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**USAID/Thailand**  
**USIS CONFERENCE**

Draft Final Report

August 13, 1990

*Price Waterhouse*



August 13, 1990

Mr. James T. Grossman  
USAID/Thailand  
37 Petchburi 15, Petchburi Road  
Bangkok 10400 Thailand

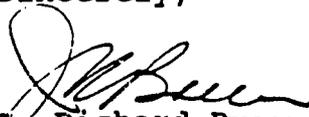
Dear Mr. Grossman:

Re: Financial Sector Development Project  
Contract No. PDC-2206-z-00-8191-00  
USIS Conference

Attached please find ten (10) copies of our Draft Final Report on interviews conducted with Thai officials in the public and private sector on the state of the Thai financial sector as prepared by Price Waterhouse, Prime Contractor under FSDP.

It has been a pleasure to work with the Mission on this activity. We look forward to continued work with you on other projects in the future.

Sincerely,

  
Richard Breen  
Director, FSDP

Attachments

DRAFT FINAL

USAID Activity in Thai Financial Markets

June 30, 1990

This memorandum summarizes results of my visit to Thailand from June 19 to June 30, 1990. I was asked to participate in the USIS seminar held in Hua Hin on June 22-24, to assess the issues raised there for their impact on AID's proposed strategy, and to obtain reactions to the Price Waterhouse report of March, 1990 both from others at the seminar and key people who didn't attend. I was also asked to prepare a report that would help the Mission define more clearly the areas that would be most appropriate for USAID involvement and to prepare the outline of a Scope of Work for subsequent analysis.

## I. NARROWING THE RANGE

The report submitted to AID by Price Waterhouse in March, 1990 listed seven areas for possible USAID work in the financial markets. The range is much too wide, and my principal effort here has been to narrow it down, looking especially for areas of the keenest interest by responsible Thai, for opportunities to benefit US interests, and for points of practical attack, where a program could be organized without great delay.

My conclusion is that there are three areas for concentration:

Legal and Regulatory Reform  
Improving the Quality of Financial Information  
Training for Financial Management

The first two of these are taken directly from the March report, while the third is a redefined and renamed version of the fifth of the original areas, called in the March report "Improving the Commercial Banking System".

My main reason for this choice is that these three, and especially the first two, almost invariably drew favorable reaction from persons interviewed, both Thai and American, both government and private. Other areas brought more mixed reactions, some negative and some simply indifferent or perplexed. The first two of the three areas listed above elicited the comment from thoughtful Thai that these are "core problems"; wherever there are gaps or weaknesses in the Thai financial system, one or both of these is involved. The third area, Training, was encountered as a key problem not only in commercial banking, but across all sectors of the financial system.

Another important reason for my choice is that these three seem to me to represent the best organizing principle for a USAID program. Legal framework, information, and human resources cut across the financial system on the same plane. When the Price Waterhouse team first began work, it tried to organize by an alternative principle--segmenting the market by institution: commercial banks, the equity market, the bond market, etc. This simply didn't work. Too many of the problems spread across these segments. For example, the lack of reliable company financial statements is a major obstacle for the commercial banks, where it interferes with credit evaluation, for the equity market, where it hinders investors from making informed choices, and in the bond market, where it will make life difficult for the (yet to be established) rating agency. On the same reasoning, I believe it should be easier to structure and staff a USAID program on the legal-information-human resources array than on any alternative I can identify.

Before discussing the three areas in more detail, I would like to add that the three are not of equal importance. The relative importance of the three is on the order of four-two-one, and the importance of the first area is accentuated because it is here that the potential benefits to the US and US firms are concentrated.

The first area, Legal and Regulatory Reform, while undoubtedly the most important, may at the same time be the most difficult to approach. The problems to attack consist of literally dozens of separate obstacles: regulations and laws that need to be changed or that do not exist at all and need to be introduced. Many of these issues are spelled out in the World Bank's Financial Sector Study, dated February 20, 1990, especially in Volume I, Chapter IX. For present purposes it may be sufficient to cite a couple of examples. The existence of an active bond market is deterred by Ministry of Finance regulations establishing bank reserve requirements, by a series of taxes that bear unequally on bonds and on equities, and by restrictions on the type of corporation authorized to issue bonds. Broadening of the market for SET shares is hampered by the legal monopoly granted to the Mutual Fund Company and by restrictions on the investments that can be made by insurance companies and provident funds.

