

M R Chatu Mongol Sonakul: Some ideas for the new government in Thailand

Statement by Mr M R Chatu Mongol Sonakul, Governor of the Bank of Thailand, at the British Chamber of Commerce, Bangkok, on 23 November 2000.

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Chairman of the British Chamber of Commerce and all the chambers here today, distinguished guests, and ladies and gentlemen. Good afternoon.

Let me begin by saying that it behoves me, and I have to use that word as a career civil servant who has taken his duty righteously for the last 35 years, not to comment on the work of the present government especially during an election period. In any case what they have done is fast becoming history and we have to take it as facts. A datum from which we will have to operate.

In my career, I have been unenthusiastic in commenting about history, and only study it with a view to creating the future rather than commenting on it. If I wanted to comment on history, I guess I would have continued my dual career as a university lecturer which ended abruptly after the first year of my working life, since I found the responsibility of turning up regularly on time every week for anything quite unbearable as well as preferring to be on the implementation side rather than a commentator or analyst.

I shall keep my comments mainly therefore to what the new government should do, be it really a new government or just the old one in a new bottle, and I shall refer only to the present or historical developments only in so far as it is necessary to understand future recommendations.

As this is an after lunch speech, I shall also keep it short and not try to be comprehensive, but only comment on things that interest me or I think might be useful to the audience.

Let's start with a simple concept, the Credit Bureau. One of the reasons the NPL could become so high, and banks with high NPLs could remain supported by the public, is because in the present law the concept is that financial transactions are secret and banks are secret places, looked after and owned and supervised by responsible people.

It would be nice if it were true, but the banking industry is leveraged by a ratio of 12:1 and the temptation is rather great for the owner to take advantage of other people's money, people who have no right to know what is going on with their money even once a year because they are not shareholders but just depositors. The temptation of the supervisors to evade their responsibilities by not taking the correct action is also great, as rich people are powerful, and bad political systems over a long time do not help to make you brave.

This philosophy must be changed. We must go on to the philosophy of transparency where offences and important financial ratios or numbers are publicised, and peer or investor pressure could be used to reduce the flow of resources to wrong-doers.

Back to the Credit Bureau, of course, borrowers are very important in all this. Banks shouldn't lend to bad borrowers, and banks that lend to bad borrowers are bad banks. But how can banks not lend to bad borrowers, if they don't know who they are? There are, of course, alternative remedies, but the best instrument is to have an industry-wide Credit Bureau which keeps track of the credit standing of borrowers.

This is not possible at present because the law does not allow you to disclose clients' information. The Bank of Thailand has required that prospective borrowers and renewals must sign a form declaring that they will allow their credit standings to be disclosed, but this is a feeble alternative. It is very time consuming and argumentative, with all its consequences. A Credit Bureau Law should be quickly legislated, where, as a price for a better society, bad debtors can be identified.

As to commercial banks, good governance should be put in place. Audit committees are now required. Independent directors, not voted upon by the major shareholders, are being encouraged. NPL, related lending and fines and penalties imposed must be disclosed by each bank at the end of every month, and are published in the BOT's web.

Directors must devote their time to the bank, cannot be a director of more than three other profit-seeking companies, as well as disallowing of borrowing where cross ownership is more than one percent of the paid up capital of the borrower.

Of the 92 people involved, 53 have now complied, and arrangements have been made for most of the others to comply, with the possible exception of the representatives of the Ministry of Finance who may find that their representatives are not the sort of people who can devote that much time to the bank because they are not part of the ownership or operation of the bank, but are just government representatives. We are looking into this and will discuss with the Ministry when the time is right.

The problem in fact is not as innocuous as it looks as state bank remunerations are affected by considerations other than just how should directors be rewarded so that shareholders' value can be maximised.

But all this is being done through sanctions and coercion, and in the New Commercial Bank Act the authority will be explicit.

My last words on commercial banks, the intervened banks might not yet be completely taken care of, but at least the cost of rescue can now be well estimated. The proper financing of the debt burden is probably one of the first jobs of the new government.

Temporary or provisional financing is better than none, but a clear-cut schedule on how the very large debt should be financed over the next ten or twenty years must be made if investors and trading partners are to have confidence or a clear idea of what they are dealing with, and I think that is essential.

How central banking will be done is also important. The Bank of Thailand itself is being revolutionised. The pay system will change, the promotion system will change and career development has been instituted. Risk management supervision will be instituted from the first of January next year.

Simple things such as a letter of transmittal of the supervision team to the manager of the bank will be required. This may seem trivial, but it will put responsibility firmly on the supervisors, which was never possible before because supervision missions went whenever they felt like it and did not tell anybody except the banks. It also makes job control of the supervisors impossible and it is very dangerous to allow people with criminal prosecution capabilities to work in this manner.

