

Globalization, Market Failure, Banking & Crisis Resolution : Thailand Experience

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Agenda

I. Prologue:

Globalization, Trilemma and Market Failures

II. Setting: Pre and Post the 1997 Crisis

III. Discussion on Selected issues

V. Conclusion.

II. Prologue: Trilemma on Political Econ.

1. **Capitalism** is a belief in '**inequality**'. It is a 'free' market oriented system and based on rational self-interest individuals.
2. **Democracy** is a belief in '**equality**'. It is a political process based on one man, one vote with guaranteed 'freedom of speech'.
3. **Social Welfare max.** should be a government main objective. State social welfare system is invented to make capitalism and democracy ideals **compatible**.

BEHAVIOR Trade-off between claims of economic efficiency and claims of distributive equity in **different** speed of adjustments.

Democratic Societies rely upon voting to establish social objectives.

The origin of Thailand dual tracks !

1. 'Social Welfare and Grass Root' Approach – for Popularity ?,
2. 'Creative Destruction and FTA' approach – for Business ?

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I. Prologue:

- Globalization & Trilemma

II. Setting :

- Pre and Post the 1997 Crisis

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III The 1997 Thailand Post Mortem: Coordination Failure

Political Economic Impact in 1997 were as follows :

- **Currency Instability** : Baht from 25 to 57 /USD causing devaluation in the region. (Globalization !)
- **Blanket Guarantee** was issued to protect Bank/ Fin. Depositors/creditors to stop bank run.
- Only 19% of Thai firms had any hedging at all.
- SME and/or family owned firms borrowing in bahts went under because of **high** interest rate – over 20%!
Crisis of SME/Middle Class Collapse
- Collapse of the financial and banking sectors
- Major Economic Contraction (-10% GDP)
- Fall of the **PM Chavalit Gov't** shortly after in late 97

III Change everything all at once

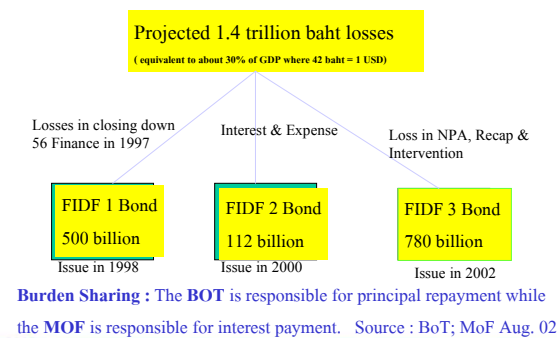
IMF & High Hope: **PM Chuan Gov't** (Aug'97 - Feb 01)

1. **Fin. Sector Reforms** (asper IMF's request- Pro free market)

- **Increased Foreign Participation** : Bank/NPL sell off, M & A, no foreign ownership limit...
- **Forced Insolvent Institutions to close and FIDF** took over 58 finances and 4 banks; later forced merge
Results : Only 12 Banks and about 20 finances left
- **Fin Institution Act** – Modernize the framework
- **Bank of Thailand Act** – Independent & A/C
- Passed **Bankruptcy Act** – Chapter 11 & others.
- Amended the Public Co. Act & SEC.

Speed up Privatization : Master Plan in 1998

(2) **Burden Sharing : Fiscalization of FIDF losses**



III Reform Fatigue, Coordination Failure & Capacity Problem

The Fallouts of Market base Policy : **PM Chuan Gov't**

2. **Market must clear itself.** Where is the cash/market ?

- **Fired Sale** of NPA by Financial Restructure Agency causing deep discount price benchmark causing a complete collapse in asset based loan lending >>>SME
 - **Wealth Redistribution & Agency Problem** : snap up cheap assets – NPLs, NPAs, distressed loans..
3. Setting up TAMC (owned by FIDF) to buy the residual NPL: warehousing subjected to common agency prob.
4. Cutting down social welfare : education subsidy...

Are people both public & private be ready for... ?

No Pain, No Gain !!! >> **Not Popular Ideas !!!**

III To Preserve Democracy or Economic Reform ?

