NORTH-HOLLAND

Journal of Asian Economics 13 (2002) 597–613

JOURNAL OF ASIAN ECONOMICS

Financial crisis and restructuring in Thailand

June Charoenseang, Pornkamol Manakit*

Faculty of Economics, Chulalongkorn University, Bangkok 10330, Thailand

Received 1 June 2002; received in revised form 1 July 2002; accepted 1 August 2002

Abstract

The financial crisis has substantially damaged the Thai economy. Dealing with the economic recovery is not a simple task. Both banking and corporate sectors must be restructured simultaneously. Therefore, the Thai government has implemented its restructuring program in both banking sector and corporate sectors. Besides, expansionary fiscal policy has been implemented as well. Although significant progress has achieved in financial restructuring, much remains to be done to take the Thai economy out of the recession, as there are a number of structural weaknesses.

JEL classification: E44; E65; G28; Z00

Keywords: Financial crisis; Financial restructuring; Corporate restructuring; Thailand

1. Introduction

The financial sector, in general, helps allocating funds from economic agents who do not have productive investment opportunities to those who have such opportunities. Financial crises have occurred in many parts of the world during the past two decades. These crises lead many countries to severe reduction in economic activities; resulted in significant wealth loss, decline in asset prices, capital flight, and volatility in exchange rates and instability in the financial system. In sum, the crisis wrecks our economy and shred our social welfare.

The collapse of the Thai bath in July 1997 marked the starting of Asia financial crisis. This turmoil spread rapidly and led Asia's economies into a deep recession. The financial crisis in East Asia has led policymakers to an unprecedented reappraisal of policies.

* Corresponding author.
E-mail address: pornkamol.m@chula.ac.th (P. Manakit).

PII: S1049-0078(02)00175-6

The appropriate policy responses depend in large part on an understanding of what caused the crisis. Two explanations dominate the debate over what caused the crisis. One argues that weak economic fundamentals and policy inconsistencies are main causes of the crisis. The other blames a financial panic where interaction between expectations directly influences macroeconomic policy decisions.

Early research on currency crises usually refers to as the "first generation models" developed by Krugman (1979) and Flood and Garber (1986). These "first generation model" explained currency crises as the result of fundamental inconsistencies in domestic policies. Therefore, the "first generation models" predict that deterioration in the fundamentals should be indicated prior to a crisis by developing overvalued real exchange rate, large current account and trade deficits, and high rate of monetary growth, high inflation, and rising domestic interest rates. In other words, warning signals exist.

By contrast, the interaction between expectations directly influence macroeconomic policy decisions in "second generation models" of currency crises developed by Obstfeld (1996) provide a generic feature of theoretical macroeconomic models with rational expectations, in which market expectations directly influence macroeconomic policy decisions. One version of this debate explains the East Asian crises as a bank run (Kaminsky & Reinhart, 1999). If many investors are panic and demand immediate payment, then financial intermediaries are faced with liquidity problem, which forces them to liquidate long-term assets at a great cost. In other words, the self-fulfilling pessimism of lenders is the cause of the crisis.

Banking sector covers both the "first generation models" and the "second generation models." Several studies also pointed out that banking and currency crises can generate a vicious circle by amplifying each other (Glick & Hutchison, 1999). If bank liabilities are denominated in a foreign currency, devaluation largely increases the value of those liabilities. Moreover, as banks usually lend in their local currency, the devaluation, thus, exposes these banks to a substantial mismatch and worsening balance sheet thereafter. In addition, a bank crisis does put a burden to the government. Investors, thus, expect that the government will be forced to adopt an expansionary monetary policy to finance its bailout intervention. As monetary expansion is inconsistent with the exchange rate peg, it leads investors to believe that the currency will soon devalue. Such an expectation will trigger a speculative attack. In other words, a banking crisis is associated with a worsening fiscal position of a country that triggers expectations of a monetization of the fiscal deficit and exchange rate devaluation eventually. This scenario is thus consistent with the explanation of the "first-generation models" of currency crisis that emphasizes the role of unsustainable fiscal policy.

Moreover, in an open economy with liberalized capital market, if investors anticipate a speculative run, they will try to exchange their claims on financial institutions for foreign currencies. As a result, banks need to liquidate their investments. Unfortunately, most of their investments are in the form of long-term investments; therefore, they can be liquidated only at highly discounted rate. Consequently, bank eventually become insolvent, this situation, thus validates the initial expectation of a run. The run could spread to the entire banking and financial system that eventually leads to a substantial loss of international reserves and thus a currency crisis. This liquidity-driven crisis in the banking sector thus reflects the interaction between expectation and outcomes; therefore, validates the "second generation models'' of crisis. There is, therefore, connection among financial, currency, and banking crises.

2. The evolution of the crisis in Thailand since the 1980s

In the first half of the 1980s, Thailand's export dropped sharply. Nonetheless, the government refused to devalue the currency, they chose to dampen domestic demand to restore balance of payments by imposing credit controls. This credit restraint program had a significant impact on the Thai economy. A lower credit creation led to a slump in domestic demand and lower asset prices thereafter. There was also a distress in financial sector where there was the closure of 20 finance companies whereas another finance companies that could be revived were rescued by the central bank of Thailand. At that time, the Ministry of Finance set up the Financial Institutions Development Fund (FIDF). The purpose of this Fund was to rehabilitate and revive financial institutions. Although none of the law gave depositors any explicit guarantee, the way the government and the central bank provided assistance in times of financial distress during the 1980s led people to believe implicitly that their deposits at the commercial banks were quite safe. Moreover, the financial institutions themselves also believed that the government implicitly guaranteed their financial liabilities. As a result, this type of environment created an additional moral hazard problem on the part of financial institutions to undertake high-risk lending activities.

