

## I. ECONOMIC ENVIRONMENT

### (1) INTRODUCTION

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%).<sup>1</sup> 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 remained relatively weak, especially in 2006.<sup>2</sup> 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). Thailand maintained its position virtually unchanged in the medium UN human development category of countries, ranking 74<sup>th</sup> out of 177 in 2004.<sup>3</sup> Between 1990 and 2004, average income poverty levels remained stable with around 2% of the population living below the US\$1 a day poverty line.<sup>4</sup> Income inequality (as measured by the Gini coefficient)<sup>5</sup> dropped slightly (from 0.525 in 2000 to 0.499 in 2004).

2. Although poverty remains significant in poorer regions and rural areas, Thailand surpassed its poverty reduction targets under the Millennium Development Goals (MDG) as well as the targets set under its 9<sup>th</sup> National Economic and Social Development Plan in 2003<sup>6</sup>; with the support of UNDP and the World Bank, it adopted the MDG-plus targets in 2004.<sup>7</sup> However, Thailand's competitiveness seems to have declined as a result of, *inter alia*, exchange rate appreciation, and risks of political instability and uncertainty.<sup>8</sup> Major impediments to Thailand's growth, relatively slow growth in private investment, infrastructure deficiencies (mainly outside metropolitan areas) and burdensome government regulation (including price controls) remain.<sup>9</sup> Although the authorities expect the Thai economy to maintain its growth momentum, exogenous factors, including weather, international oil prices, and a slowdown in international and domestic demand as well as of private investment, may pose challenges to sustained growth. Tax reform has been undertaken to raise tax collection, deal with tax evasion, and reduce the cost of doing business in Thailand. Privatization has progressed slowly.

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<sup>1</sup> Figure for average of GDP growth 2003-06, based on data from the National Economic and Social Development Board GDP 2007Q1 statistics, 4 June 2007.

<sup>2</sup> The weakness of investment in Thailand since the Asian crisis has been considerable and prolonged. While investment has grown, it remains below pre-crisis levels (i.e. 40% of GDP during 1990-96) (IMF, 2007).

<sup>3</sup> UNDP (2003) and (2006).

<sup>4</sup> Period averages for the population living below the US\$2 poverty line registered a drop from 32.5% to 25.2%. UNDP (2003) and (2006).

<sup>5</sup> The Gini coefficient measures the inequality of income distribution within a country. It varies from zero, which indicates perfect equality, with every household earning exactly the same, to 1, which implies absolute inequality, with a single household earning a country's entire income (World Bank, 2005b).

<sup>6</sup> World Bank (2003).

<sup>7</sup> Having already reached the international MDG target of halving the proportion of people living in poverty between 1990 and 2015, Thailand has set an MDG-plus target of reducing the proportion of people in poverty by 2009. If successful, this will represent a stunning four-fifths reduction in poverty since 1990. MDG-plus targets have also been set for education, health, gender equality, and the environment (UNDP online information. Viewed at: <http://www.undp.or.th/mdg/index.html>).

<sup>8</sup> According to the 2007 edition of the *World Competitiveness Yearbook*, Thailand's ranking fell sharply from 29<sup>th</sup> in 2006 to 33<sup>rd</sup> (out of 55) in 2007 (The *Nation*, "Thailand's competitiveness ranking slips", 10 May 2007. Viewed at: [http://www.nationmultimedia.com/2007/05/10/business/business\\_30033809.php](http://www.nationmultimedia.com/2007/05/10/business/business_30033809.php) [18 May 2007]). Furthermore, according to the World Economic Forum Growth Competitiveness Index, Thailand moved from the 33<sup>rd</sup> (out of 117 countries) in 2005 to 35<sup>th</sup> (out of 125) in 2006. The Index comprises the technology index, the public institutions index, and the macroeconomic environment index. For further information, see WEF online information. Viewed at: <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm> [18 May 2007].

<sup>9</sup> World Bank (2007).

3. The economy has become more outward-oriented, with trade in goods and non-factor services rising from 124.6% of GDP in 2003 to 143.5% in 2006, and inward foreign direct investment increasing by 86.4% during 2003-06 (Tables I.1 and I.4).<sup>10</sup> Nevertheless, Thailand's degree of integration into the global economy still seems to be fairly low.<sup>11</sup>

**Table I.1**  
**Selected macroeconomic indicators, 2002-06**

|   | 2002   | 2003      | 2004      | 2005      | 2006 <sup>a</sup> |
|---|--|-----------|-----------|-----------|-------------------|
| <b>National accounts</b>  |  |           |           |           |                   |
|   | <i>(Percentage change)</i>                           |           |           |           |                   |
| Real GDP (at 1988 prices)                                       | 5.3  | 7.1       | 6.3       | 4.5       | 5.0               |
| Consumption   | 4.8  | 5.9       | 6.1       | 5.5       | 3.2               |
| Private consumption   | 5.4  | 6.5       | 6.2       | 4.3       | 3.1               |
| Government consumption  | 0.7  | 2.5       | 5.6       | 13.7      | 3.4               |
| Gross fixed capital formation                                   | 6.5  | 12.1      | 13.2      | 11.1      | 4.0               |
| Exports of goods and non-factor services                        | 12.0   | 7.1       | 9.6       | 4.3       | 8.6               |
| Imports of goods and non-factor services                        | 13.7   | 8.4       | 13.4      | 9.3       | 1.6               |
| XGS/GDP (%) (at current market prices)                          | 64.2   | 65.7      | 70.7      | 73.8      | 73.7              |
| MGS/GDP (%) (at current market prices)                          | 57.5   | 58.9      | 65.8      | 75.1      | 69.8              |
| Unemployment rate (%)   | 2.4  | 2.2       | 2.1       | 1.8       | 1.5               |
| <b>Productivity</b>   |  |           |           |           |                   |
|   | <i>(Percentage change)</i>                           |           |           |           |                   |
| Labour productivity   | 2.3  | 4.7       | 3.6       | 2.9       | 3.8               |
| Capital productivity  | 3.9  | 5.1       | 3.5       | 1.4       | 1.5               |
| Total factor productivity                                       | 3.4  | 5.1       | 3.6       | 2.0       | 2.3               |
| Industrial capacity utilization (%)                             | 64.4   | 69.8      | 71.5      | 72.1      | 74.2              |
| <b>Prices and interest rates</b>                                |  |           |           |           |                   |
|   | <i>(Per cent)</i>                                    |           |           |           |                   |
| Inflation (CPI, % change)                                       | 0.6  | 1.8       | 2.8       | 4.5       | 4.7               |
| Core inflation (% change)                                       | 0.4  | 0.2       | 0.4       | 1.6       | 2.3               |
| Interbank lending rate (overnight average, end of period)       | 1.59   | 1.03      | 1.79      | 3.80      | 4.85              |
| Bank repurchase rate (14-day average, end-of-period)            | 1.75   | 1.25      | 1.90      | 3.94      | 5.00              |
| Bank repurchase rate (1-day average, end-of-period)             | 1.52   | 1.01      | 1.79      | 3.85      | 4.89              |
| Commercial bank minimum lending rate (largest 5, end-of-period) | 6.50-7.00  | 5.50-5.75 | 5.50-5.75 | 6.50-6.75 | 7.50-8.00         |
| <b>Money credit (end period)<sup>b</sup></b>                    |  |           |           |           |                   |
|   | <i>(Percentage change)</i>                           |           |           |           |                   |
| Narrow money  | 15.6   | 14.7      | 10.7      | 7.8       | 1.9               |
| Broad money   | 1.3  | 6.1       | 5.7       | 6.3       | 6.2               |
| Credit to private sector  | 7.2  | 2.3       | 8.8       | 6.2       | 4.2               |
| <b>Exchange rate</b>  |  |           |           |           |                   |
| Baht/US\$ (annual average)                                      | 43.00  | 41.53     | 40.27     | 40.27     | 37.93             |
| Real effective exchange rate (% change)                         | 2.0  | -2.1      | -0.3      | 1.6       | 8.1               |
| Nominal effective exchange rate (% change)                      | 2.5  | -2.4      | -1.0      | -0.6      | 5.7               |
|   | <i>(Per cent of GDP, unless otherwise indicated)</i> |           |           |           |                   |
| <b>Central government balance (year ending 30 September)</b>    |  |           |           |           |                   |
| Net operating balance   | -4.3   | 3.8       | 2.5       | 3.4       | 4.4               |
| Revenue   | 17.5   | 20.1      | 20.2      | 20.8      | 20.6              |
| Tax revenue   | 14.5   | 15.8      | 16.3      | 17.0      | 17.2              |
| Expenditure   | 21.8   | 16.2      | 17.6      | 17.4      | 16.3              |
| Government total debt (end-period, calendar year)               | 31.0   | 27.6      | 27.9      | 26.2      | 25.0              |
| Domestic debt   | 23.7   | 21.6      | 23.2      | 22.8      | 23.0              |

**Table I.1 (cont'd)**

<sup>10</sup> Figures based on data from the National Economic and Social Development Board GDP 2007Q1 statistics, 4 June 2007.

