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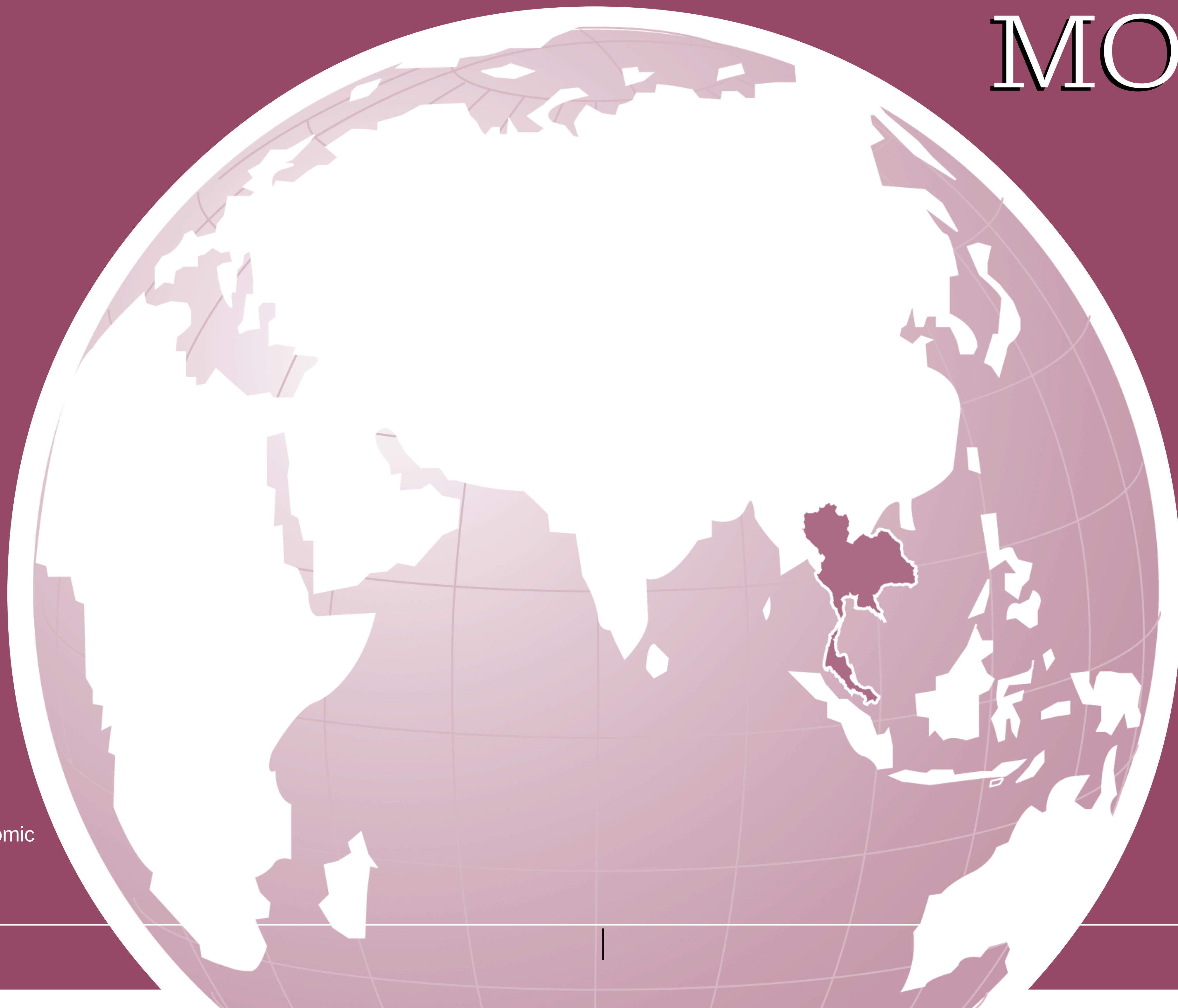

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ABBREVIATIONS

ACMECS	Ayeyawady-Chao Phraya-Mekong Economic Corporation Strategy
ADB	Asian Development Bank
AGM	Annual General Meeting
AMC	Asset Management Companies
ASEAN	Association of Southeast Asian Nations
BAAC	Bank for Agriculture and Agricultural Cooperatives
BOI	Board of Investment
BOT	Bank of Thailand
BMA	Bond Market Association
CAT	CAT Telecom Plc.
CDP	Country Development Partnership
CEP	Closer Economic Partnership
CPI	Consumer Price Index
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DDC	Department of Disease Control
DOR	Department of Rice
e-GP	E-Government procedure
EGAT	Electricity Generating Authority of Thailand
EPPO	Energy Policy and Planning Office
EU	European Union
EXIM Bank	Export-Import Bank
FDI	Foreign Direct Investments
FIDF	Financial Institutions Development Fund
FPO	Fiscal Policy Office
FTA	Free Trade Agreements
FY	Fiscal Year
GCC	Gulf Cooperation Council
GCS	Government Counter Services
GDP	Gross Domestic Product
GFMIS	Government Fiscal Management Information System
GMS	Greater Mekong Subregion
GSB	Government Savings Bank
GSMS	Government Strategic Management System
HS	Harmonized System
ICAAT	The Institute of Certified Accountant and Auditor of Thailand
ICP	Insurance Core Principles
ICT	Information and Communications Technology
IEA	International Energy Agency
ISIC	International Standard Industrial Classification
ISDA	Swap and Derivative Association
ISP	Internet Service Provider
ITSC	International Trade Strategic Agency
JBIC	Japan Bank for International Cooperation
KPIs	Key Performance Indicators
LRC	Legal Reform Committee for Development of Thailand
MOC	Ministry of Commerce
MOU	Memorandum of Understanding

MLR	Minimum Loan Rates
NBFIs	Non-bank Financial Institutions
NCC	National Communications Commission
NHSO	National Health Security Office
NIA	National Innovation Agency
NIDA	National Institute for Development Administration
NESDB	National Economic and Social Development Board
NPM	Net Profit Margin
NTC	National Telecommunications Commission
OECD	Organization for Economic Cooperation and Development
OPDC	Office of Public Development Commission
OSU	Oversight Support Unit
OTOP	One Tambon One Product
PAMP	Public Affairs Management Plan
PATH	People's Audit for Thailand
PICS	Productivity and Investment Climate Study
PII	Private Investment Index
PPI	Producer Price Index
PPP	Private Public Partnership
PSA	Public Sector Account
PSDS	Public Sector Development Strategy
SDUs	Service Delivery Units
SDF	Skill Development Fund
SEA	Securities and Exchange Commission Act
SEC	Securities Exchange Commission
SES	Socio-Economic Survey
SET	Stock Exchange of Thailand
SFIs	Specialized Financial Institutions
SMEs	Small and Medium Enterprises
SML	Small-Medium-Large
SOEs	State-owned Enterprises
SPVs	Special Purpose Vehicles
SRRT	Surveillance Rapid Response Teams
SSO	Social Security Office
SSS	Social Security Scheme
TAMC	Thai Asset Management Corporation
TCI	Technology Capacity Index
TFEX	Thailand Future Exchange
TFP	Total Factor Productivity
TOT	Telephone Organization of Thailand
TSD	Thailand Security Depositary Company
TVQ	Thai Vocational Qualifications
UTCC	University of The Thai Chamber of Commerce
WB	World Bank
WTI	West Texas Intermediate
yoy	Year-on-year

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OVERVIEW

GDP growth will recover modestly to 5 percent in 2006 on the back of stronger export growth, notwithstanding recent developments. Growth in private consumption and in private investment will slow down as the economy adjusts to higher oil prices and tightening of monetary policy. Public investment growth will also decelerate due to delays in mega-infrastructure-investments program, relative to the projected disbursements shown in the last *Economic Monitor.* However, higher growth in world trade volume this year will strengthen export growth, even as imports slow in line with total investment trends.

There is a clear dip in growth performance in both 2005 and 2006, relative to the average growth of nearly 6 percent in the previous three years. The tsunami, the drought, and a large rise in oil prices took their toll on domestic demand growth in 2005. Higher oil prices will continue to depress private investment growth this year as manufacturers take time to adjust. Private investment will also be dampened by rising interest rates, real appreciation and slower improvements in infrastructure services. Nevertheless, Thailand's timely decision to pass-through world oil prices to domestic prices ensured fiscal balance, protected fiscal space for infrastructure investment and encouraged the search for alternative energy, creating a better medium-term growth environment.

Headline inflation rose to an average of 4.5 percent in 2005 but is expected to come down to 4 percent in 2006. This rise in inflation was largely due to a jump in retail price of oil and in food prices due to drought. Headline inflation has been falling gradually from its peak of 6.2 percent in October 2005 to 5.6 percent in February 2006. Core inflation has however been on the rise. The Bank of Thailand has thus been raising interest rates, and is expected to raise them further.

The external and fiscal situation remains sound. At the end of 2005, external reserves stood at US$52 billion (3.1 times short-term external debt), and total external debt fell to around 29 percent of GDP. The current account balance, which turned into a deficit of 2.2 percent of GDP last year, is expected to narrow considerably this year, as surplus on services account improves with recovery of tourism receipts. The Government will continue to maintain a balanced budget given buoyant revenue-collections. Public debt as a share of GDP remains below 48 percent of GDP and will decline over the next few years even with planned infrastructure investments.

Thailand has had a robust recovery in GDP growth from the crisis. Despite a slow start, real GDP per capita has surpassed pre-crisis levels as has the incidence of poverty, a performance that compares favorably with other crisis-countries of the region. The recovery was accompanied by a modest expansionary monetary policy, though tightening is inevitable now given inflationary pressures from oil. On the other hand, Thailand has moved to fiscal consolidation over the last four years, as revenue-collections rose significantly. As a result, the macroeconomic fundamentals are strong today. External vulnerability is low with a small current account deficit (around 2 percent), high foreign reserves (above $50 billion) and low external debt (30 percent of GDP). There is fiscal balance, with public debt below 50 percent of GDP.

Poverty has fallen over this period, lifting more than 5 million people out of poverty between 2000 and 2004. The incidence of poverty was nearly halved

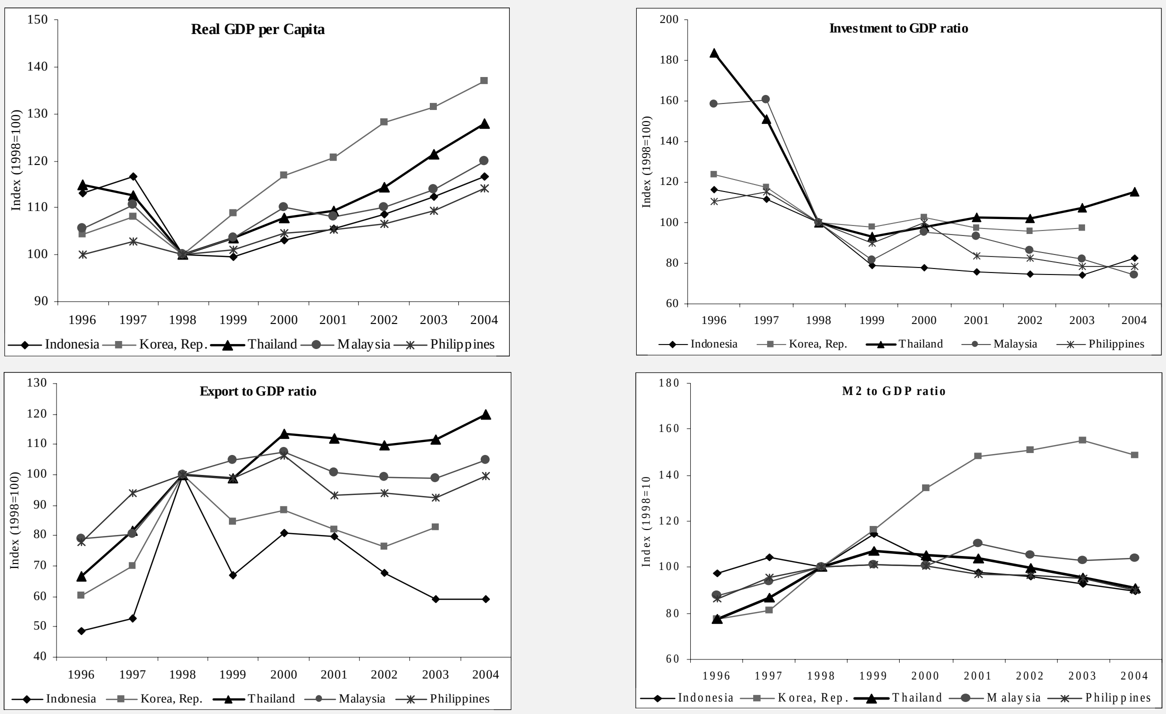
Box 1. Thailand's Recovery from Crisis

Thailand has experienced a strong recovery, despite a slow start. Real GDP per capita and incidence of poverty reached and exceeded pre-crisis levels only after 2002[1]. The growth-rate of per capita GDP has risen, but it remains significantly below that in the boom period of 1987-96, though it has come close to the longer-term trend rate. It could be argued that growth of the boom period was not sustainable, and thus settling in at more than 4.6 percent growth in per capita GDP is closer to what is sustainable. At any rate, Thailand's growth-performance after the crisis compared quite favorably with other crisis countries in the region, except South Korea who recovered more quickly and returned to its pre-crisis trend growth rate.

This was accompanied by a relaxation of monetary policy which no doubt helped the recovery process. But after the first two years, the Government also embarked on fiscal consolidation, such that it has been running a balanced budget for several years now. This has made Thailand stronger in terms of lower public debt and greater fiscal space to generate confidence and conditions for medium-term growth.

Growth in exports and in private consumption has driven the recovery, with private investment pick up playing a relatively minor role. Export performance in the post-crisis period exceeded other crisis-countries, and is surpassed only by China and Vietnam.

Figure 1. Real GDP per capita, Investment to GDP ratio, Export to GDP ratio and M2 to GDP ratio, 1996-2004



Source: WDI

This not only raised the share of exports in GDP from 45 percent to more than 65 percent but it was accompanied by a change in commodity and geographic composition. Higher-skilled products (electronics, electrical machinery and parts; non-electrical machinery and parts; transport equipment and parts) raised its share in total exports from 34 percent to 43 percent. Thai exports going to the East Asia region (including Japan) rose from 28 percent to 36 percent.

[1] The real GDP per capita at constant 2000 US$ was reached US$2,276 in 2003.

Total investment also recovered, but at a much slower rate than in previous recessions. Costs of financial and corporate restructuring and other social supports became an increasing share of total spending, with a squeeze on public investment; such retrenchment of public investment was also warranted by the investment boom that had preceded the crisis. Private investment also recovered, but very slowly; its share in GDP today remains significantly below not only pre-crisis years, but also below the average of the 1980s.

This raises questions about potential growth going forward. Increased private investment, embodying improving technology, has been an important feature of Thailand's growth experience, as has increasing education-levels of its workforce. Most of the productivity growth experienced in the past has come from a re-allocation of labor from agriculture to manufacturing and to services where productivity is 10 times and 5 times higher than agriculture, but the scope for continuing that phenomenon has reduced. With limited within-sector innovation-led productivity growth in the past, and the time needed to develop the Thai skill-base, the fragility of private investment, especially domestic private investment, is an issue that needs to be addressed aggressively.

from 21 percent to 11 percent, with incidence in the poorest Northeast region coming down from 35 percent to 17 percent.

This relatively strong recovery was supported by various reforms, especially in the early post-crisis years, and by measures to stimulate domestic demand. Reductions in trade restrictions, liberalization of investment rules, improvements in corporate governance, strengthening of legal framework for financial and corporate sector, created incentives to adjust, invest and export. Low interest rates and significantly depreciated real exchange rate also contributed to this recovery. The stimulus to private consumption and private residential construction through bank credits, tax incentives and low interest rates raised private consumption growth as well as private residential investment.

Private consumption has thus been a key driver of growth for most of the recovery, but it is reaching its limits. In 2005, private or household consumption grew by only 4.4 percent, a significant drop compared to 5.9 percent in 2004. Higher oil prices and inflation contributed to this decline, as did the fall in tourist arrivals after Tsunami. Though recovery in tourism will help this year, the high oil prices and signs of saturated demand for durables will continue to dampen growth in private consumption.

Export has been an important driver of recovery, growing rapidly and is expected to be important for this year too. This has led to a large jump in the export share in GDP from around 45 percent in pre-crisis years to 65 percent today**.** The export growth was accompanied by a significant movement *up* the value-chain from labor-intensive low-skill products to higher skill products, as evident from the rising *share* of electronics and electrical machinery, non-electrical machinery and parts, and transport machinery and parts (i.e. HS 85+84+87) *in total exports* from 34 percent in pre-crisis period to 43 percent today. There is a shift in geographic composition too as the share of the East Asia region in Thailand's total exports rose from 28 percent to 36 percent today. Export earnings growth did slow in 2005 to 15 percent (20 percent in 2004) as volume-growth halved relative to 2004, though export volume is projected to pick-up this year in line with rising world trade.

Private investment recovery has been muted over this period, and will slow further this year. The rate of increase in private investment has been lower than in earlier recoveries from recessions in Thailand, even the actual rate of rise was stronger than many crisis-countries. More importantly, its share in GDP is depressed not only relative to the high pre-crisis levels, but also relative to its average share in Thailand during the 1980s. Foreign direct investment, on the other hand, has been significantly higher than pre-crisis levels, driven in large measure by the automobile sector. This means that depressed *domestic* private investment explains most of the sluggishness in private investment recovery. This has been explained in large part by the excess capacity that existed immediately after the crisis and the excessive risk-averseness of domestic investors following their experience during the crisis. But increasingly, this explanation is inadequate for continued weakness in the fact of capacity utilization rates passing pre-crisis levels in most sub-sectors. And total *private* investment growth will slow again in 2006 to 9 percent, coming down from 11 percent in 2005 and 14 percent in 2004. Higher oil prices, rising interest rates, appreciating real exchange rates and political uncertainty are unlikely to help that situation.

With slower consumption growth in the medium-term, and various factors depressing private investment the priority addressing factors inhibiting private investment is urgent, in the face of higher oil prices. More than 1300 firms in Thailand indicated[2] that *infrastructure services*, *regulatory burden*, and *skills* are the main factors inhibiting investment and productivity growth. The survey results show that Bangkok as well as the center and east region, dominated by manufacturing and export, could increase investment and productivity if infrastructure bottlenecks were addressed by investment and better services. Reducing regulatory burden appears to be a relatively cost-less way of raising private investment. The skill-constraint on the other hand was equally important for firms in all regions, and especially constraining ICT-use, movement up the value-chain and development of the knowledge economy. Some specifics of what could be a medium-term agenda of actions is provided later in the report.

Public investment will no doubt pick up some of the slack in subsequent years, though 2006 will not see much of that. The slow down was due to lower-than-expected pace of implementation of the five-year mega-infrastructure-project investment of US$46 billion covering urban mass rapid transit in Bangkok, highways, power, low-income housing, water systems, education and health. This is planned to be financed by external borrowing (17.5 percent of program or US$7.9 billion) and significant private sector participation.

The Government has continued to take some reform measures to address some of the emerging issues. Reforms in the financial sector, trade, and public sector have been progressing. In the financial sector, the phase one of the Capital Market Master Plan (2002-2005) has been completed with satisfactory outcomes. The Capital Market Master Plan II (2006-2010) has been proposed to the Ministry of Finance. The Thailand Futures' Exchange (TFEX), which has been granted a license since February last year, will begin operations at the end of April this year. The Credit Information Business Act has been amended and was effective in February, hence reducing the onerous legal risks for the Credit Bureau and their members and provides greater flexibility for the operations of the Credit Bureau. On the trade side, further tariff reductions have taken place for 150 ICT products under the e-ASEAN Framework Agreement and for some items used in the printing industry and the electrical appliances and electronics industry in order to promote competitiveness of these industries. Key public sector reforms that took place over the last six months include the amendments to the state-owned enterprises' financial and accounting rules and regulations and the amendments to the rules and regulations on public debt in order to improve public financial and debt management. The Public Hearing Law which would help improve the accountability and transparency of government projects was enacted in the last 6 months.

The Government is preparing the 10th Five-Year National Development Plan (FY2007-2011) and it is hoped that actions to boost more efficient private investment will be taken. The Office of the National Economic and Social Development Board is responsible for drafting the Plan. The three pillars of the Plan are (1) Economic Capital, (2) Social Capital, and (3) Natural Resources. The final draft of the Plan is scheduled to be submitted to the Cabinet for approval in September 2006 and Plan will be effective in October 2006.

[2] The *Thailand Investment Climate, Firm Competitiveness and Growth* (2006), conducted jointly by the NESDB and the World Bank, showed that although Thailand had a better investment climate compared to its competition countries, there were deficiencies that reduced rates of return and weakened firms in Thailand in a highly competitive world.

Thailand clearly has a large unfinished agenda of actions needed to sustain private investment and higher productivity growth. On the back of a sound macroeconomic situation and a strong commitment to openness, Thailand will have to address constraints identified by firms and to take actions that will ensure poverty reduction in the poorest Northeast region. Some of the key business climate issues that need to be addressed relate to the regulatory burden on firms, the emerging skill-constraint and infrastructure deficiencies, if investment and innovation is to pick-up; many of these are more pressing in the Northeast. In addition, integrating Northeast with the Mekong region is also a growth opportunity for that region. Thailand also stands to make substantive gains from further liberalization of its services trade.

Relieving the regulatory burden will help Thailand improve its competitiveness in the medium term. High regulatory burden has been reported by more than 60 percent of the 1,385 firms surveyed in the *Thailand Investment Climate, Firm Competitiveness and Growth Study*. Some of the key areas of regulatory burden are for example the high uncertainty around the time taken to obtain business licenses and permits and numerous and complex hiring procedures, tax regulations, customs processes and trade regulations. These, if reduced, can help reduce the costs to firms.

Trade facilitation especially with neighboring countries is an agenda that will help boost the economy of the Northeast of Thailand, where more than half of the poor resides. Strong economic growth in the GMS region raises the benefits from trade integration among its member countries, but direct benefits to the Northeast has so far been small. The Northeast will only capture a greater share of the expanding trade among GMS countries if trade through the land route becomes less cumbersome. Thus, improving the business climate and promoting integration with a prosperous Greater Mekong Subregion can turn the Northeast from a land-locked into a land-linked region. This will require reducing structural and institutional impediments to the movements of goods, people, and capital.

Skill development is a necessary condition for firm's competitiveness and overall growth in the medium term. Lack of skills and skills mismatch are reported by firms to be one of the top three key constraints to their operations and expansions[3]. Skills development can take place at several levels. To address this issue in the short-run, vocational training and the re-training of existing workers will help produce the skills that respond to meet firms' needs. Nevertheless, for the longer-term, Thailand must continue to improve secondary and tertiary education especially in science and technology.

Thailand could secure substantial economic gains from services liberalization. A recent World Bank research further shows that Thailand stands to secure substantial economic gains from services liberalization, which far exceed those of the manufacturing and agricultural trade liberalization. The studies[4] suggest that the policy priorities appear to be in retail and wholesale trade, logistics and the professions (a part of business services), both because these sectors are large and because trade barriers in these sectors raise costs and reduce productivity in other parts of the economy that use these services as inputs. The fact that cuts in services trade barriers lead to increased productivity in the rest of the economy implies that most of the gains from services opening can be gained by unilateral liberalization; they do not depend on the rest of the world also liberalizing its services sectors. This is different from that in agriculture and manufacturing, where more of the potential gains depend on securing greater market evidence abroad.

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[3] *Thailand Investment Climate, Firm Competitiveness and Growth Study* (2006)

[4] Sources: Dee, P. 2004a, 'Measuring the cost of regulatory restrictions on services trade in Malaysia', background paper for the study 'Improving the investment climate by reducing the regulatory burden in Malaysia', World Bank, September, and Dee, P. 2004b, 'Cost of services trade restrictions in Thailand', background report to the 'Productivity and investment climate assessment in Thailand', World Bank, September.

SECTION 2

RECOVERY AND OUTLOOK

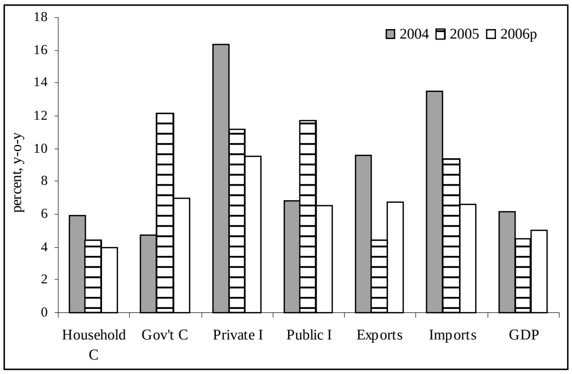
2.1 Real GDP Growth and Macroeconomic Developments

Real GDP growth last year slowed down to 4.5 percent but should recover to around 5 percent this year. Last year, growths of both domestic demand and foreign demand slowed down from those of 2004. High oil prices, the tsunami and the softening external demand for Thai exports have slowed down growths of household consumption, investments, and exports of goods and services (see Figure 2).

Last year, high energy prices, tsunami, and drought have taken their tolls on growth of domestic demand. Retail petroleum prices rose by 30.5 percent last year compared to 2004 levels and by more than 50 percent when compared to 2002. Electricity prices also rose by 3.3 percent last year[5]. These have raised firms' cost of production, thus reducing their margins. The rise in petrol prices and general prices of goods, including food prices which rose as a result of the drought last year, has eroded consumers' purchasing power. As inflation rose from 2.8 percent in 2004 to 4.5 percent last year (see Box 2 on Inflation Trend), household consumption decelerated to 4.4 percent last year from 5.9 percent a year earlier. The deceleration in the growth of household consumption last year is mirrored by the slowdown in the manufacturing production growth from 8.2 percent in 2004 to 5.5 percent in 2005. As a result, capacity utilization increased by a minimal 2 percentage-point from 2004 to 2005. The manufacturing production slowdown and existing excess capacity have limited private investment growth last year to 11.2 percent year-on-year, which is its lowest growth since 2002 (see Private Investment section).

[5] The electricity price per unit is calculated based on the total revenues of MEA divided by the total sale units.

Figure 2. GDP Growth and Selected Components, 2004-2006p



Source: NESDB and WB estimation

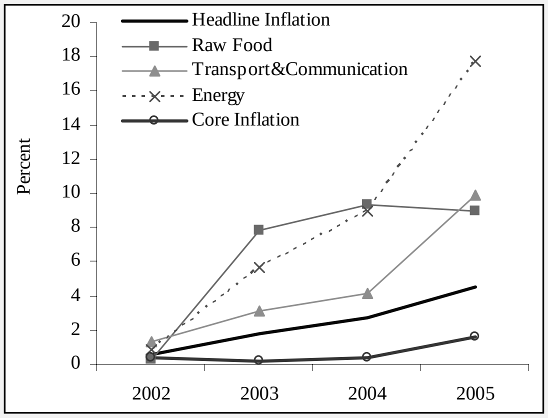
Demand for Thai exports has also slowed down last year. This is in line with the slowdown in the global economy amidst high oil prices and the slowdown in the electronics cycle in the first half of last year (see External Environment section). Export volume only grew by 4.3 percent last year, down from 8.4 percent in 2004. Exports of services growth was also down last year as a result of the slump in tourism after the tsunami disaster. Tourism receipts only expanded by 0.5 percent last year compared to more than 10 percent a year earlier. As a result, total exports of services only grew by 4.6 percent compared to 15.5 percent in 2004. With exports decelerating to half

Box 2. Inflation Trend

Inflation has been rising with the sharp rise in energy prices since 2003. Headline inflation in 2005 was 4.5 percent, the highest since 1999. The rise in the headline inflation was due to sharp rise in the prices of energy and transportation and communications last year. Price of energy (9 percent of the consumption basket) have been rising since 2003 and peaked last year at 17.7 percent (see Figure 3) when the retail prices of both benzene and diesel which have been capped since 2004 were floated. This had led to the rise in the prices of transportation and communications (22 percent of consumption basket) by 9.9 percent last year, which largely contributed to the rise in inflation last year. The rise in the prices of transportation and communications also raised core inflation[6] which for the first time rose above 1 percent since 2002. Raw food prices (15 percent of consumption basket) rose by another 9 percent last year after rising by 9.4 percent in 2004 and 7.8 percent in 2003. This is both the result of buoyant agriculture commodity export prices in the past few years and of the drought in late 2004 which reduced domestic agriculture supply last year.

