

The World Bank



# Thailand ECONOMIC MONITOR

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This Monitor was prepared by a team consisting of Angkanee Luangpenthong (team support and preparation of the report), Behdad Nowroozi (corporate governance), Dana Weist (decentralization), Ejaz Ghani (task team leader), Kaspar Richter (growth and fiscal policy), Magdi Amin (information, science and technology), Michael Markels (financial sector), Renuka Vongviriyatham (financial sector), Tanatat Puttasuwan (corporate restructuring and legal reform), and Trevor Bull (privatization and SOE reform). Inputs were received from Arvind Gupta, Peter Bimble, and Peter Raymond. The team would like to thank Homi Kharas, Ijaz Nabi, Jayasankar Shivakumar, Lars Sondergaard, Lorenzo Giorgianni, Mario Reyes Vidal, Reza Moghadam, Stefan G. Koeberle, Steve Schwartz, and a number of researchers and agencies in Thailand for their comments.

# Thailand Economic Monitor

## Summary

**Thailand's current economic situation should be seen in the context of the deterioration in the global economy, which has been sharp and sudden in 2001, but is expected to recover in 2002.** The US economy has slowed down considerably this year, with a steep fall in the manufacturing sector, led by a contraction in business investments in IT. Meanwhile, Japan is sliding into recession and Europe faces increased risk to its growth outlook. Policy makers around the world have responded to this downturn by lowering interest rates and increasing fiscal stimulus. There are early signs that this downturn may be bottoming out, as oil prices soften, inflation outlook improves, and the non-manufacturing sectors show signs of recovery. This Monitor reviews recent economic developments in Thailand against this global-economy backdrop and assesses Thailand's ability to withstand the global shocks.

**Our assessment is that Thailand will weather the global downturn.** Foreign exchange reserves have been restored to comfortable levels, increasing as a ratio to short-term debt from 57 percent in 1997 to 137 percent at end-March 2001. Total external debt has fallen from 70 percent of GDP in 1997 to 65 percent in 2001. The external trade surplus fell in the first quarter of 2001, partly as a result of the deterioration in the terms of trade, resulting from the rise in oil prices (oil accounts for 8 percent of import), depressed prices for electronic exports (electronics account for 35 percent of total exports) and non-oil commodity prices like rice. However, the terms of trade are likely to improve by 2002, as oil prices soften further, and electronic goods prices begin to improve. Despite the deterioration in the trade balance, the external current account, helped by the tourism sector, is expected to remain in surplus in 2001.

**Thailand has implemented several structural measures that address the underlying causes of the crisis in 1997.** Financial sector reform has resulted in better capitalized banks, improved regulatory and supervisory regimes, and a more balanced financial system. Capital markets have been deepened which has helped to reduce firms' reliance on external debt and the vulnerability associated with this. Non-financial corporates have improved their earnings in the last few years, helped by the export boom. Domestic economy is more diversified now. Manufacturing is no longer the largest sector in Thailand. Services replaced manufacturing as the largest contributor to growth in the second half of 2000, and attracted a large proportion of foreign direct investments in 2000.

**However, there are risks that need to be managed well.** The Thai recovery, as with the other East Asian countries, was led by exports. And now with the global downturn, export growth has lost its momentum significantly. External demand has softened at a time of weakening domestic demand. Domestic private investment and consumption growth fell in the first quarter of 2001. Recovery in business investment has been held back by the high level of distressed assets in the banking system, slow progress in corporate restructuring, and potential concern regarding the consistency of short-term policies with the medium-term goals. We now forecast GDP growth to come down to 2 percent in 2001 compared to 4.3 percent growth in 2000.

**The prospects for employment growth and poverty reduction are affected adversely by the slowdown.** Until the onset of the crisis in 1997, high growth had created many employment

opportunities, wages had increased rapidly and poverty had fallen (from 32.6 percent of the population in 1988 to 11.4 percent in 1996) lifting nearly a million people out of poverty every year. This came to a halt in 1997. As a result of the crisis, more than one million Thais are still without a job and poverty incidence increased sharply to 16 percent of the population in 1999 (i.e. 9.8 million people live at less than \$1.5 a day). Economic slowdown would delay the attainment of poverty levels of 1996 beyond 2002 and thus would prolong hardships for the poor.

**The challenge is to address the short-term downturn in a manner that positions Thailand for a healthy recovery when global economic environment improves next year.** The new Government, with a strong electoral mandate, has introduced a number of pro-poor and pro-rural programs as part of the fiscal stimulus to support recovery. These include the village fund, health fund, debt suspension for farmers, as well as a fiscal stimulus reserve fund to be implemented next fiscal year if the expected pick up in external demand does not materialize. Debt restructuring could be accelerated through the formation of a national asset management company (TAMC). The stalled privatization of state owned enterprises is being revived. These are steps broadly in the right direction. The challenge is to ensure that these policy actions are consistent with the medium term objectives of (i) maintaining sound macroeconomic policies, (ii) developing a well balanced financial sector with a strong credit culture, (iii) enabling both public and private firms to become more competitive, and (iv) developing modern public sector institutions to improve efficiency, transparency, and competition. In addition, pressure for rapid reform must be balanced against the need for transparency and broader participation in government policy formulation.

**Fiscal stimulus will need to be smart.** The government has increased the size of the budget deficit to 5.9 percent of GDP for this fiscal year from 4.6 percent last year. The fiscal impulse for the current fiscal year is likely to be positive and will reach about one percentage point of GDP. The pro-poor fiscal initiatives have not created excessive public debt burden, but the size and the content of the stimulus has to be viewed in the context of a medium-term macroeconomic framework. Public debt has increased three-fold compared to the pre-crisis levels, mostly due to costs arising from financial sector restructuring. Including the liabilities of non-financial public enterprises, public debt rose to 60 percent of GDP at September 2000. This level of public debt is comparable to the other countries in the region but is sustainable only if GDP growth remains at 4-5 percent per annum, interest rates remain low and the surplus on the primary fiscal balance can gradually be increased. The recent slowdown in growth places a limit on the size of the fiscal stimulus, as would increase in interest rates.

**The quality of the fiscal spending package is not just a question of its size, but also of its targeting and timeliness.** Pro-poor expenditures with high local content have large multiplier effects, and the impact of this additional spending on economic activity could be considerable - if delivered effectively and in a timely manner. The government could, for example, ensure that village funds are targeted at the poorest villages first, and their capacity to implement the program is strengthened. The government has protected public expenditures in the social sectors. But there has been a substantial shift from capital to current expenditures.

**The fiscal program has to be accompanied by a strong commitment to complete the on-going structural reform of the economy.** As shown by the Japanese experience, fiscal stimulus by itself will not be sufficient to sustain a healthy recovery. Structural reforms that encourage efficient utilization of capital and support broader productivity growth also need to be pursued vigorously. There are signs that the return on capital and productivity growth have started to

improve and financial sector reform must be completed so that capital allocation and project investments can continue to strengthen to bring about a robust recovery.

**If well-structured, the recently established Thai Asset Management Corporation could help boost financial restructuring.** The design of the TAMC addresses well some of the incentive issues: NPLs will be acquired from both state and (to a lesser degree) the private banks; loans to be transferred from private banks will be limited to multi-creditor, non-performing accounts larger than \$100,000 per account; private banks would share gains and losses with the government on their transferred NPLs if recovery rates turn out to be different from initial transfer prices. The design and the special legal powers granted in the TAMC Act will speed up restructuring but implementation will be a challenge. The outcome of the TAMC will depend on the quality of its management, credibility in deal making, transparency and simplicity in restructuring guidelines for borrowers and guarantors, and the incentives for TAMC managers to maximize recoveries and minimize the cost to taxpayers.

**Legal and judicial reforms are needed to help accelerate corporate restructuring.** There is a huge backlog of cases in the civil courts, with over 55, 000 debt restructuring cases pending judgement. At current judgement rates, it will take 6-7 years to clear the backlog, plus another two years to auction the collateral. Given the serious backlog of cases and the limited role of TAMC in restructuring the NPLs of private banks (TAMC will purchase only 25% of their NPLs), the Government will need to accelerate legal reforms (e.g., bankruptcy and foreclosure laws) to support corporate reforms.

**The policy towards state banks should be consistent with the medium-term objective of developing a sound financial system.** Pro-active measures to manage the economic downturn by setting lending targets for the state banks, and changes in the loan classification and provisioning standards to make it easier for the banks to lend, should not conflict with the medium-term objectives of improving credit culture, strengthening prudential regulation, and promoting competition. Because banks are still coping with the NPL problem, they will continue to be cautious in extending new loans, given the poor credit quality and lack of credit information on most borrowers. But loans are starting to grow (incremental bank loans increased in Q1 2001) after substantial declines in 1999. Setting lending targets that require state banks to lend more than prudence and caution demands would conflict with the objective of developing a sound financial system and must be eschewed.

**Several measures have been announced to revive the privatization program, which is a welcome development.** These include (i) government announcement that 18 state owned enterprises would be privatized by 2003; (ii) creation of a National Holding Company under which commercial state enterprises will be gathered; (iii) announcement of a schedule of Initial Public Offerings (IPOs) of state enterprises on the Thai stock market; and (iv) inclusion of Employee Share Ownership Programs (ESOP) in the IPO transactions. These announced measures, if properly implemented, would speed up privatization of large-scale enterprises, and could significantly deepen and strengthen the capital markets. A key implementation challenge is the organization structure, transparency in operations, and the management of the proposed national holding company. If handled with skill, the IPO approach can drive forward regulatory and structural reforms, and instill confidence in the general public, among the employees (via the proposed ESOPs) and in the investment community and thus provide greater momentum to the privatization program. Transition to commercially based governance will be important for improving efficiency and protecting the rights of minority shareholders.

## **I. Introduction**

Thailand's growth outlook has deteriorated since the publication of the last Economic Monitor in December 2000 as a result of the sharp and sudden downturn of the global economy and weak domestic demand. We now forecast GDP growth of 2 percent in 2001, compared to a 4.3 percent growth rate in 2000. This slowdown in economic activity presents Thailand with the immediate task to put the economy back on track for recovery. However, this year's growth reduction is unlikely to turn into a recession, let alone magnify into the crisis proportions experienced in 1997/98. The challenge for the government is to implement policies that are consistent with the medium-term growth and poverty reduction objectives, so that Thailand will be well placed to benefit from the return of a more favorable external environment predicted for 2002.

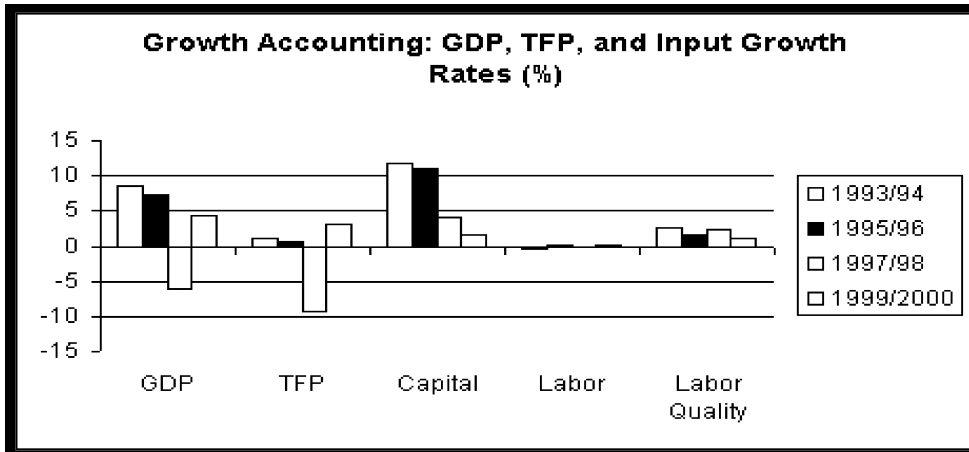
Thailand will be able to weather the current downturn and return to a higher growth trajectory. Thailand's external vulnerability has been substantially reduced over the last years. Total external debt has fallen from 70 percent of GDP at end-1997 to 65 percent of GDP at end-March 2001. Short-term private debt continued to fall over the last year, as low domestic interest rates encouraged enterprises to pre-pay their external debt, and they reached at the end of the first quarter 2001 no more than half of the end-1997 level. Gross foreign exchange reserves have been restored to comfortable levels, increasing as a ratio to short-term debt from 57 percent in 1997 to 137 percent at end-March 2001. Capital outflows have slowed down as Thai banks have already reduced their foreign obligations by three quarters since the end of 1997.

The improvements in the external balance have been supported by progress in financial and corporate restructuring. Several private banks have reduced their distressed assets,

returned to profitability, and raised substantial amounts in new capital. State bank restructuring has been less speedy, but the creation of the Thai Asset Management Corporation (TAMC) provides a potentially powerful tool to accelerate debt restructuring. Firms, especially in the tradable goods sector, have shown strong earnings figures over recent years, and are in a sound position to cope with the short-term economic slowdown.

