6

Operating Environment

The analysis and case studies that have been presented in Chapter 5 make a compelling case that a sound banking sector is critical for macroeconomic stability. The effects of systemic banking failures have been dramatic not only in the countries studied in detail in that chapter, but also in most of the 140 countries listed in Table 2. When an outright crisis occurs as the result of extensive banking sector problems, the impact on the real economy is usually immediate and obvious. Even when an outright crisis has been averted, the cost of distortions in resource use and of restructuring and recapitalizing the banking sector will burden the economy for years to come. Particularly where such costs are borne by the public sector, the implications will haunt economic management for an extended period of time.

Preventing such problems, or, more positively, maintaining a sound banking system, is therefore a legitimate and necessary goal of economic policy. Clearly this goal has microeconomic dimensions, and policies that affect the structure, conduct, and performance of the financial industry directly affect the achievement of this objective. The following chapters present a framework for sound banking that comprises a supportive operating environment, internal governance, external discipline provided by market forces, and external governance provided by regulation and supervision at the domestic and international levels. No single one of these elements is sufficient by itself; each is subject to failure, or may be underdeveloped in a given economy.

The economic environment, the quality of internal governance of banks, and the structure of the markets in which banks operate will all affect bank behavior and their soundness. A sound banking system requires an appropriate infrastructure to support the efficient conduct of banking business and a stable macroeconomic environment, which is conducive to efficient savings and investment decisions.

Economic Infrastructure

There are two important elements of economic infrastructure: the institutional framework, which includes the legal, administrative, and political structures that guide economic and financial transactions, and the structure of financial markets, which provides the immediate operating context for banks.

Institutional Framework

Banking requires a legal system that facilitates the enforcement of financial contracts, loan recovery, and realization of collateral. Banks must be able to collect what is due to them. If they have no recourse against borrowers who default, borrowers will have reduced incentives to repay their loans. Poorly defined bankruptcy procedures can further reduce incentives to repay and impair asset recovery. Similarly, where banks cannot rely on collateral, the value of their portfolios may be in jeopardy; problems in establishing full title to and realizing collateral have exacerbated bank weakness in a number of countries. Thus, the legal framework should include adequate corporate, bankruptcy, contract, and private property laws.

There must also be an administrative structure capable of enforcing the laws. The judicial system must be impartial, honest, and knowledgeable regarding financial transactions so that banks can rely on fair and speedy enforcement of economic rights and obligations. In addition, governing political structures must respect legal procedures and property rights, and not interfere in the operations of banks or in the administration of laws and regulations, including the enforcement of loan recovery. Inadequate legal frameworks characterized most of the developing and transition economies in our sample (Table 12), and many of the banking systems suffered from political interference in lending.

The structure of the banking industry also influences its soundness. A competitive banking system is essential for long-term efficiency and soundness. While a concentrated banking industry may enjoy economic rents, it often becomes inefficient and unable to respond innovatively to charges in the economic environment. This phenomenon is prevalent in banking systems dominated by state-owned banks. A significant number of countries with concentrated but inefficient systems have had banking problems, including 23 of the countries in our sample (Table 12). Competition and a well-functioning market for corporate control can potentially remove inefficient or unprofitable banks before they become insolvent. An open and competitive banking market exerts its own form of discipline against weak banks while encouraging well-managed banks.

Table 12. Financial and Legal Framework[1]

Argentina (1980–82): The financial system was bank dependent and dominated by publicly owned banks.

(1989–90): There were still few alternatives to banks, and state-owned banks still dominated the system with 64% of bank assets. The system was moderately concentrated at the top with 5 banks holding 36% of banking sector assets. Banking groups were important.

(1995): There were still few alternatives to banks, and state banks still dominated, although their share had fallen to 40%. Foreign competition comprised 16.5% of system assets. However, the system was overbanked with smaller banks because entry was easy.

Bangladesh (1980s-present): There was insufficient competition. The contract and credit laws were antiquated and an anti-repayment and anti-enforcement culture within a weak judicial system made obtaining judgment in loan-default cases virtually impossible. Bank exit is a problem as the central bank, Ministry of Finance, and the courts are all involved.

Bolivia (1994–present): The banking system is somewhat concentrated—two banks own 30% of assets. Laws and regulations and their implementation and enforcement are inadequate. Judgments are delayed.