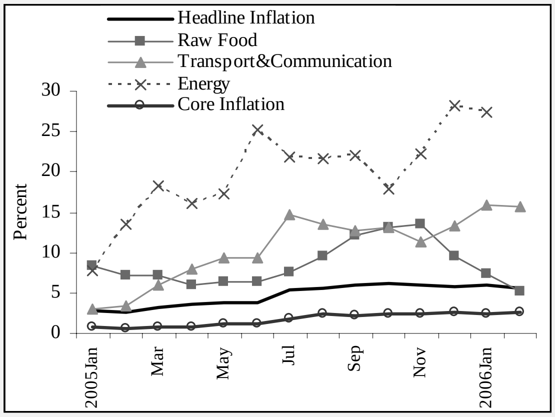
Headline inflation should ease this year to 4 percent. After the flotation of the diesel prices in July last year, retail petrol prices this year should rise by another 25 percent compared to a 33 percent rise last year. This would lead to the rise in energy prices but by a lesser extent than that of last year. The increase in transportation and communications prices which tracks energy prices closely (see Figure 4) should therefore also slow down from that of last year. The increase in prices of raw food has also been slowing down since December last year as prices of rice and cereal products and eggs and milk products fell year-on year. Hence, overall, headline inflation as well as core inflation this year is expected to be lower than last year's.

Figure 3. Inflation, 2002-2005



Source: BOT

Figure 4. Monthly Inflation (year-on-year)



Source: BOT

of its growth in 2004, net exports fell by almost 17 percent. GDP growth last year therefore was negatively affected by the deceleration of both the domestic and foreign demands (see Figure 2).

This year, real GDP growth will benefit from the higher net export growth. Exports of goods and services continue to expand from the second half of last year, while imports are expected to slow down from last year in line with lower consumption and investment growths. Household consumption should continue to decelerate as interest rates rise and oil prices rise further this year. Public investment growths should

[6] The core inflation excludes raw food and energy items from the consumer price basket.

slow down this year with the delays in the public mega-project investment projects. Capacity utilization in the manufacturing sector only rose by slightly last year as the manufacturing production, especially in the non-exporting industries, grew minimally in line with the slow down in household consumption. Private investment growth will therefore slow down this year as there still exists excess capacity in many industries. In addition, firms will need to adjust to higher oil prices and will thus delay some of their investments to the following years. Hence, GDP growth this year will rely more on the growths of net exports than domestic demand (see Figure 2).

Household consumption growth this year will continue to decelerate. With retail oil prices projected to increase by another 25 percent this year, inflation is expected to rise to roughly 4 percent this year. Interest rates will also rise further as the Bank of Thailand maintains a check on inflation. These together with recent political uncertainties, have been affecting consumers' confidence and will hence dampen their spending increases. Moreover, the rise in household debt and rapid rise in durables purchases in the past few years will also limit household consumption growth this year and in the medium term.

Private investment growth this year will also continue to be constrained as firms are adjusting to the high level of petrol prices. Private investments that will take place this year will therefore be limited to industries in which capacity utilization is high and near-term growth prospects are bright. These are mainly industries in the exporting sector such as compressors, rubber gloves, and integrated circuits[7]. However, industries producing for the domestic sector will unlikely see high investment growth given the slowdown in household consumption growth. As public investments slow down this year due to the likely delays in implementation of the mega-infrastructure projects (see Public Investment section), private investment in the infrastructure related sectors will not grow as much as previously anticipated. Hence, overall domestic demand growth should slow down in growth this year.

Net exports will however make a greater contribution to GDP growth this year as export growth accelerates, while imports slow down. Exports prospects for this year are better than that of last year. Orders of Thailand's top exports such as electronics and integrated circuits have increased since the beginning of this year as the electronics cycle recovers (see External Environment section). Thus, export volumes growth should continue accelerating since the second half of last year. Tourism receipts will also recover from the tsunami impact last year, contributing to a larger growth of exports of services. On the other hand, growth of import volume, particularly those of capital goods, should slowdown significantly in line with the slow down in investments. Import growth has shown signs of deceleration in the first two months of this year. Imports of steel, which has increased sharply last year as a result of the temporary closing of large local steel producers and stocking up in the first half of last year, declined in the first 2 months of this year. Similarly, imports of oil should also decelerate as retail prices of petroleum products this year will rise by an additional 25 percent since the prices of all types are floated since July last year. Moreover, imports of aircrafts by Thai Airways will be half that of last year[8]. As a result, import volume growth should significantly slow down and net exports should be higher than last year, thus contributing positively to GDP growth this year.

The current account deficit is expected to fall to around 1.8 percent of GDP this year, lower than the deficit of 2.1 percent of GDP last year. The growth of the import bill this year will fall with the deceleration of import volume growth. In addition, world crude oil prices will not rise as much as it did last year[9] (see External Environment section). Thus, the

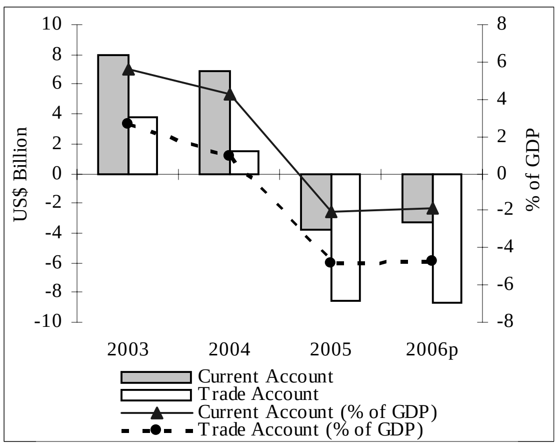
[7] The capacity utilization levels of the first two exceeded 100 percent in 2005 while that of the integrated circuits was above the average rate of 1995 and 1996.

[8] Thai Airways imported 8 airplanes last year, and will import 4 airplanes this year.

[9] Crude oil price rose by more than 40 percent year-on-year last year. It is expected to rise by 10 percent this year. Crude oil imports were 14.4 percent of total imports in 2005.

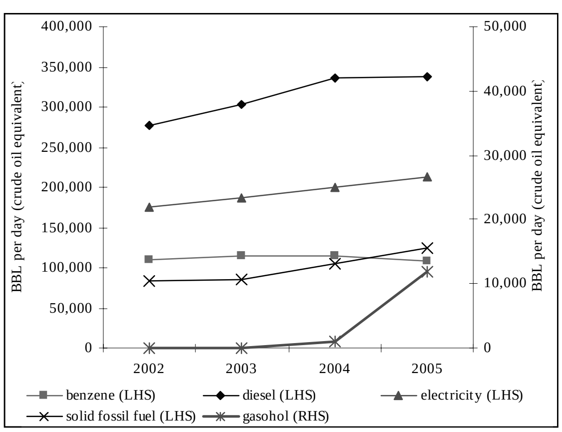
import bill growth should only be half of the 26 percent growth last year. On the other hand, exports receipts should grow at a similar rate as last year. Although its volume growth will increase, export prices will not be as robust as last year. Hence, the trade account will continue to be in deficit although as a percent of GDP, it will be less than that of last year (see Figure 5). The services balance, however, will be in larger surplus than that of last year, given the recovery in tourist receipts. Overall, the current account deficit this year will be less than that of last year both in nominal terms and as a share of GDP.

Figure 5. Trade and Current Account, 2003-2006p



Source: BOT and WB estimation

Figure 6. Consumptions of Benzene, Diesel, Electricity, Solid Fossil Fuels, and Gasohol, 2002-2005



Source: EPPO

Despite the slow down in growth last year, Thailand's external position remains strong. At the end of 2005, international reserves stood at US$52 billion or 3.1 times of short-term external debt. Total external debt fell to US$50.9 billion or 30 percent of GDP down from 31.7 percent in 2004. Short-term external debt represents 33 percent of total external debt (See Box 5 on External Debt).

The government's fiscal situation remains strong and public debt as a share of GDP is also on a declining trend. The Government has been running a balanced budget since fiscal year 2005 and will continue to be run a balanced budget this year. Public debt as a share of GDP has also been on a declining trend and remained below 46.4 percent of GDP at the end of last year (see Box 4 for detailed discussion on Thailand's public debt).

The impact of high oil prices should dissipate in the next year or so as firms and households adjust themselves. Last year, domestic retail prices of petroleum products rose by more than 30 percent and will increase by another 25 percent this year as increases in world oil prices were judiciously passed through to the consumers[10]. Energy producers, households and firms have started to adjust to rapid increase in petrol prices by switching to cheaper energy sources. Last year, benzene and diesel consumption fell while those of gasohol, electricity, and solid fossil fuels increased (see Figure 6). Efforts to develop alternative energy sources such as bio-fuels have been underway (see Box 3 on Development of Alternative Energy). The impact of the increase in retail oil prices will extend into this year with firms and households adapting to cope with the higher oil prices. However, the impact should dissipate in the medium term as the adjustment process is completed.

Thailand's growth in the medium term would depend on exports and private investment growths and less on household consumption. Household consumption, which grew rapidly at an

[10] Price ceiling on benzene was lifted in October 2004. Price ceiling on diesel was lifted on July 2005.

Box 3. Development of Renewable Energy and Biofuels in Thailand

As an importer of oil, Thailand has for the past decade advocated energy conservation and has been initiating programs to develop renewable sources of energy, especially for transportation as it uses over 60 percent of oil consumption, mainly in the forms of benzene and high-speed diesel.

Government's energy policies/programs that are related to renewable energy over the past decade includes

- **Energy Conservation (ENCON) Program (1994).** The program promoted renewable energy through funding support, such as a subsidy to biomass projects and pig farm biogas projects.
- **Ministry of Energy's strategy for competitiveness (2003)** The Ministry aims to promote more efficient use of energy in transport sector and conservation in industrial sector. The goal is also to increase the share of renewable energy in commercial primary energy use from 0.5 percent in 2002 to 8 percent by 2011 by enforcing the Renewable Portfolio Standard (RPS), which requires power plants to have 4-5 percent of their generating capacity coming from renewable sources and by using other fiscal incentive measures.
- **New Energy Strategic Plan (2005).** The Cabinet-approved plan lays out targets for renewable energy. It targets about 25 percent of petrol consumption for the transportation sector to be replaced with the use of natural gas, gasohol, and biodiesel by 2009. Biodiesel alone should replace 10 percent of diesel consumption by 2012. Under this plan, the agricultural sector will need to play an important role in energy supply.

Currently, biofuels are increasingly being used for transport. Both gasohol (E10: mixing 90 percent of gasoline and 10 percent of ethanol) and biodiesel (B3: 3 percent of biodiesel in diesel) have been actively promoted in the past year by using both awareness campaigns and pricing policies such as excise tax exemption. The use of gasohol increase from almost none in 2003 to 3 billion liters in 2005, while that of benzene (ULG91 and 95) decreased from 7.5 billion liters in 2003 to roughly 6.5 billion in 2005.

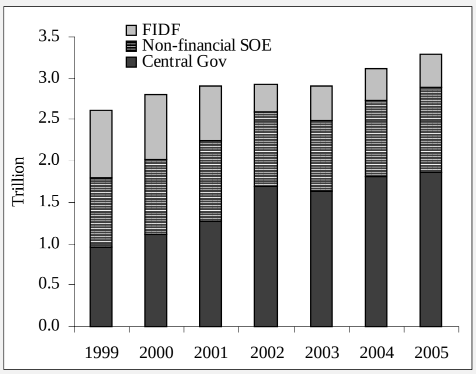
average of 5.5 percent per year from 2002 to 2005, has been an important contributor to GDP growth. However, going forward, the accumulation of household debt and higher real interest rates will limit household consumption growth. Moreover, the purchase of durables which has increased rapidly in response to the pent up demand during the crisis is also slowing down. Hence, household consumption growths has been on a declining trend since 2004 and will unlikely be a key driver of growth as in the medium term (see Household Consumption section). Exports, which are over 60 percent of total GDP, could continue to be the key driver of Thailand's growth. Export volume growth, however, has been decelerating since 2002 and is expected to pick up only this year. It is therefore important to ensure that Thailand remains competitive in the export market in order to keep its exports growing. To sustain growth in the medium term, private investment will also need to pick up more strongly. As of last year, the share of private investment in GDP remains below 20 percent, which is lower than its share in the 1980s. With the slowdown in private investment growth last year and this year, it will take longer than previously anticipated before private investment recovers to its previous levels. With oil prices likely to remain at a high level in the next few years, it is therefore of urgency to improve the investment climate such as reducing regulatory burden on firms, improving labor skills, and raising public infrastructure investments[11] such that the costs of doing business is low in order to encourage firm investment and expansion (see Medium Term Agenda for Growth and Poverty Reduction for a detailed discussion).

[11] From Thailand Investment Climate, Firm Competitiveness and Growth (2006).

Box 4. Thailand's Public Debt

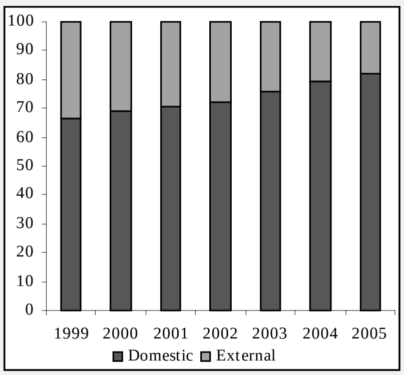
Public debt level has risen from its 1999 levels but has fallen as a share of GDP with more than half of it belonging to the central government. Public debt[12] level has been increasing from Bt2.6 trillion in 1999 to Bt3.3 trillion in 2005. However, its share of GDP has fallen from its peak of 57 percent in 1999 to 46 percent. The increase in the level of public debt came mainly from the increase in the central government debt which almost doubled over this period as the Government shouldered the losses of the Financial Institution Development Fund (FIDF). Central government debt represented 56 percent of total public debt at the end of 2005 compared to 36 percent back in 1999. On the other hand, debt that is held directly by the FIDF has reduced by half over the period of 1999 to 2005 (see Figure 7).

Figure 7. Public Debt by Borrower



Source: PDMO

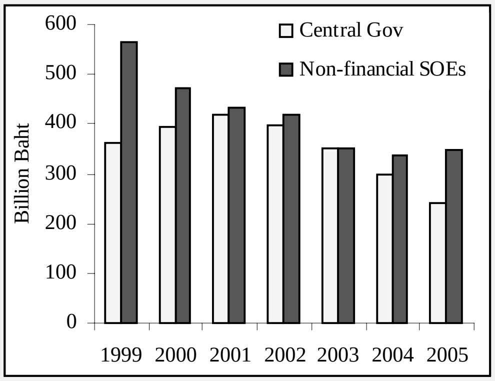
Figure 8. Domestic and External Public Debt



Source: PDMO

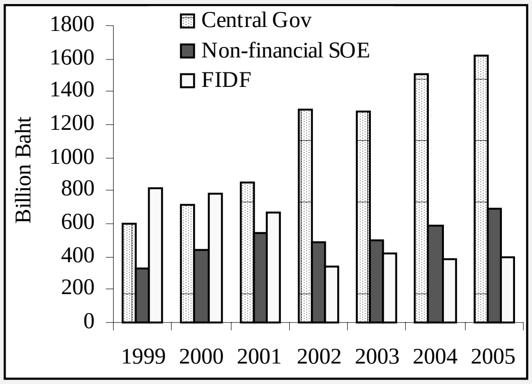
Since 1999, public debt shifted from foreign debt to domestic debt. External public debt in 2005 was US$14.4 billion or two-thirds its level in 1999 and only 18 percent of total public debt compared to over 30 percent in 1999 (see Figure 8). The decline in external debt was mainly the result of the decline in non-financial state-own enterprises' external debt from its peak of Bt560 billion in 1999 to Bt350 billion in 2005 (see Figure 9). Since 2002, external public debt is largely denominated in Japanese Yen which is mostly with the Japan Bank for International Cooperation (JBIC).

Figure 9. Central Government and Non-financial SOE External Debt



Source: PDMO

Figure 10. Central Government and Non-financial SOE Domestic Debt

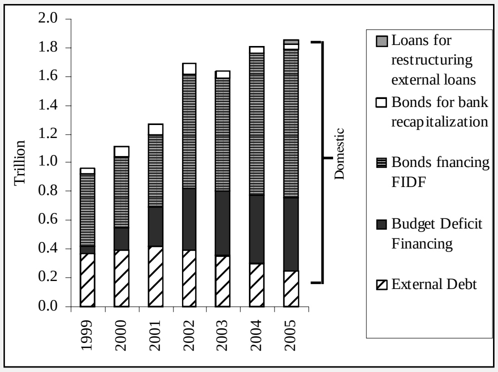


Source: PDMO

[12] Public debt includes domestic and external debts of the central government, non-financial state-owned enterprises (NFSOEs), and Financial Institution Development Fund (FIDF) debt. The latter two include government-guaranteed and non-guaranteed debt. NFSOEs include Urban and Village Fund and Oil fund.

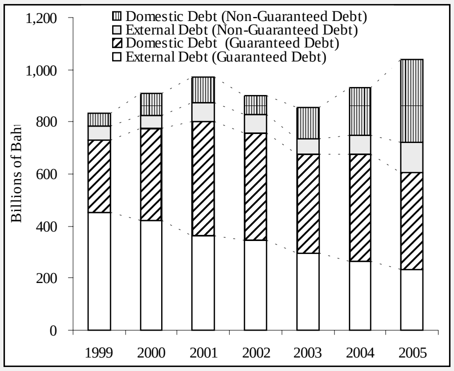
The increase in domestic public debt since 1999 was primarily from those of the central government and non-financial state-owned enterprises. Total domestic debt at the end of 2005 stood at Bt2.7 trillion, an increase from Bt1.7 trillion in 1999. Central government debt, which accounts for two-thirds of total domestic debt, doubled in this period and so did non-financial state-owned enterprises' (NFSOEs) domestic debt (see Figure 10). The sharp increase in domestic debt in the recent 2 years could also be attributed to the increase in the Central Government's bond issuance to finance the losses of the FIDF. Central government debt used to finance FIDF losses increased by Bt257 billion from 2003 to 2005 (see Figure 11). In that period, NFSOEs' domestic debt also increased by Bt188 billion. This increase is in line with the increase in public investments, which started to expand in 2004 after declining for 5 consecutive years prior to that.

Figure 11. Central Government Debt



Source: PDMO

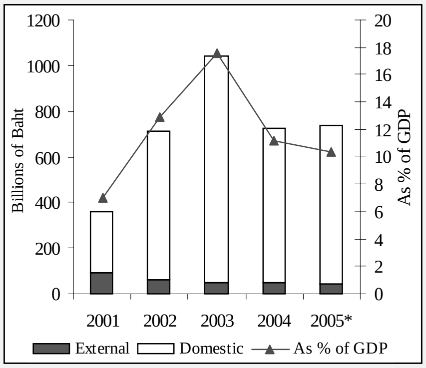
Figure 12. Non-financial SOE Debt, Guaranteed and Non-guaranteed



Source: PDMO

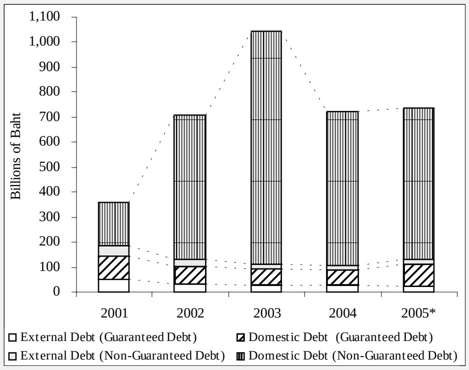
Non-financial state-owned enterprises' domestic debt has been increasingly non-guaranteed. Non-government guaranteed domestic debt have replaced the guaranteed external ones, which have been declining over the past 6 years. NFSOE's non-guaranteed domestic debt in 2005 was over 6 times that of 1999. NFSOE's non-guaranteed external debt also doubled. As a result, the share of non-guaranteed debt increased from 12.5 percent of total non-financial SOE debt to over 40 percent at the end of 2005 (see Figure 12).

Figure 13. Financial SOE Debt



Source: PDMO * data as of September 2005

Figure 14. Financial SOE Debt, Guaranteed and Non-guaranteed



Source: PDMO * data as of September 2005

Debt of financial SOEs, currently not included in public debt, are roughly 10 percent of GDP. Financial SOEs includes Specialized Financial Institutions (SFIs) and Krungthai Bank. Their debts have doubled from 2001 to 2005 and their shares in GDP have gone up from 7 percent in 2001 to a peak of 18 percent in 2003 before easing to 10 percent in 2005 (see Figure 13). Financial SOEs' debt increased by Bt350 billion in 2002 and another Bt300 billion in 2003 as a result of the debt of three new state asset management companies (AMCs), namely, the Sukhumvit, Petchaburi, and Radanasin AMCs, which were established in 2001. The increase in financial SOE debt is mostly from the rise in non-guaranteed domestic debt, while external debt and government-guaranteed debt have been declining. In 2005, non-guaranteed domestic debt was 3.5 times that of 2001 (see Figure 14). Table 1 below summarizes the public and financial SOE debt by external and domestic sources.

Table 1. Public Debt and Financial State-owned Enterprise Debt

	2001	2002	2003	2004	2005
	As Percent of Total				
External Debt	**29.0**	**24.0**	**19.1**	**17.9**	**15.7**
Public Debt	**26.2**	**22.4**	**17.9**	**16.6**	**14.7**
Central Government	12.9	10.9	8.9	7.8	6.0
Non-financial SOE	13.3	11.5	8.9	8.8	8.6
FIDF	0.0	0.0	0.0	0.0	0.0
Financial SOE*	**2.8**	**1.6**	**1.2**	**1.2**	**1.0**
Domestic Debt	**71.0**	**76.0**	**80.9**	**82.1**	**84.3**
Public Debt	**62.8**	**58.1**	**55.7**	**64.6**	**67.1**
Central Government	25.9	35.5	32.4	39.2	40.0
Non-financial SOE	16.6	13.2	12.7	15.4	17.1
FIDF	20.3	9.3	10.6	9.9	10.0
Financial SOE*	**8.2**	**17.9**	**25.2**	**17.6**	**17.3**
TOTAL (Billion Bt)	**3,259.7**	**3,641.3**	**3,945.4**	**3,844.8**	**4,033.1**
% GDP	**63.5**	**66.8**	**66.5**	**59.1**	**56.8**

Source: PDMO

* Data for 2003 is as of September 2005

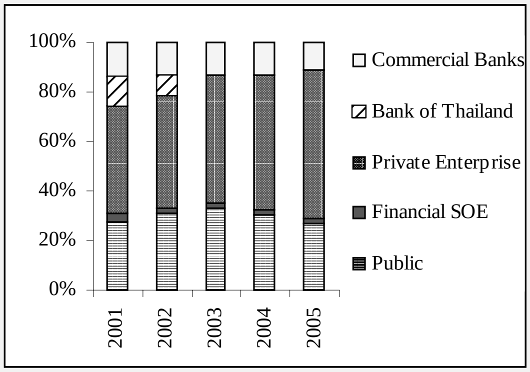
Box 5. Thailand's External Debt

Thailand's total external debt has fallen by half of its 1999 level and is roughly 30 percent of GDP at the end of 2005. Total external debt stood at US$50.9 billion compared to US$95 billion or 85 percent of GDP in 1999. Figure 15 shows the breakdown of public and non-public[13] sector debt. At the end of 2005, private enterprise external debt represented 18 percent of GDP, while that of the public external debt and commercial banks account for 8 percent and 3.5 percent, respectively.

Less than a third of total external debt is short-term, while long term debt declined by half from 1999 to 2005. From 1999 to 2005, long term debt fell from 67 percent of GDP to 20 percent. However, because long-term debt has declined by half and short-term debt in the form of trade credits to private enterprises increased significantly in 2005, short-term debt as a share of total debt rose from 21 percent in 1999 to 33 percent in 2005 (see Figure 16). Nevertheless, short-term debt is currently a third of international reserves.

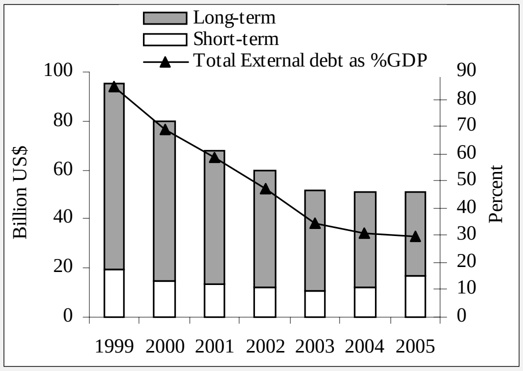
[13] Non-public debt includes financial SOEs' debt and those of private enterprises, the Bank of Thailand, and commercial banks.

Figure 15. Public and Non-public External Debt



Source: PDMO and BOT

Figure 16. Short and Long Term External Debt

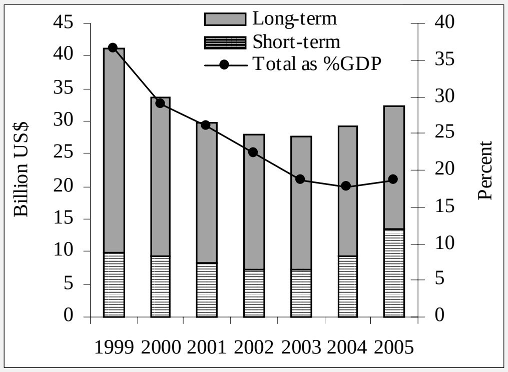


Source: BOT

Private enterprise external debt, that largest share of total external debt, has been falling over the past six years. Private enterprise external debt fell by almost US$10 billion from 1999 to 2005. It was US$32 billion in 2005 or 18 percent of GDP compared to 37 percent in 1999. This decline is mainly the result of the fall in long term debt from US$31 billion in 1999 to US$19 billion in 2005 (see Figure 17). Short-term external debt, on the other hand, increased especially in 2004 and 2005 as inter-company loans and trade credits rose, which is in line with the high increase in foreign direct investment (FDI) and increase in exports in the past two years. At the end of 2005, short-term private enterprise debt is roughly two-fifths of its total debt.

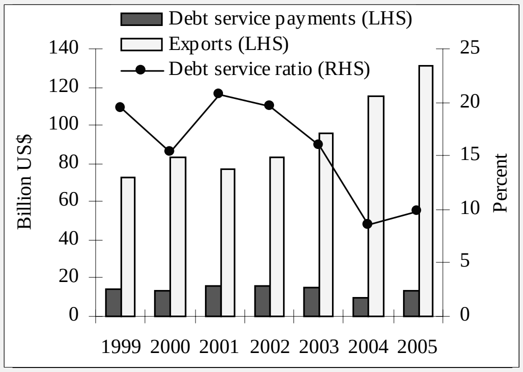
Debt service to exports ratio has also declined. The debt service ratio was less than 10 percent in 2005 compared to 19 percent in 1999. Debt service payments have been around US$10-16 billion in the past 6 years. Because export receipt has been increasing rapidly, the debt service ratio has been falling rapidly (see Figure 18).

Figure 17. Private Enterprise External Debt



Source: BOT

Figure 18. Debt Service Payments and Debt Service Ratio



Source: BOT

2.2 Poverty

Poverty had been declining, between 2000 and 2004. The number of poor people decreased from 12.8 to 7.08 million or approximately 5 million people were lifted out of poverty within the period of four years. As a result, the incidence of poverty[14] dropped by almost half from 21.3 percent to 11.3percent.

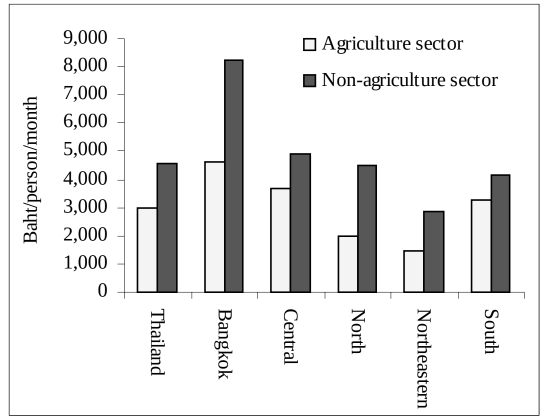
Despite progress in poverty reduction, poverty incidence remains highly concentrated in rural areas and the Northeastern Region of Thailand. Almost 90 percent of the poor are living in rural areas and more than half of the poor reside in the northeastern provinces. The majority of the poor are employed in agriculture where the average income is significantly less than the average income in the non-agriculture sector (see Figure 19). The increase in farm incomes over the past few years have thus contributed to the decline in poverty.