In November 1984, the bath was devalued whereas the Bank of Thailand raised credit growth targets for commercial bank lending. Economic growth picked up again in the second half of the 1980s, as reflected in the rising real GDP that accelerated from 5.5% in 1986 to 9.5% in 1987 and further to 13.2% in 1988 and continued to grow at double-digit rates until the end of the decade (Table 1). Exports grew at an average rate of 26.1% per year in 1985–1990 and 15.7% in 1991–1996. Inflation rate remained quite low at an average annual rate of 3.9% in 1985–1990 and 15.9% in 1991–1996. Inflation rate remained quite low at an average annual rate of 3.7% in 1985–1990 and 5% in 1991–1996. Domestic saving had been impressive, Government saving as a result of the fiscal budget surplus, which had started since 1988 and continue to do so until 1996, also enhanced this high saving rate. Despite such an impressive set of macroeconomic data, not all the data was so impressive. The current account had gotten into deficit since 1987; foreign borrowing largely financed this deficit.

For many years, Thai economy kept her financial system relatively closed. Foreign borrowing was limited and capital inflows were controlled. However, the global environment had changed during the 1990s. Thailand had also embarked on a comprehensive liberalization of domestic financial markets and capital account transactions. In 1990, Thailand accepted the obligations under Article 8 of the International Monetary Fund (2001), and completed the opening up the foreign exchange market for current account transactions in 1992. There was also a concurrent liberalization of capital account transaction; one of the important strategies for this liberalization was the establishment of the Bangkok International Banking Facility (BIBF), an offshore banking center, in 1993.

Consequently, Thai financial institutions began to enjoy a more liberal economic environment, including favorable funding terms from domestic and foreign sources.

Table 1
Thailand macroeconomic indicators

Year	GDP growth rate (%)[a]	Inflation rate (%)	Unemployment rate (%)	Interest rate (%)[b]	Domestic credit (%)[c]	Deposit (%)	Export (%)	Import (%)	Trade balance/GDP	Current account/GDP	Net capital/GDP	International reserve	Exchange rate[d]
1980	4.80	19.70	0.90	16.50	18.80	24.40	23.08	24.00	−0.09	−6.40	0.08	3.05	20.48
1981	5.91	12.80	1.26	17.00	16.80	20.30	7.81	6.45	−0.09	−7.38	0.07	2.75	21.82
1982	5.35	5.20	3.56	16.00	22.40	24.90	−1.45	−15.15	−0.04	−2.84	0.05	2.68	23.00
1983	5.58	3.80	4.58	15.5–16.5	25.60	26.20	−7.35	21.43	−0.10	−7.24	0.04	2.55	23.00
1984	5.75	0.90	4.36	16.50	17.10	21.90	15.87	0.00	−0.07	−5.02	0.06	2.70	23.64
1985	4.65	2.40	4.97	15.50	8.40	12.20	−2.74	−8.82	−0.06	−3.86	0.05	3.00	27.16
1986	5.53	1.90	5.58	12.0–12.25	6.10	12.70	23.94	1.08	−0.01	0.70	−0.01	3.80	26.30
1987	9.52	2.50	5.92	11.50	17.60	19.80	31.82	41.49	−0.03	−0.59	0.02	5.20	25.74
1988	13.29	3.80	4.32	12.0	15.60	19.00	37.07	48.87	−0.06	−2.43	0.06	7.10	25.29
1989	12.19	5.40	3.59	12.5–13.5	19.80	26.80	25.16	27.27	−0.07	−3.32	0.08	10.50	25.70
1990	11.17	5.90	2.24	16.25	26.90	27.50	15.08	29.76	−0.11	−8.32	0.11	14.30	25.59
1991	8.56	5.73	3.12	14.00	15.50	21.40	23.58	15.60	−0.10	−7.53	0.12	18.40	25.52
1992	8.08	4.07	2.84	11.50	18.00	16.20	13.78	6.08	−0.07	−5.47	0.07	21.20	25.40
1993	8.30	3.30	2.62	10.50	22.70	19.20	13.66	12.47	−0.07	−4.87	0.08	25.40	25.32
1994	8.95	5.00	2.62	11.75	28.90	13.10	22.13	18.40	−0.06	−5.40	0.08	30.30	25.15
1995	9.20	5.80	1.71	13.75	22.90	18.20	24.61	31.84	−0.09	−7.86	0.13	37.00	24.92
1996	5.88	5.90	1.54	13.00–13.25	13.90	13.70	−1.80	0.57	−0.09	−7.90	0.11	38.70	25.34
1997	−1.45	5.60	1.51	15.25	34.50	16.00	3.66	−13.42	−0.03	−2.00	−0.03	27.00	31.37
1998	−10.50	8.10	4.37	11.50–12.00	−1.20	8.80	−6.75	−33.77	0.11	12.70	−0.09	29.50	41.37
1999	4.40	0.30	4.20	8.25–8.5	−4.20	−0.50	7.43	16.90	0.08	10.20	−0.06	34.80	37.84
2000P	4.60	1.60	3.61	7.50–8.25	−7.40	5.30	19.60	31.30	0.05	7.60	−0.08	32.70	40.16
2001P	1.80	1.60	3.36	7.00–7.50	−6.10	4.00	−6.90	−2.80	0.02	5.40	−0.05	33.00	44.48

Source: Bank of Thailand (online).

P = preliminary data.

[a] Constant 1998 price.

[b] Minimum loan rates (as quoted by the five largest banks). Domestic Credit, Deposit, Exports, and Imports are represented in terms of percentage change.

[c] Exclude foreign and interbank deposits.

[d] baht: US $ (reference rate) average. Since July 1997, the figures are represented by average inter-bank exchange rate.