Difficulties for USAID in attacking this area include the fact that the Thai Civil Code is quite different from the American legal system, so that most American lawyers are unfamiliar with it. There is also the obvious problem that USAID can only analyse and advise; the actual changes will be in hands

of Thai Government executive and legislative bodies, whose actions may be slow. Thus a USAID effort might well stall out. Against that is the sheer importance of this area, the fact that Thai officials seem to want US help with it, and also the fact that there is now more movement in this area than has been true for years. Finally, it is an area in which many potential benefits to US firms can be perceived. The US banks, for instance, are currently unable to engage in a range of profitable lines of business for which they have strong comparative advantage. Over the last dozen years, American banks and other American financial houses have led the way in development of a variety of merchant banking techniques. These techniques and products help corporate clients to lower their borrowing costs and tax liabilities, and to hedge their interest rate and exchange rate risks.

The second area selected, Improving the Quality of Financial Information, approaches the first in importance and is frequently twinned with it in comments by people interviewed. The poor quality of financial data is, among other things, a serious barrier to the linking of Thailand to world markets, and one of many obstacles in the way of making Bangkok into a regional financial center. American firms in Thailand complain of it continually, and I think it will not be difficult to make the case for benefit to US interests. For USAID, it presents some project possibilities that lie well within AID's experience. Among those mentioned are the need to establish Thai equivalents to the American Institute of Certified Public Accountants (AICPA) and the US Financial Accounting Standards Board (FASB). There are probably also training requirements, an overlap with the third area, below, and regulatory issues, overlapping with the first area. One stubborn problem will be encountered: secretiveness is a deeply-embedded characteristic of Thai and Sino-Thai business culture. Most business groups, even those that are publicly listed, are family controlled, and financial data are closely guarded within the family. This is very gradually changing, but is sure to make progress slow for USAID.

The third area, which I am calling Training for Financial Management, is one on which the original Price Waterhouse report didn't put much emphasis. But further acquaintance with the situation here makes me think it deserves inclusion in a narrowed set of possibilities. The key point is that Thai financial markets have expanded so rapidly during the last decade that the staffing of institutions across the board has been left far behind. Various measures of the rapidity of financial growth could be offered. The ratio of M2 to GNP, one useful measure, grew from 38.5% in 1981 to 65.4% in 1989. The shortages of staff exist at all levels, but appear to be most acute at the middle

level, i.e., people who are junior officers and acquiring some managerial functions. At that level, knowledge of modern computer technology becomes important, as well as an understanding of the whole array of financial services and products, including international transactions. Despite in-house training programs, the American banks suffer from these shortages along with everyone else. However, benefit to the US will also derive from the acquaintance that trainees make with American methods, software and hardware.

In selecting the three areas above, I have left out four from the March report. A brief explanation: The first area omitted, Expansion of the Equity Market, boils down to problems of legal and regulatory reform, and can be dealt with under that heading. The second, Mobilizing National Savings, aroused mixed reactions from persons interviewed. It was generally held that a compulsory system would be politically unacceptable in Thailand. The view was also encountered that Foreign fund managers would never be permitted to participate in a national system, were it created. I think the subject can therefore be shelved, possibly to be raised again at a later stage. The third omission, Developing Thailand into a Regional Financial Center, evoked skepticism from most Thai interviewed. They tend to see it as a possibility at least 10 years off, and one on which not much can really be accomplished until some acute infrastructure problems, especially in telecommunications, are solved. This doesn't mean that certain aspects cannot be attacked now, but they are ones that fall under the headings of Legal Reform or Quality of Information. Finally, Privatization is a subject I believe best handled under other programs, even though admittedly relevant.

## II. NEXT STEPS.

Following is an outline of the main steps that need to be taken in order to arrive at a firm USAID program in the Financial Markets area.

### A. Review other donor activity.

We have picked up some information about other donors on a rather casual basis, but this needs to be gone over with more precision and updated. Calls need to be made on the World Bank and IFC in Washington, on the ADB in Manila, and on a number of Thai government offices in Bangkok. There doesn't seem to be any agency of the Thai government that is specifically responsible for coordinating aid to the financial sector.

### B. Identify Thai Government Counterpart.

Although a number of Thai officials have been interviewed,

and we have received a variety of expressions of support for a USAID initiative, we have not identified a central point in the Government that would take responsibility. Most likely, this would lie in the Bank of Thailand, though the Ministry of Finance is also possible. It will be necessary to pin this down before work can proceed much further.

C. Reach agreement on areas of concentration.

If AID accepts the three areas recommended in this report, some degree of formalized acceptance by the Thai Government should be sought.

