

**FOR
AGENDA**

EBS/85/128

CONFIDENTIAL

May 15, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Thailand - Staff Report for the 1985 Article IV Consultation
and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Thailand and its request for a stand-by arrangement equivalent to SDR 400 million. Draft decisions appear on page 26.

It is proposed to bring this subject, together with Thailand's request for a purchase under the compensatory financing facility (EBS/85/129, 5/15/85), to the agenda for discussion on Friday, June 14, 1985.

Mr. Aghevli (ext. 7177) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

THAILAND

Staff Report for the 1985 Article IV Consultation
and Request for Stand-By Arrangement

Prepared by the Asian and Exchange and
Trade Relations Departments

(In consultation with the Fiscal Affairs, Legal,
Research, and Treasurer's Departments)

Approved by P. R. Narvekar and Manuel Guitian

May 15, 1985

	<u>Contents</u>	<u>Page</u>
I.	Introduction	1
II.	Background to the Discussions	3
	1. Historical trends, 1960-80	3
	2. The adjustment program of 1981-83	3
	3. Developments in 1984	6
III.	Policy Discussions and the Economic Program for 1985-86	9
	1. Fiscal policy	11
	2. Operations of public enterprises	13
	3. Monetary policy	16
	4. Exchange rate management	18
	5. Structural policies	19
	6. Short-term prospects	20
	7. Medium-term projections	22
	8. Performance criteria and phasing of purchases	22
IV.	Staff Appraisal	23

Text Tables

1.	Fund Position During Period of Arrangement, June 1985-March 1987	2
2.	Selected Economic and Financial Indicators, 1981-86	5
3.	Aggregate Demand and Supply at 1972 Prices, 1980-84	8
4.	External Indicators, 1981-86	10
5.	Central Government Budgetary Operations, 1980/81-1985/86	12
6.	Consolidated Financial Position of the Public Enterprise Sector, 1980/81-1984/85	14
7.	Monetary Survey, 1981-85	17

Appendix Tables

8.	Balance of Payments, 1981-86	27
9.	External Debt, 1981-90	28
10.	Medium-Term Scenario, 1985-90	29

Charts

1.	Historical Economic Trends,	4a
2.	Selected Economic Indicators, 1981-86	12a
3.	Exchange Rate Indices,	20a
4.	External Debt Indicators,	22a

Annexes

I.	Fund Relations	30
II.	Relations with IBRD and IDA	32
III.	Summary of Financial Program	34

Attachment

Stand-By Arrangement	36
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I. Introduction

The 1985 Article IV consultation discussions with Thailand were held in Bangkok during January 3-29 and March 25-April 5, 1985. ^{1/} At the same time, an economic program was developed in support of which Thailand has requested access to Fund resources. The staff representatives met with the Minister of Finance, the Governor of the Bank of Thailand, the Secretary-General of the National Economic and Social Development Board, the Economic Advisor to the Prime Minister, and other government officials. The staff team consisted of Mr. Aghevli (Head, ASD), Mr. Heller (FAD), Mr. Schulz, Mr. Marquez-Ruarte, and Ms. Schadler (all ASD), Mr. Nivollet (ETR), and as secretaries Mrs. Ellyn and Miss Hoole (both ASD). Mr. Ismael, the Executive Director for Thailand, visited Bangkok for a few days during the mission's March visit and Mrs. Sirivedhin, Advisor to Mr. Ismael, attended some of the meetings in January.

The Government of Thailand has requested a stand-by arrangement in the amount of SDR 400 million, ^{2/} or 103 percent of quota (equivalent to a yearly access of 56 percent of quota), for the period extending from the day of approval through March 31, 1987. A waiver of the limitation of Article V, Section 3(b)(iii) of the Articles of Agreement is required. The Government's economic program for 1985 and 1986, in support of which the stand-by arrangement is requested, is described in the attached letter from the Minister of Finance and the Governor of the Bank of Thailand, dated May 15, 1985. The Thai authorities have also requested a purchase under the compensatory financing facility in the amount of SDR 185 million (48 percent of quota); the request is dealt with in a separate document circulated at the same time as this paper.

Thailand has had three stand-by arrangements with the Fund; the last one expired on December 31, 1983 and the full amount of the arrangement was drawn. As of May 31, 1985, Thailand's use of Fund credit under tranche policies stood at 144 percent of Thailand's quota of SDR 386.6 million; in addition, 45 percent of quota was outstanding under the compensatory financing and buffer stock facilities. Full use of the requested stand-by arrangement, together with scheduled repurchases, would raise Thailand's use of Fund credit to 236 percent of quota by the end of the stand-by period (Table 1). Information on Thailand's relations with the Fund is provided in Annex I.

^{1/} Thailand continues to avail itself of the transitional arrangements of Article XIV; it maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

^{2/} Including SDR 206.63 million of borrowed resources.

Table 1. Thailand: Fund Position During Period of Arrangement,
June 1985-March 1987

	Outstanding May 31, 1985	1985			1986	1987
		June	July- Sept.	Oct.- Dec.		Jan.- March
(In millions of SDRs)						
Transactions under						
tranche policies (net)	<u>25.3</u>	<u>22.1</u>	<u>14.0</u>	<u>58.1</u>	<u>23.0</u>	
Purchases	<u>50.0</u>	<u>50.0</u>	<u>50.0</u>	<u>200.0</u>	<u>50.0</u>	
Ordinary resources	(25.0)	(25.0)	(25.0)	(100.0)	(18.4)	
Borrowed resources	(25.0)	(25.0)	(25.0)	(100.0)	(31.6)	
Repurchases	-24.7	-27.9	-36.0	-141.9	-27.0	
Ordinary resources	(-15.6)	(-20.7)	(-20.7)	(-87.3)	(-10.3)	
Borrowed resources	(-9.1)	(-7.2)	(-15.3)	(-54.6)	(-16.7)	
Transactions under special						
facilities (net) <u>1/</u>	<u>185.0</u>	<u>-23.3</u>	<u>-23.3</u>	<u>-89.0</u>	<u>-7.3</u>	
Purchases	<u>185.0</u> <u>2/</u>	--	--	--	--	
Repurchases	--	-23.3	-23.3	-89.0	-7.3	
Total Fund credit out-						
standing (end-of-period)	<u>728.8</u>	<u>939.1</u>	<u>938.0</u>	<u>897.7</u>	<u>913.4</u>	
Under tranche policies	<u>556.2</u>	<u>581.5</u>	<u>603.6</u>	<u>675.7</u>	<u>698.7</u>	
Special facilities <u>1/</u>	<u>172.6</u>	<u>357.6</u>	<u>334.3</u>	<u>222.0</u>	<u>214.7</u>	
(As percent of quota)						
Total Fund credit out-						
standing (end-of-period)	<u>188.5</u>	<u>242.9</u>	<u>242.6</u>	<u>232.2</u>	<u>236.2</u>	
Under tranche policies	<u>143.9</u>	<u>150.4</u>	<u>156.1</u>	<u>174.8</u>	<u>180.7</u>	
Special facilities <u>1/</u>	<u>44.6</u>	<u>92.5</u>	<u>86.5</u>	<u>57.4</u>	<u>55.5</u>	

Source: International Monetary Fund.

1/ Compensatory financing and buffer stock facilities.

2/ Proposed compensatory financing purchase.

II. Background to the Discussions

1. Historical trends, 1960-80

Thailand made impressive economic progress during the 1960s and the first half of the 1970s. Output rose by about 7 percent per annum during 1960-74, and, with a significant deceleration in population growth, real GNP per capita almost doubled to \$550 (1980 prices) in 1974. During this period, inflation was low, and the external current account was generally in balance. Government policy aimed at building infrastructure, preserving financial stability, encouraging foreign trade, and stimulating private savings and investment. Between 1960 and 1974, the shares of investment and savings in GDP rose from about 15 percent to 25 percent.

The economy continued to grow rapidly during the late 1970s and early 1980s, but inflation rose and a sizable external current account deficit emerged (Chart 1). Reflecting the priorities of the Fourth Development Plan (1977-81), the growth rate of output was maintained at over 7 percent between 1975 and 1980, and there was substantial progress in diversifying the structure of the economy. Always a major exporter of rice, Thailand also became an important producer of rubber, tapioca, tin, sugar, and fruits and vegetables. The volume of exports rose sharply and, despite a virtually continuous deterioration in the terms of trade, the import purchasing power of export receipts increased substantially. However, by the turn of the decade the strains on the economy of both adverse external developments and the relatively ambitious Fourth Development Plan had become apparent. Domestic inflation, which is heavily influenced by foreign price developments, surged to over 15 percent during 1979-80, largely in response to the second oil price increase and the accompanying rise in foreign inflation rates. More importantly, the external current account position deteriorated from near balance in 1974 to a deficit of 7 percent of GDP during 1979-80. This deterioration reflected almost entirely a shift in the public sector savings-investment balance: a sharp increase in public sector investment was accompanied by a weakening in public sector savings. The central government balance moved from a surplus equivalent to 1 1/2 percent of GDP in fiscal year 1973/74 to a deficit of nearly 5 percent of GDP in 1979/80. ^{1/} As the shares of private sector saving and investment in GDP remained relatively stable throughout the period, foreign borrowing increased substantially.

2. The adjustment program of 1981-83

The sizable external imbalance prompted the authorities to undertake a comprehensive adjustment program during 1981-83 that was supported by two stand-by arrangements with the Fund and two structural adjustment loans from the World Bank. The adjustment program, which was

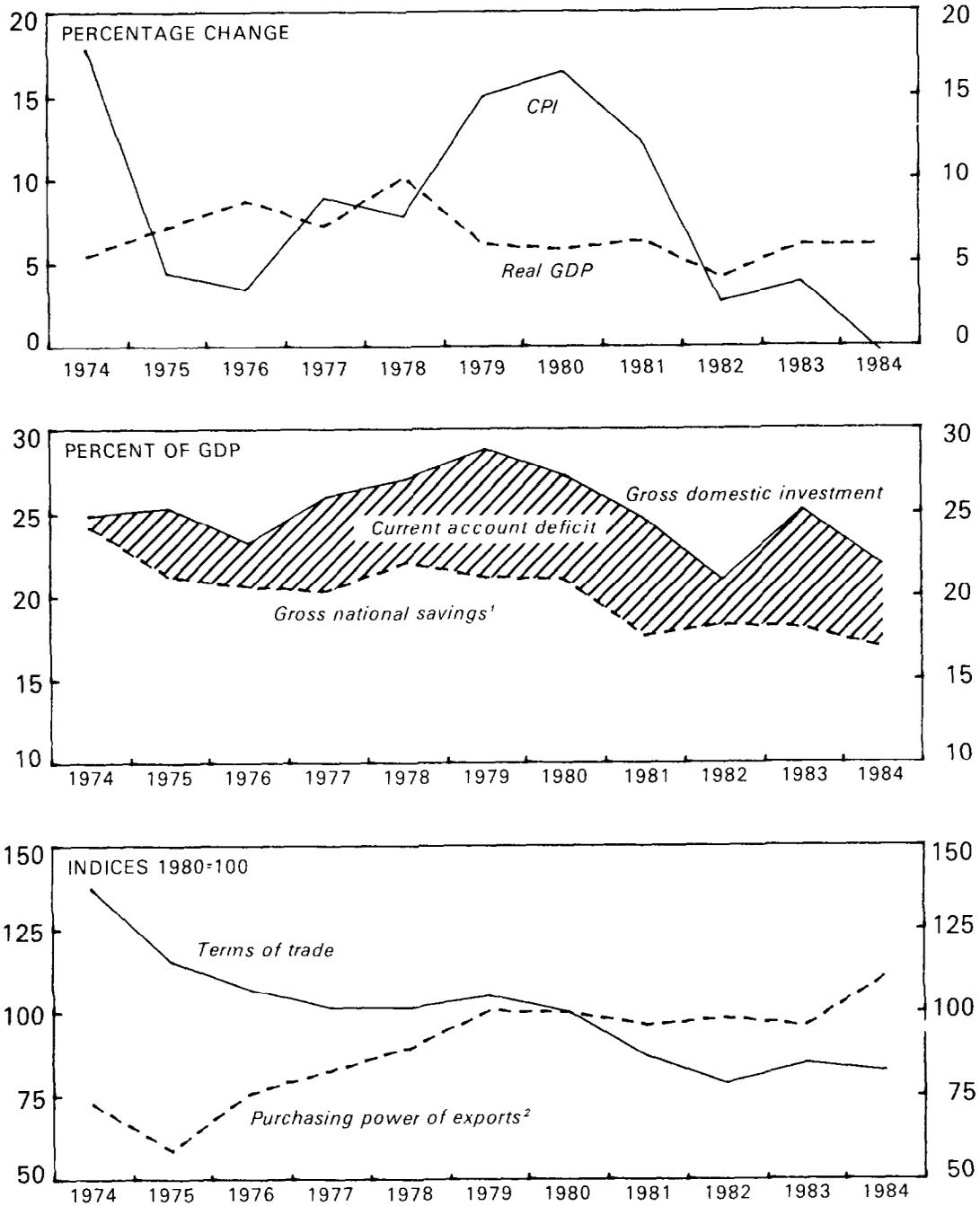
^{1/} The fiscal year begins on October 1.

formulated under the guidelines of the Fifth Development Plan (1982-86), placed the highest priority on the attainment of price stability and external adjustment. The objective of a substantial reduction in the external current account deficit was to be achieved largely through a rise in national savings, as the share of investment in GDP was projected to decline only slightly. However, the extent of the adjustment achieved during 1981-83 was severely hampered by autonomous disturbances, including a sharp deterioration in the terms of trade between 1980 and 1982 and an exceptionally poor harvest in 1982. Contrary to expectations, the savings ratio declined sharply in 1981 and remained low in the subsequent two years. With a contraction of domestic investment, the current account deficit fell to a trough in 1982; however, a subsequent relaxation of credit policy reinforced a cyclical upturn in investment in 1983, and the current account deficit rebounded to the peak levels of 1979-81 (Table 2).

