Overall, the US continues to be the major driver of global growth and recovery. A robust US economy and healthy US dollar are important to ensure that this year's global rebound remains on track. As one of the most globally integrated subregions in the world, East Asia's rebound is inextricably linked to the health of the US and world economy.

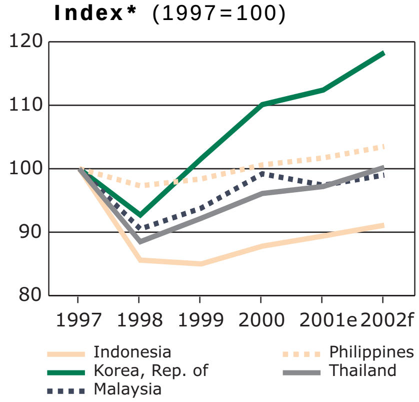
Five Years after the Crisis

Real Sector Trends — An Overview

The five years since the onset of the Asian financial crisis in July 1997 represent the most turbulent half decade in East Asia's recent economic history. Overall, given the severity of the crisis, the region's recovery has been reasonably good. In most countries, the pace of recovery has been faster than expected.

However, five years on, growth rates in the five affected countries are still below their precrisis trend levels (see Table 1 on page 15). At 2.7%, the average annual growth rate achieved by the five countries since the crisis is much lower than the 8% average annual figure they achieved during the decade before the crisis. The gap is particularly large for Indonesia and Thailand. And although it is narrower for other countries, it is still significant. Malaysia's average GDP growth has fallen from 9.1% during the precrisis decade to 2.3% since the crisis, while at 4.5%, Korea's average growth in the postcrisis years is almost half the 8.1% growth achieved before the crisis. The corresponding decline in average growth for the Philippines is from 3.7% to 2.8%.

Figure 24: **GDP Per Capita Index*** (1997=100)

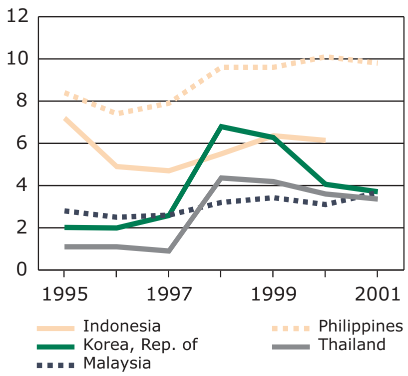


e=estimate; f=forecast
*Except for census years, population data are estimates. 2002 population was calculated using growth rates in 2001. GDP forecasts are from Consensus Economics Inc.
Sources: ADB, *Asian Development Outlook*, April 2002; Consensus Economics Inc., *Asia Pacific Consensus Forecasts*, June 2002; various national sources.

The sharp decline in average growth after the Asian financial crisis had serious implications for per capita incomes, unemployment, and poverty in the region. Even with this year's faster-than-expected economic rebound, real per capita incomes will be lower than their 1997 levels in Indonesia, hover around the 1997 level in Malaysia and Thailand, and be only marginally higher in the Philippines (Figure 24). Among the five crisis-affected countries, only Korea has made significant gains in per capita GDP since the 1997 crisis. For the other four countries, the last five years are effectively a lost half decade in terms of improvements in per capita incomes.

The 1997 crisis and the recession that followed in 1998 led to a sharp contraction in employment in the five affected countries. As a result,

Figure 25: **Unemployment Rate** (%)



Source: ARIC Indicators.

unemployment rates shot up. The recovery in 1999 and 2000 enabled Korea and Thailand to reduce the unemployment rates from their peak levels at the height of the crisis. Unemployment rates in the two countries have been brought down from 6.8% to 3.7% and 4.4% to 3.4% during the period 1998 to 2001, respectively (Figure 25). On the other hand, Indonesia, Malaysia, and the Philippines have not seen much reduction in the unemployment rates following the recovery years of 1999–2000. In all of the affected countries, unemployment rates remain higher today then during the precrisis years.

Losses in per capita incomes and depressed employment conditions have also proven a setback to progress in poverty reduction. According to latest World Bank estimates, in 2002 the incidence of $2-a-day poverty in the five affected countries taken together is likely to be around 41% compared to about 39% in 1996 (Table 3). Two countries account for this increase in poverty incidence: Indonesia (from 51% to 56%) and Thailand (from 28% to 32%). Poverty incidence has fallen in Malaysia and in the Philippines.

Table 3: **Poverty Incidence, $2 per person per Day—Five Crisis-Affected Countries*** (%)

	1996	1999	2000	2001	2002
Indonesia	50.5	65.1	58.9	57.8	56.4
Korea, Rep. of	0.0	0.2	0.2	0.2	0.2
Malaysia	11.5	8.1	5.1	5.5	5.1
Philippines	46.5	45.0	46.8	45.1	44.0
Thailand	28.2	33.4	35.6	34.2	32.3
Five Crisis-Affected	**38.5**	**46.8**	**43.7**	**42.6**	**41.4**

*Data for 1997 and 1998 are not available.
Source: World Bank, *East Asia Half-Yearly Update,* April 2002.

Despite these gaps in the five years since the crisis, progress has been made in three broad areas: (i) strengthening macroeconomic management (by permitting greater flexibility in exchange rates supplemented in several countries by a system of inflation targeting, and reducing the level of external debt and increasing its average maturity) and building up foreign exchange reserves; (ii) restructuring the financial and corporate sectors; and (iii) enhancing regional self-help and support measures by promoting monetary and financial cooperation. These efforts are laying the foundation for sustained economic growth in the longer term and enhancing the region's resilience to external shocks.

As pointed out in the previous chapter, prudential indicators relating to the external payments situation of most East Asian countries have improved in recent years (see Page 17). Countries have also made significant progress in financial and corporate sector restructuring. These measures at the national levels have been augmented by efforts to promote regional monetary and financial cooperation (see December 2001 AEM, and update in Box 4).

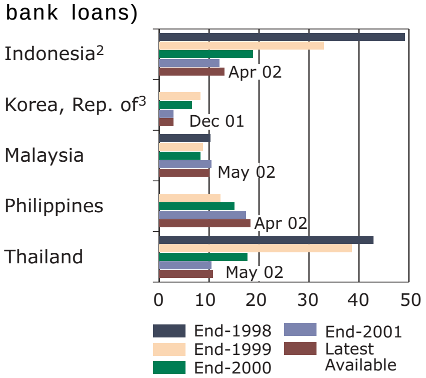
These efforts are rapidly changing the economic and financial landscape of East Asia, making the region more responsive to market forces while at the same time enhancing resilience to external shocks. Overall, they are laying the foundation for sustained long-term growth.

