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Competition Policy in WTO: How to Make It a Developing Countries' Agenda*

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1. HOW DID COMPETITION POLICY ENTER WTO?

1. Competition policy is one of the four "Singapore Issues," or new issues, that were introduced at the First World Trade Organization (WTO) Ministerial Conference held at Singapore in December 1996.[1] According to the Declaration of the Singapore Ministerial Conference, a working group to study issues raised by members concerning the interaction between trade and competition policy is to be established in order to identify possible areas that may be the subject of a multilateral framework agreement. Pursuant to the Doha mandate, the General Council of WTO established the Working Group on the Interaction between Trade and Competition Policy (WGTCP) in 1997. Its task is only exploratory in nature as the declaration made clear that no decision had been reached on whether there would be negotiations in the future, and that any discussions could not develop into negotiations without an explicit consensus on the modalities of the negotiations.

2. At the fourth WTO Ministerial Conference held at Doha, Qatar in November 2001, it was decided that until the Fifth WTO Ministerial Conference at Cancun, Mexico in September 2003, the Working Group should focus on clarification of specific issues that may form the framework for possible negotiations in the coming round. These issues are described in paragraphs 23-25 of the Doha Ministerial Declaration (see Box 1). These are (a) technical assistance and capacity-building for developing countries; (b) provisions dealing with hard-core cartels;[2] (c) modalities for voluntary multilateral cooperation; and (d) core principles in the enforcement of competition law, which refers to non-discrimination, transparency and procedural fairness. Pursuant to the Declaration, the three Working Group meetings held during the year 2002 were dedicated to addressing these four specific areas. Each of these issues will be elaborated in greater detail in the next section.

BOX 1

DOHA DECLARATION

INTERACTION BETWEEN TRADE AND COMPETITION POLICY

23. Recognizing the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 24, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations.

24. We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we shall work in cooperation with other relevant intergovernmental organisations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.

25. In the period until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, and provisions on hardcore cartels; modalities for *voluntary* cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building. Full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them.

Note: Underlining and italic emphasis added by author.
Source: http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm

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2. WHAT IS THE OBJECTIVE AND RATIONALE FOR HAVING COMPETITION POLICY IN WTO?

What does a multilateral competition framework hope to achieve?

3. A possible multilateral competition framework (MCF) would have a two-fold objective. One is to establish competition in the domestic market so as to ensure a certain degree of contestability within domestic markets in order to ensure that market access gained from trade concessions are not nullified by domestic anti-competitive practices. The other is to discipline cross-border restrictive business practices undertaken by private companies that affect the price and availability of goods available to member states. It is not clear on which objective WGTCP should be focusing, or to which it should give priority, in the discussions. Perhaps it is being left to the members to decide during the course of discussions in the working group meetings. Indeed, different objectives will give rise to a different MCF that describes the rights and obligations of members.

4. Most developed countries are concerned about market access issues since most have investment interests in many developing countries that do not yet have a competition law or a competition regime that can protect foreign companies from anti-competitive practices carried out by local incumbents with market power. Since more than 50 WTO members still do not have such a law, a multilateral agreement that would require all members to have a national competition regime, which would, in effect, guarantee foreign investors a certain degree of competition in domestic markets. The regime supposedly would not discriminate between domestic and foreign companies and have transparent procedures that would guarantee effective and fair enforcement.

5. Most developing countries, on the other hand, are more concerned about restrictive business practices of foreign multinationals, such as abuse of intellectual property rights, price-fixing, or bid-rigging that lead to higher prices of imported products or services. Trade liberalization has increasingly exposed them to multinational enterprises' abusive conduct and practices. Unlike their more developed counterparts, developing countries have very little outward investment and thus are not too concerned about whether their national companies operating overseas are protected by a competition regime in the host country. Thus, they are not interested in having national competition laws dealing with domestic anti-competitive practices. Rather, they are interested in having a global rule that would ban cross-border restrictive business practices that harm their economies but are beyond the reach of domestic authorities.

6. The proposals and views expressed by delegates from developed and developing countries in the WGTCP clearly reflected their underlying interests and concerns. Developing countries are opposed to a binding obligation to have a national competition regime or to adopt the core principles of discrimination, transparency and due process. Developed economies, on the other hand, responded negatively to the developing countries' proposal regarding a ban on export and international cartels or a binding commitment to provide cooperation in the investigation and prosecution of such cartels.

Is it necessary to introduce competition policy into WTO?

7. Existing WTO agreements include several competition-related provisions in both the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS). However, these are limited in scope in two important ways. First, these provisions target only measures taken by the State, not by business entities, unless they are State-owned.[3] This means that private anti-competitive practices such as cartels are not within the realm of the existing WTO rules. Second, these provisions do not apply to domestic laws and regulations. In other words, there is rarely a WTO agreement that requires member parties to have domestic rules or regulations that protect or assure competition in the market, with the exception of trade-related aspects of intellectual property rights (TRIPS).[4]

8. To illustrate the limitation of existing WTO provisions in dealing with private restrictive business practices, let us examine key provisions in GATT and GATS. GATT Article XI prohibits *members* from imposing quantitative restrictions as well as "measures other than duties" on *importation and exportation*.[5] This implies that members must not pass domestic rules and regulations that would result in a restriction of exports or imports, or "encourage" private companies to act in such a way that would restrict trade. However, should the private firm be engaged in an anti-competitive practice without the aid or prodding of the State, such a practice will not be considered a violation of the WTO law. Moreover, members may "condone" private practices that result in input or output restrictions. For example, members may exempt cartels from national competition laws, or not have a competition law to deal with such cartels that restrict the quantity and raise prices of exports. At the same time, GATT Article XI applies only to governmental measures that may restrict "importation and exportation" of goods across the border, not the production of these goods behind the border. This is because GATT is concerned mainly with trade, not investment.

9. The GATS general obligation does not have a provision equivalent to GATT Article XI. However, it does have a weak provision addressing private anti-competitive practices. GATS Article IX requires members to consult, with a view to eliminate certain (private) business practices that may restrain competition. However, in practice members have not made use of this rather general provision.

10. Owing to the limitations of current competition-related provisions in GATT and GATS, competition policy was introduced into WTO. Unlike trade policy, competition policy concerns private practices rather than State practices. At the national level, a national competition regime assures contestability in the domestic market, while at the global level, a multilateral competition rule can be a tool used in dealing with cross border restrictive business practices such as cartels. Thus, competition policy can fill in the gaps not covered by other non-competition WTO agreements and address the competition concerns of both developed and developing countries.

3. WHAT ARE THE MAIN CONCLUSIONS FROM THE WGTCP?

11. As mentioned previously, the three WGTCP meetings in the year 2002 were dedicated to the four issues spelled out in the Doha Ministerial Declaration. The following is a brief summary of the discussions in the working group based on the WGTCP Report for the year 2002 submitted to the General Council (WT/EGTCP/6).

3.1 Core principles

12. Core principles, including, but not limited to, *transparency, procedural fairness* and *non-discrimination*, are believed to be key elements that would foster effective and credible competition regime. The inclusion of these principles in a WTO agreement would assure traders and investors a level playing field in competition, thereby contributing to enhanced trade and investment flows.

13. *Transparency* is often referred to the publication of laws, regulations and guidelines of general application as well as exclusions and exemptions. Members would have to ensure that these documents were available to the public either in an official gazette or journal, or in electronic form accessible from a website. The transparency obligation may also involve mandatory notification of these elements to WTO. Many members raised concerns that disclosure requirements that come with transparency obligations may not be workable since different competition authorities have different administrative rules regarding what type of information can be disclosed and what type must be kept secret. There were also worries that too much disclosure would impose a heavy compliance burden, particularly on developing members.

14. *Procedural fairness* ensures that parties facing adverse decisions and sanctions would be given adequate basic rights to defend their cases. These include (a) the right to be notified that a formal investigation against them was pending; (b) the right to submit evidentiary proof and documents and to present their views to the authority either in writing or by participating in public hearings; (c) the right to appeal and; (d) the right to have private confidential information submitted to the authority protected.

15. *Non-discrimination* is probably the most controversial principle. Non-discrimination in WTO refers to two components: most-favored nation treatment (MFN) and national treatment. Although no competition law in existence discriminates between foreign companies of different nationalities on a de jure basis, but issues could arise with regard to the status of bilateral and regional cooperation arrangements in competition policy. As is the case for regional or bilateral trade agreements, cooperation arrangements in competition policy imply that certain members will be treated on a preferential basis. For example, suppose the United States of America and the European Union have a bilateral agreement whereby mergers that affect both jurisdictions – such as that between the Boeing Company and Airbus – must submit pre-merger notification and obtain clearance from both competition authorities. All other jurisdictions will not be notified and will have no say in the decision. This would constitute an MFN violation. However, the view taken in WGTCP is that bilateral and regional arrangements should be allowed to continue to operate in parallel with more basic multilateral obligations.

16. National treatment, a general obligation in GATT, refers to equal treatment for domestic and foreign products. GATT Article III.4 specifies that laws, regulations and requirements affecting internal sale must be equally favorable to domestic and foreign products. In GATS, national treatment is not a general obligation. Rather, it is tied to specific market access commitments that must be negotiated by the service sector or sub-sector. For example, if country A made a scheduled commitment to liberalize its fixed-line telephone service, then it would have the obligation to remove internal rules and regulations that discriminate between domestic and foreign firms. But if country A does not make such a market access commitment, then it would have no obligation to ensure equal treatment of foreign and domestic telecom companies. Thus, the non-discrimination obligation in GATS is much weaker than that in GATT.

17. The definition of national treatment as proposed by the European Union in the WGTCP is slightly different from those in GATT and GATS. First, it refers to the nationality of the "firms" rather than that of "products" as is the case in GATT. This implies that the non-discrimination principle discussed thus far concerns foreign investment more than foreign trade. Second, it is applied only on a de jure basis – i.e., to discrimination embodied in the laws, regulations and guidelines of general application. Consequently, the scope of application of the non-discrimination principle is greater when compared with that in GATT, which prohibits discrimination on both de jure and de facto bases. The reason provided is that it would be practically difficult to distinguish de facto discrimination from the reasonable exercise of prosecutorial discretion of the national competition authority, which is based on

objective factors. More importantly, members would be reluctant to have an international body reviewing sovereign decisions made by their competition. Nevertheless, views were also expressed that, if non-discrimination applies only to the letter of the law, then it would have no real effect since most competition laws do not have provisions that provide for special treatment or privileges to national firms as opposed to foreign ones.

18. Questions were also raised whether exemptions provided for export and international cartels would be considered discriminatory as they allowed private firms to pursue collusive practices overseas, while the very same practices were banned domestically. It would appear that the same conduct, such as price-fixing and bid-rigging, should be subject to the same discipline and sanctions regardless of whether harm is done to domestic consumers or those overseas.