D. Selection of Pilot Projects.

Draw up plans for one initiating project in each of the

three areas. Selection would be based on a number of criteria: (1) Thai Government advice on priorities, (2) a workable definition of the objective to be achieved, (3) definable benefit to US interests, and (4) moderate cost. This is really the moment of truth for the whole effort. If a workable project cannot be defined in at least two of the three areas, then I would have to question whether USAID can operate in the financial markets area.

The following are suggestions on pilot projects:

(1) In the Legal and Regulatory Reform area, focus in on the obstacles in the way of developing markets for bonds, commercial paper, and merchant banking products. Make a conscious effort to concentrate on markets and products in which the American firms have an advantage. Work on whatever set of laws and regulations seem most burdensome. Aim at presenting the Thai authorities with a package of reform proposals that are attractive to the Bank of Thailand and Ministry of Finance technicians but also politically saleable.

Should such a project prove impossible to construct, a possible fallback in the same general area would be one aimed at breaking down the barriers to wider participation in the mutual fund business. This should also be one in which American firms have more experience and expertise than those of other countries. Resistance in Thailand to an opening in this sector arises, however, not only from fears about foreign domination, but from a reluctance to see the large Thai groups take over another market. The problems in structuring a project to meet those concerns are major, but the rewards for success could be great.

A third possibility in this area was suggested to me by a Thai Government official on my last day of interviewing. Both the Bank of Thailand and the Ministry of Finance are now concerned with what are seen as dilemmas between deregulation and supervision. They want liberalization and openness to proceed, but they fear that the present institutional structure has weaknesses that are not easily remedied by supervision. (See for instance an article by Governor Chavalit in the Far Eastern Economic Review, 28 June 1990, p. 78.) More specifically, they believe that some of the smaller banks and quite a few of the smaller finance and securities companies would not be viable under strain and should be merged into larger units. The whole problem is heavily politicized, which may account for some muddled language in public statements. A USAID project in this area is imaginable: it would pull together the various policy threads into a package of reforms that would permit liberalization to proceed while minimizing risks to depositors or burdening the Government with an excessive liability. It would obviously require expertise of the highest order.

(2) In the Information area, my choice would be to work on accounting standards. Try to see if one or both of the two US institutions mentioned above (FASB and AICPA) could be used as models for Thailand. Probe the area of legal reporting requirements and their enforcement.

A fallback in this area would be to involve USAID in the creation of a rating agency. The current ADB project, according to my understanding, is limited to a feasibility study. It may rest there unless another push is applied.

(3) With respect to Training, enter conversations with the Thai Bankers Association aimed at defining a USAID supported course for middle level staff, to include introduction to the use of US style methods and equipment, and to emphasize international financial linkages. If the Institute now in operation under the TBA proves unsatisfactory as a device for USAID participation, an alternative would be to organize a series of seminars under direct USAID auspices.

### III. ISSUES RAISED AT THE USIS SEMINAR

Perhaps the most relevant issue raised at the USIS seminar in Hua Hin was access to the Thai financial market by foreign firms, i.e., by new entrants. Openness in this respect was supported in the speech by the American Embassy Economic Counselor, Robert Duncan. His views were immediately attacked by an official of the Thai Investment and Securities Co. (TISCO),

and the issue was then commented on by a number of Thai and American participants. The issue was not clearly drawn between Thai and Americans: TISCO, in fact, is 25% owned (and said to be controlled) by Bankers Trust. However, the balance of Thai participants seemed to favor some caution and restraint in admitting new foreign firms. The case against openness could, I think, be summarized as follows: First, Thailand is just now taking important liberalizing measures involving interest rates and capital flows, and may need to digest these before proceeding further. Second, the Americans already have a strong position in the financial market, including 4 of the 14 foreign bank licenses, ownership of the largest life insurance company, and interests in several of the finance and securities companies. Third, that, with American banks in retreat from foreign markets, an opening to new entrants would probably benefit the Japanese and Europeans, bringing more competition to the existing American branches. The case in favor of openness was based on the argument that open markets eventually benefit everyone. It was also denied by an American banker that US banks are really in retreat. (Conversations with other US bankers in Bangkok, however, showed them to be uneasy about the prospect of more competition).

I felt that there was an undercurrent of criticism directed at American business practices and attitudes, expressed always politely but from time to time with a sharp edge. A Thai banker, once with the Bank of Thailand, recalled that American bankers calling on the Bank of Thailand often insisted on seeing a top official and would decline to be met by a subordinate. Another Thai banker said that "Americans see business as a series of deals; the Japanese see it as developing long-term relationships." Remarks by Dr. Snoh, former Governor of the Bank of Thailand and the most senior Thai at the seminar, included cautions, directed at the American side, not to push Thailand too hard on issues like openness of the market.

