

# TDRI

Quarterly  
Review

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*What do emerging markets think of the international financial architecture? See the executive summary of the report by the Emerging Markets Eminent Persons Group (EMEPG) on Page 3. The report covers recommendations in eight topics.*

# Rebuilding the International Financial Architecture

## *Emerging Markets Eminent Persons Group Report\**

### FOREWORD

by Dr. Il SaKong

Waves of financial crises in emerging markets during recent years have given rise to widespread calls for a new 'international financial architecture' that would allow global capital markets to function properly and ensure global financial stability.

A number of distinguished expert groups have recently addressed these issues and have put forward valuable proposals for reforming the international financial architecture (IFA). However, these reports primarily reflect the views of G7 industrialised countries without reflecting the views of emerging markets, although emerging markets are most vulnerable to international financial instability and are most directly affected by the proposed institutional and regulatory arrangements.

With the support of the Ford Foundation, a group of experts from emerging markets has been established to gather consensus views among themselves regarding major issues for reforming the IFA. The Group first met in Seoul, Korea on 9-10 November, 2000, where critical issue areas were identified and discussed among EMEPG members together with leading experts as resource persons. The second meeting was held in Santiago, Chile on 7-8 March, 2001, where a preliminary report was prepared based on discussions among EMEPG members. The final meeting took place in New York, USA on 3-4 May, 2001, where the preliminary report prepared in Santiago was closely reviewed. The views of the EMEPG members who

could not attend these meetings were incorporated in the draft through communication.

The Emerging Markets Eminent Persons Group (EMEPG) is made up of the following independent senior personalities:

Il SaKong (chairman)	Korea
Edmar Bacha	Brazil
Kwesi Botchwey	Ghana
Solita Collas-Monsod	Philippines
Ruth de Krivoy	Venezuela
Mar'ie Mohammed	Indonesia
Jaime Serra-Puche	Mexico
Manmohan Singh	India
Noordin Sopiee	Malaysia
Chalongphob Sussangkarn	Thailand
Roberto Zahler	Chile

The Group invited world-renowned experts regarding these issues to join the Advisory Board for the project, which was composed of:

C. Fred Bergsten	USA
Rolf Luders	Chile
Ronald McKinnon	USA
Ernest Stern	USA
Joseph Stiglitz	USA
Paul Volcker	USA

The advisory board members were invited to attend the EMEPG's New York meeting, where they provided their comments and participated in the discussions.

\* This is the Executive Summary of the Emerging Markets Eminent Persons Group Report on "Rebuilding the International Financial Architecture" which was published by the Institute of Economics, Seoul, South Korea in October 2001, with a foreword by Dr. Il SaKong, Chairman and CEO of the Institute of Global Economics and Chairman of the Emerging Markets Eminent Persons Group.

Professor Valpy FitzGerald of the University of Oxford, who participated in the project as a rapporteur and resource person, drafted the report. The secretariat was provided by the Korea Institute for International Economic Policy (KIEP) and led by Dr. Yunjong Wang.

The EMEPG is naturally concerned with the role of emerging market economies in establishing new international financial architecture. In particular, despite the fact that most of the officially proposed changes to the existing system mainly affect emerging markets, the governments of these countries have not formed part of the bodies that have been mainly responsible for formulating these international norms. The Group is also concerned that stances taken by the G7 countries on their domestic financial, monetary or fiscal policies may have major externalities which destabilise emerging markets despite their best efforts to maintain sound economic policies. The orderly functioning of the global capital and currency market as a whole is central to both the short-term stability and sustainable growth of emerging markets.

The main aim of the Group has been to address the international financial architecture. In consequence, our Report focuses on international financial issues rather than domestic policy reform.

Where we do discuss national policies, it is mainly in the context of the international norms or actions that constrain government actions. This focus in no way implies that emerging market governments have no responsibility for instability: in many cases there is still much to be achieved before sound fiscal, monetary and regulatory positions are reached. However, there is clearly an incomplete international agenda to which this Group attempts to contribute.

In the light of these considerations, the Report makes a total of thirty-three recommendations for the consideration of the international policy-making community, which relate to the eight topics that constitute its separate chapters.

The views contained herein represent those of the EMEPG in general. Although not all members are in full agreement with all details of the report, they support the general thrust of the report and the logic of the recommendations. It also has to be mentioned that although the Advisory Board members were asked to review the report and share their valuable opinions, the views contained herein are solely of the EMEPG and do not necessarily reflect the views of the Advisory Board or any of its members.

## EXECUTIVE SUMMARY

A central characteristic of the world in the twenty-first century is the increasingly free movement of goods and services across national boundaries. It is now generally agreed that the integration of middle-income developing countries (the 'emerging market countries') to global capital and currency markets can lead to increased access to a larger savings pool, the transfer of modern technologies and the opportunity to diversify risk. This integration thus forms part of the economic strategy of almost all countries, although the potential gains must be set against the risk of exogenous shocks transmitted from international markets that can destabilise emerging markets, with profound economic and social consequences.

The first half of the 1990s saw a massive expansion of private financial flows from developed to developing countries, which was widely welcomed as a positive contribution to development. However, the second half of the 1990s revealed that these private flows could be easily reversible, as a succession of financial crises in emerging markets seriously set back important progress in economic growth and poverty reduction. The opening months of the twenty-first century have seen remarkable recuperation of production levels in some emerging markets but continued financial vulnerability in others, while contagion still appears to affect

international investors and global capital markets are conditioned by uncertainty as to G3 growth prospects.

Financial fragility in many emerging market economies has been exacerbated in the past by poor corporate governance in (domestic) financial institutions and corporations (both state-owned and private), inadequate financial regulation and supervision, weak institutions and insolvent fiscal systems. Much progress has been made – often under adverse circumstances – to correct these deficiencies by almost all emerging market governments in recent years. However, stronger prudential standards, sound macroeconomic fundamentals, enhanced risk management and improved transparency, although necessary, are not sufficient to provide an assurance of market stability. International action on a coordinated basis is clearly also required.

A number of distinguished expert groups have recently addressed these issues and have put forward valuable proposals. However, these reports primarily reflect the views of G7 industrialised countries, despite the fact that emerging markets are the most vulnerable to international financial instability. With the support of the Ford Foundation, a group of independent and authoritative persons from emerging markets has thus been established to gather consensus views among themselves regarding major issues for reforming the 'international financial architecture' (IFA). The Emerging Markets Eminent Persons Group on International Financial Architecture is thus composed of

eleven senior private figures from emerging market countries. The Group also invited six leading international experts regarding these issues to join the Advisory Board for the project.

The Group is naturally concerned with the role of the emerging market economies in establishing new international financial architecture. In particular, despite the fact that most of the officially proposed changes to the existing system mainly affect emerging markets, the governments of these countries have not formed part of the bodies that have been mainly responsible for formulating these international norms. The Group is also concerned that stances taken by the G7 countries on their domestic financial, monetary or fiscal policies may have major externalities which destabilise emerging markets despite their best efforts to maintain sound economic policies. The orderly functioning of the global capital and currency market as a whole is central to both the short-term stability and sustainable growth of emerging markets.

The main aim of the Group has been to address the international financial architecture. In consequence, our Report focuses on international financial issues rather than domestic policy reform. Where we do discuss national policies, it is mainly in the context of the international norms or actions that constrain government actions. This focus in no way implies that emerging market governments have no responsibility for instability: in many cases there is still much to be achieved before sound fiscal, monetary and regulatory positions are reached. However, there is clearly an incomplete international agenda to which this Group attempts to contribute.

In our Report, we discuss eight key topics grouped in three issue areas. First, how emerging market countries should best manage their integration into global financial markets so as to ensure stability and growth; and how best this integration might be supported by the international institutions and the policies of G7 countries themselves. This area includes the speed and sequencing of *capital account liberalisation* and the choice of appropriate *exchange rate regime*. Second, how the inter-governmental regulatory regimes affecting international banks, bond and equity funds and other financial intermediaries can support emerging markets, and by extension global financial stability. This area includes the *regulation of highly leveraged institutions (HLIs)*, the setting of *international financial codes and standards*, and *private participation* in crisis prevention and resolution. Third, how institutions at the international, regional and country level can best be adapted in order to reduce social cost of financial instability and develop a system of global monetary and financial governance appropriate for the changed global financial market. This area includes *social protection mechanisms* for financial stability, the *reform of international financial institutions (IFIs)*, and *regional monetary and financial co-operation*.

In the light of these considerations, the Group has made a total of thirty-three recommendations for the consideration of the international policy-making community, which relate to these eight topics.

### **The Speed and Sequencing of Capital Account Liberalisation**

We urge emerging market governments to adopt appropriate sequencing, pace and scope of capital account liberalisation. After all, capital account liberalisation is not an end in itself, but a means to sustained higher growth.

Prior actions that should be undertaken before liberalizing the capital account include not only fiscal and monetary discipline and trade liberalisation but also measures to attain a private sector savings-investment balance and prudential regulation of bank and non-bank financial intermediaries.

Governments should not be prevented from using market-based instruments (such as transaction taxes or reserve requirements) on short-term capital flows in order to prevent disruptive capital inflows that threaten effective domestic monetary policy and raise the probability of sudden reversals of capital flows. However, such instruments should be used as a temporary safeguards.

Emerging markets should encourage longer maturities on private capital inflows, and discourage short-term borrowing by domestic firms. Banks should be regulated to avoid unmatched and unhedged currency exposure in their balance sheets. Foreign direct investment should be encouraged as it combines long maturity with other benefits such as risk sharing and technology transfer.

Emerging economies should be cautious in internationalising their currencies as offshore markets can be used for speculative activities that can destabilise vulnerable financial systems. Countries should apply an integrated set of rules and regulations to prevent an overly active offshore market for domestic currencies, with the support of international authorities where appropriate.

