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An Analysis of Public Finances in Thailand from an Equity Perspective

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Abstract

Despite chronic inequalities, successive governments in Thailand have maintained a conservative fiscal stance. Revenue mobilisation efforts have been circumscribed by efforts aimed at attracting foreign capital for export promotion and financial sector expansion. On the expenditure side, capital spending remains abysmally low, reflecting Thailand's continued inability to create domestic productive and infrastructural capacities that will help reduce its external dependence. Social expenditure policies under Thaksin Shinawatra led to a break from past trends. However, the economy was still starved of investments which would complement the beneficial impact of the income support measures. Although transfers to local governments have been significant recently, they have not been utilised for improving income inequalities through increased local expenditure.

JEL Classification
H 200; H 500; H 700

Key Words
Thailand, fiscal policy, public finances, inequality, taxation, revenue, government expenditure, social policy, income tax, exemptions, financial liberalisation, decentralisation

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An Analysis of Public Finances in Thailand from an Equity Perspective*

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I. Introduction

Thailand – a country with a unitary form of government – was among the fastest growing economies in the world until the 1997 financial crisis. It is credited with having achieved a large reduction in income poverty. Poverty incidence declined sharply from 33.7 per cent in 1990 to 14.8 per cent in 1996. Although it rose to nearly 21 per cent in 2000[1] in the aftermath of the 1997 financial crisis, poverty incidence declined again to 11 per cent in 2004. By the early 2000s, Thailand had already reached its Millennium Development Goal (MDG) poverty target of halving the poverty headcount ratio between 1990 and 2015. The poverty ratio stood at 8.95 per cent of the population in 2008 (MDG Report, 2009).

This picture of a sound economy with a successful poverty reduction performance is marred by the record of chronic social and economic inequalities troubling the social fabric of the country. Thailand's Gini coefficient has persistently remained very high among the Southeast Asian economies. In fact, it increased marginally from 0.49 in 1988 to 0.51 in 1996, making Thailand one of the more unequal societies in Asia even during its period of rapid growth. Inequalities have continued to rise, with the result that the richest Thais earned 14.7 times more than the poorest in 2007. The bottom 60 per cent of the population's share of the income was only 25 per cent (Thailand Human Development Report, 2009).

There are large inter-regional variations in poverty incidence within the country. In 2008, while national poverty incidence was about 3 per cent and 4 per cent respectively in the central and southern regions, it was more than 14 per cent in the northeast and 13 per cent in the north. In the deep southern provinces also, poverty incidence was almost double the national average. In general, the poor in Thailand have been increasingly concentrated in rural areas. In 2008, 90 per cent of Thailand's 5.2 million poor resided in the rural areas. Poverty incidence is also the highest among the elderly and children. The deep inter-regional inequalities have been starkly exposed by the socio-political divide and unrest in the country in recent years.

Clearly the gains from economic growth have not been distributed broadly within the society. Questions had been raised by several analysts inside and outside the country since the early-1990s as to whether government policies primarily oriented towards high GDP growth have contributed to wide inequalities in household incomes and in access to public services, leading to the observed pattern of chronic economic and social disparities.

Against this backdrop, this paper attempts to analyse the role played by Thailand's public finance policies in poverty reduction and income inequalities by linking governments' resource mobilisation strategies and expenditure policies to the observed poverty and distributional outcomes. Following this introductory section, Section 2 reviews the country's economic growth experience and the evolution of its macroeconomic policies briefly to understand the nature of its overall fiscal stance. In order to understand how this fiscal stance has impacted income inequalities, Section 3 analyses government revenue and changes in revenue mobilisation policies in detail. Section 4 examines how government expenditure policies have impacted the observed socioeconomic inequalities. The increased role played by transfers to local governments and its implications are also analysed here. Section 5 concludes by highlighting the main findings of the study and making some policy suggestions.

II. Macroeconomic Backdrop and Fiscal Stance

II.1 The Pre-1990 Decades

In Thailand, the five year development plans by the National Economic and Social Development Board (NESDB) provide the overall policy guidelines. However, the other central agencies, namely, the Bank of Thailand, the Bureau of the Budget and the Fiscal Policy Office have played the dominant roles in policy making, focused on conservative macroeconomic management.[2] It should be remembered that by the mid-1950s, the confluence in the interests of various domestic and external players and dissatisfaction with state-led growth[3] had led to a major shift in the country's economic policy orientation away from government ownership and control of industrial enterprises towards economic growth led by private enterprise and exports. Planning has been directed mainly towards securing a smooth functioning of markets, and government activities were restricted to building infrastructure for facilitating and supporting production activities. Thus throughout the sixties and seventies, fiscal and monetary policies remained conservative.

When we consider data from 1960 onwards, both government revenue and expenditure were relatively low in Thailand as a proportion to GDP. While the revenue-GDP ratio hovered in the 12-14 per cent range until the early-1980s (except for 1966 and during 1969-70), the expenditure-GDP ratio also hovered only slightly above the revenue ratio until the mid-1960s.[4] Thus even though deficits were the norm for government budget balance during the period 1950-1987 (except for three years – 1961, 1962 and 1975), budget deficits averaged below 2 per cent of GDP during this period.

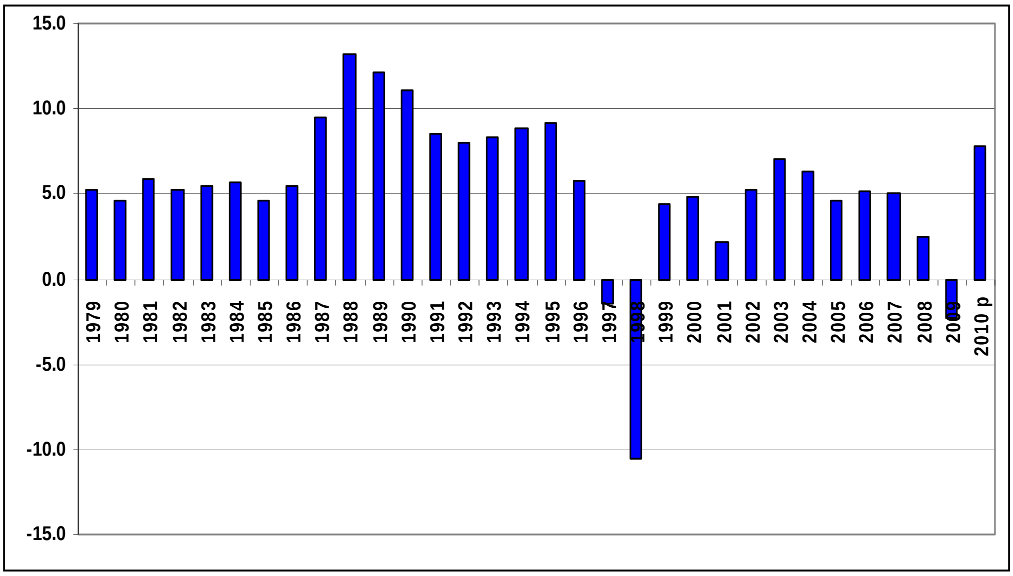
But there was an overall, though gradual, upward trend in the expenditure-GDP ratio from the mid-1960s, which reflected large-scale public expenditure made possible through massive inflows of foreign grant aid and institutional loans during these years.[5] Expenditure-GDP ratio reached just below 18 per cent coinciding with the first oil price shock in 1971.

Agricultural sector benefited the most from this infrastructure build-up, especially through transport in previously inaccessible cultivable areas in the countryside. Economic growth during this period was driven by the growth in agricultural exports that was thus achieved. However, the fact that there was little emphasis on land or income redistribution to help disadvantaged groups[6] had implications for the subsequent pattern of inequality. Meanwhile, agricultural exports, particularly rice, were taxed to keep the price of staple food low, which kept the urban cost of living under control to support industrialisation. In this phase, industrialisation was primarily oriented towards the domestic market.

The dependence on external resources rather than domestic revenue mobilisation meant that when there was a decline in aid flows during the early 1970s[7], the military resorted to huge external borrowings from foreign commercial banks. External debt as a percentage of GDP grew from virtually zero in 1973 to 21 per cent in 1980. Following the second oil price shock of 1979-80, high interest rates, declining terms of trade and declining growth of export volumes resulted in the economy lurching towards a balance of payments crisis, as debt service on the private and public sector foreign loans incurred since 1975 increased significantly. The expenditure-GDP ratio increased to more than 18 per cent in the early 1980s as a consequence.

Chart 1: Real GDP Growth (at 1988 prices)

(Percentage)



Source: Bank of Thailand

The deterioration in the balance of payments (BoP) during 1979-80 pushed Thailand to turn to World Bank loans under its structural adjustment programs, which led to major institutional and policy reforms designed to reorient the economy towards manufactured exports. The focus was on restoring macroeconomic stability at all cost, through a sharp fiscal contraction involving cuts in public expenditure, a strict monetary policy to control credit expansion, along with exchange rate and tariff reforms, etc. The government effected a major devaluation of the baht, subsequent to which the baht was tied to a basket of currencies instead of the US dollar alone.

Due to the combined effects of devaluation, the yen adjustment under the 1985 international currency realignments and the relocation of investments from Japan and the newly industrialised countries of Singapore, Hong Kong, South Korea and Taiwan (NICs) through foreign direct investment (FDI), Thailand became a base for assembly-based manufactured exports based on low wage labour. It became a manufacturing base for US and EU multinational companies too. The dramatic improvement in general economic conditions in the latter half of the 1980s was also owing to a combination of several external factors such as the decline in oil prices, reduction in international interest rates (that brought in foreign capital inflows) and recovery in export commodity prices. Under the combined effect of all these factors, Thailand achieved rapid economic growth until the 1997-98 financial crisis (see Chart 1).