The speech by Dr. Vijit, newly-promoted Deputy Governor of the Bank of Thailand, was closely followed for indications of future BOT policy. Vijit spoke of the liberalization measures already undertaken as an irreversible trend. However, he remarked that liberalization and deregulation can bring a need for closer supervision. He spoke of a need to consolidate and strengthen both the local banking industry and the finance companies. He thought that some of the largest of the finance companies could become banks, while some of the weakest would have to be merged or disappear. Dr. Thomas D. Thomson of the Federal Reserve Bank of San Francisco had argued in his talk that if a country opened up its capital flows while holding its exchange rate fixed, its monetary authorities would lose control

of monetary policy. This led to questioning of Vijit on whether the exchange rate was under-valued, whether the BOT would consider changing the rate, etc., questions on which Vijit of course refused to be drawn.

#### REACTIONS TO THE PRICE WATERHOUSE REPORT'

A number of reactions to the report were collected at the seminar in Hua Hin, especially during a breakfast meeting with five senior Thai officials and bankers. Other reactions were gathered before and after the seminar in Bangkok. (See attached list of persons interviewed.) I have attempted to reflect those reactions in the choices of areas of concentration above. A point made several times, especially by American bankers, not directed to the report but relevant, is that the absence of a Thai-US tax treaty is a serious handicap. The only additional remark to be made is that Thai Government officials, including some who expressed reservations about opening of the market to more US firms, appeared generally to favor a USAID effort in the area of legal and regulatory reform.

AREAS FOR USAID ACTIVITY IN THE FINANCIAL SECTOR

Chase Manhattan Bank, Siam Center  
June 20, 1990

Kenneth White, CMB Country Manager  
Chulatip Nitibhon, CMB Country Wholesale Manager  
James T. Grossmann, PDS/PSI-USAID  
Willard D. Sharpe, Price Waterhouse

Sharpe asked for a reaction to the recent paper done by Price Waterhouse.

White first mentioned the area of Security Exchange of Thailand (SET) regulation. He described SET as very loosely regulated and expressed concern that a large scandal as has happened in the past could effect public confidence in the market. A second point is SET back office operation. A lot of hardware is on order, but there is need for training and standardization of software.

With respect to the quality of financial information, White seemed skeptical that anything useful could be accomplished. A rating agency will be established, but independence and credibility will be difficult to achieve for it.

The prospects for assisting establishment of a health services program were discussed rather inconclusively. White noted that the law on provident funds has recently been improved, giving better tax incentives and liberalizing portfolio requirements. Opportunities for U.S. money managers may exist.

White noted that leasing is an area that needs a better legal framework. White was skeptical about the value of involving USAID in development of capital markets in Thailand. The private sector is already actively innovating, with new instruments being launched.

He noted that U.S. firms are not major participants in most sectors of the Thai economy, making it possible that any improvements worked by USAID would benefit U.S. firms less than others.

He thinks it unlikely that Thailand will ever become a regional financial center in the usual sense, but thought it might become a regional commercial center instead.

DRAFT FINAL

USAID ACTIVITY IN FINANCIAL MARKETS

June 21, 1990

Robert Muscat, Advisor, TDRI  
Willard D. Sharpe, Price Waterhouse

Muscat has recently moved from NESDB to TDRI along with Dr. Snoh. He says that NESDB is now much less influential than it was in the Prem Government. Muscat has written a history of USAID in Thailand, recently published but as yet unavailable in Bangkok.

He had read the Price Waterhouse paper on Financial Markets, but had little to offer in the way of suggestions in this area. He is a skeptic regarding Thailand's future as a regional financial center and thought that the idea had been tossed around by Thai who hadn't given much real thought to what is implied. He is interested by the concept of moving Thailand to a higher savings rate, but didn't seem to think that a compulsory provident fund was a viable way to do it.

He regards the Thai banks as quite inefficient and a headache to deal with. He said that one, the Bank of Asia, has hired an American named Jim Stent and given him the assignment of modernizing the bank's operations. This after the bank had gone through a period of crisis.

Muscat does not regard bank profits as exceptionally high, and thinks that some banks are quite weak as the result of losses sustained in the recession period in the mid-eighties.

He also said that he doesn't regard the debt-equity ratios of Thai business as out of line with common practice in Asia. Even in Japan the ratios are often extremely high by US standards. He was skeptical of the assertion in our paper that high debt-equity ratios are a danger to the financial stability of the economy.