High Hope: **PM Chuan Gov't** (Aug'97 - Feb 01)
with mandate for political economic reform

4. **New People Constitution** & Election in 2001

- Popular Voting Method to elect the Senators.
- Establish of 'independent agencies/watchdog - NCCC, Election Comm., Admin. Court, NGOs
- Public Info Disclosure Act
- Decentralization Initiative in admin & tax power

The aim is for fewer political, stronger parties.

Reforming both econ. & political system at the same time,
but forget to assist the social and community burden.

III. The Rise of PM Thaksin & TRT Populist Policy

After suffering from tremendous pain and agony, in Feb 01 Thai people had handed in a land slide victory to **PM Dr. Thaksin** and his 'Thai loves Thai' (TRT) party on a populist platform

1. Debt Suspension for farmers,
2. One 'Tamboon' (village,) One product (OTOP),
3. Million baht (25,000\$)/ village fund >> People Bank,
4. 30 baht (.70\$/) health care per visit scheme,
5. 'Eua-Athorn' / Cheap housing, computer, taxi....

TRT Campaign promises to ease the pain of crisis !

Bounded rational and willpower prevail !

Agenda

- I. **Abstract**
- II. **Prologue:** Globalization, Trilemma & Market Failure
- II. **Setting:** Pre and Post the 1997 Crisis
- III. **Discussion on Selected issues**
 1. **Macro Econ Recovery**
 2. **Crisis Resolution**
 3. **Banking Resolution**
 4. **Behavior Econ. & Micro Econ. Concerns**
- IV. **Conclusion.**

Thai Experience confirm Pomerleano and Vojta 2002 study

Loan portfolio management, asset-liability mgt and mgt info services

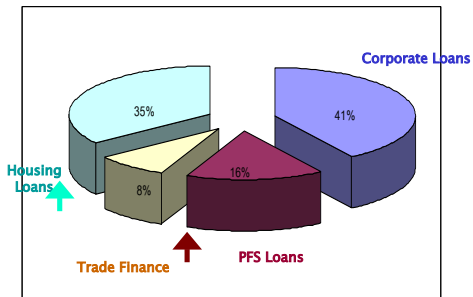
Foreign Banks

- Cash Flow based lending – Corp. Loan
- Retail Loan
- **Off-B/S & Trading**
- ALM more accurately captures time value of money
- Tech platform centered on “global hubs”
- MIS presents economies of scale.

Domestic Banks

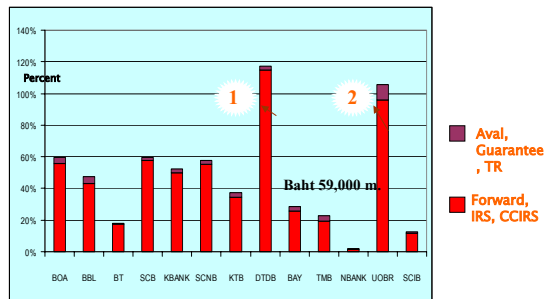
- Collateral SME lending
- Corp. and Retail loans
- **Little off B/S and Trading**
- Nearly all private banks - adoption of foreign banks’ risk management and ALM practices
- State banks has difficult time to adjust.
- Difficult choice for MIS: to “build or buy” -- both risky and expensive

Typical Foreign owned Bank Loan Portfolio as of Mar 03



Active in Personal Loan and Corp Loan, **no SME Lending**

Off Balance Sheet Items per Total Assets



Source : From Financial Statement as at 31/12/02

(3) Banking Crisis Resolution Implications

1.4 More SMEs are conjectured to be in shadow economy....Regulatory implications – Tax, Admin.

Why not emphasized more

- (a) on cleaning up debt overhang (**Market Based ?**), especially during low interest rate environment
- (b) extending **partial guarantee** to SME loan and
- (c) **in capacity building, asset accumulation** and adjusted program for SME though this may **not** be politically popular comparing to grass root route.

Micro-enterprises has much lower probability to be a large, professional firm than SMEs.

(4) Behavior Econ. & Micro Economic Concerns (by design)

1.5 **State Bank Lending** as quasi-fiscal spending distorts from Private lead Bank to **Command and Control Bank System**.

