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SUSTAINABLE FINANCE FOR INCLUSIVE GROWTH IN THAILAND

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By Adam Bogiatzis, Hidekatsu Asada and Mohamed Rizwan Habeeb Rahuman

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ABSTRACT/RESUMÉ

Sustainable finance for inclusive growth in Thailand

The Partnerships pillar of the 2030 Agenda for Sustainable Development cuts across all the goals focusing on the mobilisation of resources needed to implement the agenda.

Thailand's "sufficiency economy philosophy" encourages the prioritisation of long-term sustainability over short-term benefits. As such, Thailand has a long history of fiscal prudence that has served the country well in times of economic and political instability. However, relying on current fiscal buffers to finance foreseeable expenditure pressures is not sufficient or sustainable. A rapidly ageing population and shrinking workforce will weigh on future public finances and on the ability to achieve the Sustainable Development Goals.

To ensure that Thailand is well placed over the medium term to meet growing social, environmental and infrastructure requirements, the government should: (i) increase tax revenues by broadening the tax base and enhancing collection efficiency; (ii) facilitate greater private sector investment in productive infrastructure; and (iii) reform the healthcare and pension systems to increase their efficiency and effectiveness.

This Working Paper relates to the *Initial Assessment report of the Multi-dimensional Country Review of Thailand*. (<http://www.oecd.org/eco/surveys/multi-dimensional-review-thailand.htm>)

JEL classification: E62, H21, H30, H51, H54, H55, H61, H62, H63, H68, H70.

Keywords: Fiscal consolidation, healthcare, inclusive growth, pension, public-private partnerships, regional development, social protection, tax, transfer

Financer durablement la croissance inclusive en Thaïlande

Le pilier Partenariats du Programme de Développement Durable à l'horizon 2030 concerne tous les objectifs qui nécessitent la mobilisation de ressources pour mettre en œuvre ce programme.

La « philosophie économique de suffisance » de la Thaïlande met l'accent sur la soutenabilité à long terme plutôt que les gains à court terme. Ainsi, la Thaïlande a longtemps pratiqué une politique budgétaire prudente qui a été bénéfique au pays dans les moments d'instabilité économique ou politique. Cependant, la marge de manœuvre budgétaire actuelle ne suffira pas pour couvrir l'augmentation prévisible des dépenses. Le vieillissement démographique rapide et la diminution de la population active vont peser sur les finances publiques et sur la capacité à réaliser les Objectifs de Développement Durable.

Afin d'assurer que la Thaïlande soit bien placée sur le moyen terme pour faire face à des besoins croissants en matière sociale, environnementale et d'infrastructures, le gouvernement devrait: (i) augmenter les recettes fiscales en élargissant la base fiscale et en améliorant l'efficacité de la collecte; (ii) faciliter une plus grande participation du secteur privé dans l'investissement en infrastructures productives; et (iii) réformer les systèmes de santé et de retraites pour en améliorer l'efficacité et l'impact.

Ce Document de travail se rapporte à *l'évaluation initiale de l'Examen multidimensionnel de la Thaïlande* (<http://www.oecd.org/eco/surveys/multi-dimensional-review-thailand.htm>)

Classification JEL: E62, H21, H30, H51, H54, H55, H61, H62, H63, H68, H70.

Mots-clés: Consolidation budgétaire, santé, croissance inclusive, pension, partenariats public-privé, développement régional, protection sociale, impôt, transfert

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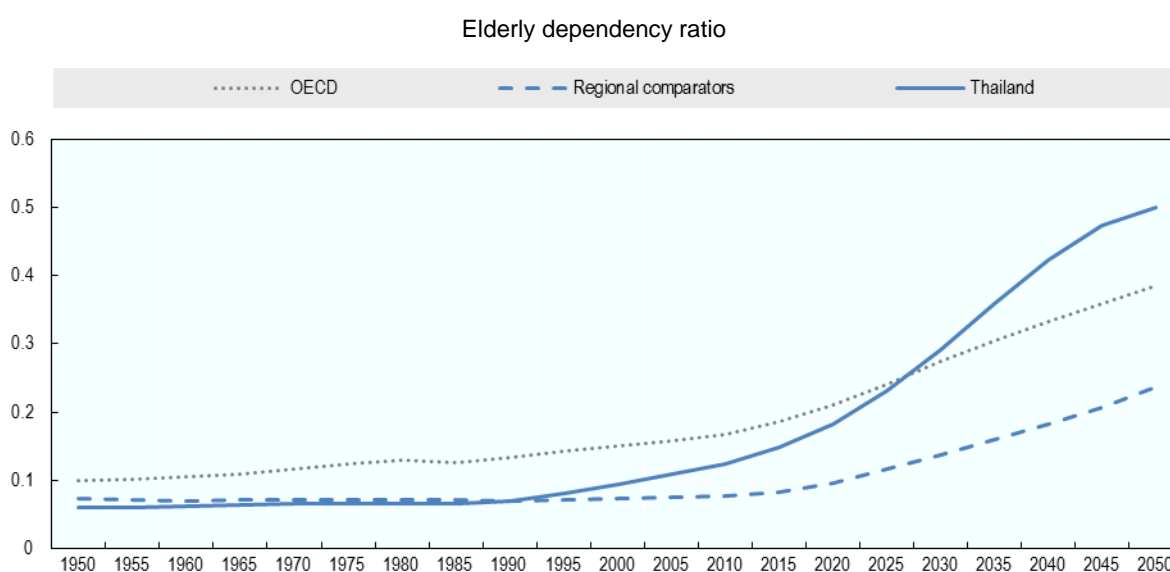
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SUSTAINABLE FINANCE FOR INCLUSIVE GROWTH IN THAILAND

By Adam Bogiatzis, Hidekatsu Asada and Mohamed Rizwan Habeeb Rahuman¹

Thailand's current fiscal position is sound (Koen et al., 2018), but its population is ageing much faster than in comparator countries. With rising life expectancy and low fertility rates (1.5 child per woman (World Bank, 2017b)), Thailand's dependency ratio is more in line with high-income countries such as Korea and Singapore, than other regional emerging economies such as Indonesia, the Philippines, Malaysia or Viet Nam (Figure 1). The drivers of Thailand's low fertility rates – increased education and career opportunities for women and high childrearing costs – are not dissimilar to those of East Asian high-income countries (UNFPA and NESDB, 2015). As a result, the cost of financial and social support for the elderly will rise considerably as demand for improved social outcomes and the weight of the elderly population both increase. Moreover, further investment in economic and social infrastructure is necessary to increase economic potential and ultimately attain high-income status. To this end, Thailand has to better marshal domestic resources by broadening the tax base and enhancing collection efficiency. At the same time, the private sector must play a greater role in financing productive infrastructure through enhanced public-private partnerships, while the social healthcare and pension system needs to be reformed without compromising quality and accessibility. This will help ensure Thailand achieves the objectives presented under the Partnerships pillar of the Sustainable Development Goals, which focuses on mobilising the resources needed to implement the agenda.

Figure 1. Thailand's elderly dependency ratio is expected to exceed the OECD average by 2030



Note: The elderly dependency ratio refers to the number of persons (aged 65 and above) per working age population (aged 15 to 64). Regional comparators refer to the simple average elderly dependency ratio for Malaysia, Philippines, Indonesia and Viet Nam.

Source: UN Population projections, 2017 revision.

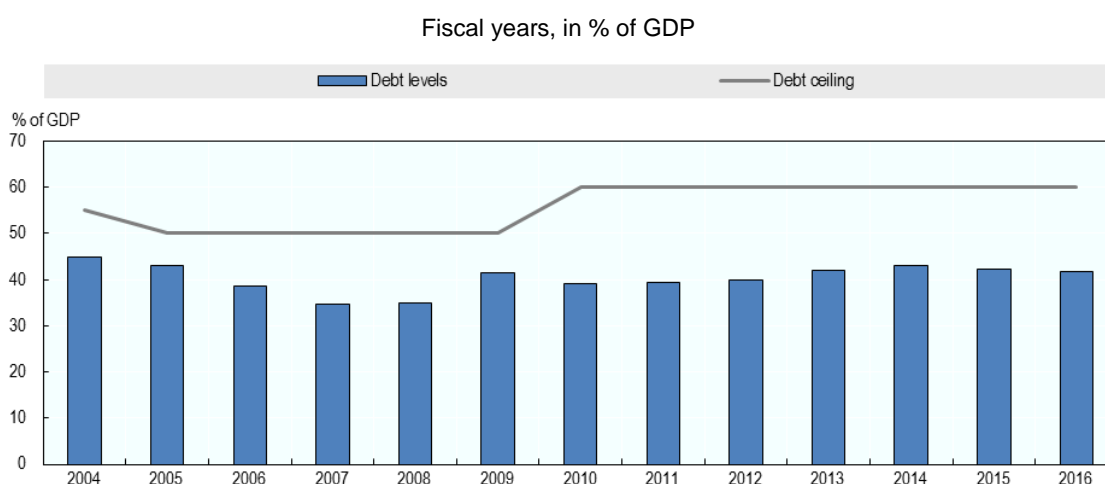
¹ The authors worked in the OECD Economics Department at the time of writing. The authors thank Thailand officials, members of the Economic and Development Review Committee and the Development Centre's Mutual Learning Group, Alvaro Pereira, Vincent Koen and Patrice Ollivaud from the Economics Department, and Bert Brys from Centre for Tax Policy and Administration for their valuable comments. Special thanks are due to Jan Rieländer, Catriona Marshall, Andrea Colombo and Vararat Atisophon at the Development Centre for co-ordinating and supporting the project of the Initial Assessment Report of the Multi-dimensional Country Review of Thailand, and to Mercedes Burgos and Sisse Nielsen for technical preparation.

