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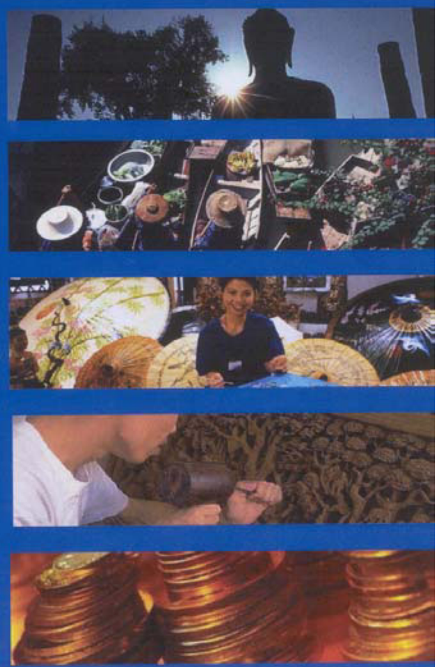
Thailand
ECONOMIC MONITOR



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KINGDOM OF THAILAND – FISCAL YEAR
October 1 – September 30

ABBREVIATIONS

AMC	Asset Management Companies
BOI	Board of Investment
BOT	Bank of Thailand
BPC	Budget Policy Committee
CDRAC	Corporate Debt Restructuring Advisory Committee
DEP	Department of Export Promotion
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EDI	Electronic Data Interchange
FDI	Foreign Direct Investments
FIDF	Financial Institutions Development Fund
ICA	Inter - Creditor Agreement
ICAAT	Institute of Certified Accountants and Auditors of Thailand
ICT	Information and Communication Technology
LGOs	Local Government Organizations
MBIs	Market - Based Instruments
MCFD	Mediation Center for Financial Disputes
MLR	Minimum Lending Rate
MNC	Multinational Corporation
MOC	Ministry of Commerce
MOF	Ministry of Finance
MPI	Manufacturing Production Index
MRA	Ministerial Restructuring Act
NCC	National Competitiveness Committee
NCCC	National Counter Corruption Commission
NESDB	National Economic and Social Development Board

NPLs	Non-Performing Loans
NPV	Net Present Valuation
NSTDA	National Science and Technology Development Agency
OECD	Organization for Economic Co-Operation and Development
OTOP	One Tambon One Product
PAA	Public Administration Act
PAO	Provincial Administrative Organizations
PDC	Public Sector Development Committee
PDMA	Public Debt Management Act
PMO	Procurement Management Office
R&D	Research and Development
ROSCs	Reports on Observance of Standards and Codes
SARS	Severe Acute Respiratory Syndrome
SBL	Securities Borrowing and Lending
SMEs	Small and Medium scale Enterprise
TAMC	Thai Asset Management Corporation
TAO	Tambon Administration Organization
TBDC	Thai Bond Dealing Center
TRIS	Thai Rating and Information Service
UTCC	The University of the Thai Chamber of Commerce
WTO	World Trade Organization

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Section 1: Overview

Thailand's growth jumped to 5.2 percent in 2002, the highest since 1997. Domestic demand, especially private consumption, and exports contributed most to this growth. Policies to stimulate private consumption and investment, including a supportive fiscal and monetary policy, as well as some progress in corporate and financial restructuring raised domestic demand. The targeting of new export markets, including China, also raised export earnings by more than 5 percent.

Poverty came down close to pre-crisis level. The 1997 crisis increased the incidence of poverty significantly, but the four-year-old recovery has reduced poverty from 13.8 percent in 2000 to 10.4 percent in 2002[1]. This was in part because poverty in the Northeast region, home to two-thirds of Thailand's poor, fell from 27.4 percent to 17.8 percent over the same period. Overall inequality declined too, but the current level is still high relative to other countries in the region.

Successful macroeconomic adjustment continued to reduce external vulnerability. A current account surplus of more than US$ 7 billion boosted foreign exchange reserves to nearly US$ 39 billion in 2002. External debt was down to 47 percent of GDP, nearly half the share in 1998, including private external debt, especially of short-term maturity. Thailand is relatively well placed to deal adequately with most external shocks, and this is reflected by the markets in a reduction in the interest-rate spread on Thai debt relative to countries like Malaysia and China.

Structural reform progressed in some areas as a fuller strategy to improve competitiveness is being developed. The Government established last year a National Committee on Competitiveness (NCC) headed by the Prime Minister to formulate a comprehensive strategy and to initiate new measures. The NCC is supporting several initiatives, including the benchmarking of Thailand's sectoral competitiveness and the prioritization of policy measures to promote productivity growth, including in several niche markets. Efforts to target new export markets, including China, are paying off, while the creation of a separate ICT ministry, the placing of education reform on the agenda and the re-focusing on poverty and regional balance, have been positive steps. Several reforms in respect of public administration and budget procedures were implemented last year. Nevertheless, the slowdown of financial and corporate restructuring, of privatization, and of business-environment deregulation compared to 2001 is likely to prolong domestic vulnerabilities as well as to handicap Thailand's efforts to move to higher rates of productivity growth and real GDP growth.

The ongoing Thai recovery faces an uncertain external environment. Expectations for developed country growth have been lowered to 1.8 percent, which is only slightly higher than that achieved in 2002. Average growth in East Asia, and developing countries within it, are expected to experience a slowdown this year relative to last year, even if that growth is still higher than any other developing region in the world. But any projection for 2003 is even more uncertain than ordinarily, because of the great uncertainties about the impact of the SARS outbreak, as well as – to a lesser extent – that of the Iraq crisis, and the implications of these shocks for an already fragile global recovery.

In 2003, Thailand's real GDP growth is projected to slow down to 4.5 percent. Though data for the first quarter show a continuation of recovery, performance in March show a dampening of domestic demand and a slowdown in the rate of export growth, relative to the first two months. Tourism, which contributes 6 percent of GDP, is adversely affected by SARS outbreak as evident in the falling tourist arrivals and

[1] Figure is based on the 2002 half-yearly survey. Results of the 2002 full survey are not yet available.

significant cancellations of airline, tour and hotel bookings in March and April, this year. This growth projection is consistent with the latest Consensus Forecast[2] and official forecasts.

The external sector contributed more to 2002 growth than was expected earlier. Total exports in US dollar terms grew by more than 5 percent and in volume, by 14 percent. There were at least 12 manufactured export items that grew at double digit rates, supported no doubt by the huge real depreciation of the exchange rate that took place during the crisis and was sustained for the most part. However, several labor-intensive manufactured exports shrunk. The region was the main driver of Thai exports, with China, ASEAN and other Asia, contributing the bulk of this export growth; other non-traditional markets like Middle East and Australia, contributed the rest. Aggregate exports to the United States, Europe and Japan combined, comprising more than half of all Thai exports, stagnated, even as China expanded its share in those markets. Thailand successfully tapped into the expanding Chinese market. Thai exports to China grew by a blistering 24 percent, comprising mostly of manufactures and relatively more technology-intensive products.

Growth in domestic demand contributed most to real GDP growth in 2002. The Government succeeded in promoting consumer confidence to an all time high and in stimulating private consumption, which grew by nearly 5 percent. Private investment grew for the fourth year and this time by more than 13 percent, even if from a very low share of GDP. This was in part because of a 36 percent growth in residential construction, promoted by tax incentives and bank credit. Gross inflows of foreign direct investment (FDI) fell in 2002, from relatively high levels in 2001, and it is not clear whether this is a blip or start of a trend, given the many factors at work. But given the importance of FDI in Thailand's future competitiveness and productivity, this needs to be watched carefully.

Recent financial and corporate sector restructuring and reforms have been limited. While Thailand made significant progress since the crisis in strengthening its banking sector, including restructuring and regulatory improvements, progress in the last 12 months has been limited. The banking system's financial position, although improving, remains fragile. Reforms for the development of the non-bank sector and capital market remain mixed. Corporate restructuring, as manifest in falling debt-equity ratios and rising interest-coverage ratios, suggest progress driven largely by improving demand and profitability; nevertheless the average debt-equity ratios of Thailand's corporate sector remain high and bank lending to firms remains limited by fragile balance sheets. While this has not prevented a robust recovery, it is likely to inhibit private investment and sustained high growth of the corporate sector over the medium-term.

Fiscal policy was supportive of domestic demand even as there was fiscal consolidation. The stimulus measures – village fund, health care scheme and farmers' debt moratorium – added to public spending, but the deficit was less than planned because of higher-than-expected revenue and shortfalls in other types of government spending. Further consolidation of the fiscal accounts is planned for this year. As a result, public debt stabilized in 2002; it fell from its peak of 58 percent of GDP in 2000 to 54 percent in 2002. It is expected to decline further over the medium-term as long as growth continues to hover at around 5 percent. There are risks however to this planned fiscal consolidation, mitigated somewhat by the potential for raising revenue: slower real GDP growth, higher public investment in infrastructure, and off-budget funding of stimulus turning into liabilities for the budget.

[2] Consensus Forecast is a monthly publication by Consensus Economics Inc., which presents economic forecasts of prominent economic and financial forecasters for countries around the world.

Public sector governance reforms have shown the most progress in the last 12 months. Different components have progressed differently in this period. In public administration, the Ministerial Restructuring Act (MRA) and the Public Administration Act (PAA) enacted in October 2002 will fashion ministerial reorganization and public administration. In public financial management, new results-based budgeting procedures were introduced in the preparation of the FY2003 budget and the Procurement Management Office was established charged with developing a new procurement system including e-procurement. In decentralization, the Decentralization Action Plan was passed by the Parliament in February 2002, but further re-examination of decentralization has slowed implementation.

Over the medium term, Thailand will have to improve its competitiveness significantly. This means that the Government will have to enhance competition by deregulating the business-environment further, by opening up more to foreign trade and by supporting the move towards the knowledge economy. The first two sets of measures can be initiated quite quickly, while the third would require further progress in Government's recent initiatives in education reform and regional development. The latter, would help over the medium term, to facilitate Thailand's expansion into middle and high-tech industries as well as development of better quality business services. For this purpose, the Government needs to encourage innovation systems in firms, to develop human resources through improved secondary and tertiary education as well as skill development and research and development in firms and to promote development of information and communication technology (ICT).

Section 2: Recovery and Outlook

2.1 Real GDP Growth

Thailand's recovery strengthened in 2002, and poverty fell to its pre-crisis levels. Real GDP recorded a relatively high growth of 5.2 percent last year, and for the first time, exceeded the 1996 levels. GDP per capita reached the level of 1996, and poverty fell to 10.4 percent in 2002[3].

Growth was driven mainly by private consumption, though exports and private investment grew more rapidly than was expected. Supported by a rise in consumer credit and in farm incomes, private consumption grew by 4.7 percent, contributing half the real GDP growth in 2002. In addition, various stimulus programs of the government helped to boost consumer confidence significantly. Export grew by 5.4 percent in value and by 14 percent in volume while private investment grew by 13.3 percent, driven mainly by residential construction, purchase of commercial vehicles and office equipment.

Macroeconomic adjustment continues to be strong. With the increase in its current account surplus, Thailand's reserves have been on the rise and outstanding external debt on the decline. In 2002, reserves to short-term external debt exceeds 300 percent, the highest level since the crisis. External debt fell from 59% of GDP in 2001 to 47% of GDP in 2002, which is nearly half the share in 1998. Public debt[4] has been stable at around Bt2.9 trillion since 2001, bringing down its share in GDP from 56.6 percent in 2001 to 54.0 percent at the end of 2002, and more than half comprises of long-term debts.

Real GDP growth is projected to be around 4.5 percent in 2003. Performance over the first quarter suggests that the recovery will continue but at a slower pace. Exports will grow in line with projected

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[3] Poverty data is based on survey results as of the first half of 2002.

[4] Public debt is defined as a sum of direct Government debt, non-financial state-owned enterprise debt, and FIDF debt. These include domestic and external debts and government guaranteed and non-government guaranteed debts are included.

increases in trade volume but imports are likely to grow too, reducing contribution of external sector to growth.

Domestic demand will continue to be the main driver of growth. Private consumption is expected to maintain its growth momentum as banks extend consumer loans. Government's stimulus measures are strengthened. Private investment growth, on the other hand, is expected to slow down as investors wait and see how the second half of 2003 unfolds.

The key risk to this projection comes from impact of the SARS outbreak. With tourism contributing around 6 percent to Thailand's GDP, and tourist arrivals declining significantly in March and April, the range of its potential is large. Some of this is incorporated in the current projection.

2.2 Poverty

Poverty, for the first time, has returned to the pre-crisis levels. The financial crisis of 1997 increased poverty significantly but the recent recovery of the economy reversed this trend. The proportion of individuals living below the poverty line in the Kingdom dropped to about 10.4% in 2002, compared to 13.8% in 2000[5].

Rural poverty fell too, and the poorest Northeast made significant gains. Nine out of ten poor people reside in rural areas, and the northeast region is home to two thirds of the Thailand's poor. Between 1987-1996, Bangkok accounted for over 52% of the rise in GDP, while its share in the increase in population was 11%, while the Northeast accounted for only 11% of the increase in GDP but for 32% of the increase in population, reinforcing the regional inequality. Growth between 2000 and 2002 reduced the poverty headcount in the Northeast from 27.4% to 17.8%, narrowing the poverty gap between the region and Bangkok that has existed for a long time.

Declining overall poverty is explained by the 10 percent points fall in Northeast's poverty. A possible reason for the decline in poverty in the Northeast is the rise in farm incomes in 2002. Increased remittance of incomes by Northeasterners working in cities may also contribute to the fall in Northeast poverty. Workers from the Northeast would have benefited from the growth particularly in the service sectors such as construction and wholesale and retail trade, which is reflected in increased employment and wages in those sectors in 2002. The rural poor may have also benefited from the various Government stimulus measures targeted at lower income groups in the rural areas such as Village Fund program, though the exact impacts of such programs on the poor are still quite difficult to quantify.

Inequality is declining, but from a high level. In the aftermath of the financial crisis, income inequality as measured by the Gini coefficient rose from 0.511 in 1996 to 0.533 in 1999. Subsequent economic growth benefited the bottom tail of the income distribution, triggering a decline in the Gini coefficient (in the first half of 2002) to 0.511, the pre-crisis level. Similarly, the ratio of income received by the richest fifth of the population to that earned by the poorest fifth dropped from 15.4 in 1999 to 13.7 in the first half of 2002. In spite of this recent improvement, inequality stays high. A regional comparison suggests that only Papua New Guinea, the Philippines and Malaysia show higher inequality in East Asia.