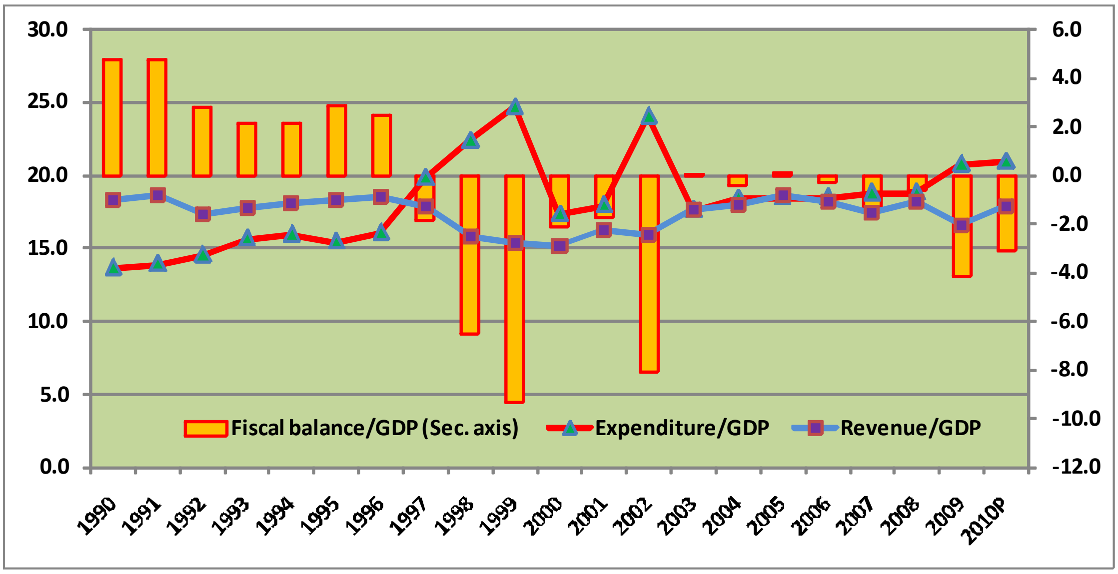
Along with economic growth, the ratio of revenue to GDP increased to 18 per cent. Thus the fiscal deficit that had reached a peak of 5 per cent of GDP in 1984 was transformed into a surplus equivalent to 1.3 per cent of GDP in 1988 and as high as 4.7 per cent in 1990 (See Chart 2).

II.2 The Period of Rapid Growth and the Crisis Years

However, the unexpected economic boom of the late eighties created major infrastructure bottlenecks. These aggravated rapidly as the private sector got into an expansive mood with the continued policy emphasis on export-oriented manufacturing. At the same time, a shortage of skilled labour emerged and the country was finding it difficult to move up from low skill, assembly-based activities based on relocative FDI to medium- and high-technology intensive activities. But despite some infrastructural investments undertaken by the government related to urban infrastructure, increased government spending on the required scale did not happen.

Chart 2: Revenue and Expenditure Ratios and Fiscal Balance in Thailand, 1990-2010

(Percentage of GDP)



Note: Fiscal balance is calculated as Revenue - (Expense + Net acquisition of non-financial assets)

Source: Based on GFS data from the Fiscal Policy Office (FPO).

Thus during 1990-96 when the economy enjoyed a real average growth rate of nearly 8 per cent, average government expenditure constituted only about 15 per cent of GDP (see Table 1). As a result, the economy ran continuous budget surpluses during a period of sustained growth, until the 1997 financial crisis (Chart 2).

On the other hand, against the backdrop of a drop in FDI inflows after 1990 due to increased competition for FDI from China, Mexico (with the coming into force of NAFTA), and to a lesser extent from another catching-up economy, Vietnam, the rapid growth generated immense pressures for financial liberalisation, to continue attracting foreign capital to fund the huge investment needed for both infrastructural projects and the planned manufacturing sector expansion. The Bank of Thailand's financial liberalisation package in the early 1990s included capital account convertibility, stock market reforms, and the creation of an offshore banking facility to facilitate foreign borrowing.

Coming at a time of excess liquidity in advanced economies and enthusiasm for "emerging markets" and an "Asian miracle",[8] this liberalisation led to huge capital inflows during 1990-96. Following the debt crisis of the early 1980s, foreign borrowing in the public sector, which was the largest component of Thailand's net capital flows in the first half of the 1980s, had been contained by putting caps in place. But financial liberalisation in the first half of the nineties led to: (i) a ballooning of the external debt held by the private sector in both banking and non-banking sectors (especially short-term debt); (ii) appreciation of the baht that undermined export performance after 1995; and (iii) crowding of foreign savings and speculative investments leading to asset price inflation mainly involving real estate and share prices. While export growth declined to zero in 1996, imports continued to grow – encouraged by an appreciating baht – leading to current account deficits of around 8 per cent of GDP in both 1995 and 1996. The latter, in turn, led to speculative attacks on the baht and culminated in the crisis.[9]

Meanwhile, even as FDI in the manufacturing sector became more entrenched under the export-oriented policies since the late eighties, deregulation and privatisation policies since the late eighties led to the increased participation of foreign companies in various service sector activities too.[10] The nineties also saw the privatisation of public enterprises such as the State Railways of Thailand and the Telephone Authority of Thailand (TOT).

Once the crisis hit and the government was forced to float the baht in July 1997, IMF assistance was sought, which came with an ill-suited policy conditionality package for a crisis that was not caused by public sector debt. The IMF insisted that the government impose no restrictions on capital flight and guarantee the debts of foreign financial institutions. With the exchange rate dropping to about half of its previous value, the baht value of foreign loans rose steeply, wrecking the balance sheets of the majority of the big firms that had accumulated dollar-denominated loans. The IMF's deflationary package raised domestic interest rates above 20 per cent, adding to the costs of financing.[11] With many firms collapsing under the pressures of the depreciation, high interest rates and plummeting business activity, government revenue declined significantly during the crisis and post-crisis years (Chart 2 and Table 1).

Table 1: Thailand's Budget Aggregates

(Percentage)

	1990-96	1997-2002	2003-07	2008	2009	2010p
Expenditure/GDP	15.0	21.0	18.4	18.8	20.8	20.9
Revenue/GDP	18.1	16.1	18.0	18.2	16.6	17.9
Real GDP growth rate	7.7	0.8	5.6	2.5	-2.3	7.8
Fiscal balance/GDP	3.1	-4.9	-0.4	-0.6	-4.2	-3.1
Primary balance/GDP	4.0	-4.1	0.8	0.6	-3.1	-1.8
Interest/GDP	0.9	0.9	1.2	1.2	1.1	1.2

Source: Calculated based on GFS data from the FPO and BOT.

On the other hand, even though the government cut its capital expenditure deeply, fiscal deficits re-emerged. The bad debts of some 56 financial firms that were closed down under IMF conditionality were taken over by the government. But as the IMF-imposed fiscal austerity pushed the economy and society into severe stress,[12] this was finally reversed in favour of fiscal expansion in May 1998 to stimulate consumption. With expenditure-GDP ratio spiking at nearly 25 per cent, the fiscal deficit reached a high of 9.3 per cent of GDP in 1999.

While the major brunt of the crisis in terms of unemployment and declining wage levels fell on manufacturing sector workers, the rural masses were also affected severely by the decline in remittance support, return migration and falling agricultural prices. Despite an increase in the expenditure on social safety nets from May 1998, poverty incidence spiralled from about 15 per cent in 1996 to nearly 21 per cent in 2000.[13]

When many domestic firms collapsed with the mismanagement of the crisis and there was further liberalisation of foreign ownership rules, Thai domestic capital was replaced by foreign capital in many leading sectors of the economy, particularly in export-oriented manufacturing, finance and modern retail. The extent of foreign ownership in the economy, which was already quite high, thus went up further in the post-crisis period. On the other hand, in addition to agri-processing industries, domestic entrepreneurs became more prominent in service sectors like hospitality, media, entertainment, property and construction, telecom, etc. in the post-crisis period.

By 1999, economic growth recovered, led by private and especially foreign investments and on the basis of renewed exports from sectors such as electrical machinery, electronics, automotive industries, chemicals and petrochemicals, all dominated by multinational companies (MNCs). But this export boom collapsed in late 2000 when the US economic growth came down. Together with a fall in global prices, agricultural exports also declined during this period.

II.3 The Post-2001 Phase

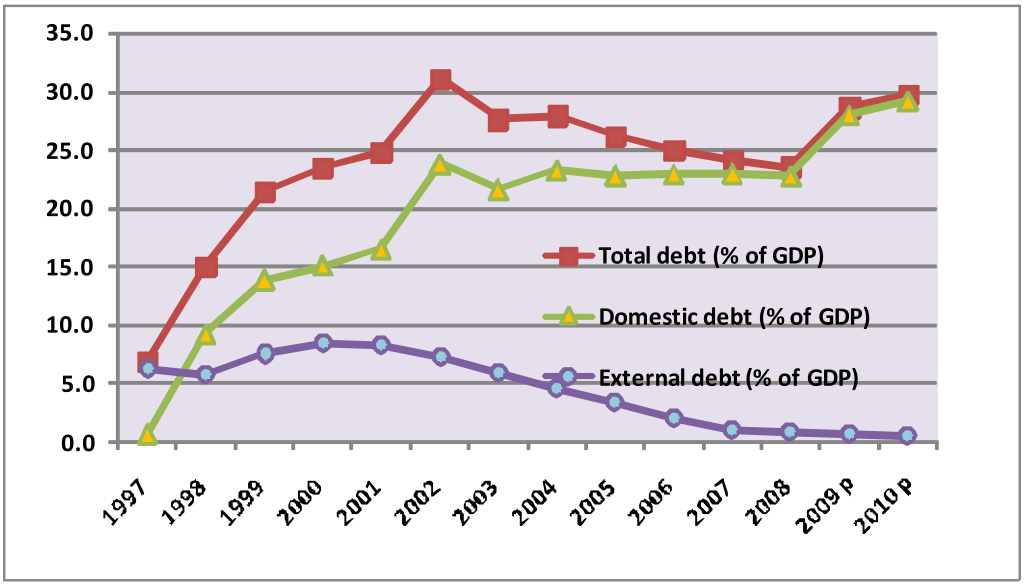
Riding on the nation-wide backlash against IMF conditionalities, Thaksin Shinawatra government came to power in January 2001 appealing to the rural masses and to the domestic enterprises that had become prominent in domestic-oriented sectors. He promised a “dual-track” economic policy to stimulate demand, promote domestic entrepreneurship and reduce poverty, by injecting funds particularly in the rural areas (Pasuk and Baker, 2004).

One of the schemes that were implemented by mid-2002 was a one million baht revolving fund for each of the country’s 70,000 villages. In addition, while a debt moratorium was announced for farmers, the government created a People’s Bank for micro-credit, which offered further loans under a “One Village, One Product” scheme. Further, the 30-baht health scheme was introduced, under which people can obtain a health card that gives them right to medical treatment at a fixed cost of 30 baht per visit. Despite widespread criticism of being populist, Thaksin’s expenditure policies put the neglected rural and social sectors into focus for the first time, which continue to be significant issues in the country’s electoral politics ever since. Thus all the governments since Thaksin have advocated parts of his three major policy programs in their own policy platforms.[14] Further, these policies do seem to have played a major role in leading to the reduction in poverty rates between 2000 and 2008 as we saw in Section 1, even though average GDP growth rates did not reach the pre-crisis levels.

But although expenditure-GDP ratio reached 24 per cent and fiscal deficit was again at a high of 8 per cent of GDP in 2002, part of the fiscal deficits during 1999-2002 was due to the socialisation of the bad debts in the financial system during the crisis. Through the bonds issued to finance the restructuring of financial institutions in the aftermath of the financial crisis, total public sector debt had peaked at over 57 per cent in 2000 and 2001, and stood at 54 per cent of GDP by the end of 2002.

