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Trade Policy Review Body

TRADE POLICY REVIEW

Report by the Secretariat

THAILAND

Revision

This report, prepared for the fifth Trade Policy Review of Thailand, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from Thailand on its trade policies and practices.

Any technical questions arising from this report may be addressed to Sergios Stamnas (tel: 022 739 5382).

Document WT/TPR/G/191 contains the policy statement submitted by Thailand.

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SUMMARY OBSERVATIONS

(1) ECONOMIC ENVIRONMENT

1. Since its previous Trade Policy Review in 2003, despite a series of negative shocks, Thailand's real GDP has grown at an average annual rate of 5.7% (with inflation averaging a modest 3.4%). This is largely the result of strong growth in exports and domestic consumption, although the latter's growth has been slowing; by contrast, growth of private investment has been relatively weak, especially in 2006. Concurrently, GDP per capita rose from US$2,007 in 2002 to US$3,159 in 2006, slightly higher than its pre- (Asian) crisis level of US$3,032 (1996). Average income poverty has remained stable, with around 2% of the population living below US$1 a day. Income inequality (as measured by the Gini coefficient) dropped slightly (from 0.525 in 2000 to 0.499 in 2004). Overall unemployment has declined from 2.4% in 2002 to around 1.5% in 2006 as a result of increased employment in the services sector.

2. Since 2005, however, a confluence of factors has led to a slowdown in real GDP growth, which is expected to be 4.3% in 2007. The factors include higher oil prices, slower growth in the economies of Thailand's major trading partners, the downward electronic cycle, a devastating tsunami, a prolonged drought, political instability and uncertainty, as well as continued unrest in the southern part of the country. These have all undermined consumer and investor confidence as well as export growth. The slowdown in GDP growth in 2007 is also partly because growth from increased capacity utilization has been exhausted, and new capacity is expanding slowly due to sluggish investment resulting from domestic investors' lack of confidence. These developments, together with persistent infrastructure deficiencies (mainly outside metropolitan areas) burdensome government regulation (including price controls), and the decline in Thailand's international competitiveness as a result of, *inter alia*, the recent appreciation of its currency, pose challenges to sustained future growth. Thailand's economic outlook thus depends, in particular, on the Government's ability to restore consumer and investor confidence and to undertake pending structural reforms that would help improve Thailand's competitiveness.

3. Thailand's Tenth National Economic and Social Development Plan, is guided by the "sufficiency economy" principle, which is based on the idea of building economic resilience to internal and outside shocks, keeping investment and household debt within sustainable levels, and ensuring growth with stability. Thailand surpassed its poverty reduction targets although poverty remains significant in poorer regions and rural areas. Despite longstanding efforts, corruption remains significant in both the private and public sectors; a Government anti-corruption campaign is aimed in particular at high-ranking decision-makers and bureaucrats.

4. During much of the period under review, Thailand has mostly pursued an accommodative monetary policy so as to encourage demand and foster economic growth. The continuing strength of capital inflows and the virtually continuous current account surplus (reflecting national savings higher than gross domestic investment) have exerted upward pressure on the national currency, the baht. Between January 2004 and December 2006, the real effective exchange rate appreciated by 12.7%, while the nominal effective exchange rate appreciated by 6.9%.

5. Thailand's fiscal position has remained strong, underpinned by robust growth in tax revenues with the fiscal surplus rising from 3.8% of GDP in 2003 to 4.4% in 2006. A large portion of the Government's expenditure is off-budget and includes provision of credit to SME's, and housing projects for the poor; its cumulative cost between 2001 and 2004 was estimated to be 6% of GDP. Fiscal decentralization has progressed slower than initially planned. Tax reform has been focused on raising tax collection, dealing with tax evasion and reducing the cost of doing business in Thailand; a Roadmap for Tax

Reform seems to be under preparation with a view to, *inter alia*, broadening the tax base.

6. During the period under review, sustained growth in exports of goods and services resulted in a current account surplus in all years except for 2005. Strong capital inflows coupled with this current account surplus have resulted in a rise in foreign exchange reserves from US$42 billion in 2003 to US$71 billion in March 2007, more than three times the level of short-term external debt and equivalent to roughly 6.7 months of merchandise imports. The ratio of external debt to GDP and the debt service ratio have declined due, *inter alia*, to the Government's policy of retiring high interest debt.