He is also skeptical of the ability of the USAID program to assert much direct leverage in favor of the US private sector, noting that the Japanese aid program is fifty times larger. However, the long history of AID in Thailand and the fact that many high-ranking Thai officials were once trained in AID-funded programs mean that even a small AID program can still influence Thai policy.

DRAFT FINAL

POSSIBLE USAID ACTIVITY IN FINANCIAL SECTOR

Hua Hin, Sofitel Central Hotel  
June 23, 1990

Eugene Davis, Managing Director, Chase Manhattan  
(Thailand)  
Willard D. Sharpe, Price Waterhouse

Davis believes it would be unwise for USAID to attempt direct aid to the Security Exchange of Thailand (SET). For one thing, both the brokers and the SET itself are now making a lot of money. There is no shortage of resources. The Midwest Stock Exchange contract calls for installation of equipment by the end of this year and for a period thereafter during which the Exchange will help to smooth out the operation of the new systems.

Davis believes that the area of financial information may offer good possibilities for USAID. It is a real mess, and data are poor even for many listed firms. There is, however, one firm in town that is offering services as an independent data source: TARA Siam. TARA is seeking to become the rating agency, for which the Asian Development Bank (ADB) is doing a feasibility study.

We then got into an extended discussion of the possibilities for a bond market. Davis said that there are important tax obstacles. A series of taxes--transfer tax, stamp duty, capital gains tax, and withholding tax on interest--bear more heavily on bonds than on equities. These taxes make it more or less unrewarding to underwrite, own, or trade in bonds. Davis also thinks it will be necessary to make some institutional changes before a government bond market can operate. He called attention to the system in the US, in which the Fed uses a set of money market houses as buffers between it and the broader market.

Davis likes the idea of a USAID participation in bank training, saying most of the Thai banks are at present poorly staffed with modern skills.

He was skeptical that Thailand would ever adopt a national savings scheme analogous to the Singapore or Malaysian Provident Funds. He added that if such a system did come into existence and gathered large funds, foreign money managers "would never be allowed within a mile of it".

DRAFT FINAL

USAID ACTIVITY IN FINANCIAL MARKETS

Bank of America, Bangkok  
June 26, 1990

Ted Heyermann, Bank of America Manager  
Willard D. Sharpe, Price Waterhouse

In reference to the quality of financial information, Heyermann said that the poor quality of company data is a major handicap for his bank, making it difficult to evaluate credit risks. This problem may be more serious for foreign banks than for the local ones, who know their customers better. Heyermann thinks a part of the problem is that anyone can become an accountant: there is no equivalent of the US AICPA, and no certification is required. Another part of the problem is the fact that in Thai legislation, disclosure requirements are minimal. New legislation is required. Finally, there is the cultural problem. The Sino-Thai firms are especially secretive, usually employing no one from outside of the immediate family as Chief Financial Officer.

With regard to the training, Heyermann said that the shortage of trained officer-level staff is pervasive in the Thai financial sector. Most banks have some kind of internal training program, but only the largest are doing a really good job. Aside from in-house programs, the best training establishment known to Heyermann is one located in Singapore, called (he thought) the International Banking Institute. He thinks the Institute organized here by the Thai Bankers Association is inadequate because it is aimed only at training low-level staff, hardly above clerical level. The real need is at the officer level.

In general, comments on the condition of the financial sector, Heyermann said that there are several Thai banks that are not in good shape, and which have questionable loan portfolios. He believes there has been discrimination against the foreign banks in the handling of the 1984-86 financial sector crisis: bad loans affected everyone, including the foreign banks, but the local banks were bailed out, while the foreign banks simply had to swallow their losses. He also thinks that the Finance and Securities Companies sector needs to be cleaned up. There are approximately one hundred of these companies, too many to supervise adequately, and some are of doubtful quality.

USAID ACTIVITY IN FINANCIAL MARKETS

Hua Hin Sofitel Central Hotel  
June 24, 1990

M. R. Chatu Mongol Sonakul, Comptroller General,  
Ministry of Finance  
Dr. Snoh Unakul, Chairman, TDRI  
Mr. Aswin Kongsiri, President, IFTC  
Dr. Vichit Suraphongchai, Senior Executive VP,  
Bangkok Bank  
Dr. Weerasak Suk Anarak, VP, SET  
Dr. John Eriksson, USAID Director  
James T. Grossman, USAID  
Ms. Judith Kocher, USAID  
Dr. Willard D. Sharpe, Price Waterhouse

Dr. Eriksson explained that we are looking for comments on the Price Waterhouse paper and for any other suggestions on possible USAID activity in the financial sector. Sharpe then began eliciting comments on the areas recommended in the Price Waterhouse paper.