<sup>11</sup> For example, according to the 2005 Globalization Index, Thailand ranks 46<sup>th</sup> overall (out of 62 countries) (A.T. Kearney, 2005).

|  | 2002 | 2003 | 2004 | 2005 | 2006 <sup>a</sup> |
|--|------|------|------|------|-------------------|
| <b>Saving and investment</b>                                   |      |      |      |      |                   |
| Gross national savings   | 29.3 | 30.5 | 31.0 | 29.5 | ..                |
| Public sector  | 7.1  | 7.7  | 7.3  | 7.1  | ..                |
| Gross domestic investment                                      | 23.8 | 25.0 | 26.8 | 31.5 | ..                |
| Public sector  | 6.9  | 6.6  | 6.6  | 7.2  | ..                |
| Savings-investment gap   | 5.5  | 5.6  | 4.2  | -2.0 | ..                |
| <b>External sector</b>   |      |      |      |      |                   |
| Current account balance  | 3.7  | 3.3  | 1.7  | -4.4 | 1.5               |
| Net merchandise trade  | 2.2  | 2.6  | 0.9  | -4.8 | 1.0               |
| Merchandise exports  | 52.1 | 54.6 | 58.9 | 62.1 | 62.0              |
| Merchandise imports  | 49.9 | 52.0 | 58.0 | 66.8 | 61.0              |
| Services balance   | 4.0  | 3.5  | 3.3  | 2.7  | 2.3               |
| Capital account  | -1.5 | -3.4 | 2.3  | 7.2  | 4.3               |
| Direct investment  | 2.5  | 3.2  | 3.6  | 4.8  | 4.4               |
| Balance of payments  | 3.3  | 0.0  | 3.5  | 3.1  | 6.1               |
| Terms of trade   | 92.1 | 94.2 | 95.9 | 96.7 | 95.6              |
| Merchandise exports (% change)                                 | 1.3  | 13.9 | 18.2 | 15.1 | 10.2              |
| Merchandise imports (% change)                                 | 1.0  | 13.2 | 22.3 | 25.9 | 0.7               |
| Service exports (% change)                                     | 14.4 | -1.2 | 17.1 | 6.1  | 12.4              |
| Service imports (% change)                                     | 17.4 | -0.3 | 24.4 | 12.0 | 18.7              |
| International reserves <sup>c</sup> (US\$ billion, end-period) | 38.9 | 42.1 | 49.8 | 52.1 | 67.0              |
| in months of imports   | 7.3  | 6.8  | 7.0  | 5.8  | 6.6               |
| Foreign exchange reserves (US\$ billion, end-period)           | 38.1 | 41.0 | 48.5 | 50.5 | 65.1              |
| Total external debt (US\$ billion; end-period)                 | 59.5 | 51.8 | 51.3 | 52.0 | 59.9              |
| Debt service ratio   | 19.6 | 16.0 | 8.5  | 10.8 | 8.3               |

.. Not available.

a Provisional.

b Narrow money refers to currency outside depository corporations and demand deposits at depository corporations. Broad money refers to narrow money plus other deposits at depository corporations and securities other than shares.

c Including foreign exchange reserves, gold, SDRs (Special Drawing Rights), and Reserve Position in IMF.

Source: Bank of Thailand; Ministry of Finance and data provided by the authorities.

## (2) RECENT ECONOMIC DEVELOPMENTS

4. During the period under review, annual real GDP growth averaged 5.7% (2003-06), but it is expected to slow to 4.3 % in 2007. Growth has been fuelled by growth in domestic consumption and exports. This is reflected in the growth of manufacturing, which has averaged 7.5% over the period (Table I.2). However, since 2005 a confluence of factors such as the higher oil prices, slower growth in the economies of its major trading partners, the downward electronic cycle, the devastating tsunami, a prolonged drought, political uncertainty, and continued unrest in the southern part of the country, have led to a slowdown in activity; these developments had an adverse effect on consumer and investor confidence as well as export growth. Furthermore, the slowdown in GDP growth in 2007 is in part because the easy gains from increased utilization of excess capacity have been exhausted<sup>12</sup>, and in part because new capacity is expanding slowly as investor confidence is low. This may lead to growth and inflation concerns.<sup>13</sup>

<sup>12</sup> According to Bank of Thailand data, between 2002 and 2006 total industrial capacity utilization rose from 64.4% to 74.2%. Sectors with capacity utilization of over 90% were paper, petrochemical, and integrated circuits industries.

<sup>13</sup> World Bank (2007).

5. Overall unemployment declined from 2.4% in 2002 to around 1.5% in 2006 as a result of increased employment in the services sector (Table I.2).<sup>14</sup> Average total factor productivity (TFP) growth increased from 1.6% (1977-96) to 2.1% (1999-04).<sup>15</sup> The gains were initially due to labour shifting from agriculture to higher productivity manufacturing rather than improvements within the industrial sector. Furthermore, rapid employment growth in manufacturing is unlikely; thus, sustained growth in the future would require a significant increase in investment or improved TFP. The latter is partly affected by the slowdown in domestic demand and existing price controls (Chapter III), which constitute disincentives to firms to improve their efficiency and innovate. The 10<sup>th</sup> National Economic and Social Development Plan (Chapter II) emphasizes the need to move towards a knowledge-based economy that would increase TFP growth and thus export competitiveness.

6. Services have remained the largest contributor to GDP, despite a drop of their share (Table I.2); their lacklustre performance in 2005 and 2006 is attributed to the fall in tourism.

**Table I.2**  
**Basic economic and social indicators, 2002-06**

|   | 2002     | 2003     | 2004      | 2005      | 2006      |
|---|----------|----------|-----------|-----------|-----------|
| Real GDP at market prices (baht billion, 1988 prices)               | 3,237.0  | 3,468.2  | 3,685.9   | 3,851.3   | 4,044.6   |
| Current GDP at market price (baht billion)                          | 5,450.6  | 5,917.4  | 6,489.8   | 7,087.7   | 7,816.5   |
| Current GDP at market price (US\$ billion)                          | 126.7    | 142.5    | 161.2     | 176.0     | 206.1     |
| GDP per capita at current market price (baht)                       | 86,322.2 | 92,960.0 | 101,092.7 | 109,440.0 | 119,823.9 |
| GDP per capita at current market price (US\$)                       | 2,007.3  | 2,238.4  | 2,510.4   | 2,717.7   | 3,159.2   |
| <i>(Annual percentage change)</i>                                   |          |          |           |           |           |
| <b>GDP by economic activity at constant 1988 prices</b>             |          |          |           |           |           |
| Agriculture, forestry, and fishing                                  | 0.7      | 12.7     | -2.4      | -3.2      | 4.8       |
| Mining and quarrying  | 11.0     | 6.8      | 5.5       | 8.8       | 3.6       |
| Manufacturing   | 7.1      | 10.7     | 8.2       | 5.2       | 6.1       |
| Electricity, gas, and water   | 6.0      | 4.6      | 6.4       | 5.3       | 5.1       |
| Construction  | 5.4      | 2.8      | 7.2       | 6.0       | 4.9       |
| Services  | 4.6      | 3.5      | 6.7       | 5.2       | 4.2       |
| Wholesale and retail trade, repair of vehicles, and household goods | 2.2      | 2.9      | 4.6       | 4.2       | 2.7       |
| Hotels and restaurants  | 4.5      | -4.2     | 12.2      | 2.1       | 10.5      |
| Transport, storage, and communication                               | 6.8      | 2.9      | 7.4       | 4.8       | 5.8       |
| Financial intermediation  | 11.6     | 16.8     | 12.4      | 7.5       | 2.9       |
| Real estate, renting and business activities                        | 4.9      | 4.9      | 6.6       | 4.8       | 2.0       |
| Public administration and defence, compulsory social security       | 6.5      | 3.0      | 3.0       | 6.1       | 3.7       |
| Education   | 1.0      | 1.1      | 3.4       | 8.4       | 2.9       |
| Health and social work  | -0.3     | -3.8     | 2.1       | 12.3      | 8.8       |
| Other community, social and personal service activity               | 8.1      | 11.8     | 12.4      | 6.6       | 2.2       |
| Other   | 0.3      | 2.9      | 3.6       | 0.2       | -2.3      |

**Table I.2 (cont'd)**

<sup>14</sup> Data provided by the authorities and contained at the National Statistical Office (NSO) Labour Force Survey; this figure could not be verified as most of the site is in Thai language only. According to the BOT and IMF, respectively, this indicator is at 1.4% and 1.6% for 2006.

