restructuring</b>	<b>291</b>	<b>497,837</b>	<b>33.2</b>
Cases where CDRAC advises legal action	150	328,222	21.9
Cases in which creditors took legal action independently	63	84,841	5.6
<b>Total cases in process of legal action</b>	<b>213</b>	<b>413,134</b>	<b>27.5</b>
<b>Cases which have recovered to normal status</b>	<b>60</b>	<b>159,662</b>	<b>10.6</b>
<b>Total cases</b>	<b>702</b>	<b>1,500,242</b>	<b>100.0</b>

Source: Bank of Thailand Office of Corporate Debt Restructuring

4.18 Corporate debt restructuring has begun to yield visible results. The central bank reported its largest monthly increase in restructured debt in June, as it restructured 136 billion baht (\$3.6 billion) in distressed debt. It restructured 62 billion baht more in July bringing, total restructured debt to 629 billion baht (\$16.5 billion). For the first time since the crisis began, restructuring has begun to lower nonperforming loans as a share of outstanding loans from 42.3 percent to 42 percent.

4.19 Some restructured cases have returned to nonperforming status, provoking concerns about sustainability. It is important that unsupportable debt be written down or swapped for equity and that debt restructuring catalyze operational and strategic change—maximizing cash from available revenue, strategic divesting some businesses, longer-term rebuilding of competitiveness in well-chosen segments. Strategic restructuring—particularly divestiture—

<sup>2</sup> The number of CDRAC target cases has been expanded by the addition of 989 medium and 1,500 small debtors. Total outstanding credit of the target caseload now exceeds Bt 2 trillion. This analysis focuses on the original pool of 702 cases.

cannot be separated from debt restructuring or governance. Since restructuring involves a financially painful investment, the support of financial stakeholders (owners and creditors) is a prerequisite. Restructuring has worked in Thailand where there has been strong governance, strategic investment, creditor leverage (especially, bankruptcy reorganizations) or supportive banks.

4.20 Government has addressed sustainability in several ways. A package of measures announced in August 1999 provides for a Venture Capital Investment Fund, an Equity Fund, and a Recovery Fund to support the development of competitive enterprises, including those now restructuring their debt. Operational restructuring seminars—where participants received restructuring manuals—have been conducted with the support of the World Bank. The seminars trained bankers to understand the operational causes of financial distress and develop solutions accordingly. The first of several centers for training restructuring service providers will open in October. Yet more work is needed to inform and convince entrepreneurs of the need for change. The Industrial Restructuring Masterplan launched by the Ministry of Industry last year provides funding and programs for training and the adoption of new technology, management techniques, and marketing strategies. But the use of these facilities remains low.

4.21 ***Improving the Incentive Framework for Corporate Restructuring*** The government has implemented tax incentives for restructuring covering income tax, value-added tax, specific business tax, and duty stamp in restructuring cases; taxation of debt write-off (to be considered an expense, thereby reducing a financial institution's tax liability and reducing the tax on transfer of real estate).

4.22 The Stock Exchange of Thailand (SET) and the Securities and Exchange Commission (SEC) have facilitated restructuring through suspension and delisting actions against firms in debt restructuring, firms with negative equity or unsustainable debt, firms in bankruptcy and firms not in compliance with financial disclosure requirements.

4.23 The SEC has amended notification requirements for companies in rehabilitation, reducing the approval period from 45 to 30 days and relaxing some approval criteria. The SEC has adopted a disclosure-based approach instead of a merit-based approach for small and medium-size enterprises. Furthermore, the SEC issued a notification of conditions under which the purchaser of a company can be exempted from having to make a formal tender offer when purchasing a company for rehabilitation.

4.24 ***The Remaining Agenda.*** Restructuring operationally viable corporations with funding problems is well underway, both through the CDRAC process and through informal restructuring. Restructuring in the steel, chemical, textile, and electrical appliance sectors may be more difficult because of the magnitude of the necessary write-downs. Given the relatively weak incentive structure and ongoing recapitalization of the banking system, stronger approaches may be required to deal with restructuring of less viable sectors. The voluntary process may need to be further accelerated to ensure timely action. This will require funding for intermediation, managing debtor-creditor and intercreditor agreements, and making firms competitive so that they can increase capacity utilization and thus their revenue base. Other remaining issues are:

- Developing private asset management companies by extending to them (beyond December 31, 1999) tax privileges granted to parent financial institutions.
- Clarifying discrepancies between reported progress in restructuring and levels of nonperforming loans in the financial system.
- Amending the Bankruptcy Act to replace the discretionary solvency test with an objective rule based on ability to pay debts as they become due and to further stabilize the remaining areas of discretion and uncertainty, such that the Act facilitates early action by both debtors and creditors to address insolvency at an early stage.
- Removing tax disincentives to mergers, acquisitions and asset dispositions. Few mergers of distressed firms have occurred. The merger process is time consuming and onerous, requiring a six-month period when creditors may object to the merger or demand immediate payment. The Civil and Commercial Code and the Public Limited Companies Act require that entities seeking a merger lose their legal status before creating a new legal entity. The tax code for mergers is biased against non-cash transactions (taxes from any realized premium are payable immediately, even for a share-swap merger in which no shares are sold).
- Finding mechanisms to deal with the many distressed small and medium-size companies. The small company sector presents a unique challenge to the Thai financial system: because of the firms' small individual transaction size and their geographic and sectoral dispersal, the costs of case-by-case restructuring is prohibitively high. Broader solutions should be sought for smaller loans.
- Establishing a credit bureau to increase transparency, improve lending decisions, and enable lenders to exercise due diligence.
- Ensuring that the debt restructuring process leads to operational restructuring (Box 4.1).

<b>Box 4.1 Accelerating Corporate Debt Restructuring</b>
<b>CDRAC process</b>
Providing a program of mediation, accounting, legal, and industry expertise to accelerate and improve quality of restructuring
Improving reporting on restructuring progress
<b>Enabling environment</b>
Extending tax incentives for restructuring to private asset management companies
Opening the Credit Bureau
Expanding tax incentives for mergers and acquisitions to facilitate non-cash mergers
Revising the Public Companies Act to enhance corporate governance, treatment of treasury stock, and capital reductions
<b>Legal and Regulatory reform</b>
Providing a secured lending regime, including registry system
Implementing remaining amendment to Code of Civil Procedure on default judgments
Removing obstacles to restructuring by state-owned financial institutions
Ongoing review of insolvency regime as currently conducted by the Ministry of Justice to address the discretionary test of solvency, the role of planner, and criteria for conversion of a reorganization case to liquidation on failure to confirm a plan.

## **Corporate Governance**

4.25 Good corporate governance promotes relationships of accountability among the primary corporate participants to enhance corporate performance. It holds management accountable to boards and boards accountable to shareholders. The East Asia crisis has shown how macroeconomic difficulties can be exacerbated by systemic failures of corporate governance stemming from weak or ineffective regulatory systems, poor accounting and auditing practices, ineffective oversight by the board of directors, and a disregard of minority shareholder rights. In international comparisons, shareholder protection, legal enforcement, and accounting and auditing practices in Thailand have been particularly weak (Table 4.2 below).

**Table 4.2 Legal Protection for External Financiers of Firms,  
Selected Countries and Regions**

	<b>Shareholder Protection</b>	<b>Creditor protection</b>	<b>Degree of judicial enforcement</b>	<b>Accounting standards</b>
Thailand	3	3	5.9	64
Malaysia	3	4	7.7	76
Korea	2	3	6.7	62
Latin America	2.5	1	6.2	53
United States	5	1	9.5	71
United Kingdom	4	4	9.4	78
Japan	3	2	9.4	65
Germany	1	4	9.4	62

Note: For shareholder and creditor protection measures, the scale is from 1 to 5 with 5 representing the strongest protections and 1 the weakest. For enforcement, the scale is from 1 to 10, with 10 representing the highest degree of judicial enforcement and 1 the lowest. For accounting standards, the higher the measure the higher the standards. Latin America is the average of Argentina, Brazil, Chile, and Mexico.

Source: La Porta et al (1998).

4.26 The challenge for Thailand is to establish and enforce legal standards to govern the relationships among shareholders, directors, and managers. This includes rules and standards addressing the fiduciary duty of directors and the responsibility of managers, protection of shareholder rights, and enforcement of those rights.

4.27 The Government reform strategy for corporate governance has so far focused on streamlining institutional arrangements, enhancing the reliability and transparency of financial information and disclosures, improving corporate board oversight and effectiveness, and improving the legal and regulatory framework for the enforcement of company laws and regulations.

4.28 The next phase will focus on improving enforcement, increasing accountability of directors and management, and increasing minority shareholder rights. These measures should contribute to the creation of an environment that promotes shareholder activism. The authorities are preparing necessary changes to the Public Company Act (PCA) and the Security Exchange Act (SEA) that will be the centerpiece of the reform.

4.29 **Reform Agenda.** For Thailand to resume growth, it needs to improve corporate governance and further develop capital markets. The authorities need to::

- Establish the Thailand Financial Accounting Standards Board as an independent organization with authority to set accounting standards, subject to parliamentary approval.
- Make the Institute of Certified Accountants and Auditors (ICAAT) a fully operational, self-regulatory professional body.
- Implement measures, through SEC and ICAAT, to more effectively discipline accountants who breach their professional duties.

with a top rate of 30 percent. The simple average tariff rate is now about 19 percent and the effective rate is 3.6. The rate reductions and the crisis-related drop in imports have caused customs revenue to fall (a decline in line with the Government's intention to reduce its dependence on customs receipts). Customs revenues now account for about 8 percent of government tax revenue. Significant progress has been made in reducing nontariff barriers. Import licenses were eliminated for 31 products in 1992 and converted into tariffs. Along with subsequent changes only 20 products with nontariff barriers remain. These changes represent a major step forward. However, a number of problems remain:

- Significant exceptions to the top tariff rate of 30 percent (cars at up to 80 percent, motorcycles at up to 72 percent, and a broad range of agricultural products) generate effective rates of protection of 90 percent or more for some products (beef, lamb, beverage and tobacco products, wearing apparel, and motor vehicles and parts).
- High levels of protection for the upstream petroleum sector create a high-cost environment for many downstream industries, including textiles, electronics, and packaging.
- A large number of specific duties were introduced. Although they have been eroded by the devaluation, they contribute to complexity of the rate structure.
- A (temporary) special duty was introduced during the crises, raising many 5 percent rates to 10 percent. The rise is permanent for wheat flour.
- A large and complex system of tax exemptions means that over half of Thailand's imports are admitted with reduced or zero duties, many related to the programs of the Board of Investment.

4.31 While there has been significant progress in trade reform, much of it is quite recent and the current industrial structure reflects the policies of the past. For instance, Thailand's difficulty in developing industrial linkages and natural clusters may reflect policies that singled out particular industries for tax-based incentives. This approach isolates firms and exposes some industries to higher tax burdens in a way that frustrates the development of linkages. Uncertainty about the permanence of incentives further undermines the process. Rationalization of taxes, lowering of rates, and broadening of the tax base is the best approach. This is clearly the direction in which Thailand is going, but it will take time for the results to be seen.

4.32 The ASEAN Free Trade Area (AFTA) agreement will present some special challenges. Thailand has agreed to bring 85 percent of tariff line items into the 0-5 percent band. In addition, imports of a 153 items will be exempt from duties under the Information Technology Agreement. These changes will place significant pressure on Thai producers serving the domestic market. Thailand cannot retain duties on capital goods and raw materials (particularly petroleum-based products) and still be competitive with regional imports of finished goods entering at 0-5 percent when regional competitors do not have duties on their capital goods and materials.

4.33 Anticipating these changes the Government announced a package of economic stimulus measures on August 10, 1999, which included reductions of most favored nation tariffs on

capital goods and raw materials and elimination of the surcharge. The package also lifted restrictions on gold imports and exports to help the jewelry and electronics industries.

### **Investment Incentives**

4.34 Thailand's corporate tax system, with a marginal effective tax rate of 46 percent, imposes one of the highest tax burdens within the region on income from direct investments. The tax burden is reduced significantly by tax holidays (to only 7 percent at the margin) offered through the Board of Investment (BOI). The tax incentives are excessively complex (they depend on the region, the type of technology, the impact on the balance of payments, type of project), and there is little evidence that it is effective. By lowering the effective cost of capital and encouraging the use of duty-exempt imported inputs, it encourages the substitution of capital and imported inputs for labor and local inputs. Recent analysis of financial statements of companies promoted by BOI and other companies found that promoted companies are less efficient on average, more highly leveraged, and more dependent on income from noncore activities.<sup>3</sup> Some 81 percent of the promoted investments were found to be redundant, meaning that they would have occurred without incentives. The revenue costs were estimated at 28,500 million baht (0.61 percent of GDP). At 1,380,000 baht per job, this is significantly higher than the opportunity cost of labor. The incentives appear to have had limited success in encouraging firms in the Bangkok region to consider locating their projects in outer areas, one of the objectives of the program.

4.35 The incentives system is increasingly described as discretionary, inconsistent, nontransparent, expectation-based, unfocused, and not in keeping with the principles of good governance. The BOI engaged the Financial Investment Advisory Service (FIAS) to assess the structure and administration of incentives. A widely attended public conference was held in August 1999 to review the FIAS study. Changes are being planned for introduction early 2000 after public hearings. They will reflect the FIAS recommendations for decreased reliance on broad tax holidays in favor of narrower investment tax credits and depreciation allowances and a general switch in emphasis from concession-granting to investment promotion.<sup>4</sup>

### **Competition Policy**

4.36 Before 1999, business competition in Thailand was governed by the Price Fixing and Anti-Monopoly Act of 1979. The competition authority rarely contested cases of anticompetitive behavior, focusing instead on consumer protection and price control. With the transformation from a largely agricultural economy to one with large manufacturing and service sectors, the potential for the exercise of market power increased.

4.37 The Competition Act of 1999 embodies modern concepts of competitive behavior. Abuse of dominance, price fixing, and collusion are clearly defined. Allowable practices for mergers and acquisitions are spelled out, and provision is made for advance judgments and appeals.

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<sup>3</sup> Thailand: A Review of Investment Incentives, Foreign Investment Advisory Service, June 1999.

<sup>4</sup> August 10 1999 package of incentives also included provision for the enhancement of depreciation allowances for fixed assets, establishment of an equity investment fund, a Recovery Fund and a Venture capital Investment Fund for SMEs and certain measures to promote the recovery of the real estate sector.

4.38 While the legislative basis for competition policy has been set, detailed regulations are needed to give substance to the law. These are currently being prepared, and the Bank is providing technical assistance to review them prior to their introduction by ministerial decree. Efforts are also needed to establish the institutional capacity within the Business Competition Committee of the Department of Internal Trade to oversee and enforce the new law and associated regulations. In addition, lawyers and other participants in the judicial system have to become familiar with the concepts and practices associated with the new law. The Bank is prepared to offer technical assistance to achieve these objectives and will help revise the operational guidelines now being prepared by the Department of Internal Trade.

4.39 Further work remains to be done. One concern is the independence of the Business Competition Committee whose senior members are drawn from the ministries. There are independent members on the Committee as well, and there is a clear route of appeal from Committee decisions to the courts. While there is some international precedent for this arrangement, countries at Thailand's stage of development are generally advised to adopt a smaller and more independent competition authority.

#### **D. IMPROVING FACTORS OF PRODUCTION**

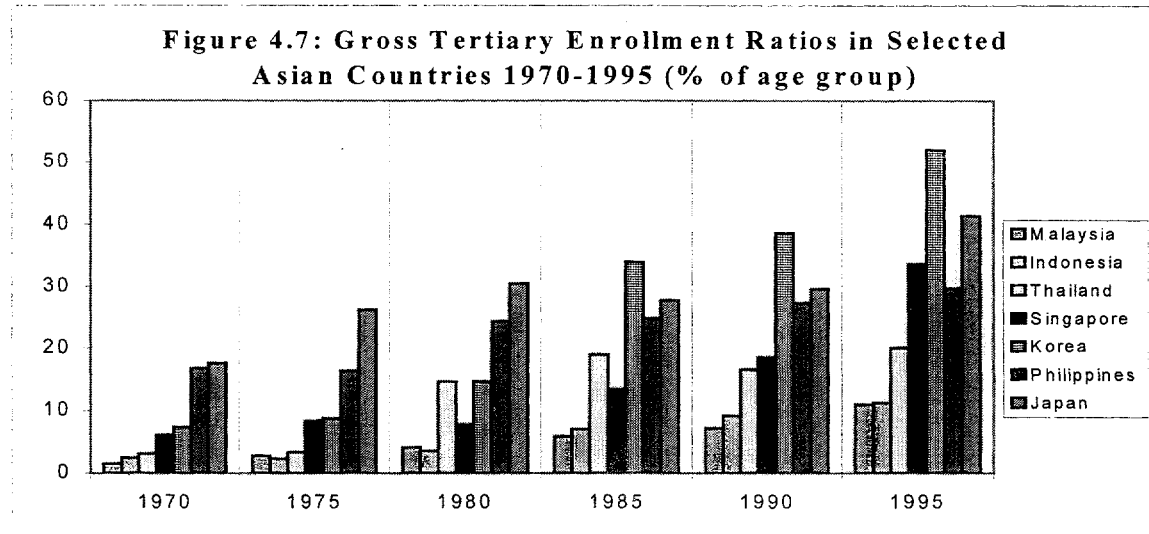
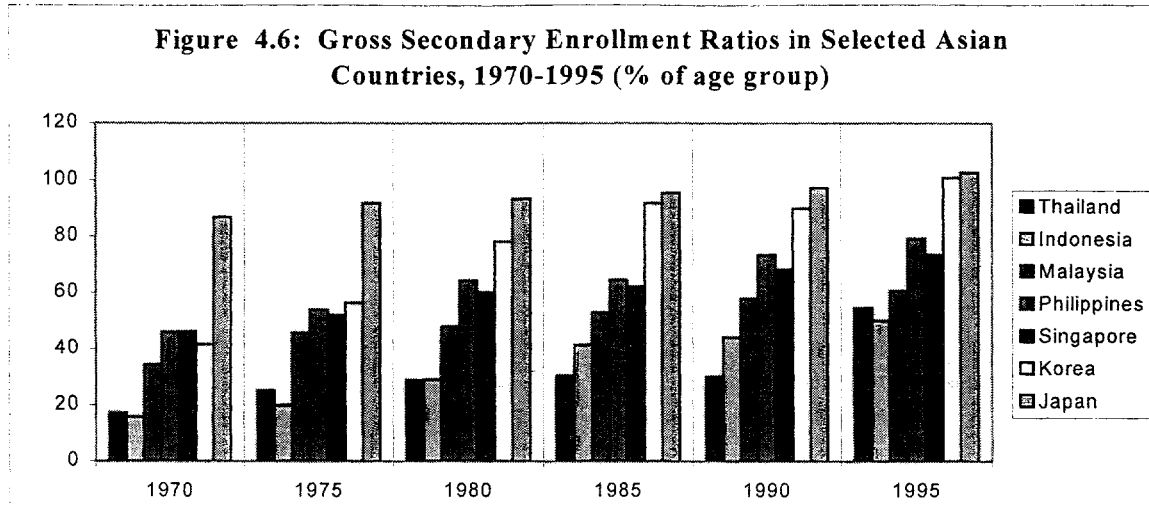
##### **Labor Markets, Education and Training**

4.40 *Shortages of Skilled Labor Have Hurt Competitiveness.* Immediately preceding the crisis, annual wages were growing rapidly. Wages were 14 times the level in China and exceeded those in Indonesia, Philippines, and even Malaysia. A mismatch between rewards and skills created high unit labor costs (labor productivity relative to wages). Three-quarters of respondents to a BOI survey indicate that labor costs affect investment decisions. The recent devaluation does not help much because competitors also devalued and does not address skill shortages.

4.41 *A Shift in Education and Training is Needed.* The problem behind the inadequate supply of skilled workers is not primary education, which by 1990 was essentially universal, but education at secondary and higher levels, where Thailand has fallen behind competitors, affecting both competitiveness and equitable growth (Figures 4.6 and 4.7).

4.42 Aggregate public funding of education is adequate (25 percent of the budget) but there is room for improving its allocative efficiency. In addition to meet the rapid expansion of upper-secondary education required by the 1997 Constitution and embodied in the Education Act of 1999, measures are needed to reduce regulatory constraints on private school establishment and expansion. More efficient use of public resources and a larger role for the private sector are essential in meeting the cost of rapid expansion in secondary schooling while maintaining, if not improving, quality.





4.43 Low enrollments at the university level have resulted in a small stock of science and engineering skills relative to competitors. In 1995, Thailand had 119 scientists and engineers per million people. Korea and Singapore had more than 2,500, and China had 350. Projections are that, as growth resumes, demand will far outstrip supply.

4.44 Quality is another concern. As measured by international assessments, achievements in science and mathematics in academic secondary education are good by world standards, but fall below those of competitor nations. At the university level, graduates of public universities command lower wages reflecting inadequate academic achievements due largely to poorly trained teachers. But graduate of vocational secondary schools are weak in general communication and problem-solving skills because of the narrow craft skill focus of the curricula. This reduces their capacity for retraining as jobs change in an increasingly technological economy.

4.45 ***Vocational Training.*** Graduates of vocational secondary schools earn higher starting wages than graduates of academic secondary schools. Even when the higher costs of vocational schooling are taken into account, the economic returns to vocational secondary education have been high for over a decade. The main issues in vocational education policy is whether the narrow, craft-based curricula that are followed by most schools, both public and private, will prepare young workers for effective participation in the rapidly evolving knowledge economy.

