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

Country Director: J. Shivakumar
Comments to:
David A. Robalino, Ejaz Ghani,
Kirida Bhaopichitr
DRobalino@worldbank.org
EGhani@worldbank.org
KBhaopichitr@worldbank.org

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The Monitor was prepared by Abha Joshi Ghani, Alex Mutebi, Arvind Gupta, Behdad Nowroozi, Dana Weist, David Robalino, Ejaz Ghani (Task Team Leader), Ijaz Nabi, Kirida Bhaopichitr, Michael Markels, Mario Reyes Vidal, Melissa Fossberg, Renuka Vongviriyatham, Tanatat Puttasuwan, and Tip-arpar Karasudhi. The views expressed in the Thailand Economic Monitor are entirely those of the authors and should not be cited without prior permission. They do not necessarily represent the view of the World Bank, its Executive Directors, or the countries they represent. The material contained herein has been obtained from sources believed reliable but is not necessarily complete and cannot be guaranteed.

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PREFACE

The *Thailand Economic Monitor* reviews major developments and challenges in the areas of poverty reduction, the real economy, financial and corporate sector reform, public sector reform, and medium-term competitiveness.

The last three years have been very difficult for Thailand. However, this period has also been one of rapid institutional and policy change. The government has shown its ability to design and implement a complex strategy to stabilize the economy and to move the reform agenda forward to prepare Thailand for the challenges posed by globalization.

This *Economic Monitor* depicts an economy in expansion that is likely to recover its pre-crisis levels of output and welfare within two or three years. As the economy recovers, the major challenge is to maintain the momentum of institutional and policy reform and to shift the focus from crisis management to medium-term economic and social development. The *Monitor* shows that while the policy and institutional framework is largely in place, implementation in some areas needs to be accelerated. Thailand needs to more rapidly reduce the volume of non-performing loans and to improve the pace and quality of corporate debt restructuring, while improving the effectiveness of its bankruptcy and debt recovery laws. A critical part of the reform program will be to provide momentum to development and usage of information technology -- an area where Thailand is currently lagging -- but which will be essential for the country to compete in the new knowledge economy.

This *Monitor* responds to increasing demand for information on Thailand's reform program. We hope that this publication will be useful to those monitoring Thailand's short and medium-term outlook. Details on other World Bank publications on Thailand can be found at the website http://www.worldbank.or.th.

J. Shivakumar

J. Shivakumar
Country Director
World Bank Office- Bangkok

May 30, 2000

EXECUTIVE SUMMARY

- *This Monitor takes a comprehensive look at the Thai reform program.* The crisis had revealed weaknesses in several areas including the social, financial, and corporate sectors, competitiveness, and public sector institutions. These weaknesses had interrupted the development process. In response, Thailand has been implementing a comprehensive reform program, both as a response to the crisis and the new constitution adopted in 1997. This *Monitor* examines the progress made so far in eliminating both the short and the medium-term structural weaknesses. It also identifies some of the challenges ahead.

- *While Thailand deserves credit for putting in place a comprehensive reform program, stronger implementation holds the key to the success.* Thailand has introduced a remarkable range of reforms in a short period of time. Fundamental changes in laws, practices, mind-sets, institutions and policies have been initiated. These reforms promote competitiveness, governance, and social justice, and auger well for securing better quality of life for all citizens. However, elements of the program need further fine tuning to remove remaining constraints. More energetic implementation, with support of the private sector and civil society, remains a high priority.

- *The adverse impact of the crisis is still being felt by the Thai people*. Although economic growth in 1999 has helped to reduce the poverty incidence, around 7.5 million Thai people remain below the poverty line. Unemployment rate has fallen from 5.4 percent in 1999 to 4.8 percent in February 2000. Fiscal policy will need to carefully manage the tradeoffs between employment creation, social protection and sustainability of the public debt.

- *Communities have played an exemplary role in tackling the crisis.* Communities have received support from various sources including the Community Development Department and the Social Investment Fund. These vibrant community organizations, besides influencing values and bolstering morale during the crisis, have been directly involved in employment generation, training and income transfer programs targeted at those worst affected. An adequate level of government support for such a continued role is justified until recovery is fully restored.

- *Economic recovery is on track*. Export performance remains strong. Fiscal stimulus is being delivered. Private investment, although fragile, is on an upward trend. On balance, GDP is expected to grow by 4 to 5 percent in 2000. The downside risks to the growth outlook include both domestic and external developments. Internally, the pace and quality of bank and corporate restructuring, constrained by a weak legal framework, could slow down the momentum of recovery. External developments (in the US and Japan) could adversely impact exports, a key driver of Thailand's recovery.

- *Macroeconomic policies continue to support recovery*. Given low inflation and a substantial output gap, fiscal and monetary policies continue to support recovery. Public sector has played an important role in recovery. As a consequence, public debt has increased, but is sustainable, if the growth momentum is maintained. Public debt would need to be carefully managed over time. The Thai Government has established the Public Debt Management Office, which will be responsible for setting the overall public debt policy. The Ministry of Finance is in the process of drafting the Debt Management Law enabling flexibility in public debt management.

- *The market-led, decentralized approach to financial sector restructuring is an appropriate strategy, but understated losses on bank balance sheets could pose a risk.* Additional capital to handle understated losses (beyond year-end 2000 provisions) may require some form of public policy support, linked to further rationalization of the sector. Significant progress has been made with the privatization of the three government run banks. The competitive dynamics of the IT driven, knowledge based economy will put more pressure on financial institutions to consolidate. Thailand is in the process of defining a medium-term vision for the financial sector. The supervisory and regulatory framework for the financial sector is being strengthened. The draft Financial Institutions Act, aimed at modernizing the regulatory framework (consolidating supervision of financial conglomerates, tightening rules on insider lending, linking capital adequacy to risk profile) has been approved by the Council of State and it now needs the parliamentary approval. The draft Deposit Insurance Act, which would replace the blanket guarantee with limited depositor protection, is under preparation. The Bank of Thailand is being restructured to strengthen its independence, accountability and transparency. Alongside the rebuilding of the banking sector, progress is being made towards developing the capital markets. Deepening the capital markets will improve corporate behavior and help buffer the economy against future shocks.

- *Corporate debt restructuring needs to accelerate.* The first quarter of 2000 saw a slow down in both the number of cases and the value of debt restructured as compared to the fourth quarter of 1999. Restructuring is still concentrated in large corporate firms. Medium and small loans and their underlying assets are being restructured slowly, and markets for distressed assets are not clearing. The corporate restructuring completion ratio (debt restructured as a ratio of size of NPLs) is high for services and export sectors but relatively low for the construction, real estate and manufacturing sectors. Over time, the firms approaching Corporate Debt Restructuring Advisory Committee (CDRAC) for assistance are likely to be in less viable sectors or small and medium-sized firms. CDRAC will need to be stricter in enforcing adherence to the time schedules set out in the voluntary agreements among debtors and creditors. Bankruptcy and debt collection regimes need to be more supportive of reform. Finally, debt restructuring guidelines for remaining state banks should be finalized quickly, approved at the appropriate governmental level to reduce the cloud of legal liability for reasonable write-offs, and implemented.

- *Medium-term competitiveness reform will help to achieve high-quality growth.* Since the crisis, both capital and labor have shown modest productivity gains. Going forward, there is tremendous potential for productivity gains. High-quality growth will require shifting away from an input-based to a knowledge-based economy. The latter will require modernizing institutions and policies aimed at improving corporate governance, skills and technology, introducing competition and protecting consumer welfare, and providing an enabling environment for small and medium scale enterprises. While substantial progress has been made in improving corporate governance, much of the reform agenda remains unfinished. The Public Company Act needs to be amended to improve minority shareholder protection, and to change provisions related to the duties of directors, and sanctions for fraudulent practices. In response to concerns related to skill shortages, Thailand is undertaking a comprehensive reform of the educational system with the objective of improving the quality of education, and improving access to secondary and higher education. A new Education Act provides the framework for reform and its implementation is underway. With regard to competition, Thailand has drafted a number of laws (e.g., Business Competition Act) which will improve competitiveness, productivity, and help facilitate technology upgrading. The momentum on capacity building to implement these regulations needs to be maintained. Trade policy reforms (e.g., elimination of import surcharges introduced during the crisis, amendment of customs Act) will help to strengthen Thailand's ability to compete in the international markets.

- *Thailand is developing an effective information technology strategy.* The range of constraints that Thailand faces in this critical area extends from lack of access and coverage of telecommunication infrastructure, through obstacles to E-Commerce and E-Government, to shortages of skilled manpower, not only at the sophisticated end but even for widespread use of new technology. Thailand is preparing a comprehensive program to address these issues in the context of the new economy.

- *Thailand is proceeding with its privatization agenda*. Upcoming transactions include the strategic sale or public offering of a stake in Thai Airways International; the Airports Authority of Thailand (Regional Airports); the Petroleum Authority of Thailand; the Ratchaburi Power Plant; the Communications Authority of Thailand; and the Telephone Organization of Thailand. While Thailand remains fully committed to privatizing state-owned enterprises to improve their efficiency and improve the quality of services offered to the public, it has also rightly placed a high priority on modernizing and strengthening its regulatory framework and institutions.

- *Public sector reform momentum is critical*. The new Constitution provides the underpinning of a modern democratic governance regime and supports greater citizen participation, decentralization, accountability, and transparency. With the policy and institutional frameworks in place in several key areas, implementation now holds the key to results on the ground. Progress is being made on strengthening performance-based resource management, improving service delivery, and strengthening accountability and transparency across the public sector as decentralization proceeds. The key challenge is sustaining the momentum of the program, improving coordination across agencies, motivating civil servants to play their new role, and using the potential offered by information technology to speed up reforms.

POVERTY

Key Developments

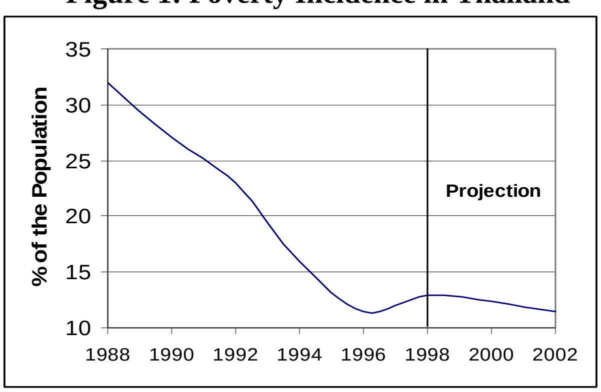
- As the recovery takes place, the share of the population living below the poverty line is expected to decline following the halt in Thailand's sustained progress in reducing poverty due to the crisis. However, the absolute number of poor (at US$ 1.5 a day) is expected to remain between 7.3 to 7.7 million at the end of 2000. The share of population living below the poverty line is expected to decline to its pre-crisis levels by 2002.
- Thailand has successfully managed the social impact of the crisis. Both formal and informal safety nets have cushioned the impact of the crisis. Latest estimates suggest that the public safety net programs have benefited over 4.5 million workers, 35,000 low-income households and 400,000 poor elderly.
- Going forward, fiscal policy will need to carefully manage the tradeoffs between economic stimulus, social protection and sustainability of the public debt. Although fiscal stimulus is being delivered, there is a downside risk of a shortfall in the overall deficit during the second half of this fiscal year, with some of the cuts falling on social safety net programs, now that nearly 83 percent of the Miyazawa package has been disbursed.
- The crisis has unveiled both structural and institutional weaknesses in the social policy framework. There is considerable room for improving the efficiency and equity aspects of taxes, allocation of public expenditures, and the mechanisms used to target social safety net programs. Reforms in these areas will improve the benefit of growth and public interventions to the poor.
- Thailand has emphasized educational opportunities and community capacity building as the two pillars for improving social equity on a lasting basis. On local capacity building, the Government has been supporting community organizations such as savings groups, vocational groups, and community markets through the Community Development Department. The Government has plans to establish a Community Organization Development Institute, and a draft bill which would improve the enabling environment and support for civil society organizations is awaiting Parliamentary approval. Such local capacity building is all the more important because the 1997 Constitution emphasizes increased citizen participation, community-based development, and greater decentralization.
- On educational opportunities, Thailand is undertaking a comprehensive reform of the educational system with the objective of improving the quality of learning and expanding enrollment in secondary and higher education. Secondary education enrollment expanded slowly in Thailand and only reached 60 percent in 1998. The Constitution of 1997 now provides all citizens with the right to 12 years of publicly financed education.
- The legal basis for the ongoing education reform is the Education Act (1999) which gives a three-year timeframe for reducing the power of the central ministry, decentralizing to new school districts, establishing quality control mechanisms, reforming teacher employment, moving to block grant financing, and increasing school autonomy and accountability.

Public sector safety net programs have been largely successful. While data about the number and socio-demographic characteristics of beneficiaries from the different social programs is still scarce, preliminary analysis suggests that original targets were usually achieved. For instance, in the case of the Miyazawa Plan's programs for employment generation, 65,223 educated workers (76 percent of the target) and 3.5 million unskilled workers (80 percent of the target) had been hired by the end of 1999 (the average employment length was 18 days). Also, 2,000 villages received training and financial support through the Department of Community Development. The same program provided loans to 30,000 farmers, while the Department of Agricultural Promotion provided training to 1,094 farmers out of 1,270. For programs providing cash or in-kind transfers (e.g., meals for children), estimates suggest that they have benefited over 1.2 million persons or 35,000 households. The programs also included provision of financial support (Bt 10,000) to 990 HIV/AIDS-affected persons, and monthly transfers of Bt 300 to 400,000 for the elderly poor.

Since the Social Investment Fund (a component of the Social Investment Project financed by the World Bank) was launched on September 9, 1998, a total of 2,279 sub-projects have been approved with a total budget of Bt 2,636 million (approximately US$ 67.6 million). The sub-projects cover 76 provinces with over 4.3 million beneficiaries. The demand for Social Investment Fund resources continues to grow. The Social Fund has stimulated the emergence of community organizations and community networks capable of efficient sub-project and local community management and administration. This growing partnership with civil society has stimulated disbursements and improved the delivery of social assistance to the poor.

Despite the recovery, the number of poor remains above pre-crisis levels. Thailand was very successful in reducing the poverty incidence during the decade preceding the crisis (see Figure 1). Hence, in less than ten years, the poverty incidence was more than halved, falling from 32 percent in 1988 to roughly 11 percent in 1996. This reduction was mostly the result of economic growth. Flexible labor markets and high levels of social capital (e.g., strong family ties) diminished the crisis' impact on unemployment and poverty. Despite these natural stabilization mechanisms, poverty incidence increased by 13 percent between 1996 and 1998 (from 11.4 percent of the total population to 12.9 percent).

Figure 1: Poverty Incidence in Thailand

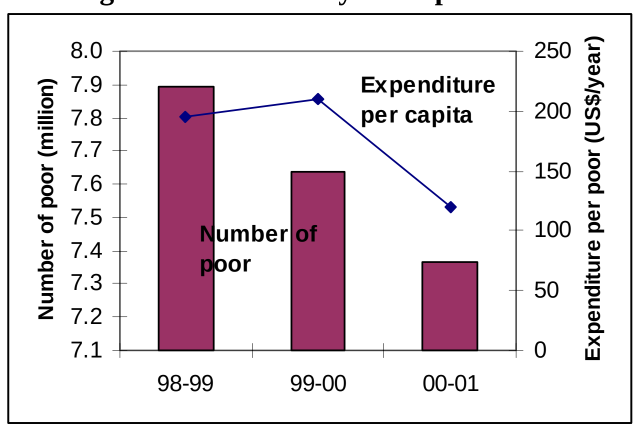


Source: NESDB and Staff calculations

Although economic growth in 1999 and 2000 will reduce poverty incidence, the number of poor is likely to remain above 7.5 million (mostly concentrated in the North and Northeast regions, see *Thailand: Economic Monitor February 2000*). Given that poverty incidence and unemployment remain above the pre-crisis level, work-fare programs and means-tested cash transfers and in-kind transfers will need to be preserved in the future. This will be a challenge in FY2001, as foreign financed expenditures (roughly 50 percent of total safety net expenditures) gradually decline.

Given the recovery, safety net expenditures should be adjusted. The reduction in the unemployment rate observed in February (see section on Labor Markets) could justify lower levels of expenditures on income generation programs. However, reductions should be carefully assessed given that the unemployment rate remains 4 percentage points above pre-crisis levels (MOL projects that in year 2000, 1 million workers will remain unemployed) and the construction sector, which in the past acted as a safety net for agricultural workers during the non-harvesting season, remains weak.

Figure 2: Social safety net expenditures



Sources : Bureau of the Budget and Staff calculations

There is scope for improving the effectiveness of the safety net programs. Two years of experience in the implementation of social programs have revealed weaknesses in three areas**:** 1) targeting; 2) cost-effectiveness of programs and evaluation; and 3) coordination between agencies and network units.

Table 1:Estimates of government-financed safety net expenditures for FY01 (Baht million)

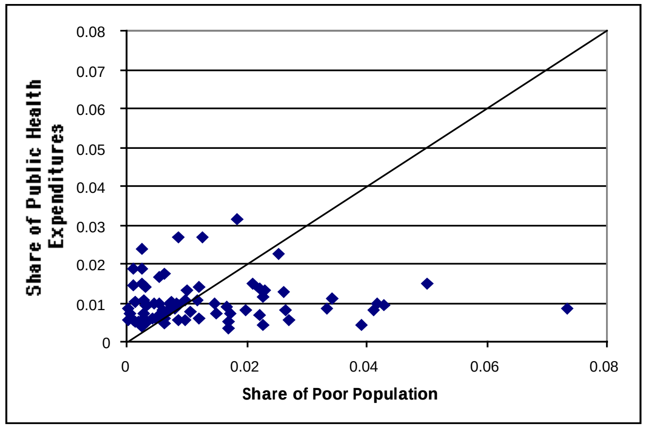
	1998/99	1999/00	2000/01p
Income Generation	**18,300.8**	**20,587.2**	**11,771.7**
In Kind transfers	**4,947.0**	**12,538.1**	**14,942.6**
School lunch programs	2,425.4	2,364.6	2,546.4
Housing	502.6	352.7	1,150.0
Health	8,417.7	9,820.8	11,246.2
Cash Transfers	**1,820.8**	**1,687.7**	**2,338.7**
TOTAL	**33,988.9**	**34,813.0**	**29,053.0**
% Change		2.42%	-16.55%

Source: Bureau of the Budget.

In terms of targeting, social programs have not always been successful in identifying and helping the poor. In part, this is a consequence of the tradeoff between the speed of disbursement, which is critical during a downturn, and the effectiveness of the targeting mechanism. However, the problem of appropriately targeting social expenditures goes beyond safety net programs. Recent studies have suggested that in general social expenditures are not focused on the poor, but rather the middle and high-income groups. In 1994, for example, only 6 percent of total public expenditures benefited the poorest decile, while 25 percent concentrated on the richest decile. Similarly, per capita public expenditures by regions tend to increase as the income per capita of the region increases, showing that public resources tend to concentrate in rich regions. Figure 3 also shows that there is no coherent relationship between the share of total health expenditures received by a given province, and the share of poor population living in that province.

Central agencies have faced difficulties in identifying cost-effective employment and training programs. Indeed, some of the programs are often designed without the proper knowledge of the cultural and socioeconomic characteristics of the population they target. For instance, some programs, such as job creation through infrastructure projects, targeted workers who were not prepared to work on these projects. Similarly, some of the training programs have not had any impact on the employment situation of their trainees (e.g., training programs for rubber tapping).

Figure 3: Share of Public Health Expenditures and Share of Poor Population by Region



Improved coordination between line agencies will have large benefits. The implementation of safety net programs has induced the proliferation of social funds which often target the same markets or population groups. Although the magnitude of the coordination failure has not been evaluated it is likely to have reduced the effectiveness of the policy interventions.

On the positive side, safety net programs may have increased transparency in the use of funds. Central and line agencies have suggested that because the development and implementation of safety net programs usually involve different stakeholders, transparency tends to increase. The media has focused on corruption and lack of transparency in budget allocations. Preliminary audits by Government suggest that social safety net funds have been managed relatively free of corruption. For instance, from more than 80,000 projects supported within the Miyazawa package, some 300 complaints have been received.

Going forward

Given that unemployment and poverty remain above pre-crisis levels, it is important to maintain appropriate levels of expenditures on safety nets and strengthen the institutional framework to implement and manage these programs.

