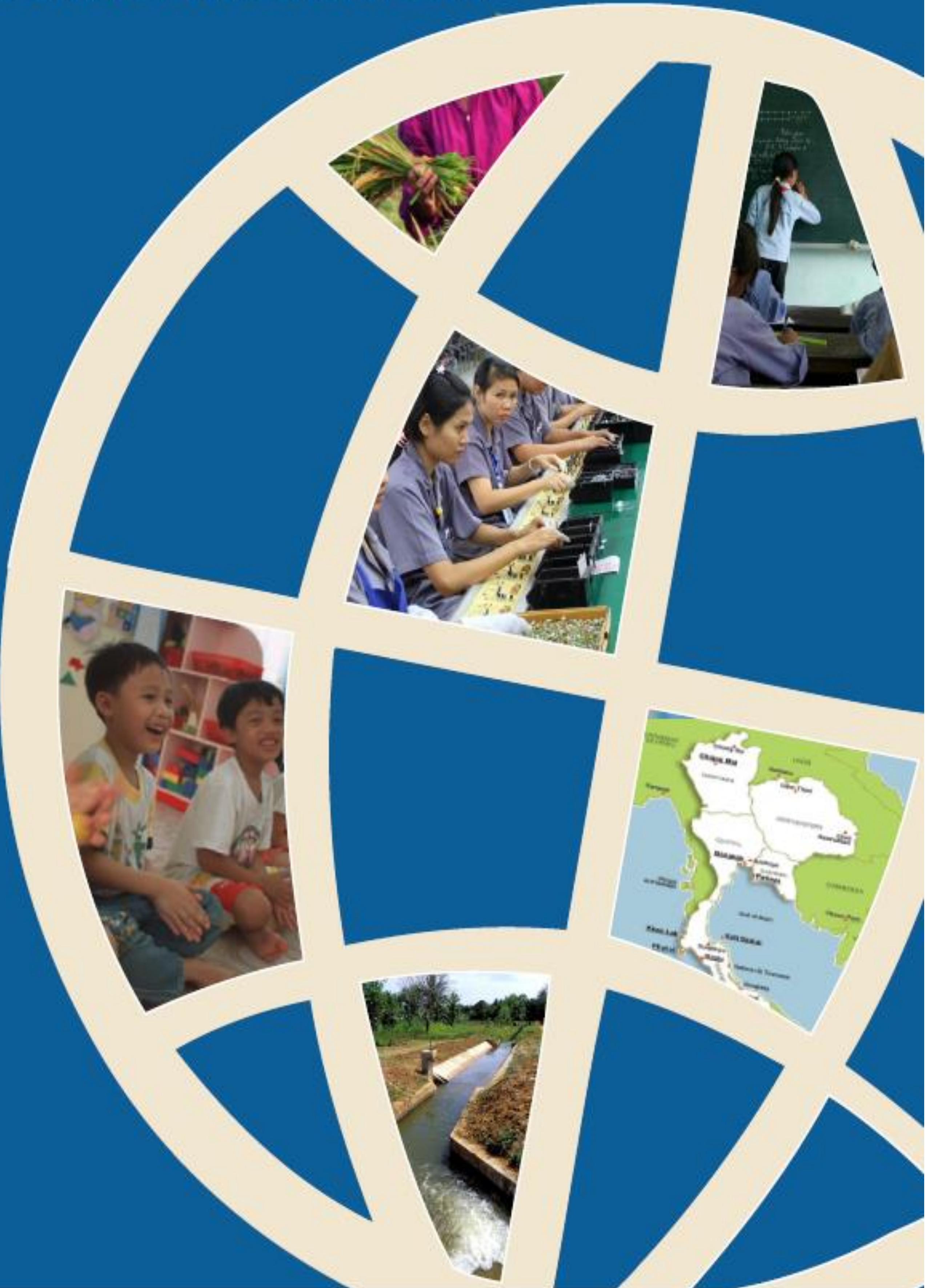
The World Bank

Thailand
ECONOMIC MONITOR



THAILAND ECONOMIC MONITOR

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THAILAND ECONOMIC MONITOR

SUMMARY

The Thai economy has been recovering slowly from the Global Financial Crisis compared to countries like Malaysia and China. Growth in 2013 is projected to be 3 percent with slower than expected performance in all components of GDP – consumption, investment, net exports and government spending. While some of the weakness in exports can be explained by the structure of production - falling global PC sales relative to tablets may have reduced exports of hard disk drives, sectors such as agro-products and metals have also performed poorly. The weakness in household consumption is partially explained by tax incentives for car purchases that expired at the end of 2012 and led to preponing of consumption. The fast growing levels of household debt, more rigorous macro prudential measures by the Bank of Thailand, and arrears in payments on the Paddy Pledging Program[1] have also been contributing factors. The slowdown was evident by the third quarter, before the protests began. The protests are unlikely to have had a significant macroeconomic impact in 2013.

Growth is projected to be 4.0 percent in 2014 as the global economy recovers. Exports should accelerate and may well be helped by the tapering of the US Quantitative Easing (QE) as the baht depreciates. As household financial balances begin to strengthen, consumption should recover, albeit slightly. Downside risks arise if the political unrest is prolonged. Tourism receipts, consumer confidence, and investor confidence will be negatively affected by the political unrest. Large public transport infrastructure projects may be delayed if there are delays in forming the new Government.

Taking a longer perspective, there remains visible inequality in public service delivery and human achievement outcomes. This is evident even at the regional level. Addressing the regional disparities is important for Thailand not only from a social equity perspective, but also from a competitiveness and economic growth perspective. As the population ages, Thailand is seeking to move to a high income economy. Such a transition will require a much broader base of healthy and high skilled citizens. Suggested policy responses include (a) rebalancing public spending regionally, (b) improve the functioning of local administration by devolving more responsibility to local levels, and (c) supporting greater accountability at the local level. These issues are discussed in Part 2.

PART I. MACROECONOMIC DEVELOPMENTS IN 2013 AND 2014

A. Economic Developments in 2013

The Thai economy expanded by 3 percent in 2013 with slower growths of household consumption and merchandise exports (Table 1). Household consumption expanded by only around 1.3 percent in 2013 compared to its 6.7 percent growth in 2012. Merchandise exports in 2013 contracted by 0.4 percent in real GDP terms following a similar contraction in the post-flood 2012. Their slowdown was reflected in manufacturing production which contracted since the second quarter of 2013 (Figure 1). With the slowdown in production coupled with the fact that many firms had invested in 2012 to rehabilitate themselves from the 2011 floods, private investment grew by just

[1] As of February 10th, 2014, the Program has still owes farmers a total of Bt130 billion or around 1 percent of GDP, of which Bt700 million is for paddy pledged in 2012/13 harvest year and Bt129.3 billion for paddy that has been pledged since October 2013.

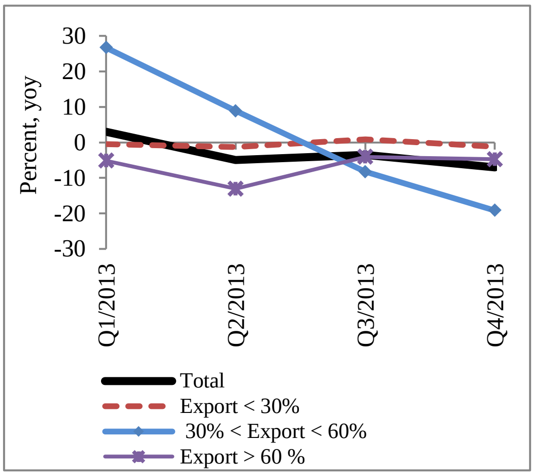
around 1 percent. As a result, domestic demand expanded by less than 2 percent in 2013, compared to 9.4 percent in 2012. With the slowdown in production and consumption, imports grew by only 2.2 percent, resulting resulted in a 10 percent growth in net foreign demand which supported growth in 2013.

Table 1: Real Gross Domestic Product Growth, 2012 and 2013
(Percent, year-on-year)

	Share of 2012 GDP	2012	2013 Q1	2013 Q2	2013 Q3	2013 Q4e	2013e
Total Consumption	62.2	6.8	4.2	3.3	0.5	0.3	2.0
Private consumption	52.1	6.7	4.4	2.5	-1.2	-0.4	1.3
Government consumption	10.1	7.5	2.9	7.6	7.4	4.5	5.8
Gross Fixed Capital Formation	22.8	13.2	5.8	4.7	-6.5	2.4	1.4
Private Investment	18.0	14.4	2.9	2.0	-3.3	3.0	1.1
Public Investment	4.8	8.9	18.8	15.4	-16.2	0.0	2.5
Total Domestic Demand	**85.9**	**9.4**	**5.0**	**3.8**	**0.1**	**-1.0**	**1.9**
Exports	73.0	3.1	8.3	2.9	3.9	1.2	4.0
Goods	58.0	-0.4	3.7	-1.5	-1.4	-2.0	-0.4
Services	15.0	19.1	25.7	22.4	25.5	12.0	20.9
Imports	59.6	6.2	8.1	4.5	0.7	-2.3	2.6
Goods	50.5	6.5	9.5	4.4	-0.5	-3.7	2.2
Services	9.1	4.6	1.2	5.3	7.4	5.0	4.7
Net Foreign Demand	**13.5**	**-8.9**	**9.0**	**-6.0**	**18.6**	**16.5**	**10.3**
GDP	**100.0**	**6.5**	**5.4**	**2.9**	**2.7**	**1.3**	**3.0**