### **The Choice of Appropriate Exchange Rate Regimes**

The international financial community should acknowledge the systemic problems faced by countries whose financial markets are still at an intermediate stage of development and not sufficiently integrated to global markets to rely on permanent access to private financing. The choice of exchange rate regime in order to avoid misalignment should be left to the government. This choice should not be constrained by international financial institutions to the 'corner' options of a permanently fixed parity or a free float.

An 'intermediate' exchange rate regime may well be preferable in practice for countries trading worldwide and subject to external financial shocks. This intermediate exchange rate regime may need to be supported by market-based intervention instruments or other appropriate regulations in order to contain speculative attacks.

The wide swings of dollar/yen/euro exchange rates are one of important sources of external shocks to emerging market economies, undermining their efforts to maintain sound financial policies and macroeconomic balances. We strongly urge the G3 countries to develop a system by which stable exchange rates among major currencies be maintained.

### **The Regulation of Highly Leveraged Institutions**

Although the use of modern financial instruments such as derivatives can help develop emerging markets, they can also be a destabilising factor in times of economic stress. It is thus urgent that the G7 governments adopt the proposals of the Financial Stability Forum for indirect regulatory measures to be applied to Highly Leveraged Institutions.

In particular, it is important for G7 supervisors to regulate bank lending to HLIs in order to reduce their ability to mount speculative attacks on emerging markets. The timely disclosure of the uncovered positions of large hedge funds and the proprietary trading desks of global banks would also assist in this aim.

G7 governments should encourage their financial supervisors to share appropriate information regarding financial intermediaries under their supervision with emerging markets' regulatory authorities. By creating mechanisms for effective information sharing, G7 supervisors could effectively monitor the overall size of creditors' exposure to HLIs.

### **Setting International Financial Codes and Standards**

There is an evident need for emerging market authorities to apply sound regulatory standards, both to ensure the integrity of their own financial markets and to gain sustained access to international capital markets. However, these codes and standards must be flexible in terms of both their timing and their scope. Prior implementation of a single set of 'core' codes and standards should thus not be made a condition for support from the international financial community – such as pre-qualification for contingent credit lines.

This flexibility is required in order to permit adaptation to the specific characteristics of emerging market economies. It is necessary to focus on those aspects of the Financial Stability Forum proposals (such as transparency and timely reporting) needed to ensure access to private capital markets.

The international bodies concerned with global financial standards (the Financial Stability Forum in particular) must adequately represent emerging market

authorities because it is these economies where the proposed codes and standards will have most impact.

The G7 governments and the international financial institutions themselves should provide resources and technical assistance to support emerging market governments without sufficient domestic implementation capacity.

The revision of the Basle Capital Accord on bank supervision needs a particular attention paid not to shorten the maturity of private bank lending to emerging markets.

The G7 should take steps towards ensuring stricter supervision of financial transactions in offshore financial centres, and support the US initiative to increase the risk weighting on lending to such centres not meeting international supervision standards.

### **Private Participation in Crisis Prevention and Resolution**

Over borrowing by emerging market governments, banks and firms is logically matched by voluntary over lending by private investors in advanced economies. There is thus a need for more equitable burden sharing when initial expectations are not supported by subsequent events. Increased private burden sharing would also help to reduce moral hazard on the part of lenders.

For that purpose, the international financial community should explore measures to facilitate greater private sector involvement on fair burden sharing principles. Such measures should be used for a quick and orderly execution of debt relief and restructuring, without undermining the debt contracts, which would restrain market access. Protection of debtors and creditors should be carried out on equitable grounds.

In the long-term, the establishment of an international legal mechanism for restructuring sovereign debt contracts similar to the Chapter XI proceedings under the US bankruptcy law may be desirable. Emerging market economies should first strengthen their domestic bankruptcy laws. They should then explore the possibility of establishing mutual recognition agreements with the leading financial centres.

Ex ante measures for debt restructuring will enhance the degree of predictability when a need to restructure international sovereign bonds arises. Sovereign debtors, both G-7 and emerging market countries alike, should encourage the use of 'collective action clauses' in debt contracts. Conditions such as put-options and cross default clauses that can precipitate default during payment difficulties should be cautiously utilized.

When a debtor country has entered 'bona fide' negotiations with a majority of its private creditors, and is following the terms of an agreement with the IMF, the International Monetary Fund should sanction, and the G7 governments support, a temporary suspension of payments if needed in order to allow negotiations to be successfully concluded.

### **Social Protection Mechanisms for Financial Stability**

The international community should recognise that sound social protection systems should be in place in order to both protect vulnerable groups in emerging market countries and maintain political consensus on sound economic policy.

Greater use of fiscal resources by emerging market governments for public provision of social protection should be encouraged by creditors, so long as it is consistent with fiscal prudence.

The international financial institutions should provide more long-term social funding for emerging market countries when the need arises. Provisions should be made for more rapid and less conditional disbursement of funds as safety nets in crises.

### **The Reform of International Financial Institutions**

Reformed International Financial Institutions (IFIs) form an essential part of the new International Financial Architecture: their constitutional structures, developmental mandates and operating principles require revision in the light of the realities of global capital markets in the 21<sup>st</sup> century.

In view of the extremely pro-cyclical nature of private capital flows, there is an urgent need for the International Monetary Fund to stand ready to provide the required liquidity on a timely basis, for which purpose greater resources will be needed.

The policy conditions included in loan agreements with the Fund should be tailored to specific economic conditions of the recipient country in question. The imposition of a single model of monetary stabilisation and structural adjustment should be avoided, particularly in the midst of financial crises. The Fund should strengthen and broaden its understanding of the characteristics of emerging market economies by drawing on expertise from these countries.

The pre-qualification conditions for Contingent Credit Lines should be made more realistic so that they help rather than hinder crisis prevention and resolution. This would increase the likelihood that such facilities would be taken up by emerging market governments.

The 'division of labour' between the Bretton Woods institutions should be clarified. The IMF should focus on short-run stabilisation policy advice and the provision of liquidity; and should avoid pressures to extend its mission to wider matters of institutional change and development strategy.

The World Bank should focus on longer-term development support, particularly the funding of social and economic infrastructure where private capital is not available on reasonable terms. The ability of the World Bank and other multilateral development banks to support long-term private lending should be augmented by a modification of the gearing ratios in their guarantee schemes. The Bank and the Fund must also coordinate more effectively in crisis situations.

Emerging market countries' representation in the share capital and executive boards of the International Financial Institutions (IFIs) should reflect more accurately their respective importance in the world economy. Meanwhile, the IFIs themselves should apply internationally accepted principles of institutional transparency and accountability in order to protect the interests of emerging market countries as 'minority shareholders.'

### **Regional Monetary Arrangements and Financial Co-operation**

Regional economic and financial cooperation arrangements should be strengthened in order to promote regional stability, and contribute to crisis prevention and resolution. This in turn should contribute to the stability of the global economy. Regional arrangements for monetary and financial cooperation should be encouraged and supported by the G7 as complementary to the multilateral IFIs.

A future direction for the coordinated use of reserves by central banks in order to prevent speculative attacks has been illustrated in the currency swap arrangements under the initiative of ASEAN+3 countries. Such arrangements may not be as effective for regions where the level of reserves is limited, but the scope for collective action by monetary authorities in support of regional financial stability is worth further exploration.



# Improved Conditions in the Child Labor Market: Causes and Future Concerns

Nipon Poapongsakorn\*  
Suwanna Tulyawasinphong\*\*

**T**his paper summarizes some of the major findings of the research report entitled “Problems and Trend of Child Labor in Thailand: Consequences on the Future Opportunity of Child Labor.”<sup>1</sup> It focuses on just three important issues. The first issue centers on the child employment scenario during the last 15 years (1984-2000). In the early 1980’s when there was high incidence of child labor, there were reports of serious child labor abuses. Most child workers came from the poor families. They seemed to have no choice but to accept extremely low wage jobs in the sweatshops. Local and global events such as the economic meltdown, advanced technical know-how, and globalization and conglomeration have brought about tumultuous changes in the labor market in the last fifteen years. It is time, therefore, to review the current situation in the child labor market. The second issue deals with factors that affect the choices of children (and/or choices of their parents): whether to continue with work or with education? It also explores the opportunities available to the child laborer for job advancement. Finally, the paper addresses some major concerns about the child labor.

The study utilizes three major sources of data. The first two sources are the national survey of the Labor Force Survey and the Household Socio-economic Survey carried out by the National Statistical Office. The third set of data comes from household survey in rural areas, while the survey of child laborers was done in Bangkok. The sample size consists of 343 child workers in Bangkok and metropolitan areas, and 255 households from Kanchanaburi, Chiang Mai, Si Sa Ket, Ubon Ratchathani and Songkhla areas. The research was conducted between November 2000 and February 2001.