[5] The figures are as of the first half of each year. The poverty survey is conducted once every 2 years. However for 2002, only data for the first half of the year is currently available.

2.3 Uncertain External Environment

The global recovery lost momentum in the fourth quarter of 2002, when growth rates in the US, Europe and Japan all slowed significantly. A variety of monthly indicators suggested some continued softness in the early months of 2003. In the *United States,* strength in consumer spending and residential construction, supported by low interest rates, had helped ease the 2001 recession and spur the 2002 recovery. However, consumer spending growth decelerated and consumer confidence fell sharply in the fourth quarter of 2002 and early 2003. In *Europe,* the EU's economic sentiment index remained at a low level in February, with continued declines in consumer and industrial confidence. In Japan, worsening wage and employment conditions contributed to weak household spending in early 2003 and a sharp fall in the index of leading indicators in January raised the possibility that the economy could slip back into recession.

Global recovery is expected to gain strength later in 2003. OECD economic growth is expected to reach 1.8 percent this year, the second year of recovery since 2001 – only mildly higher than the 1.5 percent pace achieved last year and well below the OECD trend growth rate over the last two decades. The growth outlook for the year is expected to be restrained by the impact of the Iraq crisis on oil prices and the SARS crisis, as well as by significant financial and economic imbalances and vulnerabilities that were built up during the late 1990s, and which have not yet been resolved.

The *Iraq crisis* weakened world activity through concerns about its potential impact. Business and consumer confidence was hurt by the threat of surging oil prices; heightened domestic political tensions in the Middle East, and parts of East Asia, the possibility of renewed terrorist attacks; a pullback in world tourism; a feared disruption of migrant worker employment in the Middle East and worsened political tensions among the major developed countries. Though the swift execution of the military operation in Iraq has minimized the extent of their impact, it nevertheless slowed world growth in the first half of 2003.

The *Severe Acute Respiratory Syndrome (SARS)* is also impacting growth adversely. SARS has sparked extraordinary public concern throughout East Asia, and more widely in the world. Assessing the economic impact of the disease is unusually difficult for a couple of reasons. First, public health experts still do not fully understand the SARS virus, how to test for or treat it. Second, in the short run the economic consequences arise almost entirely from public perceptions and fears about the disease, and from precautions the public is taking against it, rather than from the disease itself. The worst affected industries in the short run are therefore service industries based on face to face interaction between service providers and customers, for example tourism, transportation and retail sales, which face a sharp fall in demand for a limited time from a risk-averse public. A purely illustrative scenario suggests that the impact effect of SARS could reduce East Asian growth by 0.3 percentage points.

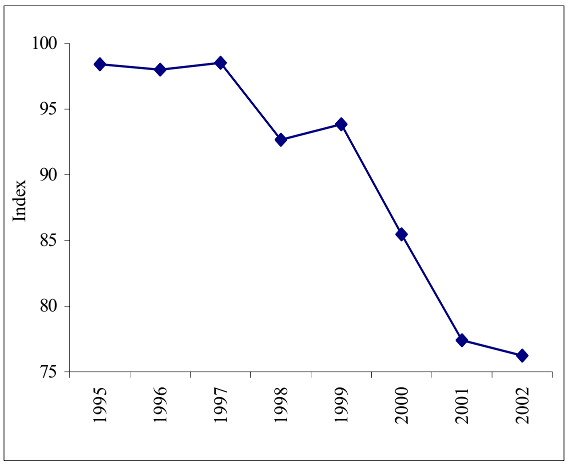
East Asian[6] GDP growth is expected to slow to 5 percent in 2003, having risen sharply to 5.8 percent in 2002. A sharp rebound in exports was one important driver in the 2002 recovery led by strong intra-regional exports, in particular exports to China which is emerging as a major hub for production and trade networks. The slowdown this year is because of the large external uncertainties and temporary shocks like the SARS outbreak affecting the world and regional economies this year. But as these temporary shocks pass out of the system, and as the world recovery further gathers pace, East Asian growth is expected to return closer to the 6 percent range in 2004.

[6] East Asia comprises Developing Asia (China, Indonesia, Malaysia, Philippines, Thailand and a number of small economies) and four NIES (Hong Kong , Korea, Singapore and Taiwan, China).

2.4 Export Performance & Outlook

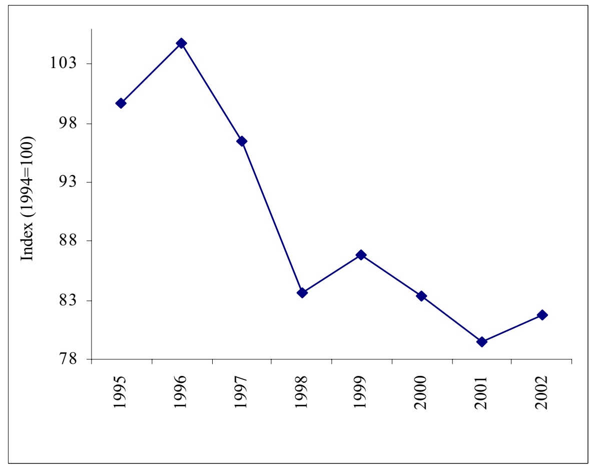
Exports grew strongly, led by manufactured exports. The large real depreciation during the crisis, especially with continued decline of Thailand's terms of trade, still provided a significant advantage to exporters in 2002 (see Figure 1 and Figure 2). This advantage is eroding and improvements in productivity will be needed going forward to raise and sustain higher export growth in the medium-term.

Figure 1. Thailand's Terms of Trade



Source: BOT

Figure 2. Thailand's Real Effective Exchange Rate



Source: BOT

Nearly a dozen manufactured export items grew at double-digit rates. Many of them sustained annual average double-digit rates over the 1999-2002 period. These include semi-conductors, radio and television receivers and parts, video recording, automobiles and parts, iron and steel products, plastic products, rubber products and chemical products (see Table 1). On the other hand, there were also items that were on the decline; exports of garments, fabrics, footwear, frozen fish and shrimps, computer and parts, and rice, comprising nearly 15 percent of total exports, fell further from their depressed levels in 2001.

This growth was driven mainly by exports to region. China, ASEAN and other Asian countries contributed more than three-quarters of the export expansion. Where Thailand did less well was in its traditional markets of Europe, Japan and the United States; the three together accounted for more than half of all exports but contributed less than 1 percent to 2002 export growth (see Figure 3).

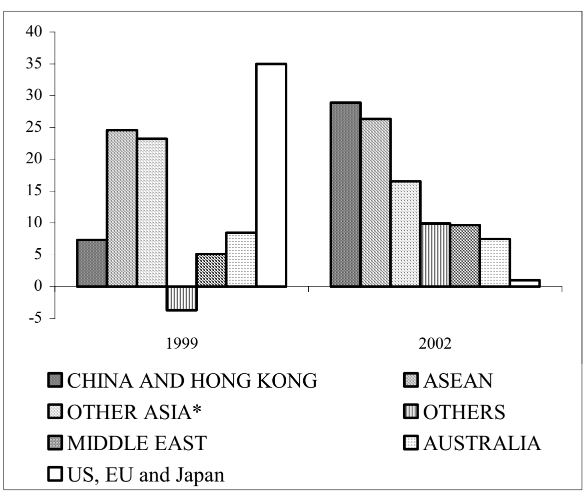
Table 1. Twelve Fastest Growing Manufactured Exports

No.	Items	Growth 2002 (%)	Annual average growth 1999-2002 (%)
1	Semi-conductor devices, transistors and diodes	64	30
2	Rubber	31	17
3	Radio-broadcast receivers, television receiver and parts thereof	24	19
4	Precious stones and jewelry	18	8
5	Video recording, and parts thereof	34	16
6	Motor cars, parts and accessories	10	18
7	Iron and steel and their products	17	11
8	Polymers of ethylene, propylene, etc in primary forms	11	16
9	Chemical products	18	10
10	Rubber products	16	15
11	Plastic products	18	11
12	Electric motors and generators	20	6

Source: MOC

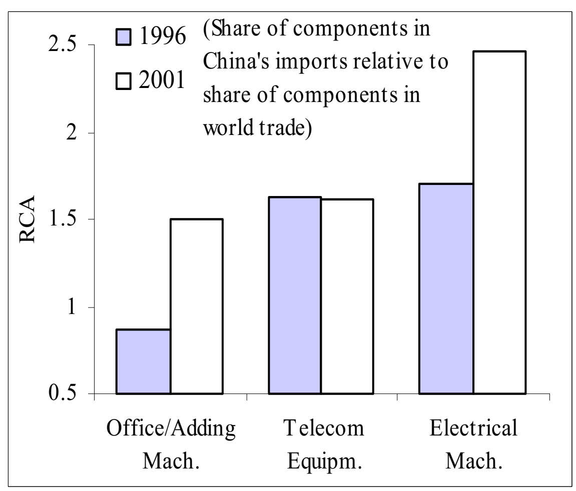
China's entry into the WTO represented an important opportunity for Thailand's exports. More than 60 percent of China's imports are sourced from countries in East Asia. The share of hi-tech items in China's own imports from all sources, especially components for telecom equipment and electrical machinery, has been rising rapidly in recent years. In 2002, Thailand's exports to China grew by 23 percent and its composition reflected the shift in China imports towards manufactures and within that, to more technology-intensive manufactures.

Figure 3. Contribution to Thailand's Export Growth



Source: MOC
*Other ASIA includes all countries except ASEAN(10), Japan, China and Hong Kong

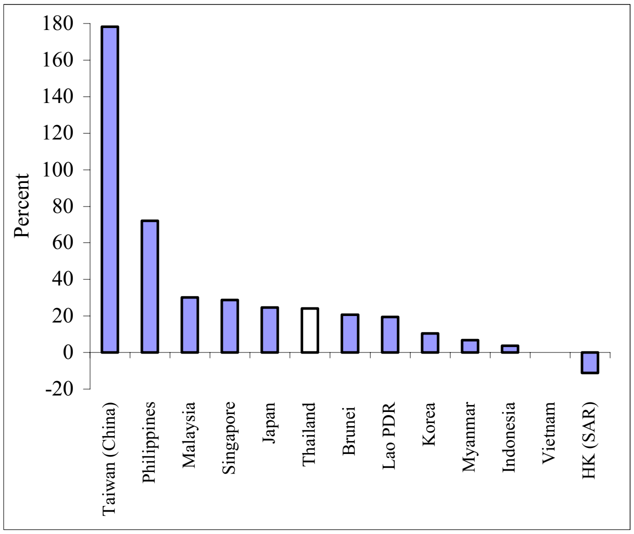
Figure 4. China's High-tech Component Imports for Assembly



Source: UNCTAD

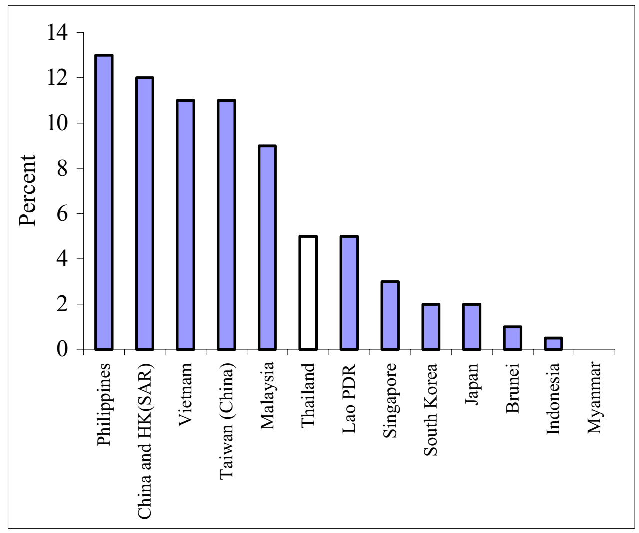
Chinese competition was also evident. Chinese exports to the markets of Europe, Japan and the United States in 2002 grew much more rapidly than Thailand's to the European Union (18 percent growth for China versus -3 percent for Thailand), to the United States (29 versus 2 percent) and Japan (8 versus 0.5 percent)[7]. This is in part because Thailand's labor-intensive exports were vulnerable to competition from China.

Figure 5. Export Growth of East Asian Countries to Chinese Market in 2002



Source: DOT

Figure 6. Export Growth of East Asian Countries in 2002



Source: DOT

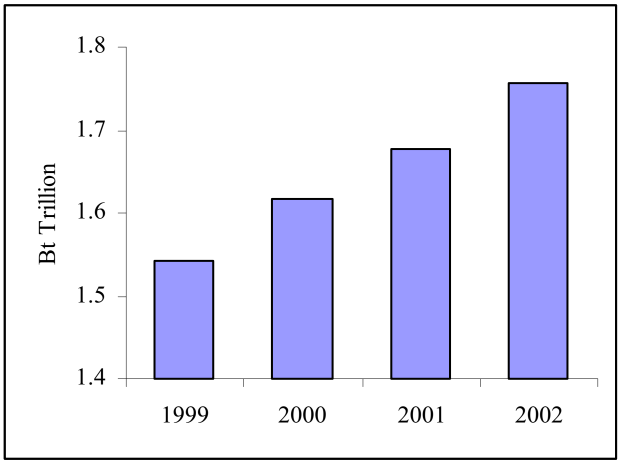
Export growth will remain strong in 2003, but more efforts will be needed for the medium-term. With slightly better global conditions and continued efforts to tap the Chinese and other non-traditional markets, export earning are projected to be around 7-8 percent. The free trade arrangement with China -- including zero duty exports of fruits and vegetables to China -- will be a useful stimulus for Thai exports to China. Over the medium-term, Thailand will have to do much better. Even in 2002, while Thailand did much better than several countries in the region, there were several others that outperformed Thailand in terms of total export growth as well as growth into the Chinese market (see Figure 5 and Figure 6).

2.5 Household Consumption

Consumer spending by households continued to grow robustly, bolstering Thailand's recovery. The Government succeeded in raising consumer confidence which reached an all time high, with the index standing at 92 in 2002 relative to 73 in 2001 (see Figure 8). Real private consumption, which has been growing since 1999, grew by 4.7 percent in 2002, maintaining its share in GDP at about 55 percent (see Figure 7). Private consumption growth was especially high in automobiles, communication equipment and televisions. This was supported in part by low interest rates and increased consumer lending, by higher farm income and by Government's measures to stimulate private consumption. Real private consumption growth is expected to remain an important driver of growth over the next year or two.