Early in the discussion, Mr. Aswin commented that USAID would need to focus on regulatory reform and the quality of financial information, because these were at the heart of most of the problems in the Thai financial sector. In particular, he thought that little progress could be made without the appropriate legal framework. These remarks drew general assent on the Thai side.

In a discussion of the SET, Dr. Snoh said that there is a danger in trying to expand the number of listed companies. Some may be brought in that are too small or otherwise inappropriate. As for firms that did not wish to list because they were unwilling to make the required disclosures, Snoh said they might just as well be left out. On the demand side, it would be desirable to have more purchases by institutional investors, but there are regulatory blockages.

With respect to bonds, M. R. Chatu Mongol said there is currently little demand for them. However, after discussion it was agreed among the Thai participants that demand would develop if the right instruments were presented, and that an active bond market would improve the financial sector by offering savers a wider choice of investments. The Thai participants were agreed that the most important element was the need for a government bond market, which would establish the base for other bonds and should come first. Mr. Aswin thought that municipal bonds were not the right idea, at least to begin with; investors would be looking for the Royal Thailand Government (RTG) name as their guarantee of safety. Getting a government bond market started was cited as another legal and regulatory problem.

On the possibility of an involuntary savings scheme such as a compulsory provident fund, M. R. Chatu Mongol said that a bill had recently been discussed in the cabinet for some sort of national provident fund, but the proposal had been withdrawn on the grounds that it would be difficult to administer. Several of the Thai participants believed that a compulsory system would not be desirable or fit with Thai culture. Dr. Vichit was especially opposed, saying it would wind up as an added cost to employers. Dr. Weerasak said he thought the best way to increase national savings would be to develop a wider range of attractive, safe instruments.

In connection with legal reform, Chatu Mongkol mentioned that a committee involving members of several ministries has been working on a "Chapter 11" bankruptcy law. He thought that some Canadians are working with the Chulalongkorn University's Faculty of Law on the same issue.

Mention of the possibility that Thailand could become a regional financial center evoked skeptical comments. Dr. Vichit remarked that there are tremendous infrastructure requirements to be met before this could be considered.

The subject of privatization drew little discussion, and the Thai participants didn't react to the possibility of basing an effort on health care services. With respect to bank training, it was remarked that there is a need for training not only in the banks but in the financial sector generally, because the volume of business and the technology are both advancing so rapidly.

Dr. Snoh undertook to sum up by saying that the Thai financial system has two core problems: legal and regulatory problems on the one hand, and quality of information on the other. Most of the weaknesses of the system came back to these two. He also warned that USAID would have to review what is being done by other agencies, in order to avoid duplication.

DRAFT FINAL

USAID ACTIVITY IN FINANCIAL MARKETS

June 27, 1990

Dr. Siri Ganjarerndee, Director, Department of Economic  
Research, Bank of Thailand  
Willard D. Sharpe, Price Waterhouse

It proved to be somewhat difficult to focus Dr. Siri on the subject of interest to me, as he was clearly preoccupied with a dozen other matters, including exchange rates and trade flows. When I did get him around to a possible AID program, he said he thought a good area for exploration would be the need to develop secondary markets for fixed-income securities, and the complex of obstacles to that development. Within the array of obstacles, the one he thought most challenging is the fact that the tax treatment of bonds is not equivalent to that of equities or other instruments. A number of different taxes are involved, and the situation is so complex that no one really understands it, least of all (he remarked) the tax authorities.

He said that Thailand is embarked on a process of liberalization and deregulation, which probably would proceed rapidly during the next few months, but he is afraid that there has been inadequate preparation for these changes, and that not all of their consequences are understood. He is also worried that Governor Chavalit will have to leave at the end of September, as required by law, despite statements by the Minister of Finance that he would like him to stay on. With a new Governor, the whole process of liberalization will have to be re-argued.

In response to my question of what person or office we could look to for coordination of foreign aid efforts, he said there is no single point, and we would have to check each of the main departments of the Bank of Thailand. He asked for a copy of the Price Waterhouse report, which he had not seen, and I said we would keep him informed of our efforts.