<sup>15</sup> World Bank (2005b).

|   | 2002              | 2003  | 2004  | 2005  | 2006  |
|---|-------------------|-------|-------|-------|-------|
|   | <i>(Per cent)</i> |       |       |       |       |
| <b>Share of main sectors in current GDP</b>                         |                   |       |       |       |       |
| Agriculture, forestry, and fishing                                  | 9.4               | 10.4  | 10.3  | 10.2  | 10.7  |
| Mining and quarrying  | 2.5               | 2.6   | 2.7   | 3.1   | 3.3   |
| Manufacturing   | 33.7              | 34.8  | 34.5  | 34.8  | 35.0  |
| Electricity, gas, and water   | 3.2               | 3.2   | 3.2   | 3.1   | 3.2   |
| Construction  | 3.0               | 3.0   | 3.0   | 3.1   | 3.1   |
| Services  | 48.1              | 46.0  | 46.3  | 45.7  | 44.7  |
| Wholesale and retail trade, repair of vehicles, and household goods | 15.9              | 15.0  | 14.9  | 14.6  | 14.3  |
| Hotels and restaurants  | 5.7               | 5.1   | 5.1   | 4.9   | 5.0   |
| Transport, storage, and communication                               | 8.2               | 7.7   | 7.6   | 7.4   | 7.3   |
| Financial intermediation  | 3.1               | 3.4   | 3.6   | 3.7   | 3.6   |
| Real estate, renting and business activities                        | 3.2               | 3.0   | 2.9   | 2.8   | 2.6   |
| Public administration and defence, compulsory social security       | 4.5               | 4.4   | 4.6   | 4.6   | 4.5   |
| Education   | 3.9               | 3.7   | 3.8   | 3.9   | 3.8   |
| Health and social work  | 2.0               | 1.8   | 1.8   | 1.9   | 1.9   |
| Other community, social and personal service activity               | 1.6               | 1.6   | 1.8   | 1.8   | 1.6   |
| Other   | 0.1               | 0.1   | 0.1   | 0.1   | 0.1   |
| <b>Share of sector in total employment</b>                          |                   |       |       |       |       |
| Agriculture, hunting, and fishery                                   | 42.5              | 41.0  | 39.3  | 38.6  | 39.7  |
| Mining and quarrying  | 0.1               | 0.1   | 0.1   | 0.2   | 0.2   |
| Manufacturing   | 15.3              | 15.7  | 15.8  | 15.8  | 15.4  |
| Electricity, gas, and water   | 0.3               | 0.3   | 0.3   | 0.3   | 0.3   |
| Construction  | 5.4               | 5.6   | 6.0   | 6.0   | 6.0   |
| Services  | 36.4              | 37.4  | 38.5  | 39.0  | 38.4  |
| Wholesale and retail trade, repair of vehicles, and household goods | 15.0              | 15.4  | 16.0  | 15.8  | 15.5  |
| Hotels and restaurants  | 6.2               | 6.3   | 6.5   | 6.7   | 6.4   |
| Transport, storage, and communication                               | 3.1               | 3.1   | 3.2   | 3.1   | 3.0   |
| Financial intermediation  | 0.8               | 0.9   | 0.9   | 0.9   | 1.0   |
| Real estate, renting and business activities                        | 1.5               | 1.6   | 1.8   | 1.8   | 1.9   |
| Public administration and defence, compulsory social security       | 2.9               | 2.8   | 2.9   | 3.1   | 3.2   |
| Education   | 2.9               | 2.9   | 3.0   | 3.0   | 2.9   |
| Health and social work  | 1.4               | 1.5   | 1.6   | 1.7   | 1.7   |
| Other community, social and personal service activity               | 1.9               | 2.0   | 2.1   | 2.1   | 2.1   |
| Other   | 0.8               | 0.8   | 0.8   | 0.8   | 0.8   |
| <i>Memorandum</i>   |                   |       |       |       |       |
| Life expectancy at birth (years)                                    | 69.1              | 70.0  | 70.3  | 73.6  | ..    |
| Infant mortality rate (per 1,000 live births)                       | 24.0              | 19.0  | 18.0  | 11.3  | ..    |
| Adult literacy rate (%)   | 92.6              | 92.6  | 92.6  | 93.5  | ..    |
| Enrolment ratio (net) in education                                  |                   |       |       |       |       |
| Primary (%)   | 104.8             | 104.5 | 104.2 | 104.2 | 103.5 |
| Secondary (%)   | 71.1              | 71.8  | 78.6  | 80.0  | 81.3  |

.. Not available.

Source: Bank of Thailand (2006), *Economic and Financial Statistics, Fourth Quarter*; National Statistics Office; UNDP, *Human Development Report* (various issues); and data provided by the authorities.

7. Thailand's marked reduction in poverty levels (section (1)) allowed it to surpass its targets under the Millennium Development Goals and its 9<sup>th</sup> Plan in 2003.<sup>16</sup> Poverty alleviation has been due to a rise in real incomes in the agriculture sector (80% of the poor are in this sector), which have been growing at 5% per annum since 2001. In addition, unemployment in agriculture fell by more than 70% between 2001 and 2005.<sup>17</sup> To alleviate the high incidence of poverty in the north-east of the country, where the majority of the poor live, targeted action included a substantial package of farm, village, and small-enterprise-oriented programmes designed to expand productive employment opportunities for low-income groups as well as a low-cost universal health scheme to cover the uninsured. Additionally, on 1 January 2004, an unemployment security fund was introduced to provide a safety net for those laid off, and action was intensified through a "war on poverty" campaign aimed at eradicating poverty within six years, through registration of vulnerable people with the National Poverty Eradication Centre.<sup>18</sup> Other social indicators, such as infant mortality and life expectancy, have also improved.

8. During the period under review, inflation has been on an upward trend (Table I.1). Between 2003 and 2004, Thailand had a relatively benign inflationary environment, enabling the authorities to keep real interest rates low so as to encourage consumption and investment and thus foster growth. Retail oil prices were subsidized (Chapters III and IV) and there was excess capacity in the manufacturing sector. The combined effect of removing the oil price subsidy in 2004, which resulted in a 40% rise in retail petrol prices in 2005 (over 2003), and the decline in excess capacity to 80% for many industries<sup>19</sup>, resulted in headline inflation rising to 4.7% in 2006. Core inflation averaged 2.3% in 2006, well within the target range of zero to 3.5% (section (3)(i)(a)).<sup>20</sup> Subsequently, a slowdown in domestic demand coupled with a reduction in oil prices has reduced inflationary pressure.

### **(3) MAIN MACROECONOMIC POLICY DEVELOPMENTS**

#### **(i) Monetary and exchange rate policy**

##### **(a) Monetary policy**

9. Monetary policy is the responsibility of the Bank of Thailand (BOT) (Chapter IV). Despite some weaknesses in the current legal framework (i.e. the Minister of Finance is given the power to supervise BOT activities), the BOT is able to maintain operational independence in the formulation of monetary policy through an independent and open decision-making process, including the Monetary Policy Committee (MPC)<sup>21</sup>, and mechanisms to ensure accountability and transparency. According to the authorities, changes in the monetary policy stance and the operational framework are regularly explained to the public and announced in a timely manner.

<sup>16</sup> World Bank (2003).

<sup>17</sup> World Bank (2006c).

<sup>18</sup> World Bank (2004b).

<sup>19</sup> World Bank (2005b).

<sup>20</sup> Core inflation is defined as headline inflation less raw food and energy, because of their price volatility.

<sup>21</sup> The Monetary Policy Committee (MPC), formed in April 2000, under the name of Monetary Policy Board is appointed by the Governor of the Bank of Thailand; it comprises the Governor, two deputy governors, and four external members, two of them also directors of the BOT's Court of Directors. The MPC meets eight times a year to set monetary policy deemed appropriate to economic conditions and forecasts. It also approves the Bank's quarterly Inflation Report. This helps the MPC to explain its monetary policy decisions to the public by providing information on economic conditions as well as forecasts for eight quarters ahead. The amendment of the Central Bank Act, which is before parliament would provide greater autonomy and accountability to the Bank of Thailand. For further details about the MPC, see BOT online information. Viewed at: [http://www.bot.or.th.bothomepage/BankAtWork/monetary&fxpolicies/index\\_eng\\_i.asp](http://www.bot.or.th.bothomepage/BankAtWork/monetary&fxpolicies/index_eng_i.asp) [11 June 2007].

10. The main objective of Thai monetary policy is to achieve price stability. The monetary target adopted with the floating of the currency in July 1997 was replaced in May 2000 with inflation targeting, which the authorities considered more effective, since the money supply and output relationship had become less stable. A quarterly average core inflation rate of zero to 3.5% year-on-year is set as the policy target: the authorities consider the target range appropriate to maintain inflation in line with Thailand's trading partners, and thereby to preserve export competitiveness and currency stability, and to promote growth. The main policy instrument to achieve the inflation target is the BOT's 1-day repurchase (repo) rate<sup>22</sup>, currently set at 3.5% per annum. The inflation-targeting policy framework, together with the managed floating exchange rate regime are seen by the authorities as providing sufficient flexibility to respond quickly to changing domestic and external developments while ensuring long-run price stability conducive to sustainable economic growth.