4.46 Public vocational training is small relative to vocational education in schools, and is designed principally to serve dropouts from the formal school system. Here again curricula are narrow, but the system, managed by the Ministry of Labor and Social Welfare has shown considerable flexibility in the face of changing demand. Most recently, this has taken the form of a doubling of intake and output in response to the rising unemployment caused by the financial crisis.

4.47 Recent evidence suggests that Thai employers have gone a long way toward making up for weaknesses in the public education system. Surveys show that large firms (300 workers or more and accounting for more than half the manufacturing output) provide considerable training of workers. About a third of all employees being trained were completing general education equivalency programs offered by the Ministry of Education. Large firms, many of them joint ventures with foreign partners, often have their own training and education programs in order to produce to international standards. However, enterprise training cannot fully compensate for deficiencies in the formal education system. And small firms, which employ more than half of the workforce, train much less than large ones.

4.48 Looking to the future, Thailand will need to increase its share in technologically complex exports and to upgrade the quality of its labor-intensive exports. This will require better and more varied skills. Because labor is mobile, firms cannot capture all the benefits of training and thus tend to underinvest in training programs. To avoid an escalation of skilled wages and to facilitate access to trained workers for smaller firms, there is a strong case for more public investment in secondary and higher education and in vocational education and training to improve responsiveness to a changing economy.

4.49 ***Priorities and Government Programs.*** Reform of education and training in Thailand has been set by the 1997 Constitution and the 1999 Education Act. Over the next three years, a substantially reformed public education system will be put in place. Key policy elements include:

- Expanding of secondary education to raise gross enrollment rates from 45 percent to 75 percent over ten years.
- Expanding of higher education by making public universities autonomous and reducing public funding over time and by providing incentives for private education.
- Placing more emphasis on technical and engineering subjects in universities.
- Allocating public education resources more efficiently by decentralizing budgetary decisions and reforming teacher employment.

- Establishing mechanisms for accountability to increase the efficiency of resource use.
- Creating a coherent organizational structure for managing the reform program and overcoming the centralized education bureaucracy.
- Reforming public schools through curricula, reforming teacher education and training, liberalizing markets for educational materials, and using educational technology more extensively.
- Reforming vocational secondary education to meet the challenges of continuing economic change.

### **Infrastructure and Trade Logistics**

4.50 Rapid economic growth and export expansion have strained Thailand's infrastructure. The extensive network of rural highways, which compares favorably with competitors, is beginning to deteriorate and requires more attention. The logistics component of the cost of retail goods is estimated at 20-25 percent in countries with well-developed infrastructure and at 40 percent in Thailand. Thailand ranks 67 out of 106 countries surveyed recently in paved roads, 70 out of 130 countries in telephone lines, and 51 out of 107 in power system losses. Approximately 90 percent land transport is by truck, reflecting the very limited rail system (with single tracks) and inland water transport system.

4.51 Industries producing high value-added goods, dealing with perishable stock, or with time- and quality-sensitive products have resorted to in-house power generation and water supply and investment in costly transportation equipment. In-house production of these services is costly and runs counter to the international trend of outsourcing all such activities.

4.52 Custom clearance delays have recently been brought down to 2 days, but this is still longer than in competing countries. Importer complaints of "tea-money" demanded by freight handlers in customs are rampant. But ameliorating measures are being taken. Exporters report unreasonable delays with duty drawbacks and VAT rebates. This is not necessarily a problem of customs *per se*, but it is costly to exporters..

4.53 An overhaul of customs administration is going on. An electronic data interchange (EDI) system is being implemented, and customs brokers are being registered and regulated. A shift to the World Trade Organization (WTO) transaction valuation method is scheduled for 2000. Efforts are being made to improve the services of customs brokers (currently below international standards) through training and oversight.

4.54 Following the opening up of ocean transport of imports and exports to international competition in 1994, freight rates fell 30-40 percent. Private participation in port management and financing has reduced terminal handling charges by up to 70 percent. A comprehensive strategy for privatizing state and local monopolies in water, power, telecommunications, and transportation is being developed under the Master Plan for State Enterprise reform approved by the Cabinet on September 1, 1998.

4.55 Priorities and government program include the following:

- Complete the privatization of infrastructure services and establish the regulatory authorities for the privatized industries.
- Complete the implementation of the electronic data interchange and customs improvement programs, including establishment of registered self-regulating customs brokers and the customs valuation programs.
- Resolve “tea money” problem at ports.
- Establish an integrated government/industry group to oversee supply chain management.

### **R&D and Technology Upgrading**

4.56 R&D in Thailand is only 0.2 percent of GDP, lower than in virtually all competitors. Private R&D constitutes a tiny 10 percent of total R&D expenditure. For the size of the economy, Thailand also has a relatively small number of ISO 9000 certificates: by end-1997, Thai firms held 1,104 certificates, as compared to 2,909 in Singapore, 1,610 in Malaysia, 1,273 in Indonesia, 5,806 in Korea, and 5,698 in China.

4.57 Low domestic R&D capabilities result in the slow growth of local content in complex industrial activities and of technological upgrading of functions transferred to Thailand by multinational companies. Royalty and license fees are relatively high, reflecting a strong propensity to rely on off-the-shelf technology imports with little adaptation or improvement.

4.58 Thailand’s R&D strategy must focus on medium- and high-technology products, which constitute the most dynamic segment of world trade. Thailand has built up a substantial export capacity in these sectors, but with low local value added. Developing stronger technological capabilities in these activities is essential for competitiveness as wages rise and lower-cost competitors emerge. The focus of such capabilities should be private industry rather than public research laboratories, as at present, and there should be much closer links between the technology infrastructure and enterprises.

<b>Box 4.2: Reform Program for Private Sector Development</b>	
<b>Enabling Environment for Competitiveness</b>	
<b>Corporate debt restructuring</b>	<p>Strengthen of judicial capacity to implement the new bankruptcy code and the Code of Civil Procedures concerning foreclosure to motivate debt restructuring.</p> <p>Remove of remaining disincentives to mergers, acquisitions and assets disposal</p> <p>Attend to SME debt restructuring.</p> <p>Establish a credit bureau to increase transparency</p>
<b>Corporate governance</b>	<p>Strengthen institutional framework for setting standards and regulating accounting and auditing practices.</p> <p>Upgrade procedures and standards to improve the quality of information provided by corporates.</p> <p>Improve financial oversight of the board of directors of listed companies</p> <p>Establish accountability norms for board of directors and management and strengthening minority shareholder rights</p> <p>Streamline enforcement processes.</p>
<b>Removing Hurdles to Competition</b>	
<b>Trade regime</b>	<p>Reduce protection on automobiles, petroleum products and selected agricultural products.</p> <p>Rationalize specific duties to reduce complexity in the rate structure.</p> <p>Rationalize exemptions.</p> <p>Reform MFN and ATFA tariff rates to ensure the competitiveness of Thai Products.</p> <p>Provide supporting legislation to newly passed Competition Act, building up court capacity to enforce the new Act.</p>
<b>Competition policy</b>	<p>Complete detailed regulations for the Competition Act of 1999.</p> <p>Familiarize members of the legal profession with the new law.</p>
<b>Investment incentives</b>	<p>Rationalize the incentive system to reduce complexity, and increase effectiveness and transparency. Make complementary adjustments to the corporate tax system.</p>
<b>Improving Factors of Productions</b>	<p>Provide autonomy to universities, and greater emphasis on technical and engineering subjects to expand quality higher education.</p>
<b>Upgrading worker skills</b>	<p>Decentralize public education resources, instituting greater accountability and reform of teacher employment.</p> <p>Reform curriculum and teaching practices.</p> <p>Reform vocational secondary education</p>
<b>Infrastructure and trade logistics</b>	<p>Establish an integrated government/industry group to oversee supply chain management</p> <p>Resolve the persistent problems with duty drawbacks and VAT rebates.</p>
<b>R&amp;D and technology upgrading</b>	<p>Encourage greater private sector investment in research and development</p>

**Table 4.3: A Comparison of Corporate Restructuring in East Asia, August 1999**

	Indonesia	Korea	Malaysia	Thailand
<i>Out-of-court restructuring</i>				
Number of registered cases	234	92 <sup>1</sup>	53	825
Number of cases started	157	83	27	430
Number of restructured cases	22	46	10	167
Restructured debt/total debt (%)	13	40	32	22
<i>In-court restructuring</i>				
Number of registered cases	88	48	52	30
Number of cases started	78	27	34	22
Number of restructured cases	8	19	12	8
Restructured debt/total debt (%)	4	8		7

Source: World Bank data.

Note: 1. This number does not take into account restructuring outside the 6th largest to the 64th largest chaebol; many restructurings have taken place among small- and medium-sized enterprises.

**Table 4.4: Financial Accountability and Corporate Governance Reform in Thailand and Korea-Progress Report**

<b>Reform Measure</b>	<b>Thailand</b>	<b>Korea</b>
<b>1. Rationalize the institutional framework for setting standards and regulating accounting and auditing practices</b>	<ul style="list-style-type: none"> <li>• Cabinet approved a plan to establish TFASB and strengthen ICAAT</li> <li>• Amendments to Accountant's Professional and Accounting act under way</li> </ul>	<ul style="list-style-type: none"> <li>• Adopted a plan to establish KASB and strengthen KICPA. Established KASB in September 1999</li> <li>• Amendments to relevant laws and regulations under way</li> </ul>
<b>2. Improve the quality and reliability of key financial and non-financial information provided by public corporations</b>	<ul style="list-style-type: none"> <li>• Issued new and revised accounting and auditing standards</li> <li>• Preparation and audit of financial statement in accordance with international standards in 1999</li> <li>• Issuance of new specific rules on accounting and auditing for banks and SFIs under way</li> <li>• Enforcement of enhanced disciplinary measure for accountants under way</li> <li>• Improvement of listing rules under way</li> </ul>	<ul style="list-style-type: none"> <li>• Issued revised and new accounting and auditing standards</li> <li>• Preparation and audit of financial statements in accordance with international standards in 1999</li> <li>• Issued specific accounting standards for commercial banks</li> <li>• Enforcement of enhanced disciplinary measures for accountants under way</li> </ul>
<b>3. Improve accountability of boards of directors and management, and increase minority shareholder rights of public corporations</b>	<ul style="list-style-type: none"> <li>• Conducted a comprehensive review of duties and accountabilities of officers and directors, protection of shareholder rights, and sanctions</li> <li>• Cabinet approved framework for changes to PCA and SEA</li> <li>• Amendments to PCA and SEA under way</li> </ul>	<ul style="list-style-type: none"> <li>• Conducted a comprehensive review of duties and accountabilities of officers and directors, protection of shareholder rights, and sanctions</li> <li>• Amended relevant laws and regulation</li> </ul>
<b>4. Strengthen the financial oversight role of boards of directors of listed corporations</b>	<ul style="list-style-type: none"> <li>• Reviewed existing requirements for the audit committees of the boards of directors</li> <li>• Revised guidelines on the code of best practice</li> <li>• Improvement of audit committees of the boards of directors and internal control to be consistent with international best practice under way</li> </ul>	<ul style="list-style-type: none"> <li>• Reviewed existing requirements for the audit committees of the boards of directors</li> <li>• Adopted a plan to amend laws and regulations</li> <li>• Introduction of audit committees of the boards of directors in year 2000</li> </ul>
<b>5. Rationalize the regulatory framework and improve enforcement of laws and regulations for public corporations</b>	<ul style="list-style-type: none"> <li>• Reviewed roles and responsibilities of SET, SEC, and MOC</li> <li>• Clarified enforcement arrangement in effect</li> <li>• Amendments to the PCA and SEA to support the arrangement under way</li> </ul>	<ul style="list-style-type: none"> <li>• Amended relevant laws</li> <li>• Strengthened enforcement</li> </ul>

Abbreviations:

ICAAT: Institute of Certified Accountants and Auditors of Thailand  
MOC: Ministry of Commerce  
KASB: Korea Accounting Standard Board  
KICPA: Korea Institute of Certified Public Accountants  
PCA: Public Company Act  
SEA: Security and Exchange Act  
SEC: Security and Exchange Commission  
SET: Stock Exchange of Thailand  
TFASB: Thailand Financial Accounting Standard Board

## 5. ENVIRONMENTAL CHALLENGES AND STRATEGY<sup>1</sup>

### A. INTRODUCTION

5.1 As Thailand approaches economic recovery, it faces three major environmental and natural resources challenges to maintain and enhance investments for reducing air and water pollution in Bangkok and other urban areas; to achieve sustainable natural resources use and reverse environmental degradation of forests, watersheds, and marine ecosystems; and to harness community demands that emerged during the crisis and promote community involvement in environmental protection.

5.2 These challenges arise from the rapid economic growth in the three decades preceding the crisis, growth accompanied by serious environmental costs. In response to the subsequent congestion, pollution, and rapid rural-urban migration, the government:

- Established a legal framework for protecting the environment.
- Set up numerous (perhaps too many) government agencies to design standards for implementing and monitoring abatement policies.
- Implemented a series of pollution reduction initiatives such as the phase out of leaded gasoline, improved energy efficiency, increased investment in wastewater treatment, and increased budgetary resources for pollution control (0.8 percent of GDP in the years leading up to the crisis).
- Unveiled an ambitious 20-year plan in November 1996 that clearly sets out spatial and sectoral priorities.

5.3 Although the crisis slowed economic activity and thereby reduced pollution generation, the government has cut the budget for environmental protection by about 20 percent from 1996 levels. This has hurt pollution control and natural resource conservation programs, especially wastewater treatment systems operated by local governments. As the economy recovers, the environment agenda needs to be reactivated and more sharply defined.

5.4 The World Bank and the Ministry of Science, Technology and Environment (MoSTE) recently defined environmental priorities for Bank assistance in the Environmental Sector Strategy Note (ESSN).

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<sup>1</sup> This chapter is based on the recently completed Environmental Sector Strategy Note titled "Building Partnerships for Environmental and Natural Resources management" by the World Bank and the Ministry of Science, Technology and Environment.



## B. STATE OF THE ENVIRONMENT

5.5 The ESSN provides a comprehensive assessment of the state of the environment in Thailand (Table 5.1). It ranks environmental issues by severity and assesses the impacts and potential benefits of remedial actions. But detailed analysis of the costs of mitigation has not been completed for this exercise and would likely lead to a more precise ranking of priorities.

5.6 Air and water pollution are widespread in urban areas and have high economic costs.<sup>2</sup> It is no surprise then that air and water pollution are a top priority in urban Thailand, especially in the Bangkok area. During the economic boom, workers moved from rural areas to cities in search of employment and vehicle ownership increased rapidly (particularly automobiles and two strokes motorcycles) along with demand for housing and commercial services. These developments strained the urban infrastructure: traffic congestion and air pollution increased; untreated domestic and industrial waste discharges polluted waterways. The health effects of diesel and gasoline particulate emissions cost city residents an estimated 8-10 percent of their annual income, and this share is expected to rise to 20 percent in the next two decades. Improving air quality is expected to cost \$600 million to \$1.5 billion a year through 2020. But the health and economic benefits of this investment would be at least ten times the costs.<sup>3</sup> Likewise, urban households spend about 10 percent of their income for safe water -- more than the cost to provide piped water directly to households. An investment of \$1.5-2 billion annually will be needed to provide universal safe water and sanitation by 2020. These investments would avert some 4,000 infant deaths and provide \$9 billion in direct economic benefits.

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<sup>2</sup> The estimates presented for air and water pollution are based on valuation done using dose-response functions from other countries, and therefore should be considered preliminary.

<sup>3</sup> A separate analysis concluded that particulate emissions could be reduced by more than 80 percent by converting two-stroke engine motorcycles to four-stroke ones with reasonable emissions control. The benefit of an estimated 40 percent drop in exposure to hydrocarbon emissions would be about \$ 1 billion a year.

**Table 5.1: Overview of Environmental Trends and Responses**

Issue	Severity	Trend	Causes and relative contribution	Response	Other donor activities
Declining water quality in Chao Phraya	High	<ul style="list-style-type: none"> <li>37% of surface water bodies classified as low quality, including Chao Phraya and Thachine</li> </ul>	<ul style="list-style-type: none"> <li>Domestic sewage (H)</li> <li>Industrial effluent (H)</li> <li>Agricultural runoff (H)</li> </ul>	<ul style="list-style-type: none"> <li>\$550M committed for wastewater collection /treatment in BMA in 1998</li> <li>Pollution discharge standards introduced</li> </ul>	ADB, AusAid, DANCED
Increasing water scarcity	High	<ul style="list-style-type: none"> <li>Per capita consumption doubled</li> <li>Water scarcity increasing, worse in dry periods</li> </ul>	<ul style="list-style-type: none"> <li>Irrigation (H)</li> <li>Domestic (M)</li> <li>Industrial (M)</li> <li>Drought (L)</li> </ul>	<ul style="list-style-type: none"> <li>Policy, institutional and regulatory framework for integrated water resources management completed</li> <li>Comprehensive water management strategy completed</li> </ul>	ADB, CIM, DANCED
Declining air quality in Bangkok Metropolitan Area	High	<ul style="list-style-type: none"> <li>Ambient levels of lead, Sox, Nox and CO reduced significantly</li> <li>PM10, TSP, ozone and HC exceed standards</li> </ul>	<ul style="list-style-type: none"> <li>Transport (H)</li> <li>Industry (M)</li> <li>Power (M)</li> <li>Indoor air pollutants (L)</li> <li>Garbage burning (L)</li> </ul>	<ul style="list-style-type: none"> <li>Unleaded gasoline introduced</li> <li>Improvements in traffic management</li> <li>Mass transit</li> <li>Dust control measures</li> <li>Revisions to regulatory enforcement</li> </ul>	DANCED, GTZ, NEDO, SIDA, World Bank
Loss of critical habitats	High	<ul style="list-style-type: none"> <li>Significant losses reported</li> <li>About 100 species of plants classified as endangered; 900 considered rare and vulnerable</li> </ul>	<ul style="list-style-type: none"> <li>Deforestation (H)</li> <li>Pollution (H)</li> <li>Fishing practices (H)</li> <li>Economic incentives (M)</li> <li>Poaching (M)</li> </ul>	<ul style="list-style-type: none"> <li>Extended and representative protected area system established (50 M rai), covering 16% of total land area</li> </ul>	AusAid; BDW, BGR; CIDA
Watershed degradation	Medium	<ul style="list-style-type: none"> <li>Increase in soil erosion and downstream sedimentation</li> </ul>	<ul style="list-style-type: none"> <li>Land use planning and management (H)</li> <li>Land conversion for agriculture (H)</li> <li>Encroachment in uplands (M)</li> <li>Land tenure (M)</li> </ul>	<ul style="list-style-type: none"> <li>Watersheds have been classified and mapped</li> <li>Intended land use specified and regulated</li> </ul>	BDW, BGR, CIDA, DANCED, JICA, NIDO, World Bank
Declining marine and freshwater resources	Medium	<ul style="list-style-type: none"> <li>Significant reduction in catch per unit effort over 20 yrs.</li> <li>50% reduction in mangroves between 1961-93</li> </ul>	<ul style="list-style-type: none"> <li>Effluents and agricultural runoff (H)</li> <li>Fishing practices (H)</li> <li>Mangrove conversion (M)</li> </ul>	<ul style="list-style-type: none"> <li>Programs developed for sustainable aquaculture and marine fisheries management</li> <li>Targets established for mangrove reforestation and conservation</li> </ul>	CIDA, DANCED, UK
Land degradation	Medium	<ul style="list-style-type: none"> <li>Increasing soil erosion in upland areas</li> <li>Salinization on southern coast</li> </ul>	<ul style="list-style-type: none"> <li>Land conversion for agriculture (H)</li> <li>Soil erosion (H)</li> <li>Land tenure (H)</li> <li>Salinization (M)</li> </ul>	<ul style="list-style-type: none"> <li>Improvements in land use management /planning</li> <li>Forest encroachment reduced by designating appropriate areas for agriculture</li> <li>Pilot soil conservation projects</li> </ul>	AusAid, CIM, JICA
Increasing solid and hazardous waste	Medium	<ul style="list-style-type: none"> <li>Per capita urban household waste generation 0.5-1 kg/day</li> <li>Industrial units in BMR generated 2 M tons of hazardous waste in 1997</li> </ul>	<ul style="list-style-type: none"> <li>Industry (H)</li> <li>Households (H)</li> </ul>	<ul style="list-style-type: none"> <li>Improvements in garbage collection</li> <li>Pollution prevention techniques introduced for hazardous waste</li> <li>Sanitary landfills and treatment facilities</li> </ul>	ADB, BGR, CIM, DANCED, EU, GTZ, JICA, USAID
Declining forest cover	Low	<ul style="list-style-type: none"> <li>Total forest cover declined from 53% of total land area in 1961 to 25% in 1998.</li> <li>Rate of deforestation slowed from 0.9%/year, pre-1989, to 0.2%/yr between 1995-1998.</li> </ul>	<ul style="list-style-type: none"> <li>Logging (H)</li> <li>Protected areas management policies (H)</li> <li>Encroachment (L)</li> <li>Inundation (L)</li> </ul>	<ul style="list-style-type: none"> <li>Established forest classification</li> <li>Reforestation targets set at 40% of land area</li> <li>Investments in 1996 as a percentage of GDP</li> </ul>	AusAid, DANCED, JICA, World Bank

5.7 To realize the full potential of agriculture, forestry, fisheries, and tourism Thailand must reverse the degradation of key natural resources and address the underlying causes. As with urban pollution, it is the poor who suffer disproportionately from the declining productivity of forests, soils, and fisheries.

5.8 Very little analytical work has been done in estimating the costs of natural resource degradation in Thailand. Improving environmental management requires a systemic program of valuing the costs of environmental impacts in order to define priorities.