Total public debt has two principal components: government debt, comprising central government debt and liabilities of the Financial Institutions Development Fund (FIDF)[15]; and the debt of non-financial public enterprises. The ratio of government debt to GDP, which was very low at below 7 per cent in 1997 had increased dramatically and reached a peak of 31 per cent in 2002. At the same time, the share of domestic debt in total government debt, which was just 10 per cent in 1997 increased sharply to 60 per cent of GDP in 1998.

Chart 3: Thailand's Government Debt (1997-2010)



Source: Bank of Thailand

Interest payments on government debt took more than 7 per cent of government spending in 2000-02, up from one per cent in 1996 (see Table 1). In a budget that was already under pressure from IMF conditionalities, interest payments on socialised debt (arising from liberalised private sector borrowing) crowded out other government expenditures that could have enabled the government to bring about a more effective shift towards domestic demand-driven growth.

In the post-crisis years, there was significant talk of shifting the focus away from export orientation towards domestic demand-led growth and "sufficiency economy".[16] Increased social spending for providing income support for the lower classes was in fact meant to stimulate domestic demand. However, due to the continued conservative fiscal stance overall, government seemed to have missed the opportunity to build up capacities and improve productivity that would help reorient the economy towards domestic-led growth, move up the value chain in export production and reduce its vulnerabilities to external shocks.

During 2002-07 while the revenue-GDP ratio averaged about 18 per cent with relatively strong economic growth, the expenditure-GDP ratio hovered around 18.4 per cent with the result that fiscal deficit-to-GDP ratios were at near zero levels during 2003-06 (see Chart 2 and Table 1). This does not point to any significant expansionary stance that would reflect a macroeconomic policy change required for an economy that was trying to reduce its heavy reliance on external capital and export-led growth, which in turn would help reduce the existing inequalities. It was with the decline in revenue due to the onset of economic slowdown in 2007 that fiscal deficit began increasing again in 2007. Indeed during the four years 2003-06, government's primary balance was positive at more than 1 per cent of GDP, even though the average for 2003-07 comes to only 0.8 (Table 1).

The continued maintenance of such a conservative fiscal stance implied that the economy was starved of much needed investments in infrastructure, education, technical skill upgradation, etc., which should have complemented the beneficial impact of the income support measures undertaken by Thaksin to generate longer-term impacts on physical and human capacities. Despite increasing expenditure on social and rural sectors, studies have suggested that the three major social programs undertaken by the Thaksin government were themselves not adequately funded, which would help explain why they could not make a sufficient impact on reducing inequalities.[17] Further, Thaksin did not undertake any tax reforms or land reform, land-to-the-tiller programmes, or other policies to improve the structural position of peasants within the national economy (Baker 2005: 132).[18]

Another contradiction was that despite the promise to energise domestic capital to counterbalance the trend towards greater outward exposure, Thaksin explicitly abandoned his original attempt to protect or strengthen domestic capital from competition, because it would antagonise multinational companies and foreign investors. Instead he too began to pursue policies that increased the level of foreign investment in both the private and public sectors.[19] He continued the privatisation of state enterprises (that was already significant since the mid-1980s) involving energy, water, transportation and telecom.

Even as Thailand's macroeconomic indicators were all in good shape, Thailand was once again severely affected by the external shocks in the wake of the global financial crisis in 2007. The dramatic fall in world trade during the Global Recession caused Thailand's exports and tourism to shrink sharply. Despite the fact that the government undertook significant stimulus measures, amidst domestic political turmoil, there was again a significant slowdown in 2008 and the GDP growth was negative in 2009, before recovering to grow at 7.8 per cent in 2010 (see Chart 1). However, according to the latest Bank of Thailand estimates, GDP grew only by 0.1 per cent in 2011, owing to the natural disasters in Japan, the global economic slowdown and especially the unparalleled devastation caused by Thailand's 2011 year-end floods.

Meanwhile, even as revenue continued to fall, expenditure-GDP ratio rose steadily from 2008 following the fiscal stimulus undertaken in the aftermath of the global economic crisis, and stood at about 21 per cent in 2010 (Table 1).

Although government debt had declined during 2003-2008[20] primarily due to a decline in foreign debt (see Chart 3), it increased sharply in 2009 and 2010. This was also led solely by a growth in domestic debt. Foreign debt continued to decline and accounted for just about 2 per cent of total government debt in 2010. Despite the growth in domestic debt, total public debt stood at 38 per cent of GDP as of November 2009, significantly lower than the stipulated threshold of 50 per cent of GDP. Existing guidelines require total public debt to be kept below 50 per cent of GDP and debt service (interest plus capital repayments) to be kept within 15 per cent of total budget expenditure.

The discussion in this section reveals that successive governments in Thailand have maintained a rather conservative stance, especially during periods of strong economic growth. In order to understand how this pro-cyclical fiscal stance impacted income inequalities, the following section analyses government revenue and changes in revenue mobilisation policies in detail.

III. Structure and Policies of Revenue Mobilisation

III.1 Composition of Revenue

As we saw in the earlier section, until the early 1980s Thailand's revenue-GDP ratio had hovered in the 12-14 per cent range. The share of tax revenue in total revenue was about 88 per cent during the 1970s and the first half of the eighties.[21] Following the strong economic growth in the second half of the eighties, the share of taxes in total revenue began rising and reached an average 90 per cent during 1990-96. This share declined during the period 1997-2003 under the impact of the financial crisis and increased during the years of recovery and growth during 2004-08 (Table 2). But the tax share fell again to 87 per cent in 2010, following the economic contraction under the impact of the global recession. Overall, the trend has been one of a slight decline in the share of tax revenue in total revenue, despite the high growth rates experienced by the country. This is also visible when we look at the tax revenue-to-GDP ratio, which declined from nearly 17 per cent during 1990-91 to an average 15 per cent during 2009-10.

Table 2: Composition of Thailand's Government Revenue, 1990-2010

(Percentage of Total Revenue)

	1990-96	1997-2002	2003-07	2008	2009	2010
Taxes	89.8	86.6	87.8	88.3	88.0	86.9
Social contributions	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.8	0.5	0.2	0.1	0.1	0.1
Other revenue	9.4	12.9	12.0	11.6	11.9	13.0

Source: Calculated based on GFS data from the Fiscal Policy Office.

With the shares of grants and social contributions being insignificant, the 'other revenue' category has been the most significant contributor to government revenue after taxes. Its share showed a marked rise from about 9 per cent of total revenue during 1990-96 to about 13 per cent during 1997-2002. Although it declined slightly subsequently, it was again at 13 per cent in 2010.

Table 3 shows that the other revenue category was dominated by "property income" within which dividends from government enterprises accounted for the largest share, which was followed by rent. Given that the share of tax revenue had declined during 1997-2002, the role played by property income in supporting government revenue was especially significant during this period. Proceeds from the sales of goods and services (dominated by administrative fees) was the second largest other revenue sub-group.

Table 3: Composition of Thailand's Other Revenue Category

(Percentage of Total Revenue)

		1990-96	1997-2002	2003-07	2008	2009	2010
	OTHER REVENUE	9.4	12.9	12.0	11.6	11.9	13.0
a.	**Property income**	**6.7**	**7.8**	**7.4**	**9.0**	**8.5**	**7.5**
	Interest	n.a.	0.0	0.1	0.3	0.4	0.2
	Dividends	6.1	6.5	3.1	5.8	5.1	4.8
	Withdrawals from income of quasi-corporations	n.a.	n.a.	3.6	n.a.	n.a.	n.a.
	Rent	0.6	1.3	2.1	2.9	3.0	2.6
b.	**Sales of goods and services**	**1.2**	**2.6**	**3.3**	**2.3**	**2.8**	**2.6**
	Sales of market establishments*	n.a.	n.a.	n.a.	2.0*	0.0	0.0
	Administrative fees	1.2	2.6	2.7	2.2	2.7	2.4
	Incidental sales by nonmarket establishments	n.a.	0.5	0.2	0.1	0.2	0.1
	Imputed sales of goods and services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
c.	**Fines, penalties, and forfeits**	**0.6**	**1.0**	**0.4**	**0.4**	**0.5**	**0.5**
d.	**Voluntary transfers other than grants**	**0.0**	**0.0**	**0.3**	**0.1**	**0.2**	**0.1**
e.	**Miscellaneous and unidentified revenue**	**0.8**	**1.6**	**0.5**	**-0.2**	**0.0**	**2.3**

Note: *The given share refers only to 2005.

Source: Calculated based on GFS data from the Fiscal Policy Office.

Within taxes, the share of indirect taxes has been historically high in Thailand. It contributed about 52 per cent of total tax revenue during the second half of the 1970s and first half of the 1980s. International trade taxes contributed the second largest share, accounting for about 26 per cent of total tax revenue.[22] The contribution of direct (income) taxes was on average only 20 per cent of total revenue between the mid-1970s and mid-1980s.

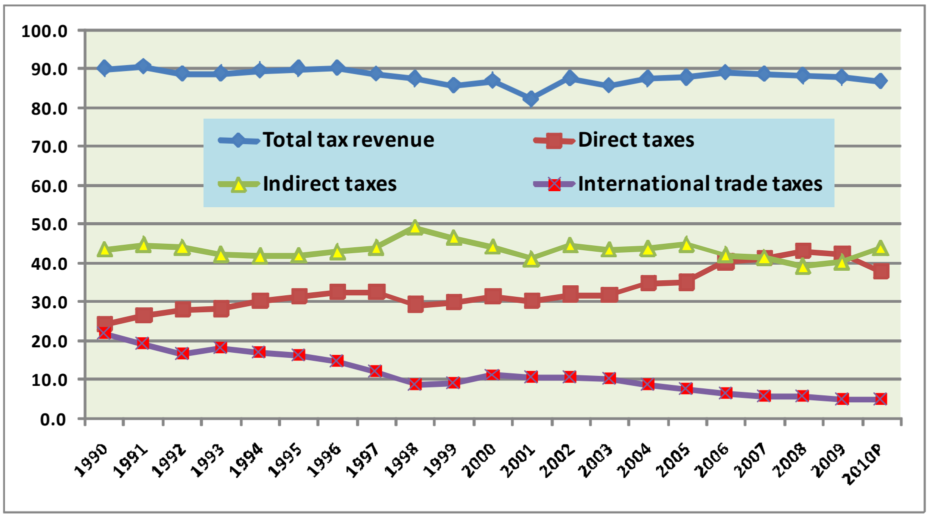
We know that income taxes are generally more progressive than indirect taxes from the point of view of improving income distribution. Given the high levels of indirect taxation in Thailand, it is not surprising that the country was an exception among East and Southeast Asian economies such as Korea, Taiwan, Malaysia and Indonesia where income inequality declined or remained constant between 1976 and 1985.[23] Historically, Thailand did not use taxation policy to make significant changes in its income distribution.