Future programs should reflect lessons of experience. This is particularly relevant for income generation programs. There is evidence that projects that have been implemented by networks of communities have tended to be more effective.

Future implementation could encourage this type of coordination.

Mechanisms to allocate public expenditures across regions and demographic groups should be reviewed. Preliminary evaluation reports suggest that decentralized mechanisms tend to be more effective in targeting the poor than centralized mechanisms. However, this is only true if the initial allocation across local governments or communities is efficient. To date the practice has been to distribute the same amount of resources to each local unit (the tambon). The justification is that no data is available to measure poverty incidence or other social indicators that could serve as criteria for targeting. However, a more efficient strategy would be to allocate resources to *groups* of tambons, the size of the group being chosen to facilitate the calculation of the indicators involved in the allocation criteria. In terms of the latter, the main indicator could be the share of the poor population living in the sub-regions under consideration. This criteria maximizes the number of poor who receive support *even* under the assumption that the allocation within sub-regions is *random*. Other indicators could be introduced in the criteria (e.g., the share of child population, female population, or AIDS-infected population). Experience shows that a criteria using more than 3 indicators becomes cumbersome given the need to choose weights for each of the indicators.

Continued progress should be made towards improving the quality and reliability of social data. This is essential for an adequate monitoring of poverty, unemployment, and the timely design of alternative policy interventions

There is also room to improve the redistributive role of fiscal policy. Authorities need to identify mechanisms to increase efficiency in the composition and allocation of public expenditures and taxes. Changes in the current structures of taxes and expenditures could reduce inequality and the poverty incidence.

ECONOMIC RECOVERY

Key Developments

- Economic recovery is on track. Export performance has been impressive. Fiscal stimulus is being delivered. Private investment, although fragile, is on an upward trend. Recent data on consumption show a mixed picture, although it is difficult to say whether this is a temporary Y2K-related phenomenon, or a fundamental slow down. On balance, GDP is expected to grow by 4 to 5 percent in 2000. The downside risks to the growth outlook include both domestic and external developments. Internally, the pace and quality of bank and corporate restructuring could slow down the momentum of recovery, while developments in the US and Japan could impact exports, a key driver of Thailand's recovery.

- Thailand's external position has strengthened with international reserves reaching US$32 billion, equivalent to 200 percent of debt maturing in the next 12 months, and 6 months of imports.

- Recent results from the Labor Force Survey suggest that employment is expanding. The February unemployment rate fell from 5.4 percent in 1999 to 4.8 percent in 2000. However, the pace at which the unemployment rate has adjusted downwards is slower compared to the previous crisis in the 1980s. While the current unemployment rate appears to be modest when compared to European countries, Thailand has no unemployment insurance system and welfare impacts can be severe. However, a review of the adjustments in the labor market shows that wage reductions among less educated workers were less severe compared to the educated workers, suggesting that labor markets protected the less well off.

- Agriculture did not provide the expected safety net, as the employment levels in that sector have continued to fall.

Key drivers of growth. After growing by 4.2 percent in 1999, real GDP is expected to expand by 4 to 5 percent in year 2000. The major contributors to growth continue to be exports (6.3 percentage points) and private consumption (3.4 percentage points). Private investment is likely to contribute around 1.2 percentage points, while the total contribution of public expenditures (current and capital) is around 1 percentage point (Table 2).

Table 2: Contribution to Growth, 2000 (%)

	Growth	Contributions to growth
Real GDP growth (%)	4.5	4.5
Private consumption	6.4	3.4
Public consumption	4.9	0.46
GDFI	8.04	1.37
Public total investment	4.5	0.43
Private total investment	11.0	1.22
Exports	11.0	6.33
Imports	17.0	-7.54

Source: Staff calculations

Exports continue on a fast track. Exports grew by 9 percent in volume terms in 1999 and are expected to grow by 11 percent in year 2000. During the first quarter 2000, exports in US$ have been growing at an average of 30 percent per month, helped by the regional recovery, a competitive real exchange rate, real wages that are below pre-crisis levels, and productivity gains.

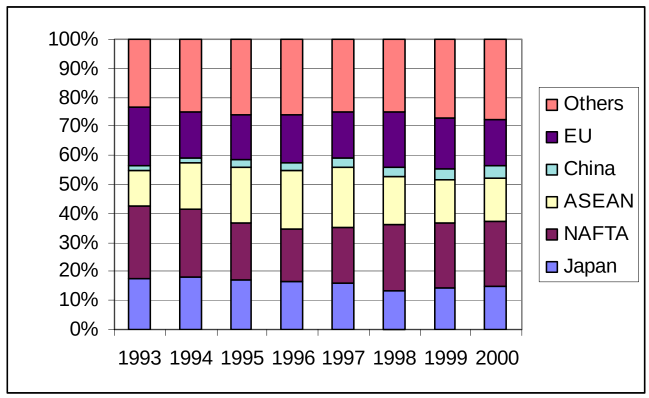
Table 3: Thai exports (1999-2000) (Share of Total Exports)

	1997	1999			2000
		Oct	Nov	Dec	Jan
Agriculture	10.3%	7.4%	8.2%	9.3%	8.8%
Fisheries	4.0%	4.0%	3.5%	3.5%	3.1%
Forestry	0.1%	0.1%	0.1%	0.1%	0.1%
Mining	0.9%	0.5%	0.9%	1.2%	1.6%
Manufacturing	82.5%	85.2%	83.0%	83.6%	83.5%
Other	2.0%	2.6%	4.0%	2.1%	2.6%
Re-exports	0.3%	0.2%	0.3%	0.2%	0.3%
Total exports (Million US$)	56,626	5,335	5,120	5,245	5,401

Expansion of exports has been confined to the manufacture, mining, and re-export sectors, which have received the bulk of foreign investment. The US$ value of exports in agriculture-related sectors have been contracting, in part as a result of falling commodity prices, but also possibly due to shortages of working capital.

The relative importance of different markets for Thai exports has remained roughly constant over time (Figure 4), with NAFTA and Japan accounting for close to 36 percent. A slow down in the United States economy and lack of full recovery in Japan could negatively affect Thai exports. Furthermore, low profit margins among hardware producers in the United States could slow down the demand for electronic components which currently represent 7-10 percent of total exports. In the medium term, however, the performance of the export sector will depend on Thailand's ability to reduce transaction costs and improve production factors (see Competitiveness section).

Figure 4: Destination of Thai exports



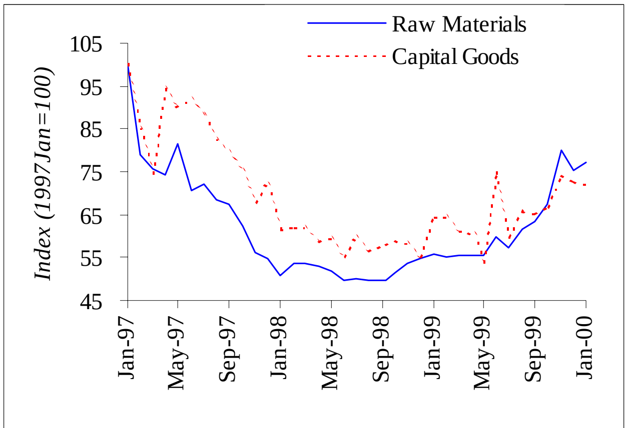
Imports also signal recovery. Since mid 1999 imports have been growing rapidly. In January, February and March 2000, imports in US$ grew by 27 percent, 65.8 percent and 24.8 percent respectively. While initially growth was driven by consumer goods, imports of raw material and capital goods have gradually recovered (Figure 5).

Private Consumption. Given that households are not as heavily indebted as the corporate sector, private consumption will continue to be an important driver of the recovery (Figure 6).

In 1999, total private consumption grew by 3.5 percent, recovering from the sharp contraction in 1998 (-12.3 percent). This recovery is broadly consistent with the return of consumer confidence, reflected in an increase in the propensity to consume (Figure 6), as well as the recovery in aggregate disposable income resulting from rising wages and

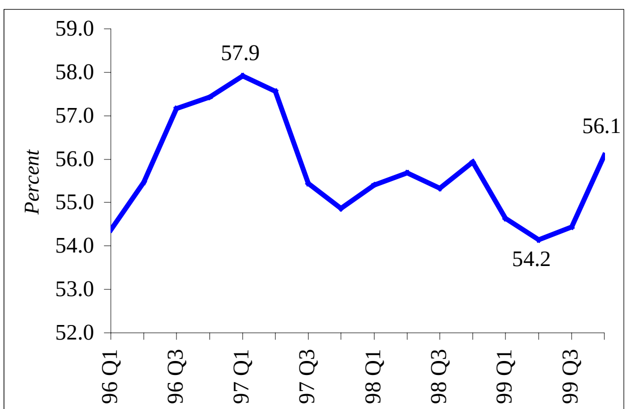
higher levels of employment (see section on Labor Markets)[1].

Figure 5: Imports are on the rise (US$)



(Seasonally Adjusted)

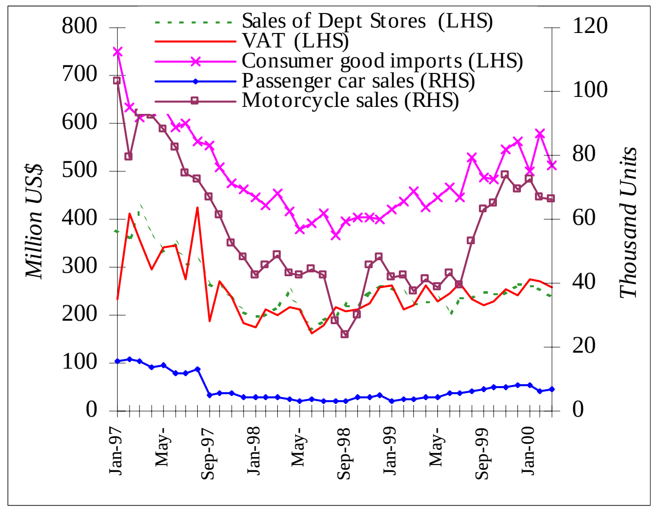
Figure 6: Real private consumption to GDP has been recovering



Note: Computations are based on seasonally adjusted series of private consumption and GDP

During the first quarter 2000, however, data on private consumption send mixed signals. Several indicators suggest that private consumption could be slowing down. For instance, department store sales and import of consumer goods have moderated in Q1 2000, while the rapid growth in sale of motor cycles and automobiles witnessed last year may be running out of steam (Figure 7). There is a possibility that this slow down in consumption in Q1 2000 may be explained by exaggerated preparations for Y2K-related emergencies. It may also reflect a negative wealth effect arising from the recent fall in the stock markets (analysis shows that deviations from the trend in consumption are highly correlated with movements in the stock market). If the slowdown is not a mere fluctuation but a more permanent change in trend, fiscal policy along with structural reforms may need to be pursued more pro-actively.

Figure 7: Private consumption indicators



(Seasonally Adjusted)

Private investment. In 1999, total investments reached 20.4 percent of GDP, an increase of 12 percent from 1998 (in 1996, 1997 and 1998 total investment as a share of GDP was respectively 43 percent, 33.6 percent and 19 percent). Despite this recovery, the investment rate remains below the rate observed in Korea (27 percent) and Malaysia (22 percent) (Table 4).

Since January 1999, indicators such as cement sales and BOI approvals have remained mostly flat. However, historically, BOI only represents a small share of total investments (less than 3 percent of GDP). Other indicators such as imports of capital

[1] The contribution to disposable income from non-wage related earnings (e.g., corporate profits, property rent) has less impact on consumption (for each dollar of this type of income, only 60 cents tend to be consumed on average). However, given that historically this type of earning has represented close to 60 percent of disposable income, the observed recovery in the rate of return to capital should also be contributing to consumption growth.

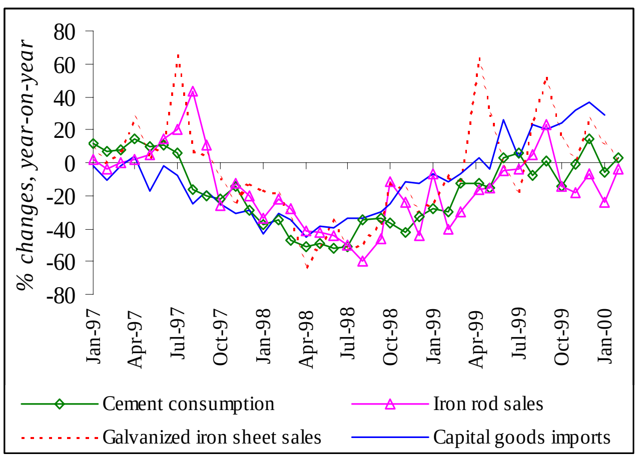
goods, which constitute a better proxy for aggregate investment, are trending up, suggesting that investment is recovering (Figure 8). Hence, total investments in the economy are expected to grow by close to 8 percent this year (this forecast is also supported by an increase in SOE investments).

Table 4: Investments and savings in East Asian countries (percent of GDP)

		1996	1997	1998	1999e
Thailand	Savings	33.2	31.9	31.1	30.1
	Investment	43.7	33.6	19.0	20.4
Indonesia	Savings	28.7	28.1	23.0	12.4
	Investment	32.1	31.3	19.1	11.6
Korea	Savings	33.7	33.1	32.8	33
	Investment	37.9	34.2	21.2	26.8
Malaysia	Savings	38.2	38.5	43.1	41.5
	Investment	41.5	42.9	26.7	22.3

Source: JP Morgan and NESDB

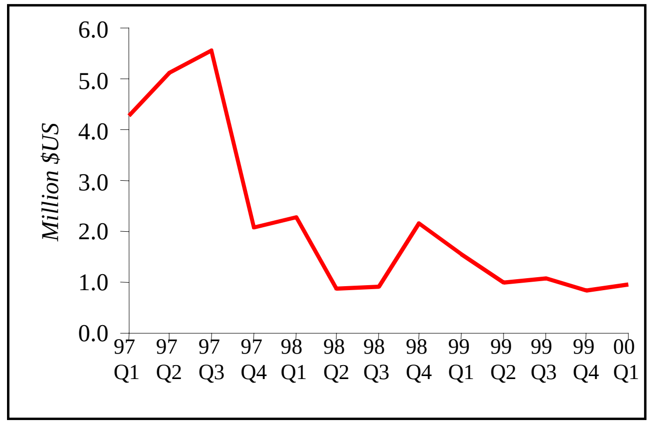
Figure 8: Investment recovery is gradual



Source: Bank of Thailand

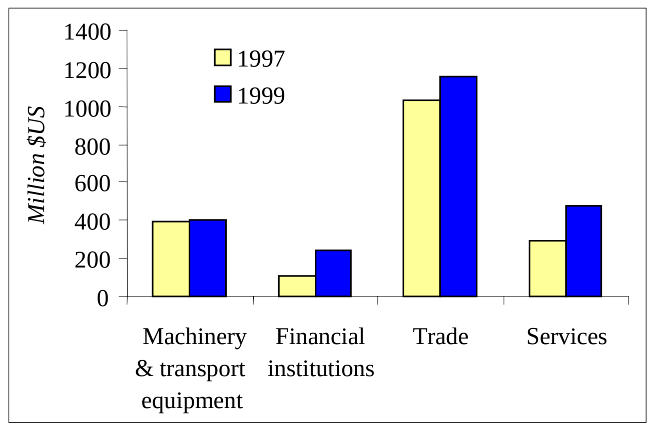
Will weak bank credit growth constrain private investment? Even with domestic credit contracting, output grew in 1999 and private investments represented roughly half of total investments or 11 percent of GDP. To finance these new investments corporations had three potential sources of funds: (1) bonds and equity (12 percent of GDP), (2) net foreign direct investment and portfolio investment (4.3 percent of GDP net), and (3) corporate savings (4 percent of GDP). Net credit from the rest of the world was negative (-4 percent of GDP).

Figure 9: BOI approvals are flat (Seasonally adjusted)



Source: Bank of Thailand

Figure 10: More dynamic sectors have attracted FDI



Source: Bank of Thailand

So far, the lack of bank credit has not hindered recovery. As recovery broadens, however, it will be accompanied by higher credit demand, especially from SMEs and new borrowers. The growth of bank credit to the private sector is projected to remain flat in 2000. This could be a problem going forward, at least for firms with no access to equity and bond markets.

Box 1 : Net Foreign Direct Investment in Thailand

In 1999, inflows of foreign direct investment (FDI) represented 4.6 percent of GDP, while outflows (foreign investments by Thai companies abroad) accounted for less than 0.3 percent of GDP. Hence, net foreign direct investments amounted to 4.3 percent of GDP, twice the average for the period 1990-1995. This level of foreign direct investment is considerably higher than the level observed in other East Asian countries with the exception of Singapore.

Table 1: Net FDI as a share of GDP by Country

	1999	*2000*	*2001*
Indonesia	-0.34%	1.29%	1.63%
Philippines	2.28%	1.77%	1.61%
Singapore	5.78%	5.79%	5.38%
Thailand	4.30%	3.49%	2.97%
Malaysia	0.13%	0.57%	1.45%
Korea	1.20%	1.21%	0.87%

Source: ABN-AMRO and Staff Calculations for Thailand

Lately, there is some evidence that the flow of FDI is slowing down in sectors such as real estate, financial intermediation, and construction. FDI in the industrial sector has also shown some weakness since Q4 1999. However, in the services and trade sectors, where perspectives about future productivity growth are encouraging, the trend in FDI has been stable and could be peaking up. Overall, the flow of foreign direct investments should be expected to slow down as foreign investors exhaust extraordinary investment opportunities which emerged during the crisis in sectors such as real estate. Higher interest rates in the United States may also contribute to this slow down. Nonetheless, it is likely that in the medium term, FDI flows will be above the pre-crisis level. The institutional and policy reforms that Thailand is currently implementing to improve competitiveness should contribute to attract investments from the rest of the world.

Figure 1: Net Flows of Foreign Direct Investment (US$ million)

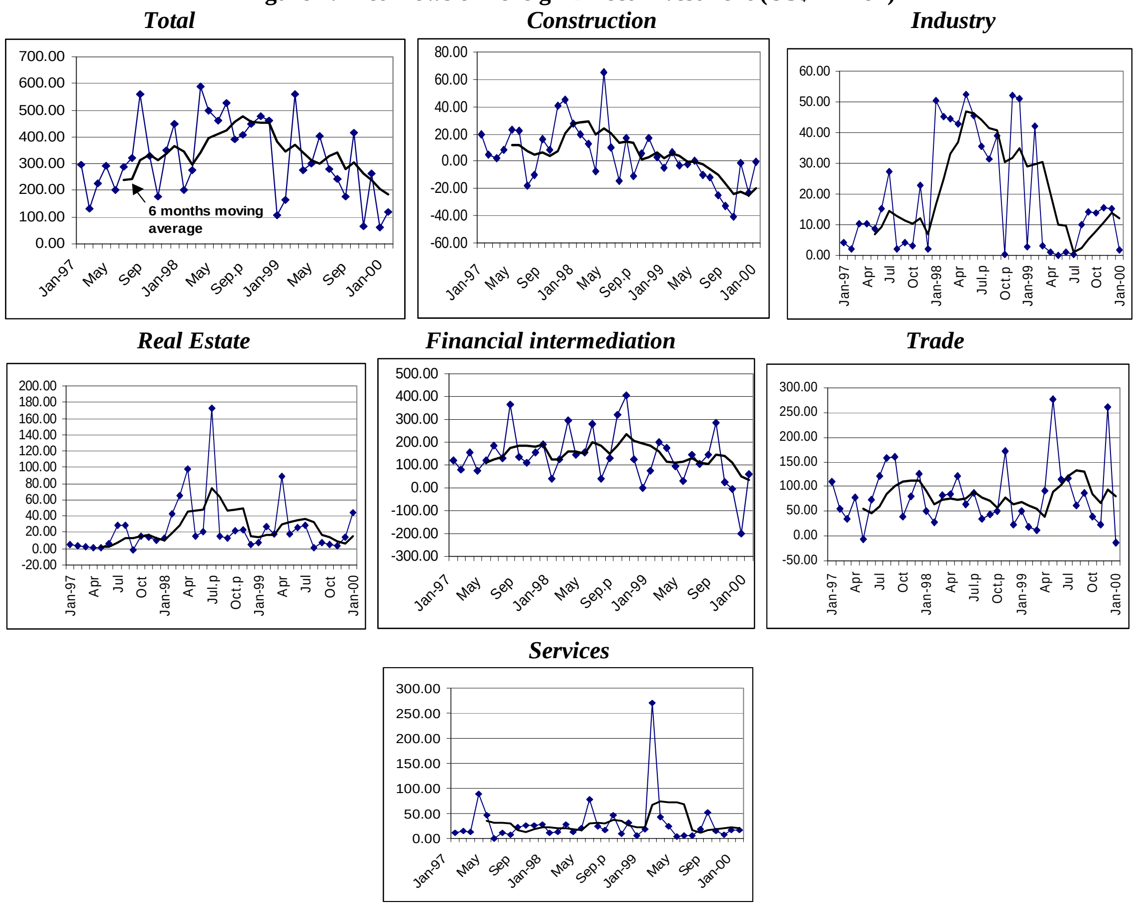
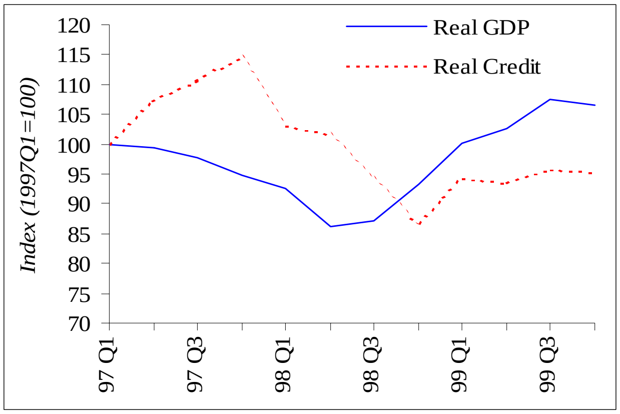


Figure 11: Credit-to-GDP ratio is still falling



Source: Bank of Thailand

Domestic saving remains strong. Unlike Indonesia, savings in Thailand remain strong. Domestic savings is currently close to 30 percent of GDP (Table 4), below Korea (33 percent) and Malaysia (41 percent), but above Indonesia (18 percent). Preliminary analysis suggests that this level of savings should be sufficient to support 4-5 percent GDP growth rates.