Brazil (1994–present): Weaknesses in the regulatory and supervisory structure are being addressed by the authorities.

Chile (1981–86): Increasing concentration of bank and corporate ownership led to the emergence of unregulated conglomerates that practiced oligopoly pricing.

Czech Republic (1991–present): The money, credit, and capital markets are thin, but developing. The banking system is concentrated—5 banks own 73% of bank assets.

Egypt (1991–95): Competition exists but remains limited.

Estonia (1992–95): At the start of the crisis, the financial markets were still underdeveloped, and were in transition to a market economy. The state still owned the savings bank. The banking system was concentrated. There was no direct foreign competition—only joint ownership was permitted.

Finland (1991–94): The money and capital markets were undeveloped until the late 1980s. Competition was limited in terms of the number of credit institutions and new entrants in the late 1980s. The banking system was highly concentrated.

France (1991–95): There is an adequate legal framework; however, the system includes several significant state-owned institutions, and the regulatory system did not eliminate the unequal advantages and constraints that differentially affected public and private institutions.

Ghana (1983–89): The government wholly or partly owned virtually all banks. Money market development was hampered by an inadequate operational framework. Competition was limited: the largest bank accounted for 44% of total assets and the 7 largest banks, for 70%. There was an inadequate legal, regulatory, and supervisory framework.

Table 12 *(continued)*

Hungary (1987–present): State ownership of large banks had fallen to 38% by the end of 1991 but rose again to 70% in 1994 owing to recapitalization. The system is concentrated (5 banks owned 84% assets in 1989 and now hold 64%). Foreign competition is important and increased further in 1995 with the privatization of one commercial bank and the partial sale of the large savings bank. New financial sector legislation is expected to be enacted in 1996.

Indonesia (1992–present): The financial markets are bank dominated. Liberal licensing in the late 1980s and the growing number of private banks have increased competition, and the market share of state banks has declined.

Japan (1992–present): There are deep and broad financial markets, but they are bank dominated and there is high concentration. Foreign competition is weak and entry is difficult. Some banks are segregated by region and industry. Foreclosures are difficult.

Kazakstan (1991–95): The banking system is concentrated, with 4 banks owning 80% of the assets. Many new licenses have been issued and competition is increasing, but foreign banks have difficulty entering the market, which is segregated by industry. The bankruptcy and collateral laws were inadequate. An improved banking law is now in place, but accounting is still weak and the courts are unreliable.

Kuwait (1990–91): There is a high degree of competition among domestic banks and other financial institutions, although the regulations prevent the entry of foreign banks.

Latvia (1995–present): The financial sector is dominated by banking institutions and is highly concentrated and segmented. Lack of collateral laws and poor enterprise accounting resulted in high credit risk.

Lithuania (1995–present): The banking system was highly concentrated and state dominated, with 5 banks accounting for about 70% of total assets, and 3 of the 4 largest banks state owned. Banking laws and accounting practices were inadequate.

Malaysia (1985–88): The financial markets were broad and deep and foreign ownership was strong (16 of 36 banks). The court system provided fast and stern judgments.

Mexico (1994–present): Between 1991 and 1994, the Mexican financial system was reprivatized and grew considerably. The number of commercial banks increased from 20 to 35, although foreign participation in the financial system was limited. Credit-rating bureaus did not exist until 1995.

Norway (1987–93): There was no foreign ownership until 1984. Finance companies were unlicensed until 1978. The securities markets were thin.

Pakistan (1980–present): Despite some entry, there is still little competition. The legal procedures for recovering bad debts are generally very protracted.

Paraguay (1995–present): Licensing is lax, despite legislation on minimum entry capital. Liquidation is carried out through the courts.

Philippines (1981–87): Segregation of commercial and development banks weakened competition as did high concentration at state banks and financial groups.

Poland (1991–present): The banking system is somewhat concentrated (5 banks own 50% of assets). Needed laws and regulations have been introduced, but they are not yet fully effective.

Table 12 *(concluded)*

Russia (1992-present): Competition exists but the market is segmented. The legal infrastructure is weak and, in some cases, contradictory.

Spain (1977–85): The thin financial markets were bank dependent. Entry had been severely restricted, so concentration was relatively high, although foreign entry was permitted after 1963. The licensing laws became relaxed and many of the 35 new banks quickly failed.