## C. AN AGENDA FOR REFORM

### Institutional and Policy Reform

5.9 *Strengthening Environmental Governance.* To implement effective environmental governance, the government needs to focus attention, over the next few years, on restructuring environmental agencies, improving compliance, decentralizing environmental functions to provincial and local administration, and widening opportunities for community involvement (Table 5.2).

- *Institutional restructuring.* The government recently announced an ambitious public sector reform program to improve the performance and functional efficiency of public sector agencies. The program will establish environmental and natural resources agencies within the Ministries of Science, Technology and Environment; Agriculture and Cooperatives; and Industry. The program will enhance staff skills, harmonize functions across agencies, clarify enforcement responsibilities, separate regulatory functions from promotion and development functions, strengthen monitoring and public disclosure, promote customer orientation in service delivery (as in procedures for environmental impact assessment), and promulgate required legal changes.
- *Compliance.* Split institutional responsibility and the command-and-control approach to environmental management have prevented Thailand from capturing the benefits made possible by newer and more flexible instruments for pollution reduction. Neighboring countries have begun introducing incentives, voluntary measures and public disclosure to augment regulatory measures. Thailand too can use these to encourage polluters to become more compliant.
- *Decentralization.* The amended Thai Constitution articulates that environmental and natural resources functions should be decentralized to local governments, and gives a more central role to communities in decisionmaking. Under the current environmental law, provinces with known pollution hotspots must prepare Provincial Environmental Action Plans for reversing environmental degradation. Though not perfect, this process provides a launching pad to further decentralize to tambons and municipalities. To be successful, the government needs to encourage strong participation by grass root organizations and local officials who can support trained

professionals. This will require significant capacity building efforts at different levels of government.

- **Empowering Communities.** Community groups, NGOs, and local governments could become effective partners in a broad range of environmental activities, such as, neighborhood improvement, environmental awareness raising and environmental education at the grassroots level, monitoring of environmental compliance, and facilitation of broad acceptance of environmental policy and development projects through multi-party dialogue. Through the Social Investment Fund, financial assistance should be extended to implement community-based initiatives in forestry, urban sanitation, and awareness raising in the short run.

5.10 ***Establishing a Sustainable Financing Mechanism.*** Several measures can be used to provide sustainable financing for environmental management.

- **Restructuring the Environment Fund (EF).** This fund has emerged as the major financier of local government investments in environmental improvement. Though established as a revolving mechanism, most of its assistance has been in the form of grants. The viability of the Fund is thus in question, and the government intends to overhaul its operations immediately. Lack of skilled staff, a multiplicity of uncoordinated sources of funding, and poor cost-recovery practices at local levels need to be addressed. A revitalized and properly functioning Fund will also trigger improvements in other environmental financing mechanisms. For this to happen, the entire financing of municipal environmental services must be reexamined, particularly the multiplicity of uncoordinated funding sources for public investment (for example, the Bureau of Budget, the Environment Fund, and the Ministry of Interior).
- **Cost Recovery.** Cost-recovery measures are needed to ensure efficiency in service provision and implementation of the "polluter pays" principle. The government would need to (i) restructure existing tariff charges to reflect actual use and costs; (ii) merge water supply and wastewater disposal functions; and (iii) encourage private sector participation. During decentralization efforts, provincial and local administrations should receive help in developing sound financial management systems and recruiting staff with accounting skills.
- **Market-based instruments.** Market-based instruments provide incentives that promote voluntary compliance by polluters. Among market-based incentives, pollution charges will be the most important to Thailand. The Department of Industrial Works is amending the Factory Act to institute pollution charges by 2001. The challenge is to keep the charges simple and credible, initially targeting only a few polluters and pollutants. The revenues generated by the scheme should go into the restructured Environment Fund and not into a separate and competing fund, to avoid creating pricing distortions.

## Targeting Investment for Priority Environment Improvement

5.11 Bangkok Metropolis will continue to be the country's engine of growth. The Bangkok Metropolitan Administration (BMA) and the national government need to work toward removing policy hurdles to improve public and private behavior. BMA would need to invest in improvements in air quality, wastewater treatment, and safe disposal of municipal solid waste.

- ***Air quality management.*** The next air pollutant to target is air-borne particulates of less than 10 micron in size, a pollutant largely emitted by transport vehicles. Interventions should aim to reduce emissions from two-stroke motorcycles and diesel-powered buses and trucks and to controlling resuspension of road dust and other source emissions. But air pollution cannot be tackled without efficient transport management, a major bottleneck to the city's growth.
- ***Wastewater and solid waste management.*** Priority should be assigned to reviving wastewater schemes halted during the crisis and expanding coverage to Thailand's most populous areas – Thonburi and Klong Toey. BMA wants to reexamine its wastewater masterplan to create technologically simpler and more cost-effective options that target localities with a high incidence of waterborne diseases. BMA needs to invest in solid waste disposal facilities which are environmentally sound and cost-effective. This would mean more composting, waste recycling, and sanitary landfilling. BMA will involve the private sector in the operation and maintenance of the facilities.
- ***Capacity building.*** Though the premier local government in the country, BMA needs to improve its staff capability and professional and managerial capacity. It can train its existing staff while bringing in new blood in such areas as accounting and financial management, regulatory oversight, and planning. BMA should consolidate its partnership with the political leadership in adjacent provinces to create a regional planning and management structure of infrastructure and services.

5.12 The Chao Phraya is not only the most important river system in Thailand, it is the country's lifeline. An important part of the country's rich and fabled traditions, the Chao Phraya is the site of Thailand's first Bank-financed investment project. But past inefficient water management threatens the ecological balance of the river system and the region's socioeconomic development. Renewed efforts should be made to protect the watershed and improve water management of surfacewater and groundwater through an appropriate institutional framework and full participation by users.

- ***Rethinking role of the state.*** The government should gradually divest its functions as a service provider and develop its capacity to create institutions and a legal and regulatory framework central for effective water management.
- ***Institutional framework.*** Institutional mechanisms at different levels from water user associations to basin organization allow civil society to participate with government in making decisions that will balance competing demands of different users, give greater attention to environmental sustainability, and ensure that policies outside of

the water sector (such as land use policy) consider their implications for water management.

- ***Incentives.*** Instruments such as licensing, tradable rights, and service provision charges can promote voluntary cooperation among users. This cooperation will ensure that water is used efficiently and is moved voluntarily from low-value to high-value users and, that services can be operated and maintained without large government subsidies.

#### **D. IMPLEMENTING THE POLICY AGENDA**

5.13 From these policy options, the Government and the Bank have chosen a few that can be implemented in the two to three years. These are identified in Table 5.2, along with approximate time targets and progress indicators.

**Table 5.2: Proposed World Bank Involvement**

<b>Policy Change</b>	<b>Actions</b>	<b>Agency</b>	<b>Timeline</b>
<b>Instituting Institutional and Policy Reforms</b>			
<i>Restructuring environmental agencies</i>	a. Prepare reform plans b. Implement plan and consolidate functions across ministries c. Introduce legal changes d. Put new structure in place	MoSTE, MoAC and DIW	April 2000 September 2000  September 2000 August 2001
<i>Restructuring the Environmental Fund</i>	a. Institute government policy on financing environmental services and establishing environmental funds. b. Make an operational plan c. Make legislative amendments d. Implement the new fund structure and organization	MoSTE	January 2000  November 1999 April 2000  May 2000
<i>Introduction of pollution charges</i>	Announce of government policy for a single unified scheme	DIW and PCD	To be determined
<i>Decentralization</i>	Reform the provincial environmental action planning process to include participation of local administration and community groups	OEPP and DOLA	December 1999
<b>Targeting Investments for Priority Environmental Improvement</b>			
<i>Improving air quality in Bangkok</i>	a. Review fuel pricing policies b. Handle others policies in the context of the proposed project	NEPO	To be determined
<i>Expanding sewerage coverage and solid waste disposal in Bangkok</i>	a. Implement policy on cost recovery and adjusting tariffs b. Develop a new policy on sanitation coverage for the poorer areas c. Create incentives for waste separation and recycling. d. Remove constraints for private sector participation	BMA & Ministry of Interior	To be determined
<i>Water Management in the Chao Phraya River Basin</i>	Creating of new organizational structures that will be addressed as part of project dialogue	MoAC	To be determined

## 6. DEBT MANAGEMENT AND PUBLIC SECTOR REFORM

### A. INTRODUCTION

6.1 Thailand has been praised for its management of the aggregate fiscal account. International comparisons, however, reveal weaknesses in the performance of Thailand's public institutions (Tables 6.1 and 6.2). The reform measures proposed in the previous chapters depend crucially on the quality of the public institutions that will implement them. There are several interrelated challenges:

- Managing the increased stock of public debt to ensure medium-term fiscal sustainability and to minimize fiscal risks to the budget.
- Reforming state-owned enterprises to allow competitive private provision of infrastructure services.
- Meeting the rising aspirations of Thai citizens demanding better public sector governance, including more transparency, better quality of public services, and greater efficiency in the management of public resources.

**Table 6.1: Regional Ranking of Public Sector Management and Institutions**  
on a scale of 1 (low) to 5 (high)

Country	Economic Performance		Property rights & governance	Quality of budget & financial management	Efficiency of revenue mobilization	Efficiency Of Public Expenditure	Transparency, account ability corruption in public sector	Average
	General Macro	Fiscal Policy						
Indonesia	3.5	2.5	2.5	3.5	3.0	4.0	2.0	3.0
Korea, Rep.of	5.0	4.5	4.0	4.5	4.0	4.0	4.0	4.1
Malaysia	4.5	4.0	4.0	4.5	4.0	4.0	3.5	4.0
Philippines	4.0	3.5	3.0	4.0	3.5	3.5	3.5	3.5
Thailand	4.5	4.5	3.5	4.0	3.0	4.5	3.5	3.7

Source: World Bank Country Performance and Institutional Assessment 1999.



**Table 6.2: Perceptions of Public Sector Competitiveness in Thailand**  
(ranking among 46 countries)

Assets	Ranking	Liabilities	Ranking
Central government budget	2	Customs administration	41
Government employment	4	Management of public finances	40
Central government domestic debt	5	Transparency	39
Central government expenditures	5	Improper practices	38
State involvement in production	7	Political system	37
Total tax revenues	14	Legislative activity of the parliament	35

Source: World Competitiveness Yearbook, 1997 (Pre-Crisis).

## B. PUBLIC DEBT MANAGEMENT AND FISCAL SUSTAINABILITY

### Urgent Need for a Comprehensive Debt Management Strategy

6.2 *Public debt has increased during the crisis.* Before the crisis, fiscal surpluses and rapid GDP growth were lowering public debt (as a share of GDP), including external and domestic debt obligations of government agencies and state enterprises. Since July 1997, public sector debt has more than doubled, rising from 16.5 percent of GDP (773 billion baht) in June 1997 to 45 percent of GDP (more than 2 trillion baht) in March 1999. Debt service payments will account for a large share of Government expenditures in the near future, limiting room for discretionary spending. The Government had to introduce legislation in 1998 to enable it to borrow domestically beyond the ceiling set forth in the 1962 Budget Act (B.E. 2502). This is the *Emergency Decree empowering MOF to issue Financial Institutions Development Fund (FIDF) bonds* and the *Emergency Decree empowering MOF to borrow until December 31, 2000, to strengthen the financial sector*. Thailand's debt burden is likely to rise even further as the costs of financial sector assistance are firmed up and other contingent and explicit liabilities are fully recognized (Table 6.3).

6.3 Strategic debt management is more important than ever because of the rising vulnerability of key macroeconomic variables (interest rates, exchange rates, prices of tradeables) associated with increased globalization and the risk of contagion. Government needs a debt management structure that assesses vulnerability, risk, and cost within a sovereign balance sheet framework. Important issues include tradeoffs between foreign exchange and interest rate risks and the tradeoff between price and refinancing risk. Have real exchange rate movements have been hedged "naturally" by the nature of foreign exchange inflows and outflows from Thailand? Is the level of debt fiscally sustainable, given the Government's budget constraint? How severely will public resources be squeezed by future debt service obligations?

**Table 6.3: Thailand's External Debt, 1997-2000**

Item	Estimated	Projected	Projected	
	1997	1998	1999	2000
Total external debt (US\$ billion)	93.4	86.3	76.1	67.9
of which:				
Public sector	24.3	31.6	36.5	37.7
Private sector	69.1	54.7	39.6	30.2
Medium and long-term	34.3	31.3	25.8	21.1
Short-term	34.8	23.4	13.9	9.0
<i>Memo items (percent)</i>				
Debt service ratio	13.8	20.7	20.4	18.0
Public interest payments a/ as share of total revenue	4.8	16.7	12.6	15.0

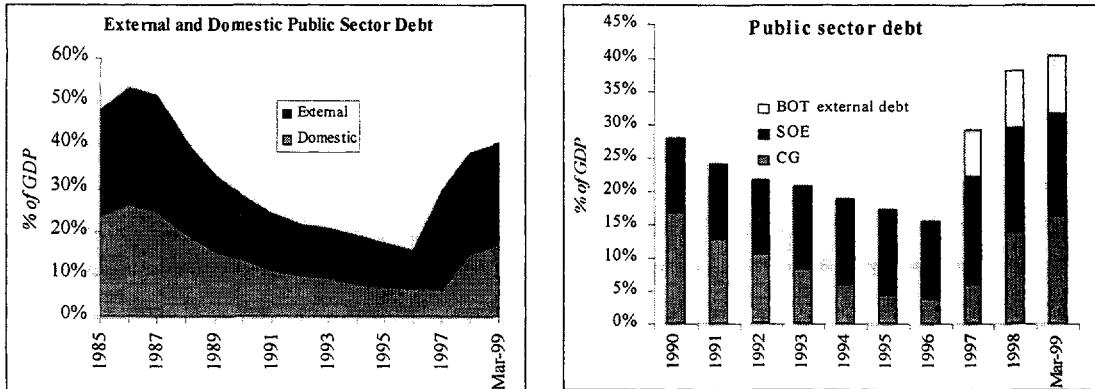
Note: a. Includes interest costs of financial sector restructuring.

Source: IMF and Thai authorities.

### **Fiscal Sustainability and Implications for Fiscal Policy**

6.4 The combined effects of financial sector recapitalization, rising interest expenses, and future fiscal stimulus packages will raise public debt significantly above the end-1998 level of 38 percent of GDP for the next few years (Figure 6.1). First, while more than half of total financial sector restructuring costs have already been incurred, they have not all been fiscalized. The Government has already issued 500 billion Baht in FIDF bonds (FIDF is the banking sector's lender of last resort), but an additional 350 billion baht is planned before the end of fiscal year 2003. Debt servicing, rather than principal payments, will account for most of additional public sector debt costs. Principal payments will arise, mainly from the redemption of bonds under the note exchange program for the closed finances companies, resolution of intervened banks, and recapitalization of state banks and private banks joining the Tier 1 capital support scheme. Second, the 1999 fiscal stimulus package will cost the Government approximately 6 percent of GDP, and 2000 is likely to be another deficit year. Finally, the rising costs of financial sector restructuring and the fiscal stimulus packages mean that interest expenses (already up from 2 percent of the budget in 1996 to almost 5 percent in fiscal 1999) continue to rise over the medium term.

Figure 6.1: External and Domestic Public Sector Debt

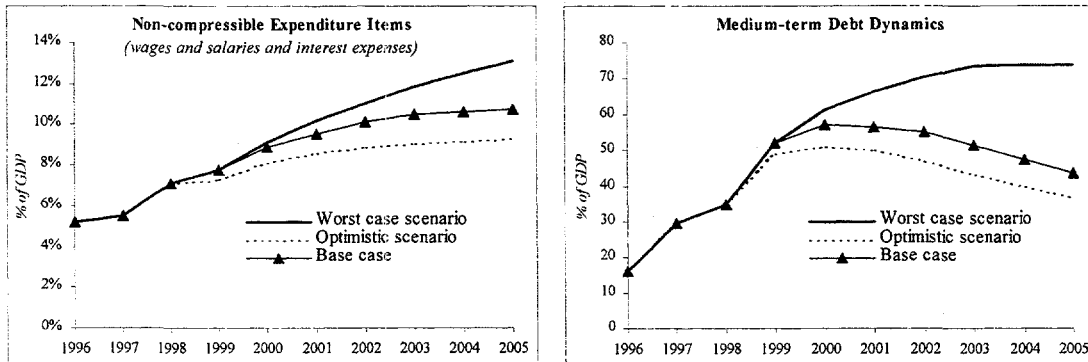


6.5 Thailand's overall debt will rise to more than 40 percent of GDP in the next few years from 16 percent in 1996. Despite the higher level of debt, fiscal sustainability is not a cause for major concern, given Thailand's past ability to grow faster than the real interest rate and generate large fiscal surpluses. Simulation exercises looking at the speed of economic recovery, the size of financial sector restructuring, and the pace at which public sector deficits can be turned into surpluses, show that Thailand should be in a strong position to maintain the debt to GDP ratio at that level or lower it. Public sector debt should peak within two to three years at around 55-65 percent and then start to decline. Only under very unfavorable future conditions does the stock of debt not peak before 2005.<sup>1</sup>

6.6 There is some concern, however, about the inflexibility of the central government's budget. Noncompressible items, such as wages, salaries, and interest payments could rise to 11 percent of GDP (Figure 6.2). With revenues historically averaging 16-17 percent of GDP, there is concern that investment will fall to unacceptable levels. Taxes must rise in the medium term to restore flexibility to fiscal policy and state-owned enterprises should be sold to reduce overall debt and thereby interest expenses. External financing of investment projects, or general budgetary support, can also help maintain investment at acceptable levels.

<sup>1</sup> In the worst case scenario, GDP growth is assumed to be stagnant (and lower than the real interest rate), both the central government and SOEs run large deficits and the future costs of financial sector restructuring will be large. In such an environment, public sector debt will keep climbing to more than 73 percent by 2005.

Figure 6.2: Debt Sustainability



Source: IMF and Thai authorities.

### Measures Underway to Improve Debt Management in Government

6.7 The Government recognizes the need for a coordinated approach to comprehensive strategic public debt management. On September 20, 1999, it announced the creation of a Public Debt Management Office (PDMO) within the Ministry of Finance, with full responsibility for debt management. The new office, in close collaboration with the Bank of Thailand, will assist policymakers to develop a comprehensive medium-term financial and debt management strategy and will support the development of the domestic debt market and appropriate benchmarks. It will also assist in the creation of short- to long-term borrowing plans consistent with the National Economic and Social Development Plan and the Government's fiscal and monetary stance over the planning horizon.

6.8 To carry this effort forward, the Interministerial Domestic Bond Market Committee of the Government (chaired by the Ministry of Finance), jointly with the World Bank, held a "Workshop on Debt Management in a Sovereign Asset Liabilities Management Framework" on September 21-23, 1999 in Bangkok. More than 60 public and private sector participants shared experiences about the roles and responsibilities of different stakeholders with respect to the PDMO's role and the next steps in building institutional capacity in the Government to better manage debt and debt risks.

### Next Steps in Strategic Debt Management

6.9 The next step is to *define the roles and responsibilities and appropriate staffing for each entity within the PDMO*. Measures will be needed to strengthen the coordination with other agencies as well, such as BOT and SEC, and to avoid inefficient overlapping responsibilities, such as those between the Fiscal Policy Office, BOT, and the Comptroller-General's Department within MOF. The World Bank stands ready to

share its cross-country experience on alternative institutional structures for debt management.

6.10 PDMO needs an *integrated debt database and information system* with aggregate information on private nonguaranteed debt, especially the contingent liabilities of the Government. An appropriate package of technical assistance, training, study tours, and resources will be needed to strengthen the authorities' ability to monitor and enforce the issuance of sovereign guarantees and to evaluate risk and alternative cash management strategies over the medium term. Corresponding *regulatory changes* will also need to be formalized within the Thai context to facilitate active but responsible debt and risk management by PDMO.

6.11 Analysis of the fiscal implications of a public debt management and borrowing strategy also requires *diagnostic of the main sources of fiscal risks*. Institutional arrangements also need to be set up to monitor and control these risks and to deal with those that would become unmanageable if left alone.

6.12 The authorities are working to *develop and deepen the domestic bond market*. This effort should be coordinated and consistent with macroeconomic and debt management policies, to *maintain investor confidence* and attract non-debt private capital flows. An assessment of the *tax impediments* to the development of domestic debt markets (primary and secondary) would help to identify ways to encourage more active trading of a wider spectrum of debt instruments. Diversification of funding sources will enable the Government to better manage the risk associated with its public debt obligations while meeting its macroeconomic policy objectives.

### **C. REFORM OF STATE-OWNED ENTERPRISE**

6.13 Thailand's 65 state-owned enterprises operate in four infrastructure sectors (energy, telecommunications, transportation and water) and in banking, services, and manufacturing (Table 6.4). In 1998 they employed just over 1 percent of the labor force and had revenues of approximately 14 percent of 1997 GNP. Most of the activities of these enterprises are generally considered to be outside core government functions, and could be delivered by the private sector, thereby freeing up government resources, widening the tax base, spurring economic activity, and creating efficiency gains.