Even though high economic growth and improvement in infrastructure support poverty reduction in Thailand, income inequality remains unchanged. The Gini-coefficient[15] is around 0.5 for the past decade and the gap between the richest and the poorest remains extensive. The poorest who live in the bottom 20 percent quintile received only 4 percent of total national income while the richest who live in the top 20 percent quintile received more than 55 percent of total national income (see Figure 20).

2.3 External Environment

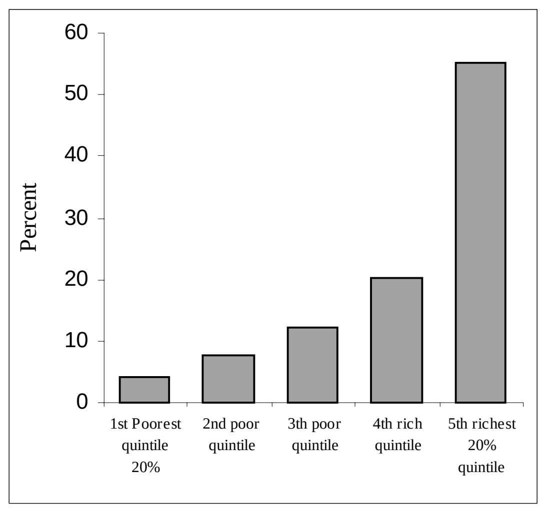
World oil prices this year are forecasted to increase by another 10.5 percent from last year. Oil prices increased sharply since 2003. Oil prices in 2005 are double that of 2003. This year, oil prices are expected to rise by another 10.5 percent from US$53 per barrel to US$59 per barrel before easing to US$56 in 2007 (see Table 1). After climbing quite steadily for almost two years, world oil prices appear to have entered a more uncertain phase in the last quarter of 2005 and the first quarter of 2006, fluctuating in a range between US$55 and US$63 a barrel (in monthly average

Figure 19. Average Household Income: Agriculture and Non-agriculture Sector, 2004



Source: NESDB

Figure 20. Ratio of Income Distribution Classified into 5 Income Levels, 2004



Source: NESDB

14 Measured by the headcount ratio which is the percentage share of total population below the poverty line.

15 A Gini-coefficient of 0 indicates that the share of income is proportionate to the share of population, For example, 10 percent of the population owns 10 percent of total income of the country, 20 percent of the population owns 20 percent of total income, and so on. Thus, there is no income inequality. A Gini-coefficient of 1 indicates perfect income inequality.

Table 2. International Economic Environment

	Actual 2004	*Actual* 2005	*Projected* 2006
GDP Growth			
World	3.8	3.3	3.3
World (PPP Weights)	4.9	4.3	4.3
OECD	3.1	2.7	2.9
United States	4.0	3.5	3.4
Euro Area	1.9	1.4	2.1
Japan	2.3	2.8	2.8
Australia	3.6	2.5	3.2
World Trade (Volume)	10.3	6.5	8.4
CPI Inflation - G7 [a/]	2.1	2.6	2.2
Oil Price - $/bbl	37.7	53.4	59.0
- % Change	30.6	41.5	10.5
Non-oil Commodity Prices	17.5	13.4	-3.7
LIBOR (US$. 6 Mo.)	1.6	3.6	5.1

Source: World Bank DEC Prospects Group update 9 March 2006.
a/ In local currency, aggregated using 1995 weights.

terms).[16] Looking forward, oil prices are expected to gradually decline from current levels, averaging $59 per barrel in 2006 and $54 in 2007. Underlying this view is the expectation that, while demand-supply factors are fairly evenly balanced at present, over time growing supply capacity will gain the upper hand over demand. Nevertheless, given the unusually narrow margin of effective spare production capacity in OPEC at present, the market remains highly vulnerable to concern about politically driven disruptions of supply, for example an escalation of conflict with Iran, or internal political instability in a major OPEC oil producer, or to other unexpected supply or demand shocks.

World real output growth will be similar to that of last year. While the doubling of oil prices between 2003 and 2005 has undoubtedly slowed world growth, the extent of that impact has been surprisingly limited. World growth slowed from the exceptional 3.8 percent rate experienced in 2004, but still reached a healthy 3.3 percent pace in 2005. Growth among the developed OECD countries eased from 3.1 percent in 2004 to a still healthy 2.7 percent in 2005, and is even expected to strengthen mildly to 2.9 percent in 2006, the result of recovery in Japan and Europe offsetting a mild slowing in the US (see Table 2).

World trade volumes will accelerate this year after it slowed down last year. World trade volumes last year slowed down from exceptionally high growth of 10.3 percent in 2004. This year, it is expected to pick up with accelerated growths of the EU and Australia markets. This would have positive implications for Thailand as the EU is a key market for Thai exports.

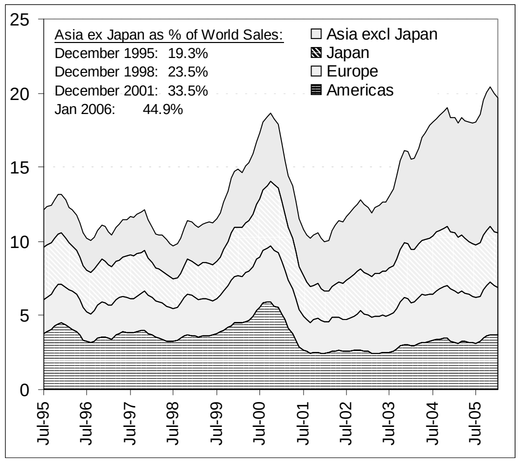
[16] This reference price is an average of Brent, Dubai and West Texas Intermediate (WTI) crudes. This average has generally been lower than the more widely reported WTI price, which averaged over US$61.5 in February, for example. Exceptionally strong demand for light crudes like WTI over the past two years, limited light crude production capacity among OPEC Arab members and limited refining capacity for light crudes have boosted the price differential for light crudes over heavier crudes like Dubai. The WTI-Dubai differential averaged over US$7 a barrel in 2005, compared to a more normal US$3-4. The price differential fell back to US$4 in February 2006, suggesting some easing in underlying market imbalances.

Inflation in the G-7 will decline slightly this year as oil price increase eases. Prices in the G-7 countries increased by 2.6 percent last year. This year, as oil price rise decelerates, inflation in the G-7 countries is expected to ease slightly to 2.2 percent. This means that Thai exports to those countries will likely receive a higher price in their currencies, but imports of manufactures from these countries will also be slightly more costly.

World non-oil commodity prices are forecasted to decline this year, but prices of Thailand's key crop prices look favorable this year so far. World non-oil commodity prices last year were around 40 percent higher than that in 2002. This year, it is forecasted to decline slightly by 3.7 percent from that of last year. However, prices of key agricultural commodities of Thailand such as rice and rubber are still robust in the 6 months to February 2006. World rubber prices rose by 28 percent in those 6 months due to supply shortages in Malaysia and Thailand, continued growth in demand from China and Japan and high oil prices, which have pushed synthetic rubber prices higher. World prices for rice were up about 7 percent in the last six months.

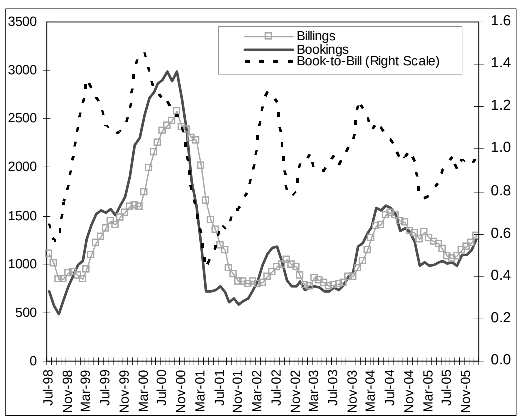
Prospects for high-tech commodities expansion this year are reasonably good. Global high tech markets saw renewed strong growth in activity in the second half of 2005, following a period of flat activity extending from mid 2004 to mid 2005. World semiconductor sales rose 13.6 percent in dollar terms between June and December 2005, before a modest easing in the first two months of 2006 (see Figure 21). Among other indicators, North American semiconductor equipment bookings rebounded in the last quarter of 2005 (see Figure 22). Looking forward, the prospects for continued expansion in high tech markets seem reasonably good, although growth will likely be at more moderate rates than during the 2003 and early 2004 cyclical rebound from the dot com crash[17].

Figure 21. World Semi-conductor Billings (US$ Billion, 3 Month Moving Averages) September 1995-January 2006



Source: Semiconductor Equipment and Materials International

Figure 22. Semiconductor Equipment Orders and Billings (N. America, US$, 3 Month Moving Averages), July 1998-January 2006



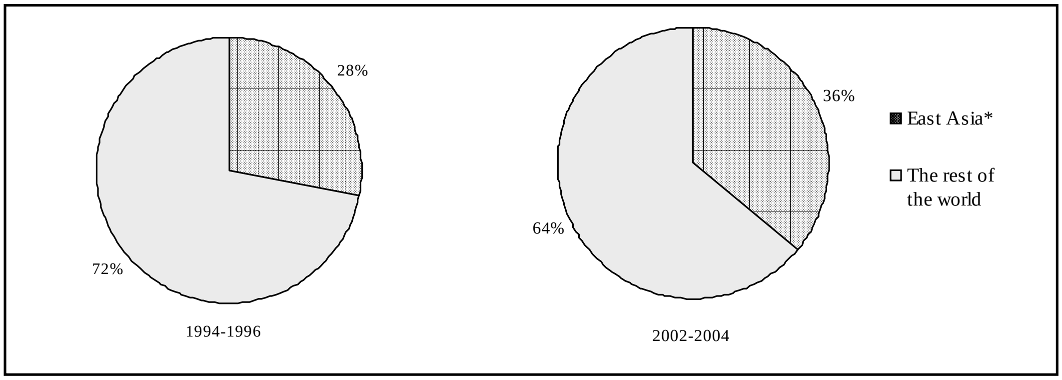
Source: Semiconductor Equipment and Materials International

2.4 Export Performance

Growth in total export earnings in 2005 slowed to 15 percent (22 percent in 2004) but is expected to pick in 2006. Export volume fell more sharply due to falling global electronics demand and drought induced reductions in agricultural exports. However, the pick-up this year is expected to be driven by the rise in world trade volume growth and by tariff reductions for Thai exports in various markets with recently approved FTAs.

[17] For further discussion on the high-tech product cycle, see East Asia and Pacific Regional Update (March 2006), World Bank.

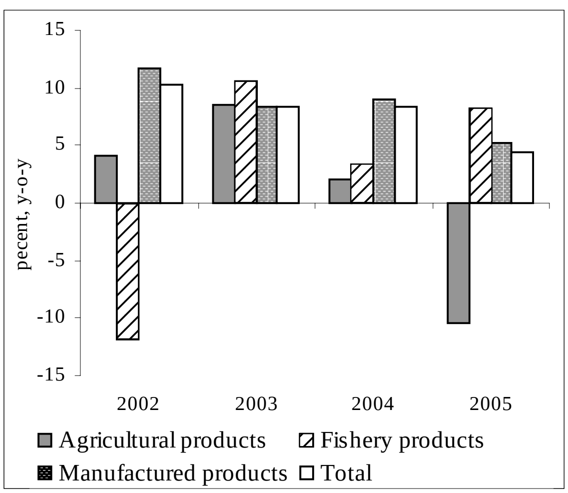
Figure 23. Average Shares of Thailand Exports to East Asia*, and the Rest of the World in 1994-1996 and 2002-2004



Source: DOT

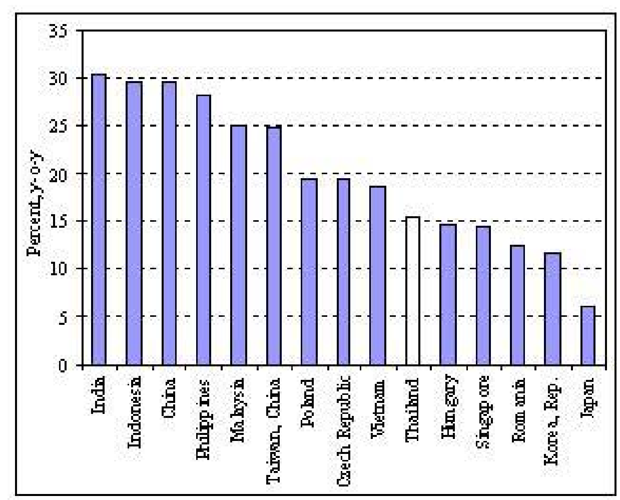
Remark: * East Asia includes East Asian Countries and Japan

Figure 24. Export Volume Growth 2002 - 2005



Source: BOT

Figure 25. Growth Rates of Competitors' Total Export Earnings (US dollar), January to October 2005



Source: DOT

Export growth has been an important driver of recovery so far, raising its share in GDP from around 45 percent in pre-crisis years to 65 percent today. This growth was accompanied by a significant shift in commodity and geographic composition. Exports moved *up* the value-chain from labor-intensive low-skill products to higher skill products, as evident from the *share* of electronics and electrical machinery, non-electrical machinery and parts, and vehicles and parts (i.e. HS 85+84+87) *in total exports* which rose from 34 percent in pre-crisis to 43 percent today. The share of the East Asia region in Thailand's total exports also rose from 28 percent to 36 percent during this recovery, (see Figure 23).

In 2005, growth in Thailand's total export volume halved relative to 2002-04 period. This was largely because of the large drop in growth rate of manufactured export volume (see Figure 24) resulting in part from the slump in global electronics demand[18];

[18] Export earnings from electrical machinery and equipment (HS85), the biggest export share accounting for 18.8 percent of total exports, decelerated from 18.3 percent in 2004 to 2.3 percent in 2005

volume of rice and rubber exports, a tenth of total exports, actually contracted last year, in part due to the drought that affected Thailand and parts of the Mekong region.

Export earnings growth slowed too in 2005, even if much less than decline in volume-growth, because export prices remained robust. Export value growth of 15 percent last year (20 percent in 2004) was accompanied by export price increases of around 12 percent. Rubber, export earnings grew at a respectable rate despite the contraction in volume largely because of relatively high prices. Thus Thailand's overall export earnings performance in 2005 compared quite favorably with many of its competitors in East Asia and Eastern Europe (see Figure 25), but it fell short of China and India (30 percent growth), Philippines (28 percent) and Malaysia (25 percent).

The commodity-composition of Thailand's exports has moved up the value-chain during the recovery. This has been evident for several years, where the *Monitor* has been highlighting the rapid growth of non-electrical machinery and parts, electronics and electronic machinery, as well as vehicles and parts (i.e. HS 84, 85 & 87). They have been the top three export categories in terms of growth-rates, with their aggregate share reaching 44 percent of total exports in 2004. Only in 2005, did growth in electronics and electrical machinery exports fall to 2.3 percent compared to 18-20 percent in the previous three years, largely due to the slump in global electronics demand. This growth in higher-skill products comprising of machinery & parts of different types has come from East Asian markets as well as others.

In 2005, electronics and electrical machinery as well as rice were no longer among the top ten fastest growers as they have been in the recent past. Table 3 provides the list of two-digit HS code exports whose earnings growth have been among the top ten in recent years. Together with the two poor performers, we have two better performers too relative to 2004 i.e. jewelry and fishery.

Table 3. Top Ten Export Products in 2004 and 2005

(Percent)

No.	HS Code	Description	2004			2005		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	85	Electrical machinery and equipment	21.0	18.3	19.4	18.8	2.3	3.3
2	84	Non-electrical machinery and parts	16.4	23.0	18.3	17.6	22.5	25.5
3	87	Vehicle and parts	6.0	40.1	10.2	7.4	41.3	17.1
4	40	Rubber and articles thereof	5.7	23.6	6.5	5.7	13.4	5.3
5	39	Plastics and articles thereof	4.7	33.0	7.0	5.4	32.2	10.5
6	27	Mineral fuel oil wax	3.5	61.0	8.0	4.3	39.7	9.7
7	16	Preparation of meat fish	3.0	9.1	1.5	3.1	16.7	3.5
8	71	Pearls, precious stones and metals	2.7	4.9	0.8	2.9	21.7	4.1
9	10	Cereal	3.0	51.6	6.0	2.1	-16.9	-3.4
10	03	Fish Crustacean Mollusk	1.8	0.6	0.1	1.8	9.9	1.3

Source: MOC

In the first two months of 2006 exports of electrical machinery and parts (HS 85) as well as of non-electrical machinery and parts (HS84) grew much more strongly than last year, which augurs well for 2006. Tables 4 and 5 provide breakdown of sub-items growth suggesting a big recovery of semiconductors from the slump last year.

Thailand's export growth (volume and earnings) in 2006 is expected to be better than last year for several reasons. World trade volume is projected to grow faster than last year suggesting improved external environment facing Thai exports. There will also be tariff reductions and improved trade facilitation under ASEAN-China FTA, Thailand and Australia FTA and

Table 4. Top Five Export Products under HS 85 in 2003 to the First Two Months of 2006

(Percent)

		2003		2004		2005		Jan-Feb 2005		Jan-Feb 2006	
		Growth	Share	Growth	Share	Growth	Share	Growth	Share	Growth	Share
HS 85	**Electrical machinery and equipment**	**15.5**	**100.0**	**18.3**	**100.0**	**2.3**	**100.0**	**-5.5**	**100.0**	**12.6**	**100.0**
8542	Electronic integrated circuits	39.8	27.0	5.8	24.1	12.7	26.6	-16.1	23.0	52.9	31.2
8528	Reception apparatus for television	1.0	6.6	44.9	8.1	1.0	8.0	37.3	8.7	-19.2	6.2
8534	Printed circuits	24.4	4.3	75.6	6.4	-3.0	6.1	60.1	8.1	-27.2	5.2
8541	Semiconductor devices	-6.1	7.9	-20.3	5.3	-24.4	4.0	-25.0	4.6	-2.4	4.0
8517	Electrical apparatus for telephone	24.1	6.3	-2.3	5.2	-1.8	5.0	-38.5	4.1	4.4	3.8

Source: MOC

Table 5. Top Five Export Products under HS 84 in 2003 to the First Two Months of 2006

(Percent)

		2003		2004		2005		Jan-Feb 2005		Jan-Feb 2006	
		Growth	Share	Growth	Share	Growth	Share	Growth	Share	Growth	Share
HS 84	**Non-electrical machinery and parts**	**17.8**	**100.0**	**23.0**	**100.0**	**22.5**	**100.0**	**7.9**	**100.0**	**32.9**	**100.0**
8471	Hard disk drive	58.9	34.9	19.3	33.9	56.1	43.1	7.1	33.0	75.4	43.6
8473	Parts of office machines	-18.5	28.3	0.2	23.0	-13.7	16.2	3.1	23.4	-5.3	16.7
8415	Air conditioning machines	29.8	11.2	37.9	12.6	9.3	11.2	7.8	12.4	22.3	11.4
8418	Refrigerators	22.2	4.1	28.6	4.3	20.9	4.2	18.1	4.5	15.1	3.9
8407	Internal combustion piston engines	291.4	1.6	292.0	5.0	-18.9	3.3	-12.0	4.4	3.9	3.5

Source: MOC

Table 6. Top Ten Export Products to Chinese Market in 2004 and 2005

(Percent)

No.	HS Code	Description	2004			2005		
			Share	Growth	Contribution to export growth	Share	Growth	Contribution to export growth
1.	84	Non-electrical machinery and parts	24.4	33.2	30.6	28.6	50.5	42.8
2	85	Electrical machinery and equipment	13.4	20.7	11.5	13.5	29.9	13.9
3	40	Rubber and articles thereof	12.5	14.0	7.7	10.6	9.5	4.1
4	27	Mineral fuel oil wax	9.3	6.6	2.9	8.9	23.2	7.5
5	39	Plastics and articles thereof	8.7	44.6	13.4	8.8	31.0	9.3
6	29	Organic chemical	4.7	15.3	3.1	5.3	45.2	7.3
7	07	Edible vegetables	3.0	64.1	5.9	3.2	38.7	4.0
8	44	Wood and articles	2.9	49.9	4.9	2.5	10.2	1.0
9	72	Iron and steel	1.5	-41.2	-5.2	2.4	108.7	5.6
10	10	Cereal	3.2	132.5	9.0	2.1	-12.8	-1.4

Source: MOC

Thailand and New Zealand FTA that would support an expansion in export flows to these countries. The global electronics demand is recovering from the slump last year, given the more favorable semiconductor book to bill ratio[19]. Also the automobile sector continues to expand[20]. However, the anticipated real appreciation of the Thai baht could be a damper, but is unlikely to offset the favorable impacts of other factors. The first two month of 2006, where exports grew by 19 percent (or twice last year's) augurs well for export growth this year.

Exports to China

Even though there was a slowdown in Chinese imports, Thailand still registered strong performance in 2005 and is expected to continue in 2006. China's overall import growth slowed sharply last year, but Chinese imports from Thailand increased by more than 21 percent, second only to Chinese import growth from Philippines. The share of Thai exports going to China also rose to 8 percent, a large rise relative to 4 percent in 2000. In the first two months of 2006, Thailand's exports to China already expanded by 43 percent compared to 5 percent in the same period of last year.

More than half of total Thai exports to China comprises of three types of items: non-electrical machinery and parts, electrical machinery and parts and rubber. The first two of the three items are part and parcel of the production network where parts are exported for assembly in China. The top ten exports to China are shown in Table 6 and they include manufactures like chemicals, plastic articles, iron/steel, and wooden manufactures, as well as vegetables and wooden-articles.

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[19] The semiconductor Book-to-Bill ratio is calculated by taking a three-month moving average of North American headquartered equipment manufacturers booking divided by a three-month average of billings for the same period of time. A book-to-bill above one represents an expanding market; the semiconductor book to bill ratio in February 2006 was 1.01.

[20] The NISSAN car factory relocated from Japan and is expected to start its production in the fourth quarter of this year raising production capacity by 50,000 pick-ups.

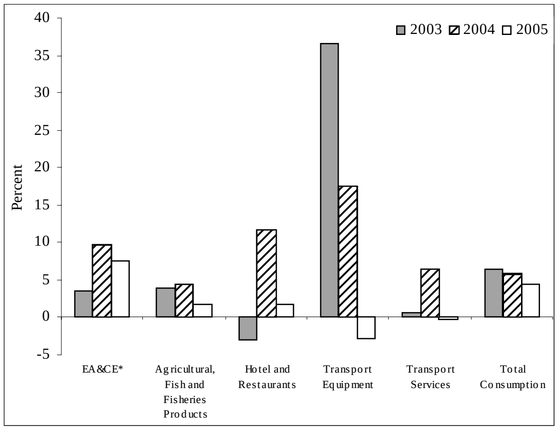
Thailand continued to be a net exporter of items under HS01-HS08 with the exception of meat (HS02) as China's tariffs on these items were reduced to zero under Early Harvest program[21]. Thailand ran a total net trade surplus of the eight categories by US$281 million in 2005 compared to US$190 million in 2004. Within these categories, Thailand, however, was a net importer of HS02 (meat and edible meat) and HS 05 (other animal products) equal to US$15.8 million. These two categories accounted for less than 0.8 percent of total trade.

However, the additional tariff reduction under ASEAN-China FTA effective in July 2005 increased trade flow in the second half of the year[22]. The exports of HS09-HS99 increased by 33.7 percent in the second half of 2005 faster than the import growth rate of 24.8 percent in the same period last year. Therefore, Thailand was a net importer of US$573 million during July to December 2005 dropped from US$720 in the previous period.

2.5 Household Consumption

Household consumption growth showed signs of slowing down last year and will unlikely be the key driver of growth in the medium term. Household consumption grew by only 4.4 percent last year compared to 5.9 percent in 2004, and was the lowest growth since 2002. Growth last year was particularly slow in the consumption of agricultural products, hotel and restaurants, and was negative for vehicles and transport services (see Figure 26). The latter is a result of the higher price of petroleum, which rose by 24.7 percent from 2004's level[23] (see Figure 27) and hence raised the costs of transport last year. Other factors contributing to the slow down in household consumption last year are the rise in real interest rates,

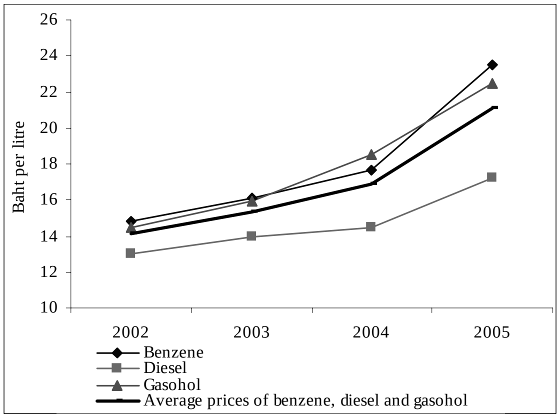
Figure 26. Growth of Household Consumption and Selected Components, 2003-2005



Source: NESDB

Remark: *Electrical Machinery, Radio, Television and Communication Equipment

Figure 27. Price Levels of Benzene, Diesel and Gasohol, 2002-2005



Source: EPPO

[21] HS01-08 includes HS01 (live animals), HS02 (meat and edible meat offal), HS03 (fish and seafood), HS04 (dairy products), HS05 (other animal products), HS06 (live trees), HS07 (edible vegetables) and HS08 (edible fruits and nuts). Under the Early Harvest Program, tariff rates of products under HS01 and HS08 were reduced and become zero rates by 2006.

[22] Thailand's normal track list includes 5,121 items. Of which, tariffs of 843 items, including, for example, apparels, plastic and its products, and vehicle and parts, were exempted on 20 July 2005 while tariffs of 278 items, such as jewelry, electronics, chemical products, were removed within 2005. The remaining will become zero rates by 2010. China's normal track list includes 6,583 items. Of which, tariffs of 2,682 items, including , for example, textiles and apparels, machinery, and chemical products, were exempted on 20 July 2005 while tariffs of 575 items such as wood and wooden products, machinery and electronics, were abolished within 2005. The remaining will become zero rates by 2010.

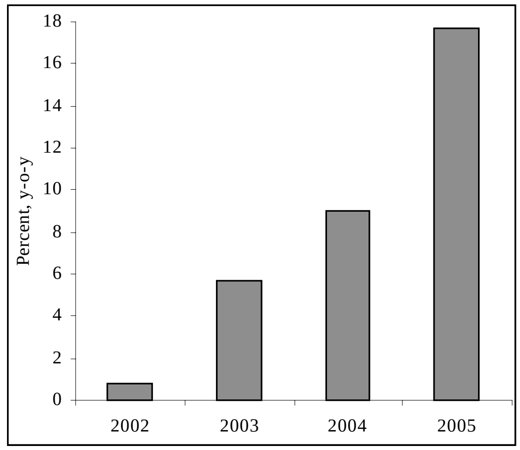
[23] Simple average prices of benzene, diesel and gasohol.

the decline in the terms of trade, and falling consumer confidence. Given that many of the factors that affect household consumption last year will linger into this year, household consumption is expected to decelerate further this year. With the consumption of durables rising rapidly since the 1998 crisis, its growth will likely slow down this year and in the medium term. Moreover, rise in the level of household debt will limit the ability of households to finance its consumption expansion via loans going forward. Thus, household consumption will unlikely be the key driver of growth in the medium term.

In 2005, household consumption was affected by rising prices and declining terms of trade. Inflation in 2005 was 4.5percent, which is the highest since the 1998 crisis. This is partly the result of the 17.7 percent increase in energy prices in the consumer price index last year. Energy prices last year are 35 percent higher than that in 2002 (see Figure 28). Consumers have started to adjust by decreasing benzene consumption and partially replacing it with gasohol (see Figure 32). This has negative implications on the purchases of vehicles and travel/transport services, both of which declined last year. Moreover, terms of trade has declined by 5.1 percent last year as prices of imports soared by more than those of exports (see Figure 29). This has eroded the overall purchasing power of consumers. As a result, household consumption growth has slowed down last year.