7. The economy has become more outward-oriented, with trade in goods and non-factor services rising from 124.6% in 2003 to 143.5% in 2006, and inward foreign direct investment (FDI) increasing by more than 86%. Manufactured exports still account for more than three quarters of total merchandise exports. During the period under review, there has been a marked shift in Thailand's trade destinations; most Asian economies have gained at the expense of the EC-25 and the United States, although these, together with Japan, remain Thailand's largest export markets.

8. Thailand continues to operate a generally liberal foreign investment regime. Negative lists restricting levels of FDI in some activities have remained unchanged. However, amendments of certain legal provisions are under way to prevent foreign investors from using nominee shareholders or preferential voting rights to take control of Thai companies in restricted sectors. U.S. investors receive preferential treatment, being exempt from most FDI restrictions under a 1966 Treaty. Annual FDI inflows grew from US$11.5 billion in 2003 to US$20.4 billion in 2006; nevertheless, gross domestic investment remained below its pre-crisis levels (i.e. 40% of GDP during 1990-96 compared with 29% in 2005). Manufacturing has remained the largest recipient of FDI, followed by retail and wholesale trading, non-bank financial institutions, and real estate activities; as of 2006, Singapore was the largest overseas investor, followed by Japan, the EC-25, and the United States. Privatization, a contentious issue, progressed slowly before being halted in 2006; as in other areas, progress depends on political developments.

(2) TRADE POLICY FRAMEWORK

9. Thailand is an original Member of the WTO. It grants at least MFN treatment to all its trading partners and receives the special and differential treatment provided for in the WTO Agreements.

10. Despite constitutional and legislative changes owing to the 2006 political developments, the structure of trade policy formulation and implementation in Thailand has remained unchanged since its previous Trade Policy Review in 2003.

11. A new Constitution was approved by referendum in August 2007. Although the 2006 Interim Constitution did not contain any clauses on economic principles and freedom, it guaranteed the protection of rights, liberties, and equality in accordance with the customary practice of democratic government as well as Thailand's existing international obligations.

12. Priority areas of the 10th National Economic and Social Development Plan include human and social capital development, community strengthening, economic restructuring, environmental diversity, and good governance. Thailand's trade policies embody, *inter alia*, guiding principles such as "sufficiency" and "sustainable economy" as well as "fair" and progressive trade liberalization.

13. Regulatory reform has progressed under the National Laws Development Plan 2005-2008. Several laws or amendments have been enacted during the period under review (e.g. customs valuation, intellectual property rights, competition policy, bankruptcy) or are at different stages of preparation (government

procurement, energy, electricity, telecoms, e-commerce, tourism).

14. Thailand has maintained its support and commitment to the liberalization of the multilateral trading system, especially for agriculture. It also remains committed to "open regionalism" and considers regional trade liberalization an effective catalyst for freer trade and complementary to multilateralism. However, the focus of foreign policy now appears to be the strengthening of regional links, not only with immediate neighbours, but in the wider Asian region through free-trade agreements (FTAs). The expansion and deepening of preferential treatment and regional integration is among the most notable developments during the period under review (2003-07). In addition to expanding intra-ASEAN FTA undertakings as well as ASEAN agreements with third countries, and participating in the establishment of the Bangladesh – India – Myanmar – Sri Lanka – Thailand Economic Cooperation (BIMST-EC) FTA, Thailand has concluded a network of bilateral preferential trading arrangements with several trading partners (Australia, Bahrain, India, Japan, Peru, New Zealand). Certain agreements also include liberalization of trade in certain services.

15. Thailand, a beneficiary under various GSP schemes and an active participant in the GSTP, is expected to benefit from improved preferential access for certain items under the EC and U.S. GSP schemes.

16. An E-Government Action Plan (2005-07), which promotes e-services and is aimed at developing a government portal, should help increase transparency. Thailand has made efforts to meet its transparency obligations at the multilateral level by, *inter alia*, meeting WTO notification requirements in several areas (e.g. agriculture, subsidies, customs tariff) and submitting its first replies to the WTO Questionnaire on Import Licensing Procedures in January 2007. Despite efforts to increase the level of transparency and disclosure, allegations of corruption have remained in Thailand's customs procedures, customs valuation, tariff-rate-quota licensing, government procurement, and the granting of tax incentives.