Income taxes began playing an increasing role only from the mid-1980s as the share of wage payments and of corporate profits in the formal sector of the economy increased (Jansen and Choedchai, 2009). We find that continuing the trend from the second half of the eighties, the share of income taxes in total revenue increased steadily during 1990-96. Although it declined during the economic downturn of 1998-2002, its share increased from an average 29 per cent of total revenue during 1990-96 to as much as 43 per cent in 2008, before declining to about 38 per cent in 2010 (see Chart 4 and Table 4).

At the same time, the share of indirect taxes, which was already high at about 43 per cent during 1990-96, increased to an average 45 per cent during the crisis period (1997-2002) driven by increased excise tax revenue, before declining to 40 per cent in 2009. In 2007, before the impact of the global recession, the shares of direct and indirect taxes in total revenue were roughly the same. With the decline in the share of direct taxes in 2010, the share of indirect taxes increased again to 43 per cent. On the other hand, along with the rapid trade liberalisation undertaken by the country, the share of trade taxes declined sharply from about 22 per cent in 1991 to just 5 per cent of total revenue in 2009.

Chart 4: Share of Direct and Indirect Taxes in Thailand's Total Tax Revenue, 1990-2010

(Percentage)



Note: Indirect taxes comprise of items 2, 3, 4 and 6 in Table 4.

Source: Calculated based on GFS data from the Fiscal Policy Office

Within direct taxes, the major part was contributed by corporate income taxes. Significantly, the share of corporate income tax in total revenue more than doubled from about 15 per cent in 1990 to about 32 per cent in 2008, before declining slightly from 2009 onwards (Table 4). During the entire period 1990-2008, the increase in corporate income tax share was steady except during the crisis (1997-2001) and this more than compensated for the decline in trade tax revenue. In contrast, the share of personal income taxes shows only a marginal rise, from about 10 per cent of total revenue during 1990-97 to about 12 per cent in 2009 before declining in 2010.

Table 4: Composition of Thailand's Government Tax Revenue, 1990-2010

(Pr cent of Total Revenue)

	Composition of Tax Revenue	1990-96	1997-2002	2003-07	2008	2009	2010
	Taxes	89.8	86.6	87.8	88.3	88.0	86.9
1.	**Taxes on income, profits, and capital gains**	**28.8**	**31.0**	**36.7**	**43.1**	**42.5**	**37.9**
	Payable by individuals	10.4	13.1	11.0	11.3	11.8	10.4
	Payable by corporations and other enterprises	18.4	17.8	25.6	31.8	30.7	27.4
2.	**Taxes on payroll and workforce**	0.0	0.0	0.0	n.a.	n.a.	n.a.
3.	**Taxes on property**	**2.4**	**0.5**	**0.0**	**n.a.**	**n.a.**	**n.a.**
	Taxes on financial and capital transactions	2.4	0.5	0.0	n.a.	n.a.	n.a.
4.	**Taxes on goods and services**	**40.0**	**44.0**	**42.6**	**38.8**	**39.7**	**43.3**
5.	**Taxes on international trade and transactions**	**17.9**	**10.6**	**8.0**	**5.8**	**5.1**	**5.1**
6.	**Other taxes**	0.8	0.5	0.6	0.6	0.7	0.6

Note: The table includes tax components with significant values only.

Source: Calculated based on GFS data from the Fiscal Policy Office

It is clear that there is a significant increase in direct tax revenue mobilisation in the country from the period of rapid growth of the late eighties, mainly contributed by an increase in corporate income tax. We will look at the direct and indirect taxes in more detail in the following sub-sections to understand to what extent these changes reflect government efforts to reduce income inequalities.

III.2 Personal Income Tax

Thailand's top rate for personal income tax (PIT), which used to be 65 per cent before 1986, was reduced to 55 per cent in that year and further to 37 per cent in 1991 (Jansen and Choedchai, 2009). These tax reforms were facilitated by the unexpected upturn in the economy since 1986, which enabled the government to collect much larger revenues. The latter was made possible by the increased economic activity and the broadening of the tax base owing to an increase in the share of formal sector employment in total employment. The income brackets for the PIT have also been adjusted over the 1990s and 2000s. It seems from the current PIT structure (Table 5) and the range of covered incomes listed below that personal income taxation is quite progressive.

Table 5: Personal Income Tax Rates in Thailand, 2010

Net income (baht)	PIT
0 - 1,50,000*	0
1,50,001 - 5,00,000	10
5,00,001 - 10,00,000	20
10,00,001 - 40,00,000	30
> 40,00,000	37

Note: For Thai residents of 65 years or older, this exemption is up to baht 1,90,000.

The following are the classes of income that the personal income tax is applicable to:

1. Salaries and wages (including stock options and some fringe benefits);
2. Hire of work, office of employment, or services rendered;
3. Goodwill, copyright, franchise, patent, other rights, annuity, etc.;
4. Interest, dividend, bonus for investors, gain on amalgamation, acquisition or dissolution, gain on transfer of shares, etc.;
5. Lease of property, etc.;
6. Income from liberal professions such as law, medicine, engineering, architecture, accountancy and fine arts;
7. Income from the contract of a work where the contractor provides materials other than tools; and
8. Income from business, commerce, industry and income other than as specified in (1)- (7).

However, significant personal income tax-payers represent a very small minority (0.5 million out of 64 million) of the total population (PEFA, 2009). This low base seems paradoxical given that the growth of wage labour in the formal sector had intensified following rapid export-oriented manufacturing expansion from the late-1980s.[24]

This may be explained by the fact that while Thailand's record in basic education in exceptionally good, basic education has offered access to mostly low-skilled jobs in the growing manufacturing and service sectors, and cannot offer significant earnings or upward mobility in the absence of improvements in technical and tertiary education.[25] On the other hand, the shortage of skilled labour that had emerged as a serious constraint in the economy's transition to higher technology sectors had pushed up the wages of skilled workers substantially from the early 1990s.[26] As a result, as Jetin (2009) shows, until 1996, the income share of wage earners as a whole was increasing, but at a slow pace. After the 1997 crisis, this trend was reversed. A section of wage earners who lost their jobs during the crisis and became self-employed have not returned to salary jobs after the crisis. Thus the share of wage earners declined from its peak of 42 per cent in 1999 to 38 per cent in 2005.[27] The low personal income tax base despite the growth in formal sector employment is partly explained by the decline of wage earners' share in national income.

The relatively low levels of personal income tax contribution to total revenue also seems to arise due to the various exemptions, which have benefited higher wage earners and higher income groups rather than lower income groups. For instance, deductible expenses are significant. In particular, for income category numbered (5) in the list above, the rates of deduction vary from 10-30 per cent depending on the type of property.[28] For incomes under (6), (7) and (8), the rates of deduction vary from 30 per cent to 85 per cent. Further, there is no upper limit prescribed for deductions under these categories, while there is an upper limit on the deduction of *expenses* up to a maximum of baht 60,000. Again, profits earned from the corpus of a legacy or inheritance, which could be relevant for many elites, are exempt.

Further, even though income from stock options and other equity compensation benefits are taxable, there are significant exemptions on gains from direct financial market transactions. For instance, capital gains on the sale of shares listed in the Stock Exchange of Thailand (SET), income from mutual funds and sale of investments in mutual funds are all exempt from taxable income, with a view to promoting capital market transactions. Exemptions on capital gains increase existing inequalities not only by raising the level of disposable income at the hands of higher income categories, but more crucially, by reducing the tax revenue for the government – especially during the high growth periods that invariably involved financial sector booms. This could explain why the country continues to fall behind in utilising the most progressive tax in improving income inequalities, even though these were already recognised to be high by the early nineties.

III.3 Corporate Income Tax

The sharp rise in corporate income tax revenue is clearly related to the growing share of profits in national income at the cost of labour share, as mentioned earlier. As shown in Jetin (2009), the share of capital in GDP increased from 17 per cent in 1980 to a maximum of 38 per cent in 1996 at the end of the boom period, fell to 25 per cent in 1999 and then increased again to 30 per cent during the recovery period. The movements in the share of corporate tax revenue parallel these trends and the trends in economic growth rates (see Table 4).[29] However, as a share of GDP, corporate income tax revenue had only increased from 2.7 per cent in 1990 to 3.7 per cent in 1996, before declining to about 2 per cent during 1998-99. It did recover from 2003 onwards and reached a peak of nearly 6 per cent of GDP in 2008, before declining to 5 per cent during 2009-10. It is clear that the increase in corporate income tax (CIT) revenue share in GDP has not been commensurate with the increase in profit share of national income. We explore the reasons for this below.

Thailand has applied a uniform CIT rate since 1978. At present, the standard CIT rate is 30 per cent. However, small and medium companies (SMEs – that is, those with paid-up capital not exceeding 5 million baht) get an exemption from CIT up to baht 1,50,000 of net profit and are subject to reduced rates subsequently. There are also specific concessions to businesses engaging in research and development (R&D) and deductions allowed for skill development and training, energy saving equipment, etc., which are encouraging.

But despite the significant rise in the share of corporate income tax in government revenue, corporate income tax also seems to be based on a small base like the personal income tax. According to PEFA (2009), about 2,500 (mainly corporate) large taxpayers (under the responsibility of the Large Business Tax Administration Office (LTO)) accounted for nearly 50 percent of Revenue Department (RD) receipts.[30] This is because of the large number of exemptions allowed under the law as discussed below.

Companies listed on the Stock Exchange of Thailand (SET) and the Market for Alternative Investment (MAI) have been eligible for reduced rates of 25 per cent and 20 per cent respectively for different periods since 2001. There are also several companies that enjoy tax exemption under the Board of Investment's Investment Promotion Acts, which range up to eight years of tax exemption. Further, while all capital gains are taxable in principle, the following type of exemptions makes the actual corporate income tax collected lower in effect.

- Dividends or share of profits paid by an unincorporated joint venture to a Thai or foreign company carrying on business in Thailand;
- Dividends received by listed and non-listed Thai companies from Thai companies (without direct or indirect cross-shareholding);
- Dividends received from foreign investments by Thai companies (with a minimum 25 per cent shareholding);
- Interest on foreign currency deposits received from a commercial bank for lending to non-Thai nationals resident abroad, foreign companies not carrying on business in Thailand and foreign banks.

