

Section 1

Thailand's road to recovery

Section profile

In this section, five key areas of Thailand's economic rehabilitation programme are examined and evaluated: financial sector reforms, monetary and fiscal policies, bureaucratic reforms and privatisation, industrial restructuring, and social and environmental agendas. In addition, the progress of legal, social and political reforms is also addressed.

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1.1 Onset of the crisis and Thailand's response

Between the mid-1980s and 1995 Thailand set the standard for economic development with its record-breaking growth rates. With annual growth in that period averaging over eight percent, Thailand appeared to have perfected the formula for industrialisation. Thailand served as a model for other developing countries because of its success and due to the fact that its achievements were essentially led by the private sector, which is a sharp contrast from the heavily state-guided models of South Korea, Japan, Taiwan, and Singapore.

However, after these years of rapid economic growth and industrialisation, Thailand's runaway economy came to an abrupt halt in mid-1997 with the onset of what developed into the Asian economic crisis. Years of high annual growth rates, at times exceeding 10 percent, gave way to a severe recession that saw Thailand experience declining growth in 1997 of one percent and a contraction of 9.4 percent in 1998. While not alone in suffering from a major reversal, Thailand has been forced to confront the structural deficiencies that underlie its economy and political system. Many of the factors that enabled it to achieve unprecedented growth rates and achievements also sowed the seeds for the rapid decline.

Signs of an economic slowdown appeared in 1996, when Thailand's exports declined 1.9 percent, its current account deficit rose to eight percent of GDP, and the country's foreign debt amounted to US\$90.5 billion. Of this US\$90.5 billion, nearly \$74 billion was private sector debt. By 1997 the economy began to unravel. The stock market continued its plunge from over 1,200 points in mid-1996 to 370 at the end of 1997 and as low as 253 by the third quarter of 1998. The Thai baht faced increasing pressure as speculators began to attack what had become a vulnerable and over-valued currency, forcing the Bank of Thailand (BOT) to expend billions of dollars in foreign reserves defending its pegged value of 25 baht to a basket of currencies dominated by the US dollar.

With foreign reserves nearly depleted at US\$800 million, the Thai government decided on July 2, 1997 to float the value of the baht. Thailand's currency immediately depreciated, which in turn opened up a Pandora's Box of other problems, including triggering a regional currency crisis. The baht began a downward spiral, made worse by the eventual depreciation of other currencies in the region, and hit an all-time low of 56.2 to the US dollar in January 1998.

The heavily indebted private sector could no longer afford to repay short-term debt to foreign institutions and domestic lending institutions, thereby setting off a financial and banking crisis in Thailand. The early stages of the crisis exposed the irregular practices of Thailand's financial and banking institutions and the inadequate regulatory framework and supervision by the government. The end result was the closure of 56 finance firms by the end of 1997 and the nationalisation of six commercial banks in 1998.

Other sectors of the economy, such as manufacturing and agricultural, also faced severe setbacks as they were confronted with falling world prices, fierce export competition from other crisis-struck countries, low domestic demand, tight liquidity, and high interest rates.

There were various causes of the crisis, and all of them were complex and highly interrelated, but at the core of Thailand's problems was the one factor that led to the country's exceptional growth: financial liberalisation. When Thailand liberalised its financial structure in the 1980s, huge sums of foreign capital flowed into the country, but the eventual problem was that this capital in-flow was unchecked and poorly managed, both on the part of the public and private sectors. The more specific causes of the crisis can be categorised as excessive investment in

high-risk sectors; over-borrowing and over-lending; an unsound financial sector, including the regulatory framework; and a rigid pegged exchange rate of the Thai baht.

Excessive investment in high-risk sectors

Thai and foreign businesses held high levels of investment in high-risk and highly volatile projects such as property and real estate. Matters were made worse by the oversupply in the property sector and speculative purchases of land, office buildings, and condominiums. Gradually an asset “bubble” emerged, meaning that assets are sold at a price far beyond normal profit margins. Hence the term “bubble economy.” In 1997 the bubble began to burst as the stock market dropped sharply and defaults on loans rose quickly. Those who gambled heavily in the property market were suddenly left holding empty and often unfinished projects and unable to pay back their short-term debts.

Over-borrowing and over-lending

During Thailand’s boom years access to capital was readily available both domestically and from overseas. Encouraged by seemingly endless rapid growth rates, the Thai private sector borrowed heavily to finance its expansion projects, and local banks and financial firms were more than willing to meet the demands for loans. Overseas lenders and investors also contributed to the over-extension and high debt of the Thai private sector. International banks lent vast sums of money to Thai banks and other Asian countries under the belief that the governments would continue to provide bail-out guarantees if problems arose. Foreign financial institutions lacked careful monitoring of their lending practices to Thai banks and firms while disregarding obvious risks, especially in the swollen property sector. The result was that Thailand experienced huge capital inflows and accumulated excessive debt, particularly short-term, foreign currency denominated debt.

Unsound financial sector

Thailand’s banking and financial sector had been practising unsound lending activities, replete with inadequate or no collateral, low bank capital requirements, and misallocation of funds. Moreover, bank and financial firm officials siphoned off significant amounts of funds for their own personal use and investments.

Compounding the problems were an extremely lax regulatory framework, including inadequate supervision and a lack of transparency, a bankruptcy law without any teeth, and growing political interference in macroeconomic management. Banks and finance companies had taken on huge levels of foreign debt and extended loans beyond their means, often illegally, to questionable clients. The combination of the property sector going under, the stock market plummeting, and the eventual float of the baht crippled the financial sector with an untenable level of non-performing loans (NPLs). The government and central bank attempted to prop up the ailing financial institutions by dumping billions of baht into them and extending even more loans. The only outcome of this was an increase in the public debt.

Rigid pegged exchange rate

For several years up to 1997, the Thai baht had remained essentially fixed to the US dollar at 25 baht to the dollar. Thailand’s central bank consciously maintained this exchange rate to provide a stable environment for exports and an overall benefit to the economy. As shortcomings in the Thai economy became manifest in 1997, the Thai baht faced speculative attacks by foreign currency traders who saw that the baht was clearly overvalued in light of the current economic conditions. The Bank of Thailand, under pressure from banks, finance companies, big business, and politicians, countered these attacks on the baht by utilising its foreign reserves to prop up the currency and maintain its rate of 25 to the dollar.

The government's unwillingness to let market forces determine the baht's value forced the Bank of Thailand to nearly deplete the country's foreign reserves. Nearly US\$24 billion in foreign reserves were spent propping up the currency. With no let up in sight from the currency attacks and its foreign reserves nearly gone, the Thai government decided on July 2, 1997 to allow the baht to float freely against the US dollar. Lifting the pegged exchange rate had an enormous impact on those firms that had heavy borrowings in foreign denominated currencies, because the depreciating value of the baht multiplied the burden of debt repayment.

Immediately after the float of the baht Thai firms and financial institutions scrambled to cover their foreign liabilities by dumping the baht in favour of dollars, which in turn further depreciated the baht. Debtors began defaulting on their loans, and the banks and finance companies were saddled with vast amounts of NPLs and could not collect collateral due to irregular lending practices. Many banks and finance companies were unable to pay their own short-term debts, and thus Thailand's entire financial sector appeared on the verge of collapse. The crisis led to a rapid reversal of capital flow: whereas capital had flowed into the country during the boom years, a strong outflow occurred in 1997 and 1998 as investors dumped the Thai currency, stocks, and other assets.

The effects of the crisis pervaded the entire economy. Domestic consumption dropped, unemployment began to rise, the property sector crashed, and the construction industry stagnated. The boom years were clearly over.

Confronting the demon

The Thai government recognised the challenge of regaining macroeconomic stability in mid-1997, and so it reached an agreement for a US\$17.2 billion assistance package with the International Monetary Fund (IMF) on August 20 of that year. Thailand's policy makers committed to a set of comprehensive measures to rehabilitate and restructure the economy. The reform package was prepared with assistance from the IMF, the World Bank, and the Asian Development Bank.

The Thai government willingly accepted the conditions of the IMF assistance package, including the economic and political reforms required under the loan. The original terms of the deal in August 1997 called for the Thai government to reduce its current account deficit, raise taxes, reduce government spending to produce a budget surplus of one percent of GDP in 1998, privatise selected state enterprises, and reform various components of the economic and political sectors.

The comprehensive rehabilitation plan encompasses five main areas: financial sector reform; monetary and fiscal policies; bureaucratic reforms and privatisation; industrial and agriculture restructuring; and social and environmental agendas.