## THE DECLINE IN CHILD LABOR

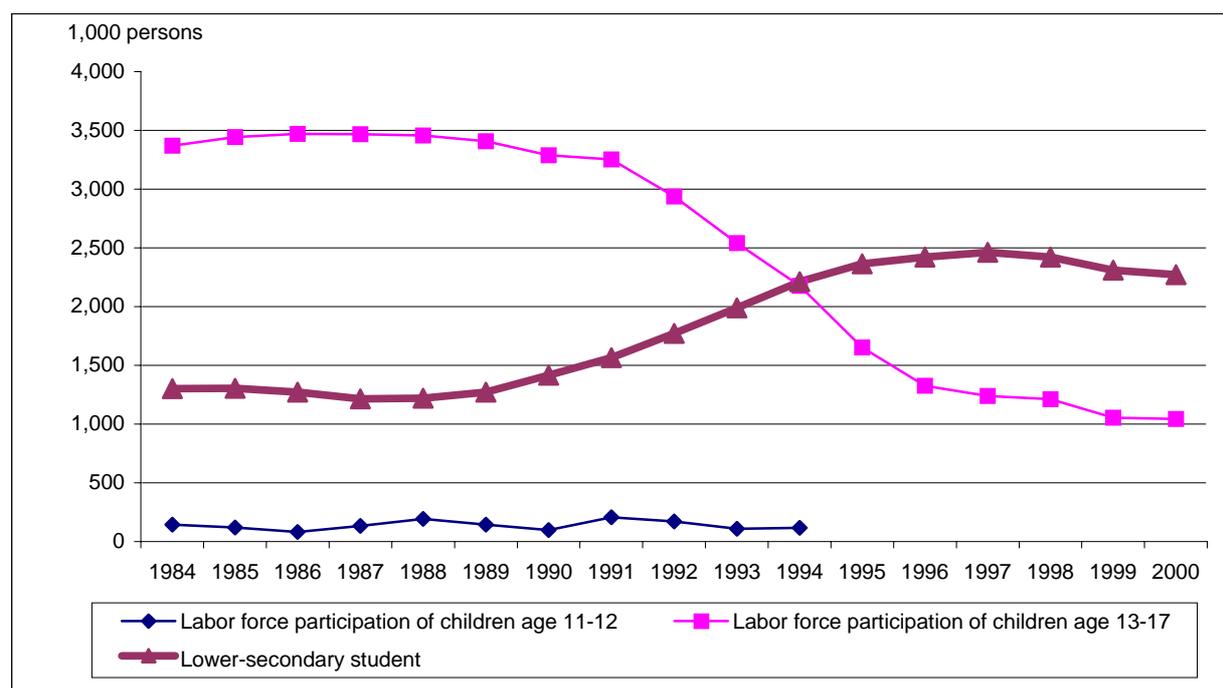
During the 1984-2000 period, the child labor declined dramatically. Figure 1 shows that the number of child workers aged 13–17 years fell from 3.37 million to 1.04 million, which is a reduction of 69 percent. Child labor also declined in the younger group of 11–12 years old. As there is no official data available after 1994 for this group, actual estimation cannot be tabulated. The

three factors that account for decline in the child labor force are: the increased enrollments at the secondary education level, decline in population growth rate, and increased household income.<sup>2</sup> Perhaps the most important factor is the expansion of enrollments at the secondary education level, which is attributed to the government policy initiated in 1988 (see Figure 1). The number of secondary students almost doubled from 1.3 million in 1984 to 2.3 million in 2000. At the same time, as a result of slower population growth, the population in the age group of 11–17 also declined from 8.69 million to 7.87 million over the same period.

The related important policy in question is whether or not the policy of education expansion has helped reduce sourcing of child labor from poor families. Although the question cannot be directly tackled, Table 1 helps shed some light. Using the Socio-economic survey, we classify children aged 11–17 years by their schooling status and by household income, using the poverty incidence criteria. At least three conclusions can be drawn from Table 1. First, over the 1992–1998 period, the percentage of children attending school increased significantly by 17 percent. But the important change is that the “rural–urban” gap in educational opportunities had substantially narrowed. In 1992, only 65.6 percent of children in rural areas attended secondary school, compared to 79 percent for the urban children. By 1998, the gap was less than 3 percent. Second, educational opportunities for children from the poor households had improved markedly. This is evident from the fact that poor children who attended school, their overall average jumped from 58.6 percent to 80.6 percent during the 1992–98 period. The third conclusion, which is very surprising, is that the children from the rural poor families tend to have more opportunities than their fellows from the urban poor families. There are a few plausible explanations. One is that the opportunity cost of schooling for the poor urban households is higher than the poor rural households. Another explanation is that the poor urban households may be under higher financial pressure to send their children to work. And yet the third possible reason is that many urban poor children do not have proper legal documents to be eligible for schooling. Anyway, the upshot is that the secondary education expansion policy is the effective way in reducing the

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**Figure 1 Labor force participation of children and number of lower-secondary students**

Source: Labor Force Survey 1984-2000 by National Statistical Office and Students Statistics by the Ministry of Education.

**Table 1 Number of children aged 11-17 in the poor and non-poor families selected by area and schooling status**

Area	Household Income	Schooling Status	1992	1994	1996	1998
Urban	Non-poor	Attending school (%)	79.81	83.06	85.51	87.92
		Not attending school (%)	20.19	16.94	14.49	12.08
		Total (person)	1,157,651	1,307,745	1,243,169	1,240,004
	Poor	Attending school (%)	65.72	72.01	73.18	70.66
		Not attending school (%)	34.28	27.99	26.82	29.34
		Total (person)	65,492	50,210	58,282	55,897
	Total (Poor+Non-poor)	Attending school (%)	79.06	82.65	84.96	87.18
		Not attending school (%)	20.94	17.35	15.04	12.82
		Total (person)	1,223,144	1,357,955	1,301,451	1,295,901
Rural	Non-poor	Attending school (%)	68.74	78.83	85.64	86.01
		Not attending school (%)	31.26	21.17	14.36	13.99
		Total (person)	4,660,233	4,939,521	4,592,835	4,472,666
	Poor	Attending school (%)	58.39	72.19	78.87	80.87
		Not attending school (%)	41.61	27.81	21.13	19.13
		Total (person)	2,018,674	1,493,518	1,691,119	1,970,527
	Total (Non-poor+Poor)	Attending school (%)	65.61	77.29	83.82	84.44
		Not attending school (%)	34.39	22.71	16.18	15.56
		Total (person)	6,678,907	6,433,039	6,283,953	6,443,193
Total (Urban+rural)	Non-poor	Attending school (%)	70.94	79.71	85.61	86.42
		Not attending school (%)	29.06	20.29	14.39	13.58
		Total (person)	5,817,884	6,247,266	5,836,004	5,712,670
	Poor	Attending school (%)	58.62	72.19	78.68	80.59
		Not attending school (%)	41.38	27.81	21.32	19.41
		Total (person)	2,084,166	1,543,728	1,749,401	2,026,424
	Total (Non-poor+Poor)	Attending school (%)	67.69	78.22	84.01	84.90
		Not attending school (%)	32.31	21.78	15.99	15.10
		Total (person)	7,902,051	7,790,994	7,585,404	7,739,094

Source: Computed from the Socio-Economic Survey 1992,1994,1996,1998.

child labor from poor families. But this is not to deny the importance of other socio-economic variables and the child labor regulations that reinforce the impact of the education policy.

Another important development in the child labor market is the improvement in the working conditions of child labor. Perhaps the most significant factor is the decline in the weekly hours of work for child labor. Figure 2 compares hours of work of the child laborer with those of the adult worker in non-agricultural sector. Before 1993, children worked longer hours than adult workers, since 1995, their hours of work have declined sharply and has become even shorter than the adults. As a consequence, weekly working hours of the child laborer fell from 54.5 hours in 1989 to 47.4 hours in 2000. Girls and boys do not have much difference in hours of work allotted. But in the late 1980's, girls had higher average working hours than boys. On the contrary, in the agricultural sector boys tend to work a few more hours than girls. And yet, these children still work almost eight hours a day and six days a week, while their peers from the well-to-do families attend schools.

As a consequence of sharp decline in the supply of child labor, both in terms of number of workers and hours of work, their real wages have increased faster than those of the adult workers, resulting in a narrower wage differentials (see Figure 3).

Our survey of child labor in Bangkok also confirms that their working conditions have improved. But this does not mean that the employers have been

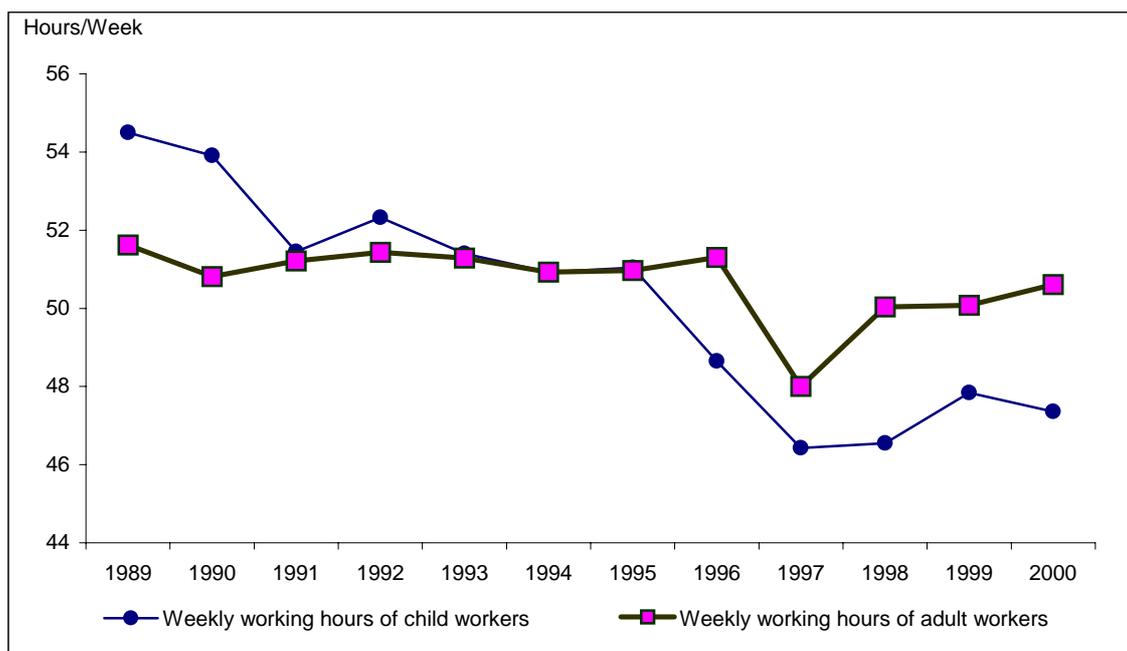
wholly compliant with the labor laws. The issue of working conditions will be discussed later.