This working paper discusses the sustainability of Thailand's public finances, breaking down the structure of public revenue and assessing how revenues can be increased through future tax reform. It also discusses how to better fund long-term infrastructure projects, including through greater private sector participation. Building on the analysis presented in Fleischer et al. (2018), it then reviews how to improve the financial sustainability of the pension and healthcare system.

The fiscal position is healthy, thanks to a record of fiscal prudence

Over the past 10 years, Thailand's public debt has averaged 40% of GDP (Figure 2). This is far below the 60% peak in 2000 and compares well with most countries in the region (in 2016, it stood at 53%, 42% and 62% in Malaysia, the Philippines and Viet Nam, respectively). Over the past four fiscal years, the general government fiscal balance has averaged a surplus of 0.1% of GDP, while the central government fiscal deficit has been relatively low, averaging 2.3% of GDP. The cyclically adjusted primary balance averaged a surplus of 0.9% of GDP over the same period.

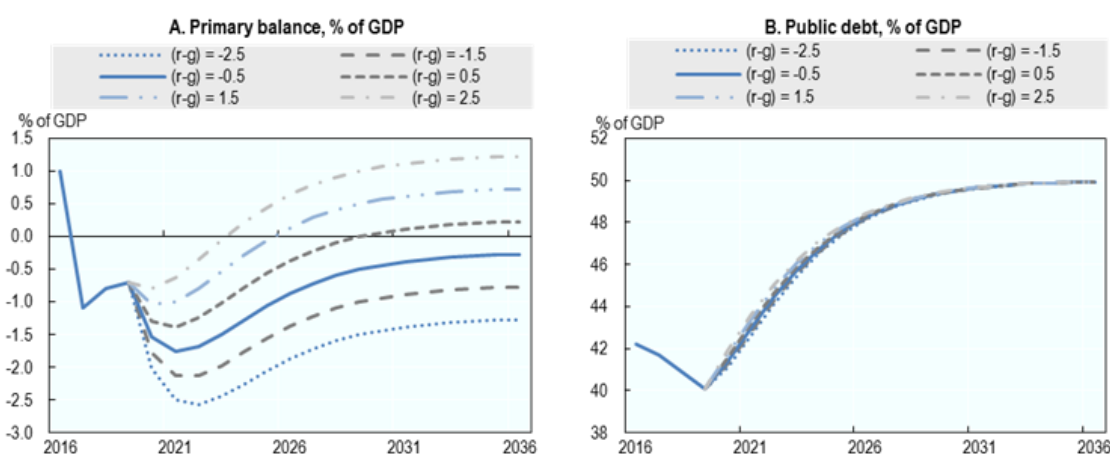
Figure 2. Thailand's gross public debt ratio has remained moderate



Note: The Ministry of Finance raised the debt ceiling in 2010 to 60% of GDP to ensure the availability of sufficient fiscal space in the event of a downturn. Public debt includes general government debt and state-owned enterprise debt. Fiscal year N runs from October in year N-1 to September in year N.

Source: Fiscal Policy Office and NESDB.

Looking ahead, there is room for ongoing fiscal stimulus without compromising longer-run sustainability. According to OECD model simulations, if nominal GDP growth and effective interest rates were to remain around current levels, there would be room for further fiscal expansion beyond the 2017 deficit without pushing gross public debt above 50% of GDP over the longer term, provided that the primary deficit is subsequently brought back gradually to around 0.5% of GDP (Figure 3). As long as the cost of debt financing remains low, borrowing to boost the productive capacity of the economy over the long term is a sensible strategy. However, interest rates are bound to rise from current low levels and without structural reform to boost economic potential, GDP growth could lose momentum. This would limit the available fiscal space and require a reversion to primary surpluses to safeguard debt sustainability.

Figure 3. Thailand has fiscal space in the near term

Note: r is the nominal implicit interest rate on government debt and g is the nominal potential growth. If current interest rates and economic potential are held constant ($r-g$) will be around -0.5. Figure 3A shows the evolution of the primary balance required under various assumptions about ($r-g$) to ensure longer-term convergence of the public debt ratio to 50%.

Source: OECD calculations; Datastream.

Since 2001, a formal sustainability framework has guided Thailand's fiscal policy. The framework includes four parameters periodically updated by the Ministry of Finance (Table 1). Since 2014, they are: (i) public debt not exceeding 60% of GDP, (ii) debt-servicing obligations not exceeding 15% of the annual budget, (iii) a balanced budget in the medium term, and (iv) capital spending reaching at least 25% of the annual budget (FPO, 2017a).

Table 1. Thailand's self-imposed fiscal sustainability framework

	2001-02	2002-03	2003-04	2004-09	2009-14	2014-21
Public debt/GDP (%)	≤ 65	≤ 60	≤ 55	≤ 50	≤ 60	≤ 60
Debt service/budget (%)	≤ 16	≤ 16	≤ 16	≤ 15	≤ 15	≤ 15
Budget balance	Balance in FY2009	Balance in FY2008	Balance in FY2005	Balance from FY2005 onwards	Maintain budget balance	Balance in medium term
Capital expenditure/budget (%)	-	-	-	≥ 25	≥ 25	≥ 25

Source: Fiscal Policy Office; Siksamat and Wanitthanankun (2015).

While not legally binding, Thailand has sought to adhere to this framework. It has never exceeded the public debt or debt servicing ceilings. The results are more mixed for the remaining parameters on capital expenditure and balanced budgets. To further strengthen fiscal discipline, the Cabinet recently approved a Fiscal Responsibility Bill, which is currently under review by the National Legislative Assembly. The Bill imposes a requirement for future governments to prepare medium-term economic forecasts of up to five years and projections for public debt, revenue, expenditure and contingent liabilities. The Bill also seeks to guard against open-ended populist measures by requiring future governments to calculate the costs of policy decisions and identify sources of funding prior to implementation.

Improved fiscal transparency has helped strengthen Thailand's credibility and performance

Thailand's prudent fiscal management is also a result of improved fiscal transparency across government. Key economic agencies including the Bank of Thailand and the Ministry of Finance have ensured that reporting on Thailand's public finances is accessible, reliable and timely. This has given successive governments the tools needed to make well-informed decisions on the economy, while also building fiscal credibility by providing citizens and markets, including foreign investors, with sound and consistent information.

Thailand has steadily increased the availability of budget documentation to meet international standards (Table 2). However, the comprehensiveness of the data can be improved. A recent study highlighted shortcomings in the provision of fiscal risk analysis, notably with respect to the disclosure of Thailand's financial derivative position, major and multi-annual contracts, environmental risks, and fiscal risks related to healthcare and social security funds (Siksamat and Wanitthanankun, 2015). In addition, the contingent liabilities and quasi-fiscal activities of some Specialised Financial Institutions are not well tracked. To further improve transparency and accountability Thailand should strengthen reporting in these areas. Against this background, the additional reporting requirements included in the aforementioned Fiscal Responsibility Bill are a welcome development.