The main elements of the adjustment program in 1981 consisted of a tightening of fiscal and monetary policies, an upward adjustment in interest rate ceilings, and, in July, a devaluation of the baht. The program also included a liberalization of the trade system, a reduction in export taxes on agricultural exports, elimination of price controls, and upward adjustments in energy prices. The dampening impact of the tight financial policies on domestic demand, together with the disturbances noted above, brought down the growth of output from 6 percent in 1981 to 4 percent in 1982. The current account deficit fell to below 3 percent of GDP in 1982, owing to a sharp decline in the volume of imports and continued strong growth in the volume of exports in the wake of the bountiful harvest of the previous year. At the same time, inflation slowed to 5 percent. The slower growth of activity led to a substantial weakening of fiscal revenues in 1981/82, which, together with a sizable expansion in expenditure, led to a widening of the central government deficit to near 6 percent of GDP. A large increase in bank credit to the Government resulted in a substantial acceleration in the growth of total domestic credit in 1982.

During 1983, the authorities made a concerted effort to reverse the deterioration in the fiscal position by implementing new revenue measures and cutbacks in capital expenditures. The deficit of the Central Government dropped to about 4 percent of GDP in 1982/83. The financial position of the public enterprise sector also improved primarily because of a rise in operating profits of the Oil Fund, a price stabilization scheme for petroleum products. The improved position of the Oil Fund reflected the authorities' decision to pass through to consumers only part of the decline in international prices of petroleum products. Credit policy, however, was designed to fully accommodate the anticipated recovery of private demand with the result that the growth of domestic credit accelerated in 1983. Both domestic demand and agricultural output recovered, and the growth of GDP rebounded to 6 percent. The volume of imports responded rapidly to the pickup in demand, while the volume of exports declined in response to the lagged effects of the

CHART 1
THAILAND
HISTORICAL ECONOMIC TRENDS



Sources: Data provided by the Thai authorities, and Fund staff estimates.

¹Defined as the sum of gross domestic investment and the balance of payments current account surplus.

²Defined as the product of the terms of trade and export volume.



Table 2. Thailand: Selected Economic and Financial Indicators, 1981-86

	1981	1982	1983	1984 Est.	1985 Proj.	1986 Proj.
(Annual percentage changes, unless otherwise specified)						
National income and prices						
Real GDP	6.3	4.1	6.0	6.3	6.0	6.0
GDP deflator	8.0	3.4	3.2	0.7	7.0	5.5
CPI (Dec. to Dec.)	12.3	2.6	3.8	-0.8	9.0	5.0
CPI (period average)	12.7	5.2	3.8	0.9	7.0	5.5
Rate of unemployment	1.1	1.8	1.9	2.2	2.2	2.2
External sector (in U.S. dollars)						
Exports, f.o.b.	7.5	-1.0	-8.3	16.1	10.9	16.0
Imports, c.i.f.	7.5	-13.7	20.3	1.2	4.0	10.8
Non-oil imports, c.i.f.	8.3	-10.5	32.2	1.5	6.4	12.4
Export volume	12.0	11.6	-9.6	19.3	11.5	10.4
Import volume	--	-11.3	27.0	0.3	2.1	7.0
Terms of trade	-12.6	-11.1	7.1	-3.6	-2.4	1.5
Nominal effective exchange rate <u>1/</u>	-6.0	6.6	1.8	-10.3
Real effective exchange rate <u>1/</u>	-1.7	6.2	3.0	-12.8
Central Government <u>2/</u>						
Revenue and grants	19.4	2.8	17.3	9.0	15.2	13.7
Expenditure and net lending	9.3	19.0	5.7	6.8	11.0	5.7
Money and credit						
Money (M2)	16.1	24.4	24.0	20.2	19.3	...
Domestic credit	16.7	22.6	25.6	17.1	19.0	...
Velocity (level)	2.7	2.3	2.1	1.8	1.7	...
Interest rate (end of period, one-year time deposit)	13.0	12.5	12.5	13.0
(In percent of GDP)						
Central Government (fiscal years) <u>2/</u>						
Revenue and grants	14.7	14.1	15.0	15.3	15.6	15.9
Expenditure and net lending	18.0	19.9	19.1	19.0	18.7	17.7
Deficit (-)	-3.2	-5.8	-4.1	-3.8	-3.1	-1.8
Domestic bank financing	2.1	3.5	1.5	2.2	1.0	0.2
Foreign financing	0.7	1.1	0.9	0.5	1.0	0.6
Public sector deficit (-)	-7.0	-7.0	-5.0	-4.6	-4.0	-3.0
Gross national savings <u>3/</u>	17.6	18.3	17.9	17.0	18.0	19.0
Gross domestic investment	24.7	21.0	25.2	22.0	22.0	22.0
External current account deficit (-)	-7.1	-2.7	-7.2	-5.0	-4.0	-3.1
External debt	28.0	31.0	31.7	33.6	37.4	36.1
Inclusive of use of Fund credit	30.6	33.3	34.7	36.6	39.9	37.6
Debt service ratio <u>4/</u>	19.0	20.9	23.2	23.7	25.7	24.3
(In billions of U.S. dollars)						
Current account	-2.5	-1.0	-2.9	-2.1	-1.7	-1.5
Overall balance	-0.1	0.1	-0.8	0.4	-0.2	0.1
Gross official reserves	2.7	2.6	2.5	2.7	2.6	2.7
(Months of current year's imports)	(3.3)	(3.7)	(2.9)	(3.1)	(2.9)	(2.7)

Sources: Data provided by the Thai authorities; and staff estimates.

1/ Change from December to December.

2/ Fiscal year ending September 30.

3/ Includes statistical discrepancy.

4/ Debt service as a percent of exports of goods and nonfactor services.

poor harvest in 1982, an intensification of protectionism abroad, and a substantial real appreciation of the baht that had reversed the effects of the 1981 devaluation. The diverging trends of imports and exports led to a widening of the current account deficit to 7 percent of GDP. The overall payments position, which had been in balance in 1982, recorded a substantial deficit.

3. Developments in 1984

Concerned by the resurgence of the external imbalance, the authorities renewed their adjustment efforts beginning in late 1983. They implemented measures to raise revenues and curtail expenditure and reduced the rate of domestic credit expansion. These policies, together with favorable external developments, resulted in a marked improvement in the external current account in 1984, while growth was maintained at about 6 percent and inflation fell to almost zero.

Progress in reducing the central government deficit was continued in 1983/84, albeit at a slower pace than in the previous year. With tax measures introduced in early 1983/84, the ratio of government revenues to GDP rose somewhat to 15.3 percent, while the ratio of government expenditure to GDP remained at about 19 percent. Consequently, the authorities succeeded in containing the central government deficit to 3.8 percent of GDP. The financial position of the public enterprise sector continued to improve primarily because of higher profits in the energy sector that were associated with increased production of oil and natural gas; the Oil Fund recorded a substantial surplus for the second consecutive year.

Starting in late 1983, the Bank of Thailand sought to rein in the expansion of bank credit through increases in interest rates, direct credit ceilings, and sales of assets from the Bank's portfolio. In December 1983, the Bank raised its discount rates, restrained the issuance of import letters of credit, and curtailed the access of commercial banks to borrowing in the repurchase market. In January 1984, the Bank of Thailand requested commercial banks to restrict the growth of credit to the private sector to 18 percent during 1984, down from 32 percent in 1983. The authorities also raised the ceilings on interest rates on loans and short-term deposits of banks and other financial institutions. Following a marked deceleration in credit expansion, the Bank of Thailand eliminated the 18 percent credit ceiling in August 1984, but continued to enforce tight credit conditions through sales of government bonds to the commercial banks. The rate of domestic credit expansion fell from 26 percent in 1983 to 17 percent in 1984. Broad money continued to grow by over 20 percent in real terms owing to a high elasticity of the demand for money with respect to real income, as well as the continued adjustment to lower inflationary expectations.

Despite the tightening of domestic credit conditions, interest rates on loans and deposits rose only slightly. Oligopolistic practices in the banking sector have traditionally inhibited movements in these rates even in the face of sizable swings in the stance of credit policy and in foreign interest rates. However, with the fall in inflation during the year, the real cost of loans and the real yield on deposits (measured as nominal rates less the concurrent rate of inflation) increased substantially--nominal deposits and lending rates were in the range of 13-20 percent, while domestic prices were stable. Rates in the repurchase and interbank markets--which normally reflect shifts in money market conditions--eased throughout the year. The downward pressure on these rates arose from the ceiling on bank credit, which raised banks' liquidity in the first part of the year, and from the decline in foreign interest rates in the latter part of the year.

The conduct of monetary policy in 1984 was complicated by a number of adverse developments in the financial sector. In August, one of the country's medium-sized banks experienced a run on its deposits because of concerns with its solvency; a financial crisis was avoided by an immediate takeover of the bank by the Government. The authorities also took measures to shore up the financial position and improve the management of the nonbank financial institutions, which had experienced a sharp decline in deposits in late 1983 when a number of finance and credit foncier companies failed. By late 1984, deposits in the nonbank financial institutions had begun to rise, but the authorities are still monitoring the situation closely. The authorities also introduced legislation aimed at dissolving pyramidal schemes in the unorganized market which were a potential source of instability in the financial system.

The tightening of financial policies in 1984 succeeded in curbing the growth of domestic demand. The growth of real private consumption fell from almost 8 percent in 1983 to just over 5 percent, while private fixed investment, which had risen by 20 percent in 1983, grew by only 5 percent (Table 3). A swing in stockbuilding reduced domestic demand by the equivalent of 2 1/2 percent of GDP. Together with a substantial deceleration in public sector demand, these developments brought about a decline in the growth of real domestic demand from 11 percent in 1983 to 2 percent in 1984. The slower growth of domestic demand, however, was offset by a sharp improvement in the foreign balance, and the growth of real GDP was maintained at about 6 percent. Nevertheless, since the growth of the labor force remained strong and the growth of employment in the agricultural sector declined somewhat, the recorded rate of unemployment rose slightly to 2.2 percent.

The trade deficit narrowed significantly in 1984 as a result of a sharp recovery in export earnings and a slowdown in import demand. The volume of exports rose by almost 20 percent owing to the lagged effects of the recovery of agricultural production in the previous year and to buoyant foreign demand emanating particularly from Japan and the United

Table 3. Thailand: Aggregate Demand and Supply
at 1972 Prices, 1980-84

(Annual percentage changes)

	1980	1981	1982	1983	1984
Consumption	4.2	4.1	2.6	7.0	5.1
Private	4.7	3.2	2.5	7.7	5.4
Public	1.4	8.6	3.2	3.8	3.7
Gross fixed investment	3.2	1.7	-10.9	15.0	5.4
Private	-3.4	--	-11.1	20.0	4.9
Public	19.7	5.1	-10.4	5.4	4.3
Stockbuilding <u>1/</u>	-1.4	-0.3	-0.7	2.0	-2.5
Domestic demand	2.5	3.2	-1.3	10.9	2.3
Foreign balance <u>1/</u>	1.6	3.3	6.7	-5.3	3.8
Exports of goods and services	8.2	17.3	17.6	-3.2	16.5
Imports of goods and services	0.3	0.8	-13.1	26.2	0.1
GDP	5.8	6.3	4.1	6.0	6.3
Agriculture	2.0	6.7	1.0	3.6	5.2
Nonagriculture	7.1	6.1	5.1	6.8	6.7
(Manufacturing)	(4.8)	(6.4)	(4.3)	(7.1)	(6.8)

Source: Data provided by the Thai authorities.

1/ Change as a percent of GDP.

States. The volume of imports, which had grown by 27 percent in 1983, stagnated because of the weakness of domestic demand--particularly stockbuilding--and the restraint imposed since late 1983 on the issuance of letters of credit. Despite a small deterioration in the terms of trade, the merchandise trade deficit fell from \$3.9 billion in 1983 to \$3.0 billion. The surplus on invisibles remained unchanged and the external current account deficit fell from \$2.9 billion (7 percent of GDP) in 1983 to \$2.1 billion (5 percent) in 1984 (Table 4).

On the capital account, net nonmonetary inflows rose from \$1.5 billion in 1983 to \$2.5 billion, reflecting a surge in net private capital inflows. Swings in these inflows, which have been large in recent years, are difficult to explain; in 1984, tight domestic credit conditions and the continued strong growth of economic activity were probably the main factors inducing the inflows. The overall balance of payments swung from a deficit of \$0.8 billion in 1983 to a surplus of \$0.4 billion in 1984, and gross official reserves increased by \$0.2 billion to \$2.7 billion (3.1 months of current imports).

Despite the substantial improvement in the current account, the underlying external situation remained weak and, by late 1984, the authorities clearly saw the need to accelerate the pace of external adjustment. Gross international reserves were below the 1980 level, external debt had almost doubled since 1980, and the debt service ratio had increased from 17 percent to 24 percent. While Thailand's reception in the international capital market remained favorable, it was apparent that the continuation of this sentiment would require a significant reduction in external borrowing. To this end, the authorities devalued the baht on November 5, 1984 by 14.8 percent. At the same time, they announced that the baht would be linked to a basket of currencies of major trading partners--thereby abandoning the de facto peg to the U.S. dollar that had been in effect for three decades. Soon after these steps were taken, discussions with the Fund staff were commenced on a broad range of policy issues with the objective of formulating a set of financial and structural policies that would reinforce the exchange rate action.