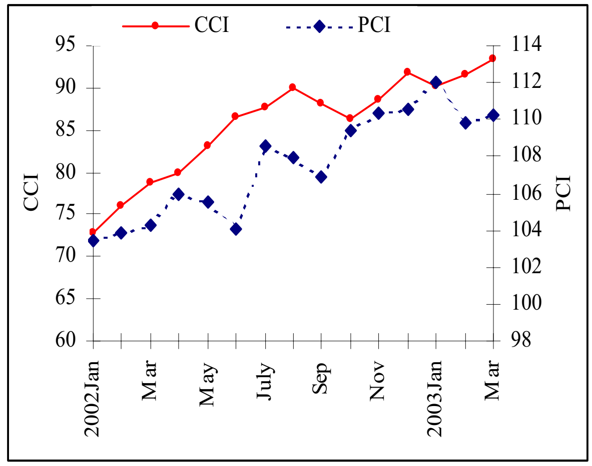
[7] In 2002, Chinese exports to ASEAN grew at twice the growth rate of Thai exports to that market. Integrated circuits, data-processing machines and semi-conductor devices grow at 33, 94 and 123 percent respectively, albeit from a low base.

Figure 7. Real Private Consumption



Source: NESDB

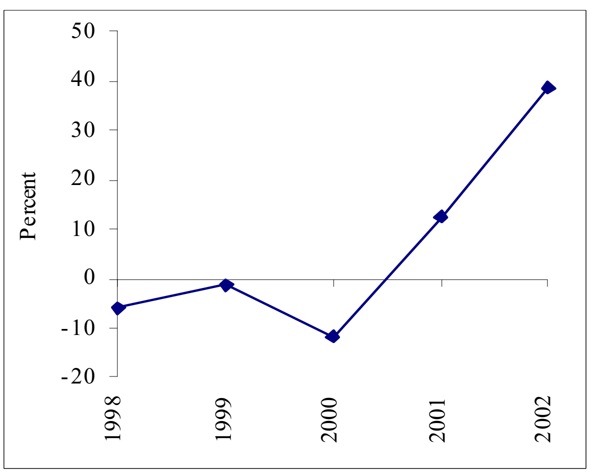
Figure 8. Consumer Confidence Index (CCI) and Private Consumption Index (PCI)



Source: BOT, UTCC

Private consumption growth was financed by consumer credits. High growth in consumer credits encouraged by low real interest rates helped boost private consumption in 2002. Consumer credits[8] expanded by 40 percent year-on-year, the highest rate since the crisis (see Figure 9) with private commercial banks accounting for a quarter of the growth. With continued slow growth of bank credit to the corporate sector, consumer credit competition will remain strong in 2003.

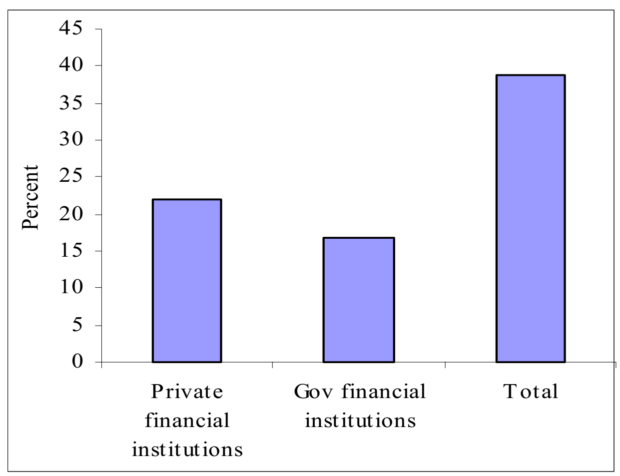
Figure 9. Consumer Credit Growth



Source: BOT

Note: Consumer credit does not include housing loans.

Figure 10. Contribution to Consumer Credit Growth by Financial Institutions, 2002



Source: BOT

Note: Private financial institutions include commercial banks and financial and securities companies. Government financial institutions include the Government Savings Bank and state-owned banks.

[8] Consumer credits do not include housing loans as housing is categorized as private investment and *not* private consumption in national income accounting.

In addition, household debt as a share of disposable income in Thailand remains relatively low, when compared to countries in the region such as Malaysia and South Korea. Though lower than those of Malaysia and South Korea, Thailand's household debt of a third of disposable income is not insignificant, given Thailand's per capita income level is only one-half that of Malaysia and one-fifth that of South Korea (see Table 2).

A recent household socio-economic survey shows that household debt is rising and households with high average incomes per annum have higher average debt to income ratios (see Figure 11). This means that higher income households are significantly more indebted and will be less likely to add to that debt. Thus, although there is scope for the growth of consumer loans in Thailand in 2003, going forward, the limits are eminent.

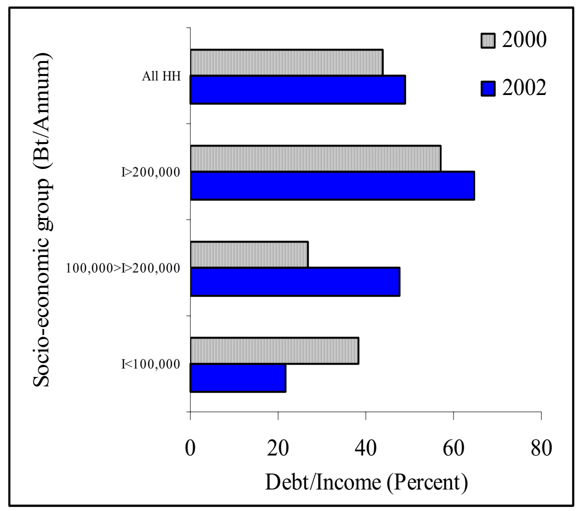
Table 2. Household Debt Comparisons – Thailand, Malaysia, and Korea*

	Thailand		Malaysia	S. Korea
	2001	2002	2002	2002
Total (US$ bn)	21	26	46	329
Mortgage	15	18	26	149
Consumer loans	6	8	20	180
As a % of GDP				
Total	18	20	50	69
Mortgage	13	14	28	31
Consumer loans	5	6	22	38
As a % Disposable Income				
Total	29	33	77	109
Mortgage	21	22	43	49
Consumer loans	8	10	34	60

Source: BOTand NESDB for Thailand, Goldman Sachs for Malaysia and S.Korea

Note: Data as of June 2002 for S. Korea, September 2002 for Malaysia, and December 2002 for Thailand

Figure 11. Household Debt by Socio-Economic Group*



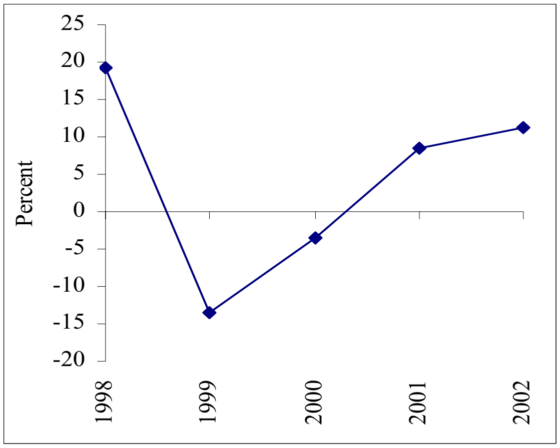
Source: NSO

Rise in farm incomes in 2002 also supported private consumption growth.

In 2002, farm incomes rose by 11 percent year-on-year, in line with the large rise in crop prices. With prices of manufacturing products rising more slowly, there was a rise in *real* farm incomes.

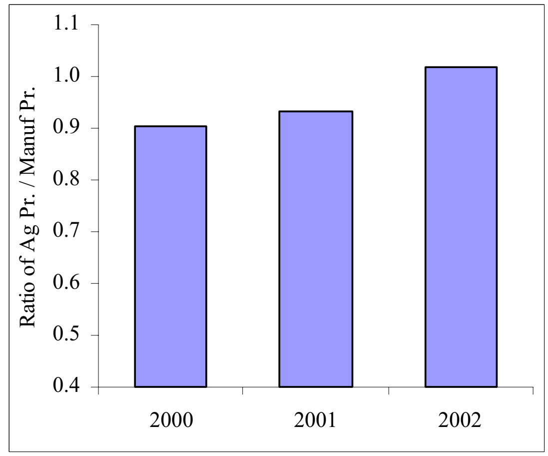
Farm incomes continue to rise in the first quarter of 2003. With agricultural producer prices expected to rise faster than that of manufacturing producer prices, albeit less than in 2002, this source of private consumption growth will continue.

Figure 12. Growth in Nominal Farm Incomes



Source: BOT

Figure 13. Relative Price of Agricultural Products to Manufactures



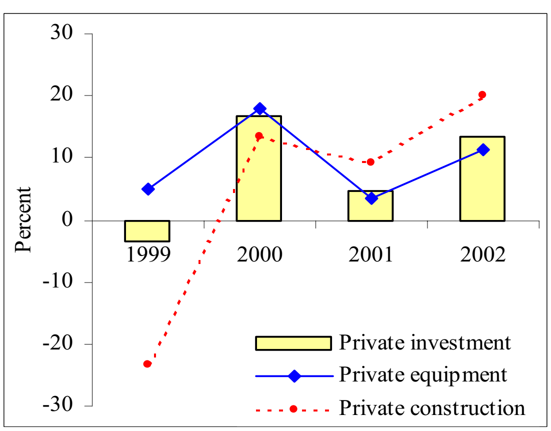
Source: BOT

The Government implemented various measures to boost consumer confidence and private consumption. The Village Fund, the Thirty-Baht Health Care Scheme, the Farmers Debt Moratorium, and the People's Bank program continue into 2003. In addition, new measures like an income tax cut for low-income earners and the award to retired civil servants of a significant portion of their death allowance have been introduced this year.

2.6 Private Investment

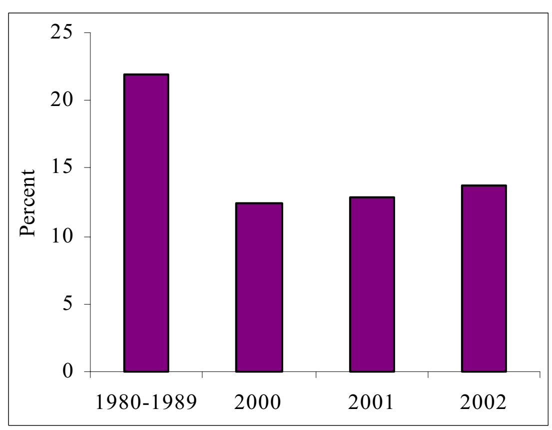
Private investment grew by more than 13 percent in 2002 though from a relatively low base. This raised the share of private investment in GDP to around 14 percent in 2002, considerably lower than not only the pre-crisis levels, but also the average of 22 percent during 1980-89 period. The expansion in private investment last year was driven by private construction, which grew by 20 percent. Investment in equipment also grew by 11 percent.

Figure 14. Growth Rate of Investment



Source: NESDB

Figure 15. Private Investment as a Share of GDP

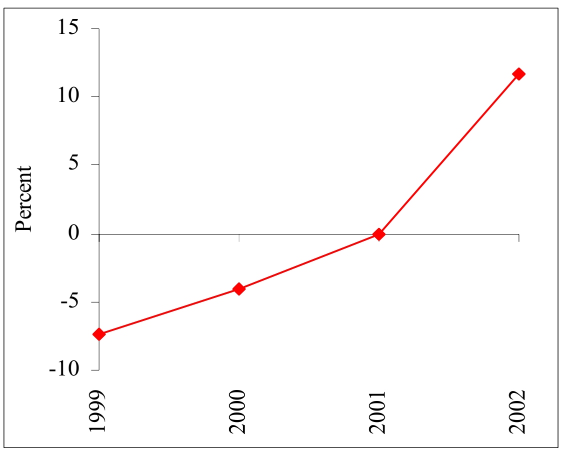


Source: NESDB

Tax incentives, low interest rates and expansion of housing loans prompted a jump in growth of residential construction last year which may slow down in 2003. Vacancy rates of both office and retail space, though falling from its peak in 1998, were still relatively high at the end of 2002. Growth in private construction is expected to slow in 2003, as most potential residential owners took advantage of the low interest rates and housing incentives last year. The Government's low-income housing initiative will help, but there will be little growth in commercial space construction in 2003.

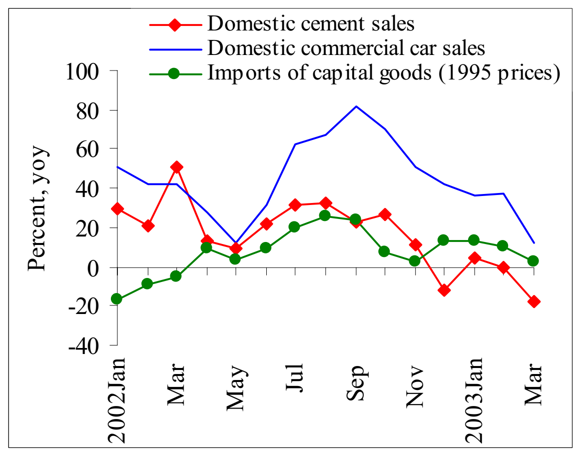
Growth in private investment is likely to be dampened this year. Though rising capacity utilization, investors are delaying their investment decisions to the second half of 2003 due to uncertain external conditions including the SARS outbreak. There are signs of a slow down in the first quarter of 2003, with private investment index growing in March by 3 percent, year-on-year, relative to 17 percent in February. Some of the indicators included in the index such as sales of cement, commercial cars and imports of capital goods have recorded slower growth in both February and March of 2003 (see Figure 17).