Sectoral Performance

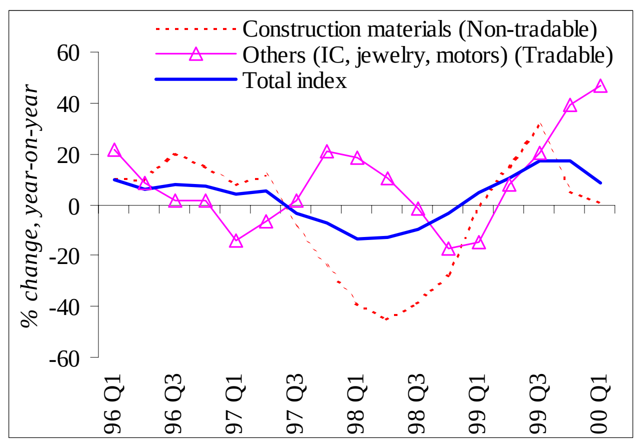
From the supply side, recovery has broadened, but manufacturing production, in the non-tradable sector, may be slowing down. All sectors were growing in the last quarter of 1999 with the exception of the agricultural and financial sectors. The sector with highest growth was manufacturing which rebounded since the beginning of 1999. The BOT production indexes suggest that all sectors continued to expand in the first quarter of 2000, again excluding agriculture. In particular, the "other" sector, which is heavily export oriented (including the production of integrated circuits, jewelry and ornaments, electrical motors, television sets, and glass sheets), grew in March by 46.6 percent. In the meantime, the construction sector (including the production of cement) remains fragile, registering a modest growth of 1.1 percent (Figure 12). Vacancy rates in Bangkok are among the highest in the region.

Table 5: Vacancy rates remain high (percent)

	Jun-97	Jun-98	Jun-99	Jun-00f
Bangkok	17.7	27.0	40.0	35.0
Jakarta	13.1	16.0	22.2	22.0
Kuala Lumpur	10.3	16.8	21.0	24.0
Seoul	12.0	15.0	15.0	12.0

In Q1 2000, growth in the Manufacture Production Index slowed down from 17.5 percent in the previous quarter to 8.8 percent. Indeed, between December 1999 and February 2000, the manufacturing production index was declining. In part the slow down is the result of the decline in beverage production (beverage plants increased production significantly at the end of 1999 to stock their products because production licenses were expiring) and the decline in production of petroleum products due to closure of some oil refineries for repair and maintenance (Figure 13). However, the slowdown could also reflect a contraction in consumers' demand, hence the need for carefully monitoring private consumption.

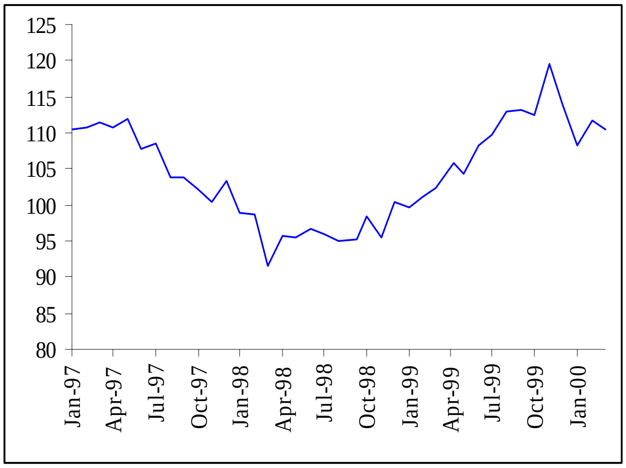
Figure 12: Non-tradable sector is weak



Source: Bank of Thailand

Capacity utilization has shown very modest signs of recovery. In January 2000 aggregate capacity utilization declined, probably as a result of excessive preparation for Y2K-related emergencies. Since January it has been growing in all sectors. For instance, in the transportation sector it increased from 21.0 percent in Q1 1999 to 41.8 percent in Q1 2000.

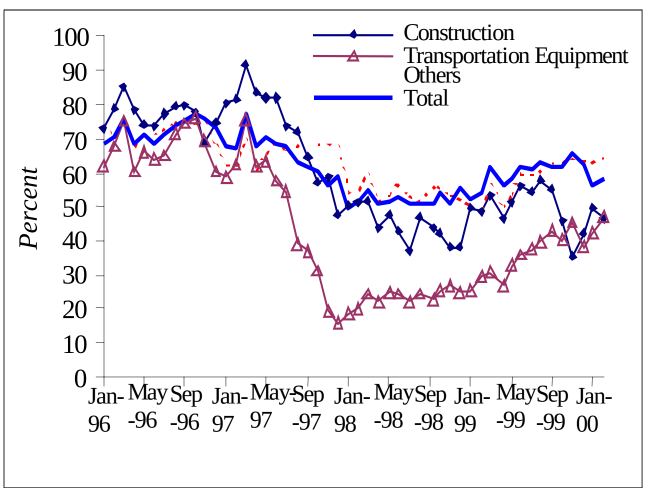
Figure 13: Manufacturing production is moderating



Seasonally adjusted index

Similarly, capacity utilization in the "others" category (mostly goods produced for foreign markets) has increased from close to 50 percent in March 1999 to 63 percent (the highest level across sectors) (Figure 14). Nonetheless, the average capacity utilization in the economy reached 57.7 percent in Q1 2000, only 0.8 percentage points above the level observed in Q1 1999 and still significantly lower than the 71.8 percent average in 1995-1997.

Figure 14: Capacity utilization is recovering slowly

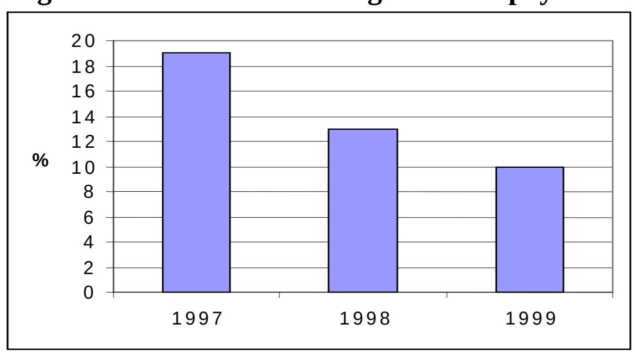


Source: Bank of Thailand

Labor Markets

The Labor Force Surveys (LFS) for August and November 1999 showed that while the unemployment rate had begun to fall, employment was contracting and the share of the labor force working less than 20 and 30 hours per week was increasing. The falling unemployment rate was simply due to the fact that since 1989 the participation rate (the share of the labor force in the population over 13 years of age) had been falling at an average rate of –1.4 percent per year (Figure 16). This falling participation rate can be explained by observed high returns to education in Thailand. The crisis did not have a statistically significant impact on the dynamics of the participation rate, and the latest round (February 2000) of the LFS confirms its long-run downward trend (Figure 16).

Figure 15: Workers receiving overtime payments



Source : Labor Force Surveys (LFS)

…..But recent data show that new jobs are being created. The February 2000 LFS shows that employment has expanded in all sectors except agriculture. Indeed, between 1999 and 2000 approximately 500 thousand new workers were employed thus reducing the February unemployment rate from 5.4 percent in 1999 to 4.8 percent in 2000 (data on the average number of hours worked is not yet available). While this is a positive development, data also show that the unemployment rate is falling at a very slow pace.

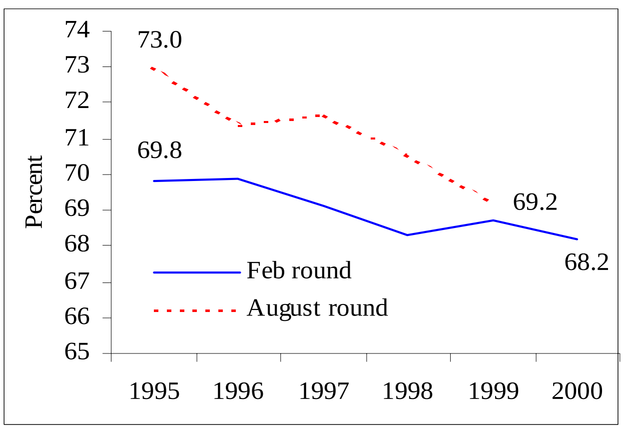
This is a major difference between the 1997 crisis and the 1989 crisis. In the latter, negative terms of trade shocks were absorbed rapidly and, in a period of one year, the unemployment rate came back to pre-crisis levels. This crisis is in part associated with structural weaknesses in the financial and corporate sector, and therefore the recovery is expected to take longer.

Table 6: Unemployment in Thailand (Based on August Round)

	1995	1996	1997	1998	1999	Change 97-98
1. Persons aged 13 years and over	45,196	45,869	46,798	47,265	47,974	2.51%
2. Total labor force (2+3+4)	33,002	32,750	33,56	33,353	33,210	-1.0%
2.1. Employed	32,575	32,232	33,162	32,138	32,087	-3.2%
of which working less than 20 hours		581	721	938	954	32.3%
2.2. Unemployed	375	354	293	1,138	986	237%
2.3. Waiting to farm	52	164	106	77	137	29.8%
3. Participation rate (2/1)	0.730	0.714	0.717	0.706	0.692	-3.4%
4. Unemployment rate (2.2/2)	1.2%	1.1%	0.9%	3.5%	3.1%	248%
5. Real wages	100.0	98.5	104.3	102.3	99.6	-4.5%
6. Real consumption per capita (Baht)	26,939	28,493	27,912	24,231	24,830	11.0%

Source : Labor Force Surveys (LFS)

Figure 16: Long-run decline in the Labor Participation Rate



Source : Labor Force Surveys (LFS)

While the 4-5 percent unemployment rate could be considered modest by European standards, its welfare impact can be severe, given that Thailand does not have unemployment insurance systems similar to those available in European countries. Nonetheless, in addition to the Government-supported employment creation and training programs, Thailand's relatively flexible labor markets have helped mitigate the impact of the crisis. Interestingly, wage adjustments were more severe among educated workers than uneducated workers.

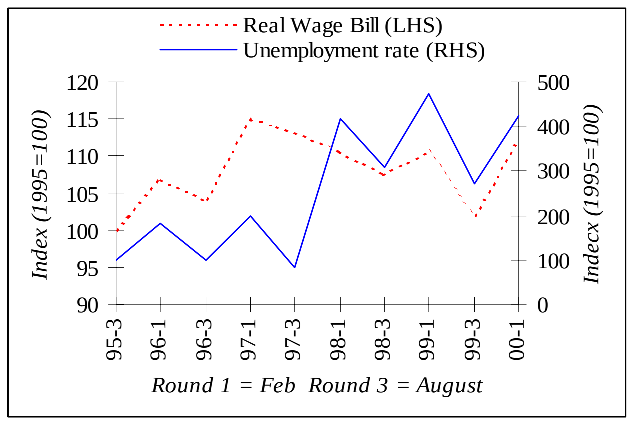
Table 7: Changes in average real wages and total employment by sector (February round)

% Changes	Employment		Real Wages at 1994 prices	
	Feb-99	Feb-00	Feb-99	Feb-00E
Total	**2.1**	**1.9**	**-2.1**	**-0.2**
Agriculture, forestry, hunting & fishing	7.8	-3.9	-7.2	-4.1
Manufacturing	-1.3	10.6	-1.6	4.2
Construction, repair and demolition	-23.6	11.6	-0.1	-1.6
Commerce	1.6	5.4	-11.9	1.9
Service	3.4	3.4	-1.2	-0.4

E = Estimate by Bank Staff

Note: Average real wage is the average real wage per person per month in a particular sector.

Figure 17: Total real wage bill and unemployment rates



Source: Bank of Thailand

New jobs are being created in the manufacturing and construction sectors. The fact that employment in the construction sector is expanding (as well as output, see Section on Sectoral Performance) is encouraging. Indeed, in the past, the construction sector constituted a safety net for agricultural workers during the non-harvesting season. Despite the observed recovery, however, claiming that the construction sector is ready to resume this role would be premature. Government safety net programs remain important.

Total wage bill bottomed out in August 1999 and is now on an upward trend. Total wages paid are a better measure of workers' welfare than the unemployment rate. For instance, while the unemployment rate was falling between August 1998 and August 1999, total wages paid continued to decline. Since 1999, however, total wages paid started to grow again (Figure 17). Although data on wages for the LFS February 2000 round are not yet available, preliminary estimates suggest that total wages paid may have grown by 1.3 percent between February 1999 and February 2000. This not only reflects the expansion in employment, but also a smaller contraction in average real wages as compared to February 1999 (Table 7). Despite the recovery, however, real wages remain below pre-crisis levels.

MACROECONOMIC POLICY AND THE REAL ECONOMY

Key Developments

- Given low inflation and a substantial output gap, macroeconomic policies continue to support recovery.
- Public expenditures have played a key role in the recovery process. Once recovery has fully firmed up, fiscal policy will need to be consolidated.
- Thailand is modernizing its public debt management capacity to reduce risks and costs associated with public debt.
- While the public debt has increased and will need to be carefully managed, current levels are sustainable, if the growth momentum is maintained, and the agenda on public sector reform is accelerated.

Table 8: Public Deficit in Asian Countries, 1999 (%GDP)

	Total	Primary
Thailand	-7.0	-3.4
Indonesia	-4.8	1.6
Korea	-2.6	-1.1
Malaysia	-4.5	-1.3

Total fiscal balance includes interest cost of financial sector restructuring for Thailand.

Fiscal Policy

Fiscal policy continues to support the recovery. The overall public sector deficit (including interest cost of financial sector restructuring) for year FY00 is projected to be around 7 percent of GDP and is expected to contribute around 1 percentage point to economic growth. The deficit for January-March 2000 has been in line with the target (in March the budgetary deficit amounted to Bt 4.9 billion). However, there is a downside risk of a shortfall in the overall deficit during the second half of this fiscal year. To date, total revenue has been in line with expectations, with consumption-based taxes offsetting shortfalls in income tax receipts and non-tax revenue. Fiscal consolidation is expected to start in the next fiscal year and will need to be carefully aligned with the strength of the recovery in the real sector. If there are signs that the recovery is slowing down, fiscal consolidation may need to be delayed.

While the public debt has increased and will need to be carefully managed, it is sustainable. As of March 2000, Thailand's public debt had increased to close to 55 percent of 1999 GDP according to the Royal Thai Government estimates (including Bt 500 billion issued to cover FIDF debt and additional 776 billion of *currently* outstanding FIDF liabilities). While existing FIDF liabilities are included in March 2000 public debt figure (Table 10), only current and future net losses will impact the central government budget. MOF and BOT estimates place these losses in the range of Bt 800-1,200 billion.

Table 9: Public Debt in Asian Countries (%GDP)

	1996	1999
Indonesia	32.3	86.7
Korea	14.0	41.0
Malaysia	35.6	41.5

Source: JP Morgan

Experience from other countries shows that the cost of financial sector restructuring depend on a number of factors including the strength of future economic recovery, and recovery rate of assets. Even under a worst case scenario, preliminary analysis suggests that Thailand's public debt dynamics are sustainable, provided the growth momentum is maintained and the reform program is on track.

Table 10: Public debt as of March 2000

	Baht Billion
Central Government debt	983.2
Guaranteed SOE debt	698.4
Non-Guaranteed SOE debt	139.2
FIDF outstanding liabilities (a)	776.8
Total public sector debt	2,597

Source: Ministry of Finance
(a) as of December 1999

Table 11 shows the size of the primary fiscal balance that the Government will need to generate to stabilize the public-debt-to-GDP ratio, under different assumptions on the gap between the real GDP growth rate (g) and the real interest (r) paid on debt. Even under a worst case scenario, assuming that the fiscal cost of financial sector restructuring turns out to be higher than currently projected, with public debt peaking at 65 percent of GDP, debt dynamics is sustainable. If real interest rates were to exceed real GDP growth by 1 percentage point, Thailand will be able to stabilize its debt-to-GDP ratio at 60 percent by running a surplus of 0.2% of GDP on the primary fiscal balance, net of seignorage revenue. To lower the debt-to-GDP ratio further to 40 percent, it will need to generate a surplus on the primary balance of around 3.4 percent of GDP. Once recovery has cemented, fiscal consolidation should receive a high priority.

Table 11: Long Run Fiscal Sustainability

Target for the total public sector debt to GDP ratio by year 2010 (%)	Primary Balance (as % of GDP) required to stabilize debt.			
	g-r= -1%	g-r= 0%	g-r= 1%	g-r= 2%
60	0.18	-0.82	-1.78	-2.7
50	1.8	0.84	-0.07	-0.96
40	3.43	2.51	1.63	0.78

"i" is real interest rate, and "**g**" is real GDP growth
Assumes seignorage revenue of 1% of GDP equal to the average for the period 1980-1995.
Seignorage revenue is defined as (Base money/GDP)*Nominal GDP growth

Source: Staff calculations

Government is working towards strengthening capacity to manage public debt. The Ministry of Finance and the Bank of Thailand with support from the World Bank are currently working together to increase efficiency in public debt management. This implies not only improving coordination and information-sharing mechanisms, but also developing and implementing an action plan to increase institutional capacity in PDMO. Updated information systems and targeted training programs for staff are critical elements of this action plan.

Monetary Policy

The BOT has maintained an appropriate monetary stance. Despite an accommodative monetary stance, however, bank credit has not picked up. Indeed, given high levels of NPLs and a weak corporate sector, only limited investment opportunities with reasonable risk-adjusted rates of return are seen by domestic banks.

Table 12: Nonperforming Loan Estimates*
(% of total loans)

	Peak[1]	Latest estimates[1]		Transferred[2]
Thailand	46.8	38.2	Feb. 00	0.0
Indonesia	70.0	30.0	Apr. 00	47.0
Korea	25.0	11.3	Dec. 99	13.2
Malaysia	24.5	11.3	Feb. 00	13.0

* Official data and J.P. Morgan estimates
[1] NPLs in the banking system.
[2] NPLs transferred to public asset management and bank restructuring agencies (excludes NPLs assumed by Thailand's Financial Restructuring Agency during the closure of 56 finance companies in 1997)

Source : JP Morgan

Inflation is not a risk. High oil prices, and a shrinking output gap, over time, could add inflationary pressures. Nonetheless, given low commodity prices and low capacity utilization, forecasts suggest that inflation in year 2000 will not be above 3 percent. Tentatively, the Government has set an inflation ceiling of 3.5 percent for the medium term.

