3

Asian Restructuring: From Cyclical Recovery to Sustainable Growth

SINCE THE ONSET OF THE EAST ASIAN CRISIS more than two years ago, the corporate sectors and financial systems in the crisis economies have remained in severe distress. Nonperforming loans (loans made by the financial system that are not being fully repaid) have skyrocketed to unprecedented levels: 19 percent of all loans and 27 percent of gross domestic product (GDP) in the Republic of Korea, 20 percent of all loans and 30 percent of GDP in Malaysia, 45 percent of all loans and 60 percent of GDP in Thailand, and over 50 percent of all loans and 25 percent of GDP in Indonesia. In contrast, nonperforming loans in other major emerging market crises (Chile in the early 1980s and Mexico in 1995) were less than 20 percent of GDP. In the Scandinavian banking crises during the early 1990s, nonperforming loans amounted to approximately 5 percent of GDP. East Asia's heavy reliance on bank-based financial systems and the high debt-equity ratios of corporations have made the economic distress especially acute.

Nonetheless, recovery has begun. This recovery, along with the major policy measures used to resolve the distress, raises the possibility that the process may now work in reverse: a rising tide may lift all boats. That welcome possibility, however, cannot be presumed. While a strong cyclical recovery may continue, the aftereffects of the financial shock will persist, and continued restructuring is essential both to reinforce that recovery and to reduce future vulnerabilities.

This chapter reviews the evidence on the extent of corporate and financial distress in East Asia's crisis countries and the significant progress made to resolve that distress. It discusses the relative roles of positive macroeconomic trends and financial restructuring for continued recovery and sustainable growth. It also draws policy lessons for managing corporate and financial distress.

The chapter reaches the following conclusions:

- The ongoing recovery is still fragile and uneven. The externally triggered liquidity crisis during the second half of 1997 indiscriminately submerged both strong and weak producers and financiers. The rising tide is lifting the strong, especially those benefiting from trade growth in electronics products, but the financially weak continue to struggle on account of both crisis-induced and long standing vulnerabilities.
- Without vigorous corporate and financial restructuring, the return to sustainable growth will likely take longer, the fiscal costs of the crisis could rise, and the economies will remain vulnerable to new external and internal shocks. Weak firms in East Asia operated on thin margins in the years leading up to the crisis, and their inability to pay interest following the onset of the crisis has added to their debt burden. Such firms constitute a significant

portion of the corporate sector in each of the crisis economies, and the appetite to invest in them is extremely limited. They will continue to act as a drag on investment and growth until the financial claims on these firms are resolved, and either their operations return to adequate profitability or their assets are redeployed.

- Recognizing the urgency, East Asian governments were quick to create an institutional structure for corporate and financial restructuring; they also earmarked funds for bank recapitalization. The political momentum for reform has, however, slowed down, in part because the deeper structural problems now need to be addressed. Experience from other economies, including Japan, shows that a slackening of the reform effort can undo progress.
- Government restructuring initiatives—though required on many fronts—need to be guided by two policy considerations: limiting the likelihood of systemic disruption; and clarifying financial claims while also facilitating asset reallocation. To contain fiscal outlays, these initiatives should be directed principally to honor the social contract to protect bank depositors and, where necessary, to preserve the payments system and the orderly flow of credit. Government funds should not normally be required for corporate restructuring.
- Bank restructuring is important because it contributes to both policy objectives. Expeditiously restoring the health of the banking system is required because a poorly capitalized banking sector creates continued systemic risks and growing fiscal liabilities for governments. Healthy banks are also best positioned to enforce claims and to pursue corporate restructuring.
- The process of restructuring can itself be disruptive if it is not carefully managed. Restructuring should be undertaken in a manner that ensures the integrity and the organizational capital of the financial system so that prudent lending to businesses and households may continue. Achieving this objective requires difficult choices. Having provided implicit or explicit guarantees, governments can either move ahead rapidly by taking fiscal responsibility for the costs of the crisis, or they can encourage private resolution of the distress while applying regulatory forbearance. Waiting to resolve problems is likely to make them worse. However, expeditious and transparent action should be accompanied by market-based measures to recoup fiscal costs and to signal credibly a commitment to severely restrict guarantees and bailouts in the future.
- Corporate restructuring needs to deal first with the delineation and allocation of losses. Improvements in accounting standards and bankruptcy regimes can help support this process. However, in the absence of effective bankruptcy procedures, out-of-court procedures offer a mechanism for resolution. Once financial claims are resolved, corporate restructuring can be expected to occur through natural market forces, except where major impediments prevent such forces from working. Governments can facilitate asset mobility by creating a framework for effective domestic and cross-border mergers and acquisitions. The Japanese experience cautions that, without an adequate framework for resolving claims and for fostering asset mobility, fundamental corporate restructuring can be indefinitely deferred at a high economic cost even in a sophisticated economy.

The uneven recovery

A strong cyclical recovery is taking place in the crisis economies of East Asia, raising the possibility that growth may alleviate or even eliminate the corporate and financial distress. Although the sharp recovery from the depression-like conditions is expected to con-

tinue over the short to medium term (see chapter 1), its transformation into high and sustainable growth will require more than the present temporary stimuli: the buildup in inventories, low interest rates, and gains from currency depreciation. The recovery has been uneven thus far, with rapid growth in the high technology sectors but more modest growth, and even continued decline, in important segments of the Asian economies. Banking systems, therefore, remain severely distressed. The corporate and financial distress can persist, absent vigorous restructuring, because the incentives to accept and allocate losses are weak. That delay, in turn, can hamper growth by restraining investment and raising the fiscal costs of resolution.

The sources of unevenness

The observed unevenness in recovery is not surprising. "Creative destruction" permits the atrophy of the weak and the shift of resources to higher productivity sectors (Harberger 1998). For instance, with currencies still below precrisis levels, a period of slow growth in the nontradable sectors can be expected. The crisis has also emphasized weaknesses in the competitive ability of traditional manufacturing and has had disproportionate effects on small- and medium-size firms.[1] Though the unevenness is not surprising, it is important, since weak production performance contributes to the already massive financial sector distress and, in turn, hampers growth.

Nontradable sectors. The aftermath of the crisis has seen a sharp decline in the nontraded sectors, where production remains below precrisis levels (figure 3.1). This is to be expected because currency depreciations, which favor traded goods, reduce the incentive to invest in the nontraded goods sectors. The poor performance of nontraded sectors was also a feature of Mexico's revival from its crisis (Krueger and Tornell 1999). Mexican nontraded production took almost three years to reach precrisis levels.

As discussed below, the share of firms unable to pay their debts is significantly higher in the nontradable sectors than in the tradable sectors. In Malaysia about three-quarters of the nonperforming loans are to enterprises in the nontradable sectors. The high distress reflects endemic characteristics. Even prior to

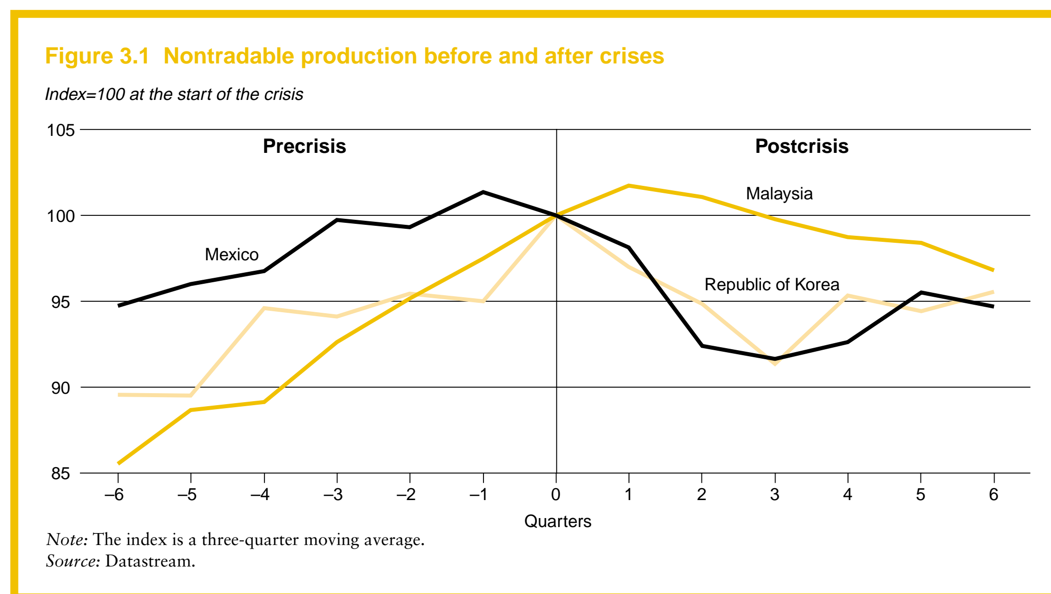


Figure 3.1 Nontradable production before and after crises

Index=100 at the start of the crisis

Note: The index is a three-quarter moving average.
Source: Datastream.

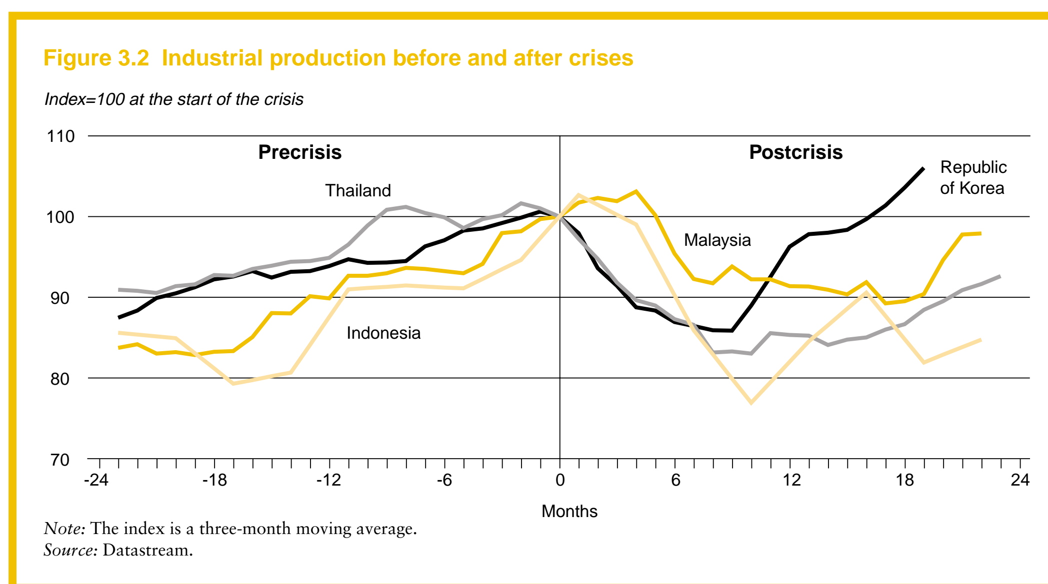
the crisis, the nontradable sectors had been characterized by overcapacity and low productivity (Crafts 1999), reflecting local monopolies in sectors such as retail trade and distribution. The Japanese experience shows that deregulation of domestic trade is important to spur competition and to increase productivity (Alexander 1999). Low productivity also reflects excess capacity in the real estate sector.

