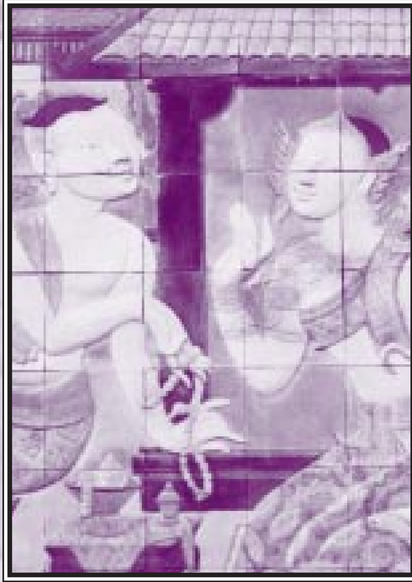
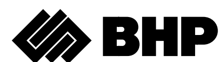


TRANSFORMING THAILAND

CHOICES FOR THE NEW MILLENNIUM

DEPARTMENT OF FOREIGN AFFAIRS AND TRADE



www.dfat.gov.au/eaau

EXECUTIVE SUMMARY

In 2000, Thailand's economy is at the crossroads; the Government's policy choices will determine how successfully Thailand sustains its recovery and grows over the next decade. Thailand has made many important structural reforms since the crisis began, facilitating recovery and generating new commercial opportunities. However, many more reforms to key economic institutions remain incomplete. In 2000 and 2001, Thai Government choices on crucial financial and corporate restructuring, economic and corporate governance, and legal, trade and investment reforms will determine if the country can grow robustly and sustainably over the next decade. Such reforms would insulate Thailand from future economic shocks and continue progress towards developed country status. This report identifies both long term prospects and short term commercial opportunities by tracking Thailand's progress in its reform task, and highlights key indicators of future policy directions.

This report is designed primarily to assist Australian business assess the long term impact of crisis driven reforms on Thailand's economy and Australian trade and investment prospects in Thailand. The report also highlights priorities of the Australian Government in bilateral relations, trade negotiations and official development assistance.

AUSTRALIAN TRADE OPPORTUNITIES

Thailand largely resisted imposing new trade barriers during the financial crisis; clearly, the Government is committed to achieving free trade. However, by regional standards, protection is still high. In 2000, the Government is encountering resistance to plans to cut tariffs further. Consequently, if the Government successfully completes planned tariff band rationalisation and cuts tariffs in 2000, it will indicate the Government can deliver the trade liberalisation essential for Thailand's future growth.

Forecast trade growth is slower than in pre-crisis years. While imports will grow by around 20 per cent in 2000, lower medium term GDP growth forecasts suggest Thai imports probably will grow only 10 to 14 per cent per year in 2001-05 compared to 18 per cent in the early 1990s; exports probably will grow only about 10 per cent, well below the 19 per cent achieved in the first half of the 1990s.

Trade liberalisation, Thai industrialisation and rising incomes, and Australia's strong comparative advantage in supplying industrial raw materials, food and niche manufactures generated A$1.4 billion of Australian-Thai trade in 1999. Throughout the decade to 1997, Australian exports to Thailand grew twice as fast as Australia's average export growth. Assuming Australia holds its current market share, Australian exports to Thailand could increase by about 10 per cent per year to exceed A$2.5 billion by 2005.

While exports to Thailand of Australian bulk commodities will remain important, Thai import demand is shifting from commodities to manufactured and higher value-added foods and services. As Thailand consolidates its recovery, significant

opportunities are emerging for Australian automotive components, information technology equipment and services, medical equipment, pharmaceutical, education, tourism and business service exports.

Australia's relatively low share of Thai imports is due partly to high trade barriers and poor recognition of Thai market opportunities. Australia's 2 per cent share of the Thai market remains small compared to its market share in comparable Asian markets, like Indonesia and the Republic of Korea (6 per cent and 4.5 per cent). Tariffs of 30 to 80 per cent on some prospective Australian agricultural and automotive exports, where local demand is potentially quite high, contribute to this low market share. In 1999, Australia was Thailand's eleventh largest import supplier, while Thailand was Australia's fourteenth largest export market and thirteenth largest trading partner.

FOREIGN INVESTMENT OPPORTUNITIES

Since 1997, Thailand has increased its efforts to attract foreign direct investment although many sectoral and ownership limits remain. Foreigners can own 100 per cent of banks, manufacturing enterprises and large scale retail outlets, but restrictions remain in agriculture, mining and many services sectors. Restrictions on foreigners owning land also have been eased. In 1998 and 1999, as the foreign investment regime became more liberal, new foreign direct investment reached around US$12 billion, more than the previous five years' total. Because of the crisis, many Thai companies are seeking foreign partners to raise capital and improve their competitiveness through new technology, management and marketing skills. As corporate structuring progresses in 2000 and 2001, opportunities for foreign investors to purchase non-core assets should increase.