## DECISION TO WORK AND CAREER ADVANCEMENT

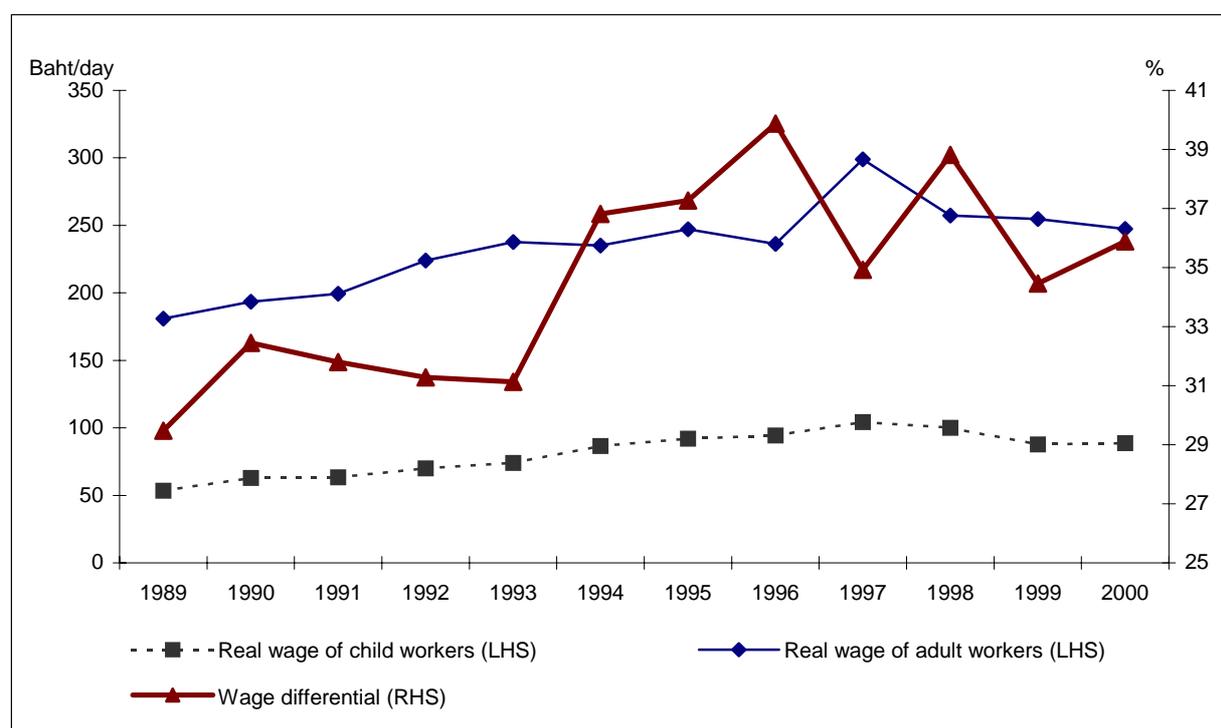
Although educating the children seems to be the most effective means of reducing child labor from poor families, the problems of child labor still persistently remains. Obviously, the problems are far more complicated and may require more sophisticated set of policy measures than just one simple measure of education expansion. The research, therefore, addresses two important issues. (I) Why do children work? (II) Does it pay to work? The first question has been researched quite extensively and our study confirms the results of previous research that poverty is the chief factor. However, the second question has not been seriously researched in Thailand before.

The decision to work or to study is very complex. Our survey reveals that most of the urban child workers who came from the rural urban areas (48%) made their own decision to work, and a quarter of them made a joint decision with their parents. Only 20 percent worked because of their parents' decision. At the same time, parents of the child worker also confirmed that most children did make their own decisions. Only 15 percent of the parents admitted they made the unilateral decision (see Table 2). It is also interesting to note that boys tend to make decisions by themselves.

Figure 2 Weekly hours of work in the non-agricultural sector of child and adult workers



Source: National Statistical Office. Labor Force Survey Round 3<sup>rd</sup> 1984-2000.

**Figure 3 Real wage rate and wage differentials of child and adult workers**

Source: Computed from Labor Force Survey Round 3<sup>rd</sup> 1984-2000.

**Table 2 Age at first job, decision-making and reasons to work as a child laborer**

Topics	In persons			% of total
	Boys	Girls	Total	
<b>Age at first job</b>	165	178	343	100
7 – 11 years old	12	10	22	6.4
12 – 13 years old	32	44	76	22.1
14 – 15 years old	84	74	158	46.1
16 – 17 years old	37	50	87	25.4
<b>Who made the decision to work?</b>	165	178	343	100
Children	86	80	166	48.4
Parents	28	41	69	20.1
Co-decision	38	49	87	25.4
Relatives	10	8	18	3.4
Others	3	0	3	0.9
<b>Reasons to work</b>	157	164	321	93.6
Financial reason	54	53	107	33.3
To support family	27	53	80	24.9
Nothing to do at home	17	11	28	8.7
Want to be self-reliant	10	13	23	7.2
Work experience	15	8	23	7.2
Don't want to continue study	12	6	18	5.6
Don't want to stay at home	5	9	14	4.4
Others (e.g. want to see Bangkok etc.)	17	11	28	8.7

Source: TDRI's survey, November 2000-February 2001.

To analyze factors affecting the children's decision to work, two sets of the logit equations were estimated, i.e., the first equation explaining the decision to study and the other explaining the decision to work<sup>3</sup> (Table 3). In general, children from the well-to-do families have higher probability to further their studies at the secondary educational level. Surprisingly, the most robust proxy for the household wealth is the value of debt outstanding and family financial problems when their child was in grade 6. It is interesting to note that mothers who have had primary education, their children have less probability to work than those children whose mothers are illiterate. Girls in our sample have higher chances to go to secondary school than boys; however, gender does not affect the decision to work after controlling for other factors. Family size has the negative effect on the probability of schooling but surprisingly does not affect the probability to work. Another surprising finding is that the existence of a secondary school in the village reduces the probability of children deciding to work, but not the decision to study.

Since the results come from a small set of 255 rural households, they must be confirmed and complemented by the estimates using the national survey. The results in Table 4 confirm the role of mother's education and the family size in the children's decision to study, but not their decision to work. This is because studying competes for the family's limited resources.

The majority (46%) of children began to work at the age of 14-15 years and the average work experience

was only 1.5 years.<sup>4</sup> The questions are whether or not these experiences have any positive impact on their real wages, and what are the important factors that contribute to the wages that the children earn?

Surprisingly, the real wages of our sample increased by 7 percent per year, which was higher than growth rate of national real wage rates between 1997 and 1999 (see Table 5). However, it should not be ignored that more than 76 percent of the child laborers still receive wages that are less than Baht 100 per day; although the current minimum wage is Baht 165 per day.

An interesting question is, what explains the increase in the child labor's real wages? Do human capital variables play the important role? To answer these questions, two tests are employed, i.e., the regressions explaining the wage level and the growth rate of real wages, and the regression explaining the job changes.

Two wage regressions are estimated to explain real wages of the child laborer. The first is the current wage rate and the second is the wage function for the first job. The results are interesting; in the wage function for the first job, age is positively significant (see Table 6). Boys surprisingly receive lower wages than girls in their first job. The result may reflect the fact that the decision about going to work, most boys tends to make it by themselves. Thus not having a mentor to guide and negotiate on their behalf about job duties and wages, the boys get exploited. But this is only a conjecture.

**Table 3 Logit analysis: small sample household survey**

Independent variables	Dependent variable			
	Enrolled in secondary school		Decision to work	
	Coefficients	Z-stat	Coefficients	Z-stat
Family wealth				
No. of land holding	-0.00003	-0.003	-0.01	-1.44
No. of debt	0.00001	2.92	-0.000005	-2.19
Expenditure problem	-1.05	-5.14	2.54	7.32
Family characteristics				
Family size	-0.15	-2.46	0.005	0.06
No parent	-0.10	-0.23	0.06	0.10
Mother's education- primary school	0.002	0.01	-0.79	-3.11
Mother's education- secondary school	0.55	0.71	-1.02	-1.43
Children characteristics				
Female child	0.36	1.86	-0.23	-0.97
Child health	0.02	0.10	-0.13	-0.44
Related factors				
Have secondary school in village	0.29	1.25	-0.63	-2.06
Region 1 (Bangkok)	0.58	1.91	0.07	0.19
Region 2 (Northeastern)	0.37	1.60	0.37	1.16
Region 3 (North)	0.30	0.90	-0.32	-0.74
Constant				
Observations	506		506	
Log likelihood	-318.25		-226.64	
McFadden R-squared	0.09		0.24	

Source: Computed from TDRI's survey data.

**Table 4 Logit analysis: National survey**

Independent variables	Dependent variable			
	Enrolled in secondary school		Decision to work	
	Coefficients	Z-stat	Coefficients	Z-stat
Family wealth				
Income	0.000003	3.71	-0.000005	-1.43
Family characteristics				
Family size	-0.09	-3.47	0.13	3.94
No parent	0.38	2.22	0.41	1.89
Mother's education- primary school	-0.42	-2.62	-0.37	-1.59
Mother's education- secondary school	-0.56	-2.45	-0.004	-0.01
Children characteristics				
Female child	0.04	0.40	-0.37	-3.05
Related factors				
Region 1 (Bangkok)	0.32	1.02	0.05	0.14
Region 2 (Northeastern)	0.01	0.09	0.33	1.93
Region 3 (North)	0.03	0.22	0.06	0.28
Observations	3,534		3,534	
Log likelihood	-1400.06		-984.53	
McFadden R-squared	0.02		0.04	

Source: Computed from the Socio-Economic Survey 1999.

**Table 5 Real wages at the first and the current jobs**

Year	Real wages* (Baht/day)		Percent change
	First job	Current job	
1992	48.84	38.40	-3.01
1993	105.08	76.80	-4.48
1995	81.83	59.74	-6.29
1996	67.49	90.06	7.21
1997	76.98	80.41	1.45
1998	67.38	83.70	10.85
1999	62.88	67.61	7.26

Note: at 1994 price.

Source: TDRI's survey, November 2000-February 2001.