Weaknesses in traditional manufacturing. Of all the crisis countries, Korea's industrial production has recovered the fastest, rising above precrisis levels (figure 3.2). The more rapid recovery in Korea reflects in part its greater strengths in sectors such as electronics, computers, and telecommunications (figure 3.3). Korean firms have also done well in the transport equipment sector, whereas Malaysian and Thai firms in this sector have suffered. Traditional manufacturing sectors would have been expected to lead the way to recovery in the lower wage crisis countries. In Thailand the textiles sector grew rapidly following the depreciation, but output has fallen back to precrisis levels as the currency has appreciated. Thai products are having a hard time competing in export markets (EIU 1999b). Traditional manufacturing in Korea rebounded only slightly after the crisis, reinforcing a secular decline that significantly predates the crisis (figure 3.3).

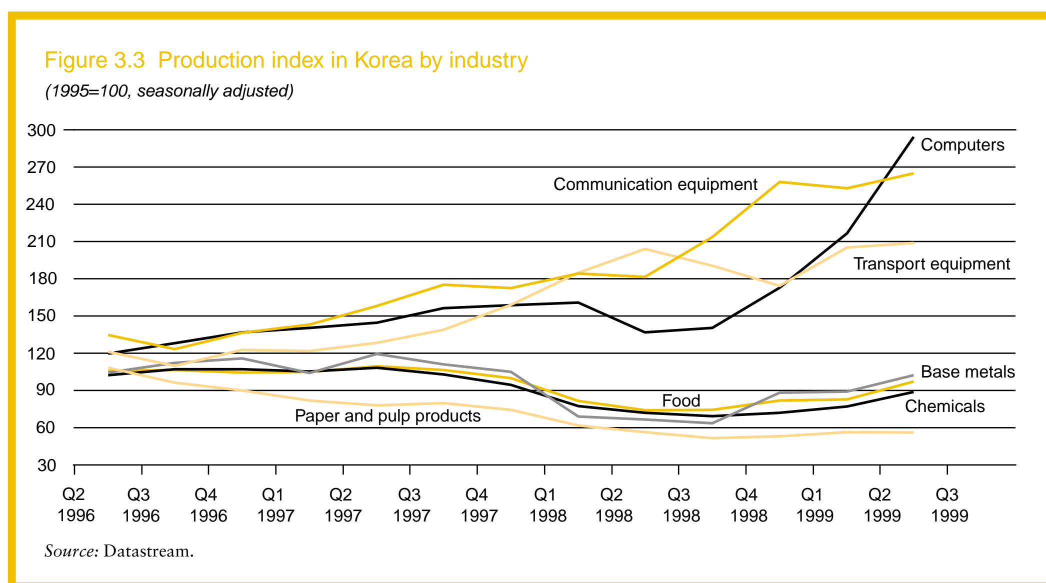
Effects on small and medium-size firms. Small and medium-size firms are suffering disproportionately. While aggregate Korean industrial production bottomed out in late 1998, production by small firms continued to fall in absolute terms until July 1999, resulting in a decline of about one-third from precrisis production levels. In other countries, where small and medium-size firms have a greater industrial presence, their financial inability to withstand crisis has proved more of an economy-wide setback (see Domac and Ferri 1998 for Korea; Domac 1999 and EIU 1999a for Malaysia; Mako 1999 for Thailand). For example, more than 50,000 small firms and 400,000 households throughout Thailand account for about 50 percent of the country's nonperforming loans (Mako 1999).The inability to restructure these debts effectively contributes to financial sector problems, which feed back into continued financial difficulties for small firms.[2]

Figure 3.2 Industrial production before and after crises

Index=100 at the start of the crisis



Note: The index is a three-month moving average.
Source: Datastream.



Source: Datastream.

Even though large firms have been the drivers of recovery, they—especially the large conglomerates—also pose systemic risks. In Korea the onset of the crisis was, in part, associated with the collapse of two conglomerates, Hanbo Steel and Kia. In Thailand the financial troubles of Thai Petrochemicals symbolized overinvestment in capacity and excessive reliance on external debt. Throughout the region diversified conglomerates were initially regarded as too big to fail, as demonstrated in the Korean and Malaysian governments' early efforts to support the survival of their largest business groups. However, that perception may be changing, especially in Korea, as troubles have mounted at the *chaebol* Daewoo, where a creditor-led restructuring is ongoing.

Continued high levels of corporate and financial distress

The uneven recovery is reflected in continued corporate and financial distress. Two measures

Table 3.1 Corporate distress, past and projected, 1995–2002

(percentage of firms unable to meet current debt repayments)

Country	1995 Total	1996 Total	1997 Total	1998 Total	1999 (Q2) Total	1999 (Q2) Manufacturing	1999 (Q2) Services	1999 (Q2) Real estate	2000–2002[a] Total	2000–2002[b] Total
Indonesia	12.6	17.9	40.3	58.2	63.8	41.8	66.8	86.9	52.9	60.8
Korea, Rep. of	8.5	11.2	24.3	33.8	26.7	19.6	28.1	43.9	17.2	22.6
Malaysia[c]	3.4	5.6	17.1	34.3	26.3	39.3	33.3	52.8	13.8	17.4
Thailand	6.7	10.4	32.6	30.4	28.3	21.8	29.4	46.9	22.3	27.1

a. Estimate, based on the assumption that interest rates stay at their current level throughout the period.
b. Estimate, based on the assumption that interest rates regain their 1990–95 averages.
c. Malaysian firms in agriculture and utilities bring down the average for all firms in 1999.
Note: Growth rates assumed through 2002 are based on IMF projections (IMF 1998).
Source: Claessens, Djankov, and Klingebiel 1999; sectoral estimates provided by Claessens, Djankov, and Klingebiel for this publication.

of distress are firms' inability to meet their debt obligations and the mirror image of that inability in nonperforming loans on the balance sheet of banks. These measures rank the level of country distress similarly. Indonesia has the highest level of financial distress, whereas Korea and Malaysia have the lowest.[3] The distress in all four countries is, however, historically severe when compared with other countries that have experienced financial crises, because of the high levels of bank credit-to-GDP ratios and high corporate debt-to-equity ratios (World Bank 1999). While the sharply lower interest rates should provide relief, several factors, which are likely to persist, have kept the distress at high levels.

Interest rates and fiscal distress. Lower interest rates are unlikely to suffice in eliminating distress. Based on financial statements of firms listed on stock exchanges, the ability of firms to meet their current interest payment obligations can be estimated (table 3.1). These estimates need to be interpreted carefully because they are typically based on a small sample of listed firms for which the most complete information is available.

In all countries, the level of distress had been building since 1995. In 1996, even when growth was still booming, more than 10 percent of firms (except in Malaysia) were already unable to service their debt. The estimates show that in the second quarter of 1999 more than a quarter of listed firms in Korea and Malaysia were unable to service their current debt repayments. In Indonesia almost two-thirds of all firms were under severe liquidity stress (table 3.1). In all countries, distress was especially high in the nontraded sectors (services and real estate), as could be expected from the trends in nontraded production described in the previous section.

The crisis of 1997 moved many marginal firms into illiquidity. Moreover, such firms have accumulated debt since the crisis because they have been unable to make interest payments. This suggests that many firms that have recently emerged from the worst effects of the crisis are still in a precarious situation and are vulnerable to further shocks. Projections for 2000–2002 show that, on current assumptions of growth rates in the respective countries, a significant portion of the firms will remain in distress. If interest rates rise from their present low levels to their 1990–95 averages, the distress will be even greater.

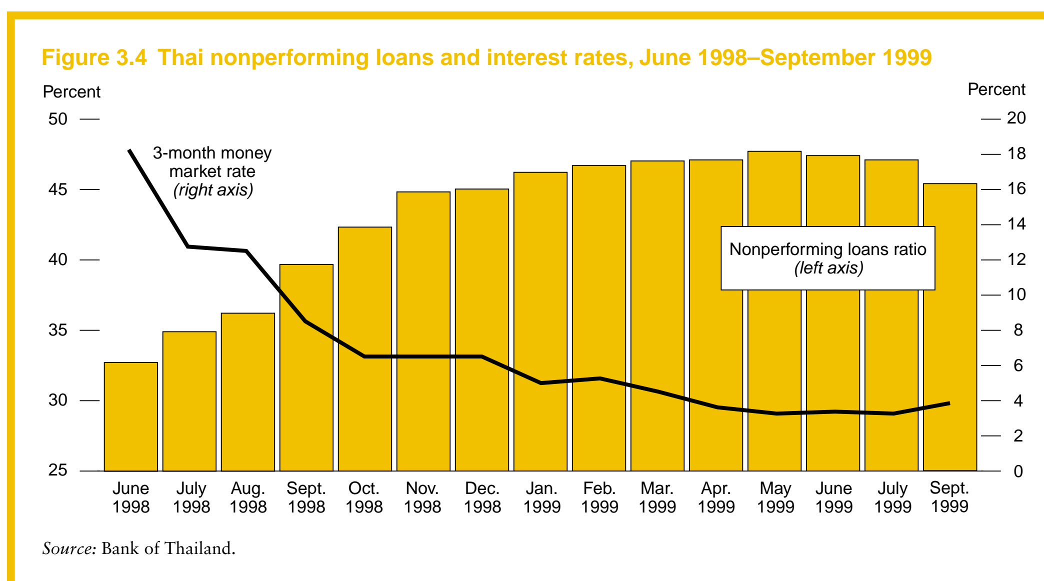
Interest rates and nonperforming loans. Nonperforming loans increased in the first half of 1999 despite declining interest rates, and are stubbornly high—at historically unprecedented levels (table 3.2).[4] In Thailand the problems now center around the commercial banks because, following their closure after the crisis, the assets in nonbank finance companies have shrunk to a small fraction of financial system assets. However, in Korea and Malaysia, the noncommercial bank sector (in-

Table 3.2 Ratio of nonperforming loans to total loans, December 1998–September 1999
(percent)

	Malaysia		Rep. of Korea		Thailand	
	Dec. 1998	June 1999	Dec. 1998	June 1999	Dec. 1998	Sept. 1999
Commercial banks	13.0	12.8	7.4	8.7	42.9	44.6
Merchant banks	30.6	31.6	20.0	11.9	—	—
Other financial institutions	26.8	23.9	13.1	14.5	70.2	62.3
Asset management companies	100.0	100.0	100.0	100.0	—	—
Total financial system	19.7	21.2	16.8	19.2	45.0	45.3

— Not applicable.
Note: Nonperforming loans are measured on a gross, three-month basis and include assets carved out for sale by the asset management companies, which by definition have 100 percent of their loans nonperforming. The steps toward sales of nonperforming loans are discussed later in this chapter.
Source: Financial Supervisory Services (Republic of Korea), Bank Negara (Malaysia), and Bank of Thailand.

Figure 3.4 Thai nonperforming loans and interest rates, June 1998–September 1999



Source: Bank of Thailand.

surance companies and investment and trust companies in Korea, and finance companies and merchant banks in Malaysia) continues to account for about a quarter of the nonperforming loans. Projections of continued growth in nonperforming loans stem largely from the likely increase of such loans in the nonbank financial institutions (see, for example, Xie 1999).

The decline in interest rates has not been sufficient to provide immediate relief. On the contrary, especially in Thailand, but also in Indonesia and Korea, nonperforming loans rose even as interest rates fell (figure 3.4).[5] Fragile firms, operating on thin margins, experienced a severe decline in their net worth when interest rates rose sharply. The sharp fall in output further aggravated the problem. Recovery for the distressed firms will likely be slow. Experience shows that economic downturns associated with financial crises have more enduring consequences than downturns caused, for example, by inventory-driven business cycles (Furman and Stiglitz 1998).