1.2 Financial sector reform

Several financial sector reforms are currently being implemented to develop a strong and viable financial system – one that will restore the full confidence of both domestic and international creditors and depositors.

The Ministry of Finance (MOF) and the Bank of Thailand introduced several measures to address the structural weaknesses of the country's financial system. The major guidelines were delineated in the government's August 14, 1998 financial sector reform package worth 300 billion baht. The financial sector restructuring plan contains five main aspects: 1) accelerated consolidation of bank and finance companies through government intervention; 2)

the efficient management of non-performing loans; 3) provision of public funds to recapitalise all remaining financial institutions; 4) the encouragement of private investment in the banking system and the preparation of state banks for eventual privatisation; and 5) strengthening regulatory supervision and accelerating the adoption of international best practices.

Intervention in financial institutions

Soon after the onset of the crisis, the government suspended 58 insolvent finance companies. By the end of 1997, 56 of the firms were permanently closed and their assets transferred to state institutions, leaving only 33 finance companies in operation. In addition to huge debts incurred before the crisis, the closed firms had borrowed over 430 billion baht from the Bank of Thailand without demonstrating an ability to function without government assistance. Additional finance firms were eventually merged or taken over, and another one was closed in 1999. As of mid-1999, only 22 finance firms remain.

After the initial suspension of the 58 finance companies, the government had to act quickly to prevent further runs on financial institutions and restore public confidence. The Bank of Thailand's Financial Institutions Development Fund (FIDF) extended a guarantee of the deposits and liabilities for the remaining financial institutions. Other institutions were formed in October 1997 to restructure and manage the assets of the closed finance firms, such as the Financial Restructuring Authority (FRA) and Asset Management Corporation (AMC).

The FRA was established to review the rehabilitation plans of the 58 suspended finance companies and oversee their liquidation process. The assets of the 56 insolvent firms, worth about 860 billion baht, were transferred to the FRA to be auctioned off. The proceeds will be repaid to the creditors. The AMC was founded as a limited company to manage and sell the good assets of the 56 closed finance companies. It acts as a buyer of last resort to prevent the fire sale of assets in the FRA auctions. The purchased assets will be managed and rehabilitated for resale later.

The FRA held six auctions between June 1998 and August 1999, selling 146 billion baht worth of core assets. However, the book values of these assets were worth 584 billion baht, meaning that the recovery rate from the auctions was merely 25 percent.

The finance companies were not alone in causing the near collapse of the financial sector. Commercial banks also faltered, and eventually six of them were nationalised by the government: Bangkok Metropolitan Bank (BMB), SCIB, Bangkok Bank of Commerce (BBC), which came under government regulatory control in 1998, First Bangkok City Bank (FBCB), Union Bank of Bangkok (UBB), and Laem Thong Bank (LTB). BMB and SCIB will be recapitalised and privatised; BBC was converted into an asset management company under control of the state-owned Krung Thai Bank (KTB) – the “good” assets were transferred to Krung Thai and its “bad” assets to an asset management corporation; FBCB was integrated into KTB; UBB merged with several finance companies to become Bank Thai; and LTB was acquired by the newly established (1998) Radanasin Bank. The latter bank was set up by the government as a “bidder of last resort” for asset auctions by the FRA.

In November 1999 the Central Bank finalised the sale of a 75 percent stake in Radanasin Bank to Singapore's United Overseas Bank (UOB) for 15.089 billion baht. Nearly 45 billion baht in ailing assets have been transferred to Radanasin Asset Management Co., a firm managed by UOB but wholly-owned by the FIDF. Assets were sold by Radanasin to the management firm for promissory notes guaranteed by the FIDF.

The state-owned Krung Thai Bank is also subject to restructuring. Among the changes in KTB is a new board of directors; a full-time executive board; an audit committee composed of non-bank employees; and an asset management unit which will handle KTB's bad assets. Eventually KTB will be privatised.

Debt restructuring efforts

The high level of non-performing loans (NPLs) crippled many finance companies and banks. In fact, as seen in Figure 1.1, approximately 47 percent of all loans were classified as NPLs, equal to 2.73 trillion baht, in May and June 1999. The strain of carrying an enormous level of NPLs has been a major factor in the collapse of lending in Thailand, which in turn affects the economy's ability to recover. The other major factor constraining lending is that banks fear new loans will turn into NPLs and further increase the provisioning requirements.

Figure 1.1: Reported non-performing loans to loans

(percent)

	Jan-99	Feb-99	Mar-99	Apr-99	May-99	Jun-99
Private banks	42.0	42.5	42.3	42.5	42.8	41.0
State banks	65.1	67.8	68.2	67.7	69.4	70.6
Foreign banks	10.1	10.3	11.5	11.6	11.7	12.3
Commercial banks	44.0	45.8	46.2	46.2	46.8	46.5
Fincos	71.9	65.4	65.5	65.7	67.0	67.4
Financial institutions	46.2	46.7	47.0	47.1	47.7	47.5

Source: Bank of Thailand

Debt restructuring, therefore, plays a crucial role in rehabilitating the economy. The government has devised several options to facilitate debt restructuring so that normal lending can resume. In addition to the FRA and AMC's activities in rehabilitating bad debts, the government has attempted to make asset management and recovery more flexible by introducing new procedures for inter-creditor and creditor-debtor mediation and arbitration, and by encouraging banks to set up asset management companies.

The arbitration and mediation procedures, including the establishment of the Corporate Debt Restructuring Advisory Committee (CDRAC), intend to allow out-of-court debt restructuring. Restructuring cases handled before the implementation of these measures often took more than one year to complete, if at all, but now the expectation is that these out-of-court procedures will accomplish restructuring settlements within a few months. New arbitration procedures reduce the number of cases where a single creditor can hold up the restructuring plan. Another agreement signed in May 1999 calls for a settlement of restructuring within 60 days and imposes penalties on parties who refuse to co-operate in the negotiations.

Debt restructuring also required an alteration of the regulatory framework to allow banks to create asset management companies. The private asset management companies are being set up essentially to rehabilitate non-performing assets. Most banks that are establishing AMCs have designed them to manage only NPLs, but at least one bank, Bangkok Bank, will have its AMC handle only restructured loans. Banks can transfer problem loans to AMCs and then remove the NPLs from their balance sheets, but several concerns have been raised recently because of the lack of legislation governing their activities and no standardised accounting process for transferring the assets. Some critics have suggested that AMCs are merely accounting tricks to make the banking sector appear healthier.

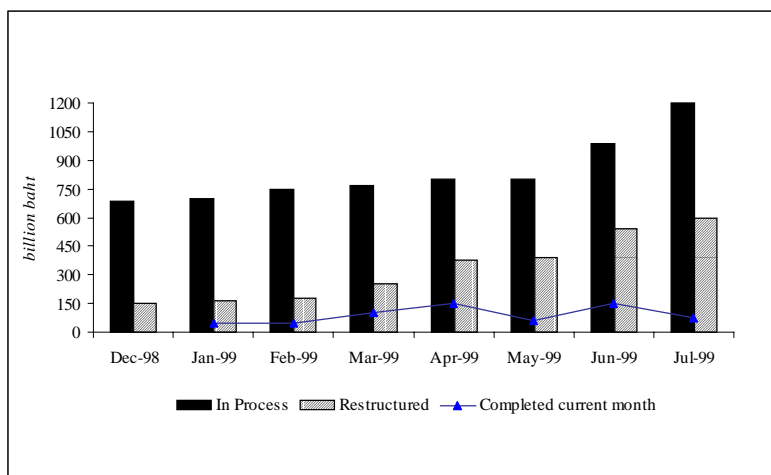
A key component affecting debt restructuring is reforming important legislation such as the Bankruptcy Act and the Code of Civil Procedure. The old bankruptcy law gave debtors leniency and protection. Under the previous system creditors had little recourse to action against delinquent debtors, and debtors with the ability to pay often took advantage of the

weak legal framework and avoided repaying loans, leading to a phenomenon called “strategic non-performing loans.” Some estimates indicate that up to 50 percent of NPLs can be restructured, approximately 30 percent cannot be repaid, and 20-30 percent are strategic NPLs.

The amended Bankruptcy Act, approved in April 1998, addresses several of the faults of the old law by improving security for new lending to troubled corporate entities, voting by creditor class, and limits on the courts' discretion. Parliament also approved the creation of bankruptcy courts, which began operations in mid-1999. Amendments to the Code of Civil Procedure, passed by Parliament in March 1999, will expedite the foreclosure process by limiting the number of appeals by debtors to delay final foreclosure. The new procedures place limits on appeals to the court of first appeals and the discretionary power of judges to obstruct auction sales.