**Table 6.4: Public Enterprise Financial Indicators, 1998**  
(billions of baht)

Sector	No.	Assets	Liabilities	Net assets	Revenue	Earnings	Prof/ assets	Profits/ NA	Profits/ Sales	Number of Employees
Energy	7	644.9	388.6	256.3	465.8	54.8	8.5	21.4	11.8	93,578
Transport	5	178.7	127.1	51.6	18.1	-2.4	-1.3	-4.7	-13.3	57,376
Marine transport	4	18.2	5.3	12.9	9.6	3.1	17.0	24.0	32.3	10,168
Aviation	4	160.4	108.9	51.5	89.3	8.9	5.5	17.3	10.0	32,001
Communications	3	254.9	61.7	193.2	71.3	29.6	11.6	15.3	41.5	54,580
Water and housing	4	96.7	62	34.7	15.2	2.5	2.6	7.2	16.4	16,610
Industrial	13	37.1	9.5	27.6	44	5.4	14.6	19.6	12.3	16,321
Manufacturing										
Agriculture	9	12.8	8.3	4.5	6.4	-1.2	-9.4	-26.7	-18.8	9,550
Services	11	12.3	4.1	8.2	20.4	1.1	8.9	13.4	5.4	5,122
Subtotal	60	1416	775.5	640.5	740.1	101.8	7.2	15.9	13.8	295,306
Financial institutions	5	1,407.1	1,304.4	102.7	144.1	24.5	..	23.9	17.0	41,342
Total	65	2,823.1	2,079.9	743.2	884.2	126.3	..	..	..	336,648

Source: Government of Thailand.

6.14 **Overall progress.** Since the crisis, the Government has made state enterprise reform and privatization a key plank of its economic reform program (Table 6.5). The Master Plan for State Enterprise reform of September 1998 provides a detailed roadmap for privatization in the communications, water, energy, and transport sectors. Slow, but measured progress has been made on reform initiatives in key sectors, and studies have been undertaken to create a framework for SOE reform. Regulatory guidelines have been drafted, along with transport, water, and energy sector restructuring plans. Privatization has begun for certain key SOEs (Thai Airways, Airport Authority of Thailand (AAT)).

6.15 **Constraints.** The slow pace of privatization during the first years of the economic crisis, despite an ambitious Master Plan, has allowed well organized opposition groups, including employees of state enterprises, to mobilize against the program. These groups oppose privatization primarily because of concerns about job security and redundancies. The Government has so far not effectively communicated the benefits of privatization to concerned labor groups or to the public at large. Also impeding progress is the failure to fully define the authority of the Office of State Enterprises and to adequately fund its activities. As a result, the office has been unable to fund a public communications strategy and undertake detailed studies and other privatization plan development efforts.

6.16 A key motivation for privatization was the need to raise revenues. With most state enterprises concentrated in the infrastructure sectors, it has become clear that complex regulatory reforms are also needed and that depressed asset markets have to recover before substantial asset divestitures could take place. The argument for reducing the role of the state in public enterprises should be made in terms of creating competitive markets for the private provision of infrastructure to lower costs for consumers, thereby reducing subsidies and reaping efficiency gains (from better access to management know-how and technology).

6.17 Because of a lack of Government focus, there is a risk that the momentum for privatization may slow down. Privatization under such a scenario is likely to proceed on a case-by-case basis, with transactions and policy directed by the individual line ministries, which might result in a less coherent privatization strategy.

**Table 6.5: State Enterprise Reform - The Critical Agenda for 1999/2000**

Objectives	Sectors	Benchmark actions 1999/2000
Create strong coordinating function Communicate benefits of SOE reform Address labor issues Sequence sectoral reforms adequately	Overall reform program Overall reform program Overall reform program Water	OSE capacity building Management information system Communications campaign, investor relations Finalize design of Employee Compensation Fund
	Telecommunications	Finalize PPI studies on PWA and MWA Initiate concession bidding Adopt Telecom Act Corporatize TOT and CAT Initiate concession conversions Finalize study on power pool - Sell 50% of Ratchaburi plant - Sell 12.5% of ESSO
Establish regulatory and legal framework	Energy Transport Telecom, transport, water, energy	Review transport studies - Initiate restructuring of SRT and BMTA - Sell 23% of Thai airways - Corporatize AAT Increase private participation in bus services Establish regulatory guidelines - Implement Corporatization Act - Amend Thai Airways and Telecoms Acts

### The Water Sector

6.18 **Reform Agenda.** To prepare for the next steps in reform and privatization of the water sector, a study will analyze options for private sector participation in the activities of the Provincial Water Authority (PWA), the Municipal Water Authority (MWA), and the Wastewater Management Authority (WMA). The study will also conduct an analysis of water tariff and make recommendations, and will draft legislation to establish a regulatory body for the sector. Responsibility for overseeing the water sector strategy has been transferred from MOF to the Ministry of Interior (MOI).

### The Telecommunications Sector

6.19 **Reform Agenda.** The Government made a commitment to the World Trade Organization (WTO) to fully liberalize its telecommunications market by 2006. Thailand will gradually liberalize the market for domestic investors, increase competition, and privatize domestic and long distance carriers, Communication Authority of Thailand (CAT) and the Telephone Organization of Thailand (TOT). Sales of a strategic stake in these companies (possible in 2000) must await corporatization, pending approval of the Corporatization Act. The risk of regulatory failure in this sector is real, and Bank dialogue with the Government suggests the need for technical assistance in the following areas: (i) preparation of detailed draft licenses for main operators, (ii) capacity building

and training for new regulatory agency staff, (iii) advisory services and development of regulatory tools for the new agency, and (iv) support for the launch of a telecommunications customer group to represent customer interests before the regulator.

6.20 **Concession Conversions.** Conversion of existing concession contracts remains a most difficult issue. Thai telecom SOEs entered into revenue-sharing built-transfer-operate (BTO) concession contracts with private companies in the early 1990s. Substantial expansion of network, cellular, and satellite services resulted. With the economic downturn, the revenue sharing requirements became unsustainable burdens for many of the concessionaires. Further, the concessions provide concessionaires with exclusive rights to certain services or markets, which is contrary to the announced policy of full domestic market liberalization in 1999/2000. Before privatization to strategic investors can proceed (assuming that is the strategy adopted), resolution of these concession issues is likely to be required.

### **The Energy Sector**

6.21 **Reform Agenda.** Thailand's energy sector has been the most dynamic proponent of liberalization. The National Energy Policy Office (NEPO), which has the authority to direct privatization efforts in the energy sector, hopes to establish a competitive power pool market by 2003. In mid-1998, the Electricity Generating Authority of Thailand (EGAT) sold a 14.9 percent share in the Electricity Generating Company Plc (EGCO), which was formed as a subsidiary of EGAT. The first legislation under the privatization guidelines is expected to be presented to Parliament in the first half of 2000.

6.22 **EGAT and ESSO.** Under a Bank-supported guarantee for a \$300 million EGAT bond issue approved in September 1998, EGAT has agreed to increase its self-financing ratio and lower its debt-equity ratio. Both of these moves are largely contingent on the sale of over half of the shares of the Ratchaburi power plant. That sale was delayed for three months for a committee review of employee issues and concerns and is now expected by the first quarter of 2000. The State Enterprise Policy Committee has also approved the privatization plan for sale of the 12.5 percent of shares in ESSO held by MOF. ESSO's privatization plan calls for selling the shares to a strategic investor in a bidding process at the end of 1999.

### **The Transport Sector**

6.23 **Policy and Regulation.** Reform of the transport sector is being managed by the SEPC Subcommittee on Transportation, which is considering the recommendations of two World Bank-sponsored studies on improved policy and planning in the sector, development of regulators, and the direction of reform for the 14 enterprises in the sector.

6.24 **Reform Agenda.** Reform efforts in the transport sector remain on a critical path. Thai International Airways has retained a financial advisor and a share sale is expected by the end of the first quarter of 2000 (an initial public offering, a strategic stake or a combination). AAT has retained a financial advisor and its share sale is expected in 2000. SEPC has approved Transport Company's initial privatization plan, which calls for separating operations from policy and regulation, and increasing private sector



participation in bus routes. Thai Maritime's initial proposal to create a national fleet has been rejected. Private shippers have been invited to propose an alternative plan.

6.25 *State Railways of Thailand (SRT)*. SRT restructuring will be based on two World Bank-financed studies that are looking at options to separate rail operations (freight and passenger services) from infrastructure (mainly rails) and real estate (including land and a large number of buildings). Another key recommendation is to separate suburban passenger service from the SRT and allocated to Bangkok.

6.26 *Bangkok Metropolitan Transport Authority (BMTA)*. BMTA has net indebtedness of over 20 billion baht, and debt is growing at over 3 billion baht a year. Despite this high annual loss, BMTA is unable to maintain services under the low fare structures. Most bus services are provided under subfranchises by the private sector using a fleet of old, environmentally damaging vehicles. Long routes and poor route structures further compromise service quality. Reform of the regulatory system to more effectively mobilize the potential of a competitive private sector will be needed to enable BMTA to reduce the fiscal burden of its deficits while improving the quality of services. The first step is to select the form of competition and design the system accordingly. In the public sector, operations would need to be separated from service regulation and procurement with the operating sector restructured to develop competitive capability. The recommendations of the sector review call for transforming BMTA into a planning and regulating body.

### **Institutional Issues in State Enterprise Reform**

6.27 *Overall Coordination*. The Office of State Enterprises (OSE) within the Comptroller General's Department in MOF plays a critical steering and support role in privatization, acting as the secretariat to the SEPC, chaired by the Deputy Prime Minister. To handle this, coordination role well, OSE needs both the institutional capacity and a strong political mandate at the highest level to champion privatization efforts. Strengthening the expertise and political backing of the OSE remains a critical item on the agenda. Better investor relations and public relations programs are also important.

6.28 *Regulatory Reform Agenda*. Substantial progress has been made in developing guidelines for *new regulatory bodies* in Thailand. The State Enterprise Policy Commission is preparing guidelines for the creation of regulatory bodies in the telecommunications, transport, water, and energy sectors. The guidelines will outline and clarify the key foundations of regulation (commission structure, appointment and dismissal procedures, qualifications, funding of regulators, reporting responsibilities, consumer protection, dispute resolution) for legislation to be drafted by the line ministries). On the critical path is the regulation of the energy sector, and legislation creating a telecoms regulator.

6.29 **Legal Reform Agenda.** An important item on the legal reform agenda is the constitutional challenge launched against the Corporatization Law passed by Parliament in March 1999. The challenge is being considered by the Constitutional Court. Assuming the law survives the challenge, corporatization is likely to start with CAT, TOT, AAT, and PTT. Asset valuation is required for the enterprises to determine the book value and number of shares of the newly corporatized companies. The Corporatization Law enables the appointment of new and more business-oriented boards to the SOEs. As most privatizations are expected to be staged (strategic share sale, followed by IPO(s)), good governance of the SOEs will be important. The Ministry of Finance, as shareholder, has primary responsibility for developing and implementing a new corporate governance program. This will also require obtaining accurate, standardized SOE data through a management information system.

6.30 A proposed amendment to the Aviation Act which passed its first reading in the Lower House in 1999 would allow for the sale of more shares in Thai Airways (the Government now holds 93 percent) to private investors. The Telecommunications Act which passed its first reading in Parliament in 1999, would regulate telecommunications, radio and television, and allocates frequencies for these media.

#### **D. PUBLIC SECTOR REFORM**

6.31 Several factors are driving Thailand's quest for a better public sector. First, the new debt burden requires better financial management to do more with less. Second, the public is demanding better services and less corruption. Third, the new Constitution provides a solid foundation for decentralizing decisionmaking to local communities and promoting public accountability. This constitutional and democratic opening promises greater voice for citizens, more responsive political and administrative institutions, and increased pressure from the media and interest groups for cleaner government and better services. Finally, momentum also comes from the increasing awareness of many Thai civil servants of the global experience in reinventing government and modernizing public administration (Box 6.1).

##### **Box 6.1. The New Constitution**

Designed to end the inertia that had virtually paralyzed recent governments, the new Constitution, approved by Parliament in October 1997, introduces broad reforms to combat corruption and electoral fraud, empower civil society, and safeguard individual liberties. The Constitution mandates broad changes in public expenditure management, including how finances are managed, how and what services are delivered, and how they are reported to the public. It requires the Auditor General to report findings to the Parliament. The Constitution mandates the establishment of key institutions to provide grievance mechanisms, including the Office of the Ombudsman and the National Counter Corruption Commission. It calls for universal access to education through grade 12 and defines a strong role for the private sector in delivering educational services. The Constitution also envisages the decentralization of government activities by increasing the share of local government expenditures, assigning more revenue sources to local governments, and revising the system of intergovernmental transfers to provide grants in a more transparent and predictable way.

### **Toward Comprehensive Reform**

6.32 The first critical steps in Thailand's medium-term reform program were implemented in 1999. A Memoranda of Understanding on resource flexibility was signed by the Bureau of the Budget and the Ministry of Health and Education; memorandums will also be rolled out to other ministries. Other key steps include the publication of a Public Expenditure Assessment and the completion of a functional review of the Ministry of Commerce. A Large Business Tax Office was set up in the Revenue Department, a major step forward. Recent legislation on Autonomous Public Organizations, State Audits, National Decentralization Committee, National Counter-Corruption Committee, the Ombudsman and Administrative Courts provides broad new scope for strengthening public sector accountability.

6.33 Over the next three years, the reform program is expected to result in improved resource management, better service delivery, and stronger accountability and transparency to boost public and investor confidence in Thailand. The test of the Government's commitment will be measurable progress toward the reform benchmarks set out in critical areas, including the management of expenditures, human resources, and revenues, as well as fiscal decentralization and transparency (Table 6.6).

**Table 6.6: Thailand Public Sector Reform Program**

Objectives	Reform Areas	Priorities	Benchmark Actions 1999/2000
<i>Improved Performance-Based Resource Management</i>	<b><i>Expenditure Management</i></b>	<ul style="list-style-type: none"> <li>▪ Implement performance-based budgeting for line ministries</li> <li>▪ Strengthen the capability of central agencies to review and evaluate sector policies and performance</li> <li>▪ Improve fiscal transparency</li> </ul>	<ul style="list-style-type: none"> <li>▪ Conclude resource agreements between Bureau of Budget and line ministries to allow increased resource flexibility</li> <li>▪ Conduct household survey and multi-agency evaluation work program</li> <li>▪ Prepared Law on State Audit and better government reporting standards</li> </ul>
<i>Better Service Delivery</i>  <i>Greater Accountability and Transparency</i>	<b><i>Human Resource Management</i></b>	<ul style="list-style-type: none"> <li>▪ Develop detailed programs to align organizational structures of line ministries with their new functional objectives</li> <li>▪ Match staffing profiles and numbers to new functional requirements of civil service and contain cost of government</li> <li>▪ Develop modern performance-based human resource management systems for civil service</li> <li>▪ Develop well-motivated, politically neutral, cross-governmental senior cadre to lead civil service renewal program</li> <li>▪ Develop regulatory framework for autonomous public organizations (APOs)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Complete functional reviews and initiate restructuring of MOPH, MOC, MOF</li> <li>▪ Implement early retirement scheme, establish Transition and Outplacement Center</li> <li>▪ Introduce performance-based management system</li> <li>▪ Devolve HR responsibility to pilot agencies</li> <li>▪ Design and initiate Senior Executive Service</li> <li>▪ Identify APO performance measures and reporting requirements</li> </ul>
	<b><i>Revenue Management</i></b>	<ul style="list-style-type: none"> <li>▪ Improve taxpayer compliance</li> <li>▪ Strengthen collection enforcement</li> <li>▪ Balance business and Information Technology (IT) priorities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strengthen Large Business Tax Administration Office</li> <li>▪ Reduce tax arrears</li> <li>▪ Develop Corporate Income tax reporting modules</li> </ul>



### ***Expenditure Management***

6.34 The recent economic crisis has placed Thailand's budget and revenue systems under stress and highlighted a number of structural weaknesses in expenditure management and tax administration. To meet the demands of a globalized economy, expenditure management must link Thailand's planning, sector policymaking, and budgeting processes; measure outputs and outcomes instead of controlling inputs; improve the quality of fiscal adjustment; and improve financial transparency. The reform strategy consists of the following elements:

- Implement performance budgeting by formulating strategic plans, forming resource agreements with performance targets in sector ministries, and incorporating budget evaluation-feedback into the budget cycle.
- Improve the planning capability of sector ministries through functional reviews of program areas, corporate plans, and performance-based budgeting.
- Improve line ministry performance through resource agreements and monitoring, with increased flexibility granted by the Bureau of the Budget.
- Routinely monitor the distributional incidence of fiscal policy through multi-purpose household surveys and surveys of unit costs, prices, and subsidies.
- Improve the targeting of expenditures and the progressivity of subsidies by routinely using distributional criteria in making *ex ante* expenditure decisions.
- Strengthen key government agencies in monitoring and evaluating the effectiveness of service delivery.
- Establish a medium-term macro-fiscal plan that would influence annual budgets.
- Adopt international standards for fiscal transparency.
- Prepare complete government financial statements (including contingent liabilities) and present annual audit report to Parliament.

### ***Human Resource Management***

6.35 The lack of a service-oriented, cost-effective civil service driven by results rather than entitlements has impeded implementation of government programs. Public institutions are highly segmented, with limited cooperation across agencies. Public confidence in the quality and probity of civil service management has eroded. The recent financial crisis has brought the shortcomings of the Thai civil service into even sharper relief, underscoring citizen dissatisfaction with government deficiencies and highlighting the need to strengthen civil service capacity to resume economic growth.

6.36 Delivering better services in a cost-effective and equitable way is a key objective of the reform program. This will require enhancing the access, timeliness, and quality of

public services through outsourcing, restructuring, or decentralizing activities and being more responsive to clients. Administrative renewal involves modernizing the role, organization, and processes of key line ministries to enhance their performance in delivering services. More efficient use of public resources requires streamlining procedures, eliminating duplicative structures, and devolving to local governments or outsourcing to the private sector activities inappropriate for government involvement.

6.37 Thailand's reform strategy includes the following elements:

- Use functional reviews to identify opportunities for restructuring, re-engineering, outsourcing, and decentralizing public sector functions for effective policymaking and service delivery.
- Align organizational development and restructuring programs for government ministries and departments with their service objectives.
- Devolve noncore functions to local governments; contract to the private sector or to autonomous public organizations.
- Improve the efficiency of service delivery in core areas of ministry activity.
- Strengthen human resources and structure staffing levels to meet the ministry's objectives.
- Adjust staffing levels to new public sector requirements (an expected reduction of 10 percent of staff).
- Introduce performance-based human resource management systems for the civil service (individual job description and classification systems, greater flexibility in employment system, performance appraisal and remuneration, career development and advancement, disciplinary and complaint systems).
- Strengthen the caliber of senior government staff by developing a Senior Executive Service cadre groomed for civil service leadership posts.

### ***Revenue Management***

6.38 Deficiencies in Thailand's tax administration that were little noticed during periods of rapid economic growth are now large enough to challenge future fiscal sustainability. Tax collections fell by 0.5 percent of GDP in 1997 and 0.9 percent in 1998, a drop greater than could be explained by the recession, and tax arrears doubled (to 79.1 billion baht, or more than 1.5 percent of GDP). The Government must recover these lost revenues *and* mobilize additional revenues to compensate for lower trade tariffs under APEC, pay for losses in the financial system, and meet the budgetary demands for increased expenditures for the poor. Tax rates should eventually be lowered to encourage private sector development, employment growth, and expansion of the formal economy. That will require further improvements in tax administration to offset these revenue losses.

6.39 The objectives of the proposed tax administration reforms are to ensure adequate and sustainable revenue; improve revenue collection, widen the tax base, and achieve a more equitable distribution of the tax burden; and strengthen the managerial capacity of the Revenue Department to perform its functions in a sustainable and transparent basis. The reform strategy expects to achieve the following results over the next three years

- Strengthen tax collection enforcement to rein in the growth in tax arrears.
- Improve taxpayer compliance by establishing unique taxpayer identification numbers, coordinating audit with the collection of delinquent accounts, and developing and implementing a comprehensive audit strategy.
- Improve overall revenue management by developing strategic plans, establishing information technology priorities, and developing new applications.

### ***Decentralization***

6.40 Thailand is a highly centralized country with limited local autonomy in terms of functions, area, staffing, funding, and decisionmaking. The central government spends 93 percent of total general expenditures and collects 95 percent of general tax revenues; only 25 percent of municipal revenues are locally collected and retained; and the central government appoints chief local officials, determines local salaries, and approves local budgets. Reducing the role of the central government and moving toward a decentralized fiscal system will require significant changes in institutions, processes, and culture.

6.41 Objectives envisioned in the reform program, supported by the new Constitution, include increasing the share of local government expenditures, assigning more revenue sources to local governments, revising the system of intergovernmental transfers to provide grants in a more transparent and predictable way, and promoting mechanisms for local accountability. The strategy for reform would focus on the following priorities:

- Establish an independent authority (the National Decentralization Committee) to monitor decentralization reforms and promote cooperation among ministries and agencies.
- Clearly assign expenditure functions among levels of government, and devolve functions to local governments.
- Allocate adequate local revenues (including phasing in the new property tax and strengthening the Central Valuation Agency), and enhance local collections.
- Improve the equalization impact of intergovernmental grants by introducing more general-purpose grants and allocating them by transparent and equalizing formulas.
- Develop mechanisms for local accountability and transparency.
- Monitor the status of decentralization and local public finances by developing local finance benchmarks and publishing regular reports on local finance.



## **Strengthening Cross-Government Accountability and Transparency**

6.42 Despite pervasive rules governing procurement and budgeting, accountability in managing the affairs of Thai government institutions is poor. Lack of transparency and accountability may manifest itself in widespread corruption. Civil servant salaries are well below levels in the private sector, and civil servants are not sufficiently protected from political pressures and corrupting influences. The negative effects of corruption -- distorting government resource allocation decisions, reducing economic efficiency, undermining legitimacy of public institutions, and skewing income distribution in favor of the rich -- are widely reported in the media. Perceived corruption also damages Thailand's international reputation and its prospects for foreign investment. In 1998, Thailand ranked near the bottom of Transparency International's survey on perceptions of corruption, placing it 61 out of 85 countries surveyed.