Other additional principles proposed in the WGTCP

19. Besides these three core principles, two more principles were proposed and discussed in the WGTCP. They are *special and differential treatment* (S&D) and *comprehensiveness*. S&D refers to special rights and more favorable treatment for developing countries in meeting their WTO obligations. S&D provisions may include preferential market access, such as the Generalized System of Preferences (GSP), flexibility of commitments, such as the ability to impose quantitative restrictions for the purpose of establishing a domestic industry, and transitional periods in complying with WTO obligations. Several developing members believe that, since the Doha Ministerial Declaration states explicitly that *"full account shall be taken of the needs of developing and least-developed country participants*," S&*D* should constitute one of the core principles of a competition regime. How such a principle will be translated into concrete measures and obligations has yet to be discussed in greater detail.

20. Another core principle, c*omprehensiveness*, was proposed in the WGTCP in response to concerns that excessive proliferation of exemptions and exclusions may undermine the value of a multilateral agreement. Although comprehensiveness is not among WTO core principles, it is one of the four principles found in the APEC Principles to Enhance Competition and Regulatory Reform.[6] Comprehensiveness ensures a sufficiently broad application of competition principles to economic activities. It advocates that exemptions and exclusions should be designed in such a way that they minimize distortion on the competition process and that these exemptions and exemptions be subject to periodic re-examination within the context of the overall framework agreement.

Members' views

21. The European Union has been a staunch advocate of having a binding commitment to core principles. The proposal of a binding commitment raises concerns and reservations from the United States as well as developing countries. The United States was concerned about the actual implementation of these rather abstract core principles. It believes that the exact scope and coverage of these principles need to be clarified and translated into concrete obligations imposed on members. For example, what does transparency involve? Does it refer to the publication of documents such as laws, regulations and guidelines? How would it apply to common law jurisdictions where court and agency decisions could have precedential effects and thus become part of the law? What happens if members' competition authorities have different disclosure standards? For example, no information concerning a pending merger can be disclosed in the United States, but this is not the case elsewhere. It would be unimaginable to attempt harmonizing the disclosure standards and procedures.

22. Developing countries, on the other hand, are more concerned about the implications of a binding commitment in core principles for poorer countries that have limited human and financial resources. For a country without such a law, the cost of drafting and legislating the law can be hefty. For those that already have such a law, the cost of compliance with the core principles – i.e., the cost of documentation, publications, notification and establishing procedural rules – can also be equally burdensome. Many members believe that these principles should not be too prescriptive and intrusive in order to give each member the flexibility to design its own administrative procedures that will meet these principles in ways and by means that are consistent with its local legal tradition, industrial policies, institutional design and socio-political environment. Obligations under a possible MCF should focus on "achieving the end results" rather than the "prescribing the means."

3.2 Provisions on hard-core cartels

23. The term "hard-core cartels" refers to the most damaging type of collusive practices such as price- or quantity-fixing, bid-rigging and market allocation. Such practices raise prices and restrict supply, thus making goods excessively costly or even unavailable to purchasers. According to a background paper prepared for the World Bank's *World Development Report 2001*, cartel-affected imports contribute to approximately 6.7 percent of all imports (worth US$ 81 billion) by developing countries and cost developing countries approximately US$ 20 billion to 25 billion in 1997, depending on the percentage of the price mark-up. These estimates are based on only 16 products sold by known cartels, as revealed by competition authorities in Europe and the United States. The actual figures could be much higher. Cartels of a global scale may operate secretly in many countries and thus continue to elude national competition laws.

24. It was recognized in the WGTCP that hard-core cartels undermined the potential benefits of trade liberalization and imposed heavy costs, particularly on developing members that lack the bargaining power, resources and capacity to deal with such cartels. The European Union proposed that a multilateral framework on competition should have two elements regarding cartels: (a) installment of a national competition law or regime in every member country that included a provision prohibiting hard-core cartels and (b) a cooperative framework that would promote the exchange of information between WTO members regarding the cartels.

25. This proposal is built on the non-binding *OECD Council's Recommendation Concerning Effective Action Against Hard Core Cartels* adopted in 1998. The recommendation provided that member countries in the Organisation for Economic Co-operation and Development (OECD) should ensure that their competition laws would effectively stop and deter cartels and that members should cooperate with each other in enforcing the law. Exclusions and exemptions of certain sectors or practices from national competition laws are allowed, however. Thus, the European Union's proposal is mainly an extension of the OECD Recommendation to other WTO members.

26. Three issues were raised in response to the proposal. The first regards definition of hard-core cartels. What kind of collusive practices would be considered "hard core?" Should the definition be the same for cross-border versus domestic cartels? Should the definition of hard-core cartels include or exclude government and government-mandated and private export cartels? The second issue addressed concerns of developing countries with regard to the compliance cost of a possible binding commitment to the proposed principles, in particular for members that do not yet have a competition regime. The final issue concerns whether the proposed multilateral framework that is based on voluntary cooperation among competition authorities would be effective in dealing with international cartels whose operations transcend national boundaries.

Definition of a hard-core cartel

27. There are currently two sets of definition for hard-core cartels found in the non-binding agreement concerning cartels. One is the definition provided in the *OECD Council's Recommendation Concerning Effective Action Against Hard Core Cartels* adopted in 1998, which includes price-fixing, quantity-fixing, market allocation and bid-rigging. The other definition can be found in the non-binding recommendations for the control of restrictive business practices, in particular cartels, issued by the United Nations Conference on Trade and Development (UNCTAD). They are known as the "Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices," or the "Set" in short. The definition of hard-core cartels according to the Set includes – in addition to the four types of collusive practices specified in the OECD Recommendation – concerted refusal to supply potential importers, collective denial of access to an arrangement or association, and collective action to enforce a cartel arrangement, such as refusal to deal.

28. The possible definitions of hard-core cartels have been explored in the WGTCP, but no conclusion has been reached yet. Most developing countries believe that domestic and international cartels should be treated differently because of the overwhelming difference in the size of domestic markets and the global market. While there appears to be possible economic and social justification for a domestic cartel, it would be difficult to apply the same justification for collusive practices that transcend national borders. Most developing countries also believe that export cartels should be considered as international cartels since their practices lead to restrictions on exportation as well. However, developing countries would like to reserve the right to exempt cartels that consist of small- and medium-size enterprises (SMEs). While there appears to be no clear consensus concerning the two issues mentioned, there does seem to be an agreement that governmental and government-mandated cartels would not be covered by a possible multilateral competition framework.

29. The second issue concerns whether members without a competition law and authority would be able to participate in the proposed cooperative framework designed to deal with hard-core cartels. Many developing countries are of the view that members should not be obliged to introduce national competition as more than 50 member countries still do not have such a law. For these members, the obligation to introduce and enforce the law could be very costly and burdensome.

30. The third issue raised concerns the efficacy of the proposed provision on hard-core cartels. Certain members do not believe that having a national competition law that prohibits cartels will be sufficient to solve cross-border cartel problems. As mentioned previously, cartels that operate overseas are in practice beyond the reach of national competition law and authority. Even if the domestic competition authority finds foreign firms guilty of raising prices of imported goods or services, these firms need not comply with the remedial measures or sanctions imposed upon them. Unless these firms have assets in the importing country or the affected party is considered one of their important customers, there is nothing that the national competition authority or court can do when there are no reasonable substitutes for the imported products.

31. As the proposal was viewed as inadequate for certain members, a suggestion was made that perhaps the WGTCP should begin to explore the possibility of having a multilateral rule that would "prohibit" cross-border collusive practices. Such an agreement would oblige the member states, under whose jurisdiction these private companies reside, to take legal action. Given that national Governments are likely to be reluctant or legally unable to take action against local firms that impose harm overseas, only a binding global rule that prohibits

such practices can ensure effective enforcement against cartels.

32. It should be noted that this particular proposal isolates the "trade component" of competition policy from the "non-trade component." According to this proposal, the multilateral rule would apply only to collusive practices that are cross border in nature. It will say nothing about domestic competition regimes. Thus, parties to the agreement need not have a full-fledged national competition law or regime. They only need to pass a "WTO compliance law or rule" that has provisions prohibiting cross-border hard-core cartels only. That is, members would be required to take action against their own companies that are engaged in cross-border collusive practices which are damaging to other parties only. Members would not be required to take any action concerning anti-competitive practices within their own territory.

3.3 Modalities of voluntary cooperation

33. With regard to the need for a multilateral cooperation in competition policy, the view was expressed that, with the globalization of business activities, national borders cease to have any meaning. Yet, the reach of a national competition law and regime remains confined to a country's domestic jurisdiction. Thus, as with international trade, effective enforcement of competition laws and policies would require cross-border cooperation among national competition authorities.

34. Two principle types of cooperation could be foreseen in a possible MCF. The first is a general exchange of experience, knowledge, etc., among competition authorities. The second would be case-specific cooperation, whereby competition authorities may exchange non-confidential information and evidence regarding particular cases, experiences and advice regarding individual cases. The modality of cooperation would be voluntary and not limited to the case of cartels.

35. Several "tools" that will be included in a voluntary cooperative framework were also discussed. These include (a) notification, whereby a national competition authority would alert others of certain anti-competitive cases that may affect their interests; (b) exchange of information to facilitate enforcement; (c) mutual assistance in the enforcement process; (d) negative comity,[7] which requires a country to take into account the important interests of another country when considering whether or not to pursue investigation and designing remedies. It should be noted that these cooperative modalities can already be found among many bilateral agreements in competition policy between various members such as European Union and the United States. Unfortunately, agreements to cooperate in competition policy thus far seem to be a domain exclusive to developed economies with comparable economic status. Very few developing countries are involved in such an agreement.

36. Certain developing countries question the effectiveness of a cooperative framework on a voluntary basis. Since very few developing countries possess the required skills, information and resources to enforce competition laws, competition authorities in developed countries would be less willing to cooperate with counterparts that cannot offer reciprocal benefits. More importantly, developing countries are very rarely the source of cross-border anti-competitive practices since the size of their firms is often too small to dominate the global market. Thus, the occasions when a developed country would be harmed by the practices of private companies operating in a developing country's territory would be extremely rare. If so, developed countries are unlikely to be in a position to request competition authorities in developing countries to enforce the law on their behalf. Owing to the asymmetry in the benefits that arise from cooperation, developing countries are likely to be treated discriminatorily under a voluntary scheme.

37. It was proposed that cooperation should have two tracks. The first track concerns general co-operation or cooperation involving non-trade-related anti-competitive cases, which should be voluntary. This type of cooperation should not require a national competition law and authority. Each individual member should reserve the freedom to decide when it would want a competition law and authority, and thus to participate in multilateral cooperation.

38. The second track involves cross-border issues, in particular hard-core cartels. Cooperation in this track should be binding, as a non-binding alternative is unlikely to be able to solve the problem. Thus, a binding framework could be limited only to the trade-related aspect of competition, i.e., cartels. It was emphasized that, without the assurance of clear and concrete benefits from a multilateral cooperative framework, developing countries would be reluctant to accept obligations to promulgate and enforce national competition laws.

39. At the same time, however, certain developing countries were apprehensive about a binding commitment to cooperate, as they are afraid that their competition authorities may be bombarded with requests for information and assistance in investigation from their counterparts in more advanced countries. As mentioned previously, although firms from a developing country are rarely involved in cross-border cartels, foreign cartels may be operating secretly in developing economies in order to avoid the surveillance of the competition authorities in countries where they reside. It is imaginable that competition authorities in developing countries will be flooded with requests from their (more active) counterparts in the developed countries to assist in the latter's investigation against cartels operating in their territories.

