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## Thailand

*The Thai economy began to recover in 1999 from the severe recession of 1998. Manufacturing production and the external sector performance improved significantly. In the short term, the immediate challenge continues to be financial sector restructuring. In the medium and long term, industrial restructuring, technological upgrading, and improved education and training will be necessary to consolidate economic recovery and growth.*

### **RECENT TRENDS AND PROSPECTS**

**A**fter an unprecedented real GDP contraction of 10.4 percent in 1998, the economy began showing positive signs of recovery in the beginning of 1999. Real GDP growth in 1999 was 4.1 percent, led by the manufacturing sector and increased domestic demand boosted through several government stimulus packages. The capacity utilization rate in the manufacturing sector increased to 63 percent from slightly more than 50 percent in 1998. While this was still below normal levels of 70-80 percent, manufacturing was nevertheless the engine of economic recovery, with a growth rate of around 11.3 percent in 1999.

Vehicles and transportation equipment production showed the highest growth rate. New vehicle models boosted domestic demand, and exports expanded as foreign vehicle producers used Thailand as a production center for regional manufacturing. Agriculture showed modest growth of 0.5 percent, with increased production of major crops such as rice, rubber, maize, and cassava partly offset by a sharp decline in farm prices. Domestic demand, which had con-

tracted sharply the previous year, picked up, particularly in the second and third quarters of 1999, and rose to 8.5 percent for the year. Private consumption grew moderately, resulting in part from rising consumer confidence and modestly expanding farm income. Government stimulus measures, which included reducing the value-added tax rate from 10 to 7 percent and cutting taxes on petroleum products, also helped boost private consumption. Tourism continued to grow, with the number of tourists reaching 8.5 million in 1999, a 10.1 percent increase from the previous year. The private investment index declined moderately in 1999, compared with a steep decline in 1998.

The economic crisis resulted in historically high unemployment since mid-1997. Before the crisis, unemployment, including the seasonally inactive labor force, was around 3.6 percent. By 1998, this figure had almost doubled to 6.1 percent of the total labor force, and underemployment had increased significantly. The situation eased somewhat in 1999, as the unemployment rate declined slightly to 5.9 percent. Public programs boosted temporary employment, and the agriculture sector absorbed a significant

number of laid-off urban workers who had returned to their provinces. Furthermore, both output and employment growth remain below precrisis growth rates, after falling sharply in 1998 (see figure 2.12).

In 1999, the government maintained the expansionary fiscal stance it adopted in 1998, after the fiscal and monetary targets of the adjustment program of 1997 and early 1998 plunged the country into a deep recession. The government continued to relax its public sector deficit target. Under the Eighth Letter of Intent to the International Monetary Fund in September 1999, the consolidated deficit—including the cost of financial restructuring, estimated at 1.7 percent of GDP—was projected at 7.2 percent of GDP for 1999, compared with 5.5 percent the previous year. During 1999, the government launched two economic stimulus packages, with expenditures of B53 billion and B100 billion, respectively, along with tax and tariff reductions. While the March 1999 package aimed at increasing employment and stimulating private consumption, the August 1999 package focused on tax and tariff measures, equity investment funds,

recovery of the real estate sector, and financing for small and medium-size enterprises.

Despite an easing of monetary policy, the growth rate of money supply continued to slow in 1999, in line with the decrease in commercial bank credits and deposits. At the end of 1999, the increase in money supply (M2) and M2A (including finance and securities companies) was 2.1 percent and 1.3 percent, respectively, compared with 9.5 percent and 6.1 percent at the end of the previous year. With high liquidity in the money market, interest rates dropped to very low levels, with the interbank rate at 1.23 percent, prime rate at 8.25-8.50 percent, and deposit rates at 4.00-4.25 percent in December 1999. However, the credit crunch continued because of the banks' concern with existing levels of nonperforming loans (NPLs), and tightened loan-loss provisioning and capital adequacy requirements. Credit extension by commercial banks posted negative growth throughout the year. Despite progress in debt restructuring, the total amount of NPLs in this financial sector was B2,074 billion, or 38.5 percent of total loans outstanding in December 1999.

**Table 2.12 Major Economic Indicators, Thailand, 1997-2001**  
(percent)

Item	1997	1998	1999	2000	2001
GDP growth	-1.8	-10.4	4.1	4.5	4.6
Gross domestic investment/GDP	33.2	26.1	26.8	30.4	33.0
Gross savings/GDP	32.4	39.3	36.4	36.3	36.0
Inflation rate (consumer price index)	5.6	8.1	0.3	2.5	3.5
Money supply (M2) growth	16.4	9.5	2.1	8.0	12.0
Fiscal balance/GDP <sup>a</sup>	-0.9	-3.4	-3.0	-3.0	—
Merchandise exports growth	3.8	-6.8	7.4	7.0	8.0
Merchandise imports growth	-13.4	-33.8	17.7	16.5	17.0
Current account balance/GDP <sup>b</sup>	-2.1	12.7	9.1	5.5	1.9
Debt service/exports	15.6	20.8	20.4	16.0	—