Risks of a low-level equilibrium

Given enough time, financial institutions and corporations can overcome their distress as stakeholders resolve their claims on assets, even in the absence of formal bankruptcy procedures, and as restructuring is induced by market pressures. Without additional shocks, the economies would then return to their new long-term sustainable growth path, which could be lower than the precrisis level (World Bank 1999). The important issue is: how much time? That is, can better management of the restructuring process reduce the costs of the crisis and the length of the period in a "low level equilibrium"?

A slowdown or mismanagement of the restructuring process raises two concerns. First, continued distress lowers investment, which lowers growth, and in turn further contributes to nonperforming loans and reduced investment and growth prospects. While rapid recovery may counteract this negative dynamic, the evidence cautions against such a presumption. Nonperforming loans are likely to remain high, and investment rates have fallen sharply, lowering growth prospects in the short run. Second, strong incentives exist for all parties to wait rather than to resolve their problems (box 3.1). Failure to assess and allocate the losses could lead to their socialization and rising fiscal costs.

Box 3.1 Why distress can persist

The combination of high corporate financial distress, unabated banking sector problems, low levels of investment, and reduced growth rates can cause distress to persist. In a good equilibrium, several factors go together, including high growth, high demand, rising property values, and an appropriate level of credit from the financial system. In a bad equilibrium, poor corporate performance contributes to banks' nonperforming loans, reducing both their capacity and willingness to lend. When property represents a large proportion of the corporate balance sheet or important collateral for loans, as in many parts of East Asia, a decline in property prices further weighs down recovery.

The private incentives to wait hamper the resolution of the losses. For debtors who have experienced large losses in their equity holdings, there is little downside to waiting. They cannot lose much more. For creditors, acknowledging the losses requires raising new capital, which is not easily forthcoming. The problem is aggravated because those in distress have an incentive to undertake further risky investments. Their risks are no greater than when they were merely waiting for the resolution of past problems. For both creditors and debtors, there is the hope that the problems will just go away when growth resumes or if the government bails them out.

As firms and banks wait for their fortunes to improve, debt continues to accumulate. The longer that interest payments are deferred and capitalized, the higher future growth must be for a company to emerge from negative to positive cash flows. The problem becomes systemic as corporate distress reduces demand by lowering the purchases of inputs and by reducing consumer confidence, further increasing the strain on corporate cash flow and balance sheets. Continued restructuring is required to counteract such a negative feedback loop.

Nonperforming loans in East Asia. In Thailand nonperforming loans have declined modestly from their peak levels. In other countries, however, data up to June 1999 show continued growth in nonperforming loans. A number of factors contribute to the high level of nonperforming loans and the possibility that they may actually grow in the short and medium term. First, the accounting methods in place have not revealed the full extent of nonperforming loans, especially in Korea and Malaysia, where nonbank financial companies are especially important. Poor accounting and faulty credit analysis masked borrowers who were often connected to the lending institutions and who could not pay but were nevertheless able to borrow repeatedly to meet their debt obligations. While many of these nonperforming borrowers have been revealed, some observers believe, for example, that Korean nonperforming loans could grow by over a third from their present levels before they start falling (Warburg Dillon Read 1999).

Second, many firms with thin operating margins and high debt levels are endemically weak, and thus have been unable to service their debt despite the recovery. Because of the capitalization of interest, their debt levels have grown and will remain above precrisis levels for a number of years, even under optimistic growth scenarios.

Third, announcements of restructuring agreements led to the expectation that nonperforming loans would fall as a share of total bank loans. However, most agreements are just that—agreements in principle—and will take time to become effective. More important, and as discussed below, restructuring agreements have mainly taken the form of deferred debt payments, and there is little evidence to suggest that assets have been fundamentally repositioned. As such, some agreements have proved unsustainable.

Fourth, except in Korea, there has been virtually no new lending, implying that banks are not likely to grow out of their bad debt

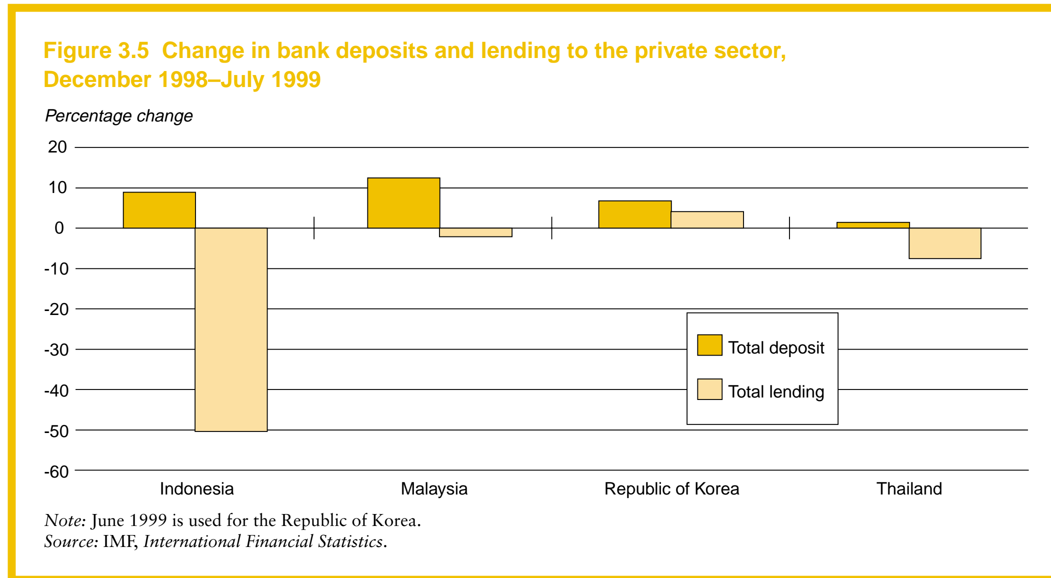


Figure 3.5 Change in bank deposits and lending to the private sector, December 1998–July 1999

Note: June 1999 is used for the Republic of Korea.
Source: IMF, *International Financial Statistics*.

problem soon. In Indonesia and Malaysia, deposits have grown significantly in 1999 (figure 3.5), reflecting a confidence in the banking systems, or at least in the governments' ability to meet their obligations to insured depositors. Increased deposits, in turn, have improved banks' liquidity, but that has not led to increased lending to the private sector. Korea, the only crisis country to experience a credit expansion, has also had the strongest recovery. Such credit expansion will continue to be necessary as Korean firms stop destocking and start rebuilding their inventories. However, with most of the banking system now owned and controlled by the government, the quality of the lending remains

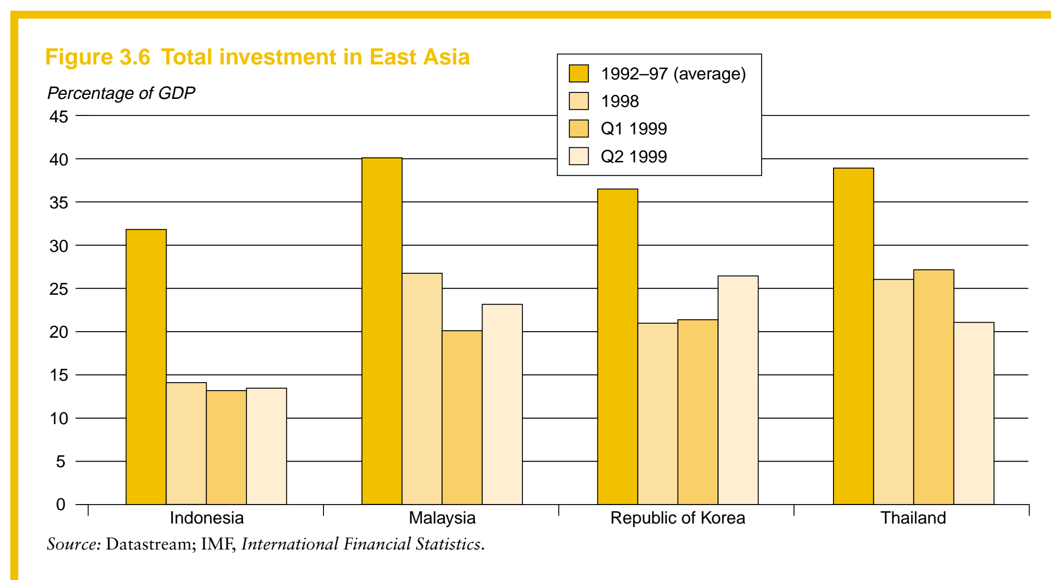


Figure 3.6 Total investment in East Asia

Source: Datastream; IMF, *International Financial Statistics*.

a concern. Korean banks hold significant deposits in the financially fragile investment and trust companies and have been under some pressure to retain these deposits.

Estimates also suggest that income generated from the difference between lending and deposit interest rates will not to be enough to deal with the nonperforming loans and the recapitalization of banks in Indonesia and Thailand (Claessens, Djankov, and Klingebiel 1999). In Korea and Malaysia, the better banks are positioned to grow out of their problems. However, even in those countries, significant distressed segments will require continued restructuring and infusion of capital. Korean banks, for example, are expected to lose 4 trillion won in 1999 to provision against stringent asset classification standards and because of increased exposure to nonperforming loans.

Fifth, some fraction of nonperforming loans are strategic—that is, borrowers can repay, but choose not to because they cannot easily be pursued by their creditors. According to informal estimates, the share of strategic defaulters in Thailand is between a fifth and a third of all defaulters. This adds to the burden on banks.

Distress, investment, and growth. A high level of distress lowers investment and growth prospects. Investment rates have fallen sharply since the onset of the crisis (figure 3.6). Relative to the average of 1992–97, the investment rate in the second quarter of 1999 was down by about 57 percent in Indonesia, 40 percent in Thailand, and 30 percent in Korea. The extent of the fall in investment is greater where the ratio of nonperforming loans is higher. Thus, distressed firms, unable to meet their debt service obligations, have been unable to obtain credit and to undertake new investment. Healthy firms have continued to invest, including in restructuring to reposition and insulate themselves from future crises. The extent of the decline in investment in Malaysia is greater than may have been anticipated by the relatively low level of nonperforming loans and by the low exposure of Malaysian banks and companies to foreign currency debt.

Where investment was initially excessive and misdirected, the fall in investment is desirable. However, a prolonged drought in investment could continue to depress growth in the short run and erode competitive ability in the long run. Moreover, the evidence shows that a decline in investment spending is associated with reduced consumer confidence and reduced consumer spending, the cumulative effect of which is to reduce growth significantly.

The fall in interest rates from the high postcrisis levels should help stimulate investment, though short-term prospects are dampened by a recent rise in the costs of capital. During the second quarter of 1999 the investment rate actually increased in Korea and Malaysia (figure 3.6). However, low levels of investment can be expected to continue in the short term, because significant capacity lies unused, corporate distress is still widespread, and continued uncertainties remain. In addition, the large fluctuations in stock market indices since the peaks reached earlier in the year (see chapter 1) and the continuing upward pressure on government bond yields imply a rising cost of capital and a higher discounting of future growth prospects.

A negative feedback loop potentially operates: distressed firms weigh down growth prospects, but it is growth that helps the firm emerge from its financial troubles. For example, a firm that is just able to service its debt before a shock and then, following the shock, misses a year's debt service finds itself in deeper trouble at the end of the year as the interest is capitalized. To meet its higher debt service obligation, the firm must grow significantly faster than the rate of interest. For a firm with high dependence on debt, a growth rate double the interest rate, continuously for two or three years, may be required to achieve positive cash flows net of interest payments.