Figure 16. Growth Rate of Housing Loans



Source: BOT

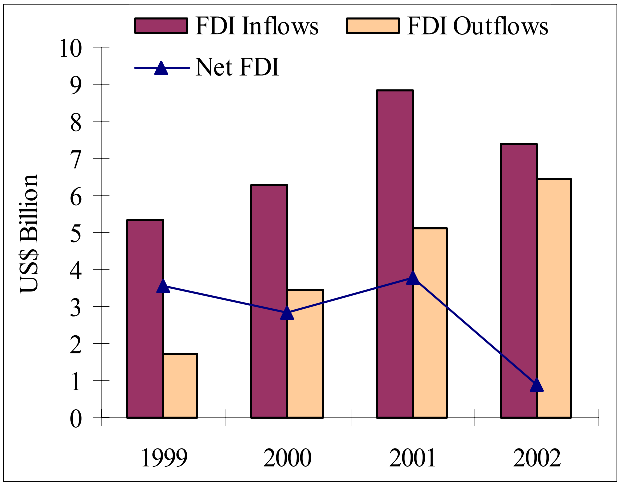
Figure 17. Private Investment Indicators Growth



Source: BOT

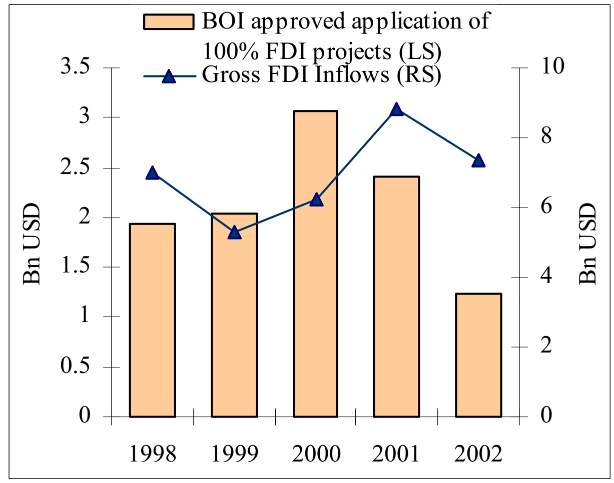
Gross FDI inflows declined in 2002, while outflows rose. Gross FDI inflows in 2002 fell by US$1.5 billion while outflows increased by US$1.4 billion relative to 2001. This resulted in an even greater fall in *net* foreign direct investment (FDI) inflows from US$3.8 billion to only US$ 0.9 billion with machinery and transport, mining and quarrying, and trade sectors, experiencing the largest fall. Nevertheless, the level of gross FDI inflows in 2002 of US$7.4 billion exceeded those of 1999 and 2000. However, a leading indicator of gross FDI inflows into Thailand, the BOI approvals of projects with 100% foreign share equity, has been falling in 2001 and 2002, suggesting a decline in gross FDI inflows in 2003 (see Figure 19).

Figure 18. FDI Inflows and Outflows



Source: BOT

Figure 19. BOI Application Approval and Gross FDI Inflows



Source: BOT and BOI

Thailand's FDI attraction would depend on many factors – competitiveness being an important one. The fall in both net equity inflows and direct loans can be attributed to the interplay of many factors. The decrease in the net inflows of equity investment is partly due to the restructuring of some MNCs in Thailand, which had shifted their funding from equity investment to offshore borrowing and using those foreign currency loans to buy their shares back from their parent companies. Another factor is the remittance of profits and investment of foreign companies who invested in FRA assets. Net direct loan inflows decreased partly as a result of the decline in the MNCs demand to borrow from parent companies for debt restructuring in 2002, while a number of MNCs have switched to domestic borrowing and used those loans and reinvested earnings to repay their direct loans.

Although the magnitude of the impact of the different factors on the fall in FDI is difficult to quantify without an in-depth study, the combination of them may well extend into 2003. Moreover, there has been an observed change in the MNCs' financial management strategies to reduce financing costs of investment by switching from equity investment in their subsidiaries to loans. In an environment of ample liquidity and low interest rates, more MNC subsidiaries in Thailand may choose to fund their investment from domestic borrowing in addition to their reinvested earnings.

However, another important factor that would determine Thailand's ability to attract similar levels of FDI inflows going forward is its competitiveness of its industries viz a viz new and existing competitors in the region. Since 1999, net FDI inflows to China have been increasing rapidly. Though net FDI inflows to Southeast Asia has been declining, net inflows to Malaysia, the Philippines, and Singapore in 2002 averaged at US$2 billion *each,* while that of Thailand was only US$0.9 billion. As a result, Thailand's share of net FDI inflows to SE Asia (4)[9] has declined from approximately 30% in 2001 to only 15% in 2002. As FDI to SE Asia declines, Thailand will face difficulties in attracting the scarce resource unless its competitiveness compared to its competitors in the region increases.

[9] Malaysia, Philippines, Singapore, and Thailand

Box 1. New Investment Promotion Strategies and Policies

Over the past year, led by the Board of Investment (BOI), new investment strategies and policies were formulated. They are aimed at attracting foreign direct investment and strengthening domestic investment especially those by SMEs including grassroot entrepreneurs, which are in line with the Government's *Dual Track Approach*. The new investment promotion policies focus on 3 dimensions: (1) attracting investments based on quality rather than quantity, which are those that will promote knowledge building, skills development, technology transfer, and innovation, (2) promoting cluster development, and (3) providing customized incentive packages which balance investor needs with economic contribution of the investments.

Implementation has begun. Zoning regulations have been relaxed such that clustering will be possible. Establishment of international networks has begun. The most notable one is the network between the BOI and the 5 banks in Japan and the Credit Agricole Indosuez in France. In addition, the BOI Unit for Industrial Linkage Development (BUILD) has been established to facilitate linkages between the SMEs and multinational firms in Thailand as a means of promoting the use of locally manufactured parts and machinery.

Investment promotion will focus on 3 regions and 5 target industries. The BOI has identified target regions and industries to proactively promote higher investments. The regions include Asia (Japan, China, Korea, and Taiwan), North America (USA and Canada), and the EU. Target industries are the agricultural industry which includes food processing and rubber products, automobile assembly and components and arts, fashion which includes garments, jewelry and leather goods, ICT and electronics, and high value-added services such as long-stay, printing, and IT software services. These are in line with the niche products identified in *Visioning Thailand*.

The BOI has assumed revised roles.
In 2002, the BOI has restructured and taken measures to revise its role from primarily providing tax incentives to focusing on delivering services which would facilitate higher investments. This includes the improvement of services through the use of ICT and proactively initiating closer collaboration with other relevant government agencies to improve the investment climate and facilitate investment in Thailand.

2.7 Improving Competitiveness

Improving competitiveness and productivity remains a key challenge. The good news is that Thailand's competitiveness, as ranked by various assessments (i.e. WEF and IMD) has improved in 2002. The not-so-good news is that Thailand still ranks lower than many of its competitors in the region and outside the region (see Table 3). Given the rising global competition, this has to be taken seriously over the short and medium-term.

Table 3. Competitiveness Rankings

Country	World Economic Forum 2002				International institute for Management Development 2003	
	Growth competitiveness index rankings		Microeconomic competitiveness index rankings		World competitiveness*	
	2002	2001	2002	2001	2003	2002
Thailand	**31**	**33**	**35**	**38**	**10**	**13**
Singapore	4	4	9	9	-	-
Hong Kong	17	13	19	18	-	-
Chile	20	27	31	29	-	-
Korea	21	23	23	26	15	10
Malaysia	27	30	26	37	4	6
Slovenia	28	31	27	32	-	-
Hungary	29	28	28	27	-	-
China	33	39	38	43	12	12
India	48	57	37	36	20	17
Philippines	61	48	61	53	22	18
Indonesia	67	64	64	55	28	25

Source: WEF(2002) and IMD (2002)

Note: *IMD's rankings based on 30 economies with population greater than 20 million

The Government has given attention to boosting Thailand's competitiveness. The Thai Government has given considerable attention to boost Thailand's competitiveness over the medium term. A National Competitiveness Committee (NCC) has been established last year and a budget of Bt17.6 billion has been allocated to develop strategies and implement measures to improve Thailand's competitiveness. Thailand has also been undertaking many reforms in the financial and corporate sectors to strengthening the operations and governance of banks and firms. Implementation of two key of public sector reform acts has begun in the end of FY2002. New investment strategies have been formulated to make Thailand more competitive in terms of attracting investments.

In "Visioning Thailand"[10], the Government has laid out Thailand's position in the medium term with several niche products and services identified for Thailand as the regional leader in providing them[11]. The

[10] Seven principles of Thailand's vision (also known as the *Seven Dreams*) were developed by the NESDB and presented at the "Visioning Thailand" workshop on January 2003. They were endorsed by participants comprising of representatives from political parties, academia, and the public and private sectors.

[11] The products are selected based on (i) their exports and import-substitution potential, (ii) their value-added as reflected in their contribution to GDP, and (iii) the readiness and willingness of the private sector to take the lead in the efforts.

niche products and services are processed food, furniture, rubber products, especially tires, vehicles and parts, fashion, health and education services, tourism, and software design (See Box **2** for discussion of Thailand's efforts in boosting competitiveness).

Box 2. Steps Taken to a Comprehensive Competitiveness Strategy

Boosting Thailand's competitiveness is a high priority on the Government's national agenda. Work on competitiveness began early 2002 with the involvements of various sectors – private, public, political and academic. The following is a chronology of steps taken to develop the competitiveness strategy to date:

- **April 2002.** The Government endorsed the Thailand Competitiveness Development Framework and allocated Bt 1 billion from the FY2002 budget to build knowledge through the following work plans: 1) strategic, operational and evaluation plans, 2) productivity improvement plan, 3) real sector strengthening plan, 4) SME network development plan and 5) general management plan
- **May 2002.** The National Competitiveness Committee (NCC) was set up to ensure the development and implementation of the competitiveness strategies and framework. The NCC is headed by the Prime Minister and included representatives from the public and private sectors; NESDB is its secretariat.
- **June 2002.** Bt 16.6 billion was allocated from the FY 2003 budget to formulate and implement the competitiveness strategies aimed at making Thailand a high performance economy.
- **October 2002.** The NCC hired the SASIN Business School to team up with the NCC Secretariat to study Thailand's competitiveness contributing factors as well as established a strategic advisory group comprising of 5 experts to advise the NCC Secretariat and the NESDB on their work on competitiveness issues
- **November 2002.** The Workplan Screening/Economic and Social Restructuring Project Committee was appointed to set the criteria for the Bt 17.6 billion budget allocation and to prioritize work plans and projects before submitting to Cabinet for approvals. The Committee is also assigned to follow-up and evaluate the approved work plans and projects
- **January 2003.** A *Visioning Thailand* workshop was held to brainstorm the future direction of Thailand, which endorsed the *Thailand's Seven Dreams* proposed by the NESDB. The dreams envisioned Thailand are 1) a country with a strong economic platform, 2) an active international player, 3) a world leader in several niche markets, 4) an innovative nation with wisdom and a strong learning base, 5) an entrepreneurial society, 6) a society with cultural pride and a global sense and 7) a country of decent environment for living.
- **March 2003.** Three committees were appointed to be responsible for identifying the goals and strategy issues and defining the implementation setup and mode of operation before overseeing the implementation of the dreams. Each committee is responsible for a group of dreams: Group 1 – dreams (1), (3), and (5), Group 2 – dreams (2) and (4), and Group 3 – dreams (6) and (7).

To date, approximately Bt1.4 billion from the budget have been allocated to develop strategies and implement measures to improve competitiveness.

More remains to be done. More needs to be done in terms of the sustaining the momentum of the reform and ensuring successful implementation of the reform measures. For example, the pace of the financial and corporate restructuring needs to be enhanced in order to improve the capacity of firms to borrow and for banks to lend, which is important for the growth of the manufacturing sector. Investment strategies which have been formulated, needs to be transformed into policy measures, aimed at promoting investment and production for not only the larger firms, but also the SMEs and grassroot entrepreneurs. In addition, measures to move to a more knowledge based economy by improving education service delivery, promoting innovation systems and R&D in firms, and investing in ICT and liberalizing telecommunications are essential if Thailand is to move up the value-chain in respect to exports and providing quality services as laid out in "Visioning Thailand".

Section 3: Implementation of Structural Reforms

Structural reform has slowed as a fuller strategy to improve competitiveness is being developed. The Government established last year a National Committee on Competitiveness (NCC) headed by the Prime Minister to revisit this issue in order to formulate a comprehensive strategy and to initiate some new measures while doing it. The NCC is supporting several initiatives, including the benchmarking of Thailand's sectoral competitiveness and the prioritization of policy measures to promote productivity growth, including in several niche markets (see Box 2). Efforts to target new export markets, including China, are paying off, while the creation of a separate ICT ministry, the placing of education reform on the agenda and the re-focusing on poverty and regional balance, have been steps in the right direction. But there has not been much movement in implementing privatization and in the deregulation of the business-environment, also relevant to competitiveness.

In public sector governance as well as financial and corporate restructuring, progress was uneven. While reforms in public administration and in budgetary management have gone well over the last 12 months, those related to decentralization have done less well. Similarly, financial and corporate sector restructuring has slowed, but corporate governance improvements have continued. Corporate restructuring, as manifested in falling debt-equity ratios and rising interest coverage, was facilitated by rising demand and good profitability, but the debt-equity ratio of 2.5 for the corporate sector is one of the highest in the region.

This Monitor examines in some detail the progress in implementation of financial and corporate restructuring and development, corporate governance, fiscal policy and public sector governance. This is in part because there is ongoing work carried out together with the Government agencies under relevant Country Development Partnerships (CDPs). In future, the Monitor will strive to monitor reform implementation in other key areas by initiating joint work with Government agencies in those areas. Below we look at the area of financial and corporate restructuring and development as well as fiscal policy and public sector governance.

3.1 Financial and Corporate Sector Restructuring and Development[12]

Financial Sector

Thailand made significant progress in banking sector restructuring, but recent progress in this has been limited. The banking system's financial position, although improving, remains fragile and the structure of the financial sector has changed little since the crisis. Banks continue to be the dominant financial intermediary and the capital market continues to be less developed. There is a clear need to reduce vulnerability of the banks by adequate recapitalization and to take measures to develop the non-bank financial sector.

The ratio of non-performing loans (NPLs)[13] to total loans of the Thai financial system declined slightly in 2002 (see Table 4)**.** Debt restructuring by financial institutions, outside the Thai Asset Management Corporation (TAMC), slowed to approximately 60 percent of the restructured amount in 2001. This may be in part because the remaining NPLs are more difficult cases requiring liquidation or foreclosure of collateral, which could be time consuming given the backlog in the courts. It may be also in

[12] Thailand and the World Bank are engaged in the "Country Development Partnership for Financial and Corporate Competitiveness", which is a demand driven program of technical support to the Ministry of Finance, regulators, financial institutions, industry associations and other partners.

[13] This does not cover the revised definition of NPLs, which will raise the ratio without having an economic impact.

part because the new NPLs and the re-entry NPLs (restructured NPLs that have become non-performing again) continue to enter the system, although they are trending down.

Table 4. Non-performing Loans (% of total loans)

	1997	1998	1999	2000				2001				2002			
	Dec.	Dec.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sep	Nov
Thailand (a)	--	45.0	41.5	39.9	34.8	31.6	29.7	29.3	28.9	29.3	29.6	29.7	29.9	29.6	29.4
Excl. AMCs and write-offs	--	45.0	39.9	38.3	32.9	24.9	19.5	19.2	13.9	14.1	11.5	11.4	11.3	11.7	11.6

Source: BOT and the World Bank's estimate

(a) First line includes commercial banks, finance companies, and estimated NPLs transferred to wholly owned private asset management companies (AMCs) and public AMCs.