Yet, it is important to reiterate that the remaining agenda of economic reforms and restructuring is still long and substantive. The process requires continuous efforts in an ever-changing global environment. As soon as a country finishes one stage of reform, progress in the next stage becomes imperative. East Asia's recent achievements as well as the future challenges in restructuring and building up resilience to shocks should, therefore, be viewed in this broader perspective. Against this backdrop, this chapter attempts a stocktaking of what has been achieved in financial and corporate restructuring in East Asia since the 1997 crisis.

Financial and Corporate Restructuring

Nonperforming Loans, Capital Adequacy, and Bank Profitability

Figure 26: **NPLs[1] of Commercial Banks** (% of total commercial bank loans)



[1]Data on NPLs exclude those transferred to AMCs. NPLs are on a three-month accrual basis in Malaysia, and three months or more in Korea and Thailand.
[2]Refer to NPLs in banking sector.
[3]NPL criteria were changed in December 1999, so no comparable data are available prior to that date.
Source: ARIC Indicators.

Compared to their peak levels during the crisis, nonperforming loan (NPL) ratios have fallen substantially in most of the affected countries. The Philippines is the notable exception, with the NPL ratio of the commercial banking sector on the rise during the past few years. The latest available data indicate that the NPL ratios range from 2.9% in Korea to 18.2% in the Philippines (Figure 26).

Caution should, however, be exercised in interpreting the recent improvements in NPL ratios. With the exception of the Philippines, to varying degrees, the reductions in NPL ratios in the affected countries were brought about by the transfer of NPLs from banks' balance sheets to the publicly-owned and centralized asset management companies (AMCs). While this has enabled banks to resume lending and support recovery, the real test of restructuring also hinges on the progress in asset disposal by AMCs. Malaysia's Danaharta had resolved nearly all of its acquired assets by the end of 2001. Korea has also made significant progress in disposing of assets acquired by the Korea Asset Management Corporation (KAMCO). In Indonesia, however, asset disposal by the Indonesian Bank Restructuring Agency (IBRA), although improving, has proved to be more difficult and slower. In Thailand, a

Box 4: **Progress in Monetary and Financial Cooperation in East Asia**

Box 5 of the December 2001 AEM highlighted the ongoing efforts to promote monetary and financial cooperation in East Asia in the areas of information exchange and regional surveillance processes, mechanisms for resource provision, and moving beyond the Chiang Mai Initiative to harmonize macroeconomic and exchange rate policies. This box reviews more recent progress.

Bilateral Swap Arrangements under the Chiang Mai Initiative

To date, seven bilateral swap arrangements (BSAs)—Japan-Korea, Japan-Thailand, Japan-Philippines, Japan-Malaysia, PRC-Thailand, PRC-Japan, and PRC-Korea with a combined size of $19 billion—have been concluded and signed (Figure 4.1). The most recent one was signed between the PRC and Korea on 24 June 2002. There has also been significant progress on three BSAs (Korea-Malaysia, Korea-Philippines, and Korea-Thailand). While negotiations on another four have started, negotiations on four more have yet to be initiated. In addition, in line with the Chiang Mai Initiative, the existing swap arrangements between Japan and Korea and Japan and Malaysia have been renewed with a combined size of $7.5 billion. The Chiang Mai Initiative is significant not only for the resources it can bring to crisis prevention and management, but also for its potential to establish a set of institutions to support regional monitoring and peer review.

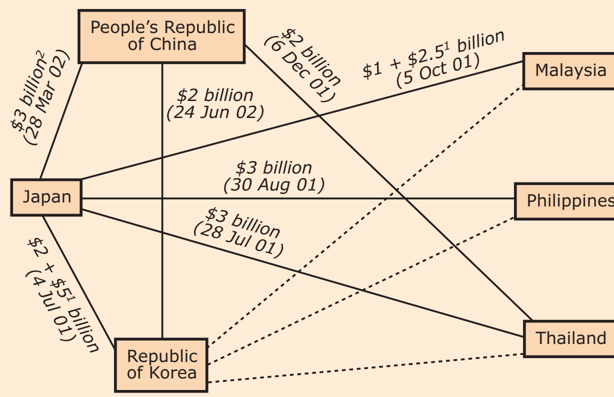
Establishment of the ASEAN+3 Regional Early Warning Systems

The establishment of an ASEAN+3 regional early warning system (EWS) prototype was alluded to in the communiqué of the ASEAN+3 Finance Ministers' meeting in Honolulu in May 2001. Subsequently, ADB provided a technical assistance to develop a regional EWS prototype to help detect emerging macroeconomic, financial, and corporate sector vulnerabilities and prevent financial crises. The prototype, which is still under development, comprises four components: (i) a set of macroprudential indicators, broadly defined as indicators of health and stability of financial systems; (ii) a non-parametric EWS model designed to assess the probability of a currency crisis within a 24-month horizon based on the signaling approach; (iii) a parametric EWS model designed to assess the probability of a currency crisis with a 24-month time horizon based on probit analysis; and (iv) a set of leading indicators of business cycles.

ASEAN+3 Study Group

Another initiative of the ASEAN+3 Finance Ministers at their May 2001 Honolulu meeting was to establish a study group to discuss ways of strengthening economic reviews and policy dialogues. The ASEAN+3 Study Group to Examine Ways of Enhancing Effectiveness of Economic Reviews and Policy Dialogues has recommended a two-phased approach. In Phase 1, the existing arrangements for economic review and policy dialogue are to be strengthened by making the process more credible and subject to more extensive discussions by the finance ministers and deputies. The frequency of the ASEAN+3 Finance Deputies meeting has also been increased to three times a year. In Phase 2, an independent, professional third party is to help prepare reviews and assessments, as well as issue papers on emerging problems affecting the region.

Figure 4.1: **Bilateral Swaps — Signed and in Advanced Stage**



—— Agreements signed (7)
----- Significant progress made (3)

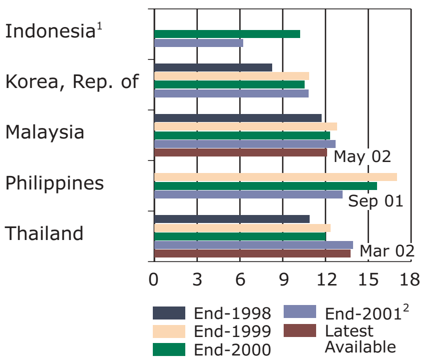
Note: Negotiations on four BSAs (Japan-Indonesia, Japan-Singapore, PRC-Malaysia, and PRC-Philippines) have been initiated. Negotiations have yet to start on four more BSAs (PRC-Indonesia, PRC-Singapore, Korea-Indonesia, and Korea-Singapore).
[1]Swap arrangement under the New Miyazawa Initiative.
[2]Two-way yen-renminbi swap arrangement.