6.43 Thailand is rationalizing the institutions responsible for ensuring public accountability and demonstrating the Government's commitment to fighting corruption. Public accountability can be enhanced by encouraging civil society to participate in government decisionmaking and to provide input on how to improve service delivery. The new Constitution grants individuals and civil society organizations the rights to participate in policy formulation and implementation to improve government services. The Government has sought regular feedback from civil society, including through the "Good Governance" working groups of the Thailand Development Research Institute, a prominent think tank.

6.44 To the extent that corruption is primarily a symptom of poor public management, reforms of public expenditure management and human resource management are critical. It is difficult to restore citizens' trust in Government, but specific interventions to increase public accountability and transparency can both reduce corruption and improve service delivery. The new Constitution provides a strong momentum for the creation of formal mechanisms of cross-government accountability and increasing the voice of civil society.

6.45 Thailand is embarking on a reform program with the following elements:

- Increase institutional accountability by strengthening formal institutional structures.
- Improve access to public information by citizens and civil society, with greater responsiveness by Government in providing this access.
- Increase probity among civil servants.
- Enhance civil society participation in improving transparency.

6.46 The outcomes associated with this strategy include:

- Establishment of a National Counter-Corruption Commission to create and enforce standards for integrity and transparency in Government, investigate allegations of corruption, and report annually to the public.

- Creation of administrative courts to provide a judicial forum to citizens to enforce their rights vis-à-vis the state.
- Establishment of an ombudsman under Parliament to address citizens' grievances and other issues of public concern.
- Strengthened capacity of the Office of the Official Information Commission to facilitate public access to information under the Official Information Act.
- Establishment of an Ethics Promotion Center, and protecting whistleblowers to promote professional quality and reduce corruption.
- Establishment of the National Economic and Social Council (NESC) to allow civil society to monitor public performance and participate in policymaking process.

<b>ANNEX 1: Financial Sector Reform; Indicators of Progress<sup>1</sup></b>	
<b>Measure</b>	<b>Date</b>
<b>I. Managing problem institutions</b>	
1. Orderly Resolution of the 56 Closed Finance Companies <ul style="list-style-type: none"> <li>• The AMC has prepared a plan for the management and ultimate disposition of assets acquired from the FRA.</li> <li>• FRA has initiated the process of adjudication of claims and distribution to creditors.</li> </ul>	Year end 1999
2. Restructuring and recapitalization of the Core Financial Institutions <ul style="list-style-type: none"> <li>• The Government has completed the operational restructuring and recapitalization of KTB (after the full provisioning).</li> <li>• The Government has completed and committed to a time bound plan for the privatization of KTB by March 2001. (Subject to upcoming discussions with the Government.)</li> <li>• The Government has completed and committed to a time bound plan for the institutional strengthening of the Government Housing Bank, with a medium-term goal of conversion to private sector ownership and governance. (Still to be negotiated with the Authorities).</li> <li>• Radhanasin Bank, Siam City Bank, Bangkok Metropolitan Bank, and Nakornthon Bank will have been privatized.</li> </ul>	Year end 1999
<b>II. Strengthening the financial sector structure</b>	
1. Strategy for the future of financial services <p>The Financial Services Task Force has:</p> <ul style="list-style-type: none"> <li>• Set a medium-term strategy for the financial sector.</li> <li>• Made its recommendations to the Government for legal/regulation policy and changes necessary to achieve that sound and efficient financial sector.</li> </ul>	Year end 1999

<sup>1</sup> These are matters under discussion between the World Bank and the Thai Authorities; they are not formal commitments by the Thai Authorities at this time.

<b>ANNEX 1: Financial Sector Reform, Indicators of Progress (continued)</b>	
<p>2. Capital market development</p> <ul style="list-style-type: none"> <li>• The task forces established under the Working Group for Domestic Bond Market Development will have finalized all the terms of reference for the seven identified components and initiated all the tasks.</li> <li>• MOF has established a Working Group to address possible reform of the asset and liability (and financial risk) management of the public sector.</li> <li>• The Ministry of Finance has established an action plan to reform the asset and liability management of the public sector.</li> <li>• BOT has established strategic steps for enhancing a system for primary issuance and distribution of government bonds, and a complete plan for a comprehensive integrated system to achieve automated delivery-versus payments for trading of government and government-guaranteed bonds.</li> </ul> <p>An appropriate government agency (i.e., BOT or SEC) has established a policy to authorize of a self-regulatory organization (SRO) in the bond market.</p>	<p>Year end 1999</p> <p>Year end 1999</p> <p>Q1, 2000</p> <p>Q1, 2000</p> <p>Q1, 2000</p>
<p>3. Specialized Financial Institutions (SFIs)</p> <ul style="list-style-type: none"> <li>• MOF has confirmed or revised the role, scope of activities and fiscal treatment of each SFI.</li> <li>• MOF has adopted a time-bound plan to strengthen the financial condition and risk management capacity of those SFIs that will be used for credit expansion, and will review the recapitalization needs of all SFIs based on independent diagnostic reviews and BOT examinations.</li> <li>• BOT and MOF has adopted a detailed action plan for the supervision of SFIs. The plan includes deadlines for the preparation and submission of appropriate amendments to the law and the issuance of enhanced prudential rules.</li> </ul>	<p>Year end 1999</p>
<b>III. Enhancing the regulatory and Supervisory regime</b>	
<p>1. A comprehensive supervision framework</p> <ul style="list-style-type: none"> <li>• MOF has established a Task Force of all supervisory authorities whose purpose is to identify and draft those regulatory changes required to supervise financial conglomerates effectively and to ensure consistency in the prudential regulation and supervision of all financial institutions.</li> <li>• The Task Force has submitted its report and recommendations.</li> </ul>	<p>Year end 1999</p> <p>Q2, 2000</p>

<b>ANNEX 1: Financial Sector Reform, Indicators of Progress (continued)</b>	
<p>2. Strengthening supervision and regulation of financial institutions</p> <ul style="list-style-type: none"><li>• The BOT/MOF have publicly announced proposed legislative amendments to the Central Bank and Commercial Banking Laws..</li><li>• BOT, consistent with the new legislation, has developed a comprehensive set of revised prudential regulations in line with best international practices.</li><li>• Streamlined regulatory reporting (both on consolidated and individual basis) has been developed and implemented in conjunction with the new legal and regulatory format, and, on the basis of this, an effective Early Warning System will be put in place by BOT.</li></ul>	<p>Year end 1999</p> <p>Q2, 2000</p> <p>Q2, 2000</p>
<p>3. Deposit insurance scheme</p> <ul style="list-style-type: none"><li>• The BOT has drafted legislation for a deposit insurance scheme.</li><li>• BOT/MOF have publicly announced the proposed deposit insurance legislation.</li></ul>	<p>Year end 1999</p>

## ANNEX IIa: THAILAND - FINANCIAL SECTOR RESTRUCTURING

**Phase 1**  
completed  
Dec 1997

**Phase 2**  
completed  
July 1998

**Phase 3**  
completed  
Mar 1999

**Phase 4**  
Ongoing

### RESOLUTION OF FINANCIAL INSTITUTIONS

- FRA and AMC
- 56 FinCos closed
- Note exchange program

- Classification of assets by FRA
- 4 Banks and 7 FinCos intervened

- Aug 98 financial sector restructuring plan
- 2 Banks and 5 FinCos intervened
- FRA asset sales

- FRA completion and proceeds distribution
- Recap / Intervention of weak banks
- Privatization

### STRENGTHENING THE SUPERVISION AND REGULATORY CAPACITY

- Enhanced supervision of non-suspended FinCos
- Initial strengthening loan provisioning rules

- New loan provisioning regulations
- FinCo diagnostic reviews
- Development plan-BOT

- Loan provisioning: 20%
- Supervisors Training & enhanced procedures
- Steering Committee
- SFI Supervision

- Loan provisioning: 40%
- New banking legislation and regulations
- School for examiners

### STRENGTHENING FINANCIAL SECTOR STRUCTURE

N/A

N/A

- Initial review of Financial Sector
- Task force on domestic bond market

- Recommendations medium-term structure of the financial sector
- Plan to develop domestic bond market

### STRENGTHENING MARKET DISCIPLINE

N/A

N/A

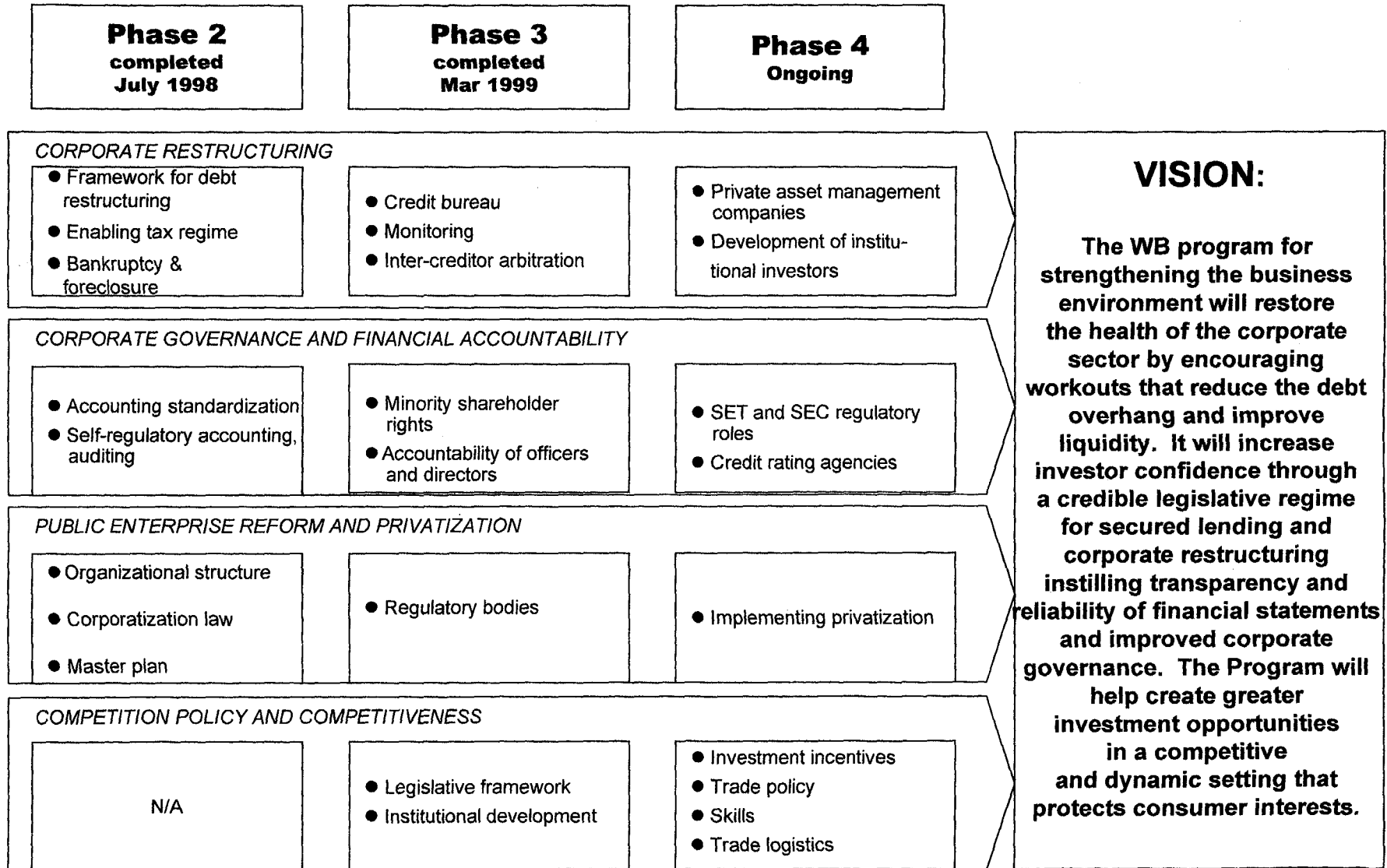
- Initial plan for deposit insurance
- Review of auditing, accounting and disclosure for financial institutions

- Deposit insurance legislation
- New accounting and auditing rules for FIs

## VISION:

The WB Thailand financial sector program will consolidate financial stability and make the financial sector sounder, more efficient and conducive to high sustainable growth. The program aims to restructure the financial sector (reform the financial sector structure, resolve the finance companies and restructure or recapitalize the core financial institutions), develop the capital market, strengthen supervision, upgrade the legal and regulatory framework and improve market discipline.

## ***ANNEX IIb: THAILAND - STRENGTHENING BUSINESS ENVIRONMENT***



## ***ANNEX IIc: THAILAND - MACROECONOMIC PROGRAM AND SOCIAL PROTECTION***

**Phase 1**  
completed  
Dec 1997

**Phase 2**  
completed  
Jul 1998

**Phase 3**  
completed  
Mar 1999

**Phase 4**  
Ongoing

### *MACRO-ECONOMIC STABILIZATION*

<ul style="list-style-type: none"> <li>● BOP support</li> <li>● Credible macro-economic policy framework</li> </ul>	<ul style="list-style-type: none"> <li>● BOP support</li> <li>● Easing liquidity constraint for existing firms</li> </ul>	<ul style="list-style-type: none"> <li>● Budgetary support</li> <li>● Fiscal stimulus</li> </ul>	N/A
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### *POVERTY AND SOCIAL PROTECTION*

N/A	<ul style="list-style-type: none"> <li>● Social investment project</li> </ul>	<ul style="list-style-type: none"> <li>● Institutional design for policy coordination</li> <li>● Work-fare programs</li> <li>● Cash &amp; Kind transfers</li> </ul>	<ul style="list-style-type: none"> <li>● Voluntary provident funds</li> <li>● Social security reform</li> <li>● Poverty monitoring</li> </ul>
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### **VISION:**

The WB Program has supported a macro-economic framework that strengthens macro-economic stability and has a flexible fiscal stance to accommodate outlays for crisis-related costs of financial sector restructuring, fiscal stimulus, and social protection. Beyond the crisis, the program puts in place structures and policies for continued monitoring of poverty and its elimination. The integrated social protection program seeks to develop a sustainable social security and old-age pension program.



**Table 1: Gross Domestic Product (Real)**

*(year-on-year changes)*

Production Side	1996	1997	1998				1999		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
Agriculture	3.8	-0.5	-1.2	-3.7	-0.7	2.2	-0.7	3.2	-0.2
Manufacturing	6.7	0.1	-13.3	-13.8	-14.8	-4.1	6.6	9.5	17.4
Construction	7.2	-26.6	-28.1	-35.8	-41.6	-40.6	-24.8	-18.4	-0.6
Wholesale and Retail Trade	1.8	-2.1	-8.8	-11.7	-10.9	-6.6	3.1	6.1	7.2
Transportation	11.9	3.8	2.5	-8.2	-6.9	3.1	1.8	9.2	0.7
Hotels and Restaurants	3.6	-2.4	-10.2	-12.5	-3.7	2.8	8.2	4.9	9.5
Financial Intermediation	5.2	-10.3	-24.2	-34.9	-38.4	-45.5	-20.6	-29.7	-9.2
Expenditure Side	1996	1997	1998				1999		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3
Private Consumption	6.8	-0.8	-10.6	-14.5	-12.8	-3.9	-0.3	1.1	5.5
Government Consumption	11.9	-3.6	-6.4	-6.0	11.9	15.5	1.4	15.5	3.4
Gross Fixed Investment	7.4	-20.3	-23.8	-33.4	-31.2	-19.2	-13.9	1.1	6.1
Private	..	29.6	-30.7	-33.8	-29.8	-14.7	-7.8	0.9	7.7
Public	..	8.8	-6.1	-32.4	-33.2	-28.5	-25.4	1.5	3.6
Exports of Goods and Services	-5.5	8.4	15.0	8.9	5.7	-1.2	-1.8	7.6	13.3
Imports of Goods and Services	-0.5	-11.4	-28.5	-29.8	-23.5	-11.8	8.5	23.2	21.6
<b>GDP</b>	<b>5.9</b>	<b>-1.8</b>	<b>-9.0</b>	<b>-12.7</b>	<b>-13.2</b>	<b>-6.6</b>	<b>0.9</b>	<b>3.3</b>	<b>7.7</b>

Source: NESDB

Note: Real gross domestic product (GDP) are GDP at 1988 prices.

**Table 2: Balance of Payments**

(billion US\$)

	1998					1999				
	1997	1998	Q1 <sup>P</sup>	Q2 <sup>P</sup>	Q3 <sup>P</sup>	Q4 <sup>P</sup>	Q1 <sup>P</sup>	Q2 <sup>P</sup>	Q3 <sup>P</sup>	Oct <sup>P</sup>
<b>Exports (f.o.b.)</b>	56,627	52,798	13,234	12,928	13,240	13,396	12,667	13,666	14,686	5,330
<b>Imports (c.i.f.)</b>	61,249	40,583	10,110	10,334	10,099	10,041	10,001	11,549	12,316	4,476
<b>Trade balance</b>	-4,622	12,214	3,124	2,594	3,142	3,355	2,666	2,116	2,369	854
Net services & transfers	1,512	2,057	1,081	211	263	502	766	434	424	170
Current account balance	-3,110	14,271	4,205	2,805	3,404	3,857	3,432	2,550	2,793	1,023
<b>Capital and financial account</b>	-9,050	-9,635	-2,437	-3,326	-1,952	-1,919	-3,195	329	-2,920	-947
Private	-8,081	-15,593	-4,021	-2,067	-3,120	-6,385	-5,965	-2,966	-2,641	-1,137
Public	1,584	1,975	569	204	649	553	1,579	663	-480	191
Monetary authorities 1/	-2,553	3,983	1,015	-1,462	519	3,912	1,191	2,631	202	0
<b>Net errors &amp; omissions</b>	1,531	-2,904	-998	-346	-987	-573	571	-1,263	33	-53
<b>Balance of payments</b>	-10,629	1,733	770	-868	466	1,364	808	1,615	-94	24

Source: Bank of Thailand

Remarks: Figures are converted into US dollars using monthly average exchange rates.

1/ Including Bank of Thailand's borrowing and other off-shore transactions.

P/ Preliminary

**Table 3: Manufacturing Production**

(% changes since previous year)

	Weight	1997	1998	1999			Oct	Nov	Dec
				Q1	Q2	Q3			
Manufacturing Production Index	100.0	-0.5	-10.0	4.8	10.6	17.5	14.3	20.7	15.3
<i>Foods</i>	9.6	1.8	-5.3	20.6	22.0	16.6	16.8	4.3	-2.4
<i>Beverages</i>	10.6	14.3	2.3	13.2	28.0	31.0	9.2	17.2	13.3
<i>Tobacco</i>	3.0	-9.9	-20.3	-17.8	-2.9	-6.1	-12.5	-8.1	-11.4
<i>Textiles &amp; Textile Products</i>	22.8	1.8	2.9	-0.7	-2.7	-0.9	-0.2	0.1	-0.5
<i>Petroleum Products</i>	11.5	15.9	-6.4	8.8	-1.4	-0.1	-1.4	22.0	-0.7
<i>Construction Materials</i>	4.1	-3.2	-38.3	-0.1	15.2	31.2	10.1	-4.4	9.8
<i>Iron &amp; Steel Products</i>	3.3	-2.4	-31.5	-5.6	19.0	28.7	4.5	12.7	42.9
<i>Transportation Equipments</i>	16.4	-26.5	-54.1	61.0	62.1	100.9	87.8	95.2	74.2
<i>Others</i>	18.7	0.2	0.9	-14.9	7.9	20.6	27.9	35.2	44.0

Note: The manufacturing production index accounts for 62 percent of the 1995 manufacturing sector value added.

Source: Bank of Thailand

**Table 4: Key Private Investment Indicators**

	1999									
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Private investment index	-73.3	-49.6	-16.7	41.3	148.9	259.1	486.2	725.7	1035.6	1210.5
<i>(% changes of 12-month MA)</i>	21.0	18.6	-16.2	-14.5	-10.9	-9.0	-7.0	-5.0	0.0	0.0
<i>Import value of capital goods (baht)</i>	-15.0	-2.3	-9.3	9.8	-7.6	12.7	18.9	28.9	39.7	na
<i>Import value of capital goods (US\$)</i>	-5.4	2.9	-4.7	25.5	3.1	23.2	21.2	24.5	31.4	na
<i>Domestic cement consumption</i>	-12.7	-12.7	-15.2	3.0	5.6	-7.3	1.3	-14.3	-0.6	14.6
<i>Commercial banks' credit for industry</i>	-4.4	-2.9	-3.7	-3.2	-1.6	-1.8	-2.2	-2.5	-0.3	na
<i>Commercial banks' credit for construction</i>	3.6	7.1	5.6	0.5	3.0	5.7	na	0.6	0.6	na

Source: Bank of Thailand

**Table 5: Capacity Utilization**  
(percent)

	Weight	1996	1997	1998	1998	1998	1999			
					Q3	Q4	Q1	Q2	Q3	Q4
Total capacity utilization	44.8	72.4	65.0	52.1	51.0	53.6	61.9	61.7	61.8	61.5
<i>Foods</i>	3.6	37.3	37.5	33.7	22.7	33.5	67.3	33.8	30.9	38.2
<i>Beverages</i>	5.7	83	79.1	77.2	77.8	94.4	79.3	103.8	108.1	103.3
<i>Tobacco</i>	1.9	84.2	75.8	60.4	53.1	57.4	59.8	56.8	49.9	52.7
<i>Construction materials</i>	4.3	72	72.9	44.6	38.6	39.5	50.6	51.3	55.8	43.9
<i>Iron and steel</i>	..	..	51.9	32.4	..	30.9	30.3	33.0	37.2	36.0
<i>Transportation equipment</i>	10.5	67.6	48.6	24.0	24.6	25.9	28.5	31.9	39.9	40.4
<i>Petroleum products</i>	7.4	85.7	90.1	83.9	85.3	79.8	86.8	89.4	85.5	85.0
<i>Others</i>	11.6	71.9	64.6	54.5	53.2	54.6	52.0	54.8	61.4	62.3

Note: Capacity utilization of 44.5 percent of the 1995 manufacturing sector value added.