DRAFT FINAL

USAID ACTIVITY IN FINANCIAL MARKETS

June 28, 1990

Mr. Pakorn Thavisin, President, Thai Danu Bank  
James T. Grossman, USAID  
Willard D. Sharpe, Price Waterhouse

We discussed the status of the Thai Bankers Association (TBA) training institute. Mr. Pakorn said that there had been a previous program, with a two-year term, which did not have a fixed location. The new Institute has now been in operation for two months. It has a set of three-year courses, for which the trainees can sign up and take in separate parts, with separate examinations. Most of the classes meet at night. A location has been established at Chulalongkorn University. The TBA raised 2 million baht from its members, and has spent about half of that in decorating and equipping the classrooms. Operating expenses are covered by student fees. Generally the students are at the junior level, but not clerical, and they can expect to be promoted if they complete the three year course. A special course has been started within the Institute for VP-level students.

Mr. Pakorn said that the most important immediate need of the Institute is for textbooks, that is for new textbooks to be written. He didn't mean translations, but new books that would be relevant to the Thai banking system.

We discussed accounting standards in Thailand. Admitting they are low, Mr. Pakorn said it was wholly a matter of tax evasion, and he didn't see any way of raising standards, given the prevailing climate in that respect. The Bank of Thailand does lay down requirements for financial statements (of banks?) and there is an Association of Chartered Accountants that supposedly governs professional standards.

He noted that it is very difficult to arrange mergers and acquisitions in Thailand, because of the legal restraints.

He said that banks do not return cancelled checks to customers because the law requires that the actual check, not a microfilm of it, be held for 10 years. Microfilmed copies are not acceptable as evidence in Thai courts unless both parties agree.

DRAFT FINAL

USAID ACTIVITY IN CAPITAL MARKETS

June 28, 1990

Dr. Weerasak Suk-Anarak, Vice President, Security  
Exchange of Thailand (SET)  
Willard D. Sharpe, Price Waterhouse

Dr. Weerasak explained to me the difference between "public companies" and "listed companies", which had been confusing me. Public Companies are those that meet the conditions of the Public Companies Act of 1979, which are very restrictive and unattractive. Only 28 companies in Thailand have elected to become public companies under that law, and only one of those, Samlong Hospitals (?) is listed on the SET. The conditions for listing on SET are prescribed under a different law, and are less restrictive. Parliament has under consideration a new law that would straighten this matter out.

The number of companies listed on SET is now approaching 200, with about 40 new listings in the past year. Dr. Weerasak believes that there is potential for a total of 500 listings.

The trading system used by the SET is referred to as a "matched trade, open auction" system. It differs from that used on the New York and other US exchanges by the absence of specialists who make a market in particular issues. One reason for this is the lack of a trust law in Thailand. Specialists, in the New York system, are trustees. The Midwest Stock Exchange, now busy installing a computerized trading system for the SET, will install it according to the existing trading rules, not according to its own rules.

The automated system should be in place by the end of the year and in full operation within a few months after that. It will have one major advantage for the brokers: they will be able to put terminals in provincial offices, so that people outside of Bangkok will find it easier to trade. He said that when a similar system was put in place in Taiwan, the volume of trading jumped fourfold, and he thinks that the main reason was the installation of terminals outside Taipei. There are at present only about 400,000 Thai shareholders, a very small percentage of the population.

He believes the Mutual Fund Company monopoly will be broken, probably next year. He said SET will soon add 5 more brokers, who must be chosen from among the licensed Securities companies.

DRAFT FINAL

**USAID ACTIVITY IN FINANCIAL MARKETS**

**June 29, 1990**

**Mr. David Lee Hendrix, Vice President and Country  
Corporate Officer, Citibank  
Willard D. Sharpe, Price Waterhouse**

Asked to state his list of problems that he would most like to see USAID work on, he gave the following:

(1) A rating agency.

(2) Tax reform. He said that the two most important taxes that act as barriers to a bond market are the 20% withholding tax on interest and the capital gains tax. Both discriminate in favor of equity shares as against fixed income securities. The 20% withholding tax would not be a problem if there were a US-Thai tax treaty. As it is, the tax can be gotten around by transactions through Singapore or another country that has a tax treaty, but this requires two willing parties and is cumbersome and time-consuming.

(3) A law recognizing trust arrangements. He said that among other things the lack of a trust law prevents the creation of special vehicles for securitization of receivables. In the US, entities such as Ginnie Mae, Fannie Mae, General Motors Acceptance Corporation, and the Real Estate Investment Trusts (REITS) are all vehicles for securitization, and are a major element of the US financial system.

In a discussion of the Thai banking scene, he said that there is a distinct difference in the operations of the US and the Japanese Banks. The Japanese banks are "relationship-oriented" while the US banks are "product-oriented". One peculiar result is that often a Japanese corporation will seek out a US bank for a particular product, and the US banks therefore usually have an officer specialized in Japanese clients. The reverse isn't true; US firms rarely use Japanese banks.