However, in 1998 and 1999, a hostile Senate thwarted the Government's attempts to liberalise the alien business law; consequently, the new law is only marginally less restrictive than the old one. In mid 2000, an anticipated new investment incentive system was expected to reduce incentives to prosperous provinces closer to Bangkok and redistribute them to poorer provinces, but these reforms are now in doubt.

Australian investment in Thailand is relatively small compared with its investment in other regional countries, but reforms and restructuring triggered by Thailand's financial crisis have opened up new opportunities in the financial sector, large scale retailing, manufacturing, logistics and privatising utilities like telecommunications, transport and energy. Ongoing restrictions on foreign investment continue to deter inflows into many other sectors of potential interest to Australia, including business services, mining and agribusiness.

CRISIS CAUSES

In mid 1997, a collapse of confidence after a long period of exuberant but increasingly fragile growth caused Thailand's financial crisis, and triggered contagion in the rest of the region. From the early 1980s, successful Thai macroeconomic management and export-oriented industrialisation policies produced 8 to 9 per cent economic growth, rapidly lifting Thai living standards and reducing poverty. However, by the mid 1990s, short term foreign borrowing had flooded into speculative investments in real estate and the financial sector, causing a real estate

glut and asset price inflation. By 1996, a widening current account deficit, insolvencies among local financial institutions and declining exports signalled growing macroeconomic imbalances. By 1997, short term foreign debt reached 23 per cent of GDP and was 1.35 times foreign reserves. The term and currency mismatch in Thai corporates' short term foreign liabilities and long term baht assets finally triggered the crisis.

However, the underlying problem was a systemic failure; inadequate prudential controls allowed this mismatch to occur and the country's foreign exchange reserves were mismanaged in defending an inappropriate currency peg. Years of rapid growth had concealed financial institutions' weak risk management procedures and borrowers' poor corporate governance practices. As in Australia in the 1980s, financial sector and capital account liberalisation were not matched by strengthened prudential controls, and many corporates and financial institutions took excessive risks. In mid 1997, Thailand's miracle growth halted abruptly; when the Bank of Thailand failed in its defence of the baht's de facto US dollar peg, Thailand had to seek assistance from the International Monetary Fund. After authorities freed the baht and raised interest rates to prevent the currency's free fall, Thailand entered a severe recession, with GDP dropping 10.2 per cent in 1998.

CRISIS RESPONSES

From early 1998, to prevent Thailand's economic collapse and facilitate sustainable growth, the new Thai Government intervened in the financial sector to protect depositors, implemented many significant economic reforms and relaxed macroeconomic settings. By mid 2000, the Government's financial sector intervention had avoided systemic crisis, and restructuring had introduced more competition, including from foreigners. In 1999, these policies produced a short term recovery, with Thailand eventually achieving 4.2 per cent real GDP growth. Economic recovery and policies implemented to achieve it are generating improved business prospects in Thailand. However, many policy reforms remain incomplete and the Government faces important choices in 2000 which will determine long term prospects.

Political Tests

Crisis induced stresses tested the stability of the political system as well as economic policy making. At the time of the crisis, Thailand was undertaking major constitutional reform aimed largely at increasing governmental transparency and accountability. Consequently, Thailand's greatest achievement in recent years has been to overcome the crisis while retaining political and social stability.

RECOVERY PROSPECTS AND RISKS

In mid 2000, the recovery started in 1999 is gaining momentum. Fiscal activity is expanding; exports are growing strongly; consumer confidence is improving and investment is picking up slowly. Real GDP should grow 5 to 6 per cent in 2000 and 2001.

From 2001, some sectors will use their full industrial capacity, then their medium to long term prospects will depend on new investment, productivity growth and

international competitiveness. However, Thailand's medium to long term growth prospects still are uncertain. The reform agenda is unfinished and government debt has increased greatly; furthermore, continued reform is more difficult in 2000, an election year. Future growth will depend mostly on new investment, which will rely on domestic lending and foreign investors for funding. However, domestic and foreign bankers and portfolio investors will remain cautious until legal system, financial and corporate restructuring, and governance reforms are completed, improving transparency and reducing risk for investors and creditors. Without continued structural reform, analysts estimate Thailand's medium term growth could fall up to two percentage points below its long term potential of 7 to 8 per cent per year to only 5 to 6 per cent. Lower growth of this magnitude would forestall improvements in living standards and reduce Thai commercial opportunities.

However, if these reforms are achieved, strengthened institutions will boost Thailand's long term growth prospects. Key signals of continued reform commitment will include: accelerating progress on corporate restructuring; completion of financial sector refinancing and provisioning; solid achievements in privatising nationalised financial institutions and state enterprises; reform of tariff bands; more liberal interpretation of foreign business and visa legislation protecting business services and other sectors; passage of Bank of Thailand and other key financial institution legislation; and continued progress strengthening bankruptcy law implementation.