Sweden (1990–93): Thin financial markets were bank dependent. The banking system is an oligopoly with little foreign competition. After entry was eased in 1985, several new banks (both domestic and foreign) entered the market.

Tanzania (1988-present): The financial system is concentrated and bank dependent with little competition—1 bank holds more than 75% of assets. Foreign banks were allowed only in 1992.

Thailand (1983–87): There was a lack of competition and heavy concentration—3 banks owned 57% of assets. The foreign banking presence was minimal.

Turkey (1994): Competition exists, but many banks have close linkages to business groups both domestically and internationally and banks are specialized by industry.

United States (1980–92): The financial markets were deep and broad and bank concentration was low. Interstate restrictions forced banks to be undiversified, however. Entry restrictions for banks were relaxed in the mid-1980s and many of the new banks subsequently failed.

Venezuela (1994-present): The banking system was concentrated (6 banks held 57% of bank assets) and foreign competition was limited until 1995. Laws, regulations and enforcement were weak.

Zambia (1994–present): The financial system is bank dependent and concentrated, with 5 of 19 banks holding 85% of the assets. 12 new licenses are outstanding.

[1] Years in parentheses denote the period of banking problems.

Therefore, an appropriate structure of antimonopoly laws and competition policies can make an important contribution to the long-term soundness of a banking system.

Financial Markets

The financial markets define the operating context for banks and the set of opportunities available to them. Banks that are part of a financial system with well-developed interbank and money markets will have available a wider range of investments and sources of liquidity and face different forms of competition than banks in less-well-developed markets. In general, this would be expected to enhance systemic soundness, by providing banks with greater opportunities to diversify risk and increase efficiency

in resource use. It may, however, also result in more competitive pressure, and in greater risks of contagion and domino effects when banks fail to control their interactions with unsound banks.

Perhaps the most important aspect of banks' market interactions is their central role in the payments system. Operating within the payments system exposes participants to various forms of risk. The most pervasive among these are credit risk and liquidity risk. Credit risk is the risk that one party in a transaction may not be able to meet its obligation because of insolvency; liquidity risk is the probability that the counterparty will not be able to settle on time. Another risk is operational risk, which arises when payments are delayed as a result of a technical problem. The most worrisome risk, however, is systemic risk. This occurs when the failure of one or more institution(s) to meet its (their) settlement obligations has a domino effect throughout the system, leading to liquidity or solvency problems in other institutions.

Steps can be taken to reduce risk in the payments system. Making transactions irreversible and as simultaneous as possible is one approach. Sometimes this is done by channeling settlement through the central bank, particularly for large-value payments, and by specifying finality rules. Real time gross settlement also reduces payments risk but is not cost-effective in all situations and may leave the system susceptible to gridlock unless accommodated by appropriate liquidity support. Retail, high-volume/low-value payments are usually cleared through clearing houses, which often have sought to control risk by removing from the settlement the transactions of any bank that cannot fulfill its obligations. Such arrangements could create systemic problems, however, as withdrawing one bank's transactions could cause other banks to be unable to settle their obligations. Thus, increased emphasis has been placed on other solutions, such as explicit loss-sharing arrangements to enable settlement to occur and having banks control bilateral exposures to each other. While progress has been made on modernizing and standardizing laws and practices governing payments across countries, much remains to be done to create a legal framework that will support payments systems that can reduce international payments risk.

The broader financial markets also have important influences on bank soundness. Banks must compete with debt and equity markets as sources of finance for enterprises. Banks may also engage in securities market operations on behalf of customers or for their own accounts. These activities provide opportunities for profit, but also present additional risks. Securities markets that are themselves poorly regulated or subject to wide fluctuations can adversely affect bank portfolios and thus the soundness of banks. For example, several banks operating in India incurred large losses in 1992 due to irregularities in trading in Indian equities, government

securities, and public sector bond markets. In Japan, banks holding large equity positions were adversely affected by the sharp decline of the Japanese stock market after 1990.

Economic Conditions and Noneconomic Shocks

An adequate infrastructure is not sufficient to ensure that the banking system remains sound. As discussed above, the banking system mirrors the health of the economy as a whole. If the economy has experienced recession, policy shocks, or other disruptions, the banking system will reflect these events in its balance sheet (see Table 4). When the economy weakens, banks in general may find that their capital, based on earlier expectations of loss, is no longer adequate. A sound banking system will have the capital and reserves necessary to weather normal business cycles; however, events in many countries have shown that existing minimum capital standards have not been sufficient to withstand substantial or prolonged economic crises.