40. In light of the obvious resource constraint that poorer countries face, should an MCF include a binding commitment to cooperate, certain special and differential treatment for developing members must be

provided to ensure that compliance will not be overly burdensome for developing countries.

3.4 Support for progressive reinforcement of competition institutions in developing countries (paragraph 25 of the Doha Ministerial Declaration)

41. Technical assistance and capacity-building comprise an agenda advocated by developing countries. This is because many developing countries still do not have a competition law, or face implementation problems. Thus, much technical assistance and capacity-building will be required to build technical expertise in competition analysis and effective enforcement of a competition regime in developing countries.

42. There is a clear consensus in the WGTCP that technical assistance and capacity-building will be necessary to strengthen institutional capacities in developing countries. It was agreed that such assistance should be long-term and tailored to the specific needs of member countries. One-shot programmes that last several days or conferences that focus mainly on general issues concerning competition law and policy are generally ineffective since the materials presented cannot be applied at the practical level.

43. It was also mentioned that assistance should be aimed at building developing countries' ability to sustain training on their own. That is, training should be tailored to "train the trainers." The curriculum used for the training should also be in the local language(s) and tailored specifically to the local environment. Case-specific studies have proven to be one of the most effective training modes. Better coordination among different donors was also called for. It was proposed that international organizations such as UNCTAD could help to take stock and coordinate bilateral assistance to ensure that these programmes are complementary and do not overlap or become redundant.

3.5 Flexibility and the needs of the developing members

44. Paragraph 25 of the Doha Ministerial Declaration state: "Full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them." The task of the WGTCP is to clarify what kind of flexibility would meet the needs of developing countries.

45. Two types of flexibility were proposed and discussed in the WGTCP. The first is the ability to exempt or exclude certain sectors or businesses from national competition laws or regimes in order for members to be able to achieve other national objectives such as social, economic and industrial development. It is also proposed, however, that exemptions and exceptions must be subject to transparent procedures and periodic review, as mentioned previously. The second type of flexibility refers to compliance transition periods. That is, developing countries without a national competition law, or those with such a law but facing implementation problems, will be allowed an extended period of time for phasing in the introduction and implementation of competition legislation.

46. Questions were raised about both types of flexibility. With regard to exemptions and exceptions, certain members were concerned that a proliferation of exemptions and exceptions may undermine the value of a competition regime. Thus, it was proposed that "comprehensiveness" should be included as one of the core principles to ensure that the competition regime maintains an acceptable scope of application. Views were expressed that exemptions and exceptions provided for international cartels should not be allowed, as these cross-border restrictive business practices do not have any justifiable defense, be it developmental, social or economic.

47. With regard to the transition period, certain developing countries suggested that it be linked to the individual member's level of development rather than be given a fixed time period that appears to be arbitrary. That is, as was the case with GSP, where members would "graduate" from the special preferential tariff scheme as their incomes exceed a certain threshold, flexibility in a possible MCF should also allow an individual member to continue to be exempted from obligations until its level of development reaches a predetermined threshold.

3.6 Compliance mechanism

48. There are several compliance mechanisms in WTO, ranging from the "softer" ones such as consultation, to binding ones that are subject to the dispute settlement understanding (DSU). Those that have been considered in the WGTCP include consultation, peer review and DSU.

49. Consultation can be an effective means to solve disputes as it enables parties to try to settle voluntarily a dispute on their own and thus helps to screen cases that will have to go through a formal DSU that is information- and time-intensive. As a result, members are required to consult each other and try to work out a solution before resorting to a DSU. At the same time, consultation is also used without the backing of a DSU for weaker obligations. Experience shows that while consultation may prove to be an efficient means of settling disputes, its non-binding nature may cause parties not to take it seriously.

50. Peer review is another compliance mechanism WTO has used. This non-adversarial collegial review is supposed to serve as "peer pressure" on members to put forth their "best efforts" in complying with non-binding obligations. Currently, the only peer review mechanism in use in WTO is the Trade Policy Review Mechanism, which periodically assess members' laws, regulations, procedures and institutions concerned mostly with trade. The reviewing committee often consists of representatives from the WTO Secretariat, the country being reviewed and examiners who are normally

drawn from the peer group. The review process involves examination of documents submitted by members, investigation and examination; a report is then prepared by the Secretariat for dissemination.

51. The DSU is the main pillar of WTO. The mechanism ensures that members' rights and obligations are in keeping with provisions of agreements. It provides for the establishment of a panel of experts to resolve disputes where consultations failed to reach a solution. Panel decisions are binding but appeal procedures are available. Non-compliance with the decision of the dispute settlement body (DSB) may result in suspension of concessions and, less commonly, compensation.

52. The discussion on the compliance mechanism in the WGTCP thus far has focused mainly on the issue of core principles. As mentioned previously, the European Union is a staunch advocate of having a binding commitment in core principles. Developing countries, in particular those without a national competition law and competition institution, are opposed. A suggestion was made that a possible way forward would be to have a general set of principles that are binding and a set of detailed approaches for the application of such principles in the form of non-binding guidelines or a menu of options.

53. As for other issues, including hard-core cartels, cooperation and technical assistance, the assumed compliance mechanism is non-binding, as explained previously. The European Union's proposal includes a mechanism of consultation and voluntary cooperation on cross-border hard-core cartels. Technical assistance and capacity-building are assumed to be voluntary in nature since there has not been a precedential binding commitment in this area in WTO.

4. WILL AND CAN DEVELOPING COUNTRIES GAIN FROM A MULTILATERAL AGREEMENT ON COMPETITION POLICY?

54. Can developing countries benefit from a multilateral agreement on competition policy? The answer, of course, will depend on the framework and the modalities of the negotiation.

55. In a nutshell, developing countries will gain from an agreement that will effectively ban hard-core cartels that are estimated to cost developing countries approximately US$ 20 billion to US$ 25 billion annually. This amount is almost double the size of welfare gains that would accrue to developing economies if there were a worldwide 50 percent cut in agricultural subsidies, which are estimated to be worth US$ 13.4 billion.[8] Thus, there is no doubt that if these large annual transfers of rent from consumers in developing countries to multinational companies in developed countries could be halted or minimized, the developing world would have much to gain.

56. In the author's view, the call from developing countries for a WTO law that would ban transnational private cartels would be most justified. WTO has done much to promote free trade, but very little to ensure fair trade to protect smaller members with little or no economic power. The minimal approach in dealing with cartels proposed by the European Union, which entails voluntary cooperation among competition authorities, would not guarantee any benefits to developing countries. In the end, developing countries may be forced to pass and implement national competition laws that would serve only to prosecute domestic cartels and ensure market access for foreign firms operating in their territories, while blatant cross-border anti-competitive practices would continue to operate unabated.

57. To ensure that developing countries' interests are maximized, the following positions should be considered when considering a possible multilateral competition framework in the WGTCP.

4.1 Core principles

58. Much of the attention in the Working Group has been devoted to the discussion or core principles advocated by the European Union. While it has been made explicit that there is no intention to harmonize national competition policies, these principles can nevertheless be seen as the first step toward harmonization of national competition laws. Although these general principles indeed have merits, to have a multilateral agreement prescribing them is not necessarily in the interest of members that do not yet have a competition law or those whose enforcement procedures do not yet comply with the core principles of non-discrimination, transparency and procedural fairness, owing to institutional, resource or other constraints.

59. First, commitment to these principles would require a national competition law, although it was proposed that a regional competition regime, such as that in the case of the COMESA (Common Market for Eastern and Southern Africa),[9] would be workable. However, given that a regional regime is not an option for many members, a competition regime would normally require a national competition law. While a competition regime could certainly help to promote competition in the domestic market, the decision regarding how and when a country would want to have such a law should not be dictated by a multilateral agreement. Rather, it should be a sovereign choice. Competition law and policy is a complex subject. If the implementing authority does not have sufficient skills, resources, information or experience, the law can be easily be used by dominant or powerful private firms as a tool to secure market share rather than to promote competition.[10] A badly set up competition regime may also fall victim to political influences that serve to protect the interests of powerful incumbents. Thus,

having a national competition law is indeed not a panacea.

60. Second, although the core principles are desirable qualities of a competition regime, individual member States should be able to decide how and when to adopt them. By prescribing these principles, the multilateral framework would be imposing a regime developed in more advanced countries on less advanced countries, with which it can be very costly to comply. The Doha Ministerial Declaration stated clearly that any multilateral agreement should not impose an excessive financial burden on less developed members.

61. Third, a commitment to the non-discrimination principle that applies to the nationality of "firms" rather than "products" may undermine ongoing sector-specific negotiations in GATS. This is because GATS does not impose a non-discrimination principle as part of the general obligation; the condition is binding only when a member country makes a specific market access commitment to liberalize a particular service sector or sub-sector. Thus, developing countries should be made aware of the implications of a horizontal non-discrimination commitment in competition policy on their bargaining positions and interests in other issues.

62. Fourth, competition law is concerned with market access for business entities with a commercial presence in the domestic market. Thus, it is directly related to investment. As there is not yet an agreement in WTO on cross-border investment, a binding non-discrimination obligation based on the nationality of the firm would be premature.

4.2 Hard-core cartels and multilateral cooperation agreement

63. The second meeting of the WGTCP in 2002 was dedicated to issues concerning hard-core cartels and "voluntary" cooperation. In the author's view, the aggregation of these two issues in a single meeting may have downplayed the importance of cross-border hard-core cartel problems. Also, by "bundling" the two issues together, voluntary cooperation was taken as the "given" provision to deal with hard-core cartels, and thus foreclose other better and more effective options. Nevertheless, the inadequacy of voluntary cooperation in dealing with international cartels was recognized by certain members, and a WTO "prohibition" of cross-border private cartels was proposed as an alternative provision. Unfortunately, it has not yet had a chance to be explored in greater depths in the WGTCP.

64. In the author's view, much work has to be done on assessing the various options that would effectively deal with international cartels. For example, one may examine existing provisions in GATT that deal with quantitative restrictions or GATS that deal with private restrictive practices and see what can be done to increase the scope of their application to cover private cartels. Alternatively, one could consider the possibility of foreign companies affected by cartels to have a "legal standing" in the court of another member country where the firms alleged to be involved in a cartel case are registered. This option is similar to TRIPS. Further, as with the United States Foreign Corrupt Practices Act, bid-rigging and price-fixing may be treated as being equivalent to corruption; thus, such activities are considered illegal regardless of where they take place.

4.3 Technical assistance and capacity-building

65. While the discussion in the WGTCP confirms that technical assistance and capacity-building will be required for developing countries and that such assistance should be long-term and tailored to the specific needs of member countries, there was no mention of a bound commitment. In WTO, there has never been a bound commitment to provide technical assistance and capacity-building, despite the fact that the needs are well recognized by all members.

66. An example of a costly compliance is the TRIPS agreement, whereby developing countries are obliged to pass internal laws that protect the foreign intellectual property rights of patent holders, most of which are from the developed countries. While the agreement has already resulted in a massive transfer of rents from developing to developed economies in terms of royalty fees, the cost of promulgating the law, setting up the necessary institutions and enforcement has imposed additional costs that developing countries have had to bear in order to protect the interests of mainly foreign patent holders.