In the longer term, to sustain growth, Thailand also must deal with longstanding human resource and infrastructure weaknesses. In an important recent initiative, the Government is making education compulsory and free for much longer than previously, and improving workforce training. However, these reforms will not upgrade workforce skills for many years. The Government also is attempting to address infrastructure inadequacies by privatising state enterprises and encouraging private sector infrastructure provision. However, implementation problems and political resistance slow progress in private infrastructure; this could constrain long term growth prospects.

FINANCIAL RESTRUCTURING AND REFORM

While financial restructuring and refinancing has progressed reasonably well, policies employed to resuscitate the financial system were slower than approaches the Republic of Korea or Malaysia took. Since the crisis began, the Government has closed or nationalised 76 insolvent banks and finance companies, permitted foreign competition, tightened prudential regulations and required remaining institutions to recapitalise. However, the Government's private sector-led approach to recapitalisation and lenient timetables for reaching capital adequacy and provisioning requirements have slowed recapitalisation and non-performing loan write offs. Non-performing loans peaked at 50 per cent peak, but in March 2000, still 37 per cent of loans were non-performing. Rather than requiring banks to sell non-performing loans to a government owned asset management company immediately, banks were permitted to set up their own companies to remove bad loans from their books gradually and so preserve owners' control. This has slowed banks' capacity to recommence normal lending. The cost of the financial sector rescue and depositor guarantees could reach Baht 2 trillion (US$54 billion) or 35 to 40 per cent of 1999 GDP.

Foreign banks now have majority shares in four nationwide banks and are well placed to increase their market share as the recovery quickens. A fifth bank sale to foreigners was announced in May 2000. Foreign banks' innovative new products and services directly compete with Thai bank offerings. Not surprisingly, Thai commercial banks are upgrading their accounting, auditing, risk management, customer service and information systems to compete for market share. This is generating many financial service and related IT opportunities for foreign suppliers.

CORPORATE RESTRUCTURING AND GOVERNANCE

Corporate debt restructuring finally appears to be accelerating in mid 2000. The main approach uses voluntary, out-of-court debt work outs, with the Corporate Debt Restructuring Advisory Committee expediting large work outs by pressing for timebound negotiations. However, while the Corporate Debt Restructuring Advisory Committee expects restructuring to accelerate throughout 2000, by March 2000, it had resolved only one third of debt under its large case programs. Furthermore, many analysts fear a high proportion of restructured debts may reappear as non-performing loans.

In 1999, the Government strengthened bankruptcy legislation. In March 2000, the Central Bankruptcy Court found Thai Petrochemical Industry, TPI, Thailand's largest debtor, insolvent; this watershed decision should accelerate other major debt work outs. However, bankruptcy and insolvency processes still favour debtors over creditors and pursuing bankruptcy cases through Thai courts is time consuming and expensive.

Corporate governance reform is in its early stages. The financial crisis highlighted weak corporate governance; this reflects the dominant culture of family owned and managed businesses. The Government is seeking to strengthen accounting, auditing, disclosure and directors' standards. However, most of these reforms are embryonic, and will take many years to produce major improvements.

PRIVATISATION

By mid 2000, the Government had made some progress in readying state enterprises for privatisation but was well behind its ambitious 1998 reform schedule. The Government recognises strong frameworks will ensure efficient and equitable outcomes, so first it is developing appropriate legal, regulatory and market frameworks. However, by mid 2000, problems in developing and passing enabling legislation had delayed timetables 12 to 18 months. Furthermore, the Government's commitment to privatisation could waiver under strong union and management opposition, particularly in an election year. Nationalist elements also are vocal in their concerns about possible sale of state enterprise assets to foreigners.

However, if privatisation momentum resumes in 2001 and beyond, it should generate investment and participation opportunities in previously monopolised industries. Corporatising state enterprises and developing market frameworks are generating many consultancy opportunities, and as sectors open to new entrants, investment and export opportunities should increase as privatised operations upgrade and expand.

IMPLICATIONS FOR AUSTRALIA

In the short term, Australian business opportunities should grow as the Thai economy strengthens and the Thai Government continues its trade and foreign investment reforms. However, unless the Government achieves financial and corporate restructuring, vigorously pursues legal, state enterprise, regulatory trade and investment reforms, and increases the bureaucracy's capacity to develop and implement these reforms, Thailand's long term annual GDP growth could be significantly lower than its potential. This would not only lower prospects for rising incomes and living standards, but would reduce significantly Australian trade and investment opportunities in Thailand. On the other hand, if the Government successfully implements these essential structural reforms, Thailand should sustain strong growth over the coming decade, and be well placed to move closer to developed country status. It is too early to pick which path Thailand will chose; however, the report identifies key indicators of future policy directions. Reforms achieved to date, continuing progress in financial and corporate restructuring and strengthening economic indicators all are cause for cautious optimism.