This liberalization of the domestic credit market led Thai financial institutions to face a far more competitive environment. However, Thailand's financial system was not sufficiently resilient to adjust to problems created by large capital inflows and subsequent expansion of domestic credit. Moreover, the supervisory and regulatory authorities did not possess the independence needed to ensure that prudential standards were met; which resulted in a lag of transparency and lax regulation. Policy toward distressed financial institutions was not clearly stated. As a result, the credit boom and bust that preceded the currency crisis was a major problem of the Thai financial system.

As international capital markets were accessed easier than before and domestic markets were deregulated as well; there was a drastic increase in foreign borrowing in the 1990s before the crisis. Thai commercial banks and finance companies borrowed large amounts of short-term funds from abroad; these borrowings were unhedged as the pegged exchange rate eliminated exchange risks in borrowing in dollars or any other foreign currencies (Table 2). On the lender side, these foreign investors suffered from low interest rate in the industrialized countries, consequently they were more than willing to lend. A sudden increase in the availability of credit through capital inflows was one of the major factors that encourage increasing investment in risky projects such as lending to real estate or securities market participants. In addition, there were no prudential limits on loan concentration; as a result, banks were overexposed to particular sectors. These risky investments, therefore, worsen the quality of the portfolio of those Thai financial institutions. The quality of loan portfolios in both banks and finance companies was weak. Therefore, inadequate regulation and supervision were two of the factors contributed to the weakness of the Thai financial system. Moreover, there was a maturity mismatch in the balance sheets of domestic financial institutions where short-term borrowing was used to finance long-term projects. There was also a currency denomination mismatch as domestic banks lent in local currency but borrowing in foreign currencies without hedging.

Table 2
Thailand external debt

Year	Million baht			
	Short-term external debt		Total external debt	
	End of period	As % of total external debt	End of period	As % of GDP
1990	10.417	35.5432	29.308	
1991	15.391	40.63309	37.878	
1992	18.914	43.35985	43.621	
1993	22.634	43.43754	52.107	41.68726
1994	29.179	44.98281	64.867	44.95758
1995	52.398	51.96565	100.832	60.02388
1996	47.743	43.90484	108.742	59.7847
1997	38.294	35.04338	109.276	69.37696
1998	28.44	27.06973	105.062	93.05842
1999	19.539	20.55633	95.051	77.66377
2000	14.694	18.43317	79.715	65.18584
2001	13.37	19.85152	67.35	58.72762

Source: Bank of Thailand (online).

Nonetheless, signs of trouble were not obvious until early 1996 when pressures on the bath emerged. The business environment for financial institutions were worsen as there were oversupplying in the real estate, falling stock prices, and selling of baht in the foreign exchange market. As a result, many international creditors started to stop lending and some creditors even refused to roll over their loans, which worsened the deteriorating balance sheets of banks and finance companies.

On March 3, 1997, the Bank of Thailand and the ministry of finance announced that 10 finance companies had asset quality problems and insufficient liquidity; and these companies were required to increase their capital. Nonetheless, the Bank of Thailand assured the public that other financial companies were financially sound. Bank of Thailand provided liquidity support through FIDF for these troubled companies. The government also established the Property Loan Management Organization (PLMO); an agency to purchase and manage property loans from financial institutions subjected to certain conditions. The market came to realize the weak quality of banks' assets that coupled with excessive foreign borrowings with short maturities. Market perception reversed sharply which had resulted in massive capital outflows. These outflows were one of the factors that helped trigger the crisis. Economic fundamentals continued to deteriorate when there was a massive speculative attack in May 1997, by that time, almost all of foreign exchange reserves were depleted by the Bank of Thailand in a continuous attempt to defend the fixed exchange rate system.

The problems of finance companies became more explicit at the end of June 1997 when the Bank of Thailand suspended the operations of 16 finance companies, including the above 10 finance companies. The Bank of Thailand ordered these companies to restructure their management. At the same time, the Bank of Thailand declared that no other companies would be suspended. However, the other 42 finance companies were ordered to suspend their operations in August of the same year.

As for the real sectors, there was perceptible slowdown in exports; a sign of an unsustainable current account deficit was strong. The business environment was deteriorating. Simultaneously, there was a substantial appreciation of the real effective exchange rate, rising short-term foreign debt, a deteriorating fiscal balance. On July 2, 1997, Thailand could not defend her fixed exchange rate regime any more, and the bath was float then.

The response to the crisis followed a fairly standard pattern, which was to accept the IMF assistance under an austerity program. However, as there was substantial deterioration of the financial system, therefore, there was a need for urgent reforms in financial sector (World Bank, 1998).

3. The restructuring process

The government had more incentive decided to tackle the economic crisis by starting with financial sector. These are because the balance sheets of financial firms were more legally controlled compared with non-financial firms. Furthermore, because of the deposit guarantee, the government and the taxpayers were more directly exposed to bank and finance company's bankruptcy than to that of financial firms.

3.1. Financial restructuring

Approaches adopted in Thailand for restructuring have involved the injection of central bank liquidity, regulatory forbearance, closure of deeply insolvent financial institutions, takeovers, carving out and transferring bad assets to a central management agency, and capital injection from private and public resources. The restructuring process can be summarized as follows.

3.1.1. Segregation of viable and nonviable financial institution

To save the overall financial system and to provide new basis for subsequent reforms and rehabilitations, the banks and finance companies were forced to take the initiative in cleaning up their own and their borrowers' balance sheets. During June to August 1997, a total of 58 finance companies were suspended. In order to restore the public confidence, the FIDF had provided a guarantee of the deposits and liabilities of the remaining financial institutions. Furthermore, the Financial Restructuring Authority (FRA) were established on October 1997 in order to review rehabilitation plans of 58 suspended finance companies and oversee their liquidation process. Then in December 1997, FRA has announced that 56 finance companies were permanently closed and their assets had to undergo a liquidation process and were transferred to the FRA. The auction process of these assets has to be properly managed by the FRA of which proceeds would be subsequently repaid to the creditors. In addition, the Asset Management Corporation (AMC) was established to ensure the orderly sale of lowest quality assets of the 56 closed finance companies. It acts as a buyer of last resort to prevent fire sale of assets, which in turn could undermine underlying collateral values in the total financial system. The assets bought are managed for resale later.