Source: Bank of Thailand

**Table 6: Changes in Consumer Prices**  
(year-on-year % changes)

	1999											
	Jan	Feb	Mar	April	May	Jun	July	Aug	Sept	Oct	Nov	Dec
<b>All commodities</b>	<b>3.5</b>	<b>2.9</b>	<b>1.6</b>	<b>0.4</b>	<b>-0.5</b>	<b>-1.2</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-0.8</b>	<b>-0.5</b>	<b>0.0</b>	<b>0.7</b>
<b>Food and beverages</b>	<b>4.7</b>	<b>3.4</b>	<b>0.9</b>	<b>-0.3</b>	<b>-1.4</b>	<b>-2.0</b>	<b>-2.3</b>	<b>-3.1</b>	<b>-3.1</b>	<b>-2.7</b>	<b>-1.7</b>	<b>-1.8</b>
Rice and cereal products	-4.7	-12.8	-15.5	-16.5	-18.1	-18.5	-19.0	-18.4	-16.6	-14.1	-11.4	-7.4
Meat, poultry and fish	7.0	6.7	5.0	5.2	5.4	4.9	4.2	3.2	1.3	-1.0	-0.2	-0.3
Vegetables and fruits	9.1	9.2	-4.9	-9.3	-14.7	-15.8	-17.1	-17.6	-16.8	-11.8	-6.1	-9.4
Eggs and milk products	11.4	9.8	8.1	3.6	0.6	-2.7	-3.1	-3.9	-4.7	-5.0	-5.2	-4.2
Other food bought from the market	9.5	7.0	6.7	5.1	4.4	2.9	2.4	1.0	-0.1	-1.9	-2.8	-6.1
Non-alcoholic beverages	9.7	9.1	8.6	7.0	7.1	3.2	1.9	-1.5	-1.9	-2.3	-2.3	-2.4
Prepared food	3.1	2.9	2.3	2.1	2.1	2.1	2.1	1.6	1.5	1.5	1.4	1.4
<b>Clothing</b>	<b>3.9</b>	<b>3.8</b>	<b>2.8</b>	<b>1.4</b>	<b>1.0</b>	<b>0.2</b>	<b>-0.2</b>	<b>0.6</b>	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>
Men's and boys'	3.6	3.4	1.8	-0.2	-0.6	-0.8	-1.0	0.4	0.2	-0.2	-0.2	-0.1
Women's and girls'	4.2	4.1	3.4	2.2	1.7	0.5	-0.3	-0.1	-0.2	-0.1	-0.2	-0.1
Cloth and sewing services	3.8	4.1	4.7	4.9	4.3	3.7	3.3	3.1	3.1	3.3	3.5	3.4
<b>Housing and furnishing</b>	<b>2.8</b>	<b>2.5</b>	<b>2.4</b>	<b>0.8</b>	<b>-0.7</b>	<b>-1.0</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.3</b>	<b>-1.3</b>	<b>0.5</b>
Shelter	0.7	0.4	0.5	0.6	0.6	0.4	0.3	0.4	0.4	0.3	0.4	0.3
Furniture and equipment	3.5	3.1	1.2	0.0	-0.1	-0.7	-1.0	-1.1	-1.2	-1.4	-1.6	-1.0
Housekeeping and cleaning supplies	0.0	-0.9	-1.6	-4.4	-5.0	-4.5	-8.0	-7.6	-7.5	-6.8	-5.9	-5.0
Household textiles	2.5	1.7	1.6	2.1	1.6	1.5	1.3	1.2	1.3	1.2	1.1	1.1
Electricity, fuel and water	11.1	11.1	10.1	2.7	-3.8	-5.0	-4.6	-5.1	-4.9	-4.9	-4.8	2.7
<b>Personal and medical care</b>	<b>6.4</b>	<b>6.1</b>	<b>5.3</b>	<b>3.9</b>	<b>3.3</b>	<b>2.4</b>	<b>2.3</b>	<b>1.9</b>	<b>1.2</b>	<b>1.1</b>	<b>1.5</b>	<b>2.2</b>
Medical care	2.0	2.1	2.5	2.5	2.4	2.4	3.4	3.2	2.5	2.5	2.3	2.3
Personal care	11.6	10.6	8.6	5.5	4.5	2.2	0.9	0.5	-0.2	-0.5	0.5	2.0
<b>Transportation and communication</b>	<b>-0.4</b>	<b>-1.0</b>	<b>-0.9</b>	<b>-1.1</b>	<b>-1.4</b>	<b>-1.7</b>	<b>-0.3</b>	<b>1.5</b>	<b>3.7</b>	<b>4.0</b>	<b>4.9</b>	<b>6.9</b>
Vehicles	-5.3	-6.1	-4.2	-2.3	-2.7	-2.8	-0.5	1.9	5.6	6.1	7.5	10.6
Public transportation	11.2	11.4	5.1	2.6	2.5	1.4	1.5	1.5	1.2	0.7	0.7	0.4
Communication and equipment	8.8	8.8	8.9	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
<b>Recreation and education</b>	<b>3.1</b>	<b>2.8</b>	<b>2.0</b>	<b>1.5</b>	<b>-0.2</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.3</b>	<b>-0.4</b>	<b>-0.3</b>	<b>-0.5</b>
Recreation	4.8	4.3	2.8	1.4	1.5	0.9	0.8	0.9	1.3	1.2	1.3	1.1
Reading and education	1.2	1.2	1.1	1.0	-2.0	-2.0	-2.0	-1.9	-2.0	-2.0	-2.0	-2.1
Tobacco and alcoholic beverages	10.0	9.7	6.7	3.7	2.4	0.0	1.0	1.4	1.2	2.6	2.2	2.0
<b>Non-food and beverages</b>	<b>2.9</b>	<b>2.5</b>	<b>2.1</b>	<b>0.8</b>	<b>-0.1</b>	<b>-0.7</b>	<b>-0.3</b>	<b>0.2</b>	<b>0.7</b>	<b>0.8</b>	<b>1.1</b>	<b>2.2</b>

Source: Bank of Thailand

**Table 7: Net Capital Flows to the Private Sector 1/**  
(million US\$)

	1996	1997	1998	1998			1999		
				H1	Q3 <sup>P</sup>	Q4 <sup>P</sup>	Q1 <sup>c</sup>	Q2 <sup>c</sup>	Q3 <sup>c</sup>
<b>Bank</b>	<b>5,002</b>	<b>-6,640</b>	<b>-13,944</b>	<b>-225,944</b>	<b>-179,801</b>	<b>-155,011</b>	<b>-196,562</b>	<b>-79,888</b>	<b>-100,652</b>
Commercial bank	428	-4,727	-4,310	-41,482	-100,350	-26,515	-125,372	15,319	17,349
of which Recapitalization	n.a.	0	1,986	85,757	0	0	783	44,865	16,116
BIBFs	4,574	-1,913	-9,634	-184,462	-79,450	-128,496	-71,189	-95,207	-118,001
<b>Non-bank</b>	<b>13,170</b>	<b>-1,912</b>	<b>-2,024</b>	<b>-62,188</b>	<b>51,411</b>	<b>-81,404</b>	<b>-17,183</b>	<b>-30,865</b>	<b>-265</b>
Direct investment	1,453	3,201	4,688	107,587	49,996	35,962	33,514	29,240	31,689
Foreign direct investment 2/	2,268	3,641	4,810	108,173	51,226	38,867	36,968	36,565	32,255
Thai direct investment abroad	-815	-440	-123	-586	-1,230	-2,905	-3,454	-7,325	-566
Others loans	5,446	-3,783	-4,279	-129,236	-30,257	-25,210	-45,934	-40,356	-57,573
Portfolio investment	3,482	4,494	539	22,951	-696	2,286	8,196	10,745	5,345
Equity securities	1,122	3,869	354	15,428	-3,158	4,562	8,528	10,674	6,843
Debt securities	2,360	625	185	7,523	2,462	-2,276	-332	71	-1,498
Non-resident baht account	2,911	-5,839	-2,714	-57,027	32,375	-90,782	-11,675	-39,883	15,815
Trade credits	-146	-242	-494	-12,445	-6,557	-2,106	67	8,611	3,330
Others	25	256	237	5,982	6,550	-1,554	-1,350	778	1,129
<b>Total</b>	<b>18,172</b>	<b>-8,552</b>	<b>-15,967</b>	<b>-288,132</b>	<b>-128,390</b>	<b>-236,415</b>	<b>-213,744</b>	<b>-110,753</b>	<b>-100,917</b>

Source: Bank of Thailand and own calculations

1/ Data is from BOT's Monthly Bulletin (January), converted into US dollars.

2/ Excluding \$2.1 billion in bank recapitalization. BOT will eventually update their tables so that the FDI figures for 1998 is consistently in the \$7 billion range.

**Table 8: Trade Indexes and Terms of Trade 1/**

1995=100	1997		(in terms of US\$)										
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
<b>Exports:</b>													
Export unit value	105.3	109.7	109.6	108.9	108.0	107.2	106.5	105.7	104.7	103.7	101.9	99.7	97.6
Export value	101.8	98.0	90.7	105.1	91.8	102.7	99.9	102.1	103.1	107.4	110.7	103.0	106.9
Export volume	96.7	89.3	82.8	96.5	85.0	95.8	93.8	96.6	98.5	103.5	108.7	103.3	109.6
<b>Imports:</b>													
Import unit value	107.4	112.7	112.5	111.9	110.2	108.2	108.1	106.3	105.4	103.8	103.8	103.6	101.9
Import value	86.8	103.1	85.7	98.0	99.1	91.8	94.8	89.9	91.0	81.3	77.1	67.2	67.1
Import volume 2/	80.8	91.5	76.2	87.6	90.0	84.8	87.7	84.6	86.4	78.3	74.3	64.8	65.9
<b>Terms of trade</b>	<b>98.0</b>	<b>97.3</b>	<b>97.4</b>	<b>97.3</b>	<b>98.0</b>	<b>99.0</b>	<b>98.6</b>	<b>99.4</b>	<b>99.4</b>	<b>99.8</b>	<b>98.2</b>	<b>96.2</b>	<b>95.8</b>
	<b>1998</b>												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
<b>Exports:</b>													
Export unit value	90.7	94.2	93.0	92.1	91.2	90.8	89.6	89.9	90.7	90.7	89.1	88.7	89.0
Export value	94.9	90.2	93.7	101.4	91.6	90.5	96.7	98.2	91.0	96.3	96.7	94.3	97.8
Export volume	104.6	95.8	100.8	110.1	100.5	99.7	107.9	109.2	100.4	106.1	108.6	106.4	109.9
<b>Imports:</b>													
Import unit value	98.0	100.6	101.1	102.0	102.4	101.2	98.6	97.4	94.7	93.5	94.1	94.8	94.9
Import value	57.7	56.6	54.7	61.2	60.4	55.3	60.8	61.2	56.2	55.0	58.0	57.0	56.5
Import volume 2/	59.0	56.3	54.2	60.0	59.0	54.7	61.6	62.8	59.3	58.9	61.6	60.1	59.5
<b>Terms of trade</b>	<b>92.7</b>	<b>93.6</b>	<b>92.0</b>	<b>90.2</b>	<b>89.0</b>	<b>89.7</b>	<b>90.9</b>	<b>92.3</b>	<b>95.7</b>	<b>97.0</b>	<b>94.7</b>	<b>93.5</b>	<b>93.8</b>
	<b>1999</b>												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
<b>Exports:</b>													
Export unit value	90.5	90.9	91.4	90.5	88.3	88.8	86.9	85.0	84.7	83.0			
Export value	85.7	87.8	99.8	94.2	98.2	102.3	105.3	104.7	106.6	114.8			
Export volume	94.7	96.7	109.2	104.1	111.2	115.3	121.1	123.3	125.8	138.3			
<b>Imports:</b>													
Import unit value	93.9	92.1	90.4	89.4	91.4	92.6	92.5	93.2	94.3	95.6			
Import value	54.4	53.6	62.9	62.8	61.3	73.1	66.8	70.2	73.2	73.7			
Import volume 2/	57.9	58.2	69.6	70.3	67.1	78.9	72.3	75.4	77.7	77.1			
<b>Terms of trade</b>	<b>96.4</b>	<b>98.6</b>	<b>101.1</b>	<b>101.3</b>	<b>96.7</b>	<b>95.9</b>	<b>94.0</b>	<b>91.2</b>	<b>89.9</b>	<b>86.9</b>			

Source: Bank of Thailand

1/ From January 1996 onwards, base year was 1995 (1995=100) and the indexes are calculated using the Fisher chained method.

2/ Volume indexes are calculated based on the "factor reversal test".

**Table 9: Exports**  
(year-on-year percentage changes in terms of US dollars)

	% of Total Exports (Jan- Jun 1999)	1996	1997	1998	1998 Q2	Q3	Q4	1999 Q1	Q2	Q3
<b>Agricultural products</b>	<b>8.5</b>	<b>2.5</b>	<b>-9.5</b>	<b>-15.6</b>	<b>-20.9</b>	<b>-22.4</b>	<b>-15.3</b>	<b>-19.6</b>	<b>-4.5</b>	<b>1.6</b>
<b>Fishery products</b>	<b>3.3</b>	<b>-12.3</b>	<b>-7.6</b>	<b>-7.0</b>	<b>-13.4</b>	<b>-20.9</b>	<b>1.2</b>	<b>-18.3</b>	<b>-10.0</b>	<b>18.6</b>
Others	3.6	26.2	61.3	22.1	41.6	21.4	-10.0	-12.8	-24.9	3.1
<b>Manufactured goods</b>	<b>84.6</b>	<b>-1.7</b>	<b>5.6</b>	<b>-7.2</b>	<b>-5.6</b>	<b>-8.0</b>	<b>-9.8</b>	<b>-1.9</b>	<b>9.5</b>	<b>10.5</b>
Labor intensive goods	13.0	-17.1	-7.4	-12.5	-12.4	-11.4	-12.5	-3.6	1.9	2.8
High tech products	57.1	4.1	10.7	-2.8	-0.3	-3.3	-6.2	1.4	10.8	11.2
Resource based manufactured products	9.6	3.3	-0.1	-12.6	-13.5	-12.9	-10.1	-4.2	19.5	18.2
Other manufactured goods	5.0	-4.6	7.6	-23.2	-21.4	-29.8	-33.1	-24.1	-1.3	12.0
<b>TOTAL EXPORTS</b>	<b>100.0</b>	<b>-1.3</b>	<b>4.4</b>	<b>-7.1</b>	<b>-6.1</b>	<b>-9.1</b>	<b>-9.9</b>	<b>-4.9</b>	<b>5.9</b>	<b>9.7</b>

P/ Preliminary

e/ Estimate

Source: Bank of Thailand

**Table 10: External Debt 1/**

(million US\$)

	1996	1997	1998				1999	
			Q1	Q2	Q3	Q4	H1 <sup>F</sup>	Q3 <sup>F</sup>
<b>Total Debt Stocks (End of Period)</b>								
<b>Public Sector</b>	<b>16,805</b>	<b>24,323</b>	<b>26,814</b>	<b>26,963</b>	<b>28,556</b>	<b>31,509</b>	<b>33,890</b>	<b>35,726</b>
<b>Govt and SOEs</b>	<b>16,805</b>	<b>17,166</b>	<b>17,695</b>	<b>17,524</b>	<b>18,268</b>	<b>20,305</b>	<b>21,987</b>	<b>23,024</b>
Long-term	16,751	17,146	17,675	17,504	18,118	20,155	21,857	22,894
Short-term <sup>1</sup>	54	20	20	20	150	150	130	130
<b>BOT (long term)</b>	<b>0</b>	<b>7,157</b>	<b>9,119</b>	<b>9,439</b>	<b>10,288</b>	<b>11,204</b>	<b>11,903</b>	<b>12,702</b>
Use of IMF credit	0	2,429	2,672	2,796	3,017	3,239	3,344	3,470
Others	0	4,728	6,447	6,643	7,271	7,965	8,559	9,232
<b>Private Sector</b>	<b>73,731</b>	<b>69,093</b>	<b>64,922</b>	<b>61,163</b>	<b>58,136</b>	<b>54,650</b>	<b>46,765</b>	<b>43,008</b>
Long-term	36,172	34,277	33,575	32,827	32,192	31,278	29,328	27,450
Short-term	37,559	34,816	31,347	28,336	25,944	23,372	17,437	15,558
Commercial Bank	10,682	9,488	9,147	8,747	7,823	7,059	6,135	5,997
Long-term	2,314	3,824	3,167	3,971	3,638	3,738	3,447	3,179
Short-term	8,368	5,664	5,980	4,776	4,185	3,321	2,688	2,818
BIBF <sup>2</sup>	31,187	30,079	27,819	25,679	23,679	21,892	16,577	14,260
Long-term	10,697	10,317	9,820	8,236	7,843	6,946	5,676	5,045
Short-term	20,490	19,762	17,999	17,443	15,836	14,946	10,901	9,215
Non-Bank <sup>3</sup>	31,862	29,526	27,956	26,737	26,634	25,700	24,053	22,751
Long-term	23,161	20,136	20,588	20,620	20,711	20,594	20,205	19,226
Short-term	8,701	9,390	7,368	6,117	5,923	5,106	3,848	3,525
<b>Total</b>	<b>90,536</b>	<b>93,416</b>	<b>91,736</b>	<b>88,126</b>	<b>86,692</b>	<b>86,159</b>	<b>80,655</b>	<b>78,734</b>
Long-term	52,923	58,580	60,369	59,770	60,598	62,637	63,088	63,046
Short-term <sup>1</sup>	37,613	34,836	31,367	28,356	26,094	23,522	17,567	15,688
<b>Bank foreign assets</b>	<b>7,362</b>	<b>8,887</b>	<b>8,744</b>	<b>11,201</b>	<b>12,564</b>	<b>12,836</b>	<b>15,799</b>	<b>14,133</b>
<b>Gross official reserves</b>	<b>38,725</b>	<b>26,968</b>	<b>27,680</b>	<b>26,572</b>	<b>27,291</b>	<b>29,536</b>	<b>31,434</b>	<b>32,362</b>
<b>Debt Service Payments</b>	<b>9,024</b>	<b>11,630</b>	<b>3,218</b>	<b>3,017</b>	<b>4,027</b>	<b>3,391</b>	<b>3,357</b>	<b>4646</b>
Principal	3,822	6,072	1,894	1,673	2,664	2,090	2,351	3555
Interest	5,202	5,558	1,324	1,344	1,363	1,300	1,006	1091
Public sector	1,845	1,959	514	496	656	517	624	994
Private sector	7,179	9,671	2,704	2,521	3,371	2,873	2,733	3652
<b>Export of goods and services</b>	<b>73,497</b>	<b>74,431</b>	<b>16,833</b>	<b>16,291</b>	<b>16,624</b>	<b>17,533</b>	<b>17,659</b>	<b>18386</b>
<b>Debt Service Ratio</b>	<b>12</b>	<b>16</b>	<b>19</b>	<b>19</b>	<b>24</b>	<b>19</b>	<b>19</b>	<b>25.3</b>

Source: Bank of Thailand

1/ Short-term external debt is defined as debt that has an original maturity of one year or less.

2/ BIBF's debt, which was compiled according to remaining maturity since the establishment of BIBF's activities in 1993 has been adjusted to original maturity basis since January, 1996, consistent with other external debt items.

3/ Non-bank debt is adjusted back to January 1997 based on the result of March 1998 survey and December 1997 bond data from IMF.

Notes: 1. The revised definition of private sector debt has been made since 1986. It consists of three parts, namely commercial bank, BIBF and non-bank debt. 2. Total monetary authority debt includes the use of IMF credits and bilateral loans under IMF package. Structural Adjustment Loans (SAL) of World Bank and Asian Development Bank under the same package, however, are included in public sector debt. 3. Debt service payments in private sector has also been revised to include principal and interest payments on BOT debt since 1986.



**Table 11: Central Government Balance**

(million baht)

	CY1996	CY1997	CY1998	1999					
				Q1	Q2	Q3	Sep	Oct	Nov
Revenue(+)	853,201	847,696	717,779	179,600	189,473	178,567	62,819	46,522	59,943
Expenditures(-)	819,083	874,403	842,581	183,502	212,186	215,442	89,743	59,726	91,459
Budgetary deficit(-) or surplus(+)	34,118	-27,914	-124,802	-3,902	-22,713	-36,875	-26,924	-13,204	-31,516
Non-budgetary deficit / surplus(+)	9,185	12,855	-4,150	3,791	-23,020	-10,867	-6,653	2,016	-1,901
Cash deficit(-) or surplus(+)	43,303	-15,059	-128,952	-111	-45,733	-47,742	-33,577	-11,188	-33,417
Financing:									
Net domestic borrowings(+):	-25,123	-16,380	-3,081	6,013	10,062	22,778	17,948	-1,867	23,052
- Bank of Thailand 1/	2,054	-5,800	2,482	7,253	-7,176	3,571	2,958	-1,853	5,893
- Commercial banks	-21,320	-710	-1,651	-965	1,065	14,016	13,063	-1,189	6,083
- Government Savings Bank	-3,570	-8,200	-3,000	0	0	1,758	1,758	-119	-792
- Others	-2,287	-1,670	-912	-275	16,173	3,433	169	1,294	11,868
Net foreign borrowings (+)	-3,665	-3,747	-4,403	-1,550	47,343	-7,370	-897	-320	-302
Government Pension Fund	-	-55,991	-280	0	0	0	0	0	0
Gov't Bond for FIDF	0	0	400,000	102,383	101,408	1,111	925	2,679	6,762
Lending to FIDF	0	0	-400,000	-102,383	-101,408	-1,111	-925	-2,679	-6,762
Use of Treasury cash balances(+)	-14,515	91,177	136,715	-4,352	-11,673	32,334	16,526	13,375	10,667

Source : Comptroller-General's Department and the Bank of Thailand

1/ Including Exchange Equalization Fund.