11. Between 2003 and 2004, the BOT pursued an accommodative monetary policy to encourage demand and foster economic growth; this was facilitated by mild inflationary pressure. The dismantling of the oil subsidy (section (2)), rising commodity prices, and increasing capacity utilization resulted in rising inflationary pressure, prompting the BOT to tighten monetary policy. Between 2004 and 2006, the BOT increased the 14-day repo rate from 1.25% to 5%, primarily to contain inflationary pressure. However, with inflationary pressure receding and the need to spur growth as from January 2007, the BOT has eased monetary policy, by reducing the 1-day repo rate five times (totalling 1.75 percentage points), from 5% to 3.25% (in July 2007).<sup>23</sup>

(b) Exchange rate policy

12. The Government is committed to a flexible market-determined exchange rate; the BOT intervenes in the foreign exchange market only when appropriate to smooth out fluctuations. Intervention is believed to help limit the extent of exchange-rate overshooting, thus avoiding the disruptive impact and the need for costly real economic adjustment.

13. The continuing strength of capital inflows and the virtually continuous current account surplus (reflecting national saving higher than gross domestic investment) have exerted upward pressure on the baht, which has eroded the export competitiveness of the labour-intensive industries (such as textiles, clothing, and footwear) that have been unable to improve their productivity sufficiently to offset the baht's appreciation and withstand increased competition from China and other countries in the region.<sup>24</sup> During the period under review, the Thai currency appreciated by around 9% against the U.S. dollar.<sup>25</sup> Furthermore, both the real effective exchange rate and the nominal effective exchange rate, constructed from bilateral exchange rates of the baht *vis-à-vis* Thailand's 21 major trading partners and competitors, have been appreciating since 2004. Between January 2004 and December 2006, the real effective exchange rate appreciated by 12.7%, while the nominal rate

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<sup>22</sup> The 14-day repurchase rate was replaced as the policy rate by the 1-day repurchase rate from 17 January 2007.

<sup>23</sup> BOT online information. Viewed at: [http://www.bot.or.th/bothomepage/BankAtWork/monetary&fxpolicies/index\\_eng\\_i.asp](http://www.bot.or.th/bothomepage/BankAtWork/monetary&fxpolicies/index_eng_i.asp) [11 June 2007]; and World Bank (2007).

<sup>24</sup> By contrast, many of Thailand's higher-value export industries (such as automobiles, automobile components, and electronics) contain a significant proportion of imported components that have become cheaper as a result of the baht's appreciation, thereby mitigating the latter's effect on their competitiveness. IMF Public Information Notice (PIN) No. 07/39, 23 March 2007. Viewed at: <http://www.imf.org/external/np/sec/pn/2007/pn0739.htm>.

<sup>25</sup> The appreciation rate is based on an average annual exchange rate for the baht; the appreciation would have been higher if point-to-point exchange rates were considered.

appreciated by 6.9%.<sup>26</sup> In 2006, the baht appreciated significantly compared with other regional currencies to a nine-year high of B 35.1/US\$1, prompting the BOT to implement an unremunerated reserve requirement (URR) measure on short-term capital inflows on 18 December 2006.<sup>27</sup> This measure, which resulted in different exchange rates for the offshore and onshore markets, has been relaxed progressively since 1 February 2007.<sup>28</sup>

**(ii) Fiscal policy**

14. During the period under review, Thailand's fiscal position has remained strong, underpinned by robust growth in tax revenues; the fiscal surplus (based on net operating balance figures) rose from 3.8% of GDP in 2003 to 4.4% in 2006 (Table I.1).<sup>29</sup> Although the share of import duties to total tax revenue has declined (Chapter III), this has been more than offset by increased corporate and value-added tax receipts as a result of economic growth and improved tax administration and collection. Net revenues from extra budgetary funds and the social security fund also contributed to the fiscal surplus.<sup>30</sup> In 2005, four fiscal targets were set: fiscal balance from FY 2005 onwards; public debt to GDP less than 50%; capital expenditure more than 25% of the budget; and debt service share less than 15% of the budget.<sup>31</sup> Fiscal decentralization has progressed slower than initially planned (Chapter II).

15. On the expenditure front, external debt service payments in proportion to export earnings have been falling (from 16% in 2003 to 8.3% in 2006 (Table I.1)) due, *inter alia*, to the Government's policy of retiring expensive debt. Additionally, government disbursements were delayed as a result of, *inter alia*, slow expansion of public investments by the central government and state-owned enterprises, the closer monitoring of government procurement processes, and a declining budget for the import-intensive projects as the baht appreciated.<sup>32</sup> According to IMF data, the fiscal surplus has resulted in falling public debt as a percentage of GDP, from 51% in 2003 to 42% in 2006<sup>33</sup>; according to BOT data, total government domestic and external debt (excluding IMF loan payments) followed a similar trend, declining from 27.6% of GDP to 25% (Table I.1).

16. A large portion of the Government's expenditure is off-budget, including provision of credit to SMEs, and housing projects for the poor.<sup>34</sup> The cumulative cost of off-budget items between 2001 and 2004 was estimated at 6% of GDP; according to the authorities this is not a concern because most credit is commercial-based credit extended by specialized financial institutions.

<sup>26</sup> BOT online information on nominal effective exchange rates and real effective exchange rates. Viewed at: [http://www.bot.or.th/BOTHomepage/DataBank/Econcond/econind/Effective\\_Exchange/index\\_eng\\_i.asp](http://www.bot.or.th/BOTHomepage/DataBank/Econcond/econind/Effective_Exchange/index_eng_i.asp).

<sup>27</sup> A 30% non-interest-bearing reserve requirement was imposed on capital inflows. If the reserve-associated funds were withdrawn within a year, only two thirds of the reserve amount would be released, which was equivalent to a 10% tax.

<sup>28</sup> While trade- and service-related transactions as well as FDI flows (excluding direct loans) were not subject to URR from the start, equity investment inflows (excluding mutual funds and warrants) in listed companies were exempt from the restrictions as from 19 December 2006. More URR exemptions have been available for loans (effective from 1 February 2007), debt securities, mutual funds and property funds (effective from 15 March 2007) (BOT online information. Viewed at: <http://www.bot.or.th/fips/ Documents/FOG/2549/EngPDF/25490114.pdf> and <http://www.bot.or.th/fips/ Documents/FOG/2550/EngPDF/25500013.pdf>).

<sup>29</sup> The fiscal surplus (based on net operating balance figures) was 2.5% of GDP during 2004 and 3.4% during 2005, rising to 4.4% in 2006.

<sup>30</sup> World Bank (2006).

<sup>31</sup> Ministry of Finance (2005).

<sup>32</sup> World Bank (2007).

<sup>33</sup> IMF data from IMF Public Information Notice (PIN) No. 07/39, 23 March 2007.

<sup>34</sup> Asian Development Bank (2005) and (2004).



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**(4) MAIN STRUCTURAL POLICY DEVELOPMENTS****(i) Tax reform**

17. The objectives of Thailand's tax reform are to reinforce the fiscal sustainability framework, incorporate environmental and social objectives, enhance the country's competitiveness, and stabilize the level of economic development. Several initiatives were announced during the review period. For instance in 2003, the authorities planned a broad tax reform, which would enhance the efficiency of the tax system and support revenues.<sup>35</sup> In 2005, it was recognized that the tax reform should be undertaken within a framework of fiscal sustainability and four fiscal targets were set (section (3)(ii)). In 2005, the Government was formulating the Roadmap for Tax Reform with a view to broadening the tax base, increasing competitiveness, promoting social development, and increasing private sector participation.<sup>36</sup> The structure of the corporate income tax, personal income tax, value-added tax, excise tax, and customs duties were to be reviewed. No information on action resulting from these plans was available from the authorities (and access to Fiscal Policy Office online information in English was not possible).

18. During the period under review, Thailand reduced certain tax rates and maintained numerous tax incentives in line with specific policy objectives (Chapter III), while trying to increase tax revenues through greater compliance and better tax administration and collection. Initiatives to modernize the tax administration, such as e-revenue, e-excise, and e-customs appear to have facilitated taxpayers' dealings with the tax collecting agencies and helped reduce tax evasion and corruption by minimizing face-to-face contacts.

**(ii) Financial and capital markets reform**

19. The Government initiated a Financial Sector Market Master Plan in 2004 and a Capital Market Master Plan II, as well as Financial Sector Master Plan II in 2006 (Chapter IV). These plans seek to, *inter alia*, increase the depth of the financial and capital markets and make them more accessible through liberalization. At the same time, the Government intends to put in place international best practices with regard to corporate governance and supervision (Chapter III). Legal reforms to enhance the efficiency and effectiveness of the financial sector are making progress. Amendments to the Central Bank Act, the Securities and Exchange Commission Act and the Deposit Insurance Act to increase the autonomy of and mitigate political influence in regulatory agencies appear to have been approved by the Cabinet but need to be approved by the Council of State and the National Legislative Assembly to become effective. Additionally, new accounting standards (IAS39) and a capital adequacy framework (Basel II) are to be implemented in 2007 and 2008, respectively (Chapter IV). These measures would improve provisioning and thus strengthen the banks' balance sheets.