Kobe Research Project

The Kobe Research Project is an initiative of the Asia-Europe Finance Ministers to promote greater cooperation including monetary and financial cooperation in East Asia by learning from the experience of Europe. Under this Project, six research studies have been undertaken by institutions and individuals in Asia and Europe.[1] ADB has contributed to three of these studies. The initial results of the Project were presented to ministers at the Fourth Asia-Europe Finance Ministers' Meeting in Copenhagen on 5–6 July 2002.

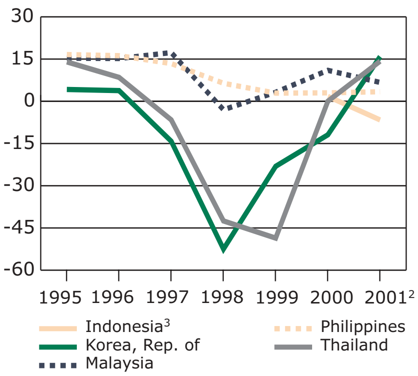
[1]The six studies were: (i) Exchange Rate Regime for Asia and EU Accession Countries, (ii) Requirements for Successful Currency Regime, (iii) Strengthening Financial Cooperation and Surveillance, (iv) Enhancing Regional Monitoring and Instruments, (v) European and Asian Financial Systems and Perspectives, and (vi) China in a Regional Monetary Framework. ADB contributed to studies (i), (iii), and (v) by preparing reports on Monetary and Financial Cooperation in East Asia, Issues in Development of Bond Markets, and Development of a Regional Early Warning System Prototype.

Figure 27: **Capital Adequacy Ratios of Commercial Banks** (%)



[1]For seven recapitalized banks (BII, Bank Universal, Bank Patriot, Bank Artamedia, Bank Prima Express, Bukopin, and Lippo).
[2]Except for Philippines which is for September 2001.
Source: ARIC Indicators.

Figure 28: **Banking Sector Profitability[1]** (%)



[1]Data refer to average return on equity of all commercial banks except for Malaysia, which refer to listed commercial banks only.
[2]Except for the Philippines, where datum is annualized estimate for 2001.
[3]Average ROE of seven recapitalized banks (BII, Bank Universal, Bank Patriot, Bank Artamedia, Bank Prima Express, Bukopin, and Lippo) as reported by IBRA.
Sources: Web sites of the Financial Supervisory Service, Bangko Sentral ng Pilipinas, Stock Exchange of Thailand, IBRA, and Bloomberg.

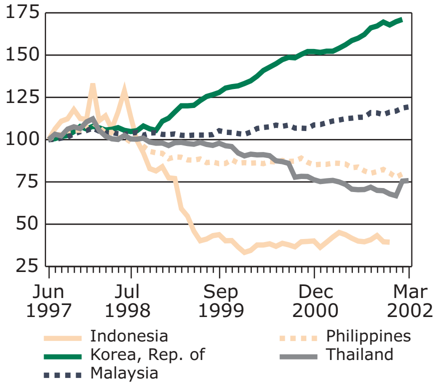
centralized AMC was set up only last year and asset disposal is still in its early stage, although this is proceeding according to plan. Inclusive of assets still held by these centralized AMCs, the NPL ratio remained as high as 50% in Indonesia and more than 20% in Thailand as of the end of 2001. Unlike other countries in the region, the Philippine Government has not set up a publicly-owned and centralized AMC to take over banks' NPLs, and this to some extent explains the country's relatively high NPL ratio.

Because of the success of bank recapitalization programs in most affected countries, banking sectors have seen their capital adequacy ratios (CARs) improving in recent years. The only exception is the Philippines, where there has been no publicly-funded recapitalization and the CAR of commercial banks has declined somewhat. Even so, the country's CAR is still well above the 8% Basel standard, as is also the case in Korea, Malaysia, and Thailand (Figure 27). In Indonesia, CAR data are not available for the entire banking sector. But for the seven banks recapitalized by IBRA, the average CAR was 6.2% as of end-December 2001.

Banking sector profitability has also improved in most countries (Figure 28). In Korea, the average return on equity (ROE) of all the domestic commercial banks rose to 15.9% in 2001, a big turnaround from -11.9% in 2000 and -52.5% in 1998. In Thailand, the average ROE of all commercial banks, domestic and foreign, rose to 14.3% in 2001 from a near-zero level in 2000 and -42.5% in 1998. In the Philippines, the average ROE of all domestic and foreign banks in 2001 was 3.4%, compared to 3% in 2000 and 2.9% in 1999. In Malaysia, the average ROE of all the listed commercial banks rose from -2.9% in 1998 to 11% in 2000. In 2001, however, there was evidence that banking sector profitability worsened in Malaysia, with the average ROE of the listed commercial banks declining to 6.7% in 2001, possibly due to the economic slowdown. The average ROE of Indonesia's seven recapitalized banks turned negative in 2001 compared to 1.7% in 2000.

In Korea and Malaysia, the stock of real bank credit to the private sector has continued to grow, reflecting success in reforms and strong domestic demand (Figures 29). In Thailand, after three and a half years' consecutive contraction, real bank credit appears to have stabilized since early this year. Indonesia, meanwhile, saw its stock of real bank credit stabilize in most of 2001, but comparable data for 2002 are not yet available. In the Philippines, however, real bank credit has been declining since early 2001.

Figure 29: **Real Bank Credit*—Five Crisis-Affected Countries** (1997June=100), seasonally adjusted



*Claims on the private sector: deposit money banks.
Source: ARIC Indicators.

Banking Sector Consolidation and Divestment

The banking sectors of the five crisis-affected countries have undergone substantial consolidation in recent years.

- **Malaysia.** The country has advanced furthest in this direction. The banking sector merger program announced in mid-1999 resulted in 52 domestic banking institutions being consolidated into 10 banking groups. The Government has recently indicated that the banking sector will be further consolidated, with the 10 groups expected to be merged into six to eight banks over the next 10 years.