Despite the improvements in the legal framework, few debt restructurings were achieved during the amended Bankruptcy Law's first year in effect. Moreover, the bankruptcy courts have heard few cases. In a bid to boost the number of restructuring agreements, the Bank of Thailand in March 1999 intervened to urge creditors and debtors to sign binding agreements to resolve their problems within five months or submit the case to a bankruptcy court.

Figure 1.2: Amount of corporate debt restructuring



The central bank's brokering tactics achieved immediate results in terms of an increase in the number of debt restructuring deals. Figure 1.2 shows the increase in the amount of restructured corporate debt after the March 1999 government strategy. It is too early to tell how effective the new framework and laws will be. The level of NPLs continued to increase in

Source: World Bank

early 1999 because many restructured loans had fallen back into non-performing status. Approximately 10-15 percent of restructured loans have become NPLs once again. However, the turning point may be on the horizon, as the percentage of banks' NPLs finally began to drop slightly in June 1999 and by December they had fallen to 38.54 percent of total loans after peaking at 47 percent in May. At year end, the bad loans totalled 2.073 trillion baht. Private sector forecasts expect bad loans to drop to 20 percent by year-end 2000. Central Bank officials say that debt restructuring, lower interest rates and improved economic forecasts had helped reduce bad loan levels.

Recapitalisation and financial institutions reforms

Private sector-led recapitalisation of financial institutions, in co-operation with the state, is a key element of strengthening Thailand's banking sector. Also important to the sector's revitalisation are extensive reforms to financial institutions, in particular privatising state-owned banks and allowing greater foreign participation.

Two recapitalisation schemes were introduced in August 1998 to help the financial institutions resume lending activities and maintain solvency. The first scheme, involving tier 1 capital, aims at injecting new capital from private investors in the form of new preferred shares exchanged for 10-year government bonds. The second scheme, tier 2 capital, involves the issuing of new subordinated debentures in exchange for non-tradable government bonds. Both schemes contain eligibility requirements, and institutions must abide by specific obligations set forth by the government, possibly including management changes.

Bank recapitalisation has been slower than anticipated. The Bank of Thailand reported that between April 1998 and July 1999, the 13 commercial banks raised 642.7 billion baht in tier 1 capital, which is about one-half of their expected minimum recapitalisation requirements. Part of the delay in recapitalisation is that the private banks are unwilling, except as a last resort, to accept the August 1998 government programs for tier 1 capital. The government schemes involve writing down capital and thereby diluting ownership.

By early 1999 the three largest banks raised sufficient capital without having to participate in the government program. The fourth largest bank, Siam Commercial, resorted to tier 1 capital from the government, which is to be matched by the existing shareholders. The state-owned commercial banks are also undertaking capital injections from the government because of their inability to raise adequate capital from private sources.

Additional problems have emerged with the recapitalisation plans. According to the World Bank data in Figure 1.3, state-owned banks increased their capital to only 45 percent of the expected needs, while the private commercial banks have achieved approximately 86 percent of their needed tier 1 capital. Even with the recapitalisation to date, the current levels of capital and reserves are likely below the level by which loans will have to be written down. Also, one-third of the private banks' tier 1 capital is in a form that needs to be refinanced after five years.

Recent controversy over the Krung Thai Bank has caused jitters in the banking sector. KTB received its first two capital injections, and it is expected to receive a total of 108 billion baht of new capital because of its acquisition of FCB and BBC. However, concerns are being raised that even this amount of recapitalisation will not be adequate. In August 1999, an internal audit conducted by PricewaterhouseCoopers was leaked to the media noting that KTB's NPLs total 84 percent of all its loans. This figure is in sharp contrast to the official statements from the bank that NPLs equate to 59 percent of its total loans.

Figure 1.3: Recapitalisation progress

(million baht)

	State Banks	Private Banks	Total
Additional recapitalisation needed*	432,700	45,881	478,581
Capital raised from April 98 to July 99	361,100	281,600	642,700
Total Recap Need	793,800	327,481	1,121,281
Completion (Percentage)	45	86	57

Source: The World Bank and Bank of Thailand

* Based on 1Q 1999 financial statement

* Assume 60 and 45 NPL recovery rate for private banks and state banks, respectively

Privatisation and foreign participation

Thailand's public debt was relatively low by international standards, and therefore the government's increased role in holding the finance sector's debt is sustainable in the short-run, particularly as the privatisation and recovery of assets continues. The increased role of the government in the banking sector is only a temporary measure, as many of the state-controlled banks are scheduled to be privatised. Also, the government is in the process of liberalising Thailand's banking sector to open it to greater foreign participation.

The Bank of Thailand aims to complete the privatisation of Radanasin Bank, Bangkok Metropolitan Bank, Nakornthon Bank, and Siam City Bank by the end of 1999. The sales of these banks are expected to raise US\$2.5 billion. The future owners of the nationalised banks will absorb all assets and liabilities, including the non-performing loans, but the government will provide loss-sharing or stop-loss guarantees on NPLs.

Several delays in the sale of these banks are aggravating the public burden, because as the sales of the banks stall, their asset values continue to deteriorate. The central bank decided to postpone its announcement of the winning bid for Radanasin Bank because of various complications with some of the bidders. The government backed out of a preliminary deal in April 1999 with Standard Charter Bank to purchase Nakornthon Bank, and instead opened it up for competitive bidding. In the meanwhile, the bank was ordered to write-down its capital from 2 billion baht to 2 million baht and received seven billion baht in capital from FIDF.

Krung Thai Bank will eventually be privatised. A strategic partner will hold up to 20 percent of the shares, thereby reducing the government's holding to less than 50 percent. However, the sale of KTB is now on hold because of the leaked internal audit that says its NPLs are 84 percent of all loans. Such rumours, whether true or not, are certain to have adverse implications on the bank's ability to find partners and sell its shares at a reasonable price.

The government is also liberalising limits on foreign equity in financial institutions in order to attract foreign capital and make the Thai banking sector more competitive regionally. Foreign investors are allowed to acquire majority shareholding in local financial institutions for up to 10 years. After the 10-year period they will not be permitted to take up new shares until their ratio is brought down below 49 percent. The previous limit of foreign ownership was 25 percent. Four banks have been sold or on the verge of being sold to foreign banks: Radanasin Bank, Nakornthon Bank (to United Kingdom's Standard Chartered Bank), Bank of Asia (sold to Holland's ABM-Amro), and Thai Danu (sold to DBS Singapore).

A final major change in the banking sector is the Bank of Thailand's guidelines for receiving a limited banking license. Five or more finance firms with over 10 billion baht in capital are entitled to apply. Aside from a few restrictions, limited banks will function similarly to commercial banks, and after five years the limited banks can apply for full bank status.

Strengthening supervision and adoption of international best practices

An important reform measure in the financial sector is the gradual tightening of loan classification and provisioning standards. The Bank of Thailand is introducing new loan classification and provisioning rules that gradually will bring the sector in line with international standards by the year 2000. These rules will be developed in close consultation with the banking industry and international institutions.

The increased supervision follows the largely unregulated borrowing that followed the introduction of the first Bangkok International Banking Facilities (BIBF) in 1993 as part of plans to attract increased foreign capital and to open up the banking sector to new competition.

Run by local and foreign banks, BIBFs were able to accept deposits and make loans in foreign currencies. Loans through BIBFs grew rapidly in the mid-1990s, from a total of 200.8 billion baht in 1993 to 1.2 trillion baht in 1995, and a peak of 1.88 trillion in 1997.

Much of this “easy” money went into speculative ventures, such as property development, and in turn they became a major source of Non Performing Loans as they had not been adequately hedged.

But the float of the baht in mid-1997, which introduced currency risks for foreign loans, and the decline in domestic interest rates – at their lowest level in decades – relative to foreign rates, caused BIBF activities to drop rapidly.

At the end of 1999, total loans amounted to 600.1 billion baht, according to the Bank of Thailand. Bankers have become more cautious about extending foreign currency loans, and they will seek customers with counterbalancing foreign currency revenues or high expertise in risk management to hedge away currency risks. The continued government policy of low interest rates also makes foreign money less attractive.

One major change that has been introduced in the wake of the crisis is that the Bank of Thailand altered the rules on classifying loans as non-performing. The new regulations state that NPLs can be classified as normal loans once the loan restructuring is approved. The previous classification process required a three-month waiting period before the restructured loan could be classified as normal. The BOT has also put forth safeguards to prevent abuses of reclassification of restructured loans. Among these new requirements are that restructuring must be done under the CDRAC process or through the judicial courts. New loan classification rules tighten the requiring provisioning for all loans more than six months overdue and prohibit the accruing of interest on NPLs for more than six months.