FINANCIAL SECTOR REFORM

Key Developments

- Non-Performing Loans (NPLs) are declining slowly across all sectors. Reported NPLs could reach 35 percent of total loans by the end of 2000 if net NPLs continue to decline at the rate of 1.5 percent of total loans per quarter. If NPLs transferred to Asset Management Companies (AMCs) are excluded from the total, NPLs could reach 22.5 percent of total loans by year-end.

- However, the pace of NPL reduction may slow down next year as less complex cases have been already restructured or rescheduled (see section "Corporate Restructuring"). As of December 1999, 88 percent of classified loans (more that 3 months delinquent, including write-offs) were more than one-year overdue ("doubtful loss" classification).

- Banks are capital constrained and are concerned that their borrowers are not recovering as hoped. In order to avoid write-offs, banks may continue to reschedule loans (term extension plus grace periods, without net present value reduction), instead of restructuring them such that the borrower's underlying cash flows can cover the debt service. This could lead to multiple restructuring events for the same accounts, incremental loss recognition and more rounds of bank recapitalization over time. Larger, syndicated loans with foreign creditors under CDRAC monitoring are being restructured in a higher quality fashion.

- Banks are expected to meet year-end 2000 provisioning requirements. Private banks need only Bt 21 billion additional tier-1 capital to meet the BOT's year-end 2000 provisioning requirement.

- More pessimistic assumptions on NPL, recovery rates suggest that recapitalization needs may be much higher. From the regulatory standpoint, provisions are calculated net of collateral value, which comprises about 55 percent of current loss coverage. This collateral, about 90 percent of which is property, appears to have not been marked to market, given the uneven quality of valuation in Thailand. Banks are currently using a collateral coverage ratio of between 40-70 percent of NPLs when calculating year-end 2000 provisions.

- Bank portfolios may be valued more rigorously next year due to steps taken by leading banks to obtain clean opinions from their external auditors. Most banks have qualified audit opinions today, given that they have not valued their portfolios according to audit standards.

- An important step that the government could take would be to reduce the time it takes to foreclose collateral from years to months. This would promote more equitable burden sharing by borrowers in troubled debt situations, facilitate voluntary negotiations, and speed the clearing of NPLs off bank balance sheets.

- Banks have started to show positive operating profits (before provisions), given positive spreads and the progress in loan restructuring.

- Unfortunately, corporate interest coverage (EBITDA/interest expenses) has not improved for SET-listed companies over the past two quarters, which may be due in part to seasonality. This, coupled with real interest rates in the 7 percent range and exposure to rising US rates, means that NPL re-entry may increase in the future.

- Loans outstanding continued to decline. The ratio of total loans to GDP has dropped from a peak of 139 percent at the end of 1997 to 113 percent at the end of 1999. Excess capacity, excess leverage in the real sector, and dis-intermediation could suppress loan growth to below GDP growth over the next few years. However, weak financial institutions do not seem to have been a constraint on growth so far; creditworthy borrowers have access to credit from banks and the bond market. Going forward, a broad-based recovery will require further strengthening of the financial sector.

- The BOT announced that the sale of Bangkok Metropolitan Bank (BMB) to Hong Kong and Shanghai Bank Corporation (HSBC) is to be finalized soon, but the Government is revisiting its plan to sell Siam City Bank (SCB), as is, given the lack of competition among bidders.

- While foreign banks and so-called hybrid banks still have low market share in assets (approximately 10 percent including BMB, excluding SCIB), they have branch networks for the first time and can compete directly with Thai banks. Several foreign and hybrid banks aim for the retail and middle markets, as well as the large corporate customers. The requirement to support two cost bases, the existing distribution system plus a new virtual or e-bank delivery system, favors the foreign banks. A shakeout may be expected in five years from these competitive forces. In response, several banks have announced major cost-cutting initiatives.

- In a positive development, the Cabinet approved the establishment of an AMC, owned by the FIDF, to manage Krung Thai Bank (KTB)'s NPLs.

- The Financial Sector Restructuring Authority (FRA) continues to dispose of the remaining non-core assets and will start to distribute proceeds in June 2000. The AMC, set up as the bidder of last resort for FRA assets, reports that it has restructured Bt 144 billion of its assets.

- Primary bond issues by firms increased in Q1 2000, before implementation of the SEC's new requirement that all debentures must be rated. The SET and the SEC are considering measures to promote utilization of the domestic stock market, given that many firms find listing requirements onerous in the context of lax governance and disclosure requirements for unlisted firms.

- Supervisory capacity of the BOT continues to be strengthened. The passage of the new "Financial Institutions Act," aimed at modernizing the regulatory framework, will likely be delayed until after the elections. A task force is developing an enhanced supervisory regime for financial conglomerates, which are formalized under the draft law.

- Independence of the Central Bank as the bank supervisor and monetary authority is under debate in the draft "Central Bank Act." The MOF and the BOT have agreed on a transfer of about US$3.4 billion of foreign reserves from BOT's accounts to cover a portion of FIDF's losses from financial sector restructuring.

A Market Led-Decentralized Approach to Financial Sector Reform

The objective of the government's reform of the Thai financial sector is to enhance the competitiveness of productive enterprises as they emerge from the crisis and compete in the global market. More efficient intermediation and the allocation of savings to the most productive investments are prerequisites to a competitive Thailand.

The Thailand financial sector program comprises a sizable reform agenda to restore financial sector soundness. Given the close linkages, corporate debt restructuring and capital market development are vital complements to the comprehensive financial sector restructuring strategy. The major objectives of the financial sector program in Thailand include:

- Resolving the finance company sector, restructuring and recapitalizing viable financial institutions and restoring confidence to facilitate new lending into the real sector;
- Facilitating corporate debt restructuring and upgrading the legal framework for bankruptcies and secured lending;
- Strengthening the supervisory capacity of the Bank of Thailand, the Securities and Exchange Commission and the Department of Insurance;
- Increasing market discipline and corporate governance of financial institutions; and
- Building capital markets.

Table 13: List of Asset Management Companies in Thailand

	Face value of NPLs (Bt mn)	Transfer price	Purpose	Established
		(a)	Private AMC	
TFB	61,000	50%	manage worst category of NPLs	Completed
PHATRA	40,000	Book value after Provision	manage NPLs of TFB's subsidiary	Completed
SCB	26,000-30,000	50%	manage NPLs	Planned
BBL	500 (registered capital)	Book value	manage foreclosed properties	Already set up / expect to operate in July 2000
TMB	50,000	n.a.	manage NPLs	Planned
		(b)	Public AMC	
BBC	80,000	Book value	government subsidized AMC	Completed
UOB	45,000	Book value	government subsidized AMC	Completed
KTB	530,000	80%*	government subsidized AMC	Expect in Q3 2000
AMC	197,000	17%	auction assets from the FRA	Completed

* Merrill Lynch Phatra's estimate

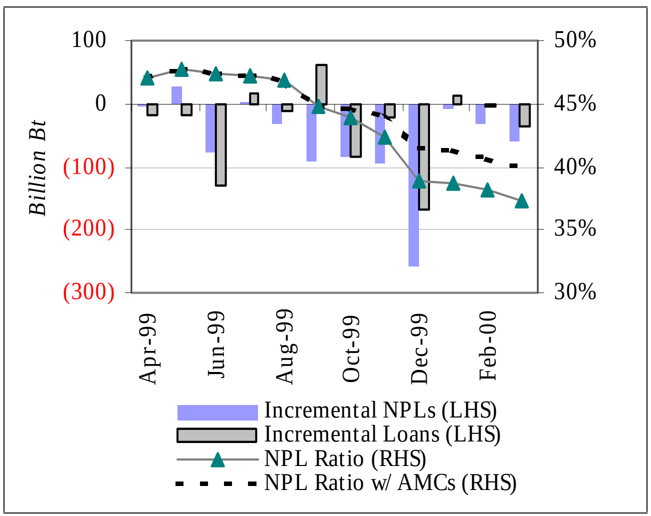
Table 14: Flow of NPLs as a Percentage of Loans

	Oct-99	Nov-99	Dec-99	Jan-00	Feb-00	Mar-00	Monthly Average	4Q 99	1Q 00
Increase in NPLs									
New NPLs	0.8%	0.9%	0.8%	0.7%	0.5%	0.6%	0.7%	2.5%	1.8%
Reentry NPLs	0.2%	0.1%	0.3%	0.2%	0.2%	0.3%	0.2%	0.6%	0.7%
	1.0%	1.1%	1.0%	0.9%	0.7%	0.9%	0.9%	3.1%	2.5%
NPL Reduction									
Debt Restructuring	1.0%	1.0%	2.8%	0.6%	0.8%	1.3%	1.3%	4.7%	2.8%
Others	1.5%	1.8%	3.0%	0.4%	0.4%	0.7%	1.3%	6.4%	1.5%
	2.5%	2.8%	5.8%	1.0%	1.3%	2.0%	2.6%	11.1%	4.3%
Net NPL Reduction	1.5%	1.7%	4.8%	0.1%	0.6%	1.1%	1.6%	8.0%	1.8%
AMC	0.8%	1.0%	0.8%	0.0%	0.0%	0.0%	0.4%	2.5%	0.0%
Net NPL Reduction (w/o AMC)	0.7%	0.7%	4.0%	0.1%	0.6%	1.1%	1.6%	5.5%	1.8%

Source: The Bank of Thailand

Thailand's reform program should be differentiated from other programs in the region. The magnitude of Thailand's peak NPLs as a percentage of total loans is larger that in Korea or Malaysia, though less than Indonesia. In those countries, central governments vested new public institutions, to resolve corporate debts and restructure banks. Thailand did the same for the finance companies, which were the first hit by the crisis, but which represented a small part of the overall losses in the system. However, for banks, which went into crisis later, the Thai Government has followed a market-led, decentralized approach to reform, which is appropriate to the country situation.

Figure 18: Headline NPLs are falling



Source:The Bank of Thailand

Restructuring of the Banking Sector

NPLs are declining slowly. The BOT reported that NPLs of financial institutions as of March 2000 amounted to Bt 1.99 trillion (37 percent of total loans), 10.5 percentage points lower than the peak in May 1999. If NPLs transferred to AMCs were included, reported NPLs would reach Bt 2.13 trillion (39.8 percent of total loans), 8 percentage points lower than the peak. Net NPLs reduction in Q1 2000 (1.8 percent of total loans) was less than Q4 1999 (8 percent of total loans), mainly due to slower completed restructuring (2.8 percent of total loans in Q1 2000 versus 4.7 percent of total loans in Q4 1999) and accelerated activity for year-end accounting. In Q1 2000, new NPLs continued to enter into system, but at a slower pace (1.8 percent of total loans) than in Q4 1999 (2.5 percent of total loans). The magnitude of re-entry NPLs in Q1 2000 was similar (0.7 percent of total loans) to the Q4 1999 (0.6 percent) (Table 14 and Figure 18).

NPLs have declined across all sectors[2]. The import sector experienced the lowest reduction of NPLs, perhaps because imports were severely affected by the Baht depreciation in 1997. Even so, NPLs in the import sector dropped 15 percent from June 1999 to March 2000. The sector with the best performance has been personal loans; in March 2000, those NPLs dropped 34.5 percent from the June 1999 level (Figure 19). The bias resulting from the exclusion of NPLs transferred to AMCs from reported sectoral NPLs is small given that only 3 percent of NPLs have been transferred to AMCs to date. However, the data will be biased further once KTB transfers NPLs to its AMC. A closer look at new NPLs by sector during January to March 2000 showed that new NPLs in the mining and service sectors as a percentage of the sectors' loans were among the highest, while the utilities, banking (interbank, lending to bank subsidiaries, etc.) and construction sectors have been among the lowest.

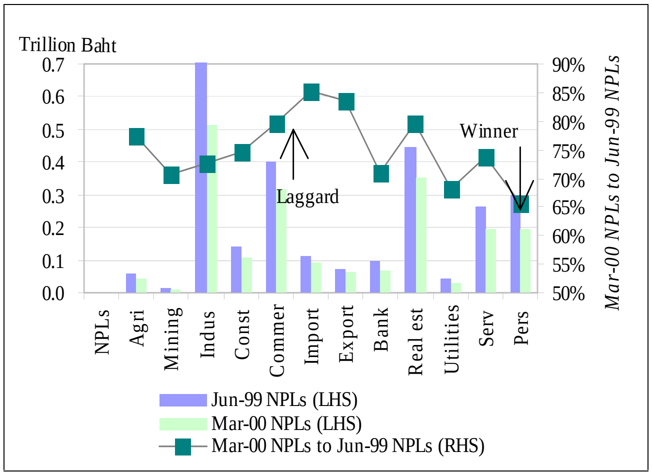
Table 15: NPL Ratio Forecast at the End 2000

March NPLs (incl. AMCs)	39.84%
Est. Net NPL reduction in the next 3 quarters*	(4.50%)
Est. NPLs at end-2000 (including AMCs)	35.34%
AMCs to be established**	(10.20%)
Existing AMCs	(2.59%)
Est. NPLs at end-2000 excluding AMCs	22.55%

* based on estimated net NPL reduction of 1.5 percent per quarter
** AMCs which are expected to establish before year end.

[2] The BOT has recently relaxed the criteria by which restructured loans are removed from NPL status. Today, any new restructuring agreement qualifies for NPL exit without any track record for repayments or other quality control. This raises questions about how many restructured loans may become NPLs once again. Since the revised NPL definition is more lenient than before, caution needs to be exercised regarding NPL existing under the revised definition so as to pre-empt their returning as NPLs in future.

Figure 19: Sectoral NPLs

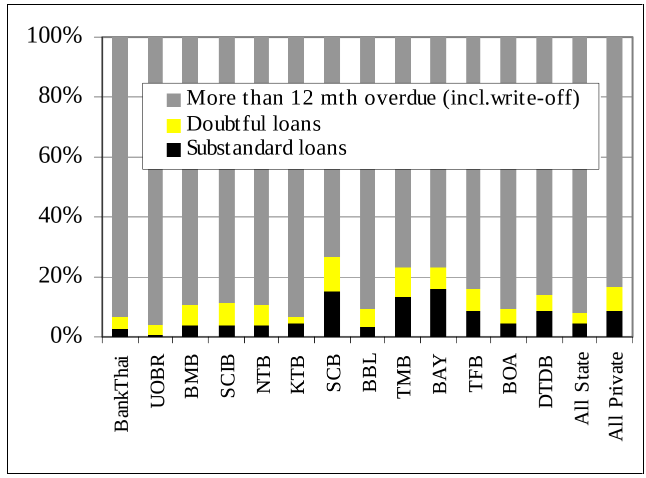


Source: Bank of Thailand

If NPLs continue to decline at the rate of 1.5 percent of total loans per quarter, reported NPLs should drop to 35 percent of total loans by the end of year 2000. If NPLs in existing and proposed AMCs are excluded, reported NPLs could go down to 22.6 percent by year-end. Our projected rate of NPL reduction (1.5 percent per quarter) is lower than the rate of NPL reduction during last two quarters (1.8 percent of total loans in Q1 2000 versus 8 percent of total loans in Q4 1999) (Table 15). We assume that the easier restructuring cases have been addressed, and the more complex cases remain, thus slowing the pace of restructuring in the next year. While banks have so far incurred only small net present value reductions (0-10 percent) from loan restructuring, they are likely to face larger haircuts going forward, when more difficult cases are restructured. The breakdown of classified loans supports these assumptions: 88 percent of the remaining classified loans below substandard as of December 1999 were more than 12 months past due.

The pace of NPL reduction will depend on sustainable economic recovery and a supportive interest rate environment. Real interest rates are in the 7 percent range, a further rise in Thai interest rates would be a blow to borrowers. In addition, the magnitude of non-restructurable cases (non-viable borrowers) is unknown, but depends in part on sectoral economic recovery. Banks which have recapitalized have expressed concern that their borrowers are not recovering as hoped, which means more rounds of recapitalization. Resolution of non-restructurable NPLs relies heavily on efficient foreclosure and liquidation processes, both of which take years. The post-judgement administrative process for foreclosure should be streamlined so that the process does not take more than a few months.

Figure 20: Classified Delinquent Loan Breakdown



Source: Bank of Thailand

Recapitalization continues. Four banks have announced plans to raise capital amidst negative sentiment from international investors. Thai Military Bank (TMB) needs to raise capital to meet the provisioning schedule under the BOT's forbearance program. Of Bt 30 billion raised, Bt 20 billion came from the government's capital support program and Bt 10 billion from the private capital market. TMB is targeting local investors to capture excess liquidity in the system. TMB's capital raising is made possible by enhancements to the government's capital support program. Innovative capital instruments (SLIPS and CAPS) are now permitted as matching private capital for the governments' stake, which means that private investors will receive two warrants (instead of one) for each share purchased. Each warrant will entitle the private investors to buy one of the Government's new shares for Bt 11 at any time during the next three years. Other banks acknowledge that they will have to raise more capital beyond prudential requirement if the recovery continues at the current pace.

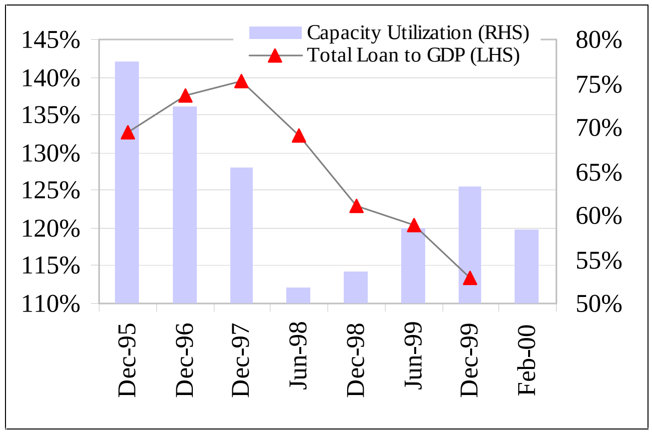
More banks reported positive pre-provision profits, but their sustainability depends on funding costs and economic conditions. Contributions to operating profits in Q1 2000 came from net interest income, primarily due to the fall in funding costs. For private banks, funding costs have dropped from 5.1 percent in Q1 1999 to 3.5 percent in Q1 2000, while interest yields have dropped from 5.6 percent to 5.1 percent over the same period. The recovery in Thai banks' earnings may carry on because (1) continued NPL restructuring might improve their spread (debt restructuring is resulting in more income, albeit at concessional rates); (2) costs, especially personnel costs, are being cut; and (3) banks will slow their provisioning once they meet the BOT's year-end 2000 requirement. However, the magnitude and sustainability of their earnings recovery depends on the degree to which Thai funding costs are immunized from increases in interest rates, the economic outlook (net NPL flow) and on the BOT's policy regarding continued forbearance on loss recognition (e.g., allowing provisions to be calculated net of inflated collateral values).

Loan volume declined further. Total loans (banks and finance companies) as of end 1999 declined 20 percent from the 1997 peak. However, in 1999 loans decreased at a slower rate than the decrease in 1998 (at 7 percent per year versus 13 percent). The loan-to-GDP ratio declined to 113 percent in 1999 from 139 percent in 1997 (Figure 21). This reduction reflects de-leveraging by Thai companies and write-offs of bad loans by banks (total Bt 185 billion loans were written off in 1999). Because of the undeveloped secured lending regime in Thailand, property is the dominant source of collateral for loans, so loans to the tradable sector are most often secured by assets from the non-tradable sector, where demand is low and values are uncertain, further constraining loan growth. Continued de-leveraging by domestic companies and financial dis-intermediation from the bond market may restrain loan growth below GDP growth.

Developments in the State Agencies

The BOT is expected to finalize the sale of Bangkok Metropolitan Bank (BMB) soon. The sale of BMB will minimize the public burden, and is a major step forward towards restructuring the banking system. On the other hand, the privatization of Siam City Bank has been delayed, since the price offered by bidders is considered too low. Bank Thai, which was created through the merger of a failed bank and a dozen finance companies, plans to raise capital in H2 2000 after its proposed yield maintenance and loss sharing scheme has been approved by the BOT, MOF, and the Cabinet. If successful, its planned capital increase would reduce the FIDF's stake to 49 percent, which would release the bank from rules governing state enterprises, and would give management a chance to compete effectively.