The budgetary deficit/surplus is the balance between revenue and expenditure from the current year budget and carryover expenditure from the previous two budgets. The overall balance is a cash balance, which is composed of the budgetary balance and the non-budgetary balance. The non-budgetary balance, reported above the line, represents mainly changes in deposits of government agencies at the Ministry of Finance which are of revenue-related and expenditure-related types.

**Table 12: Budget Appropriation for FY 2000 by Economic Services**  
(million baht)

	Amount	ratio to budget	+/-	%
<b>Total</b>	<b>860,000</b>	<b>100.0</b>	<b>35,000</b>	<b>4.2</b>
1. Agriculture	66,656.9	7.7	5,224.6	8.5
2. Industry and mining	3,670.8	0.4	429.3	13.2
3. Transportation and Communication	59,907.5	7.0	-4,982.9	-7.7
4. Commerce and Tourism	5,615.7	0.7	-1,,79.3	-17.4
5. Sciences and Technology	15,240.5	1.8	2,609.0	20.7
6. Education	222,401.3	25.9	13,785.2	6.6
7. Public Health	65,760.2	7.6	3,292.8	5.3
8. Social and Public Welfare	93,646.2	10.9	-5,011.6	-5.1
9. Defense	88,608.6	10.3	1,690.2	1.9
10. Internal security	43,648.9	5.1	-905.7	-2.0
11. Public administration	115,777.1	13.5	16,183.7	16.3
12. Loan payment	79,066.3	9.2	3,864.7	5.1

Source: Government Spokesman Bureau

**Table 13: Budget Appropriation for FY 2000 by Ministry**  
(million baht)

	amount	ratio to budget	+/-	%
<b>Total</b>	<b>860,000</b>	<b>100.0</b>	<b>35,000.0</b>	<b>4.2</b>
1. Central fund	82,920.4	9.6	6,009.9	7.8
2. Office of the PM	8,003.8	0.9	998.8	14.3
3. Defense	77,299.8	9.0	232.9	0.3
4. Finance	76,961.5	9.0	1,747.3	2.3
5. Foreign Affairs	3,943.4	0.5	-163.2	-4.0
6. Agriculture	70,668.2	8.2	5,260.3	8.0
7. Transport and Communications	51,244.2	6.0	-5,679.6	-10.0
8. Commerce	4,359.1	0.5	416.6	10.6
9. Interior	93,209.4	10.8	-4,727.5	-4.8
10. Labor and Social Welfare	17,546.6	2.0	6,419.4	57.7
11. Justice	180.4	0.02	-4,887.7	-96.4
12. Sciences, Technology and Env.	13,886.7	1.6	2,641.9	23.5
13. Education	159,261.4	18.5	7,509.3	4.9
14. Public Health	59,183.6	6.9	2,012.3	3.5
15. Industry	4,483.0	0.5	602.2	15.5
16. University Affairs	34,420.0	4.0	151.8	0.4
17. Others except Office of the PM	47,025.7	5.5	4,432.9	10.4
18. State enterprises	24,326.8	2.8	3,266.4	15.5
19. Revolving fund	30,010.0	3.5	7,690.0	34.5
20. Independent agencies in line with the Constitution	1,066.0	0.1	1,066.0	100.0

Source: Government Spokesman Bureau

**Table 14: Public Sector Debt**  
(billion baht)

	Central government			State-owned enterprises				BOT		Total		
	Domestic debt	<i>Of which: loan for FIDF and financial restructu- ring</i>	External debt	Domestic debt	Non-guarante ed domestic debt	External debt	Non-guarant eed external debt	Total	External debt (US\$)	External debt (baht)	Total debt	% of GDP
1979	90,166	..	23,210	..	..	32,181	121	32,302	..	..	..	..
1980	109,781	..	30,035	..	..	49,879	1,235	51,114	..	..	..	..
1981	127,455	..	41,383	..	..	72,880	2,757	75,637	..	..	..	..
1982	160,372	..	49,132	..	..	89,604	57	89,661	..	..	..	..
1983	185,815	..	56,717	..	..	101,430	91	101,522	..	..	..	..
1984	219,143	..	73,779	..	..	128,059	119	128,178	..	..	421,101	42.6%
1985	249,253	..	101,883	..	..	154,537	2,722	157,259	..	..	508,395	48.1%
1986	301,235	..	112,361	..	..	160,729	..	160,729	1,069	27,933	602,258	53.1%
1987	322,122	..	129,606	..	..	194,772	..	194,772	973	24,393	670,893	51.6%
1988	304,878	..	133,567	..	..	184,792	..	184,792	672	16,961	640,199	41.0%
1989	291,255	..	127,168	..	..	187,214	..	187,214	275	7,065	612,701	33.0%
1990	278,346	..	93,608	16,594	1,595	223,273	..	241,462	1	25	613,441	28.1%
1991	230,109	..	95,749	49,367	1,269	228,037	..	278,674	0	0	604,531	24.1%
1992	202,694	..	97,567	62,938	13,245	235,928	..	312,111	0	0	612,372	21.6%
1993	161,071	..	104,102	109,694	25,254	257,826	..	392,773	0	0	657,946	20.8%
1994	103,200	..	116,629	159,815	30,589	277,635	..	468,039	0	0	687,868	18.9%
1995	72,696	..	120,934	208,690	29,589	292,232	..	530,511	0	0	724,141	17.3%
1996	44,254	..	131,340	239,690	38,678	266,572	..	544,940	0	0	720,534	15.7%
1997	31,755	..	267,792	247,259	46,510	476,717	..	770,487	7,157	338,168	1,408,202	29.2%
1998	426,928	400,000	247,104	255,696	44,910	443,825	..	744,431	11,204	413,091	1,831,554	38.2%
99Q1	528,869	502,383	323,682	266,506	44,910	485,896	..	797,312	11,286	423,789	2,073,653	39.6%
99Q2	580,652	537,251	319,255	265,598	42,689	492,286	..	800,573	11,903	439,340	2,139,819	45.8
99Q3	598,728	537,553	359,635	284,360	42,689	558,650	..	885,699	12,702	506,604	2,350,666	50.3

Source: MOF, BOT, NESDB, NSO, and author's calculations

Note: 1999 nominal GDP figure used in calculating percentage of debt to GDP in 1999 is based on 4.0% year-on-year growth of real GDP in 1999.

**Table 15: Progress in Corporate Restructuring**  
*billion baht*

	<i>In Process</i>									<i>Completed</i>								
	Jun	Dec	Jan	Feb	Mar	Apr	May	June	July	Jun	Dec	Jan	Feb	Mar	Apr	May	June	July
<b>Mfg</b>	131	296	311	326	328	363	365	410	436	2	51	66	75	95	119	131	182	196
<b>Const.</b>	6	20	19	21	25	26	26	42	47		3	3	5	9	10	12	15	17
<b>Real Est.</b>	29	115	122	124	142	148	148	183	221	0	34	36	39	44	58	65	81	96
<b>Exports</b>	6	17	19	19	20	22	22	23	27		5	8	8	8	10	11	17	17
<b>Services</b>		58	62	62	66	76	74	104	115		20	22	25	34	64	72	81	89
<b>Others</b>	45	184	184	195	209	182	190	269	319	1	44	52	64	91	123	139	190	214
<b>Total</b>	217	690	717	747	790	817	825	1031	1165	3	157	187	216	281	384	430	566	629

Source: Bank of Thailand

**Table 16: Bankruptcy Reorganization in Process**

<b>Firm</b>	<b>Sector</b>	<b>Total Debt Petitioned  Bt Million</b>	<b>Date of Petition</b>	<b>Plan submission/approval</b>	<b>Creditor or Debtor- appointed planner</b>
Alphatec Electronics	Electronics	17,220	May 98	Approved Feb 99	Creditor: BBL + others
Thai Modern Plastics	Plastic pkg.	20,450	August 98	Approved April 99	Creditor: TFB, TMB
Manager Media	Publish.	2,737	October 98	Approved July 99	Creditor: Multiple
Thai Identity Sugar	Sugar Mill	7,130	December 98	Due August 99	Creditor: Krung Thai + others
Kaset Thai Sugar	Sugar Mill	10,808	December 98	Due August 99	Creditor: Krung Thai + others
Ruampol Sugar	Sugar Mill	4,865	December 98	Due August 99	Creditor: Krung Thai + others
Lime Quality Company	Construction Material	714	December 98	Approved July 99	Debtor
Thai Gypsum	Construction Material	6,020	February 99	July 99	Creditor
Presicso Pro Packaging	Plastic pkg.	702	March 99		Debtor
Thai Phatana Steel	Smelter	4,137	April 99		Debtor
Sri Thai Superware	Plastic products	6,477	April 27, 1999		Mutually agreed
Kasemkij Construction	Const.	5,065	April 30, 1999		Debtor
Namprasert Construction	Const.	1,877	April 30, 1999		Debtor
Panjapol Pulp	Paper / Pulp	2,656	May 17		Debtor
Panjapol Paper	Paper/ Pulp	3,142	May 18		Debtor
High Pressure Steel Pipe	Steel pipe	4,700	May 28		Creditor: Phatra- Thanakit N/A
Tonping	Resort	500	June 3		
SVOA	Comput. Distrib.	6,000	June 21		Mutually agreed
Suranakorn Muangmai	Agr. Market	117	July 8		Debtor
Siam Steel	Furniture	2,922	July 19		Creditor : HBSC
Thai German	Stainless	10,254	Aug 4		Debtor
Thai Precision	Alum.	719	Aug 16		Creditor: BBL
<i>22 cases</i>					
		<i>Bt 120 billion</i>			
		<i>(\$3.2 billion)</i>			

Source: Ministry of Justice

Table 17: Key Social Indicators

	Latest data (date)	Previous Period (date)
<b>Human Development</b>	<b>1997-98</b>	<b>1994-95</b>
Primary enrollment rate (gross) <sup>1</sup>	91.4	91.0
Male	93.1	92.3
Female	90.0	89.0
Secondary enrollment rate (gross) <sup>1</sup>	60.3	60.0
Male	58.0	58.4
Female	63.0	61.0
Tertiary enrolment rate <sup>1</sup>	21.0	19.3
Male	19.0	18.0
Female	23.1	21.0
Infant mortality rate <sup>2</sup>	26.1 (1995-96)	34.5 (1991)
<b>Poverty and Income Distribution<sup>3</sup></b>	<b>1998</b>	<b>1996</b>
National Headcount Index (% of population)	13.0	11.4
Gini Index (based on per capita expenditure)	0.415	0.439
<b>Government Expenditure<sup>4</sup></b>	<b>(Billion Baht)</b>	<b>(Billion Baht)</b>
<b>(budget allocations)</b>	<b>FY98</b>	<b>FY97</b>
Nominal Health (% of total)	73.0	71.3
Real Health (1994=100)	60.3	57.1
Nominal Education (% of total)	219.7	203.8
Real Education (1994=100)	172.4	171.9
<b>Labor Market</b>	<b>May 1999</b>	<b>May 1998</b>
Unemployment rate (%) <sup>5</sup>	5.6	5.3
Female	47.0	47.0
Participation rate (%) <sup>6</sup>		
Female	69.0	68.0
Male	87.0	86.0
Share of female employment in total wage employment	40.3	39.6
Strike incidents/workers involved during year	2/685 (1998) <sup>7</sup>	20/14,130 (1997)
Real wages (% change)	-	-
Female/Male nominal wage ratio (%)		
Private sector	83.3	
Government sector	100.4	

1. Office of the National Education Commission.
2. NESDB/ADB, "Health and Nutrition in Thailand", Volume 3, Number 3: July 1999. Estimates obtained from the Survey of Population Change.
3. NESDB/ADB, "Poverty and Inequality During the Economic Crisis in Thailand", Volume 3, Number 1: January 1999. Estimates obtained from the Social and Economic Survey.
4. Bureau of Budget, Sectoral budget classification.
5. National Statistics Office Labor Force Survey.
6. Calculated as number of female in the labor force as percentage of females between the ages of 13 and 59.
7. Bank of Thailand, Key economic indicators, June 30, 1999.

**Table18: Summary Table on Unemployment**

(thousands)

Labor force status	Aug-96 Total	Feb-97 Total	Aug-97 Total <sup>1/</sup>	Feb-98 Total	May-98 Total	Aug-98 Total	Feb-99 Total	May-99 Total	Aug-99 Total
Total Population	60,045	60,351	60,649	60,949	61,098	61,248	61,551	61,704	61,857
Total labor force	32,750	32,000	33,561	32,143	32,170	33,353	32,810	32,971	33,210
1.Current labor force	32,586	30,964	33,455	30,892	30,168	33,276	31,740	31,591	33,073
1.1 Employed	32,232	30,266	33,162	29,413	28,555	32,138	30,025	29,832	32,087
Underemployed (<20 hours/week) <sup>2</sup>	581	544	721	1,477	363	938	863	753.4	953.8
% of total labor force	1.8	1.7	2.1	4.6	1.1	2.8	2.6	2.3	2.9
% of current labor force	1.8	1.8	2.2	4.8	1.2	2.8	2.7	2.4	2.9
1.2 Unemployed	354	698	293	1,479	1,613	1,138	1,716	1,759	985.7
% of total labor force	1.1	2.2	0.9	4.6	5.0	3.4	5.2	5.3	3.0
% of current labor force	1.1	2.3	0.9	4.8	5.3	3.4	5.4	5.6	3.0
1) Looking for work	110	180	96	403	492	477	476	498.0	326
2) Available / not looking for work	244	518	196	1,077	1,120	662	1,240	1,260.4	659.7
2.Seasonally inactive labor force	164	1,036	106	1,251	2,002	77	1,070	1,380	137.2
% of total labor force	0.5	3.2	0.3	3.9	6.2	0.2	3.3	4.2	0.4
Unemployed + seasonally inactive labor force	518	1,734	398	2,730	3,615	1,215	2,786	3,139	1,123
% of total labor force	1.6	5.4	1.2	8.5	11.2	3.6	8.5	9.5	3.4

Source: Labor Force Survey by National Statistical Office

1/ The May round was skipped in 1997.

2/ Line added by World Bank staff. Underemployment is (arbitrarily) defined here as those employed working less than 20 hours/week.

**Table 19: Assistance to Thailand (Ongoing and Planned) - Financial and Corporate Sectors**

Action Items	Government Counterparts	Donor/ Funding Sources	Description of Assistance
<b>FINANCIAL SECTOR RESTRUCTURING</b>			
<b>Managing Problem Institutions</b>			
Orderly resolution of the 56 closed finance companies	Financial Restructuring Agency	World Bank Asian Development Bank	Advisory and direct technical assistance
Restructuring and recapitalization of the core financial institutions	Bank of Thailand Ministry of Finance	PHRD Funds FSIA	
<b>Strengthening Financial Sector Structure</b>			
Strategy for the future of financial services	Financial Services Task Force Bank of Thailand	World Bank The International Monetary Fund	Research, advisory, and round table discussion
Capital market development	Working Group on Bond Market Development Ministry of Finance Bank of Thailand Securities Exchange Commission Ministry of Labor CGD BDC CGD	World Bank  FSIA ASEM U.S. Treasury Asian Development Bank	Advisory services and workshops
Specialized Financial Institutions (SFIs)	Bank of Thailand Ministry of Finance Ministry of Industry Government Housing Bank Government Savings Bank Bank of Agriculture and Cooperative	World Bank ASEM Asian Development Bank AusAid JICA OECD	Advisory services and technical assistance
SEC Enhance capacity to supervise IT of securities firms Enhance capacity to supervise management of securities firms Strengthening Information Disclosure and Compliance	Securities Exchange Commission	Asian Development Bank World Bank	
<b>Enhancing the Regulatory and Supervisory Regime</b>			
A comprehensive supervision framework	Ministry of Finance Ministry of Industry	World Bank PHRD Japan Development Bank The Shoko Chukin Bank	Advisory on legal advice and best practice, conference, training, technical assistance, reviews, supervision standard and new regulation, Institution design for DIA, drafting assistance
Strengthening supervision and regulation of financial institutions	Bank of Thailand Ministry of Finance	World Bank ASEM PHRD Miyazawa AusAid U.S. Treasury Supplement budget for emergency support for Asian economic crisis	
Develop a limited-deposit insurance scheme to replace the existing blanket guarantee	Bank of Thailand	WB PHRD	
Draft deposit insurance law		ASEM	



**Table 19: Assistance to Thailand (Ongoing and Planned) - Financial and Corporate Sectors (continued)**

Action Items	Government Counterparts	Donor/ Funding Sources	Description of Assistance
<b>CORPORATE RESTRUCTURING</b>			
<b>Strengthening the Legal Framework</b>			
Provide appropriate legislative and institutional frameworks for corporate bankruptcies and reorganizations	Ministry of Justice	WB FSIA	Advisory service and technical assistance
Provide appropriate legislative and institutional framework for secured lending	Ministry of Finance	Asian Development Bank	
<b>Strengthening the Enabling Environment</b>			
Facilitate information sharing among creditors on debt service performance by individual companies	Bank of Thailand	ASEM	Private or corporate technical assistance
Facilitate debt/equity conversions and the efficient sale of distressed financial assets			
Eliminate remaining tax disincentives to corporate restructuring			
<b>Speeding The Restructuring Process</b>			
Debt restructuring monitoring system	CDRAC	ASEM	Framework design, database development, advisory services, training seminars, technical assistance, neutral mediation, research
BOT will review options to resolve disputes among financial institution creditors	Bank of Thailand	PHRD	
Mediation Pilot	Ministry of Finance	EPA	
Develop a clear strategy concerning the position of the Government as a creditor or shareholders of distressed corporates	Ministry of Industry	MITI	
Manual on Legal documentation of debt restructuring		OECD	
Industry Studies / Competitiveness	Ministry of Commerce	Fair Trade Commission	
SME	National Economic and Social Development Board		
	FTI		
	CDPD		
	AFC		
	SIFC		
	BAAC		
	TBA		
<b>Financial Accountability and Corporate Governance</b>			
Strengthen ICAAT/Improve accounting and auditing standard	ICAAT	World Bank (IDF Grant)	Capacity Building
Institutional strengthening of the Thailand Financial Accounting Standard Board	OAG	PHRD (special)	
Institutional strengthening of the Institute of Directors	Stock Exchange of Thailand	ASEM	
Institutional strengthening of Office of Auditor General			

Remark: Details on the Government reform of financial and corporate sectors and partnership with aid agencies can be found at [www.worldbank.org/ta/](http://www.worldbank.org/ta/)

**Table 20: Partners to Thailand's Public Sector Reform Program**

Major Objectives of the Royal Thai Government's Public Sector Reform Program	Responsible Thai Agencies	Multilateral and Bilateral Partners	Nature of Support
<p><b>1. Expenditure management</b></p> <p>The objective of expenditure management reform for Thailand is to delegate the necessary budgetary authority to sector ministries and to hold them accountable for performance. The performance of sector ministries will be measured by their ability to reflect Cabinet priorities in their strategic plans and to deliver promised results. The task of the central agencies – particularly of the Bureau of the Budget -- is to define a new framework of flexibility and accountability for sector ministries and then to enable sector ministries to implement the framework.</p>	<p>Attorney-General's Office</p> <p>Bureau of Budget</p> <p>Comptroller General's Department</p> <p>Office of Civil Service Commission</p>	<p>Asian Development Bank</p> <p>Ausaid</p> <p>Canadian International Development Agency</p> <p>International Monetary Fund</p> <p>New Zealand Official Development Assistance</p> <p>Overseas Economic Cooperation Fund of Japan</p> <p>World Bank</p>	<p>Financial Markets Reform Program Assistance</p> <p>Technical Assistance Grants</p> <p>Governance and Restructuring Assistance</p> <p>Standby Monetary Support</p> <p>Needs Assessment Studies</p> <p>Overseas Training Visits for Senior Public Officials</p> <p>Post-Graduate Scholarships</p> <p>Advisory Services</p>
<p><b>2. Revenue management</b></p> <p>The objectives of the proposed tax administration reforms are to: (i) ensure adequate and sustainable revenue; (ii) improve revenue collection, widen the tax base, and achieve a more equitable distribution of the tax burden; and, (iii) strengthen the managerial capacity of the Revenue Department to perform its functions efficiently and effectively on a sustainable and transparent basis.</p>	<p>Customs Department</p> <p>Revenue Department</p>	<p>World Bank</p> <p>International Monetary Fund</p>	<p>Tax Administration Assistance</p> <p>Customs Administration Studies</p> <p>Technical advice</p>
<p><b>3. Human resource management</b></p> <p>Delivering better services in a cost effective and equitable way is a key objective of the Royal Thai Government's reform program. This will require enhancing the access, timeliness and quality of public services through outsourcing, restructuring or decentralizing activities and being more responsive to clients. Administrative renewal involves modernizing the role, organization, and processes of key line ministries to enhance their performance in delivering services. More efficient use of public resources requires streamlining procedures, eliminating duplicative structures, devolving to local governments administrations or outsourcing activities inappropriate for government involvement to the private sector.</p>	<p>Office of the Civil Service Commission</p> <p>Bureau of the Budget</p> <p>Comptroller General's Department</p> <p>Attorney General's Department</p> <p>AusAid</p>	<p>AusAid</p> <p>World Bank</p>	<p>Short-term Courses for Thai Officials</p>