Other measures completed or in the process of being finalised are capital adequacy ratios (CAR) for banks and finance companies, and new regulations on foreign exposure and lending to related parties. Banks are required by the end of 2000 to have provisions equal to 20 percent of loans in default for three months, 50 percent of loans that have been in default for six months, and 100 percent of loans in default for 12 months.

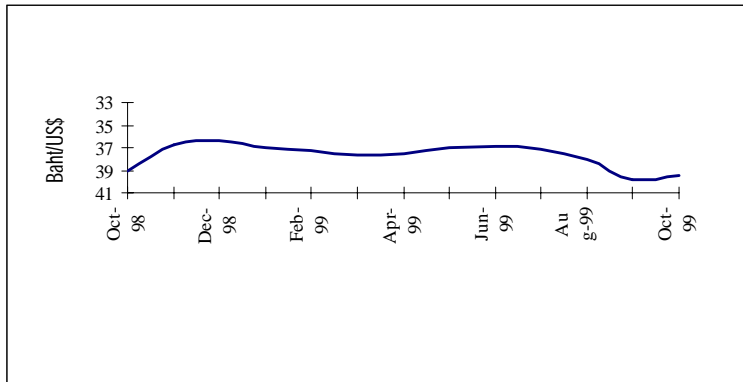
Recent changes in the legal and regulatory frameworks have tightened and strengthened the financial sector to prevent the kinds of questionable lending practices and debtor problems that contributed to the economic crisis. The Commercial Banking Law was amended to allow the establishment of asset management companies and also to facilitate the mergers and acquisitions of banks. Mergers were necessary to consolidate the banking sector into healthy institutions. The Financial Institutions Act, drafted in March 1999, intends to strengthen supervision procedures.

Other forthcoming pieces of legislation include a new Central Bank Act, which intends to strengthen the Bank of Thailand and increase its accountability, and amendments to the Currency Act. As noted earlier, the Bankruptcy Act was amended to tighten the foreclosure procedures and also to establish the bankruptcy courts. Another legislative measure includes the drafting of a deposit insurance bill for the financial system to replace the blanket guarantee that was implemented at the beginning of the recovery program.

1.3 Monetary and fiscal policies

At the onset of the crisis the Thai government implemented tight fiscal and monetary policies in accordance with the austerity requirements of the IMF program. For the fiscal year (FY) 1998 budget, the government reduced its budget to 830 billion baht, down from 916 billion baht in 1996/97. In addition to cutting public expenditures, the value-added tax (VAT) was raised from seven percent to 10 percent in August 1997 to decrease the consumption rate during a time when the current account deficit was inappropriately high and foreign reserves excessively low.

Figure 1.4: The baht's value against the US\$



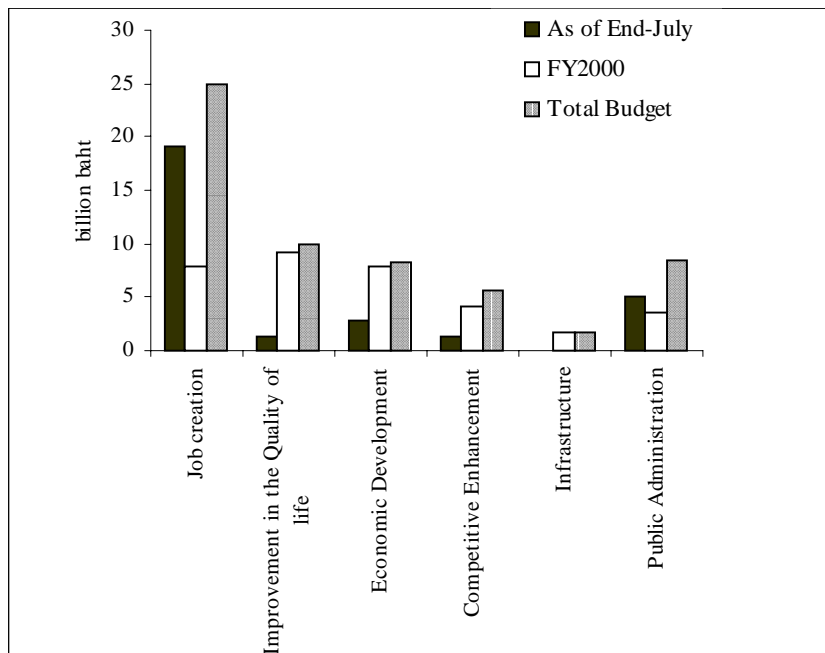
Source: World Bank

The VAT increase also intended to increase government revenue in line with the anticipated costs of financial sector restructuring. The initial goal was to produce a government budget surplus of at least one percent of GDP for the fiscal year, while cutting the current account deficit to around three percent of GDP for FY 1998. The fiscal and monetary policies also aimed to reduce annual inflation to five or six

percent. Thailand faced a serious threat in 1997, when its foreign reserves went from over US\$33 billion in late 1996 to only US\$800 million in August because of the failed attempts at defending the baht's value. Naturally two of the government's priorities were to stabilise the value of the baht, although allowing it to be determined by market forces within a certain range, and replenishing foreign reserves. To achieve these ends, the government implemented a tight and prudent monetary policy, but many economic indicators worsened as 1998 began.

The priorities were to restore the external balance of trade, stem the outflow of capital, and restore confidence in the baht. After plunging to an exchange rate of 56 baht to the US dollar in January 1998, the baht gradually recovered much of its value and has been holding relatively steady at 37 baht since January 1999. Figure 1.4 demonstrates the baht's stability and implies that the currency has found its market value.

Figure 1.5: Allocation of 53 million baht stimulus package



Source: Bank of Thailand

Domestic interest rates were maintained at a high level to prevent additional capital flight. While these tight fiscal and monetary policies in late 1997 through 1998 stabilised the baht and eventually reduced the outflow of capital, they also hurt the prospects for domestic recovery. Partially because of the

government's policies and partly because of the near collapse of the financial sector, liquidity became extremely tight and high interest rates prevented lending activity. The outcome was

that domestic demand failed to rebound, and production and manufacturing indices hit historical lows.

To make matters worse, the regional turmoil, particularly the riots in Indonesia, diminished any hope for a quick recovery. Thailand and the IMF, therefore, reassessed the economic policies and determined in February 1998 that the country's fiscal policy had to be expanded.

The revised strategy became one of stimulating domestic demand by injecting billions of baht into the economy while simultaneously reducing taxes and energy prices. One of the first changes entailed going from a one percent budget surplus to a maximum of two percent deficit to reinvigorate domestic demand.

The government's fiscal policy for 1999 continues the expansionary plans. For FY 1999, the government increased its expenditures from 830 billion baht to 939 billion. This will be complemented by a monetary policy that seeks to reduce interest rates to facilitate the recapitalisation of financial institutions.

In March 1999 the Thai government announced a new three-fold economic stimulus package: increased public expenditures, tax reductions, and lower energy prices. An additional 53 million baht was earmarked for increasing the public sector's fiscal deficit from three to five percent with the aim being to create 486,000 jobs and directly purchase goods and services worth 40 billion baht.

The increased expenditures intended to further stimulate domestic demand, create employment opportunities, improve liquidity, and address the needs of particular social groups severely hurt by the economic crisis. The tax reduction measures consisted of a temporary reduction of the VAT from 10 percent to seven percent (until March 31, 2001), eliminating the 1.5 percent VAT on small businesses, and a reduction in personal income taxes.

The objective was to stimulate private investment and consumption by improving people's purchasing power through increased disposable income. The tax reductions were expected to circulate another 54.67 billion baht per year. Naturally the Thai government will lose revenue from the tax reductions in the short run, but the expected benefit will be an improved tax collection base which will increase the government's coffers in the long run. The third component of the stimulus package entailed price reductions in electricity, fuel oil, and liquefied petroleum gas. Lower energy prices would serve to lower the cost of living for citizens and decrease production costs. The expected benefits are to facilitate greater disposable income, free up more capital for new investment, and ease the financial burden on households.

Part of the economic stimulus package included additional borrowing from overseas, namely from the Overseas Economic Co-operation Fund (US\$250 million), the Japanese Export-Import Bank (US\$600 million), and from the World Bank (US\$600 million). These loans will be used to support the expansion of public expenditures. The expected results of the government's increased expenditures for selected programs are:

- Relieve unemployment
- Develop needed skills in the workforce, especially for the poor in rural and urban areas
- Improve the quality of life for the public through building sewers, rural water systems, or public infrastructure projects, and public health centres. Figure 1.5 shows the distribution of the March 1999 stimulus package according to the five strategic categories.