The most important thing about the new central bank though is probably to keep it really independent. Thailand is now quite a complicated place, a large economy with considerable sophistication. The role of the central bank in helping finance development and directing among the sectors of the economy will soon no longer be possible.

If the central bank could keep the economy stable, that would be a major achievement.

But most forces in the country, especially the political ones, are directed towards higher growth rather than the sustainability or stable growth, even if in the end stability would probably lead to a better and higher level of the economy than the roller coaster growth of the past.

To do that, the central bank will have to go against the rest of the economy and the government from time to time as has been evident in the past year or two. If the central bank is not independent, it will be very difficult to do this.

In my mind, the best model of central banking is one where the central bank becomes a constitutional body of parliament just like the Election Commission or The National Frequency Management Board.

This doesn't mean that we have to change the constitution because the constitution differs from ordinary law mainly in so far as it supersedes ordinary law and the procedure for changing its

provisions are rather complicated. By ordinary legislation, we could make the central bank a body of parliament or the senate which is what other new central bank legislations now usually do.

This doesn't mean either that the central bank will be operating monetary policy independent of the economic and social policy of the government. The two must be made to intertwine and clear legislation should be made for the procedures for the central bank at appropriate intervals to agree monetary targets with the government and then to be allowed to implement its work independently and unimpeded.

But I guess there's no point in talking much about it now. Let's wait and see what mandate people give during the election. The only obvious thing is that the present Senate seems to be quite qualified to take up such an important role as safeguarding the central bank.

Let me continue on what the new government has to look at, for instance the general guarantee on deposit. This general guarantee cuts across all good banking practices. Banks that misbehave are not being penalised and those that try to do well are dragged down by those who are capricious with the general guarantee that the government gives.

The general guarantee will have to be got rid of sooner rather than later if Thailand is to get back on an even path. Probably, in order to do this, some kind of deposit insurance will have to be in place and seen to be working.

It does look like a long road for the new government, where sequencing and implementation of many difficult concepts is still needed before full prosperity returns.

Let's start on this road to prosperity as soon as possible.

Ladies and gentlemen, let me turn to the general economy because a central bank or commercial banks alone cannot make the country good very quickly.

It is quite obvious that world grain prices are on the way down. Between the years 1800-1900 when the West was being opened in the United States, grain prices fell over 30% over a span of a century.

With genetic engineering, something of a similar nature might happen over the next 20 or 50 years. We have to plan our still agricultural-dominated population for this eventuality.

It does not make sense to base strategy on an expansion of production in a falling market. It makes much more sense to base strategy on cost reduction and to add value to the final agricultural products.

A ton of grain may be worth 10,000 baht, but a ton of biscuits is worth 100,000 baht. But to make biscuits, you need a brand and you need flavours, things which take a long time to develop and endow to the economy.

As to agricultural finance, the most that is available at the moment is crop finance. But you can't make the weather to order. The bad year will kill you, and a mechanism must be developed to finance the disaster of the bad years from the abundance of the good years rather than leaving it to pot luck or to the effort of individual farmers as at present.

Again in the same vein, resources must be made available for farmers to better their production methods or change the nature of their farming so that costs can be reduced or farmers can change to more valuable products needing bigger investments or having larger gestation periods. No doubt in doing this, old debts, being quite considerable and pervasive, will also have to be looked at.

In industry, the problems and the roles of the SMEs are obvious. There is no major industrial economy without SMEs. I would say that over half the SMEs are NPL. And a lot of the owners have abandoned their old companies because they don't need historic records or quota, for instance. They could assume some other identity and live another life and become SMEs again in a not too difficult way, but it is a big burden on the banks.

A lot of SMEs can't do that because they need past performance records. Efforts to prod these SMEs into viability are obviously going to need some government assistance. The problem is too big for commercial banks to handle alone.

The government has made some efforts in improving the technology, marketing and management of the SMEs. How well it has done this depends on who you ask and I am not really in the field of the SMEs well enough to know the generality of what most people are thinking.

But in financing, it is quite obvious that the SMEs with NPL have to get some more money or some guarantees, and one or the other must come from the government. This happens to be the one area where, for various reasons, there is the least progress. The new government must take a look at this immediately and bite the bullet and adopt what might well be necessarily a fairly costly solution.

Another important or strategic sector of the economy is probably tourism with Thailand well-situated in the air routes of the world.

But people don't want to spend 50 weeks in a year or half of their life, whichever the case, and then spend time in an inhospitable location. We have to clean up, especially the visual environment of Bangkok, and the major historical sites of Ayuthaya, Sri Satchanalai and Chiangmai. Putting the electric power line for these cities underground, for instance, would be a most expensive investment, but worthwhile, and the new government must immediately begin to adopt long-term solutions like these.

The last area of the private sector which I would like to talk about today is the Stock Exchange of Thailand.