**Table 6 Factors determining real wage in the first and present jobs: Regression analysis**

Estimation method: Least Squares

Independent variables	Dependent variable			
	Real wage of present job		Real wage of first job	
	Coefficients	T-stat	Coefficients	T-stat
Education	0.20	0.89	-	-
Male	-0.14	-1.74	-0.31	-4.30
Occupation change	0.07	0.60	-	-
Total work-hours of first job	-	-	-0.03	-2.12
Total work-hours of present job	-0.10	-0.84	-	-
Age at the first job	-	-	0.06	2.97
Present age	0.09	3.50	-	-
Network	0.20	2.28	-0.08	-0.94
Type of present job-Trade	0.33	1.08	0.15	0.50
Type of present job-Service	0.41	1.32	0.13	0.42
Type of present job-Industry	0.46	1.49	0.33	1.05
Type of present job-Construction	0.82	1.95	0.46	1.27
Number of job change	-0.05	-0.55	-	-
Constant	2.37	4.07	3.67	8.79
<b>Adjusted R-squared</b>	<b>0.05</b>		<b>0.09</b>	

Source: Computed from TDRI's survey data.

In the wage function of their current job, age is again positively significant; while the education variable is not. This strongly suggests that child's productivity depends on their age. It provides a strong justification for government intervention to ban employment of the very young children. The only variable confirming the importance of human capital formation is the significance of a dummy variable representing the construction job in the regression of wages of the current jobs. The most interesting result is the significance of a dummy variable that represents networking for a job. This means that the child's first job was obtained with the assistance of their parents and relatives. Although the network affects the current real wages positively, it is not significant in the first job regression. One possible explanation is that most child workers tend to receive more or less the same wage rate in their first job regardless of which channel is utilized for their job search, as these children possess only "raw labor." But networking plays an important function of information provider for both the employers and the employees. From the employers' point of view, the new employee will be reliable and hard working as the child is recommended from a trusted source that the employer knows. From the child's point of view, he or she has some necessary information about the job and the employer. As a result, after controlling for job changes and work experience, the network provides critical information that allows both employer and employees to be efficiently matched.

Networking also plays an effective role in providing job information to those children who wish to change jobs. Child workers revealed during interviews that there are various meeting places in Bangkok where children and workers of the same province (or same region) get together during the weekends. At these gatherings, they traded employment information that enabled them to move on to better jobs.

But the regressions of job changes and wage changes are not satisfactory perhaps because of the small sample size. However when the boys change their jobs, their wages increased.

### SOME CONCERNS

That the child laborer enjoys relatively higher wage growth, is good news. But the bad news is that except gender, the wage increases cannot be explained by any human capital variables. Changes in job, which is expected to have positive impact on the wage growth are not statistically significant and may negatively impact the wage level, and this can only be explained by age and occupational dummy variables. But there are more serious concerns. First, 76 percent of the sample child workers in Bangkok still receive the wage lower than Baht 100 per day, compared to the current minimum wage of Baht 165. Second, children are also required to work nearly 10 hours per day without sufficient break

time, let alone recreation (Table 7). A third of the children have to work six days a week. As a result the average wage is only Baht 10 per hour. Despite such low wages, some children do manage to save some money. Most children (69%) send money to their parents, amounting to an average of Baht 1,000 per month. Thus, these children are hardly able to make any savings for themselves. Third, improvement of skills is not required in most jobs; as 66 percent of the child laborers acquire the requisite skill in just two weeks on duty. Given these facts, the chance, if it exists, for the child workers to make progress is, therefore, minimal. Fourth, although they were minor ones, almost 20 percent of the sample did experience accidents in the work place. Finally, 25 percent of the child earners did not get paid when they took a sick leave. And although the employers did pay for medical bills for most child laborers when they were ill, there still remain almost 29 percent of the children who have to pay for medical expenses from their own pockets.

**Table 7: Working conditions of the child laborer**

Conditions	Persons	%
<i>Working hours (Average = 10.15 hours/day)</i>		
Less than 8 hours/day	40	12.0
8-10 hours/day	142	42.8
11-12 hours/day	87	26.2
more than 12 hours/day	63	19.0
<i>Rest hour (Average = 55 minutes/day)</i>		
Less than 1 hour/day	116	39.7
1 hour/day	164	56.5
More than 1 hour/day	11	3.8
<i>Number of holidays per week</i>		
1 day	93	34.0
2 days	163	59.5
More than 2 days	18	6.6
<i>Do you work during the weekends?</i>		
Yes	115	34.1
No	222	65.9
<i>Is it compulsory to work on weekends?</i>		
Yes	90	78.3
No	25	21.7
<i>When you get sick, your employer approves sick leave.</i>		
With full wages	101	29.9
Part-time wages	7	2.1
Without pay	85	25.1
Does not allow to take sick leave	6	1.8
Don't know	7	2.1
Never been ill	132	39.1
<i>Who pays your medical bills?</i>		
Employers bear all the expenses	104	48.6
Partly paid by the employers	21	9.8
Employers don't pay	61	28.5
Social insurance	1	0.5
Don't know	3	1.4
Parents/Relatives	7	3.3
By yourselves	17	7.9
<i>Ever experienced accident?</i>		
No	275	80.9
Yes	65	19.1

Source: TDRI's survey, November 2000-February 2001.

In the past two decades, Thailand has made progress in amending the laws covering child labor protection rights to achieve standards closer to other advanced countries. The child labor protection law, first legislated in 1956, has been revised twice, in 1990 and 1998. Each time the revision was made to raise the levels of protection to meet international standards. In the 1998 law, the legal minimum age for a child worker is at least 15 years. The law also specifies the type of work that children can do and regulates the number of working hours and their working conditions. Other laws regulating child labor are the commercial and the penal codes.

A number of government agencies as well as some NGO's have been actively involved in the activities to protect the rights of the child laborer. But the management of child labor protection policy has certain weakness. First, in the past four decades, the child labor protection policy has still emphasized on the amendment of laws covering child labor protection and of legal enforcement. This survey found that many employers still use child labor in a way not in accordance with the laws. Moreover, a number of children under 15 years of age are still required to earn for themselves and their families, in spite of the law prohibiting child labor under the age of 15. One consequence of increased child protection is the increased wage cost of child labor. This has led to an observation raised by certain labor experts that some employers have turned to employing foreign child labor and foreign adult labor since their wages are lower than Thai labor. The second weakness concerns the legal enforcement. In the interviews with children and business owners about the employment conditions of child laborers, it was discovered that some employers often violated the child labor protection law. In general, the employment condition of some children can still be considered to be unsatisfactory. For instance, 40 percent of the children have a rest period of less than one hour per day; 34 percent have only one rest day per week; 22 percent have to work over-time; 6 percent has no clean drinking water or no toilet facilities; 30 percent reported that the work place has no first aid box or medical treatment unit and 19 percent have been involved in accidents during work. Third, even though there is a national co-ordination authority to deal with the child labor problems, there still exists a bureaucratic fragmentation in the activities of child labor protection, without any mechanism or systematic co-ordinating unit in the middle and low levels of administration.

### **POLICY PROPOSALS: A CHANGE OF STRATEGY IN IMPLEMENTATION OF CHILD LABOR POLICY**

The above findings point to the weakness of previous strategies and the implementation of child labor policy in the past; the emphasis has been on amendment of laws so as to increase the levels and standards of child labor protection. The research found that the reasons for

the reduction of child labor was due more to increased opportunities in education and the growth of economy than to factors such as stricter legal enforcement of child protection and a decline in demand for child labor. It is due to family poverty that both the employers and the children become parties in violating the law. At the same time, the employment of children under the age of 15 has to be made secretly which results in the children themselves losing their legal rights to benefits and any other protection as provided by labor laws. Good intentions on the part of the state have turned against the children themselves. A change of concept, attitude and strategy in the implementation of child labor policy is therefore, urgently needed. The previous strategy which emphasized protection should be changed into a strategy that focuses on skills and knowledge development for children. The proposals in connection with the policy for child labor development should have three objectives, namely:

- To support children from poor families to obtain opportunities to further their education up to the upper secondary level and/or vocational training after lower secondary level.
- To support the children who have left home for work to have opportunities for vocational training and/or further studies.
- To encourage the employers to reduce the employment of child labor.

The proposed policy is based upon an internationally recognized principle that "humanity has a duty to give the best things for children." The study proposes four strategies: a strategy for education at secondary level, a strategy for improvement of knowledge to poor children in the labor market, a strategy to encourage the employers to reduce the employment of child labor, and a strategy to create an umbrella organization to co-ordinate the policies and measures relating to the improvement of child labor. Details of the proposals are discussed in the final research report.

### **REFERENCE**

Nipon Poapongsakorn, et al. 2001. *Problems and Trend of Child Labor in Thailand: Consequences on the Future Opportunity of Child Labor*. Bangkok: Thailand Development Research Institute. (in Thai)

### **ENDNOTES**

- <sup>1</sup> The research is commissioned by the Ministry of Labour and Social Welfare.
- <sup>2</sup> However, the regression experiments to explain the decline in the labor force participation of child workers were not satisfactory.
- <sup>3</sup> The two equations do not yield exactly the similar results because there are a significant number of children who stay at home after their primary education.
- <sup>4</sup> This is because the sample is limited to child workers aged less than 18 years. The truncation may seriously-affect our statistical results. Moreover, such kind of sample makes it impossible to measure the job advancement of child labor.



# The Performance of Thai Banks, 1997-2001

Thida Intarachote\*

The Thai banking industry has experienced substantial changes after the 1997 financial crisis. It is evident that commercial banks have been consolidated, restructured and newly formed.<sup>1</sup> In addition, changes in regulation of banking procedures can also have potential impact on how the industry has evolved.

An analysis of a bank's balance sheet and income statement is essential in order to understand the bank's prevailing strengths and weaknesses (Sinkey 1998). A thorough analysis, therefore, of the bank's past and present performances enables the bank manager to chart the course of future events. Additionally, a comparison of the bank's present performance in relation to others in the industry also enables one to set a benchmark for banking performance. A financial statement analysis is also of interest to the bank regulators as it assists them in evaluating the potential impact brought about by changes in regulation and supervision on the bank's current and prospective financial performance and condition.

This study uses the balance sheet and income statement data of 13 Thai banks.<sup>2</sup> Data was obtained from the Thai Securities Exchange Commission website.

