

Box A: Financial Restructuring in East Asia

The Asian financial crisis has shown, among other things, that healthy financial intermediaries are essential to the efficient operation of an economy. Many of the east Asian countries that experienced financial difficulties – Indonesia, Korea, Malaysia and Thailand – have begun a process of restructuring and repairing their financial systems: closing unviable institutions, removing the burden of non-performing loans (NPLs) from remaining banks and other financial intermediaries, and recapitalising viable institutions. There has been significant progress even though the methods of intervention and resolution, and the stage of progress, vary between countries.

Table A1 shows official estimates of non-performing loans at financial institutions following the Asian crisis. The size of the problem is large, although cross-country

comparisons are complicated by different reporting and provisioning requirements. In Korea and Malaysia, non-performing loans in late 1998 were estimated at 23 per cent and 19 per cent, respectively, of total loans outstanding. In Thailand, they were more than double this. Official estimates are not currently available for Indonesia but market estimates of NPLs mostly range between 65 and 75 per cent of total loans.

In some countries, non-bank financial institutions (NBFIs) play an important part of the intermediation process and official estimates of NPLs are predominantly for that sector. In Korea, for example, the figure of 23 per cent of total loans relates to the financial sector as a whole, including NBFIs. The Financial Supervisory Commission has announced that only 8 per cent of loans at banks are non-performing.

Table A1: Aspects of Financial Restructuring

	Indonesia	Korea	Malaysia	Thailand
Non-performing loans				
Local currency	..	₩130 trillion	Rn71 billion	B2.7 trillion
US\$ billion	..	107	19	74.5
Per cent of total loans	..	23	19	46.5
Asset management				
Asset management vehicle (AMV)	Asset Management Unit (part of IBRA)	Korean Asset Management Corporation	Danaharta	Asset Management Company for NBFIs; individual bank AMVs
Amount transferred (US\$ billion)	..	36.3	5.3	4.4
Estimated cost to public sector in restructuring (% to GDP)	29	18	18	32

Sources: Fiscal cost estimates are from the IMF's December 1998 World Economic Outlook and International Capital Markets Interim Assessment. Other information is from: Korea – Financial Supervisory Commission, figures include precautionary loans (loans where interest has not been collected for between 1 and 3 months); Malaysia – Pengurusan Danaharta Nasional, figures for banks only; Thailand – Bank of Thailand; figures include NBFIs. Data are end-December 1998 but end-January 1999 for Thailand.

Countries have adopted a variety of methods in dealing with weak institutions (Table A2). In some cases, the authorities have focused on closing unviable institutions; for example, there has been substantial closure of private banks and mergers of state banks in Indonesia. In other cases, the authorities have preferred to retain existing institutions but substantially restructure, merge and recapitalise them, as in Malaysia. In Korea and Thailand, the authorities have closed non-viable NBFIs but have chosen to merge or nationalise banks rather than close them. In all cases, the authorities expect further mergers to take place.

To enable banks and other financial intermediaries to resume lending, it is necessary to write off bad loans or remove impaired assets from their balance sheets. To this end, all countries have set up asset management vehicles (AMVs) which acquire NPLs and then sell them to the market, typically over a period of time to avoid 'fire sale' values. Generally, there is one AMV in each country, apart from Thailand which has provided for each bank to set up its own AMV (although it has one AMV for finance companies). Progress is most advanced in Korea and Malaysia (in the latter case, the process is expected to be complete by mid 1999). Some sales of distressed assets by AMVs have been made,

but recovery rates are generally low, ranging between 12 and 48 per cent to date. Funds for AMVs are provided by deposit insurance corporations, the sale of distressed assets, bond issues and direct government or central bank funding.

Another focus of policy is to restore capital to international standards, but typically in graduated steps. Recapitalisation is being effected through different mechanisms. In all cases, public funds are being used – directly (Indonesia and Thailand), through the deposit insurance corporation (Korea) or through a special purpose vehicle (Danamodal in Malaysia) – often leaving the Government as majority owner of the banking system. In Indonesia, Korea and Thailand, use of foreign capital is part of the recapitalisation plan. Provisioning and reporting rules have also been generally tightened although they are not uniform between countries.

Financial restructuring has come at substantial fiscal cost. Fiscal costs are difficult to estimate: current IMF estimates range from 18 per cent of GDP in Korea and Malaysia to 32 per cent of GDP in Thailand, but market estimates are higher in some cases. In Scandinavia, the gross fiscal cost reached 17 per cent of GDP in Finland and 6 per cent in Sweden; in the United States, resolving the savings and loan crisis cost 2.4 per cent of GDP. ✧

Table A2: Financial System Restructuring
Number of financial institutions

	Indonesia	Korea	Malaysia	Thailand
Banks				
Closed	64	0	0	1
Absorbed	4	5	2	3
Nationalised	68 ^(a)	2	0	2
NBFIs				
Closed	0	87	0	56
Absorbed	0	6	16	0
Nationalised	0	0	2 ^(b)	12

(a) Includes 54 under IBRA direction.

(b) Under the direction of Danamodal.