International experience with restructuring. International experience suggests that delaying restructuring is costly. Studies of financial crises show that the average recovery

time back to trend growth rates is 2.8 years for banking crises and 1.5 years for currency crises (IMF 1998). The time required to resolve banking crises in Latin America has been longer, approximately four to five years (Rojas-Suarez and Weisrod 1996).

The Mexican experience in 1995 and the Chilean experience in 1982 offer useful lessons for East Asia. The Mexican recovery benefited from the country's participation in the North American Free Trade Agreement and from a favorable international economy. Mexico also took steps early on to resolve its banking crisis. The government carved out a substantial fraction of bad loans in the system and placed them in a special agency, the Fund for the Protection of Bank Savings (FOBAPROA), to be managed and sold.

However, despite its early and impressive recovery from the crisis, Mexico's growth performance since that time has been modest, especially in 1999. Growth has been weighed down especially by the sluggishness in the domestic economy, including the nontradable sector, and by the unwillingness and inability of the banks to lend. FOBAPROA was unable to sell virtually any of the assets it had acquired. More important, the banking sector's problems were not fully resolved and nonperforming loans continued to increase. Krueger and Tornell (1999, 33–34) find that "nonperforming loans are unlikely to disappear on their own, even under a high GDP growth scenario." The continued presence of nonperforming loans has hurt the ability of the bank sector to perform its functions adequately, with credit especially constrained to producers selling in the domestic market. The authors draw three lessons from their findings. First, the Mexican authorities could have been more ambitious in extracting problem loans from the banking system. Second, the government did not take sufficient steps to subsequently discipline the banking sector, leaving open the prospect of further bailouts. Finally, Mexico's bankruptcy procedures are still ineffective, rendering restructuring problematic.

In comparison with Mexico's recovery, Chile's recovery was much slower. Yet, despite the slow recovery, Chile has enjoyed robust and sustained growth. What explains the difference? First, although initially slow to recognize the full extent of the problem, Chilean authorities persisted in their efforts to resolve the problems of the banking sector, including undertaking measures to discipline it. Second, Chile undertook far-reaching reforms to foster capital market development and to encourage greater competition in the economy, especially in nontradable sectors such as infrastructure.

Mounting fiscal costs

The fiscal costs of the crisis are large (table 3.3). These estimated costs are illustrative and depend upon a number of assumptions, including the extent of nonperforming loans at their peak, the degree to which the nonperforming loans will have some future value, and the interest rate that the governments will need to pay for the recapitalization funds (as described in more detail in the next section, table 3.7). Keeping in view these limitations, in all countries plausible scenarios indicate that the bank recapitalization costs are significantly large in relation to existing public debt. Once again, the extent of Korea's problem is large but still modest in relation to that of others, while Indonesia's problem is the most severe. Korea has had low public debt and, while recapitalization costs are significant and may even grow, the interest burden is modest. The reported Malaysian recapitalization costs are relatively small because it is assumed that significant repayments can be collected from existing nonperforming loans. Without the ability to collect on nonperforming loans, however, Malaysian debt levels will actually be higher.

These higher debt levels can reduce growth prospects through different channels. By increasing the government demand for funds, they raise interest rates and, hence, crowd out private investment. Government flexibility to act in a countercyclical manner

Table 3.3 Public debt and recapitalization costs as share of GDP, 1998
(percent)

	Indonesia	Malaysia	Rep. of Korea	Thailand
Public debt, 1996	23.9	35.3	8.0	3.7
Public debt, 1998[a]	72.5	33.3	10.5	14.6
Estimated recapitalization costs[a, b]	58.3	10.0	16.0	31.9
Funds disbursed	10.6	4.2	12.5	23.9
Expected additional costs	47.7	5.8	3.6	8.0
Estimated debt after recapitalization	106.6	43.3	26.5	46.6
Total interest payment	16.7	3.1	1.9	5.0
Portion for recapitalization	9.2	0.7	1.2	3.4
Fiscal surplus/deficit, 1998[a]	1.4	–1.6	–2.9	–2.8
Government bond yield (percent)[c]	15.7	7.3	7.2	10.8

a. 1997 data is used for Indonesia.
b. For details on recapitalization costs, see table 3.6. For Thailand, the fiscal costs in this table include the net costs incurred for the finance companies (B600 billion) less private resources raised (B250 billion).
c. The bank lending rate is used for Malaysia.
Source: IMF, *International Financial Statistics.*

is reduced. Higher income and corporate tax rates reduce incentives to invest while higher trade taxes can lead to misallocation of resources. Note also that recent analysis has called into question the reported budget deficit estimates in the crisis countries (Kharas and Mishra 1999). The analysis indicates that the true budget deficits have been larger than reported because activities with significant financial implications have been undertaken off budget. In such a context, the rise in the debt levels could have a more serious impact on interest rates, government flexibility, and tax rates.

The focal point of restructuring: the financial sector

In contrast to corporate restructuring, which should be led by the private sector, financial sector restructuring is more the government's responsibility. Major systemwide concerns (safeguarding the payments system and restoring credit availability) and the potentially large fiscal costs are centered around banks and other distressed segments of the financial systems. Moreover, through restructuring the financial system, governments can facilitate corporate restructuring: healthy and soundly managed financial intermediaries are better positioned to negotiate with borrowers and to encourage corporate restructuring than are governments. Governments can also assist corporate restructuring by implementing policies that clarify and enforce financial claims, as discussed in the next section.

Governments in East Asia took early steps to contain the crisis by extending insurance to depositors and creditors. As the crisis spread and deepened, this was followed by the establishment of an institutional structure for managing the restructuring process and by closing, merging, and nationalizing several banks and nonbank financial companies. Significant recapitalization funds were committed, some of which have since been disbursed.

The lesson of this crisis, as well as of past crises, is that the momentum of government action needs to be maintained, while ensuring, whenever possible, that the informational and organizational capital of the financial system is preserved. Forbearance has been used to permit the graduated attainment of prudential standards, and this can have some important benefits. Judging by experience, however, continued generalized forbearance runs the risk of increasing the scale of future problems. Because governments have provided extensive guarantees to bank depositors and creditors,

Table 3.4 Institutional arrangements for corporate and financial restructuring

	Voluntary corporate workout	Asset resolution company	Agency for bank recapitalization
Indonesia	Jakarta Initiative Task Force	Indonesian Bank Restructuring Authority	Indonesian Bank Restructuring Authority
Korea, Rep. of	Corporate Restructuring Coordination Committee	Korea Asset Management Corporation	Korea Deposit Insurance Corporation
Malaysia	Corporate Debt Restructuring Committee	Danaharta	Danamodal
Thailand	Corporate Debt Restructuring Advisory Committee	Financial Sector Restructuring Authority and Asset Management Corporation (for nonbank finance companies)	Financial Restructuring Advisory Committee (funded by the Financial Institutions Development Fund)

Source: IMF 1999; World Bank staff.

on balance, it is desirable for governments to assume early responsibility for recapitalization. At the same time, measures to contain the fiscal burden should be used to signal a commitment that the government is serious about limiting further exposure through explicit or implicit guarantees. These measures include sharing in the upside of nonperforming assets that are sold, making it worthwhile for banks to recoup from defaulting debtors when nonperforming loans are left with banks, and privatizing acquired banks.

Early and strong government involvement

The East Asian economies were quick to begin dealing with the banking sector crisis by creating new institutions, reorganizing the financial sector, and creating mechanisms for asset resolution and the recapitalization of banks.

Institutions for restructuring. An impressive array of institutions has been put in place to deal with corporate and financial restructuring (table 3.4). The agencies for voluntary

Table 3.5 Structural changes in the financial system

	Closures	State takeovers	Mergers
Indonesia	64 banks (18 percent)	12 commercial banks (20 percent)	4 of 7 state banks to be merged into a single bank (54 percent)
Korea, Rep. of	5 commercial banks, 17 merchant banks, and more than 100 nonbank financial institutions (15 percent)	4 commercial banks (25 percent)	9 banks and 2 merchant banks to create 4 new commercial banks (15 percent)
Malaysia	None	1 commercial bank, 1 merchant bank, and 3 financial companies under central bank control (12 percent)	6 mergers of finance companies and commercial banks (2 percent)
Thailand	57 finance companies (11 percent) and 1 commercial bank (2 percent)	7 commercial banks (13–15 percent) and 12 finance companies (2.2 percent)	5 commercial banks and 13 finance companies into 3 banks (20 percent)

Note: Figures in parentheses refer to percentage of assets in the financial sector.
Source: IMF 1999; World Bank country reports.

corporate workouts and asset resolution have all been established since the crisis. In Malaysia the agency for bank recapitalization, Danamodal, is also new. Recapitalization agencies in the other countries have been adapted to deal with the crisis. The contrast with Japan is especially striking. In Japan, recognizing the problem took much longer, but in the crisis countries of East Asia, the problems were too severe to wait.

Reorganization of the financial sector. Even though the institutional structures for dealing with the crisis are similar, the different countries have chosen quite different restructuring options. These options range from closing nonviable financial institutions early on and disposing of their assets, to retaining the institutions but fostering strength through mergers.

The early closure option has been employed in several countries. In Thailand virtually the entire segment of finance companies was closed; in Korea select finance companies and commercial banks, and many small banks were closed; and in Indonesia several weak banks were closed (table 3.5). However, in Indonesia more than 170 banks remain even after the closures. Malaysia has not closed any of the financial institutions and is relying instead on extensive mergers of financial institutions; the government expects mergers with good banks to help resolve the problems of the poorly performing banks. The Malaysian plan to mandate the reconstitution of the entire financial sector into six groups has given way to a more flexible, but as yet evolving approach.

While Thailand has largely dismantled its nonbank financial institutions and Malaysia has decided to merge them into more viable, often parent, banks, Korea has yet to develop a strategy for this segment of the financial sector. The close ties between the nonbank financial institutions and the Korean *chaebols* has complicated and aggravated the restructuring task. For example, the absence of early restructuring at the second largest *chaebol*, Daewoo, led to a significant deterioration in the financial status of nonbank financial companies. These institutions, moreover, were not subjected to the necessary discipline and continued to lend to Daewoo, even while its viability was in question. The revelation of that debt's unsustainability casts the main shadow on Korea's recovery.

Since governments have become substantial owners of the banking systems through their direct takeovers and recapitalization initiatives, the reprivatization of these institutions poses a major challenge that will influence the long-term structure and performance of the financial sectors. So far, efforts at privatization have encountered problems, partly as a result of the continued growth of nonperforming loans, which new acquirers have difficulty valuing. The recent experience suggests that differences in perceptions of value can be large. The protracted negotiations for the sale of Korea First Bank centered around the valuation of nonperforming loans that had not been carved out or revealed and on the extent of continued government obligations to assume nonperforming loans following the privatization. With Daewoo as a principal client of Korea First Bank, the uncertainties in valuation were not altogether surprising. The sale of Seoul Bank has, for the present, been deferred. In Indonesia and also in Thailand, sales of banks have stalled for similar reasons. While several possibilities exist in Thailand, so far in 1999 two small nationalized banks have been sold, with substantial government injection of funds or commitment to assume responsibility for further growth in nonperforming loans.