(3) TRADE POLICY DEVELOPMENTS

17. The customs tariff is one of Thailand's main trade policy instruments as well as a major, albeit declining, source of tax revenue (7.4% of total tax revenue). The introduction of the 8-digit ASEAN Harmonized Tariff Nomenclature (AHTN) 2007 in January 2007 increased the number of tariff lines by 50.8%; the lack of a workable version in an official WTO language confined the tariff analysis in this report to the 2006 tariff. The tariff is relatively complex, involving a multiplicity of rates (31 *ad valorem*, 19 specific duties and 158 alternative duties). Tariff cuts involving more than a third of the lines, reduced the overall simple average applied MFN tariff from 13% (2003) to 11% (2006). Although the number of duty-free tariff lines has increased considerably (to 18.4%), and 37.3% of lines are subject to applied tariff rates of 5% or less, peak *ad valorem* rates (of up to 80%) have remained unchanged and concentrated in a few sensitive items (e.g. motor vehicles, sugar, motor cycles, tea). Insofar as estimates of the *ad valorem* equivalents (AVEs) of non-*ad valorem* duties exist, they show that such duties tend to conceal relatively high rates of tariff protection; for example, three of the top 20 tariff lines had non-*ad valorem* duties with AVEs that ranged from 87.7% (prepared or preserved fish, minced) to 340.2% (certain ethyl alcohol). The simple average of non-*ad valorem* rates for which AVEs were available fell from 20.5% (2003) to 16.5% (2006). The average applied customs duty on agricultural products (WTO definition), at 25% remains higher than the average for industrial goods (8.8%).

18. Thailand has bound 73.7% of its tariff lines: 100% of agricultural lines (WTO definition) and 69.5% of its non-agricultural lines; Thailand concluded the process of binding its tariffs on specific information technology products at zero at end-2005.

When an applied MFN rate is higher than the bound rate, observance of the binding commitment depends on the implementation of the "whichever is lower" principle; for a few tariff lines, the bound duty type is not the same as the applied one (e.g. the applied rate is specific but the bound rate is *ad valorem*). The adoption of the AHTN nomenclature, which increased considerably the number of tariff lines, makes the transposition of existing binding commitments to HS 2007 a priority task; in June 2007, the authorities indicated that they were to start the relevant WTO procedures. The gap of 16.5 percentage points between the average bound and applied MFN tariff rates still imparts a strong degree of unpredictability to the tariff regime and provides a great deal of scope for the authorities to raise applied rates within the bindings; for instance, between 2003 and 2006 duties on eight tariff lines (e.g. cuts and edible offal, fused magnesia, cocaine, raw hides and skins, flat rolled products of iron and steel) were increased considerably. Nonetheless, the overall trend in applied MFN rates is downward.

19. The transparency and simplicity of customs procedures, crucial elements of trade facilitation, have been increased; clearance times were shortened with extensive use of paperless trading, and corruption is being tackled with preventive measures, including improved salary and fringe benefits for customs officials. Further regulatory changes and training activities have enhanced the implementation and understanding of the WTO Agreement on Customs Valuation; nevertheless, the process of repealing legal provisions allowing the use of reference prices, which the authorities claim have never been invoked, is still under way. Several port charges are levied at lower rates on export cargo than on import cargo.

20. Import licensing and prohibitions on various items for, *inter alia*, economic reasons (infant industry protection) have remained generally unchanged since the last Review of Thailand. Coverage of products can be altered through notifications of the Ministry of Commerce. During the review period, Thailand initiated several anti-dumping cases involving mainly base metals and products thereof and chemicals; anti-dumping duties on hot-rolled steel caused market supply problems, and were relaxed temporarily. Thailand maintains few compulsory standards, and the number of Thai industrial standards based on international standards has continued to rise; various amendments were made to laws related to quarantine requirements.

21. Institutional improvements have been aimed at clamping down on re-exporting intended to circumvent or benefit from origin-related treatment in third markets. The persistence of relatively high statutory export taxes on a few commodities (wood and articles thereof, hides) and the possibility of re-instating others, constitutes assistance to the downstream processing of such commodities as well as an element of uncertainty. The scope of export licensing and prohibitions has been reduced since 2003; they are maintained for economic, quality, health, and safety purposes. Exports of items that are in short supply domestically or that might raise prices unduly are subject to quotas (e.g. sugar). The state-owned Export-Import Bank of Thailand (EXIM Bank), which provides relevant financial services that are not adequately provided in the Thai banking system, has launched a new credit facility for small and medium enterprise (SME) exporters; losses incurred from the Bank's export credit insurance or business transactions can be compensated by the Ministry of Finance, but apparently this has never been the case so far. Exports involving 5,224 tariff lines remain eligible for "tax and duty compensation", which is set as a fixed percentage of the f.o.b. value for each product, thus providing the possibility for over- and under-compensation despite regular adjustments; at present average compensation rates by product range from 0.74% to 3.86%.