67. In the author's view, any multilateral agreement should not impose the burden of compliance cost on developing members any more than it would on developed members. However, if a multilateral agreement in competition policy imposes similar costly obligations in terms of passing and implementing competition laws, a "competition policy fund," earmarked for technical assistance and capacity-building, should be established to help offset the costs. How much funding developed countries would be willing to commit for an extended period of time should be part of the negotiation, and the commitment made should be binding.

4.4 Flexibility and the needs of the developing members

68. As mentioned previously, flexibility in a possible MCF has been referred to (a) the ability of members to exempt or exclude certain sectors or businesses from national competition laws and (b) a transitional period allowed for developing members that do not yet have a law to introduce and implement a competition law. The latter type of flexibility has been labeled as "progressivity" in the WGTCP, in order to reflect gradual implementation of a possible WTO obligation for developing members. The question is, will developing countries benefit from the proposed flexibility and progressivity?

69. The author does not believe that the proposed flexibility and progressivity will meet the needs of developing countries. First, progressivity in the form of transition periods does not necessarily benefit developing countries if the substantive elements of the pending obligations are not in the interest of developing countries. For example, the TRIPS agreement requires all members to comply with the substantive provisions by 1 January 1996. Developing and transitional countries were allowed a transition period until 1 January 2000; the least developed countries, 1 January 2006. Delayed compliance does not make TRIPS any more agreeable to these countries as it simply defers the heavy cost burden to a later date. Similarly, if the obligation to pass a national competition law and adopt the proposed core principles is not to the advantage of developing countries to begin with, then transition periods – however long – would be to no advantage for developing countries.

70. As for the flexibility to exempt a particular sector or industry from the competition law, TRIPS is a two-edged sword. First, developing countries must recognize that exclusions and exemptions do not represent a special and differential treatment for developing countries, since developed countries, too, are also allowed to make exemptions. In fact, these exemptions may run against the interest of developing countries considering the fact that many developed countries exempt export cartels and some, international cartels – in particular shipping cartels – from their national laws. Thus, continued cartel exemptions would undermine efforts to stamp out anti-competitive cartels, which developing countries would hope to achieve in a possible MCF.

71. In the author's view, if exemptions and exceptions from national or regional competition law are allowed, those that concern cross-border collusive practices should not qualify. This is because allowing domestic firms to be involved in cross-border collusive practices that raise the prices of products sold elsewhere (as long as it is not at home) is very much a "beggar thy neighbor" policy that serves only the interests of the exporting countries to the detriment of global trade. Such practices should be outlawed in WTO to ensure that national competition regimes do not condone practices that have "negative spillovers" on other member countries.

72. The author believes that a meaningful special and differential treatment for developing countries should entail non-reciprocal or unilateral commitment on the part of developed economies to deal effectively with cartels that originate in their countries. For example, this could include a unilateral commitment on the part of developed members to (a) provide cooperation in assisting developing countries in the investigation and prosecution of cartels; (b) remove export/international cartels' exemptions from national competition laws; (c) comply with core principles in enforcing the law; or (d) demonstrate "best efforts" in dealing with cartels that are found to harm other parties by employing administrative measures to sanction export and international cartels when such cartels are beyond the reach of the national competition law of the parties affected. A "peer review" may be conducted to monitor actual efforts taken.

4.5 Compliance mechanism

73. According to the European Union's proposal, a possible MCF would include a binding commitment on core principles and non-binding commitments on other elements including cooperation and technical assistance. It is difficult to see how developing countries could benefit from the proposed compliance mechanism. Having a national competition law would by no means promote market access for developing countries. On the contrary, it would tend to promote market access by foreign multinationals that are located overseas.

74. If the European Union succeeds in making the core principles a binding commitment, developing countries will have to mobilize resources to comply with such an agreement without any secured technical assistance, capacity-building and cooperation from more advanced members, as these elements are non-binding. What is more worrying is that there appears to be no clear logic or principle in deciding which element of an MCF should be binding and which should be voluntary. The proposed compliance mechanism assigned to each specific issue seems to be "picked and chosen" arbitrarily without any clear objective. How does one decide on an "appropriate" compliance mechanism? The lack of clarity raises many questions concerning the proposed compliance mechanism.

75. For example, what would a binding commitment in core principles be aimed at achieving? Market access for foreign companies or fair cross-border trade? On which element should a peer review mechanism be used? Should it be used to review members' progress on the legislation and implementation of national competition laws? Or should it be used to review whether members had put in their "best efforts" in providing technical assistance and capacity-building, or in trying to discourage or discipline cross-border collusive practices (including export cartels)? Why is cooperation in dealing with cross-border cartels voluntary?

76. In the author's view, clear objectives of a possible MCF have to be established and different objectives need to be prioritized. Since WTO is very much a trade forum, despite the fact that non-trade issue such as intellectual property rights managed to enter into its domain, the strongest provisions should apply to elements with the strongest trade component. Elements that have only secondary links to trade, i.e., those that are considered "behind the border" issues, which concern domestic rules and regulations more than trade, should have weaker compliance provisions. According to this logic, then, a binding commitment on cross-border cartels would be most appropriate, while that on the core principles should be voluntary.

4.6 Conclusion

77. The author believes that competition law per se does not have a place in WTO, and that the important issue should be the trade-related dimension of competition law and policy, which is cross-border anti-competitive trade practices, in particular international and export cartels. The question that should be addressed is how multilateral agreement can help to solve cross-border anti-competitive practices such as price-fixing cartels that are beyond the reach of national competition authority.

78. Competition law and policy is a complex subject, in particular for member countries that do not yet have such a law. Thus, developing countries are suspicious that the underlying agenda would be more about developed countries' investors seeking access to developing countries' markets by meddling with the domestic regulatory regime, rather than a genuine commitment to establish fair cross-border trade. If that is the case, developing countries would need to "do their homework" in order to be able to counter the proposals currently tabled to ensure that the framework and modalities are consistent with their interests.

5. OPTIONS FOR DEVELOPING COUNTRIES GOING FORWARD

79. At the Fifth WTO Ministerial Conference in Cancun, in September 2003, members were expected to decide whether they would want to include competition policy in the list of issues that will be negotiated in the next round. There is very little time remaining and thus the following options may be considered: (a) decide not to negotiate and maintain the status quo; (b) continue exploring a possible MCF; and (c) decide to negotiate.

5.1 Maintain the status quo

80. If members cannot come to a consensus on the modality of the negotiation by the time of the Fifth Ministerial Meeting, competition policy will not enter the next round of the WTO negotiation. What this means is that developing countries would not have any obligations relating to the legislation and enforcement of a national competition law. At the same time, however, international cartels will continue to operate unabated, which means that consumers in developing countries will continue to pay billions of dollars for overpriced imports as a result of cartelized activities. Indeed, maintaining the status quo is a definitely worrisome option.

5.2 Continue exploring a possible MCF

81. There is no doubt that much more technical assistance and capacity-building in this area are required so that developing members may better evaluate the implications of closer multilateral cooperation or a multilateral rule regarding competition policy, as stated in paragraph 24 of the Doha agenda. Thus, the option of not abandoning the issue altogether, but extend the period required for members to develop a deeper comprehension of the various issues discussed, would seem to be ideal. It is undeniable that, since competition policy entered WTO in 1996, members that do not yet have a competition law, or that are not enforcing it, have become much more aware of competition law and policy. So, it would be a loss to halt the current momentum.

82. However, advocates of having competition policy included in the next round of negotiation are concerned that the WGTCP has spent six years exploring the issue, it would be difficult to justify a further extension. Also, if competition policy is not part of the coming round of negotiation, it would be decades until any substantive agreement on this issue could be expected from the ensuing round of negotiation.

5.3 Agree to negotiate

83. Although there seems to be no clear consensus on the modalities in the WGTCP at this time, as the deadline approaches, things may change rapidly beyond one's imagination. The reality is that competition policy is only one of several issues on the table. It may be only a bargaining chip used in the negotiation of other key issues, in particular agriculture. What this means is that developing countries may agree in the end to enter negotiations on competition policy in exchange for more favorable concessions on other issues, say, agriculture. However, the author would like to point out that international cartels can be just as costly, if not more costly, to developing countries as agricultural protection is, as was pointed out previously. Thus, developing countries should put forth their best efforts to ensure that the modalities for negotiation in competition policy are in their best interest. Competition policy need not be a developed country's agenda if the developing world can participate effectively in setting the agenda. The author of this paper has tried to point out ways in which competition policy in WTO can become a developing country's agenda.

ENDNOTES

[1] Other issues included are trade and investment, transparency of government procurement and trade facilitation.

[2] Hard-core cartels refer to the most damaging type of collusive practices such as price-fixing and bid-rigging. The exact definition of "hard core" is not yet precise. However, possible definitions have been examined in the WGTCP as will be elaborated in greater details in section 3.

[3] Anti-dumping is probably the only provision that deals with private practices. But even in that case, there are no prohibitions. The agreement merely allows the member State whose industry is adversely

affected by such practices to impose surcharges as a remedial measure.

[4] The Telecommunications Reference Paper, which is part of the Agreement on Basic Telecommunications (ABT) concluded in 1997, is another agreement that binds agreed parties to adopt domestic rules and regulations that will maintain adequate measures to prevent potentially anti-competitive practices undertaken by dominant suppliers in the market. The agreement is an extension of competition rules to international trade in services. However, even with these provisions, the agreement is very limited in its application. Members are free to commit or not commit to the Reference Paper, or choose to commit to certain parts of the Paper.

[5] GATT Article XI. General Elimination of Quantitative Restrictions. (1) No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses, or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of another contracting party or on the exportation or sale of export of any product destined for the territory of any other contracting party.

[6] The four principles of the Asia-Pacific Economic Cooperation forum include accountability, transparency, non-discrimination and comprehensiveness.

[7] Negative comity principles are designed to avoid conflicts between the enforcement of different national competition laws. It implies that, in the case of a transnational violation of competition law, a competition authority in a particular country may refrain from enforcing the law and leave it to the authority of a foreign country, where a significant interest of that country might be affected. In return, the competition authority in the foreign country would take into consideration the interests of the country practicing a negative comity. In contrast, a positive comity agreement refers to a situation in which a competition authority in a country harmed by cross-border anti-competitive practices would request another competition authority that is better placed to tackle the violation to investigate the case. The positive comity principle requires highly developed competition regimes with comparable substantive and procedural provisions.

[8] UNCTAD (2003), Back to Basics, Chapter 5.

[9] COMESA has drafted a regional competition regime, the COMESA Regional Competition Regulations and Rules, in order first to ensure fair competition within that region and second that the benefits from economic integration and trade liberalization do not accrue to a limited section of the economy.

[10] For example, an incumbent may claim that competitors are pursuing predatory pricing and thus the incumbent may request the competition authority to issue an order to stop the price-undercutting.