Asset resolution mechanisms. The two extreme choices for asset management strategies include setting up a government agency with the full responsibility of acquiring, restructuring, and selling the assets or letting banks manage their own nonperforming assets. A specialized agency may be required when the task of dealing with nonperforming loans is fundamentally different from that of making new loans and banks possess limited management capacity with a comparative advantage in new lending. However, justification

for that agency to be government-owned and -operated arises either when extrajudicial powers are required to deal with the nonperforming loans problem, or when there exist significant economies of scale in asset management that cannot be realized by private contracting. Intermediate approaches include those employed in Thailand with the government principally acting as an intermediary for the market-based sales of nonperforming assets or facilitating private asset management through tax incentives.

Governments removed a significant share of nonperforming loans from the financial system and transferred them to government agencies: 26 percent ($37 billion) in Korea, 66 percent ($28 billion) in Indonesia, and 50 percent ($11 billion) in Malaysia (Claessens, Djankov, and Klingebiel 1999).[6] In Thailand, the entire assets of 57 nonbank finance companies (over $20 billion) were transferred to the Financial Sector Restructuring Authority, followed by the only significant subsequent resale of nonperforming assets. However, the Thai government has not acquired the nonperforming assets of commercial banks.

Government ownership or management of a specialized asset management company may be justified if it is given administrative powers that overcome the higher transaction costs of the regular bankruptcy and judicial system. In Indonesia and Malaysia, the Indonesian Bank Restructuring Authority and Danaharta, respectively, have extrajudicial powers to receive compensation from debtors. Malaysia's Danaharta also plans to take a more active role in restructuring assets before selling them. Through restructuring of the assets prior to their sale, the expectation is that value will be enhanced. The evidence on successful restructuring by a government-run asset management company for loans other than for real estate is, however, weak (Klingebiel 1999). The realization rate by Mexico's FOBAPROA is expected to be in the low single digits. The resources and skills required for success restructuring of assets are demanding. In fact, government agencies can reduce the effectiveness of market-based solutions. The terms offered by Danaharta to banks—for example, special provisioning requirements and generous share of recovered amounts—has implied that private buyers of distressed debt have essentially been priced out, thus reducing the space for market-oriented restructuring.

In Korea, and especially in Thailand, alternative market-based approaches are being attempted. The speed at which the Financial Sector Restructuring Authority in Thailand operated was noteworthy. The realization rate of 25 percent was low, but there is no evidence that waiting would have increased it. In Korea, the Korea Asset Management Company, which acquires the nonperforming loans, expects to delegate the task of managing and

Table 3.6 Estimated recapitalization costs for commercial banks, mid-October 1999

	Estimated costs	Amount disbursed			Remaining fiscal costs as percentage of GDP
		Local currency	U.S. dollars	Percentage of GDP	
Indonesia	550 trillion rupiah	100 trillion	14 billion	11	48
Korea, Rep. of	72 trillion won	56 trillion	47 billion	13	4
Malaysia[a]	31 billion ringgit	13 billion	3.4 billion	4	6
Thailand[b]	1,121 billion baht	751 billion	11 billion	16	8

a. Estimated costs include those to be incurred by Danaharta for purchasing nonperforming loans (15 billion ringgit) and recapitalization funds injected by Danamodal (16 billion ringgit).
b. Amount disbursed includes significant private sector funding of recapitalization, as discussed in the text.
Note: These are illustrative numbers based on varying assumptions of recovery of nonperforming loans, as discussed in the text.
Source: Central bank data.

selling these loans to private contractors. For commercial banks in Thailand the government is providing special tax incentives to privately run asset management companies.

Recapitalization of commercial banks. All the crisis countries have taken significant initiatives toward injecting new funds into their banking systems (table 3.6). Except in Thailand, governments have been the dominant source of funds. In all countries, however, much remains to be done.

Reported estimates of recapitalization costs vary significantly, in part because the strategies are complex, but also because important judgments are required to arrive at a final number. First, a judgment is required on whether nonperforming loans will continue to increase. Some estimates suggest that they will in both Korea and Malaysia, but have reached their peak in Indonesia and Thailand (Warburg Dillon Read 1999). Second, a judgment is required on what fraction of the nonperforming loans will eventually be recovered. This judgment is perhaps more difficult to make than the first. The estimates of recapitalization costs in table 3.6, which are based on official country sources, assume that the recovery rate on nonperforming loans will be around 50 percent in Korea and Thailand, about 70 percent in Malaysia, and less than 25 percent in Indonesia. The range reflects assumptions about economic growth and interest rates and also about the intrinsic worth of those assets. Auctions of distressed assets conducted in Korea and Thailand caution that the realization rates may be lower than currently anticipated. In both countries real estate loans have sold for about 50 percent of the original value of the loan. Loans based on automobile hire-purchase contracts have been similarly discounted. Commercial or business loans have fared substantially worse, with realization levels typically in the 20 percent range. When all loans sold are added up, the realization rate in Thailand has been approximately 25 percent.

The pressure on Thai fiscal resources has been mitigated through private efforts to raise capital, which has amounted to about B250 billion, or about one-third the amount so far disbursed. The Thai government has set aside B300 billion in a scheme to provide matching funds for privately raised capital. However, only B32.5 billion have been used by private banks because the government funding was tied to management changes, which has led to private solutions. Privately funded recapitalization through equity issues and innovative debt instruments has, therefore, been more extensive in Thailand than elsewhere. While such private solutions are desirable, thus far they have resulted in high costs of funding, which is unlikely to heal the cash flows of the already distressed banks.

Government funds for augmenting the balance sheets of banks have been the smallest in Malaysia, where about RM13 billion (4 percent of GDP) were disbursed by July 1999 through Danaharta's purchase of nonperforming loans and through capital injections via Danamodal. Malaysia's smaller costs in relation to GDP reflect both the smaller shock Malaysia's financial system faces relative to other countries and the precrisis levels of capitalization, which were, on average, higher than in the other crisis countries. However, costs will be greater if the nonperforming loans continue to rise, as some observers expect, and also if the realization rates on these loans are lower than those currently assumed. For funding the recapitalization, Malaysia has relied on zero-coupon bonds—that is, on bonds that pay no interest on an ongoing basis. While this alleviates short-term fiscal costs, the repayments will be bunched and, therefore, presume either significant economic growth or the continued ability to roll over the debt.

Complex tradeoffs for policymakers

While the achievements thus far have been significant, major challenges remain. Large segments of the banking systems remain undercapitalized and, except in Korea, banks have been reluctant or unable to increase their stock of loans. The institutional structure created to deal with the crisis has few "sticks" to

force the pace and has, consequently, not counteracted creditors' and debtors' natural tendency to wait (box 3.1). With fiscal costs rising and some of the more difficult problems still ahead, governments face the complex task of managing their fiscal costs while also ensuring the continued integrity of, and in some cases the strengthening of, their countries' financial systems. Yet experience has shown that a loss of political momentum in dealing with the problems is only likely to aggravate them.

Forbearance versus recapitalization. In the wake of a crisis, the objective of bank restructuring should be to maintain the flow of credit while ensuring that the new lending is prudent (Stiglitz 1999). Achieving this objective presents different options. Lending could be encouraged by exercising regulatory forbearance. However, the evidence does not suggest that simply encouraging voluntary workouts while engaging in regulatory forbearance leads to a resumption of lending. In fact, the experience from past systemic crises warns that forbearance without tight oversight could make matters worse. At the same time, the alternative strategy of government-financed recapitalization could stimulate new lending, but may entail large fiscal costs and may reduce incentives for prudent lending. Both forbearance and government bailouts may undermine the regulatory challenge of building a sound and competitive financial system.

While all countries have updated their financial sector regulatory systems to be more in line with international reporting standards and prudential norms, varying degrees of regulatory forbearance are in place to permit a graduated achievement of these norms. These apply, for example, to the following:

- Less stringent recognition of nonperforming loans (as in Malaysia, where loans are considered nonperforming if they have not been serviced for six months rather than three months elsewhere)[7]
- Relaxed provisioning against the nonperforming loans (as in Korea, where loans considered restructured have very low provisioning when, in fact, they remain extremely risky)
- Breathing room to achieve capital adequacy standards (especially in Indonesia and Thailand).

There are important reasons for exercising forbearance. First, bank restructuring and corporate restructuring through a workout program are inextricably tied to each other with respect to incentives. The banks need to have incentives to take the debtors through the workout process, which is often difficult, protracted, and costly. Also, workouts often take place while the bank itself is undergoing restructuring and is under severe pressure to meet capital adequacy ratio requirements. Banks need to be encouraged to reach a restructuring agreement with the debtor that is realistic and that matches the debtor's ability to repay. Reassurances from regulatory authorities of capital adequacy forbearance can help. Otherwise, banks will be tempted to paper over their agreements with their debtors and not to recognize the true extent of potential portfolio losses. As such, initial forbearance may have been the most realistic response to systemic crisis and simultaneous distress among hundreds of large corporations and thousands of smaller ones. Second, in the absence of forbearance, the alternative may be to close down an institution, which creates a bankruptcy cost—that is, the constituent elements of a closed institution may sell for less than the institution's value as an ongoing entity.

However, the evidence suggests that, while selective forbearance of relatively sound banks and securitized transactions may be appropriate, continued generalized forbearance could ultimately prove costly. The timely adoption of more stringent accounting standards for restructured debt is needed. Forbearance does not create stronger balance sheets, which are required to meet the new working capital needs of firms in distress. Rather, it dilutes the banks' incentives to negotiate more forcefully with

the controlling shareholders of distressed corporations and leads to an unrealistic assessment of recapitalization needs. The overwhelming international experience is that forbearance, on balance, works to delay, but not to heal (Kane 1989; Brinkmann, Horvitz, and Huang 1996; and Sheng 1996).

Government financed recapitalization also presents difficult tradeoffs. Early recapitalization can release capacity for new lending that permits a broad-based recovery. "An essential element of banking reform is recapitalization of the banks with enough income earning assets to leave a prudential capital base in place after provisioning for bad loans" (van Wijnbergen 1998, 11). However, recapitalization of the financial system generates not only immediate fiscal costs, but also creates a moral hazard for the future. Early resolution of the problems is favored, because the dilemma can typically be expected to worsen. Firms with heavy debt burdens, unable to obtain new financing and hence unable to grow, find their debt burden increasing over time, thereby increasing the extent and severity of nonperforming loans at banks (Stiglitz 1999). Delays may also contribute to a culture of debt default, further aggravating both the size of the problem and the uncertainties in the timing of government outlays.

Under the circumstances, an early recognition of the governments' fiscal obligations is needed not just to honor their commitments to depositors, but also to create the basis for market-led restructuring. To protect depositors, banks can, for example, be "paid" with government bonds, the interest on which can be combined with a portion of the net earnings to service the interest claims of depositors. Bonds should also be tradable to permit repayment where depositors decide to take their savings elsewhere. At the same time, as safe assets, the bonds on the balance sheet of the banks would greatly improve the capital of the banks. This should improve the incentives of banks to recognize losses without fear of depleting capital to an unsustainable level. Such recognition should, in turn, improve the efficiency of the corporate restructuring process. In addition, if governments can credibly commit to refrain from further bailouts, incentives for further risky lending would decline.

Recovering recapitalization cost. The cost of recapitalization can be lowered through incentives to encourage increased reflows from the nonperforming assets. Government support could be conditional on contractual provisions that share in the success if asset values recover. For example, when Chrysler Corporation was bailed out in the United States, the government obtained warrants as a quid pro quo that could be exercised at favorable value in the event of a recovery. Similarly, when a bank retains a nonperforming loan to benefit from government recapitalization, the proceeds from any recovery could be shared with the bank managing the loan. Such a provision was used in Chile. Finally, the privatization of government-acquired banking institutions remains a priority, both to recover fiscal outlays and to lay the foundation for private risk bearing. Especially in Malaysia, which envisages an extensive merger program, but also in other countries the objective of containing fiscal costs and restructuring the banking sector may be combined. In place of administratively mandated mergers, governments could use the sale of their ownership stakes to promote market-based mergers.