Figure 21: Loan to GDP and Capacity Utilization



Source : Bank of Thailand

The first step in Krung Thai Bank's (KTB) restructuring was endorsed by the Cabinet. The Cabinet has approved the FIDF's proposal to set up its wholly owned asset management corporation (AMC) to buy Bt 537 billion NPLs from KTB (FBCB: Bt 232 billion; KTB: Bt 305 billion). The purchase price was set such that KTB will be adequately capitalized, but uncovered losses will be transferred to the AMC and will be recognized over time. KTB will receive a Bt 328 billion five-year AMC note from the FIDF. The amount of AMC note is net of Bt 108 billion capital, which KTB will have to return the FIDF. The transaction will reduce FIDF's stake in KTB from 93.5 percent to 87.2 percent. After the transfer of NPLs to an AMC, KTB's NPLs will go down to 16.5 percent (from 57 percent), and its tier-1 capital will be 9.56 percent. The AMC will be established with Bt 25 million initial capital. The establishment and transfer of NPLs to AMC will be finalized in Q3 2000. The

FIDF plans to engage professional, third party asset managers with proper incentives to maximize returns to the taxpayer on the AMC's assets.

Core assets have been sold, and the FRA plans to complete sales of non-core assets by year-end. The remaining value of non-core assets of the failed finance companies is not believed to be significant. Thus far, proceeds from non-core asset auctions total Bt 34 billion and proceeds from the sale of core assets are Bt 152 billion (25 percent of outstanding principal balance). Details for all sales are summarized in Table 16 and Table 17. Creditor claims have been adjudicated for approximately 50 finance companies, and they plan to complete that process by mid-year. However, the FRA is facing some legal challenges regarding the distribution of proceeds. Some creditors have sought court judgements for full repayment, instead of their prorata share based on the relative amount of each creditor's claim. Therefore, the FRA has filed bankruptcy petitions against those particular finance companies to pre-empt possible judgements for other than prorata distribution of proceeds. At the FRA's request, the Council of State is reviewing whether the FRA can distribute proceeds to creditors on a prorata basis before petitioning for receivership of each finance company. Another challenge is the distribution of collateral for syndicated loans which is co-owned by separate purchasers of auctioned assets. So far, voluntary negotiation has worked. There are over 200 cases still to be negotiated.

According to management, the Asset Management Corporation (AMC) has restructured or resolved a total of Bt 144 billion assets, which is 73 percent of its total portfolio of Bt 196 billion (outstanding principal balance). The AMC was established to be a bidder of last resort for auctions of assets from the failed finance companies by the FRA. Most resolved cases were property loans. 30 percent of total restructuring year to date were settled by transfers of property by the debtors to the AMC (deed in lieu of foreclosure). The AMC will allow debtors to continue to manage the properties if the projects appear feasible. Other restructuring methods include debt to equity swap (9 percent), maturity extension (9 percent), and legal action (10 percent). The remaining Bt 52 billion assets consist mostly of commercial loans, which have proven to be more difficult to resolve. AMC management plans to manage down its assets in five years.

Table 16: Financial Sector Restructuring Authority Auction Results (Core Assets)

Bid Date	*Core Assets*	*Book Value*	*Recovery*	
		(Bt Billion)	*(Bt Billion)*	*%*
25-Jun-98	Auto hire purchase contracts	51.8	24.9	48.0%
13-Aug-98	Residential mortgage loans	24.6	11.5	46.8%
15-Dec-98	Business loans (1st Round)	155.7	39.0	25.0%
19-Mar-99	Business loans (2nd Round)	221.5	40.3	18.2%
6-Jul-99	Construction loans	1.3	0.2	12.2%
11-Aug-99	Commercial & other loans (1st)	129.0	31.0	24.0%
11-Nov-99	Commercial & other loans (2nd)	16.3	5.4	32.9%
Total		**600.2**	**152.2**	**25.4%**

Source: Financial Sector Restructuring Authority

Capital Market Development

The BOT is leading a task force within the Domestic Bond Market Committee to reduce counterparty risk in the system to settle bond trades. Bahtnet 2, an automatic delivery vs. payments settlement system, is under development. This will allow the anonymous market system to function by eliminating counterparty risk, which was the downfall of the market when the crisis broke. In addition, the Revenue Department is identifying tax impediments to the derivatives and bond market, and plans to make recommendations to eliminate those impediments this year.

Debenture issuance by domestic corporations continues to be active in Q1 2000. Domestic companies have raised Bt 67 billion worth of debentures in Q1 2000 versus Bt 59 billion in Q4 1999. Q1 activity was prompted by a new SEC rule,

Table 17: Summary of Non-Core Asset Sales (as of March 30, 2000)

Non-Core Assets	Bid Price (Million Baht)
Repossessed automobiles and a yacht	1, 439
Other	
- Golf club memberships	32
- Mobile phones, pagers, books	6
- Art objects	59
- Furniture, office equipment and computers	420
- Mini computer	3
Real estate	2,430
Capital Investments	
- Government securities	18,085
- Listed securities	2,127
- Non-listed securities	1,954
- Mutual fund unit trust	1,971
- Corporate debentures and convertible debentures	6,292
Total non-core assets sold	**34, 818**

Source: Financial Sector Restructuring Authority

which requires that after April 2000, all debentures, including those offered through private placement, must be rated by a credit rating agency. Previously, the SEC required a rating for only public offerings. The soaring activity in the primary market has been driven by increased demand for fixed income instruments at the long-end of the yield curve. Competing yields from bank deposit rates are historically low (3-4 percent). On the supply side, firms are refinancing their current borrowings. Although debenture issuance by private companies has soared, government issues still dominate the domestic bond market. As of March 2000, government bonds made up of 49.6 percent of a total of Bt 1.4 trillion outstanding issues. Bt 500 billion in FIDF refinancing bonds accounts for the largest portion.

The SEC and SET are promoting the domestic stock market. Their aim is to enhance the competitive edge of the Thai stock market in response to globalization. Their proposal promotes both the demand and supply side by: (1) merging the foreign board with the main board to increase flexibility for foreign investors; (2) allowing for dual or multiple listings; (3) allowing securities companies to invest overseas; and (4) introducing new hedging instruments. The new Derivatives Act is to go before the Parliament in July. In addition, the SET approved in principle the termination of the fixed par value requirement at Bt 10 per share for listed companies to boost the number of tradable securities. This proposal is under review by the SEC. To promote new listings, the SEC proposed to reduce requirements for new listings on both the SET and the MAI (the Market for Alternative Investment). In addition, many unlisted firms under report income in order to avoid taxes. In order to attract them to the SET, the SEC has proposed a tax amnesty on past performance for newly listed companies.

Supervisory Regime

The Draft "Financial Institution Law" was approved by Cabinet and the Council of State in Q1 2000. The Cabinet's approved version does not materially differ from the BOT's version. The draft law will consolidate laws governing banks, finance companies and credit fonciers. The emphasis of the draft law includes financial liberalization, strengthened supervision, prompt corrective action, and improvement in disclosure and corporate governance. The draft law is awaiting final cabinet endorsement, after which it will be submitted to the lower House for the first reading. This draft law, the draft "Bank of Thailand Act" and the draft "Currency Act" are moving through the legislative process together. The draft "Deposit Insurance Act," which would replace the blanket guarantee with limited depositor protection, has been held until market confidence is fully restored. One problem, however, is that the exit procedures outlined in the draft "Deposit Insurance Act" were not transferred in whole to the "Financial Institutions Law" for actions in the interim. Another problem is that clauses which remove impediments to mergers and acquisitions of financial institutions were removed in favor of a future general revision to the legal regime for mergers and acquisitions for all firms. However, such revisions to the legal framework outside of the draft "Financial Institutions Law" will take some time, and market-led consolidation of the banking industry is imminent.

The BOT is reengineering its supervision function, with the assistance of a management consultant and professional supervisors from the US. Risk-focused supervision is replacing transaction testing. A commissioning process and training courses for examiners has been established. Offsite reporting and on-site supervision processes are being revamped according to best practice in the Thai context. Information system supervision is being developed. A complete listing of technical support to the financial and corporate sectors by all partners to the Thai authorities is available on the web at **www.worldbank.or.th/ta/**.

The Ministry of Finance has formed a Task Force on the Supervision of Financial Conglomerates. For the first time, the MOF has brought together representatives from all supervisory agencies, including the Bank of Thailand, the Securities and Exchange Commission, the Department of Insurance, the Auditor General, the Comptroller General's Department (MOF) and the Fiscal Policy Office (MOF), to establish arrangements for supervision of financial conglomerates. The draft "Financial Institutions Law" allows financial firms to own other financial firms as subsidiaries, and also allows a holding company structure. Currently, links among financial institutions occur through cross ownership and control by family shareholders, but banks can hold only up to 10 percent of another financial firm, with exceptions granted on a one-off basis. Under the draft law, equity investment by banks in non-financial firms would be limited. To aid coordination, the authorities are considering whether to move the insurance regulator from under the purview of the Ministry of Commerce to the purview of the Ministry of Finance along with the BOT and the SEC. In its early deliberations, the Task Force is favoring decentralized examination and supervision by separate, specialized supervisory agencies, which will share risk analysis on the different businesses within each financial conglomerate.

Table 18: Supervision Responsibility

Roles	Commercial Banks		SFIs
	Private banks	State banks	
Mandate	Shareholders	MOF/CGO*	MOF/CGO*
Enforcement	BOT	MOF	MOF to BOT
Prudential / Supervision	BOT	BOT	MOF to BOT
Examination	BOT	BOT	BOT

* CGO = Comptroller General Office
SFI = State Financial Institutions

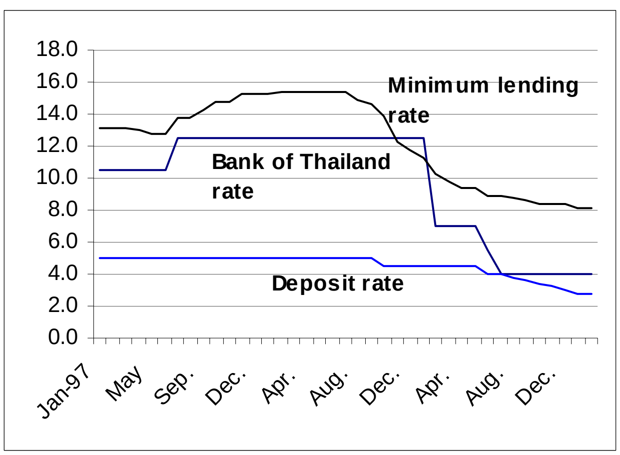
The Financial Services Task Force is now focusing on the medium-term strategy for the finance company sector and the capital market. During the crisis, the finance companies were hardest hit, and have undergone substantial consolidation, from 91 to 20 companies. This consolidation is likely to continue as a result of their competitive disadvantages vis-a-vis banks, given that leasing, now the exclusive territory of finance companies, will soon be opened to banks as well. Even though the existing market share of finance companies in the loan market has declined from 25 percent pre-crisis to below 5 percent today, the remaining firms pose a potential challenge to the regulator. In response, the BOT is proactively evaluating its strategic options going forward. The SEC is preparing a medium-term strategic plan for the capital market, which will be incorporated into the recommendations of the Task Force to the Ministry of Finance.

Challenges Ahead

Given the improvement in external balance, monetary policy should continue to accommodate financial and corporate sector restructuring. Although real interest rates have come down from the peak in mid 1999 to slightly below the pre-crisis level (Figure 22), the current level of real interest rates appear relatively high. While the current level of real lending rates is below the pre-crisis level (7.16 percent versus 7.76 percent), given the current economic conditions, real lending rates are not low enough to stimulate demand. Unfortunately, domestic interest rates appear to be at their bottom, given rising US interest rates. An increase in interest rates at this point in a fragile recovery could trigger an increase in new NPLs and the re-entry of previously restructured NPLs, as well as complicating debt restructuring negotiations. In addition, any increase in bank funding costs would compress already weak margins, given that most borrowers cannot afford higher lending rates.

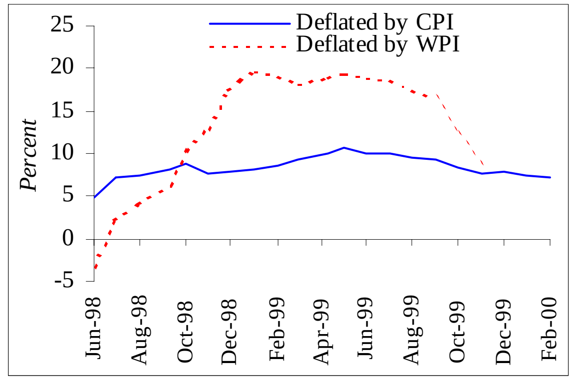
Loss sharing among all stakeholders should be more fairly distributed. The burden of financial sector restructuring has been most heavily borne by taxpayers and both existing and new shareholders of financial institutions (creditors). Depositors are protected by the government's guarantee, but they bear the cost of reduced return on their deposits. The weak legal and administrative regimes for bankruptcy and debt collection allows defaulted debtors to avoid sharing losses. Good debtors are being penalized by paying high real lending rates on their debt, charged by banks to cover the NPLs in their portfolio. Due to weak penalties, debtors are incentivized to default on their loans. This uneven burden sharing harms credit culture and overall economic performance. Instead, losses should be re-distributed more evenly so that defaulted debtors, not performing debtors, are penalized by rapid and transparent enforcement of the loan contract. In addition to a strengthened CDRAC, an effective tool to speed debt resolution would be to streamline the legal regime for debt collection, such that the post-judgement administrative processes take months instead of years. In addition, expansion of the court's capacity to support a larger volume of cases would also contribute to enhanced credit culture.

Figure 22: Interest Rates 1997-2000



Source : Bank of Thailand

Figure 23 : Real MLR



Source: BOT and Staff Calculations

The domestic capital market should enable banks to finance their near-term capital requirements, but recapitalization beyond that level may require a supportive policy. As of December 1999, banks have already set aside 69 percent of the provisions required for the end of year 2000, and their tier-1 capital was 8.5 percent. Private banks' provisions were 82 percent of the year-end 2000 standard; state banks' provisions were 60 percent of that level (See Table 19). To reach the full provisioningrequirement, state banks need Bt 232 billion while private banks need only Bt 21 billion of additional tier-1 capital. Since the amount of additional capital required for private banks to meet 2000 provision rule is not substantial, the domestic capital market should be able to finance their near-term need. However, more pessimistic assumptions on NPL recovery rate will increase the amount of private banks' capital need by ten fold. The domestic capital market may be able to finance private banks' recapitalization need beyond the regulatory requirement, but only if such financing occurs over several years. An extension of the government's capital support program as a last resort may be needed past the end of the year.

Table 19: Existing Reserve + Write offs to Total Required by Year 2000 Rule* (Billion Baht)

	Dec 99 Loan Reserve (1)	Write off (2)	(1) + (2) = (3)	(4) 2000 Required Reserve*	(3) / (4)	Recap Need for 2000 Rule*
Private banks	294	152	446	546	81.75%	21
Bangkok Bank	167	3	170	208	81.98%	7
Thai Farmers Bank	24	79	102	109	94.27%	0
Bank of Ayudhya	27	4	31	42	73.56%	0
Siam Commercial Bank	19	64	83	96	86.62%	0
Thai Military Bank**	21	1	22	41	53.45%	12
DBS Thai Danu Bank	19	2	20	25	80.37%	2
Bank of Asia	18	0	18	26	68.50%	1
State banks***	435	26	461	770	59.89%	233
Total Domestic Commercial Banks	729	178	907	1,316	68.96%	254

Source: Annual Reports
* Assume 100 percent required reserve for substandard and doubtful loans
** TMB already raised Bt 30 billion in Q2 2000
*** Include privatized banks, whose losses in next 5 years are to be shared by the state under the sharing agreement.
*** Before KTB's AMC

A financing plan for the losses of the Financial Institution Development Fund (FIDF) is under development. The FIDF estimates that the future value of its net losses in the next 5 years ranges between Bt 800-1,200 billion (US$ 21-31 billion), in addition to the Bt 500 billion (US$ 13 billion) of FIDF refinancing bonds already issued by the Government. The range of estimated losses is driven by different assumptions on asset recovery rates (35 percent versus 45 percent) and the inclusion or exclusion of Bt 20 billion annual fees paid to FIDF by financial institutions. The BOT has agreed with the MOF to finance Bt 132 billion losses by using "excess" foreign reserves held by the BOT, after the passage of the Central Bank Act and the Currency Act. However, the MOF has not yet clarified the financing plan for the remaining losses of the FIDF. More than 60 percent of the FIDF's liabilities are mostly funded inexpensively in the short-term market, but with high interest rate risk.

CORPORATE RESTRUCTURING

Key Developments

- Restructuring is still concentrated in large corporate firms. Medium and small loans and their underlying assets are being restructured slowly, and markets for distressed assets are not clearing. The corporate restructuring completion ratio (debt restructured as a ratio of size of NPLs) is high for services and export sectors and relatively low for the construction, real estate and manufacturing sectors.

- The first quarter of 2000 saw a slow down in both the number of cases and the value of debt restructured as compared to the fourth quarter of 1999.

- Additional medium-size cases were added to the Bank of Thailand's CDRAC target program. At the end of April 2000, 32 percent of total debt by volume had been restructured under CDRAC.

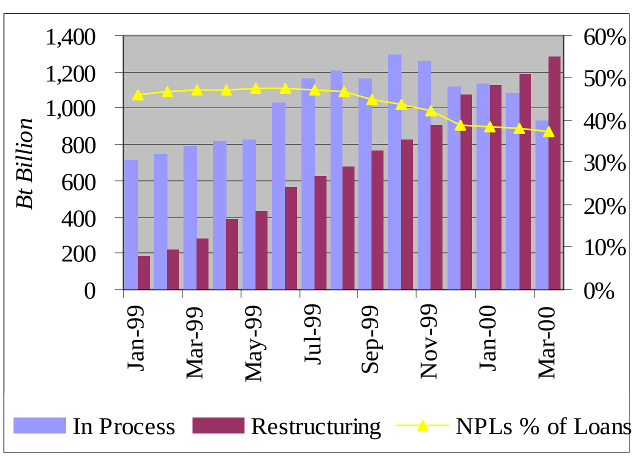
- Court-supervised business reorganization and liquidation petitions filed with the Central Bankruptcy Court have increased in volume during the first quarter of 2000.

- There is scope for improving both the pace and quality of corporate restructuring. Financial leverage of firms still remains high and they are vulnerable to any future increases in interest rates.

Overall pace of the debt restructuring completion rate has slowed down in the first quarter of year 2000. During the first quarter 2000, Bt 213 billion of debt was restructured as compared to Bt 309 billion during the fourth quarter of 1999. The decrease in the completion rate was expected as financial institutions usually accelerate restructuring at the end of the accounting periods in June and December to report favorable NPLs.

To date, 47 percent of total peak NPLs have been restructured. At the end of March 2000, financial institutions increased the total completed debt restructuring by 52,579 cases from December 1999 to a total of 213,791 cases. The credit amount restructured over the same period increased by Bt 207 billion to a total of Bt 1.29 trillion. This represents 47% of peak NPLs of Bt 2.7 trillion at the end of May 1999 (Figure 24). The reported progress also includes completed restructuring under CDRAC, which targets proactive restructuring of non-NPL cases.

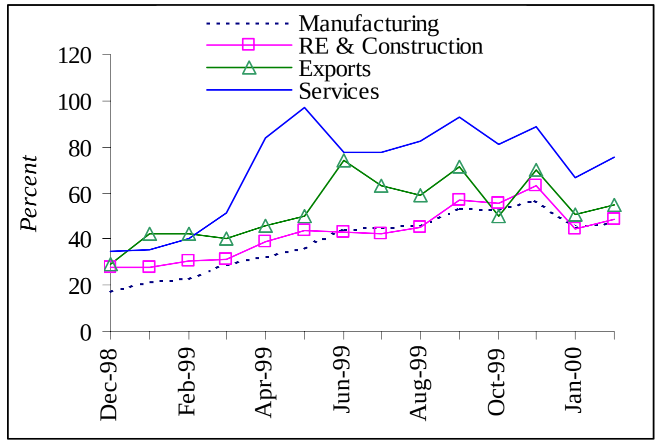
Figure 24: Progress on Total Debt Restructuring



Source: Bank of Thailand

Figure 25: Sectoral Corporate Restructuring Completion Ratio

(Debt restructured as a ratio of size of NPLs)

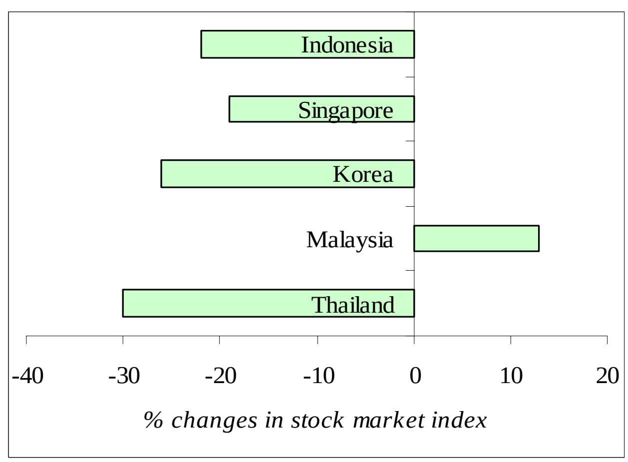


Source: Bank of Thailand

Completed restructuring varied across sectors. Restructuring completion rate is high in services and export sectors but relatively low in real estate (including construction) and manufacturing sectors (Figure 25). Improving economic conditions, lower market interest rates, and increasing success of bilateral restructuring were the contributing factors to raise the completion rate, while limited domestic demand and investment, and lack of FDI have been the cause of slow restructuring in the affected sectors.