The emphasis of the stimulus package, as clearly seen in Figure 1.3 is on job creation, which is arguably the most self-sustaining method for stimulating domestic demand. Nearly half of the package was earmarked for job creation.

A second economic stimulus package was presented in August 1999 to further bolster domestic recovery. The August package comprised three main components: 1) deep cuts in duties on numerous imports; 2) over 20 billion baht in capital to boost cash-strapped businesses; and 3) 65 billion baht in new liquidity for the private sector.

Duties on hundreds of capital goods and raw materials will be reduced significantly, in some cases up to 30 percent. Such dramatic reductions in tariffs will put Thailand far ahead of the requirements of the ASEAN Free Trade Area (AFTA) and the World Trade Organisation (WTO).

Several funds and other forms of capital injections were contained in the second stimulus package. The 18.5 billion baht Equity Fund for companies attempting to restructure will be financed by the Thai government, Thai private investors, the World Bank's International Finance Corporation, and foreign investors.

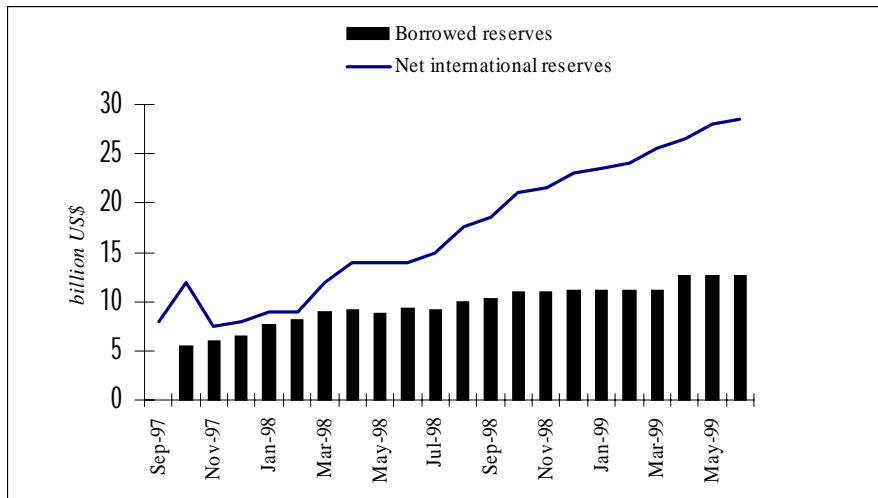
Other aspects of the capital injection focus specifically on small to medium-size enterprises (SMEs) because they contribute approximately 50 percent of the country's GDP and account for nearly 70 percent of all jobs. Two SME investment funds will be established: 1) the Fund for Venture Capital Investment in SMEs; and 2) the Thailand Recovery Fund, which will be a privately managed fund with 3.7 billion baht in initial capital.

Two other institutions will also facilitate the revitalisation of SMEs. The Small Industry Credit Guarantee Corporation will assist SMEs seeking collateral guarantees up to 20 million baht. The second, the Small Industry Finance Corporation, has already increased its capital to 2.8 billion baht and will receive another 5 billion baht from the government by 2003.

The third component of the August 1999 stimulus package aims to reinvigorate the ailing property sector, which remains a major obstacle to economic recovery. The new stimulus measures for the property sector include the following:

- The Government Housing Bank will provide 46 billion baht in mortgages, with nearly half of the amount being offered directly to borrowers
- The National Housing Authority intends to purchase 15 billion baht worth of finished and unfinished housing projects
- The Secondary Mortgage Corporation will purchase up to 4 billion baht worth of distressed mortgages from financial institutions
- Duties have been cut on property transactions.

Figure 1.6: Estimate of amount of borrowed reserves



Source: Bank of Thailand

The adjusted fiscal and monetary policies, in particular the two economic stimulus packages, appear to be paying dividends for the Thai economy. The economic performance for the first half of 1999 showed several indications that

Thailand may be emerging, albeit slowly, from the economic crisis. Prices remain stable, inflation has declined during the first half of the year, and liquidity remains relatively high.

Thailand also continues to enjoy a trade surplus, and its current account surplus for the year is expected to be better than the predictions in early 1999. Official foreign reserves, steadily on the increase since November 1997 (see Figure 1.6), are expected to be around US\$32-34 billion for 1999. The currency remains rather stable at a rate between 36-40 baht to the US dollar, due in great part to a flexible interest rate policy. Additionally, the money market rates are now around four to six percent, which is lower than the pre-crisis rates. The current lower interest rates will reduce the costs of financial sector restructuring to around two percent of GDP, compared to the earlier estimates of nearly three percent. Overall, the Thai economy is expected to achieve a modest growth rate of 1-1.5 percent.

However, the economic stimulus packages could fall short of expectations. Actual government expenditures may end up less than anticipated because of delays in foreign financing and numerous problems with implementing many of the projects funded by public expenditures.

More problematic is the likelihood that private demand will not revive on its own to stimulate economic growth, because the capacity for higher levels of private consumption and investment appear limited. Bank lending remains weak due to concerns about the rising level of NPLs among state-owned banks and the new stringent requirements for reserves. Moreover, exports continue to decline partly because of the baht's appreciation, and thus the estimates for export growth for 1999 have been revised down from four percent to 2.1 percent.

1.4 Bureaucratic reforms and privatisation

If one positive element about the economic crisis can be identified it is that the crisis impelled the government to make long overdue bureaucratic reforms and to begin reducing the government's production role in the economy. Thailand's pre-crisis systems of corporate governance and change management were severely lacking accountability, transparency, and

sufficient oversight on enterprises. Thailand is currently undertaking dramatic reforms in its bureaucracy and the 65 state-owned enterprises (SOEs) to increase the contribution and effectiveness of the private sector in the economy, to increase the efficiency of the economy, and to improve the overall welfare of Thai citizens.

The guidelines for reform are delineated in the Master Plan for State Enterprises, which was laid out in September 1998. The goal is to change the state's role from one of being a major player/stakeholder in the economy to one focusing on policy making, effective regulation, and providing a level playing field for all participants in the economy. By reducing its role as a major participant in the economy (i.e., through SOEs) and allowing the private sector to perform many of the state's economic activities, Thailand's economy is bound to become far more efficient than ever before. The government envisages maintaining an operating role only in certain economic activities deemed to be vital to the country's security, social obligations, and other necessities for the quality of life of the public.

The public sector reforms and privatisation of SOEs are expected to bring a multitude of structural, financial, and social benefits. The structural benefits to the economy include the following:

- Enhance economic efficiency and improving service quality
- Reduce the number of sectors with state-owned monopolies
- Improve the quality of goods at the lowest cost
- Expand choices for consumers
- Help private companies compete better internationally
- Completion of infrastructure investment projects (by attracting greater private investment).

The financial benefits of privatising selected SOEs will extend to the state and to the public in two ways: 1) many proceeds from privatisation, gained mainly from divestiture, will be reinvested into the economy; and 2) the investment burden on the state through loan guarantees and subsidies to SOEs will be lowered dramatically.

The social benefits to bureaucratic reform and privatisation are equally important. Among the anticipated social benefits are the following:

- Proceeds from privatisation will be channelled into social, health, and welfare benefits, such as education, labour welfare, and agriculture
- Enable the state to concentrate more on generating new employment opportunities through job training programs and other human resource development projects
- Expand essential public services.

Thailand's bureaucratic reforms and privatisation program are being implemented in four ways: legal reforms, regulatory reforms, divestiture, and transformation of remaining SOEs. This four-fold strategy represents a comprehensive approach to radically altering the public sector. The economic crisis made these needed reforms manifest, and Thailand is fully committed to the successful implementation of all aspects of the reform process.

Legal reforms

Laws are being passed and amended to provide the proper legal authority to the state to withdraw from certain economic activities and to privatise selected SOEs. Thailand's 1997 constitution provides the framework for such legislation and regulations and ensures that the public's interests will be embodied in any such alterations. One of the key pieces of legislation in this process is the State Enterprise Corporatisation Act, which enables SOEs to be transformed into corporate structures for future privatisation.

Regulatory reforms

The key change in the regulatory framework is to make a clearer separation of policy making, regulation, and operation. This includes clearly delineating the roles and responsibilities of the state agencies and institutions involved in the oversight of the economy and establishing individual regulatory bodies for each infrastructure sector (namely, telecommunications, water, transportation, and energy). Such changes will help eliminate overlap, confused lines of jurisdiction, conflicting policies and interpretations, conflicts of interest between regulatory bodies and their closely associated SOEs, and create greater accountability of the regulatory bodies. Also within this category is outright deregulation of certain sectors of the economy to allow new private sector participation in previously restricted sectors.