Source: NESDB and World Bank Staff Calculation
e = estimated
p = projection

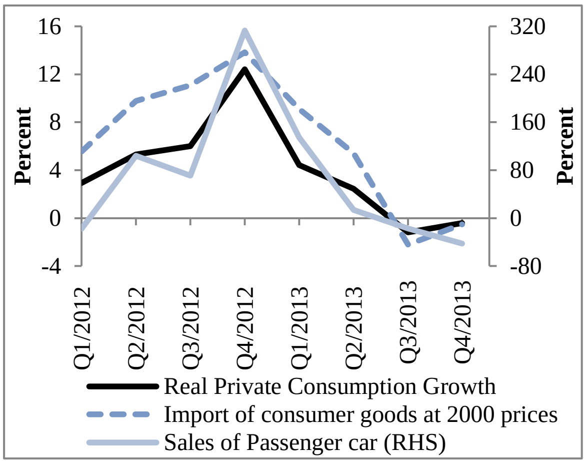
Figure 1. Manufacturing Production Growth by Export Intensity



Source: Bank of Thailand (BOT)

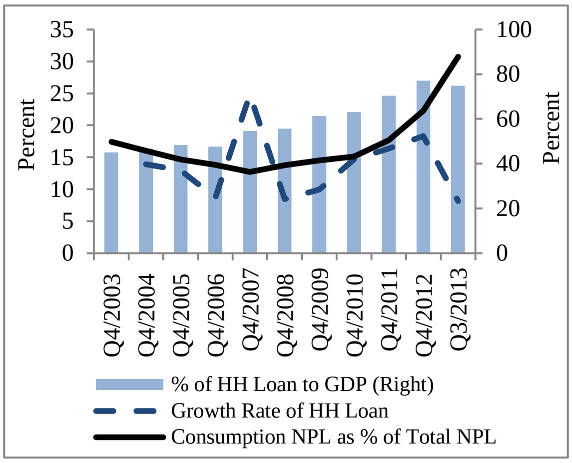
Household consumption expanded modestly in 2013. Following its peak in the fourth quarter of 2012, household consumption started to decelerate in the subsequent quarters reflecting the declining impact of government's income and consumption stimulus measures implemented in 2012 such as the minimum wage increase and the First Car Program. Sales of passenger cars that rose by more than 100 percent year-on-year in the first quarter of the year contracted by 42 percent by the fourth quarter of 2013 (Figure 2). In addition, the arrears in the Paddy Pledging Program which amounts to Bt130 billion or 1 percent of GDP will limit rice farming household spending until they are paid. Consumer's purchasing power was also constrained by the current high level

Figure 2. Growth of Real Household Consumption and Its Indicators



Source: BOT and World Bank Calculation

Figure 3. Household Loans and Consumption Non-Performing Loans

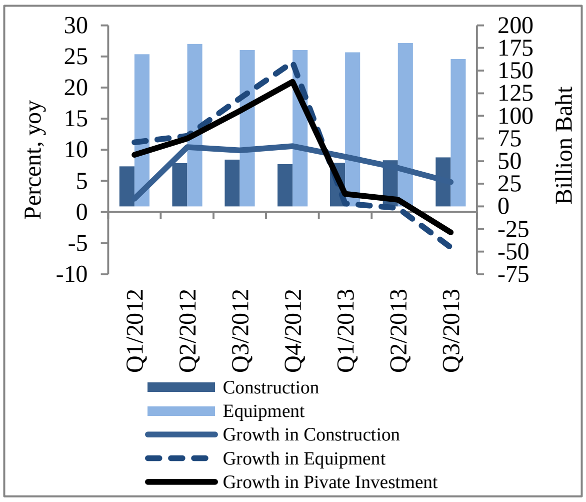


Source: BOT and World Bank Calculation

of household debt (80 percent of GDP in the third quarter of 2013). Banks have slowed down consumer loan growth in the third quarter of 2013 as the share of consumer non-performing loans (NPL) has risen quickly to a third of total NPLs by the end of 2012 (Figure 3). With these conditions, real private consumption is estimated to grow moderately by around 1.3 percent in 2013 (Table 1).

Private investment, coming from the extraordinarily high base from post-floods investment in 2012, was dampened by sluggish domestic demand and the uncertain global environment. This was particularly true for investments in the form of equipments which contracted by almost 6 percent year on year in the third quarter of 2013 (Figure 4). For the entire 2013, private investment will expand by around 1 percent.

Figure 4. Real Private Investments

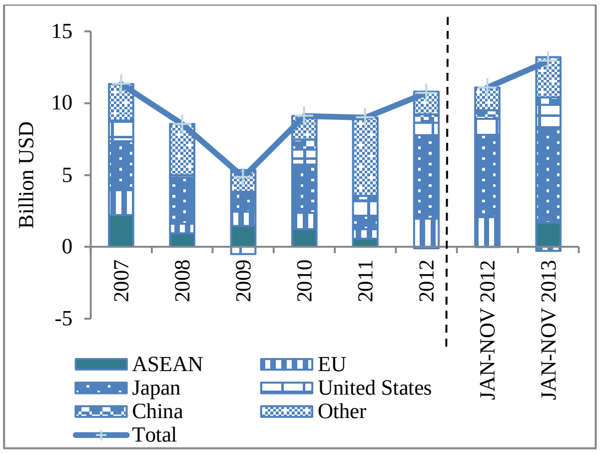


Source: BOT, NESDB and World Bank Calculation

Foreign direct investment had supported private investment growth as it continued to rise in 2013. Total net foreign direct investments stood at US$12.9 billion in the first 11 months of 2013 compared with US$11 billion in the same period of 2012. In the first 11 months of 2013, there was a net outflow of foreign direct investment (FDI) from the EU at US$0.26 billion, mainly from the Netherlands. This was, however, offset by higher investments from Japan, ASEAN, and the US (Figure 5).

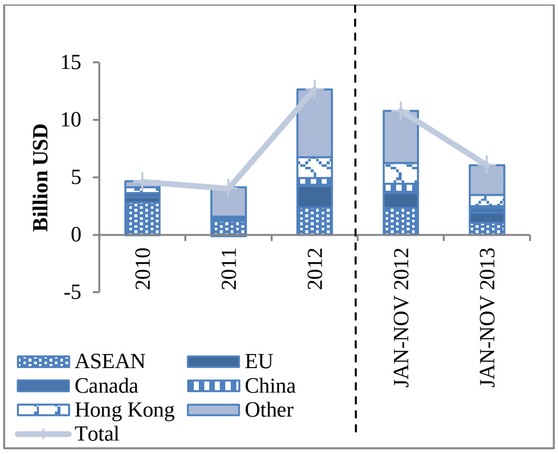
Direct investments abroad by Thais, on the other hand, have dropped from its peak in 2012, but remains at a high level. In the first 11 months of 2013, Thai firms have invested US$6.1 billion compared to US$10.8 billion in the same period of 2012. Thai direct investment abroad was quite high in 2012 with aggressive investments in China, Hong Kong (China), the EU and Myanmar. As the asset prices in the Eurozone and the Euro weakened, Thai firms took the opportunity to invest there in 2012. Thai firms also entered Myanmar as the country opened up to foreign investors. These investments, however, have decelerated in 2013 with the exception of investments in Hong Kong (China). However, this investment level is still high when compared to pre-2012 levels, signaling the ability of Thai firms to expand their business abroad (Figure 6).

Figure 5. Net Foreign Direct Investment in Thailand



Source: BOT and World Bank Calculation

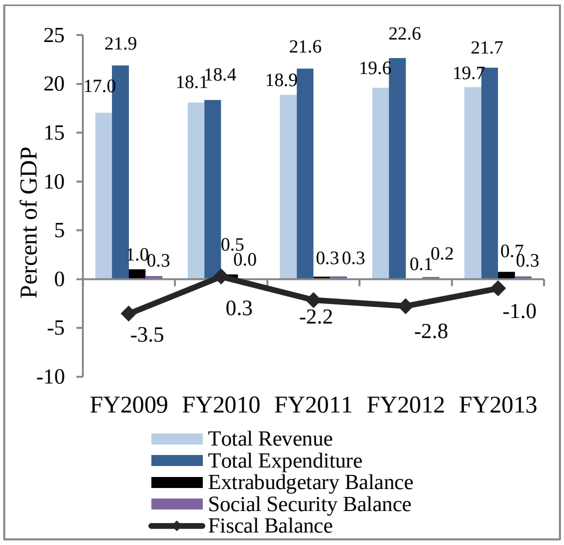
Figure 6. Net Thai Direct Investment Abroad



Source: BOT and World Bank Calculation

In 2013, public investment is estimated to expand by around 2.5 percent as the delays in disbursements continues into the final quarter of the year. Public investment in real terms grew by more than 15 percent year-on-year in the first two quarters of the year before contracting by 16 percent in the third quarter. The disbursement from Bt350 billion Water Management Project, an off-budget expenditure which was planned for the second half of 2013, was delayed since the Central Administrative Court has ordered the government to conduct public consultations prior to the actual implementation. Nevertheless, the off-budget investment spending in 2013, which includes the TKK program[2] and the initial disbursements from Water Management Project, have contributed to public investment growth.