**Table 20: Partners to Thailand's Public Sector Reform Program (continued)**

Major Objectives of the Royal Thai Government's Public Sector Reform Program	Responsible Thai Agencies	Multilateral and Bilateral Partners	Nature of Support
<p><b>4. Decentralization</b></p> <p>Thailand has identified decentralization as a policy priority in Thailand's 8th National Economic and Social Development Plan. The Constitution features decentralization prominently, specifying principles of local autonomy and elected local representatives, among other aspects of local governance. Objectives envisioned in the Constitution include increasing the share of local governments administrations expenditures, assigning more revenue sources to local governments administrations, revising the system of intergovernmental transfers to provide grants in a more transparent and predictable way, and promoting mechanisms for local accountability</p>	<p><b>Decentralization Commission</b></p> <p><b>Ministry of Interior</b></p> <p><b>National Economic and Social Development Board</b></p>	<p><b>Asia Foundation</b></p> <p><b>German Development Cooperation (GTZ)</b></p> <p><b>United Nations Development Program</b></p> <p><b>World Bank</b></p>	<p>Advisory Services</p> <p>Rural-Urban Development Assistance</p>
<p><b>5. Accountability and Transparency</b></p> <p>Public accountability and transparency are key elements of Thailand's reform strategy to ensure that government institutions, and the civil servants within them, are responsive to public needs, efficient in the use of public funds, and accountable to the public for their actions. Greater of transparency and accountability in managing the affairs of government and public resources are crucial to strengthen citizens' trust in public administration. Supported by the Constitution, Thailand's public sector reform will create the institutions responsible for ensuring public accountability and demonstrate the Government's commitment to fighting corruption.</p>	<p><b>Office of the Civil Service Commission</b></p> <p><b>Office of Official Information Commission</b></p> <p><b>National Counter Corruption Commission</b></p> <p><b>Ombudsman</b></p> <p><b>State Auditors</b></p>	<p><b>AusAid</b></p> <p><b>Canadian International Development Agency</b></p> <p><b>New Zealand Official Development Assistance</b></p> <p><b>United Nations Development Program</b></p> <p><b>The Asia Foundation</b></p> <p><b>Thai Research Fund</b></p> <p><b>World Bank</b></p>	<p>Advisory Services</p> <p>Thematic Workshops, Conferences and Seminars</p> <p>Various research studies on corruption, governance and accountability.</p> <p>Database construction</p> <p>Anti-corruption surveys</p>

**Table 21: Thailand - Key Economic Indicators**

Indicator	Actual			Estimate		Projected		
	1995	1996	1997	1998	1999	2000	2001	2002
<b>National accounts (as % GDP at current market prices)</b>								
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture <sup>a</sup>	9.8	9.6	9.8	11.7	8.8	8.5	8.2	7.9
Industry <sup>a</sup>	58.4	58.8	57.5	54.7	55.9	55.1	54.7	54.1
Services <sup>a</sup>	31.8	31.6	32.7	33.6	35.3	36.4	37.1	38.0
Total Consumption	68.2	68.1	66.9	63.1	68.5	68.9	69.1	70.5
Gross domestic fixed investment	42.2	42.4	33.2	21.4	22.0	23.0	24.1	24.4
Government investment	9.0	10.3	11.5	9.8	9.5	9.3	8.9	8.6
Private investment								
(includes increase in stocks)	33.2	32.1	21.7	11.6	12.5	13.7	15.2	15.8
Exports (GNFS)	42.0	39.4	48.1	58.9	57.2	60.3	64.9	70.0
Imports (GNFS)	52.4	49.9	48.2	43.3	47.8	52.2	58.1	64.8
Gross domestic savings	35.7	35.3	35.2	46.8	40.0	34.9	34.1	31.6
Gross national savings <sup>c</sup>	34.3	33.7	31.1	34.1	31.0	28.7	29.1	28.0
<i>Memorandum Items</i>								
Gross domestic product (US\$ million at current prices)	167995.7	181838.3	150582.1	112209.4	123456.5	125439.4	126380.2	127391.2
Gross national product per capita (US\$, Atlas method)	2,828	3,030	2,485	1,836	1,997	2,013	2,015	2,018
Real annual growth rates (% calculated from 1988 prices)								
Gross domestic product at market prices	8.9	5.9	-1.8	-10.4	4.0	4.0	4.5	5.0
Real annual per capita growth rates (% Calculated from 1988 prices)								
Gross domestic product at market prices	8.0	4.9	-2.7	-11.1	2.8	3.2	3.8	4.3
Total consumption	6.7	6.4	-2.1	-9.5	4.3	5.5	4.8	5.8
Private consumption	7.6	5.8	-1.8	-11.4	2.6	3.6	3.7	4.5
<b>Balance of Payments (US\$m)</b>								
Exports (GNFS)	70578.4	71686.9	72484	66039	70662	75608	82035	89123
Merchandise FOB	55,731	54,677	56,721	52,873	55,600	59,700	64,800	70,400
Imports (GNFS)	88082	90777	72633	48621	58977	65465	73422	82584
Merchandise CIF	63360	70800	61347	40641	46400	54300	60900	68500
Resource Balance	-17504	-19090	-149	17418	11684	10143	8613	6538
Net current transfers (including official current transfers)	487	761	479.04	415	..	..	..	..
Current account balance (after official capital grants)	-13215.0	-14359.9	-3100	14300	11200	7900	7000	5500
Net private foreign investment	1182.6	3000	7300.0	7300.0	6300.0	4400.0	3960.0	3168.0
Long-term loans (net)	41998	53164	56466	59410	..	..	..	..
Official	16881	16929	22324	28113	..	..	..	..
Private	25117	36235	34142	31297	..	..	..	..
Other capital (net, excluding errors and omm)	-2376.2	-3482.6	..	..	..	..	..	..
Change in reserves <sup>d</sup> (increase -)	-7236	-1700	10600	-2600	-3400	-1500	-3830	-3800

**Table 21: Thailand - Key Economic Indicators (contd.)**

Indicator	Actual			Estimate		Projected		
	1995	1996	1997	1998	1999	2000	2001	2002
<i>Memorandum items</i>								
Resource balance (% of GDP at current market prices)	-10.4	-10.5	-0.1	15.5	9.5	8.1	6.8	5.1
Real annual growth rates (1988 prices)								
Merchandise export	24.8	-1.9	3.8	-6.8	5.1	7.4	8.5	8.6
Primary	26.1	-0.2	-11.7	-18.8	-11.2	9.1	10.7	12.1
Manufactures	25.3	-2.0	6.0	-4.7	5.9	7.2	8.3	8.2
Merchandise imports (CIF)	30.4	0.6	-13.4	-33.8	14.2	16.9	12.2	12.4
<b>Public finance</b>								
<i>(as % of GDP at current market prices)<sup>e</sup></i>								
Revenues	18.6	18.5	18.6	16.2	15.1	15.3	17.2	19.4
Expenditures	15.4	17.8	19.5	18.7	18.1	18.3	19.5	20.7
Budget surplus (+) or deficit (-)	3.2	0.7	-0.9	-2.5	-3.0	-3.0	-2.3	-1.4
Capital expenditure	5.3	7.9	6.8	5.7	5.2	..	..	..
Foreign financing	0.2	0.3	1.1	2.3	2.0	..	..	..
<b>Monetary indicators</b>								
M2/GDP (at current market prices)	79.1	80.9	91.9	102.4	103.9	109.3	116.0	126.6
Growth of M2 (%)	17.0	12.6	16.4	9.5	2.1	5.9	7.0	10.0
Private sector credit growth/total credit growth (%)	68.4	64.2	106.2	222.8	69.2	41.5	40.7	40.2
<b>Price indices (1994=100)</b>								
Merchandise export price index	111.2	107.9	102.4	88.2	85.6	86.9	88.3	89.8
Merchandise import price index	110.0	109.2	108.1	101.3	95.3	97.5	98.3	99.4
Merchandise terms of trade index	101.1	98.7	94.7	87.1	89.8	89.1	89.8	90.3
<b>Real exchange rate (US\$/LCU)</b>								
(1990=100) end of period <sup>f</sup>	101.5	107.5	75.5	89.6	82.0	82.0	82.0	82.0
Consumer price index (growth rate)	5.8	5.8	5.6	8.1	0.3	2.5	2.8	3.0
GDP deflator (%growth rate)	5.8	5.9	5.7	8.8	-2.6	1.0	..	..

a. GDP components are estimated at market prices

b. "GNFS" denotes "goods and nonfactor services"

c. Includes net unrequited transfers excluding official capital grants

d. Includes use of IMF resources

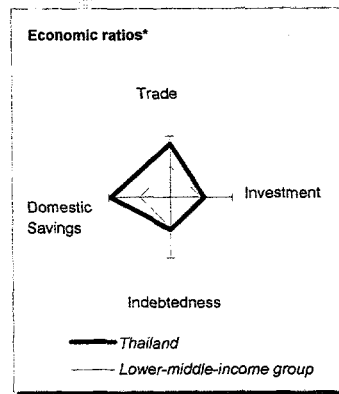
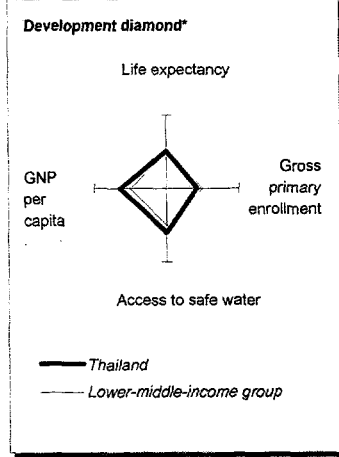
e. Central government, fiscal year

f. "LCU" denotes "local currency units." An increase in \$US/LCU denotes appreciation

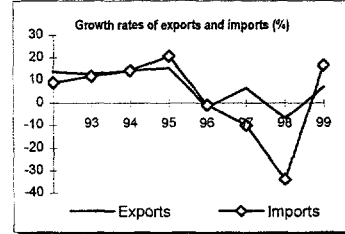
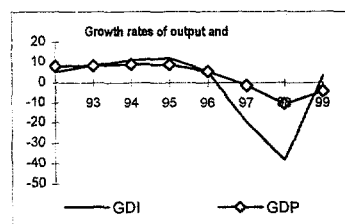
Table 22: Thailand at a Glance

1/2/00

POVERTY and SOCIAL	Thailand	East	Lower-		
		Asia & Pacific	middle-income		
<b>1998</b>					
Population, mid-year (millions)	61.1	1,817	908		
GNP per capita (Atlas method, US\$)	2,200	990	1,710		
GNP (Atlas method, US\$ billions)	134.4	1,802	1,557		
<b>Average annual growth, 1992-98</b>					
Population (%)	1.1	1.2	1.1		
Labor force (%)	0.8	1.6	1.5		
<b>Most recent estimate (latest year available, 1992-98)</b>					
Poverty (% of population below national poverty line)	13	..	..		
Urban population (% of total population)	40	35	58		
Life expectancy at birth (years)	69	69	68		
Infant mortality (per 1,000 live births)	26	37	38		
Child malnutrition (% of children under 5)	11	20	..		
Access to safe water (% of population)	89	77	75		
Illiteracy (% of population age 15+)	5	15	14		
Gross primary enrollment (% of school-age population)	91	117	103		
Male	93	119	105		
Female	90	118	100		
<b>KEY ECONOMIC RATIOS and LONG-TERM TRENDS</b>					
	1977	1987	1997	1999	
GDP (US\$ billions)	19.8	50.5	150	127.0	
Gross domestic investment/GDP	26.9	27.9	30.1	29.7	
Exports of goods and services/GDP	20.0	28.9	48.1	56.7	
Gross domestic savings/GDP	21.5	28.4	35.2	40.0	
Gross national savings/GDP	21.5	27.1	33.0	31.0	
Current account balance/GDP	-5.5	-0.7	-2.0	9.0	
Interest payments/GDP	0.6	2.1	0.1	2.7	
Total debt/GDP	16.9	40.3	62.3	61.3	
Total debt service/exports	13.7	21.9	16.2	20.4	
Present value of debt/GDP	..	..	59.3	..	
Present value of debt/exports	..	..	119.4	..	
	1977-87	1988-98	1997	1999	2000-03
<i>(average annual growth)</i>					
GDP	5.8	6.9	-1.3	4.0	5.0
GNP per capita	3.6	5.5	-2.7	2.8	..
Exports of goods and services	9.5	11.3	1.1	7.0	3.8



STRUCTURE of the ECONOMY	1977	1987	1997	1999
Agriculture	24.8	15.7	9.5	8.9
Industry	29.3	33.3	42.8	41.2
Manufacturing	20.2	24.3	31.2	32.1
Services	45.9	50.9	47.7	49.9
Private consumption	67.9	60.2	55.4	54.2
General government consumption	10.6	11.3	10.1	11.5
Imports of goods and services	25.4	28.3	48.2	45.0
	1977-87	1988-98	1997	1999
<i>(average annual growth)</i>				
Agriculture	3.5	2.6	2.1	2.6
Industry	6.9	8.8	-0.6	4.2
Manufacturing	6.2	9.3	2.5	7.8
Services	6.1	6.5	-2.1	5.1
Private consumption	4.6	5.7	-0.9	3.8
General government consumption	6.6	5.8	-1.6	6.3
Gross domestic investment	4.1	6.2	-19.7	3.4
Imports of goods and services	4.4	9.0	-10.0	21.3
Gross national product	5.6	6.9	-1.1	..

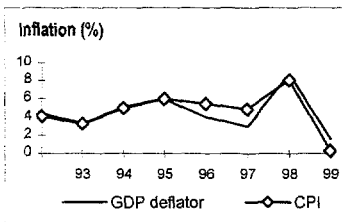


Note: 1999 data are preliminary estimates and are inputs from field office staffs.  
 1998 Poverty and Social indicators figures have been updated by field office staffs and may therefore differ from existing figures in the formal AAG table.  
 \* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Table 22: Thailand at a Glance (contd.)

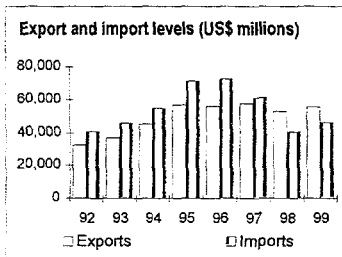
**PRICES and GOVERNMENT FINANCE**

	1977	1987	1997	1999
<b>Domestic prices</b>				
(% change)				
Consumer prices	..	2.5	4.9	0.3
Implicit GDP deflator	6.0	4.7	5.7	-2.6
<b>Government finance</b>				
(% of GDP, includes current grants)				
Current revenue	12.9	15.3	18.6	15.1
Current budget balance	1.2	1.1	..	..
Overall surplus/deficit	-2.9	-2.1	-0.9	-3.0



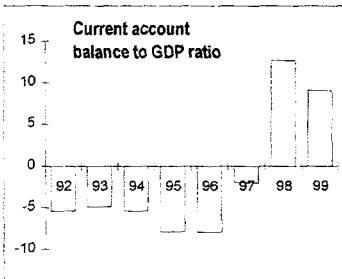
**TRADE**

	1977	1987	1997	1999
(US\$ millions)				Jan-Oct
Total exports (fob)	3,490	11,654	57,604	47,519.0
Rice	656	884	2,075	1,544.2
Rubber	302	799	1,832	890.1
Manufactures	..	6,989	45,113	40,153.1
Total imports (cif)	..	13,471	61,353	38,341.9
Food	..	..	2,041	852.7
Fuel and energy	..	1,733	5,367	3,336.7
Capital goods	..	..	29,796	19,496.3
Export price index (1995=100)	..	95	105	88.0
Import price index (1995=100)	..	71	107	92.5
Terms of trade (1995=100)	..	133	98	87.0



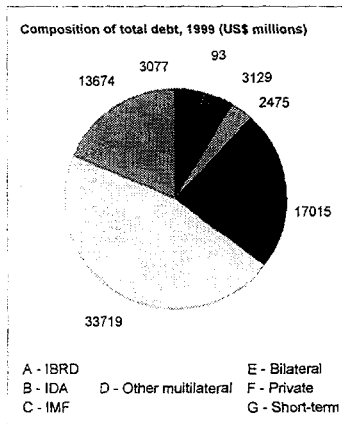
**BALANCE of PAYMENTS**

	1977	1987	1997	1999
(US\$ millions)				
Exports of goods and services	3,985	14,665	72,484	70,662
Imports of goods and services	5,083	14,361	72,633	58,977
Resource balance	-1,098	304	-149	11,684
Net income	-38	-894	-3,481	..
Net current transfers	39	225	479	..
Current account balance	-1,098	-365	-3,481	11,200
Financing items (net)	1,106	1,277	-15,226	-14,600
Changes in net reserves	-9	-912	18,250	3,300
<b>Memo:</b>				
Reserves including gold (US\$ millions)	..	..	27,000	34,800
Conversion rate (DEC, local/US\$)	20.4	25.7	31.4	37.8



**EXTERNAL DEBT and RESOURCE FLOWS**

	1977	1987	1997	1999
(US\$ millions)				
Total debt outstanding and disbursed	3,344	20,385	93,731	70,323
IBRD	346	3,413	1,728	3,077.0
IDA	19	111	98	93.0
Total debt service	572	3,458	11,778	13,261
IBRD	44	445	296	301
IDA	0	1	3	3
Composition of net resource flows				1998
Official grants	14	129	78	..
Official creditors	165	30	422.4	1,094
Private creditors	165	-103	-732.7	1,458
Foreign direct investment	106	352	3,745	2,512 <sup>b</sup>
Portfolio equity	0	115	-308	652 <sup>b</sup>
World Bank program				1999
Commitments	138	34	767	1,690
Disbursements	75	157	443	1,090
Principal repayments	19	181	194	184
Net flows	56	-25	249	906
Interest payments	25	265	104	191
Net transfers	31	-289	145	715

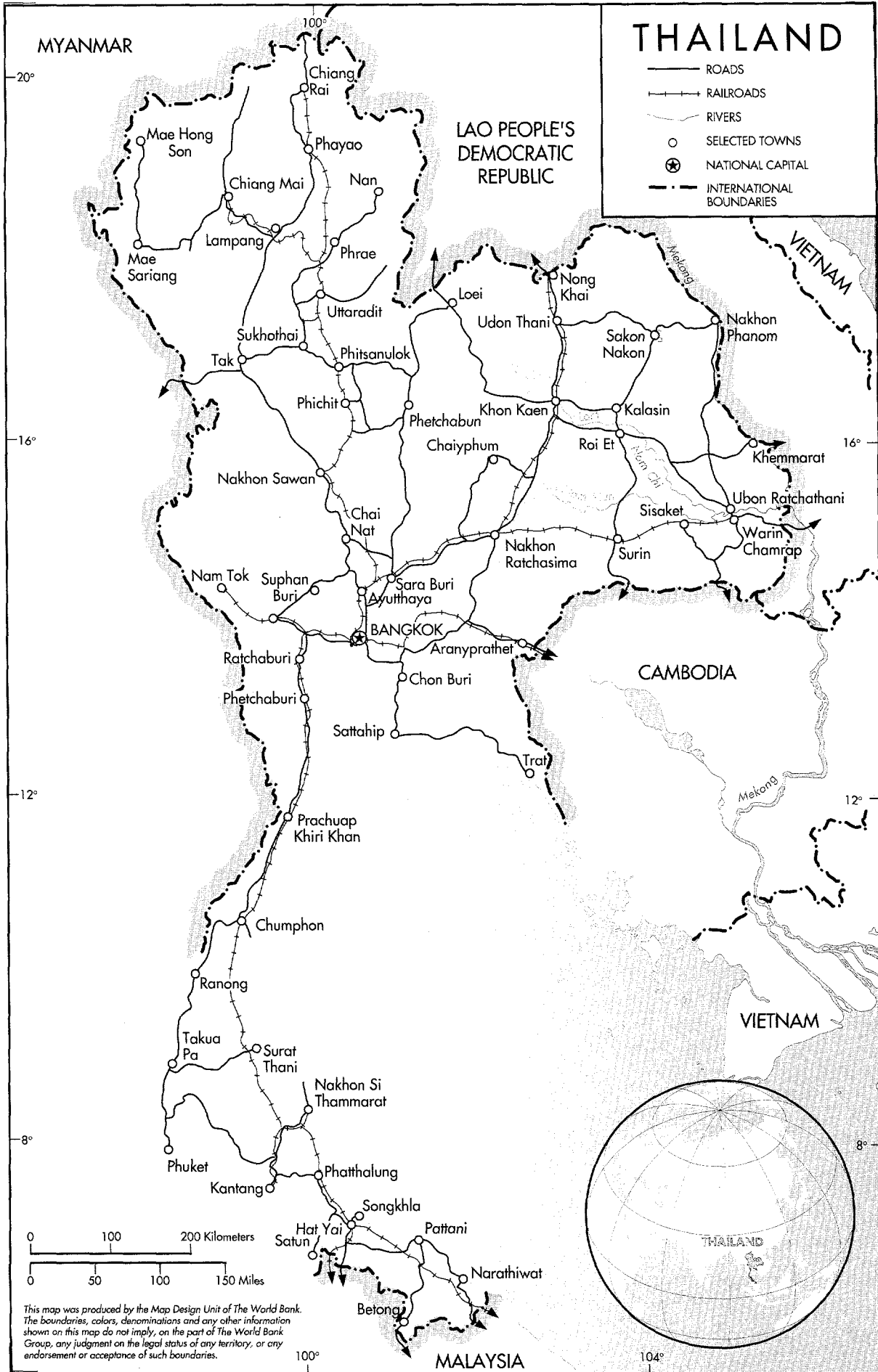


<sup>a</sup> as of fiscal year 1999 (Oct98-Sep99)    <sup>b</sup> Jan-Oct99

MAP SECTION







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