III. Policy Discussions and the Economic Program for 1985-86

During policy discussions in January and in March-April, an adjustment program was developed for 1985 and 1986, in support of which the authorities have requested access to Fund resources. In order to bring about the significant improvement in the external position that is clearly needed to preserve Thailand's strong standing in the international capital markets, the program aims at narrowing the external current account deficit from 5 percent of GDP in 1984 to 4 percent in 1985 and 3 percent in 1986, while sustaining a growth of output of about 6 percent a year. The rate of inflation is expected to rise to about

Table 4. Thailand: External Indicators, 1981-86

(In billions of U.S. dollars)

	1981	1982	1983	1984 Est.	1985 Proj.	1986 Proj.
Exports, f.o.b.	6.9	6.8	6.3	7.3	8.1	9.4
Imports, c.i.f.	-9.9	-8.4	-10.2	-10.3	-10.7	-11.9
Current account balance	-2.5	-1.0	-2.9	-2.1	-1.7	-1.5
(As percent of GDP)	(7.1)	(2.7)	(7.2)	(5.0)	(4.0)	(3.1)
Overall balance	-0.1	0.1	-0.8	0.4	-0.2	0.1
External reserves	2.7	2.6	2.5	2.7	2.6	2.7
(In months of current year's imports)	(3.3)	(3.7)	(2.9)	(3.1)	(2.9)	(2.7)
Public external debt ^{1/}						
As percent of GDP	14.1	16.4	17.1	17.5	19.7	19.4
Share of short-term debt	6.7	4.7	3.1	2.4	1.0	--
Debt service ratio	7.3	9.4	10.6	10.4	10.7	10.4
Total external debt	11.0	12.2	14.0	15.5	16.7	17.7
(As percent of GDP)	(30.6)	(33.3)	(34.7)	(36.6)	(39.9)	(37.6)
(Share of short-term debt)	(25.5)	(24.6)	(23.6)	(22.6)	(20.0)	(18.6)
(Debt service ratio)	(19.0)	(20.9)	(23.2)	(23.7)	(25.7)	(24.3)

Sources: Appendix Tables 8 and 9.

^{1/} Exclusive of obligations to the IMF.

9 percent in 1985 because of the lagged impact of the recent devaluation, but it should converge to the foreign inflation rate of close to 5 percent in 1986 (Chart 2).

The strategy underlying the authorities' adjustment program is to narrow the savings-investment gap and promote sustained growth by increasing public savings, rationalizing public investment, and encouraging saving and productive investment by the private sector. In the fiscal area, the authorities have taken measures to control central government spending and raise tax revenues; they have also increased a number of tariffs to enhance the profitability of key public enterprises and have established guidelines aimed at streamlining the public investment program. The authorities will continue to pursue a tight credit policy and to allow domestic interest rates to adjust in response to movements in foreign interest rates, domestic credit conditions, and inflationary expectations; this policy orientation is expected to encourage private savings and discourage nonproductive investment. The authorities are committed to continue to manage the exchange rate flexibly so as to avoid a deterioration in external competitiveness. Structural policies focus on prices and wages, development of agriculture, and promotion of exports.

1. Fiscal policy

The authorities' efforts to improve the financial position of the Central Government constitute the centerpiece of their adjustment program. In order to maintain the momentum of the deficit reduction efforts and to offset the adverse effects of the November devaluation on spending and revenue, the authorities adopted, in early 1985, a comprehensive package of measures to reduce budgetary expenditures and raise additional revenues. This package is expected to further reduce the deficit of the Central Government from nearly 4 percent of GDP in 1983/84 to about 3 percent in 1984/85 and to below 2 percent in 1985/86 (Table 5 and Chart 2).

The November devaluation led to increases in some areas of spending, notably debt service and capital expenditure. In early 1985, the Government cut budgetary allocations for the current fiscal year, 1984/85, by a total of B 4 billion (approximately 2 percent of expenditure). The economies will affect both current and capital expenditures. Excluding debt service, current expenditure in real terms will decline by almost 2 percent in 1984/85, while capital expenditure in real terms will increase by only 2 percent. As regards wage outlays, no general wage increase is planned for the public sector--no such increase has taken place since 1982--and hiring of personnel will be delayed. Cutbacks will also be made in purchases of goods and in overseas travel by government officials. The growth of capital expenditure will be curbed by rephrasing some ongoing projects and delaying new projects. For 1985/86, the Government has decided to limit the growth of

Table 5. Thailand: Central Government Budgetary Operations,
1980/81-1985/86

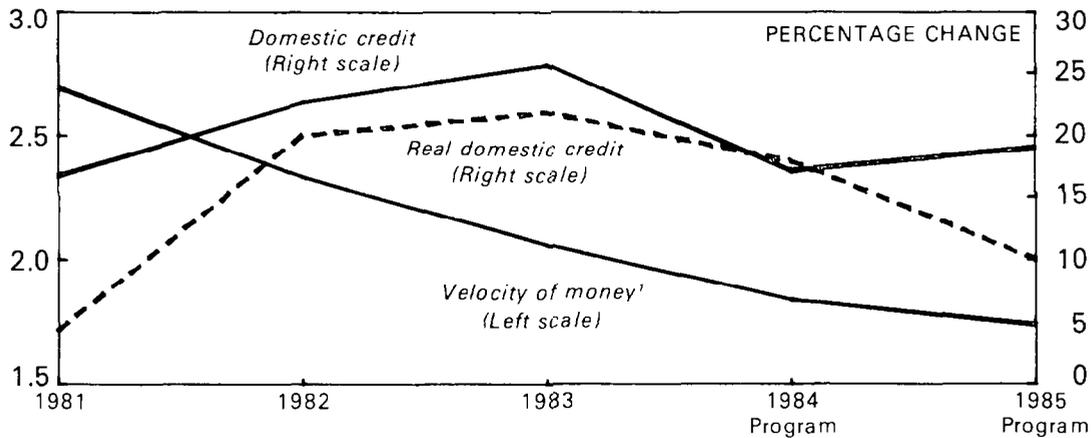
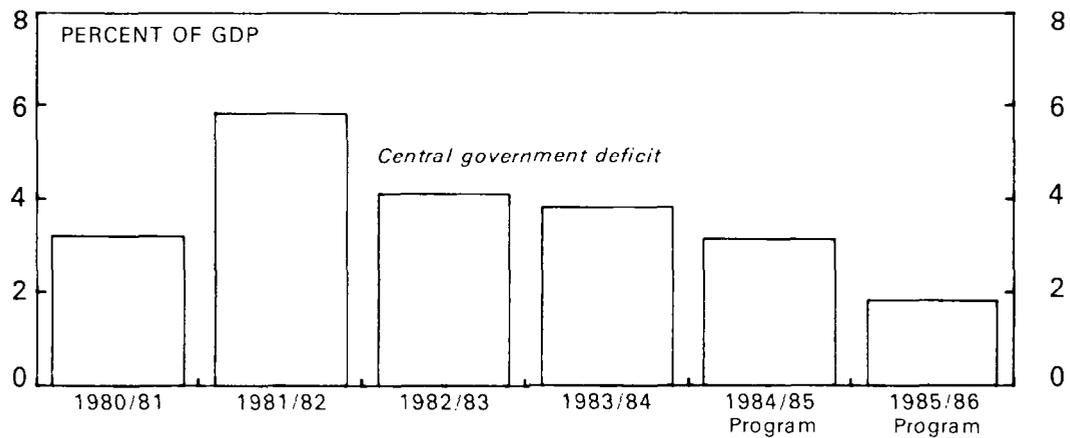
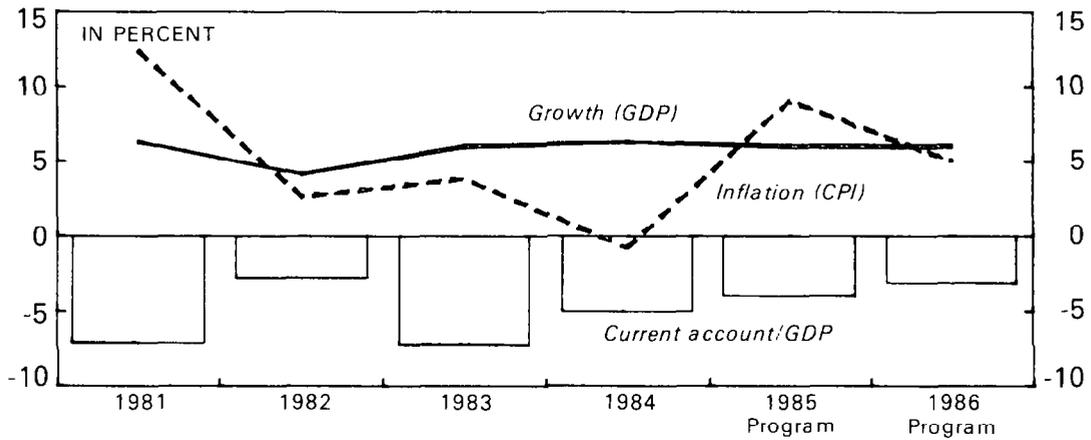
	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86
					Program	
	(In billions of baht)					
Total revenue and grants	115.8	119.1	139.7	152.3	175.5	199.6
Total revenue	112.1	116.5	136.7	148.3	170.6	194.7
Tax	(100.7)	(104.5)	(123.3)	(134.9)	(154.9)	(180.3)
Nontax	(11.4)	(12.0)	(13.4)	(13.4)	(15.7)	(14.4)
Grants	3.7	2.6	3.0	4.0	4.9	4.9
Total expenditure and net lending	141.2	168.0	177.6	189.7	210.5	222.5
Current	110.5	126.9	140.6	153.6	167.4	181.6
Capital	32.3	38.3	36.1	37.2	40.6	38.0
Other <u>1/</u>	-1.6	2.8	0.8	-1.1	2.4	2.8
Overall surplus or deficit (-)	-25.3	-48.9	-37.9	-37.4	-35.0	-22.9
Financing (net)	25.3	48.9	37.9	37.4	35.0	22.9
External	5.6	9.5	8.2	4.7	10.8	7.0
Domestic	19.7	39.4	29.7	32.7	24.2	15.9
Banking system	(16.6)	(29.9)	(13.5)	(21.9)	(13.8)	(...)
Nonbank public <u>2/</u>	(3.1)	(9.5)	(16.1)	(10.8)	(10.5)	(...)
Memorandum items:	(As percent of GDP)					
Total revenue and grants	14.7	14.1	15.0	15.3	15.6	15.9
Total revenue	14.3	13.8	14.7	14.9	15.2	15.5
Total expenditure	18.0	19.9	19.1	19.0	18.7	17.7
Of which: Current	(14.1)	(15.0)	(15.1)	(15.4)	(14.9)	(14.5)
Capital	(4.1)	(4.5)	(3.9)	(3.7)	(3.6)	(3.0)
Overall surplus or deficit (-)	-3.2	-5.8	-4.1	-3.8	-3.1	-1.8

Sources: Data provided by the Thai authorities; and staff estimates.

1/ Includes net lending.

2/ Includes the Government Savings Bank, domestic bond issues, and float arising from difference between transactions recorded in the government accounts and those in the monetary survey.

CHART 2
THAILAND
SELECTED ECONOMIC INDICATORS, 1981-86



Sources: Data provided by the Thai authorities and Fund staff estimates.
¹Defined as the ratio of yearly GDP to the year end stock of broad money.



expenditure to 6 percent, which implies no increase in real terms. The ratio of expenditure to GDP will decline moderately to below 19 percent in the current fiscal year and to below 18 percent in 1985/86.

On the revenue side, a substantial shortfall was expected to materialize in 1984/85 because of the measures that followed the November devaluation, including the lifting of the import surcharge, a reduction of the export duty on rubber, the write-off of capital losses associated with the devaluation, and the increase in income tax allowances. To avert such a shortfall, the Government adopted a tax package in April 1985 that is expected to generate additional resources equivalent to about 1 percent of GDP (on an annual basis) and about half of that in 1984/85. The main elements of the tax package are an increase in the excise tax rates on beer, liquor and tobacco; a rationalization of the customs code that places most commodities within a 5-60 percent tariff bracket; increases in the import duty rates on capital equipment, automobiles, vans, and trucks; and a further reduction in the export duty on rubber. ^{1/} The Government is also considering an increase in the tax on interest from fixed deposits, but the revenue effect of this measure could be offset by a downward adjustment in some marginal tax rates on personal income. Additional resources are expected to be generated through improvements in tax administration. Also, an acceleration of transfers from public enterprises to the Central Government should produce a once-and-for-all gain in revenues in 1984/85. As a result of these measures, central government revenues and grants are projected to rise steadily from 15.3 percent of GDP in 1983/84 to about 16 percent of GDP in 1985/86, thus achieving the revenue target for the Fifth Development Plan.

The Government intends to strengthen the elasticity of the tax system over the medium term by rationalizing the structure and administration of direct and indirect taxes. Attention will also be paid to reducing revenue losses arising from excessive incentives granted by the Board of Investment. The authorities expressed interest in seeking assistance from the Fund and the Bank in designing a strategy for adjustment of the tax system. In providing such assistance, the staff will coordinate its efforts with those of the Bank staff.

2. Operations of public enterprises

Available information suggests that the overall deficit of the public enterprise sector has declined substantially during the past five years and that the magnitude of this deficit is not large (Table 6). ^{2/}

^{1/} For a more detailed description of the new tax measures, see the accompanying Recent Economic Developments paper.

^{2/} Although substantial progress has been made in improving the consolidated data for the nonfinancial public enterprise sector, caution is still needed in interpreting these data.

Table 6. Thailand: Consolidated Financial Position of the Public Enterprise Sector, 1980/81-1984/85

	1980/81	1981/82	1982/83	1983/84	1984/85 Program
	(In billions of baht)				
Gross fixed capital expenditure	30.1	30.2	30.6	34.1	34.8
Net operating profits <u>1/</u>	3.9	13.3	21.3	28.6	20.3
Overall surplus (+)/deficit (-)	-26.1	-16.9	-9.3	-5.5	-14.5
Financing	26.1	16.9	9.3	5.5	14.5
External financing (net)	17.2	16.5	13.8	10.8	13.0
Domestic financing	9.0	0.5	-4.5	-5.3	1.5
Bank	2.4	-2.1	-3.8	-3.7	-0.6
Nonbank	7.6	1.2	-0.7	0.6	2.3
Net transfers and loans from the Central Government <u>2/</u>	-1.0	1.4	--	-2.3	-0.2
	(As a percentage of GDP)				
Gross fixed capital expenditure	3.8	3.6	3.3	3.4	3.1
Net operating profits (Excluding the Oil Fund)	0.5 (0.8)	1.6 (1.6)	2.3 (1.8)	2.9 (2.4)	1.8 (2.1)
Overall surplus (+)/deficit (-) (Excluding the Oil Fund)	-3.3 (-3.0)	-2.0 (-1.9)	-1.0 (-1.5)	-0.6 (-1.0)	-1.3 (-1.0)

Sources: Data provided by the authorities; and staff estimates.