- **Korea.** The number of banks fell from 33 to 20 by the end of last year. In 2001, three large new financial groups, Woori, Shinhan, and Kookmin, were formed. Woori is a financial holding company that groups together a number of financial companies that have received government funds for recapitalization, while Kookmin Bank, now the country's largest lender, was created through a merger of Kookmin Bank and Housing & Commercial Bank.

- **Philippines.** Banking industry consolidation has continued. As a result of three mergers and the exit of 19 banks in 2001, the number of Philippine banks has fallen to 929. These comprise of 44 commercial banks, 104 thrift banks, and 781 rural/cooperative banks.

- **Thailand.** Bank consolidation is also under way. The Ministry of Finance in March 2002 approved the merger of Bangkok Metropolitan Bank with Siam City Bank. Bank consolidation is seen as an effective way to promote financial restructuring, enhance stability of the financial system, and improve the competitiveness of domestic banks in the domestic and international markets.

- **Indonesia.** The banking restructuring program over the past years has left the country with five state banks, 26 regional development banks, and 80 private banks. Further consolidation is seen as a priority to carry forward and complete the country's bank restructuring process.

The current wave of bank consolidation has been seen as a positive development in the restructuring, reforming, and modernizing of banking sectors in the region. Some also see these as a broad movement away from the family-owned banks toward more "corporatized" banks. Concerns have, however, been raised that the consolidation process has largely been led by the governments rather than driven by market forces. Further, the enlargement of bank sizes should not substitute efforts to improve banks' internal risk management. To avoid excessive concentration of the banking sector, suggestions have been made that bank consolidation should be carried forward through mergers between small and medium-sized banks, rather than led by large banks, and that entry barriers for foreign banks should be lowered further.

As highlighted in previous issues of AEM, financial restructuring has involved the government injecting a large amount of capital into or nationalizing troubled banks in many affected countries, resulting in the state owning a high proportion of the banking sector. Although governments are committed to privatizing these nationalized banks and divesting state ownership in the sector, the process of privatization and divestment has been slow over the past few years due partly to poor market conditions and political sensitivity in selling bank assets to foreign buyers. But there are signs that the pace of bank privatization and divestment is picking up.

- **Indonesia.** After 18 months and three attempts, the Government's 51% stake in Bank Central Asia was sold in early 2002 for an estimated Rp5.6 trillion. The Government had also planned to sell its 30% stake in the country's largest bank, Bank Mandiri, by end-June 2002 and a 51% stake in Bank Niaga this year. However, due to some legal problems over the capital structure, the sale of Bank Mandiri has been postponed to the third quarter. In the case of Bank Niaga, due to low bids, the authorities had to scrap the original sale plan. A new sale strategy has been revealed, under which the Government will sell up to a 20% share of the Bank Niaga directly into market and will relaunch the sale of a majority stake in the bank by end-June 2002, with a view to completing the sale by mid-September. The Government has also finalized a plan to divest the remaining IBRA banks and submitted the plan to Parliament in early June.

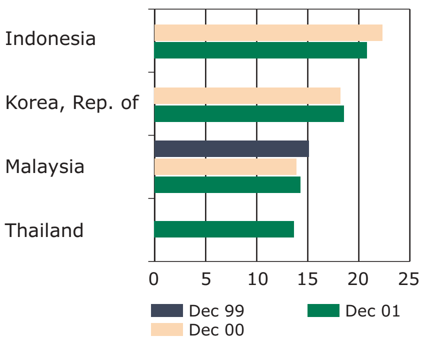
- **Korea.** The process of divestment started in the immediate aftermath of the 1997 financial crisis, although much remains to be done. In 1999, the Government offered Seoul Bank and Korea First Bank for sale. The Korea First Bank was subsequently sold to Newbridge Capital Ltd., an American-owned investment firm. However, as of early June 2002, the sale of Seoul Bank had still not been completed. The Government now plans to sell a 51% stake in Seoul Bank by the end of July 2002. In January 2002, the Government announced a plan to use the economic recovery as an opportunity to sell off most of its controlling stakes in banks over the next three to four years. In May this year, Woori financial holding company offered a 11.8% stake for sale in a public offering and in June listed its shares on the Korean Stock Exchange.

- **Malaysia.** 2001 saw the completion of the divestment of Danamodal's 100% equity stake in MBf Finance Berhad. As of end-December 2001, about 72% of original investment in troubled banks by Danamodal, a government-owned special purpose agency tasked to recapitalize illiquid but viable banks, had been repaid.

Asset Disposal by Centralized Asset Management Companies

In the aftermath of the crisis, AMCs were established to clean up bank balance sheets in several countries.

Figure 30: **NPLs Purchased by AMCs*** (% of GDP)

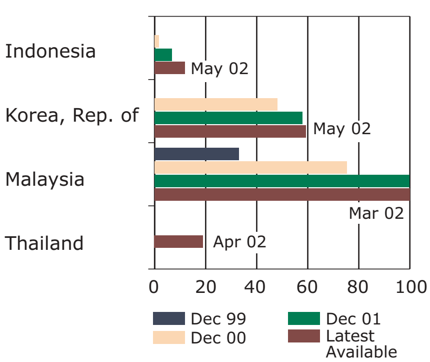


*Refer to those by IBRA in Indonesia, KAMCO in Korea, Danaharta in Malaysia, and TAMC in Thailand, as of the dates indicated.
Source: REMU calculations based on data from KAMCO, Danaharta, IBRA, and TAMC.

- **Malaysia.** The country has been the front-runner. As of end-March 2002, Danaharta had acquired (in face value) about RM47.75 billion in NPLs from troubled financial institutions, about 14% of the country's GDP in 2001 (Figure 30). It has resolved nearly all of these nonperforming assets (Figure 31) at an estimated recovery rate of 55%. With an average discount rate of 54.4% for its acquired NPLs, Danaharta is expected to turn in a small profit by 2005 when it will be dissolved.

- **Korea.** As of May 2002, KAMCO had acquired (in face value) a total of $81 billion in NPLs, about 19% of GDP in 2001, from troubled financial institutions at an average discount rate of about 62%. KAMCO has disposed of about 59% of these assets at an average recovery rate of 46%. By the end of this year, KAMCO will stop purchasing NPLs.

Figure 31: **NPLs Disposed of by AMCs*** (% of NPLs purchased)



*Refer to those by IBRA in Indonesia, KAMCO in Korea, Danaharta in Malaysia, and TAMC in Thailand, as of the dates indicated.
Source: ARIC Indicators.