The observation that the first two types of CIT exemption appears to contribute to significant tax avoidance is supported by a 2011 TDRI study[31] that concluded that the nature of corporate fraud in Thailand has not changed over the years. All four cases studied involved: (a) the siphoning of a listed company's assets from a public company to family-owned unlisted companies; and (b) the manipulation of share prices in order to generate capital gains from equity trade.

Given the prevalence of foreign ownership across a broad range of sectors in the Thai economy, it is also important to highlight that while foreign companies carrying on business in Thailand (like foreign branches, etc.) are subject to CIT, transfer pricing would play a significant role in reducing taxable income of foreign companies.

Although foreign companies come under a withholding tax of 10 per cent on their after-tax profits repatriated to the head office, companies incorporated in countries which have signed Double Taxation Avoidance Treaties (DTAA) are exempt from this withholding tax. Similarly, capital gains by a foreign company not carrying on business in Thailand are subject to a 15 per cent withholding tax (presumably to discourage foreign portfolio inflows), these are also exempt under DTAAs. Given that Thailand has DTAAs with about 55 countries, including tax havens such as Mauritius and Seychelles as well as the major investor countries in the country such as the US, EU countries, ASEAN members and China, and given the level of financial liberalisation pursued by the country since the early 1990s, the corporate income tax revenue foregone under this exemption would be significant especially during periods of high growth involving financial sector booms.

Thus while the contribution of corporate income tax in Thailand's revenue mobilisation has increased significantly reflecting the increase of profit share in national income, the nature of exemptions and the high prevalence of foreign ownership across many sectors have meant that the proportion of revenue that should have accrued from CIT has actually been lower than what is due (especially during periods of high growth involving financial sector booms).

III.4 Indirect Taxes

Despite the increase in direct tax revenue since the 1990s, the share of indirect taxes has been higher than that of direct taxes except for 2008-09 (See Table 4). Thus the incidence of the indirect tax burden continues to play a significant role in determining the pro-poorness of the government's revenue mobilisation policies.

As seen in Table 6, indirect taxes have been dominated by value added taxes (VAT) and excise taxes, which have together accounted for an average 39 per cent of total revenue since 1990. Although the share of excise taxes, which is more progressive in reducing income inequalities, has been higher than that of VAT during these years (except in 2008) this was only marginally so. Thus the incidence of value added taxes, which treat the poor and non-poor alike, does impact income inequalities significantly.

Until 1991, the basic indirect tax in Thailand was the business tax introduced in 1961. There were 14 categories of business tax, with rates ranging from 1 to 50 per cent. Despite this wide range, the effective tax rate depended on the structure of the sector. In highly segmented sectors, the cascading of the business taxes was considered to have led to high effective rates (Jansen and Choedchai, 2009). The value added tax (VAT) was imposed in the place of business tax in January 1992 at a flat rate of 10 per cent, as a noncumulative consumption tax. Persons who have annual turnover above baht 1,800,000 are required to register as VAT operators and only registered VAT operators are eligible for input VAT refund.

Table 6: Composition of Indirect Taxes in Thailand, 1990-2010

(per cent of Total Revenue)

		1990-96	1997-2002	2003-07	2008	2009	2010
	Taxes on goods and services	40.0	44.0	42.6	38.8	39.7	43.3
a.	General taxes on goods and services	19.4	21.3	20.4	20.1	18.5	19.2
	Value-added taxes	**21.2***	**19.4**	**19.1**	**20.1**	**18.5**	**19.2**
	Sales taxes	n.a.	1.6	1.7	n.a.	n.a.	n.a.
b.	**Excises**	**19.3**	**21.9**	**20.2**	**16.7**	**19.2**	**22.3**
c.	Profits of fiscal monopolies	0.4	0.7	0.4	0.4	0.7	0.3
d.	Taxes on specific services	0.0	0.0	1.3	1.5	1.2	1.2
e.	Taxes on use of goods, permission to use goods	0.8	0.2	0.3	n.a.	0.1	0.2

Note: * The given data refers only to 1996.

Source: Calculated based on GFS data from the Fiscal Policy Office.

There are four major activities that are subject to VAT: sales of goods; sales of services; imports; and exports. The current rate of VAT for most goods and services is 7 per cent. This was raised to 10 per cent in 1997 as part of the IMF conditionality after the Asian crisis. However, when economic growth collapsed under the IMF's contractionary fiscal and monetary policy conditionalities, the rate was lowered from 10 per cent to 7 per cent in April 1999 to stimulate consumption. Although this was meant to be a temporary measure, the VAT rate continues to be at 7 per cent.

Apart from the services of government agencies and local governments, the following are some of the goods and activities exempted from VAT:

1. Tax payers with total sales less than baht 1,800,000;

   Sale of unprocessed agricultural products;

   Sale of goods or products related to agricultural products (eg. fertilisers, pesticides, animal feed);

   Sales of newspapers, magazines and textbooks;

   Sales of animals, whether dead or alive.

2. Educational services, including government and private schools;
3. Artistic, cultural services; public performers; and religious activities and public charities;
4. Medical, auditing and court practising services;
5. Healthcare services, including government and private hospitals and clinics;
6. Research and technical services;
7. Domestic transportation;
8. International transport by land;
9. Rental of immovable property;
10. Imported goods brought into duty free zones as well as sales of goods and services between enterprises in duty free zones or bonded warehouses;
11. Goods exempt from import duties (under Chapter 4 of the Customs Code);
12. All exported goods

In general, VAT exemptions on sale of unprocessed agricultural products and agriculture-related goods and services seem to be in favour of lower income groups rather than the upper income groups. At the same time, it will also benefit the large agri-business firms that have come to dominate Thai agricultural sector in the segments of fertilisers, animal feed, etc. VAT exemptions on government health and educational services are very progressive. However, given that government has been encouraging privatisation in the heath and education sectors as a result of which more of these services are being provided on the user-pay principle, it is not clear whether exemptions on private healthcare and educational facilities are actually more beneficial for the lower income groups, or are appropriated by the service providers.

Further, it is striking that food and other essential items are not exempt from VAT. It is known that the incidence of tax burden in the case of such essential commodities is borne disproportionately more by the lower income groups than the middle or upper income groups.

Further, VAT exemptions on imported goods, where the majority of production is foreign-owned and export-oriented are also not progressive. While this has been a long-standing practice in the FDI-dependent export-promotion strategy of the country, there is significant revenue foregone through this exemption.

When it comes to excise tax, it is imposed on selected goods and services on both domestically produced and imported goods. Some of these are:

- fuel and petroleum products;
- alcoholic beverages and certain non-alcoholic beverages;
- certain electrical appliances;
- motor vehicles;
- cigarettes containing tobacco;
- perfume products and cosmetics;
- entertaining services,
- turf courses and golf courses;
- motor bicycles; batteries; playing cards; and
- ozone depleting substances.[32]

Excise taxes are known to be more progressive than VAT and have contributed significantly to Thailand's revenue.

Due to the difficulty of assessing value added income in the case of certain services, Thailand also applies an alternative Special Business Tax (SBT) on gross revenue at a fixed rate on these services as follows:

Table 7: Special Business Tax rates

Special business tax category	Rate (per cent)
Commercial banking, financial and credit foncier business	3.0
Life insurance	2.5
Pawn shop brokerage	2.5
Sale of immovable property, real estate	3.0
Sale of securities in the stock exchange	0.1
Business with regular transactions similar to commercial banking	3.0

Source: Based on PWC (2011)

However, currently, sale of securities, agricultural futures contracts and derivatives are exempt from SBT, while the rate of SBT in the case of some banking businesses has been reduced from 3 per cent to 0.01per cent.[33] Again, the tax bias in favour of financial market players and activities is visible.

III.5 Trade Taxes

The major component of tax revenue that has seen a sharp contraction is the trade taxes, whose share declined from an average 18 per cent during 1990-96 to 11 per cent during 1997-2002, and further to just 5 per cent in 2010 (Table 4). Major trade taxes are the customs duties on imports and export taxes on select items.

It should be remembered that from 1985 onwards Thailand's tariff policy had become intensely focussed on facilitating export expansion. After a first round of tariff cuts in 1988, the beginning of the 1990s saw further major changes in the structure of tariff protection for the cause of export promotion. In late 1991, tariff protection on capital goods, which was as high as 35 per cent was reduced to 5 per cent on average. The fall in trade tax revenue became more significant from 1994 onwards, the year in which Thailand began reducing its customs duties drastically following the entry into force of the ASEAN Free Trade Agreement (AFTA). Despite the reduction in tariffs undertaken as part of the AFTA, Thai tariffs ranged between 0-80 per cent until the 1990s, the highest rate being for passenger cars.

It is true that since the mid-1980s, actual tariff revenue collection was already lower than what would have been possible. This was because there were lots of import duty exemptions as part of Board of Investment's incentives for foreign investors, for free trade zones, for companies in industrial estates and bonded warehouses, etc., which was mainly benefiting foreign and other big investors. Further, there was continuous tariff liberalisation undertaken by the government focussed on FDI-led export growth strategy amidst the constant pressure faced by Thailand to continue to be a "competitive" part of regional production networks, in the middle of rising competition especially from China and Vietnam. Thus whatever revenue mobilisation that occurred also came down dramatically from the late 1990s onwards.

There was a further customs tariff reform in 2007, with the number of tariffs reduced and the range narrowed down to that of targeting 3 rates for production processes, namely:

(a) 1 per cent for raw materials and inputs not produced locally,

(b) 5 per cent for semi-finished products,

(c) 10 per cent for finished products, products requiring extra protection, and luxury goods.

The average tariff rate as of January 1, 2008 is 11.45 per cent (*A Guide to Thai Taxation*, 2008).

At the same time, Thailand has signed preferential trade agreements with China, Japan, India, Australia, South Korea and New Zealand, as part of the ASEAN grouping as well as individually with Japan, India, Australia and New Zealand. Duty free trade under these trade agreements have also contributed to the decline in total revenue share of trade taxes.

The discussion so far indicates that overall, successive central governments' tax revenue mobilisation efforts since the late 1980s have been circumscribed by conservative fiscal management aimed at attracting foreign capital for export promotion (due to the nature of the growth strategy followed) and for promoting service sector growth, particularly the financial sector. This in turn has adversely impacted the role that state could have played in improving income inequalities.

In this context, the role of local governments was insignificant – up to the late 1990s the role of local governments in revenue mobilisation was small. A considerable part of the taxes received by local government was collected locally by central government agencies. Revenue from property taxes, certain excise taxes and 30 per cent of the yield of VAT was assigned to local government. Another major source of local government revenue was the grants received from the central government. According to the Decentralization of Power to Local Governments Act (1999) based on the provisions in the 1997 Constitution, 35 per cent of government revenues had to be allocated to local governments by 2006.