Table 2. The availability of budget documents has improved over time

	2010	2012	2015	2017
Pre-budget statement	x	x	✓	✓
Executive's budget proposal	✓	✓	✓	✓
Enacted budget	✓	✓	✓	✓
Citizens budget	x	✓	✓	✓
In-year report	✓	✓	✓	✓
Mid-year review	x	x	x	✓
Year-end report	x	x	x	x
Audit report	✓	x	x	✓

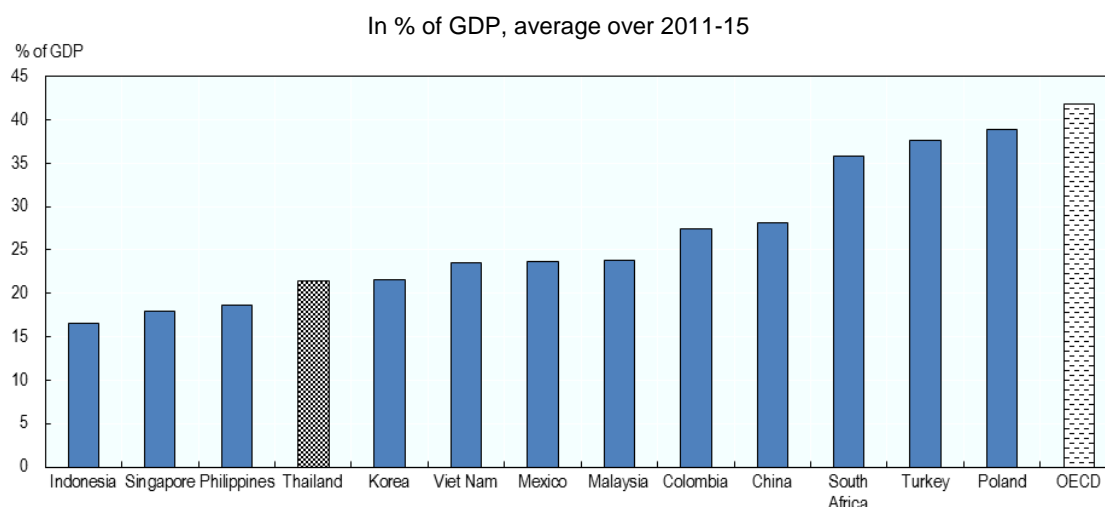
Source: International Budget Partnership (2017, 2015, 2012 and 2010).

Revenue will need to increase to fund social protection and safeguard fiscal sustainability

The Fiscal Responsibility Bill will avoid excessive debt and deficit, but adhering to the Bill while also funding a foreseeable expansion in government outlays will require additional revenue. Total public revenues, at 21% of GDP, are largely in line with other countries in the region with similar income levels, although much lower than the OECD average (Figure 4). So are total tax collections, at 17% of GDP in 2016, which the government aims to raise to 20% of GDP by 2020 (RD, 2016).

Increasing tax revenue over the longer term is needed to sustainably fund social and economic development. This calls for tax reform, however, which should be designed in a way that supports innovation, investment and competitiveness. The government's recent reforms have helped in this regard, but greater effort will be required.

In relation to the tax mix, indirect and direct taxes accounted for 59% and 41% of total tax revenue, respectively, in 2016. Taxes on specific goods and services (which include a range of consumption taxes such as excises but exclude value-added tax (VAT)) are the largest contributor to indirect taxes and account for about a third of all tax collections (or 6% of GDP). This proportion is among the highest of all comparator countries. Corporate income tax is the largest contributor to direct taxes, accounting for a quarter of all tax revenues (4.6% of GDP). Social security contributions amounted to 1.2% of GDP – above most regional peers but well below the 9.1% OECD average (Figure 5). Meanwhile, taxes collected by local administrative organisations (LAOs) accounted for 8.4% of general government tax collection. Revenue redistributed from the central government is the primary funding source for LAOs (Box 1).

Figure 4. General government revenue is broadly in line with regional comparators

Source: Datastream; OECD Revenue Statistics (2017)

Box 1. Working toward effective fiscal decentralisation in Thailand

The government has long sought to empower local municipalities through greater fiscal autonomy and decision-making powers (Mohd Arif et al., 2018). While LAOs levy local taxes and duties, they rely on central government transfers for around 90% of their income.

In 1999, the government introduced laws to guarantee the level of revenue transferred from the central government to LAOs. In 2007, it was mandated that the central government would distribute no less than 25% of net revenues. As a result, the proportion of central government net revenue distributed to LAOs has increased from 13% in 2000 to an estimated 29% for the financial year 2018. Central government revenues are distributed through three types of intergovernmental grants:

(i) *General grants* are allocated to equalise fiscal capacity across LAOs, based on a formula whereby the amount is inversely related to each local jurisdiction's revenue-generating capacity. Local governments enjoy broad discretion concerning their use. Unspent funds at the end of the fiscal year do not have to be returned to the Ministry of Finance.

(ii) *General purposive grants* are allocated on a per-recipient basis to implement government programmes transferred to local authorities under to the National Decentralisation Plan (e.g. school lunch programmes, student achievement programmes, HIV-infected patients' stipends). Unspent funds at the end of the fiscal year do not have to be returned to the Ministry of Finance.

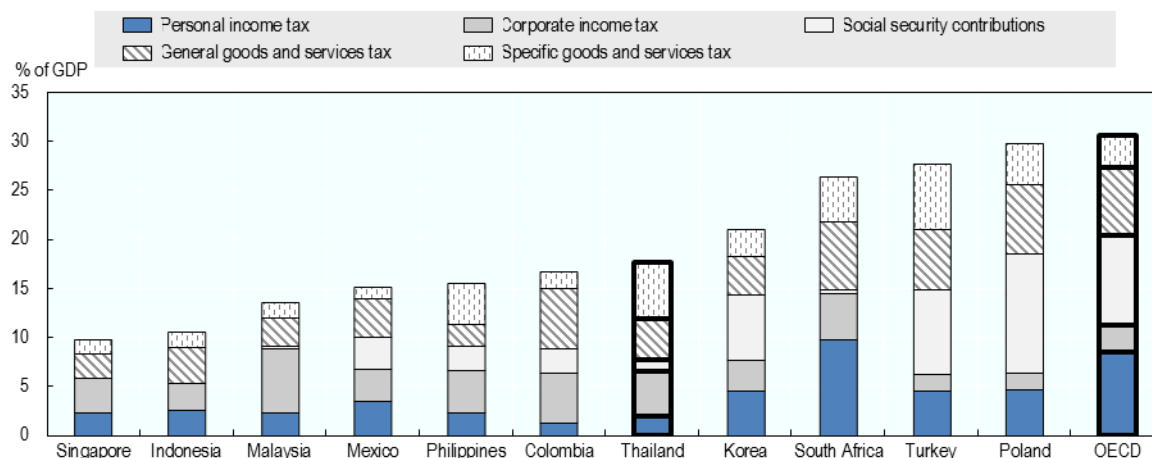
(iii) *Specific grants* are the instrument used to implement the central government's policy agenda at the local level. Allocation is not based on a formula and is determined by the specific aspects of the projects local governments must implement. Unspent funds at the end of the fiscal year must be returned to the Ministry of Finance.

Although the fiscal autonomy of the regions has increased, local experience suggests that further improvements can be made regarding the distribution of funds. For instance, a review of the distribution of general (non-earmarked) grants in Khon Kaen province revealed that grants were made available to local governments with higher revenue-generating capacity and higher per capita income, contrary to the intended purpose of the grant scheme. Instead of promoting horizontal fiscal equalisation, this practice risks fuelling imbalances in fiscal capacity, hampering inclusiveness and government effectiveness across municipalities (Mohd Arif et al., 2018).

As part of the 12th Plan, the government seeks to further improve the capacity of LAOs, by increasing their financial independence over the longer term. To this end, the government aims to increase local revenue streams by providing subsidies to LAOs to undertake local tax reform, undertaking further decentralisation of government taxes, revising laws to increase LAOs' non-tax revenue base and strengthening local fiscal management capacity.

Source: BoB (2017); FPO (2017b); Marks and Lebel (2016); Sudhipongpracha and Wongpredee (2015); and Wongpredee and Sudhipongprac (2014).

Figure 5. Thailand relies more on specific goods and services taxes than most comparator countries



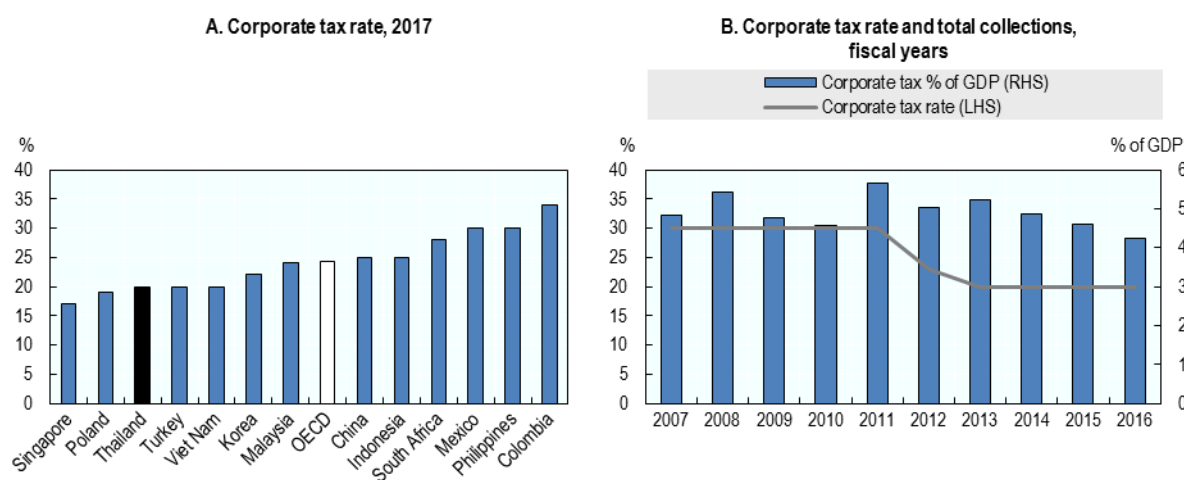
Note: Data for 2014 used for Poland and the OECD average. The figure does not include all sources of tax revenue. It excludes tax collections from international trade and transactions and other taxes.