**(iii) Privatization**

20. State intervention in the economy persists in certain activities (Chapters III and IV). The privatization process, a contentious issue, has been slow: there has been only nominal divestment in a small number of state-owned enterprises (SOEs). According to April 2004 statements, the Government would maintain a 50% stake in all SOEs and a 75% holding in power and water utilities; thus, the State would remain the majority stakeholder. The planned privatization of the state-owned power company, Electricity Generating Authority of Thailand (EGAT), was suspended by the

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<sup>35</sup> IMF Public Information Notice (PIN) No. 03/119, 17 September 2003.

<sup>36</sup> Ministry of Finance (2005).

Supreme Administrative Court in 2006 (Chapter IV). The Government aims to privatize ten SOEs between 2007 and 2009, depending on the political situation.

**(iv) Labour**

21. Under the Labour Protection Act of 1998, employers must comply with minimum wage requirements for full-time permanent and part-time employees, thereby preventing employers from circumventing minimum wage obligations; violations are considered criminal offences. Where violations are found, a labour inspector must either issue to the employer a warning or a written order to comply with the law; follow-up inspections are performed to ensure compliance. In case of non-compliance, employees may submit a complaint to the labour inspector, or sue the employer directly in the Labour Court for any unpaid wages, subject to specific rates of interest and surcharge. The Social Security Scheme covers enterprises with one or more workers. At present, 8.9 million insured persons are covered by the Social Security Fund, which is financed by tripartite contributions (employers, employees, and the Government) and provides sickness, maternity, invalidity, death, child allowance, old-age pension, and unemployment benefits. The old-age benefits were launched on 31 December 1998; the retirement age (for insured persons) is 55 years. The Social Security Office is to increase the old-age pension from 15% to 20% of the average wage of the last 60 months of employment of the insuree or 20% and 1.5% per additional 12 months of contribution above 180 months. The SSO will commence pension distribution in 2013. According to the authorities, under the new pension rate, the result of actuarial projection showed that the fund will be sufficient for the next 50 years.

22. According to a 2006 NSO survey, about 21.8 million persons are employed in the informal sector (equivalent to 61.5% of the total 35.5 million employed persons). The agriculture and trading sectors account for 57.5% and 17.1% of employment in the informal sector, respectively. Measures to integrate the informal sector into the formal economy include the extension of social security coverage to establishments with less than ten employees since April 2002; this measure led to a 17.6% increase of the number of insured persons in 2002.

**(v) Governance**

23. Efforts to improve transparency have been undertaken in several policy areas during the period under review, e.g. customs, taxation, and government procurement (Chapters II and III). Issues relating to the transparency and accountability of public administration as well as the proper management of public affairs have an important impact on the economic environment and growth prospects.

24. Corruption increases the cost of doing business and thus reduces competitiveness. According to a 2007 World Bank report, Thailand has fallen back on several key governance indicators, except for that of control of corruption.<sup>37</sup> According to the global corruption perceptions index calculated by Transparency International, Thailand's ranking improved from 70 in 2003 (out of 133 countries) to 59 (out of 158 countries) in 2005 before dropping to 63 (out of 163 countries) in 2006<sup>38</sup>, lower than that of some competing countries in the region. The authorities indicate that the Corruption Perception Index (CPI) is measured mainly on perception. In Thailand's view, changes in Thailand's ranking might be attributed to, *inter alia*, reporting on corruption in the former Government (i.e. in

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<sup>37</sup> The report displays the country's performance for all available years between 1996 and 2006 in six governance dimensions: (i) voice and accountability, (ii) political stability and lack of violence/terrorism, (iii) government effectiveness, (iv) regulatory quality, (v) rule of law, and (vi) control of corruption (Kaufmann et al. 2007).

<sup>38</sup> Transparency International (2006).

buying the Computer Tomography X-Ray machines for the new airport), increase in the number of countries ranked, and political instability.

25. Despite long-standing efforts, corruption remains significant, both in the private and public sectors; it is often encountered in connection with government procurement, customs, and other business transactions.<sup>39</sup> Thailand's legal system is considered relatively weak, and the abrogated 1997 Constitution (Chapter II) constituted a serious attempt to strengthen judicial awareness. The National Counter Corruption Commission (NCCC), the main coordinator of anti-corruption measures, received 852 complaints about corruption in local government in 2003. However, investigations are very slow, and few officials have been punished so far. The Anti-Money Laundering Office (AMLO), under the Minister of Justice, has continued to work to enhance the effectiveness of law enforcement and related implementation. Since August 1999, the Transaction Committee, chaired by the Secretary-General of the Anti-Money Laundering Board, has been authorized to seize or freeze assets when there is evidence of corruption. Enforcement has improved since 2003: the Transaction Committee has ordered the seizure or freezing of assets worth B 118.8 million in connection with 16 cases of corruption. Thailand has taken the first steps towards implementing more e-government (Chapter II), but this is not well developed. E-auctions and e-procurement have been used for public projects (Chapter III). The current Government runs an anti-corruption campaign aimed, in particular, at high-ranking decision-makers and bureaucrats.

## **(5) BALANCE-OF-PAYMENTS DEVELOPMENTS**

### **(i) Current and trade accounts**

26. The current account posted a surplus in each year of the review period except 2005 (Table I.3)<sup>40</sup>; nevertheless, in relation to GDP it declined from 3.3% in 2003 to 1.5% in 2006. The current account balance reflects the difference between gross national savings and gross domestic investment. Private and public investment has been sluggish during the period as corporations have still not recovered fully from the 1997 crisis. Public investment increased in 2005, partly due to the initiation of mega-infrastructure projects (section (4)(iv) and Chapter III); private investment also rose. At the same time, rising household incomes resulted in increased savings. Continued capital inflows coupled with a current account surplus led to a rise in international reserves from US\$42 billion in 2003 to US\$67 billion in 2006 (Table I.1), and US\$71 billion in March 2007, accounting for 344% (as of March 2007) of short-term external debt and covering more than 6.7 months of merchandise imports; this considerably reduces external vulnerability.<sup>41</sup>

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<sup>39</sup> An estimate made by the National Counter Corruption Commission calculates that up to 30% of government procurement budgets vanish because of corrupt practices. The National Institute of Development Administration reported that 95 mega-projects cost the state B 400 billion (Chapter III), solely due to corruption, within the last five and a half years. It was also found that 79% of all businesses had to bribe officials in order to obtain the desired service or to obtain a contract. Bribery costs were estimated to add 20% to the overall costs of a contract (Business Anti-Corruption online information. Viewed at: <http://www.business-anti-corruption.com/normal.asp?pageid=241>).

<sup>40</sup> In 2005, the current account recorded a deficit of 4.4% of GDP.

<sup>41</sup> Bank of Thailand and World Bank (2007).