Figure 26: Stock Market Performance

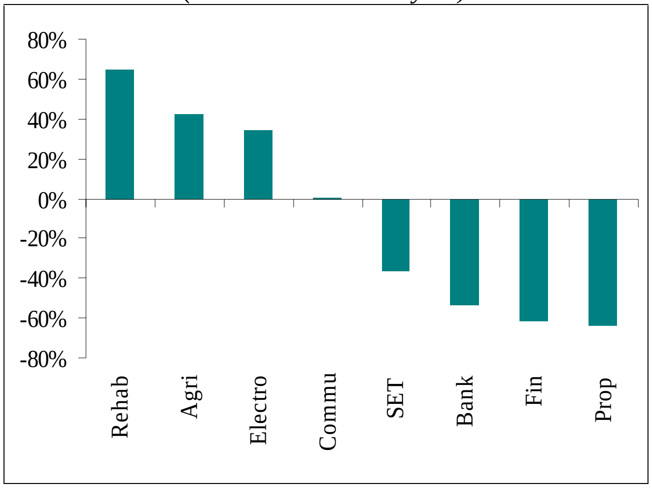
(Change between end-December 1999 – March 2000)



Source: Stock Exchange of Thailand

Figure 27: Changes in stock index by sectors, Thailand

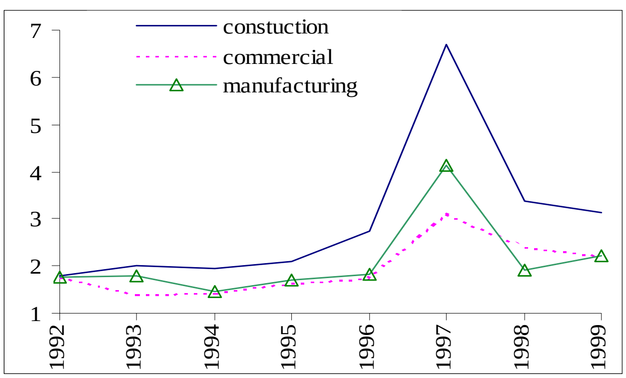
(22 June 99 to 12 May 00)



Source: Stock Exchange of Thailand

Since the crisis, most sectors have experienced a reduction in the debt-to-equity ratio. For example, the debt-to-equity ratio for the construction sector fell from 7 in 1997 to around 3 in 1999. Similar trends can be observed in manufacturing and commerce. But the level of debt-to-equity remains high, particularly in the construction sector (Figure 28).

Figure 28: Debt to Equity Ratio by Sector, Thailand



Source: Stock Exchange of Thailand

CDRAC

More target cases have been added to CDRAC Program. At the end of April 2000, target debtors under CDRAC totaled 9,142 cases (credit outstanding of Bt 2,562,173 million), which comprised of 2,682 corporate cases (credit outstanding of Bt 2,272,198 million), and 6,460 small and medium sized cases (credit outstanding of Bt 289,975 million). Completed restructuring totaled 3,328 cases (Bt 811,817 million, or 32 percent of total credit outstanding), of which 374 are large target cases (Bt 768,781 million, or 33.8 percent of total outstanding credit), and 2,954 are small to medium cases (Bt 43,036 million, or 14.8 percent of total outstanding credit). 1,732 cases (Bt 859,980 million or 33.6 percent of total outstanding credit) have failed the CDRAC process and have proceeded to legal actions.

Cases under CDRAC consist of NPLs, defaulted investments, and proactive restructuring of loans yet to be classified as NPLs. Therefore, the total exposure under CDRAC is higher than the reported NPLs of the system.

CDRAC is concerned with the slow progress of the small and medium-sized cases. At the end of April 2000, only 2,954 cases (Bt 43,036 million, or 15 percent of total outstanding credit) have been restructured, while 452 cases (Bt 35,579 million) have proceeded to legal action. (See Table 20).

Court-Supervised Restructuring and Liquidation

Court-supervised debt restructuring has increased in volume. Between January through March 2000, 14 business reorganization petitions (value over Bt 169 billion) were filed with the Central Bankruptcy Court, a substantial increase from the total of 37 cases (value Bt 363 billion) filed in 1999. In April, the number of filings increased to 15 petitions (value over Bt 140 billion). Liquidation petitions have also increased during the first quarter of 2000. In 1999, 441 petitions were filed (value under Bt 11 billion), while in the first quarter 2000, 240 petitions (value over Bt 10.7 billion) were filed. Court officials felt that debtors and creditors have a better understanding of the bankruptcy law and are more confident in the legal protection under the court system. More debtors are filing petitions to protect their businesses as out-of-court direct negotiations with creditors proved futile. (Table 21).

Table 20: Status of CDRAC Target Cases

As of April 30, 2000

Stages	Corporate (Groups 1,2,3)		SMEs		Total		
	#Cases	Amt.	#Cases	Amt.	#Cases	Amt.	% of Total
Completed cases (signed restructuring contract, agreed on plan & in process of signing)	266	468,697	2,954	43,036	3,220	511,733	
Agreed on plan, in process of signing restructure contract	93	169,682	-	-	93	169,682	
Plan accepted, will file in court	15	130,402	-	-	15	134,402	
Total Completed Cases:	374	768,781	2,954	43,036	3,328	811,817	31.7%
In Restructuring Process (draft/ propose/amend plan, to be voted)	420	258,803	684	51,722	1,104	310,525	12.1%
Plan Rejected (after 2nd vote) – Will Proceed to Court Action	125	172,222	452	35,579	577	207,801	8.1%
Debtors not signatory under DCA/ICA/SA, proceed to court	779	746,913	831	57,578	1,610	804,491	
Unsuccessful restructuring	39	53,031	83	2,458	122	55,489	
In Process of Legal Action	818	799,944	914	60,036	1,732	859,980	33.6%
In Process of Signing Debtor Accession	885	112,786	1,456	99,602	2,341	212,388	
Returned to performing loans	60	159,662	-	-	60	159,662	
Total Approved Target Debtors	2,682	2,272,198	6,460	289,975	9,142	2,562,173	100.0%

Source: The Bank of Thailand

Table 21: Progress of Central Bankruptcy Court

Business Reorganization and Liquidation
As of April 30, 2000

Type of Filing	Volume	1999	Jan-00	Feb-00	Mar-00	Apr-00	Jan-Apr 00 Total
Reorganization	Cases	37	3	3	8	15	**29**
	Million	362,841	118,169	13,395	38,374	139,333	**309,271**
Liquidation	Cases	441	88	71	8	56	**223**
	Million	10,500	7,411	1,128	2,168	1,775	**12,482**

Source: Central Bankruptcy Court

Box 2

Landmark Insolvency Decision: The TPI Case

The Central Bankruptcy Court ruled in favor of the creditors in the TPI insolvency case. Effective Planner Co., Ltd., was later appointed as the Planner to restructure over Bt 120 billion bad debt. The ruling was based on the existing legal definition of insolvency, namely "liabilities exceed assets". Therefore, the so called "balance sheet test" prevailed in the decision. Creditors' valuation assumptions and appraisal methods were found to be more reliable than the methods presented by the debtor. While the decision is viewed as a positive step, it should not be regarded as a legal precedent for defining insolvency under the more appropriate criteria of "ability to pay when debt falls due". The insolvency test remains the discretion of the court, and as a result, further reform of the insolvency regime is still needed.

Strategies to Accelerate Debt Restructuring

Increasing restructuring completion rate and eliminating unnecessary delays. CDRAC and BOT play an implicit, strategic role in directing the quality of debt restructuring through establishing the acceptable restructuring principles and qualitative targets. However, with perceived slowness in debt restructuring, CDRAC and the BOT have recently taken a more proactive role to accelerate the process. New measures include (1) The Executive Decision Panel (EDP) has been established to render binding decisions on deadlocked issues between debtors and creditors upon request. The EDP process may occur anytime prior to legal action which automatically proceeds 60 days after the failed second vote, and it can be requested either by the debtor or the creditor. To date, 29 cases have been referred to EDP, with binding decisions rendered on 9 cases; (2) CDRAC is considering mediation services to help the negotiation process; (3) the requirement for financial institutions to forward cases to CDRAC if they were unable to successfully negotiate restructuring by May 2000; and (4) a restructuring target of 16,000 cases per month for financial institutions in 2000.

CDRAC is strengthening restructuring capacity. Several independent debt restructuring advisors will be contracted to assist CDRAC in facilitating and accelerating the restructuring of small and medium-sized cases as well as corporate loans.

Reforming the legal framework to enhance restructuring. The Ministry of Justice Committee is working on the amendment of the Bankruptcy Act. The Committee announced that it is considering several crucial issues: (1) reviewing the "excessive debt" criteria which defines "insolvency", and possibly broadening the definition to include the "liquidity problem" of the debtors; (2) allowing honest and yet-to-be declared insolvent small, medium, and individual debtors to petition for protection as an opportunity to revive the business; (3) separating of individual from corporate bankruptcies; and (4) assessing the cost of appointing independent business reorganization planners. However, the committee has not announced the timeline to put forth the amendments, which is in itself a lengthy legislative process.

The draft Secured Transaction Act approved by the Cabinet. The Cabinet approved the draft Act in early May 2000. The Act provides for legal inclusion of a wider range of personal and business assets, such as receivables and property rights, which can be pledged as collateral. It gives both the debtors and creditors more options to negotiate and agree on loan restructuring and new credit facilities. The act is now being reviewed by the Council of State prior to submission to the Parliament for approval.

Challenges Ahead

Increasing the recovery rate of distressed assets. In a restructuring environment characterized by low capitalization and weak legal implementation, sectors which do not promise a high recovery rate on restructuring will pose an overwhelming challenge.

Addressing excess capacity in core sectors. Creditor-driven removal of capacity is by and large not occurring. Even where firms have negative equity and whose petitions are likely to be accepted by the bankruptcy court, creditors have in general not filed petitions and as a result assets are not clearing.

Debt collection outside bankruptcy law needs strengthening. Enforcement of security interests is difficult both in terms of time as well as in terms of procedures. This unduly increases the burden on bankruptcy proceedings. The Civil Procedures Code on Default has been passed into law. The procedures could result in greater reliance in asset sales and would facilitate rationalization of capacity in the real sectors.

Few, if any, mergers between distressed firms have occurred. The merger process in Thailand is time consuming and onerous, requiring six month notice period during which creditors may object to the merger or demand immediate payment. The Civil and Commercial Code and the Public Limited Companies Act require that the two merged entities lose legal status before creating a new legal entity out of the two independent units. In addition, although the tax code for mergers has been improved to waive taxable of non-cash transactions, it is still biased against the ability to carry net losses forward to the new entity. The authorities need to consider removal of these impediments to streamline market-led mergers and acquisitions.

Strengthening CDRAC's ability to deal with less viable cases. Over time, the firms approaching CDRAC for assistance are likely to be in less viable sectors or small and medium-sized firms. CDRAC's successful restructuring will require more resources devoted to analysis, business restructuring, and mediation.

Addressing NPLs of state-owned banks. The growth rate of loss-classified loans among state-owned banks indicates that the institutions are not equipped to deal with debt restructuring. The Bank of Thailand is in the process of adopting the Principles and Guidelines for Valuation of Debt Restructuring, to be used by state banks. In addition, asset management companies are being set up, organized on a sector basis and staffed with management qualified to deal to restructure debt and manage assets in those sectors.

Court-supervised restructuring is expected to increase. To prevent delays due to higher volume, the court will have to improve its administrative procedures and capability to maintain or improve the current average of 4 months case completion. The court has expressed concern, but assured the public that it has sufficient resources to handle more cases.

MEDIUM-TERM COMPETITIVENESS

Key Developments

- Total factor productivity growth (TFP), quality adjusted labor growth, changes in the structure of manufacturing exports, and the steps taken to modernize regulatory institutions and business environment, all suggest that Thailand is making progress towards strengthening its medium-term competitiveness.
- Sustained and high quality growth will require further deepening reforms: improving corporate governance, openness, skills, competition, and providing an enabling environment for SMEs.
- As part of the strategy to increase domestic value-added and strengthen backward linkages, Thailand has embarked on a program to improve the competitiveness of the SME sector.
- Thailand has a strong foundation of basic education, but important challenges remain in terms of post-basic education and development of workers' skills.
- Thailand is developing a comprehensive information technology strategy. The first priority has been to develop the legal framework for e-commerce transactions, including the Electronics Transactions Act and the Digital Signature Act. Further legislation, including the Universal Access Law; Data Protection Law; Computer Crime Law; and the Electronic Funds Transfer Law are in the process of being drafted. At the same time, National Electronics and

computer Technology Center (NECTEC) has also been conducting intensive education and training programs in the e-commerce area.

- Thailand is proceeding with its privatization agenda. The Corporatization Act, which was passed by Parliament last year, facilitates corporatization and private participation in state enterprises. Detailed restructuring plans for the telecommunications and energy sectors are ready. Upcoming transactions include the strategic sale or public offering of a stake in Thai Airways International; the Airports Authority of Thailand (Regional Airports); the Petroleum Authority of Thailand; the Ratchaburi Power Plant; the Communications Authority of Thailand; and the Telephone Organization of Thailand. While Thailand remains fully committed to privatizing state-owned enterprises to improve their efficiency and improve the quality of services offered to the public, it has also placed a high priority on modernizing and strengthening its regulatory framework and institutions.

- The Customs Act was amended in March 2000. This will allow Thailand to introduce the WTO Agreement on Customs Valuations which will help to increase transparency, and reduce uncertainty and corruption in the process of import valuation, and allow the implementation of an electronic system for the submission of claims, and an ex-post auditing system based on importers' and exporters' customs records.

Problems and Challenges

Growth in Thailand has been input rather than knowledge driven. The financial crisis unveiled structural weakness hidden behind Thailand's exceptional growth rates during the 1990s. Indeed, growth in Thailand, as well as in other East Asian countries, was driven by accumulation of physical capital, with little improvement in total factor productivity (i.e., technological progress). Since 1989, the growth rate of total factor productivity had been declining, from 5 percent during the early 90s to -1.8 percent in 1996 (Figure 29 and Table 22). Since 1999 TFP has started to grow again, mostly as a result of a "bounce-back". In the medium term the TFP growth rate is estimated to be 1-1.4 percent per year. Higher growth rates, which approximate those observed in the late 1980s, will require completing the agenda of institutional reforms (discussed in the next sections), aimed at moving from an input to a knowledge-based economy.

Figure 29: Dynamics of Total Factor Productivity

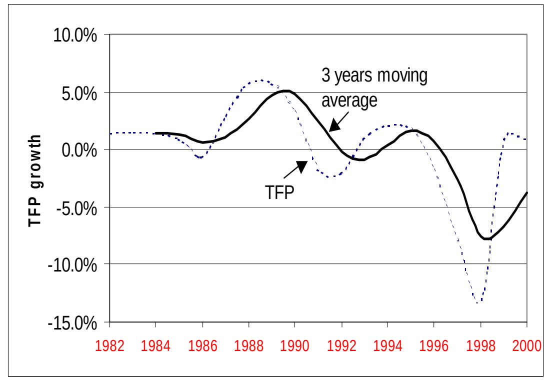


Table 22: TFP and GDP Growth (1995-2000)

	Capital	Quality adjusted labor	TFP	GDP
1995	6.16%	1.03%	1.69%	8.9%
1996	5.36%	1.83%	-1.80%	5.4%
1997	3.40%	2.75%	-7.85%	-1.7%
1998	1.77%	1.32%	-13.09%	-10.0%
1999	1.77%	1.41%	0.82%	4.0%
2000	1.94%	1.61%	0.95%	4.5%
Medium Term	1.99%	1.61%	1.41%	5.0%

Source: Staff Calculations

Corporate Governance

Good corporate governance promotes relationships of accountability among the primary corporate participants with the objective of enhancing corporate performance. It holds management accountable to boards and boards accountable to shareholders. The recent financial crisis has highlighted the need for more clear rules and legal standards to govern the relationships among shareholders, directors, and management. These include rules and standards addressing the fiduciary duty of directors and responsibility of management, the protection of shareholder rights and most, importantly, enforcement of those rights.

While substantial progress has been made in improving corporate governance, much of the reform agenda remains unfinished. The Government has approved a framework as well as draft legislation to: (a) streamline the institutional framework for setting standards and regulating the profession; (b) establish the Thailand Financial Accounting Standard Board (TFASB) as an independent entity with authority for setting accounting standards; and (c) make the Institute of Certified Accountants and Auditors of Thailand (ICAAT) an independent self-regulatory professional body consistent with international best practice. In order to improve quality of audits, the content of audit reports has been improved. The Accounting Act has been passed by the Parliament and a plan has been adopted to implement and remove the burdensome statutory audit requirement for about 200,000 limited partnerships. BOT has prepared new specific rules on accounting for banks and finance companies. The Committee on Good Corporate Governance from a wide spectrum of professionals, including businessmen, lawyers, bankers, and accountants has been established. Improved guidelines on the code of best practice for listed company directors have been issued.

Accounting standards consistent with international best practice are being adopted. The Government has required that financial statements of listed companies, as well as non-listed public companies, banks, and other financial institutions with assets in excess of Bt 1 billion, be prepared and audited in accordance with improved standards starting financial year 1999 (Box 3).

The Public Companies Act (PCA) is being amended. A working group has prepared changes to the PCA that will improve shareholder protection, such as access to performance-related information and procedures for calling a shareholder meeting. These changes also include provisions related to duties of directors, director and management self-dealing, and sanctions for fraudulent practices. Draft amendments to the PCA and the Security and Exchange Act (SEA) are being finalized and is expected to be submitted to the Parliament by December 2000.

In addition, SET has revised the guidelines on the code of best practice for listed company directors consistent with international best practice, and has made disclosure of non-compliance with such guidelines mandatory under the listing rules. All listed companies are now required to have an audit committee of the board of directors. Moreover, existing requirements for internal controls for listed companies and for the audit committees of boards of directors, including their roles and responsibilities, have been improved.

In order to increase the effectiveness of the regulatory framework, the roles and responsibilities of SET, SEC, and MOC, in monitoring compliance with and enforcing the PCA and SEA, have been clarified. Under the new arrangement, SET is the front-line regulator in monitoring and administratively enforcing listed companies' compliance with the SEC and the SET regulations. The SET is responsible for preliminary investigation of any violation and will defer cases to the SEC for further investigation as necessary. The SEC is responsible for monitoring the performance of auditors of listed companies and securities companies. While SEC focuses on listed companies, MOC has responsibility for monitoring all public companies.

In order to improve corporate governance practices, Thailand will need to intensify its effort to provide clear and enforceable securities and public companies laws to protect shareholder rights and to ensure an effective regulatory framework capable of enforcing such laws.