Source: OECD Revenue statistics database (2017); Thailand Ministry of Finance, Government Finance Statistics (2017).

Direct taxes were cut to boost competitiveness

Between 2011 and 2013, the corporate income tax rate for large firms was cut by one-third to 20%, down to the lower end of the international range, leading to a fall in corporate tax collection (Figure 6). The lower rate applied to small and medium enterprises (SMEs) remained unchanged at 15% over this period. Moving forward, Thailand should avoid further corporate tax cuts and look to other areas to improve competitiveness. Indeed, OECD experience indicates that when institutional efficiency and macroeconomic stability are not in doubt, the corporate tax rate has a limited impact on overall attractiveness as an investment destination (Matthews, 2011).

Figure 6. Thailand’s corporate tax rate is now at the lower end of the international range



Source: KPMG (2017a); Thailand Ministry of Finance, Government Finance Statistics (2017).

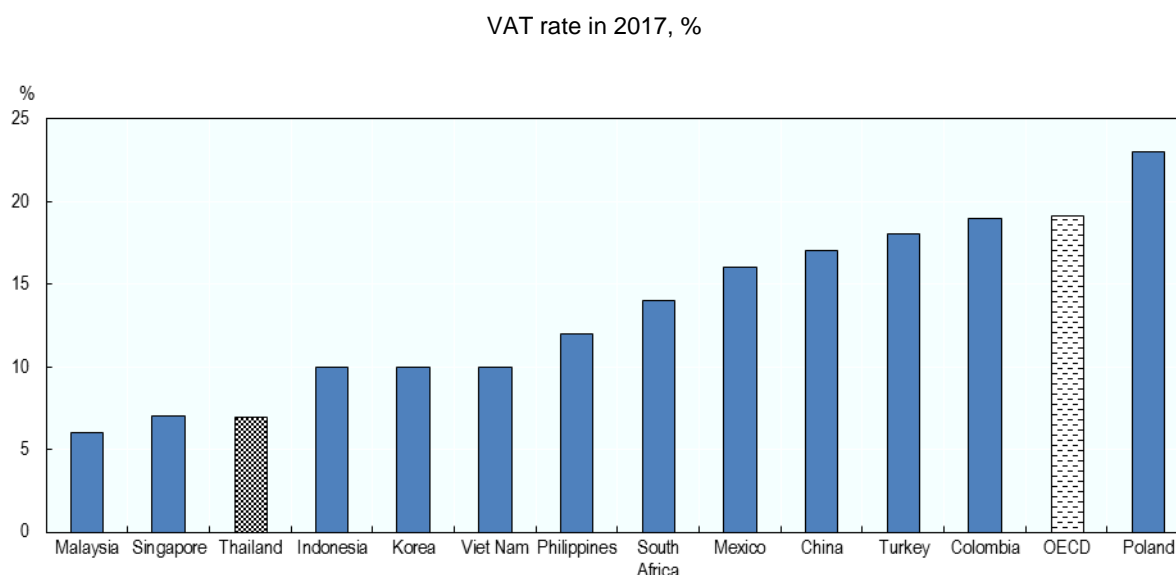
Thailand has also adjusted personal income tax settings, but high labour force informality – estimated at 56% (Fleischer et al., 2018) – combined with a generous tax-free threshold mean that only one-fifth of the working-age population (15-64) pay any income tax. In 2013, the top rate was cut from 37% to 35%, and in 2017, thresholds and deductibles were raised substantially. Personal income tax is levied at a progressive rate ranging between 5% and 35%. It includes a tax-free threshold of up to THB 150 000 (around USD 4 500), only slightly below the average wage of around THB 165 000 per year. Continuing efforts to reduce the high levels of informality are also key to improving revenue collection and ensuring more people benefit from appropriate safeguards under labour laws and are easily identified for social security purposes.

Increasing indirect taxes can raise additional revenue

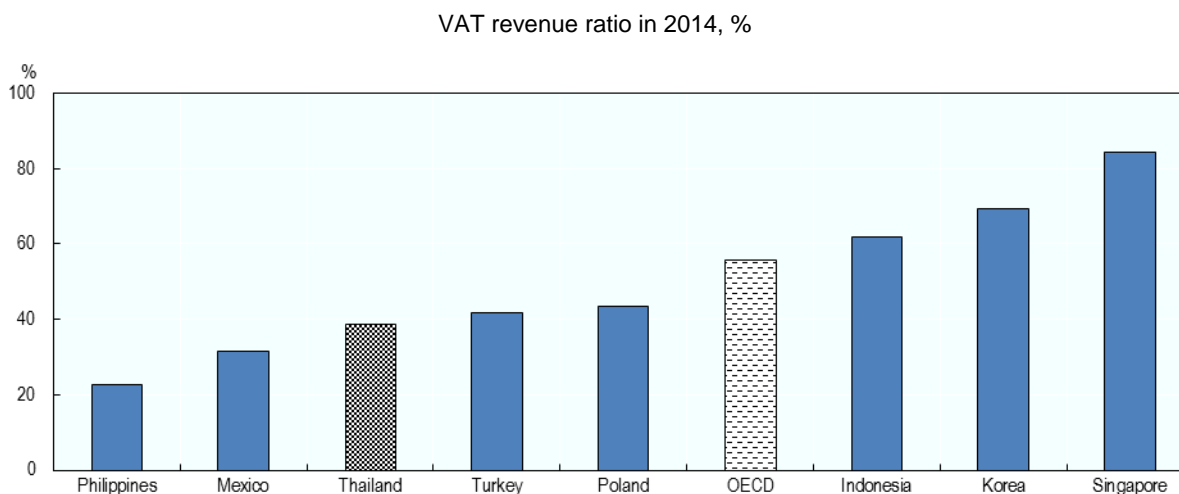
Net VAT collections account for over a third of indirect tax collection. As noted, individual excises are also major contributors, accounting for just under 40% of indirect taxes. Their share has grown substantially in recent years following reforms to reduce fuel subsidies and reinstate excises on diesel, gasoline and oil (intake from oil excises tripled between 2014 and 2016). Such reforms reduce price distortions, rationalise public expenditures and improve environmental outcomes. Thailand is also raising excises on other goods and services deemed harmful including alcohol, tobacco and gambling.

The statutory rate of VAT is 10%, but in practice it has been set at 7% since 1999 through royal decrees, making it one of the lowest rates in the world (Figure 7). Thailand's VAT has a single rate and is relatively simple. However, its contribution to revenue is undermined by non-compliance and a range of exemptions (e.g. businesses with an annual turnover below THB 1.8 million, sales of agricultural products, and transportation, healthcare, educational and cultural services). As a result, the VAT revenue ratio (actual VAT revenues divided by potential revenues, assuming the standard rate applies to all consumption) is only 38%, against a 56% OECD average (Figure 8) (OECD, 2016). Raising the VAT revenue ratio to the OECD average by abolishing VAT exemptions and/or improving compliance would increase revenues by up to 1.5% of GDP.

Figure 7. The VAT rate is low by international standards



Source: KPMG (2017b).

Figure 8. Thailand's VAT revenue ratio remains below some comparator countries

Note: The VAT revenue ratio is defined as the ratio between actual VAT revenue collected on a net basis and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption.

Source: OECD (2016), *Consumption Tax Trends*; OECD (2017c), *Revenue Statistics in Asian Countries: Trends in Indonesia, Japan, Kazakhstan, Korea, Malaysia, the Philippines and Singapore*; and OECD calculations based on data from Thailand Revenue Department.

Thailand should consider gradually broadening the scope of the VAT and raising its rate, using additional revenues to fund increases in targeted social protection to ensure that the most vulnerable remain supported. Indeed, recent analysis suggests that increasing the VAT rate by one percentage point could yield as much as 0.6% of GDP in additional revenue, although around a quarter thereof would be required to compensate for the ensuing consumption loss borne by the bottom quintile (IMF, 2017).