1/ Gross cash operating profits less losses.

2/ Government capital and current transfers plus net loans less contributions from profit-making enterprises in lieu of corporate tax payments.

However, this deficit is expected to widen by nearly 1 percent of GDP in 1984/85 because of a swing in the financial position of the Oil Fund. The swing arises from the Government's decision not to pass through the impact of the devaluation to domestic prices of petroleum products until the accumulated surpluses of the Oil Fund are exhausted later this year. An important component of the program, therefore, is an adjustment of domestic prices of petroleum products before the end of the year in order to eliminate any further losses of the Oil Fund. Progress made in this area will be an important element of the completion of the first review of the program.

To bolster the resources of other public enterprises, a number of measures have been introduced in recent months. These measures include a phased increase of 150 percent in water rates, which will eliminate the losses previously sustained by the Provincial and Metropolitan Water Authorities; an increase of 50 percent in the installation deposit (in the form of a bond) of the Telephone Organization of Thailand; and a unification of bus fares at a level 30 percent higher than the previous minimum fare. On the expenditure side, investment outlays of public enterprises as a ratio of GDP will be reduced moderately to 3.1 percent by scaling down a number of projects in the telecommunications, transport, and power sectors. The overall deficit of public enterprises (excluding the Oil Fund) is projected to remain at about 1 percent of GDP in 1984/85. Projections pertaining to operations of public enterprises in 1985/86 are in a preliminary stage, but the authorities have indicated their commitment to undertaking any necessary measures to maintain the financial viability of the public enterprise sector. Policies relating to the operations of public enterprises in 1985/86 will be assessed at the time of the first review of the program.

The authorities indicated that, in reviewing issues related to the public investment program and the structure of tariffs of public enterprises, they intend to rely on assistance from the World Bank staff, which is currently assessing these issues in the context of a possible structural adjustment loan (SAL III). ^{1/} The Bank staff has provided a broad assessment of the public investment program. This assessment generally supports the Government's investment strategy, but it identifies a number of areas that need further strengthening. The Bank staff fully supports the authorities' intention of undertaking a careful review of the Eastern Seaboard Development Program (including the construction of two deep-sea ports and one major railway line) with a view to rephrasing and scaling down the Program. The key issues relating to the telecommunication sector are the rephrasing of the investment program and further measures to raise revenues. The Bank staff also sees the need for additional measures to increase revenues and enhance the operating efficiency of the transportation sector.

^{1/} Information on Thailand's relations with the World Bank are provided in Annex II.

The authorities explained that they have greatly strengthened their ability to monitor the operations of public enterprises. The Debt Policy Committee has been authorized to review all investment projects of public enterprises before approving external or domestic financing. Also, a committee is being established to monitor the operations of these enterprises. This committee will recommend measures to strengthen the financial position of public enterprises, including appropriate tariff adjustments, and will establish guidelines and procedures for the privatization of some enterprises.

3. Monetary policy

The adjustment program calls for continued monetary restraint to contain the inflationary impact of the recent devaluation and ensure the attainment of the balance of payments objective. During 1985, the expansion of domestic credit of the banking system will be limited to 19 percent (a performance criterion), compared with 17 percent in 1984. The small acceleration of credit expansion is warranted by the expected increase in prices of tradable goods induced by the devaluation. In real terms, credit will increase by less than 10 percent, or about half of the increase in each of the previous three years (Table 7 and Chart 2). Consequently, credit conditions will tighten considerably during 1985.

In order to ensure adequate credit to the private sector, the increase in net credit to the Central Government from the banking system will be limited to B 11 billion during 1985 (a performance criterion), equivalent to less than 1 percent of GDP. Present monitoring procedures are not adequate for setting a ceiling on borrowings of public enterprises from the banking system--which, in any event, have been relatively small in recent years. The authorities intend to strengthen their capacity to monitor bank lending to enterprises with a view to setting a ceiling on such credit, if necessary, at the time of the first review of the program.

Credit policy for 1985 is consistent with the projected increase in the demand for broad money and the desired movement in net foreign assets of the banking system. Broad money has been rising considerably faster than nominal GDP during the past three years, owing to the high income elasticity of the demand for money (1.5), the rapid decline in inflationary expectations, and the persistent flow of funds from the nonbank financial markets into the banking system. The authorities expect that the velocity of broad money will continue to fall during 1985, but at a slower rate than in the recent past. ^{1/} Inflationary expectations are bound to be higher in 1985 because of the anticipated

^{1/} The income velocity of broad money fell at an average annual rate of about 9 percent during 1981-84; it is projected to decline by 5 percent in 1985.

Table 7. Thailand: Monetary Survey, 1981-85

	1981 Dec.	1982 Dec.	1983 Dec.	1984 Dec.	1985 Dec. Proj.
<u>(In billions of baht)</u>					
Net foreign assets	34.3	38.6	16.5	28.3	22.8
Net domestic assets	258.1	325.3	434.7	514.2	624.5
Domestic credit	356.9	437.5	549.7	643.9	766.2
Central Government (net)	(92.5)	(124.5)	(135.3)	(154.4)	(165.5)
Private sector	(264.4)	(313.0)	(414.4)	(489.5)	(600.7)
Other items (net)	-98.7	-112.2	-115.0	-129.7	-141.7
Broad money	292.4	363.8	451.2	542.5	647.3
<u>(Percentage change)</u>					
Net domestic assets	23.3	26.0	33.6	18.3	21.5
Domestic credit	16.7	22.6	25.6	17.1	19.0
Central Government (net)	(23.8)	(34.7)	(8.7)	(14.1)	(7.2)
Private sector	(14.4)	(18.4)	(32.4)	(18.1)	(22.7)
Broad money	16.1	24.4	24.0	20.2	19.3

Sources: Data provided by the Thai authorities; and Fund staff estimates.

increase in prices of tradable goods arising from the devaluation. Moreover, notwithstanding the difficulties in forecasting the flow of funds into the banking system, it does appear unlikely that this flow would continue at the pace observed in recent years. Against this background, the authorities have formulated their credit policy on the basis of the assumption that the demand for money will grow by about 10 percent in real terms during 1985--about half the rate recorded in 1984. In nominal terms, broad money is projected to grow by 19 percent.

The authorities recognize that because of the uncertainties in projecting the demand for broad money, credit developments need to be carefully monitored to ensure that net foreign assets do not fall below the target. If the demand for broad money turns out to be weaker than expected, the authorities intend to restrain credit expansion sufficiently below the ceiling so as not to jeopardize the external objective. The program target for the balance of payments (a performance criterion) limits the decline in net foreign assets of the banking system to B 5.5 billion (\$0.2 billion) during 1985.

Monetary developments since the lifting of the credit ceiling in August 1984 demonstrate the ability of the Bank of Thailand to effectively control credit expansion through open market operations. The authorities have sought to gain further control over credit expansion through a regulation enacted in November 1984 that effectively forces the commercial banks to seek forward cover when resorting to foreign borrowing. ^{1/} This regulation reduces the incentive of commercial banks to borrow abroad, when domestic liquidity becomes tight, because the forward discount on the baht generally reflects the difference between yields in the domestic and foreign money markets. The authorities expressed their commitment to maintaining a flexible interest rate policy by allowing domestic rates to play an equilibrating role in the financial markets; they intend to raise present ceilings on lending and deposit rates if these ceilings impede upward adjustments in domestic rates. They are also considering a tightening of procedures for registering foreign borrowing by the private sector in order to discourage speculative capital flows.

4. Exchange rate management

The devaluation of the baht in November has restored Thailand's external competitiveness to an adequate level. Since the devaluation, the exchange rate of the baht vis-a-vis the U.S. dollar, the intervention currency, has been set daily on the basis of the relationship of

^{1/} This regulation limits the open position that commercial banks can hold on their combined spot and forward foreign exchange transactions to the equivalent of 20 percent of capital or \$5 million, whichever is greater.

the baht to a basket of currencies. This practice is expected to safeguard against a loss of external competitiveness due to realignments of major currencies. The authorities also believe that by pegging the baht to a basket, they will avoid the political resistance to exchange rate adjustments that is inherent in a dollar-peg regime. The new practice has proved particularly valuable in the recent period when the U.S. dollar has moved rapidly against other currencies; since November, the value of the baht has fluctuated in the range of B 26.8 to B 28.3 per U.S. dollar, while, in effective terms, it has remained stable (Chart 3). The authorities are committed to managing the exchange rate flexibly so as to protect the competitiveness of exports and help bring about the desired reduction in the external current account deficit.

5. Structural policies

The Government's structural policies focus on removing economic distortions and improving resource allocation. The most important of these policies relate to prices and wages, agricultural development, and export promotion.

After the November 1984 devaluation, the authorities imposed temporary price controls to prevent profiteering. Producers and traders were requested to maintain the selling prices of their goods until old stocks were exhausted, but upward price adjustments were allowed in accordance with increases in import costs. These price controls were largely phased out by early 1985. The authorities have continued to pursue a restrained wage policy. Minimum wage rates were kept unchanged during 1984, but they were raised by almost 6 percent on January 1, 1985, to compensate partially for the effects of the baht devaluation on incomes. The Government will seek to persuade employers and workers to limit further wage increases during 1985-86 to gains in productivity.

In order to encourage production and exports of agricultural products and to support rural income, the Government will continue to rely mostly on market mechanisms. In recent years, the Government has eliminated the price support programs for rice, which had proved ineffective and costly. Instead, the Government introduced mortgage and loan schemes that reduce the pressure on farmers to sell their produce early in the cropping season and help eliminate seasonal fluctuations in farmgate prices. The Government has continued to reduce export taxation to improve farmgate prices for rice and rubber. Export taxes for rice were reduced in late 1983 by 50 percent to about 6 percent of the average export price, and have been kept unchanged since that time. Export taxes for rubber were lowered in November 1984 and April 1985.

Promotion of nontraditional exports should contribute significantly to strengthening the external balance. The authorities said that a major effort will be made to acquaint foreign importers with Thai products, mainly through an increase in the number and destinations of Thai trade missions, greater participation in trade fairs, and the

sponsorship of visits of potential buyers to Thailand. In addition, quality standards will be set and administrative obstacles reduced. The authorities are also considering improving incentives, in the form of investment promotion and export credit guarantee schemes, for small-scale industries, while avoiding direct export subsidies. Since 1984, the Board of Investment provides automatic tax privileges for businesses expanding existing capacity, when new products are involved, 80 percent of the additional production is exported, factories are located in specified regions, or the capacity expansion involves significant inter-industry linkages. The authorities are reviewing the activities of the Board of Investment to ensure that promotional efforts are consistent with an efficient allocation of resources.

In recent years, the Government has had substantial success in encouraging energy conservation and reducing oil imports; further progress during the program period is envisaged. Until the November devaluation, domestic prices of petroleum products were considerably above international prices. This promoted energy saving, although distortions in the domestic pricing structure tended to skew consumption toward lower grade products, particularly diesel and kerosene. The authorities are reviewing the structure of energy pricing with a view to redressing existing distortions.

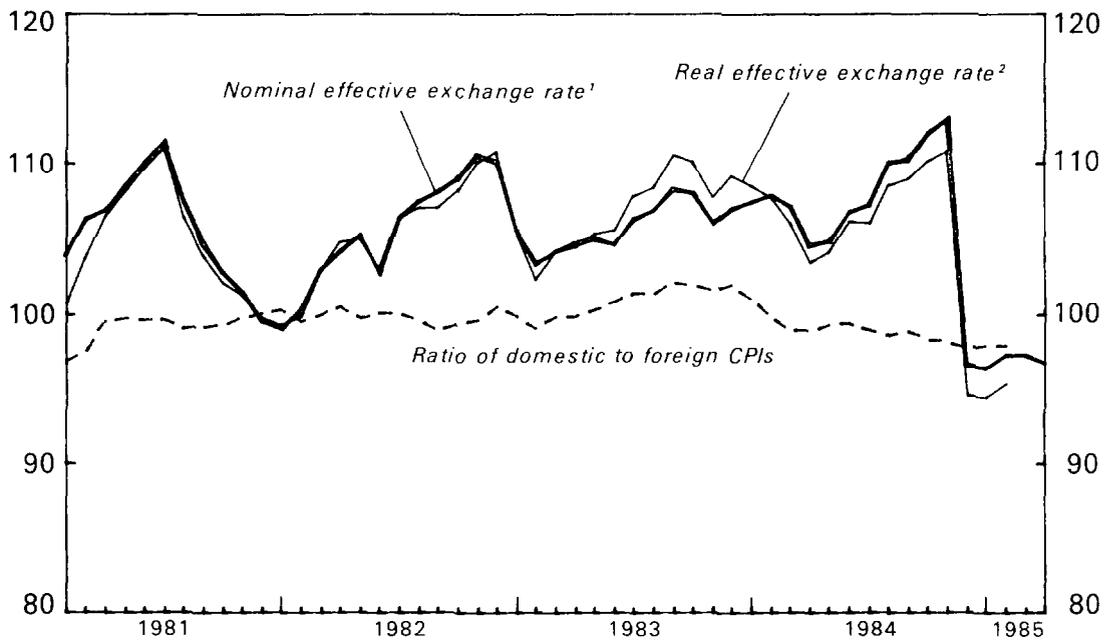
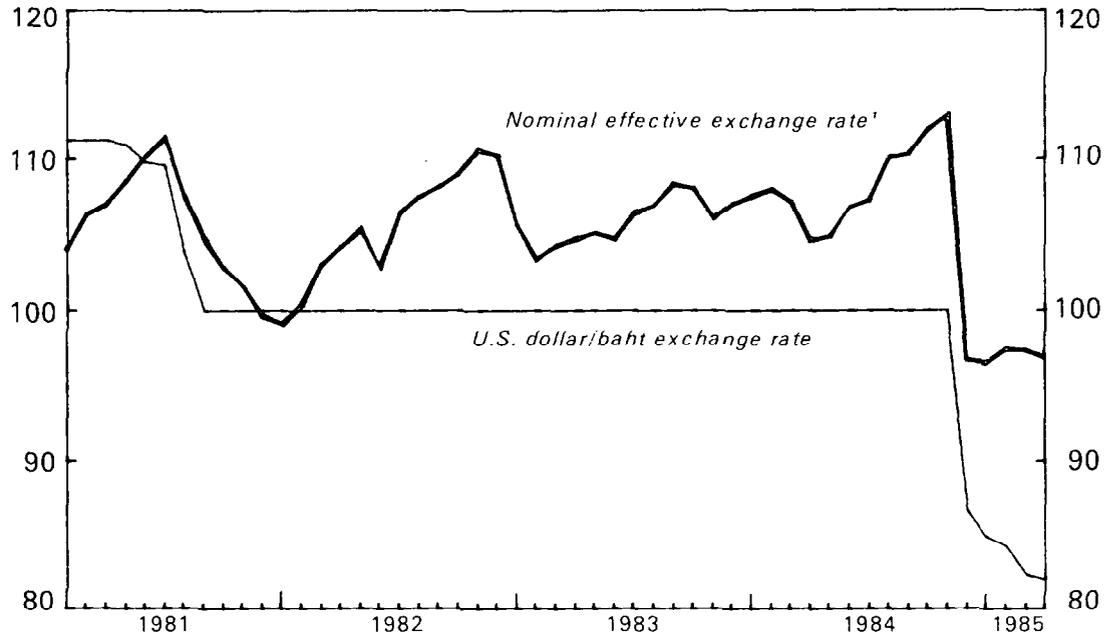
6. Short-term prospects