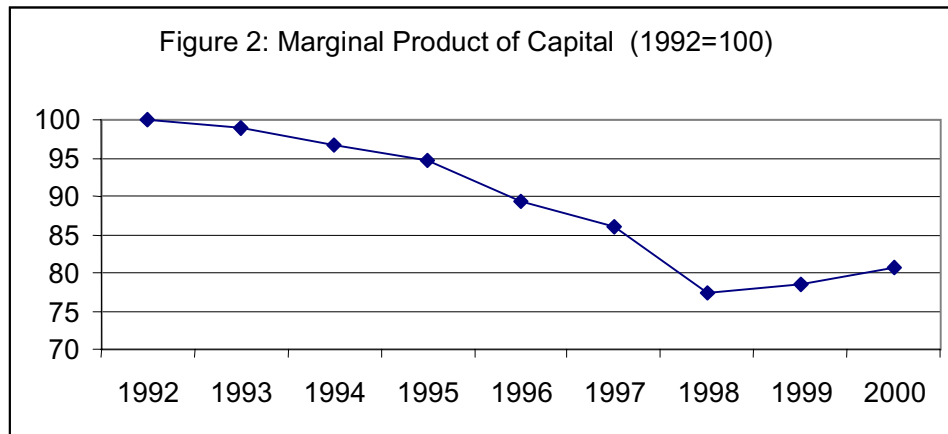
In spite of the achieved progress, further structural reforms are essential to improve the medium term growth outlook. A "growth accounting" exercise for Thailand since 1993 shows that until 1996, growth was based on sluggish total factor productivity (TFP) growth, modest expansion of the labor force, and vast capital accumulation. High rates of investment led to increases in the capital-output ratio, and to declines in the marginal product of capital. This period of "extensive" growth, based on increases in factor inputs, came to a sudden hold during the crisis. Capital accumulation fell by almost two thirds, and TFP growth dropped by close to 10 percent, leading to a large contraction in GDP. As the economic recovery has gone under way in the last two years, the growth in capital and labor has remained slow, while TFP growth has improved somewhat. The fall in the investment rate reflects a number of factors, including excess capacity, a downward adjustment in the medium-term growth prospects, and misallocation of capital, as evident from the high share of non-performing loans on banks' balance sheets. The marginal product of capital is low, but it may have bottomed out. Over the medium-run, output growth of 4-6 percent will only be possible with higher TFP growth, stronger growth in human capital, and a recovery in private investment, all of which require stronger implementation of structural reforms.

**Figure 1: There is room for investment and productivity growth**



Source : Staff Estimates.

**Figure 2: Return to capital has bottomed out**



Source : Staff Estimates, IMF.

The establishment of a National Holding Company (NHC) and the corporatisation and listing of 18 state enterprises on the Stock Exchange of Thailand will strengthen the capital market. To fully realize the potential, the NHC will need to ensure that issues relating to governance, organizational, transparency and management and board competence are dealt with effectively. Should such issues not be taken into account, then significant risks will be posed to the commercial operations of the NHC and its subsidiary operating entities. Further, this has the potential to result in the accumulation and amalgamation of the inefficiencies inherent in the state enterprise operating and decision making structure as

well as weakening the ability of the NHC to separate commercial objectives from political objectives.

This Economic Monitor analyses Thailand's challenges in sustaining a healthy recovery process against the backdrop of weakening global demand. The first section sets the context by describing the impact of the global slowdown on the Thai economy. Subsequent sections explore recent developments in six key dimensions of the medium-term policy and structural reform agenda:

- Fiscal stimulus, public expenditure, and public sector reform
- Financial restructuring
- Corporate restructuring and legal reform

Progress in these areas will allow Thailand to take full advantage of the next upswing in global growth, raise GDP growth in the

- Corporate Governance
- Privatization and SOE reform
- IT and science and technology

medium-term, and ensure further reduction in poverty and improvements in living standards.

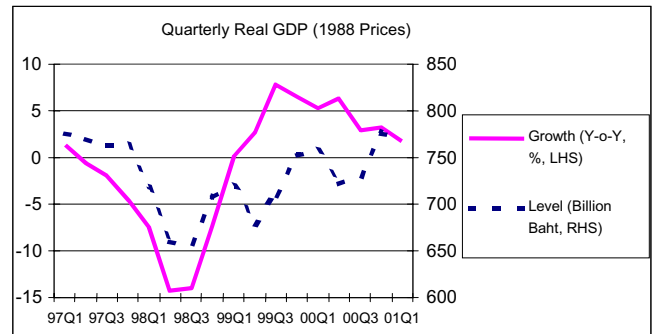
## II. Growth outlook uncertain

Four years after the onset of the crisis, Thailand is continuing its fragile recovery process. Over the last years, a supportive macroeconomic policy framework and strong external demand have fostered the economy's recovery. With large current account surpluses offsetting capital outflows, reserves have been stable and adequate to cover the stock of short-term debt. Against this backdrop, the short-term outlook has deteriorated as Thailand feels the impact of a global economic downturn, which is being exacerbated by the weakness in domestic private demand.

### Sluggish growth

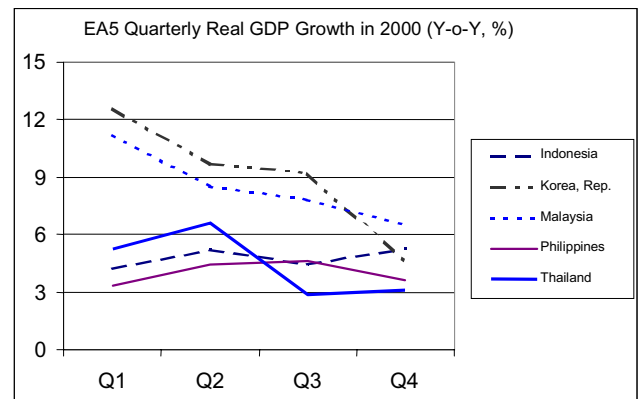
Thailand, just as the other export-oriented countries in the East Asia region, is affected by the global downturn and weak domestic demand. Real GDP growth fell to below 3 percent during the second half of 2000, the lowest level of any of the East Asian crisis countries (EA5), and reached just over 4 percent over the entire year, about the same growth rate as in 1999. The slowdown continued in the first quarter of 2001, with annual GDP growing by only 1.8 percent (and, seasonally adjusted, by just below zero), the lowest level since the second quarter of 1999.

Figure 3: Thailand's recovery slowing...



Source : BOT, NESDB.

Figure 4: ...mirroring similar trends across the region

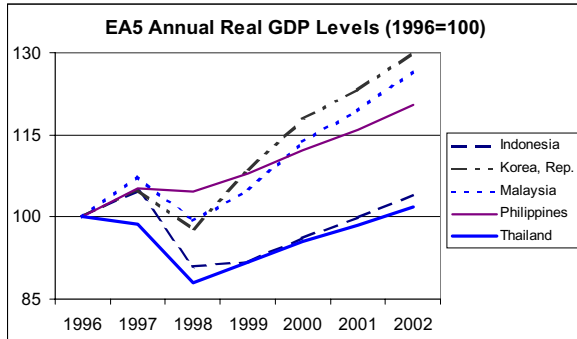


Source : World Bank East Asia Brief.

Thailand was at the end of last year together with Indonesia the only EA5 country still below the pre-crisis GDP level. It felt the impact of the crisis stronger than other EA5 countries, and rebounded from the steep output decline in 1998 more slowly, especially in comparison to Korea and

Malaysia. The sluggish recovery points to a large unfinished economic reform agenda, ranging from corporate and financial restructuring to legal reform.

**Figure 5: Thai output is still below pre-crisis levels**

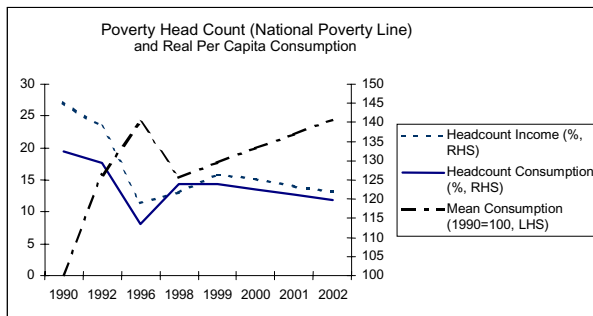


Source : World Bank East Asia Brief.

**Poverty reduction stalled**

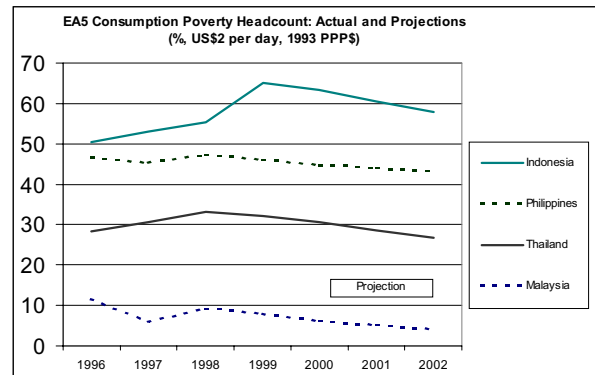
Lower growth has led to less poverty reduction. The decade of the 1990s was a period of strong growth and poverty reduction in Thailand and in the East Asia region as a whole. The trajectory of growth with poverty reduction over the 1990s was interrupted by the Asian crisis. Amongst the EA5 countries, Thailand, together with Indonesia and South Korea, witnessed sharp increases in poverty by the end of 1997. With the resumption of growth, per capita consumption levels have started to rise again, but it will take Thailand up to 2002 or beyond until poverty has returned to the 1996 levels.

**Figure 6: Poverty reduction stalled...**



Source : World Bank East Asia Brief.

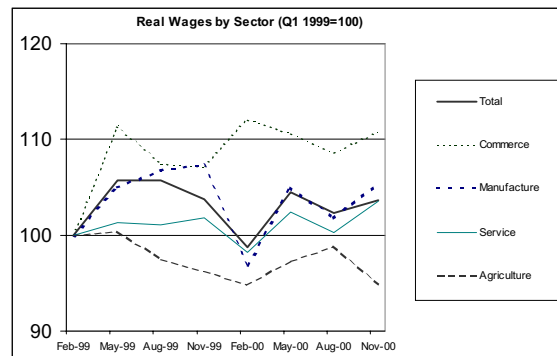
**Figure 7: ...but is expected to pick up with recovery next year**



Source : World Bank East Asia Brief.

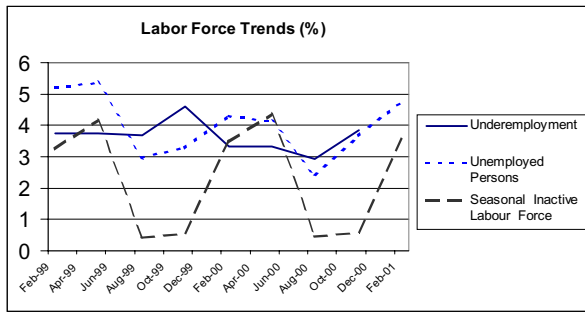
Other dimensions of well-being also point to little improvement in living standards over the last year. According to the latest Labor Force Survey, real wages remained flat from November 1999 to November 2000. However, there was a large variation across sectors. Since early 1999, real wage increases were highest in the commerce industry, whereas agricultural wages declined. In addition, the situation on the labor market is improving only slowly. In November 2000, 92 percent of the labor force were in full-time employment, compared to 91.6 percent in November 1999 and 89.2 percent in November 1998. The number of unemployed increased over the 12 months until November 2000 from just over one million (3.3 percent) to 1,200,000 (3.6 percent) individuals.

**Figure 8: Real wages differ across sectors**



Source : NSO, Labor Force Survey.

**Figure 9: Unemployment remains high**



Source : NSO, Labor Force Survey.

**Recovery was export-driven...**

Thailand's recovery was export-driven. The economy has seen large increases in trade of goods and services with other countries, with exports and imports rising in dollar terms by 20 to 30 percent. Net exports have for the third year running made a positive contribution to GDP growth. Exports and imports of goods and services exceeded each separately private consumption as a share of GDP for the first time in 2000. Domestic consumption and investment, while picking up during last year, have provided less absolute stimulus for growth than in other EA5 economies, in particular Korea and Malaysia.

**Table 1: Growth dependent on strong domestic demand**

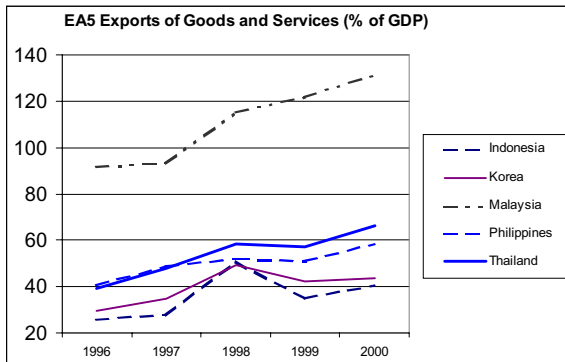
	EA5 GDP Growth and its Components (% , 1998-2000)					
	Indonesia 1999-2000	Korea 1999-2000	Malaysia 1999-2000	Philippines 1999-2000	Thailand 1999	Thailand 2000
<b>Real GDP Growth Rate</b>	2.8	9.9	7.2	3.6	4.2	4.3
<b>Contributions to Growth:</b>						
Consumption	3.2	4.7	4.4	2.7	2.2	3.0
Investment	-1.9	4.3	2.7	-0.1	1.4	2.6
Net Exports	1.6	1.4	0	4.3	1.3	0.5
Exports	-3.7	8.7	15.8	4.2	5.5	8.9
Imports	-5.3	7.3	15.8	-0.2	4.1	8.4
Statistical Discrepancy	-0.1	-0.5	0.1	-3.3	-0.7	-1.8

Source : IMF.

**...but now the global downturn**

Now, negative external developments cast a shadow on the fragile economic recovery. The slowdown in US markets, the sluggish economy in Japan, and the weakness in the global IT and semiconductor sector have worsened the short-term outlook. High-technology products (including automobiles and based on BOT definition) account for over 60 percent of Thai exports. IT exports to the USA and Asia total up to 10 percent of GDP, and semiconductor exports alone account for 4 percent of GDP. High-tech exports, which started to decline since the end of last year, continued their slowdown in 2001. Overall, the value of exports in the first four months of 2001 declined by almost 3 percent year-on-year in U.S. dollar terms.