Financial information and disclosures are an efficient means of protecting shareholders and are at the heart of good corporate governance. Significant efforts have been expended in the last year to upgrade Thai accounting standards to international levels and much additional work is underway. While more effort is warranted to improve standards, the challenge now is to ensure the application, compliance, and enforcement of those standards by practitioners, professional institutions, and regulators. Much

Box 3 : Improved Accounting Standards Adopted by The Institute of Certified Accountants and Auditors of Thailand in 1998 and 1999

Thai Accounting Standards	Based on	Effective Date
Framework of the Preparation and Presentation of Financial Statements	IASC Framework	
TAS 32: Property, Plant and Equipment	IAS 16 (1998)	Approved & Effective: Jan ‘99
TAS 33: Borrowing Costs	IAS 23 (1993)	Approved & Effective: Jan ‘99
TAS 34: Troubled Debt Restructuring	SFAS 15 SFAS 114	Approved: Jan ’99; Effective: Jan ‘99
TAS 35: Presentation of Financial Statements	IAS 1 (1997)	Approved & Effective: Jan ‘99
TAS 36: Impairment of Assets	IAS 36 (1998)	Approved: Feb. 99 Effective: Jan 99
TAS 37: Revenue Recognition	IAS 18 (1993)	Approved: Feb ‘99 Effective: Jan ‘99
TAS 38: Earnings Per Share	IAS 33 (1997)	Approved: Feb ‘99 Effective: Jan ‘99
TAS 39: Net Profit or Loss for the Period, Fundamental Errors, and Accounting Changes	IAS 8 (1993)	Approved: Feb ‘99 Effective: Jan ‘99
TAS 40: Accounting for Investments in Debt and Equity Securities	SFAS 115 IAS 39	Approved: Feb ‘99 Effective: Jan ‘99
TAS 41: Interim Financial Statements	IAS 34 (1998)	Approved: Mar ‘99 Effective: Jan 2000
TAS 42: Accounting for Investments Companies	AICPA Industrial Audit Guide	Approved: June ‘99 Effective: Jan 2000
TAS 43: Business Combinations	IAS 22 (1998)	Approved: May ‘99 Effective: Jan 2000
TAS 44: Consolidated Financial Statements and Accounting for Investments in Subsidiaries	IAS 27 (1998)	Approved: May ‘99 Effective: Jan 2000
TAS 45: Accounting for Investments in Associates	IAS 28 (1998)	Approved: May ‘99 Effective: Jan 2000
TAS 46: Financial Reporting of Interests in Joint Ventures	IAS 31 (1998)	Approved: June ‘99 Effective: Jan 2000
TAS 47: Related Party Disclosures	IAS 24 (1994)	Approved: June ‘99 Effective: Jan 2000
TAS 48: Financial Instruments: Disclosure and Presentation	IAS 32 (1998)	Approved: June ‘99 Effective: Jan 2000

Source: The Institute of Certified Accountants and Auditors of Thailand further efforts will be required to strengthen necessary institutions responsible for ensuring compliance, including the professional institutes, and to improve and enforce necessary mechanisms such as the code of ethics and code of conduct for accountants, and the code of best practices for directors. Enactment of amendments to the Accountants' Professional Act will allow establishment of the Thailand Financial Accounting Standard Board to set accounting standards and enhance the role of the Institute of Certified Accountants and Auditors of Thailand as a self-regulatory professional body.

Thai corporate governance has largely been self-regulatory. Going forward, it is important to ensure that a proper balance is maintained between self-enforcement and effective enforcement of regulation by regulators. While self-regulation is desired and ideal, enforcement by outside shareholders, and effective enforcement of regulations and legislation by regulators should help change corporate culture and business practices and can pave the way for effective self-regulation in the long run. Minority shareholder rights need to be significantly strengthened, and accountability and liability of directors in the case of breach of duty further clarified. Amendments to the PCA and SEA should improve shareholder rights and the ease with which they exercise those rights, better protect outside shareholders against conflict-of-interest transactions benefiting insiders, increase accountability of directors to the shareholders, and improve administrative enforcement by regulators. In order to promote voluntary compliance, the Thailand Institute of Directors has been established to train company directors and 100 company directors are expected to be trained on the roles and responsibilities of directors by December 31, 2000.

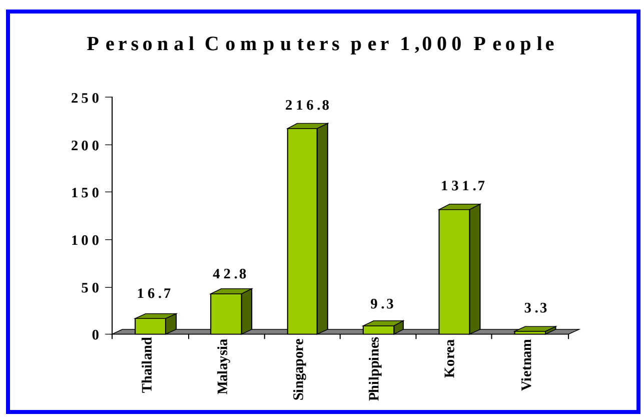
The challenge is to focus on more effective enforcement of laws and regulations by the regulatory agencies. Thai judiciary system is perceived by the market as having lax and ineffective enforcement. It is recognized that until significant improvements are made in the system, a strong regulator can compensate for a weak judiciary. Efforts need to be intensified on improving effectiveness of the legal and regulatory framework. SEC's role in enforcement of securities regulations needs to be further strengthened by streamlining criminal procedures for violations of SEA. In order to further raise the level of confidence in the Thai capital market, enforcement of sanctions on insiders for false or misleading disclosure, self-dealing transactions, or conflict-of-interest cases, need to be carried out more effectively and expeditiously.

Information Technology Strategy

Current trends point to the pre-eminence of information and communication technology - the knowledge economy – as a source of future productivity gains. How is Thailand positioned to make the most of these trends?

Thailand is in the process of developing a comprehensive information technology strategy. The National Information Technology Committee located in the Prime Minister's Office is coordinating this task. The National Electronics and Computer Technology Center (NECTEC) in the Ministry of Science, Technology and Environment is the secretariat for the committee. Thailand's strategy aims to create a legal framework and an information infrastructure that enables businesses to expand the range and value of their goods and services. An important element of this strategy is to tap the potential for e-commerce especially in the business-to-business arena.

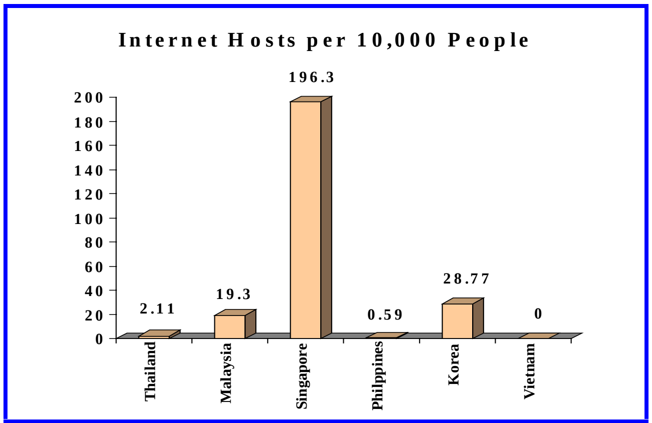
Figure 30: Personal computers per 1,000 people



Source: NECTEC

NECTEC has also been conducting an intensive education, training and awareness building program in the area of e-commerce. Sector specific awareness and partnership programs have been conducted all over Thailand. NECTEC has also been developing the RTG Intra-Net with a view to linking RTG agencies and facilitating interface with the private sector.

Figure 31: Internet hosts per 10,000 people



Source: NECTEC

By October 2000 the Digital Signature Act will be finalized. By the end of the year the remaining four pieces of legislation would be drafted. Before finalizing the laws, NECTEC will also embark on an intensive program of discussing these laws and infrastructure requirements with the business and legal community. This is with a view to ensuring that the laws are responsive to business needs and consistent with market structures and practices.

Thailand must build a new economic base. It is at the heart of the dynamic new economy, as it supports the sharing of knowledge, flexible and strategic partnering, more efficient processes, domestic and global networking, market expansion, and more.

SMEs

As part of the strategy to increase domestic value-added and strengthen backward linkages Thailand has embarked on a program to strengthen the competitiveness of the SME sector. The Government has finished a review of the legal and institutional framework for the development of SME's. Based on this review the SME Promotion Act has been passed into law. This law provides the basis for coordinating, financing and implementing SME support activities by various RTG agencies. Under this law a new agency called the Office of Small and Medium-Sized Enterprise Promotion will be established. A Master Plan for development of SMEs in the manufacturing sector has also been submitted to the Cabinet. An Institute for SMEs Development (ISMED) has also been established as the core institution to provide business management and technology services and training to SMEs.

The Office of Small and Medium-Sized Enterprise would have the important task of disseminating information to SMEs on management, skills development and technology upgradation support services. The SME Act also calls for the creation of an SME Fund. This Fund will address the adverse impact of the banking crisis on the SME sector and will aim at making SMEs more creditworthy and bankable. By the end of the year, the policies and operating procedures for the SME Fund will also be announced. During the second half of this year the Government will also develop a Master Plan for supporting SMEs in the trade and services sector.

Skills Development

Thailand has a strong foundation of basic education, but important challenges remain in terms of post-basic education and development of workers' skills. While modern-sector wage employees have on average 9 years of formal education, much lower levels of education persist among older workers and workers in the informal sector. This restricts labor mobility to modern-sector wage employment and imposes constraints to the adoption and diffusion of new technologies.

The distribution of employer-provided formal training is very uneven, with the incidence of training being particularly low among small and medium-size companies. Almost 40 percent of manufacturing establishments provide formal skills training to some members of their workforce, either through in-house training programs, or through courses given by external training providers. The incidence of in-service formal training in Thai manufacturing appears to be as high as that in Malaysia and higher than those in other developing countries with lower average per capita incomes where broadly comparable training data are available. However, as Table 23 shows, the distribution of employer-provided formal training is very uneven, with the incidence of training being particularly low among small and medium-size companies. What accounts for this uneven distribution of training in Thailand is not known, but some studies reveal that while many firms do not train because the derived demand for skills from using old technology is low, many firms and SMEs, in particular, are also constrained by high labor turnover (and loss of training investments), poor knowledge about how to train or the benefits of training, and access to finance for training.

Thailand has instituted a number of demand-side policies over the past five years to promote skills training among workers, the labor market at large, as well as in companies. On the worker side, the Skills Development Fund (SDF) was created in 1997 to provide new labor market entrants, the unemployed, and currently employed workers with low-interest short-term loans for approved training courses that would provide skills certification. In principle, the SDF is a useful instrument for enabling workers whose employers are not training them to self- finance the acquisition of certified skills that would improve their job prospects both within and, perhaps more importantly, outside the firm. Policies more pertinent to promoting employer training include the (1) 1994 Vocational Training Promotion Act to set up company-based vocational training centers for new hires with 50 percent tax exemption on qualified training expenses; (2) the 1995 Training Tax Exemption Decree to provide tax incentives for employers to train employees with more than 6 months of seniority, either within the firm or in government vocational institutions or approved schools.

The tax exemption incentives of 1994 and 1995 are relatively benign but generally ineffective policies as evident in the very low rate of use by companies. Interviews with employers and both regional and international experience provide some perspectives on these latter policies. First, tax-based training policies tend to be very diffused and difficult to target. International experience indicates that training tax incentives tend to be used mainly by large companies and multinationals, most of whom already train, so that there is little “additionality”; they do little to induce training among SMEs, the population of firms least likely to train. Since 1995, the MOL has qualified less than 450 firms to receive training tax exemptions. This low take-up is reflected in the 1997 TICS survey data (Table 23), where less than 2 percent of firms reported using the training tax exemption. The major beneficiaries of this incentive were larger firms and not SMEs, even though a high proportion of both groups of firms reported providing formal training to employees.

Table 23: Formal Enterprise-Based Training in Thai Manufacturing 1997 (%)

	SMALL	*MEDIUM*	*LARGE*	*TOTAL*
Any Formal Training	28.3	62.2	82.1	40.1
In-house Formal Training	14.2	44.1	71.8	35.5
External Formal Training	22.8	54.0	79.1	34.0
Use Training Tax Exemption	0.8%	4.0%	3.6%	1.9%

Source: 1997 Thailand Industrial and Competitiveness Survey (TICS)
Notes: Survey of 1277 firms in five sectors, with approximate inverse sampling weights
Size definitions: Small <50, Medium 50-300, Large <300 employees.

Thailand is reviewing its strategy on skills development, particularly in small and medium-sized enterprises, in order to amplify its impact. The objectives include: i) reforming the current Vocational Education Act; ii) strengthening the organizational structure, financing mechanisms, and a medium-term strategy for specialized institutes; and iii) amending the Skills Development and Promotion Act and developing regulations with particular focus on financing and operation mechanisms for the Skills Development Fund and the certification of training programs.

Technological Capability

The two major manifestations of the technological gap in Thailand include the rapid reduction in the

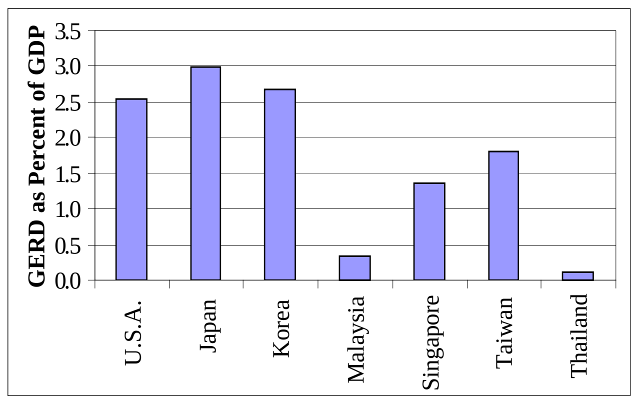
growth rate of total factor productivity observed since the late 1980s, and strikingly low levels of R&D in the private sector, one of the lowest in the region as a proportion of GDP. While Thailand has managed to update its technological base through foreign direct investment (during the 1990s foreign direct investment represented close to 26 percent of total private gross investment), its technological capability is limited. Though Thailand gives generous tax incentives for R&D, few firms use the incentives. Institutional support for technological activity is also not well coordinated. The Science and Technology (S&T) infrastructure is at present largely geared to a "supply push" strategy of technology development, with weak linkages with industry and a mutual lack of interaction and trust. The incentive structure and culture in the research institutions seems to be unsuited for a supportive role for technological activity in Thai industry.

The Government has undertaken several measures to facilitate technological upgrading and stimulate R&D investment in Thai industry. It has reorganized the Thai Industrial Standards Institute (TISI) to hive off its testing functions and letting it specialize in the core "public goods" functions of writing standards and accrediting testing laboratories. This has opened up the field for private provision of testing and calibration services. It has set up a National Metrology Institute to coordinate the different institutions previously providing calibration and improving the traceability of national measures. The laboratories under NSTDA are considering reorienting themselves to providing more services to industry. New/revamped mechanisms for providing technology finance are being considered. SMEs are being targeted in a program of financial and technological support. The new industry centers under MOI, with private sector representation, are charged with providing technology upgrading and training services to industry.

In addition, studies are being conducted to address the following issues: i) reforming incentives for R&D; ii) reorienting the mission of public research laboratories; iii) better integrating technology services provided by the MOI industry centers with client needs; iv) assessing skills needs for R&D, and v) reviewing financing programs for R&D.

Investment promotion embodied in the Investment Promotion Act and administered by the Board of Investment (BOI) has been Thailand's main vehicle for attracting foreign direct investment. The BOI can authorize and approve a wide range of tax, tariff and non-tax incentives to new investors. In the past these measures were successful in inducing large FDI flows to Thailand. However, in the last couple of years the Government has been re-examining the efficacy of these incentives. At the request of the Government, FIAS undertook a detailed review of the efficiency of these incentives. This review concluded that these incentives were often unnecessarily complex. Moreover, the incentives did not result in spillovers to the local economy in the form of increased productivity or skills development.

Figure 32: International Comparison of R&D Investments



Competition Policy

Thailand has enacted or drafted a number of laws that will improve competitiveness, productivity, and help facilitate technology upgrading. The new pieces of legislation or amendments to existing laws include the Foreign Business Act, the Patent Act, Law on Property Leases for Commerce and Industries, and amendment to the 1991 Trademark Act. To enhance product quality and increase the acceptability of Thai products in international markets, since 1997, Thai industrial standards are now systematically based on international standards.

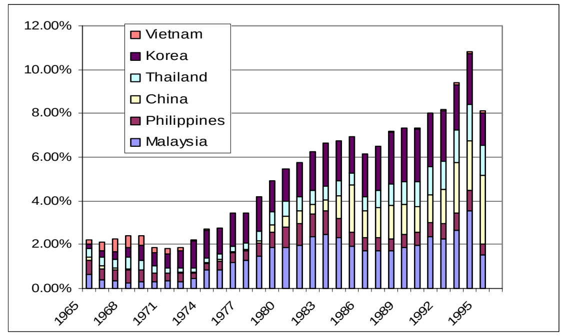
To keep pace with rapid changes in market structures in the financial and real sectors, the Government has revamped the Price Fixing and Anti-Monopoly Act of 1979. In 1999, the Parliament enacted the Business Competition Act, 1999 and the Price of Goods and Services Act, 1999 to replace the 1979 Act. These two acts aim to ensure fair competition, provide consumer protection and combat monopoly practices.

The Business Competition Act of 1999 embodies modern concepts of anti-competitive behavior. It provides a sound legal basis for the three substantive areas of competition policy: prohibited practices; abuse of dominant position, price fixing and collusion; and mergers and acquisitions, joint ventures and strategic alliances. The Act provides for the creation of an independent, free of conflict competition policy authority to oversee implementation of the Act. As required by law, the twelve members to the Committee have been appointed.

The 12-member Committee on Business Competition was established in November 1999. This Committee is located in the Department of Internal Trade, Ministry of Commerce. Under the proposed loan, RTG also took up the task of building the Committee's capacity to oversee and implement the Business Competition Act. Starting in the second half of 1999, the Government started implementing a program to provide the Committee with technical skills and resources for implementing the new Act. Under this draft, implementing regulations have been developed along with the corresponding guidelines and interpretation documents, containing standards, methodologies, and administrative procedures for the enforcement of the remedies and actions provided by the law. Training programs and seminars were also conducted for Committee staff on key competition policy issues.

The momentum on capacity building needs to be maintained, implementing regulations need to be finalized, and a manual of operating procedures and staff training needs to be prepared. The Competition Commission would also develop a strategy for disseminating information to the public and for encouraging a voluntary compliance strategy.

Figure 33: World market shares for exports of electronics



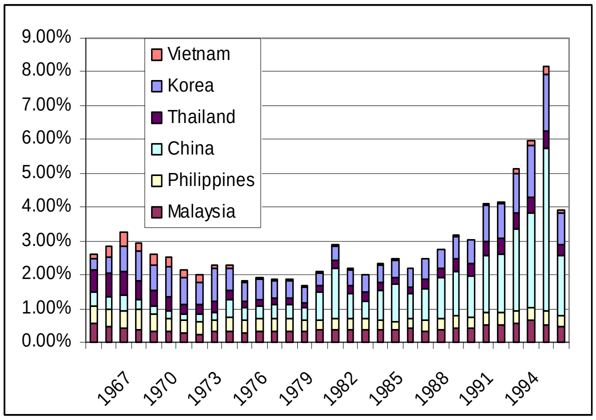
Trade Policy

Even before the crisis, concerns were raised about Thailand's ability to compete in international markets. The reason for this was the stagnant share of Thai exports in world trade. Indeed, a review of the international trade flows by sector, before the crisis, shows Thailand's market share as stagnant, while the market shares of countries such as China were growing rapidly.

Thailand will face global competition. A mechanism to evaluate the level of competition faced by countries is to compare the correlation between the structure of their exports. Table 24 presents the correlation at the three-digit SITC level across East Asian Countries. The results indicate high correlation across most of the countries. Thailand faces competition from all East Asian countries (Indonesia to a lesser extent), and in particular China which has only weak correlation with the majority of other countries.

China's potential adherence to the World Trade Organization provides both an opportunity and a new challenge to Thailand. China's proposal is to reduce its average industrial import tariffs from 25 percent in 1997 to 9.4 percent by 2005. The share of its imports covered by administrative barriers would also fall to 11 percent from 33 percent. China's offer on services includes opening up the distribution and retail system, telecommunications and financial services. Foreign investors will be able to invest in joint ventures in these areas for the first time. Clearly these concessions offer Thailand potential gains in terms of access to Chinese markets. However, there could be potential losses in international commodities and capital markets as China is granted MFN benefits.

Figure 34: World Market Share for Exports of Textiles



Thailand has succeeded in climbing up the technology ladder. The structure of exports has changed over time. As shown in Table 25, the share of technology intensive exports has increased while resource-based exports have contracted.