Divestiture

The state will divest itself from numerous economic operations and assets through the sale, lease, or other means such as concession contracts, public offerings, debt for equity swaps, and joint ventures. Selected assets and economic activities previously owned and performed by the state will be turned over to the private sector with the expectation that these assets and activities will be managed more efficiently and effectively. Divestiture will also enable the state to redirect its attention on truly public goods such as education and health.

Transforming remaining SOEs

SOEs not scheduled to be privatised are also subject to reform in order to increase their efficiency, improve their transparency, and ensure greater accountability to the public.

The privatisation plans for SOEs are generally contained in four sectors: communications, water, transportation, and energy. The sections that follow provide an overview of the plans for each sector, including the privatisation and reform of SOEs and the measures being taken to increase private sector participation in these areas, and an analysis of the progress to date.

Communications

The key activities subject to reform and restructuring in the communications sector are telecommunications, broadcasting, and postal service. Thailand has committed to fully liberalise its telecommunications sector by 2006, as stated in the Ministry of Transport and Communications' Telecommunications Master Plan (1997). The sector will commence with liberalisation through increased domestic competition and then open to foreign competitors. Initial reforms in this sector will be modest for the next two to five years in which competition will be somewhat restricted because of complexities with previously awarded concessions, but afterwards more open competition will be allowed.

Other proposed changes include the creation of an independent regulatory body called the National Communications Commission and a new Telecommunications Act.

Water

Reforms are underway in the water supply and distribution systems in Thailand. The goal is to increase the private sector's participation in providing water utilities. The Metropolitan Waterworks Authority (MWA) is weighing two options for reform: either create two separate companies called the East Bangkok Co. and West Bangkok Co., or corporatise the MWA into MWA Co. with a strategic partner.

The Provincial Water Authority (PWA) is exploring the possibility of becoming a contract manager that oversees the concession arrangements for the various regions. PWA is considering dividing itself into separate regional water utilities and allowing greater private sector participation. Both the PWA and the MWA will likely rescind their policy making and service functions and serve merely as sub-sector regulatory bodies instead.

Wastewater treatment is opening to private sector participation, which means that the Waste Water Management Organisation, created in 1996, may also be altered. An independent

regulator might be established to ensure environmental quality, provide interpretation of contracts or concession agreements, and to handle other activities as appropriate. The necessary legal reforms for the water sector are expected to be complete by the end of 1999.

Transportation

Currently the transportation sector's 14 SOEs relate to land, water, and air transportation. The Transport Sector Framework reform study was completed in April 1999, and provides a set of guidelines for restructuring the sector and its 14 SOEs, along with plans for the creation of transport regulators. Discussions include the possibility of setting up sub-sector regulatory bodies for air, land, and water. Two key privatisation plans in the transportation sector are for Thai Airways International (THAI) and the Airport Authority of Thailand (AAT). Another major transformation in this sector will be to increase the private sector's participation, particularly in activities in which SOEs provide services in competition with the private sector.

Energy

Energy is one of Thailand's most highly regulated sectors, but extensive reforms are underway to expand the private sector's role in energy production and supply. Reforms seek to lower tariffs, improve services, and increase energy efficiency and conservation. The Electricity Generating Authority of Thailand (EGAT) is the main body for electricity generation, transmission, and sale. The sector's main privatisation plans encompass the following elements:

- Divestiture of all power generation activities from EGAT, transforming the agency into an electricity transmission company
- Establishing a competitive wholesale power pool and retail competition
- Separate power supply and distribution activities.

The power industry has been using the Independent Power Producers and Small Power Producers programs over the past several years, and thus the next step is to foster a more competitive market in power and to privatise EGAT. EGAT will be corporatised as a whole but have autonomous business units operating for profit. Also, numerous power plants in the EGAT structure are scheduled to be privatised. Eventually third parties will be allowed to sell power directly to users. The final step for reform in the power sector is to introduce retail competition by 2002-2004.

In the natural gas field, the objective is to promote competition by separating the state-owned PTT Gas transportation and trading functions, and by allowing third party access to gas transmission pipelines for greater competition in supplying gas. The Petroleum Authority of Thailand (PTT) is currently being transformed into a holding company, but the final approval has yet to come from the Cabinet.

Other sectors

Forty-two other SOEs are found in several sectors, including banking, industry, commercial and services, agriculture, and social and technology. The government will assess which of these SOEs are involved in core government functions and privatise those deemed non-core activities.

Progress to date

Since the approval of the SOE Master Plan in September 1998, Thailand's report card on progress in SOE privatisation receives mixed results.

Select SOEs were placed on a “fast track schedule” for the sale of shares, and those scheduled for completion by the end of 1999 are THAI, the AAT, Esso (Thailand), and the Ratchaburi Power Plant. Divestiture of government equity in Bangchak Petroleum was scheduled to start by mid-year. Additional plans have been approved for restructuring the Natural Gas Supply Industry. The PTT is currently restructuring its subsidiaries, which are expected to be privatised in 2000. Its main achievement thus far has been in selling its stake in PTT Exploration and Production Co., Ltd. in November 1997, but this was before the Master Plan had been drawn up. Another accomplishment was EGAT selling its stake in Electricity Generating Co., Ltd.

Overall, however, progress has been slow and limited to the preliminary stages of planning and rationalisation of the organisational structure of SOEs. The groundwork for privatisation has been completed for only a few enterprises, and very little implementation has occurred. Therefore, it is likely that many of the target dates for privatisation will be missed. For instance, the Ministry of Finance is still deciding on the bidding methodology for its plans to divest in Esso Thailand, and THAI is at a similar stage of merely devising the bidding prospectus for privatisation. Amendments to the 1954 Aviation Act also need approval of the Parliament in order to allow THAI to sell shares to domestic and foreign investors, but the amendments are being held up in parliament. Likewise, the AAT is only at the point of selecting financial advisors in its plans for corporatisation despite the target of achieving privatisation by the end of 1999.

In the telecommunications sector, little progress has been made through mid-1999. The legislation for a regulatory agency and the Telecommunications Act have been delayed since 1998 due to continuing deliberations in parliament, and the National Communications Commission is yet to be established. Privatisation plans include corporatising the two government agencies in the sector, the Telephone Organisation of Thailand (TOT) and the Communications Authority of Thailand (CAT). Both agencies were expected to be privatised in 1999, but several delays are hindering progress. For instance, the Corporatisation Bill has been approved by Parliament, but it has not become law as it is awaiting an interpretation by the Constitutional Court. SOE workers challenged the constitutionality of the bill and requested that the court render a decision. However, the CAT and the TOT have completed most of the needed groundwork to proceed once the bill passes.

Many analysts expect that the privatisation of the telecommunications sector is at least a year behind schedule, but complications related to the sale of shares may actually prolong the process even further. One of the more difficult issues to be resolved is the conversion of existing build-operate-transfer concessions given to private companies, many of which were given long-term exclusive rights.

Plans for privatising the energy sector have faced strong and at times violent opposition from the state power utility labour union, in particular over the sale of the Ratchaburi power plant. SOE labour unions have vigorously opposed the privatisation of state-run enterprises, because they fear that privatisation will lead to a loss of jobs, job security, and government privileges. Social activists and labour leaders have also aired concerns over the loss of national control stemming from the sale of shares to foreigners and increased consumer prices. EGAT employees held public rallies to express their concerns, and the government assuaged them by offering to explore other ways of easing EGAT’s cashflow problem without selling the plant. This clearly contradicts the government’s stated position of selling the plant, and as a result the World Bank refuses to guarantee EGAT’s second \$300 million bond issue unless the plant is sold.

Civil service reform

In addition to privatising SOEs, the Thai government is committed to reforming the civil administration system. Thailand's 1997 Constitution, considered to be the country's most democratic ever, will protect the people's liberties and freedoms, promote their participation in the political system, and ensure that state officials do not violate the public's rights. By reforming the civil service, decentralising authority, and promoting popular participation, the government aims to improve the efficiency, effectiveness, and accountability of public personnel and government agencies.

The economic crisis heightened the awareness of the need for political reform, as many of the causes of the economic crisis related to the lack of transparency, excessive corruption, and collusion between select members of the private and public sectors. Public funds were often inappropriately allocated or used inefficiently, causing Thai citizens to shoulder the burden once the crisis erupted, and hence two important components of civil service reform are to increase transparency and institutionalise the political neutrality of the civil service.