The Government's adjustment program is designed to substantially reduce the savings-investment gap during 1985-86, without adversely affecting economic growth and price stability. The improvement in the savings-investment balance (by 1 percentage point in both 1985 and 1986) is projected to arise mainly from an increase in the share of national savings in GDP. Fiscal restraint is expected to improve the public sector savings ratio, while steadier behavior of the terms of trade and adequate levels of real interest rates should improve private saving performance. ^{1/} On the investment side, some retrenchment in public investment is expected, but private investment--which was weak in 1984--should recover during 1985-86. The share of total domestic investment in GDP is therefore envisaged to remain at its 1984 level, which should support a continuation of the recent rate of output growth of 6 percent. The growth of domestic consumption--both private and public--is expected to slow, but the expansion of output will be sustained through an increase in the growth of external demand.

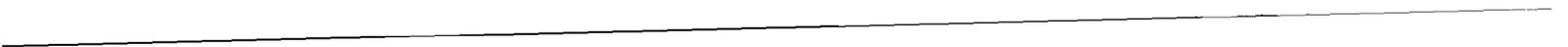
The current account deficit is expected to decline from 5 percent of GDP (\$2.1 billion) in 1984 to 4 percent (\$1.7 billion) in 1985. The volume of merchandise exports is projected to continue to grow rapidly;

^{1/} While it is difficult to reconcile the national and the fiscal accounts, the savings-investment gap of the public sector on a calendar year basis is likely to decline by 0.6 percent of GDP in 1985 and by 1 percent of GDP in 1986.

CHART 3
THAILAND
EXCHANGE RATE INDICES
(1981-IV=100)



Sources: Data provided by the Thai authorities, and Fund staff estimates.
1 Trade weighted exchange rate; an increase indicates appreciation
2 Effective exchange rate adjusted by relative movements in CPIs



the recent real depreciation of the baht and ample domestic supplies should compensate for a projected deceleration in the growth of foreign demand. Growth in the volume of merchandise imports is expected to be restrained by the continued weakness in domestic demand and a rise in the price of imports relative to domestic goods. Despite a further small deterioration in the terms of trade, the trade deficit should narrow from \$3 billion in 1984 to \$2.6 billion in 1985. Little change is projected for the surplus on invisibles (Table 3 and Appendix Table 8).

Owing to the openness of Thailand's financial markets and the volatility of capital flows in recent years, projections of capital movements are subject to great uncertainty. With this caveat in mind, it is projected that net inflows of nonmonetary capital will decline by \$1 billion to \$1.5 billion. This decline reflects entirely a drop in net private sector inflows to a level close to that recorded during 1981-83 (large net outflows during the first two months of 1985 support this projection). Net external borrowing by the public sector is projected to increase moderately. Taken together, these developments would imply an overall payments deficit of \$0.2 billion in 1985.

In 1986, the growth of export volume is expected to remain strong and that of import volume to increase. A small improvement in the terms of trade is foreseen and the current account deficit is projected to fall by \$0.2 billion to \$1.5 billion (3 percent of GDP). Net capital inflows are projected to increase slightly, leading to a small surplus in the overall balance of payments (\$0.1 billion). The pattern of reserve movements embodied in the projections would result in a decline in the ratio of reserves to imports from 3.1 months in 1984 to 2.7 months in 1986.

The improvement in the external current account during 1985-86 will permit a slowdown in the growth of external debt from about 12 percent a year during 1982-84 to 6-7 percent during 1985-86 (Appendix Table 9). Short-term debt is projected to fall during 1985-86, largely reflecting repayments by the public enterprises and a slowdown in commercial bank borrowing. ^{1/} Consequently, the share of short-term debt in total, which declined significantly during 1982-84, is projected to fall further to below 19 percent by 1986. The debt service ratio will continue to rise in 1985, but should decline to 24 percent in 1986.

Outstanding medium- and long-term public debt (excluding Fund credit) is projected to rise by 12 percent in 1985 and 9 percent in 1986, compared with an average rate of growth of 17 percent during 1981-84. The ratio of external public debt to GDP will remain below 20 percent through 1986. The authorities intend to carefully monitor

^{1/} Short-term external borrowing by commercial banks is expected to slow in response to the recent regulation that limits their open foreign exchange position.

developments in external debt and, in any case, will limit new commitments of public and publicly guaranteed debt with maturities of one year or more to \$1.3 billion in 1985 (a performance criterion).

The maturity structure of external public debt has improved in recent years and is not a source of concern. The average maturity of new (medium- and long-term) public debt commitments has increased from 19 years to 23 years during 1980-84, and is anticipated to increase to 25 years by 1986. The Central Government does not engage in short-term external borrowing, and only three public enterprises are allowed to borrow abroad on a short-term basis. Short-term debt of the public sector amounted to only \$0.2 billion in 1984 (2 percent of total external public debt) and projected to fall by half in 1985, as one of the two major borrowing enterprises plans to convert its short-term debt into long-term debt.

7. Medium-term projections

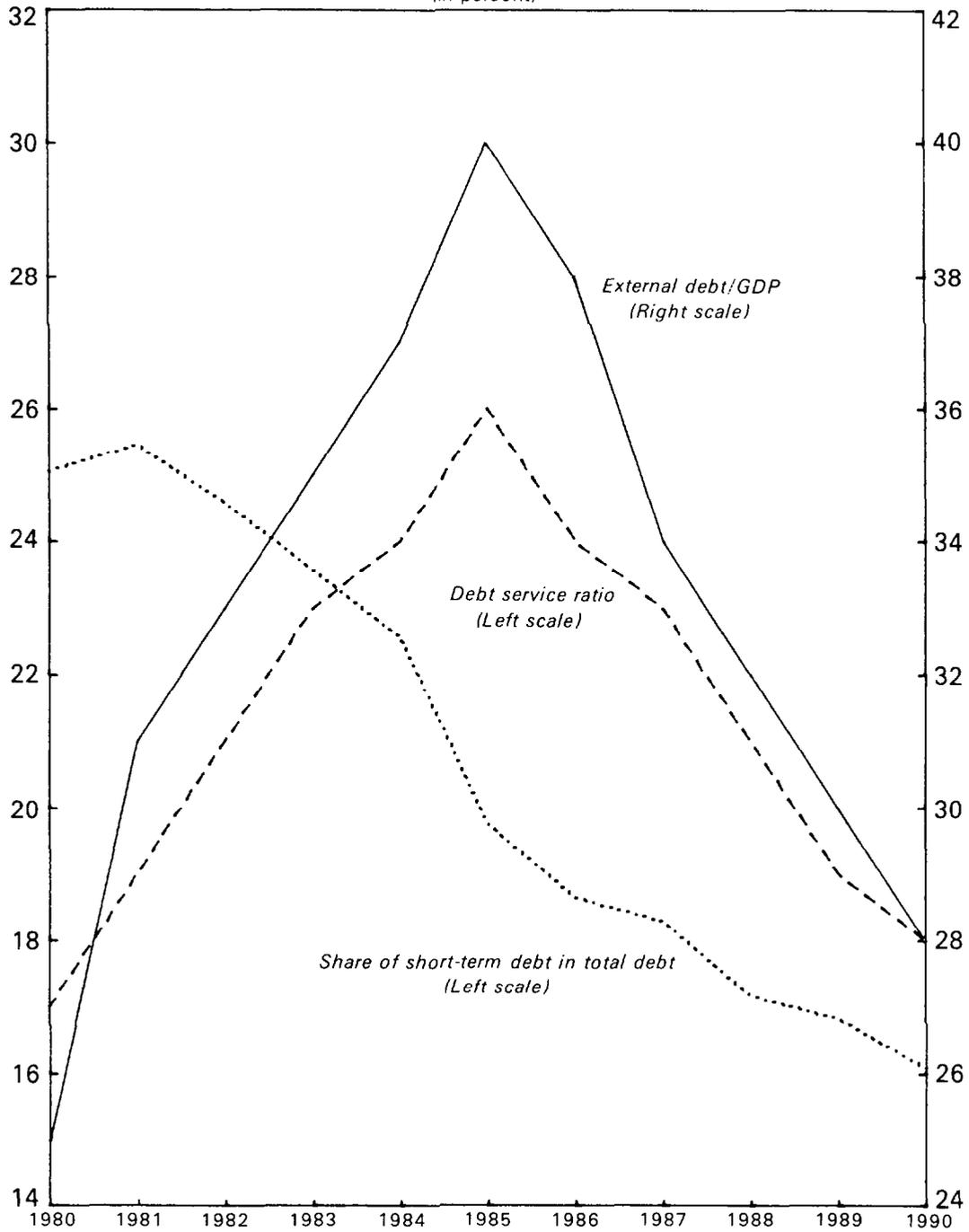
Medium-term projections prepared by the staff are broadly in line with those made by the authorities (Appendix Table 10). Assuming that restrained financial policies are implemented and external competitiveness is maintained, it is expected that the growth of output will be sustained at about 6 percent, inflation will be low, and the current account deficit will decline to 2 percent of GDP by 1990. Under these conditions, and assuming that international reserves will not fall below 2.5 months of imports, external debt would rise by about 8 percent a year during 1987-90. The debt service ratio would decline from 24 percent in 1986 to 18 percent in 1990 (Chart 4).

These medium-term projections are highly sensitive to the underlying assumptions, particularly those relating to developments in export markets and foreign interest rates. The staff has prepared an alternative scenario, under which export markets grow more slowly (by 1 percentage point less a year), the terms of trade decline (by 1 percent a year), and LIBOR rises (by 1 percentage point). Assuming that no policy adjustments are made in response to the hypothetical deterioration in the external environment, the current account deficit would rise to over 5 percent of GDP by 1990. This outcome would imply that external debt would grow by 12 percent--assuming that the reserve target is not altered--and the debt service ratio would remain at 24 percent.

8. Performance criteria and phasing of purchases

The program contains the following performance criteria: (a) a set of ceilings on domestic credit of the banking system, including subceilings on net credit to the Central Government; (b) a set of floors on net foreign assets of the banking system; (c) a ceiling on new commitments of public and publicly guaranteed external debt with maturities of one year and over; (d) two reviews with the Fund, to be completed prior to December 31, 1985 and June 30, 1986; and (e) the customary injunction

CHART 4
THAILAND
EXTERNAL DEBT INDICATORS
(In percent)



Sources: Data provided by the Thai authorities; and Fund staff estimates.



regarding exchange and trade restrictions. Quantitative performance criteria have been set for the period through February 1986 (Table in the Attachment). Performance criteria for the remaining period of the stand-by arrangement will be set at the time of the reviews. In the course of the reviews, the staff will discuss the progress made in achieving the program objectives and negotiate the policy commitments for the second year of the program. An important subject of the first review will be progress made in implementing remaining measures in the fiscal area.

The amount of the stand-by arrangement (SDR 400 million) is to be disbursed in eight equal installments of SDR 50 million. The first installment will become available on approval of the arrangement; the remaining installments will become available every three months starting in September 1985. Each purchase after the first will be conditional on observance of the corresponding performance criteria; in addition, the March and September 1986 purchases will be conditional on completion of the respective reviews. Total purchases will not exceed SDR 150 million (39 percent of quota) until the first review has been completed and will not exceed SDR 250 million (65 percent of quota) until the second review has been completed.

IV. Staff Appraisal

Thailand's economic performance improved significantly in 1984 because of both favorable external developments and effective demand management policies. The momentum of growth was maintained, domestic inflation fell to near zero, and the external current account deficit declined substantially. However, despite the improvement in the external position, Thailand's current account deficit far exceeded a sustainable level. The rising external debt burden has become a source of concern, as the level of debt almost doubled during the last four years and the debt service ratio rose significantly. In order to reverse this trend, the Government intensified its adjustment effort in late 1984.