(b) Note that there is no good information about debt restructuring within asset management companies, both publicly owned and subsidiaries of private banks. It would be helpful to policy makers and market participants if the BOT were to collect and distribute this information.

The banks overall financial situation has improved, but they remain under-capitalized on an economic basis. The large banks have done a better job of rebuilding capital internally than the medium-sized ones. Profits before provisioning expenses have increased, but net profits of the system have not. Net interest margins of the banking system have improved only marginally, and non-interest income has risen more, though the latter is unlikely to recur (see Table 5).

Table 5. Performance Indicators of Domestic Commercial Banks (Percent)

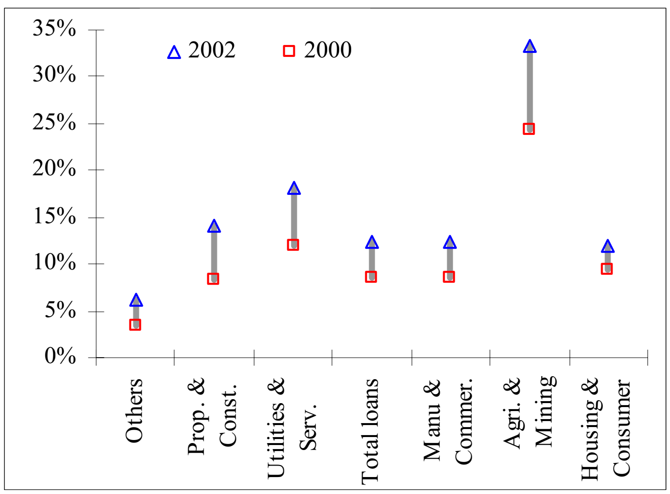
	1997	1998	1999	2000	2001	2002
Asset yield	11.5	9.6	5.1	4.7	4.6	4.2
Funding costs	8.7	10.0	5.1	3.7	2.9	2.4
Interest spread	2.7	-0.3	0.0	1.1	1.6	1.8
Net interest income to average assets	3.2	0.5	0.6	1.4	1.7	1.8
Non interest income to average assets	1.2	0.9	0.9	0.9	0.9	1.1
Operating expenses to average assets	2.3	2.7	2.6	2.3	2.2	2.0
Pre provision profit to average assets	2.1	-1.2	-1.1	0.0	0.4	1.0
Return on average assets	-1.4	-6.1	-6.1	-0.2	1.5	0.2
Return on average equities	-20.4	-110.8	-109.4	-4.8	32.8	4.2
Equity to total assets	5.7	5.3	5.3	5.8	4.3	5.0
Tier-1					8.9	8.9
Tier-1 (ex. hybrid capital)					6.4	6.6
Total capital					13.3	13.0
Minimum required tier-1 capital	6	4.25	4.25	4.25	4.25	4.25
Minimum required total capital	8.5	8.5	8.5	8.5	8.5	8.5

Source: BOT, CLSA, and the World Bank's estimate

Total bank lending has picked up slightly, but has not been broad-based. Total loans outstanding rose by less than 2 percent, once we factor in the write-back of provisioned NPLs that were written off as well as finance companies' loans that were reclassified as bank loans after their merger into the new Thanachart Bank. Most of the new bank loans were to households and to domestic-based sectors such as utilities and services.

State owned commercial banks gained market share following aggressive loan growth in 2002. The biggest increases in its loan market shares have been in domestic sectors (property, construction, utilities and service sectors) as shown in Figure 20. This is in line with the government's policy to drive growth from domestic economy and reduce Thailand's reliance on the external market. However, this exposes the banking system to two risks. First, with state-owned banks' balance sheets cleaned via transfers of NPLs to the state AMCs and re-capitalized through government funding, spreads of weak private banks would be under pressure; banks are going after the same limited set of sound corporate customers. Second, lending by state-owned banks, if not supported by strengthened risk-management processes in those banks, could create a new stock of NPLs and losses for the taxpayer.

Figure 20. Loan Market Share of the Largest State Bank



Source: Bank's report and the World Bank's estimate

Bankers also report that demand for corporate loans from credit worthy borrowers is low. The rising profitability of Thai firms has increased their ability to fund working capital internally. With average capacity utilization percentages still in the high 60s, need for new funding to finance investment in new capacity is relatively limited. Export oriented sectors, where capacity utilization is much higher, may soon need new funding to finance investment in new capacity. However industries operating near full capacity account for only a third of all 32 industries tracked in Thailand.

The newly enacted Credit Bureau & Information Act has not had the desired impact. Credit bureaus are critical parts of the credit infrastructure that is necessary to sustain credit to individuals and SMEs because it helps to provide information to all. Thailand has two bureaus: one of the bureaus, sponsored by the Thai Bankers Association focuses on credit information for firms and the other, sponsored by the Government Housing Bank, focuses on individuals. The Credit Information Business Act, enacted in late 2002 and effective from March 14, 2003, has many positive attributes. Under it, a Credit Protection

Committee has been established to supervise and monitor the bureaus and the participating financial institutions regarding the sharing of credit information. The law legally permits sharing of information among financial institutions through the licensed credit bureaus, which should increase incentive for debtors to be disciplined and enable financial institutions to better manage their risk by reducing costs of asymmetric information and transaction costs. But the Act over-compensates for the lack of legal framework for consumer protection in Thailand. The notification requirements create significant administrative burden and criminal penalties are mandated for unintended violations under the Act, not just willful violations and fraud, which is the international standard. As a result, both bureaus have ceased operation upon enactment of the Act in March 2003. It remains to be seen if and when the law will be amended, and how the bureaus will operate in the meantime.

Supervision of banks and finance companies is improving, but lags in the insurance industry. The regulator has a role to discipline financial institutions by monitoring their ability to control risk, by assessing their risk portfolio and their capital. The Bank of Thailand has improved its supervision capacity substantially, and in addition to assessing solvency (capital levels), is now broadened its focus to a bank's ability to control its own risk as required by the next generation of regulatory standards. The Department of Insurance is lagging behind in its methods and capacity to supervise the insurance companies. It still focuses on controlling product and prices, and has not yet made the transition to assessing the solvency of insurers or their ability to control their own risks.

The transition to a more market disciplined system with less regulatory forbearance has been delayed[14]. The market does not discipline the financially weak Thai banks because of the implicit government guarantee of all deposits and because there is regulatory forbearance in respect of recognizing loan losses[15]. Now that the banks are making money and in most cases have improved their risk management capacity, it may be time to reduce regulatory forbearance on recognition of loan losses by the weaker banks, and to make any forbearance transparent. The move from the current blanket guarantee of all deposits to more limited guarantee where the very large depositors will not be insured would have permitted sophisticated depositors to discipline banks through the threat of withdrawal. But the draft "Deposit Insurance Act" has been delayed.

The structure of the Thai financial system has changed very little since the crisis, despite a need to move away from its excessive dependence on banks as intermediaries (see Figure 21). As a result, Thailand continues to trap domestic savings and foreign flows, intermediate them through a few banks, and collateralize most domestic lending with property. Without safety valves, this could lead to another bubble in property prices[16]. Banks are competitively fueling price increases because they have excess liquidity, are trying to book loans in order to pay for their NPL overhang, see little effective demand in the productive sector, and see property as the only reasonable collateral, even though it still takes three to five years to

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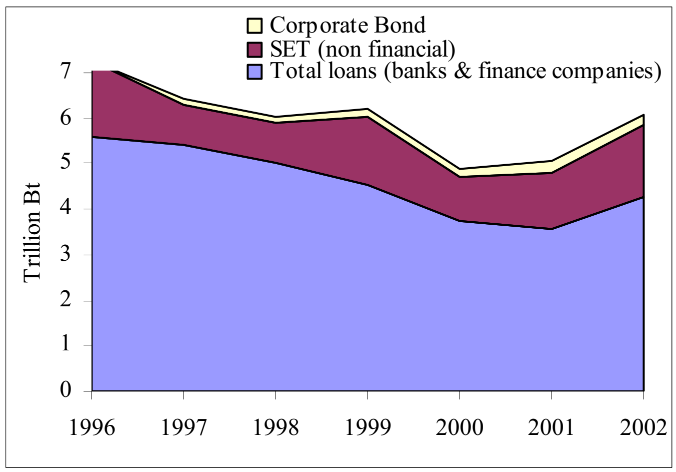
[14] There have been three basic types of implicit forbearance. First, financial institutions are allowed to provision for loan losses net of collateral value, which is mostly property. This allows some banks to understate provisions by overstating appraisals. Hopefully, most of this has been rung out of the system over the five years since the crisis. Second, the regulator does not require stringent quality control, such as repayment history, over the reclassification of restructured loans. So debt rescheduling results in write backs of provisions. Third, the regulator has accepted changes in Thai Accounting Standard 34 (TAS 34), which allows banks to use funding costs as discount rates for valuation of restructured debts, and retain the current practice of relying on collateral value.

[15] The regulation on valuation of restructured debts by financial institutions and the revised accounting standard for the same purpose, Thai Accounting Standard 34 (TAS 34), allow banks to report higher value of restructured debts compared to international standards.

[16] Anecdotal evidence suggests that the prices of quality property in Bangkok has begun to rise rapidly.

foreclose in a default situation. It can become dangerous when prices outstrip wages and the ability to cover debt service decline, especially given that most loans are now underwritten with significant risk of payment shock should interest rates rise. Allowing Thais to invest savings abroad would diversify their holdings, provide for a more secure retirement, and reduce the excess liquidity held by banks. As a result, the banks would become healthier. A new secured lending act would allow banks to diversify their collateral. And further development of the capital market, a priority of the government, will allow the better companies to tap other sources of funds, not tied to the banks nor property collateral. Deeper capital markets would also provide an alternative mechanism to allocate savings into viable investments, given high governance standards; would price assets on a risk adjusted basis, given high disclosure standards; and would provide more risk management products for the market.

Figure 21. Total Loans (Banks and Finance Companies) and Size of Capital Market



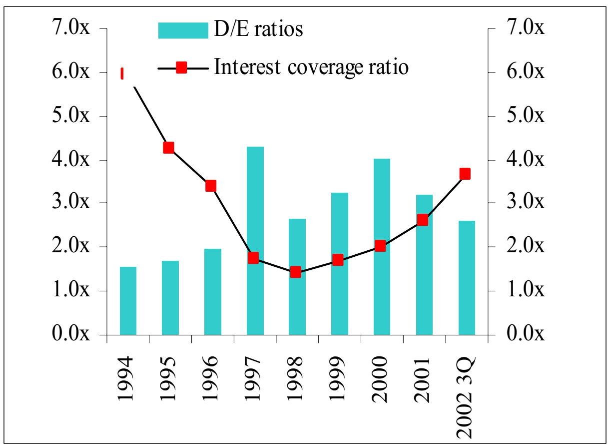
Source: SEC, BOT and the World Bank's estimate

There are initiatives to improve the capital market infrastructure, namely a unified clearing and settlement system for all securities and an organized trading platform for the bond market. In addition, the Futures Contract Act is expected to be enacted this year. This Act establishes the legal and supervisory framework for futures transactions, which will allow banks and firms to better hedge some of their risks. The authorities are also working to identify and remove impediments to securities borrowing and lending (SBL). SBL is an essential tool to minimize risks inherent in the clearing and settlement process. In addition, a well-developed SBL market will foster the development of derivatives market and assist participants in managing investment strategies. Another initiative, supported by dialogue among the APEC countries, is to remove impediments to domestic asset backed securitization in Thailand and other countries in the region. Securitization allows originators, such as banks which originate mortgage loans or leasing companies which originate leases, to attract new funding by selling to bondholders rights to the payments of principal and interest from the borrowers on the underlying assets. Regionally, there is discussion of a "regional bond fund", made up of contributions of dollar reserves by regional central banks.

Corporate Sector

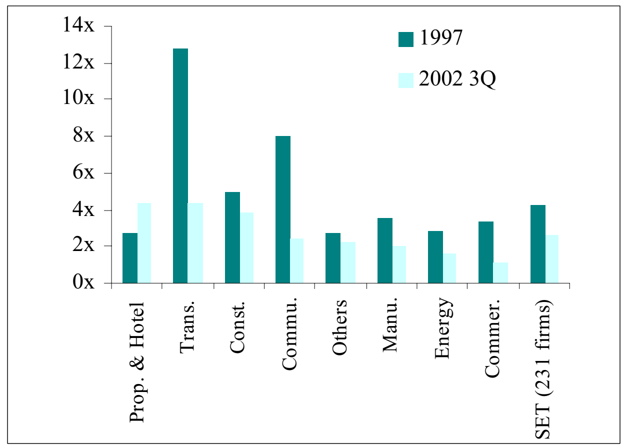
The corporate sector has improved its position but debt to equity and interest coverage ratios have been improving. Debt to equity ratios[17] of the 231 non-financial listed firms[18] increased from less than 2 times in 1996 to over 4 times during the crisis in 1997, dropped in 1998, rose again to over 4 times in 2000, and has declined to just under 3 times in Q3 2002 (see Figure 22). In 1998, the improved ratio was due to debt reduction, through repayments and restructuring of debt. The improvement in 2001-2002 was driven by improved profits, which flow into and increase equity. The property and hotel industry reported the highest debt to equity ratios while commerce industry reported the lowest. The ability of Thai listed firms to service debt as measured by interest coverage ratios (EBITDA to interest expense) has improved from the 1998 low and now exceeds the level in 1996.

Figure 22. Debt to Equity and Interest Coverage Ratios of 231 Non Financial Listed Firms



Source: the SET, MLP, and the World Bank's estimate
Note: Primary data not subject to quality control.

Figure 23. Debt to Equity Ratios of 231 Non Financial Listed Firms



Source: the SET, MLP, and the World Bank's estimate
Note: 1) Primary data not subject to quality control.
2) Charts from left to right are ranked by debt to equity ratios as of 2002 3Q.