However, it was found that in the second half of 1998, the banks' balance sheets had not been cleaned up. The downturn in the economy and the consequent delay in economic recovery was entirely due to the delay in adjusting the wrong valuations in the balance sheets. The burden, therefore, was posed on financial institutions.

3.1.2. Financial sector restructuring program of August 14, 1998

The problem of weak financial sector did not go away after the first process. The government, thus, made a major announcement to assist in the recapitalization of private banks. It contained four major components (Asian Development Bank, 1999).

First, in order to assist in recapitalization of private banks, capital adequacy requirements were announced. It undertook to match the banks' success in raising both tier-1 and tier-2 capital for banks. The overall capital adequacy ratio was to remain at 8.5% for banks and at 8% for finance companies. But tier-1 capital requirements for banks were lowered from 6% to 4.25%, and the tier-2 component was raised from 2.5% to 4.25%. Participating banks had to meet the provisioning requirements immediately upon receipt of the capital injection, without a phase-in period.

Second, the government set asides for the exercise 300 billion baht for two capital support schemes (tier-1 and tier-2 schemes). The measure was purposed to encourage recapitalization of Thai commercial banks and finance companies thereby restoring and maintaining their solvency. The tier-1 capital support facility was aimed at catalyzing the entry of private capital, whereas the tier-2 capital support facility was aimed at providing financial resources and incentives to accelerate corporate debt restructuring.

The most important condition for participation in the tier-1 scheme was the adoption of loan classification and provisioning (LCP) standard. The strategy has been to progressively strengthen their capital bases through a combination of more realistic LCP and private sector-led capitalization. The deadline of December 2000 was set for the banks to meet the new requirements.

Under the tier-2 scheme, the government forced financial institutions to tackle the balance sheets of non-financial sector. The government would inject capital through the exchange of nontradable government bonds for bank debentures for a maximum of 2% of risk-weighted assets. The amount of funds available would be based on the magnitude of the write-offs resulting from corporate debt restructuring, net of previous provisioning, and the net increase in lending to the private sector.

Third, financial institutions were allowed to establish individual asset management companies. The policy measures were adopted to encourage the banks to set up private AMCs. AMCs provide a channel for banks to separate the good assets from the bad assets, improve that bank's balance sheets and asset quality and concentrate on future businesses of the good banks.

The benefit of establishing such private AMCs is that it allows bank management to focus on the good bank and new lending, while attracting superior and dedicated management to perform the specialized task of resolving NPLs. That is, the bank's majority-owned AMC was an alternative to managing the NPLs in-house. The scheme enables NPLs to be valued at market prices, and requires recapitalization to cover the losses beyond existing provisions on transferred NPLs. The regulation allows the remainder of loan losses to be taken in the AMCs, not in the bank.

Fourth, the consolidation of the banks and the finance companies was to be accelerated through additional Bank of Thailand interventions and proposed mergers. For banks and finance companies unable to recapitalize, the Bank of Thailand had no choice but to intervene. The government took over, merged, closed down some finance companies and banks.

3.1.3. Progress after the August 1998 program

The task of capital support schemes led banks to manage and raise altogether some 959 billion baht in the process of capitalization. From this amount, government provided 293 billion, of which 241 billion baht went to state banks including the private banks that were taken over. In addition, another 10 billion baht was provided to a number of finance companies.

Such measures had helped to reduce a new level of NPLs,[1] however, with such a long time span (Table 3) at the end of June 1998, the total financial system NPLs amounted to 32.69% of total loans (Figs. 1 and 2). With continued stagnation of economic activity and delays in corporate debt restructuring, total financial institution NPLs had increased steadily since June 1998 and reached its peak of 2.73 billion baht or 47.7% of total loans in the system in May 1999. Private banks accounted for 1.3 trillion or 42.82% of total loans, while state banks accounted for 1.17 trillion baht or 69.36 of total loans. NPLs of foreign banks and finance companies totaled 0.08 trillion or 11.52% and 0.17 trillion or 67.18%, respectively. In the second half of 1999, NPLs gradually declined to 30.94% of total loans in August 2000. Although the worse is over, the problem remained large. By September 2000,

Table 3
NPLs outstanding—classified by Financial Institution Group

	Million baht				
	1998	1999	2000	2001	2002 (February)
Private banks (% to total loans)	1,239,944 (40.48)	885,441 (30.59)	476,360 (18.00)	370,480 (14.42)	374,424 (14.53)
State-owned banks (% to total loans)	1,036,654 (62.45)	1,057,276 (62.84)	308,053 (21.63)	71,468 (5.59)	69,719 (5.46)
Foreign banks (full branch) (% to total loans)	74,244 (9.81)	61,575 (9.94)	38,176 (6.60)	16,590 (3.20)	11,787 (2.19)
Total commercial banks (% to total loans)	2,350,842 (42.90)	2,004,292 (38.57)	822,589 (17.70)	458,538 (10.50)	455,930 (10.38)
Finance companies (% to total loans)	323,691 (70.16)	90,133 (49.22)	34,752 (24.48)	15,453 (9.46)	14,754 (8.74)
Grand total (% to total loans)	2,674,533 (45.02)	2,094,425 (38.93)	857,341 (17.90)	473,991 (10.46)	470,684 (10.32)
New IBFs (% to total loans)			4960 (6.40)	2462 (4.81)	2028 (4.44)
Credit Foncier Companies (% to total loans)			1362 (40.92)	952 (24.30)	943 (21.05)
Total financial institutions (% to total loans)			863,663 (17.73)	477,405 (10.41)	473,655 (10.27)

Source: Bank of Thailand (online).
Remarks: (1) NPL = over 3 months past due loans; (2) excluding New IBFs and Credit Foncier Companies.