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Exchange Rate Pass-Through in Thailand's Import Industries

Piriya Pholphirul*

I. INTRODUCTION

Since the collapse of the Bretton-Woods exchange rate system in 1973, thousands of articles have been published about studies of the law of one price, purchasing power parity, exchange rate pass-through, and pricing-to-market. However, the term exchange rate pass-through, referring to the response of import prices to exchange rate change, has evolved considerably over time. Initially, the model of balance of payments assumed a one-for-one response of import/export prices to exchange rates as a "full" or "complete" exchange rate pass-through. However, several studies suggest that exchange rate pass-through is less than complete where the price of foreign products sold in the domestic market changes by a lower percentage than do exchange rates.[1] After a long period of debate over the law of one price, beginning in the late 1980s exchange rate pass-through studies in industrial organization emphasized the role of segmentation and price discrimination across geographically distinct product markets. The rise of imperfect competition and strategic trade theory led researchers to estimate exchange rate pass-through at the industry level. Incomplete pass-through occurs when the markup of prices over marginal costs changes with exchange rate changes and performs as a non-zero markup. Because the non-zero markup is a deviation from conditions of perfect competition, an incomplete exchange rate pass-through validates the shift toward models of imperfect competition.

Besides the industrial organization approach, understanding the properties of exchange rate pass-through has been extended to explain appropriate monetary policy and exchange rate regime optimality. This concept explains that, when prices are not very responsive to exchange rates or a lower degree of exchange rate pass-through, monetary policymakers cannot rely on exchange rates to provide the necessary monetary expansion. As a result, customers in that country do not interpret exchange rate changes as relative price changes, which makes policy ineffective for stabilizing growth.[2] Exchange rate pass-through is also important for trade economists with regard to whether or not currency devaluation would improve a country's trade balance. With the small extent of pass-through, the nation's balance of trade may not improve as a result of that government's currency devaluation. Economists argue that the reason that the trade balance does not improve immediately after the devaluation of a domestic currency may be related to the lag or gradual adjustment of trade flow, which is explained as the *J-Curve* Model.

Exchange rate pass-through in Thailand, however, does not gain much consideration, even though there were huge fluctuations in the value of the Thai Baht after the 1997 crisis. The floating Baht regime nonetheless had an impact on prices through trade and expectations, in the external sector, on financial stability, and on the functioning of foreign exchange markets. Figure 1 presents high volatility of Thailand after the 1997 financial crisis. This after-shock effect after 1997-crisis should therefore play an important role on country's international pricing. For these reasons, the purpose of this paper is threefold. First, it implements the estimation procedure of exchange rate pass-through coefficients of Thai import industries of both short-run and long-run coefficients. Second, this paper determines how the degree of exchange rate pass-through has been affected by the high volatility of the Baht currency since the 1997 crisis. Third, the policy implications and the policy debate are discussed in the context of pass-through rates as an effective indicator of three major economic policies: 1) policy development to foster market competition, 2) monetary policy, and 3) international trade policy.

The next section of this paper provides exchange rate pass-through estimation on short-term and long-term bases. Section III discusses the policy implications and policy debate, and Section IV concludes the paper.

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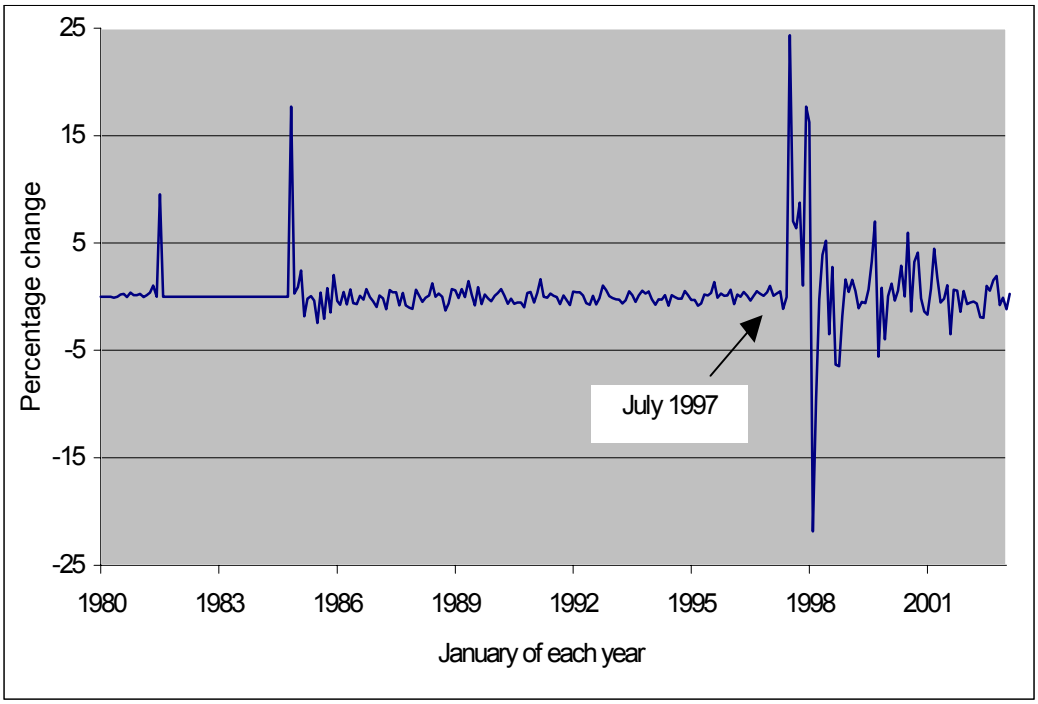
Figure 1 Monthly Percentage Change of the Baht/US$ Exchange Rate: January 1980 – June 2003



Source: International Financial Statistics, IMF: January 1980 – June 2003.

II. DATA AND ESTIMATION

This pricing framework refers to a simple model of the international price-cost margin in which import prices are affected by three components: (i) changes in exporters' marginal costs, (ii) changes in the markup of prices over marginal costs (price elasticity), and (iii) changes in exchange rates.[3]

$$P = e.MC.\frac{\varepsilon_t}{\varepsilon_t - 1} \quad \text{.....} (1)$$

where P is the price in the import currency unit, e is the exchange rate, and MC is the foreign exporters' marginal cost.

Thai monthly data from January 1996 to May 2003 used in this study are based on the above international price-cost margin. However, before proceeding to make estimates, it is necessary that each time series be stationary. The Augmented Dickey-Fuller (ADF) tests on the natural logarithm of the import price index and exchange rates show that most of the time the null hypothesis of a unit root cannot be rejected at the 95 percent confidence level for the AR(1) process. Given that the existing time series is non-stationary, ordinary least squares estimation has been applied to data that were transformed into natural logarithm differences based on Campa and Goldberg (2002).

The dependent variable p_t, collected from the Bank of Thailand, is the Thailand's import price index in Baht classified according to nine major import industries, and p_{t-1} is its one-period lag; e_t is the nominal effective exchange rate provided by *International Financial Statistics*. There are two control variables: c_t, which is a proxy for foreign export costs, and y_t, which is another proxy of the productivity index representing domestic demand conditions. The last independent variable, *Crisis*, denotes a dummy variable, which equals "zero" when referring to pre-July 1997 crisis and equals "one" when referring to post-July 1997 crisis.

$$\Delta ln\, p_t = \beta_0 + \beta_1.\Delta ln\, e_t + \beta_2.\Delta ln\, p_{t-1} + \beta_3.\Delta ln\, c_t + \beta_4.\Delta ln\, y_t + \beta_5.Crisis + \varepsilon_t \quad \text{.....}(2)$$

Again, based on Campa and Goldberg (2002), the exporters' cost, c_t, is the conversion of the Baht import price into a foreign currency price, adjusted by the real effective exchange rate as calculated below:

$$c_t = \frac{re_t}{ne_t}.p_t, \quad \text{.....}(3)$$

where ne_t and re_t are the nominal and real effective exchange rates, respectively.

In the above model, β_1 is the short-run exchange rate pass-through elasticity with expected positive sign (i.e., the percentage increase in the import price index for a 1 percent depreciation in the Baht) and $\beta_1/1-\beta_2$ is its long-run coefficient. The effect of the 1997 crisis on pass-through elasticity in the short run is therefore measured by $\beta_1 + \beta_5$ in the short run and by $(\beta_1 + \beta_5)/1-\beta_2$ in the long run.[4] β_3 is an estimated

coefficient of a control variable accounting for the exporters' cost effect and β_4 accounts for the demand effect. Total import industries comprise 6,034 import items under the Harmonized System covering more than 90 percent of total import values. The Bank of Thailand compiles data as a chained index with 1995 as the base year. Then it groups those items into nine industries based on the Standard International Trade Classification (SITC) scheme. The results of this regression over the sample period on the nine industries are presented in Table 1. In addition, Table 2 shows the estimated coefficients classified into the short-run and long-run effects of both the pre-1997 crisis and the post-1997 crisis.

With regard to the results shown in the tables below, we can find evidence, first, that the exchange rate pass-through coefficients of Thailand's import industries are quite low. The low degree of pass-through plays somewhat of a determinant role for policymakers to be concerned less about the effectiveness of monetary policy in stabilizing growth and international trade policy in boosting trade volume. The lower the extent of pass-through, the less is the substitution between import goods and domestic consumption; also, this situation generates market inefficiency in that there is a non-zero markup of import prices relative to the exporters' costs. This implies that the price of imported products is considerably higher compared with the exporters' costs. The pass-through coefficients are found to be the lowest in the crude materials industry, and the animal and vegetable oils and fats industry; they are the highest in the machinery industry. However, the pass-through coefficients are not significant in the mineral fuels and lubricants industry.

Table 1: Regression of Exchange Rate Pass-through Coefficients of Nine Major Industries

Industry	Constant	e_t	p_{t-1}	c_t	y_t	*Crisis*	Adjust R^2
- Food	0.099*** (3.56)	0.395*** (5.97)	0.690*** (14.35)	0.112** (1.97)	-0.215*** (-4.42)	-0.115*** (-4.12)	0.925
- Beverages and tobacco	0.123** (2.00)	0.450*** (4.45)	0.670*** (9.95)	0.213* (1.67)	-0.334*** (-4.23)	-0.143*** (-3.89)	0.895
- Crude materials	0.039 (1.29)	0.170*** (2.73)	0.839*** (17.33)	0.157** (1.96)	-0.033 (-0.74)	-0.050* (-1.76)	0.879
- Mineral fuels and lubricants	-0.037 (-0.70)	-0.079 (-0.71)	0.965*** (30.44)	0.234** (2.01)	0.062 (0.78)	0.046 (0.92)	0.857
- Animal and vegetable oils and fats	0.048 (1.48)	0.104* (1.64)	0.998*** (32.76)	0.132 (1.45)	-0.005 (-0.06)	-0.051 (-1.59)	0.873
- Chemicals	0.091*** (3.26)	0.358*** (5.11)	0.703*** (14.25)	0.324 (1.00)	-0.032 (-0.80)	-0.093*** (-3.30)	0.934
- Manufactured goods	0.008 (0.35)	0.297*** (6.07)	0.712*** (17.73)	0.435* (1.65)	0.014 (0.40)	-0.035 (1.61)	0.965
- Machinery	0.122*** (4.61)	0.527*** (7.29)	0.722*** (20.70)	0.274 (0.98)	0.021 (0.53)	-0.122*** (-4.66)	0.981
- Miscellaneous manufactured goods	0.027* (1.77)	0.496*** (12.91)	0.578*** (20.47)	0.184 (1.11)	0.120*** (4.57)	-0.021 (1.41)	0.992

Note: Values enclosed in parentheses represent *t-statistics*. $*p < 0.10$, $**p < 0.05$, $***p < 0.01$.