USAID ACTIVITY IN FINANCIAL MARKETS

June 29, 1990

Mr. Mont Saranusit, Director, Monetary Policy and  
Financial Institutions Division, Financial Policy  
Office, Ministry of Finance  
Willard D. Sharpe, Price Waterhouse

The problem on Mr. Mont's mind, from which I could not divert him during the conversation, is the relationship between deregulation and supervision. He said he doesn't believe that deposit insurance is a proper way for Thailand to proceed. The real problem is that there are a number of weak banks and a larger number of weak finance companies, and that no amount of supervision can remedy this, because these firms are politically protected. There should be a series of mergers to eliminate the weak entities, but all of them are family-owned, and no family wants to give up control. In the past, when these weak firms got into trouble, they were usually bailed out, rather than closed up. But they are still weak and will be in trouble again the next time there is a recession.

He said that the technocrats in the Bank of Thailand and the Ministry of Finance are all agreed on this, and have repeatedly recommended solutions, to no avail. The problem cannot be solved "from the bottom up" but must be solved "from the top down". He finally suggested that if USAID could finance a highly-prestigious team that could recommend a package of measures to fix things up, that might provide the leverage needed to get action.

USAID ACTIVITY IN FINANCIAL MARKETS

June 29, 1990

Mr. Chaktip Nitibhon, General Manager, Banque  
Indosuez  
Willard D. Sharpe, Price Waterhouse

With respect to the prospects for a bond market, Mr. Chaktip remarked that the first essential was a commitment by the Government to change its policy of using the banks as a captive market at below market rates for its bonds. But there are other problems, he said. The Public Companies Act of 1979 (also called the Limited Public Companies Law) places severe restrictions on issuance of bonds by corporations. Later on, it was made possible for any company listed by SET to issue bonds, but the procedures are lengthy and the tax aspects unfavorable, so few corporations have taken advantage of this.

The Mutual Fund Company was set up about ten years ago on the initiative of Dr. Sommai, the then Minister of Finance. He became its first chairman and stoutly protected its monopoly, arguing that if others were authorized to enter the business, foreigners would become dominant. There was, according to Chaktip, an unvoiced further consideration: the fear that the already powerful families that control the five or six largest banks and industrial groups would come in and control this too.

In a discussion of the foreign banks, he said that of the 14 licenses, 4 are held by Asian banks and are not very active, 4 are European and tend to concentrate on the business of their respective countries. Of the two Japanese banks, one, Mitsui, is a member of an industrial group and operates rather narrowly with its own corporate clientele, so that only the Bank of Tokyo is regarded as a neutral. But even that bank tends to stick to its own list of traditional relationships and to conservative banking practices. In the end, it is only the American banks that have been active across the board and have been willing to innovate, particularly in merchant banking products. For this reason, even Japanese companies, when they come to Thailand, often go to the American banks for special types of service, such as risk-hedging products. The fact is that the American banks have a wide comparative advantage in modern merchant banking techniques, and would be able to exploit this more fully if there were not so many regulatory restraints.

With respect to a rating agency, Chaktip thinks that it will be useful, even though initially there will be few companies whose accounts are good enough to deserve to be rated. Those companies will stand to benefit, and others will follow.

PERSONS INTERVIEWED

- M. R. Chatu Mongol Sonakul. Comptroller General. Ministry of Finance
- Mr. Mont Saranusit. Director, Monetary Policy and Financial Institutions Division, Financial Policy Office, Ministry of Finance
- Dr. Siri Gangarerndee, Director, Department of Economic Research, Bank of Thailand
- Dr. Snoh Unakul, Chairman, Thai Development Research Institute
- Mr. Aswin Kongsiri, President, Industrial Finance Corporation of Thailand
- Dr. Weerasak Suk-Anarak, Vice President, Stock Exchange of Thailand
- Dr. Vichit Suraphongchai, Senior Executive VP, Bangkok Bank
- Mr. Prakorn Thavisin, President, Thai Danu Bank
- Mr. Chaktip Nitibohn, General Manager, Banque Indosuez
- Dr. Robert Muscat, Advisor, Thai Development Research Institute
- Mr. David Lee Hendrix, VP, Country Corporate Officer, Citibank
- Mr. Kenneth White, VP, Country Manager, Chase Manhattan Bank
- Mr. Chulatip Nitibohn, VP, Country Wholesale Manager, Chase Manhattan Bank
- Mr. Eugene Davis. General Manager, Chase Manhattan (Thailand)
- Mr. Ted Heyermann, VP, Country Manager, Bank of America