The role of deposit insurance role in crisis situations.[8] An explicit system of deposit insurance put in place when the banking system is in sound health should, in the event of a crisis, deal with its obligations early to contain the crisis. However, extending the system of deposit insurance after the onset of a crisis creates bad incentives (Garcia 1999). In Indonesia unconditional and comprehensive guarantees were extended to all parts of the system, which was soon revealed to have deep-seated problems. Guarantees were even extended to some depositors of the 16 banks that had been closed down before the guarantee scheme was announced. In Thailand a July 1997 cabinet decision partially guaranteed depositors and creditors of the 57 finance companies that were

subsequently closed down; this was followed by a blanket guarantee covering all depositors and creditors of the remaining finance companies and commercial banks (IMF 1999). Evidence from other postcrisis situations suggests that imposing losses on depositors and creditors need not lead to panics and bank runs.[9]

Corporate restructuring: some progress, but a long way to go

Government funds are not required for corporate restructuring, and their supply may even hinder private resolution as stakeholders are induced to seek these subsidies. The proper role for governments is to facilitate resolution of financial claims and foster the reallocation and mobility of assets. In the absence of efficiently functioning systems to resolve financial claims, governments in all the crisis countries have instituted out-of-court mechanisms to encourage financial settlements. Beyond these immediate measures, but also aiding in the short term, are ongoing efforts to achieve effective bankruptcy regimes and improved accounting standards. Once financial property rights have been clarified, the market system and the private sector should be in a position to undertake the required reallocations of productive assets, but governments can play an important role in permitting greater asset mobility. The Japanese experience shows that without fundamental reforms to foster asset mobility through bankruptcy processes and mergers and acquisitions policies, corporations may be slow to undertake significant restructuring (box 3.2). That experience, though, also shows that success requires continuing procedural innovation and adaptation to meet the evolving needs of the corporate sector.

Slow resolution of financial claims

Immediately following the crisis, governments in the crisis countries helped establish out-of-court mechanisms (see table 3.4) that could speed up the settlement of financial claims in the absence of bankruptcy regimes able to handle the large-scale distress. These mechanisms have been slow to produce results, in part because they depend on moral suasion. However, progress has been achieved in Korea and Malaysia. At the same time, account-

Table 3.7 Restructuring: out-of-court and in-court progress, August 1999

	Indonesia	Malaysia	Rep. of Korea	Thailand
Out-of-court procedures				
All or the majority of financial institutions signed on to accord	No	Yes	Yes	Yes
Formal process of arbitration exists, with deadlines	No	Yes	No	Yes
Provision of penalties for noncompliance	No	No	Yes	Yes[a]
Out-of-court restructurings				
Number of registered cases	234	53	92	825
Number of cases started	157	27	83	430
Number of restructured cases	22	10	46	167
Percentage of restructured debt in total debt	13	32	40	22
In-court restructurings				
Number of registered cases	88	52	48	30
Number of cases started	78	34	27	22
Number of restructured cases	8	12	19	8
Percentage of restructured debt in total debt	4	..	8	7

.. Not available.
a. In Thailand, penalties for noncompliance were introduced in August 1999 for creditors who had signed intercreditor agreements.
Source: Claessens, Djankov, and Klingebiel 1999.

Box 3.2 Redeployment of assets: lessons from Japan

Restructuring in Japan is finally beginning under the immense pressures of a long recession, but it is being helped by improved regulations governing bankruptcy and mergers and acquisitions. Japanese businesses are restructuring at a faster pace than during past economic downturns. Mergers and acquisitions are occurring in numbers unprecedented for Japan, while the debt associated with bankruptcies has also hit new highs. The unemployment rate is at a postwar peak, with more than 1 million jobs lost in the last 18 months alone. This contrasts with the 1990–91 recession, when Japanese firms were much more reluctant to reduce their work force. Companies are also shedding cross-held shares and major corporations are shutting down subsidiaries, closing operations, and selling off unprofitable businesses.

The Japanese experience offers several lessons. Delays in restructuring weak banks and corporations can contribute to long periods of low growth. Absent active governmental effort, an inadequate institutional infrastructure for resolving financial claims can persist even in an industrial country. Moreover, effective redeployment of assets through bankruptcy processes and mergers and acquisitions requires an ongoing adaptation of regulations, and changes in business practices, as constraints are revealed.

Bankruptcy. Until the early 1990s, approximately 15 percent of broadly defined business failures involved formal bankruptcy proceedings. The proportion has risen in recent years to 30 percent, as larger firms are now failing. These firms are more likely to prefer the protections and safeguards of courts over the cheaper and faster proceedings of private negotiations. For small firms, private procedures typically implied a freezing of credit and the cessation of operations, which is the worst possible social outcome.

Gatekeeping procedures in Japanese law and regulations act as a barrier to court actions. Advance deposits for court costs are especially onerous for small firms. Japanese courts can take a few months to determine if a bankruptcy petition meets certain conditions, and they do not issue an automatic stay, rendering firms vulnerable to raiding by creditors.

Several changes are being proposed to make bankruptcy procedures more efficient. In April 1998 the Justice Ministry proposed revisions to integrate the five laws governing corporate bankruptcy into a single law. Many of the changes are aimed at making formal bankruptcy more accessible to small firms. Officials have sought to enhance the prospects of reorganization rather than liquidation. The current law permits applications for reorganization only after a firm is virtually insolvent, favors change in

ing standards and bankruptcy systems, where needed, have been reformed, which may also help resolution of financial claims in the short run and may provide a sounder basis for improved corporate governance in the long run.

Voluntary workout mechanisms. Voluntary mechanisms rely on the so-called London Approach and provide a framework within which claims can be settled.[10] While the details vary across countries, their main features include: binding agreements on the part of banks to participate in and honor the agreements, with some possibility of penalties if agreements are not adhered to; timetables to achieve resolution; and standardized agreements between debtors and creditors and, equally important, between creditors themselves. The main characteristics of such mechanisms across countries and their achievements are described in table 3.7.

Korea and Malaysia appear to have benefited the most from these out-of-court mechanisms, in part because they have more binding agreements among banks. In Korea, penalties exist for noncompliance, while Malaysia has well-defined implementation schedules. Thai procedures, though similar to those of Malaysia, have achieved less, reflecting the deeper

Box 3.2 (continued)

management, and requires a reorganization plan at about the same time as the bankruptcy petition. Under the proposed approach, companies could apply to the courts for protection with more of their assets intact, keep their management in place, and receive more time to draw up a turnaround plan. Also included in the proposal is the shortening of the period of asset assessment from the current three to seven months to one month. Other changes call for greater information disclosure and removal of barriers to selling parts of a company.

Mergers and acquisitions. Mergers and acquisitions are on the rise in Japan, though their importance to the economy is still a small fraction of that in the United Kingdom or the United States. The value of foreign takeovers in Japan rose from $1.1 billion in 1997 to $6.9 billion in 1998, and then shot up to $7.1 billion in just the first quarter of 1999. Similarly, domestic mergers and acquisitions have also risen briskly.

For years, mergers and acquisitions were a mark of failure associated with companies on the verge of bankruptcy, but there were also real economic barriers. The lack of transparency in the books of potential targets was a serious problem. For example, a department store with a strong franchise and substantial real estate assets found no buyers because the scale of off-balance sheet guarantees provided by the store was large and uncertain. Another problem was the widespread system of cross-shareholding. The practice of mutual shareholding, initiated in the 1970s, was designed explicitly to ward off undesired acquisitions.

However, economic forces are eroding barriers to mergers and acquisitions, aided by the decline in cross-shareholdings and facilitated by regulatory changes. Many Japanese companies, especially family-owned businesses established in the early postwar period, are seeking injections of capital, as operating losses and write-offs of bad assets have been a drain. Cross-shareholdings are being eliminated, as the returns on these equity holdings have been persistently low or negative. At the same time, many regulatory constraints on business activities are being removed, and specific measures to facilitate mergers and acquisitions are being instituted. For instance, a 1997 amendment of the Commercial Code by the Japanese Diet reduces the number of shareholder meetings to approve mergers. The Holding Company Law of 1997 removes constraints on carving out subsidiaries for sale and allows buyers more freedom in structuring their acquisitions. The securities transaction tax formerly required when an acquisition involved share purchases was discarded in April 1999. In addition, the moves to international accounting principles and, in particular, consolidated reporting, are bringing more transparency to the operation of subsidiaries.

Source: Alexander 1999.

problems of Thai restructuring and the relative weakness of the bankruptcy regime in that country. Stronger procedures recently included in Thailand—penalties for noncompliance by creditors who have signed intercreditor agreements—should help force the pace.

While the progress achieved is significant, it is premature to judge the quality of these restructurings and the impact that they will have on the debt resolution problems. A waiting strategy is reflected in the use of instruments that postpone the repayment of debt and has been especially evident in, though not confined to, Malaysia. The Malaysian Corporate Debt Restructuring Committee, which oversees the voluntary debt workout program, had, by June 1999, helped reschedule approximately RM11 billion of debt (EIU 1999a). Of that amount, RM8.5 involved the issuance of a seven-year zero-coupon bond to purchase the existing debt of Renong Corporation and its subsidiary, United Engineers Malaysia. The Ratings Agency of Malaysia has assessed that Renong and United Engineers Malaysia will be unable to pay the debt and would, consequently, need to refinance 60 percent of the debt outstanding at the time the bond matures. According to Claessens, Djankov, and

Klingebiel (1999), two-thirds of the restructuring agreements in Korea involve a combination of interest rate reduction, capitalization of the interest rate, and longer grace periods.[11] In Thailand the quality of the restructuring agreements has been such that 13 percent of the restructured debts have already reverted to nonperforming status. Note also that reported nonperforming loans do not yet register the impact of agreements. This may partly reflect a statistical reporting lag, because nonperforming loan data may not yet have been updated to reflect the agreements, or because weaknesses exist in the agreements themselves.

Bankruptcy reform. By creating a legal basis and orderly mechanisms for the resolution of debt defaults, bankruptcy procedures can provide the stick that complements voluntary restructuring initiatives in the crisis countries. Effective bankruptcy systems should resolve the conflicting claims of stakeholders on the assets of insolvent corporations. They should help preserve and quickly restructure viable firms as ongoing entities and should result in the expeditious liquidation of nonviable firms.

Indonesia and Thailand have implemented significant legislative changes since the onset of the crisis. Korea and Malaysia, in contrast, have relatively sophisticated bankruptcy codes. In Korea, the law, though well established, is also thought to be complex in its implementation and to favor debtors excessively (see *The Economist* 1999). Thus, except in Malaysia, the bankruptcy process is unlikely to play a significant role in resolving the present debt overhang.

To a greater extent than in other countries, procedural capacity in Indonesia remains a bottleneck to the effective enforcement of insolvency laws. In August 1998 Indonesia amended its bankruptcy legislation, creating, in particular, a specialized commercial court with jurisdiction over all bankruptcy-related matters and subject to review only by the Supreme Court (Mojdehi and Ito 1998). The amendment also created expedited timetables and introduced a stay provision similar to that under the U.S. Bankruptcy Code. At the same time, the voluntary workout mechanism under the Jakarta Initiative Task Force (see table 3.4) is helping to develop precedents for dealing with complex debt renegotiations. In practice, however, the amended bankruptcy law has not succeeded in alleviating the widespread corporate and financial distress. Realistically, the bankruptcy court can help only modestly in the present crisis by pronouncing in a consistent manner on a select number of cases. The vast majority of the 15,000 nonperforming loans will be settled out of court.

