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10 Years after the crisis: Thailand's financial system reform

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Abstract

This paper uses the framework of long-term financial system development to describe and assess the reform process in Thailand after 1997. The present financial reforms are well in line with the pattern of financial development found in the academic literature. A detailed analysis of capital markets, specialized financial institutions and supervisory regulation shows recent advancements and open issues. The rapid rise of non-banks financial institutions can serve as a paradigmatic example of market driven dynamism requiring appropriate policy action. Overall, the building of modern and sophisticated financial institutions is an ongoing process which should consider human resource constraints.

JEL classification : O 1 (economic development); G 2 (financial institutions)

Keywords: Financial institutions; Financial development; Thailand

1. Introduction

Thailand is back on its long-term growth path. Annual growth rates during the last 5 years, i.e. 2002 to 2006, average more than 4.5% and are thus somewhat above acceleration of the world economy with about 3 to 4% during the same period (calculated in real per capita terms). So Thailand has managed to overcome the depression caused by the Asian financial crisis and has regained its earlier position as a rapidly growing economy.

This ambitious development process includes a continuing reform of Thailand's financial sector. We can, indeed, show that the phase where financial reforms were dictated by the needs of crisis resolution has gone and that the country is back to a ''normal'' situation. Normal, however, does not mean ''no change'' as Thailand's economy is evolving with high speed. High growth

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implies continuous severe structural changes and one of the important areas of change is the financial system. This paper addresses this financial system change with an emphasis on the policy viewpoint, neglecting the dynamics within single institutions. Accordingly, we use the macroeconomic literature on long-term financial system development as a framework to describe and assess the reform process in Thailand after 1997.

It turns out that this perspective is well suited to understand major steps in Thailand's present reform process. Reforms are largely in line with the pattern of financial development found in the academic literature. The quite general pattern needs, however, many supplements to generate a consistent and detailed reform perspective. We discuss major issues in this respect.

Due to the present development stage of the Thai economy, the role of non-bank financial institutions has become a most important issue. That is why we focus on this aspect which will receive even increased attention during the next decade. This focus serves a second purpose as it illustrates the race between dynamic market forces pushing forward and authorities aiming for a consistent regulation of the financial sector. An efficient balancing of these forces will decide about the financial system's long-run success (Rajan & Zingales, 2003).

The rest of the paper is structured from general to the specific and unfolds as follows: Section 2 contains the long-term perspective structuring our discussion. Section 3 describes measures of financial crisis resolution in short, whereas we put more emphasis on Section 4 which presents the measures taken thereafter, i.e. roughly during the last 5 years. Section 5 turns to recent developments of non-banks financial institutions which are heavily engaged in the market for personal, i.e. mainly consumer, loans. Finally, Section 6 concludes.

2. Long-term financial system development

The available long-term as well as cross-sectional evidence documents well that the financial system develops in line with the overall economy. Stylized facts include overwhelming evidence that the financial system develops even faster than the rest of the economy over large periods as early shown by Goldsmith (1969). Most of this evidence is provided in terms of nominal assets of the financial sector put in relation to nominal GDP. However, the story holds when financial sector growth is rather measured in real terms, such as income generated or simply the number of branches etc. (Levine, 1997). So, high financial sector growth is evident and Thailand is – as an emerging economy – in the middle of dynamism in this process.

In some contrast to the undisputed relation between financial and overall economic growth, the issue of causality created long-standing controversy. At present, it seems fair to conclude that the basic thrust is from financial development to economic growth and less so the other way round (see Fase & Abma, 2003, for Asian countries). There are some caveats although, because there is still lots of reverse and two-way causality as first shown by Demetriades and Hussein (1996). Moreover, the experience of countries (De Gregorio & Guidotti, 1995) and episodes (Graff & Karmann, 2006) demonstrates that financial growth can be even harmful or at least useless for overall development. So, policy makers are well advised to put the right dose of reform to the economy and neither being too cautious – thus giving growth opportunities away – nor being too ambitious – thus wasting resources and possibly risking crises.

The heterogeneous experiences with financial market reforms indicate that it is not just the "amount" of development that matters but probably also the "step" of development. Again,