## PROFITABILITY

The profitability measurement shows how well the bank has performed and whether it has earned acceptable returns. The five indicators of bank profitability that have been examined are: return on assets, interest margin, net margin, yield on earning assets and asset utilization.

The first profitability measurement is the return on assets (ROA). This indicates the capability of the bank management in increasing the earnings from the bank's assets. Table 1 shows a decrease in average ROA during 1997-2001, which is the result of the apparent consequences of the financial crisis. The average figure increased in 2001 in which BBL had the highest ROA of 0.5 percent. The result indicates low but improved ROA.

**Table 1 Return on assets (%)**

	1997	1998	1999	2000	2001
BBL	0.29	-3.91	-5.08	-1.51	0.52
BAY	0.40	-1.98	-4.70	-1.98	-0.60
BMB	-12.41	-31.51	-3.71	-3.06	n.a.
BOA	0.03	-5.17	-7.39	-2.64	-2.40
BT	-2.49	-24.73	-8.14	-2.05	0.39
KTB	0.03	-5.78	-9.26	7.71	-0.45
SCB	0.45	-1.76	-7.11	0.50	0.06
SCIB	-5.29	-15.22	-2.84	-2.81	n.a.
DTDB	0.02	-6.86	-12.01	-14.43	0.17
TFB	0.10	-5.66	-7.24	0.16	0.13
TMB	0.35	-0.83	-3.47	-7.45	0.18
UOBR	-1.74	-35.15	16.61	-2.37	-1.22
SCNB	-0.23	-5.39	-3.03	-3.26	-1.05
<b>AVERAGE</b>	<b>-1.58</b>	<b>-11.07</b>	<b>-4.41</b>	<b>-2.55</b>	<b>-0.39</b>

Source: The author's own calculation.

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Table 2 shows the net interest margin. It is the ratio of interest income minus interest expense divided by earning assets, where the earning assets consists of all securities and loans. This ratio measures net interest yield on assets tied to the intermediation process. It appears that average interest margins were relatively small between 1998 and 1999 as a consequence of the 1997 financial crisis. Subsequently, the average ratio of the banks improved in 2001 compared to 2000, the only two exceptions were BAY and KTB. The results suggest an increasing trend of improved bank performances.

Net margin is interest and dividend income minus both interest and non-interest expenses, divided by revenues. Net margin reflects a bank's ability to cover all other costs. Table 3 shows that Thai banks, except

for SCB, did not make adequate income to cover their expenses. However the performance of 11 out of 13 banks in 2001 relative to 2000, clearly improved. This was mainly due to measures adopted to reduce costs, which included branch closure and early retirement scheme. SCB was the only bank that had a positive net margin of 0.05 percent in 2001. On average, the result suggests that banks were making progress on achieving profitability.

Table 4 shows the yield on earning assets, which is a measure for gross rate of return on earning assets. It appears that average rate decreased from 12.44 percent in 1997 to 5.68 percent in 2001. The declining trend suggests that banks chose to invest in lower return than before.

**Table 2 Net interest margin (%)**

	1997	1998	1999	2000	2001
BBL	4.15	0.91	0.84	2.55	2.59
BAY	3.53	1.20	0.83	1.68	1.38
BMB	0.45	-7.96	-1.65	-0.76	0.57
BOA	2.70	0.18	1.02	2.06	2.80
BT	1.97	-3.14	-1.85	-1.08	-0.45
KTB	4.05	1.42	0.76	3.32	2.69
SCB	4.04	2.20	1.83	2.55	2.94
SCIB	3.09	-2.11	-0.53	-0.35	0.77
DTDB	3.91	1.66	1.04	2.55	2.70
TFB	4.42	2.44	1.84	2.80	3.20
TMB	2.88	0.29	0.67	0.64	1.44
UOBR	1.78	-7.65	-23.98	-1.44	0.89
SCNB	3.02	0.24	0.89	2.11	3.30
<b>AVERAGE</b>	<b>3.08</b>	<b>-0.79</b>	<b>-1.41</b>	<b>1.28</b>	<b>1.91</b>

Note: the average value in 1999 is 0.47% if UOBR is excluded.

Source: The author's own calculation.

**Table 3 Net margin (%)**

	1997	1998	1999	2000	2001
BBL	0.144	-0.170	-0.232	-0.026	-0.011
BAY	0.087	-0.157	-0.274	-0.150	-0.201
BMB	-0.126	-1.051	-0.930	-1.066	-0.448
BOA	0.076	-0.208	-0.312	-0.172	-0.119
BT	-0.057	-1.162	-1.229	-0.833	-1.070
KTB	0.163	-0.065	-0.269	-0.143	-0.042
SCB	0.125	-0.141	-0.103	0.019	0.053
SCIB	0.069	-0.609	-0.827	-0.982	-0.507
DTDB	0.119	-0.176	-0.616	-2.072	-0.006
TFB	0.137	-0.156	-0.393	-0.122	-0.104
TMB	0.055	-0.193	-0.229	-0.295	-0.152
UOBR	-0.166	-1.052	-3.209	-0.723	-0.532
SCNB	0.055	-0.194	-0.632	-0.533	-0.255
<b>AVERAGE</b>	<b>0.052</b>	<b>-0.410</b>	<b>-0.712</b>	<b>-0.546</b>	<b>-0.261</b>

Source: The author's own calculation.

**Table 4 Yield on earning assets (%)**

	1997	1998	1999	2000	2001
BBL	12.16	11.66	7.25	7.41	6.57
BAY	12.58	14.10	7.35	6.43	5.15
BMB	12.90	12.31	5.00	3.82	4.29
BOA	11.11	12.35	5.75	5.63	5.61
BT	12.97	13.75	4.11	4.21	3.92
KTB	11.55	9.30	6.10	10.20	5.46
SCB	11.44	12.47	7.07	6.15	5.98
SCIB	13.21	10.87	5.28	4.33	4.27
DTDB	13.51	13.85	7.54	7.51	6.20
TFB	12.73	13.83	7.96	7.52	7.11
TMB	12.80	6.09	6.65	4.92	5.07
UOBR	11.95	10.87	21.69	18.53	7.80
SCNB	12.78	14.63	7.10	5.73	6.46
<b>AVERAGE</b>	<b>12.44</b>	<b>12.01</b>	<b>7.60</b>	<b>7.11</b>	<b>5.68</b>

Source: The author's own calculation.

Table 5 shows similar results to those in Table 4. The average asset utilization ratio, which reflects productivity of assets, reduced from 10.61 percent in 1997 to 4.22 percent in 2001. The result suggests a decline in total revenue produced by assets.

The analysis above indicates that banks did not earn adequate income to cover the costs because the rate of return on earning assets, on average, was decreasing. On the other hand, an increasing trend of interest margin and net margin implies an effort to reduce costs in order to improve their performance.

### Risk

In evaluating bank performance, risk measures are related to return on investments, because a bank must earn adequate profit to cover the risk assumed. An appropriate degree of total risks a bank should take is mainly influenced by its past performance, especially in those areas of investments in which adequate returns were obtained. A bank's level of risk should also be compared with similar banks and/or peer groups of

banks. Three main categories of risk measurement examined are capital adequacy risk, liquidity risk and credit risk.

A bank's capital adequacy indicates its ability to absorb unanticipated losses associated with various risks of banking (Sinkey 1998). Bank regulators view capital as a cushion for absorbing losses; therefore, capital adequacy standards is regarded as the most important measure of safety and soundness of depository institutions. *Ceteris paribus* the greater the capital, the lower the probability of insolvency. The adequacy of bank capital is gauged here by the ratio of capital to assets, because it is an overall indicator of capital strength.

Table 6 shows that there was a declining trend of average capital adequacy ratio. This was partly due to the bad debt write off that reduced the bank's retained earning; hence the decline in capital. It is noticeable that only SCB steadily increased its capital, this suggests that SCB is relatively less exposed to solvency risks than other banks.

**Table 5 Asset utilization (%)**

	1997	1998	1999	2000	2001
BBL	9.44	8.92	5.53	5.41	4.83
BAY	10.71	11.22	6.01	5.20	4.33
BMB	11.51	8.98	4.24	3.24	3.17
BOA	10.12	11.37	5.11	4.69	4.49
BT	10.99	10.63	3.10	2.99	2.40
KTB	10.12	7.85	4.89	4.25	4.04
SCB	9.54	10.22	5.99	5.09	4.61
SCIB	11.24	9.12	4.58	3.67	3.71
DTDB	12.23	12.23	6.47	6.10	5.17
TFB	10.08	10.84	6.12	5.31	5.04
TMB	10.31	5.17	5.74	4.42	4.38
UOBR	10.73	7.85	1.89	3.30	3.18
SCNB	10.89	10.92	6.18	4.94	5.57
<b>AVERAGE</b>	<b>10.61</b>	<b>9.64</b>	<b>5.07</b>	<b>4.51</b>	<b>4.22</b>

Source: The author's own calculation.

**Table 6 Capital to assets ratio (%)**

	1997	1998	1999	2000	2001
BBL	7.33	7.98	3.80	2.75	3.45
BAY	5.31	5.56	5.47	3.57	3.42
BMB	n.a.	n.a.	n.a.	n.a.	5.20
BOA	6.31	6.50	7.84	7.54	5.43
BT	4.07	n.a.	7.22	4.57	4.24
KTB	5.79	7.84	10.19	6.62	6.50
SCB	5.82	5.39	8.41	8.46	8.57
SCIB	n.a.	3.43	1.28	n.a.	6.25
DTDB	6.99	6.27	3.53	4.30	4.22
TFB	7.14	7.44	3.61	3.33	3.49
TMB	5.72	5.89	2.64	3.87	3.71
UOBR	6.01	n.a.	n.a.	6.24	4.97
SCNB	5.70	1.57	9.61	5.38	4.56
<b>AVERAGE</b>	<b>6.02</b>	<b>5.79</b>	<b>5.78</b>	<b>5.15</b>	<b>4.92</b>

Source: The author's own calculation.