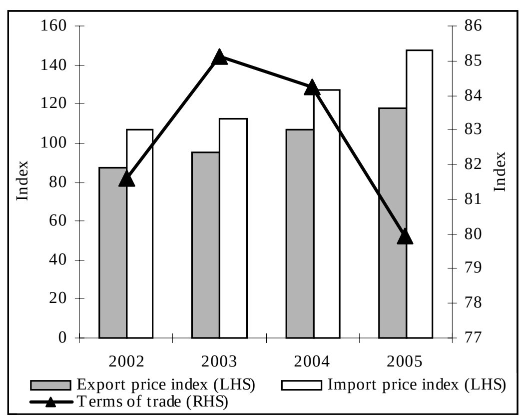
Household consumption will likely decelerate further this year with consumer confidence continuing to fall and interest rates rising. Nominal interest rates have risen by 1 percent last year and will continue rising this year. As inflation this year will likely be lower than last year's, real interest rates will therefore be higher than that of last year. With household debt as a share of household's disposable income having been on the rise in the past few years (see Figure 34), the rise in interest rates would raise households' debt burden and thus limit their ability to increase their consumption. While petrol prices remain high and political uncertainties further dampen consumer confidence this year (see Figure 30), households will be more cautious in their spending. Thus, household consumption growth this year is expected to slow down from that of last year. In January, vehicle purchase has declined compared to January last year and a significant slowdown in the growth of imports of consumer goods. This is consistent with the slowdown in the private consumption index (see Figure 31).

Figure 28. Growth of Energy Prices, 2002-2005



Source: BOT

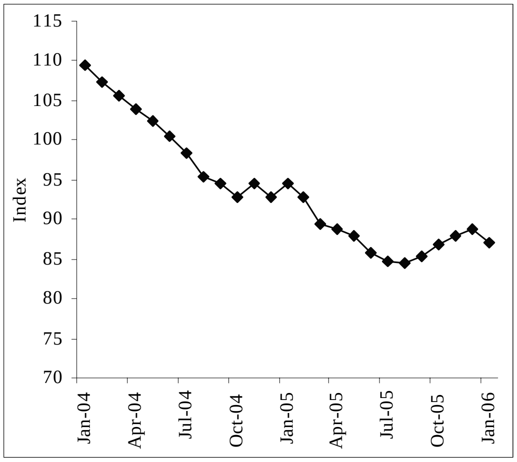
Figure 29. Export Price Index, Import Price Index and Terms of Trade, 2002-2005



Source: BOT

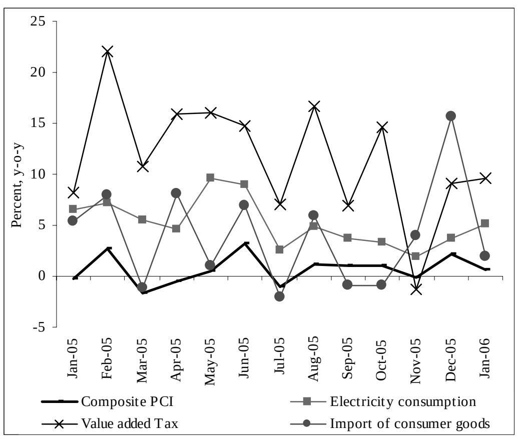
The impact of higher petroleum prices on household consumption should be relieved in the next year or so. In response to the sharp rise in petrol prices last year, consumers have started to adjust their use of petroleum products by both reducing their overall petrol consumption and by replacing benzene consumption with the cheaper gasohol. Benzene consumption last year declined by 1,027.8 million liters from that of 2004, while

Figure 30. Consumer Confidence Index, January 2004-January 2006



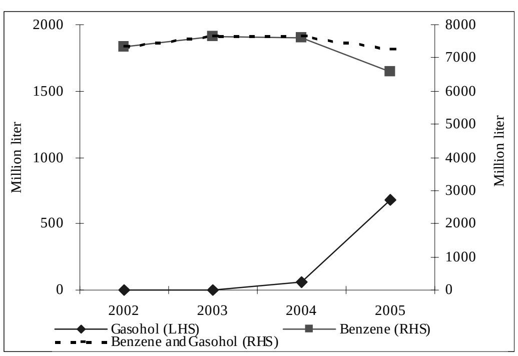
Source: UTCC

Figure 31. Growth of Private Consumption Index and Its Components, January 2005-January 2006



Source: BOT

Figure 32. Consumption of Benzene and Gasohol, 2002-2005

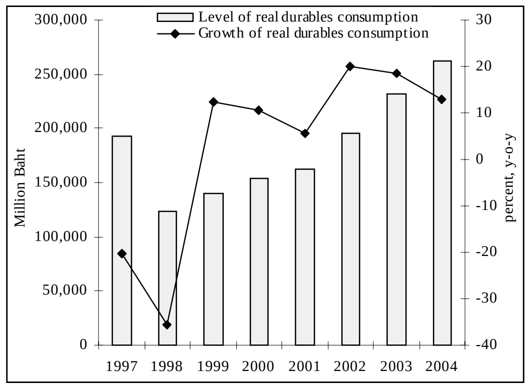


Source: EPPO

gasohol consumption rose by 615.3 million liters (see Figure 32). Thus, overall household petrol consumption dropped by 412.5 million liters. Although it will take consumers more time to adjust to high petrol prices, the adjustment could be completed in the next year or so.

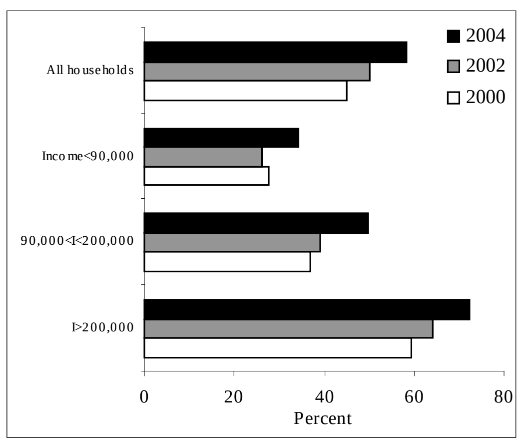
However, the rising levels of household debt and the slowdown in durables consumption will limit household consumption growth in the medium term. In the medium term, high household consumption growths as those after the crisis are unlikely as the consumption of durables[24] will slow down. Growth of

Figure 33. Level and Growth of Real Durables Consumption, 1997-2004



Source: NESDB

Figure 34. Household Debt to Disposable Income, 2000, 2002 and 2004



Source: SES2004

24 Durables represent roughly 10 percent of total private consumption. It does not include home purchases.

consumption of durables has been rapid after the crisis as households have retrenched their purchases of durables during the crisis years (1997-1998). In 1998, durables purchases were only half of its 1996 level. But since 1999, households spending on durables have increased and have caught up to its 1997 levels only in 2004 (see Figure 33). Since 2003, household's purchases of durables have decelerated and will unlikely grow rapidly in the near future. The increase in household purchases of durables and other consumer goods have been partly financed by loans. Household debt in 2004 is 1.5 times higher than that of 2000. Its debt to disposable in 2004 is 1.3 times higher than that in 2000 (see Figure 34). With the increased stock of debt and interest rates on a rising trend, household's debt burden is now much larger than a few years ago. This would limit their ability to increase consumption rapidly in the medium term. Thus, in the medium term, household consumption will unlikely be a key driver of growth as it has in the past recent years.

2.6 Investment

Growth in total investment demand will slow down further in 2006, having fallen last year relative to 2004. This is due to a slowdown in private investment growth as firms adjust to higher energy prices and poor business sentiments. Faster growth in private investment over the medium-term will have to await actions to address regulatory burden, skill constraint and infrastructure deficiencies. Public investment growth this calendar year will be lower than previously expected as all planned disbursements for mega infrastructure projects are delayed due to delays in approving projects and contracts with suppliers.

2.6.1 Private Investment

Last year, private investment grew by only 11.3 percent, the lowest rate since 2002, and further decline is likely this year. There was a sharp deceleration in the growth of private investment in residential-construction as well as in manufacturing sector, both reflecting falling business sentiments Growth of construction-sector slowed to only 7 percent and manufacturing production slowed to 5.5 percent in 2005 relative to 8 percent in 2004. Foreign direct investment (FDI) rose robustly by 21 percent, showing no sign of weakening, driven largely by the automotive sector. FDI in infrastructure is likely to be dampened in the near term by slower mega-infrastructure project implementation. Though skill and infrastructure constraints are increasingly felt by foreign investors, FDI is likely to remain strong in the medium-term. A good deal will thus depend on how domestic investors respond in the coming years.

Slowdown in manufacturing production is largely due to the adjustment to high energy prices and falling consumption and housing demand. Most of this slowdown is in sub-sectors that produce primarily for the domestic markets (see Table 7), because oil prices are rising for the third year, even if at a lower rate and other energy prices are also on the rise, limiting production as well as investments. As a result, capacity

Table 7. Manufacturing Production Index Growth

(Percent)

	Weight	2003	2004	2005
MPI growth	**100.0**	**13.9**	**11.5**	**9.2**
Export less than 30% of total production	34.0	15.6	9.8	0.3
Export between 30% to 60% of total production	30.9	8.6	7.6	4.9
Export more than 60% of total production	35.1	17.3	17.0	22.6

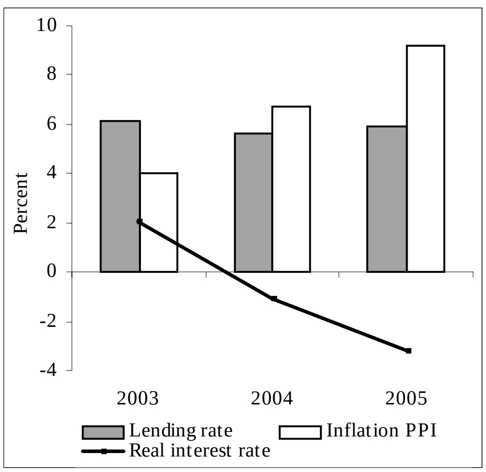
Source: BOT

Remark: * Classified by the ratio of export production to total production of each industry.

utilization which is significantly higher than in 2000, increased last year by only 2 percentage points. Consumption growth was also down last year (see Household Consumption section) as higher energy prices and falling tourist arrivals hurt spending.

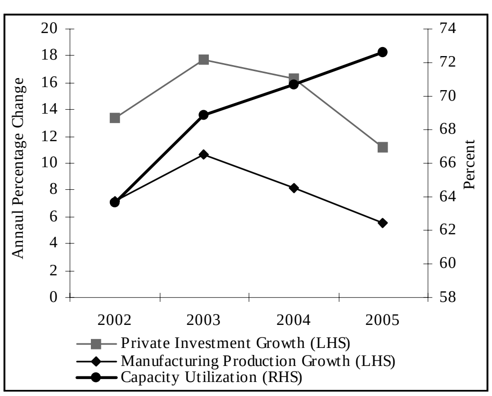
Nevertheless, low real interest rates and real depreciation have supported private investment during the recovery, but are unlikely to continue in the near future. In fact, real interest rates faced by firms were increasingly negative in 2004 and 2005 as the producer price index increases outpaced bank's lending rate rises[25] (see Figure 35). Investors have also been supported the growth in loans to the business sector of 11 percent in 2004 and 6.6 percent in 2005. Real exchange rates have also depreciated since 2000, and it appears that this has had, on average, a favorable impact on private investment (see Box 6).

Figure 35. Nominal Interest Rates, PPI Inflation, and Real Interest Rates, 2003-2005



Source: BOT

Figure 36. Private Investment Growth, Manufacturing Production Growth, and Capacity Utilization, 2002-2005



Source: NESDB and BOT

Private investment growth is likely to remain depressed unless significant steps are taken to address constraints that firms in Thailand have identified – regulatory burden, infrastructure deficiencies and skill-development. Real interest rates will rise this year as nominal interest rates rise and inflation eases. Public investment in infrastructure is slowing down relative to earlier announcements. Depreciation in real effective exchange rates stalled and is likely to turn into appreciation (see Figure 37). And GDP growth is likely to take some time to get back to the rates achieved during 2003-04 period. Retail petrol prices are expected to remain high this year with another 20 percent rise from last year and electricity and transport prices are still on the rise. Growth in household consumption is less robust than it has been in the past. The fact that capacity utilization rates are much higher now than at the beginning of recovery will no doubt help. Going forward, without significant improvements in the investment climate facing investors and thus in the rates of return, an upturn in private investment growth will be difficult.

Higher energy prices and real interest rates will raise costs for firms, thus, affecting their ability to raise investments this year. Prices of energy that are used by firms (diesel, fuel oil, and electricity) rose by 33 percent last year (see Figure 38). With retail petrol prices expected to rise by another 25 percent this year, energy prices will be almost double its level in 2002. This has contributed to a rapid rise on firms' cost of production and reduced their margins. Firms have been coping with high oil prices by adjusting their energy mix last year (see Figure 39). However, as oil intensity of Thai firm has been high, firms will need time to adjust to be more fuel efficient. Moreover, real interest rates, which have been negative since 2004

[25] Bank's lending rate is proxied by the minimum lending rate (MLR).

Box 6. Determinants of Private Investment Growth in Thailand

Private investment plays a vital role in the growth generating process in developing countries including Thailand. Thailand's private investment dropped sharply from 1997 to 1999. Even with its high growths from 2000 onwards, private investment's share in GDP only increased slowly and remained lower than that in the 1980s. A better understanding of the determinants of private investment growth in Thailand is therefore helpful in understanding private investment behavior and also in policy formulation to facilitate private investments.

An econometric estimate of determinants of private investment (1960-2004) shows that the following are the significant determinants of private investment in Thailand: output growth, output gap, real effective exchange rate, real cost of capital, and private investment levels in the previous year, availability of private domestic credit, and real public investment. In the long run, output growth in the previous year, real effective exchange rate, growth of real cost of capital, and public investment have significantly large impacts on private investment growth.

The short and long-run elasticicities[26] of private investment to the variables above is summarized below:

Variable	In the short-run, if the variable increases by 1 percentage-point, private investment will change by…	In the long-run, if the variable increases by 1 percentage-point, private investment will change by…
GDP growth in the previous year	+2.98 %	+30.65 %
Output gap a/	+0.78 %	
Real effective exchange rate b/	+0.34 %	+3.50 %
Growth of real cost of capital in the previous year	-0.19 %	-1.91 %
Private investment in the previous year	-0.10 %	
Availability of private domestic credit	+0.07 %	
Real public investment in the previous year	+0.05 %	+0.51 %

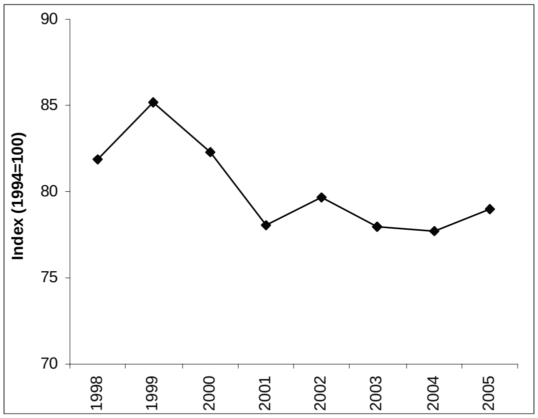
a/ Output gap = Actual output – Potential output measured by GDP. An increase in the actual output gap means that there is less excess capacity.
b/ Increase indicates depreciation.

Promoting overall growth would promote private investment both on the short-run and the long-run. The output gap, an indictor of capacity utilization, positively affects private investment and has been constraining it in the early years. Recent increases in capacity utilization should lead to pressure for rising private investment. Depreciation in the real effective exchange rate seems to have a positive impact on private investment in both the short and long run suggesting that export sector remains an important driver of private investment. Increases in the real cost of capital, affected by real interest rates, reduce private investments in both the short and long-run. Public investment, on the other hand, has a smaller positive impact on private investment in the short-run but larger impact with time; it helps to reduce costs of doing business and therefore facilitate firms' expansion/investments in the longer run.

Source: Jongwanich and Konpaiboon, Determinants of Private Investment in Thailand (forthcoming).

[26] Indicates private investment growth (percent) in response to a one percentage-point increase in the variables

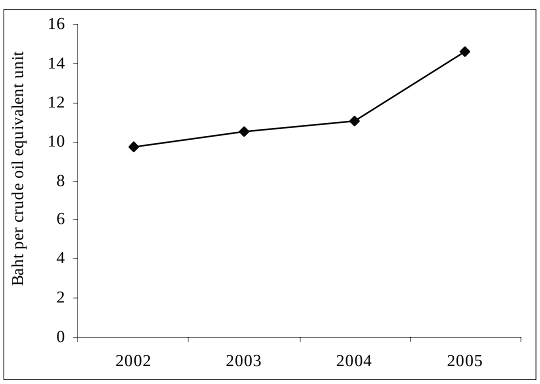
Figure 37. Real Effective Rates, 1998-2005



Source: BOT

Note: Increase means an appreciation.

Figure 38. Weighted Average of Electricity and Petroleum Prices Used by Manufacturers



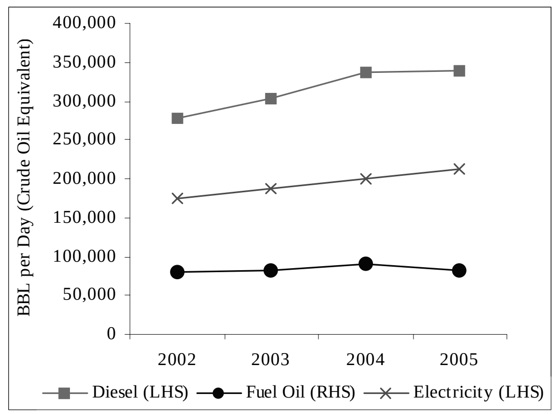
Source: BOT

Remark: Petroleum products include Diesel HSD and Fuel oil. Prices are weighted by their consumption.

(see Figure 35) will no longer be so with nominal interest rates rising further this year while inflation will be less than that of last year's. Higher energy prices and real interest rates will make the costs of operations for firms significantly higher than just a few years ago. Hence, firm's decisions to expand/invest this year may be delayed.

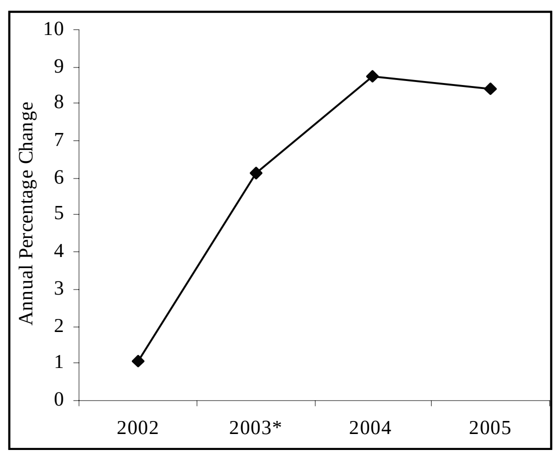
Financial sector loans to the business sector decelerated last year and will be on a similar trend this year. Growth of loans to businesses or corporate loans which has been accelerating since 2002 slowed to less than 5 percent last year compared to 8 percent in 2004 (see Figure 40). The slowdown was most prominent in loans to manufacturing and transportation sectors, in line with the deceleration in their respective output growths last year (see Table 8). Commercial bank loans last year to the construction and real estate industries grew by half that of 2004 as construction sector growth slowed down.

Figure 39. Consumption of Diesel, Fuel Oil and Electricity



Source: EPPO

Figure 40. Financial Sector Business Loan Growth, 2002-2005**



Source: BOT

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

** Loans are adjusted by adding back loan write-off and loan transfer to AMCs excl. loan to AMCs. Financial sector includes commercial bank and SFIs.

Table 8. Growth of Commercial Bank Loans

(Percent)

	2004		2005	
	Share of Loans	**Growth***	**Share of Loans**	**Growth***
Total Commercial Banks' Loans	100.0	8.3	100.0	8.8
Household Loans	16.0	11.3	16.3	9.2
Loans to Financial Institutions	12.9	-0.7	12.3	10.0
Business Sector Loans	71.1	11.1	71.4	6.6
of which				
Manufacturing	27.3	16.1	27.4	4.7
Public Utilities	2.0	23.3	2.1	9.1
Construction	3.0	13.9	2.8	5.7
Commerce	17.4	6.1	17.5	3.1
Hotel and Restaurant	3.7	22.7	3.7	9.9
Transportation	4.3	41.0	4.4	10.5
Real Estate	7.4	15.1	8.1	9.7
Others**	6.0	-3.8	5.5	-3.8

Source: BOT

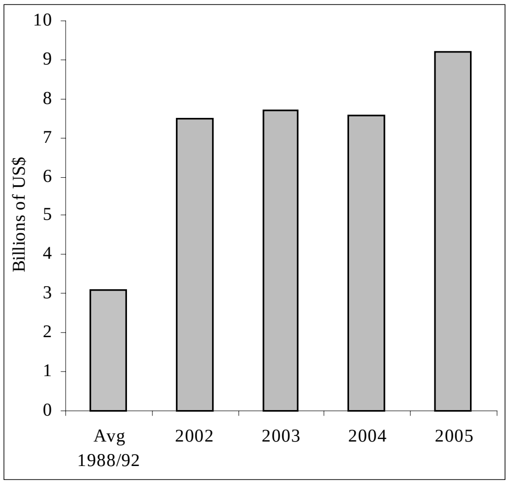
Note: * Due to lack of sectoral adjustment data, these growth figures are unadjusted for write-offs, write-back, transfers to AMCs, the effect of a merger in 2004 between a specialized financial institution and two commercial banks, and the effect of new banks.

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

Delays and uncertainties in public investment this year will also negatively affect private investment. Public investment this year will likely be less than previously planned and its growth will slow down from last year (see next section on Public Investment). Thus, its crowding-in of private investment will be smaller than previously expected. Private investment in the construction materials industry (e.g. cement, iron, and steel), for example, would slow down. Moreover, private investment in sectors that would have been favorably affected by public investment (e.g. housing near mass transit train lines and highways projects) will likely be delayed as well. Private investments especially in the form of construction will therefore slow down further this year, after it has showed signs of deceleration since last year.

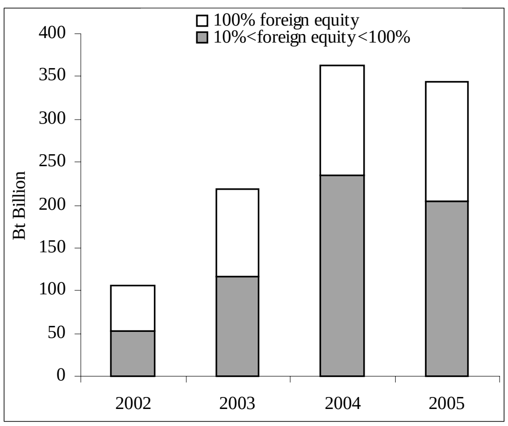
FDI trends look favorable but may slightly soften this year. Since the crisis, gross FDI inflows into Thailand have been strong. In 2005, FDI rose by US$ 1.6 Billion or 21.3 percent from 2004 levels (see Figure 41). This is in line with the Board of Investment (BOI) approvals of foreign and joint venture projects which have doubled in 2003 and again in 2004 (see Figure 42). As it takes two years on average for a BOI approved project to be translated into actual investments, high gross FDI in 2005 corresponds to the jump in the approved projects in 2003. In 2006, FDI should again increase given that the BOI approvals of foreign and joint venture projects in 2004 were 65 percent higher than that in 2003. This year, FDI should remain strong in the automotive and the electronics sector. However, the political uncertainties and the delays in the public mega-project investments may delay some of the FDI decisions, especially those in the infrastructure-related sector. Hence, gross inflows of FDI this year will unlikely rise as much as that of last year.

Figure 41. Gross FDI Inflows



Source: BOT

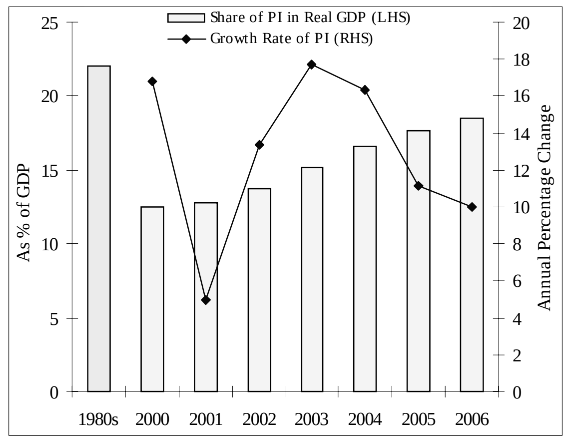
Figure 42. BOI FDI Approvals



Source: BOI

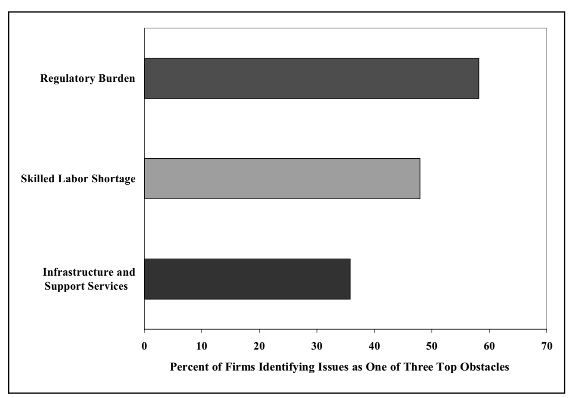
The recent slowdown in private investment underscores even higher importance for Thailand to boost private investment by improving its investment climate. Private investment's share in real GDP has increased only slowly since the crisis. Due to its sharp retrenchment in 1997 to 1999, private investment has not reached even its 1980s level despite its expansion since 2000 (see Figure 43). With private consumption growth on a slowing down trend, private investment will need to be a key driver of growth in the near future. However, in an unfavorable investment environment of higher energy prices and real interest rates, a rapid pick up of private investment will be difficult unless other constraints on the investment climate are urgently addressed. Some of the key investment climate constraints identified by firms in the *Thailand Investment Climate, Firm Competitiveness and Growth Study*[27] are the regulatory burden on firms, shortage of workers with the skills that firms need, as well as inadequate infrastructure (see Figure 44 and Section 3 for greater discussion of the findings and recommendations from the *Thailand Investment Climate, Firm Competitiveness and Growth Study*).

Figure 43. Private Investment Share in GDP and Growth



Source: NESDB

Figure 44. Major Business Climate Concerns for Firms in Thailand



Source: Thailand Investment Climate, Firm Competitiveness and Growth Study (2006)

[27] A joint study by the NESDB and World Bank. Data for the survey is as of 2004.

2.6.2 Public Investment

Public investment last year grew rapidly but will slow down this year due to the delays in the disbursement of the mega infrastructure projects. Public investment expanded by 11.7 percent year-on-year last year, the highest rate since 1998. This was partly contributed by the commencement of the disbursements of Bt42.7 billion for mega-infrastructure projects on top of the Bt438 billion non-mega project investments last year. The plan for this fiscal year is to invest another Bt290 billion for mega-projects (see Table 9), particularly in the mass transit, transportation, housing and water resources sectors. However, there will likely be significant delays in the investments in some of these projects. Therefore, expansion in public investment this year will be around 6.5 percent or half of previously expected.

Table 9. Mega-Project Investment Plan

(Billion Bt)

	2005	2006	2007	2008	2009	TOTAL
Planned Investment	**42.7**	**290.0**	**506.1**	**514.5**	**450.9**	**1,804.2**

Source: Cabinet meeting resolution, November 1, 2005

Investment for mega-infrastructure projects this year will likely be roughly half of what is planned. The reasons are the possible delays in the approval of additional projects by the Cabinet amidst political uncertainties and the approval of investment funds from the budget by the Parliament. On-going and new mega-projects that have already been approved and contracted have started for this year so far sum up to Bt150 billion or half of the Bt290 billion. They include the purchase of four Thai Airways airplanes, investments by the State Railway, Petroleum Authority of Thailand, and Metropolitan Rapid Transit, and investments for the low income housing project, roads, and canals. The remaining investments will be delayed as the proposal submissions for the projects in which the Government has asked international bidders to participate has been delayed from April to May with possibilities of further delay due to the current political uncertainties. Moreover, the Parliamentary approval of the FY2007 budget has been delayed as it is awaiting the new Parliament. This will therefore delay the Parliamentary approval of public investment projects (both mega and non-mega projects) for the next fiscal year which includes public investment in the last quarter of this year.