22. In order to encourage investment in priority sectors, remote areas, and production by SMEs Thailand continues to use tax (e.g. duty exemptions or reductions, corporate tax

holidays, accelerated depreciation) and non-tax incentives (e.g. low interest loans), whose cost-effectiveness is questionable. Various subsidies tied to exports have been removed.

23. Price controls and/or monitoring continue to affect more than 200 products and 20 services, perhaps accounting for as much as 20% of the CPI basket of goods and services. The list of controlled goods or services is reviewed at least once a year.

24. State involvement in the economy persists (e.g. in agriculture and natural resources, energy, manufacturing, financial, telecoms, transportation, infrastructure, and other services). Regulatory changes have been made to prevent abuse of corporatized entities' monopoly power.

25. Government procurement remains an important instrument of economic policy, with 3% price preferences accorded to domestic suppliers. Reportedly, language used in procurement tenders may exclude foreign products from the process, although relevant regulations require that wording does not obstruct competition or benefit specific suppliers. Countertrade requirements tied to public procurement contracts were officially repealed in early 2007.

26. Thailand has strengthened its legal framework for the protection of intellectual property rights (lPRs) by enacting legislation on geographical indications and optical disc production; action was also taken to promote, coordinate, and enforce IPR protection through a Memorandum of Understanding with a number of private-sector representatives and law-enforcement groups, and by strengthening the institutional framework for enforcement. In late 2006 and early 2007, Thailand issued three compulsory licences, for three medicines, without the consent of the patent holder, for use by the Government; the Government Pharmaceutical Organization was granted the rights relating to the patent-protected invention against payment of a royalty fee to the right holder of 0.5% of the total sales value.

27. To cope with competition policy weaknesses, in 2007 Thailand enacted a definition of the dominant player in the market, based on market share and sales volume. State-owned enterprises and farmers' cooperatives are not covered by the competition legislation, whose enforcement remains weak (one case has been dealt with since 2003). Reforms in the corporate governance legal framework seem to have been slow.

(4) SECTORAL POLICY DEVELOPMENTS

28. Agriculture, where labour productivity is relatively low, remains an important component of the Thai economy, external trade, and employment; it also plays a key role in achieving increased food "sufficiency", and poverty reduction. Government policy has been geared not only towards raising productivity and per capita income in the sector, but also implementing the "Sufficiency Economy" philosophy, which argues that production diversity reduces the risk of single commodity dependence and improves land fertility. Tariff protection for agricultural goods has remained unchanged. Thailand relaxed its tariff rate quotas, which apply to 23 agricultural commodities, by increasing the in-quota volume of potatoes and allowing unlimited imports of soya bean and soya bean cake for certain producer groups at lower in-quota rates. Domestic producers have benefited from various types of support, including general services measures, market price intervention, soft loans, price support for certain inputs, and subsidized electricity tariffs for agricultural pumping; such support is equivalent to about 1% of GDP and more than 6% of total government expenditure. Support has remained focused on measures exempt from the reduction commitment (75% of total support expenditure) and observed *de minimis* requirements established under the Agreement on Agriculture. A paddy pledging scheme remains in place. Incentives have been available for shifting away from garlic production; support for bio-fuel-related crops is under consideration.