The three indicators of a bank's exposure to liquidity risk are now examined. These are the ratio of loans to total assets, customer deposits to total assets and loans to customer deposits. A bank's liquidity risk arises from unexpected changes in the sources and uses of bank funds brought about by either (i) internal factors: such as poor liquidity planning and management, or (ii) external factors: such as unexpected demands and/or economic or financial collapse (Sinkey 1998). There is a trade-off between returns and liquidity risk. For example, a shift from short-term securities into long-term securities or loans could raise a bank's return, but increases its liquidity risk. Thus, a higher liquidity ratio for a bank indicates less risk and correspondingly a less profitable bank.

Table 7 shows that there was a downward trend of average loans to assets ratio, it decreased from 81.4

percent in 1997 to 64 percent in 2001. SCNB had the highest ratio of 81.6 percent while UOBR had the lowest of 38.3 percent in 2001. It appears that eight out of 13 banks in 2001 had lower ratio than that of the previous year. The result indicates a decreased liquidity risk and proportionately less bank lending following the 1997 financial crisis.

This section analyzes ratio of customer deposits to assets. The higher this ratio, the better a bank's liquidity position and a lower liquidity risk because customer deposits are generally a more stable source of funding. Table 8 shows an increasing trend of average ratio from about 65 percent in 1997 to 83 percent in 2001. The reduction of average ratio in 2001 from the previous year is partly due to substantial decreased ratio for BT and DTDB. However, the overall result suggests a higher liquidity of the Thai banking system.

**Table 7 The ratio of loans to total assets**

	1997	1998	1999	2000	2001
BBL	0.7289	0.6768	0.6398	0.5906	0.5240
BAY	0.8161	0.7576	0.7570	0.7474	0.7613
BMB	0.8754	0.6902	0.7925	0.7626	0.6872
BOA	0.8540	0.8160	0.7174	0.7168	0.6629
BT	0.7829	0.7060	0.6778	0.6415	0.4709
KTB	0.8469	0.8055	0.7564	0.3838	0.6971
SCB	0.7808	0.7483	0.6916	0.6553	0.6035
SCIB	0.8190	0.7462	0.7357	0.7081	0.6984
DTDB	0.8801	0.7618	0.7757	0.7345	0.7384
TFB	0.7425	0.7091	0.6457	0.5971	0.5493
TMB	0.7718	0.8091	0.8088	0.7859	0.7259
UOBR	0.8818	0.6934	0.0558	0.1532	0.3830
SCNB	0.8060	0.6856	0.7828	0.7773	0.8164
<b>Average</b>	<b>0.8143</b>	<b>0.7389</b>	<b>0.6798</b>	<b>0.6349</b>	<b>0.6399</b>

Source: The author's own calculation.

**Table 8 The ratio of customer deposits to total assets**

	1997	1998	1999	2000	2001
BBL	0.6720	0.7654	0.8092	0.8360	0.8620
BAY	0.7879	0.8358	0.8064	0.8330	0.8473
BMB	0.4227	0.9408	0.9637	1.0235	0.9128
BOA	0.5117	0.7764	0.7954	0.8628	0.8764
BT	0.6598	0.9182	0.7206	0.7401	0.6210
KTB	0.7332	0.7544	0.8080	0.8529	0.8873
SCB	0.7794	0.8373	0.8214	0.8342	0.8381
SCIB	0.5983	0.7470	0.8004	0.8997	0.8802
DTDB	0.6898	0.8206	0.8288	0.8046	0.7793
TFB	0.7398	0.8226	0.8368	0.8438	0.8579
TMB	0.6629	0.7904	0.7756	0.7978	0.8202
UOBR	0.5208	0.8375	0.6949	0.8957	0.7654
SCNB	0.6340	0.8234	0.7582	0.8120	0.8245
<b>Average</b>	<b>0.6471</b>	<b>0.8208</b>	<b>0.8015</b>	<b>0.8489</b>	<b>0.8286</b>

Source: The author's own calculation.

Table 9 shows the ratio of loans to customer deposits. The higher this ratio, the greater the proportion of deposits invested in loans. The results are consistent to those in Tables 7 and 8, suggesting a decreased liquidity risk of banks during 1997-2001. DTDB and SCNB had a relatively large ratio of greater than 90 percent, which was higher than the industry average of 77 percent in 2001. In general, the proportion of bank lending decreased.

Table 10 shows the share of bad debt provision or expenses set aside as a proportion of total loans, which is a measure of credit risk. It appears that the average ratio was relatively high in 1998 and 1999 as a result of financial crisis in 1997. Thereafter, the average ratio reduced to 1.2 percent in 2001. The results suggest a decreased credit risk of Thai banks.

Overall analysis of bank risk indicates a substantial fall in the amount of bank capital, except for

SCB, during 1997-2001. Additionally, there was a decrease in liquidity risk and credit risk because of reduced bank lending. This led to increased liquidity in the banking system, and as already explained it is due to the relaxation of liquidity requirement ratio during the studied period.

### Efficiency

Financial ratio analysis of bank efficiency provides useful supplemental information to return and risk measures (Hempel and Simonson 1999). It reflects the competitive advantage of a bank i.e., it indicates the cost of transforming bank liabilities and assets into earning assets. Efficiency can be measured in several ways. The method employed here are: the ratio of net non-interest expenses to total assets, earning power, cost rate on purchased funds and cost to income.

**Table 9 The ratio of loans to customer deposits**

	1997	1998	1999	2000	2001
BBL	1.0847	0.8841	0.7906	0.7065	0.6079
BAY	1.0358	0.9064	0.9388	0.8973	0.8985
BMB	2.0710	0.7336	0.8224	0.7451	0.7529
BOA	1.6688	1.0510	0.9020	0.8308	0.7564
BT	1.1866	0.7689	0.9406	0.8668	0.7584
KTB	1.1550	1.0678	0.9362	0.4500	0.7857
SCB	1.0018	0.8936	0.8420	0.7855	0.7202
SCIB	1.3689	0.9990	0.9192	0.7871	0.7935
DTDB	1.2758	0.9284	0.9359	0.9129	0.9474
TFB	1.0037	0.8620	0.7717	0.7076	0.6402
TMB	1.1642	1.0237	1.0427	0.9850	0.8850
UOBR	1.6931	0.8280	0.0804	0.1710	0.5004
SCNB	1.2714	0.8326	1.0324	0.9572	0.9901
<b>Average</b>	<b>1.3062</b>	<b>0.9061</b>	<b>0.8427</b>	<b>0.7541</b>	<b>0.7721</b>

Source: The author's own calculation.

**Table 10 Past due loans to total loans (%)**

	1997	1998	1999	2000	2001
BBL	2.76	5.60	8.94	4.79	0.78
BAY	1.76	1.26	4.68	2.05	0.39
BMB	n.a.	n.a.	n.a.	n.a.	1.98
BOA	1.20	4.59	9.36	4.22	4.10
BT	3.63	17.95	6.93	n.a.	n.a.
KTB	2.83	7.57	11.24	7.32	1.43
SCB	2.07	2.14	10.87	1.34	n.a.
SCIB	8.16	13.22	0.02	0.05	1.37
DTDB	1.95	6.93	11.31	2.04	0.62
TFB	2.85	7.73	8.24	n.a.	0.51
TMB	1.17	0.26	3.36	8.78	0.07
UOBR	0.24	38.97	n.a.	2.04	0.82
SCNB	1.77	8.25	n.a.	1.30	1.13
<b>Average</b>	<b>2.53</b>	<b>9.54</b>	<b>7.49</b>	<b>3.39</b>	<b>1.20</b>

Source: The author's own calculation.

Net-non-interest expenses to assets ratio measures efficient use of overhead accounting for expenditures to create non-interest income. The lower the ratio, the more efficient is the bank. Table 11 shows a declining trend of average ratio after a sharp increase in 1998. In 2001, SCB had the lowest ratio of 0.87 percent followed by BBL (0.98) and TMB (1.0). There were eight out of 13 banks whose ratio in 2001 was less than that in 2000. The result suggests a more efficient use of overhead expenses of Thai banks.

Earning power indicates how fully a bank invests in interest yielding assets (Hempel and Simonson 1999). It is calculated by the ratio of earnings assets to total assets. *Ceteris Paribus* the higher the ratio the more efficient the bank's investment. Table 12 shows a

downward movement of average earning power. This was partly due to the decrease in bank lending (see also Tables 6 and 8). In 2001, there were six out of 13 banks whose ratio was below the industry average. The result suggests less efficient earnings of the bank's investment.

Table 13 shows the cost rate on purchased funds, where purchased funds consist of customer deposits, interbank borrowings and other borrowings. It appears that the gross interest cost of banks declined over time. This was mainly due to a reduction in interest rates over the past three years. In 2001, KTB had the lowest cost rate of 2.22 percent, followed by BOA (2.43) and SCB (2.63). The results suggest that banks have had advantages of relatively low funding costs.

**Table 11 Net non-interest expenses to total assets (%)**

	1997	1998	1999	2000	2001
BBL	0.61	0.82	0.00	0.54	0.98
BAY	1.02	1.93	1.84	1.80	1.45
BMB	n.a.	3.45	2.16	2.48	1.34
BOA	1.32	1.59	1.57	1.30	1.75
BT	1.31	9.63	2.05	1.28	1.91
KTB	1.11	1.12	1.37	1.50	1.44
SCB	1.02	1.96	1.14	0.73	0.87
SCIB	1.17	3.62	2.37	2.47	2.11
DTDB	1.77	3.04	4.12	15.00	1.62
TFB	1.25	2.35	2.98	1.71	1.77
TMB	0.91	0.86	1.32	1.12	1.00
UOBR	3.13	2.60	3.46	1.80	1.27
SCNB	1.38	1.60	4.09	4.07	2.97
<b>Average</b>	<b>1.33</b>	<b>2.66</b>	<b>2.19</b>	<b>2.75</b>	<b>1.58</b>

Note: the average value in 2000 is 1.73% if DTDB is excluded.