Import tariff surcharges introduced during the crisis have been eliminated. Thailand has largely maintained an open and export-oriented trade regime and reduced its dependence on customs receipts as a revenue source. Currently, customs revenue accounts

Table 24: Correlation of structure of manufacture exports (1995)

	CH	HK	IN	KO	MA	PH	SI	TH	TA
CH	1								
HK	0.59	1							
IN	0.35	0.17	1						
KI	0.21	0.40	0.1	1					
MA	0.17	0.43	0.18	0.73	1				
PH	0.31	0.51	0.21	0.66	0.82	1			
SI	0.2	0.36	0.07	0.66	0.74	0.62	1		
TH	**0.57**	**0.54**	**0.21**	**0.52**	**0.59**	**0.58**	**0.70**	1	
TA	0.35	0.44	0.09	0.64	0.67	0.56	0.81	**0.76**	1

Source: Lall et al (1999)

for about 8 percent of tax revenue. Applied tariffs, in September 1999, ranged from zero to 242 percent (out-of-quota duty on raw silk) with a simple average of 18.4 percent (compared to 23 percent in 1995). With the onset of the financial crisis, a 10 percent surcharge was applied to all imports bearing duties of 5 percent or more. These surcharges have now been eliminated.

Table 25: Change in the structure of manufacture exports by technological level (85-95; percentage points)

	Resource Based	Low Tech	Medium Tech	High Tech
East Asia	-11	-9	2	17
China	-28	8	8	12
Hong Kong	3	-11	-4	12
Indonesia	-31	14	10	7
Korea	2	-21	2	17
Malaysia	-36	3	9	24
Philippines	-30	-4	3	32
Taiwan	-5	-23	2	11
Thailand	-19	-10	-1	30
Latin America	-27	1	16	9
South Asia	-7	3	3	1
LDC	-16	-3	6	13
DC	-2	-1	-2	4

Source: Lall et al (1999)

Thailand intends to continue the process of liberalization by further compressing the tariff bands, and reviewing the system of special duties and exemptions. The government is currently preparing for the introduction of tariff changes within the context of AFTA agreement. According to this agreement, Thailand will have to have 85 percent of tariff line items within the 0 to 5 percent band. A certain core set of items is common to all AFTA members but broadly the individual countries are free to choose the list. Currently about 73 percent of lines are at the 0-5 percent level. The other 12 percent remain to be identified. The list will eventually be expanded to cover 100 percent of tariff line items. Thailand cannot retain significant duties on capital goods and raw materials and still be competitive with regional imports of finished goods at 0 to 5 percent. RTG has established a Tariff Committee within the Ministry of Finance to carry out a comprehensive review of the tariff schedule. It is likely that the rates for raw materials and capital goods would be reduced to zero and the other rates set in a range up to a maximum of 15 percent. Zero rates at the raw and capital end would alleviate some difficulties with rebates (drawbacks) and would reduce the need for certain BOI tariff exemptions.

Table 26: Structure of Applied Tariffs in Thailand

	INDICATORS	*1995*	*SEP-99*
1.	Bound tariff lines as a share of total lines	72.4	73.5
2.	Duty-free tariff lines	2.6	3.6
3.	Non-ad valorem tariffs/all tariffs	31.1	21.3
4.	Tariff quotas/all tariffs	0.9	0.9
5.	Tariffs with no ad valorem equivalent	2.5	0.3
6.	Simple average bound tariff rate	37.6	33.1
	Agricultural products (HS 01-24)	40.0	37.8
	Industrial products (HS 25-97)	37.3	32.0
7.	Simple average applied tariff rate	23.1	18.4
8.	Simple average applied MFN tariff rate	23.1	17.1
	Agricultural products (HS 01-24)	43.1	32.1
	Industrial products (HS 25-97)	20.7	14.6
9.	Domestic tariff peaks	0.1	7.6
10.	International tariff peaks	59.3	47.7
11.	Overall standard deviation (SD)	16.9	17.9
12.	Coefficient of variation (CV)	0.73	0.97

Source: WTO

The Customs Act was amended in March 2000. This will allow introducing the WTO Agreement on Customs Valuations which will help to increase transparency, reduce uncertainty and corruption in the process of import valuation, and allow the implementation of an electronic system for the submission of claims and an ex-post auditing system based on importers and exporters customs records. To be able to compete in an open economy Thailand needs to reduce logistic costs. To this end, consolidating Customs reform is a critical factor. Substantial progress has been made in this area. One of the main implications of the electronic system is that medium and large importers would be able to clear their merchandise without inspection, thus reducing clearing time considerably. Guidelines and regulations for the implementation of the Act have been drafted and are expected to be approved by October 2000. The Customs department would then need to focus on implementation and the completion of its internal plan for administrative reform including human resources management.

SOE Reform

Thailand's commitment to reforming state-owned enterprises (SOE) and implementing a divestiture program is articulated under the 1998 Privatization Master Plan. The objective is to improve the economic efficiency of key industries including energy, telecommunications, water and transport. The Government's privatization efforts are designed to enable competitive markets to emerge in these sectors in a framework that stimulates private investment, protects consumers and provides a basis for Thailand's long term competitiveness in the global economy. The Bank's ongoing Economic Management Assistance Project (EMAP) supports the RTG's strategy of preparing the ground for privatization by putting into place a strong regulatory framework, building institutional capacity and beginning a well contemplated, time bound program of corporatization and divestiture of selected state-owned enterprises.

Progress on privatization and SOE reform has been slower than anticipated at the time when the Privatization Master Plan was passed by the Cabinet in September 1998. This is mainly due to a heavy reform agenda; a weak legal framework; lack of institutional capacity to implement the agenda; the absence of a vision and articulation of a strong strategy and public campaign to build consensus among stakeholders, especially SOE employees and consumers, as to the benefits of privatization; and the absence of a systematic public information campaign, which led to anti-foreign ownership sentiments and resistance from employee unions. It must be acknowledged that in spite of these drawbacks, there has been a steady movement in the implementation of the agenda. However, some areas such as the water sector have lagged behind; employee issues have yet to be addressed systematically; remaining legal reforms are likely to move at a slow pace; and institutional capacity, especially in regulation, remains a key issue.

Progress has been made in the legal framework to facilitate SOE reform and divestiture. RTG's emphasis has been on putting in place a strong regulatory framework and creating independent regulatory bodies, free from political intervention, to ensure a stable investment environment and to help protect consumer interest. The State Enterprise Corporatization Act was passed in December 2000 and will enable RTG to corporatize individual enterprises without further parliamentary involvement. The enactment in 1999, of the Alien Business Act and the Act on Leasing of Property for Commerce and Industry, is significant in promoting direct investment and greater liberalization. The State Employees Labor Relations Act (SELRA), which repeals restrictions on the rights of state enterprise workers to unionize and strike, was also passed by the Parliament.

Telecommunications: The Act on Organization of Radio Frequency Wave Allocation and Supervision of Radio Broadcasting and Radio Television Broadcasting Business; and Telecommunication Business B.E. Frequency (The Frequency Management Act) became effective in March 2000 and will allow for the establishment of the National Communications Commission (NCC). The NCC will facilitate the establishment of an independent regulator in the telecommunications sector by October 2000. The Telecom Bill which provides guidelines for the regulator was endorsed by the Cabinet in March 2000 and is expected to be presented to the Parliament by July 2000. The conversion of existing Build-to-Operate (BTO) concession contracts essential for full liberalization of the telecomm sector remains one of the most challenging issues in the sector. The Cabinet recently issued a resolution specifying guidelines for conversion concessions and a committee has been formed to oversee the conversion process which is expected to be completed within the next nine months.

Transport and Energy: The cabinet has approved the regulatory framework and market structure for the energy and transport sectors and independent regulators in these sectors are expected by the end of year 2001. A comprehensive Transport Sector Framework Reform Study was undertaken and completed in April 1999. The report provides a framework for improved policy and planning in the transport sector, development of modal regulatory framework and the direction of reform for the 14 SOEs in the sector. The partial privatization of Thai Airways is expected in September 2000, the privatization of AAT is being accelerated. The state expects to sell AATs major airports this year and shares in AAT early next year. In the energy sector, NEPO is preparing detailed plan for transition to a power pool which is expected to be completed by July 2000. The partial privatization of Ratchburi power generating plant is expected in September 2000.

Water and Wastewater: Reforms in the water and wastewater sector have lagged behind, mainly because Government's focus has been on other sectors. The Government now plans to accelerate reforms in this sector.

Employee interests need to be addressed in a systematic manner. A key issue for Government is to address employee resistance to SOE reform and corporatization, and to protect their interests. In the absence of safety nets and training programs, employee resistance is likely to increase. Government has entered into a dialogue with labor on key issues in the program. As a part of the effort to address employment impacts, MOF has been preparing a series of proposals on severance pay, early retirement, training and shares' distribution to employees.

PUBLIC SECTOR REFORM

Background

The economic crisis highlighted the need for broad-based public sector reforms in Thailand. That need for reform received renewed impetus with the passage of the new Constitution in 1997 which provides for greater citizen participation, decentralization, accountability, and transparency – tools that enhance voice and improve public sector governance. The Constitution's main themes are to: promote and protect citizen's rights and human integrity, promote participatory democracy, improve political structures, decentralize authority to local bodies, redesign the work process of government agencies to be responsive to citizens' needs, and abolish cumbersome regulations that are a burden to efficient markets.

In May 1999, the Cabinet issued its Public Sector Management Reform Plan, which provides the Government's vision for modernizing the public sector. The Government's Public Sector Reform Committee is responsible for overseeing the public sector reforms. The Government's Program constitutes a three-year action agenda to reform Thailand's public sector in the areas of (i) expenditure management, (ii) human resources management, (iii) revenue management, (iv) decentralization, and (v) accountability and transparency.

The major objectives of the program are (i) enhancing performance of resource management; (ii) improving service delivery; and (iii) strengthening accountability and transparency to help boost public and investor confidence in Thailand.

The reform program explicitly recognizes that institutional reforms require time to implement and are inherently uneven in pace. Hence it has been designed around concrete objectives with flexible benchmarks that can be adjusted as necessary to accommodate the pace of implementation. Reform progress across program areas has been generally positive although somewhat uneven (as expected).

Public Expenditure Management

- Budget reform pilots have been launched in 7 government agencies in various ministries.

- "Gaps" in seven hurdle areas (budget planning, activity costing, procurement management, budget control, financial and performance reporting, asset management, internal audit) have been identified and clear work-programs have been defined to fill these gaps in three pilots.

- The Bureau of the Budget (BoB) and the Comptroller General's Department (CGD), have agreed on a common set of objectives, each formed a separate steering group, established working groups, identified pilot departments and hired international consultants who have produced numerous reports.

- The BoB has begun discussions on the need for modernizing its legal framework for budgeting.

- Significant progress has been achieved in implementing performance-based budgeting in the Ministries of Public Health (MoPH) and Commerce (MoC) as well as in the Office of the Civil Service Commission (OCSC).

- The Ministry of Finance has established a Public Debt Management Office (PDMO) to manage its debt and liabilities (see Box 4).

Human Resource Management

- The Government introduced an early retirement scheme, which targeted 30,000 officials. During the initial round from July to September 1999, 23,216 early retirements were approved; OCSC estimates that cumulative savings of almost Bt 8.4 billion will occur over ten years (see Box 5).

- Functional reviews are underway in six economic ministries and the Ministry of Public Health.

- A proposal for establishing a performance-based position classification system has been introduced to the Cabinet. The blueprint for the performance-based human resource management system includes detailed proposals concerning position classification, recruitment, selection and promotion, performance appraisal, and performance pay proposals for the civil service. Position classification reforms are being given priority, and Cabinet approval will shortly be sought to a new, more flexible and simple system, based on competency-based job descriptions, which will be piloted in two agencies before implementation in other ministries in 2002.

- Another proposal before the Cabinet seeks to develop a well-motivated, politically neutral, cross-governmental senior cadre (or Senior Executive Service) to lead the civil service renewal program. Full implementation of an SES will require a new salary system.

Revenue Management

- The Large Taxpayer Organization (LTO) has achieved significant progress: 2,318 large companies (accounting for one-half of total

Box 4 : Establishment of the Public Debt Management Office

A Public Debt Management Office (PDMO) was created in the Ministry of Finance on 20 September 1999. Its mandate is to be the single office in the Thai Government with full responsibility for monitoring and managing Thailand's public debt. It will also monitor and analyze the fiscal risks associated with the Government's contingent liabilities (e.g., sovereign guarantees on state enterprise borrowings). The PDMO, in close collaboration with the Bank of Thailand, will assist policy makers in developing a comprehensive, medium-term financial and debt management strategy. It will also assist in the creation of short-, medium- and long-term borrowing plans that are consistent with the NESDB's Development Plan and the Government's fiscal and monetary stance. To achieve these objectives, the PDMO will undertake several functions including: debt service forecasting; active debt management; cash management; risk management (to hedge against currency, interest rate, funding and refinancing, credit and operational risk, among others); monitoring project finance related transactions; and tracking and preparing to deal with contingent liabilities of Government. To this end, the PDMO is in the process of developing an appropriate information system and skills base to support integrated public debt management. This will require establishing a number of debt, cash, risk management and other systems, each linked together—both mechanically and through appropriate operational procedures and guidelines within government. These new systems will be supplemented by continuous training and guidance from local and international experts at strategic intervals during this ongoing endeavor.

revenues collected) are currently being handled by the LTO.

- Five programs to speed up collection of tax arrears have been established and debt collection strategies are being implemented. VAT registrations have increased by over 11 percent between FY98 and FY99. Rules regarding VAT refunds have been tightened, and taxpayer liability for other taxes is checked before refunds are issued. Revenue collected from audit activities have also increased, in part due to better targeting.
- The Revenue Department is discussing with the Thai Banking Association procedures for obtaining information about taxpayers' bank accounts and for seizing funds..
- 19,875 assessments totaling Bt 4,514 million with debt more than 10 years old have been written off. Writing off uncollectible debts will become a regular procedure to clear the system of bad debts, and enable staff to concentrate on collectible cases.
- The Revenue Department produced a new, draft strategic plan that assigns responsibility for implementing the strategies between the headquarters divisions and regional, area and provincial office.

Decentralization

- Members of the National Decentralization Committee have been appointed.
- The Bureau of the Budget is working to devolve 20 percent of government revenues to local governments by 2001 and to 35 percent by 2006.

Accountability and Transparency

- The organic law on Counter Corruption was enacted in November 1999; a new Office of the National Counter Corruption Commission (ONCCC) and the National Counter Corruption Commission (NCCC) were officially established, complete with adequate budgets to implement the required programs this year. New laws are being drafted for blind trusts, conflict of interest, and collusion.
- The NCCC has taken a more active role in asset declaration (Box 6). Besides the requirement for politicians and high-ranking officials, the Commission has recently passed by-laws ordering all local government representatives of Tambon Administrative Organizations (with total annual revenue equal or above Bt 50 million), Provincial

Box 5 : The Government's Early Retirement Scheme

The Government has introduced an early retirement scheme, which targeted 30,000 officials (civil servants, teachers, university staff, military and police) based on the principles of voluntary retirement, no impact on service delivery (requiring agreement from each retiree's supervisor) and only 20 percent of retirees being permitted to be replaced – on top of a general hiring freeze for the civil service. Under the first round of the scheme from July to September 1999, 23,216 early retirements were approved, including nearly 5,000 civil servants and over 12,700 teachers. Despite the relatively generous payments under the scheme – no loss in retirement benefits and payment of 7 months salary as a retirement incentive – OCSC calculates net savings by the third year and cumulative savings of almost Baht 8.4 billion over ten years. A committee representing OCSC, BoB, MoF and the central personnel agencies of the teaching service, police and military has managed the early retirement program.

While this first round appears to have been relatively successful given its limited duration, more must be done to achieve the envisaged reduction of 10 percent (about 120,000) in the total number of government officials by 2002. To meet this objective, the Office of the Civil Service Commission will recommend another similar offering of the early retirement scheme this year. Benefits to retirees will be similar, but there will be greater flexibility to ministries to re-allocate surplus staff from one area to enable retirements in another. This flexibility may also assist in better matching early retirements to areas where staff are less needed.

Box 6 : Emerging Power of New Accountability Institutions

In March 2000, the Minister of Interior was forced to resign by the National Counter Corruption Commission (NCCC) after he was accused of falsifying documents relating to a loan of Baht 45 million (US$1.2 million), and barred from holding political office for five years. It was only the second time in almost 70 years that a sitting politician was tried and convicted for corruption. Earlier in March, the Election Commission nullified the poll victories of 78 senatorial candidates on grounds of fraud, and ordered new elections in 35 provinces. A further 12 winners of the April 29 polls in nine provinces were disqualified, prompting a third round of voting.

Both these independent agencies were created by the new Constitution with a mandate to oversee politicians and bureaucrats. Along with the NCCC and Electoral Commission, the 1997 Constitution introduced Ombudsmen, a system of administrative courts and an Official Information Act allowing citizens access to all but the most sensitive public information. All these independent agencies and accompanying laws have become powerful forces and may be proof not only that the country's recovery is fostering greater economic and political transparency, but also that the checks and balances enshrined in the new Constitution will be actively applied.

Administrative Organizations (with total revenue equal or above Bt 100 million) and Municipality (with total annual revenue equal to or above Bt 200 million) to declare their assets.

- The organic law establishing the Office of the Ombudsmen was passed
- The Senate selected 17 Supreme Administrative Court judges in February. A temporary office for the Administrative Court has been established. Petition and Complaint divisions of the Council of State were transferred to the Administrative Court office.
- More than 60 percent of government agencies have established regulations and procedures to enhance responsiveness to public demands for information.
- The organic law establishing the Office of the Ombudsman was passed, although the selection of the three Ombudsmen is proceeding slowly.
- Several new Cabinet resolutions have been issued regarding information disclosure, including:
  - Cabinet resolution (1 February 2000) for all new government staff (levels C7 and above) to be knowledgeable of the Official

Information Act, and lawyers for each agency must pass an exam on the content of the OIA.

- Cabinet resolution (30 November 1999) for government inspectors of each department to monitor and evaluate the performance of their concerned agencies regarding access to public information. This must be done twice a year and reported directly to the Cabinet.

- Announced in the Royal Gazette in December 1999 that government procurement documents are considered to be part of the OOIC categories to be released to the public.

- The OCSC has established the Ethics Promotion Center (EPC) to: (i) coordinate and assist other government and non-government agencies, (ii) conduct research and development, (iii) train civil servants, and (iv) disseminate information. Currently, the EPC is working with various government agencies to assist them in developing ethical standards for their staff. The EPC has developed training courses especially for high ranking officials. Limited staff and budget have however impeded the progress of the EPC's activities.

- The Community Organization Development Institute bill was recently approved by the Cabinet, and a draft bill for the Ministry of Labor and Social Welfare to enhance the role and support for the non-government organizations has passed the scrutiny of the Council of State and is awaiting Cabinet approval.

Other Ministries

Ministry of Education (MoE)

- The Education Reform Committee (ERC) required by law has been established and staffing is underway. The ERC is responsible for securing cabinet approval for all measures needed to reform the MoE.

- The MoE has completed 20 Action Plans required by the Education Act for reform implementation, and has submitted these to the ERC. These include *inter alia* role definition for a smaller central ministry, consolidation of departments, establishment of Local Education Areas (LEAs), and teacher retraining and redeployment.

- Mapping of LEAs is well advanced, and 289 have been identified. This number may change following community consultations to be carried out over the coming months. Final mapping will be submitted to the ERC, along with recommendations on the 12 LEAs to serve as pilots for the reform, for approval and submission to Cabinet.

Ministry of Public Health (MoPH)

- A steering committee, chaired by the Permanent Secretary, has been instituted to guide the MoPH internal reform. A full master plan is expected, that will include the MoPH mission and clarification of its role in service provision, financing, regulation and quality assurance.

- The MoPH has designed new financial and cost accounting systems for hospitals; developed the chart of accounts, and written a manual for implementation. An implementation plan is ready with six "pilot" hospitals designated to implement the full financial and cost accounting system, and other hospitals to report manually on an accrual basis by September 2000.

- The MoPH is currently preparing a proposal to develop a second pilot for budgetary reform wherein provinces rather than hospitals would be block-granted.

Ministry of Commerce (MoC)

- Following a functional review, the MoC has identified core activities such as trade policy development and business support and realigned its department's functional responsibilities with these activities; the new organizational structure fits the core tasks without cross-departmental overlap.