The delays in public investment projects this year will lower the contribution of public investment growth to GDP growth, but will at the same time reduce the imports needed for the investments. The slowdown in the mega-project investments and hence public investments growth to roughly 6.5 percent will result in only a 0.4 percent contribution of public investment to the 5 percent projected growth this year, not different to that of 2004. With the slow down in public investments, the pressure for imports is lessened. It is now estimated that direct imports for the mega projects will be around Bt79 billion this year or equivalent to 1.2 percent of 2006 nominal GDP compared to about Bt100 billion if all the planned mega-infrastructure investment projects for this fiscal year go through. This would therefore put less pressure on Thailand's current account deficit this year.

Public investments are needed to increase Thailand's competitiveness in the medium term. Inadequate infrastructure was reported by firms as one of the 3 major constraints to their business operations and expansions[28]. Hence, public investments in infrastructure are needed for firms in Thailand to remain competitive and for them to invest going forward. Given the current political uncertainties, public mega-project investments will likely be delayed beyond 2009 if not reduced. This would have negative implications on the expansion of investments of private firms.

[28] *Thailand Investment Climate, Firm Competitiveness and Growth Study (2006).*

2.7 Financial and Corporate Sector Development

Banking Sector Developments

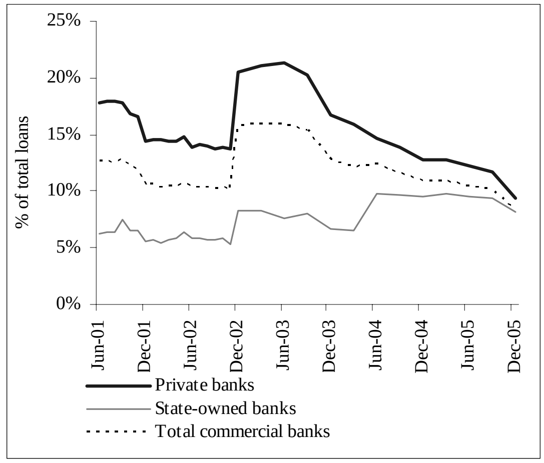
Over the past year, non performing loans (NPL) have come down to single digit for the first time since the financial crisis. In the last three months of the year there was a significant decrease of 17 percent from Bt576.5 billion in the last quarter of 2004 to Bt477.2 billion in 2005. At the end of 2005, NPLs dipped to 8.2 percent of total loans from 11.6 percent at the end of 2004.

The decline in NPLs came mainly from private banks. In the last quarter of 2005, private banks' NPLs as a share of total loans fell by 4 percentage points from the previous quarter. As a result, at the end of 2005, private banks' NPLs as a share of total loans fell to a single digit of 9.4 percent for the first time since the crisis. The reduction is a much faster pace than that of state-owned banks, whose NPLs stood at 8.1 percent of their total loans at the end of 2005 (see Figure 45). This rapid reduction of NPLs in the last quarter of 2005 is the result of the removal of restructured NPLs which have been able to make payments according to their restructuring agreements. The increase in new and re-entry NPLs in the third quarter of 2005 has also declined from that of the previous quarter (see Figure 46).

Banks' balance sheets have further strengthened in 2005 under the combined effects of stronger loan growth and wider interest rate margins. As of December 2005, prevailing interest margins of the Thai commercial banking sector were at 2.9 percent, while its return on assets (ROA) stood at 1.4 percent and return on equity (ROE) at 16.5 percent reflecting the overall strength of the sector (see Table 10).

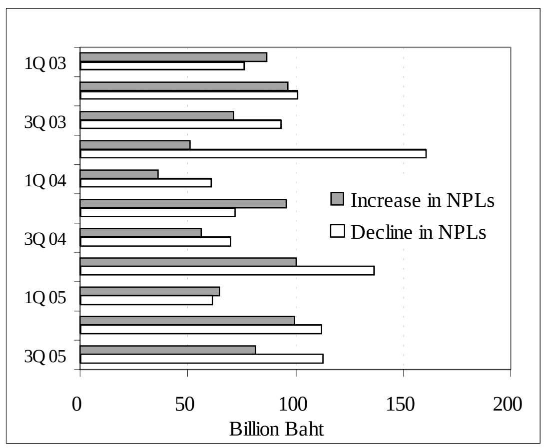
Excess liquidity in the banking system remained high and was estimated to be approximately 518.7 billion baht at end-November 2005, up from 489.0 billion baht at end-September 2005 and 452.4 billion baht as of December 2004. The ratio of excess liquidity to total deposits was 8.5 per cent, slightly lower than the average of 8.7 percent in 2004.

Figure 45. Non-performing Loans 2001-2005



Source: BOT and the World Bank's estimate
Note: Total NPL amount, taking into account neither transfers to neither AMCs nor write-offs (NPLs total financial institutions / total loans financial institutions not including write-offs).

Figure 46. Changes in NPLs (quarter-on-quarter)



Source: BOT and World Bank's estimates (3rd quarter 2005 are preliminary data)

The Cabinet acknowledged in October 2005 the Ministry of Finance's proposal of a debt relief program for small individual debtors. Under the program, financial institutions will give a 50 percent haircut on the principal and 100 percent haircut on accumulated overdue interest to eligible debtors participating in the program subject to their ability to

Table 10. Indicators of Commercial Banking Sector Health

(Percent)

	2000	2001	2002	2003	2004	2005
Interest margin	1.1	1.6	1.8	2.0	2.5	2.9
Return on Equity (ROE)	-4.8	32.8	4.2	10.5	16.8	16.5
Return on Asset (ROA)	-0.2	1.5	0.2	0.7	1.2	1.4
Pre-provision profit to assets	0.0	0.4	1.0	1.4	1.7	1.9
Provision expenses to assets	2.2	0.6	0.7	0.7	0.5	0.4
Total capital adequacy ratio	11.3	13.3	13.0	13.4	11.9	13.2
Tier-1 capital	7.5	8.9	8.9	9.6	9.0	10.0
Equity to total assets	4.3	5.0	5.5	7.1	7.7	9.0

Source: BOT

meet the new payment obligations. Debtors can choose to pay the remaining 50 percent amount all at once by June 2006 or apply for loans from the Government Savings Bank (GSB) to pay back financial institutions and pay the installments to GSB by June 2009. Individual debtors who are eligible for the program should have debt outstanding with financial institutions which are classified as non-performing loans as of June 2005. In addition, to be eligible, the debt outstanding of each borrower should not exceed Bt200,000 per each financial institution and a case should have already been filed in court for the collection of the debt. Sixteen banks, 3 finance companies, and 6 AMCs, agreeing to participate in the program, already signed the Memorandum of Understandings (MOUs) with the MOF. There is not yet a full assessment of this program's cost, but it needs to be carefully watched.

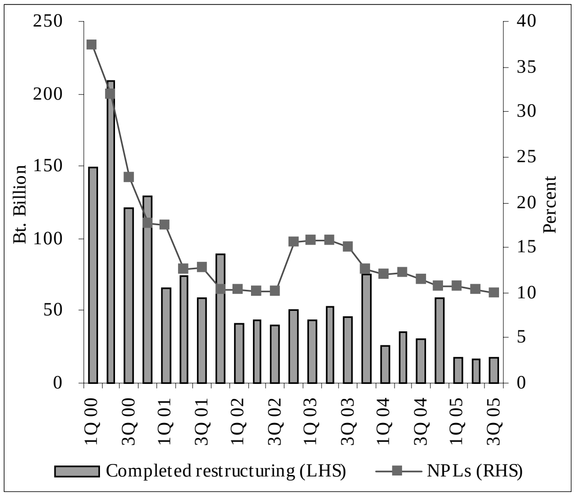
Over all, performance of Thai banks improved in 2005. General retained earnings turned positive for the first time since 1998 and net profits were up approximately 19 percent since end 2004. Accrued interest receivables continued to show improvement through further reductions. Credit growth remained strong, but does not appear to be out of control. Non-interest fee income appears to have leveled off and actually dropped in 2005. This is the first reported drop since a new emphasis was placed on bank income in 2001. A couple of areas should be watched in the future which could impact overall bank performance. One area to be watched will be the foreclosure numbers. A second area to be watched is operating expenses. Operating expenses dropped between end 1998 and end 2002, but since then have begun to rise. In 2005, it continued the upward trend with a year on year increase of higher than 12 percent. This trend if continued could impact the overall profitability of the banking sector and might be of concern given the trend to higher funding and salary costs going forward.

Corporate Sector Developments

The corporate sector of listed companies continued to improve its financial health. Median corporate debt-equity ratios have fallen significantly in the post-crisis period as a result of corporate debt restructuring, a significant paying down of debt by firms, and improving profitability with the recovery. Thailand's corporate sector shows significant gains in terms of interest coverage and return on assets.

However, completed debt restructuring in 2005 has slowed as growth has put firms in a good situation. The BOT reported that completed debt restructuring by financial institutions during the first nine months of 2005 was about half of the amount completed during the same period in 2004 (see Figure 47). The slowdown in debt restructuring in 2005 may be because remaining NPLs are difficult to restructure and should be resolved through liquidation or foreclosure.

Figure 47. Completed Restructuring and NPLs, Q1 2000-Q3 2005



Source: BOT and WB analysis

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

The CDRAC process has helped debt restructuring in its 6 years of operation. The CDRAC voluntary out of court process completed 52 percent or Bt1.48 trillion of its Bt2.84 trillion targeted cases in its six-year operation. Completed debt restructuring through CDRAC process represented 85 percent of the cumulative debt restructuring by financial institution to date.[29] However the CDRAC did not track the quality of completed debt restructuring through its process, therefore difficult to assess the impact so far.

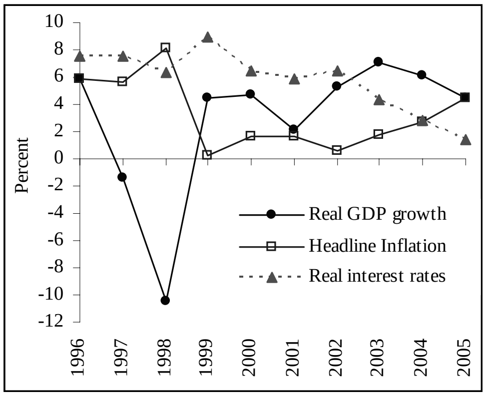
2.8 Medium Term Agenda for Growth and Poverty Reduction

Thailand's potential for strong and sustainable GDP growth in the medium term is good given its macroeconomic situation and its general commitment to openness.

However, a further improvement in GDP growth performance next year is expected and the prospects for sustained strong growth in Thailand are high. These come from the back of (a) the strong macroeconomic situation, (b) country's continued commitment to integration and (c) impending investments and actions to enhance infrastructure-services. However, these will have to be accompanied by actions to reduce regulatory burden, skill development, and the completion of many unfinished agenda especially in the financial and corporate sectors. They are discussed in turn below.

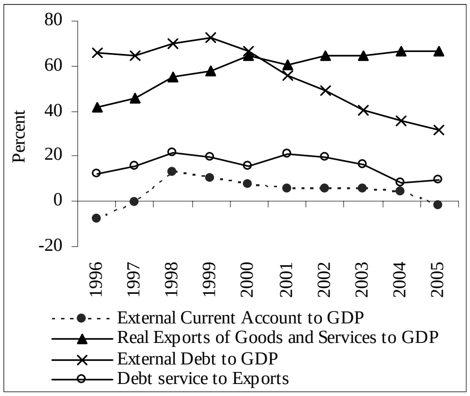
Not only has real GDP per capita growth surpassed per-crisis levels, but its fiscal situation is sound,

Figure 48. Real GDP Growth, Inflation, and Real Interest Rates



Source: BOT and NESDB

Figure 49. Indicators of External Situation



Source: BOT and NESDB

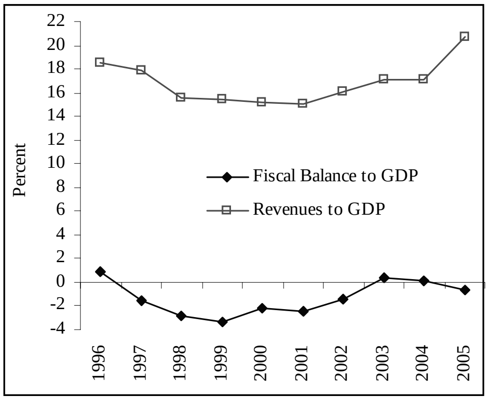
[29] The information was as of September 2005. Note that targeted cases under the CDRAC process go beyond NPLs at financial institutions. For example the process also includes bond holders and other creditors.

with a balanced budget and low public debt. Revenues have been on the rise. External vulnerability is low. Inflation did pick-up with jumps in oil prices, but tightening monetary policy is bringing it down (see Figure 48) and real interest rates are negative, though it is expected to rise quickly. The external situation is also strong (see Figure 49).

Thailand has also been committed to and achieved an increasing degree of openness. Compared to pre-crisis, Thailand is now more open to trade and investments, largely due to significant reforms in the early years after the crisis. More recently reforms had slowed, though with initiatives for FTAs and tariff rationalization, the situation has been improving.

Impending investments in infrastructure will help alleviate the bottlenecks as identified by firms as a major constraint to their investment and productivity growth. More than 30 percent of firms in the *Thailand Investment Climate, Firm Competitiveness and Growth Study*[30] indicated inadequate infrastructure as a key constraint to their business operations and expansions. This is particularly important for the growth key manufacturing regions in Thailand, namely Bangkok and vicinity, the Central, and East. A larger number of firms in the East relative to the other two regions report that they are faced with inadequate

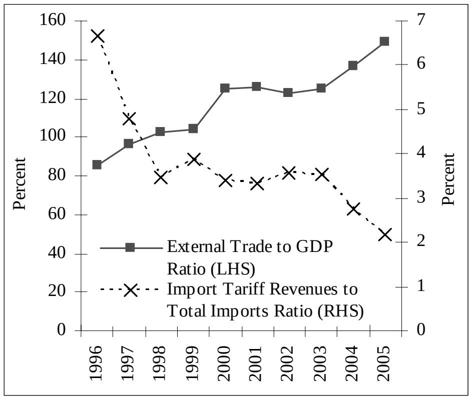
Figure 50. Fiscal Stance



Source: BOT

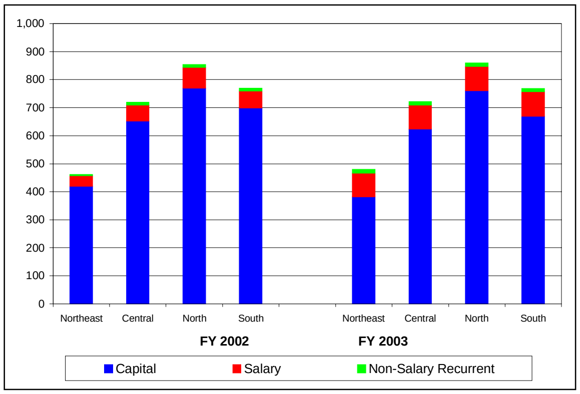
[30] *Thailand Investment Climate, Firm Competitiveness and Growth Study* (2006), a joint study between the NESDB and the World Bank. Data in the study is as of 2004.

Figure 51. Indicators of Openness



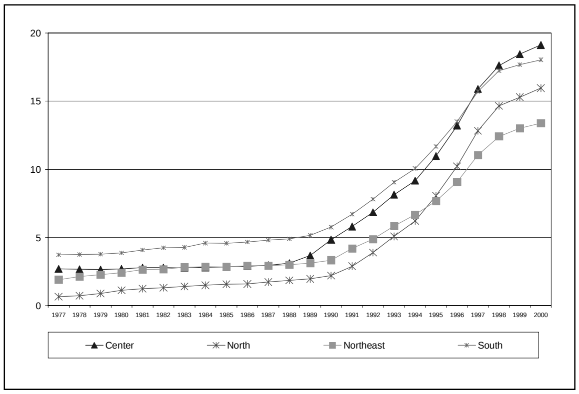
Source: BOT

Figure 52. Public Per Capita Spending on Transportation and Infrastructure, FY 2002 and 2003



Source: Thailand Northeast Economic Development Report

Figure 53. Rural Roads (Per 1,000 Rural Population)



Source: Thailand Northeast Economic Development Report

Table 11. Firm's Response on Infrastructure

(Firms Evaluating Constraint as "Major" or "Severe")

(Percent)

	Thailand	North	Central	Bangkok & Vicinity	East	Northeast	South
Telecommunications	11.4	6.8	8.8	8.3	18.2	18.3	24.3
Electricity	25.6	21.9	21.6	21.2	37	32.4	41.1
Transportation	13.8	13.7	9.5	14	15.6	12.7	15.9

Source: *Thailand Investment Climate, Firm Competitiveness and Growth Study* (2006)

infrastructure (see Table 11). Thus public infrastructure investments in the regions as planned for in the mega-infrastructure project programs will help alleviate these constraints in the coming years.

Infrastructure investments are also important in helping to alleviate poverty in the poorest regions of Thailand. Table 11 indicates infrastructure inadequacy is a major constraint for more firms in the Northeast and the South regions relative to any other regions in Thailand. Public spending on transport and infrastructure in the Northeast, for example, were 40-50 percent lower than that in the North, Central, and South (see Figure 52). The Northeast also has the lowest rural road density per person (see Figure 53).

Unfinished Agenda

Given the strong macroeconomic growth and reforms that Thailand has been undertaking to increase its competitiveness, Thailand's growth and poverty reduction in the medium term can be sustained as if Thailand embarks on efforts to improve its business climate. Some of the key business climate issues that Thailand needs to continue addressing are regulatory burden and restrictions, regional trade facilitation, and skills development. These would help Thailand to reduce its cost of doing businesses, promote productivity, and private investments. As Thailand's growth can no longer depend on the reallocation of abundant labor from the agricultural sector to the manufacturing sector as was pre-crisis, further capital accumulation and increase in productivity will be needed to sustain future growth[31].

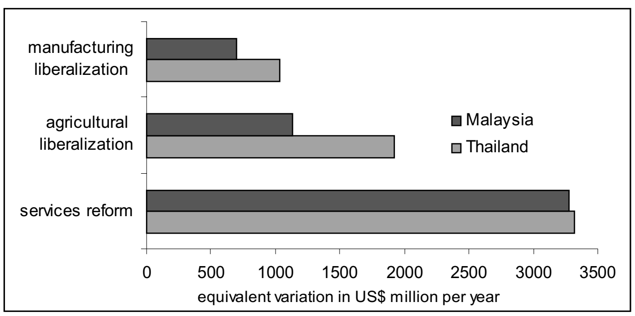
Relieving the regulatory burden will help Thailand improve its competitiveness in the medium term. High regulatory burden has been reported by more than 60 percent of the 1,385 firms surveyed in the *Thailand Investment Climate, Firm Competitiveness and Growth Study*. Some of the key areas of regulatory burden are for example the uncertainty around the time taken to obtain business licenses and permits and numerous and complex hiring procedures, tax regulations, customs processes and trade regulations. These have imposed additional costs to firms. Tax regulations/and or high tax are concerns of particularly firms in the garments, auto parts and machinery, and equipment industries. Bureaucratic burden, on the other hand, is a more severe constraint for firms in the electronics and electrical appliances industry. Large firms, exporter firms, and foreign owned firms are significantly more constrained by customs and trade regulations, which can be ascribed to the nature of their activities. In terms of regions, these regulatory burdens have been reported to be more severe for firms in key manufacturing regions such as Bangkok and the vicinity.

Thailand has made progress in improving a business competition environment, particularly in the service sector, but further liberalization of the services sector would yield higher gains to Thailand. The National Telecommunications commission (NTC), established in November 2004, is the licensing authority for telecommunications operators and has a key role in

[31] See discussion of Thailand's total factor productivity in Thailand Economic Monitor, November 2005 issue.

moving the Thailand telecommunications sector away from the concession-based regime to a licensed-based regime. Its award of licenses to the state-owned telecom operators, TOT Plc and CAT Telecom Plc is also a prerequisite for their privatization (see Box 7 for details on the telecoms sector). Liberalization of services trade is one of the important proposals under negotiation in the present Doha Round of global trade talks. A recent World Bank research further shows that Thailand stands to secure substantial economic gains from services liberalization, which far exceed those of the manufacturing and agricultural trade liberalization (see Figure 54). The studies[32] suggest that the policy priorities appear to be in retail and wholesale trade, logistics and the professions (a part of business services), both because these sectors are large and because trade barriers in these sectors raise costs and reduce productivity in other parts of the economy that use these services as inputs. The fact that cuts in services trade barriers lead to increased productivity in the rest of the economy implies that most of the gains from services opening can be gained by unilateral liberalization; they do not depend on the rest of the world also liberalizing its services sectors. This

Figure 54. Welfare Implications of Services Liberalization



Source: East Asia Update, March 2006

32 Sources: Dee, P. 2004a, 'Measuring the cost of regulatory restrictions on services trade in Malaysia', background paper for the study 'Improving the investment climate by reducing the regulatory burden in Malaysia', World Bank, September, and Dee, P. 2004b, 'Cost of services trade restrictions in Thailand', background report to the 'Productivity and investment climate assessment in Thailand', World Bank, September.

is different from that in agriculture and manufacturing, where more of the potential gains depend on securing greater market evidence abroad.

Trade facilitation especially with neighboring countries is an agenda that will help boost the economy of the Northeast of Thailand, where more than half of the poor resides. Strong economic growth in the GMS region raises the benefits from trade integration among its member countries, but direct benefits to the Northeast has so far been small. The economy of the Northeast is only half the size of China's Yunnan Province and two fifths the size of Vietnam. Since 1980, Thailand's exports increased in real terms annually by 1 percent to Lao PDR, by 13 percent to Cambodia, by 24 percent to Vietnam, and by 23 percent to Myanmar. These are encouraging developments but the direct benefits from trade integration to the Northeast remain small. Less than one percent of the around 13,500 Thai export companies are located in the Northeast. While the bulk of exports and imports with Lao PDR go through customs in the Northeast, trade with Vietnam, which accounts for the largest part of exports to the Mekong region, takes place mostly through the sea-route, by-passing the Northeast. The Northeast will only capture a greater share of the expanding trade among GMS countries if trade through the land route becomes less cumbersome. Thus, improving the business climate and promoting integration with a prosperous Greater Mekong Subregion can turn the Northeast from a land-locked into a land-linked region. This will require reducing structural and institutional impediments to the movements of goods, people, and capital.

Skill development is a necessary condition for firm's competitiveness and overall growth in the medium term. Lack of skills and skills mismatch are reported by firms to be one of the top three key constraints to their operations and expansions[33]. Skills development can take place at several levels. To address this issue in the short-run, vocational training and the re-training of existing workers to upgrade

33 *Thailand Investment Climate, Firm Competitiveness and Growth Study* (2006)

Box 7. Developments in Telecoms Liberalization in Thailand

Establishment of a regulatory agency

The National Telecommunications Commission (NTC), the licensing authority for telecommunications, officially commenced operations on November 1, 2004. It has a key role in moving the Thailand telecommunications sector away from the concession-based regime to a licensed-based regime. Award of licenses to state-owned telecom operators, TOT Plc and CAT Telecom Plc is also a prerequisite for future privatization. The rapid NTC action to license internet service providers (ISPs) at a very low fee level was an important decision that signaled the beginning of the end of the old revenue-sharing arrangements requiring ISPs to pay Communications Authority of Thailand, Plc. (CAT).

Privatization

Licenses for both TOT Plc and CAT Telecom Plc were issued in August 2005. Timing of privatization depends in part on progress on valuation of the companies and other legal issues. Valuation in turn depends on progress on: (i) discussions between these SOEs and the Ministry of Finance with respect to the application of the special telecommunications excise tax; (ii) discussions between these companies and NTC concerning license fees, and (iii) TOT's dispute with True Corporation involving access charges.

Transition from Concession Regime

There are different views on how the transition from a concession regime for the main private sector operators may proceed. In terms of preparing the ground for this transition, important steps have been the establishment of the NTC as the licensing authority and the opportunity for existing or new operators to apply for a license. In addition, in spite of the negative aspects of the special telecommunications excise tax, it was an effective way to begin the disentanglement of concession fee payments to the SOE operators. In summary, it allowed the treasury to capture part of the concession fee payment as a fee payable to the Government rather than having it continue to be paid to an operator. Nevertheless, several observers think that a "flash-cut" end of concession arrangements is unlikely. In this scenario, some existing concession contracts would continue to run their course while the same or parallel companies may seek NTC licenses for new operations outside of the concession arrangements. In this case, the market-share operating under a concession regime would decline over time and that is the more likely scenario.

Trade Negotiations

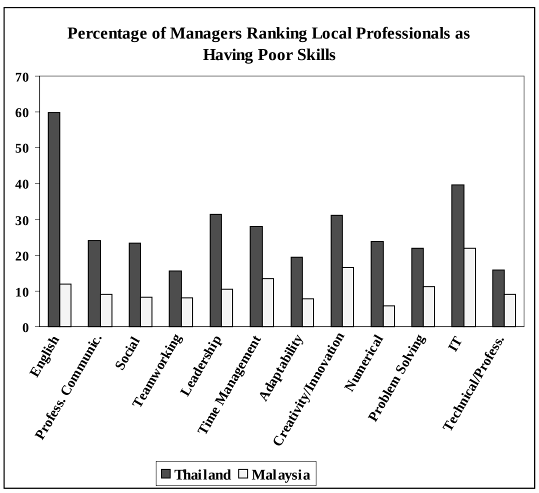
Thailand is involved in trade negotiations involving USA, Singapore and perhaps others on telecom market access. Furthermore, some WTO telecom commitments involving market access are expected to come into effect this year, but could be delayed due to the back-log of work faced by the NTC.

their skills to meet firms' needs will be important. Nevertheless, for the longer-term, Thailand must continue to improve secondary and tertiary education especially in science and technology.

There is compelling evidence of both skills shortages and mismatch in Thai manufacturing sector. Firms pay large wage premiums to tertiary education graduates, and to workers who receive training in technical skills, indicating extreme levels of excess demand for the highest skilled labor in Thailand. The incidence and intensity of hard-to-fill vacancies are high: nearly 80 percent and 95 percent of Thai manufacturing plants surveyed have had vacancies for professionals and production workers respectively in the last 2 years. Incidence of professional vacancies is far greater than in Malaysia and Indonesia where it is 50 percent and Philippines, 25 percent. Also, it takes longer (more than 6 weeks) in Thailand than in any other benchmark country to fill a vacancy of a skilled production worker or a professional. When asked about the reasons for these vacancies, over 80 percent of the managers cited the fact that applicants lack appropriate basic and technical skills.

English language and ICT skills are most in demand. Firm managers report that skills that workers lack most are English language and information and communications technology (ICT) skills, which also does not compare favorably with those in Malaysia (see Figure 55). From the *Thailand Investment Climate, Firm Competitiveness and Growth Study* data, workers with basic IT skills (e.g. printing invoices), intermediate (e.g. word processing, email), and advanced (e.g. programming) computer skills earn 9.9, 18.9, and 29.1 percent higher wages, respectively, than those with no computer skills. Workers who lack English proficiency in doing their jobs earn 2.6 percent lower wages than those with sufficient English skills.