29. During the period under review, steps were taken to promote energy conservation and increase domestic energy production, which is dominated by state firms, so as to, *inter alia*, reduce dependence on energy imports; several regulatory reforms in this regard are under way. In 2006, domestic oil production covered 13.5% of domestic consumption, compared with 73% for natural gas, which is used mostly for electricity generation. The privatization of the state monopoly Electricity Generating Authority of Thailand (EGAT), was a contentious issue and is no longer envisaged. To cope with recent fuel bill increases, the authorities subsidized retail petrol and diesel prices temporarily, and cut the excise tax on diesel. The retail price of liquefied petroleum gas used for cooking has been "stabilized" (by means of a nationwide blanket price freeze), since 7 May 2004, at B 16.81 per kg, representing an estimated cost of some B 360 million per month to the Government (May 2007); in addition, the actual costs of bio-fuels are reflected in the gas price and their retail price is lower than gasoline and diesel oil. Electricity production costs were also subsidized in 2004, as the state-owned oil and electricity firms were instructed to absorb increased fuel costs. As from 2005, a fair, "transparent" and market-based energy pricing structure that seemingly reflects actual costs has been put in place; cross-subsidization remains in favour of certain low-consumption residential categories and agricultural pumping.

30. Manufacturing's contribution to merchandise exports has risen slightly, with electronics maintaining its role as an important export earner. Overall average applied MFN tariff protection has been reduced, particularly with respect to raw materials and semi-finished items, so as to reduce the tariff's anti-export bias. Tax and non-tax incentives are in place to, *inter alia*, encourage investment in priority manufacturing industries. As a result of the expiry of the Agreement on Textiles and Clothing (ATC) and efforts to clamp down on re-exports aimed at circumventing trade measures or exploiting preferential treatment in third markets, the share of textiles and clothing in total exports dropped from 7.9% in 2002 to 6.2% in 2005. High tariff protection and escalation, favouring assembly, support the rapidly growing automotive industry, which meets 95% of domestic demand for cars. Furthermore, reductions in excise tax rates together with soft loans have assisted sales growth and promoted clean (i.e. natural gas) vehicles; a scheme to promote investment in eco-cars has been approved and the formulation of policy measures is under way. Importation of used passenger cars is generally prohibited except when imported temporarily by the public sector for re-export.

31. Overall, the services sector, which makes up a large part of the Thai economy, has benefited from limited liberalization and reform efforts in line with Thailand's existing GATS commitments, which cover close to half of the 160-odd services sectors under the GATS. As undertaken in line with its GATS commitments, Thailand increased the maximum allowable foreign ownership in telecom operators (effective January 2006), from 25% to between 49% and 100%, depending on the type of business. Nevertheless, foreign-ownership limitations remain or are under consideration in several sectors; for instance, a three-stage foreign-ownership liberalization plan for insurance, initiated in 1997, remains at its first stage. Annual life insurance premiums of up to B 50,000 are tax-deductible only for holders of policies issued by locally licensed companies. The banking sector has been improving its balance sheet and non-performing loans portfolio, and migration to more stringent Basel II capital adequacy rules is expected to be completed in late 2008. During the review period, banks maintained capital adequacy ratios in excess of minimum requirements. The domestic maritime services industry has remained protected by cargo reservation requirements and cabotage restrictions; furthermore, it has benefited from promotional measures to attract Thai operators flying the Thai flag. Privatization and divestment in Thai Airways and airports, as well as the negotiation of "open skies"

agreements with major countries from the region, have increased competition in the sector. Tourism recovered from several setbacks in 2006; however, work permits for foreign tourist guides seem to be a concern. Retail trade has been liberalized gradually since the late 1980s, but a reverse trend seems to have affected large retailers in recent years; in 2007, a draft retail law aimed at restricting the expansion of major foreign players was reviewed by the Office of the Council of State, and steps were taken to help small retailers run their business more competitively.

(5) OUTLOOK

32. By and large, Thailand's economic fundamentals remain good. In the short term, supporting domestic demand and rebuilding investor confidence, as well as moving forward with structural reforms, are the main economic policy challenges. Meeting these challenges requires supportive macroeconomic policies and addressing investor concerns regarding Thailand's openness to foreign investment. If macroeconomic targets set under the Tenth Development Plan are achieved, real GDP will be sustained and help the economy to become more competitive and productive. Total factor productivity growth (TFP) within the manufacturing and services sectors would require more domestic innovation and technological advancement. Hitherto, though the appreciation of the baht does not seem to have adversely affected exports (as currencies of competitors also appreciated during the period), further upward pressure on the baht may do so in the future, if not mitigated by improved TFP. The negotiations under way in the WTO could make a major contribution to improving Thailand's market access as well as the predictability and stability of its own trade and investment regime (by expanding its tariff bindings and GATS commitments). Nevertheless, the benefits to Thailand will not be fully realized until its economy is able to respond competitively to external demand.