The Stock Exchange of Thailand lacks sophistication. It has only just begun to allow short selling, which is essential to allow liquidity in a controlled manner. Derivatives are very rare, and this is another area which needs development to reduce the various risks associated with the market, but of course, one should only do it under well known rules, and personally I think only to a limited extent, not to the extent that the beneficiaries are mainly the intermediaries as might be the case in a really large, sophisticated market.

As to the scale of the market, I have been visiting MSCI and other important players in the world. It really is quite easy to improve our market performance. Presently, Thai market requirements are designed only to fit the Thai requirements. Requirements that are often self-destructive and unreal leading us into the bubble of 1997.

The market in the Stock Exchange has not been much changed from the bubble days. It's still doing the same thing, just without the bubble. Realistically, our rules will have to be changed so that it will comply with and take advantage of rather than be penalised by international norms.

In government, the Board of Investment (BOI) is probably a crucial instrument. It's doing a good job giving privileges on an individual project basis. That has its own limitations and faults. It might well soon be the time to make operating in Thailand generally viable.

The original BOI philosophy, in that these are projects you wouldn't get if you didn't give tax privileges and therefore have no tax loss costs, is becoming more and more untenable. Generally, systems are working better and the economy is getting bigger and bigger and more and more sophisticated; doing exemptions on a project basis, except in very rare cases, will soon hold us back.

The new government should take that last hurdle and make the general system acceptable, even if minimally by lowering taxes and making improvement in civil service performance, probably by making the civil service remunerated by output and productivity rather than the tenure system as at present.

That leads to my comment on the long term initiatives that the government might carry out that would help in the long run, which I think is the main strategy for real recovery to take place. Without good long run prospects, there isn't much hope to do well in the present.

The government will have to be moved more on to the private sector footing. This doesn't mean just selling state enterprises and such things. But it does mean that the government units that are retained would have to work for incentives in terms of output and cost reduction and have to, in general, compete with the private sector for government budget.

Generally, the private sector is not necessarily more efficient than the government. The key is that those that are not don't survive and better ones expand. This doesn't happen in the government because those that are inefficient just ask for some more budget, and this is forcibly collected.

In my own view, large complicated government units are probably not possible in Thailand unless we get some fantastic new government which is very sophisticated and lasts a very long time, say, 10 or 20 years, a prospect, which presently one should not plan on. In this case, one should then design government units to be small independent units, independently managed, and the governments that come in execute their mandate through budget allocation and legislative changes where necessary.

Interestingly, all over the world for a very long time, the concept has been that civil servants have a lot of authority and are not profit-oriented. One should make sure that they have tenure and are well compensated with pensions after they leave, otherwise they might try to stock up some assets for their later life.

The philosophy is going in the opposite direction everywhere now. Civil servants are powerful and important and therefore they should not have tenure. For that reason one must make sure that civil servants perform by giving them only limited term contracts, and they will have to perform responsibly and efficiently to get a new contract.

I am inclined more towards the latter as one can never make sure of hiring or promoting the right person, and therefore one should plan on an easy change of personnel to get the best results.

Let me make a controversial statement on the platforms of the various political parties in terms of spending more and taxing less. We routinely run the general equilibrium model and the inflation targeting model as well as Market Implied Models or MIME, a technical word that is used for trying to find things out from people's normal actions that could be captured in a data system.

We also, of course, do single equation estimates as well as pure intuition from graphs and tables and such things.

Our staff is generally of the opinion that increased expenditure and tax reduction of moderate amounts will not destabilise the economy.

This is predominantly because the economy is still very docile with a capacity utilisation stable for quite a while now at 58%. Cost push inflation from the exchange rate and the oil prices are now substantially absorbed or have been passed on, so cost push also is not presently much of a factor.

The important thing though is how to make expenditure useful and constructive in the long run without too much leakage. The important thing is how to make tax cuts reasonable and directed towards the areas where people benefiting from the cuts could utilise it for a spate of new investment. If this were to happen the debt to GDP ratio might not increase significantly due to the resulting increase in GDP over the long term.

With abundant liquidity and low interest rates, this is not just a time for a general tax cut for its own sake, but a program must be designed for it to be directed to where investment could best be made. In a way, this is not as easy as it seems, because generally we have been over investing and have great overcapacity.

But it's also not as hard as it might look. There are only a few areas that are really doing well, and benefits from the cuts could be directed there. The problem is how to make it fairly just, so that not only the good players that are already there benefit, but new players should be brought in to these all important areas.

Ladies and gentlemen, I have been giving you some of my thoughts on the economy. Thoughts that are spotty and veer obviously somewhat to the financial aspects.

The new government must be much more comprehensive. But since this is not a party platform but only some comments to make more apparent the effect of what might happen in the next few months in the hope that, as in all things, elucidation and transparency makes for a more stable market, let me therefore not bother you further with my thoughts and stop at this point.

Let us hope we will have a good new government, with new ideas to bring Thailand into the future and take Thailand into that most important next level of development, a more comfortable life, and a more stable growth.