Thailand is introducing other forms of taxation that should, over time, increase progressivity and the revenue base. In 2016, Thailand instituted an inheritance tax that requires inheritors of assets valued over THB 100 million (around USD 3 million) to pay a tax of 5% for lineal descendants or 10% for others (RD, 2015). In addition, a draft Land and Building Tax Act, if passed, will apply progressive taxation to unused properties, first properties over THB 50 million and additional properties over THB 5 million. It also includes provisions that allow local authorities to raise immovable property taxes, encouraging further policy and fiscal decentralisation. However, in its current form, it is estimated that the land and immovable property tax will collect less than 1% of total tax revenue. Only around 100 residencies worth more than THB 50 million are sold each year and it is estimated that only 10% of homeowners who own more than one house or own houses valued above THB 50 million will actually be taxed (World Bank, 2017a). Moreover, exemptions provided to state-owned enterprises will also undermine collections. Even so, the Act has received intense public criticism, resulting in a review by the Thai legislature.

Although property and inheritance taxes are politically difficult and currently raise scant revenue, if broadened, they can be a good source of revenue in the future. Property taxes of this type tend to be less distortive and can be progressive. Due to the fixed nature of immovable property and the certainty of death, immovable property and inheritance taxes are less conducive to behavioural change and distortions than many other taxes that rest on more elastic bases such as labour or financial capital (OECD, 2012b).

Boosting taxation efficiency and compliance can yield revenue gains

Increasing the efficiency of the tax system and inducing people to operate in the formal economy would also help increase revenue. In relation to VAT alone, the Revenue Department estimates that tax collections are currently 15% lower than they would be under full compliance with the law. Addressing compliance and efficiency is a priority of the government in its efforts to boost tax collection towards 20% of GDP by 2020. To achieve this, the government is adopting a multipronged approach that consists of improving ease of compliance through technological innovation, providing financial incentives to stimulate tax compliance and strengthening tax enforcement.

Thailand aims to improve the ease and efficiency of the tax system by increasing the electronic processing of all tax filings, refunds and social transfers. To facilitate this, the government is amending regulations to enable the electronic submission of tax documents. Meanwhile, the government has already launched the RD Smart Tax application, an online service for personal income tax, with the aim of having all tax returns filed electronically by 2020 (RD, 2014). The VAT system has also already been modernised to enable e-tax invoices and e-receipts to replace paper documents (MoF, 2017).

The government is also providing incentives to induce tax compliance. Prior to 2016, SMEs often kept multiple sets of accounts for different purposes including paying taxes, applying for loans and for internal business purposes. In 2015, the government introduced a single account. If SMEs consolidated their accounts and provided accurate financial statements to the Revenue Department, they received a full company tax exemption in 2016, and SMEs with a net profit greater than THB 300 000 were taxed at a discounted rate of 10% in 2017. Participating SMEs also received immunity from the Revenue Department and were not subject to tax audits for previous unpaid back taxes. In 2016, around 465 000 SMEs registered, far exceeding the government's initial expectation of around 100 000. As a result, more accurate reporting of business sales is already contributing to an increase in VAT collection. To support the plan, the government offered free and easy-to-use accounting software for SMEs that is compatible with smartphones, tablets and PCs. The software helps SMEs develop budgets and record and process accounting transactions. SMEs can also submit their electronic financial reports to the Department of Business Development via the software.

To reduce informality, the government has also encouraged small businesses to incorporate. Those who registered before the end of 2017 are eligible for exemptions for real estate transfers and double deductions for all registration fees including accounting and auditing fees. Moreover, fees for the transfer of registration of immovable property and condominiums were cut from 2% to 0.01% (RD, 2016).

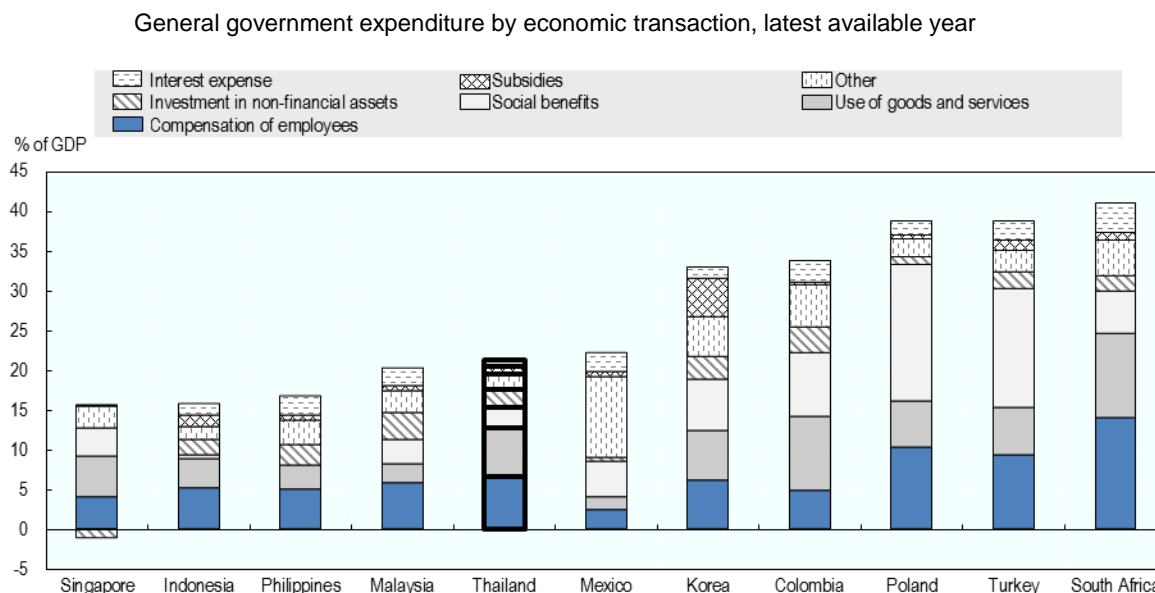
Thailand is also strengthening some enforcement procedures. Through back-office investment in digital infrastructure, the government is seeking to enhance communication between agencies to better identify fraudulent cases. Moreover, from January 2019, commercial banks will only be allowed to provide credit to SMEs on the basis of the single account submitted and accepted by the Revenue Department. This means that should SMEs under-report revenue to the government, they will undermine their access to credit (Suteerapongpun, 2016). Thailand is also working to address issues of international tax avoidance. In 2017, Thailand joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS). Thailand will collaborate with other countries and implement the OECD/G20 BEPS package (OECD, 2017b).

Government outlays will need to rise to foster development

At around 21% of GDP, general government expenditure is similar to regional comparator countries (Figure 9). However, it is expected to increase in line with growing infrastructure requirements and expanded social welfare outlays associated with an ageing population. Ensuring Thailand maintains prudent expenditure practices will be important, including by undertaking cost-benefit analysis where

appropriate and giving consideration to institutional capacity to spend efficiently. Moreover, it is crucial that budget allocation aligns with the priorities identified in the National Economic and Social Development Plan.

Figure 9. General government expenditure is similar to regional comparators



Note: Other categories include consumption of fixed capital, grants expenses and other expenses. Data for Malaysia, Mexico and the Philippines refer to central government expenditure.

Source: IMF Government Finance Statistics (2017).

More efficient infrastructure financing

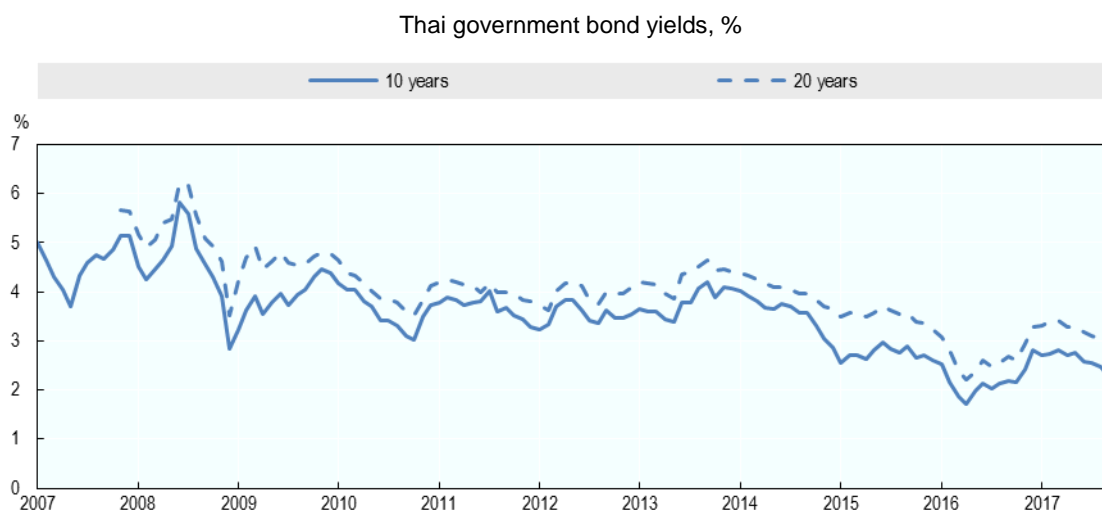
To boost the productive capacity of the economy and foster inclusive and sustainable growth, the government is undertaking an ambitious infrastructure investment programme, spearheaded by the Eastern Economic Corridor (Koen et al., 2018). However, to ensure value for money and optimal risk allocation, consideration needs to be given to the best means of financing the investment.