The Thai Asset Management Corporation (TAMC) is making progress, but faces challenges with disclosure and operations. To date, approximately 5,524 loans (Bt 759 billion) have been transferred to TAMC at an average transfer price of 34% of book value, primarily from state-owned financial institutions and AMCs. A significant operational risk is capacity constraints in the documentation and closing of transactions which have been approved by the Executive Committee. As of end 2002, the TAMC Executive Committee made decisions to restructure 615 cases (Bt 202 billion), foreclosed 1,525 cases (Bt 248 billion), and is creditor in bankruptcy rehabilitation for 61 cases (Bt 48 billion). However, TAMC has closed just over half of the 615 accounts approved for restructuring as of end 2002. Another operational risk is the servicing and negotiation of 55,000 small NPL accounts (Bt 68 billion), which TAMC plans to take over

[17] Debt to equity ratio represents the relative amount of debt or leverage those firms employ to fund its operations. A higher ratio means more debt, which means that the firm has a greater risk of default because debt must be repaid currently, unlike equity which does not have a strict repayment schedule.
[18] These firms represented 76% of total non-financial listed firms, measured by 2002 3Q assets.

from state banks and AMCs. It appears that they will be managed by state banks on behalf of TAMC, which is where they came from in the first place. A third operational risk is the management and disposition of restructured loans, property and shares in firms acquired in the restructuring process. TAMC should return the assets back into the market as soon as possible through measured sales and joint ventures. In its public disclosure, TAMC reported an estimated 34% aggregate reduction in book value from both debt restructuring and bankruptcy rehabilitation, which is a relatively low loss rate that could increase over time on a net present value basis. TAMC reported cash collections of only Bt 5.6 billion as of December 2002, about 1% of total book value of cases for which restructuring decisions have been made. Additional disclosure of the assumptions behind the loss rate and restructuring methods and progress and re-entry NPLs would help the market to understand the difference between the high rate of decisions by the Executive Committee and low rate of cash collections.

CDRAC is almost wound down, but there is a significant backlog of unresolved NPLs in the courts. From 1999 thorough 2002, a cumulative total of US$25 billion (Bt 1.06 trillion) of NPLs have been restructured, a sizeable amount given the deep negative impact on the financial and corporate sectors by the crisis. Included in the restructured loans were many firms that have taken advantage of the voluntary out-of-court workout process led by the Corporate Debt Restructuring Advisory Committee (CDRAC) within the Bank of Thailand. By end of 2002, over 41 percent of the value of total CDRAC cases failed to settle and have been transferred to the civil courts for resolution. The court process, however, suffers from long delays and a large backlog of four to five years as a result of cumbersome civil procedures and evidentiary process, the limited number of experienced judges, and the limited administrative capacity of the judiciary. The legal and tax regimes also provide significant impediments to market-based restructuring through mergers and acquisitions. Specifically, tax losses from the entities to be merged cannot be carried forward into the combined entity. Continued reforms to strengthen the bankruptcy law and judicial capacity are clearly an important priority.

The legal regime still lacks an expeditious mechanism for debt collection and enforcement of security rights outside the bankruptcy law. Despite this backlog, the government has only started to expedite the procedures or the evidentiary process in the civil courts where mortgages are enforced. Past amendments of civil court procedures have the potential to reduce the required time in the trail processes from 18 to 9 months (from 36 to 18 months if the case is appealed). The rest of the Civil Court processes have not been expedited, particularly the evidentiary and enforcement processes, which are the most time consuming and do not have a limited timeframe. While the 1999 amendments to civil procedures shortened the completion time of all court processes down to 33 from 42 months (from 60 to 42 months if the case is appealed), it still can take longer than three years if the enforcement process is included.

There are two positive developments in the civil courts, however: continuous hearings and legal execution. Since October 2002, all the Courts are constitutionally required to implement continuous hearings, and all cases must be heard by a full set of two judges. Concerns remain about the inadequate number of judges and the case management process, but the customary two to three month period between hearings should be reduced. The Office of the Judiciary is aware of the shortfall, and has been preparing judicial development plan and implementation. In addition, banks report that the Legal Execution Department is making efforts to speed up the slow process of selling foreclosed assets. At current rates, it will take ten years to liquidate Bt 152 billion foreclosed assets on banks' balance sheets at end 2002. The Legal Execution Department must resolve its capacity constraint before a significant component of the remaining NPLs (Bt 503 billion) are foreclosed and flood the Department. Outsourcing the sale of foreclosed assets to the creditors or to others in the private sector is useful options.

The Mediation Center for Financial Disputes (MCFD) is now providing an alternative resolution mechanism for NPLs. The MCFD within the Office of the Judiciary was opened in August 2000 to help relieve the backlog in the courts by providing out-of-court mediation as an alternative to trial. Mediation has long existed in Thailand in the form of in-court mediation by presiding judges. The demand for out-of-court mediation, while relatively small, has increased from an average of 5 cases per month between August-December 2000 to 97 cases per month in 2002. The rate of success has also increased from 64% of total requested mediations in 2001 to over 74% in 2002.

Corporate Governance

Thailand continues to make progress in improving corporate governance. In 2002 the National Corporate Governance Committee was established, and the year 2002 was officially designated as the year of corporate governance. The committee is presided over by the Prime Minister, with participation from the private sector. Six sub-committees have been established to intensify efforts to improve various aspects of corporate governance practices. The effort has been focused on enhancing regulatory enforcement, instituting market discipline, and promoting self-regulation.

A revised draft of the SEC Act has been prepared and regulations to improve the corporate governance of financial institutions issued. A revised draft of the SEC Act requires enhanced fiduciary duties of directors, including sanctions for violation of those duties, and it strengthens the rules governing related party transactions. An administrative order has been issued by the Court to the Ministry of Finance in order to empower the SEC and the Prosecutor's office to vet the cases of financial and criminal violations. Additionally, the SEC has improved its monitoring of audited financial statements and annual reports of listed companies. Improve guidelines on the role of audit committees are to be issued soon. On the banking side, the BOT has issued regulations to improve corporate governance of financial institutions; among other things, the regulations cover the number of independent directors and functions of various committees of the boards of directors. A director's handbook for directors of banks has been issued by the BOT to facilitate implementation of the regulations.

TRIS has been designated as sole corporate governance rating agency of listed firms in Thailand. In order to promote good practices, the Thai Rating and Information Service (TRIS) has been designated as the sole corporate governance rating agency for listed companies in Thailand. The SET and SEC have provided incentives to companies to be rated by the TRIS as a means of promoting good practices. So far, several listed firms have been rated.

The Thai Institute of Directors continues to do an excellent job in training directors. So far, more than 600 directors have completed the Institute's 5-1/2 day course. The Institute of Certified Accountants and Auditors of Thailand (ICAAT) has also intensified its efforts to improve skills and knowledge of accountants and auditors. ICAAT is now in the process of establishing a Certified Financial Officer and a Certified Management Accountant program. Efforts are also underway to improve and expand the Continuing Professional Education (CPE) for accountants and auditors, develop practical guidelines and interpretation of accounting standards, and develop accounting practice guidelines for SMEs.

The reform agenda, however, remains incomplete. While these are commendable efforts, the reform agenda remains incomplete, both in terms of legislative and regulatory reform, and in terms of changes in actual practices. Progress in revising the Public Companies Act (PCA) and Securities and Exchange Act (SEA) remains slow. In the area of financial reporting and disclosure, it is critical that Thailand adheres to international accounting and auditing standards.

The question that remains is the extent to which these efforts have translated into improvement in actual practices. The benchmarking exercise conducted by the Institute of Directors on an annual basis can provide a basis for this measurement. Additionally, the Reports on Observance of Standards and Codes (ROSCs), which benchmark a country's corporate governance practices and accounting and auditing practices against OECD principles, and international standards, can be helpful tools for assessing progress.

There is an urgent need to persist with corporate governance reform and complete the unfinished agenda. Key elements of this agenda are outlined below in the box:

Box 3. Unfinished Agenda of Corporate Governance Reform

- 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 clarity fiduciary duty of directors;
- Provide for cost-effective legal channels for shareholders seeking redress or dismissal of a director for misconduct or violation of the law or articles of incorporation;
- Further improve accounting and auditing practices to reach consistency with international standards and practices;
- Further improve quality and reliability of financial information and disclosures provided by public companies.
- Make the audit committees of boards of directors more effective;
- Amend Accounting Professional Act 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 by accountants who violate duties and commit fraud; and
- Continue to provide training for accountants on international standards and for directors of public companies on directorship best practices.

Source: Country Development Partnership for Financial and Corporate Competitiveness.

The focus should remain on implementation and on completing the legislative and regulatory agenda, improving enforcement, enhancing financial reporting and disclosure consistent with international standards, and promoting business ethics and best practices.

3.2 Fiscal Policy and Public Sector Reforms

The Government has been relatively successful in deploying fiscal policy to support economic activity as well as in implementing reforms in public sector governance; within that progress in public administration and public financial management have gone better than decentralization. Measures to stimulate domestic demand have not detracted from promoting fiscal consolidation and lowering public debt, though insufficient information on the rise in off-budget spending makes it difficult to assess the fiscal outturn adequately. Progress in implementing decentralization has been slow, but new measures to improve the administrative structure and to introduce results-based budgeting have been implemented over the last 12 months. Key challenges in the public sector reform would be to ensure the proper implementation of reforms and monitoring of results in which coordination among the key agencies are necessary conditions for their success.

Fiscal Policy

Fiscal policy proved to be less supportive in 2002 than was originally planned. The stimulus measures – village fund, health care scheme and farmers' debt moratorium – added to public spending, but the deficit was less than planned because of higher-than-expected revenue and shortfalls in other types of government spending. Further consolidation of the fiscal accounts is planned for this year.

Public debt stabilized in 2002 and is planned to be on a declining path over the medium term. As a share of GDP, public debt fell from its peak of 58 percent in 2000 to 54 percent in 2002 as fiscal deficit fell and fiscalization of FIDF losses was limited. The Government plans to continue consolidating the fiscal position. With real GDP growth expected to hover around 5 percent, public debt ratio should continue to decline over the medium term.

There are risks to the planned fiscal consolidation. First, slower real GDP growth when compared to interest rates could destabilize the public debt situation. Second, attempts to raise public investment in infrastructure could reverse the process of consolidation. Third, some of the off-budget funding of the stimulus measures in 2002 and 2003 may turn into liabilities for the budget. There is however scope for raising revenue further to meet those expenses, as long as real GDP growth stays at around 4-5 percent.

Public Administration Reform

Public administration reform implementation has picked up speed. Recent efforts to reform the public sector were reflected in the issuance of the Public Sector Management Reform Plan (PSMRP) and appointment of the high-level Public Sector Reform Committee in 1999. This was followed by the enactment of the Ministerial Restructuring Act (MRA) and the Public Administration Act (PAA) and the implementation of acts in October 2002. A public sector reform policy-making and oversight body, the Public Sector Development Commission (PDC), was appointed in December 2002, replacing the high-level Public Sector Reform Committee. In March 2003, the PDC prepared a Public Sector Development Strategy (2003-2007) which builds upon the PSMRP[19]. In addition, to promote public participation and accountability in government institutions, various accountability institutions and mechanisms have been established.

Implementation of the new public sector reform laws commenced in October 2002. Several components of the PSMRP have been implemented in pilot central and line agencies such as the Bureau of the Budget and the ministries of Commerce, Education, and Public Health. Public sector-wide reform implementation, began in October 2002 with the promulgation of the Ministerial Restructuring Act (MRA) and the Public Administration Act (PAA).

The MRA defines the reorganization of the divisions and departments in 14 existing ministries as well as establishes 6 new ministries, such that each ministry will be responsible for a set of core tasks, minimizing duplication of work among them. Ministerial restructuring according to the MRA has taken place in October 2002. Staff and assets have been transferred to the respective ministries to which agencies has been moved.

[19] The PSMRP has not been abolished, but future implementation of the public sector reform will be based on the Public Sector Development Strategy.

The PAA provides guidelines to reduce bureaucratic processes, decentralize functions and resources as well as decision making powers to local levels, respond to public needs, and promote accountability, transparency, public participation, and monitoring and evaluation of service delivery in accordance with the principles of good governance.

The Public Sector Development Commission[20] has been established and Public Sector Development Strategy formulated. The PDC formulated a Public Sector Reform Development Strategy (2003-2007), which builds upon the PSMRP. The Public Sector Reform Development Strategy (2003-2007) includes (i) reforming public administration, (ii) improving ministerial restructure, (iii) reforming budgetary and public financial management, (iv) reforming civil service and compensation system, (v) changing work cultures and values, (vi) modernizing the public sector through the use of ICT and (vii) promoting public participation in monitoring and decision-making. The Strategy was approved by the Cabinet in May 2003.

External monitoring and public participation have been promoted. The 1997 Constitution emphasizes the need to strengthen accountability and transparency in managing the affairs of Thai government institutions. The Official Information Act was passed in 1997 to provide greater public access to official information. Various external monitoring and accountability mechanisms have also been put in place, particularly, the establishment of Independent Organizations and civil society networks. Independent Organizations include the Administrative Court, Constitution Court, National Counter Corruption Commission, National Election Commission, National Human Rights Commission, Parliamentary Ombudsman and State Audit Commission.

Public Financial Management Reform

New budget procedures have been introduced in the FY2003 budget allocation. Under the budgetary reform, the budget procedures moves from the traditional line-item budgeting to budgeting which is results-based, forward-looking, deconcentrated, and accountable. The new budget procedures, as reflected in the draft Budget Procedures Act (BPA)[21], would include (i) the establishment of the Budget Policy Committee (BPC) which will take over the responsibilities for budget preparation, (ii) the results delivery agreements by ministers and heads of departments, (iii) a results monitoring and evaluation system, and (v) a medium-term expenditure framework (See Box 4 for detailed discussion).

The draft of the BPA is currently being scrutinized by the Cabinet. Nevertheless, partial implementation of the new procedures has been introduced in the preparation of the FY2003 budget, which includes the specification of indicative Government's strategic targets, ministry service delivery targets, agency outputs, and initial performance indicators.

Better accounting, financial management, and procurement systems are being developed. Accrual accounting has been developed to replace cash accounting[22] along with the Government and agency financial management information systems. In addition, new procurement process and methods are being introduced.

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[20] In December 2002, the Government appointed the Public Sector Development Commission (PDC), chaired by a Deputy Prime Minister and comprised of 14 commissioners including 10 experts from 8 fields. The PDC replaced the high-level Public Sector Reform Committee as the public sector reform policy-making and oversight body.

[21] The BPA, when enacted, will replace the current in-use Budget Procedures Act (1959)

[22] Accrual accounting records a transaction as receivables or payables once a *commitment* to the transaction is made. Cash accounting records a transaction as receivables or payables once *cash* is either received or paid.

Box 4. The New Budget Procedures

Under the new budget procedures in the draft Budget Procedures Act, a high-level Budget Policy Committee (BPC) will take over responsibilities for budget preparation and is empowered to make budgeting decisions on behalf of the executive branch. The Budget Policy Committee[23] has the potential to be a significant improvement in the machinery of fiscal policy at the levels of macro-economic strategy and sectoral allocations at a high level. The composition of the BPC and the clear delineation of roles and responsibility of various central agencies (MOF, BOB, and NESDB) involved with expenditure management will improve coordination among them.