Table 2: Exchange Rate Pass-through Coefficients of Thai Import Industries

Industry	Short-run Coefficients		Long-run Coefficients	
	Pre-crisis	Post-crisis	Pre-crisis	Post-crisis
Food	0.395***	0.280***	1.274***	0.903***
Beverages and tobacco	0.450***	0.307***	1.363***	0.930***
Crude materials	0.170***	0.120***	1.055***	0.745***
Mineral fuels and lubricants	-0.079	-0.033	-2.257	-0.942
Animal and vegetable oils and fats	0.104*	0.063	52.000	31.500
Chemicals	0.358***	0.265***	1.205***	0.892***
Manufactured goods	0.297***	0.262***	1.031***	0.909***
Machinery	0.527***	0.405***	1.895***	1.456***
Miscellaneous manufactured goods	0.496***	0.475***	1.175***	1.125***

Note: $*p < 0.10$, $**p < 0.05$, $***p < 0.01$.

The second result of this estimation also shows that the degree of exchange rate pass-through to Thailand's import prices decreased after the 1997 crisis when the Baht was highly volatile. One reason for this is that exporters, who are forward-looking and face uncertainty in predicting exchange rate volatility, would decide to hedge their export commodities toward forward-currency contracts. With such forward contracts, price setting would be more stable, not changing as much as the changes in the currency. Another reason from the exporters' perspective is whether the currency changes would be temporary or permanent. A floating exchange rate may require exporters to frequently adjust their prices, which would cost them higher "menu costs." If foreign exporters would like to avoid such menu costs, they would choose not to adjust their prices.[5]

Finally, the third result shows that a long-run pass-through is higher than a short-run pass-through, which means that the speed of adjustment to Thailand's import prices appears to be quite rapid. The price adjustment of a one-month period lagged is very responsive to exchange rates.

The next section will discuss the policy debate and the policy implications of a partial degree of exchange rate pass-through.

III. POLICY DEBATE AND IMPLICATIONS

Understanding the determinants of exchange rate pass-through is an important contribution to the policy debate. The first policy discussed here is the development policy toward market competition. The low degree of pass-through implies the market power of foreign exporters in the Thai market, that market power generates market inefficiency and market distortion, both of which are disadvantageous for customers and domestic producers. With regard to this economic development, policymakers should be concerned with improving market competition between imported goods and domestic goods, where the improvement in competition is the result of a number of policy initiatives such as production subsidies, and import substitution, among others.

Compared with other policies, the extent of exchange rate pass-through is of great concern to the Bank of Thailand in deciding to launch a monetary policy with the purpose of GDP-targeting stabilization. Obviously, the optimal monetary policy depends on a fundamental way on the type of price stickiness. In a low exchange rate pass-through context, where prices are stickier and not responsive to exchange rates, monetary policymakers cannot rely on the exchange rate to provide the necessary adjustment to real shocks. To the extent that consumers do not interpret exchange rate changes as relative price changes in the short run, monetary policy can achieve only an inferior outcome in which it is unable to control GDP targeting. Therefore, when there is a low pass-through to the price level, as noted by Devereux (2001), monetary policymakers should choose a different approach to inflation targeting, which is much easier to implement than the GDP-targeting approach. Moreover, if import prices are highly correlated with consumer prices, there will be less distinction between import prices and government control over consumer prices. Therefore, this will help in reducing the effects of low pass-through coefficients to consumer demand and cause monetary policy to be more effective. In summary, implementing a central role for intermediary agents would absorb some of the exchange rate fluctuations, as indicated by the greater degree of exchange rate pass-through to import prices than to consumer prices.

Exchange rate pass-through not only reflects the debate in policy development with regard to competitiveness and monetary policy, but it also is important in international trade policy. One of the main questions to be answered is whether devaluation of the Baht would improve Thailand's balance of trade and its implications for welfare. The limited degree of exchange rate pass-through in import goods implies less success for the currency-devaluation policy. Trade policymakers on concerning the success of such policy should therefore consider a relatively low exchange rate pass-through. Nevertheless, Tille (1999, 2000) explains that a country can benefit from the depreciation of its domestic currency depending on the degree of substitutability between goods produced domestically and those produced internationally. If the cross-country substitutability is high, domestic customers still pay higher prices for imports when the currency has been devalued, which makes it impossible to improve the trade balance. Government policy toward production subsidies and import substitution for domestic producers in Thailand may, therefore, decrease the degree of cross-country substitutability by encouraging Thai people to purchase more domestic products and less imported goods.

IV. CONCLUSION

Over the past two decades, interest in assessing the impact on prices of changes in exchange rates has increased significantly. Exchange rate pass-through, referring to the degree of response of import prices to a 1 percent change in exchange rates, is an important consideration in this relationship. A number of monthly data on the period from January 1996 to May 2003 were collected to estimate the exchange rate pass-through coefficients of Thailand's import industries. The purpose of this paper is threefold: 1) to estimate the exchange rate pass-through of Thailand's import industries in both short-run and long-run effects, 2) to investigate how the 1997 crisis should affect the degree of pass-through and price-setting behavior, and 3) to discuss the policy debate and the implications of how a low degree of exchange rate pass-through should be of concern to policymakers.

First, the estimations of nine major Thailand's import industries show that the extent of exchange rate pass-through to Thai imports is quite low, i.e., between 0.104 for the animal and vegetable oils and fats industry and 0.527 for the machinery industry. The low degree of pass-through, therefore, would be of concern to policymakers in deciding whether to launch policy initiatives. Second, the degree of exchange rate pass-through to Thailand's import industries has been found to decrease after the 1997 crisis when the Baht was highly volatile and its trends hard to predict. The prediction of a long-run pass-through is higher than a short-run pass-through, which means that the speed of adjustment of a month lagged to Thailand's import prices appears to be quite high. At the end of this paper, the policy debate and the implications of development policies toward competitiveness, optimal monetary policy, and currency devaluation policy are discussed in light of the low extent of pass-through.

ENDNOTES

1 See, for example, Dornbusch (1987), Mann (1986), and Marston (1990).

2 See, for example, Corsetti and Pesenti (2001) and Devereux and Engel (2000).

3 $P = e.Markup.MC^*$, where P is price in import currency unit, Markup is convexity of domestic demand function (price elasticity), and MC is the exporters' marginal cost.

4 This long-run determinant, however, captures the effect of a one-month lagged period. This procedure may be more relevant for quarterly or annual data.

5 See Piriya (2002) for the theoretical supports and arguments.

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Poverty, Economic Security and the Role of the Thai Government*

Somchai Jitsuchon
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Human security is a complex and encompassing concept. The concept has evolved from the 'security of territory from external aggression, or as protection of national interests in foreign policy or as global security from the threat of nuclear holocaust'[1] to 'the legitimate concerns of ordinary people who seek security in their daily lives.'[2] Yet, the concept of security in 'daily lives' has many interpretations and tends to stimulate great debates concerning its proper meaning. It is the broad meanings of the concept that have made reaching a consensus on the definition such a difficult task.

In this short paper, we confine our discussion to the economic aspects of human security, and further define it narrowly in relation to the problems of extreme poverty in Thailand. We first state the problems, conceptually and empirically, and their development over the past decade or so. Then we discuss the role of the Thai government in mitigating the problems, or in promoting the economic security of Thai people.

1. POVERTY AND INCOME DISTRIBUTION IN THAILAND: SUCCESS AND FAILURE

Among the many elements of economic insecurity, the final report of the Commission on Human Security (2003) emphasizes the importance of poverty as an obstacle to the overarching goal of achieving human security.

> *'..when people are uncertain where the next meal will come from, when their life savings suddenly plummet in value, when their crops fail and they have no savings–human security contracts.'*[3]

1.1 Income poverty

Thailand is among the countries of the world with an impressive record of poverty reduction. In the early 1960s, around 60 percent of the Thai people lived in poverty; in 2002 the proportion was less than 10 percent. However, as recently as 1986 the incidence of poverty, measured by head-count ratio, was still around 40 percent (Table 1). The pace of poverty reduction has been both rapid and virtually uninterrupted. Only twice during the past two decades has the incidence of poverty increased: first, between 1981 and 1986 when commodity prices plummeted, and second, after the financial and economic crises of 1997/98, which resulted in widespread unemployment.

Table 1 Incidence of Poverty in Thailand, 1986-2002 (head-count ratios)

Area	Region	1986	1988	1990	1992	1994	1996	1998	2000	2002
Rural	BMA*	13.3	9.7	2.8	3.3	3.2	0.4	0.6	0.1	0.9
	Central	34.1	31.0	25.3	16.1	10.4	7.9	7.5	6.4	4.5
	Northern	41.2	37.3	28.2	28.6	17.4	12.1	9.4	14.0	10.2
	Northeastern	63.7	53.6	49.8	45.6	34.4	23.4	24.2	30.9	17.2
	Southern	44.1	40.2	33.0	25.2	22.1	14.3	15.2	13.0	7.9
Urban	BMA*	10.8	10.1	8.6	3.9	1.5	1.3	0.9	1.1	1.3
	Central	24.2	20.1	20.1	7.7	7.5	4.7	5.6	4.4	2.6
	Northern	30.9	28.4	21.6	12.9	11.6	5.5	5.9	7.7	4.7
	Northeastern	40.5	32.3	31.1	28.2	20.8	12.4	12.2	17.2	9.5
	Southern	22.0	23.8	25.6	15.6	14.1	9.8	7.9	7.0	6.0
	All rural	49.1	42.8	36.8	32.1	23.5	16.1	16.0	19.2	11.4
	All urban	20.9	18.9	16.9	10.0	8.3	5.0	4.7	5.5	3.7
	Whole Kingdom	41.7	36.2	31.4	26.2	19.0	12.7	12.5	14.9	8.9

Note: * BMA = Bangkok metropolitan area, which includes Samut Prakan, Nonthaburi, Pathum Thani, and Samut Sakhon.

Source: Jiraporn and Somchai (2003).

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Of the five regions, including the Bangkok Metropolitan Area (BMA), the Northeastern region is always the one showing the highest incidence of poverty. The Northern and Southern regions have a comparable incidence of poverty, second to the Northeastern region, while the Central region and BMA enjoy the lowest incidence.

Also, as in many other countries, poverty in Thailand is largely a rural phenomenon. The rural poor accounted for around 80 percent to 85 percent of the total poor during most of the last 20 years. The fact that the proportion between the rural poor and the urban poor remains largely unchanged amid the urbanization that has taken place suggests that rural poverty declined at a somewhat slower rate than urban poverty. [4]

1.2 Incidence of chronic poverty[5]

Even though the broad picture of poverty in Thailand indicates that there is a downward trend in poverty, some households may experience rises and falls in income and consumption, and others may even become poor or escape poverty temporarily. This is the nature of vulnerability, a problem that may become increasingly important in Thailand, as the country is now exposing itself to greater economic fluctuations.