- **Indonesia.** Because of poor economic conditions, political uncertainties, an ineffective bankruptcy system, and political resistance to sell at a huge discount, the pace of asset disposal by IBRA has been slow. As of May 2002, IBRA had acquired (in face value) a total of Rp360 trillion in NPLs, about 21% of GDP in 2001, from troubled financial institutions. IBRA has managed to dispose of only about 12% of these nonperforming assets. In an attempt to speed up asset disposal, in early June 2002, IBRA launched its largest-ever asset sale program of bank loan assets worth Rp150 trillion ($17 billion). The sale, which is open for local and international investors, involves 2,500 credit portfolios consisting of restructured and non-restructured loans. The sale process is expected to be completed by August 2002. IBRA is targeting a recovery rate of around 30% from the loan sales. If successful, this would bring the country's aggregate NPL ratio (inclusive of

NPLs acquired but not yet disposed of by IBRA) down to about 30%. For 2002, despite suggestions of overoptimism, IBRA is aiming for a significant acceleration of its net cash recoveries to Rp36 trillion, up from a target of Rp27 trillion for 2001. A further Rp7.5 trillion in AMC bond recoveries is targeted for 2002. IBRA aims to return all assets under its management to the private sector by its sunset date of February 2004.

- **Thailand.** The Thailand Asset Management Company (TAMC), which was set up last year, was to acquire about half of the financial system's NPLs. As of the end of 2001, it had almost completed the transfer of eligible nonperforming assets from State-owned and private banks and AMCs amounting (in face value) to B698.4 billion at an average discount rate of 67%. Of this amount, more than 80% was transferred from State-owned financial institutions. The transfer was less than what was originally envisaged. The discrepancy was largely due to the fact that many cases had already been filed for court proceeding. In the meantime, debt resolution is also under way. In the first quarter of 2002, TAMC achieved its debt resolution target of B100 billion. As of the end of April 2002, it had resolved 238 debtor cases with a total face value of B132.7 billion, about 19% of the total NPLs it acquired.

Corporate Workouts

In addition to resolving bad debts through centralized AMCs, debt restructuring is also being carried out on a voluntary basis under the so-called London approach framework.

- **Indonesia.** The Jakarta Initiative Task Force (JITF) was created to serve as a mediator and facilitator of specific restructuring cases, particularly those involving foreign lenders. Compared to IBRA, debt restructuring under JITF is more successful. As of end-May 2002, JITF had received a total of 130 registered cases with debt value amounting to $30.3 billion, and completed the mediation of 71 cases with debt value of $15.4 billion, consisting of 48 cases worth $10.6 billion that had reached legal closures and 23 cases worth $4.8 billion that was still awaiting final closure following a memorandum of understanding (MOU) signing. In 2002, JITF is targeting the restructuring of additional debt of $4 billion–5 billion and bringing $2 billion–3 billion restructured debt to the legal closure stage. There have been concerns, however, over the quality of debt restructuring by JITF, as debt rescheduling was still the predominant method of restructuring, which in 2001 accounted for 53% of total value of the restructured debt.

- **Malaysia.** The Corporate Debt Restructuring Committee (CDRC) successfully assisted five companies in finalizing debt restructuring agreements with their respective lenders during the first quarter of 2002, addressing debts of about RM2.8 billion. CDRC was set up after the crisis to provide a platform for borrowers and creditors to work out feasible debt restructuring schemes without having to resort to legal proceedings. Only viable companies with a total borrowing in excess of RM50 million from more than one bank are eligible for workouts under this framework. As of end-March 2002, 42 cases had been successfully finalized under CDRC's sponsorship, thereby resolving debts totaling RM37.4 billion. Nine cases with cumulative debts of RM17.2 billion are outstanding. CDRC targets the resolution of all these cases by end-July 2002. It stopped accepting new cases as of March 2002, consistent with its targeted closure date of end-July 2002.

- **Korea.** Corporate restructuring has been separated into three tiers: the top-five *chaebol* including Hyundai, Daewoo, Samsung, SK Telecom Co. Ltd., and Lucky Goldstar; the heavily-indebted medium-sized *chaebol* ranked 6 to 64 by asset size; and the cash-strapped small and medium enterprises sector (SMEs). Progress is being made at all the three tiers. Daewoo, the No. 2 *chaebol*, has been declared bankrupt and broken up. In April 2002, General Motors agreed to buy 67% of Daewoo Motor. The remaining 33% will be purchased by Daewoo's creditors as agreed in the MOU signed in September 2001. Creditors of Daewoo will also commit new working capital amounting to $2 billion to help retool the facilities. Hyundai group has splintered, with its component entities going their separate ways. American International group and WL Ross signed an MOU in August 2001 to buy stakes in three Hyundai financial subsidiaries. In September 2001, creditors of Hynix (formerly Hyundai Electronics) agreed to a debt equity swap of nearly $3 billion and rolled over maturing debts. Samsung, LG, and SK groups have been forced to focus on their core competencies by divesting collateral business lines. Renault took over Samsung's car line. At the second tier, companies in formal workout programs have been rehabilitated, sold, or liquidated. Sixteen of the top 30 conglomerates of 1997 are no longer in the list. Debt-to-equity ratios at the top 30 groups have been brought down, from an average of 519% in 1997 to 171.2% at the end of 2000.

- **Thailand.** After the crisis, the Government created the Corporate Debt Restructuring Advisory Committee (CDRAC) to encourage and/or expedite out-of-court debt restructuring. As of end-April 2002, CDRAC had approved 14,850 target debtors with credits outstanding of B2,625 billion to enter the voluntary workout process. Of these approved target debtors, 10,109 cases with credits outstanding of B1,280 billion had been successfully restructured. But 4,679 cases with credits outstanding of B1,190 billion remained unrestructured, and were either in the process of being filed or have already been filed in courts by their creditors. The failure of CDRAC to facilitate debt restructuring more expeditiously, which to some extent made the Government resort to the creation of TAMC, is due to a number reasons. Among others, CDRAC did not have sufficient legal power to deal with debt cases. Moreover, most cases that had been filed in the courts were piled up, causing disruption to the debt restructuring process. In addition to restructuring under the process sponsored by CDRAC, debt cases are also being worked out by financial institutions themselves. From 1998 to the end of March 2002, a total of 494,409 cases with credits outstanding of B2,497 billion had been successfully restructured by financial institutions.

One of the weak areas of corporate restructuring has been court-led restructuring. Despite efforts to improve bankruptcy regimes in most affected countries after the crisis, many weaknesses remain and these have led to the limited number of completed cases of court-led restructuring and liquidation (see Special Chapter on Corporate Restructuring in the December 2001 AEM and discussion later).