Figure 7. Government Actual Revenues, Expenditures and Fiscal Balance



Source: CEIC and WB Calculation

Note: Total expenditure includes both budget and non-budgetary items such as the TKK and Water Management Projects

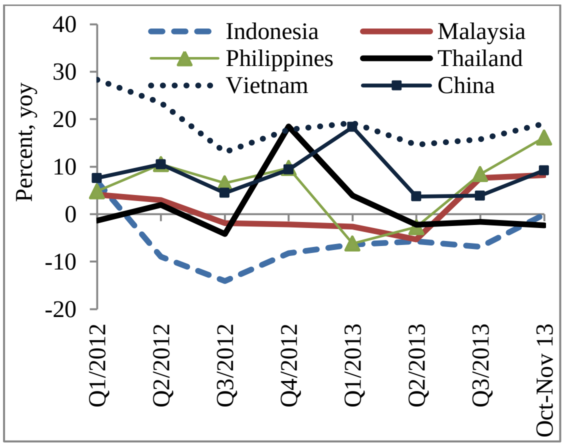
Slowing public investment led to a falling deficit and small rise in public debt in 2013. The FY2013 ended with a total deficit (budgetary and non-budgetary which includes the Paddy Pledging Program) of Bt234 billion, equivalent to around 2 percent of GDP, compared to 3 percent in FY2012. Including also the extra-budgetary balance and the social security balance, the total fiscal balance for FY2013 stood at a deficit of 1.0 percent compared

[2] TKK or Thai Kemkaeng program is the second stimulus package of Bt400 billion issued under a Emergency Decree in 2009 to cope with the impact of the Sub-prime Crisis.

to 2.8 percent in FY2012 (Figure 7). According to the Public Debt Management Office's latest data, public debt[3] to GDP stood at 45.3 percent in November 2013, compared to 43.6 percent at the end of 2012.

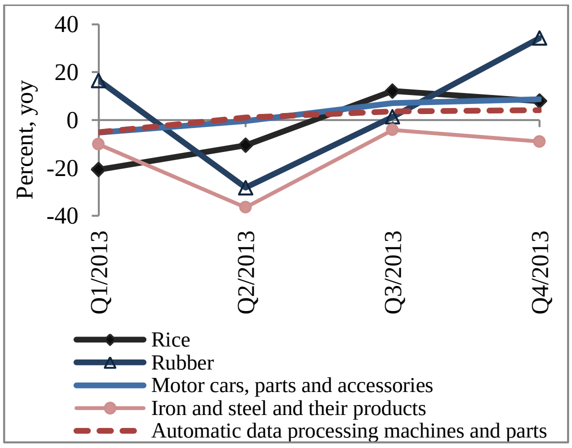
Thailand's exports have been recovering more slowly than others in the region. Figure 8 shows that exports of most other countries have either not contracted or have recovered more quickly that of Thailand. In 2013, exports of goods contracted by 0.2 percent[4] from the previous year. A contraction in export of goods is visible in most of Thailand's major trading partners – Japan, the US, EU and particularly China, which is Thailand's largest export market. By the end of 2013, only Thai exports are still contracting. This could be explained by the types of products that Thailand exports. Thai exports that fell are notably agricultural products, hard disk drives, and metal and steel (Figure 9). Agro exports fell from the fall in rice exports as rice stocks from the Paddy Pledging Program have been marginally released, and there was a decline in shrimp production following a disease outbreak. On the other hand, the fall in rubber prices by almost 10 percent in 2013 has reduced the export value of rubber (which makes up almost half of Thailand's agricultural exports). Exports of hard-disk drives contracted by 5.6 percent in 2013 of the year as demand for computers fell stemming from the decline in global purchasing power as well as competition from tablets. The latter points to the declining competitiveness of the Thai exports, making it less resilient to downturns in the global demand when compared to competitors.

Figure 8. Export growth of selected East Asian countries



Source: CEIC

Figure 9. Export growth of key export products



Source: Ministry of Commerce (MOC) (Customs basis)

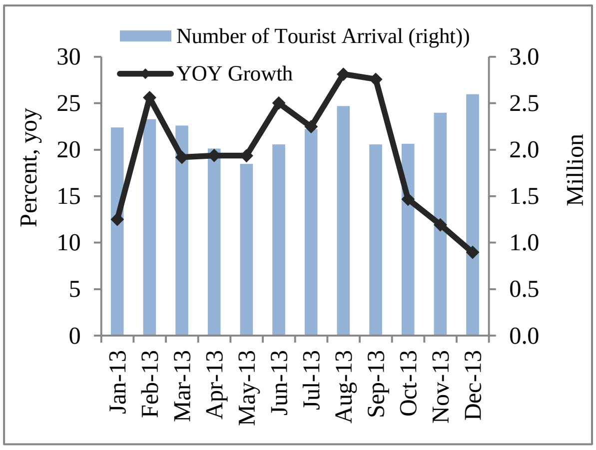
Exports of services in 2013, on the other hand, were robust with record high tourist arrivals until China's new tourism law and political unrest took their toll towards the end of the year. Tourism receipts have contributed to the rise of export of services in real GDP in the first three quarters of the year by 25 percent (y-o-y), the highest in a decade. Tourist arrivals in 2013 have increased by 22 percent year-on-year in the first three quarters There was, however, was a significant slowdown in tourist arrivals in the last quarter of 2013, growing by only 10.7 percent year-on-year, as

[3] Public debt includes domestic and external debt of the Central Government, non-financial state-owned enterprises (guaranteed and non-guaranteed by the Central Government), and financial state-owned enterprises (guaranteed by the Central Government).
[4] Based on balance of payments (BOP) basis

China announced a new tourism law and the political unrest broke out at the end of October in Bangkok (Figure 10). Nevertheless, tourist arrivals in 2013 were at a record high of over 26 million.

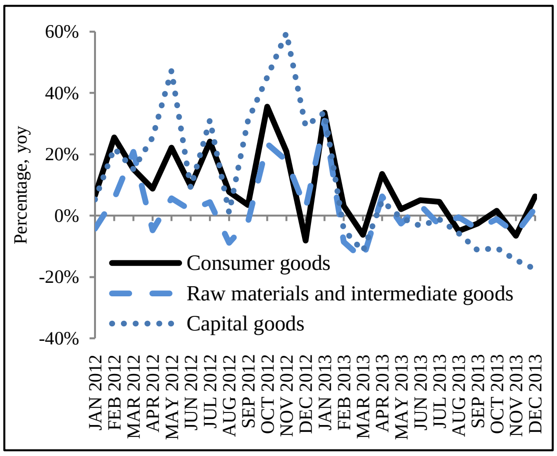
In line with the slowdown in merchandise export growth, imports of goods contracted in 2013. In the 2013, imports in US dollar terms contracted by 0.4 percent year-on-year. However, excluding the imports of gold and fuel, imports contracted by 1.7 percent. Imports have started to slowdown since the second quarter of 2013 with the slowdown in exports, investments, and household consumption. Imports of intermediate goods and machineries and equipment contracted in 2013, while imports of consumer goods expanded only modestly (Figure 11).

Figure 10. Tourist Arrivals



Source: BOT

Figure 11. Imports by product group

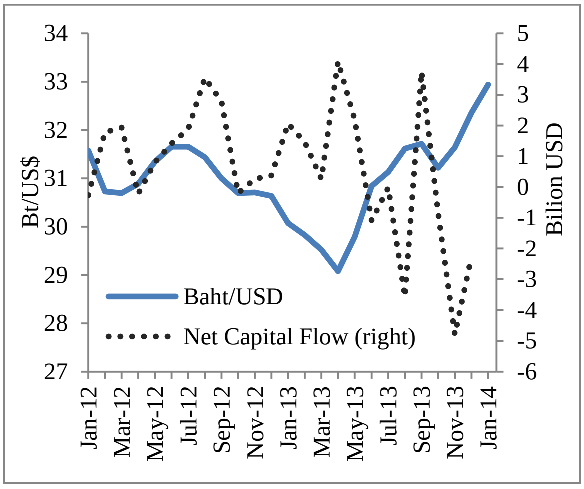


Source: BOT (Balance of Payments basis)

Capital inflows have been quite volatile in 2013. Net capital inflows into Thailand have been high starting in the third quarter of 2012, adding up to US$ 8.7 billion in the second half of 2012, and were US$9.0 billion in the first half of 2013. However, by June 2013, the trend had reversed at the news of a possible tapering of the US Quantitative Easing (QE) (Figure 12). There was a net outflow of more than US$7.7 billion in the second half of 2013, particularly from the capital market and to deposits abroad. Hence, net capital inflows in 2013 were only US$1.4 billion compared to US$14.4 in 2012.