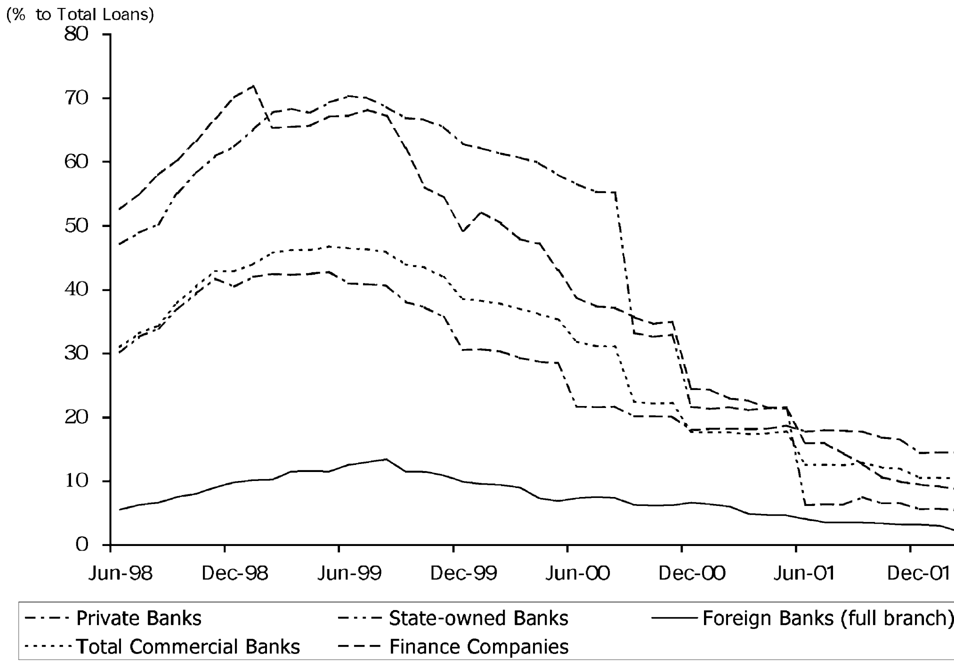

Fig. 1. NPLs outstanding—classified by Financial Institution Group.

the great strides were apparently made. NPLs dropped to 22.88% and these were partly illusory. As banks made provisions, bad loans were sometimes taken of the books altogether. This was because the government encouraged bank to establish their own AMCs. Therefore, at that time, NPLs more than 400 billion baht were transferred in an asset management

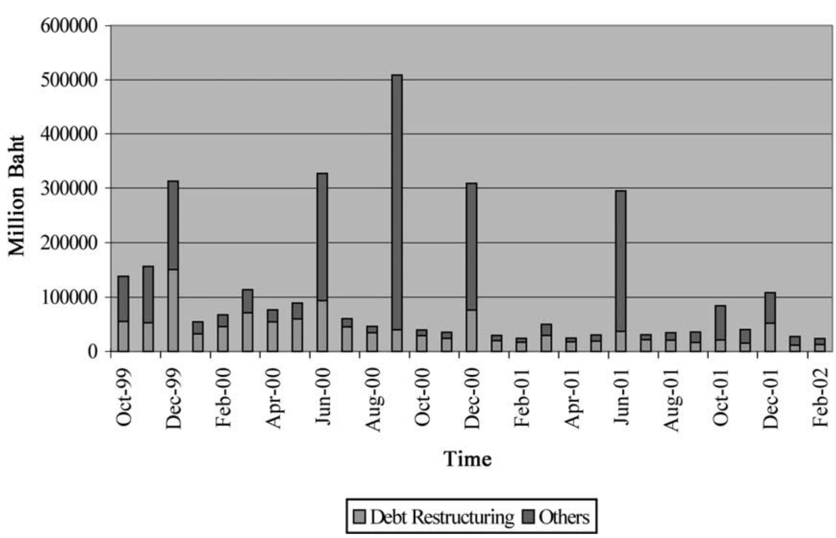

Fig. 2. Decrease in NPLs.

Table 4
Loan outstanding—classified by Financial Institution Group

	1998	1999	2000	2001	2002 (February)
Private banks	3,063,267	2,894,597	2,646,334	2,568,563	2,576,562
State-owned banks	1,660,068	1,682,553	1,424,138	1,278,681	1,277,516
Foreign banks (full branch)	756,505	619,327	578,068	518,973	538,633
Total commercial banks	5,479,840	5,196,477	4,648,540	4,366,217	4,392,711
Finance companies	461,365	183,106	141,940	163,270	168,739
Grand total (excluding New IBFs and Credit Foncier Companies)	5,941,205	5,379,583	4,790,480	4,529,487	4,561,450
New IBFs			77,480	51,175	45,714
Credit Foncier Companies			3327	3918	4480
Grand total			4,871,287	4,584,580	4,611,644

Source: Bank of Thailand (online).
Remarks: Loan Outstanding (Financial Institutions Group excluding New IBFs) in February 2002, as for calculating the ratio of NPL and total loans are excluding the followings: (1) bad debt write-off can be reaccountable will not count to NPL; (2) 100% provision of loss and doubtful loss classification of which non-collateral will not count into NPL.

company. These would disappear from the NPLs statistics, but the NPLs problem still could not be resolved. Many of the debts have merely been rescheduled. The corporate sector in Thailand still remained over-leveraged, which made it highly vulnerable to any downturn (Development Research and Policy Analysis Division, 2001). Furthermore, 3 years after the crisis, commercial bank loans have not recovered from the steady slide since a spurious jump in 1997. On average, during 1997–2001, commercial bank loans had declined at the rate of 8.1% per annum (Table 4).