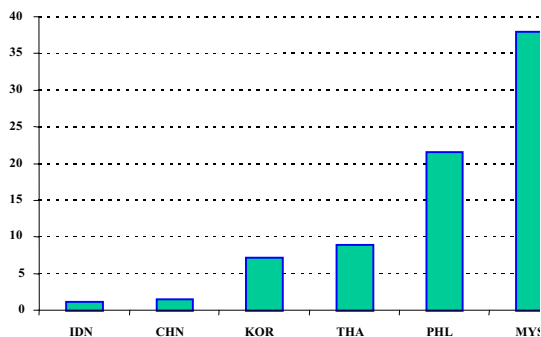
**Figure 10: Export growth strong in the past...**



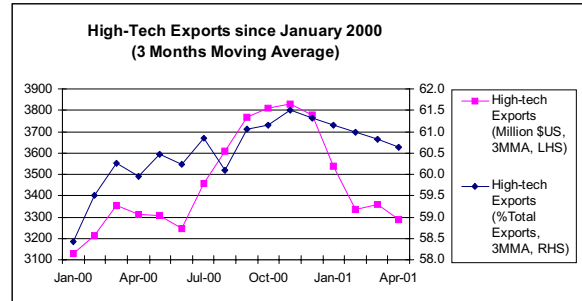
Source : World Bank East Asia Brief.

**Figure 11: ...led by IT exports,...**

IT exports to the United States and Asia  
(percent of GDP)



**Figure 12: ...but IT exports have slowed down recently**

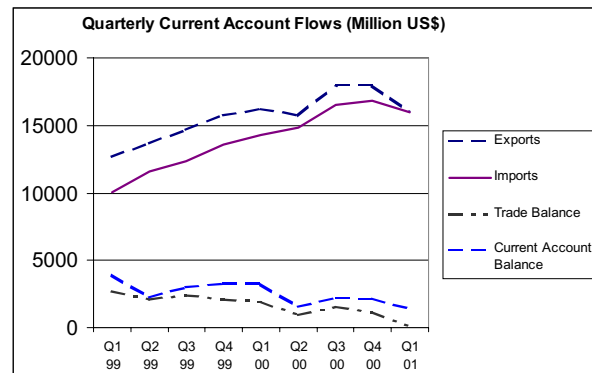


Source : BOT.

**Reduction in trade surplus**

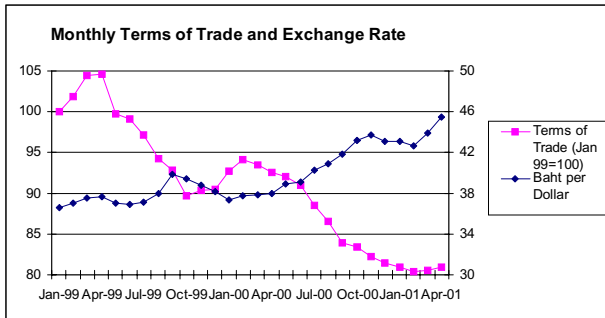
The trade surplus narrowed close to zero during the first quarter of 2001, partly as a result of the deterioration in the terms of trade. The rise in oil prices (oil accounts for about 8 percent of total imports), together with the depressed non-oil commodity prices, like rice, resulted in a drop of the terms of trade. The terms of trade are likely to improve at the end of 2001, as the weakening in the global economy puts downward pressure on oil prices.

**Figure 13: Declining surplus on external balance...**



Source : BOT.

**Figure 14: ...as terms of trade deteriorated**

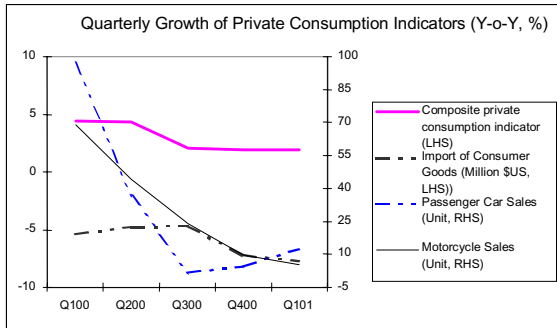


Source : BOT.

**Private consumption weak**

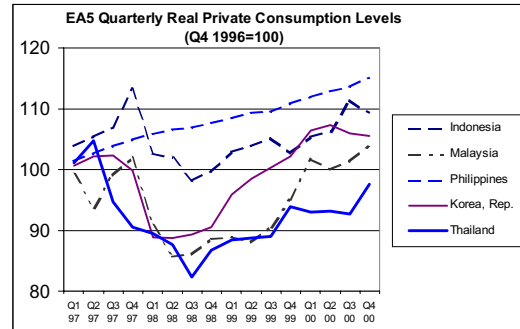
The deterioration in the external environment was compounded by weaker private consumption growth since the second half of 2000. This slowdown has continued in the first quarter of 2001. The composite private consumption index, constructed out of nine key private consumption indicators, is almost flat to slightly positive, compared to an increase of 4.4 percent a year ago. Only passenger car sales showed an increase over the last quarter in 2000. Overall, private consumption has yet to recover from the crisis. Thailand is the only EA5 country where private consumption is still below pre-crisis level.

**Figure 15: Consumption remains weak...**



Source : BOT.

**Figure 16: ...and consumption levels still below pre-crisis level**

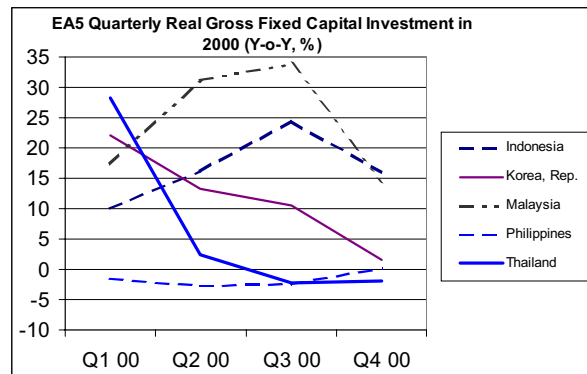


Source : World Bank East Asia Brief.

**Investments held back**

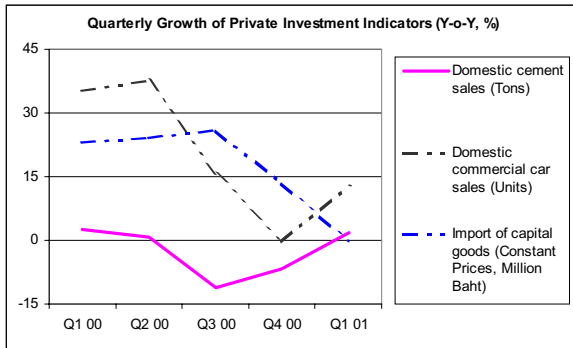
Thailand has seen no persistent investment increase since the second half of 1999 as strong private investment growth was offset by reductions in public investment. In contrast, investment in Malaysia, Philippines and Korea have already recovered from the trough. Private investment growth in Thailand slowed down from 14 percent in the second and third quarters of 2000 to 6 percent in the last quarter of 2000. It continues to remain low in the first quarter of 2001, with the quarterly growth rates of the key indicators all below the growth rates attained one year ago. While gross fixed capital investment is still below pre-crisis levels in all EA5 countries, the contraction in Thailand was by far the largest.

**Figure 17: Investment falling across the region**



Source : World Bank East Asia Brief.

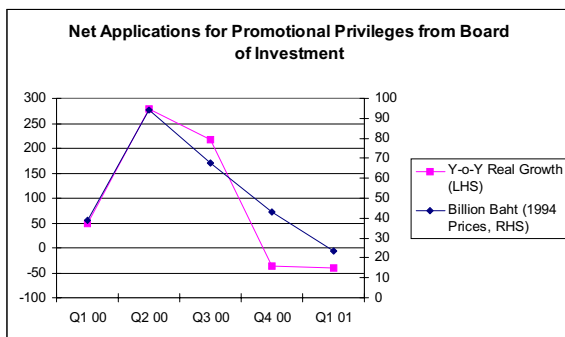
**Figure 18: Mixed signals from private investment indicators**



Source : BOT.

The decline in the BOI applications for investment privileges continued in the first quarter of 2001. Private investment is set to be weak during 2001, as enterprises continue to hold off investments. The slowdown in investment is the result of not just the short-term downward adjustment of growth prospects. It is indicative of a reversal of the “over-investment” during the 1990s in the face of excess capacity and declining marginal product of capital. For example, private investment in the construction sector is likely to remain depressed for some time in view of the oversupply of real estate. But the key to reviving private investment is financial and corporate reform to increase return to investment.

**Figure 19: Investment applications to BOI dropping**

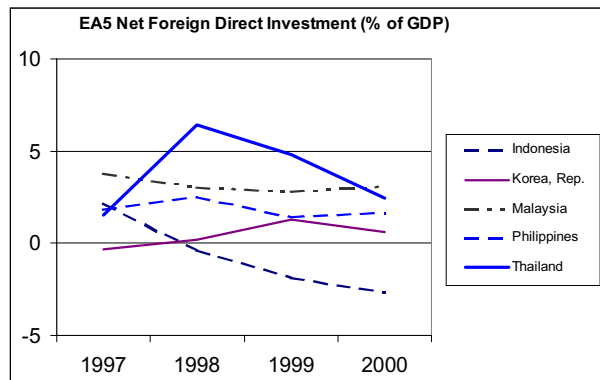


Source : BOT.

**Foreign direct investment holds up**

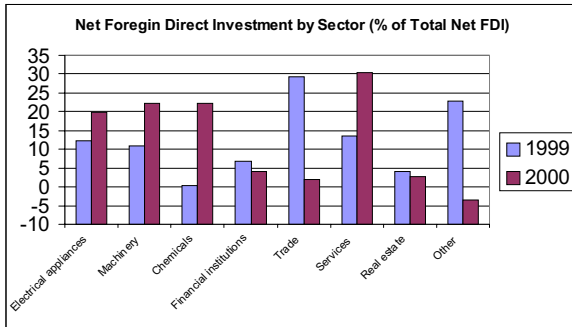
On the surface, the worsening of the investment climate also affected net foreign direct investment (FDI). Net FDI has dropped for the second year in a row, amounting only to 2.5 percent of GDP in 2000, or about one third of the 1998 level. In the competition for foreign investors, Thailand lost ground to Korea, which has advanced further in economic recovery. It received US\$50 per person, less than Korea (US\$61) and Malaysia (US\$129), whereas in 1999 all three countries still obtained about US\$100 per person. However, the large FDI flows in 1998 and 1999 were mostly for recapitalization of the Thai corporate sector rather than greenfield investments. Accounting for this one-off factor, Thailand continues to attract substantial FDI. At the same time, the sectoral composition of net FDI flows changed substantially. Services, electrical appliances, machinery and transport equipment, and chemicals all gained, while the trade sector received less than 10 percent of the 1999 flows.

**Figure 20: Thailand still attracting large FDI**



Source : World Bank East Asia Brief.

**Figure 21: FDI diversified across sectors**

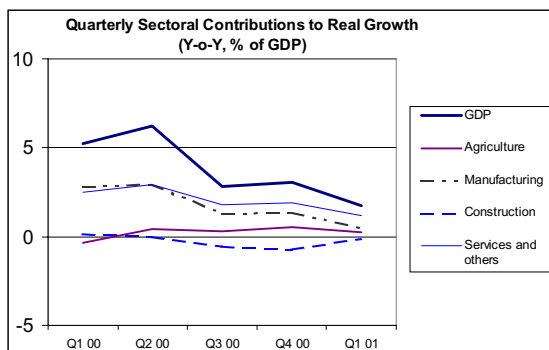


Source : BOT.

**Manufacturing no longer the largest contributor to growth**

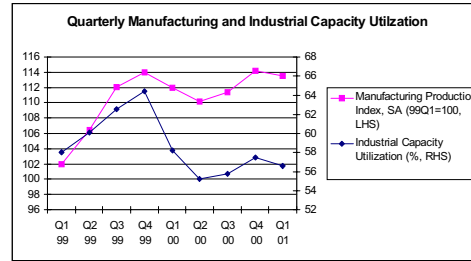
Turning to the sectoral composition of GDP, the reduction in manufacturing was a key factor in the trend decline in real GDP growth since the second half of 1999. In the second half of 2000, manufacturing was replaced by the service sector as the largest contributor to growth. The strong rise in the manufacturing index during 1999 failed to continue in 2000, leaving production up by 1.4 percent in the first quarter of 2001 year-on-year, owing to higher output of vehicles and parts and jewelry and ornaments. The slowdown in manufacturing contributed to a drop in industrial capacity utilization to no more than 56 percent.

**Figure 22: GDP follows decline in manufacturing**



Source : BOT, NESDB.

**Figure 23: Capacity utilization remains low**

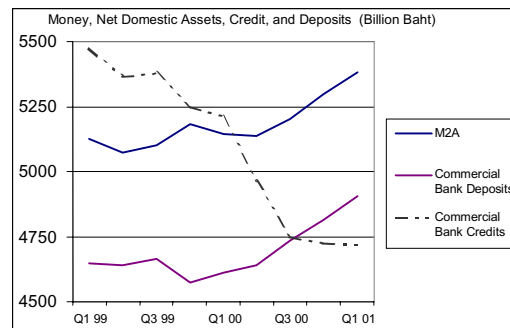


Source : BOT.