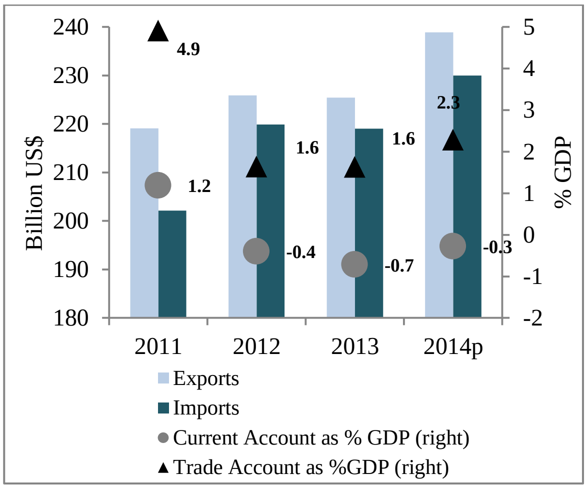
International reserves in 2013 stood at US$167.2 billion compared to US$181.6 billion in 2012. International reserves at the end of 2013 were equivalent to 2.8 times of Thailand's total external debt. The lower level of reserves in 2013 is due to the decline in the balance of payments from a US$5.3 billion surplus in 2012 to a US$5.0 billion deficit in 2013 as both the current account and the capital account balances in 2013 were smaller than those of 2012. The current account was in a US$2.8 billion deficit in 2013 (0.7 percent of GDP) compared to the US$1.5 billion deficit in 2012 (0.4 percent of GDP) (Figure 13). Similarly, there was only a US$1.4 billion capital account surplus in 2013 compared to US$14.4 billion surplus in 2012.

Figure 12. Net Capital Inflows



Source: BOT

Figure 13. Trade and Current Account Balances

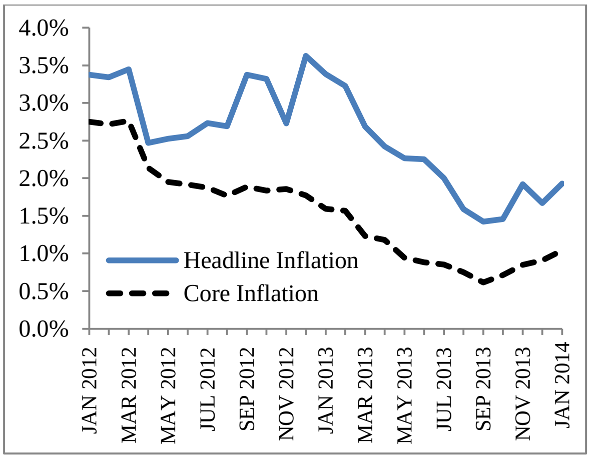


Source: BOT and World Bank staff calculations

Headline inflation (core inflation) declined to 2.2 (1.0) percent year-on-year in 2013. This was a decline from 3.0 (2.1) percent in 2012 (Figure 14). The food and beverage prices rose 3.4 percent year-on-year in 2013, led by increased in the prices of meat, poultry and fish index of around 6.6 percent. On the other hand, prices of non-food and beverage products rose by about 1.5 percent year-on-year. The fall in import prices (including oil prices) by 2 percent year-on-year since the beginning of the year have also contributed to the slower increase in non-food prices in 2013. The government had also continued to subsidize energy retail prices, especially the diesel and natural gas (NGV).

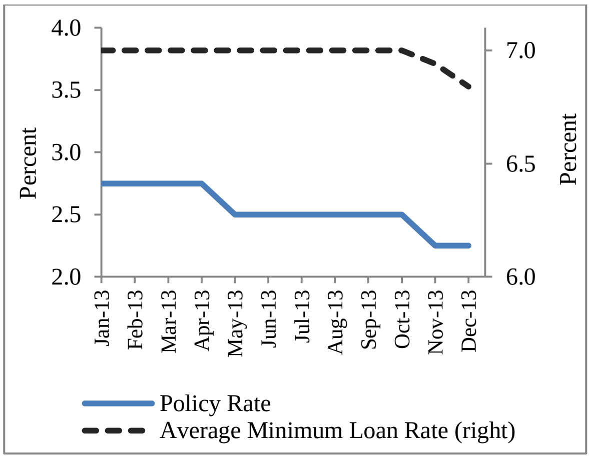
Policy rate has been reduced in November in response to the weak economic out turn and low inflation. With the low threat of rising inflation in the near future, coupled with the foreseeable slowdown in domestic demand, the Central Bank reduced its policy rate (1 day repurchase rate) by 0.25 percentage-points to 2.25 percent in November of this year. This is the second reduction this year, with the previous 0.25 percentage-point reduction in May when capital inflows peaked and there were sign of slowdown in domestic demand. Commercial banks responded in November by reducing their minimum loan rates slightly (Figure 15).

Figure 14. Core and Headline Inflation



Source: Ministry of Commerce

Figure 15. Interest rates



Source: BOT

B. Outlook for 2014

The Thai economy is projected to grow by 4.0 percent in 2014. However, this would depend on the pace of the global recovery as well as the duration of the political unrest in the country. Thai exports will benefit from the recovery in the global economy, especially those of the US and the EU which are Thailand's major trading partners. If the global economy recovers as expected (see Box 1. Recovery in the Global Environment and Implications for Thailand) and the on-going protests in Bangkok ends in June with a government being set up by then, real GDP could grow by 4.0 percent this year. However if the political turmoil lasts until June and the global economy does not recover as expected, growth could be lower than 4.0 percent.

With the recovery in the global economy, exports of goods are projected to recover in 2014, with a higher trade surplus and lower current account deficit. Exports should accelerate as the global economy recovers (see Box 1. Recovery in the Global Environment and Implications for Thailand) and may well be helped by the tapering of the US Quantitative Easing (QE) as the baht depreciates. Exports are expected to grow by 6 percent (in US dollar terms) in 2014 with the recovery of Thailand's major export markets, particularly the US and EU, larger shrimp exports after the shrimp disease outbreak was controlled, and larger rice exports as rice stock are released by the Government. As exports recover, import growth should also accelerate to around 5 percent. The trade balance is projected to be 2.3 percent of GDP, slightly higher than last year's 1.6 percent. The increase in trade surplus will contribute to a lower current account deficit this year – 0.3 percent of GDP compared to the 0.7 percent deficit in 2013 (Figure 13).

Tourism receipts, on the other hand, should continue to grow but more modestly than in 2013. China's new tourism law continues to be in effect and the on-going political unrest will result in a slowdown in tourist arrivals mainly during the months of the unrest (see Box 2 on Economic Impacts of Political Unrest). It is therefore estimated that exports of services will grow at around 10 percent in 2014 if the protests in Bangkok end in June. This compares to a 20 percent expansion in 2013 (Table 2).

On the domestic front, household consumption would recover slightly this year as household financial balances begin to strengthen. Households have begun to adjust their consumption since the second quarter of last year when the impact of the consumption stimulus measures that ended since end-2012 stated to dwindle (Table 2). The reduction in personal income tax that is effective in 2014 would also help raise effective incomes of households. However, households are likely to be more cautious in their spending this year due to several uncertainties around the impact of the political turmoil, global recovery, and the disbursements of the Paddy Pledging Program; at the same time, their debt levels remain high. Household consumption is therefore expected to expand by 1.8 percent from that of last year, a slight acceleration from its 1.3 percent growth in 2013.

Despite the political unrest, private investment should recover in 2014 as seen by the high levels of project approved by the Board of Investments since 2012. The Board of Investment (BOI) project approvals, a good 1-2 year leading indicator of future investments, were particularly high in 2012 and 2013. The approved investment values by BOI doubled in 2012 and 2013 from that of 2011, led by large jumps in the services and infrastructure, metal processing, and agro-products (Figure 16). Moreover the strong recovery of the global economy from 2014 onwards continues to make Thailand an attractive production base for exports, especially for Japanese multinational companies (see Box 1. Recovery in the Global Environment and Implications for Thailand). Hence,

Box 1. Recovery in the Global Environment and Implications for Thailand

Recovery of the global economy is forecasted to gain strength in 2014 and 2015. The world economy is projected to expand by 3.2 percent growth in 2014 and 3.4 percent in 2015 compared to 2.4 percent in 2013. The recovery is led mainly by the recovery in the US and the Euro area (see Table 1.1). China will continue to grow at a high rate of 7.5-7.7 percent, the same as in the previous years.

World trade volume will also expand this year as global demand rises. World trade volume is projected to grow by 4.6 percent in 2014 and 5.1 percent in 2015, up from only 3.1 percent in 2013. This is a positive development for Thailand's export which is closely linked to world trade growth.

Table 1.1. The Global Economy (2012-2015)

(Growth: Percentage change, unless otherwise noted)

	2012	2013e	2014f	2015f
World trade Volume (GNFS)	2.4	3.1	4.6	5.1
Consumer Prices				
G-7 Countries	1.8	1.3	1.8	1.9
United States	2.1	1.5	1.7	2.0
Commodity Prices (USD terms)				
Non-oil commodities	-8.6	-7.2	-2.6	-0.2
Oil Price (USD per barrel)	105.0	104.1	103.5	99.8
Oil Price (% change)	1.0	-0.9	-0.6	-3.5
Net Private Capital Inflows (% of GDP)				
Developing countries	5.0	4.6	4.2	4.2
East Asia and Pacific	4.7	4.4	4.0	3.9
Real GDP growth				
World	2.5	2.4	3.2	3.4
High income	1.5	1.3	2.2	2.4
Euro Area	-0.6	-0.4	1.1	1.4
Japan	1.9	1.7	1.4	1.2
United States	2.7	1.8	2.8	2.9
Developing Countries	4.8	4.8	5.3	5.5
East Asia and Pacific	7.4	7.2	7.2	7.1
China	7.7	7.7	7.7	7.5
Excluding China and India	2.9	3.2	3.6	4.0

Source: World Bank, Global Economic Prospect, January 2014

Oil prices in 2014 and 2015 are forecasted to be lower than in 2013. This reflects greater oil supply in US and easing tensions in Iran. This is also good news for Thailand, a net oil importer.