It can be seen that the major task of cleaning the financial sector's balance sheets was on the banks themselves. The August 14 package appeared to be moving at a slow pace, with few banks expressing their willingness to participate in the program for fear of losing their management control and ownership under the tough conditions of the tier-1 capital support scheme. In negotiating with debtors, Thai banks were quite reluctant to write down their debts, because that would mean they would have to set aside more money for recapitalization. Many of them chose to reschedule the loans by stretching them out, rather then to restructure them. Most obviously, the banks limited their lending, fearing that borrowers would become non-performing again. They also charged a higher margin in order to generate enough operating profits to pay for the provisioning. At the mean time, this did nothing to improve the debtors' own balance sheets. However, Thai financial institutions have been put on a firm foundation. By the end of 2000, Thai private banks have met their provisioning requirements. Finance companies have even exceeded those requirements, thus meeting the targets set out in the measures.

3.2. Corporate debt restructuring

As the crisis was a private sector driven, the corporate debt restructuring is one of the most important issues that have been widely discussed. In this connection, the process of corporate debt restructuring is an integral part of the restructuring of the NPLs because the root cause of NPL problem was the lack of good governance in many sectors, and debtors were no exception. The process of corporate debt restructuring is complex and involves difficult legal, regulatory, and administrative reforms.

One of the most important characteristics of the corporate debt in Thailand has been the prevalence of small loans extended to small and medium-size enterprises (SMEs). That is more than 50% of the nation's total classified loans were medium and small-distressed loans. In addition, almost all firms in Thailand are family-owned and family-managed. It is consequently difficult to reject the equity holders without ejecting the management. In other words, restructuring Thai corporate debt would require far more effort.

In June 1998, the government established the Corporate Debt Restructuring Advisory Committee (CDRAC) to facilitate the voluntary process of corporate restructuring and developed the Framework for Corporate Restructuring. The Governor of the Bank of Thailand is the chairman of CDRAC, while its members are represented by the chairpersons from both the creditor and debtor associations, namely the Thai Bankers' Association, the Foreign Banks' Association, the Association of Finance Companies, the Federation of Thai Industries and the Board of Trade of Thailand. The framework also called the "Bangkok Approach," modeled after the London Approach.[2]

CDRAC's debt restructuring process allows both the debtors and creditors to voluntarily negotiate the debt restructuring under a market-oriented approach. It consists of 19 principles to facilitate corporate restructuring, which define the expectations of debtors, creditors, and authorities in the voluntary, out-of-court work-out process. To attract creditors and debtors to come together to resolve their debts voluntarily, the Bank of Thailand has coordinated with the Revenue Department, the Department of Land and other relevant agencies in issuing or amending laws and measures to provide tax exemptions and reduce land-transfer fees for creditors and debtors who successfully restructured their debts.

CDRAC coordinated the restructuring efforts under the Debtor–Creditor Agreement on Debt Restructuring Process (DCA) and the Inter-Creditor Agreement on Restructure Plan Votes and Executive Decision Panel Procedures (ICA) by identifying the debtor and creditor groups and setting up the venue for the dialog and negotiations between these two groups (Dasri, 2001).

Despite the weakness that the CDRAC process could not cover creditors who were not financial institutions, it had quite succeeded in its work. By the end of December 2000, 6239 cases with debt worth 1.1 trillion baht had been resolved out of around 12,000 debtor cases. And as of April 2002, CDRAC successful facilitated 10,109 cases with credits outstanding of 1.279 trillion baht (Table 5). However, at that time, approximately 1 trillion baht worth of credits were unsuccessfully resolved under the CDRAC's target debtors have been taken to court by creditors.

3.2.1. Problems and bottlenecks delaying negotiations on corporate debt

3.2.1.1. Restructuring. Economic crisis was more severe than expected. All parties involved in debt restructuring had limited experience and practical knowledge in dealing with such high level of NPLs in the financial system. In addition, the word debt restructuring, in reality had become debt rescheduling instead.

Table 5
Debt restructuring of CDRAC target debtors by current status as of April 30, 2002

Item	Unit	DCA	SA	Total (DCA + SA)
Target debtor under the DCA–ICA or SA	Cases	1590	10,083	11,673
restructuring process	Million baht	1,467,307	201,860	1,669,167
Completed cases[a]	Cases	1018	9091	10,109
	Million baht	11,150,449	129,437	1,279,886
In process of debt restructuring	Cases	–	–	–
	Million baht	–	–	–
Unsuccessful restructuring case—case	Cases	570	992	1562
filed and to be filed in court[b]	Million baht	311,778	72,423	384,201
Transferred to TAMC	Cases	2	–	2
	Million baht	5080	–	5080
Target debtors not under the DCA–ICA or SA restructuring process (cases filed and to be filed in court/in process of signing SA/normal loans)	Cases	1269	1908	3177
	Million baht	849,969	106,087	956,056
Total approved target debtors	Cases	2859	11,991	14,850
	Million baht	2,317,276	307,947	2,625,223

Source: Bank of Thailand (online).

[a] Completed cases under DCA/ICA comprise of (1) completed cases (contract has been sign); (2) Agreement on Plan, in process of documentation and signing; and (3) Agreement on Plan, file for reorganization in Bankruptcy Court.

[b] As of April 30, 2002, there are 134 small and medium sized debtors with credit outstanding of 3891 million baht that creditors have the right to take legal action against the debtors and CDRAC had already terminated the process.

According to economic conditions, some debtors tried to conserve as much cash-flow as they could, by severely restricting the outflows of funds. Repayment of debts and even payments of interest were considered items that could be dispensed with in such difficult times. The "strategic NPLs" then occurred due to the misguided attitudes in debt restructuring. "strategic NPLs" used to mean dishonest default, that is, the debtor has the ability to make repayments but chooses not to do so (Dasri, 1999).