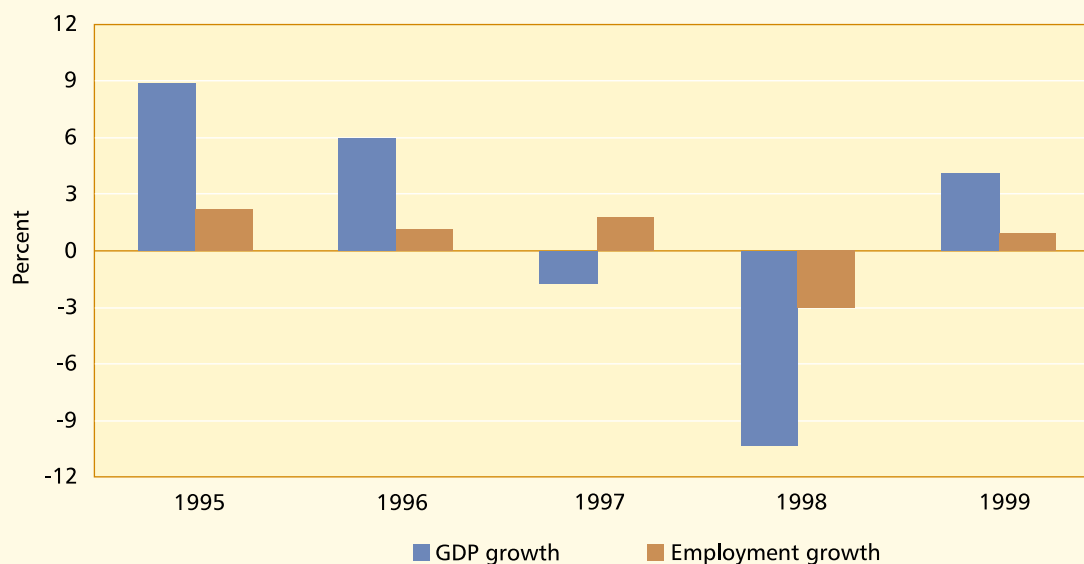
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a. On a fiscal year basis. Covers central government budgetary and nonbudgetary accounts and social security funds, and excludes interest costs of financial sector restructuring.

b. Excludes official transfers.

Sources: Bank of Thailand; Ministry of Finance; National Economic and Social Development Board; National Statistics Office; Bureau of the Budget; Ministry of Commerce; IMF reports; staff estimates.

**Figure 2.12 Comparison of GDP and Employment Growth Rates, Thailand, 1995-1999**



Source: Staff estimates.

Following a year of relatively high inflation of 8.1 percent in 1998, the price level was remarkably stable in 1999. Despite upward pressure from rising oil prices in the world market, inflation was contained at 0.3 percent for the year, the lowest level since Thailand started compiling the index more than 50 years ago. The exchange rate and most commodity prices (aside from oil) remained stable, while domestic demand recovery did not generate upward pressure on prices.

While trade and current account surpluses fell slightly in 1999, external sector performance nevertheless improved significantly as export earnings in dollar terms increased by 7.4 percent. Import growth was higher at 17.7 percent, resulting in a decline in the trade surplus from 10.9 percent of GDP in 1998 to 7.2 percent in 1999. The current account surplus fell from 12.7 percent of GDP in 1998 to 9.1 percent in 1999. Meanwhile, despite increased inflows of foreign direct investments, net capital movements registered

a deficit of \$6.1 billion, reflecting large private capital outflows as commercial banks continued to repay their external debts, in particular Bangkok International Banking Facility offshore loans. (This organization, established in 1993, allows licensed banks to operate offshore, borrow abroad, and lend to domestic borrowers in foreign currencies.)

Consequently, external debt stood at \$75.6 billion in December 1999, down from \$86.2 billion at the end of 1998; the share of short-term debt also declined from 27 percent to 19 percent of total external debt during the same period. However, public sector debt as a proportion of total external debt has almost tripled since the crisis began in July 1997, and accounted for 48 percent of total debt. Official international reserves increased to a comfortable level of \$34.8 billion (approximately 9 months of import equivalent) in December 1999. This was remarkable because international reserves essentially had been depleted by December 1997. The high level of reserves prompted

the government to suspend disbursement of the installment of \$3.5 billion due under the \$17.2 billion International Monetary Fund standby agreement of August 1997. The exchange rate remained stable at around B37-B39 per dollar in 1999.

To sum up, with the exception of private investment and commercial bank credits, indications of recovery are growing. Private consumption and manufacturing production picked up in particular in the second and third quarter of 1999, and the performance of the external sector steadily improved.

