Vo Tri Thanh
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Comments on the paper by Bandid Nijathaworn

“The Current State of the Financial Sector and the Regulatory Framework in Asian Economies: The Case of Thailand”

The paper is very informative, basically about the experience of Thai financial system after Asian financial crisis onward, including

1. Financial structure changes
2. Restructuring 1998-2007 (Recapitalization; consolidation; regulatory & supervisory reforms toward risk-based framework; deepening of capital market; FSMP I 2004-08)
3. Responses to global financial ciris (Easing M-policy; ensuring liquidity; fiscal stimulus; Gov’t guarantee on bank deposit; guarantee facility for SMEs; strengthening risk-based management and supervision; legal reform)
4. Current reforms (Implementation of FSMP II since 2010 with three pillars: operating cost reduction; efficiency promotion + access to financial services; financial infrastructure strengthening)

Several lessons can be learnt from the paper.

- To have a more balanced financial structure could be an important factor ensuring efficiency and resilience of financial system.
- Recapitalization and strengthening corporate governance should go hand-in-hand with regulatory and supervisory reform
- Success of financial reforms depends very much on the consistency and determination of implementation and (medium-term) vision of reform process

Since Thai Land is interesting case (crisis 1997; recovery and reform, policy responses to capital flows), there are some more things we would like to learn.

1. Role of financial structure

- What is the Thai experience of bond market development and the change in banking balance-sheet? *Note*: One lesson from Asian crisis is that Asia needs to have a more balanced financial system since the (corporate) bond market play essential role in minimizing “double mismatches” problem of banking system.

% of total	**1997**	**2007**
Financial system asset	**100.0**	**100.0**
Deposit-taking institutions	**61.9**	**42.2**
Bank	*42.7*	*34.1*
Private bank	29.8	22.7
State-owned	9.3	6.9
Foreign-majority owned	3.6	4.6
Non-bank institutions and funds	**15.2**	**14.4**
Capital market	**22.8**	**43.4**
Equity	*19.1*	*25.3*
Bond	*3.7*	*18.1*

Source: Calculation based on the Table 1 in the paper

- Within the Thai banking system, the role of foreign banks is limited, while that of Gov't is quite substantial. Is there any figure showing that the state-owned banks are less efficient than others? How to make sure that development of private banks (it should be!) and participation of foreign banks do not deteriorate "inclusive finance" (Inclusive finance is one of the targets of Thai financial development)

2. Interaction between macro-policies, capital flows management and financial regulations and/or supervision

This interaction is of those factors attributed to Asian crisis (exchange rate inflexibility, weak supervision, and inappropriateness in capital account opening). It is now paid more attention by economists (see, for example, Olivier Blanchard *et al*, "Rethinking Macroeconomic Policies", IMF Staff Position Note, SPN/10/03, Feb 2010, and Jonathan D. Ostry *et al*, "Capital Inflows: The Role of Controls", IMF Staff Position Note, SPN/10/14, Feb 2010).

Two episodes in the case of Thailand are worth examining in terms of policy outcomes and policy coordination effectiveness.

- The one is period from the end of 2006 to 2007 (BOT imposition of 30% reserve requirement on capital inflows in Dec 2006 and Thai stock market shrank by more than 12% in a single day; a significant outflow of the debt securities, but capital account continued being in surplus in 2006 and 2007; the peak of Thai bath appreciation in July 2007 and BOT intervention; see Kanit Sangsubhan (2010)[1].
- The second is the recent reaction to capital inflows and currency appreciation. It seems that Thailand attempted to change somehow monetary policy (to

[1] Kanit Sangsubhan, "Managing capital flows: The case of Thailand", in Kawai and Lamberte (eds), Managing Capital Flows – The Search for a Framework, ADBI & EE Publishing, 2010.

control emerging inflation) in tandem with the control of capital inflows and the encouragement of local firms' investment abroad (?)

3. Adaptation to new regulatory and supervisory frameworks

It is mentioned in the paper that "(the) implementation of FSMP II is now well underway" and it can play important role in "strengthening and development of the Thai financial sectors" in the context of changes in the global financial landscape and re-setting of global regulatory standards and policies.

There are two questions we could ask here: Is the FSMP II good enough for the reform of the present Thai financial system? How does Thailand think about the attempt by US and EU in creating stronger supervisory frameworks and in tightening and/or harmonizing world-wide financial standards?

Note: APF (2010)[2] stresses that "a one-size-fits-all approach does not put excessive burdens on Asian financial institutions. There must be scope for flexibility in the application of rules, and a balance between financial stability and financial development- including the capacity to innovate – must also be struck".

[2] See Asian Policy Forum (supported by ADBI),"Policy Recommendations to Secure Balanced and Sustainable Growth in Asia", October 2010.