The authorities devalued the baht by a substantial amount in November 1984, in the face of strong political opposition, and formulated a program of supporting policies on the basis of which they have requested access to Fund resources. The program consists of a restrictive fiscal policy, a further tightening of monetary policy, a commitment to flexible management of the exchange rate, and structural policies focusing on prices and wages, development of agriculture, and promotion of exports.

The macroeconomic objective of the program is to reduce the current account deficit from 5 percent of GDP in 1984 to 4 percent in 1985 and 3 percent in 1986, while sustaining the growth of output at about 6 percent a year. Domestic prices are expected to rise by about 9 percent in

1985 because of the lagged impact of the recent devaluation, but their rate of increase should converge to the rate of foreign inflation of close to 5 percent in 1986. The rate of growth of external debt is projected to fall significantly, and the debt service ratio to decline rapidly after 1985.

The cornerstone of the economic program is a strong fiscal package that was adopted in early 1985 to generate additional tax revenues and cut expenditures. This package is expected to reduce the central government deficit from close to 4 percent of GDP in 1983/84 to about 3 percent in 1984/85 and to below 2 percent in 1985/86. The authorities are to be commended for adopting the fiscal package under difficult circumstances. Nonetheless, it is clear that the desired improvement in the fiscal position calls for continued resolve in containing government spending.

The financial position of the public enterprise sector has been strengthened considerably in recent years. The staff welcomes the recent measures aimed at bolstering the position of key public enterprises and urges the early implementation of a number of measures now under consideration to further raise tariffs and streamline investments. The staff supports the authorities' intention of carefully assessing, in consultation with the World Bank, the feasibility of a number of large projects, particularly those relating to telecommunications and to the Eastern Seaboard Development Program, with a view to rationalizing the public investment program. These tariff and investment measures will improve the financial position of public enterprises, particularly those in transport and telecommunications. Nevertheless, the overall deficit of the public enterprise sector is expected to weaken in 1984/85 because of the decision of the Government not to pass on the effects of the devaluation to the domestic price of petroleum products until the surplus of the Oil Fund has been eliminated later this year. The staff attaches great importance to the implementation of necessary price adjustments to eliminate losses of the Oil Fund before the end of the year. The staff will have an opportunity to monitor developments in the public sector at the time of the two reviews of the stand-by arrangement.

The assessment of issues relating to the public sector has been greatly facilitated by the improvement in the quality of information pertaining to nonfinancial public enterprises. The staff fully supports the authorities' efforts to further enhance their information base and strengthen their capability in monitoring operations of the enterprises. In this regard, substantial benefits should derive from recent actions to strengthen the authority of the Debt Policy Committee in monitoring public enterprise debt and to form a new advisory group to review the overall operations of public enterprises.

The staff supports the authorities' intention of further tightening monetary policy in order to contain the impact of the devaluation on domestic prices and to effect further external adjustment. The authorities are committed to monitoring credit conditions closely so as to ensure the realization of the balance of payments target. Domestic interest rates will be allowed to play an equilibrating role, and present ceilings on interest rates will be raised if they impede upward adjustments of domestic rates. As regards exchange rate policy, the authorities intend to manage the exchange rate flexibly so as to protect the competitiveness of exports and bring about the desired reduction in the external current account deficit.

The staff believes that the authorities' program of financial and economic policies constitutes a comprehensive adjustment effort that will bring about a rapid improvement in Thailand's external position. In the past, Thailand has complied with Fund arrangements, and its outstanding use of Fund resources has not been unduly large. These considerations and Thailand's large balance of payments need justify access to Fund resources on the scale proposed.

It is recommended that the next Article IV consultation with Thailand be held on the standard 12-month cycle.

V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1985 Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Thailand, in the light of the 1985 Article IV consultation with Thailand conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Thailand continues to maintain an exchange system that is free of restrictions on payments and transfers on current international transactions.

Stand-By Arrangement

1. The Government of Thailand has requested a stand-by arrangement for the period June __, 1985 to March 31, 1987 for an amount equivalent to SDR 400 million.

2. The Fund approves the stand-by arrangement attached to EBS/85/128.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table 8. Thailand: Balance of Payments, 1981-86

(In billions of U.S. dollars)

	1981	1982	1983	1984 Est.	1985 Proj.	1986 Proj.
Trade balance	-3.0	-1.6	-3.9	-3.0	-2.6	-2.5
Exports, f.o.b.	6.9	6.8	6.3	7.3	8.1	9.4
Imports, c.i.f.	-9.9	-8.4	-10.2	-10.3	-10.7	-11.9
Services and transfers (net)	0.5	0.6	1.0	0.9	0.9	1.0
Current account balance	-2.5	-1.0	-2.9	-2.1	-1.7	-1.5
(As percent of GDP)	(7.1)	(2.7)	(7.2)	(5.0)	(4.0)	(3.1)
Nonmonetary capital move- ments (net)	2.4	1.7	1.5	2.5	1.5	1.6
Private sector	0.8	0.8	0.8	1.8	0.8	1.0
Public sector	1.6	0.9	0.7	0.7	0.7	0.6
Errors and omissions	--	-0.6	0.6	--	--	--
Overall balance	<u>-0.1</u>	<u>0.1</u>	<u>-0.8</u>	<u>0.4</u>	<u>-0.2</u>	<u>0.1</u>
Monetary movements	0.1	-0.1	0.8	-0.3	0.2	-0.1
Commercial banks (net)	-0.3	-0.3	0.7	0.1	--	--
Monetary authorities	0.4	0.2	0.1	-0.4	0.2	-0.1
Of which: Net use of Fund resources (increase -) <u>1/</u>	-0.5	--	-0.2	0.1	-0.1	--
Memorandum items:						
Gross official inter- national reserves	2.7	2.6	2.5	2.7	2.6	2.7
(In months of current year's imports)	(3.3)	(3.7)	(2.9)	(3.1)	(2.9)	(2.7)

Sources: Data provided by the Thai authorities; and staff estimates.

1/ Assumes purchases of SDR 150 million in 1985 and SDR 200 million in 1986 under the proposed stand-by arrangement; and a purchase of SDR 185 million in 1985 under the CFF.

Table 9. Thailand: External Debt, 1981-1990

	1981	1982	1983	1984 Est.	1985	1986	1987	1988	1989	1990
					Projection					
(In billions of U.S. dollars)										
Total outstanding debt (disbursed)	11.0	12.2	14.0	15.5	16.7	17.7	18.6	19.8	21.4	23.0
Medium- and long- term debt	8.2	9.2	10.7	12.0	13.4	14.4	15.2	16.4	17.8	19.3
Public sector	5.9	6.9	7.9	8.4	9.3	10.1	10.6	11.1	11.5	12.0
Of which: IMF	(0.9)	(0.8)	(1.0)	(0.9)	(1.0)	(1.0)	(0.9)	(0.8)	(0.6)	(0.4)
Non-bank private sector	2.1	2.3	2.7	3.3	3.8	4.0	4.3	5.0	6.0	7.0
Commercial banks	0.2	--	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Short-term debt	2.8	3.0	3.3	3.5	3.3	3.3	3.4	3.4	3.6	3.7
Debt service payments <u>1/</u>	1.7	1.9	2.1	2.4	2.9	3.1	3.4	3.5	3.8	4.1
Repayments to IMF <u>2/</u>	0.1	0.1	0.1	0.1	0.2	0.3	0.2	0.1	0.1	0.2
(In percent)										
Growth rate of external debt	30	12	14	11	7	6	6	7	7	7
Debt service ratio <u>1/</u> <u>3/</u>	19	21	23	24	26	24	23	21	19	18
Debt outstanding as percent of GDP	31	33	35	37	40	38	34	32	30	28

Sources: Data provided by the Thai authorities; and staff estimates.

1/ Including interest on short-term debt.

2/ Including Trust Fund.

3/ In percent of exports of goods and nonfactor services.

Table 10. Thailand: Medium-Term Scenario, 1985-90

(In billions of U.S. dollars)

	1985	1986	1987	1988	1989	1990
Debt service						
Interest payments	1.4	1.5	1.6	1.7	1.8	1.9
Amortization payments	1.5	1.6	1.8	1.8	2.0	2.2
Total	2.9	3.1	3.4	3.5	3.8	4.1
Of which: Debt service to IMF	(0.3)	(0.3)	(0.3)	(0.2)	(0.2)	(0.2)
Debt service ratio (as percent of exports of goods and nonfactor services)	25.7	24.3	23.2	20.9	19.7	18.9
Balance of payments	-0.2	0.1	0.3	0.4	0.5	0.6
Current account	-1.7	-1.5	-1.3	-1.5	-1.6	-1.7
(As percent of GDP)	(4.0)	(3.1)	(2.5)	(2.3)	(2.2)	(2.0)
Exports (f.o.b.)	8.1	9.4	10.9	12.5	14.5	16.7
Imports (c.i.f.)	10.7	11.9	13.3	15.2	17.4	19.8
Capital account (net)	1.5	1.6	1.6	1.9	2.1	2.3
Gross external reserves	2.6	2.7	2.9	3.2	3.6	4.1
(In months of imports)	(2.9)	(2.7)	(2.6)	(2.5)	(2.5)	(2.5)
External debt outstanding	16.7	17.7	18.6	19.8	21.4	23.0
(As percent of GDP)	(39.9)	(37.6)	(34.2)	(31.7)	(29.5)	(27.5)
Other macroeconomic variables						
Change in percent						
Real GNP growth rate	6.0	6.0	6.0	6.0	6.0	6.0
Export unit value (in SDRs)	6.0	5.1	3.3	3.3	3.3	3.3
Import unit value (in SDRs)	8.6	3.6	3.3	3.3	3.3	3.3
Export volume	11.5	10.4	7.1	7.2	7.3	7.6
Import volume	2.1	7.0	4.3	6.3	6.2	6.1
International rate of interest (LIBOR)	8.6	9.0	8.4	8.4	8.4	8.4
CPI (average)	7.0	5.5	5.2	4.6	4.3	4.2
Percent of GNP						
Gross domestic investment	22.0	22.0	22.0	22.0	22.0	22.0
Gross domestic savings	18.0	19.0	19.5	19.7	19.8	20.0

Sources: Bank of Thailand; and staff projections.

Thailand - Fund Relations
(As of March 31, 1985)

(Amounts in millions of SDRs,
unless otherwise indicated)

I. Membership Status

- (a) Date of membership: May 3, 1949
(b) Status: Article XIV

(A) Financial Relations

II. General Department (General Resources Account)

- (a) Quota: SDR 386.6 million
- (b) Total Fund holdings of currency:
- | | <u>Amount</u> | <u>Percent of quota</u> |
|--|---------------|-------------------------|
| | 1,121.1 | 290.0 |
- (c) Fund credit
- | | | |
|---------------------------|-------|-------|
| Of which: CFF | 763.3 | 197.4 |
| BSFF | 139.5 | 36.1 |
| Credit tranches | 56.3 | 14.6 |
| Enlarged Access Resources | 208.0 | 53.8 |
| | 359.5 | 93.0 |
- (d) Reserve tranche position: 28.8 7.4
- (e) Current Operational Budget: -- --
- (f) Lending to the Fund: None

III. Current Stand-by or Extended Arrangement and Special Facilities

- (a) Current stand-by or extended arrangement: None
- (b) Previous stand-by arrangements
- during the last 10 years:
- (1) (i) Duration: July 1978-June 1979
- (ii) Amount: SDR 45.25 million
- (iii) Utilization: SDR 45.25 million
- (iv) Undrawn balance: --
- (2) (i) Duration: June 3, 1981-Nov. 17, 1982
- (ii) Amount: SDR 814.5 million
- (iii) Utilization: SDR 345.0 million
- (iv) Undrawn balance: SDR 469.5 million

(3)	(i) Duration:	Nov. 17, 1982-Dec. 31, 1983
	(ii) Amount:	SDR 271.5 million
	(iii) Utilization:	SDR 271.5 million
	(iv) Undrawn balance:	--

(c) Special facilities in the past two years:

Buffer Stock Financing Facility:

(i) Tin:	SDR 17 million (October 1982)
(ii) Natural Rubber:	SDR 19.6 million (March 1983)
(iii) Tin:	SDR 21.81 million (June 1983)

IV.	<u>SDR Department</u>	<u>Amount</u>	<u>Percent of allocation</u>
	(a) Net cumulative allocation:	84.7	100.0
	(b) Holdings:	1.9	2.3
	(c) Current Designation Plan:	Not incl.	--
V.	<u>Administered Accounts</u>		
	(a) Trust Fund Loans:		
	(i) Disbursed:	130.9	
	(ii) Outstanding:	105.6	
	(b) SFF Subsidy Account	None	
VI.	<u>Overdue Obligations to the Fund</u>	None	

(B) Nonfinancial Relations

VII. Exchange Rate Arrangement

Effective November 5, 1984, the exchange rate of the baht was changed from B 23.00 = US\$1 to B 27.00 = US\$1, representing a depreciation of 14.8 percent in terms of the U.S. dollar. Henceforth the baht will float against a basket of currencies of major trading partners in line with domestic monetary and economic conditions. The exchange rate on March 31, 1985 was B 27.55 = US\$1.

VIII. Last Article IV Consultation

The last Article IV consultation took place during October 21-November 7, 1983. It was proposed to hold the next Article IV consultation on the standard 12-month cycle.

IX. Technical Assistance:

Fiscal: Expert assistance in the field of tax administration, fiscal reporting and public enterprise statistics.