One factor contributing to this is that loan values may decline rapidly owing to the simultaneous actions of individual distressed banks. For example, if several banks have extensive real estate exposures, problems at a few banks that result in distress sales of collateral may drive down prices, resulting in further deterioration of other banks' positions. Individual banks may not have the information necessary to assess ex ante the interlinkages between their portfolios and those of other banks and to monitor the potential impact and feedback effects of broader economic trends.

Banks may also be affected by a variety of noneconomic shocks such as political unrest or interference, or natural disasters (see Table 4). These are occasionally predictable or preventable, but often banks have little opportunity to protect themselves. Political unrest reduces confidence in the economy and the financial system and can contribute to the disappearance of markets, sudden shifts in prices or exchange rates, or episodes of capital flight. Wars affect banks in the conflicting countries but their effect may be more widespread. For example, the Falklands war adversely affected banks in Argentina, Chile, and Uruguay in 1982. The Persian Gulf war resulted in the Kuwaiti government's taking over a large portfolio of bad loans from the banking sector in that country. Several Croatian banks that might have weathered the economic aspects of the disintegration of Yugoslavia became insolvent because of war-related defaults.

Natural disasters can impair borrowers' ability to repay, as well as banks' ability to function. Insofar as natural disasters are recurrent, they should be anticipated by banks and their borrowers, with additional cushions of capital and liquidity built up for contingencies. Events like flood-

ing in areas that are prone to inundation are sometimes used as an excuse for debt forgiveness, eroding bank soundness, engendering moral hazard, and creating the basis for a culture of nonrepayment in the future. This was the case in Bangladesh.

Political interference in banking for quasi-fiscal purposes is perhaps the most common form of noneconomic disturbance. For example, governments in many countries direct banks to make loans to certain sectors or industries often without regard for proper credit evaluation criteria or at subsidized interest rates. Such interference contributes to bank fragility and is addressed further below in the context of internal governance and regulatory failure.

Financial Sector Liberalization

In recent years, many countries have implemented programs of financial sector liberalization, often as part of a broader program of stabilization and economic opening. While the long-term benefits of such programs are clear, liberalization is a form of policy shock. Deregulation permits banks to enter into new and unfamiliar areas of business, where they may incur increased exposure to credit, foreign exchange, and interest rate risk. For example, formerly regulated banks may lack the necessary credit evaluation skills to use newly available resources effectively, and rising asset prices may be relied upon for repayment, rather than projected cash flows. Deregulation often opens the domestic banking market to other financial institutions and to foreign competition; this will put pressure on the market share and profitability of domestic banks, at least in the short term.

Unless properly overseen, liberalization can result in too rapid growth of bank assets, overindebtedness, and asset price bubbles. Market participants and supervisors, as well as banks, face challenges in managing the liberalization and adjusting to the new environment. Since radical changes in banks' operating environment can be expected to increase banking risks and affect banking soundness, liberalization should be accompanied by prior or concurrent measures to strengthen the oversight framework.

Some form of liberalization was under way in most instances of banking sector problems experienced by the sample countries (Table 13). Although there is no direct connection between financial liberalization and financial crises, many banking systems have experienced significant problems following liberalization, particularly where adequate internal controls had not been developed and prudential regulation and supervision failed to contain the increased risk of new or expanded activities. Examples include Argentina (early 1980s), Finland, Thailand, the United

Table 13. Financial Sector Liberalization[1]

Argentina (1980–82): In 1977, before the crisis, the financial sector grew faster than GDP. After the removal of controls on interest rates, real rates became positive, doubled and became volatile. Entry barriers and branching restrictions were removed in 1977. The economy was opened to trade and capital flows in 1976 and 1981. The exchange rate was devalued and then allowed to float in 1981.

(1989–90): Prices and the exchange rate were freed in 1989.

(1995): Capital flows were completely liberalized under the Convertibility Law of 1991 and the Argentine peso was pegged to the U.S. dollar. Industry is being privatized.

Bangladesh (1980s-present): Two state-owned banks were privatized; credit controls were terminated; and interest rates were largely deregulated in late 1984; foreign exchange markets were unified in 1991–92; restrictions on current transactions were lifted in 1994.