Since 1999, the share of local government in central government revenue has increased rapidly and it stood at 24 per cent in 2006 (Jansen and Choedchai, 2009). Although this ratio is higher than it used to be, it was still much lower than the legal requirement. Further, the increase is largely driven by the growing importance of transfers from the central government (grants) as we will see in the expenditure analysis.

Despite the political and constitutional mandates, collection of revenues by the local governments themselves has been poor. Thus Jansen and Choedchai (2009) argue that Thai local governments have:

- under-collected the taxes that are within their power to collect (e.g. the Buildings and Land Tax and Local Development Tax);
- refrained from taking the responsibility to collect the taxes that have been allocated for them such as VAT on expenditures in their locality, excise taxes for consumption in their locality, vehicle registration fees, etc.; and,
- lacked the initiative to claim taxes for activities which are clearly in their jurisdiction that could be taxed (e.g., local income tax, as is now practiced in many countries; and, property tax).

Clearly, despite the significant increase in corporate tax revenue, which has accrued because of the increase in profit share of national income at the cost of labour share, revenue mobilisation at the central and local levels remain inadequate and less progressive than that is required to address the country's deep-seated inequalities.

In the following section, we examine how government expenditure policies may have impacted the observed socioeconomic inequalities.

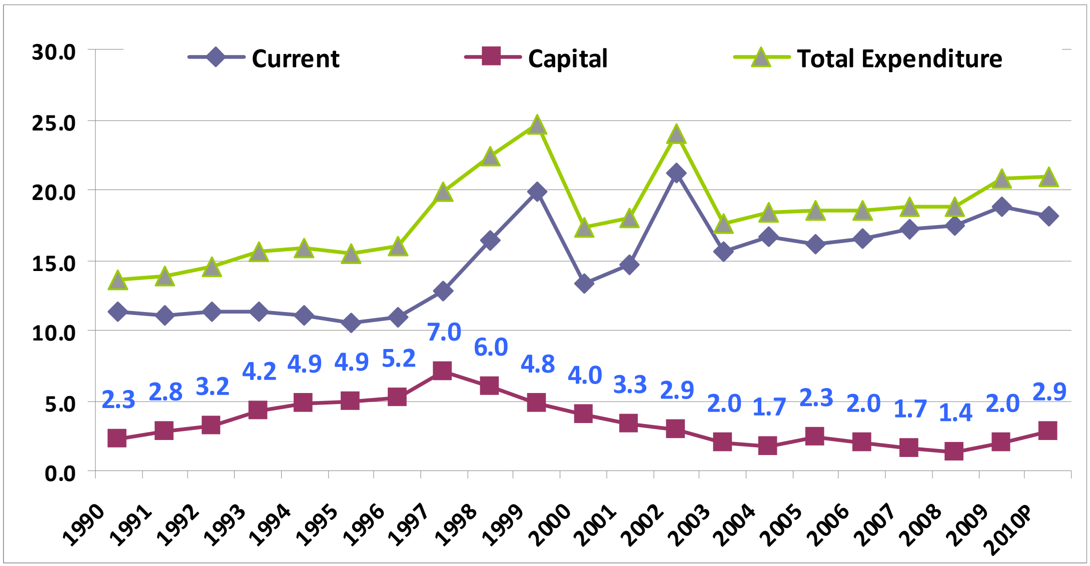
IV. Policies and Pattern in Government Expenditure

We saw that although government expenditure-GDP ratio was relatively low in Thailand, it has shown a general rise since the late 1990s' crisis. In this section we will try to understand how the pattern of expenditure has been changing since 1990.

In general, total expenditure has been dominated by current expenditures. As seen in Chart 5, the movements in total and current expenditures were in tandem in most years. The share of current expenditure increased from 11 per cent of GDP in 1990, peaked between 20-21 per cent in 1999 and 2002 and subsequently declined to 18 per cent during 2009-10.

Chart 5: Share of Current and Capital Expenditures in Thailand, 1990-2010

(Percentage of GDP)



Source: Calculated based on GFS data from the Fiscal Policy Office

On the other hand, the share of capital expenditure, which had been on a decline since the early 1980s, was abysmally low at just 2.3 per cent of GDP in 1990. Since then, capital expenditure showed an increasing trend only during the 1990-97 period. This was a reflection of the fact that the government had responded to the boom-fed increased tax revenues of the late eighties after some delay, and had begun expanding capital investments. But after peaking at 7 per cent of GDP in 1997, the share of capital expenditure declined again. In particular as mentioned already, when the economic growth momentum was strong during 2003-06, the average share of capital expenditure in GDP was at only 2 per cent of GDP, even slightly lower than the 1990 level.

This confirms the observation made in Section 2 that despite the shift to the Sufficient Economy principle, capital investments were not a priority even for the Thaksin government (Pasuk and Baker, 2009, Jetin, 2009, etc.). Part of the post-crisis decline in gross fixed capital formation in Thailand[34] has been attributed to this decline in public investment. It is clear that this continues to impact Thailand's ability to create domestic production and infrastructural capacities that will help reduce the economy's dependence on growth driven by foreign investments.

Within current expenditure, compensation of employees (mainly wages and salaries) dominated throughout the study period, followed by uses of goods and services. However, there have been significant variations during particular years as seen in Table 8. While the share of employee compensation declined from 36 per cent in 1990 to an average of 29 per cent during 1997-2002, by 2010 its share was again at 36 per cent. On the other hand, the share of use of goods and services[35] shows a gradual declining trend and despite increasing through 2009-10, it was still below the 1990 level.

Table 8: Composition of Thailand's Current Expenditure, 1990-2010

(As percentage of total expenditure)

	1990-96	1997-2002	2003-07	2008	2009	2010
Current Expenditure	**74.1**	**77.5**	**89.4**	**92.7**	**90.5**	**86.4**
Compensation of employees	33.6	28.8	32.4	34.2	34.0	35.6
Use of goods and services	25.5	17.9	18.6	19.7	23.9	23.1
Consumption of fixed capital	n.a.	n.a.	2.1	2.3	2.5	2.5
Interest	6.2	4.2	6.5	6.3	5.2	6.0
Subsidies	0.8	1.5	1.9	2.7	1.4	0.3
Grants	2.5	5.6	19.6	21.1	17.4	16.9
Social benefits	4.2	5.4	6.7	5.1	6.1	1.7
Other expense	1.4	14.0	2.4	1.3	0.1	0.2

Source: Calculated based on GFS data from the Fiscal Policy Office

As mentioned in the earlier section, interest payments were a substantial part of the expenditure. In 1990 interest payments on debt accumulated from the 1980s accounted for nearly 14 per cent of the total. Subsequently it came down substantially during 1996-98 to just 1.3 per cent of total expenditure, as the government had chosen to pay back the debt when the economic growth was relatively high during 1990-96. But due to the socialisation of private sector debt during the 1997 crisis, interest payments again began taking larger shares of total expenditure, peaking at 7 per cent in 2001. Its share was at 6 per cent of total expenditure in 2010.

The share of subsidies (dominated by those to public corporations) is seen to be very low and was significantly higher than 1 per cent of total expenditure only during 1998-2008.

But significantly, social benefits which was only 4 per cent of the total in 1990 increased sharply in 2000 and peaked at 10 per cent of total expenditures in 2004 under Thaksin's government. However, it declined after that and settled at just 1.7 per cent in 2010.

On the other hand, the component of current expenditure that shows a distinct rising pattern is grants, which comprises almost solely of grants to other general government units. From an average 4 per cent during 1999-2000, it jumped to 6 per cent and has risen sharply since then, peaking at 22 per cent in 2007. It stood at 17 per cent of total expenditure during 2009-10. This primarily consists of the transfers to local administration.

No comprehensive information has been produced about local government operations or functional distribution of their expenditure since 1996. According to the World Bank's Public Expenditure and Financial Accountability report (2009), in recent times local authorities have been running overall budget surpluses and part of the surplus has been put into a fund that is controlled by the Ministry of Interior, within the Treasury Reserve Accounts.

Thus it appears that while transfers to local governments have been a significant and increasing component of Thailand's current expenditures recently, they have not been utilised for poverty reduction or improving income inequalities through expenditure at the local administrative levels.

When we consider the functional allocation of central government's budgetary outlays, it is seen that during 1990-96, economic affairs, followed by education garnered the largest allocations on average. General public services and defence accounted for the next largest shares. During 1997-99, the shares of all other sectors dropped and economic affairs came to account for nearly 41 per cent of total outlays.

Subsequently, the share of economic affairs declined to an average 21 per cent during 2003-07 and further to 18 per cent by 2010. On the other hand, while education has more or less maintained its pre-crisis share over the recent years, general public services have come to account for the largest share since 2002.

Table 9: Thailand's Central Government Budgetary Outlays by Function, 1990-2010

(Percentage share of total)

	per cent in TOTAL OUTLAYS	1990-96	1997-2002	2003-07	2008	2009	2010
1	**General public services**	**16.0**	**17.4**	**25.5**	**26.5**	**22.2**	**26.7**
	Public debt transactions	6.1	4.2	6.5	6.3	5.2	6.1
	Transfers of general character between levels of govt.	n.a.	n.a.	20.0	21.0	17.3	17.3
2	**Defence**	**15.8**	**8.2**	**5.9**	**6.7**	**8.0**	**8.1**
3	**Public order and safety**	**5.8**	**5.4**	**6.3**	**6.4**	**6.3**	**5.9**
4	**Economic affairs**	**25.5**	**30.9**	**20.9**	**18.7**	**19.7**	**18.4**
	Agriculture, forestry, fishing, and hunting	10.1	7.0	5.6	5.0	5.0	5.6
	Fuel and energy	0.4	0.2	0.2	0.1	0.5	0.1
	Mining, manufacturing, and construction	0.5	0.6	0.5	0.4	0.5	0.4
	Transport	11.1	10.6	4.6	3.7	4.3	5.0
	Communication	n.a.	0.2	0.1	0.0	0.1	0.1
5	**Environmental protection**	**n.a.**	**0.1**	**0.8**	**0.1**	**0.2**	**0.2**
6	**Housing and community amenities**	**3.6**	**4.6**	**1.6**	**1.8**	**2.7**	**2.1**
7	**Health**	**7.3**	**6.9**	**8.3**	**9.9**	**9.8**	**9.7**
	Outpatient services	1.7	1.1	0.1	n.a.	n.a.	0.0
	Hospital services	4.1	4.0	4.2	4.1	4.4	4.4
	Public health services	n.a.	3.4	0.8	0.2	0.1	0.1
8	**Recreation, culture and religion**	**0.8**	**1.0**	**0.8**	**1.2**	**1.1**	**1.0**
9	**Education**	**21.6**	**19.9**	**20.9**	**21.3**	**21.2**	**20.5**
	Pre-primary and primary education	n.a.	n.a.	12.2	13.0	11.3	9.5
	Secondary education	16.3	14.8	4.2	1.5	2.4	4.3
	Tertiary education	3.2	3.5	3.1	4.0	3.8	3.3
10	**Social protection**	**3.6**	**5.6**	**9.0**	**7.2**	**8.9**	**7.4**