**Weak credit growth in spite of low interest rates**

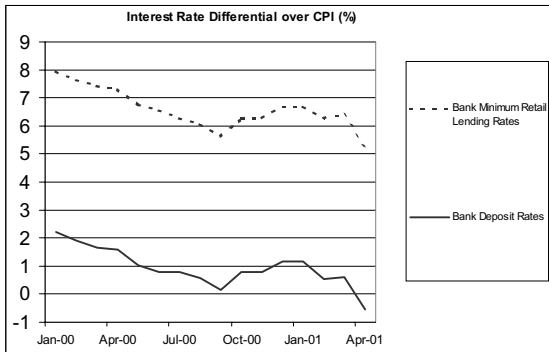
In view of the low capacity utilization and the absence of inflationary pressure, the Bank of Thailand has maintained an accommodation monetary policy. However, the large liquidity available on the markets has not transformed itself into higher credit volume due to weak investment demand and banks' high risk aversion in view of still sizable shares of non-performing loans on their balance sheets. This factor also accounts for the still large spreads of banks' lending and deposit rates. The recent increase of the Bank of Thailand of the 14-day repurchase rate by 100 basis points to 2.5 percent has so far had little impact on lending and deposit rates.

**Figure 24: Domestic credit yet to recover**



Source : BOT.

**Figure 25: Difference in lending and deposit rates stays high**

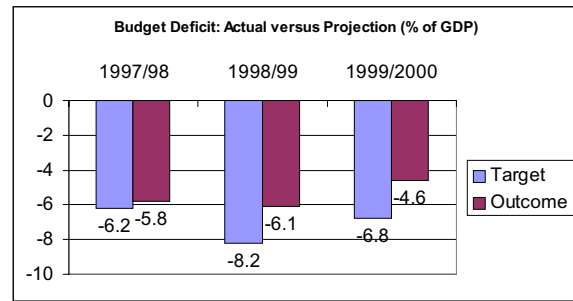


Source : BOT.

### III. Fiscal stimulus, public expenditure, and public sector reform

The government has maintained an accommodative fiscal stance to support the recovery process. However, over the past three years, the actual comprehensive public sector balance was less expansionary than planned. The undershooting of deficit targets is likely to continue also for the current fiscal year. For the first two quarter (October 2000 to March 2001), the accumulated disbursement ratio was equal to 40.5 percent, compared to a target of 40.9 percent. In addition, the balance of the non-financial public enterprises was in surplus by almost 0.5 percent of GDP, relative to a deficit target of close to 1 percent of GDP for the whole fiscal year. The authorities have stated their intention to accelerate enterprise capital spending to meet the deficit objective, but this has proven to be challenging in the past. This pattern highlights the government's difficulties to successfully implement expansionary fiscal policies during times of sluggish domestic demand.

**Figure 26: Undershooting of deficit targets**



Source : MOF, IMF, Staff Estimates.

#### New fiscal initiatives

The government's plans to boost domestic spending involve measures both on the revenue and expenditure side. It has postponed the reversal of the VAT rate from 7 to 10 percent by two more years. The administration has taken steps to implement fiscal spending programs which featured prominently in its election campaign. They include

- a three year debt suspension moratorium for farmers, with eligibility restricted to loans not exceeding Bt 100,000, for a total costs of around Bt 10-15 billion (less than 0.3 percent of 2001 GDP);
- a revolving village fund of Bt1 million, distributed to the about 70,000 villages over a three-year horizon for a total cost of up to Bt 77 billion (around 1.5 percent of 2001 GDP); and
- a universal coverage health scheme reducing out of pocket health expenditures to Bt 30 per visit, which was launched in six provinces on April 1, and is scheduled to be extended to another 15 provinces on June 1, funded by an Bt 8 billion allocation (0.15 percent of GDP) in 2001/02 as foreseen in the preliminary next year's budget plan.

While the details of these programs are still being worked out, their fiscal impact remains limited. The fiscal impulse for the current fiscal year is likely to be positive, and to reach about one percentage point of

GDP in 2000/2001. By contrast, the fiscal impulse for 2001/2002 is likely to be negative, even after including the Bt 50 billion (1 percent of GDP) fiscal stimulus

“reserve fund” that would only be spent if the expected acceleration in growth is threatened.

**Table 2: Fiscal impulse switching from current to next year**

<b>Fiscal impulse, current and next fiscal year</b>		
	<b>2000/01</b>	<b>2001/02</b>
Projected budget balance*	-5.9	-5.4
<i>of which:</i>		
Cyclically-neutral budget balance	-5.1	-5.2
Fiscal stance	0.8	0.2
Fiscal impulse	0.9	-0.5

\*For comprehensive government sector, including central and local government, extrabudgetary funds, FIDF interest payments, the non-financial public sector enterprises, and quasi-fiscal activities like village fund and debt suspension for farmers.

Source : IMF, Staff Estimates.

### **Quality of public expenditure**

The quality of the fiscal spending package is not just a question of its size, but also of its targeting and timeliness. Pro-poor expenditures with high local content have large multiplier effects, and their impact of this additional spending on economic activity could be considerable - if delivered effectively and timely. In addition, new fiscal initiatives have to be viewed in the context of sectoral strategies and their impact on the overall composition of public spending. Looking at the trend in social spending of the central government over the last four years, two features stand out. First, the share of social security in overall social spending rose from 10 in 1998/99 to 16

percent in 1999/2000 as a result of social safety net programs introduced to contain the social costs of the economic crisis. The government will have to assess whether this shift is to be temporary or preserved in the future. Second, while social sector spending of the central government as a percentage of GDP has remained fairly constant, there has been a substantial shift from capital to current expenditures. Capital expenditures accounted for about one third of spending in 1996/97, and only for 17 percent in 1999/2000. This trend applies across the board, including education, health, and housing. This pattern raises concerns with regard to the maintenance and upgrading of infrastructure in the social sectors.

**Table 3: Capital expenditures in social sectors decreasing**

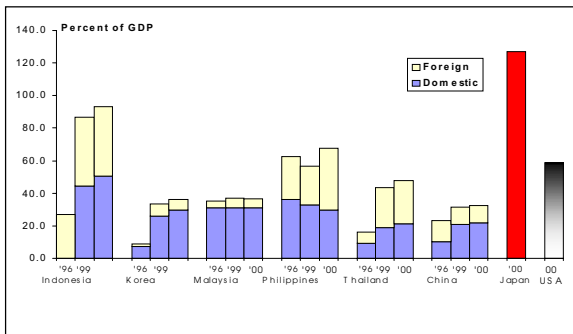
Social expenditures of the central government				
	1996/97	1997/98	1998/99	1999/00
Total expenditure	7.6	7.5	7.9	7.6
Education	4.1	4.2	4.4	4.1
Health	1.6	1.7	1.6	1.4
Social security and welfare	0.7	0.7	0.8	1.2
Housing and community amenities	1.1	0.9	1.0	0.9
Current expenditure	5.1	5.4	6.1	6.3
Education	3.1	3.3	3.7	3.6
Health	1.1	1.2	1.4	1.3
Social security and welfare	0.7	0.7	0.8	1.1
Housing and community amenities	0.1	0.1	0.2	0.3
Capital expenditure	2.5	2.1	1.8	1.3
Education	1.0	0.9	0.6	0.5
Health	0.5	0.5	0.3	0.2
Social security and welfare	0.0	0.0	0.0	0.0
Housing and community amenities	1.0	0.7	0.8	0.6

Source : IMF, Staff Estimates.

**Public debt outlook**

Any expansionary fiscal policy will have to be balanced against market concerns with regard to public debt. It increased threefold compared to pre-crisis levels, mostly due to costs arising from financial sector restructuring, and amounted, including the liabilities of nonfinancial public enterprises, to close to 60 percent of GDP at September 2000. Apart from medium-term fiscal consolidation, returning to GDP growth rates above 5 percent and maintaining low interest rates are key ingredients for a steady decline in the debt-to-GDP ratio.

**Figure 27: Thai public debt in line with EA5**



Source : World Bank East Asia Brief.

**Performance-Based Salary Increases for Thai Civil Servants**

A new compensation scheme for civil servants was introduced this year. Civil servants' compensation has not been adjusted significantly since 1994. The new scheme is designed to introduce performance-based compensation and to move away from guaranteed annual pay raises that are unrelated to performance. The Civil Service Commission has allocated Baht 14 billion for pay raises in fiscal year 2001, with Baht 5 billion realized from savings from the Government's early retirement program. Salaries for the civil service cost about Baht 280 billion a year. Performance and compensation evaluations will be conducted semi-annually (on 1 April and 2 October), with increases covering the six-month period prior to these dates. Pay raises are limited annually to 6 percent of the total salary bill in any department or agency in the previous September. The new scheme also introduced a one-month pay bonus, to be paid to the "most efficient and hard working" civil servants. Departmental-level panels will review proposed salary increases to reduce the risk of supervisors abusing their authority. Civil servants who felt that they were mistreated could seek

redress from the newly-inaugurated Administrative Courts.

### **Decentralization to Local Administrations**

The 1997 Constitution and the National Decentralization Act mandate the decentralization of service delivery and financing to local government administrations. The Act specified that by FY01, 20 percent of the total revenues collected would be allocated to local administrations, and that target will rise to 35 percent in FY06. Because local governments collect limited revenues from their own sources, the 20 percent target must be met by increased reliance on shared taxes or subsidies from the central government. In FY01, the 20 percent target was met by increasing central government subsidies for specific functions and for general purposes.

Currently a plan for decentralization of functions has not been translated into local expenditure targets for different functions. Ideally, decentralization would be driven by consideration of which level of government could most efficiently and effectively deliver and finance public services. Decentralization experience in other countries has shown that it is more effective to decentralize expenditure responsibility *before* decentralizing resources. The focus in Thailand remains on the revenue side is in part because of the target set by the Constitution on local revenues. There is currently no budget or plan for sub-national expenditures. Action plans have been developed within specific functions, but an aggregate expenditure plan should be developed to direct the decentralization process and ensure it corresponds with the revenues devolved to local governments. Local revenues (including shared taxes and subsidies) in FY01 were budgeted to increase by Baht 56 trillion to 20 percent of total government revenue as outlined by the 8th Plan. The target is interpreted as the revenues made available to local

governments, and this target will most likely be met. However, whether the actual revenues will be 20 percent is much more uncertain, due to delays in disbursing subsidies for specific projects.

The composition of sub-national revenues is likely to change as the Government moves toward the targeted 35 percent in FY06. Local own revenues are planned to increase by 0.5 percent of total government revenues per year. Part of this increase could arise from the new property tax, which is being proposed. Shared taxes are also likely to be a source of increased revenues. Local governments currently receive 8.5 percent of the revenues from VAT, but the law allows this percentage to increase to 30 percent. With the difficulties in disbursing the specific grants, the Government may choose to shift funds from specific to general subsidies, which do not require local governments to comply with regulations to the same extent.

Local governments rely heavily on shared taxes and subsidies from the Central Government. In FY01, it is estimated that 43 percent of local revenues and grants were from shared taxes, and 44 percent from grants leaving only 13 percent being locally collected revenue. Heavy reliance on shared taxes and subsidies reduces local accountability and reduces the predictability of revenue flows. Countries that use formula-based intergovernmental transfers generally have more predictable flows to sub-national governments. There are currently three types of subsidies, and a fourth is planned to replace the third in 2003.

- General grants: Grants distributed to local governments based on indicators. Indicators such as number of students, elderly, villages, and population, and local revenue, are used as proxies for local expenditure needs and revenue capacities. The grants are administered by the

Department of Local Administration (DOLA) in the Ministry of Interior.

- Specific grants: Grants to be spent on specific purposes. The grants are also administered by DOLA.
- Grants with transfer of responsibility: Grants given only to *Tambon Administrative Organizations* (TAOs). An instrument used for FY01 and FY02 to help the transition from central to local service delivery. An amount is set aside for each local government for specific purposes. Before the funds are disbursed, local governments must submit a plan and be able to procure the project. The grants are administered by various agencies.
- Sectoral block grants: A grant given to local governments that specifies which sector to spend the money on, but granting local governments much more autonomy than the two grants mentioned immediately above. This instrument is not yet implemented, but planned to be used from FY03 and beyond.

The subsidy system is changing during the process of decentralization. Before FY01, the Central Government relied on the general and specific transfers. During a transition period, “Grants with Transfer of Responsibility” were introduced to allow the Government to decentralize according to the

pace of local capacity building. From FY03, these grants will be replaced by sectoral block grants. For FY01 the budgeted general and specific grants amount to Baht 41.4 trillion, while grants with transfer of responsibility amount to Baht 32.3 trillion. The Bureau of Budget (BOB) prepares the budget, and a summary of FY01 budgeted grants is provided below. The disbursement are monitored by the Comptroller Generals Department in the Ministry of Finance.

Some of the specific subsidies are being disbursed very slowly. The disbursement of the subsidies with transfer of responsibility is contingent on *tambons’* capacity to plan and procure specific projects, and funds are disbursed after BOB’s approval of the *tambons’* proposals. With the substantial increase in local government responsibilities from FY00 to FY01, this is proving to be a stumbling block. As evident from the table, only 34.5 percent had been disbursed 8 months into the fiscal year. The problem appears to be with the investment expenditures, which require more procurement by the local governments. While overall disbursements are likely to pick up towards the end of the fiscal year, disbursements are likely to fall short of the budgeted amount.

**Table 4: Grant disbursement ratio low for investment budget**

**Disbursements of Grants with Transfer of Responsibility as of May 31, 2001**

	Budget	Expenditure	Disbursement ratio
General budget	12,350.28	9,671.17	78.3%
Investment budget	19,996.92	1,487.58	7.4%
Total	32,347.2	11,158.75	34.5%

Source: Comptroller Generals Department, Ministry of Finance.