At the beginning of each fiscal year, ministers will sign Public Service Agreements (PSAs) with the BPC, spelling out the ministry's service delivery targets or outcomes over 4 years and specific targets for each fiscal year. The targets are aimed at achieving the national agenda as defined by the Government's strategic targets.[Another critical function of the PSAs is to coordinate both the planning and implementation of policy objectives, especially those that require multi-ministries cooperation such as poverty reduction.] At the next level, heads of agencies will sign Service Delivery Agreements (SDAs) which defines the outputs that the agencies will deliver to achieve their respective ministries' service delivery targets.

Performance of ministries and agencies will be measured against the PSAs and SDAs, respectively. A performance monitoring and evaluation (M&E) system, which would evaluate the achievement of the targets or outcomes of ministries and outputs of agencies, is currently being developed.[24] Ministries are to develop outcome indicators while departments are to develop output indicators on 4 dimensions - cost, quantity, quality, and timeliness. Through the M&E system, performance of ministries and departments will be measured against these indicators, which will feedback to the allocation decisions for the ministries and departments in the following fiscal year.

In addition to the strategic level of budgeting, the new budget procedures will also have a forward-looking element of planning for medium-term fiscal policy objectives. The three-year medium term expenditure framework (MTEF) is being developed[25] and covers both top down and bottom up estimates.[26]

Preparation for the implementation of accrual accounting began in 1999 under the PSRMP[27]. In FY2003, Charts of Accounts, Standard Financial Reports, and Standard Practical Accounting Guidelines will be issued as additional guidelines for agencies, and pilot government agencies are required to begin applying accrual accounting to at least a few items. By FY2005, the accrual accounting system will be in place and all agencies will be required to initiate accrual accounting to at least a few items.

Government Financial Management Information System (GFMIS) and the Agency Financial Management Information System (AFMIS)[28] are currently being developed by the Comptroller General's Department along with progress in accrual accounting development. The hardware and software development for the systems will begin in a few months. The systems now include mainly the accounting information of the government and agencies.

[23] The BPC is likely to be chaired by the Prime Minister or the Minister of Finance.
[24] The M&E system is expected to be operational by FY2005.
[25] The MTEF will be used for FY 2008 at the earliest.
[26] Top down refers to macro fiscal projection which would establish a budget ceiling based on resources and constraints. Bottom up refers to micro baseline projections which establish baseline expenditures based on existing policies at agency level.
[27] In FY2001, Accounting Policy Books 1 and 2, which define the accrual accounting framework and items to be included, were issued as guidelines for government agencies followed by a series of training sessions. Agencies have also been required to prepare their accounts of assets.
[28] AFMIS contains financial information at the agency levels. GFMIS contains financial information at the national government level, which includes some information from the AFMIS as well as LGOs.

New procurement process and methods have been introduced by the recently established Procurement Management Office (PMO) under the Ministry of Finance. The PMO was established in October 2002 to be responsible for developing new procurement systems (including e-procurement) and reforming procurement policies and regulations. Revisions and amendments of procurement regulations, particularly those relevant to e-procurement, are being undertaken. E-auction of all government agencies of at least a few common-use items, such as computers, began in December 2002. A Procurement Master Plan will be completed and submitted to Cabinet by August 2003 and action plans will be developed and training conducted after the Cabinet approves the Master Plan.

Decentralization

Since 2000, Thailand has undertaken political, administrative and fiscal decentralization under the Decentralization Act (1999). Progress however has been mostly in the political and fiscal fronts whereby 7,951 local government organizations (LGOs) have been established, representatives elected, and at least 20% of total central government revenues has been decentralized to local governments since 2001.[29] Functional and personnel decentralization, on the other hand, has been slow to date. There has, however, been slower progress in functional and personnel decentralization, the reasons for which are discussed below.

To date, only a few functions have been decentralized. To facilitate the devolution of functions, a Decentralization action Plan (DAP), which specified 245 mandatory and voluntary functions in 6 areas[30] to be devolved and undertaken by LGOs by FY2004, was passed by the Parliament in February 2002. Nevertheless, to date the only noticeable functions decentralized are those of the Department of Public Works (PWD), the Department of Accelerated Rural Development (ARD) and Department of Energy Development and Promotion (DEP) and only about 4,000 positions have been transferred to LGOs. This functional decentralization is estimated to be significantly less than fiscal decentralization with LGOs' revenues totaling about 22 percent of central government's revenues in FY2003.[31]

The delay in the decentralization of functions can be attributed to (i) the reluctance of line ministries to transfer the functions to LGOs, (ii) inconsistencies between the Ministerial Restructuring Act (MRA) and the Decentralization Action Plan (DAP), (iii) LGO's lack of capacity and (iv) lack of a clear direction and leadership in decentralization. Under the MRA, each ministry is responsible for a set of core tasks, while non-core tasks are to be out-sourced or decentralized. However, line ministries continues to perform many of the functions that should have been decentralized according to the DAP. Moreover, certain agencies established under the MRA, such as the Department of Rural Highways in the Ministry of Transport, have responsibilities that are almost identical to those that are decentralized to LGOs under the DAP.

On the other hand, the LGOs' lack of capacity has resulted in their hesitance to undertake the decentralized functions. For example, LGOs have expressed their lack of capacity in management and technical skills such as financial management, accounting, financial reporting and the understanding of

[29] According to the Decentralization Act (1999), the share of LGOs' revenues to central Government's revenues are to be at least 20% by 2001 and increased to 35% by 2006.
[30] (i) Infrastructure, (ii) Promotion of quality of life, (iii) Community and social order, (iv) Planning and promotion of investment, trade, and tourism, (v) Natural resource and environment management, and (vi) Culture, values, and local wisdom
[31] LGOs' own-collected revenues in FY2003 are estimated at 12 percent of their total revenues, suggesting that 88 percent of their revenues have been transferred to them from the central government.

laws and procurement procedures governing them.[32] Central government agencies whose functions are to be transferred are best placed to provide training in the respective technical and managerial skills. However, due to the lack of a coherent training program for LGOs and the reluctance of central agencies to decentralize, training for LGOs have not been sufficient (neither in quantity nor quality) nor systematic.

LGO's capacity is also constrained by the fact that LGOs are restricted in the number of staff they may hire and the administrative expenses they may incur. The Local government organization Personnel Act specifies that LGO's staff costs are to be no greater 40 percent of total expenses. In addition, Level 5 Tambon Administrative Organizations (TAOs)[33] are allowed to have no more than 3 staff positions and Level 1 TAO are allowed no more than 21 positions. This limits their ability and willingness to accept transferred personnel.

LGOs also lack the necessary equipment to perform many of the transferred functions. For example, the recently transferred functions of the PWD and the ARD to the TAOs, which includes the construction and maintenance of rural roads and bridges, were not accompanied by adequate transfer of tractors and other necessary equipment. Some TAOs resort to borrowing equipment from their respective Provincial Administration Organizations (PAOs) to carry out the functions. However, only some PAOs have adequate equipment. Even if they do, they are insufficient. Thus, most TAOs are unable to perform the functions and hence are reluctant to hire the transferred central government personnels.

In the past one year, decentralization has suffered from the lack of a clear direction and leadership. In mid-2002, the Parliament has instructed the revisiting of decentralization. As a result, the Department of Local Government Organization Promotion (DGLP) has commissioned six studies to provide recommendations on the future direction of decentralization in Thailand. They cover the structure and size of LGOs, fiscal transfers, LGO management monitoring and evaluation system, capacity assessment, and personnel management. This has in part contributed to the central government agencies to "hold back" decentralizing their functions as they wait for a clearer direction. However, the clearer direction is unlikely to emerge without a strong leadership from the top levels.

Key Challenges to Public Sector Reform

A key challenge in public sector reform is the implementation of all the pieces of the reform, including decentralization, in a comprehensive manner. Public sector reform involves work and reforms in many interrelated areas, which are often carried out by different government agencies or designated committees. In order for the public sector reform to translate into its ultimate outcome – improved service delivery for the public – effective implementation and the coordination of the implementation efforts in the various areas are needed. For example, to ensure that budget planning, execution, evaluation and reporting are coordinated, the budgetary and public financial management reforms need to be consistent and coordinated. The consistency between the reforms in expenditure management and in the areas of public administration and civil service is of equal importance to assure that the changes in public administration are supported by complimentary changes in the procedures for budgeting and financial reporting.

[32] Based on frequent visits to LGOs by officials of the Office of the National Decentralization Committee and *Local Government Organization Capacity Assessment* study by the World Bank (February 2002).
[33] Level 5 TAOs are the smallest unit of LGOs and have an average population size of 8,000.

For the public sector reform to produce continuing improvements in performance, there needs to be a focus on an integrated management system with results monitored. The integrated system should bring together decision-making about policy at the strategic level, budgeting, financial reporting, public administration reform, human resource management and civil service reform, performance management, and sectoral reforms and decentralization to LGOs. The Public Sector Development Committee (PDC) has the potential to coordinate the on-going and future areas of reforms at the policy level. It is however equally important to ensure that the policies are translated into effective actions at the implementation levels.

Monitoring of the reform implementation for results through systematic monitoring mechanisms is therefore quite important. The PDC has the mandate to oversee and report the progress of the reform as well as make suggestions to the Cabinet. However, encouraging and strengthening external bodies such as academic institutions, civil society networks and communities in monitoring the results of the reforms will generate valuable inputs and feedback which would assist the Government in adequately achieving the outcomes of the reform. However, one of the major constraints facing the external monitoring bodies in performing such a role is the lack of access to information. Providing better access to information and encouraging civil society and community participation and monitoring in addition to training them on these roles could increase accountability, especially at the regional and local government levels.

Appendix 1: Key Economic Indicators

	2001	2002 e/			2002		2003	2002		2003	
	Year	Year	Q1	Q2	Q3	Q4	Q1	Dec	Jan	Feb	Mar
Output, Employment and Prices											
GDP (% change, previous year)	1.9	5.2	3.9	5.1	5.8	6.1	..	..	..	..	..
Manufacturing production index (1995=100)	113.6	123.3	123.1	118.4	121.2	130.4	139.8	131.7	136.8	132.6	149.9
(% change, previous year)	1.3	8.5	4.2	7.9	10.7	11.4	13.6	11.9	15.2	12.8	12.7
Unemployment rate (%)	3.3	2.4	3.2	2.9	1.8	1.8	..	1.4	3.4	2.3	..
Real wage growth (%) 1/	-0.6	-1.5	-1.9	-0.1	-1.2	-2.5	..	..	..	..	..
Consumer price index (% change, previous year)	1.6	0.7	0.6	0.2	0.3	1.4	1.9	1.6	2.2	1.9	1.7
Public Sector											
Government cash balance (Billion Baht)	-123.0	-76.8	-70.7	35.8	-14.7	-27.2	93.7	3.1	-4.3	7.0	6.6
Government cash balance (% GDP)	-2.4	-1.4	-5.3	2.7	-1.1	-1.9	..	..	..	..	..
Public sector debt (% GDP)2/	56.6	54.0	..	..	..	54.0	..	54.0	49.9	..	..
Foreign Trade, BOP and External Debt											
Trade balance (US$ million)	2,525	3,453	696	617	880	1,260	1,096	421	34	670	392
Exports of goods (fob, US$ million)	63,190	66,886	15,015	16,163	17,820	17,888	18,165	5,477	5,899	5,903	6,363
(% change, previous year)	-6.9	5.8	-6.3	3.4	11.3	15.2	21.0	10.3	25.0	24.7	14.4
Imports of goods (cif, US$ million)	60,665	63,433	14,319	15,546	16,940	16,628	17,069	5,056	5,865	5,233	5,971
(% change, previous year)	-2.8	4.6	-10.2	2.1	12.9	14.8	19.2	15.6	19.8	22.9	15.6
Current account balance (US$ million)	6,236	7,631	1,901	850	2,025	2,855	2,690	868	654	1305	731
(% GDP)	5.4	6.0	6.2	2.8	6.3	8.7	..	..	..	..	..
Foreign direct investment, net (US$ million)	3,759	899	219	336	-246	590	..	37	36	69	..

	2001	2002 e/			2002		2003	2002		2003	
	Year	Year	Q1	Q2	Q3	Q4	Q1	Dec	Jan	Feb	Mar
Total external debt (US$ million)	67,511	58,922	64,522	65,526	61,644	58,922	..	58922	58412	57391	..
(% GDP)	58.6	46.7	55.4	54.7	49.9	46.6	..	..	..	..	..
Short-term debt (US$ million)	13,389	11,898	13,240	13,725	14,505	11,898	..	11,898	11,865	11,727	..
Debt service ratio (% exports of goods and services)	20.7	18.0	24.4	16.4	18.0	14.1	..	..	..	..	..
Reserves, including gold (US$ million)	33,048	38,924	33,615	36,791	37,652	38,924	37,632	38,924	39,776	38,753	37,632
(months of imports of goods)	6.5	7.4	7.0	7.1	6.7	7.0	6.6	7.7	6.8	7.4	6.3
Financial Markets											
Domestic credit (% change, previous year) 3/	-4.6	3.6	-6.3	-3.7	-1.6	3.6	..	3.6	..	..	..
Short-term interest rate (end-of-period) 4/	2.4	1.8	2.1	2.0	2.0	1.8	1.5	1.75	1.75	1.75	1.5
Exchange rate (average period)	44.5	43.0	43.7	42.8	42.1	43.4	42.8	43.3	42.8	42.9	42.8
Real effective exchange rate (1994=100)	79.5	81.7	82.8	82.8	81.5	79.7	..	79.5	79.5	..	..
(% change, previous year)	-4.7	2.8	3.3	4.9	3.4	-0.3	..	-0.3	-2.5	..	..
Stock market index (Dec 1996=100)	303.9	356.5	374.0	389.1	331.8	356.5	364.6	356.5	370	361.3	364.6
Memo: GDP (US$ billion)	115.2	126.3	30.7	30.9	31.9	32.7	..	..	..	..	..

e = estimate
p = projection
1/ Computed from average wage of employed person from Labour Force Survey
2/ Include direct government debt, non-financial-state-enterprise debt and Financial institutions Development fund (FIDF) debt
3/ Those extended by all financial institutions
4/ Average interest rates on time deposits of less than 6 months (percent per annum)

Appendix 2: Monitoring Matrices for Structural Reform Implementation[34]

- Public Sector and Governance Reform
- Financial and Corporate Restructuring and Development
- Poverty Reduction Diagnostics
- Social Protection

[34] This appendix specifies in some detail, the reform measures taken during the last 12 months and their significance as well as measures to taken in the next 6-12 months, the latter identifying key process steps that may have been taken as a prelude to those measures to be taken. The objective and the individual areas to which these reforms relate are drawn from each of the ongoing Country Development Partnerships (CDPs) of the same name.