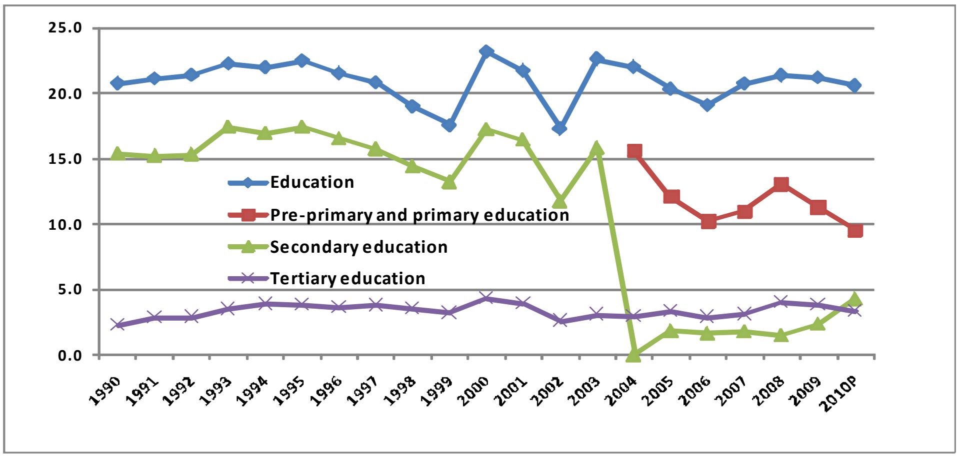
Source: Calculated based on GFS data from the Fiscal Policy Office.

Apart from a range of administrative and legislative activities, general public services outlays include expenditure for loan repayment and transfers to local administration (see Table 9). The increased outlays under this category does not seem to contribute to improving income distribution given the fact that local administrations have been running budget surpluses as already mentioned.

It is indeed remarkable that budget outlays for education have remained high. Thailand's governments had begun addressing widespread inequality in access to education since the mid-1980s, as they became more committed to export-oriented industrialisation. The country is considered to have achieved universal primary education from around 1995. When shortage of skilled labour became a serious issue constraining export growth in technology-intensive products, the government also began focusing on increasing access to secondary education. But according to MDG Report (2009), gross enrolment at the lower secondary school level has remained at the same level reached in 2006 (nearly 97 per cent), while retention rate also remains quite high at 74 per cent. On the other hand, although upper level secondary school gross enrolment rate was 68 per cent in 2008, retention rate was only about 53 per cent. It is also known that dropouts from secondary schools increase during periods of economic stress.[36] Meanwhile, the break-up of government expenditure outlays shows that the share of secondary level education expenditure has declined drastically after 2003 (Chart 6).

If this trend continues, it is unlikely that Thailand will be able to achieve the MDG target of having 70 per cent of the children complete upper secondary education by 2015. This raises serious concerns on the realisation of children's rights in the context of continuing inequalities and low productivity growth among a large segment of the workforce. In 2009, government introduced a project to provide 15 years of free education, which covered both regular and vocational education. However, as several analysts have pointed out, even as the quality of education in the country and comparative educational performance of Thai students remain very poor, average expenditure on education as a percentage of GDP has remained at the same level as that for 1990-96 (See Table 9).

Chart 6: Break-up of Central Government Education Expenditure Outlays, 1990-2010



Note: The expenditure share of pre-primary and primary education level is not available before 2004.

Source: Calculated based on GFS data from the Fiscal Policy Office.

It is known that public services such as education, health and social protection benefit the poor more proportionately than the non-poor. Health expenditure and social protection allocations have shown a gradual rise, whose combined share went up from an average of about 11 per cent during 1990-96, to peak at about 20 per cent in 2001 and 2003-04. In 2010, this combined share dropped to 17 per cent.

Thailand's Universal Health Care (UHC) system was rolled out in 2001–02.[37] By 2007, 63.2 million out of the total population of 66 million had some form of coverage. Around 8 million were covered as employees contributing to the Social Security Fund, 6 million as government, state enterprise employees or retirees or family members, 1.4 million under company schemes, 0.6 million under other schemes. The remaining 48.4 million were issued with cards entitling them to health care for a fee of 30 baht per visit. This fee was eliminated in 2007 (HDR, 2009).

Breaking the earlier record of limited welfare provision, social security programmes have also become an increasingly important part of public policy in Thailand in the past decade or so. While Thailand established a contributory social security system way back in 1971, its coverage was limited to only government servants and thus was extremely limited. Subsequently, it has been gradually extended to cover all establishments with at least one worker.[38] Employees, employers, and government each make contributions based on a percentage of the employee's income. The benefits include sickness, disability, maternity and death benefits, allowances for two children, a pension, and an unemployment benefit. Sickness and injury at work are covered by a separate Workers' Compensation Fund, to which only employers contribute. According to HDR (2009), by 2008, 9.3 million people were covered by the social security scheme and another 1.4 million by similar arrangements for government servants.

But the share of social protection in total expenditure has been on a decline since 2004. Further, even though expenditure on health and education sectors have increased or remained stable, budgetary share of housing and community services has declined. Thus overall, total expenditure on social sectors (covering, health, education, social protection and housing) have declined since 2004, except during 2008-09 (due to the income support measures taken during those two years).

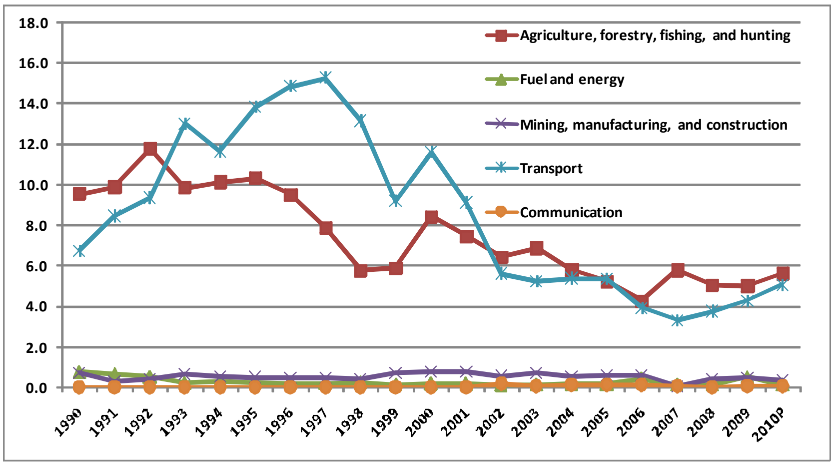
Moreover, although successive Thai governments have widened the social security system over the last decade, as several analysts have pointed out, any form of social security linked to employment status inevitably marginalises groups who do not have access to secure formal sector employment.

According to the NSO data, as much as 58.3 per cent of Thailand's employed are working in the informal sector, including most of those in agriculture, but also two-fifths of those outside agriculture. Although informal workers are especially concentrated in the transport, trade and construction sectors, about 22 per cent of total workers in the manufacturing sector were also informal (MDG Report, 2009). While overall Thai labour productivity has increased at a slower rate than in several other countries in the region, labour productivity in agriculture and construction sectors is even lower than that in other sectors. Although most of the workers in these sectors are covered by the Universal Health scheme, just 12 per cent have access to social security. According to MDG Report (2009), poverty incidence was the highest and second highest in these sectors respectively. Thus it can be seen that Thailand's social security system excludes the majority, including the most vulnerable (HDR 2009, Schramm 2001, MDG Report 2009, Lloyd-Sherlock and Schröder-Butterfill, 2008).

Meanwhile, the decomposition of government expenditure outlay for economic services, whose share has dropped drastically, reflects the dismal state of government investments in agriculture and transport.

Chart 7: Break-up of Central Government Expenditure Outlay for Economic Services, 1990-2010

(Percentage share)



Source: Calculated based on GFS data from the Fiscal Policy Office.

Expansion of agricultural production, which was previously accompanied by heavy investment in public infrastructure – especially in roads and irrigation projects in the past, was already affected by the cessation in the implementation of large-scale irrigation projects since 1983. After the rise in share in the early nineties, the share of transport sector has also come down. It is not surprising that farmers' income share has continued to decline steadily from 20 per cent in 1980 to 10 per cent of GDP in 2005 (Jetin, 2009). While a dense road network has already been built in Thailand, Fan, Somchai and Nuntaporn (2004) showed that public investments in agricultural R&D, irrigation, rural education, and infrastructure (particularly electricity, but also roads in the northeast region), still have positive marginal impacts on agricultural productivity growth and rural poverty reduction. Thus increasing public investments in agriculture and rural infrastructure will have to become a priority for reducing income inequalities and achieving greater poverty reduction.

HDR (2009) notes that in the post-2008 fiscal stimulus packages, the government consciously tried to balance help to the formal and informal sectors, to pay special attention to vulnerable groups and to build future capacities, in addition to providing current relief. For instance, in mid-2008, the government introduced price subsidies to boost incomes. In February 2009, government announced a 116,700 million baht package which extended many of those subsidies and added others (see also Table 7). It followed up with a second package of 1.56 trillion baht mostly devoted to investments in water-related schemes and public infrastructure. But the employment and income effects of large-scale infrastructure spending are lagged. Thus the overall declining trend in capital expenditure raises serious concerns about increasing adverse implications on inequalities.

V. Conclusion

Despite the chronic social and economic inequalities in Thailand, successive governments' revenue mobilisation and expenditure policies have been circumscribed by a conservative fiscal stance aimed at attracting foreign capital for export promotion and financial sector expansion.

On the one hand, this has made tax policies regressive and adversely impacted the role they should have played in improving income inequalities.

The contribution of corporate income tax in Thailand's revenue mobilisation has increased significantly, reflecting the increase in the share of profits in national income at the cost of labour share. The increase in corporate income tax revenue has more than compensated for the secular decline in revenue from trade taxes owing to trade liberalisation. However, the nature of exemptions on capital gains and the high prevalence of foreign ownership across many sectors suggest that the proportion of revenue that accrued from corporate income tax has actually been lower than what is due given the rise in profit share in national income.

Personal income taxation in Thailand is also effectively less progressive than it appears, because a significant part of the non-poor incomes that should have accrued as government revenue for public spending has been exempted due to various deductions, allowances and exemptions.

It is evident that exemptions on capital gains, in particular, increase existing inequalities not only by raising the level of disposable income at the hands of higher income groups, but more crucially, by reducing tax revenue for the government, especially during the high growth periods that have invariably involved financial sector booms.