### Accountability and Transparency

Thailand has taken significant steps towards improving accountability and transparency. The Office of the Ombudsman has been established, the Ombudsman appointed, the National Counter Corruption Commission was officially established, and seventeen Supreme Administrative Judges have been officially appointed. A code of ethics for civil servants has been revised and an Ethics Promotion Center established. Despite these achievements, independent organizations need additional resources to improve their staffing. The challenges ahead are to further develop government policies and procedures for budgeting, human resource management, and reporting functions of independent organizations; enhancing the integration of these accountability organizations with other reform agencies; and promoting public awareness of the roles and responsibilities of these organizations. Emerging issues, as emphasized in the new Government's program, include developing and vigorously implementing a government-wide anticorruption strategy.

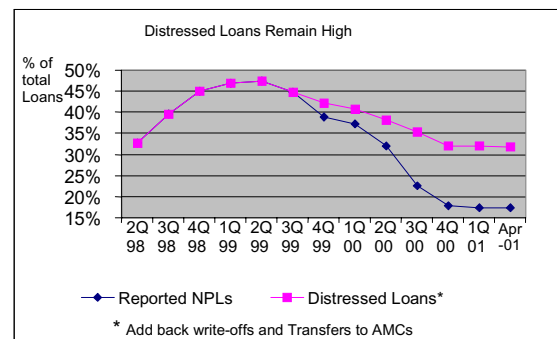
## IV. Financial Sector Development

### Resolution of NPLs

Total distressed loans of financial institutions remain high. Reported non-performing loans (NPLs) of the financial system peaked in May 1999 at 47.7% of total loans and have declined markedly since then to 17.42% of total loans in April 2001. If transfers to AMCs and write-offs are added back, total distressed loans of the financial system have declined to a lesser extent from its peak to 31.8% of total loans in April 2001. This means that NPL reduction does not represent a similar decline in corporate indebtedness. Reduction in distressed loans had accelerated during 1999 and 2000 mainly from accelerated NPL restructuring.

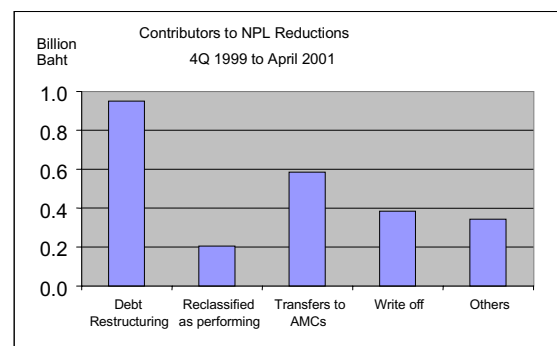
Nonetheless NPL restructuring has slowed down significantly from an average of Bt51 billion per month in 2000 to an average of Bt22 billion per month in Q1 2001 and to Bt18 billion in April 2001 because banks are now restructuring more difficult cases. As a result, distressed loans barely decreased in 1Q 2001 and increased slightly in April 2001. More worrisome is the fact that restructured loans, which have reverted to NPL status, have been rising, which reflects poor quality of completed restructuring. Due to high NPL re-entry rates, headline NPLs of financial system have risen about Bt16 billion during April-May 2001 from bottom of 17.40% of total loans in March 2001 to 17.42% of total loans in April and to an estimate of 17.79% of total loans in May 2001. As of April 2001 accumulated re-entry NPLs have reached 33% of accumulated NPL restructuring.

Figure 28 : Distressed Loans Remain High



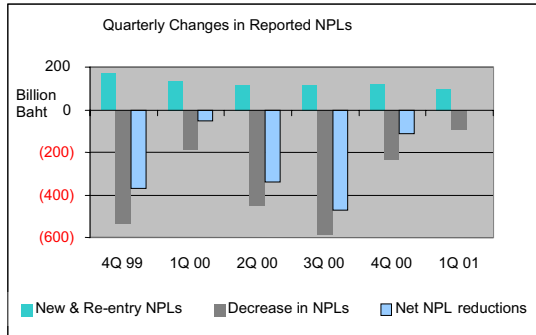
Source: the BOT, the World Bank's Estimate

Figure 29 : Contributors to NPL Reductions (4Q 1999 to April 2001)



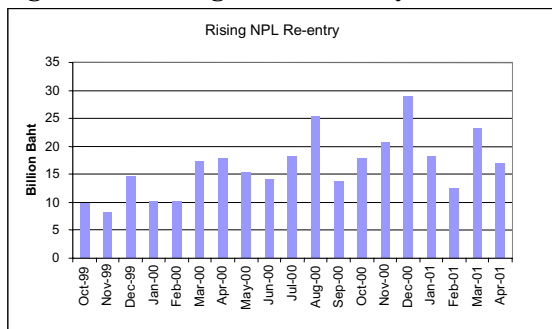
Source: the BOT

**Figure 30 : Quarterly Changes in Reported NPLs**



Source: the BOT

**Figure 31 : Rising NPL Re-entry Rates**



Source: the BOT

The government has enacted an emergency decree which fulfills its campaign promise to establish a centralized Thai Asset Management Corporation (TAMC). The TAMC will acquire up to about Bt1.24 trillion of NPLs: Bt1.1 trillion from state banks and their AMC's and Bt0.14 trillion from private banks at net book value (principal balance net of provisions). These less viable loans have failed voluntary restructuring to date and many are in the courts. TAMC will exchange FIDF guaranteed bonds, which pay at the same rate as bank deposits, for the transferred NPLs. Loans to be transferred from private banks will be limited to multi-creditor, non-performing accounts larger than Bt5 million per account. Private banks would share gains and losses with the government on their transferred NPLs if recovery rates are different than initial transfer prices. Key powers include: rapid vesting of ownership by TAMC in assets transferred by banks, indemnification of TAMC officers and

directors for reasonable actions taken within their authority, and for non-viable cases, foreclosure and disposal of collateral security without going through the civil courts.

A key characteristic of the TAMC Act is that it keeps the current players in place. The creditor with the largest exposure on an account will become the asset manager, working for the TAMC under a gain/loss sharing agreement. Except in the case of non-viable loans in which foreclosure is the only option, debtors are favored as planners and plan administrators for the firms they currently own and manage. The debtors can slow a reorganization plan. It appears that planners are liable for losses stemming from unfulfilled plans; this is a risk that the debtor already incurs and which outside professionals may not accept. And it is not clear whether the TAMC will offer reorganization candidates to the market in order to produce optional plans, management and sources of funding. As a result, the Act addresses inter-creditor problems, as did the CDRAC process, but retains a draw back of CDRAC in that debtors can change their minds and obstruct. The only option for TAMC, in case debtors reject a plan, is to liquidate the firm. Finally, the Act is favorable to guarantors and debtors in that it allows release from liability if a plan cannot be fulfilled in good faith, and in the case of a debt restructuring, if two thirds of the outstanding debt is paid.

While the TAMC Act provides for some special powers that could speed up debt restructuring, the challenge is minimizing the cost to the taxpayer and effective implementation of the special powers. The outcome will depend upon the professionalism of management and the degree to which they employ specialist expertise from the private sector; the transparency of the deal making to avoid conflicts of interest, both political interference from above and collusion from below; the effort put forth by the Executive

Board, given that they are part time; the issuance of clear debt restructuring guidelines for borrowers and guarantors; whether the bankruptcy court provides an expedited, green lane for TAMC matters; and the degree to which management seeks to maximize recoveries and minimize the cost to the taxpayer. Maximizing recoveries is not an explicit objective in the Act, but there is enough ambiguity for the management and the Board, under direction of the Minister of Finance, to steer the TAMC one way or the other.

Implicit forbearance by the BOT on the level of provisioning or loan losses continues, however, and several banks remain undercapitalized on an economic basis. Since the crisis broke in 1997, Thai banks (state owned and private) have raised Bt 910 billion total capital, of which Bt 848 billion is tier-1 capital. Of the total tier 1 raised to date, Bt 529 was from the government and Bt 319 from private investors. Thai banks have complied with the final step of the phase-in of provisioning guidelines as of year-end 2000, but significant unrecognized losses remain. Implicit forbearance props up the weaker institutions at the expense of banks which have more aggressively taken realistic losses in debt restructuring and raised capital in the markets. Three types of implicit forbearance on provisioning requirements exist. First, financial institutions are allowed to provision for loan losses net of collateral value. This generally understates provisions because appraisals of property tend to be overstated. Second, the regulator does not require stringent quality control over the reclassification of restructured loans. Third, the regulator has postponed the implementation of the accounting standard (IAS 39) which requires net present valuation of restructured loans, instead of the current practice of relying on collateral value. Without removal of existing forbearance, banks have little incentive to revalue their collateral to market levels and to recapitalize their balance

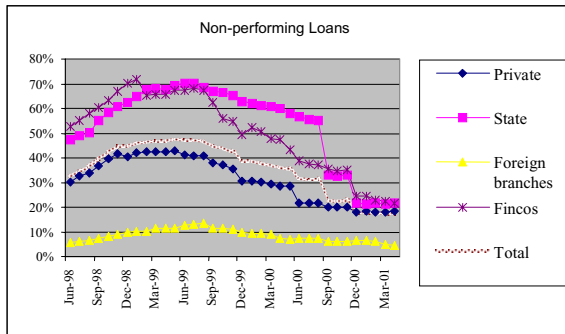
sheets, and will continue to postpone quality restructuring of their NPLs.

The large NPL burden retained by the private banks will continue to be a source of vulnerability, as the economy slows down. The TAMC is clearly intended to alleviate stress on the banks and delay any need to raise capital in the near future. The net book value transfer price and the delay until year five and year ten before settlement of loss sharing between the government and the banks for assets transferred to TAMC accomplish this. But the TAMC will not have a large effect on private banks, given that private banks will transfer only about 25% of distressed assets (NPLs plus loans transferred to AMCs and write-offs, but not yet restructured), which equates to about 30% of their NPLs. While operating earnings by the best banks and their customers have trended up into positive territory over the past year, bank earnings remain fragile, given recent negative trends in exports, continued capacity utilization in the real sector of 50-60%, and debt equity ratios among firms of between 2-3 times. As a result, banks cannot rely on earnings as the source of recapitalization.

The policy towards state banks should be consistent with the medium-term objective of developing a sound financial system. The government has announced plans for state banks to significantly increase lending, including Bt50 billion from KTB. Unfortunately, excess capacity in the economy, low credit demand among credit worthy borrowers and poor risk management capacity of state banks limit their ability to lend on a risk adjusted basis. The Government also announced plans to sell minority stakes of KTB and Bank Thai to local retail investors over the next year. However, a change towards commercially based corporate governance for these banks is necessary to enhance their viability and to promote incentives which favor the most competitive banks. Given excess capacity in the banking sector, the Government's policy

on the state banks should lead towards consolidation. However, the Cabinet decided to keep Siam City Bank and Bangkok Metropolitan Bank, another two nationalized banks, under separate management by approving the Government Pension Fund's proposal to take a 51% stake in both banks.

**Figure 32 : Non-performing Loans by Types of Financial Institutions**



Source: the BOT

Loans are starting to grow slowly after substantial declines. The ratio of commercial bank loans (after write-offs) to GDP maintained a declining trend from a peak of 128% in 1997 to below 104% in Q1 2001. Adjusted for write-offs and transfers to AMCs, incremental bank loans turned positive in 2000 (Bt23 billion) and increased in Q1 2001 (Bt33 billion). This is a significant improvement from the substantial decline in incremental loans in 1999 (Bt113 billion) and 1998 (Bt580 billion). Because banks are capital constrained in economic terms, and are still coping with NPL problems, they will continue to be cautious in extending new loans, given the poor credit quality and unavailable credit information of most borrowers. Although large corporate can raise funds directly from the capital market, SMEs still rely on bank loans for their funding.

Recent policy may not provide incentives for restructuring of banks and firms. The recent relaxation of the loan classification by the BOT to encourage new lending may

weaken the incentive for change<sup>1</sup>. Weak market information does not support a change in credit culture. Since the crisis, regulators and standards setters have made attempts to promote a change in Thai credit culture from collateral based lending to analyzing operating cash flow while underwriting new projects. Since not all improved accounting standards are fully implemented and credit information is not available for Thai firms, particularly SMEs, banks are dissuaded to move away from collateral based lending. Large number of SMEs are believed to maintain alternate sets of books for various stakeholders, including the tax authorities, and have limited skills and incentives to present their real operating cash flow. As a result, most banks continue to demand collateral when approving credits for SMEs. Changes in the incentive structure are needed in order to improve transparency.

The enactment of the “Credit Bureau Bill” should reduce the uncertainty on the sharing of credit information. It is expected that the Bill will be reviewed by the Senate in the next parliamentary session (July-August). After the crisis, two credit bureaus were established in Thailand: Central Credit Information Services (providing both commercial and consumer credit information) and Thai Credit Bureau (focusing on consumer credit information). The former was initially founded by the BOT and the latter was set up by the MOF and placed within the Government Housing Bank. Both are operating under constraints

<sup>1</sup> Previously, loans to companies which experience losses for two consecutive years and a net book value which is less than 50% of paid up capital would be classified as substandard by the BOT. A new regulation allows banks to classify those such loans as “normal”, if the following conditions are met: (1) debtors must be able to service loan obligation; (2) debtor’s financial statements receive clean audit opinion, and (3) their EBITDA (earnings before interest, tax, depreciation and amortization expenses) must be positive.

and uncertainties because the Credit Bureau Bill has not passed into law. Key issues need to be resolved. First, should the borrower's consent be a precondition for creditors to access credit information? The existing draft would demand creditors to receive debtor consent. Instead, options could be explored which would provide for broader information sharing while protecting the consumer. Second, a time bound plan should be developed for rationalization of the two new credit bureaus. Third, there is still uncertainty about data sharing agreements between banks and non-banks like utilities, given that the draft has not been finalized.