Yet another important aspect of poverty needs greater attention, that is, some families may never get out of poverty, as their resources never rise above the poverty line. This phenomenon is known as chronic poverty. The chronically poor are those trapped in poverty, for which there are many causes. A country that is badly managed economically at both the macro and micro levels, and which lacks positive economic growth for a prolonged period of time is likely to suffer from massive chronic poverty. However, it is possible, at least conceptually, that some groups of people living in countries with average positive growth may still suffer chronic poverty. Some structural impediments may prevent such people from benefiting from the increased overall wealth. One of the structural impediments that could cause chronic poverty is social exclusion. When groups of people are excluded from social, and hence economic, interactions with people outside their groups, and remain stagnant in terms of their level of economic activity within their groups, they can become chronically poor. Also, families with no income earners or with low-income earners caring for chronically ill family members are also likely to remain poor regardless of the overall economic prosperity in the society.

There has not been many advances in the research community in terms of measuring chronic poverty, although it is conceptually possible to do so. Ravallion (1988) proposed a method of classifying households into non-overlapping groups of the *chronically poor* and *transient poor*. A household is classified as chronically poor if its expected income (or expected consumption) is below the poverty line. Unfortunately, existing household survey data in Thailand do not allow the calculation of chronic poverty using this method.

Recognizing the data restrictions, Somchai (2003) attempted to find characteristics of the chronically poor in Thailand using a series of cross-sectional household surveys.[6] The idea is simple. Chronic poverty, by definition, must have an increasing share in overall poverty when the latter is falling, which is the case in Thailand. Suppose further that the chronically poor possess some observable characteristics. Those characteristics must also be more and more prominent among the overall poor. Somchai (2003) tested the following characteristics: dependency ratio, education, type of dwelling, asset ownership, and sanitary conditions. Table 2 shows the shares of these characteristics among the Thai poor from the year 1986 to 2002.

It is both surprising and interesting that almost none of the characteristics show a rising share. This may lead some to conclude that chronic poverty does not exist in Thailand. Further, many characteristics show a declining trend, such as the possession of a television, which has declined drastically from 80 percent to less than 20 percent. This observation alone may raise a question about how appropriate are the poverty lines currently being used, because it is difficult to imagine that a television could be considered a basic consumption need.[7]

However, stating that chronic poverty does not exist in Thailand may be too quick a conclusion. First, the real characteristics of the chronically poor may not be included in Table 2, or they may even be unobservable. Thus, reliable models are needed to determine and measure chronic poverty based on cross-sectional data. Second, the mechanism that creates chronic poverty may not have yet been in place in 2002. For example, once poverty reaches a level lower than the current one, around 5 percent, then the downward trend in the incidence of poverty may come to a halt. Only then might the characteristics of the chronically poor be detected.

1.3 Debts and financial security of Thai households after the 1997 crisis

Several critiques in Thailand (mostly by non-economists) suggest that poverty among Thai people has a close correlation with household indebtedness. Some even argue that poverty should be partly defined by indebtedness. Clearly, one needs to be careful about this, as there are many 'rich' people who are also heavily in debt and yet enjoy a living standard far above the basic needs level.

The above debate on the debt-related poverty definition aside, it is true that the poor (as conventionally defined) will face a great financial security problem if they accumulate large amounts of debt. Of particular interest is the impact of the 1997 financial crisis and subsequent developments, on household debts.

Table 2 Characteristics of the Thai Poor (percentage of all poor persons/households)

	1986	1988	1990	1992	1994	1996	1998	2000	2002
Rural poverty									
Dependency ratio	45.0	42.5	43.3	43.4	43.1	44.2	42.2	43.0	43.9
Laborers with >3 dependants	8.0	9.3	6.7	7.0	7.0	6.9	8.1	7.2	8.8
No education	7.3	8.0	7.6	8.6	7.6	8.3	7.1	6.1	8.5
Less then primary education	49.7	51.7	51.5	50.8	51.7	49.3	49.8	50.0	46.6
Does not own house	5.8	4.7	3.5	2.5	3.3	2.1	1.9	1.9	1.4
Temporary house	0.8	0.7	0.3	0.4	0.1	0.6	0.2	0.1	0.4
Non-durable house	11.3	0.8	0.6	7.8	6.0	5.3	3.6	4.1	6.0
No in-house toilet	62.5	45.9	36.6	24.8	12.5	8.8	5.5	3.7	3.7
No piped drinking water	96.6	95.8	94.9	96.9	95.1	92.6	91.4	88.3	86.0
No piped water	97.8	97.7	97.5	95.6	87.7	82.2	69.3	56.6	57.5
No radio	34.8	37.5	35.6	37.5	42.7	40.5	42.0	46.3	51.7
No television	80.7	71.7	59.1	48.9	36.1	29.0	20.6	16.7	18.8
Urban poverty									
Dependency ratio	43.5	40.6	39.7	40.3	40.1	40.8	41.0	40.6	41.9
Laborers with >3 dependants	5.9	5.6	5.8	3.6	6.3	4.4	5.8	4.9	3.8
No education	7.8	8.8	7.0	6.7	5.9	5.9	5.9	6.6	5.8
Less than primary education	44.0	44.6	46.9	49.8	48.6	46.4	43.7	44.0	42.3
Does not own house	31.3	35.2	30.9	32.5	24.1	28.6	29.5	21.7	30.7
Temporary house	0.8	1.2	2.7	2.2	1.9	1.9	0.5	0.4	2.0
Non-durable house	7.6	2.2	3.0	9.2	4.6	5.1	3.8	2.1	3.1
No in-house toilet	16.9	11.6	11.3	8.1	4.6	4.2	2.2	1.6	2.1
No piped drinking water	68.7	57.4	58.3	62.8	65.8	63.5	57.5	59.8	50.7
No piped water	75.1	67.6	66.7	57.2	61.0	56.2	50.1	39.9	43.3
No radio	34.4	29.1	31.9	30.0	36.7	36.7	34.9	35.9	43.5
No television	49.0	39.9	34.5	33.3	23.3	16.3	14.8	13.2	15.1

Source: Somchai (2003), Table 13.

Table 3 below shows average household debt levels, comparing them to household income for the period 1994-2002 for all households, for poor households and for ultra-poor households (those households with an income less than or equal to half of the relevant poverty lines). It is clear that household debts increased dramatically during this period, although at a somewhat different pace among the three household categories. On average, Thai households have accumulated debt much more rapidly than increases in their income. The debt-to-income ratio climbed from around 3.7 to 6.1 within fewer than 10 years. More worrisome is the debt accumulation by the poor and the ultra-poor households. The indebtedness of these two (overlapping) groups is striking; it is twice as high and almost four times as high, respectively, as the debt-to-income ratio of the average households, and the increases also were more rapid. The ultra-poor households, for example, had debts that were around 15 times larger than their income in 2002.

If the numbers from the surveys represent the truth, then Thai households are certainly face danger from debt problems, and their financial security is being compromised. The fact that around 60 percent of the average household debts were a result of consumption only makes the situation worse.

Table 3 Incidence of Household Debt before and after the 1997 Financial Crisis

	1994	1996	1998	2000	2002
All households					
Total debts (Baht)	31,079	55,300	72,345	70,586	84,603
Debt/monthly income	3.7	5.0	5.7	5.7	6.1
Percentage consumption debt	59.7%	50.8%	61.2%	61.0%	64.1%
Poor households					
Total debts (Baht)	9,727	13,698	22,787	21,818	24,876
Debt/monthly income	4.4	5.4	7.5	7.5	8.5
Percentage consumption debt	37.9%	34.3%	39.1%	41.5%	44.5%
Ultra-poor households					
Total debts (Baht)	11,830	18,593	22,968	20,083	24,188
Debt/monthly income	9.1	12.2	13.1	11.5	15.2
Percentage consumption debt	53.4%	26.9%	40.4%	37.7%	50.2%

Note: Ultra-poor households are those households with income less than half the relevant poverty line.

Source: Calculated from Socio-economic Surveys, the National Statistical Office.

The causes of debt are not clear, however, since debts started to accumulate in 1996, one year before the financial crisis occurred. One possibility is that the survey method is responsible for this discrepancy, as debt questions were added to the Socio-economic Survey in 1992 and there might have been changes in the way the questions were asked and the answered verified.

Even if that is true, household debts were still on the rise throughout the period 1998-2002. The elasticity of debt creation for consumption (with respect to overall debt creation) reveals that most of the debts created during this period were debts to finance consumption. For the years 1998-2000, this situation could be explained via the impacts of the financial crisis during which many people lost their jobs and had to borrow in order to finance their consumption. The situation in 2002, which was the year when economic growth resumed and unemployment was low, might be explained by the impacts of the transfers from the government in various forms (most notably through the Village Fund), which were used largely to finance increased consumption.

2. THE ROLE OF THE THAI GOVERNMENT IN ENHANCING ECONOMIC SECURITY

There are many ways to ensure or promote the security of individuals. On the economic front, a well-developed market system with mature insurance markets can provide protection against negative shocks, especially idiosyncratic ones where risks can be shared both interpersonally and inter-temporally. However, there are situations where interventions are needed: for example, when the market system is not well developed and markets are missing for various kinds of negative shocks. Permanent negative shocks happening to individuals (such as an illness that results in permanent disability) are difficult to insure against. Furthermore, human security is often related to distribution issues, when the fruits of economic growth are not shared equally or are even biased against the worse-off, some groups are left vulnerable. Distributional equality has never been the prime tenet of the market system.

For these reasons, the role of government in enhancing human and economic security is justified. In this section, the role of the Thai government will be reviewed and evaluated, starting with the distributional impacts of fiscal policies, and followed by the recent initiatives by the Thai government in the management and implementations of poverty-reduction policies.

2.1 Thailand's recent initiatives in the public implementation of poverty policy[8]

Various factors influence the impacts of government expenditure on human security other than the impacts caused by the distribution of income, as described in the previous section. The primary objective of various categories of government spending is precisely to reduce human insecurity. For example, providing maternal health care can prevent maternal illness and death, which constitute major security threats in some parts of the world.

In the final report of the Commission on Human Security (2003), the Commission suggested ways to increase economic security. These suggestions are summarized in Table 4.

Having established strategies is one thing; actually implementing them is another. Governments around the world have not had much success so far in achieving the initial goals when it comes to reducing human insecurity. The *World Development Report 2004*: *Making Services Work for Poor People*, for example, notes that there is no strong relationship between government spending on health and child mortality rates.[9]

Thailand's poverty reduction policies also performed weakly. Table 5 shows the access rate by poor individuals to various poverty programs that grew out of current 'poverty policies.' Although many policies do service the poor more than proportionately (compared with the overall access rates, the 'total' column in Table 5), the relative odd ratios are somewhat too low to justify them as genuine poverty policies. A few policies (the People's Bank and Village Revolving Fund) are even more likely to serve the non-poor than the poor.