Bolivia (1994–present): Liberalization was not a factor, although permission for dollar deposits and transactions contributed to capital inflows.

Brazil (1994–present): During the second half of 1994, there was a consumption boom. The disinflation process was accompanied by rising real wages and a lower inflation tax. Credit to individuals increased by 91% in the third quarter of 1994 relative to the previous quarter, and by nearly 14% in the fourth quarter of 1994.

Chile (1981–86): Comprehensive liberalization of the economy included the removal of price controls, privatization of most state-owned enterprises, trade liberalization, and financial reform. Domestic interest rates remained high, however, in both nominal and real terms.

Czech Republic (1991–present): In transition from a controlled to a market economy. Enterprise privatization is ongoing and 80% of assets are in private hands; banks have been privatized, but the state retains an important ownership interest in the largest banks.

Egypt (1991–95): The liberalization of trade, interest rates, and prices is under way; limited privatization is ongoing.

Estonia (1992–95): In transition from a controlled to a market economy.

Finland (1991–94): Capital controls and restrictions on lending were removed and credit rationing was ended in the mid-1980s. An asset-price boom followed. Foreign banks were allowed to enter in 1982. The banking industry engaged in very heavy competition for market share after deregulation in the mid-1980s. In this process, banks' margins were reduced and interest rates did not compensate for banks' risk exposure.

France (1991–95): Regulatory reforms were undertaken from the mid-1980s.

Ghana (1983–89): The exchange system was liberalized in 1986–87. Most interest rates were decontrolled in 1987. Most controls on sectoral credit allocation were abolished in 1988. The agricultural lending requirement was lifted in 1990.

Hungary (1987–present): The economy is in transition from a controlled to a market economy. Interest rates were deregulated in 1990. Banks are being privatized and competition increased.

Indonesia (1992–present): The financial sector was deregulated in the late 1980s, and reserve requirements were reduced.

Table 13 *(continued)*

Japan (1992–present): Interest rates were deregulated and capital movements were freed. The authorities continued to exercise some moral suasion, however.

Kazakstan (1991–95): In transition from a controlled to a market economy. The liberalization of prices has been completed; for interest rates and trade, it is under way. Privatization is also under way.

Kuwait (1990–91): There has been a relaxation of financial and interest rate policies and limited divestiture of public ownership.

Latvia (1995–present): In transition from a controlled to a market economy. Beginning in mid-1992, directed and subsidized credits and interest rate controls were ended. The current account became convertible and all restrictions on capital movements were removed.

Lithuania (1995–present): In transition from a controlled to a market economy.

Malaysia (1985–88): Interest rates were deregulated in 1978–82, but moral suasion continued and controls were temporarily reimposed during the crisis. The exchange rate floated with intervention. Capital flows were fairly free, but approval was needed to borrow foreign exchange.

Mexico (1994–present): Most interest rates and quantitative credit controls were eliminated in 1989. In 1991–92, banks were reprivatized. Financial liberalization and the strengthening of public finances (which reduced the public sector's resort to bank credit) resulted in a shift of lending in favor of riskier borrowers. Total loans increased in real terms by about 25% a year between 1991 and 1994.

Norway (1987–93): The financial sector was initially heavily regulated. Interest and exchange rates were deregulated in the 1980s and credit restrictions were removed. Asset prices subsequently rose sharply.

Pakistan (1980–present): The economy was overregulated, but interest rates were decontrolled in 1995 and some state banks were privatized. Bank borrowers were successful in delaying necessary reforms and also in thwarting their implementation. Slow progress in fiscal consolidation contributed to delays in liberalizing the financial system.

Paraguay (1995–present): Liberalization began in the late 1980s and was mostly completed by the early 1990s.

Philippines (1981–87): Liberalization began in the 1980s. Interest rates were freed in 1980–81. Foreign entry was eased. Universal banking was permitted, giving banks and thrifts new activities to conduct. Capital markets were fairly free.

Poland (1991–present): In transition from a controlled to a market economy. Interest rates were deregulated in 1990. Nine state banks were commercialized in 1991 and 4 of these banks had been privatized by the end of 1995.

Russia (1992–present): In transition from a controlled to a market economy. Broad-based liberalization was begun in 1992. By 1995, most prices had been decontrolled and both interest rates and exchange rates were market determined. Many state-owned banks have been privatized, as have 90% of all small and medium-sized firms, but the Savings Bank, with 40% of ruble deposits, remains state owned.