**Table I.3**  
**Balance of payments, 2002-06**  
(US\$ million)

|                                      | 2002      | 2003      | 2004     | 2005 <sup>a</sup> | 2006 <sup>a</sup> |
|--------------------------------------|-----------|-----------|----------|-------------------|-------------------|
| <b>Current account</b>               | 4,685.0   | 4,784.0   | 2,767.0  | -7,852.2          | 3,240.5           |
| Goods and services balance           | 7,746.0   | 8,821.0   | 6,754.0  | -3,735.2          | 6,902.3           |
| Trade balance                        | 2,739.0   | 3,759.0   | 1,460.0  | -8,529.6          | 2,244.7           |
| Exports (f.o.b.)                     | 66,092.0  | 78,105.0  | 94,941.0 | 109,192.8         | 128,219.9         |
| Imports (c.i.f.)                     | 63,353.0  | 74,346.0  | 93,481.0 | 117,722.4         | 125,975.2         |
| Services balance                     | 5,007.0   | 5,062.0   | 5,294.0  | 4,794.4           | 4,657.6           |
| Receipts                             | 15,391.0  | 15,801.0  | 19,050.0 | 20,165.1          | 24,098.7          |
| Travel                               | 7,902.0   | 7,855.0   | 10,057.0 | 9,576.2           | 12,441.0          |
| Transportation                       | 3,264.0   | 3,505.0   | 4,349.0  | 4,626.5           | 5,269.0           |
| Payments                             | 10,384.0  | 10,739.0  | 13,756.0 | 15,370.6          | 19,441.1          |
| Travel                               | 3,303.0   | 2,921.0   | 4,516.0  | 3,803.3           | 4,633.7           |
| Transportation                       | 1,419.0   | 1,792.0   | 2,441.0  | 3,965.3           | 4,583.2           |
| Income                               | -3,664.0  | -4,978.0  | -6,121.0 | -7,120.3          | -7,037.2          |
| Credit                               | 3,419.0   | 3,152.0   | 3,247.0  | 3,641.5           | 4,748.9           |
| Investment income                    | 2,039.0   | 1,544.0   | 1,624.0  | 2,454.4           | 3,415.5           |
| Compensation of employees            | 1,380.0   | 1,608.0   | 1,623.0  | 1,187.0           | 1,333.4           |
| Debit <sup>b</sup>                   | 7,083.0   | 8,130.0   | 9,368.0  | 10,761.8          | 11,786.1          |
| Income on equity                     | 4,692.0   | 6,260.0   | 7,676.0  | 9,242.8           | 9,733.2           |
| Income on debt                       | 2,391.0   | 1,870.0   | 1,692.0  | 1,519.0           | 2,052.9           |
| Current transfers (net)              | 603.0     | 941.0     | 2,134.0  | 3,003.3           | 3,375.4           |
| <b>Capital and financial account</b> | -1,845.0  | -4,759.0  | 3,628.0  | 12,558.0          | 8,866.3           |
| Direct investment                    | 3,164.0   | 4,614.0   | 5,786.0  | 8,405.2           | 8,960.5           |
| In Thailand                          | 3,335.0   | 5,235.0   | 5,862.0  | 8,957.0           | 9,750.7           |
| Abroad                               | -171.0    | -621.0    | -76.0    | -551.8            | -790.2            |
| Portfolio investment                 | -1,606.0  | -73.0     | 3,071.0  | 6,122.8           | 4,462.9           |
| Assets                               | -903.0    | -942.0    | 1,199.0  | -1,460.9          | -1,712.3          |
| Liabilities                          | -703.0    | 869.0     | 1,872.0  | 7,583.7           | 6,175.2           |
| Other investment                     | -3,403.0  | -9,300.0  | -5,229.0 | -1,970.0          | -4,557.1          |
| Assets                               | 2,829.0   | -65.0     | -1,698.0 | -1,307.4          | -9,337.4          |
| Liabilities                          | -6,232.0  | -9,235.0  | -3,531.0 | -662.6            | 4,780.3           |
| Loans                                | -10,300.0 | -10,488.0 | -2,269.0 | -3,325.7          | 2,896.8           |
| Net errors and omission              | 1,394.0   | 118.0     | -660.0   | 716.5             | 634.8             |
| <b>Overall balance of payments</b>   | 4,234.0   | 143.0     | 5,735.0  | 5,422.3           | 12,741.6          |

a Provisional.

b Investment income only.

Source: Bank of Thailand (2006), Economic Data: Table 53.1.

## (ii) External liabilities

27. Following the repayment of the IMF loan ahead of schedule (section (3)(ii)), the ratio of external debt to GDP fell from over 40% in 2003 to 33.1% in 2006<sup>42</sup>, while the debt service ratio also declined from 16% to 8.3% (Table I.1).

<sup>42</sup> Data provided by the Bank of Thailand are based on a three-year moving average GDP, in line with the World Bank methodology.

**(6) DEVELOPMENTS IN MERCHANDISE TRADE**

28. During the review period, the ratio of Thailand's total trade (exports and imports) in goods and non-factor-services to GDP followed an upward trend (from 124.6% in 2003 to 143.5% in 2006), reflecting the increased openness of the Thai economy as well as the importance of foreign trade (Table I.1).

**(i) Composition of trade**

29. Manufactured exports still account for more than three fourths of Thailand's total exports (Chart I.1 and Table AI.1). Their share in total exports increased during the period under review, driven mainly by a surge in export value, as well as strong global demand. However, agricultural exports contracted, due mainly to the lower domestic supply caused by the drought and bird flu, but strong agricultural commodity prices mitigated some of the impact. Manufactured items represent two thirds of total imports (Table AI.2). Import growth was fuelled by the hike in oil prices, increased imports of iron and steel due to the temporary closing of large local steel producers (Chapters III and IV), the inventory build-up, increased domestic demand on account of mega projects, and increased construction activity.<sup>43</sup>

30. According to estimates by the Intelligence Division/Investigation and Suppression Bureau of the Customs Department, the value of smuggled merchandise dropped from B 2.5 billion to B 1.3 billion between 2002 and 2006. No further information, e.g. on the type of smuggled goods and their origin, was available from the authorities.

**(ii) Direction of trade**

31. There has been a marked shift in Thailand's trade destinations during the period under review; most Asian economies have gained at the expense of the EC-25 and the United States (Chart I.2, Table AI.3 and Table AI.4). However, the United States, the EC-25, and Japan remain Thailand's largest export markets. With regard to imports, Japan remains Thailand's largest source; China has overtaken both the EC-25 and the United States. As a result of the rising oil prices, the share of goods from the Middle East has also increased.

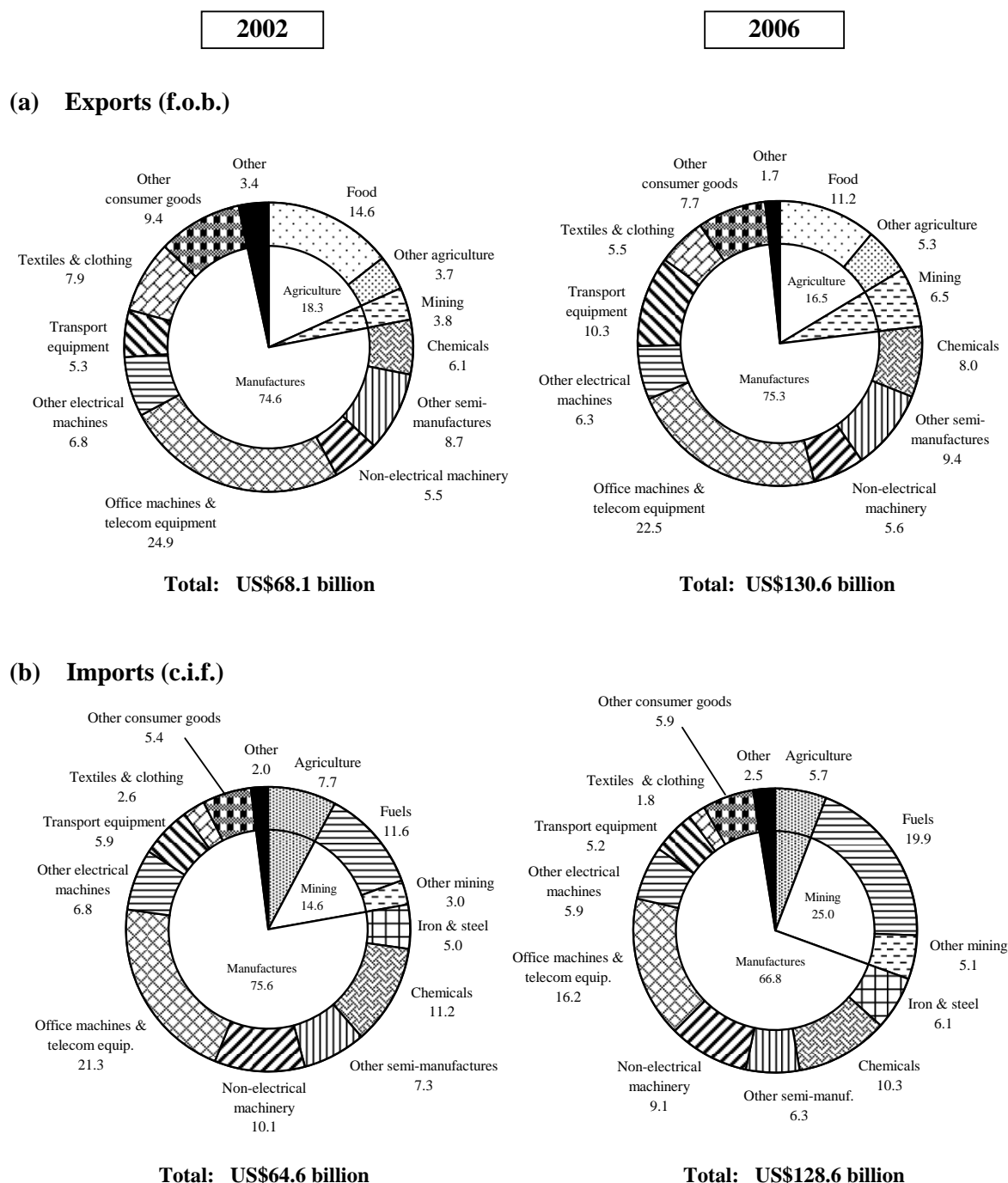
32. Thailand's trade with its FTA partners (including ASEAN) during or prior to the period under review has grown faster than trade with the rest of the world (Tables AI.3 and AI.4)<sup>44</sup>, suggesting that these agreements may have resulted in trade diversion due to vertical integration in the region. Between 2002 and 2006, trade (imports and exports) with these partners rose by 133.0%, compared with an overall growth rate of 95.2% with all trading partners; imports grew slightly faster than exports. During the same period, Thailand's trade (imports and exports) with other ASEAN partners grew by 106.3%, with imports growing faster than exports.