The 1997 Constitution requires the promulgation of several pieces of legislation related to the administration of the state and expanded measures for the protection of particularly vulnerable or disadvantaged segments of the population. These constitutionally required laws, many of which have been passed by the Parliament, will protect consumers, eradicate social injustice and unfair competition, and address many of the structural weaknesses of Thailand's economy.

Many of the reforms are supported by the World Bank through policy dialogue and technical assistance. In September 1999, the Cabinet approved the report on the negotiations between the Ministry of Finance and the World Bank for a US\$400 million loan for the Public Sector Reform Loan and the Letter of Development Policy. The Public Sector Reform Loan is part of the Programmatic Structural Adjustment Loan, which will be geared at public sector reform, fiscal management, personnel management, revenue management, and decentralisation. The World Bank's executive committee is expected to consider the loan for final approval in October 1999.

1.5 Industrial and agricultural restructuring

Despite the widespread attention on Thailand's financial sector throughout the crisis, the industrial and agricultural sectors – the “real” sectors of the economy – are receiving adequate attention from the government. Restructuring plans are also being made for the industrial and agricultural sectors to make them more competitive regionally and globally and to secure their contributions to Thailand's economic recovery. The Thai government adopted the Industrial Restructuring Master Plan, which focuses on the need for industries to improve their efficiency and international competitiveness. In September 1999, the economic ministers approved in principle the Master Plan for Agricultural Industry Development of the Ministry of Industry. The plan intends to support agro-industrial development and improve the co-ordination of relevant government agencies.

Several goals have been identified to restructure the industrial sector. First, business sector liquidity must be increased by removing unnecessary government regulations or procedures that create financial burdens and inefficiencies. The second goal is to increase exports by reforming restrictive government regulations and procedures. Third, the government will assist the private sector in upgrading Thailand's industrial competitiveness.

Short-term measures for enhancing the industrial sector's productivity pertain to providing firms with the technical expertise needed to adjust to current economic realities. Longer-term

reforms focus on increasing the resources allocated to upgrading technology and labour skills. Much of the technical assistance for these reforms will be provided by the World Bank and the ADB.

As over 90 percent of Thailand's manufacturing companies are small and medium enterprises (SMEs), several specially designed programs have been developed for SMEs. These programs include measures to enhance the development of production technologies and management techniques, as well as to strengthen human resources and technical skills.

To provide equity investment to support new investments as well as to assist the restructuring efforts of Thailand's business sector, including SMEs, three funds were recently announced: the Equity Fund, the Thailand Recovery Fund, and the Fund for Venture Capital Investment in SMEs. Investments by these funds will help to lower the debt-to-equity ratios of Thai businesses as well as to lower financial costs and reduce business risks.

Furthermore, Financial Advisory Centres for SMEs are being established by the Federation of Thai Industries and the Thai Chamber of Commerce, with government financial support, to help SMEs address their financial problems, including sourcing finance, improving financial management, and restructuring debt.

The agricultural sector is also in need of reform despite not being as adversely affected by the crisis as other sectors. Thailand is one of the world's leading agricultural exporters, but substantive changes are required to boost productivity and output, and to reduce inefficiencies. Two major problems in the agriculture sector are declining farmers' incomes and a lack of access to credit for farm households in order to expand their production or carry them over in times of drought or flood. Other problems in the agricultural sector include declining yields of certain crops, stagnating exports of agricultural goods, and weak sector management, especially in terms of marketing and government regulations.

There are six main objectives in reforming the agricultural sector:

- 1) Enable the agricultural production system to comply with market demand
- 2) Increase the number of investment opportunities for farmers and other producers in post-harvest activities and agro-processing
- 3) Support and promote research and development in the agricultural sector, namely in seeds, livestock breeding, fisheries, and disease control
- 4) Conform agricultural production to the sustainable use of natural resources and minimise the adverse effects on the environment
- 5) Facilitate technology and knowledge transfers to the producers in the agricultural sector so that they are more self-reliant, productive, and efficient
- 6) Complete the development of the irrigation system based on the Master Plan, and also make steady progress in land reform.

However, due to the political sensitivities regarding Thailand's large farm population, efforts to tackle the necessary reforms have encountered several obstacles. For instance, the government still allocates a large portion of its budget to support prices for farm products. Since 1996 Thailand has reportedly spent over 184 billion baht on farm subsidies, with 46 billion baht being set aside in 1999 for selected products. Despite this subsidisation, the prices of many agricultural products remain extremely low, leading to a questioning of the utility of government subsidies.

In mid-1999 Thailand's Deputy Prime Minister Supachai Panitchpakdi recommended abolishing agricultural subsidies because of the strain on the government budget, the inefficiencies they create, and to conform with World Trade Organisation (WTO) standards.

Less direct subsidised measures are being implemented to boost the agricultural sector. For instance, the government has established the Farmers' Assistance Policy Fund to help the marketing and production of Thailand's agricultural products. Also, the government has discussed utilising other measures more extensively, such as increasing counter trade and selling farm goods on credit.

In September 1999, the Asian Development Bank approved an ambitious five-year, US\$300 million loan for institutional and structural reforms in the agricultural sector. These reforms will improve the efficiency of the country's agricultural activities, while at the same time improving living conditions of the rural population. The ADB loan will help implement the Thai government's framework for agricultural reform which was approved in May 1998. ADB is also extending two technical assistance grants. The first grant, worth US\$1 million, is intended for capacity building in the water sector. The second grant, worth \$750,000, goes toward restructuring the Ministry of Agricultural and Co-operatives to improve its governance capabilities.

The Agriculture Sector Program Loan is expected to bring several benefits to Thailand's farmers and the overall economy:

- Rationalise the use of water resources and management of watersheds
- Utilise land and other resources more effectively and efficiently
- Allow greater access to credit for poor farmers and improved extension services
- Support and promote research and development in agriculture
- improve marketing strategies for agricultural products
- Reduce government-induced inefficiencies in input procurement, price controls, and subsidies
- Reduce the reliance on importing agricultural goods
- Increase rural employment and reduce poverty
- Facilitate technology transfers.

1.6 Social and environmental agendas

The economic crisis has had extensive social impacts on Thailand, particularly in terms of education, health, and employment. Although the scope of the social impact of the crisis has not been as extensive as anticipated, the crisis and initial austerity measures contributed to higher drop-out rates among students, reduced access to health care, and led to rising unemployment and underemployment. The adverse social consequences, however, have not been distributed equally throughout Thai society, as poorer members have borne the brunt of the social impacts of the crisis.

To address these social concerns, the Thai government placed a priority on implementing a social safety net to ease the impact on the most vulnerable groups. The social safety net, with the support of the World Bank, Asian Development Bank, and the Overseas Economic Co-operation Fund, intends to assist those displaced by the economic crisis by ensuring continued access to basic health care, education services, and employment assistance for the poorer and disadvantaged members of society. In general the social agenda covers four categories: education, health, human resources development, and employment.

Education

A serious consequence of the economic crisis has been a rise in the drop-out rates of students at all levels and the subsequent increase in child labour. Many families in the lower income bracket were compelled to withdraw their children from school due to the increased financial burden of school tuition, fees, and uniforms, and also because of the short-term need for having children work to provide additional household income.

Recognising the importance of education to Thailand's future, the government allocated more of its budget to secondary education loan programs for tuition. This supplements the existing grant program sponsored by the ADB for primary education. In addition, the government has tried to ease the financial burden of education on families by expanding the coverage of the national school lunch program from 30 percent of all students to 35 percent.

The education loans are only one aspect of Thailand's overall restructuring plans for national education. The Thai government recognises the need for improving public education, and thus in July 1999 Parliament passed the National Education Act (NEA). The NEA aims to restructure and revitalise Thailand's entire educational system by decentralising the management and administration of basic education to local authorities. A major reform will be to correct the lack of co-ordination and compartmentalised national policy making that feature prominently in the ministries and agencies responsible for education. The Ministry of University Affairs will be transformed into the Commission for Higher Education and become part of the unified Ministry of Education, Religion, and Culture. The NEA also guarantees that twelve years of basic education will be provided free of charge for all Thais.

The importance of education to the Thai government is demonstrated in the national budget, whereby the education sector has received the largest percentage of expenditures the past few years. Also in line with developing a solid educational foundation, the government has taken specific steps to revamp the educational system, such as allowing more private institutions to offer services, improving the quality of primary school teachers, and setting a timetable for complete university autonomy by 2002.