The strategic NPLs was employed by firms since, by the end of 1997, banks were reluctant to put new money in order to limit their losses. Therefore, firms had to build up a large hoard of cash reserves to sustain themselves during the interim. This gave them considerable bargaining power vis-à-vis their creditors. Such attitudes are not congruent with CDRAC's restructuring process, which aims for debtors to be able to continue their business operations in order to make fair repayments to their creditors who should receive more in return than they would from liquidation in the court proceeding.

Since November 2001, the proportions of new NPLs to reentry NPLs have been declined. For example, in January 2001, new NPLs totaled 13 billion baht, while restructured loans turning bad again totaled 18 billion baht and in January 2002, new NPLs totaled 6.8 billion baht, while restructured loans turning bad again totaled 24.3 billion baht (Fig. 3). Even though, there could be many factors that driven up NPLs, the strategic NPLs is believed to play a significant role.

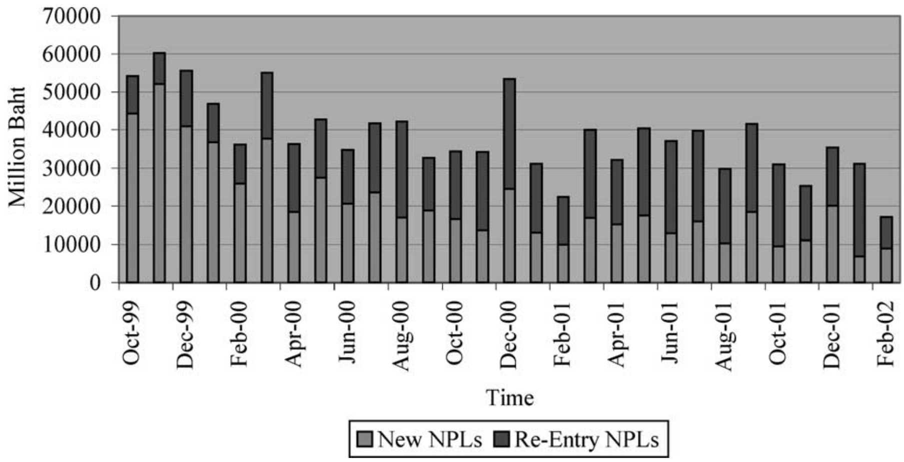

Fig. 3. Increase in NPLs.

3.3. The Thai Asset Management Corporation (TAMC)

The government established the Thai Asset Management Corporation (TAMC) in June 2001 to help alleviate weaknesses in the bank and corporate sector. It is believed that cleaning out the banks' balance sheets by buying out bad loans from them would make the banks lend again, and bring economic recovery. However, the TAMC act has been riddled with criticisms that the measure would be valid at the start of a financial meltdown, not just 3 years afterward when the economy had already paid the price of great income losses. Finally, clearing its constitutional hurdles on October 2001, the TAMC started accepting its first lot of asset transfer on October 15, 2001.

The TAMC is a government agency owned 100% by the FIDF. The TAMC is managed by a board of directors consisting of no more than 11 members appointed by the Minister of Finance and approved by the Council of Ministers. Basically, the TAMC is tasked to clean up those state banks' balance sheets. It is mandated to take over the entire NPL portfolio of the state banks, which totaled 1.1 trillion baht. Those sub-quality assets are defined as loss, doubtful of loss, doubtful or sub-standard. However, private financial institutions and asset management companies may also transfer NPLs to TAMC. These will be those secured, for which there are multiple creditors, for which the debtors were owing at least 5 million baht and for which no restructuring agreement in writing has been entered for the NPL by July 9, 2001, and for which NPLs were not part of a rehabilitation plan approved by the Bankruptcy Law before June 2001. This part is valued at approximately 250 billion baht worth. However, trade creditors, non-Thai banks and their branches are not eligible to transfer their NPLs to the TAMC.

The TAMC pricings are different for state and private banks. The price of the assets payable by TAMC to the state banks is the value of the collateral. The rules prescribed by the TAMC Board shall determine the price to be paid if there is no collateral. The price payable to private banks is the value of the collateral, or the book value of NPLs less applicable reserve amount, whichever is lesser.[3] The TAMC will pay the banks in non-transferable

10-year FIDF-guaranteed bonds, carrying a floating interest equal to the interest rate on bank deposits.

Profits and losses will be shared at the end of the 5 and 10 years. In the case of profits, the first 20% will be shared equally between TAMC and the financial institutions; additional profit not exceeding the difference between the book value and transfer price will accrue to the financial institutions; any further profits will accrue to TAMC. In the case of losses, the first 20% of transfer price will be absorbed solely by financial institutions; they will share the losses for the next 20% equally with TAMC; and any remaining loss will be borne by the TAMC.

The TAMC has very wide enforcement powers to collect from the banks'debtors. One of the most interesting powers of the TAMC is its ability to restructure the debt by unilaterally amending loan terms, forcing a debt-equity conversion, taking assignments of debts or assets from the debtor to settle debts, and taking transfer of shares or buy issued shares to increase the debtor's capital. For all these measures, only the approval of the governing board of the TAMC is required.

Currently, the TAMC has successfully transferred 4565 cases with debt amounted to 698.4 billion baht. The transferred prices were approximately 33.27% of the debt value. By the year 2002, it aims at injecting 500 billion baht.[4]

However, there seems to be little enthusiasm towards the TAMC. Bankers do not believe that it is a way to really resolve the NPLs problems. The TAMC may be a vehicle to warehouse the NPLs. With no sign for early economic recovery, injecting more capital into the system do not facilitate banks' activities. Banks still have excess liquidity since it is very difficult to find investment outlet.