Table 4 Commission on Human Security's Promotion of Economic Security

Conceptual Strategies	Implementation Strategies
Encouraging growth that reaches the extreme poor	Addressing distributional issues Reducing developed country trade barriers Developing governance and policies that empower
Supporting sustainable livelihood and decent work	Informalizing the labor force Reducing the environment and livelihood insecurity Microcredit: supporting the livelihood of poor people Improving livelihood opportunities for women
Preventing and containing the effects of economic crises and natural disasters	Containing economic and financial crises Preparing for natural disasters
Providing social protection for all situations	Empowering workers to better integrate with the market Sustaining poverty reduction Fulfilling ethical and basic socio-economic obligations Supporting community organizations: the 'first frontier' Financing social protection internationally

Source: Human Security Now, the Commission on Human Security final report, 2003.

Table 5 Access Rates to Various Poverty Programs in 2002 (percentage of respective groups)

Poverty programs	Poor people	Vulnerable groups	Non-poor, Non-vulnerable	Total
Universal Health Care (30 Baht Scheme)	85.4	86.0	67.1	69.7
Social insurance	0.5	0.8	9.3	8.1
Old-age assistance	0.5	0.7	0.4	0.4
Debt moratorium	2.4	2.4	1.9	2.0
Farmers' Assistance Fund	0.9	0.9	0.5	0.6
School Lunch Program	11.1	12.4	6.8	7.5
Education scholarships	0.3	0.2	0.2	0.2
Education loans	0.9	1.1	0.6	0.6
People's Bank	0.1	0.0	0.2	0.2
Village Revolving Fund	7.0	8.4	7.6	7.6

Note: Vulnerable groups are defined as those individuals whose household income is lower than 1.2 times the relevant poverty line.

Source: Somchai (2003), Table 1.

Thus, the lesson learned is comprising that simply setting aside financial and other resources to reduce poverty does not guarantee that poverty would actually be reduced. The implementation of the policies is more important. Table 5 shows that there is plenty of room for improvement by the Thai government in formulating poverty policies that truly will reach and benefit the poor. Some of the recent initiatives in terms of implementing poverty policies will be discussed here. Some of the initiatives are directed at the implementation of government policies in general, and would affect poverty policies as well.

Changing accountability relationships

The government's attempt to reduce poverty can be viewed as a kind of service to the public. As with all types of service provision, an accountability relationship (or lack thereof) exists between the service providers and the 'clients,' who comprise the poor in this case. However, since the government consists of many 'agents,' the accountability relationships become more complex. According to the aforementioned World Bank Report, poverty reduction services concern four 'actors,' namely, the citizens and clients, the politicians and policy makers, the organizational providers, and the frontline providers. The following are some of the interesting changes taking place with the four accountability relationships in Thailand.

First, politicians and policy makers are now more communicative with Thai citizens, including poor 'clients.' The Thai Rak Thai Party won the election in 2001 owing to its clear policy stance, implying that Thai citizens 'delegated' the government to deliver what had been promised during the election campaign.

Second, the 'public sector reform' process put forward by the current government resulted in the creation of some new ministries, the duties of which are directed more strongly toward dealing with poverty and human security problems. The creation of the Ministry of Social Development and Human Security is a prime example.

Third, now there is strong emphasis on coordination between frontline providers who interact with the poor on a constant basis. This prevents problems related to under-servicing or over-servicing in some areas and with some target groups. Also, such coordination reduces the burden of the local communities in interactions with the providers of the services.

Fourth, the citizens/poor/clients are encouraged to participate in the decision-making process. One advantage of local community participation is that the poorest of the poor are more likely to receive services.

Insulating politics from organizational providers

For poverty policies to be successful, it is imperative that political interests be removed, or prevented as much as possible, from the accountability relationships. Unfortunately, there is little evidence that any reforms have been taking place in this respect. However, two proposals can be put forward. First, genuine efforts in fiscal decentralization must be made, allowing local administrative agencies to have their own budget and decision-making power, thus partly safeguarding themselves from political demands made at the national level. Second, evaluation of the providers (organizational and frontline) should be based on their results in reducing poverty.

Area-targeting approach

The area-targeting approach is gaining more momentum lately. The government has begun to realize that poverty concentrates in some geographic areas. For example, in the case of Thailand, around two-thirds of all the poor reside in only 17 provinces, 15 of which are in the Northeastern region of the country. In this regard, three new developments are worth noting.

First, each Deputy Prime Minister was assigned supervisory duties in the overall operation of government functions in separate sub-regions, each consisting of around 10 provinces. Since some sub-regions are plagued with poverty problems, the Deputy Prime Ministers in charge of them must focus on poverty issues as one of the sub-regions' main concerns and they must coordinate the efforts to reduce poverty there.

Second, at the provincial level, the government also assigned provincial governors to actually supervise the 'management' of the overall development of their provinces. This is sometimes called the 'CEO Governors' concept.' The benefits would arise from better coordinating the frontline providers from various line ministries sent from Bangkok.

Third, advances have also been made in data support for implementing the area-targeting approach. The two primary data sources, the Ministry of Interior's rural village database Nrd2C[10] and the rural household database Basic Minimum Need have been improved in terms of data integrity. Moreover, a poverty map was constructed for the whole kingdom for the year 2000, using the World Bank's 'small area poverty map technique.' It will be updated in the near future.

Public service agreement on poverty reduction budget allocation

All services, including poverty reduction services provided by the State, must be financed through a budget allocation process. More importantly, the way that poverty reduction policies are financed will have a great impact on the success of the policies.

As in many other countries, the budgetary process in Thailand has been geared toward a performance-based budget in order to improve the efficiency and effectiveness of the allotted public money. There are yet two other recent developments: one is the budget allocation for each fiscal year according to the 'national strategies,' and the other is an attempt to apply the public service agreement (PSA) system of budgetary process. (Here we shall describe the PSA system that applies to the national strategy on poverty reduction, hereafter identified as PSA-Poverty).[11]

PSA is an agreement that the government and its subsidiaries make to the public to deliver services that contribute to the achievement of predetermined, sometimes quantified, objectives.

For PSA-Poverty, the Thai government has established the objective of reducing income poverty so that no more than 12 percent of the population would be in this category by the end of 2006. However, in order to achieve the PSA-Poverty goal, some clarification needs to be made about the target groups, the operational strategies, the measurement of outcomes and the responsibility structure through coordination between government agencies. Each of these elements is discussed below.

Clear Definitions or Characteristics of the Target Groups. Without proper definitions of the target groups, evaluation of the success of PSA would not be possible. Table 6 offers operational definitions of three distinct target groups. Those living in extreme or chronic poverty are the poor who are not likely to be able to escape poverty by their own efforts. The 'moderately poor' are those who are capable of escaping poverty. The final targets are the vulnerable groups.

Operational Strategies or Plans for Poverty Reduction. Since poverty is a multidimensional concept and possesses many different aspects, the overall poverty reduction strategy should be further refined into detailed strategies or plans. In this regard, Somchai (2003) proposed five operational strategies, as follows:

Strategy 1: *Relief of the Consequences of Poverty*. When poverty is defined by a lack of basic needs, such as inadequate food intake, clothes, minimum-condition shelters and basic medical care, the poor should then be entitled to obtain these basic needs. The government should be the primary provider of these services.

Strategy 2: *Building the Income-generating Capacity of the Poor*. The poor are also entitled to escape poverty by themselves. Education, skills, credit, access to markets and information, etc., can all contribute to enhancing the income-generating capacity of the poor.

Strategy 3: *Provisions of Social Protection.* Those living in poverty usually have to endure economic and social uncertainties without enjoying the social protection accorded to the non-poor. The role of the government in providing social protection to the poor is a vital one.

Strategy 4: *Enhancing Economic and Social Equality and Justice.* Equality of opportunity and justice for all can ensure that economic and social development will advance without disruption.

Table 6 Ad Hoc Characteristics of the PSA-Poverty Target Groups

The Extremely/Chronically Poor	The Moderately Poor	The Vulnerable
Facing extreme hardships No education No savings and assets (both durable and non-durable) General workers with large number of family dependants such as children, the elderly, chronically ill or disabled members Landless farmers Child laborers Agricultural temporary worker Unemployed with no other income	Low education No savings. May possess some low-value non-durable assets Farmers with little land and low yields Peddlers	No higher than secondary education Little savings No access to formal credits Farmers with sufficient land but located in high-risk areas Workers with sufficient income but unstable jobs Having jobs with a high risk of accidents Middle-aged workers with no modern skills Petty traders with no permanent stores Low-income earners lacking the ability to plan

Table 7 Poverty Reduction Strategies and Target Groups

Poverty Reduction Strategy	The Extremely/ Chronically Poor	The Moderately Poor	The Vulnerable
Relieve the consequences of poverty (charity)	✓✓✓	✓✓	✓
Income-generating capacity-building	✓✓✓	✓✓	✓
Social protection	✓✓	✓✓	✓✓
Economic/social equality enhancement	✓✓✓	✓✓✓	✓✓✓
Increase the efficiency of socio-economic conditions	✓	✓✓	✓✓

Note: The symbols ✓✓✓, ✓✓ and ✓ indicate the degree of need, with three symbols indicating the greatest need.

Strategy 5: *Increase the Efficiency of Socio-economic Conditions*. Efficiency gains will result in more resources being made available to the poor, both through direct participation and through increased public spending.

Table 7 above links the above operational strategies with the previously defined target groups.

Verifiable or Quantifiable Outcomes and Goals. It is important that the national outcomes and goals can be monitored directly by the public. To this end, the outcomes and goals must be at least verifiable and, if possible, quantifiable.

Coordination of Government Agencies through Shared Accountability. When accountability is shared by two or more agencies, the agencies would join their efforts and avoid the problem of duplication.

CONCLUSION

This paper discusses some of the experiences of Thailand with regard to the economic aspects of human security. Thailand has been making satisfactory progress in reducing income poverty and raising the general welfare of the Thai people. In this sense, human security is improving. Further, there is no strong evidence indicating the existence, or the severity, of the chronic poverty problem in Thailand. On the distributional impacts of fiscal policy, government expenditure was found to be equality-enhancing in general. While indirect taxes tended to increase inequality, they were offset by the progressive direct tax structure, leaving the overall tax policy only marginally affecting the distribution of household income.

There have been several developments in the implementation of poverty reduction policies by the Thai government. These include the more direct interactions of politicians and policy makers with the poor, greater fiscal decentralization, emphasis on the area-targeting approach and close coordination among government agencies and between government agencies and the poor. The budgetary process is also undergoing reform within a public service agreement framework, which has strong potential for raising the efficiency and effectiveness of the resources allocated for poverty reduction in Thailand.

ENDNOTES

1 UNDP (1994), p. 22.

2 UNDP (1994), p. 22.

3 Commission on Human Security (2003), p. 73.

4 This is true even when the urban poverty lines take into account the higher living standards of urban areas.

5 The content of this section borrows heavily from Vimut and Somchai (2003).

6 The Socio-economic Surveys conducted by the National Statistical Office.

7 The only exception is the possession of a radio, which is the only declining characteristic. However, one might reasonably argue that this is due to a substitution effect for other appliances (such as a television), making the radio an inferior good even among the poor.

8 The content of this section borrows heavily from Somchai (2003).

9 World Bank, *World Development Report 2004: Making Services Work for Poor People*, p. 11.

10 The database name was derived from the name of the committees that initiate the collection of the data, i.e., the National Rural Development Committee.

11 The following materials have been extracted from TDRI's preliminary research on PSA.

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