### **The Supervisory Regime**

BOT is developing a Financial Sector Master Plan. Thailand's Financial Sector Task Force drafted strategy notes on the Banking sector and Capital Markets last year. The Bank of Thailand (BOT) is currently planning a larger project (master-plan) to recommend a structure for the Thai financial sector in the medium term. Over the year, they plan to seek assistance from international experts in two areas: (1) the role of deposit takers over the next five years, including identification of gaps in services via surveys of suppliers and users, and (2) the development of financial conglomerates, including NBFIs and holding company structures. The Government has also given the SET the mandate to develop a medium term strategy for capital market development, which will be integrated into the financial sector master plan.

Transition to a Limited Deposit Insurance Scheme (DIS) is being developed. The authorities have started the design process for an eventual transition from the present blanket guarantee on financial institution deposits to a limited guarantee. However, before large depositors can be put at risk, the banks will have to be strengthened. Before

dropping the guarantee, the authorities plan to set a strategy which restores public confidence in Thai financial institutions and the resolve the overhang of NPLs.

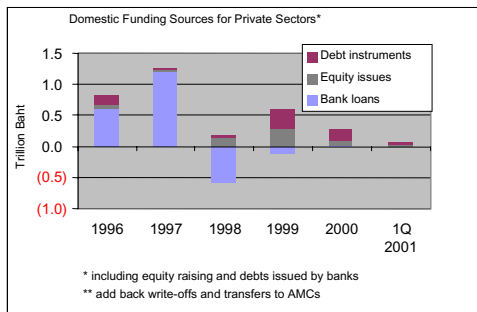
### **Capital Markets**

Primary issues in the capital market declined significantly in 2000, and picked up slightly in Q1 2001. In 2000, fund raising in the domestic market totaled Bt677 billion, down from total fund raising in 1999 of Bt1 trillion. Total fund raising from the capital market picked up again in Q1 2001, to Bt228 billion, mainly from primary issues in the equity market. The Thai private sector has raised a total of Bt72 billion from equity market and Bt170 billion from bond market in 2000 (compared to Bt277 billion from the equity market and Bt320 billion from the debt market in 1999; Bt34 billion from the equity market and Bt40 billion from the bond market in Q1 2001). The decline in fund raising activities by banks, which were the biggest issuers in the market in 1999, caused the drop in private issuance in 2000. The contribution of banks to total fund raising in the capital market has declined from 66% in 1999 to 28% in 2000 and to 17% in 1Q 2001. Government and State owned organizations remain the biggest issuers in the bond market at around Bt400-500 billion per annum.

The BOT recently conducted open market operations to increase repurchase and interbank rates, with the stated goals of curbing capital outflow and preserving the level of foreign exchange reserve. Firms had been taking advantage of the excess liquidity in the market and paying down foreign debts by raising funds in the domestic bond market. Thai depositors had gradually shifted their money from banks to fixed income mutual funds for yield pick up, given risk return trade-offs. The fixed income mutual fund industry had grown substantially to around Bt80 billion. However the unexpected raise in interest rates halted this trend, causing sudden

redemptions of about 10% over the past three weeks. The Thai government and the FIDF, the biggest borrowers in the domestic market, have been hit by increasing costs. The market estimates that a 1% increase in interest rates cause the domestic bond market to lose about Bt70 billion in value. Banks, which are the biggest investors in the domestic bonds, will have to recognize a portion of these losses over the next year, depending on how much they hold to maturity. The potential benefits of rate hikes should be carefully weighed against the costs. If the rise in interbank rates spills over to increased deposit rates, most of the benefit will flow to wealthier Thais. 75% of deposits are over Bt1 million in size. Only 17.5% of deposits are less than Bt500,000 in size; 7.5% of deposits are between Bt500,000 and Bt1 million.

**Figure 33: Domestic Funding Sources for Private Sectors**



Source: SEC, the World Bank's Estimate

The Cabinet recently approved measures to support the capital market. Several measures involve the removal of tax obstacles in debt transactions, securitization

and investment in retirement funds (see Box 1). Tax incentives will be provided for existing and newly listed companies on the SET and to newly listed companies on the MAI (Market for Alternative Investment). Necessary infrastructure will continue to be developed. The Finance Ministry was quoted in the press as saying that the expected losses in tax revenues from this package of around Bt1.4 billion will be recovered if more companies are attracted to list on the stock exchanges, which will enlarge the number of companies with transparent tax reporting.

A more effective clearing and settlement (C&S) platform for the bond market is being developed. The Securities Exchange Commission (SEC) is leading the initiative to enhance the effectiveness and efficiency of the existing C&S platform for the secondary bond market. Currently, there are two C&S systems for the Thai bond market. One is for corporate debentures, which is executed by the Thai Securities Depository (TSD). The other is for government securities, and is currently executed by the BOT. A more practical medium term solution may be to migrate to centralized C&S by shifting the C&S functions for government bonds from the BOT to TSD. Over the longer term, a thorough review and upgrade of TSD's capacity will be needed regarding risk management, ownership structure, and software and systems to execute straight through processing.

**BOX 1: MEASURES TO STIMULATE THE CAPITAL MARKET**

***EQUITY MARKET***

- Lower corporate tax rate for existing listed companies on the SET to 25% of net profit for the amount lower than Bt300 million for 5 years.
- Lower corporate tax rate for newly listed companies in the SET to 25% of net profit for 5 years.
- Lower corporate tax rate for newly listed companies in the MAI to 20% of net profits for 5 years.
- Companies can issue stock dividends; the stock dividend is subjected to income tax; the value of a stock dividend is equal to the retained earnings appropriated for the stock dividend divided by the number of shares issued for the stock dividend.
- Removal of the requirement that a financial advisor conduct due diligence for newly listed companies on the MAI.
- Time bound privatization plans will be developed for state enterprises, including Internet Thailand, Petroleum Authority of Thailand, Krungthai Bank, and Thai Airways.
- Linking BOI promotions to whether a firm is listed on the stock exchanges.
- Review the new accounting standards and the disclosure requirement which have been difficult to enforce.

***DEBT MARKET AND SECURITIZATION***

- Banks, finance companies, securities companies, and credit fonciers will soon pay their monthly specific business tax (SBT) on net capital gains (total capital gain minus total capital losses) from bond trading in each month; formerly capital losses cannot offset capital gains when calculating monthly SBT.
- Waiver of personal income tax on interest earned on debt instruments by individual persons beyond his/her holding period.
- Waiver of corporate income tax for special purpose vehicles use in securitization.
- Waiver of SBT on capital gains incurred by the sellers (borrowers) from collateralized bonds in repurchase (REPO) transactions; Waiver of duty stamp on REPO transactions.
- New “Public Debt Law” will be issued to make it easier for the government to issue bonds.

***RETIREMENT MUTUAL FUND***

- Removal of tax obstacles to investment in retirement funds.

***FINANCIAL INFRASTRUCTURE***

- The draft “Law on Derivatives” will be presented to the Cabinet in the near future.
- Amendments to the “Securities Act” to allow for electronic trade and delivery of debt instruments.
- Amendment to act to allow mutual funds to borrow.
- Banks will be allowed to trade interest rate derivatives in the stock exchange.

## **V. Corporate Restructuring**

The overall debt restructuring completion rate<sup>2</sup> has slowed system wide. At the end of March 2001, a cumulative total of Bt2.1 trillion was restructured, up from a cumulative total of Bt1.95 trillion at the end of 2000 and Bt1.1 trillion at the end of 1999. The completion rate has slowed since June 2000, from an average of Bt86 million per month during the first half of 2000 to an average of Bt61 million per month during the last six months of 2000. During the first quarter of 2001, the debt restructuring completion rate dropped to an average of Bt47 million per month.

The decline in the completion rate can be primarily attributed to: (1) viable cases have been restructured; the remaining cases are more complex and may require considerable time to reach agreements; (2) an increasing number of distressed loans have been transferred to private asset management corporations, where they are not counted in the completion rate; (3) creditors and debtors are waiting for the Thai Asset Management Corporation (TAMC) to commence operations in the hope that the loans will be worked out more favorably if transferred to the TAMC.

### **Voluntary Framework for Debt Restructuring**

Debt restructuring under the CDRAC process has been extended, and a significant portion of the cases may be transferred to the TAMC. The voluntary agreements under the CDRAC process were due to expire at the end of December 2000, but have since been extended. CDRAC received an additional mandate to facilitate and monitor the restructuring of (1) less viable cases, or the so-called small-medium-sized loans; (2) loans of affiliated companies; and

(3) loans of state-owned asset management companies. As a result, more cases have been added to the CDRAC target group. At the end of April 2001, a total of 14,386 target cases (Bt2.62 trillion) are under the auspices of CDRAC. This includes 2,845 corporate cases (Bt2.31 trillion) and 11,541 small-medium-sized cases (Bt307 billion). Sixty three percent of total target debtors (9,780 cases, for Bt1.65 trillion), signed the accession agreements (DCA/ICA/SA) to enter the CDRAC process. Of this group 47% (Bt1.23 trillion) have completed debt restructuring, while 51% (Bt1.34 trillion) did not sign the voluntary agreements or failed the CDRAC process, and must be resolved in courts.

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<sup>2</sup> Includes proactive debt restructuring.

**Table 5: Status of CDRAC Target Cases**

As of April 30, 2001

Unit: Million Baht

Stages	Corporate (Groups 1,2,3,4)		SMEs		Total		
	#Cases	Amt.	#Cases	Amt.	#Cases	Amt.	% of Total
Total completed cases*	<b>981</b>	<b>1,113,815</b>	<b>6,973</b>	<b>122,367</b>	<b>7,954</b>	<b>1,236,182</b>	<b>47%</b>
In Restructuring Process (draft/ propose/amend plan, to be voted)	<b>124</b>	<b>32,076</b>	<b>497</b>	<b>14,411</b>	<b>621</b>	<b>46,487</b>	<b>2%</b>
Unsuccessful restructuring – cases filed and to be filed in court	469	312,102	736	59,443	1,205	371,545	
Debtors not signatory under DCA/ICA/SA, proceed to court	1,271	855,802	3,335	110,547	4,606	966,349	
Total In Process of Legal Action	<b>1,740</b>	<b>1,167,904</b>	<b>4,071</b>	<b>169,990</b>	<b>5,811</b>	<b>1,337,894</b>	<b>51%</b>
Total Approved Target Debtors	<b>2,845</b>	<b>2,313,795</b>	<b>11,541</b>	<b>306,768</b>	<b>14,386</b>	<b>2,620,563</b>	<b>100.0%</b>

\* Completed cases comprise of:

1. Completed cases (restructuring contract has been signed)
2. Agreed on plan, in process of signing restructuring contract
3. Agreed on plan, file for reorganization in Bankruptcy Court

Source: Bank of Thailand

The debt restructuring of large corporate cases under the CDRAC process is having a significant impact on the reduction of overall NPLs. But the impact of the completion rate of small-medium-sized (SME) cases has been minimal. The total number of cases and credit exposure of SME loans under the CDRAC process is minute compared to the total SME credit exposures in the system. To accelerate the debt restructuring of SME loans, between 500-700 cases have been added to the CDRAC target group each month since January 2001. It takes an average of 45 days to complete the negotiation and sign a restructuring contract for the SME group. The CDRAC process strictly enforces the time restriction under the Simplified Agreement, which governs the debt restructuring of SME cases in CDRAC. In addition, the Bank of Thailand sets a target for financial institutions to restructure SME loans at 15,000 cases per month. On average,

financial institutions have been able to restructure about 12,000 SME cases per month.

### **Court-supervised Framework for Debt Restructuring**

Business reorganization filings have slowed in the Central Bankruptcy Court, while the filings for liquidation have increased significantly. The volume of business reorganization filings were steady in year 2000, but have slowed in year 2001, consistent with the decline in the overall debt restructuring completion rate. Liquidation filings average less than 80 million baht per case, and more than 55% of the cases are from the commercial wholesale/retail and personal consumption sectors. This suggests that the bankruptcy court is being used to collect smaller-sized debts, and that larger rehabilitation cases are not entering the process.

**Table 6 : Progress of Central Bankruptcy Court  
Business Reorganization and Liquidation\***

Type of Filings	Volume	Jun-Dec 1999 (6 months)	Jan-Jun 2000 (6 months)	Jul-Dec 2000 (6 months)	Jan-Mar 2001 (3 months)	Total
Business Reorganization	Cases	37	65	69	16	<b>187</b>
	Mill Bt	362,841	418,164	242,754	77,122	<b>1,100,881</b>
Liquidation	Cases	416	464	522	224	<b>1,626</b>
	Mill Bt	10,500	28,552	48,505	38,775	<b>126,332</b>

Source: Central Bankruptcy Court of Thailand

\* As of March 31, 2001

The Central Bankruptcy Court is not yet fully staffed or trained permanent court personnel and judges. The court has been operating with temporary court personnel, and the turnover rate is high. There is also a frequent rotation of judges. This could weaken the effectiveness of the court in handling a higher volume of cases. On average, it takes 7 months to render a judgement in an uncontested bankruptcy case. While the placement of permanent court staff is expected to be completed by mid year, the court should start formulating a plan to train and build capacity of the permanent staff and to further streamline court procedures to improve efficiency.