Reforms in Financial Supervision and Regulation

The five crisis affected countries have also made important efforts to strengthen supervision and regulation of their financial systems.

- **Indonesia.** The Government's focus has so far been on restructuring troubled financial institutions. But the country has also introduced over the past few years measures to improve the financial supervision and regulation framework. In January 2002, Bank Indonesia issued revised regulations raising the minimum capital adequacy requirement to 8%. According to the regulations, banks that cannot meet the new requirements within specified periods will be transferred to IBRA for resolution. During 2002, Bank Indonesia intends to complete all the specific actions in its master plan aimed at improving compliance with the Basel Core Principles for Effective Banking Supervision, including moving toward consolidated supervision. To enhance transparency and market discipline, it will begin monthly publication of key individual bank financial data. Plans are also afoot for the establishment of an integrated financial sector supervisory agency—the Financial Sector Supervisory Institution.

- **Korea.** Financial sector supervision was consolidated into the Financial Supervisory Commission in early 1998. Later this became the Financial Supervisory Service (FSS) with new management. The FSS has operational autonomy, can license and de-license financial institutions, and has supervisory responsibilities. Regulations governing the operations of banks have also been strengthened to bring them broadly in line with Basel recommendations. In April 2002, FSS issued new guidelines aimed at lowering the ratio of loans classified as substandard, doubtful, or presumed loss that are held by nonbank financial institutions (NBFIs) to improve overall asset quality. Under the guidelines, institutions are expected to enter into an agreement with FSS to reduce securities borrowing and lending ratios to 10% or lower within varying target dates. NBFIs that fail to meet the new guidelines are encouraged to undertake significant restructuring steps. In May 2002, FSS instituted new minimum mandatory loan loss provisioning ratios for domestic banks' household loans and credit card receivables.

- **Malaysia.** Several measures have been introduced to strengthen banking regulation and supervision, focusing on risk-based and consolidated supervision. The Financial Sector and Capital Market Master Plans, released last year, propose to achieve full integration of the domestic financial system into the globalized market over a 10-year period. More recently, Malaysia included discount houses in the liquidity framework coverage, with a view to improving prudential regulation. The framework requires discount houses to project maturity of assets, liabilities, and off-balance sheet requirements, and maintain adequate liquidity surplus to meet expected obligations and sustain unexpected withdrawals for at least one month. Malaysia also strengthened the institutional capacity of the Islamic banking institutions, broadened the range of financial products and services, intensified research and development efforts, and strengthened the regulatory framework.

- **Philippines.** Reforms are aiming to improve banks' risk management practices by shifting to a risk-based capital adequacy framework, strengthen prudential supervision and regulation, and promote sound bank governance. The most significant move was the passage of the General Banking Law in 2000 and the introduction of regulations to implement the Law. In September 2001, the country passed the Anti-Money Laundering Law. More recently, a House Bill was approved paving the way for the creation of privately-owned Special Purpose Asset Vehicles to acquire, manage, and dispose of NPLs and assets of financial institutions. The counterpart Bill is under consideration by the Senate.

- **Thailand.** Over the past few years, loan classification, provisioning, and interest accrual and capital adequacy rules have been tightened with a view to bringing them up to international standards. To further strengthen financial sector governance, the Government has drafted two key pieces of legislation, the new Financial Institutions Act and Bank of Thailand Act. The two proposed acts are being debated in Parliament. The new Financial Institutions Act will standardize the regulatory framework for banks, finance companies, and credit fonciers, and provide a legal basis for the consolidated supervision of financial conglomerates. It will also tighten regulations in a variety of areas, including interconnected lending, disclosure standards, and penalties and prevention against fraud. The new Bank of Thailand Act, on the other hand, will strengthen the Bank of Thailand's independence and accountability. Under this new Act, objectives of the Bank of Thailand will be limited to maintaining price stability and safeguarding the stability of the financial system.

Reforms in Corporate Governance

In all five affected countries, important reforms have been introduced since the crisis in areas of shareholder protection, transparency and disclosure, bankruptcy regimes, as well as prudential regulation and supervision of financial systems to bring corporate governance systems up to international standards.

Shareholder Protection. Reforms in this area have focused mainly on strengthening the system of the board of directors and minority shareholders' rights.

All five affected countries have introduced voluntary codes of corporate governance that largely follow international best practices. These codes require that at least 20–35% of board members of listed companies be independent and that independent board committees be set up to deal with important corporate matters, in particular, auditing. To strengthen protection of shareholders, especially minority shareholders, listed companies are required to grant shareholders such rights as proxy and cumulative voting and filing class action suits; to make shareholder approval of important transactions mandatory; and to require directors to disclose their business interests and remuneration.

Listing rules have also been revised to accommodate many of the provisions stipulated in codes of corporate governance. Stock exchanges across the region have mostly tightened rules of penalty and sanction for noncompliance.

In many countries, corporate laws have been amended to strengthen legal protection for shareholders. In Korea, the Securities and Exchange Act was revised to clarify the fiduciary responsibility of directors and lower the threshold for exercising rights to file class action suit, make proposals at a general shareholders' meeting, inspect company's financial accounts, and request the dismissal of directors or internal auditors. In the Philippines, the Securities Regulation Code enacted in 2000 introduced stricter rules related to listing, shareholder representation, board structure, and legal action against directors. Thailand amended the Public Limited Company Act in 2001 to provide mechanisms to prevent directors from making use of companies' opportunities for their own benefit and to ensure that minority shareholders can exercise their rights in making decisions for the company.

Transparency and Disclosure. Many countries have introduced changes in accounting and auditing rules to move closer to international standards. In Indonesia, major initiatives have been taken to harmonize the Financial Accounting Standards with International Accounting Standards (IAS). In Korea, legal changes have been made so that domestic accounting practices conform to international standards. Group companies are now required to compile consolidated financial statements. In Malaysia, accounting standards are among the highest in East Asia and are generally consistent with the IAS. Nevertheless, the issue of compliance and enforcement is being addressed. In the Philippines, accounting standards are also moving closer to international norms. Embodied in its May 2000 Accountancy Law, the Thai Government has started upgrading its accounting and audit standards to conform to the IAS.

Voluntary codes of corporate governance, listing rules, and corporate laws in the affected countries generally contain more stringent disclosure requirements and tougher penalties for noncompliance.