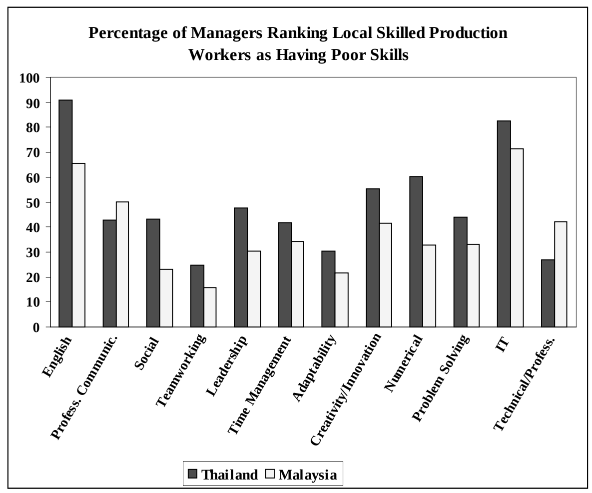
Figure 55. Managers Rank of Skills of their Local Professional Employees



Source: Thailand Investment Climate, Firm Competitiveness and Growth Study (2006)

Vocational education plays a crucial role by providing very specific technical skills to workers, and more importantly it can have the most impact on labor market in the short-to-medium term. In a tight labor market such as the one in Thailand, vocational education may play a crucial role by providing very specific technical skills to workers. However, in Thailand, the ratio of student at the upper secondary who opt for vocational education instead of general education has declined from 46 percent in 1994 to 34 percent in 2001. A recent synthesis study on vocational education also found that most vocational curriculum are not flexible, obsolete and not fitted to the needs of the employers.[34] In addition, for the first job, the salaries of vocational education's degree holders tend to be 25 to 30 percent lower than their peers with general education. There have been recent efforts to improve the quality of vocational training in Thailand. The establishment of the Thailand Vocational Qualification Institute was approved last September. In collaboration with the Federation of Thai Industries, the TVQI sill implement the Thai Vocational Qualification Program which is aimed build vocational skills that meet international standards and at the same time meet the needs of Thai firms. The draft Vocational Education Act has been prepared and support networking among education institutions, industry and communities, in order to ensure that the curriculum responds to market signals and to provide effective incentives for private participation.

Figure 56. Managers Rank of Skills of their Local Skilled Production Workers



Source: Thailand Investment Climate, Firm Competitiveness and Growth Study (2006)

Employer-provided training is the other channel through which workers accumulate firm specific skills. Given the poor quality of the educational

34 "A Synthesis of Studies in Vocational Education from 1993-1998" by Krismant Whattananarong.

output, managers in Thailand have been compensating by training workers themselves. The establishment of a Skill Development Fund (SDF) with mandatory contributions is as such a good decision. However, a stylized fact in the training literature is that SMEs, who train the least in all countries, end up subsidizing the training by large firms, as they will be forced to contribute to a funds mostly used by large firms. Investigating the reason why SMEs train fewer workers than large firms and how to effectively raise their training incidence could be an interesting follow-up investigation. Given the low external training incidence, the Government could encourage external training, especially using more suppliers to train workers. That would increase the level of technology linkages between the Thai domestic firms and multinational suppliers, one of the weakest links in the Thai technological capability chain as shown in the next chapter of this report.

Policies to address the shortage of skilled workers in Thailand should target a further expansion of secondary education in order to increase the local supply of skilled workers (professionals and sub-professionals). This will be critical to fulfill the country's agenda on competitiveness. Expansion of secondary education coverage is a condition for countries to fully reap technological spillovers from FDI and trade. Specific measures could include enforcing the NEA decision of 9 years compulsory education or raising the compulsory number of years of education, especially in rural areas and in poorer groups of the population. An increase in the secondary education attainment rates in rural areas will have the advantage of equipping the workforce with appropriate skills where they live, which could then lead to more firms settling outside Bangkok, and a slower migration of unskilled workers towards Bangkok. As the shift towards high-tech industries continues, unemployment rates among unskilled workers will likely rise and this will constitute a serious challenge for cities. Along the same lines, the RTG could accelerate the creation of more public secondary institutions in rural areas, and encourage more participation of the private sector to secondary education.

Improving the quality of secondary education is likely to increase the demand for secondary graduates and their wage premium, providing a strong incentive to complete secondary school. Convergent sources point to the fact that the quality of secondary education output in Thailand may be inadequate by international standards[35]. Specific measures could include improving the content of education for the skills that are most needed (English language proficiency and ICT skills). The RTG could consider introducing/reinforcing English in primary school, and aim at teaching one or more courses in English in secondary school, both general and vocational in 5 years. In the long run, English language could become compulsory in all skills development centers and for Diploma level. This would imply training more English teachers and improving the training of existing ones.

[35] Thai Secondary Education Students score lower than average in International Tests. The latest international test for quality of education, the "Trend in Mathematic and Science Study" (TIMSS), revealed poor results for Thailand. Also, the latest result from Program for International Student Assessment (PISA) suggests that Thai students perform below the OECD average scores, and poorly compared to peers in other Asian countries.

SECTION 3

IMPLEMENTATION OF STRUCTURAL REFORMS

The Government is preparing the 10th Five-Year National Development Plan (FY2007-2011) and it is hoped that actions to boost more efficient private investment will be taken. The Office of the National Economic and Social Development Board is responsible for drafting the Plan. The three pillars are (1) Economic Capital, (2) Social Capital, and (3) Natural Resources. The final draft of the Plan is scheduled to be submitted to the Cabinet for approval in September 2006 and Plan will be effective in October 2006.

The Government has continued to take some reform measures to address some of the emerging issues. Reforms in the financial sector, trade, and public sector have been progressing over the past year. In the financial sector, the phase one of the Capital Market Master Plan (2002-2005) has been completed with satisfactory outcomes. The Capital Market Master Plan II (2006-2010) has been proposed to the Ministry of Finance. The Thailand Futures' Exchange (TFEX), which has been granted a license since February last year, will begin operations at the end of April this year. The Credit Information Business Act has been amended and was effective in February, hence reducing the onerous legal risks for the Credit Bureau and their members and provides greater flexibility for the operations of the Credit Bureau. On the trade side, further tariff reductions have taken place for 150 ICT products under the e-ASEAN Framework Agreement and for some items used in the printing industry and the electrical appliances and electronics industry to promote competitiveness of these industries. Key public sector reforms that took place over the last six months include the amendments to the state-owned enterprises' financial and accounting rules and regulations and the amendments to the rules and regulations on public debt to improve public financial and debt management. The Public Hearing Law which would help improve the accountability and transparency of government projects was enacted.

This issue of the Monitor examines in detail the progress in the implementation of the financial and corporate sector reforms and restructuring, public sector governance reform, and trade reform. The progress in the last year is reported and reforms taken in each area in the past 2 years and in the reforms planned for in next few years are presented in boxes. In the first two areas, there is on-going work carried out with Government agencies under the relevant Country Development Partnership (CDP) programs. In the area of trade reform – which is critical for competitiveness improvement – but where there is no CDP, work with relevant agencies was carried out to ascertain the state of the progress. Below we look at the three areas.

3.1 Financial and Corporate Sector Reforms and Restructuring

Financial Sector Reforms

Between end-2004 and January 2006, 4 new banking licenses were granted, two of them to upgrade finance companies. In this period, the total number of commercial banks has increased from 30 to 34, with 14 domestic private banks (4 of them with majority foreign ownership and control), 17 foreign (single branch) banks and 3 state-owned banks. The total of financial institutions is 57 – 34 commercial banks, 9 finance companies, 4 credit foncier companies, and 10 SFIs.

The BOT's program of updating supervisory regulations and enhancing the quality and effectiveness of bank supervision has been ongoing since mid-1998. The BOT has been very observant of trends that could adversely impact the soundness of the system. In July 2005 as a means to control consumer debt, the BOT issued a regulation on consumer lending. It also established disclosure rules so consumers could better understand the rate they were being charged for the convenience of their consumer loans. In August 2005, BOT issued updated rules on institution's lending to related parties. All of the measures being taken are indications of BOT's commitment to a stronger and healthier banking system and to its commitment to be prepared for the implementation of the Basel II standards at end-2008.

The BOT continued to take steps to implement Basel II by end-2008. In late August 2005, the BOT hosted a joint conference with Deutsche Bundesbank on risk management. The focus was on BOT's expectations, incorporating discussions on the process, tools and techniques banks should be developing in order to be prepared for the changes in 2008. In October 2005, as part of its effort to better measure and control risks in the system, the BOT issued a guideline to commercial banks on the preparation of IT contingency plans. The guidelines were developed based upon the Contingency Planning Guide for Information Technology Systems of the National Institute of Standards and Technology. The BOT had also requested that all financial institutions prepare and submit by June 2006 their Basel II implementation plans as well as extensive explanations of the methods they plan to use to measure and manage risks.

The Credit Information Business Act was amended, and the amended Act was effective since February 14th, 2006. The amendments reduce onerous legal risk for the Credit Bureau and their members and provide more flexibility for the operations of the Credit Bureau. The former Act had many positive attributes but mandated large fines and criminal penalties against the bureaus or their members for all violation, including negligence. The amended Act reduces those legal liabilities; however, it still limits the types of business that the Credit Bureau can offer.

Thailand Security Depositary Company (TSD), a subsidiary of the Stock Exchange of Thailand (SET), will be responsible for clearing and settlement trading of government securities in addition to corporate bonds. The TSD is currently responsible for clearing and settlement trading of corporate bonds, while trading of government securities is currently settled by the BOT. Transfer of government securities' trade responsibility to TSD is planned to take place in May this year. Ultimately, the TSD will assume collateral management functions for securities borrowing and lending transactions. This should lead to a more efficient clearing and settlement system.

The Federation of Thai Capital Market Organizations (FeTCO) and related Government bodies have proposed the draft of the second phase of the Thai Capital Master Plan to the Ministry of Finance as a follow-up to the Capital Market Master Plan I (2002-2005). The proposed Capital Master Plan II covers the period of 2006-2010 and emphasizes measures to develop and strengthen the Thai capital market in line with international standards and to be ready for changes in the global markets. It aims to make the Thai capital market an efficient channel for fund-raising as well as a good savings choice, helping to increase the overall market capitalization and improving price stability (see Box 8 for the principle measures under the Thai Capital Master Plans I and II).

The Ministry of Finance has established a series of policies in order to improve the current Microfinance and Specialized Financial Institutions (SFIs) development framework. These include (i) creating synergies among SFIs in the areas of capital and liquidity management, (ii) promoting prudent banking among SFIs, (iii) limiting recapitalization of SFIs, (iv) reducing SFIs' NPLs, and (v) setting clear markets for SFIs (see Box 9 for details on the policies)

Box 8. Principle Measures of the Thai Capital Master Plans I and II

The Capital Market Development Master Plan I which covers the period of 2002 to 2005. With the aim of reforming the Thai capital markets, this Master Plan focused on reinforcing the strengths of the market, making it a key driving mechanism of the economy to become a full-fledged competitor in the world market. The proactive measures to enhance the potential of the Thai capital market were as follows:

1. Progress towards becoming a capital market embracing good corporate governance.
2. Enhance the quantity and quality of securities.
3. Enlarge and strengthen the size of the investor base
4. Strengthen intermediary institutions
5. Reform the structure of the supervision system to enhance the development of the capital markets
6. Enhance efficiency of the infrastructure to reduce transaction costs.

The outcome Capital Market Development Master Plan I was satisfactory. However, to date, the role of the capital market as being a good alternative choice for those who want to invest and save are still unclear. Thus, the Federation of Thai Capital Market Organizations (FeTCO) and related Government bodies have proposed the draft **Capital Market Development Master Plan II** (2006-2010) which aims to improve the attractiveness of the capital market as an alternative source of fund-raising for firms and savings choice for individuals. The quantitative targets of the Plan are to (i) increase the size of equity and debt markets to be comparable to that of the banking sector and (ii) encourage more institutional investor's participation in equity market and more individual investors in debt market. The main strategies to complete these targets are in the following seven areas:

1. Equity market: Increase market capitalization and number of domestic institutional investors from the current 10 percent of total turnover to 20 percent by

- increasing supply of stocks of large companies and, at the same time, encouraging SMEs to be listed on the Stock Exchange.
- setting up the mandatory saving system
- introducing reinvestment tax allowance
- introducing tax privilege for Venture Capital

2. Debt market: Increase the market value to that of the money market and support individual investors by

- giving the capital gain tax exemption for individual investors who trade debt instruments in BE
- encouraging Market Maker (MM) to create liquidity and stability in the market
- encouraging the role of the Credit Rating Agency
- creating credit enhancement which allow will help lower the cost of the debt instruments

3. Risk mitigation instruments:

- create exchange linkage between domestic derivative market and foreign derivative markets
- create public awareness on derivative products
- issue structured products to reduce down-side risks

4. Intermediary institutions:

- improve the capabilities of the intermediary institutions, so that they will offer better integrated products and have a more suitable capital base prior to opening up for foreign competition
- set timeline for liberalizing commission fee with the liberalization taken step-by-step, so that the business operators will have enough lead time to prepare or adjust to the liberalization

5. Corporate governance standards will be raised: Provide incentives (such as providing fast track services to companies with high corporate governance rating) and education schemes to help push forward this effort. The target is that the education outreach will cover every academic institution in the country by 2010. The Securities and Exchange Commission (SEC) and the Stock Exchange of Thailand (SET) will be responsible for this effort.

6. Education and training: Expand education and training on capital market issues to cover every province and every academic institution:

7. Regulatory: The SEC and SET to

- review the principle and time frame in processing requests to issue the debt instruments or equities and create a balance between merit and disclosure.
- review rules and regulations to make sure that they are relevant to current situation.

Box 9. Policy Framework to Develop Microfinance and Specialized Financial Institutions (SFIs)

The MOF has established a series of policies in order to improve the current framework to develop Microfinance and Specialized Financial Institutions (SFIs). The policies aim to:

- **Create synergy among SFIs** in the areas of capital and liquidity management, such as those of the Government Housing Bank (GHB) and Government Savings Bank (GSB). To facilitate this idea, a committee for SFI coordination and supervision will be established;
- **Promote prudent banking** by identifying a proper set of prudential regulations to reflect the special characteristics of SFIs, which serves Government policies;
- **Limit recapitalization of SFIs to a one-time basis.** The recapitalization figure must reflect the efficiency in SFIs management and cover the needs when SFIs become banks subject to prudent banking regulations;
- **Follow international standards in SFI's NPLs resolution while reflecting the SFIs unique character**. SFIs will be required to reduce their NPLs by less than 10 percent within 1 year; a clear and precise policy on NPLs will be established, including conditions for NPLs to be transferred to an AMC; NPLs with 3-5 year profiles with full provisioning should be written-off;
- **Establishing clear market segmentation for SFIs** such that SFIs avoid direct competition with commercial banks and deliver services to target groups not reached by commercial banks. Examples are as follows:
    - BAAC will focus on farmers' lending; GSB will play an important role in savings mobilization and microfinance;
    - GHB will provide mortgage lending with specific and unique conditions, that is, small borrowers with long term fixed rate loans;
    - SME bank will focus on SME customers that can not access commercial banks' lending; and
    - EXIM bank will focus on the external trade with neighboring countries and contract farming, since commercial banks can not enter this market.

Thailand is negotiating with the US on a Free Trade Agreement, which has financial services liberalization as one of its key areas of coverage. Although an agreement has yet to be reached, both countries continue to go forward with the negotiations. To date, the Thai and US authorities have maintained general discussions, exchanged information/views, and clarified issues such as the regulations for the movement of Thailand's investment fund, a mechanism to suppress disagreements on the role of Financial Management, business regulations and insurance. The Fiscal Policy Office recently conducted an assessment of the potential impact of financial service liberalization on domestic financial institutions and is in the process of formulating strategic options. Both parties hope to conclude discussions and reach an agreement by mid-2006.

Corporate Sector Reforms

The amendments to the Civil Procedure Code to facilitate corporate restructuring were made last year. The amendment to Civil Commercial Code on Legal Execution to reduce the fees on the sale of foreclosed properties was published in the Royal Gazette in July 2005 and hence reducing around half of the current fees[36]. The reduction in fees is expected to help attract the buyer to the foreclosed properties market. In addition, the amendment on the immediate "buyer-take-possession" in the case the creditor can proof to the court that the debtor has defaulted was also effective in July 2005. This amendment would eliminate the redundant requirement for the buyer to petition and obtain court order to transfer legal ownership of the properties, thus, reducing the transaction cost and time for both the seller and the buyer.

[36] The amendments are (1) reduce the auction fee from 5 percent to 3 percent of the sale value; (2) reduce the foreclosed property discharging fee from 3.5 percent to 2 percent; and (3) reduce the fee for sales not going through the auction process from 3 percent to 2 percent.

However, there has been no progress on some areas of legal reforms. The draft Secured Transaction Act was a case in point which has been waiting for a revision by the Joint Senate-House of Representatives committees since the Cabinet approval in 2003. This Act would allow for more flexible collateralization of liquid assets other than the traditional real estate properties. However it is not likely that the draft will be approved in the near future given the current political uncertainty. Similarly, the draft amendments to the Asset Management Corporate Act (AMC Act) to allow the Government AMC to purchase distressed assets from the private financial institutions have not been reviewed by the Parliament even if the amendments would accelerate the resolution of distressed assets in private banks and lessen their bad debt portfolios and thus reducing the level of NPLs in the financial system.

Box 10. Progress in Financial Sector Reform in Recent Years and Future Plans

Many initiatives to reform the financial sector have been implemented in the past two years. The key one is the implementation of the Financial Sector Master Plan which would change the landscape of the financial sector in Thailand. Reforms to upgrade the capital market have also been put in place beginning with the Capital Market Master Plan I (2002-2006). The reform initiatives are discussed in turn below.

The Financial Sector Master Plan became effective after being acknowledged by the Cabinet in January 2004, and is being implemented. The strategy aims to (i) develop an efficient, stable, and competitive financial sector with greater balance between the banking sector and the capital market; (ii) improve access to financial services by all market segments both rural and urban areas; and (iii) ensure consumer protection. The implementation in the first three years has focused on restructuring and strengthening existing financial institutions and improving level competition. After three years, new entrants may be allowed to enter the banking sector contingent on suitable economic conditions. Tax impediments to merger between financial institutions have been removed through the passage of the Government Decree. The Bank of Thailand (BOT) relaxed regulations on closing and opening a branch by a commercial bank and lending requirement for a provincial branch. Some restrictions for the operation of a foreign bank are being removed. There are some other regulations to be implemented, but all or them are either not initialized or at a very early stage.

The MOF issued notifications in late January 2004 detailing terms, conditions, and procedures for the application of commercial bank licenses consistent with the Master Plan. This was intended to rationalize licenses for deposit-taking financial institutions. Types of licensing for domestic deposit taking financial institutions have now been reduced from four types – commercial bank, restricted bank, finance company, and credit foncier company – to two types, that is, a commercial bank and a retail bank. There are two types of foreign bank licenses – a full branch or a subsidiary. As a result, the BOT hopes to see remaining players stronger[37].

The Bank of Thailand (BOT) has begun preparing for the full implementation of the Basel II in 2008. The BOT has developed specific measures for each of the three pillars, which include minimum capital requirement, supervisory review, and market discipline. A series of consultative papers with specific policies and guidelines have been released for industry comments and the public hearing by 2005. The BOT has continued its bilateral dialogue with commercial banks to ensure their readiness to adopt the Basel II. Its bank supervisors are being prepared through intensive training programs. A number of prudential guidelines to strengthen bank's risk management in the areas of internal rating system, loan portfolio management, credit scoring, risk model validation and credit and market risk stress testing have been issued. These tools should enable banks to better manage their risk and price loans according to customers' risk profile. The BOT targets the full implementation of Basel II by the end of 2008. Meanwhile, all financial institutions are required to submit by June 2006 their Basel II implementation plans for the BOT's approval.

The amendments to the BAAC (Bank for Agriculture and Agricultural Cooperatives) Act were approved on March 16th, 2006, to transform BAAC into a rural bank. The transformation of BAAC into a rural bank is one of the government's

[37] From December 2004 to December 2005, the total number of commercial banks has increased from former 30 to current 34. The new banks must be established formally within one year before they are officially granted with new licenses. It is expected that the total number of small financial institutions will likely reduce further with the implementation of the Financial Sector Master Plan, and in fact number of small financial companies has been reduced in this period from 18 to 9, number of credit foncier companies from 5 to 4, and SFIs number has increased from 8 to 10.

measures designed to improve access to financial services in rural areas. Using BAAC's established branch network will greatly facilitate this effort.

The government guarantee for banks' creditors was lifted in November 2003. After the Cabinet's approval, the Financial Institution Development Fund (FIDF) issued the notification late 2003 excluding creditors of financial institutions from the state guarantee while maintaining a blanket guarantee for depositors. This was a step in the transition to a limited deposit insurance scheme. It is hoped that a limited deposit insurance scheme will add market discipline to the system because large uninsured depositors (mostly institutions) will better monitor the performance and condition of banks and move their uninsured money out of weaker banks.

The National Credit Bureau started its operations in mid-2005. The legal process for a merger between the two credit bureaus – the Central Credit Information Service co., Ltd. and the Thai Credit Bureau – has been completed. The newly merged credit bureau was renamed The National Credit Bureau. Credit databases have now grown to more than 20 million accounts, covering more than 10 million consumers.

Amendments to the Credit Information Business Act to reduce the potential onerous legal risks faced by Credit Bureaus and their members and to provide greater flexibility for the operations of Credit Bureau have been approved. The amended Act became effective on February 14th, 2006. The former Act had many positive attributes but mandated large fines and criminal penalties against the bureaus or their members for all violations, including negligence. The amended Act helps to reduce legal liabilities imposed by the Law; however, it still limits the types of business that the Credit Bureaus can offer.

The Public Debt Management Act was enacted in February 2005. The new law aims to facilitate flexibility in public debt management. However the issuance of government securities for the bond market development may continue to be restricted. The government is allowed under the new law to issue debt securities for (i) financing the budget deficit, (ii) financing economic and social development expenditures, (iii) restructuring of public debts, and (iv) on-lending to other authorities.

An amendment to the SEC Act was enacted in October 2003, which allows mutual funds to encumber their assets such that they can actively manage their portfolio through repurchase agreements, short-selling and borrowings.

SEC approved in October 2005 the transformation of the Thai Bond Dealing Center (Thai BDC) to the Thai Bond Market Association (Thai BMA), which will function as an information center and as a self regulatory organization for the bond market. Its role includes (i) dissemination of quotations, reference prices and closing prices of marking-to-market information; (ii) performing the duties of market monitoring and surveillance; (iii) acting as the center of bond information and market standards and conventions; (iv) developing financial tool, analytical tool, and training courses for the bond market; and (v) facilitating discussions on bond market development.

The Capital Market Master Plan I has been developed between 2002 and 2005. With the aim of reforming the Thai capital markets, this Master Plan focused on reinforcing the strengths of the market, making it a key driving mechanism of the economy to become a full-fledged competitor in the world markets (see Box 8 on Principle Measures of the Thai Capital Master Plans I and II).

In the next two years, the Bank of Thailand and the Government will continue its efforts to strengthen the financial sector and promote greater competition and efficiency in the banking sector in preparation for the implementation of Basel II and further liberalization of the financial sector.

The BOT is in the process of strengthening the supervision regime of a financial conglomerate on a consolidated basis, although it is constrained by the current law. The BOT released in September 2005 a draft guideline on the consolidated supervision, and it is consulting the industry on the draft guideline. The guideline will clearly define the scope of a banking group, whose operations, including subsidiaries, affiliates, and other entities in which the group has substantive holdings, will be subject to a consolidated supervision. The guideline will specify intra-group transactions, required capital adequacy, and large exposure on a consolidated basis. The guideline will initially be implemented on a pilot basis for one year to ensure a smooth transition to a full implementation.

The BOT targets to launch the Master Plan for the Development of Money and Foreign Exchange Markets in Thailand by the second quarter of 2006. The BOT is taking the lead to formulate, on a consultative basis, a three-year plan, which will compliment the Financial Sector Master Plan. Its objectives are to improve the efficiency of financial intermediaries, broaden the range of financial instruments, and streamline regulations related to the money and foreign exchange markets in Thailand. A public hearing will be organized to streamline the Plan before its final launch early the second quarter of 2006.

The draft Deposit Insurance Institution Act is being reviewed by the Office of the Council of State. The draft Act was endorsed by the Cabinet in November 2004, and it was planned to have been finished in January 2006, but it has been delayed at least until end of this year due to political uncertainty. Once the legal review has been completed, the draft Act will be submitted to the Parliament for its consideration. Upon the enactment of the Act, the Deposit Insurance Agency will be set up with an initial capital base of Bt 1 billion and will offer a limited guarantee on deposits at insured financial institutions. This will replace the current blanket guarantee of the BOT's Financial Institutions Development Fund (FIDF).

The Ministry of Finance will implement the Public Service Accounts in specialized financial institutions (SFIs) after a pilot for the SME Bank in 2005. The SME Bank has taken an initial step to implement a Public Service Account (PSA) that will report costs and performance of socially mandated activities separately from its commercial activities. The SME bank has proceeded with an initial implementation of the PSA by separating social and commercial activities on its income statement since early 2005. It has yet to separate accounts on its balance sheet. A public service account reports costs and performance of social mandate activities in separation from commercial activities. This is an initial step to improve the transparency of financial reports by SFIs. By properly costing and budgeting socially mandate activities, the MOF can hold SFIs accountable for costs and benefits. The FPO has yet to finalize its proposal and establish a definite timeframe for the implementation of the PSA by remaining SFIs.

The draft Master Plan for Grass-Root Financial Services is being revised. The draft Master Plan for grass-root financial services was considered by the Permanent Secretary of the Ministry of Finance, and a seminar was hold in December 2005 to register further ideas. However, Master Plan still needs to be improved by the FPO, as Ministry wants to focus more on the legalization of the "informal groups", those microfinance institutions that are informal, mainly savings groups on rural areas. Currently, they lack enough information about this item and are currently studying if legalization would be feasible. The draft Master Plan is prepared by the Microfinance System Development Committee (MSDC), which is chaired by the Finance Minister and its members comprise of representatives from concerned agencies. The Master Plan has three strategic focuses: (1) strengthening microfinance intermediaries and their human resource and improving their service providing capacities, (2) rationalize role and responsibilities of the government agencies involved in microfinance intermediation, and (3) fostering the microfinance network for sharing of experience.

T**he Capital Market Master Plan II (2006-2010) was proposed by the Federation of Thai Capital Market Organizations (FeTCO) and related Government bodies to the Ministry of Finance.** The proposed Capital Master Plan II emphasizes measures to develop and strengthen the Thai capital market in line with international standards and to be ready for changes in the global markets. It aims to make the Thai capital market an efficient channel for fund-raising as well as a good savings choice, helping to increase the overall market capitalization and improving price stability (see Box 8 for the principle measures under the Thai Capital Master Plans I and II).

The Thailand Futures' Exchange (TFEX) will begin its operations on April 28th, 2006. The TFEX has been granted a license from the Securities and Exchange Commission (SEC) since February 2005 to operate a futures' exchange. At this point, TFEX and its members are in the process of the industry-wide test for trading and clearing. TFEX has announced the preliminary admission of 20 members, whose membership status will be granted if they have a successful result in system's test and are approved by the SEC for their operational readiness. On rules and regulations, there are some details on operational procedures and circulation that will be announced by TFEX, with some issues still to be clarified with the members. The first traded product will be the SET50 Futures' Index, and the second one will probably be an interest rate product. The establishment of an organized derivatives' exchange would add more players and liquidity to the financial market and provide investors with tools to manage their risk.

By mid-2006, Thailand Security Depositary Company (TSD) will be responsible for clearing and settling trading of government securities, which is currently performed by the BOT. The TSD is currently responsible for clearing and settlement trading of corporate bonds. Transfer of government securities' trade responsibility to TSD is planned to take place in May this year. Ultimately, the TSD will assume collateral management functions for securities borrowing and lending transactions. This should lead to a more efficient clearing and settlement system.

3.2 Recent Trade Reforms

Thailand has continued to open its market and expand access for its own exports on favorable terms. Tariffs are being reduced, FTAs are being signed and support is being provided to exporters.

Thailand further restructured the tariff rates of electrical appliance and electronic industries to enhance the competitiveness of domestic producers. In December 2005**,** the Cabinet approved the removal of tariffs on 768 items of materials related to the production of electrical appliance and electronics and on 104 items which were the specific raw materials for electrical appliance and electronic productions[38]. The purpose of the tariff reductions is to support Thailand as a production base of this industry in Asia. The tariff exemption was effective in February 2006. In addition, the Government also removed the tariff rates of 92 production factors in the printing industry and 13 items of book and printing matters to promote Thailand as a printing hub and to enhance international knowledge in the country. The tariff removal was effective in January this year.