The pace of restructuring is undermined by the backlog of cases in the Civil Courts. Civil courts enforce mortgages in Thailand. Cases that are not resolved in CDRAC or in bi-lateral negotiations are filed in the Civil Courts. The Civil Courts estimate that there are over 55,000 debt restructuring cases pending judgement. At current judgement rates, it will take 6-7 years to clear the current backlog, plus another two years to auction the collateral. NPL cases are more complex than other cases, and require knowledgeable and experienced judges. There is a shortage of experienced judges and court administrators. To expedite the court judgements and clear the backlogs, the evidentiary process, control of cash flow from collateral, court procedures and the auction process should also be streamlined.

The mediation center within the Civil Court aims to alleviate the backlogs by providing an alternative resolution mechanism for the easier cases. The Financial Dispute Mediation Center (FDMC) was opened in April 2001 with the aim of relieving the potential burden on the courts of overwhelming number of debt restructuring cases by settling the dispute out of court. To gain public acceptance, FDMC needs to illustrate that the voluntary mediation process can be fair, effective, and lessen the case backlogs of the courts. The first challenge is to recruit experienced legal and financial professionals are to serve as mediators, a process now underway. FDMC will need to also add business restructuring expertise to their services in order to expedite resolution.

## VI. The Legal Framework

While serious backlogs exist, particularly in the civil courts, the government has not moved to expedite civil procedure or the evidentiary process. In addition, the legal execution department now has about Bt 500 billion of property waiting to be auctioned. The existing legal regime lacks the mechanism for debt collection and enforcement of security rights outside the bankruptcy law. Even though debtors are able to use the legal framework to delay restructuring negotiations (see Box 2), the Government has indicated that the

Bankruptcy Act should be amended to level the playing field more in favor of debtors. The Secured Transactions Act, which is awaiting Parliamentary consideration before it is passed into law, is expected to provide debtors with the flexibility and option to use a more liquid asset (e.g. accounts receivables and securities) as collateral in debt restructuring and applying for new loans.

The Legal Reform Committee for Development of Thailand (LRC) was established in March 2001 to initiate and coordinate the reform of the country's legal framework. It is still too early to assess the effectiveness of LRC. However, the

comprehensive reform efforts may need to be coordinated and expanded to broadly include participation of the private sector, legal professionals, academia, and civil society. The comprehensive reform of bankruptcy law should also be expedited, expanded to consider other related business laws and placed within the framework of an easily monitored schedule. The amendment to the Code of Civil Procedures (Evidence) has been drafted but not yet passed into law. The Evidence law would allow the Courts of Justice to issue decrees to streamline the discovery process and provide for continuous hearings to speed up the court judgements.

### **Box 2 Why corporate restructuring continues to be slow ?**

*Lack of objective criteria for commencing bankruptcy proceedings.* Conflict in the definition of insolvency (balance sheet insolvency instead of ability of debtor to meet debt obligations as they fall due) enables debtors to contest the insolvency issue and delay bankruptcy proceedings

*Uncertainties in the planner process.* The appointment process has been adversarial, potential criminal liability for “excessive” fees and fear of not being paid has impaired the quality of debt restructuring.

*Delays in converting unsuccessful rehabilitation into liquidation proceedings.* A non-viable debtor can use delays under rehabilitation to prevent liquidation. If rehabilitation fails, the creditor terminates activities, and the court must re-affirm insolvency before bankruptcy proceedings can begin.

*Slow foreclosure.* Debtors can mount a variety of legal challenges to slow down foreclosure proceedings. The disposal process is also lengthy and cumbersome.

*Problem of personal criminal liability in state-owned financial institutions.* Under current law, state employees face potential criminal liability for taking losses on behalf of the state. This puts a legal cloud over taking reasonable losses in debt restructuring, and explains in part why officers in state-owned banks unwilling to accept haircuts in debt restructuring.

*Legal and tax obstacles impede mergers and acquisitions.* Business consolidations or mergers are viewed as a market-based tool to aid and accelerate business restructuring. However, the present tax code regime does not provide incentives for businesses to consider mergers and acquisitions. A new business entity is not allowed to transfer net losses from the merged entities onto its books.

*Secondary markets are moribund.* One of the main channels for corporate restructuring is asset disposal via secondary markets. This has yet to happen in Thailand because firms are reluctant to let go of assets and banks (with a few exceptions) are reluctant to accept losses realized from the sale of loans or collateral at market prices.

## **VII. Corporate Governance**

Thailand has improved reporting and disclosure standards. A total of 18 new or improved accounting standards have been adopted. In the last six months, 6 more accounting standards (Intangible Assets, Events after the Balance Sheet Date, Contingent Assets and Liabilities, Discontinuing Operations, Accounting for Government Grants and Disclosures, and Income taxes) have been issued and will become effective at later dates. Additionally, a total of 8 accounting standard interpretations have been issued. Improved auditing standards consistent with international standards have been put into practice, and year 2000 accounts were audited in accordance with these standards. The Accounting Act has been amended to improve its compliance with the standards issued by the ICAAT mandatory.

A revised code of best practices for company directors has been issued by the SET to guide the listed companies to improve their corporate governance. More than 90% of the listed companies now have an audit committee in place. More than 180 executives of Thai companies have completed the 5-day training program for company directors offered by the Institute of Directors. Amendment of the Public Companies and Securities and Exchange Acts is expected to improve minority shareholders' rights; clarify accountability of boards of directors and officers; and strengthen enforcement process for imposing sanctions for violation of law.

But implementation is at an early stage. The key challenges are to deepen the reform effort at the firm level and to complete the remaining legislative changes. Institutional strengthening will be critical in the areas of standard setting and application accounting

standards. Amendment of the Accounting Professional Act to allow the establishment of the Thailand Financial Accounting Standards Board and strengthening of the ICAAT could be speeded up. The proposed amendments to the Public Company Act have been split into two tracks. The first track, dealing primarily with measures to facilitate corporate restructuring (i.e. provisions related to the treasury stock, par value, debt equity swap, preferred stock and voting rights, offsetting losses with retained earnings) has been passed by the Parliament. However, the amendments empowering corporate governance through the strengthening of minority shareholder rights and the fiduciary duties of directors are yet to materialize. These amendments are expected to help improve investors' protection and strengthen market confidence.

The training of directors of public companies is a high priority. There are over 3,800 directors of listed companies in Thailand and only a fraction of them have completed the training program provided by the Institute of Directors. For SOEs that prepare for privatization, the challenge is to adhere to the highest standards of transparency and accountability, particularly in the appointment of qualified and independent board members.

More training on the application of new and improved accounting standards will be required to close the gap between the improved standards and real practices. The role of the ICAAT in provision of Continued Professional Education (CPE), promotion of code of ethics, and adherence to the professional code of conduct will be critical in improving practices. The audit committees of listed companies need to become more effective and act as an effective internal monitoring mechanism.

**Box 3: Premium for Good Corporate Governance**

The need to persist with reform is underscored in a recent investor survey of six Asian countries (Indonesia, Japan, Korea, Malaysia, Taiwan, and Thailand) by McKinsey . Both Asian and U.S. based investors assert that much remains to be done to catch up with the best practices in the region.

The McKinsey survey shows that institutional investors are prepared to pay a premium for good corporate governance. Institutional investors, the survey found, are prepared to pay a markup of more than 20% for shares of companies that demonstrate good corporate governance. The size of that premium varies from country to country: it is as high as 27.1% in Indonesia, 25.7% in Thailand, and 24.2% in Korea, and 20.2% in both Japan and Taiwan. The premium is as low as 18.3% in U.S. and 17.9% in the United Kingdom. The Asian corporations have much to gain in terms of strengthening investor confidence from making the transition to sound corporate governance.

Country	Premium for Good Corporate Governance
US	18.3
UK	17.9
Japan	20.2
Taiwan	20.2
Korea	24.2
Malaysia	24.9
Thailand	25.7
Indonesia	27.1

Source: International Investor Opinion survey., undertaken in September/October 1999 by McKensey and Company, in cooperation with Institutional Investor's Asia pacific Institute.

#### **Box 4: Corporate Governance Reform in Thailand-Challenges ahead**

##### **Recommended Amendments to the Public Companies Act, and Securities and Exchange Act**

- Enhance the role of regulators in enforcement of securities regulations by streamlining criminal procedures for violation of Securities laws;
- Improve enforcement for violation of laws, including the introduction of severe sanctions on insiders for false and misleading disclosure;
- Increase accountability of directors and management and further clarify fiduciary duty of directors;
- Further increase minority shareholder rights and the ease with which they exercise those rights, including the right to access a company's financial information, and the right to approve major and connected transactions;
- Provide for cost-effective legal channels for shareholders seeking redress or dismissal of a director for misconduct or violation of the law or article of incorporation.

##### **Other Recommended Changes**

- Further improve accounting and auditing standards and practices
- Make the audit committees of boards of directors more effective
- Amend Accounting Professional Law to allow establishment of the Thailand Financial Accounting Standards Board and strengthen ICAAT.
- Improve the process for imposing disciplinary actions and sanctions on accountants in case of violation of professional code
- Issue specific rules on accounting and disclosure for banks
- Continue to provide training for accountants on new standards and for directors of public companies on directorship best practices
- accountants who violate duties and commit fraud.

Amendments to the Public Companies Act will help to reduce the cost of capital to Thai firms and improve management performance by strengthening minority shareholders rights and clarifying duties and accountability of boards of directors. Market competition, increased role for institutional investor, shareholder activism, and creditors' rights will help improve the business environment for investors and will lead to more transparent business practices and improved financial performance of corporations in Thailand.

## **VIII. Privatization & SOE Reform**

The new Government has announced that 18 state owned enterprises would be privatized

by 2003 through minority retail share offerings on the Stock Exchange of Thailand (SET). The privatization program is intended to fulfill the Government's promise to rationalize the public sector and deepen the domestic capital market. Privatization of the 18 enterprises could increase the market capitalization of SET by nearly 50%.

The Government is moving rapidly to create a National Holding Company under which it will gather the commercial state enterprises. Concurrently, it has announced a schedule of Initial Public Offerings (IPOs) of state enterprises on the local Thai markets which, if accomplished, would represent one of the fastest and most dynamic "case by case" privatization efforts of large scale enterprises.

**TABLE 7: Estimated Market Value of State Enterprises and Listing Schedule**

(million of Baht)

	2001				2001				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Internet Thailand			176									
Thai Airways International Public Company Limited				8700								
The Petroleum Authority of Thailand				74783								
Krung Thai Bank Public Company Limited				*								
Bangkok Metropolitan Bank Public Ltd.					*							
Siam City Bank Public Company Limited					*							
Telephone Organization of Thailand						75538						
The Communication Authority of Thailand							63489					
Thailand Tobacco Monopoly							20360					
Airport Authority of Thailand							56286					
The Government Housing Bank							18397					
Port Authority of Thailand							17455					
The Government Saving Bank								52212				
The Electricity Generating Authority of Thailand										159016		
The Metropolitan Electricity Authority												34318
The Provincial Electricity Authority												69548
The Metropolitan Waterworks Authority												23407
The Provincial Waterworks Authority												23639

Source : MOF

The IPO approach offers the opportunity to create dynamism and momentum in the program. If handled with skill, it can (1) drive forward the regulatory and structural reforms already formulated, (2) instill confidence in the public, employees and investment community regarding privatization, and (3) stimulate Thai capital markets and competition. The national holding company can facilitate or obstruct

this process depending on its organization, transparency and the competence of its management and board. It is expected that a major advantage of the IPO approach will be the alleviation of employee concerns through the inclusion of Employee Share Ownership Programs (ESOP) in the transactions. All previous transactions, such as EGCO, Ratchaburi and PTTEP have included an ESOP component.

**Box 5 Lessons of Experience on National Holding Company**

Many countries faced with privatization have created national holding companies, or sector holding companies. The benefits of such an approach include centralizing control over the enterprises (moving control away from powerful ministries), organizing an efficient privatization effort (a centrally controlled disposal process is typically more cost effective, efficient and transparent than a distributed approach), and management of remaining government interests in the enterprises from a group of professional commercial managers and board members.

The experience globally however with such holding companies has not matched their potential. Frequently the creation and organization of holding companies causes delays in the privatisation process itself. In addition, management of the holding companies have vested interests in preserving the state role in the enterprises (and thereby preserving their jobs), thus delaying or obstructing privatisation. Without proper consideration given to the power and reporting structure of the holding companies, they can also be as subject to the whims of political expedient as the SOEs under their respective ministries.

Egypt provides an example of the challenges holding companies can face in executing privatisation programs, while Temesak Holdings in Singapore (the model Thailand has chosen) demonstrates some of the advantages holding companies can bring.

Among the important issues which need to be addressed in Thailand's holding company formation include: board's composition, the relationship between the holding company and the State, the role of the Office of State Enterprise, the relationship between the NHC and the IPO process; conflict of interest with competition policy, and plans to improve corporate governance of the SOEs.

**IPO PROCESS**

The approach the government appears to be taking is to begin the partial divestiture of shares of SOEs (usually not more than 25%) before the full regulatory reforms are in place.

The advantages to this approach include: rapid demonstration of commitment to share sales; stimulation of domestic capital markets by placing shares on the exchange; demonstration of benefits of privatisation (if done correctly) to key stake holders (management, public, employees); rapid corporatisation of affected SOEs, making them subject to commercial corporate governance and transparency requirements, and capital injection for the government.

The disadvantages or risks to this approach include: transferring public to private monopolies; rapid depletion of domestic capital available for share purchases, entrenchment of existing management and practices (this process raises capital without compelling needed internal and structural reforms in the SOEs); low valuations for shares (as limited liquidity in domestic market); no benefits of foreign strategic participation (management, technology, capital, know-how, global sales networks).