The early workings of a new bankruptcy regime is expected to be frustrating. In adopting a comprehensive bankruptcy law, Hungary experienced a crush in the tumult of the early postcommunist years. Due to an automatic trigger that required all firms with arrears of more than 90 days to file for either reorganization or liquidation, Hungarian courts were overwhelmed by some 22,000 bankruptcy cases soon after the law's enactment (Gray, Schlorke, and Szanyi 1996, 425). While the experience "indisputably spurred institution building in the courts, the trustee profession, and the banks," during a crisis, the formal judicial process will clearly be overwhelmed in most developing and transition countries.

The Thai experience, however, shows that, despite the many constraints, pushing ahead with improvements in bankruptcy code procedures can bring benefits. In Thailand a controversial piece of legislation has sought to enforce the rights of creditors more forcefully, including enforcing rights to personal guarantees that served as collateral. A study examined the relationship between the progress of Thai bankruptcy legislation and the equity valuation of financial and nonfinancial companies (Foley 1999). Announcements indicating a potential strengthening of bankruptcy laws enhanced the equity values for both debtors and creditors. In other words, market participants do not view a stronger bankruptcy law as a zero-sum outcome where creditors gain and equity holders lose. Rather, both can

gain, though creditors are likely to benefit more. The positive gain for all parties implies that inefficient and protracted bankruptcy proceedings have a real economic cost.

A short-term agenda for bankruptcy reform requires further development of informal, extrajudiciary processes to resolve problems, in parallel with and as a complement to, the formal insolvency process. In addition to the government-sponsored workout mechanisms, prepackaged bankruptcy procedures can speed things up. Under prepackaging, the parties involved agree to the terms of the workout, and the court then uses an expedited procedure to bind a dissenting minority and to formalize the agreement. Perhaps more so than in industrial countries, out-of-court settlements may also include methods for auctioning the rights to the firm (see Bebchuk 1996; Hauch and Ramachandran 1999). Auction procedures can help both to maintain seniority among creditors and to reveal the value of the firm.

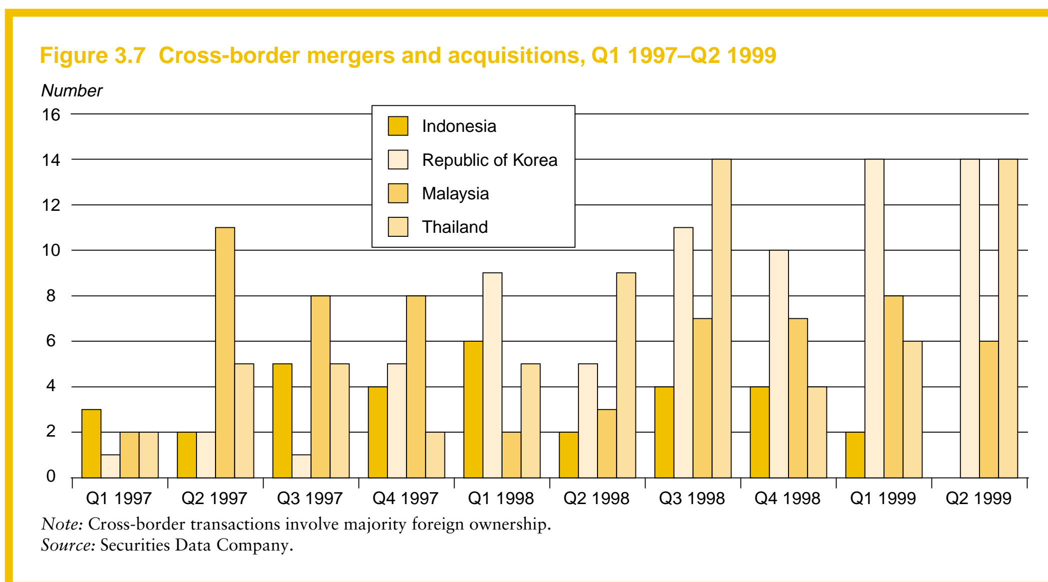
The bankruptcy process is especially prone to fraud, and the absence of adequate accounting standards makes the difficult problem of asset valuation even more complex. This underscores the urgent need for accounting and corporate governance reforms. A more immediate task may be to create greater transparency in the appointment of judges and to require the publication of decisions along with detailed rationales for those decisions.

Enhanced asset mobility

Once the financial claims on a company are resolved, market-driven mechanisms will probably reallocate the resources to their best uses. Additional government interventions may, however, be justified by the existence of institutional and market failures, such as monopolies and weak competition, cross-holdings and connected lending, or labor market rigidities. These imperfections, which were often the source of resource misallocations prior to the crisis, also now hinder the required process of reallocation.[12]

Of special importance are policies facilitating mergers and acquisitions and encouraging foreign direct investment. East Asian governments have taken several steps to encourage mergers, both international and domestic. Also, foreign investment has been liberalized in all the countries, though to vary-

Figure 3.7 Cross-border mergers and acquisitions, Q1 1997–Q2 1999



Note: Cross-border transactions involve majority foreign ownership.
Source: Securities Data Company.

Table 3.8 Illustrative postcrisis policy reforms in crisis countries

	Corporate governance	Loss allocation and transfer	Factor mobility
Indonesia	Presence of a corporate secretary to improve disclosure Bankruptcy Law updated (August 1998) Code of best practice for corporate governance (in progress)	Tax exemptions for loan-loss reserves held by banks (March 1998)	Relaxation of foreign ownership restrictions (September 1997) Tax exemptions of up to 8 years for new investments in 22 industries (January 1999)
Korea, Rep. of	Restrictions on cross-debt guarantees (April 1998) Enhancing institutional voter rights (June 1998) Introduction of international accounting standards (August 1999) Lowering the minimum equity holding requirement to exercise shareholder's rights (1999)	Revaluation and adjustment of capital and foreign exchange losses (August 1999)	Introduction of Foreign Investment Promotion Act (November 1998)
Malaysia	Creation of High-Level Finance Committee on Corporate Governance Code on takeovers and mergers with stricter disclosure standards (January 1999)	Reduction of corporate tax rate from 30 percent to 28 percent (October 1997) Tax exemption on interest from NPLs (effective for 1999 and 2000)	Reduction of real property gains tax rate from 30 percent to 5 percent for nonresidents on the sale of a property held for a minimum of five years (October 1997) Exemption of real property gains tax on mergers of financial institutions (October 1998)
Thailand	Financial statements of public companies and financial institutions to be in accord with international best practices (1999) Requirement of board audit committees (1999) Bankruptcy and foreclosure laws amended (March 1999)	Elimination/deferral of income tax and taxes on asset transfer and unpaid interest (January 1999) Introduction of new asset depreciation method (March 1999)	Alien Business Law (August 1998, revised in October 1999) Tax-free mergers and acquisitions in cases of 100 percent mergers (January 1999) Introduction of Equity Fund, Thailand Recovery Fund for large- and medium-scale companies, and Venture Capital Fund for small and medium-size enterprises (March 1999) Reduction of real estate transfer fee from 2 to 0.01 percent of the appraised value (March 1999)

ing degrees. As with bankruptcy, success of mergers and acquisitions depends heavily on procedural simplicity and clarity (see box 3.2 on the Japanese evolution in this respect). Reforms following the crisis also included short-term tax measures to facilitate asset transactions and, more importantly from a long-term perspective, better accounting standards, which should contribute to improved corporate governance through better evaluation of financial assets and liabilities (table 3.8).

Mergers and acquisitions. Since their crises in 1997, Korea and Thailand have introduced various measures to encourage business consolidation, leading to a rapid rise in cross-border mergers and acquisitions in these two countries (figure 3.7). The Korean government

released a new legislative framework in July 1999 to reduce transaction-related taxes incurred in corporate mergers, acquisitions, and restructurings. For domestic transactions, the government has provided tax exemptions and deferrals on capital gains from so-called "big deals"—that is, exchange of businesses through the transfer of shares. Thailand approved a set of new measures in January 1999, including temporary measures (expiring on December 31, 1999) to lower taxes on gains to debtors from the write-off of debts and on asset transfers from debtors to creditors. Permanent measures in Thailand are designed to facilitate mergers and business reorganization.

Unlike in Korea and Thailand where cross-border mergers have shot up, in Malaysia cross-border mergers and acquisitions have been low compared to just prior to the crisis. Malaysia has, however, had high levels of domestic mergers and acquisitions.[13] Malaysia's Promotion of Investment Act of 1986 and other measures provide various tax incentives, including investment tax allowances in the services sector. The high level of domestic merger and acquisitions activity in Malaysia suggests that the policy regime is basically a friendly one. Cross-border activity has been relatively low, possibly on account of restrictions on the repatriation of earnings (though the long-term effects of these restrictions await further empirical examination).[14]

In contrast, the Indonesian system appears not to favor mergers and acquisitions. Gains from transfers of assets in corporate reorganizations are taxable, and companies cannot transfer tax losses in a liquidation process, merger, or acquisition (Asia Law 1998). Certain exceptions apply only to banks, financial institutions, and companies going public. Merger and acquisitions activity has remained at extremely low levels.

Foreign direct investment. Foreign direct investment (FDI) inflows to Korea and Thailand increased in 1998 by 82 percent and 26 percent, respectively, and flows to these countries continued at high levels in 1999 (table 3.9). Both countries have taken effective measures to deregulate and liberalize their foreign investment policies since late 1997. Note, however, FDI includes mergers and acquisitions involving existing enterprises as well as new, or greenfield, investments. The FDI trends, therefore, reflect in part the trends in cross-border mergers and acquisitions described in the previous section (figure 3.6).

Korea has opened several sectors to foreign investors since April 1998, including various property businesses, securities dealings, and other financing businesses. The ceiling on foreign stock investment was abolished as of May 1998, granting foreign investors the right to purchase all the shares of a domestic firm. Meanwhile, the Foreign Investment Promotion Act of November 1998 affords protection for foreign direct investment through national treatment, the reduction and exemption of certain corporate taxes, the provision of financial support for local governments to attract foreign direct investment, and the establishment of foreign investment zones.

In Thailand the Board of Investment has eased its regulations to promote foreign par-

Table 3.9 FDI flows in East Asia, 1992–99
(billions of U.S. dollars)

	1992	1993	1994	1995	1996	1997	1998	Q1 1999	Q2 1999
Indonesia	1.8	2.0	2.1	4.4	6.2	4.7	–0.4	–0.03	—
Korea, Rep. of	0.7	0.6	0.8	1.8	2.3	2.8	5.1	1.0	1.8
Malaysia	5.2	5.0	4.3	4.1	5.1	5.1	5.0	—	—
Thailand	2.1	1.8	1.4	2.1	2.3	3.8	6.8	1.0	2.2

— Not available.
Source: World Bank Debtor Reporting System; IMF, *International Financial Statistics.*

ticipation in the economy. The 20-year-old Alien Business Law was replaced in August 1998 (and has since been revised again in October 1999) to incorporate sectoral liberalization measures. Under the August 1998 provisions, foreign firms are allowed to hold up to 100 percent equity in banks and in finance companies for up to 10 years, and 39 sectors have been opened for increased foreign participation, including transportation and pharmaceuticals production. Policy liberalization includes a temporary measure introduced in November 1998 (expiring in December 1999) allowing foreign firms to own a majority stake in joint ventures that received favorable policy treatment, and authorizing them to distribute their products domestically. In the meantime, the proposed cutback of import tariffs is expected to help reduce production costs for both domestic and foreign firms dependent on imported raw materials and intermediate products.