- **Indonesia.** Listed companies are required to appoint a corporate secretary responsible for corporate disclosure. Company annual reports must provide audited and annotated financial statements and a company profile. Reports must be available on the Internet and at local registries.

- **Korea.** Listed companies are required to include in their annual reports details of business goals and strategies, financial conditions, shareholder rights, cross-shareholdings, cross-debt guarantees, directors' compensation, and events likely to affect share prices, including dealings benefiting insiders and transactions that could change corporate control.

- **Malaysia.** Companies' annual reports must fully disclose information on the overall financial performance of the company, the extent of compliance with principles of good governance, and the state of internal control.

- **Philippines.** Financial reporting has been tightened. Companies are also required to detail all transactions and provide minutes of meetings to directors and shareholders.

- **Thailand.** Companies are required to provide shareholders with sufficient and timely information on the company's financial position before shareholders' meetings, information that may affect shareholder rights and investments, and information on company directors' holdings and purchases and sales of company securities.

Bankruptcy Reform. As part of corporate restructuring efforts, Indonesia, Korea, Malaysia, and Thailand in the immediate aftermath of the crisis set up mechanisms for voluntary and informal corporate workouts modeled on the London approach. There have also been efforts to address weaknesses in formal bankruptcy procedures.

- **Indonesia.** The Government amended its bankruptcy laws in 1998 and established a new commercial court to deal with bankruptcy cases. In 2000, the Government passed the Company Bankruptcy and Debt Restructuring and/or Rehabilitation Act, modeled on US Chapter 11, to facilitate reorganization of illiquid but financially viable companies. It also increased sanctions on uncooperative debtors and empowered the Attorney General to deal directly with cases, improving the incentives for debtor participation.

- **Korea.** The Government amended the bankruptcy laws in 1998, simplifying legal proceedings for corporate rehabilitation and bankruptcy filing, streamlining provisions for nonviable firms to exit markets, and improving credit bank representation during resolution. The authorities also attempted to expedite court insolvency proceedings granting district courts authority to process cases. In September 2001, a Corporate Restructuring Promotion Law (CRPL) was passed to address some of the remaining problems in corporate workouts.

- **Malaysia.** Malaysian bankruptcy laws were sound by international standards even before the crisis. Further reforms have been introduced to expedite the resolution of NPLs. Danaharta was allowed to sell NPLs it acquired from distressed banks and appoint special administrators to manage and restructure these assets. Authorities also reduced companies' ability to impose restraining orders on creditors under Section 176 of the Bankruptcy Act. In 2001, the Kuala Lumpur Stock Exchange (KLSE) introduced practice notes and guidelines, thus increasing the disclosure and reporting obligations of distressed companies on the KLSE.

- **Philippines.** Early this year, a draft of a new insolvency law was proposed and is under consideration for approval in the Congress. The proposed Corporate Recovery Act, to replace the Insolvency Law that was enacted in 1909 and Presidential Decree 902-A issued in 1976, provides debt relief and recovery measures to financially distressed enterprises and offers four modes of rehabilitation: pre-negotiated rehabilitation, fast-track rehabilitation, court-supervised rehabilitation, and dissolution-liquidation. Meanwhile, the Interim Rules of Procedure developed by the Supreme Court in December 2000 to govern rehabilitation cases and the Securities Regulation Code, which transferred the quasi-judicial jurisdiction of the Securities and Exchange Commission over suspension of payments and rehabilitation proceedings to the Regional Trial Courts, remain in place.

- **Thailand.** A Bankruptcy Act Amendment was introduced in March 1999 that prevents a company from being forced into bankruptcy due to temporary liquidity problems. The amendment introduced the Framework for Corporate Debt Restructuring to the Bankruptcy Act of 1940, along the lines of Chapter 11 of the US Bankruptcy Code.

Remaining Agenda

Despite these encouraging developments in the affected five countries, as well as positive moves in many of the other economies of East Asia (see Box 5), the road to completing financial and corporate restructuring in the region is still long.

Box 5: **Financial and Corporate Restructuring in Other East Asian Countries**

Cambodia

Cambodia's banking system is well capitalized with a capital asset ratio of about 30%, although this reflects the small asset size due to the limited loan portfolio. The NPL ratio is high, estimated at about 20% at end-December 2000.

Cambodia is undertaking a comprehensive bank restructuring program, which is nearing completion. The National Bank of Cambodia (NBC) has been closing banks that were insolvent or not complying with the law. As of end-December 2001, 18 private banks remained, of which five banks were fully relicensed and 13 banks were subject to corrective action. Most remaining banks are profitable, except those that require corrective actions and are likely to be closed at the final stage of restructuring.

To complement its weakness in bank supervision, NBC has imposed tougher prudential regulations, such as prohibiting banks from transferring domestically collected funds abroad. There are concerns, however, that too strict prudential regulation may prevent the efficient allocation of funds and discourage banking sector development.

PRC

By end-April 2002, outstanding NPLs at State-owned commercial banks in the PRC were reported at 24.54% of the total loans. Banks have been recapitalized and their NPLs have been transferred to newly established AMCs. AMCs are tapping foreign markets for some of the NPLs. Huarong auctioned off Y16.6 billion of NPLs, of which Y10.8 billion was sold to a consortium led by Morgan Stanley that included Lehman Brothers. Cinda Asset Management signed an agreement with Goldman Sachs, Deutsche Bank, and Lonestar Capital to dispose of its bad assets from China Construction Bank. Orient Asset Management will sell between 15% and 20% of its Y267 billion of nonperforming assets to foreign investors for the Bank of China. Great Wall Asset Management is also expected to auction about Y15 billion of NPLs to international investors this year. Officials expect the nonperforming assets to sell for up to 30%, which is deemed optimistic considering that the international average recovery rate is much lower.

Improvements have been made to the PRC's prudential rules, particularly with respect to loan classification. A new, more stringent asset classification system has been adopted. The four major banks have also been requested by the People's Bank of China to reduce the NPL ratio to 15% by the end of 2004. Measures to strengthen State bank governance and credit risk management are being undertaken such as establishing boards of directors, upgrading credit risk analysis and approval practices, and improving accounting standards. In early 2002, as part of its World Trade Organization (WTO) entry commitment, the PRC loosened controls on foreign-owned and joint-venture banks and financial companies offering yuan services, exposing domestic banks to further competition.

Alternative approaches to corporate restructuring have also been developed, such as the Changchuan Approach, which involves the transfer of profitable assets into a new entity funded by the major creditor who gets repaid by the funds generated. The PRC is also considering a new bankruptcy law that includes a corporate rescue procedure.