To minimize these risks, the following could be done: make explicit in the sales information memorandum the government's plans and commitments to regulatory reform and the timeline for accomplishing this (privatise first approach creates a powerful "anti-regulation" lobby in the form of this enterprise and its shareholders); announce concurrently the government's policy for implementing regulatory reform in support of the privatisations (ideally in a Cabinet decree), open up a tranche of shares in each IPO for foreign investment funds (this will bring capital to Thailand and also pressure the board to be more response to corporate governance and transparency matters), promote the domestic share offering to the general public by offering discounted shares to special groups (farmers, cooperatives, etc.); rigorously enforce corporate governance and transparency requirements.

**Table 8: Key Initiatives in Infrastructure Regulatory Reform**

	<b>Key Reform Initiatives from Master Plan</b>	<b>Progress as at March 2001</b>
<b>Policy</b>	Corporatisation of State Enterprises	Passage of the Corporatisation Act (1999) on 16 December 1999. Establishment of State Enterprise Capital Policy Committee (SEPC), under the Corporatisation Act (1999) on 26 July, 2000, chaired by the Prime Minister.
	Establishment of Independent Regulators in utility/ infrastructure sectors	Establishment of SEPC subcommittee on independent regulatory frameworks, on 5 April, 1999. Regulatory Framework Guidelines approved by Cabinet on 19 October, 1999 Regulatory Training Program approved by SEPC Regulatory subcommittee on 18 September, 2000
	Market Sector Reform	Establishment of SEPC Subcommittee on Transportation Restructuring, chaired by Minister of Transport and Communications on 8 July, 1999. SEPC approval of transport sector restructuring policy framework on 9 October 2000. Authorisation for re-establishment of sub-committee on 13 June 2000. Public Hearing on TDRI Transport Sector Restructuring Report on 15 June 2001. TDRI report under consideration of the sub-committee.
<b>Telecomm and Post</b>	Domestic market liberalisation	Establishment of Concession Conversion Committee on 17 March, 2000. Concession Conversion process under review. Domestic market liberalisation projected on completion of the corporatisation of TOT and CAT.
	Creation of independent regulator, National Communications Commission (NCC)	Spectrum Allocation and Regulation in the Broadcasting Sector and the Telecommunication Sector Act 2000 has been effective since March 7 2000 Selection Committee for NTC established. Proposal of the 7 member commission nominees to the Senate has been rejected and a new proposal is now expected by end 2001.
	Corporatisation of the Telephone Organisation of Thailand (TOT) and the Communications Authority of Thailand (CAT).	SECPC approval for TOT, CAT and Thai Post Corporatisation on 26 July, 2000. Company Establishment Preparatory Committee (CEPC) convened on 6 November 2000. Anticipated conclusion by March, 2001
	Privatisation of TOT and CAT	Cabinet approval of TOT and CAT privatisation plans on 4 November, 1998 Privatisation of TOT and CAT through Strategic Investor stake of 25% and Initial Public Offering anticipated to commence in 2 <sup>nd</sup> and 3 <sup>rd</sup> Q 2002 respectively.
<b>Broadcast</b>	Creation of independent regulator, National Broadcast Commission (NBC)	Selection Committee for NBC established. Proposal of commission nominees to the Senate delayed.
<b>Energy</b>	Power Sector restructuring	Power Pool Phase I Report March, 2000 Consultants selected for Power Pool Phase II studies on Market Rules, Stranded Costs & Secondary Regulations October, 2000. Work ongoing.
	Gas Sector liberalisation	Draft Third Party Access Code Public Hearing 9 December, 1999 Separation of PTT gas trading and distribution approved by Cabinet. Work ongoing. Department of Mineral Resources, Ministry of Industry to draft the TPA regulations under the Petroleum Act.
	Establish independent energy regulator	Draft Energy Industry Act to establish the regulator and implement power pool Public Hearing 24 August 2000. Currently under consideration by Juridical committee of the Parliament.
	Privatisation of Electricity Generating Authority of Thailand (EGAT)	Ratchaburi Initial Public Offering approved by Cabinet on November 30, 1999 launched on 18 October 2000. Domestic retail offering of 40% EGAT employees and/ or EGAT EPF 15% with EGAT holding 45%. Share Trading commenced 2 November, 2000.
	Privatisation of Petroleum Authority of Thailand (PTT)	Privatization plan approved by Cabinet on 23 January, 1996. Privatization anticipated 4 Q 2001
	Privatisation of Bangchak	SEPC approved plan on 17 December, 1999 for 32% share sale, with 16% domestic PO.
	Sale of MoF shares in Esso	Financial Advisors for 12.5% share sale selected on 16 September, 1997. Status quo.
<b>Transport</b>	Market and Regulatory reform of Aviation sub sector	SEPC approved restructuring framework on 9 October 2000. Initial study on corporatisation of provincial airports completed November 1999. Study on detailed market and regulatory structure to commence September 2001, expected to produce legislation for the independent

		aviation regulator by mid- 2002.
	Market and Regulatory reform of Maritime sub sector	SEPC approved restructuring framework on 9 October 2000. Port Authority of Thailand (PAT) study on corporatisation undertaken in 2000. PAT scheduled for privatisation for 3 <sup>rd</sup> Q 2002.
	Market and Regulatory reform of Rail and Bus (long distance) sub sector	SEPC approved restructuring framework on 9 October 2000. Restructuring study on State Railway of Thailand (SRT) completed November 2000.
	Market and Regulatory reform of Highways, Expressways and Motorways (Roads) sub sector	SEPC approved restructuring framework on 9 October 2000. Further work contingent on development of regulatory framework.
	Market and Regulatory reform of Public Transit (including urban bus) sub sector	SEPC approved restructuring framework on 9 October 2000. Study on detailed market and regulatory structure to commence Sept. 2001, expected to produce legislation for the independent public transit regulator and authority by end 2002.
	Corporatisation of State Railway of Thailand	Cabinet approved corporatisation of SRT on 7 November, 2000. Corporatisation Committee established January 2001. SRT Restructuring Committee established June 2001.
	Privatisation of THAI Airways	Plan approved by Cabinet 14 March 2000. Secondary Public Offering 23%, including ESOP and Greenshoe.. Ready to proceed – scheduled for 4 <sup>th</sup> Q 2001.
	Privatisation of Airports Authority of Thailand (AAT) Regional Airports.	Cabinet approved privatization on 21 July, 2000. Juridical Council ruling for use of Corporatisation Act in September 2000.
<b>Water</b>	Market and Regulatory Reform of Water and Wastewater sector.	Consultant consortium led by Tasman Economics commissioned to execute a study to recommend market and regulatory structure and prepare privatisation plans for Metropolitan Water Authority (MWA), Provincial Water Authority (PWA), and Wastewater Management Authority (WMA). Commencing August 2000 and results expected June 2001. Authorisation for the establishment of SEPC Water and Wastewater Sub-committee in June 2001. Govt. announced corporatisation of Water utilities and privatisation by 2003.

Source : MOF

A Master Plan for State Enterprise Reform was prepared in 1998 which outlines the objectives and timetable for regulatory reform in Thailand's utility and infrastructure sectors (telecommunications, transport, water, energy). For the utility/infrastructure, the Master Plan and related policy documents being prepared by sector Ministries and the Ministry of Finance define the market and regulatory structure in each sector. The plan calls for a clear separation of policy, regulatory and operational responsibilities and the liberalization of markets where possible. Consequently, incumbent State Enterprises will need to be prepared to compete as an operator as well as being positioned to be privatized.

With the acceleration of the privatisation program, the government would need to increase its focus on regulatory reform. A review of sectors and enterprises shows that the government is making progress, although the key challenges are the pace, consistency and transparency of the process. In the Telecom sector, the failure of the selection process for the National Telecommunications Commission could be regarded as the system of checks and balances working in favor of transparency. The corporatization of the telecom enterprises, while proceeding slowly (commenced in October 2000), is on track to meet the 2002 deadline. In the energy sector, the establishment of the independent regulator and the wholesale electricity market is delayed. Of more concern are the transport and water/wastewater sectors. The reform process for these sectors is more recent and a significant amount of work remains to be done to ensure that the challenges can be successfully met. The first phase of regulatory reform will be implemented through the use of powers under the Corporatisation Act, which allow the removal of special privileges and authorities from state enterprises to a transitional, existing or newly established committee or agency. Where appropriate,

work will continue on the full restructuring of regulatory regimes through the use of legislation, although this will take more time and may not be required for all sectors (eg where private participation is increased under a concession model, then economic regulation can be achieved through the contract).

Governance and transparency issues have previously been, and are expected to continue to be, the major challenges of the SOE privatization and regulatory reform program, given the number of agencies involved and the decision making models utilized in Thailand. The government's commitment to fundamental principles such as the separation of policy, regulatory and operational responsibilities; the operations of its enterprises on commercial principles and the implementation and maintenance of international best practices will need to be consistently reinforced and communicated.

## **VIII. Information, Science and Technology**

The Thai Cabinet recently approved the establishment of the National Science and Technology Policy Committee (NSTC). Thailand's slow progress in penetrating higher value-added product market segments and in industrial innovation is a key challenge to medium-term competitiveness and productivity growth. A number of analyses over the past decade have suggested that Thailand's technology infrastructure, including institutions, policies and incentives, do not support appropriate research nor meet private sector needs. The NSTC provides a significant opportunity for Thailand to implement an effective strategy to reform technological infrastructure. It can also serve to coordinate the many overlapping functions and mandates of the Ministry of Industry, Ministry of Science and Technology, Thai Research Fund, NSTDA, and several autonomous organizations.

Moving to a market-oriented technology strategy and greater inter-firm collaboration. The Thai innovation system can be characterized as supply, rather than demand driven. A reform strategy would need to work at several institutional levels, including NSTDA and other public agencies, universities, and industry-specific Institutes under the Ministry of Industry, as well as trade associations. Starting with the recognition that the majority of technology transfer takes place between companies (and not from state organizations), industry associations in such key sectors as food processing and automotive manufacturing need to strengthen their capacity to serve the technology needs of their members, promote cooperation within the industry on technical standards, and provide linkages with external suppliers of key services such as logistics and distribution. Industry associations can also support, through linkages with the software sector, the development of industry-specific software and services. The strategy would also need to start with a more realistic framework for technology development, oriented less toward research and development, and more toward value-added manufacturing and service competencies.

Management of the tax incentive for research and development has been changed, but it is time to rethink it entirely. In stimulating private R&D, Thailand has offered generous incentives – up to 200% of eligible expenditures can be credited against corporate income tax, and a range of soft-loan programs are available - yet the corporate sector's investment in R&D is among the lowest for middle-income countries and much of this is focused on physical capital rather than skills. Management of the incentive has been recently changed to allow NSTDA to verify that the activity proposed for the incentive is a legitimate research and development expenditure. But incentive only covers a small and less relevant portion of the technology development spectrum, and that

the incentive is unlikely to cause new investment. Greater use of flexible grant-based mechanisms to stimulate firms to undertake technology development activities involving design and engineering could be more effective.

The new Government intends to strengthen the impact of information and communication technology in governance, commerce and education. Drafts of the national IT plan, IT2010, have been circulated to some stakeholders. IT2010 builds on the previous e-Thailand draft, which contained laudable goals for e-education, e-commerce, e-industry, e-government and e-society, as well as policy reforms to enhance access to information more broadly. But as ICT has become more essential to more areas of national development, reviewers have suggested that the plan needs to be backed by more robust implementation and governance measures, including leadership and accountability. Previous ICT plans have had limited impact at the implementation level. Pilot projects in E-Government, for example, frequently use differing standards, even different physical networks, which will ultimately make information sharing goals unachievable unless reformed.

To support systematic ICT implementation, the Government has announced its intention to create the *National Information Bureau*. By having an independent secretariat and by reporting to the Prime Minister, such an office would have the power to coordinate work and policy matters across Ministries. This function, more about management (and change management) than technology, would help to ensure the interoperability of data throughout the Government, well-specified functional requirements and processes, and to support the efficient development of ICT projects consistent with national development strategies. The NIB would help address the current lack of accountability and standardization among government agencies pursuing e-government

projects as well as support the strategic process of enabling better citizen services through ICT.

Empowering rural communities through information technologies has emerged as a priority. Many of the current Government's priorities for community development (the Village Fund, the farmer debt moratorium and the One Tambon-One Product program) rely extensively on local capacity building that can be facilitated by ICT. The increased importance of networking, coupled with the recent devolution of power from Bangkok to rural villages, calls for a more fluid and transparent information and communication flow. To this end, ICT can be a powerful and complementary tool to help implement the new government's plans for resource transfer. However, the obstacles to rapid ICT diffusion are very large, and include the prevailing skill and awareness levels outside of Bangkok, the distribution of infrastructure, the lack of locally-relevant ICT content, income levels and the lack of a policy for provision of universal access. While over 80% of Thai villages now have telephone access, teledensity (lines per person) is five times higher in urban areas. According to a Government survey, 91% of internet users are urban, *and only 9% are rural.*<sup>3</sup> Roughly 10,000 villages remain without telephone service.

The Digital Signatures and Electronic Transactions Act passed the lower House of Parliament and is being scrutinized by the Senate. The National Information Infrastructure Act has passed Cabinet, while other bills related to data privacy and security, electronic funds transfer, and cybercrimes have been drafted but not yet entered the Parliamentary process.

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<sup>3</sup> *Internet User Profile 2000*, National IT Committee Secretariat, 2000.