On the other hand, net private capital inflows to developing countries, including East Asia and Thailand, are expected to decline this year as the US Quantitative Easing (QE) is tapered. Net private capital flows into East Asia are projected to be at around 4.0 percent of the region's GDP compared to 4.4 percent in 2013. Given so, capital inflows into the Thai capital markets (stocks and bonds) will likely soften compared to last year.

Table 2: Real Gross Domestic Product Growth, 2012-2014
(Percent, year-on-year)

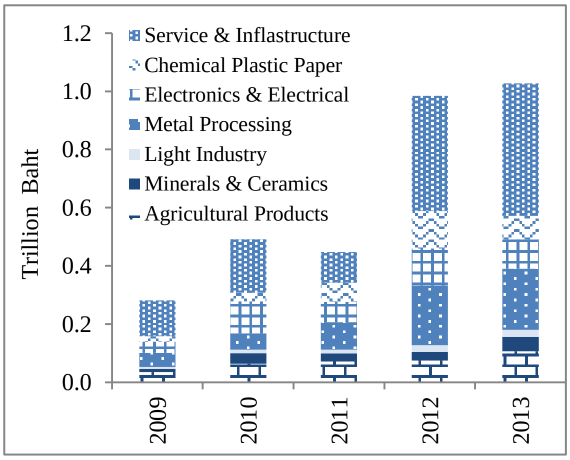
	2012	2013e	2014p
Total Consumption	6.8	2.0	2.1
Private C	6.7	1.3	1.8
Gov C	7.5	5.8	3.5
Gross fixed capital formation	13.2	1.4	4.2
Private Investment	14.4	1.1	5.0
Public Investment	8.9	2.5	1.0
Total Domestic Demand	**9.4**	**1.9**	**1.7**
Exports	3.1	4.0	6.7
Goods	-0.4	-0.4	5.6
Services	19.1	20.9	10.0
Imports	6.2	2.6	4.0
Goods	6.5	2.2	4.0
Services	4.6	4.7	4.0
Net Foreign Demand	**-8.9**	**10.3**	**17.6**
GDP	**6.5**	**3.0**	4.0

Source: NESDB and World Bank Staff Calculation
e = estimated
p = projection

private investment in real terms should be able to grow by around 5 percent in 2014 after expanding by a mere 1 percent in 2013; however, some investments could be delayed should the political turmoil be prolonged and investor confidence is severely affected.

Public investment, on the other hand, will likely expand at a similar rate to that of 2013 as large public investments continue to be delayed. The disbursement from the Water Management Project and the 7-year Bt2 trillion transport infrastructure investment will be likely be delayed this year (see Box 3. Bt2 Trillion Public Transport and Logistics Infrastructure Investment Program). Hence, public investment in 2014 would grow at around 1 percent.

Figure 16. Board of Investment Promotion Approvals



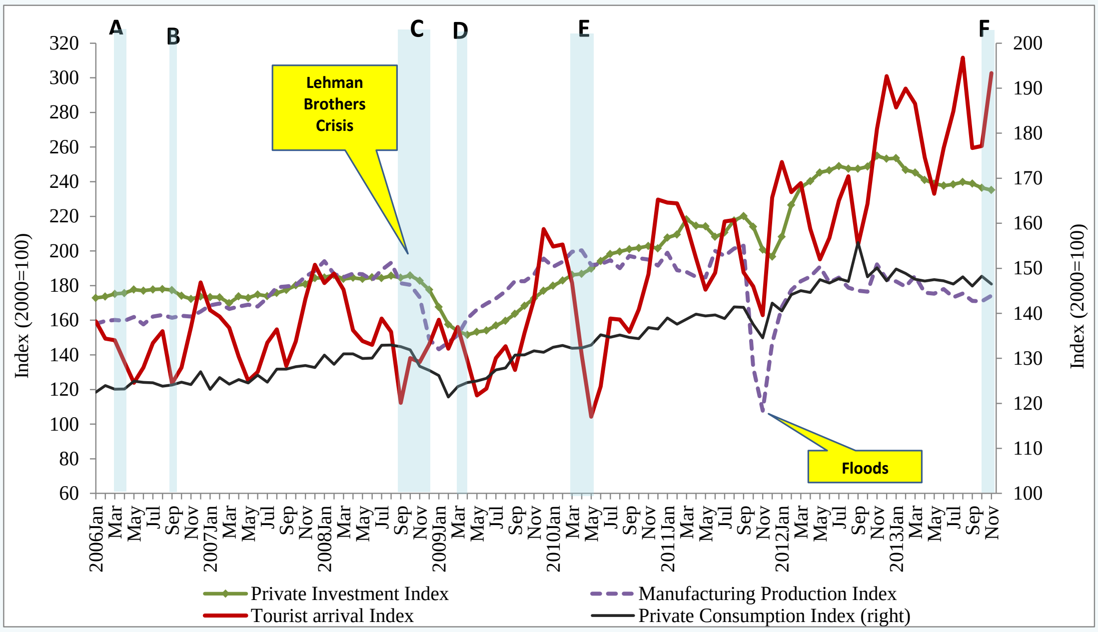
Source: BOI

The fiscal deficit for FY2014 could be slightly larger than that of FY2013. For FY2014, the on-budget deficit has been set at Bt250 billion (2 percent of GDP), and the disbursements from the off-budget Water Management Project and the Bt2 trillion transport infrastructure project are estimated at Bt20 billion and Bt60 billion, respectively (or 0.6 percent of GDP in total). In addition,

Box 2. Economic Impact of the Current and Recent Political Unrests in Thailand

The current political unrest in which large protests have been staged with blockages in major business districts in Bangkok since end-October 2013 have affected tourist arrivals as well as the capital market and the baht. Tourist arrivals decelerated sharply since October compared to around 20 percent year-on-year growth in the previous months (Figure 2.1). By the end of January 2014, the stock market has lost 10.8 percent of its value since end-October, and bond yields have increased by 2 percentage points in the end of December 2013 (Figure 2.2). In November and December alone, there were outflows of US$3.6 billion from the private sector, that largest amount compared to other months in 2013. As a result, the baht has depreciated by 3.6 percent from October to December and by another 1.8 percent in January 2014 (from December). With the announcement of the Emergency Decree which is effective 60 days since its announcement on January 21st, tourist sentiment could be further affected as well as business confidence.

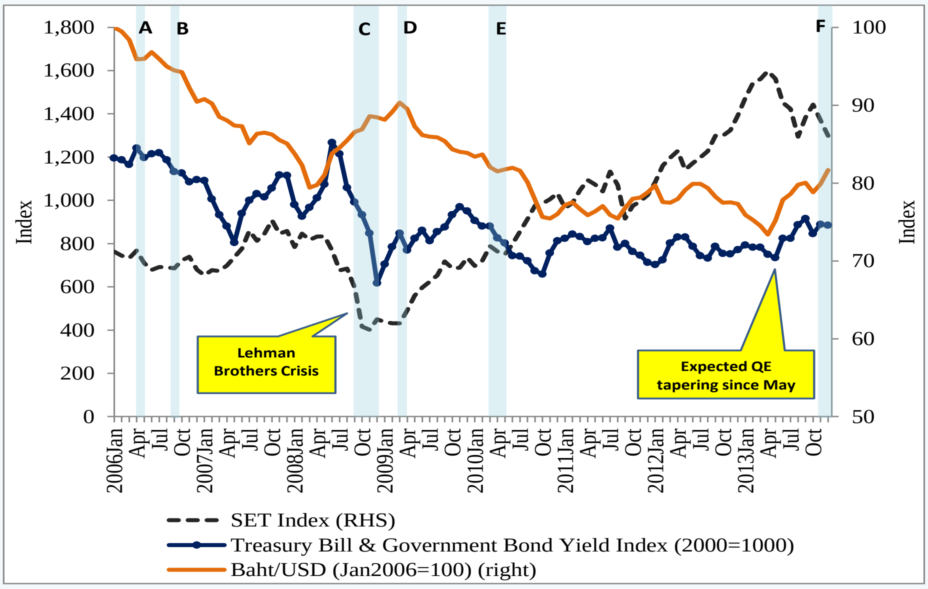
Figure 2.1. Impact of Political Turmoil on the Real Economy



Review of the economic impacts of political protests since 2006 suggests that the short term macroeconomic impacts are short-lived. Tourism receipts (around 10 percent of GDP) were most likely to be affected. The April 2010 riots in the Central Business District impacted tourism significantly but the effect had bottomed out in a month (Figure 1.1). The stock market and the exchange rate also rebounded within a month once the protest ended (Figure 2.2). Production, consumption, exports, and investments were not affected as factories continue to meet orders and there has been little disruption to production activities and logistics facilities. However, if there are problems at the main ports, airports, or highways, or if there is significant violence, then the outlook will change.