- **The 200 Bb Vayupak Mutual Fund** guaranteed by gov't is being issued to the people in order to recapitalize state banks.
- **State Banks** are prone with common agency problems with multiple objectives. High loan growth may mean high NPL.
- Government guarantee mutual fund 1) distorts market, 2) raise substantial contingency liability burden to the public and 3) creates potentially moral hazard problems.
- Mutual fund should be invested according to bank or cooperate performance and its risk-reward objective.

Suggestion : Emphasizing more on **quality intervention** to rebuild the market mechanism rather than aggressively intervene the market as the market maker, itself.

(3) Behavior Econ. & Micro Econ Concerns (by design)

1.6 Future Prospect for DIS in Thailand

- Blanket Guarantee on deposit is being withdrawn (quietly).
- New DIS law should be passed soon w/ this effective gov't.
- **FIDF as 'a cash box' now** would be transformed to be a new separate functional identity as DIS spinning off fm BoT
- All FIDF staff and many BoT associates would be transferred to this DIS unit.
- Initially, to avoid potential admin problems and to gain user's acceptance quickly as the first priority, DIS would be charged on flat fee rate same as before.
- The continuation of the asset disposal policy, privatization of nationalized banks and early warning system are expected.
- The first sign would be to **lift the guarantee of claims by creditors** (amount to abt. B200 billion) other than depositor.

(3) Banking Crisis Resolution – Warning Signs

2. Checklist Warning Signs of banking problems

2.1 Shrinking Deposit Base: Argentina 20% run

2.2 Profitability of the bank: ROA below 1%

2.3 Asset Bubble: Thai 400% in 1993 to 6

2.4 Growth in foreign loan: Columbia 22%

2.5 NPL – Thai 22% in 1997, peak 54% in 1998

2.6 Value Destruction by private sector :

$$ROIC < WAAC$$

2.7 Interest Coverage Ratio by private sector :

In 1996 Korea, half listed firm has less than 1%.

(4) Behavior Econ. & Micro Econ Concerns (by default)

1. **Possible deflation** in goods and service markets is being exported largely by China because of excess supply. Indeed, nearly all trouble nations in Asia are trying to export their way out.

- It increases ‘real’ value of debt...A curse to debtor.
- It encourages psychologically consumer to put off in spending in expectation that price would fall further.

Suggestion : To avoid a reducing demand vicious cycle, the central banks must print out money – buy bonds, equities, land and bad debt....But **Japanese experience** also indicates structural demo. problem.

If proper measures are not taken, this may create another seed of problems- asset inflation, no productivity...

(4) Behavior Econ. & Micro Econ Concerns (by default)

2. **Low Interest** causes asset reflation /bubble and consumerism. Prospect theory implies

- ‘Borrowed’ endowment effect, cognitive dissonance and metal account may dynamically cause adverse asymmetric response to high volatile economic shock.
- Overconfidence & Disposition Effect in Capital Mkt
- People are emotionally risk averse (risk taking) when they are in gain (loss) domain...Gambler’s fallacy.
- Emotional endowment effect is one of major obstacles in slow bank/crisis resolution. Ex : Family Business.

Symptoms : Loss of self-esteem, confidence, self worth...Money ...Self-Control /Choice & Fungibility Issue

Suggestion : Preventing the market excess is the best solution !

(4) Behavior Econ. & Micro Econ Concerns (by design)

3. **Populist Policy** with a strong leadership may give **'a false sense of Entitlement'** and un-funded social welfare commitment which may not be sustainable. This is **a path dependence** (QWERTY) **process** !
- 1st Degree : Durability : **Initial Condition**/ Assertion
2nd --- : Past Conditions: **Imperfect Foresight**
3rd --- : Remedial Inefficiency : Propagate Any Errors
- Suggestion : Changing attitude of ruling party and recipients from entitlement to **enable-ment policy** for asset accumulation in **market based economy** would be a better **inter-temporal** solution.
- Same implications may be applied to banking resolution!