The economy is expected to build on its 1999 performance, growing at a slightly higher rate in 2000 and 2001, but not to return to precrisis growth levels. Capacity utilization in the manufacturing sector should reach normal levels of around 70 percent in the first half of 2000, which should be reflected by a return to positive private investment levels. While the recovery in 1999 was primarily export-driven with additional support from public stimulus measures and tourism, domestic consumption must rise if GDP growth is to continue in 2000-2001. In the financial sector, transfer of bad bank loans to newly established asset management companies (AMCs) is expected to reduce the level of NPLs held by commercial banks by 2001 to around 30 percent of total loans outstanding. However, if these plans are derailed, banks are unlikely to undertake the required volume of new lending to fund a sustained recovery in production and economic growth. As demand catches up and capacity utilization rises, inflation in 2000 is forecast at about 2.5-3 percent. Implementation of the August 1999 fiscal package, along with continued financial restructuring, will keep the consolidated deficit at 6-7 percent of GDP in 2000. If the growth rate of trade continues, the trade surplus will continue to shrink to about 4 percent of GDP in 2000. This will also translate into a decline in the current account surplus to about 5-6 percent of GDP. Gross official reserves are expected to be maintained at the same level in 1999, and external debt and the debt-service ratio are expected to decline further.

### **ISSUES IN ECONOMIC MANAGEMENT**

The biggest immediate challenge is financial restructuring, in particular solving the problem of NPLs, which continue to cripple the financial sector and cause weak

credit expansion. If lending does not resume quickly, viable companies that survived the crisis may eventually succumb to sustained liquidity problems. This could cause another wave of business closures and higher unemployment. Many commercial banks have so far been reluctant to restructure problem loans and accept actual losses ("haircuts"). Instead, most have opted for less painful rescheduling such as stretching out the amortization schedule. However, this merely postpones solving the problem. Problem loans will resurface once the extended repayment period is reached, unless additional liquidity is introduced rapidly into the system through foreign capital inflows.

In contrast to other countries in the region, Thailand has not opted for commercial bank recapitalization financed by government. Such a program would encourage moral hazard and put an excessively high burden on taxpayers. Nevertheless, the government has adopted measures since the start of the crisis to help banks cope with the crisis. In addition to the ongoing financial restructuring package launched in August 1998, the government encouraged banks to set up AMCs to deal with NPLs. By separating the management of problem loans from ongoing bank activities, the banks should be able to refocus on new lending, thus helping revive the economy. However, progress has been slow and setting up some AMCs has been put on hold.

During the crisis, private consumption reached its lowest level in the third quarter of 1998. Aided by a series of stimulus measures and tax reductions, it has improved but the trend is volatile. GDP per capita was on the rise after two years of decline, but consumers remained hesitant to resume significant spending. Worries about job security and financial sector stability, a sharp rise in oil prices, and a weaker baht constrained private consumption. Confidence in government policy and the government's commitment to carrying out needed reforms will play a critical role in reestablishing consumer confidence and boosting consumption in the future.

### **POLICY AND DEVELOPMENT ISSUES**

In the medium and long term, industrial upgrading and improvement of productivity will be the main challenges. Increasing local wages have undermined

competitiveness in labor-intensive sectors, as have low wages in neighboring countries. In the end, international competitiveness can only be achieved by industrial upgrading. This requires substantial investment in specialized education, research and development, and other knowledge-enhancing measures. This should help the industry sector further develop a high-technology base in computers, electronics, and other technology- and knowledge-intensive products and services.

While the country has done exceptionally well in achieving nearly universal primary education and expanding its secondary school system, quality improvements have not accompanied quantitative achievements. Eighty percent of Thailand's labor force has only a primary education or less. Some 5.5 million persons in the 6- to 19-year-old age group are not in school or another form of training. Educational attainment also varies substantially between urban and rural areas, where participation in education and skills development is strikingly low. Enrollment in higher education focuses on the social sciences and humanities, with science and technology students making up only about 22 percent of total enrollment. Low numbers of qualified faculty and an inadequate budget for university-level research and development have impaired the capacity to conduct science and technology research and provide quality graduate education. In addition, vocational and skills training programs have been implemented largely without the active participation of the private sector in planning, design, and execution.

Consequently, concern is growing regarding the mismatch between skills generated by the education and training systems and those required to keep the corporate sector internationally competitive. In particular, the economy needs to move away from labor-intensive production. In recent years, the government has increasingly recognized the importance of human

resource development in restoring its long-term competitiveness and ensuring sustainable growth and development. Several policy initiatives address the underlying weaknesses of the educational and training system. The new constitution, approved in 1997, made education free for children up to 12 years old. In addition, the Eighth Plan (1997-2001) outlined priority areas in education and training, including improving quality, relevance, administration, management, and private sector participation.

The National Education Act of 1999 will let the government pursue sweeping education reforms. Essentially, these will cover basic education for all, early childhood education, teachers and teaching methods, educational standards and quality assurance, education management (decentralization), financial management, training and vocational education, and information technology for continued learning.

If Thailand wants to move to higher value-added production, it must also strengthen its domestic capacity for research and development, so it can master new and complex technology that will support growth and development. This would require moving away from a predominantly supply-driven, government-dominated educational system toward a more market-responsive educational system. This system should incorporate private sector participation, education and research programs in science and technology, and market-oriented, specialized training of the active labor force. Specialized and up-to-date education and training will upgrade manufacturing production, but also will improve agricultural production by allowing the use of agricultural biotechnology and environmental technology. Moreover, it is essential to promote private sector collaboration by strengthening links between university and industry. These policy initiatives were incorporated in the Higher Education Development Project approved by the Asian Development Bank in 1999.