Health

The crisis has reduced many people's access to health care because of reductions in incomes and lay-offs. The various social sector programs seek to ensure continued access for poorer members of society to basic health care. Financing from the World Bank, the ADB, and the OECF provides free medical treatment for many low-income families and individuals while also expanding and improving rural health care facilities. Rural health care facilities are receiving greater numbers of staff through redeployment programs that seek to make health care more equitable throughout the country.

Also, the government has protected maternal and child health and HIV/AIDS programs from budget cuts to ensure continued care for these needy segments of the population.

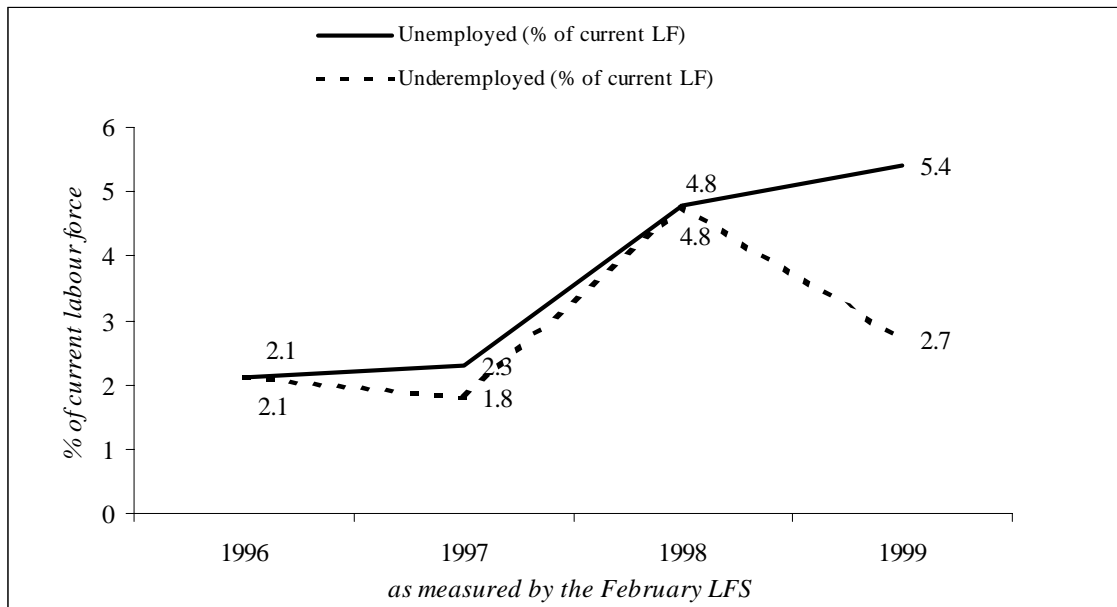
Human resource development

The economic crisis revealed that Thailand had not adequately prepared its labour force for new technology and higher-value added industries. The major shortcoming was a lack of attention on human resource development. The segments of the population that were the hardest hit by the economic crisis in terms of unemployment were those with low levels of education and few skills. Thailand aims to revamp its labour market to make it more responsive to the needs of society and of industry, which entails skills development, training, and other aspects of human resources. Training activities are being promoted by simplifying the procedures for tax deductions for employers under the Vocational Training Promotion Act. A Skill Development Fund has also been created, and it provides incentives for the private sector to contribute.

Employment

The widespread impact of the crisis and its duration created rising unemployment, particularly for disadvantaged groups. Figure 1.7 shows that unemployment rose quickly from 1997 to 1998, but it has slowed since 1998. In response, the Thai government has developed several employment programs to help these people return to work and, for short-term measures, assist them with greater social security coverage.

Figure 1.7: Unemployment and underemployment (<20 hours a week)



Source: The World Bank

The March 1999 stimulus package started numerous labour intensive projects for temporary employment. Approximately 24.8 billion baht of the package was targeted for creating 86,000 jobs for skilled workers and 400,000 jobs for unskilled workers. Several of the programs supported by the World Bank, the ADB, and the OECF provide two-year employment. Other efforts consist of "micro-credit" programs to enable unemployed people to become entrepreneurs.

Workers are also being aided by the Centre for Assistance to Laid-Off Workers, and soon parliament will pass the Labour Protection Act, which will provide compensation funds for unpaid severance payments. The funds for these compensation payments will derive from fines on companies violating the Labour Protection Act.

Specific social programs

With the help of the World Bank, the ADB, the OECF, and other agencies, Thailand has implemented several social sector programs to improve the aforementioned areas.

Social Sector Program Loan (SSPL): The SSPL provided a quick-disbursement package to economically disadvantaged groups while developing human resources and improving the delivery of social services. Some its major contributions include:

- A US\$25 million scholarship fund to 200,000 primary and secondary school students who were unable to continue their education
- US\$42.5 million in student loans to 100,000 higher secondary and university students
- Free medical treatment and improved rural health care facilities for 2.4 million people
- Support for health, disability, death, and maternity benefits for laid-off workers
- Job training projects for 120,000 people.

Social Investment Program (SIP): SIP is a project loan from the World Bank and the OECF, along with support from the United Nations Development Program (UNDP) and AusAid.

Twenty-two million baht has been earmarked for assisting the unemployed, underprivileged, and poor.

Miyazawa Fund: In conjunction with the World Bank, Japan pledged 53 billion baht in 1999 to create jobs and support other social sector activities, such as overall quality of life, economic development, competitive enhancement, infrastructure, and public administration. By the end of July 1999, over 18 billion baht of the fund had been spent.

Environmental issues

The economic crisis has given greater impetus to the social, economic, and environmental objectives articulated in Thailand's 8th National Economic and Social Development Plan (1997-2001). The 8th Plan sets forth a framework for coping with the challenges of social change, ensuring economic growth, and preserving the environment for sustainable development.

The Plan calls for utilising the country's natural resources more effectively for economic growth and social development, and at the same time preserving the environment for future generations. The current economic difficulties have given renewed vigour to these objectives. The efficient use of natural resources and promoting sustainable and renewable environmental activities are top priorities. More than ever Thailand has realised the importance of a strong natural resource base to reduce the dependence on imports and to insulate itself from drastic world price fluctuations.

1.7 The outlook for Thailand

The economic crisis has been a painful lesson for Thailand, but it also presents an opportunity to reform its political and economic systems to make the country re-emerge more democratic, equitable, and prosperous in the long term. The reforms to date appear to be moving the country towards these goals. Economic data released in mid-1999 indicate that Thailand's economy is starting to recover, albeit slowly. Manufacturing, agriculture, investment, consumption, and exports all showed gains in the second quarter of 1999 compared to a year ago, and Thailand's external debt and inflation rate are dropping. The positive signs of recovery have led the Thai government, the World Bank, and the IMF to revise their initial GDP growth projections for 1999 from one percent to the current estimate of three to four percent.

The Thai government remains confident that economic recovery is at hand, and therefore it announced in September 1999 that it does not expect to draw the remaining US\$3.7 billion from the IMF rescue package. Thailand will continue with the IMF programme to maintain the right to utilise the remaining credit until May 2000, but this is only a precautionary measure in case the external environment, namely the regional economy, were to deteriorate.

Despite several positive economic signs and the expectation that further IMF funds will not be necessary, the Thai government is aware of the challenges that still lie ahead. Many of the political and economic reforms are only in the initial stages, while others are yet to be started. Several crucial pieces of legislation required under the constitution are bogged down in Parliament, and the two-year deadline for their passage, as stated in the Constitution, is approaching quickly. Discouraging macro-economic data came out at the end of the second quarter, such as a rising government fiscal deficit, a continuing contraction in the financial and construction sectors, and the slow pace of financial restructuring.

Furthermore, the Stock Exchange of Thailand and the value of the baht dropped sharply in September 1999, raising concerns that fundamental problems still need to be tackled, especially in the financial sector.

Moreover, several daunting tasks await the social sector, particularly the restructuring of the national education system, human resource development, and an improved social safety net. The failure to address these problems could make Thailand vulnerable to another crisis in the future.

What lies ahead for Thailand is still uncertain, but the economy and the Thai people have exhibited their resiliency and responsiveness when confronted by the worst economic crisis in the country's long history. Improvements and reforms are in progress, and the key task is to fully implement the structural reforms in order to set the foundation for a sustainable economy. This requires a strong sense of public service by the Thai government, a high level of citizen participation, and a socially responsible private sector. Thailand's rapid economic growth from the 1980s until the mid-1990s demonstrates that the key elements for development are already present, and with a bit of fine tuning a just, equitable, and prosperous society will be institutionalised for subsequent generations.