4. Constraints on restructuring

After the severe economic in 1997, progress has been made in improving economic performance as well as restructuring the financial system. Real GDP growth that was sharply decline from 5.9% in 1996 to −1.4% in 1997 and drastically dropped to −10.5% in 1998, has started to recover in 1999. GDP growth slowly adjusted to 4.4% and 4.6% in 1999 and 2000, respectively.

However, the recovery has been restrained by a number of structural weaknesses. First, there is an excess liquidity in the market with historical low rate of interest and many believe that Thailand has been in a liquidity trap. One reason explaining the excess liquidity is the ill-functioned financial market, resulted from the slow pace of the financial sector restructuring. Besides, the soundness of most banks and financial companies has not been fully recovered. The resumption of lending has been slow, therefore, these financial intermediaries do not play their full role in extending the loans to investors so as to boost up the economy.

Furthermore, the role of monetary policy is rather limited under this scenario. Therefore, the government has implemented expansionary fiscal policy in assisting Thailand to take off from the economic slowdown. Nonetheless, the high percentage of the public debt seems threatening the overall economy (Sabhasri et al., 2001). The central government debt as a percentage of GDP rose from 10% in mid-1998 to 25% in the third-quarter of 2001 (Fig. 4).

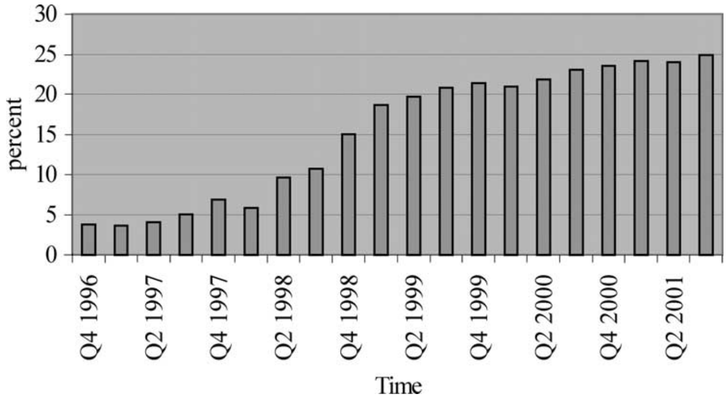

Fig. 4. Central government debt as % of GDP.

Moreover, the global economic slowdown was exacerbated by September 11 terror attack in the United States. Also there is a slow recovery in the Japan economy. External demand, therefore, has decreased further, as a result, the growth prospect is lower than earlier expected.

5. Conclusion

While globalization offers potentially immense benefits to countries. On the other hand, it also poses new challenges in terms of policy making. The financial crisis has led people to reassess the costs and benefits of globalization, especially one of financial integration. Globalization awards good policies whereas punishes bad ones. Capital flows could definitely benefit a country, if this country sufficiently prepares herself. The key factor required for a country to recover from a financial crisis is not just a traditional austerity program. We also need to restructuring the financial system and improving corporate governance. The country should also take measures to develop well-functioning capital markets. Actions are required to strengthening prudential regulations and supervisions which should also be politically independent. Moreover, transparency and disclosure of market and company information should be promoted. Improving risk assessment and providing sufficient market infrastructures are also necessary. Significant progress has been achieved through the restructuring process. Nonetheless, The pace of the restructuring should better be accelerated whereas the quality of the restructuring should be further improved. Besides, the country also needs to further develop a bond market, which will help reducing the over-dependence of corporate on bank credit, and increasing resilience in the financial system.

Notes

1. According to the new definition of NPLs (3 months of non-payment instead of 6 months), official numbers of NPL therefore were available after end of June 1998.

2. A model of large-scale corporate restructuring under a government sponsored out-of-court process.
3. Book value here means the total principal amount of the loan as at the date of transfer together with accrued interest for the 3-month period prior to the transfer date.
4. Money Magazine (2002).

References

Asian Development Bank. (1999). *Rising to the challenge in Asia: a study of financial markets*. Asian Development Bank, Manila.

Bank of Thailand Statistical Data (online). Available: http://www.bot.or.th.

Dasri, T. (1999). Out-of-court corporate debt restructuring in Thailand. *Quarterly Bullentin: Bank of Thailand*, *39*(4), 39–60.

Dasri, T. (2001). Policies and practices of corporate restructuring in East Asia. *Quarterly Bullentin: Bank of Thailand*, *39*(3), 1–9.

Development Research and Policy Analysis Division. (2001). *Governance re-invented: the progress, constraints, and remaining agenda in bank and corporate restructuring in East and South-East Asia*. Manila: DRPAD Publication.

Flood, R., & Garber, P. (1986). Collapsing exchange-rate regimes: some linear examples. *Journal of International Economics*, *17*, 1–13.

Glick, R., & Hutchison, M. (1999). *Banking and currency crises: how common are twins?* Pacific Basin Working Paper Series No. 7. San Francisco: Center for Pacific Basin Monetary and Economic Studies.

International Monetary Fund. (2001). *Thailand: selected issues*. IMF Country Report No. 01/147.

Kaminsky, G., & Reinhart, C. (1999). The twin crises: the causes of banking and balance-of-payment problems. *American Economic Review*, *89*, 473–500.

Krugman, P. (1979). A model of balance-of-payment crises. *Journal of Money, Credit, and Banking*, *11*(3), 311–325.

Money Magazine. (2002). *TAMC*, *4*(38), 20–26.

Obstfeld, M. (1996). Model of currency crises with self-fulfilling features. *European Economic Review*, *40*, 1007–1047.

Sabhasri, S., Manakit, P., & Charoenseang, J. (2001). *Macroeconomic policy management after the economic and financial crisis in East Asia: case of Thailand*. Paper presented at International Conference: Monetary Outlook on East Asia in An Integrating World Economy, Chulalongkon University, September (mimeographed).

World Bank. (1998). *East Asia: the road to recovery*. Washington, DC: World Bank.