Meanwhile, value added taxes, which remain a significant contributor to total revenue, continue to impact income inequalities significantly by treating the poor and the non-poor alike.

Overall, revenue mobilisation efforts at the central and local levels remain inadequate and are less progressive than those required to address the country's deep-seated inequalities.[39]

On the expenditure side, government's social expenditure policies under Thaksin Shinawatra did lead to a break from the past by putting the focus on the social and rural sectors. But the continued maintenance of a conservative fiscal stance (aimed at keeping expenditure low in the interest of financial sector growth) implied that the economy was starved of much needed investments in infrastructure, education, technical skill upgradation, etc. Only the latter would generate longer-term impacts on physical capacities and human capabilities.

All the governments since Thaksin have advocated parts of his three major policy programs in their own policy platforms. However, the abysmally low level of capital expenditure by the state and the decline in the share of economic affairs in total expenditure could lead to new vulnerabilities. These expenditure trends reflect Thailand's continued inability to create domestic productive and infrastructural capacities, which could help reduce the economy's dependence on growth driven by foreign investments.

Increasing public investments in agriculture and rural infrastructure will have to become a priority for reducing income inequalities and achieving greater poverty reduction.

Similarly, despite the increased allocation to the health sector, the need for better and cheaper health services across the country calls for greater public investments in public health facilities. The challenges on the education front are also significant as the majority of the labor force still possesses only primary education and the quality of the education system as a whole has not been very high. Further, the social security system, which excludes the majority of the most vulnerable belonging to the informal sector, will need to be expanded.

While transfers to local governments have been a significant and increasing component of central governments' current expenditures in the recent years, they have not been utilised for poverty reduction or improving income inequalities through expenditure at the local administrative levels. The decentralisation process does not appear to have been implemented meaningfully mainly due to a lack of political will. This could be partly explained by the low level of social participation in budget planning and implementation, despite widespread public perception of corruption.

Meanwhile, Thailand's strategy of FDI-dependent export-oriented economic growth combined with financial liberalisation has meant that with growing external dependence of the economy since the 1997 crisis and the swelling in the ranks of informal sector employees, the vulnerabilities faced by the majority of population to both internal and external shocks have been increasing. Thailand thus faces enormous challenges that call for increased public spending.

This cannot be met without making the tax system more progressive. The introduction of an inheritance tax and removal of a number of exemptions in the personal and corporate income taxes related to capital gains in particular would make the tax structure significantly more equitable. However, given the level of external integration of its financial sector, Thailand may find it difficult to make its fiscal policy more progressive without having dynamic capital management techniques in place.

Notes

* The author is grateful to Prof. Jayati Ghosh for constructive comments on an earlier version of this paper that helped improve the paper substantially. The usual caveat remains.

1 In 2004, the national poverty line was redefined to be expenditure-based, while it was income-based previously. These figures from Thailand's MDG Progress Report (2009) are based on the new poverty line. In 2008, the national poverty line was set at baht 1579 per person per month.

[2] The Board of Investment (BOI) also played a significant role in the economy, especially in terms of attracting investment through various incentives.

[3] The post-1932 nationalist government in Thailand had initiated state-led industrialisation.

[4] The discussion on the fiscal aggregates until 1990 is based on data given in Jansen and Choedchai (2009).

[5] The alignment of interests of the military regime that came into power in Thailand in 1957 with the anti-communist strategies of the US in the region led to the channelling of some US$ 2.5 billion during 1951-75 in the form of direct military aid, investment in military installations, and upkeep for troops. The IBRD was also a major source of finance for the infrastructure development programmes, amounting to US$ 440 million between 1950 and 1975, mostly directed to highways, other transport, irrigation, hydroelectricity, and education. Non-military US aid supplied another US$ 627 million over the same period. See Pasuk and Baker (1995).

[6] See also Jomo (2006).

[7] The withdrawal of the US from Indo-China in 1975 had brought the regular inflow of grant aid and military expenditures to an end.

[8] See Pasuk and Baker in Jomo ed. (2004).

[9] Ibid.

[10] Foreign demand for such services as industrial estates, hotels, golf courses, and so on has been an important development factor in Bangkok and in several industrial development zones and tourist sites outside Bangkok. See Francis (2003), Pasuk and Baker (2009), etc.

[11] See Pasuk and Baker (2004 and 2009).

[12] Jansen and Choedchai (2009) explains that apart from imposing tight monetary policy, the IMF's first Letter of Intent (LOI) of August 1997 aimed at a fiscal surplus of one per cent of GDP through increased revenue (e.g. the VAT rate went from 7 to 10 per cent) and restrained expenditure. The second LOI (November 1997) observed that economic conditions had turned more negative than expected because aggregate demand declining faster and the exchange rate was depreciating more than expected. However, the targeted fiscal surplus at one per cent of GDP was maintained and additional expenditure cuts and tax rises were introduced. In the third LOI (February 1998), the Fund still insisted on measures that would contain the deficit at one and a half per cent rather than the projected two per cent of GDP. Only in the fourth LOI (May 1998), the IMF allowed a more expansionary fiscal policy. Funds that became available from the Japanese Miyazawa Plan enabled some fiscal expansion in early 1999. Around that time, Thailand stopped drawing on the IMF facility (after about 14 of the available 17 billion dollar had been used).

[13] Poverty figures are based on the new poverty series. Source: MDG Report (2009)

[14] See Patana (2010).

[15] FIDF was established in 1985 as an independent body within the BOT to provide public support to the financial system. Apart from a blanket guarantee introduced in 1997 covering all depositors and most bank and non-bank finance companies, FIDF has also been responsible for bank recapitalisation and other rehabilitation measures under the 1998 Financial Sector Restructuring Plan. See the detailed discussion in Yuwawan (2003) and Rosengard (2004).

[16] Taking their inspiration from HM King's Sufficiency Economy, Thai policymakers placed a priority on immunising the national economy against external shocks after 1997. The three key principles of the Sufficiency Economy are: "moderation; wisdom or insight; and the need for built-in resilience against the risks which arise from internal or external change." Both five-year plans compiled after the crisis took the Sufficiency Economy as their guide. But as HDR (2009) points out, following this guide, government agencies resolved to "increase national reserves, reduce foreign debt, introduce inflation targeting, impose strict limits on government debt and fiscal balance, and institute a national risk management scheme".

[17] Pattana (2010) argued that scholars who have inquired into the effects of Thaksin's policies are divided. According to her, some have concluded that the policies did not help the poor, (e.g. the poverty incidence was not lowered as people incurred more debt), while others such as Robert Townsend and Joseph Kaboski have asserted that Thaksin's policies were effective in reducing poverty and easing the problem of inequality. Schmidt (2009) quoted Kasian (2006) and NESDB (2007) to argue that regional and income disparities continued to worsen under Thaksin and poverty increased. However, as we saw in the introduction, poverty rates declined between 2000 and 2008 (according to MDG Progress Report 2009), while inequality trends seem to be stagnant at best until 2005 (Thailand HDR 2009).

[18] Baker (2005) quoted in Schmidt (2007). See also Pasuk and Baker (2004: 129). It should be remembered that 70 per cent of the population lives in the countryside and more than 500,000 farmer households are landless in a situation where there still is plenty of arable land available (Kasian 2006 quoted in Schmidt, 2007).

[19] For detailed discussion, see Schmidt (2007), Pasuk and Thanee (2008), etc.

[20] In 2007-08, Thailand's debt service (interest plus capital repayments) was still at 10.4 per cent of GDP (PEFA, 2009).

[21] This share is calculated based on Table 2.2 in Jansen and Choedchai (2009).

[22] These average shares were calculated based on Table 2.3 in Jansen and Choedchai (2009).

[23] See Jomo (2006). It is also known that Thailand's land reforms were also not meaningful. Although the country formally introduced land reforms with the 1975 Agricultural Land Reform Act, most property was transferred to wealthy, politically influential businessmen instead of the less fortunate.

[24] While wage labour used to represent only 14 per cent of total employment in 1969, its share went up to 50 per cent in 2006 (Jetin, 2009). While there has been a dramatic fall in the share of informal employment (self-account workers plus family helpers) in total employment between these years, from 86 per cent to 50 per cent, this was on account of the drastic fall in the share of family helpers (who work mainly in agriculture) from 53 per cent in 1969 to 19 per cent in 2006. The proportion of self-account workers remained stable at around 30 per cent of total employment.

[25] Further, despite the government's introduction of a minimum wage policy in 1973, this was not implemented properly. In 1996, only 26 per cent of workers were protected by minimum wage regulation. As pointed out by several analysts, Thailand also has a record of labour repression.

[26] The increased wage differentials between skilled and unskilled labour was further underpinned by the policy of labour imports. See Francis (2003). In fact, according to Jomo (2006), inequality in wages and salaries increased sharply between 1992 and 1996. This increase was most likely due to the spectacular high-level salaries of managers and professionals, particularly in the finance, insurance, and real estate (FIRE) sectors, during the height of the boom and bubble.

[27] On the other hand, informal workers' share that had declined until 1996, recovered after 1999 and then stabilised at around 38 per cent. Thus there has been a historical downward trend in the share of labour income in Thailand's national income (GDP). The labour share in GDP fell from about 83 per cent in 1980 to a trough of 62 per cent in 1996, then recovered during the crisis years because of the fall in profits, but declined again to 70 per cent during the period of recovery (until 2005). (Jetin, 2009)

[28] It is significant to note in this context that the Crown Property Bureau, associated with the royal family owns 8400 hectares in Bangkok and a total of 33,500 hectares outside Bangkok, apart from 40,000 rental properties – about 17,000 in Bangkok – that include government offices, slum communities and prime commercial sites occupied by hotels, office blocks and shopping centres. However, given its status, there is no tax liability on the Bureau for the incomes earned through these assets. See http://www.eastasiaforum.org/2012/01/05/paying-for-higher-education-in-thailand/

[29] This also seems to explain the rise in personal income tax shares during periods of economic slowdown.

[30] The Revenue Department is responsible for personal and corporate income taxes as well as VAT.

[31] See Duenden, Sirikarn and Weerawan (2011).

[32] Source: PWC (2011)

[33] *Ibid*.

[34] Gross fixed capital formation, which had reached 10 per cent of GDP in 1996, was down to 5 per cent in 2007. See Jatin (2009).

[35] This consists of goods and services used by government for the production of goods and services (except for own-account capital formation) plus goods purchased for resale. It excludes the net change in inventories.

[36] See Jomo (2006) and MDG Report (2009).

[37] For details on the implementation of the 30-Baht Programme started in 2001 by the then Prime Minister Thaksin Shinawatra, see Schramm (2009).

[38] See Schramm (2009) and HDR (2009) for a detailed discussion.

[39] See also Pasuk (2012).

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