To date, there has been limited use of securities financing for infrastructure projects. As a result, project financing has ended up being more expensive than necessary. Thailand is seeking to make greater use of diversified funding sources, notably through the establishment of a Thai Future Fund, but has had limited success so far. This has affected the disbursement schedule and commencement of projects. For instance, the planned Thai Future Fund, first announced in 2015, seeks to raise THB 100 billion (around USD 3 billion) with the initial aim of financing several tolled road expressway projects, which are deemed commercially viable with the potential for high returns. However, its launch as an initial public offering has been delayed due to concerns over issuance and servicing costs. This continued uncertainty tends to delay further investment decisions.

Moving forward, additional sources of financing for infrastructure could be considered, in particular infrastructure bonds priced in Thai baht that can be less costly than bank financing and better match the long-term nature of such investments. Such bonds have long been used in neighbouring Malaysia and Indonesia, both in the form of conventional and Islamic securities, to finance road, airport, mass rail and seaport projects over the past two decades. This has also helped Malaysia develop a vibrant and sizable

private domestic debt securities market. The current low yields on Thai government debt (Figure 10) make infrastructure bonds particularly attractive.

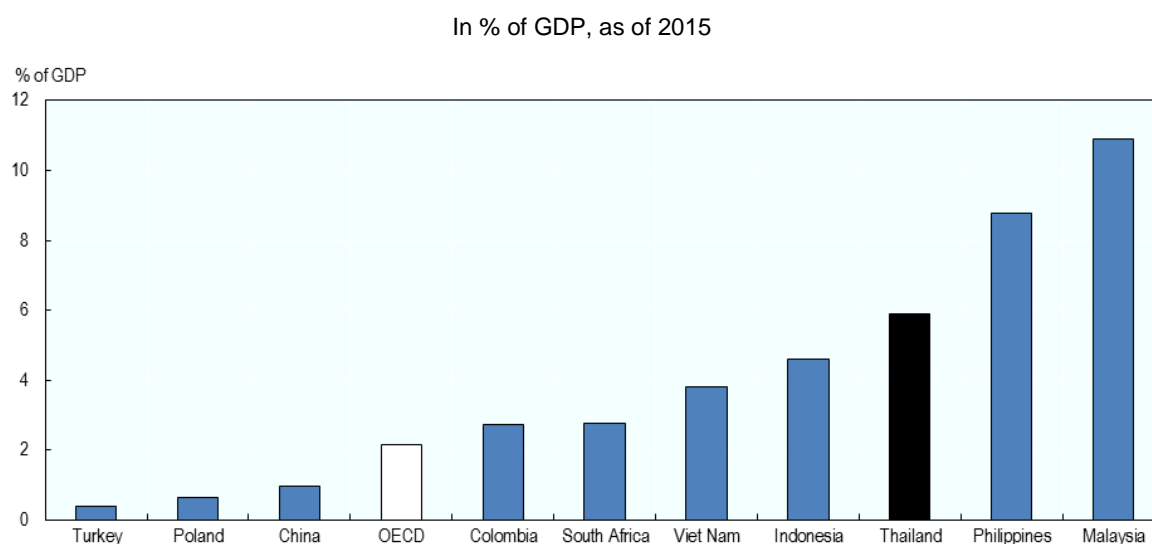
Figure 10. Thailand should take advantage of low yields to step up infrastructure investment



Source: Bank of Thailand and Asian Development Bank.

Another way forward is the broader use of public-private partnerships (PPPs) – a useful tool to boost private participation in infrastructure investment, delivery and management. Thailand has longstanding experience in this area, having established many large PPPs in the 1980s and 1990s, as reflected in the high ratio of the PPP capital stock to GDP (5.9% in 2015), which is more than twice the OECD average (Figure 11). However, success on this front has been limited in subsequent years.

Figure 11. Public-private partnership capital stock

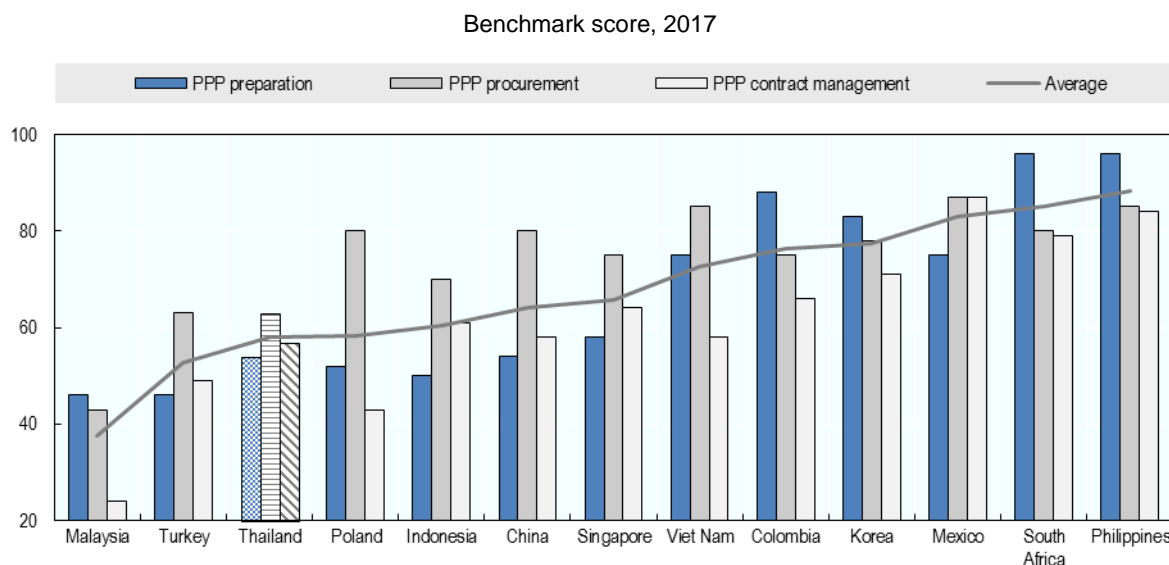


Source: IMF, Investment and capital stock dataset, January 2017, www.imf.org/external/np/fad/publicinvestment/#5.

In an effort to reinvigorate PPPs, the government has sought to reduce red tape and improve bureaucratic efficiency, reforming PPP legislation in 2013 with the introduction of time limits and standardised contracts. Moreover, the Cabinet issued a resolution in 2015 approving a means to fast-track

PPPs that expedites the project introduction phase from two years to nine months. The new legislation also requires governments to establish five-year strategic plans, with the current plan (2015-19) prioritising investment in the transport sector (Chittmitrapap and Thammavaranucupt, 2017). The plan foresees total investment of THB 1.41 trillion (i.e. over 10% of 2015 GDP) (SEPO, 2015). However, it remains to be seen whether this target will be met without further institutional improvements. Indeed, Thailand's assessed capability to prepare, procure and manage contracts remains below most comparator countries (Figure 12).

Figure 12. Thailand can improve the preparation, procurement and management of PPPs



Note: The higher the score, the more aligned with international best practice. Scores for unsolicited proposals are not considered in the above analysis as Thailand, Malaysia, Turkey, Poland and Singapore do not have any regulatory procedures.

Source: World Bank Group/PPIAF (2017), *Benchmarking Public-Private Partnerships Procurement 2017*.

Thailand should seek to make greater use of PPPs as urbanisation and infrastructure demands grow. However, it will be critical to put in place processes that ensure risks are allocated fairly and public liabilities are minimised. Further reform would help, especially to promote alignment with the OECD's Principles for Public Governance of Public-Private Partnerships (OECD, 2012a). In particular, there is a need for: (i) clear mandates and sufficient resources among key institutions engaged in PPP projects, prudent procurement and clear lines of accountability; (ii) sufficient market competition realised through a competitive tender process.

More sustainable healthcare and pension systems

With a rapidly ageing population and rising standards, the burden on public finances to provide healthcare and pensions will continue to grow. Healthcare and pensions are mostly financed by tax revenue, so the reform options outlined above to broaden and increase the tax revenue base will help fund these needs. At the same time, OECD experience shows that well-designed health and pension policies can deliver cost containment and efficiency gains (OECD, 2015a). The effectiveness and coverage of Thailand's healthcare and pension systems are assessed in Fleischer et al. (2018).