1. Public Sector and Governance Reform

	Objective	Reform Measures Taken
A.	Restructure ministerial organizations and reform public administration to (i) focus on core functions and (ii) transform internal management systems	***Measures taken and their significance*** ▪ The corner stones for the ministerial reorganization and improvement of public administration – **the Ministerial Restructuring Act (MRA) and the Public Administration Act (PAA) – were promulgated in October 2002.** ▪ **The MRA defines the reorganization of the divisions and departments** in 14 existing ministries as well as establishes 6 new ministries, such that each ministry will be responsible for a set of core tasks, minimizing duplication of work among the ministries. Ministerial restructuring according to the MRA has taken place in October 2002. ▪ **The PAA defines the public administrative reforms to be undertaken** so as to bring about an effective and efficient public sector management, reduce bureaucratic processes, decentralize functions and resources as well as decision making powers to local levels, respond to public needs, and promote accountability, transparency, public participation, and monitoring and evaluation of service delivery in accordance with the principles of good governance. Under the PAA, the Public Sector Development Commission (PDC) was established in December 2003 as the public sector reform policy-making and oversight body. The PDC also provides a vehicle of coordination among the different areas of public sector reform – budget, financial, civil service, and administrative. ▪ **The Public Sector Development Strategy (2003-2007), prepared by the PDC, was approved by the Cabinet in May 2003.** The Strategy has 7 components: (i) reforming public administration, (ii) improve ministerial restructure, (iii) budgetary and public financial management reform, (iv) reforming civil service and compensation system, (v) changing work cultures and values, (vi) modernizing the public sector through the use of ICT and (vii) promoting public participation in monitoring and decision-making. ***Measures to be taken in the next 6 months*** ▪ **Implementation of the strategy in the next 6 months** includes (1) submission of draft of the Public Administration Royal Decree[35] to the Cabinet, (2) submission of Executive Development Program curriculum to the Cabinet, (3) preparation and submission of guidelines for changing the vision and operation of civil servants to PDC, (4) launch of a course on new procurement methods and procedures, and (5) submission of new incentive package for civil servants to the Cabinet.

[35] In Thailand, Acts are effective after they are approved by the Parliament. Clauses in Acts are supported by Royal Decrees, which are effective after approval by the Cabinet.

Objective		Reform Measures Taken
B.	Reform public expenditure management to (i) link planning, sector policy making and budgeting processes, (ii) focus on outputs and outcomes instead of inputs, (iii) improve the quality of fiscal management, (iv) improve financial transparency, and (v) increase accountability and incentives for higher performance (performance-based budgeting)	***Measures taken and their significance*** ▪ **The new budget procedures above have been introduced in the preparation of the FY 2003 budget**. Initial measures undertaken in the budget process of FY2003 include the specification of indicative Government strategic targets, ministry service delivery targets, agency outputs, and respective performance indicators. ▪ Development of accrual accounting system began since 1999. Guidelines for accrual accounting have been issued and training for agencies conducted since FY2001. In FY2003, Charts of Accounts, Standard Financial Reports, and Standard Practical Accounting Guidelines will be issued as additional guidelines for agencies. **In FY2003, pilot agencies are required to begin applying accrual accounting to at least a few items.** ▪ **The Procurement Management Office has been established at the Ministry of Finance in October 2002** to be responsible for developing a new procurement system (including e-procurement) and reforming procurement policies and regulations. **E-auction of all government agencies of at least a few common-use items such as computers began in December 2002.** ***Measures to be Taken in the next 6 months*** ▪ **The new Budget Procedure Act (BPA) was submitted to Parliament in early 2003 and is expected to be enacted in the next 6 months**. The new budget focuses on budgeting for results whereby the budget allocation is (i) linked more closely to the Government's strategic goals, (ii) forward looking and embedded with the medium-term expenditure framework, (iii) deconcentrated to ministries and departments and (d) accountable. ▪ **A Procurement Master Plan will be completed** and submitted to cabinet by August 2003.

Objective		Reform Measures Taken
C.	Provide autonomy to local government organizations (LGOs) in providing public services by (i) increasing the share of LGOs' expenditures, (ii) assigning more revenue sources to LGOs, (iii) revising the system of intergovernmental transfers to provide grants in a more transparent and predictable way, (iv) promoting mechanisms for local accountability, and (v) strengthening local capacity	***Measures taken and their significance*** ▪ **The Decentralization Action Plan was passed by the Parliament in February 2002**, following on from the Decentralization Act (1999) and Decentralization Master Plan (2000). It specified 245 mandatory and voluntary functions in 6 areas to be decentralized to LGOs by 2004: (i) infrastructure, (ii) promotion of quality of life, (iii) community and social order, (iv) planning and promotion of investment, trade, and tourism, (v) natural resource and environment management, and (vi) culture, values, and local wisdom. Seven subcommittees - first 4 subcommittees corresponds to the first 4 function areas above, the 5th subcommittee is responsible for areas (v) and (iv), and the 6th and 7th subcommittees are responsible for health and education, respectively - have been established to assist in the implementation of the Decentralization Action Plan. ▪ **The first LGO Governance Survey was conducted by the Department of Local Administration**, Ministry of Interior in mid-2002. The survey results comprising of 33 governance indicators are publicly available and will be updated yearly. ***Measures to be taken in the next 6 months*** ▪ In mid-2002, the Parliament has instructed the revisiting of decentralization. The Department of Local Government Organization Promotion (DGLP) has commissioned six studies to provide recommendations on the future direction of decentralization in Thailand. They cover the structure and size of LGOs, fiscal transfers, LGO management monitoring and evaluation system, capacity assessment, and personnel management. **The studies are expected to be completed in the next 6 months.** ▪ **Training guides on LGO capacity building programs are under preparation** by the DGLP and will be distributed in FY2003.

Objective		Reform Measures Taken
D.	Strengthen cross-government accountability and transparency by (i) strengthening formal accountability institutions; (ii) improving access to, and use of, public information by individual citizens and by civil society, including improved responsiveness by Government in providing this access; (iii) increasing probity among civil servants, and (iv) enhancing civil society participation in improving transparency	***Measures taken and their significance*** ▪ **An NGO network was established** in early 2002 to monitor the public sector reform. ***Measures to be taken in the next 6 months*** ▪ A Cabinet resolution issued in early 2002 that all agencies develop anti-corruption strategies to address a set of corruption issues based on the suggestions and recommendations of the consultation with civil society, government officials, and academicians on the formulation of anti-corruption strategy held in November 2001 by the OCSC and the NCCC. Multi-agency working groups to develop anti-corruption strategies have been established. **A nation-wide anti-corruption strategy is being developed.**

2. Financial and Corporate Restructuring and Development

	Objective	Reform Measures Undertaken
A.	Enable sharing of credit information among financial institutions	***Measures taken and their significance*** ▪ **Two credit bureaus were established and have been operating.** They are a critical component of credit infrastructure necessary to increase sustainable lending to individuals and SMEs. Sharing of credit information enable financial institutions to better price loans according to the risk characteristics of debtors and to better manage their risk. Having access to credit history of debtors, financial institutions should be able to reduce transaction costs of making loans by lowering costs of asymmetric information. ▪ **The Credit Information Business Act was enacted in late 2002** and became effective in March 2003. ▪ **A Credit Protection Committee has been established** under the Act to supervise the bureaus and the participating financial institutions regarding the sharing of credit information. ▪ While the Act has many positive aspects, it has severe criminal sanctions for any violation of the Act, not just for willfull violations and fraud, which is the international standard. As a result, both bureaus ceased operation upon enactment of the Act. It remains to be seen if and when the law will be amended, and how the bureaus will operate in the meantime. ***Measures to be taken in the next 12 months*** ▪ **Implementing regulations will be developed by the Credit Protection Committee.** The Committee has already interpreted the Act by reducing the administrative burden on the bureaus and their members. ▪ **The bureaus will resume operations** once the stakeholders are satisfied with the legal and regulatory framework, either as is or amended.
B.	Formulate a medium-term strategy for Thai financial sector	***Measures taken and their importance*** ▪ Since the beginning of 2002, the **Bank of Thailand (BOT) has been leading an effort to draft a financial sector blueprint**, which aims to further modernize, balance and enhance the productivity of the Thai financial sector. It also aims to increase access to a range of financial services by users in all market segments in both urban and rural areas. ***Measures to be taken in the next 12 months*** ▪ The first stage, which involves drafting the Blueprint, is being completed in May 2003. **The next steps include broad consultation with key stakeholders, development of an action plan and implementation.**

	Objective	Reform Measures Undertaken
C.	Measured transition from the current blanket government guarantee on deposits to limited deposit insurance	***Measures taken and their significance*** ▪ **After designing a gradual and measured transition to limited deposit insurance, the Ministry of Finance held a public hearing to communicate and receive feedback on the proposed policy from the banking and academic communities.** The Ministry of Finance has since delayed submission of the draft law to Parliament. ▪ Limited deposit insurance will add market discipline to the system because large, uninsured depositors (mostly institutions) will move their money away from weaker banks. ***Measures to be taken in the next 12 months*** ▪ Weaker deposit taking institutions will have to be strengthened through recapitalization and operational improvements.
D.	Strengthen capacity to supervise deposit taking institutions	***Measures taken and their significance*** ▪ **The first class of students was commissioned by the newly established Examiners Training School at the Bank of Thailand.** This class successfully completed the five core courses and the examination process, all developed in partnership with the World Bank and foreign supervisory agencies. ***Measures to be taken in the next 12 months*** ▪ **The BOT continues to upgrade its capacity and transition to more risk focused supervision,** with the support of extensive technical assistance. ▪ **The authorities are considering participation in the Financial Sector Assessment Program,** which would include an update of the Basel Core Principles Assesment of BoT's supervisory capacity and practices.
E.	Remove legal impediments and provide an enabling environment for derivative products	***Measures taken and their significance*** ▪ **Special business tax on debt and derivative transactions have been removed.** Special business tax, a turnover tax, was an impediment to multi-level transactions, such as derivatives. The development of derivative products and markets will allow market participants to hedge some of their risks. Interest rate futures will be a starting point for the market. ***Measures to be taken in the next 12 months*** ▪ **The draft Derivatives Bill is likely to be enacted by the Parliament before year end.** ▪ Regulations may be needed after enactment.

	Objective	Reform Measures Undertaken
F.	Expedite civil procedures for foreclosure judgements and the sale of foreclosed assets	***Measures taken and their significance*** ▪ **Since October 2002, all the Courts are constitutionally required to implement continuous hearings, and all cases must be heard by a full set of two judges.** While it is too early to assess the impact of implementation, the customary two to three months period between hearings should be reduced. ▪ **In addition, banks report that the Legal Execution Department is making efforts to speed up the slow process of selling foreclosed assets.** At current rates, it will take ten years to liquidate Bt 152 billion foreclosed assets on banks' balance sheets as of end 2002. Outsourcing the sale of foreclosed assets to the creditors or to others in the private sector is useful options. ▪ Distressed assets, rather than being locked up on bank balance sheets as NPLs, should be divested back into the market so that they can be reallocated to the most productive uses. ***Measures to be taken in the next 12 months*** ▪ Regarding enhancements to civil procedures, concerns remain about the inadequate number of judges to fully implement the requirement that two judges preside for each case. **The Office of the Judiciary is aware of the shortfall, and has been preparing judicial development plan and implementation.** It is necessary to expedite the evidentiary process, but currently there is no initiative to do so.

3. Poverty Reduction Diagnostics

	Objective	Reform Measures Taken
A.	Improve quality of life for the poor both in the urban and rural areas by enhancing self-reliance and creating opportunities to improve local economy.	***Measures taken and their significance*** ▪ **The Ninth Plan (2002-2006) sets the target to reduce absolute poverty to less than 12 percent of the total population by 2006.** It pursues a holistic approach with strategies to empower people for equal access to education and social service, to upgrade the quality of life, and to promote participation in support of public sector reform. The Poverty Alleviation Strategy of the Ninth Plan aims to promote the capacity for the poor, to improve the social security system to reduce disparities between the poor and the better off, and to foster structural reform in areas with poverty impact such as natural resource management. ▪ **A substantial part of the fiscal stimulus aims to boost the incomes of rural areas**, where nine out of ten of the poor reside. The government has implemented a number of fiscal programs including the village fund scheme, the debt suspension program, the universal health coverage, and the one-tambon-one-product scheme. ***Measures to be taken in the next 6 months*** ▪ The government has set a target for all 7,255 tambons to have their own community poverty-alleviation plans developed by 2005. Under the new bottom-up approach, **local leaders, grassroots activists and local communities will integrate various community projects into one plan with a clear objective of eradicating poverty in the community. In the first year, the focus will be on communities with low levels of living standards.**

4. Social Protection

	Objective	Reform Measures Taken
A.	Establish formal social protection mechanism by diversifying social risk management instruments (social insurance, safety nets and labor market policy) while preserving the community-based approach currently practiced.	***Measures taken and their significance*** ▪ The corner stones to establish improved social protection mechanisms have been set through **the 1997 Constitution, the Ninth National Economic and Social Development Plan (2002-2006) and the 4th National Social Welfare and Social Work Development Plan (2002-2006).** ▪ The Constitution clearly articulates the rights and protection to which all citizens are entitled ▪ The Ninth Plan sets the objective of establishing a strong national development foundation where social protection is a priority for all age groups, thereby strengthening communities and civil society. ▪ The 4th National Social Welfare and Social Work Development Plan is a master plan guiding the implementation of social welfare and social work services. It emphasizes the development of human resources, improvement of social security and social protection systems to enable self-reliance. ***Measures to be taken in the next 6 months*** ▪ **Implementation of a risk and vulnerability assessment** to identify vulnerable groups and risk management mechanisms and to determine adequacy and gaps in safety nets coverage. ▪ **An information system to track indicators and programs** set up to help monitor and evaluate social assistance programs. ▪ **Development of labor market information system** to facilitate employment policy analysis and job placement. ▪ **Revision of Occupational Safety and Health Law** to incorporate modern standards, improving oversight and encouraging compliance by employers. ▪ **Implementation of a pension system** consistent with private risk sharing.