However, depending on how quickly political stability is restored, there will be longer term consequences. Most immediately, the Government's Bt2 trillion transport infrastructure investment program will be delayed and so will the private investments that would have followed. In addition delayed disbursement of Bt130 billion (around 1 percent of GDP) from the Paddy Pledging Program will affect the spending of participating farming households this year[5]. More generally, Thailand's long running political drama makes it difficult for policy makers to focus on long-term development issues for the country as well as structural reforms that are important for Thailand's future as the population ages, and countries like Indonesia, Myanmar and Vietnam become competitors.

Figure 2.2. Impact of Political Turmoil on Financial Markets in Thailand



Source: BBC and World Bank calculations

Notes:

A. 2006 April-May: Snap election called by the PM (PM) amid mass rallies against him is boycotted by the opposition and is subsequently annulled, leaving a political vacuum. The PM takes a seven-week break from politics

B. 2006 September: Military leaders stage a bloodless coup while PM Thaksin Shinawatra is at the UN General Assembly

C.2008 September-December: Opposition protesters occupy Bangkok's main government complex and begin mass anti-government protests calling for the resignation of PM Samak Sundaravej. Somchai Wongsawat chosen by parliament as the new PM, but the street protests against the Government continue. People's Alliance for Democracy supporters rally around parliament in Bangkok and blockade Thailand's main airports (November). PM Somchai Wongsawat is forced from office by a Constitutional Court ruling disbanding the governing People Power Party (December)

D. **2009 March-April:** Supporters of former PM Thaksin Shinawatra hold mass rallies against the government's economic policies. Continuing unrest forces the cancellation of an ASEAN summit after anti-government protesters storm the summit venue in the resort of Pattaya. PM Abhisit Vejjajiva moves troops into Bangkok to end an opposition protest sit-in. More than 120 people injured in resulting clashes.

E. **2010 March-May:** Thaksin supporters (trademark Red Shirts) paralyze parts of central Bangkok with months-long protests calling for PM Abhisit's resignation and early elections. Troops eventually storm the protesters' barricades and ended the demonstrations. A few high-end malls in the Bangkok CBD were burnt down by the protestors.

F. **2013 November-now**: Protest against amnesty bill followed by protest against the Thaksin regime. PM Yingluck Shinawatra dissolves Parliament.

[5] 1.4 million rice farming households (out of 3.8 million) participated in the Paddy Pledging Program

the Government plans to borrow around Bt130 billion (1.1 percent of GDP) for the Paddy Pledging Program this year. Hence, if the off-budget projects are implemented, the total fiscal deficit (including the extra-budgetary and the social security balances) could reach around 3.1 percent of GDP in FY2014. However should the public investment projects be delayed and the Government does not borrow for the Paddy Pledging Program due to the political uncertainties, the fiscal deficit would be 1.4 percent[6] of GDP compared to 1.0 percent in FY2013. Hence public debt should not exceed 50 percent of GDP this year (45.3 percent in November 2013).

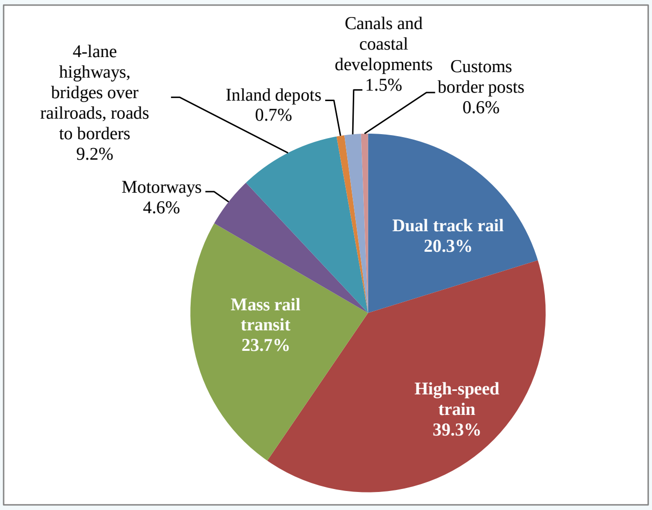
With the remaining fiscal space, public resources could be re-allocated to bring about more equitable access to public services across the country. In the next part of the Monitor, we examine the issue of regional disparities and public expenditure in the regions.

Box 3. Bt2 Trillion Public Transport and Logistics Infrastructure Investment Program

The Bt2 trillion baht program has an implementation plan of 7 years (2014-2020) and focuses on investments in dual track rail, high-speed rail system, mass transit system in Bangkok. The transport and logistics investment bill that authorizes the Ministry of Finance to borrow up to baht 2 trillion has been passed by the Parliament, but is now being considered by the Constitutional Court as to an off-budget investment as such is constitutional.

The Program comprises of 8 sub-programs. The sub-programs include the development of dual track rail system and improvement of existing rail network, construction of high speed train connecting Bangkok to regional centers and construction of deep seaport, the development of trade infrastructure facilities at the borders and expansion of highway roads. Investments in rail has a largest share of budget allocation of 83 percent (Bt 1.66 trillion), of which almost half is for high speed train construction (Baht 783 billion), and a quarter of the amount is for dual track rail system programs (Baht 403 billion). Around 14 percent of the Bt2 trillion is for highways, motorways, and bridges, 1.5 percent for waterways, and a little over 1.5 percent for inland depots and customs border posts (Figure 3.1).

Figure 3.1. Allocation of Bt2 trillion investment by types of programs



Source: Ministry of Transport

Funding from the program will be raised primarily in domestic market through government bond issuance. Other supplementary funding sources could be provided through annual budget, retained earnings of SOEs, Public-Private Partnership (PPP) and external borrowing.

[6] 1.4 percent assumes a 60 percent disbursement rate of the capital budget and includes estimated extra-budgetary surpluses

The Program, if implemented effectively, could enhance the country's competitiveness:

(1) the shift in Thailand's transport modality from road to rail would reduce the currently high logistics cost in Thailand (around 15 percent of GDP [7], of which half is the costs of transportation) due to the heavy reliance on road transport as only 2 percent of freight transportation within Thailand is currently by rail, while 85 percent is by roads

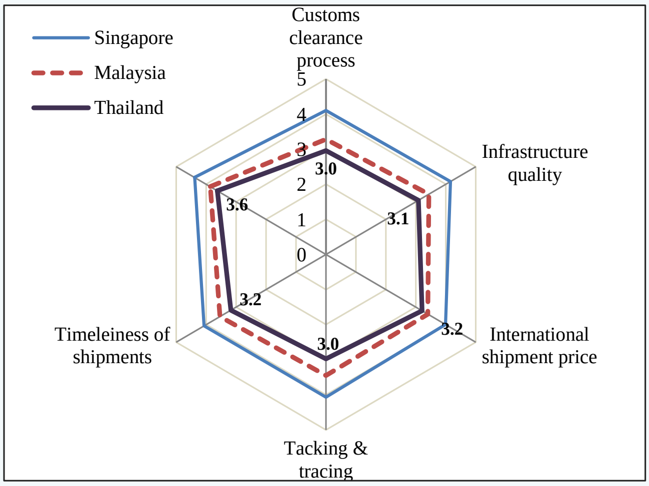
(2) the increase in transport connectivity (rail, roads, depots, and customs posts) with neighboring countries will help facilitate trade with neighboring countries (Cambodia, Lao, Myanmar, and Malaysia) which doubled over the past 5 years to around 6.5 percent of Thailand's total trade, and

(3) the increase in the mobility of people especially in Bangkok through rail mass transit would reduce the use of passenger cars, hence, reduce congestion, petrol use, and pollution in central Bangkok, while reducing the travel time and the accessibility of the public to parts of the capital.

The prioritization of the projects, their implementation, and the management and service delivery of the infrastructure will determine the success of the Program. Firstly, since this is a 7-year program, the prioritization of the projects should depend on the not only the feasibility but also on the economic justification of the project. For example, the economic justification for a high speed train system is not as clear as for the dual track rail or roads. **Secondly,** there has been public concern around the procurement process of the projects as they are off-budget, thus, may not be fully subjected to the same scrutiny on procurement as on-budget ones. The Government could put in place a procurement, monitoring, and evaluation system that would provide greater confidence to the public that the investments will be free from corruption. Successful implementation will also require improvement in implementation processes discussed in Box 4. **Thirdly,** there is a growing concern that even if the projects are well-implemented and completed, poor management of the new infrastructure will not deliver the intended services.

Investment in physical infrastructure should be accompanied by investment in the soft infrastructure. As shown by the Logistics Performance Index, Thailand ranks 38 out of 155 countries and performs relatively poorly on the dimensions of customs clearance procedures and the capacity of public and private logistics service provider (Figure 3.2); the latter includes the ability of the State Railways of Thailand to deliver rail services. Hence, in order to raise Thailand's logistics competitiveness, the new physical infrastructure would need to be accompanied by efficient procedures, rules and regulations, as well as institutional capacity to manage the service delivery of the infrastructures.

Figure 3.2. Logistics Performance Index, 2012



Source: World Bank

[7] Source: Office of the National Economic and Social Development Board (NESDB)

Box 4. Improving Implementation Effectiveness in Public Investment Projects in Thailand

Since the Asian Financial Crisis, Thailand has consistently underspent its capital budget by about 30 percent. This suggests that the constraint to increasing public investment is implementation capacity, and not just available financing. In order to ensure timely implementation of the investment program, the government may consider resolving the following three issues that currently contribute to implementation delays.