Paying for universal healthcare

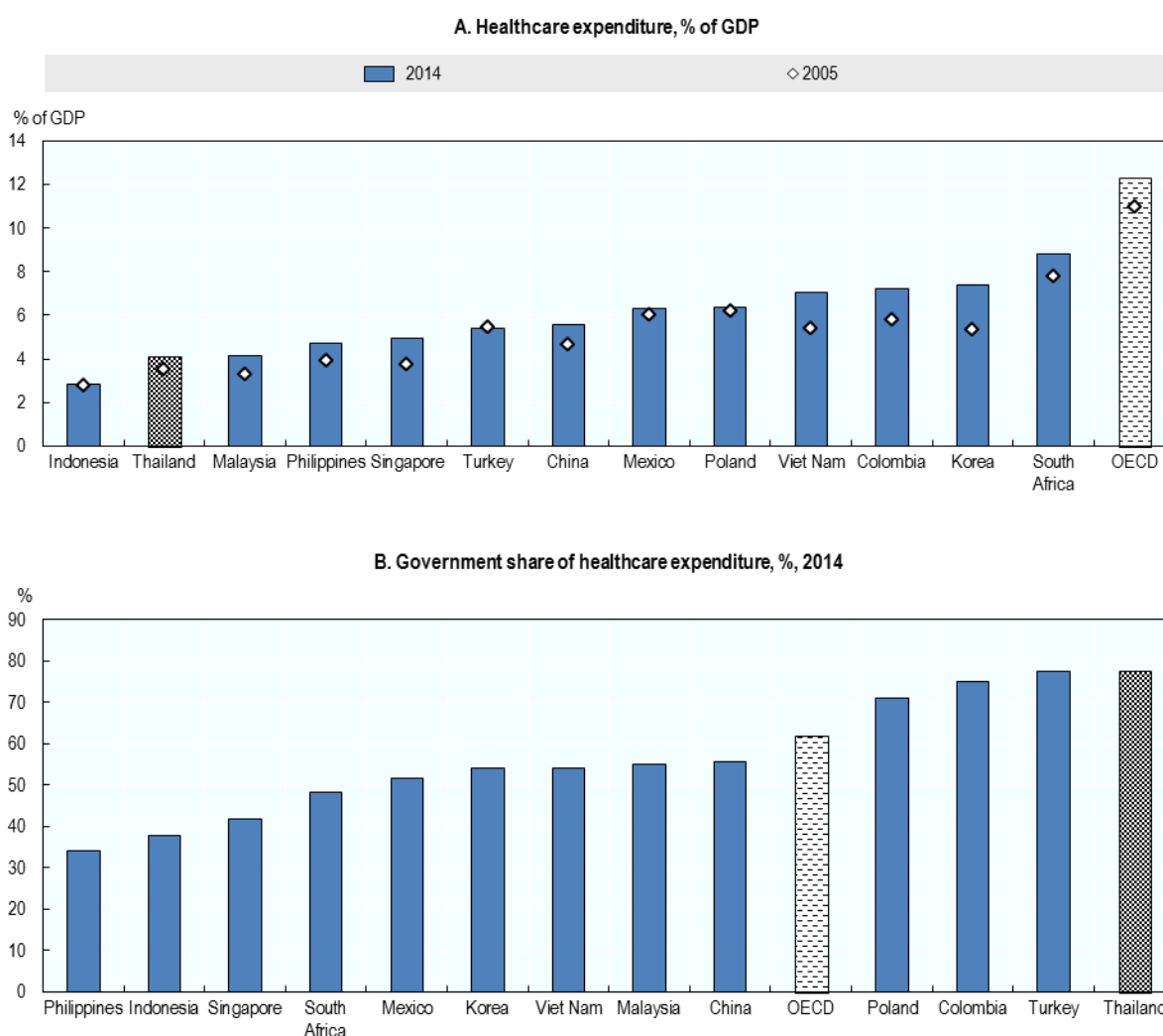
In 2002, the government launched the public Universal Coverage Scheme (UCS), which provides free healthcare for previously uninsured people. As a result, Thailand achieved universal health coverage,

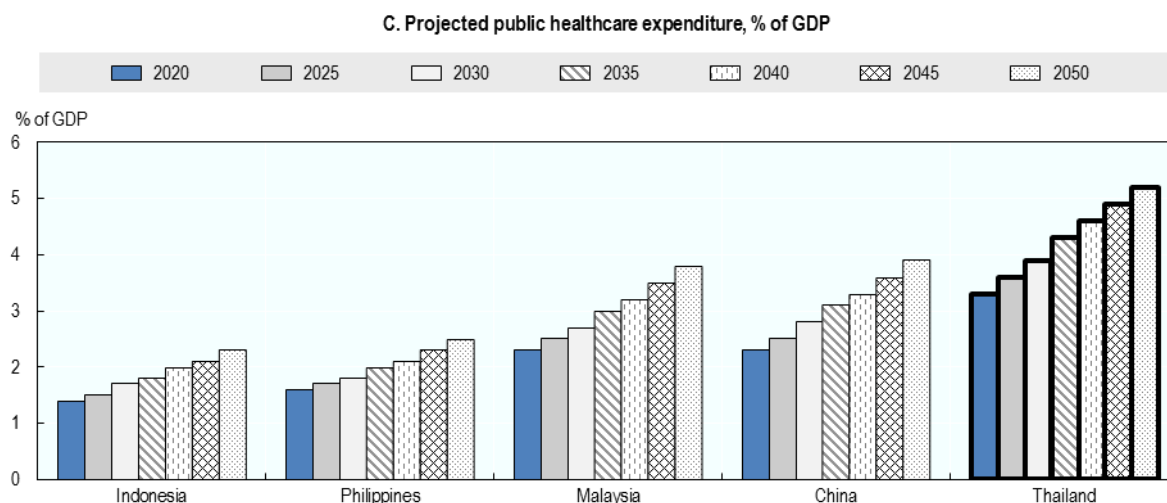
considerably boosting health outcomes. The UCS led to a significant decline in out-of-pocket expenditure and the rich–poor gap in out-of-pocket expenditure was eliminated (HISRO, 2012).

Total healthcare expenditure has grown from 3.3% of GDP in 2001 to 4.1% in 2014, but remains low. Among comparator countries, only Indonesia spends less (Figure 13A). However, as the UCS covers around three-quarters of the population and is entirely government funded (Fleischer et al., 2018), the share of public expenditure has increased more dramatically, from 56% in 2001 to 78% in 2014, above all comparator countries and the OECD average (Figure 13B). Government outlays on health thus rose from 1.9% to 3.2% of GDP over the same period.

Although healthcare costs are relatively low, they are bound to rise in line with a rapidly ageing population, and public finances will bear the brunt of the increase. According to one estimate, public healthcare costs are set to increase to over 5% of GDP over the next 30 years (Figure 13C). While this is below most OECD countries, it exceeds the costs of comparable economies within the region. Given Thailand's sound fiscal position, it can and should avoid near-term regressive and often ineffective blanket cuts to the health budget and, instead, implement targeted supply-side measures to yield efficiency gains (Fleischer et al., 2018) and financing reforms that improve affordability.

Figure 13. Healthcare expenditure is bound to grow





Source: World Bank (2017), World Development Indicators (database); Clements, Coady and Gupta, (2012), *The Economics of Public Health Care Reform in Advanced and Emerging Economies*.

Efforts to reform the financing of Thailand's healthcare system by introducing greater private contributions, for those able to afford them, can also improve sustainability. In 2006, the mandatory co-payment under the UCS was abandoned, raising the government's financial burden. In 2012, the government reintroduced the co-payment, but with exemptions for a range of different groups. Around 80% of UCS members continued to receive free services, even as high degrees of non-compliance undermined collections from those required to pay (Feige and Tiavongsuvon, 2015; Paek et al., 2016). One option is to streamline exemptions by better targeting those most in need, while improving the enforcement of co-payments for those required to pay. In addition, the co-payment amount could be linked to income.

The publicly funded Civil Servant Medical Benefit Scheme, which covers around 9% of the population, also needs reform. Unlike the UCS, it pays healthcare providers on a retrospective fee-for-service basis. This provides adverse incentives and contributes to cost inflation, notably through overuse of diagnostics and non-essential drugs (HISRO, 2012). Thailand could consider moving the scheme towards the UCS close-ended capitation model, whereby medical practitioners receive a fixed per person payment to cover all healthcare services. The payment is then adjusted depending on the patient's expected needs.

Greater participation in private health insurance can also serve to address rising healthcare costs. Uptake of private health insurance in Thailand is low and has not materially increased over the past decade despite an increase in real incomes (APO, 2015). As such, it covers only a modest share of overall healthcare costs. Given the small share of people paying personal income tax, the tax relief provided to encourage uptake of private healthcare has had limited success.