Table 13 *(concluded)*

Spain (1977–85): Interest rates were liberalized gradually between 1974 and 1981. Bank licensing and activity restrictions were eased in 1974. Capital flows were freed and exchange rate determination was based on a managed float.

Sweden (1990–93): Lending restrictions and inlerest rate controls were lifted in 1985. An asset-price bubble followed.

Tanzania (1988–present): Sharp exchange rate adjustments occurred from 1986–90. Interest and exchange rates were substantially deregulated in the early 1990s.

Thailand (1983–87): Most lending rates, but not deposit rates, were freed. Capital flows became fairly free and prime companies borrowed heavily abroad. Exchange rates were fixed in relation to a basket of currencies.

Turkey (1994): Liberalization and reforms in the banking sector were ongoing throughout the 1980s. Interest rates were deregulated and the lira was made convertible.

United States (1980–92): Interest rates were deregulated in the late 1970s and early 1980s. Legislation in 1980 and 1982 gave thrifts powers to engage in new activities, and bank licensing was temporarily eased in the mid-1980s.

Venezuela (1994–present): Interest rates were deregulated and credit controls eased in the late 1980s. There was a shift to indirect instruments of monetary policy.

Zambia (1994–present): The economy was excessively controlled until liberalization began in the late 1980s when controls on external payments, interest rates, and exchange rates were removed.

[1] Years in parentheses denote the period of banking problems.

States, Venezuela, and most economies in transition.[67] As a result, it is now well recognized that, in addition to adequate stabilization policies, timely implementation of prudential and bank restructuring policies is essential to avoid major disruptions to growth and stability during financial liberalization.[68]

This, however, raises the question of how best to design and implement prudential regulations and supervisory systems to ensure successful liberalization of financial markets and transition to market-based instruments of monetary control. Insofar as the initial condition of the banking system is marked by significant portfolio weaknesses and inadequate capitalization, rapid liberalization of interest rates and a strengthening of prudential norms will be difficult to implement, unless a program of bank restructuring is put in place in parallel with the liberalization package. In practice, policies to restructure banks (and enterprises) and strengthen

[67] See also Sundararajan and Baliño (1991), Johnston and Pazarbaşioğlu (1995), Fischer and Gueyie (1995), and Kaminsky and Reinhart (1996).

[68] See Galbis (1995).

prudential supervision can be phased in to support the interest rate liberalization process.

Country experiences suggest that the scope of official oversight systems needs to vary with the state of market development and the institutional environment, and to continuously evolve as markets evolve. Appropriate sequencing of prudential and bank-restructuring policies can serve to establish a critical mass of reforms in supervision and of bank balance sheets, which in turn would help to speed up the adoption of market-based monetary instruments and enhance their effectiveness.[69] Operational considerations suggest that reforms of accounting standards for banks and loan-valuation systems should begin early in the reform process, as these strengthen supervisors' ability to monitor banks, increase the efficacy of oversight by bank owners, and provide a basis for market discipline. Financial market discipline can be strengthened by improved data disclosure, a careful design of the regulatory framework, and policies regarding deposit guarantees, last-resort lending, market entry, and market exit that do not inhibit market discipline.

A program of systemic restructuring of banks, where necessary, should be combined with appropriately strong prudential policies—phasing in prudential regulations, bringing about balanced application of off-site analysis, on-site inspection, and external audits—and with policies to establish institutional arrangements for loan recovery and enterprise restructuring. Such a comprehensive package, encompassing both official oversight and restructuring options, is necessary to avoid adverse incentives toward excessive risk taking by banks. Moreover, reforms of commercial bank accounting systems and implementation of effective internal monitoring systems can support stabilization objectives and facilitate the task of financial restructuring of banks.

Prudential policies to strengthen the banking system should, therefore, be an integral part of any liberalization program; however, standards should not be set at levels that few banks can meet. The implementation of new or more stringent prudential standards also must be undertaken with due regard to both macroeconomic trends and the strength of the banking system. Introduction of new prudential standards may require phasing in over several years, sometimes taking into account the pace at which problem banks and their debtors can be restructured and the associated fiscal adjustments can be made.

[69] For a detailed discussion of issues in sequencing prudential reforms during financial liberalization, see Sundararajan (1995).