Source: The author's own calculation.

**Table 12 Earnings power (%)**

	1997	1998	1999	2000	2001
BBL	77.63	76.46	76.23	73.10	73.56
BAY	85.15	79.56	81.77	80.77	83.99
BMB	89.24	72.94	84.87	84.70	73.80
BOA	91.04	92.06	88.85	83.39	80.02
BT	84.69	77.31	75.36	71.12	61.14
KTB	87.64	84.37	80.24	41.70	74.06
SCB	83.38	81.98	84.66	82.71	77.02
SCIB	85.08	83.94	86.66	84.55	86.97
DTDB	90.54	88.32	85.87	81.25	83.42
TFB	79.19	78.40	76.97	70.63	70.82
TMB	80.49	84.89	86.31	89.89	86.36
UOBR	89.75	72.26	8.72	17.80	40.78
SCNB	85.17	74.64	86.95	86.33	86.30
<b>AVERAGE</b>	<b>85.31</b>	<b>80.55</b>	<b>77.19</b>	<b>72.92</b>	<b>75.25</b>

Source: The author's own calculation.

**Table 13 Cost rate on purchased funds (%)**

	1997	1998	1999	2000	2001
BBL	7.05	9.17	5.19	3.74	3.10
BAY	8.52	11.13	5.76	4.06	3.35
BMB	10.96	15.24	5.70	3.75	2.96
BOA	8.77	12.32	4.75	3.29	2.43
BT	10.41	13.22	5.09	4.04	3.44
KTB	7.28	7.39	4.86	3.15	2.22
SCB	6.85	9.22	5.00	3.33	2.63
SCIB	8.99	11.51	5.61	4.04	3.31
DTDB	9.56	11.78	5.92	4.31	3.13
TFB	7.35	9.89	4.98	3.55	2.95
TMB	8.79	5.40	5.49	4.08	3.33
UOBR	10.29	15.68	5.49	3.83	3.05
SCNB	9.16	11.12	6.14	3.60	2.98
<b>AVERAGE</b>	<b>8.77</b>	<b>11.00</b>	<b>5.38</b>	<b>3.75</b>	<b>2.99</b>

Source: The author's own calculation.

Table 14 shows a basic measure of bank operating efficiency, which indicates how well a bank is using its resources. The lower the cost to income ratio, the higher the bank's operating efficiency. Total cost here is expressed as interest plus non-interest expenses and loan loss reserves, while income comprises interest and dividend income and non-interest income. It appears that the average ratio heightened substantially in 1998 and 1999 compared to an average in 1997. Thereafter, there was a declining trend in the average cost to income ratio. In 2001, SCB had the highest operating efficiency since it reported the lowest cost to income ratio at 75 percent. Meanwhile, BT and SCIB were relatively inefficient.

On average, cost to income ratio of Thai banks was relatively high. The results are supported by the recent estimates carried out by Solomon Smith Barney,

(*Asian Banker Journal* 2002) that banks in other countries in Asia Pacific region were relatively more efficient than Thai banks except for the Philippines. The finding indicates a pressing need for Thai banks to improve their operating performances.

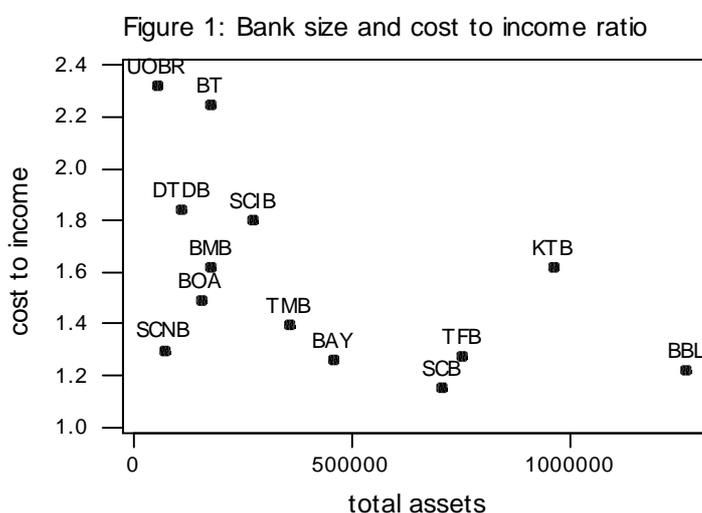
The overall results suggest a relatively low but improved efficiency of Thai banks during 1997-2001. Also, there is still a need to increase income by making efficient investment and further reduce their operation costs.

It is possible to examine further if there is a relationship between bank size and operating efficiency. Figure 1 shows the plots between the average bank size (as measured by total assets) and cost to income ratio during 1997 to 2001. The plots suggest a negative relationship, implying that bigger banks are relatively more efficient.

**Table 14 Cost to income ratio**

	1997	1998	1999	2000	2001
BBL	0.943	1.373	1.653	1.219	0.911
BAY	0.953	1.159	1.719	1.359	1.120
BMB	0.954	2.132	1.660	1.765	1.595
BOA	0.990	1.415	2.211	1.431	1.399
BT	1.207	3.215	3.420	1.570	1.800
KTB	0.996	1.713	2.668	1.610	1.094
SCB	0.931	1.151	2.010	0.921	0.756
SCIB	1.438	2.680	1.550	1.695	1.643
DTDB	0.996	1.536	2.623	3.081	0.970
TFB	0.988	1.483	1.979	0.957	0.964
TMB	0.955	1.147	1.541	2.388	0.964
UOBR	1.159	5.242	n.a.	1.626	1.261
SCNB	1.020	1.606	1.109	1.612	1.147
<b>Average</b>	<b>1.041</b>	<b>1.989</b>	<b>2.012</b>	<b>1.633</b>	<b>1.202</b>

Source: The author's own calculation.



## Discussion and Conclusion

This study examined the performance of Thai banks during 1997-2001. The results show that in certain areas the Thai banks' performance did improve. First, there was an increasing trend of profitability measures, which correspond with decline in both liquidity risk and credit risk. Second, there was a reduction of overhead costs and cost of funding. At the same time, though, Thai banks did not increase their yield on earning assets and their earning power clearly declined. There is evidence to suggest that the relaxation of liquidity assets did not promote bank lending as expected. Although, banks have now shifted their attention from firms to consumer, there is still a problem of credit information. As noted in *The Economist* (2002) pages 67-68, many banks in Asia are still in the dark about people walking into their branches because there is no credit bureau where banks can share information about their customers. At present, it is possible that fierce competition in the industry would force banks to lend blindly and recklessly to consumer. Thus, there is a need for banks, on average, to set aside

more capital than they do now to cover their potential losses.

The analysis presented in this study contributes to a greater understanding of the performance of the Thai banks. However, a more in-depth analysis in other area such as changes in efficiency and productivity of banks are warranted before coming to a policy conclusion. Overall, the immediate pressing challenge is that of improving bank's own internal efficiencies and increasing priority of cost reduction and risk management. Consolidation to build scale in order to capture opportunities in the market will be a strategic driver for some banks in the near future. In general, banks are subject to the pressures of deregulation (liberalization) and re-regulation (of prudential and supervisory rules), which may restrict bank price competitiveness. Under these conditions, quality service, customer focus, market positioning, product diversification and innovation appear to become relatively more important bank strategies. Thai banks will have to deal with these issues if they want to be competitive in attracting capital.

## ENDNOTES

- <sup>1</sup> Most of these changes occurred in 1998. For instance, the Bangkok Bank of Commerce (BBC) was ordered to write down its capital and recapitalize then transfer good assets to the Krung Thai Bank and transform itself into an asset management company. The Bank of Asia sold 75 percent of its shares to the ABN Amro Bank while the Thai Danu Bank sold 50.27 percent of its shares to the Development Bank of Singapore. The First Bangkok City Bank was ordered to write down its capital and recapitalize and later acquired by the Krung Thai Bank. The Union Bank of Bangkok was ordered to write down its capital and recapitalize, then merge with 13 finance companies to form a new bank called the Bank Thai.
- <sup>2</sup> These are Bangkok Bank (BBL), Bank of Ayudhaya (BAY), Bangkok Metropolitan Bank (BMB), Bank of Asia (BOA), Bank Thai (BT), Krung Thai Bank

(KTB), Siam Commercial Bank (SCB), Siam City Bank (SCIB), DBS Thai Danu Bank (DTDB), Thai Farmer Bank (TFB), Thai Military Bank (TMB), UOB Radanasin Bank (UOBR) and Standard Chartered Nakornthon Bank (SCNB).

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## ANNOUNCEMENT

### The 2002 Year-end Conference on

### “MEETING THE CHALLENGES FROM GLOBALIZATION”

The 2002 Year-End Conference will be organized on the theme of “Meeting the Challenges from Globalization.” The Conference will be held on December 14-15, 2002 at the Ambassador City Jomtien, Pattaya.

The Conference will be divided into five themes in two major groups:

#### 1. Influencing the external environment of globalization

- 1.1 Thailand's positioning in the context of global rules for trade, investment and finance.
- 1.2 Regional and bilateral economic cooperation to increase economic strength and leverage.

#### 2. Domestic adjustment to meet the challenges of globalization

- 2.1 Macroeconomic adjustment to restructuring to attain an appropriate balance between dependence on the external and internal environment.
- 2.2 Minimizing the effects of globalization on vulnerable groups.
- 2.3 Enhancing international competitiveness.

The first day of the Conference agenda will cover a morning plenary session and an afternoon session of five group discussions pertaining to the above themes. The second day will cover a morning plenary session to present results and recommendations from the group discussions.

For more information, please contact Ms. Raveewan at tel. 02-718-5460 ext. 220 or Mr. Jirote at ext. 222 or Ms. Ratanaporn at ext. 200, or e-mail address: [publications@tdri.or.th](mailto:publications@tdri.or.th). Updated information on the Conference can be accessed at the TDRI website: [www.tdri.or.th](http://www.tdri.or.th).



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