X. Resident Representative/Advisor: None

Thailand: Relations with IBRD and IDA

(In millions of U.S. dollars)

	<u>IBRD</u>	<u>IDA</u>	<u>Total</u>
Total lending <u>1/</u>			
Agriculture	509	25	534
Irrigation	379	12	391
Education	127	55	182
Urban development	149	--	149
Industry	83	--	83
Transportation	585	--	585
Telecommunications	303	--	303
Power and energy	1,006	--	1,006
Population	--	33	33
Structural adjustment	325	--	325
Total	<u>3,466</u>	<u>125</u>	<u>3,591</u> <u>2/</u>
Excluding cancellations	(3,374)	(125)	(3,499)
Debt outstanding (including undisbursed) <u>1/</u>	<u>2,863</u>	<u>122</u>	<u>2,985</u>
Commitments for FY 1984	<u>153</u>	<u>--</u>	<u>153</u>

Technical assistance:

In addition to the usual range of technical advice provided in connection with its project and sector work, the IBRD has provided assistance in the drafting of the Fifth Development Plan and in improving budgetary procedures and planning for capital expenditures. In addition, technical assistance for a number of analytical studies and further work on program development are included in the Structural Adjustment Loan.

Recent economic and sector missions:

Economic Report, June 1982.
 Transport Sector Review, May 1983.
 Agricultural Taxes, Subsidies and Prices Study, June 1983.
 Labor Market and Employment Study, November 1983.
 Economic Report, August 1983.

1/ As of December 31, 1984.

2/ Of which \$2,440 million disbursed.

Structural Adjustment Loans:

The Board of Directors approved a first loan for \$150 million for structural adjustment lending on March 15, 1982. The loan was fully disbursed on July 19, 1982. A second SAL for \$175.5 million was approved on March 31, 1983 and was fully disbursed on September 22, 1983. These loans were made in support of policy adjustments or development of policy programs in five broad areas with a view to: (1) promote agricultural growth and exports; (2) increase the export orientation of industry through a reform of industrial policies and investment promotion incentives; (3) provide a basis for efficient energy development and utilization through the preparation of a comprehensive energy sector program; (4) strengthen the fiscal planning and public sector resource mobilization efforts; and (5) foster the development of public institutions so as to use public resources more efficiently and provide an environment conducive to structural adjustment.

Thailand--Summary of Financial Program

	<u>1984</u>	<u>1985</u>	<u>1986</u>
		<u>Program period</u>	
I. <u>Targets</u>	(In billions of U.S. dollars)		
BOP current account balance	-2.1	-1.7	-1.5
Overall balance of payments	0.4	-0.2	0.1
Gross official reserves	2.7	2.6	2.7
	(Percentage change)		
Real GDP	6.3	6.0	6.0
CPI (December-December)	0.9	7.0	5.5
II. <u>Assumptions</u>			
Export volume	19.3	11.5	10.4
Import volume	0.3	2.1	7.0
Of which: Oil imports	4.8	-3.2	5.4
Non-oil imports	-1.6	3.8	7.6
Terms of trade	-3.6	-2.4	1.5
Income velocity of broad money	-10.7	-5.0	...

III. Principal Elements of the Program

1. Central government budget

a. The Government adopted a tax package in April 1985 that is expected to generate additional resources equivalent to about B 10 billion or 1 percent of GDP (on an annual basis) and about half of that in 1984/85. The main elements of the tax package are an increase in the excise tax rates on beer, liquor, and tobacco; a rationalization of the customs code; and an increase in import duty rates on capital equipment, automobiles, vans and trucks. Additional resources are expected to be generated through improvements in tax administration and a once-and-for-all acceleration of transfers from public enterprises.

b. In early 1985, the budgetary allocations for 1984/85 were cut by B 4 billion (approximately 2 percent of expenditure). The Government will limit the growth of expenditure to 6 percent in 1985/86.

c. The central government deficit is expected to decline from B 37 billion (3.8 percent of GDP) in 1983/84 to B 35 billion (3.1 percent of GDP) in 1984/85 and to B 23 billion (1.8 percent of GDP) in 1985/86.

2. Public enterprises

a. The level and structure of domestic prices of petroleum products will be adjusted before the end of 1985. Earlier in the year, subscriber bonds for telephone installations were increased by 50 percent, the decision was made to increase water rates by 150 percent during 1985, and bus fares were unified at a level 33 percent higher than the previous minimum fare.

b. The Government undertook to postpone or scale down investment projects in the telecommunications, transport, and power sectors. Accordingly, investment outlays of public enterprises will be limited to B 35 billion in 1984/85.

c. The Government will enhance their monitoring capabilities over public enterprise debt and operating procedures.

3. Money and banking

a. Net domestic credit of the banking system is subject to quarterly ceilings as a performance criterion. The expansion of domestic credit during 1985 will be limited to 19 percent.

b. Net credit of the banking system to the Central Government is subject to quarterly ceilings as a performance criterion. The expansion of net credit to the Government will be limited to just over 7 percent in 1985.

c. Official ceilings on interest rates will be raised if they impede the upward movement of deposit and lending rates.

4. External sector policies

a. In November 1984 the baht was devalued by 14.8 percent (in terms of foreign currency per baht). The de facto peg to the U.S. dollar was abandoned and the value of the baht was linked to a basket of currencies of major trading partners. The authorities are committed to managing the exchange rate flexibly to maintain competitiveness.

b. Net foreign assets of the banking system are subject to quarterly floors as a performance criterion. The decline in net foreign assets will be limited to B 5.5 billion (\$0.2 billion) during 1985.

c. As a performance criterion, new commitments of public and publicly guaranteed debt of more than one year maturity will be limited to \$1.3 billion in 1985.

Thailand: Stand-By Arrangement

Attached hereto is a letter, with an annexed Technical Memorandum, dated May 15, 1985 from the Minister of Finance of Thailand and the Governor of the Bank of Thailand, requesting a stand-by arrangement and setting forth:

(a) the objectives and policies that the authorities of Thailand intend to pursue for the period of this stand-by arrangement;

(b) the policies and measures that the authorities of Thailand intend to pursue for the first seven months of this stand-by arrangement; and

(c) understandings of Thailand with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Thailand will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from June .., 1985 to March 31, 1987, Thailand will have the right to make purchases from the Fund in an amount equivalent to SDR 400 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 50.00 million until September 10, 1985; the equivalent of SDR 100.00 million until December 10, 1985; the equivalent of SDR 150.00 million until March 10, 1986; the equivalent of SDR 200.00 million until June 10, 1986; the equivalent of SDR 250.00 million until September 10, 1986; the equivalent of SDR 300.00 million until December 10, 1986; and the equivalent of SDR 350.00 million until March 10, 1987.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Thailand's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1 until purchases under the arrangement reach the equivalent of SDR 386,737,430; and thereafter from borrowed resources only, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Thailand will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Thailand's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period in which the data at the end of the related month indicate that the limit on domestic credit, the limit on net credit to the Central Government, the limit on net foreign assets of the banking system, and the limit on new external public debt commitments, as described in the annexed Technical Memorandum, is not observed; or

(b) during any period after December 31, 1985 and June 30, 1986, respectively, until understandings have been reached with the Fund on appropriate policies, and suitable performance criteria have been established in consultation with the Fund, as contemplated by paragraph 28 of the attached letter, or after such performance criteria have been established, while they are not being observed; or

(c) during the entire period of this stand-by arrangement, if Thailand

(i) imposes restrictions on payments and transfers for current international transactions, or

(ii) introduces multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes import restrictions for balance of payments reasons.

When Thailand is prevented from purchasing under this arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Thailand and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Thailand will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Thailand's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision

of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Thailand. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Thailand and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Thailand, the Fund agrees to provide them at the time of the purchase.

8. The value date of a purchase under this stand-by arrangement involving borrowed resources will be determined in accordance with Rule G-4(b) of the Fund's Rules and Regulations. Thailand will consult the Fund on the timing of purchases involving borrowed resources in accordance with Rule G-4(d).

9. Thailand shall pay a charge for this arrangement in accordance with the decisions of the Fund.

10. (a) Thailand shall repurchase the outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Thailand's balance of payments and reserve position improves.

(b) Any reductions in Thailand's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

11. During the period of the stand-by arrangement, Thailand shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Thailand or of representatives of Thailand to the Fund. Thailand shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Thailand in achieving the objectives and policies set forth in the attached letter and annexed Technical Memorandum.

12. In accordance with paragraph 29 of the attached letter, Thailand will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Thailand has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Thailand's balance of payments policies.

Bangkok, Thailand

May 15, 1985

Dear Mr. de Larosiere:

1. The Government of Thailand has formulated a comprehensive financial and economic program that aims at continued external adjustment in a context of sustained growth and price stability. In support of this program, which is described below, Thailand herewith requests a stand-by arrangement with the International Monetary Fund in the amount of SDR 400 million, including access to the Fund's borrowed resources, for the period through March 31, 1987. Thailand's request for access to Fund resources on this scale is justified by Thailand's exceptional circumstances, including the need to bolster its international reserves and the strength of its adjustment effort.

Recent developments

2. The Thai economy has been buffeted by a number of exogenous shocks since 1979. The second wave of oil price increases and the steep rise in international interest rates added substantially to current account payments, while the persistent fall in commodity prices and sluggish foreign demand contributed to a significant slowdown in the growth of export earnings. Although overall growth remained strong during 1979-81, the external current account deficit rose sharply to over 7 percent of GDP. The Government responded to the deterioration in the external position by adopting a wide-ranging adjustment program, which was partly supported by two stand-by arrangements from the Fund (from June 1981 through December 1983). The main elements of the program included a sizable devaluation of the currency in mid-1981; dismantling of price controls; elimination of export controls and reductions in export taxes; a tariff reform; upward adjustment in energy prices; and restrained monetary, fiscal, and incomes policies.

3. Economic activity in Thailand slackened considerably in 1982, largely as a result of a continuing deterioration in export prices which, together with a poor harvest and high real interest rates, weakened domestic demand. Output growth declined from 6 percent in each of the previous three years to 4 percent in 1982. The current account deficit fell to below 3 percent of GDP, mainly because of a sharp contraction of domestic investment and the general economic slowdown. In 1983, fiscal policy was tightened in an effort to reduce the mounting deficits of the Central Government. However, in order to pull the economy out of the recession, the stance of credit policy was relaxed substantially. Domestic demand expanded vigorously and, together with favorable prices and climatic conditions affecting the agricultural sector, led to a rebound in the growth of output to 6 percent in 1983. Domestic inflation remained below 5 percent, mainly owing to a fall in foreign prices. However, with the upsurge in domestic demand, import volume rose strongly. At the same time, export volume fell because of

bad harvests in the previous crop year, an intensification of protectionism abroad, and a deterioration of external competitiveness. Consequently, the current account deficit rose to a peak of \$2.9 billion (7 percent of GDP) in 1983.

4. In order to alleviate pressures on the external position, the Government tightened credit policy substantially and adopted a moderately restrictive fiscal policy in 1984. The Bank of Thailand raised its discount rates in December 1983 and curtailed the access of commercial banks to borrowing in the repurchase market. The Bank also requested commercial banks to restrain the opening of letters of credit for non-oil imports. Subsequently, commercial banks were instructed to restrict the expansion of credit to the private sector to 18 percent during 1984, compared with 33 percent in 1983. The ceiling was lifted in August, but the Bank of Thailand continued to maintain tight credit conditions through active open market operations. As a result, the expansion of total credit during 1984 was kept below 18 percent.

5. The tightening of credit policy in 1984 contributed to a significant slowdown in the growth of domestic demand and helped improve the external position and further reduce domestic inflation to near zero. Nevertheless, output growth was maintained at 6 percent, largely on the strength of exports, which increased substantially in response to a revival of external markets and a plentiful supply of agricultural products. The volume of imports was stagnant because of the weakening of domestic demand and measures to restrict import letters of credit. The external current account deficit fell to \$2.1 million (5 percent of GDP) and, together with substantial inflows of capital, resulted in a swing in the overall payments position from a deficit of \$0.9 billion in the previous year to a surplus of \$0.3 billion. Gross international reserves, which had declined during the previous three years, rose moderately to \$2.7 billion, equivalent to three months of imports.

6. Notwithstanding the improved economic situation in 1984, the underlying external position remains weak. The Government is increasingly concerned about the rising external debt burden, particularly in view of the adverse conditions prevailing in the international capital market. While Thailand continues to enjoy a high standing in the international capital market, it is evident that to maintain this standing the rising trend in the external debt burden needs to be reversed.

7. To further improve Thailand's external position and reduce its external financing requirements, the Government devalued the currency by 14.8 percent against the U.S. dollar in November 1984. At the same time, the de facto peg to the U.S. dollar, which had been in effect since mid-1981, was abandoned and the value of the baht was pegged to a basket of currencies of Thailand's major trading partner countries.

The adjustment program for 1985-86

8. The Government's adjustment program is designed to further reduce the external current account deficit to 4 percent of GDP in 1985 and 3 percent in 1986, while maintaining growth at close to 6 percent. The rate of inflation is expected to rise to 7 percent in 1985 because of the inevitable impact of the devaluation on domestic prices of traded goods, but it is projected to decline to the rate of foreign inflation of about 5 percent in 1986. The achievement of the current account target would allow a sharp deceleration in the growth of external debt and a rapid decline in the debt-service ratio after 1985. The overall balance of payments is projected to record a small deficit of \$0.2 billion in 1985 and turn to a moderate surplus in 1986; gross international reserves are expected to remain in the range of 2.5 to 3 months of imports.

9. An important step in the adjustment process has already been taken by the November exchange rate action that corrected the cumulative loss of external competitiveness arising in recent years. The Government is committed to manage the exchange rate flexibly so as to protect the competitiveness of exports and help bring about the desired reduction in the external current account deficit. To ensure the success of the devaluation in improving the external position, the Government is committed to the implementation of supporting fiscal, monetary, incomes, and structural policies.

10. The program aims at a significant narrowing of the investment savings gap of the public sector. The Government has introduced a strong fiscal package to reduce the Central Government deficit. In February, the Cabinet agreed to reduce planned allotments from the budget by B 4 billion, with cutbacks in both current and capital expenditures. The cutbacks will be effected by delays in the hiring of personnel, reduced purchases of materials and supplies, reduced overseas travel by government officials, suspension of some ongoing capital projects, and deferred outlays on new projects. Excluding debt service, current expenditure will decline in real terms by almost 2 percent.