Mirroring the trends on cross-border mergers and acquisitions, foreign direct investment inflows into Malaysia, though traditionally high, have not responded as they have in Korea or Thailand, and flows have fallen sharply in Indonesia. In Malaysia new efforts to attract foreign investments have been undertaken; for example, restrictions on foreign holdings in new export-oriented manufacturing projects have been suspended until 2000 and foreign ownership limits have been relaxed. However, the value of approved projects during January–May 1999 at RM6.4 billion remained at the same annualized rate as in 1998; the value of new FDI applications fell over the six month period to RM3 billion, compared with RM12.6 billion for calendar 1998. In Indonesia the value of approved and realized foreign direct investment declined by 80 percent in the first quarter of 1999. Indonesia has recently started to implement new incentives to attract foreign investors. Foreign ownership of up to 99 percent of banks has formally been effective since May 1999. In June 1999 a new decree was announced to allow shareholdings up to 100 percent in existing establishments and to provide a clearer legal framework for the conversion of bonds issued locally into equity.

Notes

1. Although East Asian firms, including those in the crisis countries, have been adept at adopting new manufacturing techniques, they have faced continuing challenges both from low-wage producers and from Japan (see Mody, Suri, and Sanders 1992).

2. Such a financial accelerator has been documented, for example, by Bernanke, Gertler, and Gilchrist (1996, 2) who conclude: "A fall in the borrower's net worth, by raising the premium on external finance and increasing the amount of external finance required, reduces the borrower's spending and production. This last result is the heart of the financial accelerator: To the extent that negative shocks to the economy reduce the net worth of borrowers (or positive shocks increase the net worth), the spending and production effects of the initial shock will be amplified." Small firms are especially prone to the downward spiral of the financial accelerator, but large, credit-constrained firms operating on thin margins may be equally vulnerable.

3. While Thailand's relative position on the two scales is the same, the share of Thai firms unable to pay debt, 28.3 percent, is much lower than the 45 percent of nonperforming loans in Thailand, unlike countries where the ratios are quite similar. This may reflect, in part, the phenomenon of Thai strategic defaulters—that is, those able to, but not paying, their debts. In addition, small, unlisted firms contribute heavily to Thai nonperforming loans. However, Mako (1999) reports that even among listed firms, about half were unable to pay their debt, a ratio more consistent with nonperforming loans.

4. In the Scandinavian banking crises of the late 1980s and early 1990s, the share of nonperforming loans ranged from 5 to 7 percent, and these loans mainly represented failed real estate lending. Even in Chile, at the onset of the early 1980s crisis, nonperforming loans were about 5 percent of all loans.

5. Official numbers on nonperforming loans are less readily available for Indonesia. However, the percentage is generally regarded as in the range of 50 percent and is expected to rise to more than 60 percent before falling.

6. In Malaysia, unlike in the other countries, Danaharta has not only purchased some of the nonperforming assets, but also is a management agent for the restructuring of nonperforming assets.

7. The more stringent definition of nonperforming loans is, however, still used for supervision.

8. The principles for creating a competitive but sound financial system center around the appropriate role of deposit insurance, bank capital, and diversity and competition in the financial sector (see, for example, Greenspan 1998; Hellmann, Murdock, and Stiglitz 1998).

9. See Dziobek and Pazarbasioglu (1998) for experience in Côte d'Ivoire, Latvia, and Spain; Drees and Pazarbasioglu (1998) for the Norwegian experience; Baer and Klingebiel (1995) for a variety of historical episodes.

10. The London Approach operates under the auspices of the Bank of England and has been used for corporate workouts in recessionary periods when normal bankruptcy procedures have proved insufficient (see Kent 1997).

11. As of early November 1999 discussions of Daewoo's debt restructuring also included a significant component of deferred debt payments (*the Wall Street Journal*, Novemer 2, 1999).

12. For a review of the postcrisis industrial policy agenda, see Mody (1999).

13. The total number of domestic mergers and acquisitions has been about 50 to 70 per quarter in Malaysia in 1997–99, while it remained low (in the range of 4 to 10) in the other countries (see Securities Data Company 1999).

14. Survey results of Japanese investors in the early 1990s show them to be sensitive in their investment decisions to restrictions on profit repatriation (see Mody, Dasgupta, and Sinha 1999).

References

Alexander, Arthur. 1999. "Japan Confronts Corporate Restructuring." Background paper on Japan.

Asia Law. 1998. *Cross-border M&A: A Guide to Global Strategic Direct Investment for Asian Companies*. Asia Law and Practice, Euromoney Publications.

Baer, Herbert, and Daniela Klingebiel. 1995. "Systemic Risk When Depositors Bear Losses: Five Case Studies." In *Banking, Financial Markets, and Systemic Risk,* edited by George Kaufman. Greenwich, Conn.: JAI Press.

Bebchuk, L. 1996. "Chapter 11." Discussion Paper 227. Harvard Law School, Center for Law, Economics, and Business, Cambridge, Mass.

Bernanke, Ben, Mark Gertler, and Simon Gilchrist. 1996. "The Financial Accelerator and the Flight to Quality." *The Review of Economics and Statistics* 78(1): 1–15.

Brinkmann, Emile J., Paul M. Horvitz, and Ying-Lin Huang. 1996. "Forbearance: An Empirical Analysis." *Journal of Financial Services Research* 10: 27–41.

Claessens, Stijn, Simeon Djankov, and Daniela Klingebiel. 1999. "Bank and Corporate Restructuring in East Asia: Opportunities for Further Reform." Financial Sector Discussion Paper 3. World Bank, Washington D.C.

Crafts, Nicholas. 1999. "East Asian Growth Before and After the Crisis." *IMF Staff Papers* 46(2): 139–66.

Domac, Ilker. 1999. "The Distributional Consequences of Monetary Policy: Evidence from Malaysia." World Bank, Washington D.C. Draft.

Domac, Ilker, and Giovanni Ferri. 1998. "The Real Impact of Financial Shocks: Evidence from the Republic of Korea." Policy Research Paper 2010. World Bank, Washington, D.C.

Drees, Burkhard, and Ceyla Pazarbasioglu. 1998. "The Nordic Banking Crises: Pitfalls in Financial Liberalization." Occasional Paper 161. International Monetary Fund, Washington, D.C.

Dziobek, Claudia, and Ceyla Pazarbasioglu. 1998. "Lessons from Systemic Bank Restructuring." *Economic Issues* 14.

The Economist. 1999. "Death, Where is Thy Sting?" July 17.

EIU (Economist Intelligence Unit). 1999a. *Country Report: Malaysia Third Quarter.* London.

————. 1999b. *Country Report: Thailand Third Quarter.* London.

Foley, C. Fritz. 1999. "Going Bust in Bangkok: Lessons from Bankruptcy Law Reform in Thailand." Draft. Harvard Business School, Cambridge, Mass.

Furman, Jason, and Joseph E. Stiglitz. 1998. "Economic Crises: Evidence and Insights from East Asia." *Brookings Papers on Economic Activity* 2(1998): 1–135.

Garcia, Gillian G. H. 1999. "Deposit Insurance: A Survey of Actual and Best Practices." Staff Working Paper 99/54. International Monetary Fund, Washington, D.C.

Gray, Cheryl W., Sabine Schlorke, and Miklos Szanyi. 1996. "Hungary's Bankruptcy Experience, 1992–1993." *The World Bank Economic Review* 10(3): 425–50.

Greenspan, Alan. 1998. "The Role of Capital in Optimal Banking Supervision and Regulation." *Economic Policy Review* 4(October): 163–68.

Harberger, Arnold. 1998. "A Vision of the Growth Process." *American Economic Review* 88(1): 1–32.

Hauch, D., and S. Ramachandran. 1999. "Creditor Auctions to Reorganize Debts." World Bank, Washington D.C. Draft.

Hellmann, Thomas, Kevin Murdock, and Joseph Stiglitz. 1998. "Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?" Stanford Graduate School of Business, Stanford, Calif. Draft.

IMF (International Monetary Fund). 1998. *World Economic Outlook 1998*. Washington, D.C.

————. 1999. "Financial Sector Crisis and Restructuring—Lessons From Asia." August 12.

Kane, Edward. 1989. "The High Cost of Incompletely Funding the FSLIC Shortage of Explicit Capital." *Journal of Economic Perspectives* 3(4): 31–47.

Kent, Pen. 1997. "Corporate Workouts: A U.K. Perspective." In *Crisi D'Impresa E Risanamento*, edited by D. Masciandaro and F. Riolo. Milan: Edibank.

Kharas, Homi, and Deepak Mishra. 1999. "Hidden Deficits and Currency Crises." Draft. World Bank, Washington, D.C.

Klingebiel, Daniela. 1999. "The Use of Asset Management Companies in the Resolution of Banking Crises: Cross-Country Experiences." World Bank, Washington D.C.

Krueger, Anne O., and Aaron Tornell. 1999. "The Role of Bank Restructuring in Recovering from Crises: Mexico 1995–1998." Working Paper 7042. National Bureau of Economic Research, Cambridge, Mass.

Mako, William P. 1999. "Thailand Corporate Restructuring." World Bank, Washington, D.C. Processed. Draft.

Mody, Ashoka. 1999. "Industrial Policy after the East Asian Crisis: From Outward Orientation to New Internal Capabilities." Policy Research Working Paper 2112. World Bank, Washington, D.C.

Mody, Ashoka, Rajan Suri, and Jerry Sanders. 1992. "Keeping Pace with Change: Organization and Technological Imperatives." *World Development* 20(12): 1797–1816.

Mody, Ashoka, Susmita Dasgupta, and Sarbajit Sinha. 1999. "Japanese Multinationals in Asia: Drivers and Attractors." *Oxford Development Studies* 27(2): 149–64.

Mojdehi, Ali M. M., and Peter W. Ito. 1998. "Indonesian Insolvency: New Reform Law Designed to Restore Confidence." *Los Angeles Daily Journal,* December 22, p. 7.

Rojas-Suarez, Liliana, and Steven R. Weisrod. 1996. "Banking Crises in Latin America: Experiences and Issues." In *Banking Crises in Latin America*, edited by Ricardo Haussmann and Liliana Rojas-Suarez. Washington, D.C.: Inter-American Development Bank.

Securities Data Company. 1999. SDC Platinum 2.1—Mergers and Acquisitions Database.

Sheng, Andrew, ed. 1996. *Bank Restructuring: Lessons from the 1980s.* Washington D.C.: World Bank.

Stiglitz, Joseph E. 1999. "Principles of Financial Regulation: A Dynamic, Portfolio Approach." World Bank, Washington, D.C. Draft.

van Wijnbergen, Sweder. 1998. "Bank Restructuring and Enterprise Reform." Working Paper 29. European Bank for Reconstruction and Development, London.

Xie, Andy. 1999. "Korea: Another Financial Crisis?" (http://www.msdw.com)

Warburg Dillon Read. 1999. "Asian Economic and Strategy Perspectives." September.

World Bank. 1999. *Global Economic Prospects and the Developing Countries 1998/99: Beyond Financial Crisis.* Washington, D.C.