1. **Improving quality of project appraisals.** The current appraisal guidelines issued by the Bureau of the Budget and the National Economic and Social Development Board provide a good general guidepost for implementing agencies to prepare project appraisal cases. However for complex multi-dimensional projects like high speed rail and integrated water management systems, the appraisal guidelines do not provide detailed guidance. In addition, Thailand does not have an independent appraisal review body with appropriate capacity and institutional arrangements to check soundness of the appraisal case submitted by line agencies. This encourages information asymmetries -- where line agencies rely on external consultants to prepare project appraisals, with central agencies lacking the capacity to ascertain the quality of the underlying analysis. Countries without an effective independent appraisal review function have been affected by project delays and economically unsound projects being implemented. Korea experienced a similar issue in early 2000's and established an independent Public Investment Management Appraisal Centre (PIMAC) at the Korean Development Institute (KDI) to advise the Ministry of Strategy and Finance on the technical aspects of project appraisals. Since PIMAC was established in 2004, Korea has managed to stop 38 percent of projects that were proposed by line ministries but were technically unsound.

It is therefore recommended that Thailand provide more detailed project appraisal guidelines to agencies and establishes an effective independent project appraisal review body in order to improve quality of project appraisal. This is because an inappropriately appraised project is very difficult to implement in a time-effective manner.

2. **Institute mechanisms to follow-through consistently on the environmental impact management plans.** Thailand has instituted robust environmental and social safeguard policies that ensure projects are implemented in a socially and environmentally sustainable manner. Each project that adversely impacts environmental or social safeguards is required to develop an Environmental Impact Management Plan (EIMP). However, agencies are not mandated or monitored to effectively implement the EIMP – and a lot of EIMP's languish. This causes two issues: (i) a dead weight loss due to the time taken to conduct the EIMP (average of 24 months for large projects) that is not really implemented; and (ii) gives rise to lack of trust in government by affected stakeholders – which means that in the next round stakeholders do not agree to EIMP's for new projects because they believe authorities will not follow through on implementation.

Thailand may consider instituting mandatory follow-through of EIMP's and reporting to Cabinet on progress for large projects. Another option could be to outsource EIMP implementation to civil society organizations with the appropriate capacity.

3. **Develop real-time monitoring systems that allow agencies to make project modifications during implementation.** It is natural that project implementation does not go exactly as planned. However it is important to have in place a monitoring system that provides early warning of implementation bottlenecks and to have mechanisms to resolve identified issues. Currently in

Thailand monitoring systems are fragmented and focus mostly on tracking disbursements and compliance with regulations. There is lack of systematic tracking of outputs, outcomes and impact from projects during implementation. This means that during project implementation there is no feedback on intermediate outputs/impact that would be used to make appropriate modifications to the project.

It is advisable for the government to integrate financial reporting systems with the physical, technical and beneficiary details contained in project appraisal cases so that the country delivers high quality investment that achieve the desired impact.

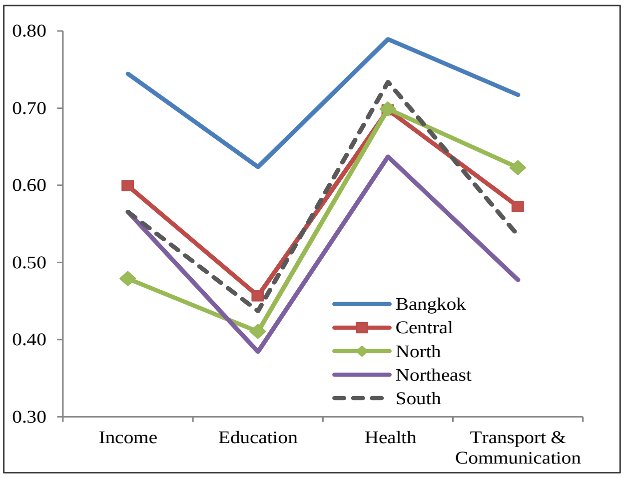
Source: Public Investment Management Review (2013), World Bank (*in draft)*

PART 2: TOWARDS A MORE EQUITABLE PUBLIC SERVICE PROVISION IN THAILAND

Over the last three decades Thailand has posted impressive economic growth – with real GDP growth rates averaging about 6 percent. Economic growth has contributed to reducing the incidence of poverty from almost 70 percent in 1988 to 13 percent by 2011. Economic growth has been geographically concentrated in the Bangkok and central region where factories deep seaports are located.

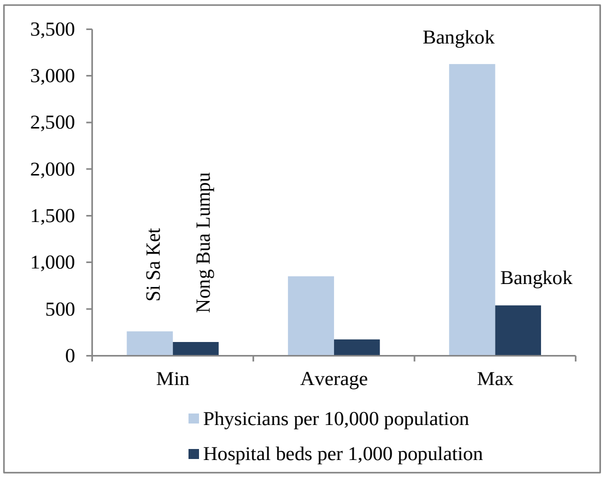
However, there remain significant regional disparities in service delivery and human achievement outcomes in Thailand. Examining the four indices of the 2010 UNDP Human Achievement Index (HAI) that relate to service delivery (health, education, income, and transportation and communication), Bangkok performs much better than other regions in all dimensions, while the Northeast region lags on health, education and transportation/ communications indicators. The North lags most on the income dimensions (Figure 17). This is mirrored by the regional disparities in public expenditure and service delivery, which is discussed in more detail below.

Figure 17: Human Achievements in Thailand by Region



Note: 0.8 = highest; 0 = lowest
Source: UNDP, Thailand Development Report 2010

Figure 18: Health Service Disparities



Source: Public Expenditure Review, World Bank (2012)

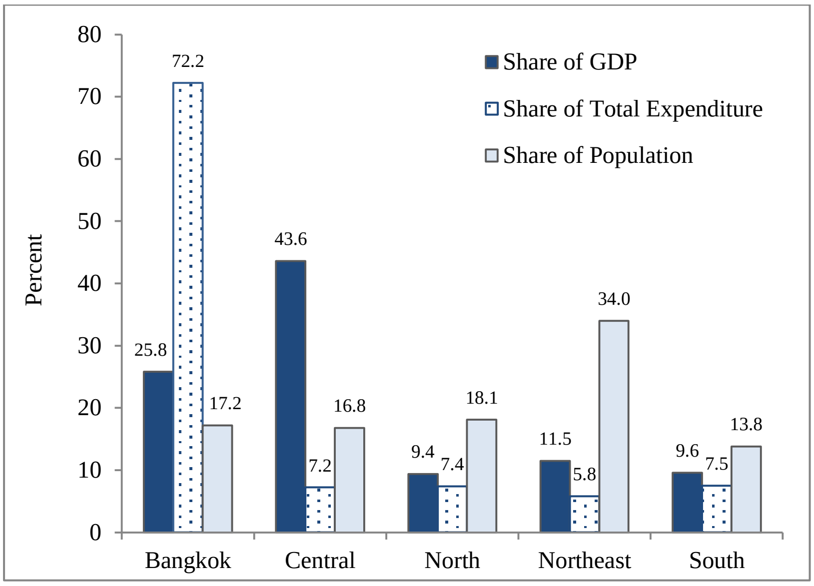
Addressing the regional disparities is important for Thailand not only from a social equity perspective, but also from a competitiveness and economic growth perspective. As the population ages, Thailand is seeking to move to a high income economy. Such a transition will require a much broader base of healthy and high skilled citizens. Some of the key actions Thailand can take to achieve greater equity are (a) rebalancing public spending regionally, (b) provide more equitable services in terms of quantity and quality regionally, and (c) institutionalize an effective system for reporting and monitoring of the service provision. The three are each discussed in turn below.

1. Rebalancing Public Spending

There is a high concentration of public spending in Bangkok, while the Northeast receives the least spending per capita (Figure 19). The concentration of public spending in Bangkok is explained by the concentration of population, economic activities, and in the Government's administrative functions in this capital city. The Government has therefore made infrastructure investments and provided social and ancillary public investments to support the productive sectors in Bangkok.

However, such concentration of expenditures is extreme, by comparative international experiences of countries with one major city with concentrated production bases.

Figure 19: Public Spending, Population and GDP by Region (2011)



Source: MOF, NESDB, and World Bank

Disparities in expenditures results in the disparities in service delivery and human development outcomes. In the health sector, for example, there are 3.5 times more doctors per capita in Bangkok than in other regions (Figure 18). While in the education sector, the experience of teachers and the scores of students are much lower in the Northeast than in Bangkok (as shown by the O-Net or PISA scores). These disparities are also correlated to human achievement outcomes in Figure 1 above in which the Northeast and the North which receives the least public spending per capita have the worst outcomes in many dimensions.