<sup>43</sup> According to the UNSD Comtrade data, the share of crude fuels as a percentage of total imports rose from 8.5% in 2002 to 14.3% in 2005 and 15.6% in 2006, while the share of iron and steel imports increased from 5.0% to 7.4% and 6.1% over the same period.

<sup>44</sup> UNSD Comtrade data. Calculations include bilateral trade with Australia, ASEAN partners, Bahrain, China, India, New Zealand, and Peru (Chapter II).

**Chart I.1**  
**Composition of merchandise trade, 2002 and 2006**

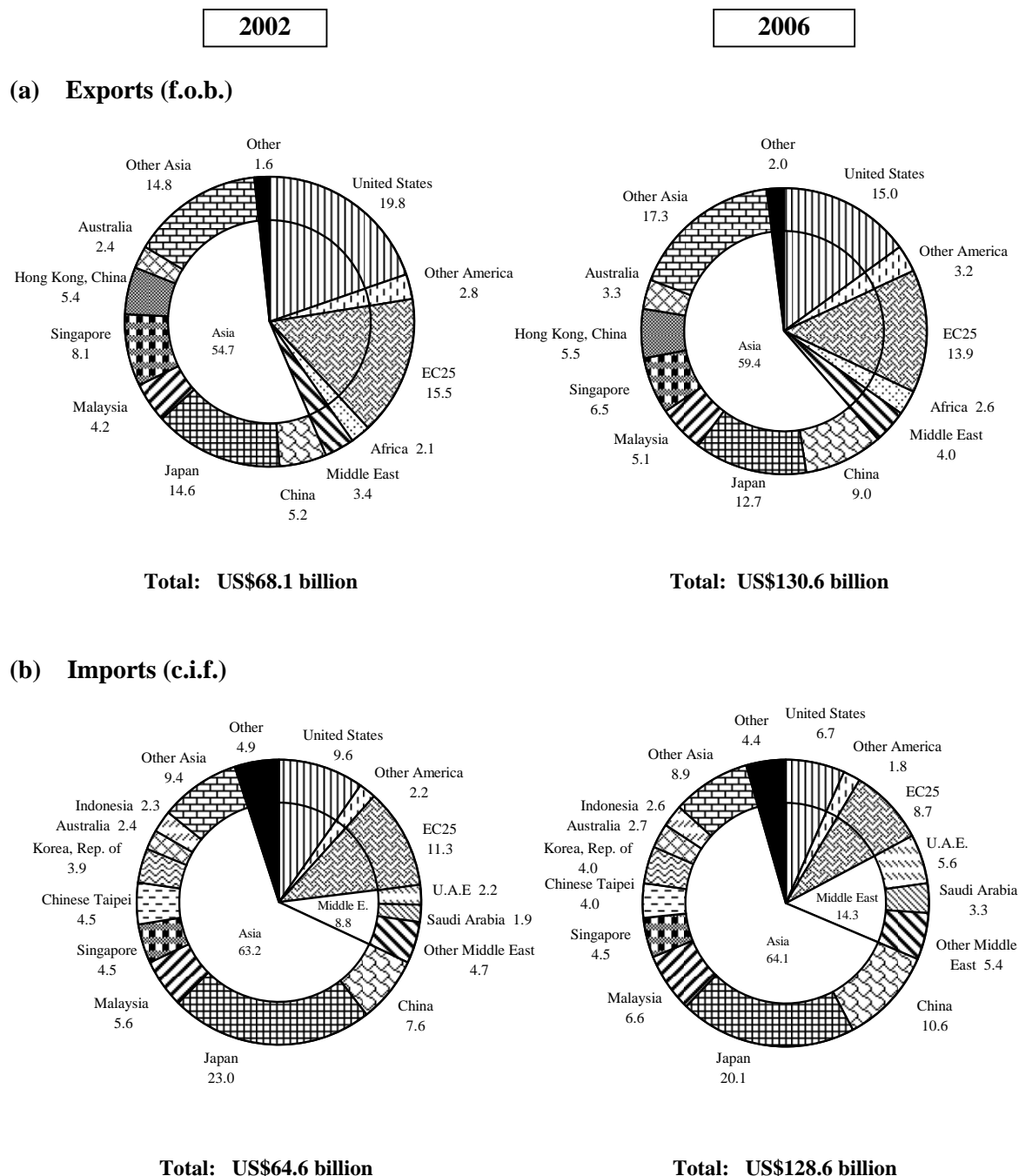
Per cent



Source : UNSD, Comtrade database (SITC Rev.3).

**Chart I.2**  
**Direction of merchandise trade, 2002 and 2006**

Per cent



Source : UNSD, Comtrade database (SITC Rev.3).

## (7) TRENDS AND PATTERNS IN FOREIGN INVESTMENT

33. Despite adverse conditions during the review period, the SARS threat in 2003, ongoing political unrest in southern provinces, the impact of the tsunami in 2004, political uncertainty, high oil prices, rising inflation and interest rates), annual net FDI inflows grew by more than 86%, from US\$11.5 billion in 2003 to US\$21.4 billion in 2006 (Table I.4). Manufacturing remained the largest recipient followed by the trade sector, non-bank investment, and real estate activities. In 2006, increases in FDI were mainly due to recapitalization in the telecommunications and the iron and steel industries; FDI into the non-bank investment sector also increased significantly; in the trading sector, the majority of FDI had gone to the petroleum businesses, while the flows into the real estate sectors were as high as those into the trading sector. Singapore is the largest overseas investor, followed by Japan, the EC-25, and the United States (Table I.4). The recent free-trade area agreement with Japan is a positive development for future FDI flows (Chapter II).

34. According to recent surveys, Thailand's investment climate has remained generally favourable and the country is still ranked ahead of other competitors, but some economies in the region seem to be catching up quickly.<sup>45</sup> Reportedly, the investment climate could be strengthened if improvements were made in the areas of regulatory burden, skills shortages, and infrastructure (Chapter II).<sup>46</sup> According to a 2005 study by the Thailand Development Research Institute, skills shortages, especially in English and Information Technology seem particularly acute and are to worsen by 2009.<sup>47</sup> Furthermore, current political uncertainty and expected changes in the Foreign Business Act in 2007<sup>48</sup> (Chapter II) have affected confidence, as Board of Investment approvals of foreign investments decreased by 18% in 2006, translating into lower investments in 2007.<sup>49</sup>

**Table I.4**  
**Inflows of foreign direct investment, 2002-06**  
(US\$ million)

|                                     | 2002                     | 2003     | 2004     | 2005 <sup>a</sup> | 2006 <sup>a</sup> |
|-------------------------------------|--------------------------|----------|----------|-------------------|-------------------|
| <b>Total inflows (US\$ million)</b> | 10,518.0                 | 11,504.0 | 13,419.0 | 15,311.6          | 21,446.8          |
|                                     | <i>Per cent of total</i> |          |          |                   |                   |
| <b>(a) Inflows by origin</b>        |                          |          |          |                   |                   |
| United States                       | 9.0                      | 7.6      | 11.3     | 9.8               | 8.0               |
| EC25                                | 15.3                     | 12.4     | 13.1     | 11.7              | 13.2              |
| United Kingdom                      | 3.4                      | 2.4      | 3.3      | 2.7               | 2.7               |
| Germany                             | 1.7                      | 2.0      | 2.7      | 3.1               | 5.1               |
| Switzerland                         | 0.8                      | 1.4      | 1.4      | 2.2               | 1.9               |
| ASEAN                               | 40.4                     | 38.3     | 28.9     | 16.2              | 37.8              |
| Singapore                           | 40.1                     | 37.1     | 26.2     | 15.3              | 36.7              |
| Malaysia                            | 0.1                      | 1.0      | 1.2      | 0.6               | 1.0               |
| Japan                               | 25.4                     | 28.3     | 29.3     | 23.9              | 19.7              |

**Table I.4 (cont'd)**

<sup>45</sup> Several surveys in 2006, including those conducted by the United Nations Industrial Development Organisation and the Japan External Trade Organisation, place Thailand in the top ranks of FDI destinations. The World Bank's 2006 survey on the ease of doing business positions Thailand 18<sup>th</sup> (out of 175 countries and territories), one place higher than in 2005. The country scored well on starting a business, dealing with licences, and registering property, but scored poorly on trading across borders and taxation (EIU, 2006b).

<sup>46</sup> World Bank (2005b), "Thailand Productivity and Investment Climate Study".

<sup>47</sup> EIU (2006b).

<sup>48</sup> The Act may require Thais to have majority voting rights; the condition could apply retroactively (Chapter II).