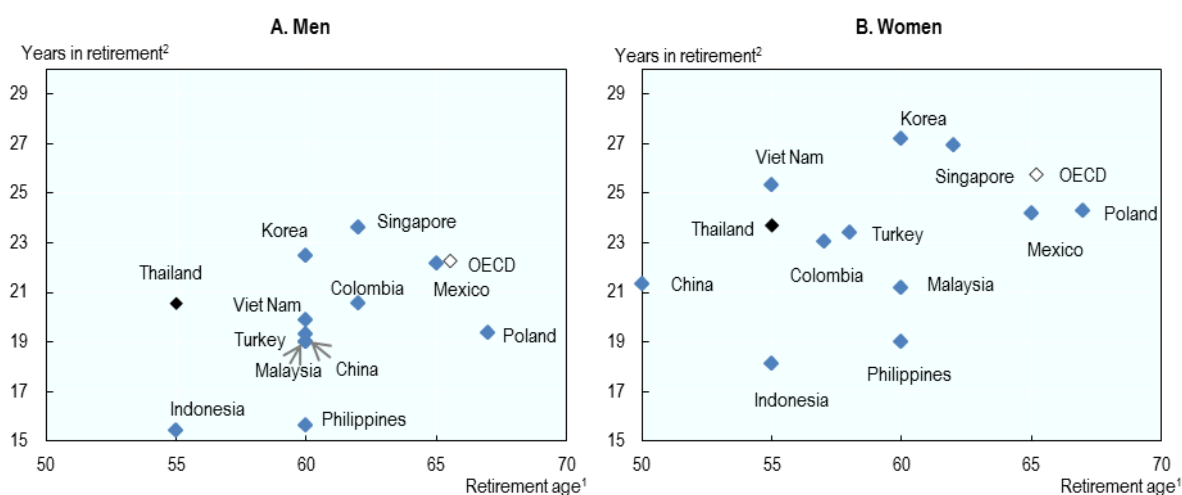
Reforming the pension system to ensure sustainability

As outlined in Fleischer et al. (2018), Thailand has a fragmented pension system with low replacement rates, particularly for non-government employees and informal workers. In 2015, Thailand's pension expenditure accounted for 2.2% of GDP, lower than comparator countries in the region including Viet Nam (2.5%), the Philippines (2.9%), Malaysia (3.8%) and China (3.6%). Although Thailand spends less than comparator countries, its future liability is likely to grow faster, particularly if the government seeks to increase the very low replacement ratios for social pension recipients. Therefore, in addition to the tax reforms suggested above, complementary reforms to the pension system are called for to ensure fiscal sustainability.

Thailand is already facing a shrinking labour force. The total number of working years is being squeezed as more people spend time obtaining a higher education before entering the workforce (Fleischer et al., 2018). Thai people are also living longer and spending more years in retirement than most countries in the region (Figure 14). As a result, there are fewer work years available to support the burgeoning number of retirees. Moreover, with declining family sizes adult children will shoulder greater financial and caregiving responsibility. Although the universal old-age allowance provides financial support, almost 80% of older persons still receive income from their children and 37% of elderly rely on this as their primary source of income (Knodel et al., 2015).

OECD research suggests that postponing retirement is an efficient way to both boost retirement income and improve the financial sustainability of the system (OECD, 2017a). Thailand's private pension scheme (which covers 30% of the population) has a pensionable age of 55, while Thailand's public sector scheme (covering 6% of the population) and old-age allowance (covering the informal workforce and about 64% of the population) both have a pensionable age of 60 (Fleischer et al. (2018) discusses coverage adequacy). This is below many regional comparators and the OECD average. As a first step, Thailand should align the pensionable age of the private pension scheme with the public sector and the social pension scheme, and put in place transitional arrangements for current or imminent retirees. Moreover, the government should consider progressively raising the official retirement age in line with life expectancy.

Figure 14. Thai citizens can expect a lengthy retirement



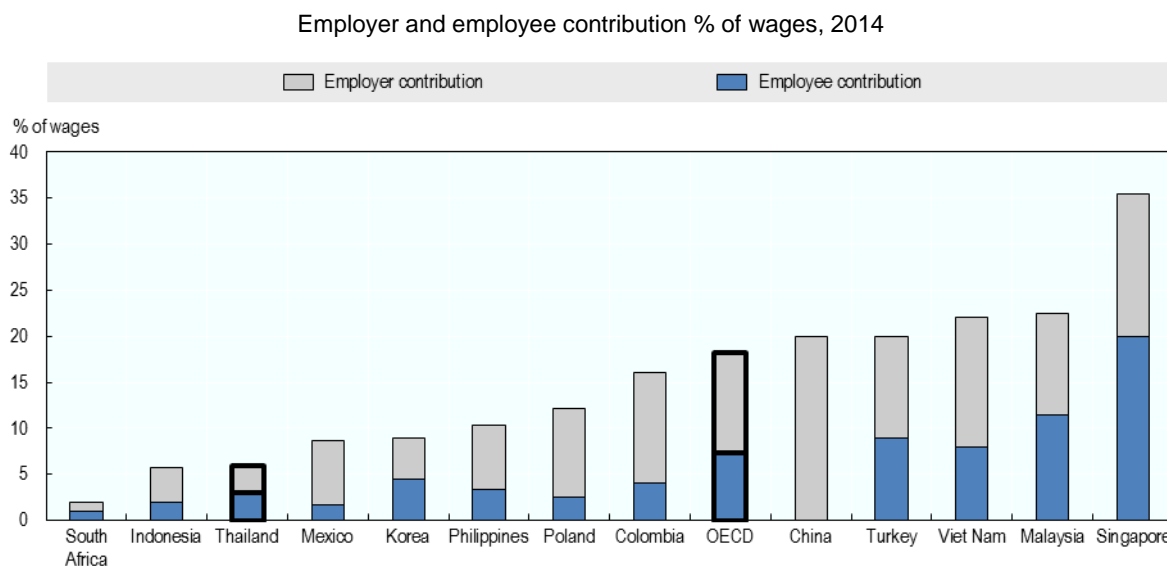
1. The age at which a man/woman can retire and receive full benefits.

2. Gap between the retirement age and life expectancy at age 60 (2015-20). The retirement age for Thailand refers to the private pension scheme, given the very low replacement rates under the old-age allowance (Fleischer et al., 2018). The retirement age for Chinese women refers to those in blue-collar jobs. The retirement age for Chinese women in white-collar jobs is 55.

Source: World Bank, Women, Business and Law (database); UN Population projections, 2017 revision.

Thailand should also gradually increase the mandated private sector contribution rate (i.e. the share of wages mandatorily contributed to a pension fund). Under the national private pension fund, employers and employees combined contribute 6% of wages. This is below the contribution rates for comparator countries and the OECD average (Figure 15). In this regard, the government is considering a proposal to phase in increased contribution rates. Businesses with over 100 employees would have to match mandated employee contribution rates, starting from 3% of wages (capped at THB 1 800 per month) in the first year to 10% by the tenth year (capped at THB 60 000 per month). The scheme would be expanded to smaller businesses within five years (TBS, 2017).

Figure 15. Thailand can boost mandatory contributions to pensions



Note: South Africa includes contributions for all social spending. In China, the employer contribution rate is 20% for the basic pension, but in the case of the Provident Fund the contribution rates vary by province. The OECD average only includes countries that have isolated contribution rates for pensions and excludes countries that have larger contribution rates for broader social security measures.

Source: OECD calculation based on World Bank Pension Data; and OECD (2015b), *Pensions at a Glance*.

The government is also seeking to boost retirement savings for the informal workforce through the launch of the National Savings Fund (NSF) in 2015, and by providing grants under Section 40 of the Social Security Fund (Fleischer et al., 2018). The NSF provides a matching grant of 50% for people aged under 30, 80% for people aged between 30 and 50, and 100% for those aged over 50, capped at THB 100 per month. Although uptake for both schemes remains relatively low, they should remain in place, but perhaps be adjusted administratively or financially to encourage participation. Indeed, OECD experience indicates that matching contributions are generally much more progressive and effective than tax incentives for workers on low-to-median incomes (OECD, 2013a).

Although relatively small in headcount coverage, civil servant pensions account for half of total public pension expenditure. In civil service defined-benefit schemes, final wages determine the size of the pension. This design can lead to undesirable effects and is not in line with best practice, as higher-paid workers tend to have earnings that rise more rapidly with age, while wage-earnings profiles for lower-paid workers tend to be flat. Such final salary plans therefore result in redistribution from low to high earners (OECD, 2013b). Thailand could consider transitioning to a scheme based on average lifetime earnings, as is the case in Viet Nam.

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