IV. Conclusion (1)

1. Central to banking and crisis resolution in Thailand is to **tradeoff** between **private** lead economy/ efficiency and people equity using mainly **public** coordination / means.
- The reversal of policy from pro-free market to big government causes delay in bank reform and create a new path dependent econ
 - **Thai bank resolution is still a-work-in-progress** with increasingly dominant by state banks.
 - Unless and until the market based and private, specially SME and investment, lead growth for higher productivity can be restored its dominant sector again as in the pre 1997 crisis, a sustainable recovery may remain doubtful in Thailand.
 - **Social welfare** would be needed to make the capitalism and democracy compatible...**But this should not be overdone** !

IV. Conclusion (2)

3. On the **macro level**, nearly all economic data in 2003 are sound w/ modest concerns in short run.
4. On the **micro level**, reducing debt overhang, jump-start SME and continuing structural reforms - both private and public for higher productivity - are among critical factors to sustainable recovery.
5. **The main concerns** are the mass behavioral economic fallouts and micro economic concerns. Bounded rational & willpower, 'a false sense' of entitlement, over-confidence and 'borrowed' endowment effect are among fine examples apart from typical microeconomic moral hazard and many-principals-common-agency problems.

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Annex 1 – Banks in Thailand

I. Private owned Banks :

1. BBL = Bangkok Bank, majority owned by Sophonpanich family
2. KBANK = formerly known as Thai Farmer Bank, majority owned by Lamsum Family
3. BAY = Bank of Ayudya, majority owned by Ratanaruk family
4. SCB = Siam Commercial Bank, majority owned by Crowned Property
5. NBANK = National (Thanachat) Bank, owned by National Finance Group (NFS executive, SCB and diffused minority shareholders)

II. Foreigned owned Bank :

1. BoA = Bank of Asia, majority (owned by) ABN Amro Bank, Netherland
2. SCNB = Standard Charter Nakornthon Bank (Standard Charter Bank, UK)
3. DTDB = DBS Thai Danu Bank (DBS Bank, Singapore)
4. UOBR = UOB Radanasin Bank (UOB Bank, Singapore)

Appendix 1 – Banks in Thailand

III. State-owned Bank :

1. BT = Bank Thai, formerly known Union Bank of Bangkok
2. KTB = Krung Thai Bank
 - largest bank in Thailand,
 - 90% owned by MoF,
 - merged with FBCB and BBC in 2000
3. SCIB = Siam City Bank, nationalized in 1998 and later merged with BMB (Bangkok Metropolitan Bank) in 2002.
4. TMB = Thai Military Bank, majority owned by Thai Army, Navy and Air force and... about to be nationalized !

Appendix 2 : Finance Institutional Development Fund

FIDF was established on Nov. 27, **1985** by enacting of an **Emergency Decree** [B.E. 2485 & 2528]

FIDF is a separated juristic entity from Bank of Thailand (BoT) but functions as BoT department.

FIDF is managed by a 9 members committee comprising BoT governor as a chairman.

FIDF is actually a 'pay-box' operated by 5 officers.

The objective is to enhance BoT ability in implementing financial-support measures, develop and rehabilitate financially distressed banks and finances in order to maintain stability in the system.

Is FIDF a de facto deposit insurance within BoT ? Any conflicts of interest ?

Appendix 2-FIDF: Role & Responsibility

FIDF Role and Responsibility are as follows :

- Lender of the last resource for finances/Banks.
- Purchased share capital increase & manage to rehabilitate financially distressed institution(s).
- Guarantee payment to depositors and creditors as conditioned by FIDF.
- Acting on behalf of the government as a guarantor for the depositors and creditors
- Monitor to protect FIDF's interest and receive proportionate payment from liquidation of asset

Appendix 3 – Chronology of Thailand 1997 Crisis Resolution

July' 97 Baht Depreciate Sharply; 42 FCs Closed

Aug' 97 USD 17 b IMF led Rescue Package

Oct' 97 Financial Restructure Agency est.

Foreigners allowed majority share in Bank for next 10 yrs

Jan/Feb' 98 Radasin Bank est.; 4 banks nationalized.

April' 98 Bankruptcy Law Amended

Sept' 98 First Bank announced in Recap. Scheme

Dec' 98 First Large Asset of closed FCs auction

Mar' 99 Second Large Asset Auction sold mostly
to newly establish AMC

May 03 Thailand exited from IMF program.

END

I love emails.

Any comments are welcome

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