Lao PDR

Based on reports by State commercial banks, NPLs constituted about 52% of outstanding loans at end-2000. To address this problem and improve bank performance, individual bank restructuring plans have been developed. Restructuring plans involve the phased recapitalization of the State commercial banks starting in September 2002 based on meeting operational and financial targets, merger of the two smaller banks plus a rationalization of banking operations, the use of strengthened debt resolution procedures, and introduction of international management advisers.

Banks are gradually adopting commercial lending practices. They have set up systems for credit risk analysis, started classifying all loans, and been instructed to make full provision for NPLs on their post-2000 loans on the basis of Bank of Lao PDR regulations. To prevent further losses, there are continuing restraints on total lending and on lending to defaulting borrowers.

Complementing bank restructuring is enterprise reform, which will initially target five of the largest SOEs. Prices of key utilities are being adjusted to improve SOE finances. The largest SOE defaulting borrower has been turned over to the Ministry of Finance for restructuring.

Singapore

As part of the comprehensive reform of domestic banking announced in 1998, Singapore liberalized further the retail and wholesale banking markets in 2001, to allow foreign banks to engage in broader business in these markets. Reforms of the regulatory and supervisory environment to enhance the safety and soundness of the financial system were carried out. These included setting guidelines on the issuance of new capital instruments for Singapore banks, and revising the framework for valuation and capital adequacy requirements for insurance companies, licensed securities dealers, and futures brokers.

Singapore has also introduced legislation to regulate capital markets. In October 2001, the Securities and Futures Act was passed to provide a comprehensive rule book on capital markets, create a flexible regulatory framework, help develop a disclosure-based regime, and boost market enforcement. The Monetary Authority of Singapore has issued a revised Code on Takeovers and Mergers effective from 1 January 2002, which brings the Singapore rules closer to those in other economies in the region, including Hong Kong, China.

In 1999, Singapore embarked on a comprehensive review of its corporate governance practices, disclosure and accounting standards, and corporate regulatory framework. In 2001, the Code of Corporate Governance and report on disclosure and accounting standards was completed and accepted by the Government. At present, public consultation on the draft report on company law

Continued next page

Box 5: **Financial and Corporate Restructuring in Other East Asian Countries** (Cont'd)

and regulatory framework and its recommendations is ongoing. Singapore is also planning to set up a private sector-led council on corporate disclosure and governance to advise the Government on matters relating to corporate governance, accounting standards, and disclosure requirements.

The Government is reviewing the role of government-linked companies (GLCs), and is considering divestment from some of them. In line with this, Temasek Holdings, the investment arm of the Ministry of Finance that owns and manages the GLCs, is working out a charter with the Ministry of Finance that will spell out Temasek's mission, role, and responsibilities.

Viet Nam

As of end-2001, the Government estimated that NPLs in the banking system amounted to $1.29 billion, or about 11% of the total lending. But, using international accounting standards, NPLs are believed to be a lot higher. The Government has launched a three-year restructuring drive to reduce its NPLs and has set a maximum bad loan ratio of 5% of the total lending by commercial banks.

Several reforms to the banking sector are also under way, such as the reduction of directed credit and allowing freer foreign bank operations. New efforts to strengthen banks' regulatory framework and supervisory oversight in line with international best practices are outlined in the 2001 Memorandum on Economic and Financial Policies with the IMF.

Since 1992, Viet Nam has equitized 800 State-owned enterprises (SOEs) and transferred, sold, or leased more than 100 others. It plans to divest a further 1,800 small SOEs by 2004, either through acquisition or outright privatization. In June 2002, the Government set up a supervision group for SOE restructuring. The Board for State-owned Enterprise Renewal is expecting the number of equitized SOEs to increase by 300% in the next five years. Of the more than 5,600 SOEs at present, 2,000 will be converted to limited liability companies, 2,000 will be equitized, 734 will remain unchanged, and the remainder will be sold or leased. But currently, enterprise reform is proceeding slower than planned because of problems in resolving inter-enterprise debt, valuation of assets, and handling labor redundancy.

In the financial sector, in several countries, particularly Indonesia and Thailand, a significant proportion of nonperforming assets remains to be resolved. Although privatization of the nationalized banks and divestment of state ownership in the banking sector are under way, a lot more needs to be done, particularly in Indonesia, Korea, and Thailand. Further, while bank consolidation is welcome, it is not a substitute for efforts to improve banks' internal risk management.

In the corporate sector, debt equity ratios have declined in several countries most notably in Korea (Table 4). However, in many countries,

Table 4: **Debt-Equity Ratios of Selected Listed Companies** (weighted average)

Year	Indonesia	Korea	Malaysia	Philippines	Thailand	Average
1995	2.4	4.7	2.1	1.7	4.4	3.1
1996	2.6	4.7	2.4	1.7	4.5	3.2
1997	4.2	6.0	2.6	2.0	7.0	4.3
1998	3.4	4.7	2.6	1.8	6.1	3.7
1999	3.7	2.8	2.7	2.0	6.0	3.4
2000	4.4	2.1	2.5	2.1	6.3	3.5
Average number of firms	259	200	456	182	317	1,414

Note: Staff calculations using Bloomberg data; composed of corporations whose stocks are included in the composite indexes of the respective markets. For Korea, only the companies comprising the KOSPI 200 (Korean Stock Price Index) are included. Companies with negative reported equity values are excluded.

operational restructuring still lags behind balance sheet restructuring. Creditors still find it difficult to enforce their claims through the courts, leading to a limited number of completed cases of court-led restructuring. The weaknesses in the bankruptcy regimes also impede restructuring via out-of-court processes.

Measures to strengthen bank prudential supervision and regulation, and changes in the legal and regulatory framework for the corporate sector have been impressive, but these are no guarantees for sound financial and corporate governance. Strict compliance and effective enforcement are equally important, if not more, and these are still big challenges facing all the affected countries.

Effective enforcement requires tackling broad governance issues, including areas such as the transparency, accountability, and responsiveness of government; effectiveness and efficiency of the legal and judicial system; the rule of law and control of corruption; and political stability. Despite efforts to tackle problems in all these areas over the past few years in the affected countries, a recent study by the World Bank reveals that there is still much ground to be covered.[2]

[2]Kaufman, Daniel, Aart Kraay, and Pablo Zoido-Lobaton. (2002), "Governance Matters II: Updating Governance Indicators for 2000/01," World Bank (http://www.worldbank.org/wbi/governance/govdata2001.htm).