A key policy is to focus on delivering public services more uniformly across the country – both in terms of quantity and quality. This will require a change in the public spending patterns. In order to accomplish this, the Government may consider:

(i) **Refocusing expenditure policy towards regions that are deficient in terms of service delivery,** with the aim of bringing them up to the Bangkok standard, while reducing spending in areas that are no longer in need, and

(ii) **Increase the equalization component of the transfer to local administrative organizations,** to support areas where there is shortage of public services

In addition to the pattern of public spending, the system of public service delivery also has to be one that is efficient and promotes equitable service provision. The system in Thailand is described in the next section.

2. Delivering Public Services More Efficiently and Equitably

In Thailand, public service is provided mainly by two organizations – by the Central Government and by local administrative organizations (LAOs)[8]. Since 2000, the decentralization has led to a significant increase in the share of finances held by LAOs – from 8 percent of general government revenues in 1999 to 26 percent by 2013. **However, there has been limited progress with decentralizing service delivery. There are essentially three key reasons for this:**

Firstly, there is effectively little autonomy for Local Administrative Organizations (LAOs) to decide on service delivery. Although the government has established new institutions of local self-government, it has yet managed to either roll back the deconcentrated arms of the central government or change their mandate away from supervision to facilitation of the new decentralized structure. Deconcentrated arms of the central government have continued to perform traditional command and control functions over local authorities.

Secondly, there is tension in service delivery between the central agencies and the LAOs, especially for health and education services, due to the lack of clearly delineated responsibilities. The lack of coordination between sectoral reforms at the central level and decentralization reforms have led a reform-flux, with agencies responsible for decentralization trying to decentralize ownership of health and education units, while central government agencies have been trying to retain control of these units.

Thirdly, there are too many small LAOs which makes them financially unviable to provide public services. More than 3,000 LAOs (out of 7,853) have population of less than five thousand. In such LAOs, a large share of resources is taken up by administration expenses, leaving little for public services. In addition, the large number of small LAOs makes effective coordination by central government agencies very difficult and burdensome and causes fragmentation in service delivery.

These three issues are making the provision of services at the LAO level inefficient and administratively very expensive. In order to address these three key issues, the government could consider the following actions:

(i) **Transition to a fully unitary decentralized government structure[9] in order to address tensions in the central-local government relations system.** This can be most simply achieved by rolling back the deconcentrated arms of the central government at the provincial level and linking LAOs directly with line and sector agencies – for example, the Ministry of Finance and Bureau of the Budget on budgeting issues, and sector ministries on service delivery issues. The role of the Department of Local Administration at the Ministry of the Interior could transition from command and control to facilitation and coordination. The pace

[8] The 1997 Constitution brought in reforms aimed at decentralizing service delivery responsibility and finances to local authorities. These reforms were intended to make public services more efficient and lead to increased public participation in decision making at the local level, and enhance local economic development.

[9] A unitary state is a sovereign state governed as one single unit in which the central government is supreme and any administrative divisions (sub-national units) exercise only powers that their central government chooses to delegate. In federal states, by contrast, states or other sub-national units share sovereignty with the central government, and the states comprising the federation have an existence and power functions that cannot be unilaterally changed by the central government.

of the roll-back should be calibrated with measures aimed at strengthening capacity of LAOs and could first be piloted for municipalities[10].

(ii) **Clarify and demarcate functional roles between the central government and LAOs and prepare a model of decentralized service delivery, especially for the health and education services.** Clarity in functional roles will help guide the management of these sectors and solve the current questions regarding structure of health and education services delivery. This will also increase accountability for results and help refocus the intergovernmental fiscal transfer system to follow functions.

(iii) **Administratively consolidate LAOs into larger, more financially viable entities through fiscal grants and other incentives.** Such administrative consolidation has been successful in other European countries such as Norway, Sweden, Denmark, Germany and Netherland. Administrative consolidation of local authorities will allow for a reduction in administrative costs which can be channeled into service delivery, improve central-local coordination and enhance voice of local authorities as larger units (Box 5).

Box 5. Administrative consolidation – options for Thailand

Thailand is not the only country to be faced with the issue of too many small local government units – other states have faced and resolved this issue through a process of administrative consolidation. Administrative consolidation can be undertaken through voluntary means (typically with the aid of a centrally provided conditional grant which helps to incentivize this consolidation amongst small local government units), or through non-voluntary means (where central government sets a minimum threshold with respect to population and or resources necessary to constitute a viable local government).

How could Thailand undertake these reforms?

Finland provides a useful illustration of how fiscal incentives can aid in voluntary consolidation, where the authorities consolidated 436 small municipalities to 342 larger and more viable units. Under Finland's municipal consolidation, a timeframe for administrative consolidation was planned out, resources were allocated, and legislation was introduced including a stepped, declining and temporary fiscal incentive which was built into the intergovernmental fiscal transfer system. In this system, the earlier the decision to consolidate was taken, and the higher the population of the post-merger municipality, the larger the fiscal grant was. Grants for earlier mergers which resulted in municipalities of more than 10,000 people were in the range of 10 million euros; grants for later mergers and lower populations could be half that amount.

Finland's reform act also included a clause which allowed central government, in the case of extreme economic difficulties in municipal areas, to propose a non-voluntary merger; however these cases were extremely rare.

Thailand may consider applying these principles in articulating an action plan for administrative consolidation in consultation with the LAOs. The action plan would consider what constitutes a viable LAO size for providing service delivery and then develop a targeted, time-bound, transparent, and temporary central-grant that would achieve the desired consolidation impact on a voluntary basis.

[10] This proposed decentralized unitary form of government administration is consistent with the 1999 and 2007 Constitution and allows for a seamless integration of LAOs with the central government. This form also requires the least restructuring of the existing central local government relations system.

3. Making Public Services More Accountable and Responsive through an Effective system for Reporting and Monitoring

Government responsiveness is currently constrained by lack of information on service delivery performance, use of public finances, and procurement of standard goods and supplies [11]. Currently there is little reporting on: (i) service delivery performance (response times and outcomes) for LAOs and centrally managed units; (ii) fiscal operations for local authorities (even for large municipalities); and (iii) unit prices of standard goods and supplies procured by government entities.

Such information is necessary for operationalizing informed accountability systems at the central and local levels. Stakeholders should be able to determine what the budget has been used for, whether or not their local authorities are obtaining goods and supplies as competitively as other jurisdictions and the central government, and the timeliness and outcomes of their service delivery. This basic reporting is well within reach of and expected by a higher middle income country like Thailand.

In order to improve service delivery and address some of the above issues, Thailand could undertake the following actions:

(i) **Establish national service delivery standards** so that public service standards (quality and response times) can become more uniform across the country, as expenditure policy is rebalanced. It could also annually publish service delivery performance by central and local authorities against these national benchmarks or in absolute terms.

(ii) **Consolidate detailed fiscal operations information of LAOs (at least at the municipal level) with that of the central government** and publish general government operations report by functional and economic classifications.

(iii) **Publish unit price information for standard supplies and goods procured by local authorities and central agencies.** Such a move will increase transparency and provide incentives for LAOs to conduct competitive procurement, along with interested citizens to see at what price their respective jurisdiction is procuring standard goods and supplies as compared with others.

The policy options presented here are similar to those undertaken by other OECD countries – pioneered by Canada (Box 6). Such reforms will ensure that growth can be sustained and prosperity shared more equitably throughout the countries via a performance oriented public sector.

[11] This is despite the fact that Thailand has established different performance management and monitoring systems at both the central and local level. Some of the main systems include: (i) the Local Quality Management system for monitoring and reporting on local authority service delivery performance; (ii) the e-Local Authority Accounting System for monitoring and reporting on local authority fiscal performance; (iii) the Public Management and Quality Assurance for making departments more effective and responsive in service delivery.

Box 6. Strengthening responsiveness and accountability in service delivery

Improving service delivery depends critically on the availability of tools and information which can be used by government to inform management and policy decisions, and by citizens to hold government accountable. As countries develop, there is typically a shift from measuring and monitoring *compliance* with rules and regulations, towards measuring and monitoring *performance* in service delivery. While different contexts call for different approaches to improve responsiveness and accountability, Thailand can draw some general principles from looking at examples within OECD countries.

Local governments in countries like the *United States*, the *United Kingdom* and *Canada* capture a wealth of information on local public finance and service delivery performance; critically, this information typically includes input data (what is being spent or used to provide public services), output data (what services are being delivered, in what quantity, and at what level of quality), and sometimes even outcome data (how these outputs contribute to broader policy objectives such as increasing literacy, improving quality of life, or reducing illness and mortality.

Another important dimension of strengthening responsiveness and accountability for Thailand to consider is related to benchmarking. In the absence of an appropriate benchmark, citizens and governments may not be able to determine how they are performing, even with good fiscal and output data. By comparing performance either to that of neighboring jurisdictions or to national averages or baselines, a much more useful picture emerges. For example, provinces in *Canada* measure and publish benchmark standards (*https://www.fcpp.org/local-government-performance-index*) for wait times for receiving various health services, such as hip replacements, MRI or CT scans, or heart operations. Citizens have a clear picture of what health services standards they should expect. Even in the absence of national standards, comparison to neighboring local governments can be a powerful tool for strengthening responsiveness and accountability.

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