Tariff on ICT products were abolished for ASEAN members in December 2005 with a retroactive effect to January 2005. According to the e-ASEAN Framework Agreement, signed in November 2000, ASEAN-6 members were obliged to eliminate their tariff rates on ICT products in 3 stages: on 1 January 2003, on 1 January 2004, and on 1 January 2005[39]. As a result, Thailand removed the tariff rates of 150 ICT products in December 2005 with a retroactive effect to 1 January 2005. These products include, for example, typewriters, telephones, answering machines and, insulated wire and cable.

Several FTAs became effective last year (see Box 12). In addition, Thailand is taking the lead in the Ayeyawady-Chao Phraya-Mekong Economic Corporation Strategy (ACMECS). The ACMECS was established in April 2003 and has since expanded to include Cambodia, Lao PDR, Myanmar, Vietnam, and Thailand. The ACMECS is acting as a catalyst to the existing regional cooperation programs, that is, the Greater Mekong Sub-region and ASEAN frameworks. The ACMECS cooperation framework consists of five areas (i) trade and investment facilitation, (ii) agricultural and industrial cooperation, (iii) transport linkages, (iv) tourism cooperation (v) human resource development. The sixth area, public health, was added in the ACMECS Ministerial Meeting in August 2005. A key initiative under the ACMECS is the tariff free-imports of 10 agricultural products to Thailand produced in the other ACMECS countries under the Contract Farming Scheme.

The EXIM Bank has also introduced an instrument to support shrimp exporters to the US. The US government has imposed the antidumping duties on Thai shrimps ranging from 5.29-6.82 percent since February last year. In order to facilitate the shrimp exports, the EXIM bank has arranged the Standby Letters of Credit (L/C) to the exporters to use as a backup for issuing the continuous bonds at the US customs[40]. The EXIM Bank offers to issue the Standby Letters of Credit directly to the exporters or to issue it in collaboration with the commercial banks with a maximum guarantee of 50 percent of total value of the standby credits.

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[38] The 768 items include, such as metal, basic chemical products, basic iron and machinery. The 104 items include, for example printed circuits, electrical appliances and electronics.

[39] The e-ASEAN Framework Agreement aims to develop a free trade area for goods, services and investment for information and communications technology (ICT) industries within ASEAN.

[40] In order to export products liable to antidumping duties to the U.S., the exporters have to post the initial antidumping deposits on the merchandise together with the continuous bond at the U.S. customs. The U.S. customs process in determining the final antidumping rate can take up to 18 months and additional duties may be collected. Therefore, the continuous bond is a guarantee from a surety company to the U.S. government that all customs duties will be properly paid. The Standby Letters of Credit, however, acts as a guarantee from an exporter to the surety company in case the exporter fail to pay as agreed.

Box 11. Tariff Reforms in Early Years after the Crisis

Thailand made a significant progress in trade reforms in the early years after the crisis in 1997. In 1998, Thailand established the tariff restructuring committee in order to enhance country's competitiveness in agricultural, industrial and service sectors. Since then, the country's tariff system has been restructured continuously and the simple average applied rate reduced from 17 percent in 1999 to 15 percent in 2002 (see Table 12).

Table 12. Tariff rates in Thailand

(percent)

	1999	2002	2003	2004	2005
Simple average applied rate	17.0	15.0	14.7	12.0	10.7
Agricultural product (HS01-24)	32.7	26.0	25.4	n.a.	n.a.
Industrial product (HS25-97)	14.6	13.1	12.9	n.a.	n.a.
Items which have been restructured into three-rate system as of 1 January of each year*	n.a.	n.a.	37.3	56.1	73.2

Source: Trade Policy Review 2003 for simple average applied rate in 1999, 2002, and 2003. FPO for 2004 and 2005 as of January and WB calculations for share of restructured items into three- rate system.
Remarks: *The three rates capture each stage of production as follows: 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods.

The Government has also reduced the tariff escalation in the tariff structure. The system is as follows; 1 percent for raw materials, 5 percent for semi-finished goods, and 10 percent for finished goods. As a result, 73.2 percent of total tariff lines were in the three-rate system in January 2005 and leading to a reduction of the simple average applied rate from 14.7 percent in 2003 to 10.7 percent in 2005 (see Table 12).

3.3 Public Sector Reforms

To improve public financial management, the government recently revised rules and regulations governing borrowing by state-owned enterprises (SOEs). Last September, the Cabinet approved the amendments made on the Ministerial regulation on Accounting and Finances of SOEs (1977). The key amendments include: (i) a revision to the definition of what constitutes an SOE; (ii) mandatory disclosure of the accounting report and financial information of SOEs to the public; (iii) a reduction in the number of years (from 2 to 1) SOEs are entitled before having to set up reserves for accrued liabilities; (iv) permission for SOEs to invest retained earnings in short term financial instruments issued by the government, government financial institution, and other SOEs; (v) a requirement for SOEs to address a letter of notification to the Ministry of Finance (MOF) on unrepayable debts; and (vi) a new ceiling for borrowing and loan-guarantees for SOEs and government financial institution, based on their debt-to-equity-ratios.

Amendments to the rules and regulations on public debt creation, guarantee, and renewal were approved in December last year. This is one of the many recent actions taken to improve public debt management (see Box 14). The amendments include (i) setting a ceiling on loans and loan-guarantees of SOEs and government financial institutions, according

Box 12. Progress on Thailand's Free Trade Agreements (FTAs)

In the past six months, Thailand has made a significant progress on the FTA negotiations with 9 countries and 2 economic integration. The FTAs that are effective are as follows:

- **ASEAN and China:** The two parties had completed the negotiations on trade in goods which led to the tariff reductions, effective in October 2003 for fruit and vegetable products, in January 2004 for items under HS01-HS08 and in July 2005 for the remaining items (HS09-HS97) under normal track list[41]. The remaining issues for the negotiation are trade in services and investment issues. However, both sides expect to conclude the negotiation on trade in services by 2006.
- **Thailand and Australia:** Thailand-Australia FTA, effective in January 2005, is the first comprehensive bilateral FTA including trade in goods and services, investment and other economic cooperation. The first meeting of Thailand-Australia FTA Joint Commission to review the progress of the FTA implementation in December 2005 concluded that the FTA helped to facilitate bilateral trade, in particular SPS measure on fruit and vegetable trade and to boost the total trade flow between the two. The commission also agreed to consider the acceleration of tariff reduction on additional products and further liberalize trade in services and investment issues.
- **Thailand and New Zealand:** Thailand and New-Zealand Closer Economic Partnership (CEP) Agreement, effective in July 2005, helped to raise total trade flow in the second half of 2005 by 34 percent compared to 17 percent in the previous period. Both sides plan to hold an FTA Joint Commission meeting in May 2006 to review the progress of the FTA implementation while the negotiation on trade in services and investment will start in 2008.
- **Thailand and India:** Thailand and India are still negotiating on trade in goods and services as well as investment issues. However, both sides have agreed to implement an early harvest program by reducing tariff rates of 82 items including iron and steel, household electrical appliances, and fresh fruits since September 2004. The tariff rates of these products will become zero rates by September 2006.

Several other bilateral agreements are under negotiation as follows:

- **Thailand and US:** The two parties held the sixth round of negotiation in January 2006. The meeting discussed several issues such as market access on agriculture and industrial products, textiles, intellectual property, and the openness of the service sector. However, there are still some differences in rules of origin, customs procedure, SPS measure, bilateral and Global safeguard, and e-commerce with a greater flexibility in export subsidies, rules of origin on textiles and the use of mutually agreed list on services liberalization.
- **Thailand and Japan:** In September 2005 meeting, the two parties had reached a major agreement on the Closer Economic Partnership. Currently, both officials are working to reconcile the remaining technical issues like rules of origin. In addition, the signing ceremony of the CEP which was planned to be held in April has been postponed to later this year due to the political uncertainty.
- **Thailand and EFTA:** The first formal meeting between Thailand and EFTA was held in October 2005 which was followed by the second meeting in January this year. The negotiation is comprehensive covering all issues such as trade in goods and services, and investment. Both sides are still negotiating on the items in the tariff reduction schedule, tariff modality (Pattern of tariff reduction), rules of origin, product standard, and trade facilitation measure. They also exchanged the offers on trade in services and investment which have not been settled yet.
- **ASEAN and Korea:** ASEAN and Korea signed the Framework Agreement on Comprehensive Economic Cooperation at the ASEAN-Korea Summit in December 2005. However, Thailand decided not to sign the Annex Agreement in Comprehensive Economic Cooperation as Korea excluded rice from the tariff schedule and planned to hold the bilateral negotiations with Korea on this issue. The ninth round of negotiation in March 2006 discussed on the exchange of the indicative sensitive list, rules of origin, services liberalization and investment.
- **Thailand and Bahrain:** Thailand and Bahrain signed a framework agreement on the Closer Economic Partnership including the early harvest program in 2002. However, as of March 2006, the tariff reductions under the early harvest program have not been effective. According to the recent meeting in June 2005, it is likely that the two will change the bilateral agreement to the multilateral agreement between Thailand and Gulf Cooperation Council (GCC).

[41] See detail of tariff reductions and product coverage in Thailand Economic Monitor November 2005 issue.

- **Thailand and Peru:** In the leader meeting in November 2005, Thailand and Peru signed a protocol on the acceleration of liberalization on trade in goods and trade facilitations. Under this protocol, tariff rates of 50 percent of Thailand's total traded goods and 54.6 percent of Peru's total traded goods will be removed on the effective date. The tariff rates of the additional 23.5 percent of Thailand's and 17.1 percent of Peru's will be eliminated in 5 years thereafter. Thai export products which would benefit from the tariff reductions includes, for example, pick-up car, plastic, rubber and its products, and washing machine. In addition, the protocol also includes trade facilitation measures such as sanitary and phyto-sanitary, trade barrier technique and customs. The remaining issues on trade in goods are sensitive list, rule of origins and safeguard measures.
- **BIMSTEC[42]:** There was a significant progress on the negotiation on trade in goods among the BIMSTEC members. In the recent meeting in February 2006, the members discussed on the draft of an agreement on trade in goods and agreed to consider reducing items on the negative list[43]. However, the members have not agreed on the rules of origins. As for the agreement on trade in services and investment, India is now drafting the agreement which will be circulated to all members for consideration in due course.

to their debt-to-equity-ratio, that is, for SOEs that are considered as companies or public companies, debt to equity ratio must not exceed a factor of 3; for government financial institution, debt to equity ratio must not exceed a factor of 6; for SOEs or financial institutions with negative funds, government will neither extend loans nor provide loan guarantees unless each case has been approved by the Public Debt Committee; for SOEs that are government agencies, there is no ceiling, but SOEs must receive the approval from the Public Debt Management Office on debt or equity financing; (ii) fee on loan guarantees for SOEs are set at a maximum rate not exceeding 0.5 percent per year; the fee computation will be estimated from the spread between SOEs' bond and financial institutions' bond and vary according to SOE's credibility; however, this fee will not be charged to SOE projects which correspond to the government strategic investment plan or non-profit basic infrastructure investment; and (iii) for government agencies and government financial institutions, the government will allow the renewal of foreign loans for projects which are necessity for economic and social development or debt restructuring program in which the MOF is the guarantor; for SOEs which are considered as companies or public companies, the government shall allow for the renewal of foreign loans only for projects having the MOF as the guarantor.

E-government procurement (e-GP) is progressing. The Comptroller-General reported that from January 1 to September 30, 2005, the government and SOEs used e-auctions in 6,450 projects (Bt109 million) mostly in construction projects and purchasing of durable goods. For e-shopping, there are 816 registered buyers in which 137 buyers (17 percent) accessed into the system. As for e-catalogue, 670 suppliers registered in e-catalogue but only 233 suppliers (35 percent) were able to publish information on e-catalogue. The government plans to improve e-GP, including through (i) the announcement of the median price in e-auctions in order to keep the bidding price from being higher than the available budget; (ii) the improvement of e-GP website (www.gprocurement.go.th) by expanding the link and regularly updating information; (iii) the development of a list of suppliers under the Supplier Management System; and (iv) the development of a comprehensive e-auction system which will cover all procurement processes, that is, bids invitation, price competition, bids result announcement, and procurement contract preparation. E-government procurement process is strengthened by the Cabinet-approved draft of the Prime Minister's proposed regulation on E-procurement on January 24, 2006. This regulation contains for example, the definition of median price for bidding and preparation process of e-procurement (that is, submitting TOR, prequalification and pricing offer documents).

[42] BIMSTEC includes seven countries, namely, Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.

[43] The negative list is the list of the products which will not be included in the tariff reduction schedule.

The Cabinet approved the Public Sector Performance Assessment Plan, which will be piloted across several government agencies in FY2007. The assessment will: (i) review outcomes by measuring the level of achievement of the stated goals; the level of the public's satisfaction with the quality of the services provided; (ii) review outputs by measuring effectiveness in terms of their economic impacts; and (iii) review intended and unintended, as well as positive and negative impacts.

Amendments of the Public Organization Law (1999), which aim to increase management efficiency and flexibility, were approved by the Cabinet in October 2005. The amendments include (i) a clear definition of characteristics and functions of public organizations; (ii) agreement on the structure and duties of public organization committees; and (iii) strengthened results-based management and accountability.

The Public Hearing Law was introduced to improve accountability and transparency of government projects. Government agencies, including the central government, provincial government, local administration, and SOEs are now required to organize a public hearing prior to starting any projects impacting on the environment, health, or livelihoods, or any projects that may have externalities on the surrounding community. The public hearing process defined in the law requires the government to disseminate project information such as project objectives, rationales, activities, place, contractor, processes and timeframes, expected results and estimates of costs to and impacts on the public, and to seek the public's opinion by interview, mail, telephone, and/or workshops, and announce results of the consultations within 15 days.

The draft "Local Administration Law" was approved by the Cabinet in January this year. The law is a compilation of all laws and regulations related to local administration, for example, establishment of local administration offices, local administrative management, responsibilities of tambon (district) and municipal administration, financial management and budgetary procedures, participation of citizen and local communities, cooperation between central government and local administrations and between local administrations.

To reduce the delay in the transfer of education functions to local administrations, the Government has reassessed the readiness of local administrations and set up new guidelines for the transfer of education. Cabinet approved the directions of transferring educational activities by considering three factors: (i) voluntarily basis of both schools and local administrations, (ii) quality of education, and (iii) the benefits to students, and (b) the Ministerial regulation on decentralization of education which outlines details on rules and regulations for decentralizing education activities and what activities should and should not be decentralized.

Box 13. Progress in Public Sector Reform in Recent Years and Future Plans

The Royal Thai Government's Public Sector Reform Program received renewed impetus in 2003 with the establishment of the Office of the Public Sector Development Commission (OPDC) and the adoption of the Public Sector Development Strategy (PSDS). The OPDC, which reports directly to the Prime Minister, is responsible for reforming and developing the public sector in Thailand in line with the PSDS (2003-2007), approved by the cabinet, and the Royal Decree on Public Administration on Good Governance[44], promulgated to ensure the implementation of the reform strategy. The main objectives of the PSDS are to: (i) reform public administration; (ii) restructure the public sector; (iii) reform budgetary and financial management; (iv) reform the civil service management and compensation system; (v) change work cultures and values; (vi) modernize the public sector through the use of ICT; and (vii) promote public participation in monitoring and decision making.

A strong emphasis is being placed on results-based-management and citizen-centric reforms. In particular, consistent with the PSDS, the more recent and wider ranging Public Affairs Management Plan (2005-2008), or PAMP, defines the government's targets, implementation plans, initial performance indicators, and responsible Ministries in nine specific areas targeted for reform.[45] For the current fiscal year (FY 2006), all government agencies have been required to submit both their medium term and annual action plans consistent with the PAMP framework. The principle aim is to enhance the ability of government to monitor and evaluate progress towards achieving targeted outcomes.

Integration and matrix management systems are being implemented. To enhance the results-based management emphasis, reduce work processes, and provide prompt and effective responses to citizens, progress has been made to better integrate government management, both within and between ministries and provinces. In particular, restructuring of line-functions through management clustering has been implemented in nine Ministries.[46]

Performance-based compensation systems have been introduced to provide incentives to improve the speed and quality of service delivery. In particular, a fast track young executive training program was launched in 2005, which aims to attract and develop a new generation of civil servants.

New government service units have been introduced. In early 2005, new "**Service Delivery Units**" or SDUs were introduced and piloted in 3 organizations[47]. The main aim of these quasi-autonomous agencies is to increase the efficiency of the non-core functions of the public sector. In addition, to enhance public service delivery, the government has piloted "**Government Counter Services**", or GCS, in Bangkok and in Chiang Mai providing 22 kinds of government services (e.g. postal service, tax filing service, personal identification card service, etc) under one roof in easily accessible areas (e.g., skytrain station in Bangkok and a large department store in Chiang Mai).

Strategic performance-based budgeting has been introduced. The budgetary system in Thailand shifted from line-item-budgeting to program-budgeting in 1982. More recently, in 2003, a strategic-performance-based-budgeting system was adopted. In particular, the Budget Procedures Act was amended to improve the budgetary system, including through:

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[44] The Royal Decree on Public Administration and Good Governance emphasizes (i) increasing benefits to citizens, (ii) creating better outcomes from government services (iii) improving efficiency and trust (iv) reducing unnecessary work processes (v) improving government services (vi) responding to citizens demands and needs (vii) and evaluating and monitoring public sector work.

[45] The nine goals of the much wider ranging Public Affairs Management Plan (PAMP) are (i) Poverty eradication (ii) Human development, policy and quality of life (iii) Economic policy restructuring to create equilibrium and competitiveness (iv) Natural resources and environmental policy (v) Foreign policy and international economic policy (vi) Development of the legal system and good governance (vii) Policy to promote Democracy and Civil society processes (viii) National security policy (ix) Responsiveness to the global dynamics.

[46] Ministry of Finance, Ministry of Agriculture and Cooperatives, Ministry of Transportation, Ministry of Natural Resources and Environment, Ministry of Commerce, Ministry of Interior, Ministry of Justice, Ministry of Health, and Ministry of Industry.

[47] Thai Mint Factory, Government Printing House, and the Civil Service Training Institute.

(i) the establishment of a Budget Policy Committee responsible for budget preparation; (ii) countersignatures on specific service delivery agreements by ministers and head of departments; (iii) the introduction of results-based management monitoring and evaluation systems; and (iv) adoption of a medium-term expenditure framework.

Public accounting, financial management and procurement systems are being enhanced. The government has moved to accrual accounting; the Procurement Management Office was established and made responsible for developing and reforming procurement systems and policies; a procurement master plan is being implemented; and an e-procurement system is being set-up.

In March 2005, the Government Financial Management Information System (GFMIS)—a real time financial management system for the public sector—was fully implemented in all government agencies. The GFMIS includes systems for: (i) budget planning and appropriation; (ii) budget monitoring, budget execution and electronic payments; (iii) national accounting; (iv) capital procurement; (v) auditing; (vi) organizational management; and (vii) personal administration and benefits.

ICT use has been expanded to enhance public administration and provide better public services. In August 2005, the cabinet approved an e-government action plan (2005-2007) which aims to: (i) expand e-services; (ii) improve ICT infrastructure both network, information and security systems; (iii) develop laws and regulations related to e-government and e-commerce; and (iv) establish an e-government agency and promote the best use of ICT.

Laws and Regulations are being revised under the "National Laws Development Plan, 2005-2008" (NLDP). Under the PAMP, all government agencies are seeking feedback from the private sector to improve laws and regulations and propose a development plan for new laws. The NLDP reform plan aims to: (i) modernize laws by simplifying or reducing their number, including through repealing unused or out-of-date laws; (ii) designing new laws to support government policy (e.g. poverty reduction) or repealing laws inhibiting economic development and improvements in competitiveness; and (iii) enhancing the legislative process, including through streamlining, greater disclosure of information to the public, and setting up systems to gauge public opinion.

Decentralization has been delayed, and progress in transferring functions, personnel and revenues to the lower levels of government has been slower than initially planned. In FY 2006, only 24.1 percent of total central government revenue has been allocated to local administrations, compared to the original target of 35 percent specified under the Decentralization Act (1999). Since 2003, only 4,458 personnel (0.4 percent of total civil servants) have been transferred to local government. In particular, the government has reassessed the abilities of local administrations and issued new guidelines requiring that the transfer of education functions from both school and local administrations be carried out on a voluntary basis. Also, on January 19, 2006 the draft Local Administration Law was approved by the Cabinet. The law establishes local administration offices and management; spells out responsibilities of Tambons (districts) and Municipal administrations; specifies financial management and budgetary procedures; encourages the participation of citizen and local communities; and defines the relationships between central government and local administration on the one hand, and between local administrations on the other.

Box 14. Recent Actions to Improve Public Debt Management

Public debt management in Thailand is primarily under the responsibility of the Public Debt Management Office (PDMO). The PDMO within the Ministry of Finance was established in September 1999 and was later upgraded to a Department status in October 2002. The PDMO role is to manage public debt such that the costs of debt are minimized under acceptable risks[48]. Public debt management includes mobilization of financing resources, provision of guarantees, restructuring of debt, and timely repayment of debts of the central government. On-lending and guarantees from Central government to the state-owned enterprises and local governments are also managed by the PDMO. In addition, the PDMO provides advice on the financial feasibility and financing sources for public investments. It also monitors the progress and disbursements of the loans. The PDMO also plays a key role in developing the bond market in Thailand with the aim of making Thailand a regional bond market. The Public Debt Management Act was recently enacted in 2005. This allows the PDMO greater flexibility for public debt management. The Act, for example, allows refinancing of debt existing debt which could not be done in the past.

Since the establishment of the PDMO in 1999, Thailand has made quick improvements in its public debt management. The achievements in the past 6 years are listed in Table 13 below.

Table 13. Recent Actions to Improve Public Debt Management

Year	Actions
1999	▪ Establishment of the PDMO under the Office of the Permanent Secretary of the Ministry of Finance in September 1999 ▪ The Oversight Support Unit (OSU), an operational unit under the Project Loan Operation Bureau of the Public Debt Management Office (PDMO), was established in October 1999. Its mandate to provide information to support the Management of PDMO in ensuring efficient use of loans obtained from multilateral and bilateral development agencies, particularly the World Bank, the Asian Development Bank, and the Japan Bank of International Cooperation. ▪ Commonwealth Secretariat Debt Recording and Management System (CS-DRMS), a database for monitoring and analyzing of public debt exists
2001	▪ Launch of PDMO website (www.pdmo.mof.go.th) which provides comprehensive monthly historical data and information on public debt
2002	▪ PDMO upgraded to a Department status under the Ministry of Finance
2004	▪ First PDMO Annual Report produced and available on the PDMO's and website provides information on the public debt situation, strategies on public debt management, the development of the debt management system in the fiscal year, as well as plans for the future. ▪ For the first time, a comprehensive annual public debt creation and restructuring plans for the fiscal year are presented to the Cabinet and the plans after Cabinet approval are posted on the PDMO's website. This will be done in the beginning of each subsequent fiscal year. ▪ Start of development of a risk management model which compliments the CS-DRMS to evaluate interest rate, currency, liquidity, and operational risks associated with public debt
2005	▪ Public Debt Management Act (2005) was enacted to provide more flexibility, prudence, and coverage on public debt creation and management ▪ The first phase of the risk management model completed ▪ Manual for International Swap and Derivative Association (ISDA) Master Agreement developed, translated into Thai to assist SOEs in making swaps ▪ Currently, the MOF has allowed International Financial Institutions and Foreign Governments to issue Baht Denominated bonds. The MOF is in the begun to draft new regulation to extend the coverage to include other types of foreign entities to be able to issue Baht denominated bond.

Source: PDMO

48 Source: Public Debt Management Office Annual Report 2004

On the back of significant improvements in its debt management capacity in just a few years, the PDMO's public debt management could further be strengthened in the areas of contingent liability monitoring and management and the use of hedging instruments. Currently, public debts that are systematically monitored and analyzed by the PDMO are those of the central government, state-owned enterprises (SOEs)[49], and Financial Institution Development Fund (FIDF). Contingent liabilities such as liabilities of the extra-budgetary funds and losses and arrears of state-owned enterprises funds are, however, not systematically collected and analyzed. Moreover, hedging instruments are not actively utilized by the PDMO for its management of central government debt although the PDMO promotes hedging and provides technical assistance to SOEs on hedging. This is due to the fact that it takes long time to get an approval due to the PDMO's internal approval requirements. Lastly, the definition of public debt[50] is currently inconsistent with GFS and could be adjusted so that international comparisons are made possible.

[49] SOEs includes financial and non-financial ones. The non-financial SOEs includes the Village Fund and Oil fund and financial and non-financial state-owned enterprises. Both central government-guaranteed and non-guaranteed debt of SOEs are monitored and reported on the PDMO's website.

[50] Public debt includes domestic and external debts of the central government, non-financial state-owned enterprises (SOEs), and Financial Institution Development Fund (FIDF) debt. The latter two include central government-guaranteed and non-guaranteed debt.

Appendix 1: Key Economic Indicators

	2004	2005 e/	2005				2006		
	Year	Year	Q1	Q2	Q3	Q4	Nov	Dec	Jan
Output, Employment and Prices									
GDP (% change, previous year)	6.2	4.5	3.2	4.6	5.4	4.7	..	..	..
Manufacturing production index (2000=100)	142.4	155.5	152.2	152.7	156.7	160.3	158.1	162.9	156.4
(% change, previous year)	11.6	9.2	6.4	11.6	11.6	7.3	7.8	6.2	5.8
Unemployment rate (%)	2.1	1.8	2.5	2.0	1.3	1.5	1.2	1.4	..
Real wage growth (%) 1/	-0.4	2.4	3.4	4.1	1.9	-0.03	..	..	..
Consumer price index (% change, previous year)	2.8	4.5	2.8	3.7	5.6	6.0	5.9	5.8	5.9
Public Sector									
Government cash balance (Billion Baht)	8.3	-45.9	-17.4	81.8	-1.2	-109.0	-24.4	-30.7	-13.4
Government cash balance (% GDP)	0.1	-0.6	-1.0	4.8	-0.1	-5.7	..	..	..
Public sector debt (% GDP, end of period) 2/	38.2	38.1	35.3	36.2	37.7	38.1	37.6	38.1	..
Foreign Trade, BOP and External Debt									
Trade balance (US$ million)	1,460	-8,578	-3,132	-4,986	289	-749	-201.5	-175.8	-388.1
Exports of goods (fob, US$ million)	94,941	109,211	24,684	26,300	29,794	28,433	9,677.8	9,352.0	8,807.0
(% change, previous year)	21.6	15.0	12.6	13.8	22.7	11.0	13.8	11.7	14.5
Imports of goods (cif, US$ million)	93,481	-117,788	27,816	31,286	29,504	29,182	9,879.3	9,527.8	9,195.1
(% change, previous year)	25.7	26.0	28.0	34.0	22.8	19.7	13.7	26.0	0.4
Current account balance (US$ million)	6,865	-3,714	-1,406	-4,457	1,239	911	441.3	401.4	504.4
(% GDP)	4.2	-2.1	-3.2	-10.5	2.8	2.0	..	..	..