<sup>49</sup> World Bank (2007) and (2006c).



|                                   | 2002 | 2003 | 2004 | 2005 <sup>a</sup> | 2006 <sup>a</sup> |
|-----------------------------------|------|------|------|-------------------|-------------------|
| Hong Kong, China                  | 2.4  | 6.5  | 6.6  | 3.3               | 3.4               |
| Chinese Taipei                    | 1.2  | 1.0  | 1.4  | 1.1               | 0.8               |
| Korea, Rep. of                    | 0.9  | 0.3  | 0.9  | 0.5               | 0.4               |
| China                             | 0.2  | 0.2  | 0.1  | 0.1               | 0.1               |
| Canada                            | 0.2  | 0.2  | 0.2  | 0.2               | 0.2               |
| Australia                         | 0.5  | 0.5  | 1.0  | 0.4               | 0.5               |
| Other                             | 3.6  | 3.2  | 5.8  | 30.5              | 14.1              |
| <b>(b) Inflows by sector</b>      |      |      |      |                   |                   |
| Agriculture                       | 0.1  | 0.3  | 0.2  | 0.0               | 0.0               |
| Mining and quarrying              | 4.5  | 4.0  | 3.0  | 1.6               | 1.6               |
| Manufacturing                     | 36.0 | 36.4 | 45.2 | 35.4              | 33.0              |
| Food and sugar                    | 1.4  | 2.6  | 3.0  | 1.3               | 1.2               |
| Textiles                          | 0.6  | 0.8  | 0.6  | 0.9               | 0.6               |
| Metal and non-metallic            | 4.9  | 4.0  | 4.2  | 2.5               | 2.6               |
| Electrical appliances             | 10.9 | 9.4  | 11.2 | 7.2               | 6.8               |
| Machinery and transport equipment | 7.9  | 9.9  | 13.0 | 11.1              | 9.6               |
| Chemicals                         | 4.8  | 3.4  | 4.1  | 3.6               | 2.9               |
| Petroleum products                | 0.6  | 1.0  | 3.8  | 2.4               | 2.2               |
| Construction materials            | 0.3  | 0.4  | 0.3  | 0.1               | 0.0               |
| Other                             | 4.6  | 4.9  | 4.9  | 6.4               | 7.1               |
| Construction                      | 0.4  | 0.6  | 0.9  | 0.5               | 0.4               |
| Trade                             | 38.3 | 34.7 | 30.5 | 14.8              | 26.7              |
| Financial institutions            | 3.9  | 3.8  | 4.6  | 10.3              | 6.8               |
| Investment                        | 0.5  | 5.0  | 2.9  | 2.9               | 11.7              |
| Real estate                       | 1.4  | 2.3  | 1.7  | 7.4               | 8.3               |
| Other services                    | 9.9  | 6.1  | 4.3  | 3.5               | 4.4               |
| Other                             | 5.1  | 6.9  | 6.8  | 23.6              | 7.2               |

a Provisional.

Note: Figures cover investment in non-bank sectors only.

Source: Data provided by the authorities.

35. FDI outflows increased by 73.4% during the period under review (Table I.5), directed mainly towards trading, manufacturing, mining, and non-bank investment. Singapore was the largest destination for outflows, followed by the EC-25, Japan, and the United States.

**Table I.5**  
**Outflows of foreign direct investment, 2002-06**  
(US\$ million)

US\$ million

|                                      | 2002                     | 2003     | 2004     | 2005 <sup>a</sup> | 2006 <sup>a</sup> |
|--------------------------------------|--------------------------|----------|----------|-------------------|-------------------|
| <b>Total outflows (US\$ million)</b> | 7,107.00                 | 6,339.00 | 8,463.00 | 7,899.47          | 10,991.05         |
|                                      | <i>Per cent of total</i> |          |          |                   |                   |
| <b>(a) Outflows by destination</b>   |                          |          |          |                   |                   |
| United States                        | 10.8                     | 8.5      | 11.5     | 15.5              | 8.1               |
| Canada                               | 0.0                      | 0.0      | 0.0      | 0.2               | 0.2               |
| EC25                                 | 25.7                     | 12.8     | 12.5     | 10.2              | 12.5              |
| Netherlands                          | 17.3                     | 1.3      | 4.0      | 2.2               | 5.8               |

Table I.5 (cont'd)

|                                   | 2002 | 2003 | 2004 | 2005 <sup>a</sup> | 2006 <sup>a</sup> |
|-----------------------------------|------|------|------|-------------------|-------------------|
| Germany                           | 1.6  | 0.4  | 1.0  | 0.8               | 3.7               |
| United Kingdom                    | 1.4  | 4.1  | 2.0  | 4.5               | 1.0               |
| Switzerland                       | 0.5  | 0.6  | 0.2  | 1.5               | 0.5               |
| ASEAN                             | 40.0 | 52.8 | 37.6 | 21.7              | 48.1              |
| Singapore                         | 39.3 | 51.6 | 37.5 | 20.9              | 47.4              |
| Malaysia                          | 0.6  | 1.1  | 0.1  | 0.5               | 0.5               |
| Japan                             | 10.9 | 15.1 | 14.0 | 9.0               | 10.1              |
| Hong Kong, China                  | 2.3  | 2.2  | 8.8  | 1.8               | 3.0               |
| Chinese Taipei                    | 0.4  | 0.7  | 0.7  | 0.2               | 0.2               |
| Korea, Rep. of                    | 0.1  | 0.2  | 0.3  | 0.4               | 0.3               |
| China                             | 0.0  | 0.1  | 0.2  | 0.2               | 0.1               |
| Australia                         | 0.7  | 0.4  | 0.5  | 0.4               | 0.3               |
| Other                             | 8.5  | 6.6  | 13.7 | 38.9              | 16.6              |
| <b>(b) Outflows by sector</b>     |      |      |      |                   |                   |
| Agriculture                       | 0.0  | 0.1  | 0.2  | 0.0               | 0.0               |
| Mining and quarrying              | 4.6  | 3.1  | 2.4  | 10.2              | 8.1               |
| Manufacturing                     | 27.4 | 28.0 | 26.9 | 16.4              | 21.9              |
| Food and sugar                    | 1.8  | 0.5  | 0.8  | 2.6               | 2.3               |
| Textiles                          | 0.3  | 0.4  | 0.5  | 0.6               | 0.3               |
| Metal and non-metallic            | 3.6  | 3.3  | 1.1  | 1.6               | 1.6               |
| Electrical appliances             | 13.0 | 11.9 | 8.3  | 3.1               | 3.8               |
| Machinery and transport equipment | 2.6  | 7.7  | 5.5  | 2.4               | 3.6               |
| Chemicals                         | 2.4  | 1.4  | 1.9  | 1.1               | 1.5               |
| Petroleum products                | 1.6  | 0.3  | 5.7  | 0.2               | 1.1               |
| Construction materials            | 0.0  | 0.8  | 0.0  | 0.0               | 0.0               |
| Other                             | 1.9  | 1.6  | 3.0  | 4.7               | 7.7               |
| Construction                      | 0.4  | 0.4  | 0.6  | 0.4               | 0.4               |
| Trade                             | 47.0 | 50.0 | 46.3 | 24.6              | 43.7              |
| Financial institutions            | 4.9  | 7.2  | 4.7  | 11.6              | 6.7               |
| Investment                        | 9.9  | 3.1  | 7.4  | 3.4               | 7.0               |
| Real estate                       | 1.1  | 2.1  | 6.7  | 0.8               | 1.1               |
| Other services                    | 4.2  | 5.4  | 3.2  | 4.3               | 2.6               |
| Other                             | 0.5  | 0.7  | 1.6  | 28.2              | 8.5               |

a Provisional.

Note: Figures cover investment in non-bank sectors only.

Source: Data provided by the authorities.

## (8) OUTLOOK

36. By and large, Thailand's economic fundamentals remain good.<sup>50</sup> In the short term, the main economic policy challenges are to support domestic demand and rebuild investor confidence, and to move forward with structural reforms. Meeting these challenges would entail supportive macroeconomic policies and addressing investor concerns regarding Thailand's openness to foreign investment. The Tenth Development Plan (2007-2011) sets economic targets at no less than 3% for total factor productivity growth, no more than 2% unemployment, no more than 4% inflation, a

<sup>50</sup> IMF Public Information Notice (PIN) No. 07/39, 23 March 2007.

current account deficit of no more than 2% of GDP, savings rate of 35% of GDP, and public debt at no more than 50% of GDP.<sup>51</sup> Furthermore, the Government has set a target of further reducing poverty in 2011.<sup>52</sup> If achieved, these targets would sustain real GDP growth at 6%<sup>53</sup>, and help the economy to become more competitive and productive. Total factor productivity growth in manufacturing and services would require more domestic innovation and technological advancement in these sectors. According to observers, the leading drivers of GDP growth would be a moderate pickup in public investment, somewhat better performance in agriculture, robust exports, and a continuing revival of the tourism industry from the setback of the tsunami.<sup>54</sup> Although the appreciation of the baht does not seem to have adversely affected exports overall (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 total factor productivity.

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<sup>51</sup> Board of Investment (2006).

<sup>52</sup> World Bank (2007).

<sup>53</sup> World Bank (2006c).

<sup>54</sup> Asian Development Bank (2006).