11. On the revenue side, the Government has introduced a comprehensive tax package that is expected to generate net additional resources of B 4.5 billion during the remainder of the current fiscal year. The main revenue raising measures include increased excises on beer, liquor and tobacco and a rationalization of the customs code. The latter includes increases in the minimum tariff rates for many commodities and in the tariffs applicable to automobiles and trucks. The Government also intends to increase the tax on interest from fixed deposits, but the revenue effect of this measure will be offset by a downward adjustment in some marginal tax rates on personal income. Furthermore, efforts to improve tax administration, will be intensified particularly through accelerated collection of revenues from tax cases under appeal. In

addition, transfer of contributions from the public enterprise sector to the budget have been accelerated. Overall, revenues and grants are projected to increase by 15 percent in 1984/85.

12. The above expenditure and revenue measures are expected to reduce the deficit of the Central Government from close to 4 percent of GDP in 1983/84 to about 3 percent in 1984/85. The Cabinet has already agreed to limit the growth of expenditure to less than 6 percent in 1985/86, which would imply a significant decline in real terms, exclusive of debt service charges. Taking into account the impact of recently introduced tax measures, revenues are projected to rise by about 14 percent. The Central Government deficit is projected to further decline to about 2 percent of GDP in 1985/86.

13. The Government is committed to strengthening the overall buoyancy of the revenue system through a rationalization of the structure and administration of direct and indirect taxes over the medium term. Attention will also be paid to reducing revenue losses arising from tax incentives granted by the Board of Investment. In designing a strategy for adjustment of the tax system, the Government intends to seek technical assistance from the Fund as well as from the World Bank in the context of a structural adjustment loan.

14. The Government's fiscal effort will also include measures to strengthen the position of the nonfinancial public enterprises. In the area of public utilities, the recent decision to gradually increase water rates by 150 percent during 1985 is expected to eliminate the losses previously sustained by the Provincial and Metropolitan Water Authorities. In order to strengthen the medium-term financial position of the Telephone Organization of Thailand, subscriber bonds for telephone installations were increased by 50 percent. In the transport sector, bus fares were recently unified at a level 33 percent higher than the previous minimum fare. This tariff increase is expected to cut the net operating loss of the Bangkok Metropolitan Transport Authority by B 0.2 billion. On the expenditure side, investment outlays of the public enterprise sector will be contained to B 35 billion in 1984/85. This target will be achieved by rephasing and scaling down a number of planned projects in the telecommunications, transport, and power sectors.

15. The above expenditure measures, together with the recent tariff increases in the public utility and transportation sectors, will significantly strengthen the financial position of public enterprises. Nevertheless, because of the substantial deterioration in the financial position of the Oil Fund in 1984/85, the deficit of the public enterprise sector will deteriorate in the current fiscal year. However, this deterioration will be more than offset by the improvement in the Central Government position; in 1984/85 the overall deficit of the public sector will not exceed last year's level of 4.5 percent of GDP.

16. The Government will redouble its efforts to improve the financial position of the public enterprise sector during the next fiscal year. The investment program of the public enterprise sector for 1985/86 will be reviewed closely in order to limit the level of such investments to B 40 billion. The Eastern Seaboard Development Program, including the construction of two deep-sea ports at Laem Chabang and Map Tapud, as well as other infrastructural projects, such as the proposed Sattahip-Rayong railway, will be scaled down and rephased. In assessing the investment program of these sectors, the Government will rely on assistance from the World Bank.

17. On the revenue side, an important measure will be the adjustment of the level and structure of domestic prices of petroleum products. Progress made in this area will be evaluated in the context of the first review of the stand-by arrangement with the Fund. The Government also intends to review the magnitude of tariff increases necessary to further reduce losses in the transport sector and improve the profit position of other sectors, particularly telecommunications. The above measures are expected to reduce the overall deficit of the public enterprise sector and contribute to a reduction in the public sector deficit to close to 3 percent of GDP in 1985/86.

18. In order to strengthen its ability to monitor the operations of the public enterprise sector, the Government has expanded the surveillance role of the Debt Policy Committee. The Committee consists of the four key agencies that deal with public enterprises--Ministry of Finance, the Bank of Thailand, the Budget Bureau and the National Economic and Social Development Board. Under its new terms of reference, the Committee will have the authority to review and approve the projects of enterprises. This Committee has recently issued formal policy guidelines for evaluating all State enterprise investment projects requiring external or domestic financing. The Government has, in March 1985, established a committee to review and monitor the operations of the state enterprise sector. The Committee will recommend measures to strengthen the financial position of state enterprises, including appropriate tariff adjustments, and will establish guidelines and procedures for privatization of some enterprises. In addition, the Government will strengthen its ability to monitor bank credit to public enterprises in order to be in a position to set ceilings on such credit, if necessary, for 1986. In this context, technical assistance will be sought from the Fund.

19. With the expected improvement in the financial position of the public sector, the external borrowing requirements of the Government will decline during 1985-86. Accordingly, new commitments of public and publicly guaranteed loans with maturities of one year or more will be limited to US\$ 1.3 billion during 1985. Debt service payments of the public sector are projected to remain below 11 percent of exports of goods and services during 1985-86.

20. The Government intends to maintain its restrictive credit policy stance to contain the inflationary effects of the devaluation and to effect further external adjustment. During 1985, the expansion of domestic credit of the banking system will not exceed 19 percent, which is consistent with the expected increase in the demand for broad money and the desired accumulation of net foreign assets by the banking system. Credit policy will be monitored closely in the light of developments in the balance of payments. If necessary, credit expansion will be curtailed further in order to meet the balance of payments target. The increase in net bank claims of the Central Government will be limited to B 11 billion during 1985.

21. The Government has long been concerned with the destabilizing effect of short-term speculative capital flows. In late 1984, the Bank of Thailand requested commercial banks to limit their net foreign exchange position (combined spot and forward) to 20 percent of their capital or to \$5 million, whichever is greater. This regulation will help contain speculation on the baht and prevent excessive short-term foreign borrowing by commercial banks. The monetary authorities will continue to watch developments in short-term capital flows, and will take additional measures that appear necessary to control such flows.

22. The Government believes that an efficient allocation of financial resources requires that interest rates be allowed to play an equilibrating role in the domestic money and credit markets. In order to preserve the flexibility that exists under the present interest rate ceilings, the authorities will not reduce these ceilings during 1985 and 1986. Furthermore, the Bank of Thailand will raise the interest rate ceilings if these ceilings impede upward adjustments of domestic rates.

23. The Government will continue to pursue a restrained incomes policy. Minimum wage rates were kept unchanged during 1984, but they were raised by 5-6 percent on January 1, 1985 to compensate partially for the effects of the baht devaluation on incomes. The Government will seek to persuade all parties in the wage determination process to limit the increase in minimum wage rates to the expected rise in productivity. No general wage or salary increase is planned for the public sector during 1984/85. Wages and salaries of civil servants and other employees in the public sector will be kept aligned with developments in wages, incomes, and prices in other sectors of the economy.

24. The Government's structural policies will focus on improving the efficiency of industry, developing indigenous energy resources, and raising productivity in agriculture. In the area of industry, substantial progress has been made in reducing the level and achieving a more uniform structure of effective protection. The Government has modified its industrial restructuring program by reducing the number of specific industries that are to be restructured from ten to five (textiles; automobiles; electric appliances and electronics; chemicals and

plastics; and steel, metal, and machinery) and by prolonging the implementation period from two and a half years to five years. In addition, the Government has adopted an industry-wide approach for promoting key sectors. The major sectors to be promoted under this approach include export-oriented industries, agro-industries, small-scale industries, and industries with good potential for growth and employment.

25. In the area of energy, the Government continues to emphasize both domestic production and conservation so as to reduce the dependency on oil imports. Natural gas production will be almost doubled, while domestic production of gas condensate, crude oil, and lignite is expected to rise substantially during 1985-86. The Government has established a gas separation plant which has already started operations in April 1985. With respect to energy conservation, the Government is granting special incentives for investments that reduce pollution and conserve energy. A newly-established Energy Conservation Center formulates guidelines and provides training on energy conservation. Domestic energy production and conservation have steadily reduced imports of crude oil from 62 million barrels in 1980 to 51 million barrels in 1984. These imports are expected to remain broadly unchanged during 1985-86, despite an expected increase in energy demand.

26. The thrust of agricultural policy in recent years has been to raise incentives for production and exports, and to increase the availability of modern inputs. The Government has suspended the costly support price program for paddy by the Public Warehouse Organization and substantially limited the purchase programs of other public marketing agencies. To increase the price to farmers early in the marketing season, the Government is now implementing a paddy-mortgage scheme and provides low interest loans for a price-guarantee scheme that is operated by farm groups and rice millers. The Government intends to rationalize the existing fertilizer promotion and distribution program. Agricultural policies during 1985-86 will continue to rely primarily on market mechanisms for increasing production incentives and improving the allocation of resources in this sector.

27. During the period of the stand-by arrangement, the Government of Thailand does not intend to introduce any multiple currency practices; impose any new or intensify any existing restrictions on payments and transfers for current international transactions; enter into any bilateral payments arrangements with Fund members; or introduce any new or intensify any existing restrictions on imports for balance of payments reasons.

28. The annexed Technical Memorandum presents operational guidelines for the period to December 31, 1985. Thailand will conduct with the Fund two reviews to assess the progress made under the program; the first review will take place prior to December 31, 1985 and the second prior to June 30, 1986. In the context of those reviews, it will reach

understandings on appropriate policies and suitable performance criteria for the remaining period of the stand-by arrangement. The Government wishes to assure you at this time that these policies and performance criteria will be fully consistent with the objectives of the program.

29. The Government of Thailand believes that the policies and measures described in this letter are adequate to achieve the objectives of the program, but will take any additional measures that may become appropriate for this purpose. During the remaining period of the arrangement, the Government will periodically consult with the Fund, in accordance with the Fund's policies on such consultations, about the progress being made in the implementation of the program and any policy adaptations judged to be appropriate for the achievement of its objectives.

Sincerely yours,

Minister of Finance

Governor
Bank of Thailand

Mr. Jacques de Larosiere
The Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
U.S.A.

May 15, 1985

Thailand - Technical Memorandum

1. This Memorandum describes the performance criteria under the stand-by arrangement and sets the quantitative limits for these criteria for the period through February 28, 1986.

2. The performance criteria consist of:

(a) Ceilings on domestic credit of the banking system.

(b) Ceilings on net credit of the banking system to the Central Government.

(c) Floors on the net foreign assets of the banking system.

(d) Ceilings on external public debt commitments.

(e) A review with the Fund to be completed prior to December 31, 1985.

(f) The observance of the commitment regarding the exchange and trade system that is stated in paragraph 27 of the Letter of Intent.

3. Domestic credit of the banking system is defined as the sum of net credit to the Central Government and credit to the private sector. The value of domestic credit on December 31, 1984 was B 643.9 billion.

4. Net credit to the Central Government is defined as the difference between the claims of the banking system on the Central Government and the deposits of the Central Government in the banking system. Claims on the Central Government include the issue of coins, and deposits of the Central Government include its holdings of currency. The value of net credit to the Central Government on December 31, 1984 was B 154.4 billion.

5. Credit to the private sector includes the gross value of all claims of the banking system on the nonfinancial public enterprises, the local government sector, the business and household sector, and the nonbank financial institutions. The value of credit to the private sector on December 31, 1984 was B 489.5 billion.

6. Net foreign assets are defined as the difference between the foreign assets and liabilities of the banking system. Foreign assets and liabilities of the monetary authorities denominated in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on December 31,

1984. Gold will be valued at a fixed accounting rate of US\$309 per fine troy ounce; and the Bank of Thailand's SDR holdings and IMF position will be valued at the rate of US\$ 0.98201 per SDR. The U.S. dollar value of foreign assets and liabilities of the Bank of Thailand will be converted into baht at the rate of B 27.125 per U.S. dollar. The baht value of the foreign assets and liabilities of the commercial banks will be multiplied by a conversion factor. The conversion factor for any month will be the ratio of the exchange rate of B 27.125 per U.S. dollar to the actual exchange rate used in the accounts of the Bank of Thailand in that month. The value of net foreign assets of the banking system on December 31, 1984 was B 28.3 billion.

7. The ceiling on external public debt commitments covers all public and publicly guaranteed external debt commitments with an initial maturity of more than one year, including liabilities of all public enterprises except the Bank of Thailand. External liabilities in currencies other than the U.S. dollar will be converted into U.S. dollars at the market rates of the respective currencies prevailing on the day of commitment. The value of external public debt contracted or guaranteed by the Government on December 31, 1984 was US\$10.5 billion.

8. Performance criteria will be tested on the last day of any month in each three-month period, at the option of the Thai authorities. All performance criteria must be met on the same date, and purchases under the stand-by arrangement must be made within three months of the test date chosen. During the period through February 28, 1986, domestic credit and net credit to the Central Government will not exceed the limits specified in the attached Table 1, and net foreign assets of the banking system will not fall below the limits specified in Table 1. New external public debt commitments during 1985 will not exceed US\$1.3 billion.

9. The data in Table 1 will be reported monthly to the Asian Department of the International Monetary Fund, not later than two months after the end of each month. Information supporting the data in Table 1 will also be reported at the request of the Asian Department. Other information necessary to assess financial and economic developments in Thailand will also be reported periodically at the request of the Asian Department of the International Monetary Fund.

Thailand: Performance Criteria
(End of month; in billions of baht)

	Domestic Credit	Net Credit to the Central Government	Net Foreign Assets
1984			
December	643.9	154.4	28.3
1985			
June	696.8	156.0	15.5
July	708.1	161.0	17.0
August	719.7	161.0	17.0
September	732.1	161.0	17.0
October	741.9	165.5	22.8
November	755.1	165.5	22.8
December	766.2	165.5	22.8
1986			
January	777.1	169.0	22.8
February	788.3	169.0	22.8