	2004	2005 e/	2005				2006		
	Year	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Nov**	**Dec**	**Jan**
Foreign direct investment, net (US$ million)	835	2,697	285	1,223	504	685	193	361	..
Total external debt (US$ million)	51,312	50,871	50,661	51,115	51,588	50,871	..	..	..
(% GDP)	35.7	31.8	34.1	33.6	33.1	32	..	..	..
Short-term debt (US$ million)	12,174	16,655	14,195	15,814	16,708	16,655	..	..	..
Debt service ratio (% exports of goods and services)	8.5	9.8	12.8	8.1	9.4	9.3	..	..	..
Reserves, including gold (US$ million)	49,832	52,066	48,681	48,357	49,795	52,066	50,749	52,066	53,229
(months of imports of goods)	6.4	5.3	5.3	4.6	5.1	5.4	5.1	5.5	5.8
Financial Markets									
Domestic credit (% change, previous year) 3/	7.4	7.7	6.8	6.1	7.5	7.7	..	..	..
Short-term interest rate (average period) 4/	1.0	1.6	1.0	1.2	1.8	2.5	2.4	2.8	3.3
Exchange rate (average period)	40.2	40.2	38.6	40.0	41.3	41.0	41.1	41.0	39.6
Real effective exchange rate (1994=100)	77.7	79.0	79.1	78.4	78.5	80.1	80.3	79.9	81.4
(% change, previous year)	-0.3	1.6	-0.2	-0.6	2.3	5.0	5.9	3.5	3.8
Stock market index (Dec 1996=100)	668.1	713.7	681.5	675.5	723.2	713.7	667.8	713.7	762.6
Memo: GDP (US$ billion)	161.7	175.2	44.5	42.3	43.4	46.4	..	..	..

e = estimate

p = projection

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

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

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

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

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

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

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

1. Poverty Reduction Diagnostics*

Objective	Reform Measures Taken
A. Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve the local economy	***Measures taken over last 6 months and their significance*** ▪ **The Cabinet approved the expansion of Urban and Village Fund** to cover new low income communities such as soldiers and policemen and extend additional funding to villages that demonstrated good performance. In addition, the Urban and Village Fund will be transformed from a public organization to the Urban and Village Fund agency to be later combined with the People's Bank. ▪ **To alleviate poor people's debt, the Cabinet approved the plan** comprising of (i) investigation and obliteration of non-banking lending (ii) renegotiation on informal debt and (iii) revision of laws viewed as obstacles for the debt relief program. ▪ **The Cabinet approved a development plan for the Northeast of Thailand,** which is divided into 4 areas based on the similarity of problems and geography, namely, upper NE, Kalasin, lower northeast and Nakorn Sawan. a) For the upper NE and Kalasin which have high income inequality, small-size economy with low growth rate, lowest education attainment, and low labor productivity, the development plan focuses on (i) reducing poverty and income inequality (ii) restructuring of agricultural product and (iii) promoting investment and tourism linkages with neighboring country. b) For the lower NE and Nakornsawan, geologically more wealthy that the upper NE with a larger economy but still have high income inequality, low education attainment, low labor productivity, narrow economic base (comprising mostly of agriculture sector and primary agriculture processing), highly dependent on amount of rainfall, and highly affected by droughts, the government's development plan focuses on (i) raising labor productivity through training and education, (ii) enlarging the region's economic base (iii) developing tourist areas and (iv) improving irrigation system and water supply. ▪ **The second phase and third phase of the Poverty Eradication Caravan was sent out in August 2005.** The second phase of the Caravan which is aimed at solving the problems of those in the poor people registration was sent out in August 2005 and will be completing its work in January 2007. The third phase of the Caravan which is aimed at monitoring the results in solving the problems was sent out in August 2005 and will complete its tasks in July 2008.

* Prepared by Cheanchom Thongjen

2. Financial and Corporate Sector Reform*

Objective		Reform Measures Taken
A.	Enable sharing of credit information among financial institutions	***Measures taken over last 6 months and their significance*** ▪ **The Amendments to the Credit Information Business Act were approved, and the amended Act became effective on February 14, 2006.** The enactment of the amendments reduced the onerous legal risk for the Credit Bureau and their members and provided greater flexibility for the operations of the Credit Bureau. It does not however, expand the types of businesses the Credit Bureau can offer.
B.	Formulate and implement a medium-term strategy for Thai financial sector	***Measures taken over last 6 months and their significance*** ▪ **The amendments to the BAAC Act were approved on March 16th, 2006,** allowing the BAAC to be transformed into a rural bank. The transformation of BAAC into a rural bank is one of the government's measures designed to improve access to financial services in rural areas. ***Measures to be taken in the next 6-12 months, but has been delayed*** ▪ **The draft Master Plan for Grass-Root Financial Services is being revised.** The draft Master Plan for grass-root financial services was reviewed by the Permanent Secretary of the Ministry of Finance, and a seminar was held in December 2005 to collect further ideas. However, the Master Plan still needs to be improved by the Ministry of Finance as it wants to focus more on the legalization of the "informal groups" — microfinance institutions that are informal, mainly savings groups on rural areas. There is no fix timeframe for this.
C.	Transition from the current blanket government guarantee on deposits to a limited deposit insurance scheme	***Measures to be taken in the next 6-12 months*** ▪ **The draft Deposit Insurance Institution Act will be reviewed by the Office of the Council of State by the end of this year.** It was endorsed by the Cabinet in November 2004, and it was planned to have been finished in January 2006, but it has been delayed at least until end of this year due to political uncertainty. Once the legal review has been completed, the draft Act will be submitted to the Parliament for its consideration. Upon the enactment of the Act, the Deposit Insurance Agency will be set up with an initial capital base of Bt 1 billion and will offer a limited guarantee on deposits at insured financial institutions. This will replace the current blanket guarantee of the BOT's Financial Institutions Development Fund (FIDF).
D.	Remove legal impediments and provide an enabling environment for derivative products	***Measures to be taken in the next 6-12 months*** ▪ **The Thailand Futures' Exchange (TFEX) will start on April 28th, 2006.** The TFEX has been granted a license from the Securities and Exchange Commission (SEC) since February 2005 to operate a futures' exchange. The first traded product will be the SET50 Futures' Index, and the second one will probably be an interest rate product. The establishment of an organized derivatives' exchange would add more players and liquidity to the financial market and provide investors with tools to manage their risk.

	Objective	Reform Measures Taken
E.	Develop the domestic financial markets, including bond, capital, and money markets.	***Measures taken over last 6 months and their significance*** ▪ **The SEC in October 2005 approved the transformation of the Thai Bond Dealing Center into a self-regulatory organization, Thai Bond Market Association (Thai BMA).** Its roles include (i) disseminating prices of bond trades; (ii) market monitoring and surveillance; (iii) providing market standards and conventions; and (iv) developing the capacity of market participants and facilitating discussions on the bond market development. ▪ **The Capital Market Master Plan I has been completed.** With the aim of reforming the Thai capital markets, this Master Plan focused on reinforcing the strengths of the market, making it a key driving mechanism of the economy to become a full-fledged competitor in the world market. The proactive measures to enhance the potential of the Thai capital market were (i) progress towards becoming a capital market embracing good corporate governance; (ii) enhance the quantity and quality of securities; (iii) enlarge and strengthen the size of the investor base; (iv) strengthen the intermediary institutions; (v) reform the structure of the supervision system to enhance the development of the capital markets; and (vi) enhance efficiency of the infrastructure to reduce transaction costs. ***Measures to be taken in the next 6-12 months*** ▪ **The BOT aims to complete drafting the Master Plan for the Development of Money and Foreign Exchange Markets in Thailand by mid-2006.** A preliminary draft has been finalized, and now a consultant will be hired to provide comments on some aspects of this draft. A public hearing will be organized to streamline the Plan before its final launch. It is planned that the draft will be submitted to the Governor of the BOT by early July 2006. The BOT has taken the lead in formulating, on a consultative basis, a three-year plan, which will compliment the Financial Sector Master Plan. Its objectives are to improve the efficiency of financial intermediaries, broaden the range of financial instruments, and streamline regulations related to the money and foreign exchange markets in Thailand. ▪ **By the second quarter of 2006, the Thailand Securities Depository Company (TSD) will be responsible for clearing and settling trading of government securities, which is currently performed by the BOT.** The transfer of this responsibility is the phase I of the Bond Market Committee's plan to centralize the depository, clearing and settlement functions for all securities at TSD. Former phase II, to consolidate those of corporate bonds at TSD, already has taken place (phase I was delayed due to technical issues). Ultimately TSD will be able to assume a collateral management function, especially of securities borrowing and lending activities. This should help to lead to a more efficient clearing and settlement system. ▪ **The BOT will issue its opinion on the Capital Market Master Plan II.** The Capital Market Master Plan II started with a public hearing last February. The Ministry of Finance has asked the ADB to comment on it. Having reviewed those comments, the BOT will soon issue its opinion. The Capital Market Master Plan II aims to improve the attractiveness of the capital market as an alternative source of fund-raising for firms and saving choice for individuals. The quantitative targets of the Plan are to (i) increase the size of equity and debt markets to be comparable to that of the banking sector and (ii) encourage more institutional investor's participation in equity market and more individual investors in debt market.

Objective		Reform Measures Taken
		▪ **The Thai Bond Market Association (BMA) will develop pricing models and market/model conventions to price new complex derivatives products and illiquid bonds by mid-2006.** The Thai BMA has been assigned by the sub-committee of the Bond Market Committee to develop pricing models and a market/model convention to price illiquid bonds and their complex derivatives. Appropriate valuation of bonds and their derivatives is critical to the further development of the Thai bond market. Limited market liquidity and less than well-functioning market-making mechanisms make the task of Thai BMA in providing fair value of bonds and their derivatives challenging.
F.	Rationalize state holding of specialized financial institutions, state owned enterprises, and state commercial banks	***Measures to be taken in the next 6-12 months, but delayed*** ▪ **The FPO will revise the core principles of the PSA after the SME bank has taken an initial step for the implementation of a Public Service Account (PSA).** The SME bank has completed on initial implementation of the PSA by separating social and commercial activities on its income statement since early 2005. A public service account reports costs and performance of social mandate activities separately from commercial activities. This is an initial step to improve the transparency of financial reports by specialized financial institutions (SFIs). By properly costing and budgeting socially mandated activities, the MOF can hold SFIs accountable for costs and benefits. The FPO is currently revising the core principles of the PSA, but no definite timeframe has been fixed.
G.	Enable corporate sector restructuring through out-of-court mediation, streamline the legal execution process for old foreclosed properties, and reduce the fees on the sale of foreclosed assets	***Measure taken in the last 6 months and their significance*.** ▪ **The amendments to Code of Civil Procedures on Legal Execution to reduce the fees on the sale of foreclosed properties and to allow for an immediate "buyer-take-possession" following the sale foreclosed was made last year.** The amendments to reduce the fees on the sale of foreclosed properties, published in the Royal Gazette in July 2005, lower auction fee from 5 percent to 3 percent, property discharging fee from 3.5 percent to 2 percent, and fee for sales not through the auction from 3.5 percent to 2 percent. The lower fees are expected to attract more buyers to the foreclosed properties market. In addition, the immediate "buyer-take-possession" in the case that the creditor can prove to the court that the debtor has defaulted was also effective in July 2005. The latter amendments are expected to eliminate the redundant requirement for the buyer to petition and obtain court order to transfer legal ownership of the properties, thus, reducing the transaction cost and time for both the seller and the buyer.

* Prepared by Pablo Gallego and Thomas Rose

3. Reforms to Improve Business and Investment Environment*

Objective		Reform Measures Taken
A.	Reform institutions to enhance competitiveness	***Measure taken in the last 6 months and their significance*** ▪ **The corporatization of the Electricity Generating Authority of Thailand (EGAT) was cancelled in March 2006.** The two Royal Decrees on the charter for EGAT's corporatization and the dissolution of the EGAT as a state enterprise was repealed by the Supreme Administrative Court in March this year. This restrained the EGAT from being listed in the Stock Exchange of Thailand.
B.	Reform of legal and judicial regime	***Measure taken in the last 6 month and their significance*** ▪ **The sub-committees of the National Legal Framework and Policy Committee begun implementing the 2005 Law Development Plan, approved by the Cabinet in March 2005.** As of July 2005, 13 laws were already reviewed by the sub-committees while 28 laws were under revision out of the 377 laws identified by line ministries to be redundant or outdated. In addition, the legal reform website and legal development journal were also established to disseminate the progress on the legal development.
C.	Improve the skills and quality of labors	***Measure to be taken in the next 6-12 months, but delayed*** ▪ **The Thai vocational qualifications program will be implemented.** Currently, the Thai vocational qualifications (TVQs) program has not been implemented as the responsible agencies have not been assigned. This program will standardize and build vocational skills.

* Prepared by Wallada Atsavasirilert

4. Trade Reforms*

	Objective	Reform Measures Taken
A.	Reduce tariff to improve Thailand's competitiveness	***Measures taken over last 6 months and their significance*** ▪ **Tariff of some items used in the printing industry and the electrical appliances and electronic industry were removed in January and February 2006, respectively.** The abolishment of tariff rates of 92 items used in a printing industry and 13 items of book and printing matters were approved in December 2005 and effective in January 2006. In addition, the Cabinet also approved the removals of tariff rates on 872 items including related raw materials and specific raw materials for electrical appliance and electronics production in December 2005 which was effective in February 2006. The main purpose of the tariff exemption is to enhance the competitiveness of these industries and to promote Thailand as a production base. ▪ **Tariff rates of 150 ICT products were abolished for ASEAN members in December 2005 with a retroactive effect to January 2005.** According to the e-ASEAN Framework Agreement, signed in November 2000, ASEAN-6 members were obliged to eliminate their tariff rates on ICT products in 3 stages: on 1 January 2003, on 1 January 2004, and on 1 January 2005. Therefore, Thailand removed the tariff rates of the last portion in December 2005 with a retroactive effect to 1 January 2005. These products include, for example, typewriters, telephones, answering machines and, insulated wire and cable.
B.	Promote Thai exports to new markets	***Measure taken over last 6 months and its significance*** ▪ **Thailand and Peru signed a protocol on the acceleration of liberalization on trade in goods and trade facilitations in November 2005.** Under this protocol, tariff rates of 50 percent of Thailand's total traded goods and 54.6 percent of Peru's total traded goods will be removed on the effective date. The tariff rates of the additional 23.5 percent of Thailand's and 17.1 percent of Peru's will be eliminated in 5 years thereafter. The protocol will be effective once the remaining technical issues on rules of origin are concluded. The other remaining issues are expected to be done in this year. ***Measures to be taken in the next 6 -12 months*** ▪ **A framework agreement on Thailand-Japan Closer Economic Partnership (CEP) is expected to be signed in 2006.** Given the political uncertainty, the signing ceremony of the framework agreement on Thailand and Japan CEP has been postponed from end of April to later this year. ▪ **A tariff reduction under the protocol on the acceleration of liberalization on trade in goods and trade facilitation between Thailand and Peru.** The tariff reductions are expected to be effective this year. ***Measure planned to be taken but has been delayed*** ▪ **Thailand-Bahrain FTA is likely to be renegotiated to include other members of the Gulf Cooperation Council (GCC) into the FTA.** In the recent leader meeting in June 2005, Bahrain would like to renegotiate the previous framework agreement to include other members in the GCC and thus the Early Harvest Program agreed previously should be delayed.

* Prepared by Wallada Atsavasirilert

5. Public Sector and Governance Reform[52]*

Objective		Reform Measures Taken
A.	Improving public service quality by streamlining and redesigning work processes and procedures	***Measure taken over the last 6 months and their significance*** ▪ **Agreement on "ASEAN Single Window" was approved by the Cabinet on Dec 6th 2005.** The Customs Department will establish a **"National Single Window"** and negotiate with the ASEAN members on how to implement the "ASEAN Single Window". With the aim to facilitate trade among ASEAN countries, the ASEAN Single Window will allow traders to submit in a single transaction all import or export documents at one customs point. ***Measures to be taken in the next 6-12 months*** ▪ **The "Government Counter Services" or GCS will be expanded to other provinces.** To provide better and more convenient services to the public, the GCS which was initially piloted in Bangkok and Chiang Mai in 2005, will be set up in other provinces. ▪ **Under the development of Government Financial Management Information System (GFMIS), there is a plan to link daily revenues collected by three tax collection agencies** (Revenue Department, Excise Department and Custom Department) to monitor government revenues on a daily basis.
B.	Changing roles, responsibilities, and rightsizing the government bureaucracy by restructuring public administration and improving intergovernmental relations at all levels	***Measures taken over the last 6 months and their significance*** ▪ **"International Trade Strategic Agency" or ITSC was established under Ministry of Commerce.** The ITSC responsibilities are to: (i) determine international trade strategies suitable for global trade; (ii) recommend ways to improve the country's competitiveness; (iii) design international trade negotiation strategies; (iv) follow up on monitoring and evaluation of benefits and impacts of free trade agreements; (v) coordinate with other government agencies/private sectors and provide information related to international trade to the public. ▪ **Amendments to the Public Organization Law (1999), which aim to increase management efficiency and flexibility, were approved by the Cabinet in October 2005.** The amendment includes: (i) a clear definition of characteristics and functions of public organizations; (ii) agreement on the structure and duties of public organization committees; and (iii) strengthened results- based management and accountability in good governance. ▪ **"Public Transport Organization", or PTO, became a new public organization.** The PTO's responsibilities are to: (i) carry on public transport policy and planning; (ii) prepare funding for public transport investment through securitization, issuing new bonds or financial instrument, and investing in financial instruments or venture capital; (iii) create good public transportation system; (iv) design a linkage of all public transportations, and set a high standard for the public transportation system. ▪ **On October 25, 2005, the Cabinet approved a law on the establishment of the "Department of Rice", or DOR, under the Ministry of Agriculture and Cooperative.** The DOR's responsibilities are to: (i) be in charge of all rice related activities; (ii) carry on research and development to conserve and protect rice breeds, rice production technology, and the value added of rice; and (iii) build up Thailand as the world's leading rice exporter.

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

Objective		Reform Measures Taken
		▪ **On November 8, 2005, the Cabinet approved a law to establish a National Innovation Agency as a public organization.** The NIA is responsible for: (i) designing the plan to support and promote innovation for competitiveness; (ii) enhancing Thailand's innovation through development of innovation projects from basic research and promote the development of commercial research. ▪ **The draft "Local Administration Law" was approved by the Cabinet on 19 January 2006.** The law is a compilation of all laws and regulations related to local administrations e.g. establishment of local administration office, local administrative management, responsibilities of Tambon and Municipal administration, financial management and budgetary procedures, participation of citizen and local communities, cooperation between central government and local administrations and between local administrations. ▪ **To reduce the delay in the transfer of education functions to local administrative offices, the government has reassessed the readiness of local administrations and set up new guidelines for the transfer of education.** Cabinet approved (a) the directions of transferring of educational activities by considering three factors: (i) voluntarily basis both school and local administration, (ii) quality of education and (iii) the benefit for students and (b) the Ministerial regulation on decentralization of education which outlines details on rules and regulation for decentralizing education activities and what activities should and should not be decentralized. ***Measure to be taken in the next 6-12 months*** ▪ **The government will set up a restructuring committee in each department and ministry to design the ministerial restructuring plans.** On 24 January 2005, the Cabinet approved the draft Ministerial Regulation setting up a government agency restructuring committee in each ministry and department, tasked with developing a restructuring plan.
C.	Enhancing capacity and performance of public sector to efficiently and effectively perform their functions by reforming financial and budgetary system, reviewing system of human resource management and compensation, developing a new mindset, work culture and value, and modernizing government operation.	***Measure taken over the last 6 months and their significance*** ▪ **Amendments to the Ministerial regulation on Accounting and Finances of State-owned Enterprises (1977) were approved by the Cabinet on 20 September 2005.** This is aimed to improve public financial management. The key amendments are: (i) the repeal of rules and regulations that are out-of-date or no longer active; (ii) revision to the definition of an SOEs to exclude Public Companies traded on the Stock Exchange of Thailand (SET), unless otherwise stated; (iii) empowerment of the Secretary-General of Ministry of Finance to adjust inappropriate rules and regulations; (iv) a requirement for SOEs to disaggregate accounting reports and make financial information available to the public; (v) a reduction in number of years (from 2 to 1) allowed to accrue liabilities and constitute reserves for bad debt; (vi) the permission for SOEs to invest retained earnings in short term financial instrument issued by the government, government financial institution, and other SOEs; (vii) a requirement for SOEs to address a letter notification to the MOF on unrepayable debts; and (viii) the authorization for MOF to determine SOEs profit remittances to the government. This is aimed to improve public financial management. ▪ **The Cabinet approved the draft of the Prime Minister's proposed regulation on e-procurement on January 24, 2006.** The regulations are to support E-government procurement. This regulation contains for example, the definition of mean price for bidding and preparation process of e-procurement (i.e. submitting TOR, prequalification and pricing offer documents).

	Objective	Reform Measures Taken
		▪ **Amendments to the rules and regulations on public debt creation, guarantee, and renewal were approved by the Cabinet on December 13, 2005.** These revisions aims to improve public debt management. The revisions include (i) Ceiling on loans and loan-guarantees of SOEs and government financial institutions, according to their debt-to-equity-ratio, (ii) Determination of a fee on loan guarantees for SOEs at maximum rate not exceeding 0.5 percent per year. The fee computation will be estimated from the spread between SOEs' bond and financial institutions' bond and vary according to SOE's credibility. However, this fee will not be charged to SOE projects which correspond to the government strategic investment plan or non-profit basic infrastructure investment. (iii) Clarification of rules and regulations on the renewal of foreign loans. For government agencies and government financial institutions, the government will allow the renewal of foreign loans for projects which are necessity for economic and social development or debt restructuring program in which the MOF is the guarantor. For SOEs which are considered as companies or public companies, the government shall allow for the renewal of foreign loans only for projects having the MOF as the guarantor. ▪ **On October 18, 2005, the Cabinet approved Public Sector Performance Assessment Plan** proposed by the NESDB and will pilot the implementation in some government agencies for FY 2006-2007. The objective is to assess the ability of public services to achieve outputs and outcomes efficiently with appropriate resources. The assessment comprises 3 dimensions, namely: (i) outcomes, by measuring the level of achievement of the goal and public satisfaction with the quality of service provision; (ii) outputs, by measuring effectiveness and economic impact; and (iii) measurement of intentional and unintentional, as well as positive and negative impacts. ***Measure to be taken in the next 6-12 months*** ▪ **The regulation on Controlling and Monitoring Civil Affairs in Provincial Government Offices is being reviewed by the State Council and is to be presented to the Cabinet.** The regulation will empower the Deputy Prime Ministers to oversee the management of provincial clusters.
D.	Improving governance in public sector through participation, accountability, and transparency	***Measures taken over the last 6 months and their significance*** ▪ **The Public Hearing Law was introduced.** The new law requires all government agencies, the central government, the provincial government and the local administration as well as SOEs, to undertake a public hearing prior to starting projects having high impact on the environment, health and livelihood, or those likely to have externalities on the community. The public hearing process as defined in the law requires the government to disseminate project information to the public (that is, project objective, rationale, activities, place, contractor, processes and time frames, and expected results and estimated cost to and impact on the public); seek public opinion (by interview, mail, telephone, and/or workshops); and announce the results of the public consultation process.

* Prepared by Cheanchom Thongjen, Kulatida Charoenphol, and Eric Sidgwick.

6. Social Protection*

Objective		Reform Measures Taken
A.	Develop social insurance mechanisms for the elderly and those affected by unemployment, work related injuries or other shocks to income	***Measures taken in the last 6 months and their significance*** ▪ **The threat of avian influenza pandemics has prompted Thai authorities to strengthen its preparedness plan.** The plan focuses on the following 5 areas, namely 1. *Control and Surveillance:* Surveillance Rapid Response Teams (SRRTs) have been established at central/regional, provincial (main coordinator at this level is also known as Mr. Bird Flu), district, sub-district, and community (through village health volunteers) levels. More than 1000 teams have already been trained, resulting in better response time. 2. *Strengthening laboratory capacity:* Laboratory facilities were expanded to 13 medical science centers around the country, plus the use of mobile labs that could go directly to outbreak areas. Trainings were conducted for 5,000 officials nationwide. As a result, the turn-around time from when a specimen is collected at the locality to test confirmation has been reduced from 60 hours to 8 hours. 3. *Case Management and Infection Control:* Table-top exercises (scenario-based and simulation) at the provincial level have been designed, together with development of a set of manuals as well as plan for provincial drills for a possible inter-pandemic situation. 4. *Risk Communication:* Centralized press release center has been established to provide daily updates. 5. *Stockpiling and logistics:* Plans for vaccine development, antiviral drug stockpiling, diagnostic test kits and respirators purchasing have been worked out. ▪ **Amendments of ministerial orders to improve coverage, benefits, and efficiency of the Social Security Scheme have received Cabinet approval.** The Cabinet has approved 3 draft ministerial order amendments, submitted by the Ministry of Labor, pertaining to (i) revision of criteria, procedural claims, and monthly entitlement of child benefits, (ii) revision of chronic diseases eligible for claims under the scheme coverage, and (iii) use of national identity cards in lieu of social security cards. ***Measures to be taken in the next 6-12 months*** ▪ **The Tsunami Early Warning Arrangement in the Indian Ocean and Southeast Asia will be in operation from November 2006 onwards.** The Arrangement has been financed by the Tsunami Regional Trust Fund to which Thailand provided seed money worth USD 10 million. Other international donors and countries have also contributed. The Early Warning Center will be established within the proximity of Asian Institute of Technology situated in Bangkok to send warning information to Myanmar, Cambodia, Vietnam and Thailand. ▪ **The launch of the Social Security Scheme (SSS)'s extension to labor in the informal sector is planned for October 2006.** Amendments to the laws, regulations, and/or procedures of the SSS's extension have been drafted and will be presented to the Cabinet. It is envisaged that the scheme will operate on a voluntary basis. The Social Security Office (SSO) is finalizing details of benefit packages which will at least cover sickness, disability, old age, and maternity. The planned launch date of the scheme's extension has been set for October 2006. However, the political uncertainty might delay the process.

	Objective	**Reform Measures Taken**
B.	Establish a safe work environment through standards and enforcement and increase labor market efficiency by facilitating job matches and placement	***Measures taken in the last 6 months and their significance*** ▪ **Review of daily minimum wages for 2006 has resulted in new daily wage rates, effective since January 1, 2006.** The previous principal rate of Baht 139 per day was increased to Baht 140 per day, and different rates for 16 provincial groupings ranging from Baht140-184 per day are effective. ▪ **Cabinet Resolution on December 20, 2005 agreed on the proposal by the Committee on Illegal Migration Management for the quota of 500,000 migrant workers from Lao PDR, Cambodia and Myanmar to work in Thailand.** 200,000 migrant workers will come from Lao PDR, Cambodia and Myanmar as established by the Memorandum of Understanding (MOUs) while 300,000 unregistered migrant workers already in Thailand will have their status regularized under the Section 17 and 54 of the Immigration Act (1979). Employers' bail out fees are THB 10,000 for registered migrants who have the State Registry (Toh Ror 38/1) in 2004 but did not apply for work permit in 2005, and THB 50,000 for migrants who have never registered and do not have the State Registry (Toh Ror 38/1). ▪ **Cabinet Resolution on January 10, 2006 approved the draft ministerial order on management of occupational safety and health and working conditions and environment relating to heat, lights, and sounds.** The Cabinet and the Council of State have approved the principles of the proposed ministerial order to be adopted by the Ministry of Labor. ***Measures to be taken in the next 6-12 months*** ▪ **Concerns among employers prompted a review of bail-out fees for the new quota of migrant workers.** The high bail-out fees have caused discontent among employers, prompting the Cabinet to set up a tri-partite working committee to resolve the issue by June 2006.
C.	Provide effective poverty alleviation and social assistance programs for those with limited or no other means of support	***Measures taken in the last 6 months and their significance*** ▪ **On January 17, 2006, Cabinet approved the draft Promoting and Improving Disabled People's Quality of Life Act.** The Cabinet approved the principles of the draft Act and requested the Ministry of Social Development and Human Security to consider and incorporate comments and suggestions from the review committee prior to presenting it before the Council of State and the House of Parliament. Clearly stated in this draft Act is the new framework and approach to improve disabled people's quality of life, including redefinition of "disability", provision of rehabilitation services, educational rights, employment services, social inclusion with improvement of infrastructures and services, access to public services including legal aid, access to information and information and communication technologies, and freedom to travel and commute through supporting public transport infrastructures. ***Measures to be taken in the next 6-12 months*** ▪ **The National Health Security Office (NHSO) and Department of Disease Control (DDC), Ministry of Public Health will established a memorandum of understanding and detailed workplan and programs on their collaboration to better manage anti-retroviral drugs/treatment for HIV/AIDS patients under the Bath 30 scheme.** For the fiscal year 2006, starting October 2005, NHSO requested a budget amount worth Baht 4.4 billion, and has been initially allocated Baht 2.79 billion to provide services in the areas of HIV/AIDS testing, monitoring of asymptomatic HIV/AIDS patients, managing the use of anti-retroviral drugs (both first-line and second-line drugs), and HIV/AIDS patients' home visits as well as collaborating with non-governmental organizations working in the area of HIV/AIDS. The overall program is a joint operation between the NHSO and DDC, aiming at better management of the fund. Both agencies are now working toward drafting a memorandum of understanding (MOU) and detailed workplan and programs.

* Prepared by Kwanchai Niyomthamkit